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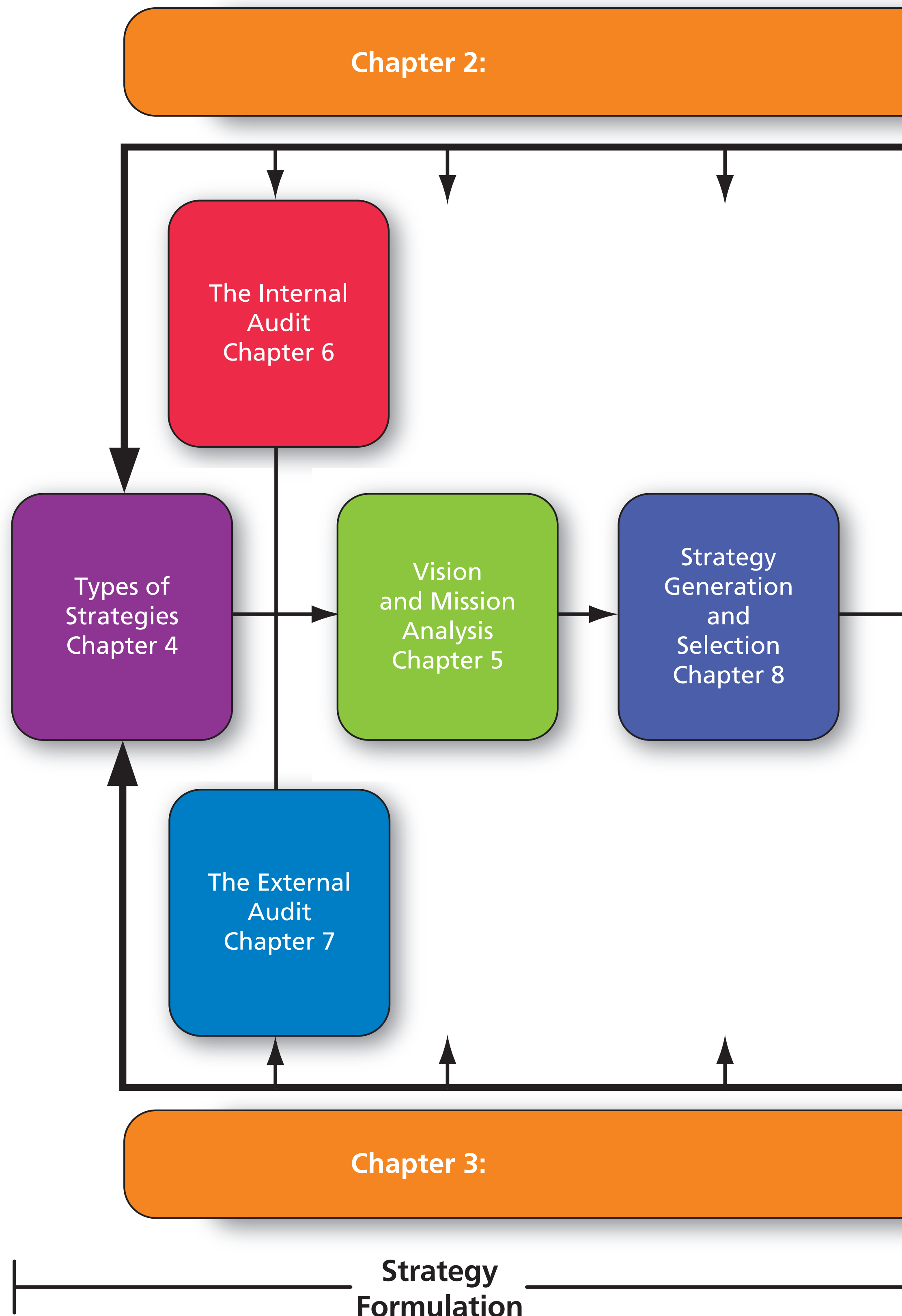

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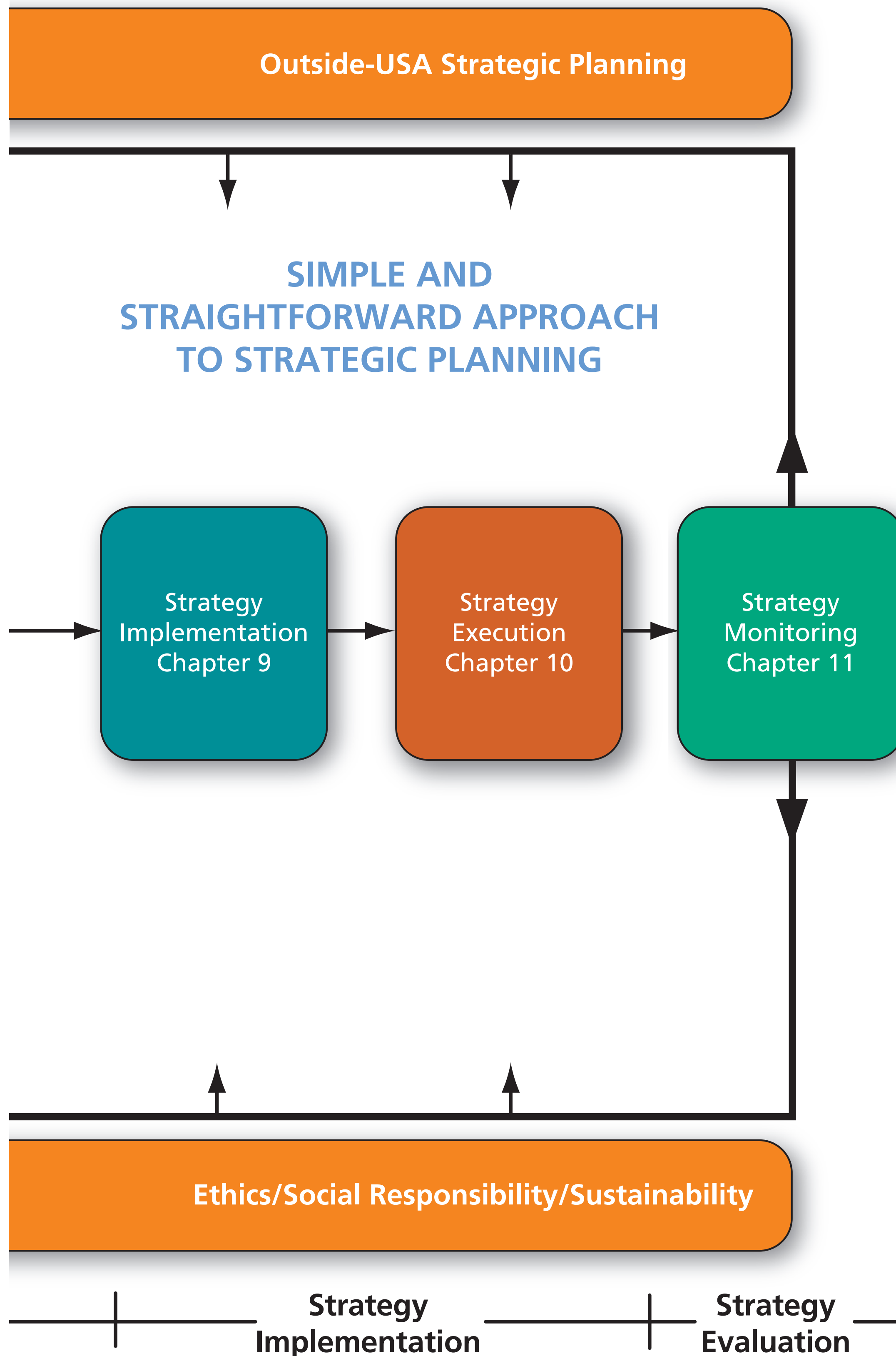

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Concepts and Cases

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Concepts and Cases

FIFTEENTH EDITION

A COMPETITIVE ADVANTAGE APPROACH

GLOBAL EDITION

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Welcome Forest, and Thank You:

- For joining me as a coauthor on this 15th edition
- For preparing the *Case Instructor's Manual* for this textbook and five previous editions
- For publishing many strategic management papers and articles with me and other authors
- For your wise strategic-management counsel over many years as this textbook has evolved
- For assisting students for many years through the Strategy Club (**www.strategyclub.com**) that now also offers your free Excel Student Template
- For developing an outstanding Case MyLab testing feature for this edition
- For preparing the *Chapter Instructor's Manual* for this edition

Preface

Why Adopt This Text?

This textbook is trusted around the world to provide managers the latest skills and concepts needed to effectively formulate and efficiently implement a strategic plan—a game plan, if you will—that can lead to sustainable competitive advantage for any type of business. The Association to Advance Collegiate Schools of Business (AACSB) increasingly advocates a more skills-oriented, practical approach in business books, which the David text provides, rather than a theory-based approach. This textbook meets all AACSB-International guidelines for the strategic-management course at both the graduate and undergraduate levels, and previous editions have been used at more than 500 colleges and universities around the world. We believe you will find this edition to be the best textbook available for communicating both the excitement and value of strategic management. Concise and exceptionally well organized, this text is now published in English, Chinese, Spanish, Thai, German, Japanese, Farsi, Indonesian, Indian, and Arabic. A version in Russian is being negotiated. Not only universities, but also hundreds of companies, organizations, and governmental bodies use this text as a management guide.

In contrast to many other strategic-management textbooks, the David book provides:

1. An effective process for developing a clear strategic plan, rather than simply presenting seminal theories in strategy, and
2. An effective model or flow for actually doing strategic planning.

Eric N. Sims, a professor who in 2013 adopted the David book for his classes at Sonoma State University in California, says:

> "I have read many strategy books. I am going to use the David book. What I like—to steal a line from Alabama coach Nick Saban—is your book teaches 'a process.' I believe at the end of your book, you can actually help a company do strategic planning. In contrast, the other books teach a number of near and far concepts related to strategy."

A recent reviewer of this textbook says:

> "One thing I admire most about the David text is that it follows the fundamental sequence of strategy formulation, implementation, and evaluation. There is a basic flow from vision/mission to internal/external environmental scanning, to strategy development, selection, implementation, and evaluation. This has been, and continues to be, a hallmark of the David text. Many other strategy texts are more disjointed in their presentation, and thus confusing to the student, especially at the undergraduate level."

New Chapter Features

1. The fifteenth edition is 40 percent new and improved from the prior edition.
2. Chapter 2, Outside-USA Strategic Planning, is expanded 30 percent with new coverage of cultural and conceptual strategic-management differences across countries. Doing business globally has become a necessity in most industries. Nearly all strategic decisions today are affected by global issues and concerns.
3. Chapter 3, Ethics/Social Responsibility/Sustainability, is expanded 30 percent, providing extensive new coverage of ethics, workplace romance, and sustainability. This text emphasizes that "good ethics is good business." Unique to strategic-management texts, the sustainability discussion is strengthened in this edition to promote and encourage firms to conduct operations in an environmentally sound manner. Respect for the natural environment has become an important concern for consumers, companies, society, and AACSB-International.

4. An updated Cohesion Case on adidas AG is provided. adidas is one of the most successful, well-known, and best-managed global companies in the world. Students apply strategy concepts to adidas at the end of each chapter through brand new Assurance of Learning Exercises.
5. New or improved Assurance of Learning Exercises appear at the end of all chapters to apply chapter concepts. The exercises prepare students for strategic-management case analysis.
6. A new boxed insert at the beginning of each chapter showcases a company doing strategic management exceptionally well.
7. There are all new examples in all the chapters.
8. There is new narrative on strategic-management theory and concepts in every chapter.
9. On average, 10 new review questions are provided at the end of each chapter.
10. New color photographs bring this new edition to life and illustrate "the practice of strategic management."
11. All current readings at the end of all chapters are new, as new research and theories of seminal thinkers are included. However, practical aspects of strategic management are center stage and the trademark of this text.
12. For the first time ever, the Excel Student Template is provided free at **www.strategyclub.com** to all students who use this textbook. Widely used for more than a decade by both students and businesses, and improved dramatically just for this edition, the free Excel Student Template enables students to more easily apply strategic-management concepts while engaging in assurance of learning exercises or case analysis. Using the Template, students can devote more time to applying strategy concepts and less time to the mechanics of formatting strategy matrices, tables, and PowerPoints.
13. Every sentence and paragraph has been scrutinized, modified, clarified, deleted, streamlined, updated, and improved to enhance the content and caliber of presentation.

New Case Features

1. All 26 cases are on student-friendly, well-known companies, thus exciting and effective for applying strategy concepts;
2. All 26 cases are undisguised, featuring real organizations in real industries using real names (nothing is fictitious in any case);
3. All 26 cases feature an organization and industry undergoing strategic change;
4. All 26 cases provide ample, excellent quantitative information, so students can prepare a defensible strategic plan;
5. All 26 cases are written in a lively, concise writing style that captures the reader's interest;
6. All 26 cases are "comprehensive," focusing on multiple business functions, rather than a single problem or issue;
7. All 26 cases include financial statements for the firm, so students can show the impact of a proposed strategic plan;
8. All 26 cases provide an organizational chart and a vision and mission statement—important strategy concepts;
9. Certain cases are supported by an excellent teacher's note, provided to professors in a new *Case Instructor's Manual*;
10. All 26 cases have been class-tested to ensure that they are interesting, challenging, and effective for illustrating strategy concepts;
11. The 26 case companies provide an excellent mix of firms performing really well and some performing very poorly, including service-based and manufacturing-based firms, and a good mix of small cap to large cap firms.
12. All 26 case companies have excellent websites in English that provide detailed financial information, history, sustainability statements, ethics statements, and press releases, so students can easily access current information to apply strategy concepts.

13. Certain cases are written by the authors, to ensure maximum control and effectiveness in applying strategic-management concepts through case analysis.
14. A Case MyLab testing feature (for 12 cases) has been carefully developed and designed specifically to apply strategic-management concepts through case analysis. The Case MyLab product assures that the cases apply the concepts, simplifies grading for professors, and achieves AACSB's key assurance of learning objectives—even in purely or partly online class settings. The new Case MyLab testing feature enables professors to use the cases to monitor student learning of strategy concepts, as revealed in the Concepts by Cases Matrix given below.

Time-Tested Features

1. This text meets all AACSB-International guidelines that support a practitioner orientation rather than a theory/research approach. This text offers a skills-oriented process for developing a vision and mission statement; performing an external audit; conducting an internal assessment; and formulating, implementing, and evaluating strategies.
2. The author's writing style is concise, conversational, interesting, logical, lively, and supported by numerous current examples.
3. A simple, integrative strategic-management model appears in all chapters and on the inside front cover. The model is widely used by strategic planning consultants and companies worldwide.
4. An exciting, updated Cohesion Case on adidas AG follows Chapter 1 and is revisited at the end of each chapter, allowing students to apply strategic-management concepts and techniques to a real company as chapter material is covered, thus preparing students for case analysis as the course evolves.
5. End-of-chapter Assurance of Learning Exercises apply chapter concepts and techniques in a challenging, meaningful, and enjoyable manner.
6. There is excellent pedagogy, including learning objectives opening each chapter and key terms, current readings, discussion questions, and assurance of learning exercises ending each chapter.
7. There is excellent coverage of strategy formulation issues, such as business ethics, global versus domestic operations, vision and mission, matrix analysis, partnering, joint venturing, competitive analysis, value chain analysis, governance, and matrices for assimilating and evaluating information.
8. There is excellent coverage of strategy implementation issues such as corporate culture, organizational structure, outsourcing, marketing concepts, financial analysis, business ethics, whistleblowing, bribery, pay and performance linkages, and workplace romance.
9. A systematic, analytical "process" is presented that includes nine matrices: IFEM, EFEM, CPM, SWOT, BCG, IE, GRAND, SPACE, and QSPM.
10. Both the chapter material and case material is published in four colors.
11. For the chapter material, an outstanding ancillary package includes a comprehensive Instructor's Manual, Test Bank, TestGen, and Chapter PowerPoints.

Instructor Supplements

At **www.pearsonglobaleditions.com/david**, instructors can access a variety of resources that accompany this new edition. Registration is easy, please contact your Pearson Sales Representative who will provide you with the access information you need.

If you ever need assistance, our dedicated technical support team is ready to help with the media supplements that accompany this text. Visit **http://247.pearsoned.com/** for answers to frequently asked questions and toll-free user support phone numbers.

The following supplements are available to adopting instructors:

- ***Chapter Instructor's Manual***
- ***Case Instructor's Manual***
- **Chapter PowerPoints**
- **Test Bank**
- **TestGen**

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American International College
American International Continental (AIU) University—Houston
American International University
American University
Anderson University
Angelo State University
Aquinas College
Arizona State University—Polytechnic Campus
Art Institute of California
Averett University
Avila University
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Baker College—Flint
Baldwin Wallace College
Barry University

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Bellevue University
Belmont Abbey College
Benedictine University
Black Hills State University
Bloomsburg University
Briar Cliff University
Brooklyn College
Broward College—Central
Broward College—North
Broward College—South
Bryant & Stratton—Orchard Park
Buena Vista University—Storm Lake
Caldwell College
California Polytechnic State University
California State University—Sacramento
California State University—San Bernadino
California University of PA
Calumet College
Capella University
Carlow University
Carson-Newman College
Catawba College
Catholic University of America
Cedar Crest College
Central Connecticut State University
Central Michigan University
Central New Mexico Community College
Central Washington University
Chatham University
Chestnut Hill College
Chicago State University
Christian Brothers University
Claflin University
Clarion University of Pennsylvania
Clarkson College
Clatsop Community College
Cleveland State University
College of William & Mary
Colorado State University—Pueblo
Columbia College
Columbia Southern University—Online
Concordia University
Concordia University Wisconsin
Curry College

Cuyahoga Community College
Daniel Webster College
Davis & Elkins College
Delaware State University
Delaware Technology & Community College—Dover
Delaware Technology & Community College—Wilmington
DePaul University—Loop Campus
East Stroudsburg University
Eastern Michigan University
Eastern Oregon University
Eastern Washington University
ECPI College of Technology—Charleston
ECPI Computer Institute
Elmhurst College
Embry-Riddle Aero University—Prescott
Ferrum College
Florida Agricultural & Mechanical University
Florida Southern College
Florida State University
Florida Technical College—Deland
Florida Technical College—Kissimmee
Florida Technical College—Orlando
Fort Valley State College
Francis Marion University
Fresno Pacific University
Frostburg State University
George Fox University
Georgetown College
Georgia Southern University
Georgia Southwestern State University
Hampton University
Harding University
Harris Stowe State University
Herzing College—Madison
Herzing College—New Orleans
Herzing College—Winter Park
Herzing University—Atlanta
High Point University
Highline Community College
Hofstra University
Hood College
Hope International University
Houghton College
Huntingdon College
Indiana University Bloomington
Indiana Wesleyan CAPS

Iona College
Iowa Lakes Community College—Emmetsburg
Jackson Community College
Jackson State University
John Brown University
Johnson & Wales—Charlotte
Johnson & Wales—Colorado
Johnson & Wales—Miami
Johnson & Wales—Rhode Island
Johnson C. Smith University
Kalamazoo College
Kansas State University
Keene State College
Kellogg Community College
La Salle University
Lake Michigan College
Lebanon Valley College
Lee University
Lehman College of CUNY
Liberty University
Limestone College—Gaffney
Lincoln Memorial University
Loyola College Business Center
Loyola College—Chennai
Loyola University—Maryland
Lyndon State College
Madonna University
Manhattan College
Manhattanville College
Marian University—Indiana
Marshall University
Marshall University Graduate College
Marymount University—Arlington
Medgar Evers College
Medical Careers Institute/Newport News
Mercer University—Atlanta
Mercer University—Macon
Miami-Dade College—Homestead
Miami-Dade College—Kendal
Miami-Dade College—North
Miami-Dade College—Wolfson
Michigan State University
Mid-America Christian
Millersville University
Mississippi University for Women
Morgan State University

Morrison College of Reno
Mount Marty College—South Dakota
Mount Mercy University
Mount Wachusett Community College
Mt. Hood Community College
Mt. Vernon Nazarene
MTI Western Business College
Muhlenberg College
Murray State University
New England College
New Mexico State University
New York University
North Carolina Wesleyan College
North Central College
North Central State College
Northwest Arkansas Community College
Northwestern College
Northwood University—Cedar Hill
Notre Dame of Maryland University
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Southern Oregon University
Southern University—Baton Rouge
Southern Wesleyan University
Southwest Baptist University
Southwest University
St. Bonaventure University
St. Francis University
St. Louis University
St. Martins University
Sterling College
Stevenson University
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Texas A&M University—Commerce
Texas A&M University—Texarkana
Texas A&M—San Antonio
Texas Tech University
The College of St. Rose
The Masters College
Tri-County Technical College
Trinity Christian College
Troy State University
Troy University—Dothan
Troy University—Main Campus
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University of Tampa
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University of The Incarnate Word
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Sample of Countries Outside the USA Where This Textbook is Very Widely Used

Mexico, China, Japan, Australia, Singapore, Canada, Indonesia, Pakistan, Iran, Kenya, Congo, Hong Kong, India, England, Argentina, Equador, Zambia, Guam, Italy, Cyprus, Colombia, Philippines, South Africa, Peru, Turkey, Malaysia, and Egypt

Acknowledgments

Many persons have contributed time, energy, ideas, and suggestions for improving this text over 15 editions. The strength of this text is largely attributed to the collective wisdom, work, and experiences of strategic-management professors, researchers, students, and practitioners. Names of particular individuals whose published research is referenced in this edition are listed alphabetically in the Name Index. To all individuals involved in making this text so popular and successful, we are indebted and thankful.

Many special persons and reviewers contributed valuable material and suggestions for this edition. We would like to thank our colleagues and friends at Auburn University, Mississippi State University, East Carolina University, the University of South Carolina, Campbell University, the University of North Carolina at Pembroke, and Francis Marion University. We have taught strategic management at all these universities. Scores of students and professors at these schools helped shape the development of this text. Many thanks go to the following reviewers whose comments shaped the fourteenth and fifteenth editions:

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Don Wicker, Brazosport College

We want to thank you, the reader, for investing the time and effort to read and study this text. It will help you formulate, implement, and evaluate strategies for any organization with which you become associated. We hope you come to share our enthusiasm for the rich subject area of strategic management and for the systematic learning approach taken in this text. We want

to welcome and invite your suggestions, ideas, thoughts, comments, and questions regarding any part of this text or the ancillary materials. Please contact Dr. Fred R. David at the following e-mail freddavid9@gmail.com, or write him at the School of Business, Francis Marion University, Florence, SC 29501. We sincerely appreciate and need your input to continually improve this text in future editions. Your willingness to draw my attention to specific errors or deficiencies in coverage or exposition will especially be appreciated.

Thank you for using this text.

Fred R. David and Forest R. David

Pearson would also like to thank and acknowledge Ivan Ninov, The Emirates Academy of Hospitality Management, and Aykut Arslan, Haliç Üniversitesi, for reviewing the Global Edition.

About the Authors

Fred R. and Forest R. David, a father–son team, have published more than 50 journal articles in outlets such as *Academy of Management Review*, *Academy of Management Executive*, *Journal of Applied Psychology*, *Long Range Planning*, *International Journal of Management*, *Journal of Business Strategy*, and *Advanced Management Journal*. Fred and Forest's February 2011 *Business Horizons* article titled "What are Business Schools Doing for Business Today?" is changing the way many business schools view their curricula.

Fred and Forest are coauthors of *Strategic Management: Concepts and Cases* that has been on a two-year revision cycle since 1986 when the first edition was published. This text is among the best-selling strategic-management textbooks in the world. This text has led the field of strategic management for more than two decades in providing an applications, practitioner-approach to the discipline. More than 500 colleges and universities have used this textbook over the years, including Harvard University, Duke University, Carnegie-Mellon University, Johns Hopkins University, the University of Maryland, University of North Carolina, University of Georgia, San Francisco State University, University of South Carolina, Wake Forest University, and countless universities in Japan, China, Australia, Mexico, and the Middle East. For six editions of this book, Forest has been sole author of the *Case Instructor's Manual*, having developed extensive teachers' notes (solutions) for all the cases. Forest is author of the Case MyLab ancillary and the free Excel Student Template that accompany this fifteenth edition.

Fred and Forest actively assist businesses globally in doing strategic planning. They have written and published more than 100 strategic management cases. Fred and Forest were recently keynote speakers at the Pearson International Forum in Monterrey, Mexico. With a PhD in Management from the University of South Carolina, Fred is the TranSouth Professor of Strategic Planning at Francis Marion University (FMU) in Florence, South Carolina. Forest has taught strategic-management courses at Mississippi State University, Campbell University, and FMU.

Fred R. David

Forest R. David

The Case Rationale

Case analysis remains the primary learning vehicle used in most strategic-management classes, for five important reasons:

1. Analyzing cases gives students the opportunity to work in teams to evaluate the internal operations and external issues facing various organizations and to craft strategies that can lead these firms to success. Working in teams gives students practical experience solving problems as part of a group. In the business world, important decisions are generally made within groups; strategic-management students learn to deal with overly aggressive group members and also timid, noncontributing group members. This experience is valuable because strategic-management students are near graduation and soon enter the working world full-time.
2. Analyzing cases enables students to improve their oral and written communication skills as well as their analytical and interpersonal skills by proposing and defending particular courses of action for the case companies.
3. Analyzing cases allows students to view a company, its competitors, and its industry concurrently, thus simulating the complex business world. Through case analysis, students learn how to apply concepts, evaluate situations, formulate strategies, and resolve implementation problems.
4. Analyzing cases allows students to apply concepts learned in many business courses. Students gain experience dealing with a wide range of organizational problems that impact all the business functions.
5. Analyzing cases gives students practice in applying concepts, evaluating situations, formulating a “game plan,” and resolving implementation problems in a variety of business and industry settings.

Case MyLab Testing Feature

New to this edition is an enhanced MyLab with some new cases that include gradeable outcomes. This feature assures that the cases are excellent for testing student learning of the key strategic-management concepts, thus serving as a great mechanism for professors to achieve AACSB's Assurance of Learning Objectives. This new testing feature simplifies grading for professors in both traditional and online class settings.

The Case MyLab testing feature includes multiple choice questions for some of the cases, comprised of *Basic* questions that simply test whether the student read the case before class, and *Applied* questions that test the student's ability to apply various strategic-management concepts. In addition, there are *Discussion* questions per case. This testing feature enables professors to determine, before class if desired, whether students 1) read the case in *Basic* terms, and/or 2) are able to *Apply* strategy concepts to resolve issues in the case. For example, the MyLab case *Basic* question may be: In what country is BMW headquartered? Whereas, a MyLab case *Applied* question may be: What are three aspects of the organizational chart given in the BMW case that violate strategic-management guidelines? The Answers to these questions can be found in the *Case Instructor's Manual*.

Case Information Matrix

Case Company	Stock Symbol	Headquarters	URL	Number of Employees	Financials (US$, millions)			Case Year
					Profit	Revenue	%	
COHESION CASE								
adidas Group	ADS	Herzogenaurach, Germany	www.adidas.com	46,300	1,599	19,558	8.2[i]	2013
SERVICE FIRMS								
Ryanair Holdings, plc	RYAAY	Dublin, Ireland	www.ryanair.ie	7,200	413	4,043	10.2	2011
The Emirates Group	n/a	Garhoud, Dubai, UAE	www.theemiratesgroup.com	67,000	986	20,934	4.7[ii]	2013
United Parcel Service, Inc.	UPS	Atlanta, GA, USA	www.ups.com	399,000	869	12,124	7.2	2013
Amazon.com, Inc.	AMZN	Seattle, WA, USA	www.amazon.com	33,700	1,152	34,204	3.3	2011
Netflix, Inc.	NFLX	Los Gatos, CA, USA	www.netflix.com	2,500	160	2,162	7.4	2011
Gap Inc.	GPS	San Fransisco, CA, USA	www.gapinc.com	135,000	1,102	14,197	7.7	2011
Walt Disney Company	DIS	Burbank, CA, USA	www.disney.com	166,000	6,173	42,278	14.6	2013
Staples, Inc.	SPLS	Farmingham, MA, USA	www.staples.com	54,100	881	25,545	3.4	2011
Office Depot Inc.	ODP	Boca Raton, FL, USA	www.officedepot.com	41,000	34	11,633	0.3	2011
Domino's Pizza, Inc.	DPZ	Ann Arbor, MI, USA	www.dominos.com	10,000	112	1,678	6.7	2013
Royal Caribbean Cruises Ltd.	RCL	Miami, FL, USA	www.royalcaribbean.com	57,000	547	6,752	8.1	2011
Carnival Corporation & plc	CCL	Miami, FL, USA	www.carnivalcorp.com	85,200	1,978	14,469	13.6	2011
JPMorgan Chase & Co.	JPM	New York, NY, USA	www.jpmorganchase.com	240,000	21,284	97,031	21.9	2013

Case Company	Stock Symbol	Headquarters	URL	Number of Employees	Financials (US$, millions)			Case Year
					Profit	Revenue	%	
MANUFACTURING FIRMS								
Proctor & Gamble Company	PG	Cincinnati, OH, USA	www.pg.com	127,000	12,736	78,938	16.1	2011
Avon Products, Inc.	AVP	New York, NY, USA	www.avoncompany.com	39,100	314	10,717	2.9	2013
Revlon, Inc.	REV	New York, NY, USA	www.revlon.com	4,800	327	1,321	24.7	2011
L'Oréal SA	LRLCF	Clichy, France	www.loreal.com	72,600	2,867	22,462	12.8	2013
Dr Pepper Snapple Group Inc.	DPS	Plano, TX, USA	www.drpeppersnapple.com	19,000	528	5,636	9.4	2011
Coca-Cola Company	KO	Atlanta, GA, USA	www.coca-colacompany.com	5,200	38	1,442	4.3	2011
Starbucks Corporation	SBUX	Seattle, WA, USA	www.starbucks.com	137,000	945	10,707	8.8	2011
Pearson PLC	PSORF	London, UK	www.pearson.com	37,000	824	8,094	10.2[iii]	2013
Bayerische Motoren Werke (BMW) Group	BMW	Munich, Germany	www.bmwgroup.com	105,000	4,226	79,386	5.3[i]	2013
Apple, Inc.	AAPL	Cupertino, CA, USA	www.apple.com	46,600	14,013	65,225	21.5	2011
Microsoft Corporation	MSFT	Redmond, WA, USA	www.microsoft.com	94,000	16,978	73,723	23.0	2013
Lenovo Group Limited	LNVGY	Beijing, China	www.lenovo.com	27,000	631	33,873	1.9	2013
Netgear, Inc.	NTGR	San Jose, CA, USA	www.netgear.com	850	86	1,271	6.8	2013

[i]Originally reported in EUR – converted at rate of 1EUR = 1.35USD
[ii]Originally reported in AED – converted at rate of 1AED = 0.27USD
[iii]Originally reported in GBP – converted at rate of 1GBP = 1.6USD

Topical Content Areas

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Cohesion Case														
adidas Group	Y	N	Y	Y	N	Y	N	N	Y	Y	N	N	Y	Y
Service Firms														
Ryanair	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	Y	Y
The Emirates Group	Y	Y	Y	Y	N	N	N	N	Y	N	N	N	Y	Y
UPS	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	Y	Y	N	N
Amazon	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	N	Y	N	N
Netflix	Y	Y	Y	N	Y	Y	Y	Y	Y	N	N	Y	N	N
Gap	Y	Y	Y	N	Y	Y	Y	Y	Y	N	N	Y	N	N
Walt Disney	Y	Y	Y	Y	N	N	N	Y	Y	N	N	N	Y	N
Staples Inc.	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	N	N	Y	N
Office Depot Inc.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	Y	N
Domino’s Pizza Inc.	Y	Y	Y	Y	Y	N	N	N	Y	N	N	Y	N	N
Royal Caribbean Cruises	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	N	Y	N	N
Carnival Corp.	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	N	Y	N	N
JPMorgan Chase & Co.	Y	Y	Y	Y	Y	N	Y	Y	Y	Y	N	Y	N	N

MANUFACTURING FIRMS														
Proctor and Gamble	Y	Y	Y	Y	Y	N	Y	Y	Y	N	Y	N	Y	N
Avon Products Inc.	Y	Y	Y	Y	N	Y	N	N	Y	Y	Y	Y	N	N
Revlon	Y	Y	Y	Y	N	N	Y	Y	Y	N	N	N	Y	N
L'Oréal	Y	Y	Y	N	N	Y	N	N	Y	N	N	Y	N	Y
Dr Pepper Snapple Group	Y	Y	Y	N	Y	Y	Y	Y	Y	N	Y	N	Y	N
The Coca-Cola Company	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	N	Y	N	N
Starbucks	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	N	N	Y	N
Pearson PLC	Y	Y	Y	N	N	N	N	Y	Y	N	Y	Y	N	Y
BMW	Y	Y	Y	N	N	N	N	N	Y	N	N	Y	N	Y
Apple	Y	Y	Y	Y	Y	N	N	Y	Y	N	N	N	Y	N
Microsoft Corp.	Y	Y	Y	Y	N	N	N	N	Y	N	Y	Y	N	N
Lenovo	Y	Y	Y	N	Y	N	Y	Y	Y	N	N	Y	N	Y
Netgear	Y	Y	Y	N	N	N	N	N	Y	N	Y	Y	N	N

1. Financial Statements Provided?
2. Organizational Chart Provided?
3. Does Company Do Business Outside the United States?
4. Is a Vision or Mission Statement Provided?
5. Business Ethics Issues Included?
6. Sustainability Issues Included?
7. Strategy Formulation Emphasis?
8. Strategy Implementation Emphasis?
9. By-Segment Financial Data Included?
10. Firm Has Declining Revenues?
11. Firm Has Declining Net Income?
12. Case Company Appears in Text for First Time?
13. Case Company Appeared in Prior Edition and Updated Now?
14. Firm Headquartered Outside the United States?

STRATEGIC MANAGEMENT
Concepts and Cases

A COMPETITIVE ADVANTAGE APPROACH

1

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Strategic Management Essentials

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Discuss the nature and role of a chief strategy officer (CSO).
2. Describe the strategic-management process.
3. Explain the need for integrating analysis and intuition in strategic management.
4. Define and give examples of key terms in strategic management.
5. Discuss the nature of strategy formulation, implementation, and evaluation activities.
6. Describe the benefits of good strategic management.
7. Discuss the relevance of Sun Tzu's *The Art of War* to strategic management.
8. Discuss how a firm may achieve sustained competitive advantage.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 1A Assess Singapore Airline's Most Recent Quarterly Performance Data

EXERCISE 1B Gathering Strategy Information on adidas AG

EXERCISE 1C Getting Familiar with the Free Excel Student Template

EXERCISE 1D Evaluating An Oral Student Presentation

EXERCISE 1E Strategic Planning at Nestlé

EXERCISE 1F Interviewing Local Strategists

When CEOs from the big three U.S. automakers—Ford, General Motors (GM), and Chrysler—showed up a few years ago without a clear strategic plan to ask congressional leaders for bailout monies, they were sent home with instructions to develop a clear strategic plan for the future. Austan Goolsbee, one of President Barack Obama's top economic advisers, said, "Asking for a bailout without a convincing business plan was crazy." Goolsbee also said, "If the three auto CEOs need a bridge, it's got to be a bridge to somewhere, not a bridge to nowhere."[1] This textbook gives the instructions on how to develop a clear strategic plan—a bridge to somewhere rather than nowhere.

This chapter provides an overview of strategic management. It introduces a practical, integrative model of the strategic-management process; it defines basic activities and terms in strategic management.

This chapter also introduces the notion of boxed inserts. A boxed insert at the beginning of each chapter reveals how some firms are doing really well competing in a growing economy. The firms showcased are utilizing excellent strategic management to prosper as their rivals weaken. Each boxed insert examines the strategies of firms doing great amid rising consumer demand and intense price competition. The first company featured for excellent performance is the 5-star airline—Singapore Airlines Limited (SIA).

adidas AG is featured as the new Cohesion Case because it is a well-known global firm undergoing strategic change and is well managed. By working through the adidas AG–related Assurance of Learning Exercises at the end of each chapter, you will be well prepared to develop an effective strategic plan for any company assigned to you this semester. The end-of-chapter exercises apply chapter tools and concepts.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Singapore Airlines

Singapore Airlines Limited (SIA) is the 5-star airline of Singapore. Singapore Airlines operates trans-Pacific flights, including the world's longest non-stop commercial flights from Singapore to Los Angeles and Newark on the Airbus A340-500. In late 2013, the company ceased offering those two long flights although Los Angeles is still served via Tokyo-Narita. The luxury airline has a strong presence in Asia. A member of the Star Alliance, Singapore Airlines carried around 18 million passengers in 2012, up from 16.9 million in 2011.

Singapore Airlines is very well managed strategically. The company has diversified airline-related businesses, such as aircraft handling and engineering, and owns SilkAir that manages regional flights to secondary cities with smaller capacity requirements. Singapore Airlines operates passenger services to more than 60 cities in over 30 countries around the world. Within Asia, passengers can connect to over 30 cities served by SilkAir. The company is the official sponsor of Singapore national football team and has been marketing Singapore Girl as central image to the airline's brand. *Fortune* in 2013 ranked Singapore Airlines as the 31st most admired company in the world outside the United States. In December 2012, Singapore Airlines sold its 49 percent stake in Virgin Atlantic for US$360 million.

In April 2012, Singapore Airlines phased out the 747 from its fleet after 40 years of service. A final round-trip commemorative flight was operated from Singapore to Hong Kong. In December 2012, Singapore Airlines began using the A380 to San Francisco via Hong Kong as a winter seasonal service, but still uses a Boeing 777-300ER for the remainder of the year. In May 2013, Singapore Airlines made a commitment to order 30 Boeing 787-10X to be delivered in 2018-2019 timeframe. In September 2013, Singapore Airlines began using the Airbus A380 on selected flights to and from Shanghai, China.

Singapore Airlines' passenger carriage (measured in revenue passenger kilometers) grew 8.6 percent in August 2013 year-on-year along with a 3.1 percent increase in capacity (measured in available seat kilometers). The company's passenger load factor (PLF) improved by 4.1 percentage points to 82.4 percent as the number of passengers carried in August 2013 increased by 11.7 percent to 1.7 million. Load factors improved across all regions, bolstered by strong leisure travel demand during the Lebaran/Hari Raya holidays, coupled with returning summer traffic. Traffic to West Asia and Africa also saw improvements.

SilkAir's systemwide passenger carriage in August 2013 increased 10.7 percent year-on-year along with a 13.4 percent growth in capacity. For that month, SilkAir's PLF was 1.8 percentage points lower at 71.7 percent. Singapore Airlines' cargo traffic (measured in freight-tonne-kilometres) was 5.7 percent lower in August 2013 year-on-year, while cargo capacity was reduced by 5.0 percent.

What Is Strategic Management?

Once there were two company presidents who competed in the same industry. These two presidents decided to go on a camping trip to discuss a possible merger. They hiked deep into the woods. Suddenly, they came upon a grizzly bear that rose up on its hind legs and snarled. Instantly, the first president took off his knapsack and got out a pair of jogging shoes. The second president said, "Hey, you can't outrun that bear." The first president responded, "Maybe I can't outrun that bear, but I surely can outrun you!" This story captures the notion of strategic management, which is to achieve and maintain competitive advantage.

Defining Strategic Management

Strategic management can be defined as the art and science of formulating, implementing, and evaluating cross-functional decisions that enable an organization to achieve its objectives. As this definition implies, strategic management focuses on integrating management, marketing, finance and accounting, production and operations, research and development, and information systems to achieve organizational success. The term *strategic management* in this text is used synonymously with the term **strategic planning**. The latter term is more often used in the business world, whereas the former is often used in academia. Sometimes the term *strategic management* is used to refer to strategy formulation, implementation, and evaluation and *strategic planning* referring only to strategy formulation. The purpose of strategic management is to exploit and create new and different opportunities for tomorrow; **long-range planning**, in contrast, tries to optimize for tomorrow the trends of today.

The term *strategic planning* originated in the 1950s and was popular between the mid-1960s and the mid-1970s. During these years, strategic planning was widely believed to be the answer for all problems. At the time, much of corporate America was "obsessed" with strategic planning. Following that boom, however, strategic planning was cast aside during the 1980s as various planning models did not yield higher returns. The 1990s, however, brought the revival of strategic planning, and the process is widely practiced today in the business world. Many companies today have a *chief strategy officer (CSO)*.

A strategic plan is, in essence, a company's game plan. Just as a football team needs a good game plan to have a chance for success, a company must have a good strategic plan to compete successfully. Profit margins among firms in most industries are so slim that there is little room for error in the overall strategic plan. A strategic plan results from tough managerial choices among numerous good alternatives, and it signals commitment to specific markets, policies, procedures, and operations in lieu of other, "less desirable" courses of action.

The term *strategic management* is used at many colleges and universities as the title for the capstone course in business administration. This course integrates material from all business courses, and, in addition, introduces new strategic management concepts and techniques being widely used by firms in strategic planning.

Stages of Strategic Management

The **strategic-management process** consists of three stages: strategy formulation, strategy implementation, and strategy evaluation. **Strategy formulation** includes developing a vision and mission, identifying an organization's external opportunities and threats, determining internal strengths and weaknesses, establishing long-term objectives, generating alternative strategies, and choosing particular strategies to pursue. Strategy-formulation issues include deciding what new businesses to enter, what businesses to abandon, whether to expand operations or diversify, whether to enter international markets, whether to merge or form a joint venture, and how to avoid a hostile takeover.

Because no organization has unlimited resources, strategists must decide which alternative strategies will benefit the firm most. Strategy-formulation decisions commit an organization to specific products, markets, resources, and technologies over an extended period of time. Strategies determine long-term competitive advantages. For better or worse, strategic decisions have major multifunctional consequences and enduring effects on an organization. Top managers have the best perspective to understand fully the ramifications of strategy-formulation decisions; they have the authority to commit the resources necessary for implementation.

Strategy implementation requires a firm to establish annual objectives, devise policies, motivate employees, and allocate resources so that formulated strategies can be executed. Strategy implementation includes developing a strategy-supportive culture, creating an effective organizational structure, redirecting marketing efforts, preparing budgets, developing and using information systems, and linking employee compensation to organizational performance.

Strategy implementation often is called the "action stage" of strategic management. Implementing strategy means mobilizing employees and managers to put formulated strategies into action. Often considered to be the most difficult stage in strategic management, strategy implementation requires personal discipline, commitment, and sacrifice. Successful strategy implementation hinges on managers' ability to motivate employees, which is more an art than a science. Strategies formulated but not implemented serve no useful purpose.

Interpersonal skills are especially critical for successful strategy implementation. Strategy-implementation activities affect all employees and managers in an organization. Every division and department must decide on answers to questions such as "What must we do to implement our part of the organization's strategy?" and "How best can we get the job done?" The challenge of implementation is to stimulate managers and employees throughout an organization to work with pride and enthusiasm toward achieving stated objectives.

Strategy evaluation is the final stage in strategic management. Managers desperately need to know when particular strategies are not working well; strategy evaluation is the primary means for obtaining this information. All strategies are subject to future modification because external and internal factors are constantly changing. Three fundamental strategy-evaluation activities are (1) reviewing external and internal factors that are the bases for current strategies, (2) measuring performance, and (3) taking corrective actions. Strategy evaluation is needed because success today is no guarantee of success tomorrow! Success always creates new and different problems; complacent organizations experience demise.

Formulation, implementation, and evaluation of strategy activities occur at three hierarchical levels in a large organization: corporate, divisional or strategic business unit, and functional. By fostering communication and interaction among managers and employees across hierarchical levels, strategic management helps a firm function as a competitive team. Most small businesses and some large businesses do not have divisions or strategic business units; they have only the corporate and functional levels. Nevertheless, managers and employees at these two levels should be actively involved in strategic-management activities.

Peter Drucker says the prime task of strategic management is thinking through the overall mission of a business:

> that is, of asking the question, "What is our business?" This leads to the setting of objectives, the development of strategies, and the making of today's decisions for tomorrow's results. This clearly must be done by a part of the organization that can see the entire business; that can balance objectives and the needs of today against the needs of tomorrow; and that can allocate resources of men and money to key results.[2]

Integrating Intuition and Analysis

Edward Deming once said, *"In God we trust. All others bring data."* The strategic-management process can be described as an objective, logical, systematic approach for making major decisions in an organization. It attempts to organize qualitative and quantitative information in a way that allows effective decisions to be made under conditions of uncertainty. Yet strategic management is not a pure science that lends itself to a nice, neat, one-two-three approach.

Based on past experiences, judgment, and feelings, most people recognize that **intuition** is essential to making good strategic decisions. Intuition is particularly useful for making decisions in situations of great uncertainty or little precedent. It is also helpful when highly interrelated variables exist or when it is necessary to choose from several plausible alternatives. Some managers and owners of businesses profess to have extraordinary abilities for using intuition alone in devising brilliant strategies. For example, Will Durant, who organized GM, was described by Alfred Sloan as "a man who would proceed on a course of action guided solely, as far as I could tell, by some intuitive flash of brilliance. He never felt obliged to make an engineering hunt for the facts. Yet at times, he was astoundingly correct in his judgment."[3] Albert Einstein acknowledged the importance of intuition when he said, "I believe in intuition

and inspiration. At times I feel certain that I am right while not knowing the reason. Imagination is more important than knowledge, because knowledge is limited, whereas imagination embraces the entire world."[4]

Although some organizations today may survive and prosper because they have intuitive geniuses managing them, most are not so fortunate. Most organizations can benefit from strategic management, which is based on integrating intuition and analysis in decision making. Choosing an intuitive or analytic approach to decision making is not an either-or proposition. Managers at all levels in an organization inject their intuition and judgment into strategic-management analyses. Analytical thinking and intuitive thinking complement each other.

Operating from the I've-already-made-up-my-mind-don't-bother-me-with-the-facts mode is not management by intuition; it is management by ignorance.[5] Drucker says, "I believe in intuition only if you discipline it. 'Hunch' artists, who make a diagnosis but don't check it out with the facts, are the ones in medicine who kill people, and in management kill businesses."[6] As Henderson notes:

> The accelerating rate of change today is producing a business world in which customary managerial habits in organizations are increasingly inadequate. Experience alone was an adequate guide when changes could be made in small increments. But intuitive and experience-based management philosophies are grossly inadequate when decisions are strategic and have major, irreversible consequences.[7]

In a sense, the strategic-management process is an attempt to duplicate what goes on in the mind of a brilliant, intuitive person who knows the business and assimilates and integrates that knowledge using analysis to formulate effective strategies.

Adapting to Change

The strategic-management process is based on the belief that organizations should continually monitor internal and external events and trends so that timely changes can be made as needed. The rate and magnitude of changes that affect organizations are increasing dramatically, as evidenced by how the global economic recession caught so many firms by surprise. Firms, like organisms, must be "adept at adapting" or they will not survive.

One company trying hard to adapt is the Washington Post Company, best known as publisher of the *Washington Post* newspaper that has a circulation of 525,000 in the Washington, DC area. But the newspaper industry is in decline globally, so the Washington Post Company recently diversified by acquiring Celtic Healthcare, a provider of hospice and home health care facilities in Pennsylvania and Maryland. Treating patients at home instead of paying for hospital stays is a much faster growing industry than selling newspapers. The Washington Post Company also owns Kaplan, a well-known source of test preparation materials, and six TV stations.

To survive, all organizations must astutely identify and adapt to change. The strategic-management process is aimed at allowing organizations to adapt effectively to change over the long run. As Waterman has noted:

> In today's business environment, more than in any preceding era, the only constant is change. Successful organizations effectively manage change, continuously adapting their bureaucracies, strategies, systems, products, and cultures to survive the shocks and prosper from the forces that decimate the competition.[8]

On a political map, the boundaries between countries may be clear, but on a competitive map showing the real flow of financial and industrial activity, the boundaries have largely disappeared. The speedy flow of information has eaten away at national boundaries so that people worldwide readily see for themselves how other people live and work. We have become a borderless world with global citizens, global competitors, global customers, global suppliers, and global distributors! U.S. firms are challenged by large rival companies in many industries. For example, Samsung recently surpassed Apple and Lenovo surpassed HP and Dell in revenues.

The need to adapt to change leads organizations to key strategic-management questions, such as "What kind of business should we become?" "Are we in the right field(s)?" "Should we reshape our business?" "What new competitors are entering our industry?" "What strategies

should we pursue?" "How are our customers changing?" "Are new technologies being developed that could put us out of business?"

The Internet promotes endless comparison shopping, which thus enables consumers worldwide to band together to demand discounts. The Internet has transferred power from businesses to individuals. Buyers used to face big obstacles when attempting to get the best price and service, such as limited time and data to compare, but now consumers can quickly scan hundreds of vendor offerings. Both the number of people shopping online and the average amount they spend is increasing dramatically. Digital communication has become the name of the game in marketing. Consumers today are flocking to blogs, sending tweets, watching and posting videos on YouTube, and spending hours on Tumbler, Facebook, Reddit, Instagram, and LinkedIn instead of watching television, listening to the radio, or reading newspapers, and magazines. Facebook and Myspace recently unveiled features that further marry these social sites to the wider Internet. Users on these social sites now can log on to many business shopping sites from their social site so their friends can see what items they have purchased on various shopping sites. Both of these social sites want their members to use their identities to manage *all* their online identities. Most traditional retailers have learned that their online sales can boost in-store sales if they use their websites to promote in-store promotions.

Key Terms in Strategic Management

Before we further discuss strategic management, we should define nine key terms: competitive advantage, strategists, vision and mission statements, external opportunities and threats, internal strengths and weaknesses, long-term objectives, strategies, annual objectives, and policies.

Competitive Advantage

Strategic management is all about gaining and maintaining **competitive advantage**. This term can be defined as "anything that a firm does especially well compared to rival firms." When a firm can do something that rival firms cannot do or owns something that rival firms desire, that can represent a competitive advantage. For example, having ample cash on the firm's balance sheet can provide a major competitive advantage. Some cash-rich firms are buying distressed rivals. Examples of cash-rich (cash as a percentage of total assets) companies today include Priceline.com (63%), Altera (80%), Franklin Resources (51%), Gilead Sciences (57%), and Lorillard (54%). Microsoft, Apple, and Samsung are cash rich, as is the Cohesion Case company, adidas AG.

Having less fixed assets than rival firms also can provide major competitive advantages. For example, Apple has no manufacturing facilities of its own, and rival Sony has 57 electronics factories. Apple relies exclusively on contract manufacturers for production of all of its products, whereas Sony owns its own plants. Less fixed assets has enabled Apple to remain financially lean with virtually no long-term debt. Sony, in contrast, has built up massive debt on its balance sheet.

CEO Paco Underhill of Envirosell says, "Where it used to be a polite war, it's now a 21st-century bar fight, where everybody is competing with everyone else for the customers' money." Shoppers are "trading down," so Nordstrom is taking customers from Neiman Marcus and Saks Fifth Avenue, TJ Maxx and Marshalls are taking customers from most other stores in the mall, and Family Dollar is taking revenues from Walmart.[9] Getting and keeping competitive advantage is essential for long-term success in an organization. In mass retailing, big-box companies such as Walmart, Best Buy, and Sears are losing competitive advantage to smaller stores, so there is a dramatic shift in mass retailing to becoming smaller. As customers shift more to online purchases, less brick and mortar is definitely better for sustaining competitive advantage in retailing. Walmart Express stores of less than 40,000 square feet each, rather than 185,000-square-foot Supercenters, and Office Depot's new 5,000-square-foot stores are examples of smaller is better.

Normally, a firm can sustain a competitive advantage for only a certain period because of rival firms imitating and undermining that advantage. Thus, it is not adequate to simply obtain competitive advantage. A firm must strive to achieve **sustained competitive advantage** by (1) continually adapting to changes in external trends and events and internal capabilities, competencies, and resources; and by (2) effectively formulating, implementing, and evaluating strategies that capitalize on those factors.

An increasing number of companies are gaining a competitive advantage by using the Internet for direct selling and for communication with suppliers, customers, creditors, partners, shareholders, clients, and competitors who may be dispersed globally. E-commerce allows firms to sell products, advertise, purchase supplies, bypass intermediaries, track inventory, eliminate paperwork, and share information. In total, e-commerce is minimizing the expense and cumbersomeness of time, distance, and space in doing business, thus yielding better customer service, greater efficiency, improved products, and higher profitability.

Strategists

Strategists are the individuals most responsible for the success or failure of an organization. Strategists have various job titles, such as chief executive officer, president, owner, chair of the board, executive director, chancellor, dean, or entrepreneur. Jay Conger, professor of organizational behavior at the London Business School and author of *Building Leaders*, says, “All strategists have to be chief learning officers. We are in an extended period of change. If our leaders aren’t highly adaptive and great models during this period, then our companies won’t adapt either, because ultimately leadership is about being a role model.”

Strategists help an organization gather, analyze, and organize information. They track industry and competitive trends, develop forecasting models and scenario analyses, evaluate corporate and divisional performance, spot emerging market opportunities, identify business threats, and develop creative action plans. Strategic planners usually serve in a support or staff role. Usually found in higher levels of management, they typically have considerable authority for decision making in the firm. The CEO is the most visible and critical strategic manager. Any manager who has responsibility for a unit or division, responsibility for profit and loss outcomes, or direct authority over a major piece of the business is a strategic manager (strategist). In the last few years, the position of CSO has emerged as a new addition to the top management ranks of many organizations, including Sun Microsystems, Network Associates, Clarus, Lante, Marimba, Sapient, Commerce One, BBDO, Cadbury Schweppes, General Motors, Ellie Mae, Cendant, Charles Schwab, Tyco, Campbell Soup, Morgan Stanley, and Reed-Elsevier. This corporate officer title represents recognition of the growing importance of strategic planning in business. Franz Koch, the CSO of German sportswear company Puma AG, was recently promoted to CEO of Puma. When asked about his plans for the company, Koch said on a conference call “I plan to just focus on the long-term strategic plan.”

Strategists differ as much as organizations themselves, and these differences must be considered in the formulation, implementation, and evaluation of strategies. Some strategists will not consider some types of strategies because of their personal philosophies. Strategists differ in their attitudes, values, ethics, willingness to take risks, concern for social responsibility, concern for profitability, concern for short-run versus long-run aims, and management style. The founder of Hershey Foods, Milton Hershey, built the company to manage an orphanage. From corporate profits, Hershey Foods today cares for about 900 boys and 1,000 girls in its boarding school for pre-K through 12 grade.

Several CSOs who spoke at the CSO Summit in May 2013 in San Francisco were:

Roland Pan at Skype
Mark Achler at Redbox
Jon Berlin at Wells Fargo
Drew Aldrich at Trans-Lux
Ann Neir at Cisco Systems
Jennifer Scott at Virgin Media
Gina Copeland at Mitsubishi Electric
Raj Ratnaker at Tyco Electronics
Tim Johnsone at Hopelink
Nhat Ngo at Omnicell
Daniel Gastel at UBS
Clarence So at Salesforce
Barry Margerum at Plantronics

Vision and Mission Statements

Many organizations today develop a **vision statement** that answers the question "What do we want to become?" Developing a vision statement is often considered the first step in strategic planning, preceding even development of a mission statement. Many vision statements are a single sentence. For example, the vision statement of Stokes Eye Clinic in Florence, South Carolina, is "Our vision is to take care of your vision."

Mission statements are "enduring statements of purpose that distinguish one business from other similar firms. A mission statement identifies the scope of a firm's operations in product and market terms."[10] It addresses the basic question that faces all strategists: "What is our business?" A clear mission statement describes the values and priorities of an organization. Developing a mission statement compels strategists to think about the nature and scope of present operations and to assess the potential attractiveness of future markets and activities. A mission statement broadly charts the future direction of an organization. A mission statement is a constant reminder to its employees of why the organization exists and what the founders envisioned when they put their fame and fortune at risk to breathe life into their dreams.

External Opportunities and Threats

External opportunities and **external threats** refer to economic, social, cultural, demographic, environmental, political, legal, governmental, technological, and competitive trends and events that could significantly benefit or harm an organization in the future. Opportunities and threats are largely beyond the control of a single organization—thus the word *external*. A few opportunities and threats that face many firms are listed here:

- Availability of capital can no longer be taken for granted.
- Consumers expect green operations and products.
- Marketing is moving rapidly to the Internet.
- Commodity food prices are increasing.
- Political unrest in the Middle East is raising oil prices.
- Computer hacker problems are increasing.
- Intense price competition is plaguing most firms.
- Unemployment and underemployment rates remain high globally.
- Interest rates are rising.
- Product life cycles are becoming shorter.
- State and local governments are financially weak.
- Drug cartel-related violence in Mexico.
- Winters are colder and summers hotter than usual.
- Home prices remain exceptionally low.
- Global markets offer the highest growth in revenues.

These types of changes are creating a different type of consumer and consequently a need for different types of products, services, and strategies. Many companies in many industries face the severe external threat of online sales capturing increasing market share in their industry.

Other opportunities and threats may include the passage of a law, the introduction of a new product by a competitor, a national catastrophe, or the declining value of the Euro. A competitor's strength could be a threat. A growing middle class in Africa, rising energy costs, or social media networking could represent an opportunity or a threat.

A basic tenet of strategic management is that firms need to formulate strategies to take advantage of external opportunities and avoid or reduce the impact of external threats. For this reason, identifying, monitoring, and evaluating external opportunities and threats are essential for success. This process of conducting research and gathering and assimilating external information is sometimes called **environmental scanning** or industry analysis. Lobbying is one activity that some organizations use to influence external opportunities and threats.

Internal Strengths and Weaknesses

Internal strengths and **internal weaknesses** are an organization's controllable activities that are performed especially well or poorly. They arise in the management, marketing, finance/accounting, production/operations, research and development (R&D), and

management information systems (MIS) activities of a business. Identifying and evaluating organizational strengths and weaknesses in the functional areas of a business is an essential strategic-management activity. Organizations strive to pursue strategies that capitalize on internal strengths and eliminate internal weaknesses.

Strengths and weaknesses are determined relative to competitors. *Relative deficiency or superiority is important information*. Also, strengths and weaknesses can be determined by elements of being rather than performance. For example, a strength may involve ownership of natural resources or a historic reputation for quality. Strengths and weaknesses may be determined relative to a firm's own objectives. For example, high levels of inventory turnover may not be a strength for a firm that seeks never to stock-out.

In performing a strategic-management case analysis, it is important to be as divisional as possible when determining and stating internal strengths and weaknesses. In other words, for a company such as Walmart saying that Sam Club's revenues grew 11 percent in the recent quarter, rather than Walmart couching all of their internal factors in terms of Walmart as a *whole*. This practice will enable strategies to be more effectively formulated because in strategic planning, firms must allocate resources among divisions (segments) of the firm (that is, by product, region, customer, or whatever the various units of the firm are), such as Sam's Club versus Supercenters or Mexico versus Europe at Walmart.

Both internal and external factors should be stated in specific terms to the extent possible, using numbers, percentages, dollars, and ratios, as well as comparisons over time and to rival firms. *Specificity is important because strategies will be formulated and resources allocated based on this information.* The more specific the underlying external and internal factors, the more effectively strategies can be formulated and resources allocated. Determining the numbers takes more time, but survival of the firm often is at stake, so identifying and estimating numbers associated with key factors is essential.

Internal factors can be determined in a number of ways, including computing ratios, measuring performance, and comparing to past periods and industry averages. Various types of surveys also can be developed and administered to examine internal factors such as employee morale, production efficiency, advertising effectiveness, and customer loyalty.

Long-Term Objectives

Objectives can be defined as specific results that an organization seeks to achieve in pursuing its basic mission. Long-term means more than one year. Objectives are essential for organizational success because they provide direction; aid in evaluation; create synergy; reveal priorities; focus coordination; and provide a basis for effective planning, organizing, motivating, and controlling activities. Objectives should be challenging, measurable, consistent, reasonable, and clear. In a multidimensional firm, objectives should be established for the overall company and for each division.

Strategies

Strategies are the means by which **long-term objectives** will be achieved. Business strategies may include geographic expansion, diversification, acquisition, product development, market penetration, retrenchment, divestiture, liquidation, and joint ventures. Strategies currently being pursued by some companies are described in Table 1-1

Strategies are potential actions that require top management decisions and large amounts of the firm's resources. In addition, strategies affect an organization's long-term prosperity, typically for at least five years, and thus are future-oriented. Strategies have multifunctional or multidivisional consequences and require consideration of both the external and internal factors facing the firm.

Annual Objectives

Annual objectives are short-term milestones that organizations must achieve to reach long-term objectives. Like long-term objectives, annual objectives should be measurable, quantitative, challenging, realistic, consistent, and prioritized. They should be established at the corporate, divisional, and functional levels in a large organization. Annual objectives should be stated in terms of management, marketing, finance/accounting, production/operations, R&D, and MIS accomplishments.

TABLE 1-1 Sample Strategies in Action in 2013

Walgreen Company
Do you prefer Walgreen's or CVS? Headquartered in Deerfield, Illinois, Walgreen's is deepening its penetration into the southeastern portion of the USA by acquiring firms such as USA Drug, May's Drug, Med-X, Drug Warehouse, and Super D Drug. At the same time, Walgreen's is expanding globally through acquisition of firms such as U.K pharmacy-led health-and-beauty retailer Alliance Boots GmbH. Perhaps a reason Walgreen's is acquiring firms is that its same-store pharmacy sales have dropped 15 percent in the last year, mainly as a result of selling more generic rather than prescription drugs, and their same-store-overall sales have dropped 10 percent, mainly because of the chain's exit from pharmacy-benefit manager Express Scripts Holding. Of course, their major rival firm, CVS, could also be a key reason why Walgreen's is acquiring other firms—to show net growth, despite lower organic (internal) revenue declines.
Netflix Inc.
Based in Los Gatos, California, the long-time DVD-by-mail provider is struggling to survive as the firm switches from the DVD business to (a) providing Internet-delivered streaming content and (b) expanding to overseas markets. Major rivals to Netflix include News Corp.'s Hulu and Coinstar's Redbox, who are growing rapidly, in the USA. Netflix's overseas efforts are not going well because that strategy requires country-by-country deals to line up video content. In a recent quarter, Netflix lost 850,000 DVD subscribers and added 530,000 movie and TV-show streaming customers. Netflix's international streaming business lost about $400 million in 2012.
Microsoft
Based in Redmond, Washington, Microsoft added 35 retail "pop-up stores" in late 2012 to go with its 30 existing retail stores in the United States and one store in Toronto. This forward integration strategy coincided with Microsoft introducing its first tablet computer, Surface, which unlike Apple's iPad, runs popular Microsoft Office apps such as Word and Excel. The Surface also has an innovative keyboard cover that makes typing easier. In addition to its new retail stores, Microsoft is also selling its new Surface tablet online, but many customers want to touch and see before buying such a product online.

A set of annual objectives is needed for each long-term objective. Annual objectives are especially important in strategy implementation, whereas long-term objectives are particularly important in strategy formulation. Annual objectives represent the basis for allocating resources.

Policies

Policies are the means by which annual objectives will be achieved. Policies include guidelines, rules, and procedures established to support efforts to achieve stated objectives. Policies are guides to decision making and address repetitive or recurring situations.

Policies are most often stated in terms of management, marketing, finance/accounting, production/operations, R&D, and MIS activities. Policies can be established at the corporate level and apply to an entire organization at the divisional level and apply to a single division, or they can be established at the functional level and apply to particular operational activities or departments. Policies, like annual objectives, are especially important in strategy implementation because they outline an organization's expectations of its employees and managers. Policies allow consistency and coordination within and between organizational departments.

Substantial research suggests that a healthier workforce can more effectively and efficiently implement strategies. Smoking has become a heavy burden for Europe's state-run social welfare systems, with smoking-related diseases costing more than $100 billion a year. Smoking also is a huge burden on companies worldwide, so firms are continually implementing policies to curtail smoking. Starbucks in mid-2013 banned smoking within 25 feet of its 7,000 stores not located inside another retail establishment.

Hotel and motels in the United States are rapidly going "smoke-free throughout" with more than 13,000 now having this policy. The American Hotel and Lodging Association says there are 50,800 hotel/motels in the USA with 15 or more rooms. All Marriotts are now nonsmoking. Almost all (except Hertz) car rental companies are exclusively nonsmoking, including Avis, Dollar, Thrifty, and Budget. Most rental car companies charge a $250 cleaning fee if a customer

smokes in their rental vehicle. More cigarettes are smoked in Russia per capita (2,786) than any other country in the world, but that country in 2013 instituted strict, mandatory new antismoking policies among all restaurants and bars and government facilities.[11] Sixty percent of men in Russia smoke. Other heavily smoking countries per capita include Japan (1,841), China (1,711), and Indonesia (1,085), compared to the USA (1,028). Excise taxes in Russia on tobacco products are set to rise 135 percent by 2015. About 400,000 Russians die each year as a result of smoking, costing the country 1.5 trillion rubles ($48.1 billion) annually in health-care costs.

The Strategic-Management Model

The strategic-management process can best be studied and applied using a model. Every model represents some kind of process. The framework illustrated in Figure 1-1 with white shading is a widely accepted, comprehensive model of the strategic-management process.[12] This model does not guarantee success, but it does represent a clear and practical approach for formulating, implementing, and evaluating strategies. Relationships among major components of the strategic-management process are shown in the model, which appears in all subsequent chapters with appropriate areas

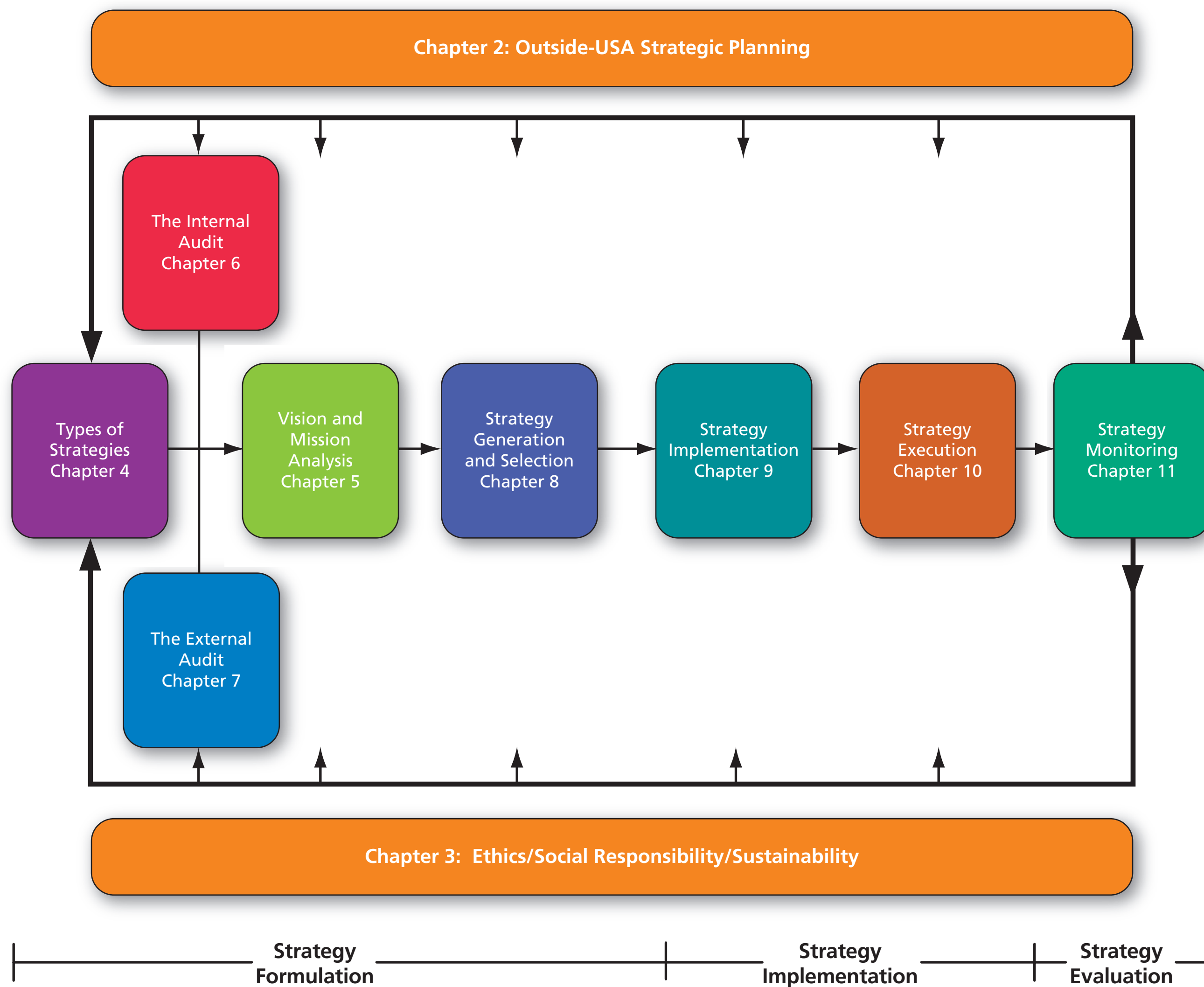

FIGURE 1-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

shaped to show the particular focus of each chapter. These are three important questions to answer in developing a strategic plan:

Where are we now?

Where do we want to go?

How are we going to get there?

Identifying an organization's existing vision, mission, objectives, and strategies is the logical starting point for strategic management because a firm's present situation and condition may preclude certain strategies and may even dictate a particular course of action. Every organization has a vision, mission, objectives, and strategy, even if these elements are not consciously designed, written, or communicated. The answer to where an organization is going can be determined largely by where the organization has been!

The strategic-management process is dynamic and continuous. A change in any one of the major components in the model can necessitate a change in any or all of the other components. For instance, African countries coming online could represent a major opportunity and require a change in long-term objectives and strategies; a failure to accomplish annual objectives could require a change in policy; or a major competitor's change in strategy could require a change in the firm's mission. Therefore, strategy formulation, implementation, and evaluation activities should be performed on a continual basis, not just at the end of the year or semiannually. The strategic-management process never really ends.

Note in the **strategic-management model** that business ethics, social responsibility, and environmental sustainability issues impact all activities in the model as discussed in Chapter 3. Also, note in the model that global and international issues also impact virtually all strategic decisions today, as described in detail in Chapter 2.

The strategic-management process is not as cleanly divided and neatly performed in practice as the strategic-management model suggests. Strategists do not go through the process in lockstep fashion. Generally, there is give-and-take among hierarchical levels of an organization. Many organizations conduct formal meetings semiannually to discuss and update the firm's vision, mission, opportunities, threats, strengths, weaknesses, strategies, objectives, policies, and performance. These meetings are commonly held off-premises and are called **retreats**. The rationale for periodically conducting strategic-management meetings away from the work site is to encourage more creativity and candor from participants. Good communication and feedback are needed throughout the strategic-management process.

Application of the strategic-management process is typically more formal in larger and well-established organizations. Formality refers to the extent that participants, responsibilities, authority, duties, and approach are specified. Smaller businesses tend to be less formal. Firms that compete in complex, rapidly changing environments, such as technology companies, tend to be more formal in strategic planning. Firms that have many divisions, products, markets, and technologies also tend to be more formal in applying strategic-management concepts. Greater formality in applying the strategic-management process is usually positively associated with the cost, comprehensiveness, accuracy, and success of planning across all types and sizes of organizations.[13]

Benefits of Strategic Management

Strategic management allows an organization to be more proactive than reactive in shaping its own future; it allows an organization to initiate and influence (rather than just respond to) activities—and thus to exert control over its own destiny. Small business owners, chief executive officers, presidents, and managers of many for-profit and nonprofit organizations have recognized and realized the benefits of strategic management.

Historically, the principal benefit of strategic management has been to help organizations formulate better strategies through the use of a more systematic, logical, and rational approach to strategic choice. This certainly continues to be a major benefit of strategic management, but research studies now indicate that the process, rather than the decision or document, is the more important contribution of strategic management.[14] *Communication is a key to successful strategic management.* Through involvement in the process, in other words, through dialogue

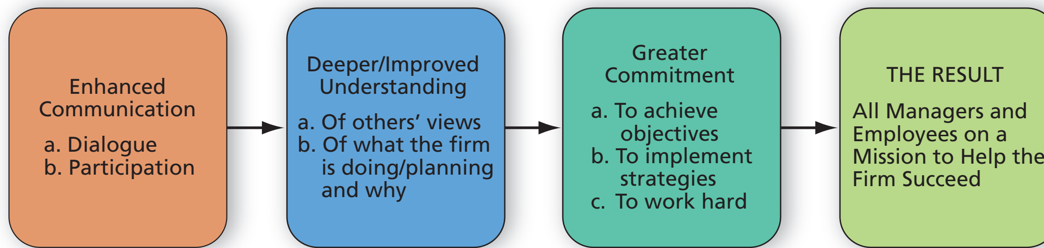

FIGURE 1-2

Benefits to a Firm That Does Strategic Planning

and participation, managers and employees become committed to supporting the organization. Figure 1-2 illustrates this intrinsic benefit of a firm engaging in strategic planning. Note that all firms need all employees "on a mission" to help the firm succeed. Dale McConkey said "plans are less important than planning."

The manner in which strategic management is carried out is thus exceptionally important. A major aim of the process is to achieve understanding and commitment from all managers and employees. Understanding may be the most important benefit of strategic management, followed by commitment. When managers and employees understand what the organization is doing and why, they often feel a part of the firm and become committed to assisting it. This is especially true when employees also understand links between their own compensation and organizational performance. Managers and employees become surprisingly creative and innovative when they understand and support the firm's mission, objectives, and strategies. A great benefit of strategic management, then, is the opportunity that the process provides to empower individuals. **Empowerment** is the act of strengthening employees' sense of effectiveness by encouraging them to participate in decision making and to exercise initiative and imagination, and rewarding them for doing so. William Fulmer said "you want your people to run the business as it if were their own."

Strategic planning is a learning, helping, educating, and supporting process, not merely a paper-shuffling activity among top executives. Strategic-management dialogue is more important than a nicely bound strategic-management document.[15] The worst thing strategists can do is develop strategic plans themselves and then present them to operating managers to execute. Through involvement in the process, line managers become "owners" of the strategy. Ownership of strategies by the people who have to execute them is a key to success!

Although making good strategic decisions is the major responsibility of an organization's owner or chief executive officer, both managers and employees must also be involved in strategy formulation, implementation, and evaluation activities. Participation is a key to gaining commitment for needed changes.

An increasing number of corporations and institutions are using strategic management to make effective decisions. But strategic management is not a guarantee for success; it can be dysfunctional if conducted haphazardly.

Financial Benefits

Research indicates that organizations that use strategic-management concepts are more profitable and successful than those that do not.[16] Businesses using strategic-management concepts show significant improvement in sales, profitability, and productivity compared to firms without systematic planning activities. High-performing firms tend to do systematic planning to prepare for future fluctuations in their external and internal environments. Firms with planning systems more closely resembling strategic-management theory generally exhibit superior long-term financial performance relative to their industry.

High-performing firms seem to make more informed decisions with good anticipation of both short- and long-term consequences. In contrast, firms that perform poorly often engage in activities that are shortsighted and do not reflect good forecasting of future conditions. Strategists of low-performing organizations are often preoccupied with solving internal

problems and meeting paperwork deadlines. They typically underestimate their competitors' strengths and overestimate their own firm's strengths. They often attribute weak performance to uncontrollable factors such as a poor economy, technological change, or foreign competition.

More than 100,000 businesses in the USA fail annually. Business failures include bankruptcies, foreclosures, liquidations, and court-mandated receiverships. Although many factors besides a lack of effective strategic management can lead to business failure, the planning concepts and tools described in this text can yield substantial financial benefits for any organization. The business failure rate in the USA fell dramatically in 2012/2013, but rates rose significantly throughout Europe.

Nonfinancial Benefits

Besides helping firms avoid financial demise, strategic management offers other tangible benefits, such as an enhanced awareness of external threats, an improved understanding of competitors' strategies, increased employee productivity, reduced resistance to change, and a clearer understanding of performance–reward relationships. Strategic management enhances the problem-prevention capabilities of organizations because it promotes interaction among managers at all divisional and functional levels. Firms that have nurtured their managers and employees, shared organizational objectives with them, empowered them to help improve the product or service, and recognized their contributions can turn to them for help in a pinch because of this interaction.

In addition to empowering managers and employees, strategic management often brings order and discipline to an otherwise floundering firm. It can be the beginning of an efficient and effective managerial system. Strategic management may renew confidence in the current business strategy or point to the need for corrective actions. The strategic-management process provides a basis for identifying and rationalizing the need for change to all managers and employees of a firm; it helps them view change as an opportunity rather than as a threat. Some nonfinancial benefits of a firm utilizing strategic management, according to Greenley, are increased discipline, improved coordination, enhanced communication, reduced resistance to change, increased forward thinking, improved decision-making, increased synergy, and more effective allocation of time and resources.[17]

Why Some Firms Do No Strategic Planning

Some firms do no strategic planning, and some firms do strategic planning but receive no support from managers and employees. Ten reasons (excuses) often given for poor or no strategic planning in a firm are as follows:

1. No formal training in strategic management
2. No understanding of or appreciation for the benefits of planning
3. No monetary rewards for doing planning
4. No punishment for not planning
5. Too busy "firefighting" (resolving internal crises) to plan ahead
6. To view planning as a waste of time, since no product/service is made
7. Laziness; effective planning takes time and effort; time is money
8. Content with current success; failure to realize that success today is no guarantee for success tomorrow; even Apple Inc. is an example
9. Overconfident
10. Prior bad experience with strategic planning done sometime/somewhere

Pitfalls in Strategic Planning

Strategic planning is an involved, intricate, and complex process that takes an organization into uncharted territory. It does not provide a ready-to-use prescription for success; instead, it takes the organization through a journey and offers a framework for addressing questions and solving problems. Being aware of potential pitfalls and being prepared to address them is essential to success.

Some pitfalls to watch for and avoid in strategic planning are these:

- Using strategic planning to gain control over decisions and resources
- Doing strategic planning only to satisfy accreditation or regulatory requirements
- Too hastily moving from mission development to strategy formulation
- Failing to communicate the plan to employees, who continue working in the dark
- Top managers making many intuitive decisions that conflict with the formal plan
- Top managers not actively supporting the strategic-planning process
- Failing to use plans as a standard for measuring performance
- Delegating planning to a "planner" rather than involving all managers
- Failing to involve key employees in all phases of planning
- Failing to create a collaborative climate supportive of change
- Viewing planning as unnecessary or unimportant
- Becoming so engrossed in current problems that insufficient or no planning is done
- Being so formal in planning that flexibility and creativity are stifled[18]

Guidelines for Effective Strategic Management

Failing to follow certain guidelines in conducting strategic management can foster criticisms of the process and create problems for the organization. Issues such as "Is strategic management in our firm a people process or a paper process?" should be addressed. Some organizations spend an inordinate amount of time developing a strategic plan, but then fail to follow through with effective implementation. Change and results in a firm come through implementation, not through formulation, although effective formulation is critically important for successful implementation. Continual evaluation of strategies is also essential because the world changes so rapidly that existing strategies can need modifying often.

Strategic management must not become a self-perpetuating bureaucratic mechanism. Rather, it must be a self-reflective learning process that familiarizes managers and employees in the organization with key strategic issues and feasible alternatives for resolving those issues. Strategic management must not become ritualistic, stilted, orchestrated, or too formal, predictable, and rigid. Words supported by numbers, rather than numbers supported by words, should represent the medium for explaining strategic issues and organizational responses. A key role of strategists is to facilitate continuous organizational learning and change.

R. T. Lenz offers six guidelines for effective strategic management:

1. Keep the process simple and easily understandable.
2. Eliminate vague planning jargon.
3. Keep the process nonroutine, so vary assignments, team membership, meeting formats, settings, and even the planning calendar.
4. Welcome bad news and encourage devil's advocate thinking.
5. Do not allow technicians to monopolize the planning process.
6. To the extent possible, involve managers from all areas of the firm.[19]

An important guideline for effective strategic management is open-mindedness. A willingness and eagerness to consider new information, new viewpoints, new ideas, and new possibilities is essential; all organizational members must share a spirit of inquiry and learning. Strategists such as chief executive officers, presidents, owners of small businesses, and heads of government agencies must commit themselves to listen to and understand managers' positions well enough to be able to restate those positions to the managers' satisfaction. In addition, managers and employees throughout the firm should be able to describe the strategists' positions to the satisfaction of the strategists. This degree of discipline will promote understanding and learning.

No organization has unlimited resources. No firm can take on an unlimited amount of debt or issue an unlimited amount of stock to raise capital. Therefore, no organization can pursue all the strategies that potentially could benefit the firm. Strategic decisions thus always have to be made to eliminate some courses of action and to allocate organizational resources among others. Most organizations can afford to pursue only a few corporate-level strategies at any given time.

TABLE 1-2 Seventeen Guidelines for the Strategic-Planning Process to Be Effective

1. It should be a people process more than a paper process.
2. It should be a learning process for all managers and employees.
3. It should be words supported by numbers rather than numbers supported by words.
4. It should be simple and nonroutine.
5. It should vary assignments, team memberships, meeting formats, and even the planning calendar.
6. It should challenge the assumptions underlying the current corporate strategy.
7. It should welcome bad news.
8. It should welcome open-mindness and a spirit of inquiry and learning.
9. It should not be a bureaucratic mechanism.
10. It should not become ritualistic, stilted, or orchestrated.
11. It should not be too formal, predictable, or rigid.
12. It should not contain jargon or arcane planning language.
13. It should not be a formal system for control.
14. It should not disregard qualitative information.
15. It should not be controlled by "technicians."
16. Do not pursue too many strategies at once.
17. Continually strengthen the "good ethics is good business" policy.

It is a critical mistake for managers to pursue too many strategies at the same time, thereby spreading the firm's resources so thin that all strategies are jeopardized.

Strategic decisions require trade-offs such as long-range versus short-range considerations or maximizing profits versus increasing shareholders' wealth. There are ethics issues too. Strategy trade-offs require subjective judgments and preferences. In many cases, a lack of objectivity in formulating strategy results in a loss of competitive posture and profitability. Most organizations today recognize that strategic-management concepts and techniques can enhance the effectiveness of decisions. Subjective factors such as attitudes toward risk, concern for social responsibility, and organizational culture will always affect strategy-formulation decisions, but organizations need to be as objective as possible in considering qualitative factors. Table 1-2 summarizes important guidelines for the strategic-planning process to be effective.

Comparing Business and Military Strategy

A strong military heritage underlies the study of strategic management. Terms such as *objectives, mission, strengths*, and *weaknesses* first were formulated to address problems on the battlefield. According to *Webster's New World Dictionary*, strategy is "the science of planning and directing large-scale military operations, of maneuvering forces into the most advantageous position prior to actual engagement with the enemy"[20]. The word *strategy* comes from the Greek *strategos*, which refers to a military general and combines *stratos* (the army) and *ago* (to lead). The history of strategic planning began in the military. A key aim of both business and military strategy is "to gain competitive advantage." In many respects, business strategy is like military strategy, and military strategists have learned much over the centuries that can benefit business strategists today. Both business and military organizations try to use their own strengths to exploit competitors' weaknesses. If an organization's overall strategy is wrong (ineffective), then all the efficiency in the world may not be enough to allow success. Business or military success is generally not the happy result of accidental strategies. Rather, success is the product of both continuous attention to changing external and internal conditions and the formulation and implementation of insightful adaptations to those conditions. The element of surprise provides great competitive advantages in both military and business strategy; information systems that provide data on opponents' or competitors' strategies and resources are also vitally important.

Of course, a fundamental difference between military and business strategy is that business strategy is formulated, implemented, and evaluated with an assumption of *competition*, whereas military strategy is based on an assumption of *conflict*. Nonetheless, military conflict and business competition are so similar that many strategic-management techniques apply equally to both. Business strategists have access to valuable insights that military thinkers have refined over time. Superior strategy formulation and implementation can overcome an opponent's superiority in numbers and resources.

Born in Pella in 356 B.C.E., Alexander the Great was king of Macedon, a state in northern ancient Greece. Tutored by Aristotle until the age of 16, Alexander had created one of the largest empires of the ancient world by the age of 30, stretching from the Ionian Sea to the Himalayas. Alexander was undefeated in battle and is considered one of history's most successful commanders. He became the measure against which military leaders even today compare themselves, and military academies throughout the world still teach his strategies and tactics. Alexander the Great once said: *"Greater is an army of sheep led by a lion, than an army of lions led be a sheep."* This quote reveals the overwhelming importance of an excellent strategic plan for any organization to succeed. The legendary Alabama football coach Bear Bryant once said: *I will defeat the opposing coach's team with my players, but if given a week's notice, I could defeat the opposing coach's team with his players and he take my players.*

Both business and military organizations must adapt to change and constantly improve to be successful. Too often, firms do not change their strategies when their environment and competitive conditions dictate the need to change. Gluck offered a classic military example of this:

> When Napoleon won, it was because his opponents were committed to the strategy, tactics, and organization of earlier wars. When he lost—against Wellington, the Russians, and the Spaniards—it was because he, in turn, used tried-and-true strategies against enemies who thought afresh, who were developing the strategies not of the last war but of the next.[21]

Similarities can be construed from Sun Tzu's writings to the practice of formulating and implementing strategies among businesses today. Table 1-3 provides narrative excerpts from *The Art of War*. As you read through the table, consider which of the principles of war apply to business strategy as companies today compete aggressively to survive and grow.

The Art of War has been applied to many fields well outside of the military. Much of the text is about how to fight wars without actually having to do battle: it gives tips on how to outsmart one's opponent so that physical battle is not necessary. As such, it has found application as a training guide for many competitive endeavors that do not involve actual combat, such as in devising courtroom trial strategy or acquiring a rival company. There are business books applying its lessons to office politics and corporate strategy. Many Japanese companies make the book required reading for their top executives. The book is a popular read among Western business managers who have turned to it for inspiration and advice on how to succeed in competitive business situations.

The Art of War has also been applied in the world of sports. NFL coach Bill Belichick is known to have read the book and used its lessons to gain insights in preparing for games. Australian cricket, as well as Brazilian association football coaches Luis Felipe Scolari and Carolos Alberto Parreira, embraced the text. Scolari made the Brazilian World Cup squad of 2002 study the ancient work during their successful campaign.

Special Note to Students

In performing strategic-management case analysis, emphasize throughout your project, beginning with the first page or slide, where your firm has competitive advantages and disadvantages. More importantly, emphasize throughout how you recommend the firm sustain and grow its competitive advantages and how you recommend the firm overcome its competitive disadvantages. Begin paving the way early for what you ultimately recommend your firm should do over the next three years. The notion of competitive advantage should be integral to the discussion of every page or PowerPoint slide. Therefore, avoid being merely *descriptive* in your written or oral analysis; rather, be *prescriptive*, insightful, and forward-looking throughout your project.

TABLE 1-3 Excerpts from Sun Tzu's *The Art of War* Writings

- War is a matter of vital importance to the state: a matter of life or death, the road either to survival or ruin. Hence, it is imperative that it be studied thoroughly.
- Warfare is based on deception. When near the enemy, make it seem that you are far away; when far away, make it seem that you are near. Hold out baits to lure the enemy. Strike the enemy when he is in disorder. Avoid the enemy when he is stronger. If your opponent is of choleric temper, try to irritate him. If he is arrogant, try to encourage his egotism. If enemy troops are well prepared after reorganization, try to wear them down. If they are united, try to sow dissension among them. Attack the enemy where he is unprepared, and appear where you are not expected. These are the keys to victory for a strategist. It is not possible to formulate them in detail beforehand.
- A speedy victory is the main object in war. If this is long in coming, weapons are blunted and morale depressed. When the army engages in protracted campaigns, the resources of the state will fall short. Thus, while we have heard of stupid haste in war, we have not yet seen a clever operation that was prolonged.
- Generally, in war the best policy is to take a state intact; to ruin it is inferior to this. To capture the enemy's entire army is better than to destroy it; to take intact a regiment, a company, or a squad is better than to destroy it. For to win one hundred victories in one hundred battles is not the epitome of skill. To subdue the enemy without fighting is the supreme excellence. Those skilled in war subdue the enemy's army without battle.
- The art of using troops is this: When ten to the enemy's one, surround him. When five times his strength, attack him. If double his strength, divide him. If equally matched, you may engage him with some good plan. If weaker, be capable of withdrawing. And if in all respects unequal, be capable of eluding him.
- Know your enemy and know yourself, and in a hundred battles you will never be defeated. When you are ignorant of the enemy but know yourself, your chances of winning or losing are equal. If ignorant both of your enemy and of yourself, you are sure to be defeated in every battle.
- He who occupies the field of battle first and awaits his enemy is at ease, and he who comes later to the scene and rushes into the fight is weary. And therefore, those skilled in war bring the enemy to the field of battle and are not brought there by him. Thus, when the enemy is at ease, be able to tire him; when well fed, be able to starve him; when at rest, be able to make him move.
- Analyze the enemy's plans so that you will know his shortcomings as well as his strong points. Agitate him to ascertain the pattern of his movement. Lure him out to reveal his dispositions and to ascertain his position. Launch a probing attack to learn where his strength is abundant and where deficient. It is according to the situation that plans are laid for victory, but the multitude does not comprehend this.
- An army may be likened to water, for just as flowing water avoids the heights and hastens to the lowlands, so an army should avoid strength and strike weakness. And as water shapes its flow in accordance with the ground, so an army manages its victory in accordance with the situation of the enemy. And as water has no constant form, there are in warfare no constant conditions. Thus, one able to win the victory by modifying his tactics in accordance with the enemy situation may be said to be divine.
- If you decide to go into battle, do not announce your intentions or plans. Project "business as usual."
- Unskilled leaders work out their conflicts in courtrooms and battlefields. Brilliant strategists rarely go to battle or to court; they generally achieve their objectives through tactical positioning well in advance of any confrontation.
- When you do decide to challenge another company (or army), much calculating, estimating, analyzing, and positioning bring triumph. Little computation brings defeat.
- Skillful leaders do not let a strategy inhibit creative counter-movement. Nor should commands from those at a distance interfere with spontaneous maneuvering in the immediate situation.
- When a decisive advantage is gained over a rival, skillful leaders do not press on. They hold their position and give their rivals the opportunity to surrender or merge. They do not allow their forces to be damaged by those who have nothing to lose.
- Brilliant strategists forge ahead with illusion, obscuring the area(s) of major confrontation, so that opponents divide their forces in an attempt to defend many areas. Create the appearance of confusion, fear, or vulnerability so the opponent is helplessly drawn toward this illusion of advantage.

Note: Substitute the words *strategy* or *strategic planning* for *war* or *warfare*.

Conclusion

All firms have a strategy, even if it is informal, unstructured, and sporadic. All organizations are heading somewhere, but unfortunately some organizations do not know where they are going. The old saying "If you do not know where you are going, then any road will lead you there!" accents the need for organizations to use strategic-management concepts and techniques. The strategic-management process is becoming more widely used by small firms, large companies, nonprofit institutions, governmental organizations, and multinational conglomerates alike. The process of empowering managers and employees has almost limitless benefits.

Organizations should take a proactive rather than a reactive approach in their industry, and they should strive to influence, anticipate, and initiate rather than just respond to events. The strategic-management process embodies this approach to decision making. It represents a logical, systematic, and objective approach for determining an enterprise's future direction. The stakes are generally too high for strategists to use intuition alone in choosing among alternative courses of action. Successful strategists take the time to think about their businesses, where they are with their businesses, and what they want to be as organizations—and then they implement programs and policies to get from where they are to where they want to be in a reasonable period of time.

It is a known and accepted fact that people and organizations that plan ahead are much more likely to become what they want to become than those that do not plan at all. A good strategist plans and controls his or her plans, whereas a bad strategist never plans and then tries to control people! This textbook is devoted to providing you with the tools necessary to be a good strategist.

Key Terms and Concepts

annual objectives (p. 45)
competitive advantage (p. 42)
empowerment (p. 49)
environmental scanning (p. 44)
external opportunities (p. 44)
external threats (p. 44)
internal strengths (p. 44)
internal weaknesses (p. 44)
intuition (p. 40)
long-range planning (p. 39)
long-term objectives (p. 45)
mission statements (p. 44)
policies (p. 46)
retreats (p. 48)
strategic management (p. 39)
strategic-management model (p. 48)
strategic-management process (p. 39)
strategic planning (p. 39)
strategies (p. 45)
strategists (p. 43)
strategy evaluation (p. 40)
strategy formulation (p. 39)
strategy implementation (p. 40)
sustained competitive advantage (p. 42)
vision statement (p. 44)

Issues for Review and Discussion

1-1. Singapore Airlines has done very well in 2013. Briefly explain whether this strategy will be just as effective going forward.

1-2. Does Singapore Airlines have its strategic plan posted on its website? Should the company do so? Why or why not?

1-3. Compare and contrast the activities involved in strategy formulation versus those involved in strategy implementation.

1-4. Given the political and economic collapse of various Middle Eastern and European countries, identify a list of companies for which gaining and sustaining competitive advantage has permanently changed.

1-5. There is a dramatic shift in mass retailing to become smaller. Give four reasons for this phenomenon, with corporate examples of each.

1-6. Avoid being merely descriptive in your written or oral case analysis; rather, be prescriptive, insightful, and forward-looking throughout your project. Discuss the meaning of this sentence.

1-7. Briefly explain what Dale McConkey means when he says, “plans are less important than planning.”

1-8. In terms of developing a strategic plan, explain what Edward Deming means by “In God we trust. All others bring data.”

1-9. In an organization, at which three hierarchal levels would strategy formulation, implementation, and evaluation activities occur?

1-10. Explain Einstein’s rationale for saying “Imagination is more important than knowledge.” Would you agree with Einstein? Why?

1-11. Explain Drucker’s statement “I believe in intuition only if you discipline it.” Do you agree with it? Give reasons for your answer.

1-12. Strategic management is all about gaining and maintaining competitive advantage. Explain using examples.

1-13. Based on the definition of strategists in Chapter 1, identify the top three strategists that you have personally spoken to, and interacted with.

1-14. Would the collapse of the euro be a major threat, or opportunity, for your college or university? Why? In your opinion, what is the probability of such a collapse?

1-15. Strategic management is not a panacea for success. It can be dysfunctional if conducted haphazardly. Give five examples of potential “haphazard” aspects of the planning process.

1-16. Explain why open-mindedness is an important guideline for effective strategic management.

1-17. Explain how and why firms use social networks these days to gain a competitive advantage.

1-18. Compare and contrast vision statements with mission statements.

1-19. Identify the top 10 external factors that you feel are affecting your university. Rank them with one being most important.

1-20. In order of importance, list six benefits of a firm engaging in strategic management.

1-21. Rank six reasons, in order of their importance, why firms don’t have strategic plans.

1-22. Identify six guidelines required while conducting strategic management activities.

1-23. Discuss how relevant you think Sun Tzu’s *Art of War* writings are, for firms today, in developing and carrying out a strategic plan.

1-24. Determine the ways and means that your college or university does strategic planning, and report on these efforts to your class.

1-25. Go to the Strategy club website (www.strategyclub.com) and describe the strategic planning products offered.

1-26. Compare and contrast the extent to which strategic-planning concepts are used by companies in your country with those in the United States.

1-27. Would strategy formulation or strategy implementation concepts differ more across countries? Why?

1-28. Compare strategic planning with long range planning.

1-29. Which three activities comprise strategy evaluation? Why is strategy evaluation important, even for successful firms?

1-30. Explain how a firm can achieve sustained competitive advantage.

1-31. Identify and give an overview of three social networking sites that firms are using to gain competitive advantage.

1-32. List four strategists whom you know personally. Rank them on their effectiveness as a leader in their organization.

1-33. List six characteristics of objectives, using examples.

1-34. Conduct an Internet research to determine what percentage of your country’s population smoke. What implications does this have for firms in your country?

1-35. List four financial and four nonfinancial benefits of a firm engaging in strategic planning.

1-36. Discuss the comparisons between business strategy and military strategy.

1-37. Briefly explain whether strategic planning should be more of a people-process than a paper process.

1-38. Do you agree with the fact that strategic planning should not be controlled by technicians. Briefly explain the reasons for your answer.

1-39. According to Sun Tzu, warfare is based on deception. Should strategic planning be based on deception? Explain.

1-40. Explain Sun Tzu’s statement “Generally, in war the best policy is to take a state intact; to ruin it is inferior to this.” Is this true in corporate strategic planning? Explain.

1-41. What is Singapore Airlines’ competitive advantage? How can this advantage be sustained?

1-42. Are there any compelling reasons why the external audit, and internal audit, should not be conducted simultaneously?

1-43. Which stage of strategic management do you feel is the most important? Give reasons for your answer.

1-44. Should strategic planning be more open or closed (i.e., hidden or transparent)? Why?

1-45. Discuss the extent to which strategic planning concepts would be applicable to individuals managing their own lives.

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

1-46. Strengths and weaknesses should be determined relative to competitors, or by elements of being, or relative to a firm's own objectives. Explain.

1-47. What are the three stages in strategic management? Which stage is more analytical? Which relies most on empowerment to be successful? Which relies most on statistics? Justify your answers.

1-48. Mymanagementlab Only—comprehensive writing assignment for this chapter.

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THE COHESION CASE

adidas Group – 2013

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Headquartered in Herzogenaurach, Germany, adidas AG is a sports apparel and footwear manufacturer and parent company of the adidas Group, which includes the Reebok sportswear company, the TaylorMade-adidas Golf, and Rockport footwear, as well as many other globally-known brands. Besides sports footwear, adidas also produces accessory products such as bags, shirts, watches, eyewear, and other sports- and clothing-related goods. The company is the largest sportswear manufacturer in Europe and the second-largest sportswear manufacturer in the world, with Nike being the first.

The company sells sports shoes, apparel, and equipment, sporting its three-stripe design in 170 countries and focuses on training equipment and apparel for sports such as soccer, basketball, and track athletics, as well as lifestyle goods including SLVR and Y-3 fashion brands. adidas has three segments: Wholesale, Retail, and Other Business. The Wholesale division supplies adidas and Reebok products to retailers globally, while the company's Retail segment operates almost 2,500 Reebok and adidas stores. The Other Business segment includes TaylorMade-adidas Golf, Rockport, Reebok-CCM Hockey, and other brands.

History

At the age of 20, Adolf 'Adi' Dassler was driven by a single idea when he made his first shoe. His vision was to produce the most durable and safest footwear for athletes in different sports. Dassler continued this vision until his death in 1978. His first shoe in 1920 was constructed of canvas due to few materials being available in the post-war period. By the 1930s, Dassler was making 30 different styles of shoes for 11 different sports and employed around 100 workers. After World War II, Dassler found himself once again making shoes with limited materials and in 1947, with only 47 workers, he resurrected shoe manufacturing using canvas and rubber from American fuel tanks. His brother, Rudolf, founded rival company Puma, which is also headquartered in Herzogenaurach. Dassler made the first post-war sports shoes in 1949 and formally registered his company adidas, which is the first three letters of his first and last names. To this day, adidas is still referred to as the "Three Stripes Company."

Perhaps the earliest and greatest pioneer in sports marketing, Dassler garnered many famous athletes to endorse his product, including Jesse Owens, Muhammad Ali, Franz Beckenbauer. The German football team won the 1954 World Cup wearing adidas shoes with screw-in studs, spurring the company to develop and promote many new products for major sporting events.

In January 2006, adidas acquired Reebok International Ltd., furthering the adidas Group as one of the top athletic footwear, apparel, and sports hardware producers in the world. In 2008, adidas entered the English cricket market by sponsoring English batsman Kevin Pietersen. The following year, adidas signed the English player Ian Bell and the Indian Player Ravindra Jadeja as brand spokesmen. The lines under which adidas produces and sells cricket bats currently include Incurza, Pellara, and Libro, and additionally, adidas manufactures the uniforms worn by both the England and the Australia cricket teams.

At the London 2012 Olympic Games, adidas outfitted all volunteers, technical staff, and officials. As the Official Partner of Team GB, adidas provided all British athletes in all Olympic sports with performance products, alongside Licensed and Event-Branded Olympic fan wear in those games.

Second Quarter (Q2) of 2013 Results

For Q2 of 2013, adidas reported growth in their Retail stores segment, but sales declined in their Wholesale and Other Businesses segments. Also for that quarter, adidas' revenues in Western Europe decreased 11 percent compared to the prior year. The company's sales in North America were down 2 percent, mainly due to sales declines at TaylorMade-adidas Golf. In Greater China for Q2, company sales were up 6 percent, while revenues in Other Asian Markets increased 7 percent. For Q2 of 2013, the best performing region for the company was Latin America where sales grew 21 percent.

From a brand perspective, adidas' sales at Reebok grew 11 percent while sales from the company's TaylorMade-adidas Golf segment declined 8 percent. The company's Rockport sales grew 7 percent and Reebok-CCM Hockey sales increased 2 percent.

Overall, adidas' revenues declined 4 percent to €3.383 billion in Q2 of 2013, from €3.517 billion in Q2 of 2012. The operating profit declined 2 percent to €252 million compared to €256 million in 2012. The company's net income grew 4 percent to €172 million (2012: €165 million) and their earnings per share rose to €0.82 (2012: €0.79).

adidas Segments

Wholesale

In 2012, sales in the adidas Wholesale segment grew 2 percent, driven by strong growth at adidas that more than offset sales declines at Reebok. Wholesale's gross profit grew 8 percent to €3.840 billion from €3.570 billion in 2011. Wholesale's operating profit improved 10 percent to €2.965 billion versus €2.690 billion in the prior year. In 2012, adidas' Wholesale segment increased in all regions except North America, where sales were down 9 percent. In 2012, adidas Sport Performance wholesale revenues grew 6 percent mainly a result of double-digit sales increases in the football, running, basketball and outdoor categories. In 2012, Reebok wholesale revenues decreased 28 percent due mainly due to the discontinuation of the NFL license agreement.

Retail

In 2012, adidas' Retail revenues increased 14 percent. The company's Concept stores, factory outlets, concession, and e-commerce corners were all up versus the prior year. The adidas Retail Segmental operating profit increased 22 percent to €724 million versus €593 million in the prior year. Retail sales increased in all regions, especially in the UK, Germany and France. Sales in European Emerging Markets rose 19 percent, with Russia leading the way. Sport Performance revenues grew 11 percent in 2012, Sport Style sales rose 20 percent, Reebok sales rose 12 percent, store sales for the adidas brand rose 7 percent. At year-end 2012, the Retail segment operated 2,446 stores, up 62 stores or 3 percent versus the prior year-end level. Of the total number of stores, 1,353 were adidas and 363 were Reebok branded and there were 730 factory outlets. During 2012, adidas opened 323 new stores, 261 stores were closed and 92 stores were remodeled. In addition in 2012, adidas opened 250 new concept stores, 110 concept stores were closed, 57 concept stores were reclassified as concession corners, and one concept store was reclassified as a factory outlet. As a result, the number of concept stores increased by 82 to 1,437 with 1,171 being adidas brand and 266 Reebok. Also in 2012, sales from adidas and Reebok e-commerce platforms were up 68 percent.

Other Businesses

The Other Businesses revenues increased at a double-digit rate in all regions. Revenues in Western Europe were up 16 percent led by double-digit sales growth at Other Centrally Managed Brands and TaylorMade-adidas Golf. Sales at Reebok-CCM Hockey grew at a low-single-digit rate, and revenues at Rockport declined at a double-digit rate. Sales in European Emerging Markets increased 17 percent led by strong double-digit growth at Rockport. Revenues at Reebok-CCM Hockey and TaylorMade-adidas Golf were up at a high-single- and mid-single-digit rate, respectively. North America revenues rose 19 percent, led by double-digit growth at TaylorMade-adidas Golf and Reebok-CCM Hockey. Revenues in Greater China were up 10 percent while sales in Other Asian Markets grew 12 percent. In Latin America, sales grew 37 percent, as a result of strong double-digit growth at TaylorMade-adidas Golf and Rockport. In 2012, TaylorMade-adidas Golf revenues grew 20 percent and Rockport revenues increased 2 percent. The company's Other Centrally Managed Brands revenues grew 61 percent.

Internal Issues

Vision and Mission

The overall mission of adidas is "to be the leading and most loved sports brand in the world.", whilst adidas' vision for their Retail segment is "to become a top retailer by delivering healthy, sustainable growth with outstanding return on investment." TaylorMade-adidas Golf's mission is "to maintain its status as the world's leading golf company in terms of sales and profitability." Rockport's mission is "to become one of the world's leading leather footwear brands through the innovative combination of contemporary style and engineered comfort."

Organizational Structure

Four young white male executives comprise the top management team at adidas. The individuals are listed below:

1. Herbert Hainer, CEO
2. Glenn Bennett, Director of Global Operations
3. Robin Stalker, CFO
4. Erich Stamminger, Director of Global Brands

Production

Production for almost all of adidas' footwear, apparel and hardware is outsourced to independent third-party suppliers, primarily located in Asia. The company operates ten production and assembly sites in Germany (1), Sweden (1), Finland (1), the USA (4) and Canada (3). In comparison, in 2012, adidas had 337 independent manufacturing partners (2011: 308). The number of suppliers increased throughout all product categories (footwear, apparel and hardware). Among these manufacturing partners, 76 percent were located in Asia, 16 percent in the Americas and 8 percent in Europe. In total, 31 percent of all adidas suppliers were located in China. In fact, 96 percent of adidas' total 2012 footwear volume for adidas, Reebok and adidas Golf was produced in Asia (2011: 97%). Vietnam housed 31 percent of adidas' production and Indonesia had 26 percent. The volume of footwear that adidas sources from Cambodia increased strongly in 2012. Overall for that year, adidas' footwear suppliers produced approximately 244 million pairs of shoes (2011: 245 million pairs), with the largest footwear factory producing about 10 percent of the footwear sourcing volume (2011: 9%). Rockport produced approximately 8 million pairs of footwear in 2012, a decrease of 5 percent from the prior year.

Apparel production in Turkey increases significantly in 2012 as company sourced 84 percent of its total apparel volume from Asia (2011: 83%). Europe remained the second-largest apparel sourcing region, representing 11% of the volume (2011: 11%). The Americas accounted for 5 percent of the volume (2011: 6%). The largest apparel factory produced approximately 10 percent.

R&D

R&D expenses increased 12 percent in 2012 to €128 million (2011: €115 million).

Finance

For the first half of 2013, adidas revenues increased its Retail and Other Businesses (TaylorMade-adidas golf and Rockport) but declined in Wholesale, as indicated in Exhibit 1. The company relies heavily on third-party Wholesale retail channels, including department stores, e-tailers and specialist sports retailers.. Over the past five years, adidas has evolved into a significant retailer itself, operating 2,446 stores for the adidas and Reebok brands worldwide, which comprise the company's Retail segment.

In the first half of 2013, adidas sales grew in all regions except Western Europe, as indicated in Exhibit 2. Revenues in Western Europe decreased 9 percent, as growth in France and Poland was more than offset by double-digit sales declines in the UK, Italy and Spain. In European Emerging Markets, adidas' reported slight sales growth in all countries except Ukraine. Sales in North America grew 1 percent and in Greater China rose 6 percent on a currency-neutral basis. Revenues in Other Asian Markets grew 1 percent, with higher increases in India, South Korea and Australia. In Latin America, adidas' sales grew 16 percent.

EXHIBIT 1 adidas Revenues by Category

	First Half Year 2013	First Half Year 2012	Change y-o-y in euro terms
	€ in millions	€ in millions	in %
Wholesale	4,495	4,727	(5)
Retail	1,589	1,547	3
Other Businesses	1,050	1,067	(2)
Total	**7,134**	**7,341**	**(3)**

Source: adidas First Half Year Report 2013.

EXHIBIT 2 adidas Sales by Region

	First Half Year 2013	First Half Year 2012	Change y-o-y in euro terms
	€ in millions	€ in millions	in %
Western Europe	1,907	2,098	(9)
European Emerging Markets	901	917	(2)
North America	1,716	1,728	(1)
Greater China	781	732	7
Other Asian Markets	1,064	1,162	(8)
Latin America	765	704	9
Total	**7,134**	**7,341**	**(3)**

Source: adidas First Half Year Report 2013.

In the first half of 2013, adidas' net income increased 6 percent to €480 million from €455 million in 2012. Net borrowings at June 30, 2013 amounted to €94 million, a decrease of €223 million, or 70 percent, versus €318 million at the end of June 2012.

Sustainability

For the 13th consecutive year in 2013, adidas was included in the Dow Jones Sustainability Indexes (DJSI) and the FTSE4Good Europe Index, the Vigeo Group's Ethibel Sustainability Index Excellence Europe as well as in the ASPI Eurozone Index. For 2012, adidas was included for the eighth consecutive time in "The Global 100 Most Sustainable Corporations in the World," a list that is revealed each year at the World Economic Forum in Davos, Switzerland. The company is a constituent of the STOXX Global ESG Leaders indices.

Product Areas

Football

As the world's most popular sport, football is a key strategic focus for adidas, and the company puts research and development into technologies for boots, apparel, and footballs at a position of high priority. In late 2013, adidas launched a stream of new and innovative football products for the World Cup. In 2013, adidas reported successes in football, such as brand spokesman Lionel Messi being awarded the FIFA Ballon d´Or as the best player of the year for the fourth time in a row, Chelsea FC won an all-adidas-sponsored final in the UEFA Europa League, and FC Bayern Munich was recently crowned UEFA Champions League winner. At the 2013 FIFA Confederations Cup, four out of eight teams are equipped by adidas, including the World and European Champion Spain, Asian Champion Japan, CONCACAF Champion Mexico and the 2013 Africa Cup winner Nigeria. The Japan team was also the very first team to qualify the 2014 FIFA World Cup in Brazil.

The company expects to achieve record sales of €2 billion in the football category in 2014. As the official sponsor, supplier and licensee of the 2014 FIFA World Cup, to be held in Brazil, and will again supply the official ball of the tournament as well as equipment for officials, referees, and volunteers. Additionally, having extended their partnership with the Union of European Football Associations, adidas will also supply the balls and equipment for the UEFA EURO 2016 tournament. These partnerships continue adidas' 30-year history of sponsoring some of the world's largest sporting events, which also includes the FIFA Confederations Cup and UEFA Champions League. Sponsorship of high-profile events such as these provide adidas with important platforms to assert and showcase their dominance in football.

In 2012 adidas sponsored Spain winning the UEFA EURO 2012 and Chelsea FC becoming the winner of the UEFA Champions League in an all-adidas final against host club FC Bayern Munich. The adizero f50 featuring miCoach has changed the way football is played and how data is analyzed. The introduction of Predator Lethal Zones marked the successful recognition of the Predator family, the most successful boot concept in football history.

Basketball

The company is expanding its market share in the North American and Chinese basketball markets and capitalizing on the growing popularity of the sport in the emerging markets by building brand equity, leveraging its status as the official NBA outfitter, and capitalizing on relationships with some of the most promising stars of the NBA, including Derrick Rose and Dwight Howard. In 2012, adidas Basketball focused on expanding the Derrick Rose signature collection and launched the 269g adizero Crazy Light 2. Also introduced were the D Rose 3.0 basketball shoe and Derrick Rose's first signature apparel collection.

Training

In 2012, adidas introduced several new technologies and product updates, such as the Adipure Trainer 360, a training shoe for men and women offering unrestricted foot movement using lightweight and flexible materials. In 2013, adidas Training introduced the next generation of the ClimaCool and ClimaWarm apparel technologies, featuring advanced fabrics, as well as expanding the Adipure footwear range, to provide athletes with the highest functionality and comfort.

Outdoor

In 1978, climbing legend Reinhold Messner used new adidas boots to reach base camp on his way to becoming the first man to climb Mount Everest without artificial oxygen. Today, adidas offers a wide range of boots for mountaineers, climbers, and hikers, as well as technical footwear, apparel, backpacks and eyewear, sometimes in collaboration with partners such as Gore-Tex, Windstopper, Primaloft and Continental. The adidas Outdoor group has close relationships with the mountain guides from the Alpine Centre in Zermatt, Switzerland, and some of the best climbing and mountaineering athletes from around the world, including world-renowned climbers like Alexander and Thomas Huber, Mayan Smith-Gobat, Dean Potter and Sasha DiGiulian, a rising star in competitive climbing. Special adidas Outdoor offerings include the Terrex Fast R and the HydroterraShandal and the TerrexIcefeather Gore-Tex Pro-Shell jacket. In 2013, adidas Outdoor launched the Terrex Solo Stealth, the first adidas shoe with Stealth rubber designed for technical climbing, where perfect grip is essential.

Sport Style

Street-wear and lifestyle sports fashion now makes up more than 28 percent of adidas brand sales globally. Originals is recognized as a legitimate sports lifestyle brand offering a wide range of products aimed at the 16- to 24-year-old consumer.

Y-3

Y-3 athletic sportswear is elegant and chic. In 2013, the Y-3 portfolio was extended with stores in London, Vienna and Hong Kong and increased emphasis on the Y-3 global e-commerce website.

Porsche Design Sport

Working closely with Porsche Design Sport, adidas creates luxury sportswear that features leading-edge performance technologies. An adidas spokesperson in this category is José Mourinho who showcases the image of Porsche Design Sport. In 2012, the men's collection included apparel, footwear and accessories in the categories of Driving, Golf, Gym, Running, Water and Snow. In 2013, adidas launched its first women's collection and introduced it with the support of its new brand ambassador, tennis player Daniela Hantuchova. New adidas products include the Made in Germany Cleat II and Compound II as well as an exclusive offer of heli-skiing items. Porsche Design Sport is available in Porsche Design stores, adidas Concept Stores and high-end department stores.

SLVR

SLVR is a sportswear clothing product offering that combines comfort and style with advanced fabrics and techniques. In fall 2013, adidas SLVR created a global e-commerce store.

Fitness Brand

The adidas-owned brand Reebok strives to become the leading fitness brand in the world, having helped usher in the aerobics movement years ago with groundbreaking, game-changing products and marketing. While the sporting goods industry and the world have changed considerably since then, Reebok wants to help shift the paradigm and change the perception of fitness, evolving it from a chore to a series of activities and a lifestyle choice. Therefore, Reebok is on a mission to empower people to be "fit for life", supporting them to achieve their full potential in a fun, collaborative and engaging way. In 2013, Reebok significantly expanded its fitness offerings and broadened its communication of what the brand stands for and what it means to wear Reebok.

Studio

In 2013 adidas began its Reebok Studio offerings that include Dance, Yoga and Aerobics product concepts and programmes for women. Dance and Yoga products launched in spring 2013, while Aerobics launched in the second half of 2013. The key dance product is the Dance UR Lead – a technical dance shoe.

TaylorMade-adidas Golf Strategy

The TaylorMade-adidas Golf segment consists of four of the most widely known and respected brands in the sport: TaylorMade, adidas Golf, Adams Golf and Ashworth.

TaylorMade is arguably the market leader in the metal woods and irons categories, and is among the leaders in other golf categories. TaylorMade-adidas Golf is a global leader in golf apparel and is among the top three in footwear sales. In 2012, TaylorMade-adidas Golf acquired Adams Golf, a company that had focused on clubs for game improvement as well as for senior and women golfers in contrast to TaylorMade's focus on younger and lower-handicap golfers. TaylorMade is the clear market leader in metalwoods (drivers, fairway woods and hybrids). The TaylorMadeRocketBallz iron was the best-selling iron in 2012 in the USA. TaylorMade offers wedges such as the ATV (All-Terrain Versatility) wedge, with its innovative sole that makes it highly effective from a wide variety of lies. The ATV was played widely on tour in 2012, and in the USA it rose to be a best-selling wedge at retail during October 2012. TaylorMade's Ghost line of putters sell well, especially the Ghost Spider line introduced in 2013, including the Ghost Spider Daddy Long Legs. In the golf ball category, in 2013, TaylorMade launched its newest tour ball, Lethal, introduced in February 2013, as well as the RocketBallz Urethane, with its three-piece construction and a tour-validated urethane cover priced well below most urethane balls.

Rockport

Rockport shoes are popular globally; 43 percent of the total Rockport revenues in 2012 came from outside Germany. In that year alone, Rockport opened more than 40 stores in Russia/CIS, Japan, South Korea and other markets around the world.

Reebok-CCM Hockey

Reebok-CCM Hockey is a leading designer and marketer of ice hockey equipment and related apparel, equipping more professional hockey players than any other company, including NHL superstars Sidney Crosby and Pavel Datsyuk. Reebok-CCM Hockey is also the official outfitter of the NHL as well as several NCAA and national teams.

Competitors

Columbia Sportswear (COLM)

Headquartered in Portland, Oregon, leading sportswear chain, Columbia Sportswear CompanyColumbia's trademark Bugaboo parka with weatherproof shell sells well globally. Columbia offers many sportswear accessories, boots, and rugged footwear, sold under brands Columbia, Mountain Hardwear, Sorel, and Montrail. Controlled by the Boyle family and run by president and CEO Tim Boyle, Columbia recently strengthened its presence in the growing Indian market by forming a distribution agreement with the New Delhi-based Chogori India Retail Ltd. whereby Chogori will serve as the sole distributor of Columbia's brands in India.

The Indian sportswear industry is growing rapidly as Indians are increasingly taking to outdoor leisure activities. Columbia Sportswear will have to compete with local brands, like Bata, Liberty and Woodland, and international players, like Nike and adidas AG. Columbia's outdoor apparel, footwear and other products are sold in approximately 100 countries. Apart from India, the company has also formed a joint venture with Swire Resources Ltd. in China to expand the company's sales there.

Puma SE

Another rival to adidas is Puma. Both firms are headquartered in Herzogenaurach, Bavaria, Germany primarily because Puma was formed when German brothers Rudi and Adi Dassler feuded and split their family firm into adidas and Puma. Puma designs and makes footwear, apparel, and accessories sold under the Puma, Tretorn, and Cobra Golf labels. While shoes are Puma's primary product line, apparel accounts for a growing portion of sales. Puma has been expanding its athletic apparel styles to include men's golf, sailing, motorsports, and denim items. Puma also operates its own retail stores and controls product distribution in many countries. French luxury-goods giant Keringowns a majority stake in Puma.

Puma owns 25 percent of American brand sports clothing maker Logo Athletic, which is licensed by American professional basketball and association football leagues. In 2013, Puma signed multi-year deals to make kits for the Rangers FC team, the Football League Championship Wolverhampton Wanderers FC, the Serbian Red Star Belgrade, and the Arsenal Football Club.

Nike (NKE)

The world's largest shoe and apparel company, Nike designs, develops, and sells a hundreds of products and services to help in playing basketball and soccer (football), as well as in running, men's and women's training, and other action sports. Nike also markets products for golf, tennis, and walking, and sportswear by Converse and Hurley. Nike sells through thousands of wholesalers but also has more than 800-owned retail stores worldwide, an e-commerce site.

Nike's recent fiscal year ended May 31, 2013 when the company reported that revenues were up 8 percent to $25.3 billion. Nike Brand wholesale revenues increased 8 percent to $18.4 billion, while Direct-to-Consumer (DTC) revenues grew 24 percent to $4.3 billion, driven by 14 percent growth in same store sales and new door expansion. As of May 31, 2013 the Nike Brand had 645 DTC stores in operation as compared to 557 the prior year. Nike reported that revenues for its Other Businesses grew 9 percent. Overall for fiscal 2013, Nike's net income increased 9 percent to $2.5 billion and inventories were $3.4 billion, up 7 percent from the prior year.

Under Armour (UA)

A rising star in the athletic appeal industry, Under Armour is very popular among young athletes. The company has license contracts with some major American universities as a provider of sports appeal and jerseys to their athletic teams. Under Armour develops, markets, and distributes performance apparel, footwear, and accessories for men, women, and youth primarily in the USA and Canada. UA offers products made from moisture-wicking fabrics designed to regulate body temperature regardless of weather conditions. The company provides products in three fit types: compression (tight fitting), fitted (athletic cut), and loose (relaxed) extending across the sporting goods, outdoor, and active lifestyle markets.

Under Armour's footwear offerings include football cleats, baseball, lacrosse, and softball cleats, and slides. The company also provides baseball bats, football, golf, and running gloves, as well as hats, eye wear, bags, and many more sports accessories. Under Armour prides itself on technology and being a good corporate citizen. Three of their main technology marketing tools are HeatGear, ColdGear, and AllSeasonGear.

Callaway Golf (ELY)

Callaway Golf is for sale and adidas is rumored to be interested in acquiring the company. Headquartered in Carlsbad, California and founded in 1982 by Eli Callaway, Callaway Golf sells, designs, and manufactures golf clubs and balls worldwide. The company also sells many accessories such as golf bags, gloves, shoes, and other apparel. Callaway gained an early reputation for producing top quality products with their 1990 introduction of the Big Bertha Driver. Today, Callaway's most innovative breakthrough clubs are sold under the Diablo name. Callaway has produced more than 1,100 United States patents, more than any other golf manufacturer.

Callaway's CEO since March 2012 is Chip Brewer is pursuing a turnaround for the company that has not made an annual profit since 2008. Brewer is seeking to restore profitability by reducing costs, streamlining operations and building market share, Callaway **recently** cut its 2013 revenue forecast for the second time to $810 million, its lowest annual sales in a decade and down from its $850 million projection in January.

Conclusion

Nike in late 2013 wrestled away from adidas the rights to the British athletics team footwear and apparel until 2020, winning the contract after a legal battle involving current supplier adidas. The new agreement includes the world athletics championships to be hosted in London in 2017. "The scale and length of their commitment is significant and demonstrates their confidence in the future of British Athletics," said UK Athletics chief executive Niels de Vos, welcoming the deal with Nike. Media reports said the contract was worth 15 million pounds ($23.44 million), double the current deal. Athletics is enjoying its highest profile in Britain since the 1980s, following the excitement generated by the London Olympicsin 2012, and will remain the kit supplier for the British Olympic team.

A clear strategic plan is needed for adidas' future. Acquisitions may be an effective means to make inroads into Nike's market share, perhaps by acquiring firms such as Callaway Golf, or even maybe Under Armour. Using adidas' financial statements provided at the end of this case, develop projected financial statements for the company given what you would recommend adidas do over the coming three years?

adidas AG Consolidated Statement of Financial Position (IFRS) (€ in millions)

	June 30, 2013	June 30, 2012	Change in %	Dec. 31, 2012
ASSETS				
Cash and cash equivalents	1,197	1,013	18.2	1,670
Short-term financial assets	29	377	(92.2)	265
Accounts receivable	2,029	2,118	(4.2)	1,688
Other current financial assets	239	256	(6.6)	192
Inventories	2,611	2,721	(4.0)	2,486
Income tax receivables	66	57	15.7	76
Other current assets	538	482	11.7	489
Assets classified as held for sale	11	25	55.4	11
Total current assets	**6,720**	**7,049**	**(4.7)**	**6,877**
Property, plant and equipment	1,123	1,003	11.9	1,095
Goodwill	1,288	1,576	(18.3)	1,281
Trademarks	1,496	1,555	(3.8)	1,484
Other intangible assets	157	156	0.5	167
Long-term financial assets	116	103	12.7	112
Other non-current financial assets	23	33	(28.5)	21
Deferred tax assets	504	506	0.3	528
Other non-current assets	98	111	12.8	86
Total non-current assets	**4,805**	**5,043**	**(4.7)**	**4,774**
Total assets	**11,525**	**12,092**	**(4.7)**	**11,651**

(*continued*)

Continued

	June 30, 2013	June 30, 2012	Change in %	Dec. 31, 2012
LIABILITIES AND EQUITY				
Short-term borrowings	163	495	(67.0)	280
Accounts payable	1,746	1,874	(6.9)	1,790
Other current financial liabilities	61	81	(26.2)	83
Income taxes	252	260	(3.1)	275
Other current provisions	462	544	(15.0)	563
Current accrued liabilities	1,123	1,053	6.7	1,084
Other current liabilities	323	319	1.5	299
Liabilities classified as held for sale	—	0	(100.0)	0
Total current liabilities	**4,130**	**4,626**	**(10.7)**	**4,374**
Long-term borrowings	1,158	1,214	(4.6)	1,207
Other non-current financial liabilities	13	6	122.0	17
Pensions and similar obligations	258	215	20.2	251
Deferred tax liabilities	385	424	(9.8)	368
Other non-current provisions	50	48	4.3	69
Non-current accrued liabilities	42	33	28.8	40
Other non-current liabilities	28	35	(23.9)	34
Total non-current liabilities	**1,934**	**1,975**	**(2.2)**	**1,986**
Share capital	209	209	—	209
Reserves	615	909	(32.4)	641
Retained earnings	4,652	4,383	6.2	4,454
Shareholders' equity	**5,476**	**5,501**	**(0.5)**	**5,304**
Non-controlling interests	(13.0)	(10.0)	28.3	(13.0)
Total equity	**5,463**	**5,491**	**(0.5)**	**5,291**
Total liabilities and equity	**11,527**	**12,092**	**(4.7)**	**11,651**

Rounding differences may arise in percentages and totals

adidas AG Consolidated Income Statement (IFRS) (€ in millions)

	First half year 2013	First half year 2012	Change	Second quarter 2013	Second quarter 2012	Change
Net sales	7,134	7,341	(2.8%)	3,383	3,517	(3.8%)
Cost of sales	3,559	3,819	(6.8%)	1,689	1,820	(7.2%)
Gross profit	**3,575**	**3,522**	**1.5%**	**1,694**	**1,697**	**(0.1%)**
(% of net sales)	50.1%	48.0%	2.1pp	50.1%	48.2%	1.8pp
Royalty and commission income	51	52	(1.9%)	26	27	(4.6%)
Other operating income	47	47	(0.4%)	29	22	32.4%
Other operating expenses	2,980	2,956	0.8%	1,497	1,490	0.6%
(% of net sales)	41.8%	40.3%	1.5pp	44.3%	42.4%	1.9pp

Continued

	First half year 2013	First half year 2012	Change	Second quarter 2013	Second quarter 2012	Change
Operating profit	**693**	**665**	**4.2%**	**252**	**256**	**(1.9%)**
(% of net sales)	9.7%	9.1%	0.7pp	7.4%	7.3%	0.1pp
Financial income	10	17	(40.7%)	6	8	(34.5%)
Financial expenses	40	57	(30.2%)	22	29	(29.9%)
Income before taxes	**663**	**625**	**6.2%**	**236**	**235**	**0.4%**
(% of net sales)	9.3%	8.5%	0.8pp	7.0%	6.7%	0.3pp
Income taxes	182	171	6.5%	65	71	(9.6%)
(% of income before taxes)	27.5%	27.4%	0.1pp	27.5%	30.5%	(3.0pp)
Net income	**481**	**454**	**6.0%**	**171**	**164**	**4.8%**
(% of net sales)	6.7%	6.2%	0.6pp	5.1%	4.7%	0.4pp
Net income attributable to shareholders	**480**	**455**	**6.5%**	**172**	**165**	**4.1%**
(% of net sales)	6.7%	6.2%	0.5pp	5.1%	4.7%	0.4pp
Net income attributable to non-controlling interests	**1**	**(1)**	**194.1%**	**(1)**	**(1)**	**71.1%**
Basic earnings per share (in €)	2.29	2.17	5.6%	0.82	0.79	4.1%
Diluted earnings per share (in €)	2.29	2.17	5.6%	0.82	0.79	4.1%

Rounding differences may arise in percentages and totals

Source: http://www.adidas-group.com/en/investors/financial-reports/

ASSURANCE OF LEARNING EXERCISES

EXERCISE 1A
Assess Singapore Airline's Most Recent Quarterly Performance Data

Purpose

This exercise gives you practice examining the progress a firm is making in executing its strategic plan. Singapore Airlines utilizes excellent strategic management as showcased at the beginning of Chapter 1.

Instructions

Step 1 Go to Singapore Airlines' website. Click on About Us and then Investor Relations.

Step 2 Review Singapore Airlines' most recent quarterly report.

Step 3 Examine the change in performance variables for that most recent quarter versus the prior year-over-year quarter.

Step 4 What strategic changes were made during that quarter? What additional changes in your view are still needed? How is the company doing? What are key problem areas?

EXERCISE 1B
Gathering Strategy Information on adidas AG

Purpose

The purpose of this exercise is to get you familiar with strategy terms introduced and defined in Chapter 1. Let's apply these terms to the Cohesion Case on adidas AG.

Instructions

Step 1 Go to the adidas corporate website. Click on Investors and then Financial Reports. Download the most recent *Annual Report*. This document may be quite long, so you may want to copy the document electronically. The *Annual Report* contains excellent information for developing a list of internal strengths and weaknesses for adidas.

Step 2 Go to your college library and make a copy of *Standard & Poor's* Industry Surveys for the athletic footwear and apparel industry. This document will contain excellent information for developing a list of external opportunities and threats facing adidas.

Step 3 Go on the Internet and find and print information about adidas's three major competitors: Nike, Puma, and Callaway Golf.

Step 4 Using the information gathered above, on a separate sheet of paper, list what you consider to be adidas's three major strengths, three major weaknesses, three major opportunities, and three major threats. Each factor listed for this exercise must include a %, #, $, or ratio to reveal some quantified fact or trend. These factors provide the underlying basis for a strategic plan, because a firm strives to take advantage of strengths, improve weaknesses, avoid threats, and capitalize on opportunities. Estimate the #'s as needed.

Step 5 Through class discussion, compare your lists of external and internal factors to those developed by other students and add to your lists of factors. Keep this information for use in later exercises at the end of other chapters.

Step 6 Be mindful that whatever case company is assigned to you and/or your team of students this semester, you can start to update the information on your company by following the steps listed for any publicly held firm.

EXERCISE 1C
Getting Familiar with the Free Excel Student Template

Purpose
This exercise is designed to help strategic management students become familiar with the free Excel student template for the case analysis offered by the authors.

Instructions
Step 1 Go to the Strategy Club's website. Download the free Excel student template.

Step 2 Write a one-page summary summarizing the template and explaining why how the template will benefit you the most in this course.

EXERCISE 1D
Evaluating An Oral Student Presentation

Purpose
Quite often in a strategic management course, a team of students is required to give a 15 to 25 minute case analysis oral presentation. This exercise gives you insight on some do's and don'ts regarding oral presentations.

Instructions
Step 1 Go to Strategy Club's website and watch the student case analysis presentation given there. Critique the presentation. What are four aspects that you liked most and four aspects that you liked least?

EXERCISE 1E
Strategic Planning at Nestlé

Purpose
The purpose of this exercise is to give you experience investigating the strategic plan of large, publicly held firms such as Nestlé SA. An important aspect of formulating a strategic plan is to assess the strategic plans of rival firms. For this exercise, you are on the top management team of M&M Mars, a large chocolate company that competes with Nestlé in the confectionery business worldwide.

Instructions
Step 1 Go to Nestlé's website and review the company's recent *Annual Report*. List as clearly as you can the five major strategies that Nestlé is pursuing worldwide.

Step 2 Go to M&M Mars's website and determine as best you can what the privately held firm is doing worldwide to compete with Nestlé.

Step 3 Write a one-page paper that summarizes your assessment of Nestlé's strategic plan as compared to M&M Mars's strategic plan. Include whether you feel being privately held, as M&M Mars is, enables a firm to conceal its strategic plan from rival firms. Do you feel it is advantageous to keep strategies secret from shareholders, employees, creditors, suppliers, and other stakeholders? What would be the advantages of being publicly held?

EXERCISE 1F

Interviewing Local Strategists

Purpose

This exercise is designed to give you experience learning first hand how strategists in your city/town formulate and implement strategies. This information can be used to compare and contrast concepts presented in this textbook with practices of local strategists. Recall that strategists include owners of businesses, directors of nonprofit organizations, top managers of large firms, CEOs, presidents, and many others.

Instructions

Visit five strategists in your city. Interview them, asking the following questions. Prepare answers and report back to your professor.

1. How do you decide which strategies to implement in this organization?
2. How often do you change strategies or take a fresh look at existing strategies?
3. How many persons assist you in formulating strategies?
4. Does your organization have written mission, vision, and objective statements?
5. Is the strategic planning process in your company more secret or open in regard to process and procedure? Which approach do you feel is best? Why?

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Outside-USA Strategic Planning

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Discuss the nature and implications of labor union membership across Europe.
2. Discuss income tax rates and practices across countries.
3. Explain the advantages and disadvantages of entering global markets.
4. Discuss protectionism as it impacts the world economy.
5. Explain when and why a firm (or industry) may need to become more or less global in nature to compete.
6. Discuss the global challenge facing U.S. firms.
7. Compare and contrast business culture in the United States with many other countries.
8. Describe how management style varies globally.
9. Discuss communication differences across countries.
10. Discuss Africa as the newest hotspot for business entry.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 2A The adidas Group wants to enter Africa. Help them.

EXERCISE 2B Assessing Differences in Culture Across Countries

EXERCISE 2C Honda Motor Company wants to enter the Vietnamese market. Help them.

EXERCISE 2D Does My University Recruit in Foreign Countries?

As illustrated in Figure 2-1 with white shading, global considerations impact virtually all strategic decisions. The boundaries of countries no longer can define the limits of our imaginations. To see and appreciate the world from the perspective of others has become a matter of survival for businesses. The underpinnings of strategic management hinge on managers gaining an understanding of competitors, markets, prices, suppliers, distributors, governments, creditors, shareholders, and customers worldwide. The price and quality of a firm's products and services must be competitive on a worldwide basis, not just on a local basis. Shareholders expect substantial revenue growth, so doing business globally is one of the best ways to achieve this end. As indicated in the boxed insert, Honda is an example business that has grown dramatically with a well-conceived rollout across the world.

The consulting firm A.T. Kearney reported in mid-2013 that the USA for the first time since 2001 has replaced China as the country with the highest prospects for foreign direct investment (FDI). Brazil is number 3, followed by Canada, India, Australia, Germany, United Kingdom (UK), Mexico, and Singapore. China's allure has dimmed lately due to rising wages, whereas the USA's surge in oil and gas production promises lower energy costs, coupled with high respect for human rights and freedom, and has led to renewed interest in the USA for FDI.

Exports of goods and services from the USA account for only 11 percent of U.S. gross domestic product, so the USA is still largely a domestic, continental economy. What happens inside the USA largely determines the strength of the economic recovery. In contrast, as a percent of gross domestic product (GDP), exports comprise 35.3 percent of the German economy, 24.5 percent of the Chinese economy, and 156 percent of the Singapore economy. Singapore's number is so high because they import oil and other products and then re-export them globally. A point here also is that the USA has substantial room for improvement in doing business globally based on the 11 percent exports to GDP number.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Honda

Honda Motor Company, headquartered in Minato, Tokyo, Japan, is the world's largest motorcycle manufacturer and the world's largest manufacturer of internal combustion engines. Honda was the eighth largest automobile manufacturer in the world. Honda will re-enter Formula One racing in 2015 as an engine supplier to the McLaren team. Honda annually produces and sells thousands of scooters, water pumps, lawn and garden equipment tools, tillers, outboard motors, robotics, jet engines, and solar cells. Honda has about 180,000 employees. In 2013, *Fortune* ranked Honda Motor Company as the 50th most admired company in the world.

In late 2013, Honda moved away from its time-tested nickel-metal hydride batteries to lighter, smaller and more powerful lithium ion chemistry, such as with the 2014 Accord Hybrid. Rival Toyota continues to stick with NMH batteries on its conventional hybrids, citing their reliability and lower cost. However, with its 2014 Accord Hybrid delivering an EPA-certified rating of 50 mpg in city driving, Honda now offers a full three miles per gallon better than the previous "gas economy king," the 47 mpg Ford Fusion Hybrid. The Toyota Camry Hybrid comes in at 43 and the Hyundai Sonata Hybrid at 40.Honda's 2014 Accord Hybrid gets about 10 percent better fuel economy around town than the original Toyota Prius, a dedicated gas-electric model that features a super-aerodynamic, ultralight body. The new hybrid arrived in dealerships in late 2013. The number 50 is significant because only the Prius has ever hit that EPA estimate mark for vehicles not plugged in for charging.

Honda is investing another $215 million in its Ohio operations, pushing the company's total to $2.7 billion in North American operations in only the past three years. The majority of the monies will be spent on an expansion of manufacturing capabilities at the company's Anna, Ohio, Engine Plant, while the remainder is earmarked for a new building in Marysville, Ohio. Honda already has the strongest foothold of any Japanese automaker, and produces more cars with U.S.-sourced parts than any automaker other than General Motors. Nine of Honda's 16 mass-market cars are made with over half American-made parts, according to the survey – that's more than Ford.

Honda is building a new car factory in Brazil, doubling its capacity in that country to 240,000 cars a year. The new factory is being built in Ityrapina, a city of almost 15,000, located approximately 120 miles northwest of Sao Paulo, Brazil's largest city. The existing Honda factory in Brazil is in Sumare, a city of around 100,000, located halfway between Ityrapina and Sao Paulo. The cost of the new factory, including the purchasing of the 1,433 acres it will be located on, is about $435 million. It will employ approximately 2,000 people, and produce the Honda Fit. The new plant should begin operations in 2015.

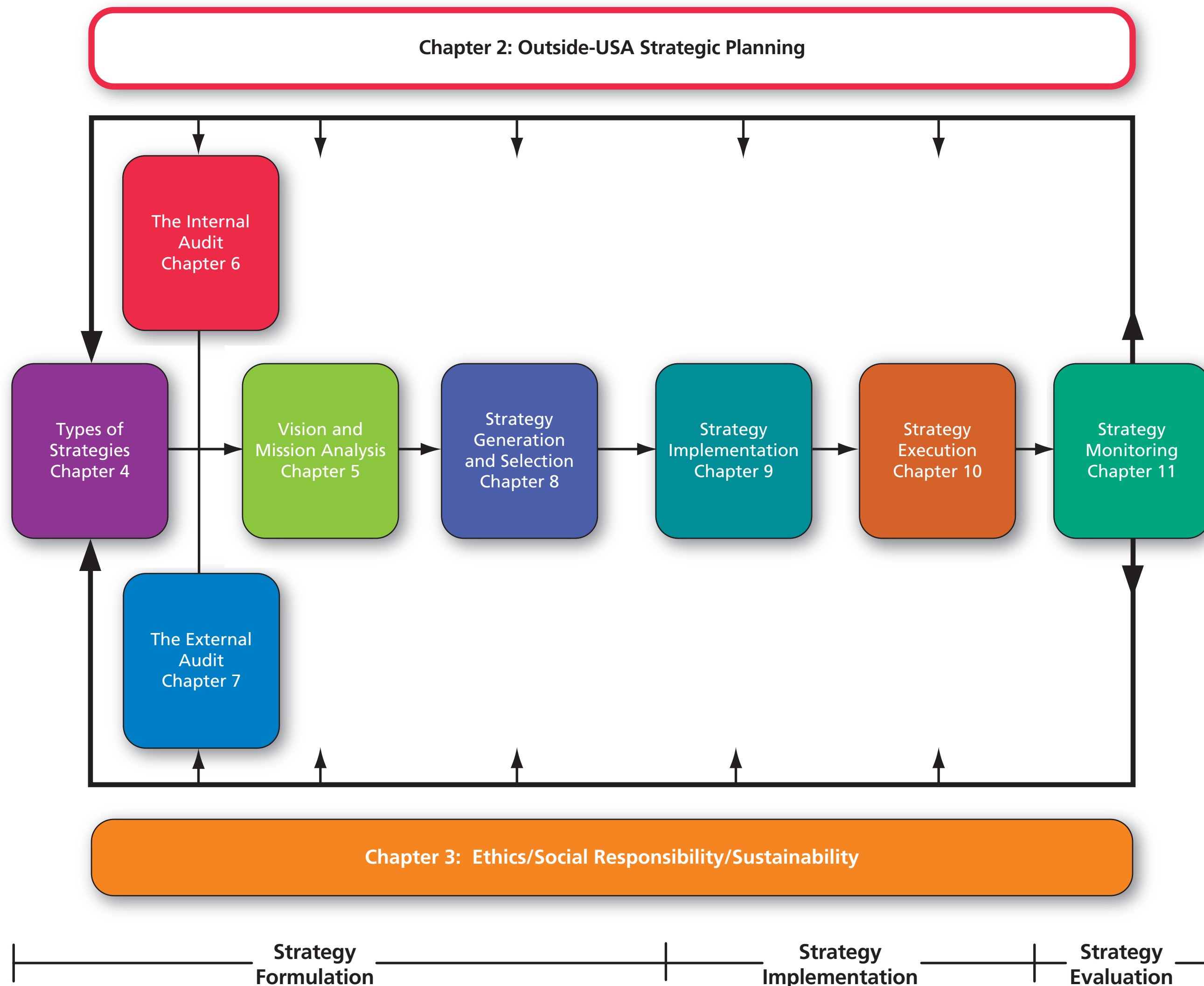

FIGURE 2-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

A world market has emerged from what previously was a multitude of distinct national markets, and the climate for international business today is more favorable than in years past. Mass communication and high technology have created similar patterns of consumption in diverse cultures worldwide. This means that many companies may find it difficult to survive by relying solely on domestic markets.

It is no exaggeration that in an industry that is, or is rapidly becoming, global, the riskiest possible posture is to remain a domestic competitor. The domestic competitor will watch as more aggressive companies use this growth to capture economies of scale and learning. The domestic competitor will then be faced with an attack on domestic markets using different (and possibly superior) technology, product design, manufacturing, marketing approaches, and economies of scale.[1]

As a point of global reference, the 5 largest companies in nine different countries are listed in Table 2-1. The largest of all 45 companies listed is Walmart, headquartered in Bentonville, Arkansas, and employing 2.1 million people worldwide. *Fortune* annually determines the most admired and least admired companies in the world in terms of "global competitiveness." Table 2-2 reveals the rankings in early 2012.

TABLE 2-1 The Five Largest (by revenue) Companies in Nine Countries (2012)

Britain	India	Japan
1. BP	1. Indian Oil	1. Toyota Motor
2. HSBC Holdings	2. Reliance Industries	2. Japan Post Holdings
3. Lloyds Banking Group	3. Bharat Petroleum	3. Nippon TeleG & TeleP
4. Tesco	4. State Bank of India	4. Hitachi
5. Aviva	5. Hindustan Petroleum	5. Honda Motor
Australia	Brazil	China
1. BHP Billiton	1. Petrobras	1. Sinopec Group
2. Wesfarmers	2. Banco do Brasil	2. China National Petroleum
3. Woolworths	3. Banco Bradesco	3. State Grid
4. Commonwealth Bank	4. Vale	4. Ind. & Com. Bank of China
5. Westpac Banking	5. JBS	5. China Mobile Communi.
USA	Canada	Germany
1. Walmart Stores	1. Manulife Financial	1. Volkswagen
2. ExxonMobil	2. Royal Bank of Canada	2. Daimier
3. Chevron	3. Suncor Energy	3. Allianz
4. Conoco Phillips	4. Power Corp. of Canada	4. E. ON
5. Fannie Mae	5. George Weston	5. Siemens

Source: Based on http://money.cnn.com/magazines/fortune/global500/2011/countries/US.html.

TABLE 2-2 *Fortune's* Most and Least Admired Companies in the World for "Global Competitiveness"

MOST ADMIRED
1. Gas Natural Fenosa
2. McDonald's
3. Nestle
4. Apple
5. IBM
6. Procter & Gamble
7. Philip Morris International
8. Yum Brands
9. Caterpillar
10. RWE
LEAST ADMIRED
1. WellCare Health Plans
2. Universal American
3. Coventry Health Care
4. Amerigroup
5. China South Industries Group
6. Health Net
7. Cracker Barrel Old Country Store
8. Jack in the Box
9. China FAW Group
10. Dongfeng Motor

Source: Based on http://money.cnn.com/magazines/fortune/most-admired/2012/best_worst/best9.html and http://money.cnn.com/magazines/fortune/most-admired/2012/best_worst/worst9.html.

Multinational Organizations

Organizations that conduct business operations across national borders are called **international firms** or **multinational corporations**. The strategic-management process is conceptually the same for multinational firms as for purely domestic firms; however, the process is more complex for international firms as a result of more variables and relationships. The social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive opportunities and threats that face a multinational corporation are almost limitless, and the number and complexity of these factors increase dramatically with the number of products produced and the number of geographic areas served.

More time and effort are required to identify and evaluate external trends and events in multinational corporations than in domestic corporations. Geographic distance, cultural and national differences, and variations in business practices often make communication between domestic headquarters and overseas operations difficult. Strategy implementation can be more difficult because different cultures have different norms, values, and work ethics.

For example, in 2013 Home Depot closed all seven of its remaining big-box stores in China after years of losses. That firm joins a growing list of retailers who stumbled in China by failing to consider local culture and customs. Historically cheap labor, coupled with apartment-based living in China, were two reasons why Home Depot, which entered China in 2006, never gained traction in that country. Mattel and Best Buy are other firms that faltered in China. Yum Brands, which owns Kentucky Fried Chicken and Pizza Hut, obtains almost 50 percent of its revenues from China, but the company's same-store sales in China dropped 4 percent in the fourth quarter of 2012, resulting primarily from thousands of new fast-food restaurants opening in China every year.

Even variables such as unemployment rates vary greatly across countries as indicated in Table 2.3. Note that Spain has the highest and Austria the lowest unemployment rate among the European countries listed. Unemployment rates are a good indicator of consumers' disposable income for purchasing all kinds of things, and the rates are a good indicator of a country's overall financial soundness and attractiveness for doing business.

In late 2012, France lost its triple-A rating by Moody's Investors Service after the S&P Ratings Services delivered a stinging critique of President Francois Hollande's attempts to turn the French economy around. Hollande is trying to shift 20 billion euros from payroll taxes to taxes on consumers, and he is pushing for 25 billion of new taxes to cut the country's deficit to 3 percent of GDP in 2013 from the expected 4.5 percent.

TABLE 2.3 Variations in Unemployment Rates Across Europe (2012)

Country	Unemployment Rate (%)
Spain	25.1
Greece	23.1
Portugal	15.7
Ireland	14.9
Euro-zone average	11.3
Italy	10.7
France	10.3
Finland	7.6
Belgium	7.2
Germany	5.5
Austria	4.5

Source: Based on Eurostat and Gabriele Steinhauser, "Euro Zone Considers Central Budget to Fix Cracks," *Wall Street Journal* (September 26, 2012): A12.

Multinational corporations (MNCs) face unique and diverse risks, such as expropriation of assets, currency losses through exchange rate fluctuations, unfavorable foreign court interpretations of contracts and agreements, social/political disturbances, import/export restrictions, tariffs, and trade barriers. Strategists in MNCs are often confronted with the need to be globally competitive and nationally responsive at the same time. With the rise in world commerce, government and regulatory bodies are more closely monitoring foreign business practices. The U.S. Foreign Corrupt Practices Act, for example, monitors business practices in many areas.

Before entering international markets, firms should scan relevant journals and patent reports, seek the advice of academic and research organizations, participate in international trade fairs, form partnerships, and conduct extensive research to broaden their contacts and diminish the risk of doing business in new markets. Firms can also offset some risks of doing business internationally by obtaining insurance from the U.S. government's Overseas Private Investment Corporation (OPIC).

Advantages and Disadvantages of International Operations

Firms have numerous reasons for formulating and implementing strategies that initiate, continue, or expand involvement in business operations across national borders. Perhaps the greatest advantage is that firms can gain new customers for their products and services, thus increasing revenues. Growth in revenues and profits is a common organizational objective and often an expectation of shareholders because it is a measure of organizational success.

Potential advantages to initiating, continuing, or expanding international operations are as follows:

1. Firms can gain new customers for their products.
2. Foreign operations can absorb excess capacity, reduce unit costs, and spread economic risks over a wider number of markets.
3. Foreign operations can allow firms to establish low-cost production facilities in locations close to raw materials or cheap labor.
4. Competitors in foreign markets may not exist, or competition may be less intense than in domestic markets.
5. Foreign operations may result in reduced tariffs, lower taxes, and favorable political treatment.
6. Joint ventures can enable firms to learn the technology, culture, and business practices of other people and to make contacts with potential customers, suppliers, creditors, and distributors in foreign countries.
7. Economies of scale can be achieved from operation in global rather than solely domestic markets. Larger-scale production and better efficiencies allow higher sales volumes and lower-price offerings.
8. A firm's power and prestige in domestic markets may be significantly enhanced if the firm competes globally. Enhanced prestige can translate into improved negotiating power among creditors, suppliers, distributors, and other important groups.

The availability, depth, and reliability of economic and marketing information in different countries vary extensively, as do industrial structures, business practices, and the number and nature of regional organizations. There are also numerous potential disadvantages of initiating, continuing, or expanding business across national borders, such as the following:

1. Foreign operations could be seized by nationalistic factions.
2. Firms confront different and often little-understood social, cultural, demographic, environmental, political, governmental, legal, technological, economic, and competitive forces when doing business internationally. These forces can make communication difficult in the firm.
3. Weaknesses of competitors in foreign lands are often overestimated, and strengths are often underestimated. Keeping informed about the number and nature of competitors is more difficult when doing business internationally.

4. Language, culture, and value systems differ among countries, which can create barriers to communication and problems managing people.
5. Gaining an understanding of regional organizations such as the European Economic Community, the Latin American Free Trade Area, the International Bank for Reconstruction and Development, and the International Finance Corporation is difficult but is often required in doing business internationally.
6. Dealing with two or more monetary systems can complicate international business operations.

The Global Challenge

Few companies can afford to ignore the presence of international competition. Firms that seem insulated and comfortable today may be vulnerable tomorrow; for example, foreign banks do not yet compete or operate in most of the USA, but this too is changing.

The U.S. economy is becoming much less American. A world economy and monetary system are emerging. Corporations in every corner of the globe are taking advantage of the opportunity to obtain customers globally. Markets are shifting rapidly and in many cases converging in tastes, trends, and prices. Innovative transport systems are accelerating the transfer of technology. Shifts in the nature and location of production systems, especially to China and India, are reducing the response time to changing market conditions. China has more than 1.3 billion residents and a dramatically growing middle class anxious to buy goods and services.

Business in Brazil is booming, with that country having more than a 7 percent annual growth in GDP. The capital of Brazil, Rio de Janeiro, is making massive preparations for the 2016 Summer Olympics, including a $5 billion investment program to extend the subway system, improve railroads, and construct new highways. Two firms in Rio that are growing exponentially are Petrobras, the world's fourth-largest oil producer, and Vale, the world's largest iron-ore mining company. Rio de Janeiro is Brazil's second largest manufacturing center in the country, but its scenic beauty and elaborate port facilities are world renowned.

More and more countries around the world are welcoming foreign investment and capital. As a result, labor markets have steadily become more international. East Asian countries are market leaders in labor-intensive industries, Brazil offers abundant natural resources and rapidly developing markets, and Germany offers skilled labor and technology. The drive to improve the efficiency of global business operations is leading to greater functional specialization. This is not limited to a search for the familiar low-cost labor in Latin America or Asia. Other considerations include the cost of energy, availability of resources, inflation rates, tax rates, and the nature of trade regulations.

Many countries became more protectionist during the recent global economic recession. **Protectionism** refers to countries imposing tariffs, taxes, and regulations on firms outside the country to favor their own companies and people. Most economists argue that protectionism harms the world economy because it inhibits trade among countries and invites retaliation.

Advancements in telecommunications are drawing countries, cultures, and organizations worldwide closer together. Foreign revenue as a percentage of total company revenues already exceeds 50 percent in hundreds of U.S. firms, including ExxonMobil, Gillette, Dow Chemical, Citicorp, Colgate-Palmolive, and Texaco.

A primary reason why most domestic firms do business globally is that growth in demand for goods and services outside the USA is considerably higher than inside. For example, the domestic food industry is growing just 3 percent per year, so Kraft Foods, the second largest food company in the world behind Nestlé, is focusing on foreign acquisitions.

Shareholders and investors expect sustained growth in revenues from firms; satisfactory growth for many firms can only be achieved by capitalizing on demand outside the USA. Joint ventures and partnerships between domestic and foreign firms are becoming the rule rather than the exception!

Fully 95 percent of the world's population lives outside the USA, and this group is growing 70 percent faster than the U.S. population. The lineup of competitors in virtually all industries is global. General Motors, Ford, and Chrysler compete with Toyota and Hyundai.

General Electric and Westinghouse battle Siemens and Mitsubishi. Caterpillar and John Deere compete with Komatsu. Goodyear battles Michelin, Bridgestone/Firestone, and Pirelli. Boeing competes with Airbus. Only a few U.S. industries—such as furniture, printing, retailing, consumer packaged goods, and retail banking—are not yet greatly challenged by foreign competitors. But many products and components in these industries too are now manufactured in foreign countries. International operations can be as simple as exporting a product to a single foreign country or as complex as operating manufacturing, distribution, and marketing facilities in many countries.

Globalization

Based in Wayne, New Jersey, Toys "R" Us is adding 30 new stores in China in 2013–2014 and launching heavy online selling efforts in China. The company knows that a growing middle class in China see playtime as increasingly essential. The firm's focus in China is on "educational toys," such as microscopes and building blocks. Sales of toys in China is growing about 20 percent annually, as increasingly affluent consumers make sure their children have plenty to play with, especially educational toys rather than Barbie Dolls.

Companies growing perhaps even faster than in China or India are those located in Thailand, Vietnam, Philippines, Indonesia, and Singapore in Southeast Asia. A *Wall Street Journal* article (12-4-12, C4) detailed how the growing middle class in these countries are hungry to consume products and services from around the world. The governments of these countries have become stable and are spending heavily on infrastructure projects. African countries too are rapidly becoming attractive for business. GE in mid-2013 began building a huge power plant in Tanzania in East Africa. The International Monetary Fund (IMF) reported in mid-2013 that by 2018, five of the world's fastest growing economies will be in sub-Saharan Africa. The IMF says Africa's economy will grow 5.6 percent in 2013 compared to 3.6 percent worldwide. Shareholders of all companies want high growth; Africa offers high growth.

Globalization is a process of doing business worldwide, so strategic decisions are made based on global profitability of the firm rather than just domestic considerations. A global strategy seeks to meet the needs of customers worldwide, with the highest value at the lowest cost. This may mean locating production in countries with the lowest labor costs or abundant natural resources, locating research and complex engineering centers where skilled scientists and engineers can be found, and locating marketing activities close to the markets to be served.

A **global strategy** includes designing, producing, and marketing products with global needs in mind, instead of considering individual countries alone. A global strategy integrates actions against competitors into a worldwide plan. Today, there are global buyers and sellers and the instant transmission of money and information across continents.

It is clear that different industries become global for different reasons. The need to amortize massive research and development (R&D) investments over many markets is a major reason why the aircraft manufacturing industry became global. Monitoring globalization in one's industry is an important strategic-management activity. Knowing how to use that information for one's competitive advantage is even more important. For example, firms may look around the world for the best technology and select one that has the most promise for the largest number of markets. When firms design a product, they design it to be marketable in as many countries as possible. When firms manufacture a product, they select the lowest-cost source, which may be Japan for semiconductors, Sri Lanka for textiles, Malaysia for simple electronics, and Europe for precision machinery.

Corporate Tax Rates Globally

Corporate tax rates vary considerably across countries and companies. Bermuda has a zero corporate income tax rate. Ireland has a 12.5 corporate tax rate. Many Internet companies have established headquarters and get the bulk of their European revenue in Ireland. For example, although Google has more than 300 employees in France, Google's customers in

France buy ads from Google Ireland Ltd., so Google pays France fees through a marketing agreement, rather than paying the 34 percent corporate tax rate in France. Microsoft has a similar arrangement in France as Google. Tax rates in countries are important in strategic decisions regarding where to build manufacturing facilities or retail stores or even where to acquire other firms. Japan recently cut its corporate tax rate by five percentage points, leaving the USA with the highest corporate tax rate among all nations in the world. Having the highest corporate tax rates is not a good position for the USA because it competes with other nations as a location for investment. High corporate tax rates deter investment in new factories and also provide strong incentives for corporations to avoid and evade taxes. However, it should be pointed out here that a recent *Wall Street Journal* article (7-2-13, p. A4) reported that on average, large, profitable U.S. companies pay a U.S. federal income tax rate of 12.6 percent of their worldwide income, compared to the average individual federal income-tax rate of 7.2 percent.

Since the 1980s, most countries have been steadily lowering their tax rates, but the United States has not cut its top statutory corporate tax rate since 1993. Top combined statutory rates among developed countries, excluding the USA, fell from an average of about 48 percent in the early 1980s to less than 25 percent in 2013.

Even within countries there is significant variation in federal taxes paid. For example, Carnival, the world's largest cruise line company, is incorporated in Panama and pays an effective tax rate of less than 1 percent even though the company is headquartered in Miami, Florida.

To avoid paying U.S. taxes on income made in other countries, many U.S. companies are cash-rich outside the USA but cash-poor inside the USA, and they bring cash back to the USA only as needed. For example in late 2012, Microsoft had $66.6 billion in total cash, but only $8.6 billion in the USA. General Electric had $85.5 billion in total cash, but only $30.7 billion in the USA. Emerson Electric has $2 billion in total cash with almost all of it in Europe and Asia so the firm had to borrow money in the USA rather than bring its cash back and pay a 35 percent corporate USA tax on corporate profits minus whatever ax it has already paid overseas. A *Wall Street Journal* article (12-4-12, p. B1) details this repercussion of the USA having the highest tax rate in the world. The article reveals that Johnson & Johnson keeps virtually all of its $24.5 billion in cash outside the USA, as does Illinois Tool Works Inc. Whirlpool has 85 percent of its cash offshore. Bruce Nolop, former CFO of Pitney Bowes explains it this way: "You end up with the really peculiar result where you are borrowing money in the USA, while you show cash on the balance sheet that is trapped overseas. It is a totally inefficient capital structure." The U.S. tax system, unfortunately for Americans, is structured so that companies can cut their tax bill by shifting income offshore to lower-tax countries.

An increasing number of U.S. companies are reincorporating in foreign countries to reduce their tax burden, and doing this typically by acquiring a foreign firm. Some U.S. firms that recently relocated are Aon Corp., Eaton Corp, Ensco International, D.E. Master Blenders, Transocean Ltd., Noble Corp, Weatherford International Ltd., and Rowan Companies. The 102-year old Eaton Corp. moved its headquarters from Cleveland, Ohio, to downtown Dublin, Ireland, and expects to save about $160 million in taxes annually solely as a result of the move. Critics of the USA tax code also point out that most developed countries tax only domestic earnings, whereas the USA taxes company profits earned abroad.

As indicated in Table 2-4, the top national statutory corporate tax rates in 2012 among sample countries ranged from 10 percent in Serbia to 35 percent in the USA. Note the countries that have a flat tax, which often, on adoption, triggers a surge in foreign direct investment.

Other factors besides the corporate tax rate obviously affect companies' decisions of where to locate plants and facilities and whether to acquire other firms. For example, the large, affluent market and efficient infrastructure in both Germany and Britain attract companies, but the high labor costs and strict labor laws there keep other companies away. The rapidly growing GDP in Brazil and India attracts companies, but violence and political unrest in Middle East countries deter investment. The USA perhaps should lower its rate to reward companies that invest in jobs domestically. Lowering the U.S. corporate tax rate should also reduce unemployment and spur growth domestically.

TABLE 2-4 Corporate Tax Rates Across Countries in 2012 (from high to low)

Country	Corporate Tax Rate (%)
USA	35
Brazil	34
France	33.33
Germany	33
India	30
Mexico	30
Italy	27.5
Japan	25.5
Israel	25
Austria	25
China	25.
Portugal	25
Finland	24.5
U.K.	24
Ukraine	21
Estonia	21
Russia	20
Greece	20
Croatia	20
Libya	20
Netherlands	20
Turkey	20
Poland	19
Czech Republic	19
Hungary	19
Singapore	17
Canada	16.5
Hong Kong	16.5
Romania	16
Latvi	15
Lithuani	15
Ireland	12.5
Serbi	10
Bulgaria	10
Cyprus	10

Source: Based on 11-1-12 information at http://www.worldwide-tax.com/#partthree.

United States versus Foreign Business Cultures

An excellent website to visit on this topic is www.worldbusinessculture.com. There you may select any country in the world and check out how business culture varies in that country vs. other lands. To compete successfully in world markets, U.S. managers must obtain a better knowledge of historical, cultural, and religious forces that motivate and drive people in other countries. In Japan, for example, business relations operate within the context of **Wa**, which stresses group harmony and social cohesion. In China, business behavior revolves around **guanxi**, or personal relations. In South Korea, activities involve concern for **inhwa**, or harmony based on respect of hierarchical relationships, including obedience to authority.[2]

In Europe, it is generally true that the farther north on the continent, the more participatory the management style. Most European workers are unionized and enjoy more frequent vacations and holidays than U.S. workers. A 90-minute lunch break plus 20-minute morning and afternoon breaks are common in European firms. Guaranteed permanent employment is typically a part of employment contracts in Europe. In socialist countries such as France, Belgium, and the United Kingdom, the only grounds for immediate dismissal from work is a criminal offense. A six-month trial period at the beginning of employment is usually part of the contract with a European firm. Many Europeans resent pay-for-performance, commission salaries, and objective measurement and reward systems. This is true especially of workers in southern Europe. Many Europeans also find the notion of team spirit difficult to grasp because the unionized environment has dichotomized worker–management relations throughout Europe.

A weakness of some U.S. firms in competing with Pacific Rim firms is a lack of understanding of Asian cultures, including how Asians think and behave. Spoken Chinese, for example, has more in common with spoken English than with spoken Japanese or Korean. U.S. managers consistently put more weight on being friendly and liked, whereas Asian and European managers often exercise authority without this concern. Americans tend to use first names instantly in business dealings with foreigners, but foreigners find this presumptuous. In Japan, for example, first names are used only among family members and intimate friends; even longtime business associates and coworkers shy away from the use of first names. Table 2-5 lists other cultural differences or pitfalls that U.S. managers need to know about.

U.S. managers have a low tolerance for silence, whereas Asian managers view extended periods of silence as important for organizing and evaluating one's thoughts. U.S. managers are much more action-oriented than their counterparts around the world; they rush to appointments, conferences, and meetings—and then feel the day has been productive. But for many foreign managers, resting, listening, meditating, and thinking is considered productive. Sitting through a conference without talking is unproductive in the United States, but it is viewed as positive in Japan if one's silence helps preserve unity.

U.S. managers place greater emphasis on short-term results than foreign managers. In marketing, for example, Japanese managers strive to achieve "everlasting customers," whereas many Americans strive to make a onetime sale. Marketing managers in Japan see making a sale

TABLE 2-5 Cultural Pitfalls That May Help You Be a Better Manager

- Waving is a serious insult in Greece and Nigeria, particularly if the hand is near someone's face.
- Making a "good-bye" wave in Europe can mean "No," but it means "Come here" in Peru.
- In China, last names are written first.
- A man named Carlos Lopez-Garcia should be addressed as Mr. Lopez in Latin America but as Mr. Garcia in Brazil.
- Breakfast meetings are considered uncivilized in most foreign countries.
- Latin Americans are on average 20 minutes late to business appointments.
- Direct eye contact is impolite in Japan.
- Do not cross your legs in any Arab or many Asian countries—it is rude to show the sole of your shoe.
- In Brazil, touching your thumb and first finger—an American "Okay" sign—is the equivalent of raising your middle finger.
- Nodding or tossing your head back in southern Italy, Malta, Greece, and Tunisia means "No." In India, this body motion means "Yes."
- Snapping your fingers is vulgar in France and Belgium.
- Folding your arms across your chest is a sign of annoyance in Finland.
- In China, leave some food on your plate to show that your host was so generous that you could not finish.
- Do not eat with your left hand when dining with clients from Malaysia or India.
- One form of communication works the same worldwide. It is the smile—so take that along wherever you go.

as the beginning, not the end, of the selling process. This is an important distinction. Japanese managers often criticize U.S. managers for worrying more about shareholders, whom they do not know, than employees, whom they do know. Americans refer to "hourly employees," whereas many Japanese companies still refer to "lifetime employees."

Rose Knotts recently summarized some important cultural differences between U.S. and foreign managers.[3] Awareness and consideration of these differences can enable a manager to be more effective, regardless of his or her own nationality.

1. Americans place an exceptionally high priority on time, viewing time as an asset. Many foreigners place more worth on relationships. This difference results in foreign managers often viewing U.S. managers as "more interested in business than people."
2. Personal touching and distance norms differ around the world. Americans generally stand about three feet from each other when carrying on business conversations, but Arabs and Africans stand about one foot apart. Touching another person with the left hand in business dealings is taboo in some countries.
3. Family roles and relationships vary in different countries. For example, males are valued more than females in some cultures, and peer pressure, work situations, and business interactions reinforce this phenomenon.
4. Business and daily life in some societies are governed by religious factors. Prayer times, holidays, daily events, and dietary restrictions, for example, need to be respected by managers not familiar with these practices in some countries.
5. Time spent with the family and the quality of relationships are more important in some cultures than the personal achievement and accomplishments espoused by the traditional U.S. manager.
6. Many cultures around the world value modesty, team spirit, collectivity, and patience much more than competitiveness and individualism, which are so important in the United States.
7. Punctuality is a valued personal trait when conducting business in the USA, but it is not revered in many of the world's societies. Eating habits also differ dramatically across cultures. For example, belching is acceptable in some countries as evidence of satisfaction with the food that has been prepared. Chinese culture considers it good manners to sample a portion of each food served.
8. To prevent social blunders when meeting with managers from other lands, one must learn and respect the rules of etiquette of others. Sitting on a toilet seat is viewed as unsanitary in most countries, but not in the USA. Leaving food or drink after dining is considered impolite in some countries, but not in China. Bowing instead of shaking hands is customary in many countries. Some cultures view Americans as unsanitary for locating toilet and bathing facilities in the same area, whereas Americans view people of some cultures as unsanitary for not taking a bath or shower every day.
9. Americans often do business with individuals they do not know, unlike businesspersons in many other cultures. In Mexico and Japan, for example, an amicable relationship is often mandatory before conducting business.

In many countries, effective managers are those who are best at negotiating with government bureaucrats rather than those who inspire workers. Many U.S. managers are uncomfortable with nepotism, which are practiced in some countries. The USA defends women from sexual harassment, and defends minorities from discrimination, but not all countries embrace the same values. For example, in Indonesia, in mid-2013, legislators were considering making sex among singles a crime with up to a 5-year prison sentence, and cohabitation a crime with up to 1 year in prison.

U.S. managers in China have to be careful about how they arrange office furniture because Chinese workers believe in **feng shui**, the practice of harnessing natural forces. U.S. managers in Japan have to be careful about **nemaswashio**, whereby Japanese workers expect supervisors to alert them privately of changes rather than informing them in a meeting. Japanese managers have little appreciation for versatility, expecting all managers to be the same. In Japan, "If a nail sticks out, you hit it into the wall," says Brad Lashbrook, an international consultant for Wilson Learning.

Probably the biggest obstacle to the effectiveness of U.S. managers—or managers from any country working in another—is the fact that it is almost impossible to change the attitude of a

foreign workforce. "The system drives you; you cannot fight the system or culture," says Bill Parker, president of Phillips Petroleum in Norway.

Communication Differences Across Countries

Americans increasingly interact with managers in other countries, so it is important to understand foreign business cultures. Americans often come across as intrusive, manipulative, and garrulous; this impression may reduce their effectiveness in communication. *Forbes* provided the following cultural hints from Charis Intercultural Training:

1. Italians, Germans, and French generally do not soften up executives with praise before they criticize. Americans do soften up folks, and this practice seems manipulative to Europeans.
2. Israelis are accustomed to fast-paced meetings and have little patience for U.S. informality and small talk.
3. British executives often complain that U.S. executives chatter too much. Informality, egalitarianism, and spontaneity from Americans in business settings jolt many foreigners.
4. Europeans feel they are being treated like children when asked to wear name tags by Americans.
5. Executives in India are used to interrupting one another. Thus, when U.S. executives listen without asking for clarification or posing questions, they are viewed by Indians as not paying attention.
6. When negotiating orally with Malaysian or Japanese executives, it is appropriate to allow periodically for a time of silence. However, no pause is needed when negotiating in Israel.
7. Refrain from asking foreign managers questions such as "How was your weekend?" That is intrusive to foreigners, who tend to regard their business and private lives as totally separate.[4]

Business Culture Across Countries[5]

A recent *USA Today* article (9-24-12, p. 8A) titled "Arab Spring Leaving Women Out in Cold" reveals that the recent changeover of regimes in Middle Eastern countries has unfortunately resulted in arguably less rights for women. Nawal Al Saadawi says for example in Egypt "Things didn't improve for women, and we are going backward." Even in a relatively progressive Middle Eastern country such as Morocco, there is legislation that allows men who rape or have sex with minors to avoid prosecution by wedding their victims. Sexual harassment of women in the streets, according to the article, especially spikes during Muslim holidays. Perhaps the worst country for women's rights is Afghanistan, although Saudi Arabia is quite restrictive. In contrast, South Korea elected its first female president late in 2012. She is Park Geun-hye, the daughter of the general who ruled the country in the 1960s and 1970s. Park joins the following other current female presidents of countries:

Australia, Julia Gillard

Denmark, Helle Thorning-Schmidt

Germany, Angela Merkel

Iceland, Johanna Sigurdardottir

Switzerland, Eveline Widmer-Schlumpf

Many countries have in the past have had female presidents, including Canada, Chile, Israel, New Zealand, Norway, Slovak Republic, Turkey, and the United Kingdom.

Another recent *USA Today* article (12-4-12, 6B) titled "Europe Tries to Put Women on Boards" reveals that in the UK, 20 percent of senior management is female, but this is higher than in the Netherlands where the percentage is 18, Denmark at 15, or Germany at 13. Germany's upper house of parliament recently approved a bill to guarantee that women make up 20 percent of boards at publicly traded companies by 2018, and 40 percent by 2023. Chancellor Angela Merkel of Germany, however, has said that she prefers voluntary measures over mandatory quotas. In Norway, 40 percent of nonexecutive board members of publicly listed companies are women, which is perhaps best of all countries on the planet.

Mexico—Business Culture

Mexico is an authoritarian society in terms of schools, churches, businesses, and families. Employers seek workers who are agreeable, respectful, and obedient, rather than innovative, creative, and independent. Mexican workers tend to be activity oriented rather than problem solvers. When visitors walk into a Mexican business, they are impressed by the cordial, friendly atmosphere. This is almost always true because Mexicans desire harmony rather than conflict; desire for harmony is part of the social fabric in worker–manager relations. There is a much lower tolerance for adversarial relations or friction at work in Mexico as compared to the USA.

Mexican employers are paternalistic, providing workers with more than a paycheck, but in return they expect allegiance. Weekly food baskets, free meals, free bus service, and free day care are often part of compensation. The ideal working condition for a Mexican worker is the family model, with people all working together, doing their share, according to their designated roles. Mexican workers do not expect or desire a work environment in which self-expression and initiative are encouraged. Whereas U.S. business embodies individualism, achievement, competition, curiosity, pragmatism, informality, spontaneity, and doing more than expected on the job, Mexican businesses stress collectivism, continuity, cooperation, belongingness, formality, and doing exactly what is told.

In Mexico, business associates rarely entertain each other at their homes, which are places reserved exclusively for close friends and family. Business meetings and entertaining are nearly always done at a restaurant. Preserving one's honor, saving face, and looking important are also exceptionally important in Mexico. This is why Mexicans do not accept criticism and change easily; many find it humiliating to acknowledge having made a mistake. A meeting among employees and managers in a business located in Mexico is a forum for giving orders and directions rather than for discussing problems or participating in decision making. Mexican workers want to be closely supervised, cared for, and corrected in a civil manner. Opinions expressed by employees are often regarded as back talk in Mexico. Mexican supervisors are viewed as weak if they explain the rationale for their orders to workers.

Mexicans do not feel compelled to follow rules that are not associated with a particular person in authority they work for or know well. Thus, signs to wear earplugs or safety glasses, or attendance or seniority policies, and even one-way street signs are often ignored. Whereas Americans follow the rules, Mexicans often do not.

Life is slower in Mexico than in the USA. The first priority is often assigned to the last request, rather than to the first. Telephone systems break down. Banks may suddenly not have pesos. Phone repair can take a month. Electricity for an entire plant or town can be down for hours or even days. Business and government offices may open and close at odd hours. Buses and taxis may be hours off schedule. Meeting times for appointments are not rigid. Tardiness is common everywhere. Effectively doing business in Mexico requires knowledge of the Mexican way of life, culture, beliefs, and customs.

In Mexico, when greeting others, it is customary for women to pat each other on the right forearm or shoulder, rather than shaking hands. Men shake hands or, if close friends, use the traditional hug and back slapping upon greeting. If visiting a Mexican home, bring a gift such as flowers or sweets. Avoid marigolds because they symbolize death. Arrive up to 30 minutes late, but definitely not early. Avoid red flowers which have a negative connotation. White flowers are an excellent choice. If you receive a gift, open it immediately and react enthusiastically. At dinner, do not sit until you are invited to and wait to be told where to sit. This is true in most foreign countries and in the USA. Do not begin eating until the hostess starts. Only men give toasts in Mexico. It is also polite to leave some food on your plate after a meal. For business appointments, as opposed to home visits, it is best to arrive on time, although your Mexican counterparts may be up to 30 minutes late. Do not get irritated at their lack of punctuality.

Mexicans often judge or stereotype a person by who introduces them and changing that first impression is difficult in business. Expect to answer questions about personal background, family, and life interests—because Mexicans consider trustworthiness and character to be of upmost importance. Mexicans are status conscious, so business titles and rank are important. Face-to-face meetings are preferred over telephone calls, letters, or e-mail. Negotiations in Mexico include a fair amount of haggling, so do not give a best offer first.

Japan—Business Culture

Japan elected a new prime minister, Shinzo Abe, in December 2012. Abe promises aggressive new monetary policy, big public works spending, and full economic recovery. Walmart believes in Abe because it, under the name Seiyu Ltd., is adding 22 stores in Japan in 2013–2014, to go along with its already 368 stores in Japan. Two trends in Japan driving the Walmart expansion are (1) single-person households, especially among the elderly, are continuing to grow and (2) people have less money to spend. Japanese consumers have traditionally equated discounts with poor quality, but that is changing. Also, Walmart gained much support throughout Japan with its quick response flying in water and food immediately after the earthquake and tsunami hit Japan in 2011.

The Japanese place great importance on group loyalty and consensus, a concept called *Wa*. Nearly all corporate activities in Japan encourage Wa among managers and employees. Wa requires that all members of a group agree and cooperate; this results in constant discussion and compromise. Japanese managers evaluate the potential attractiveness of alternative business decisions in terms of the long-term effect on the group's Wa. This is why silence, used for pondering alternatives, can be a plus in a formal Japanese meeting. Discussions potentially disruptive to Wa are generally conducted in informal settings, such as at a bar, so as to minimize harm to the group's Wa. Entertaining is an important business activity in Japan because it strengthens Wa. Formal meetings are often conducted in informal settings. When confronted with disturbing questions or opinions, Japanese managers tend to remain silent, whereas Americans tend to respond directly, defending themselves through explanation and argument.

Americans have more freedom to control their own fates than do the Japanese. The USA offers more upward mobility to its people, as indicated below:

> America is not like Japan and can never be. America's strength is the opposite: It opens its doors and brings the world's disorder in. It tolerates social change that would tear most other societies apart. This openness encourages Americans to adapt as individuals rather than as a group. Americans go west to California to get a new start; they move east to Manhattan to try to make the big time; they move to Vermont or to a farm to get close to the soil. They break away from their parents' religions or values or class; they rediscover their ethnicity. They go to night school; they change their names.[6]

Most Japanese managers are reserved, quiet, distant, introspective, and other oriented, whereas most U.S. managers are talkative, insensitive, impulsive, direct, and individual oriented. Americans often perceive Japanese managers as wasting time and carrying on pointless conversations, whereas U.S. managers often use blunt criticism, ask prying questions, and make quick decisions. These kinds of cultural differences have disrupted many potentially productive Japanese–American business endeavors. Viewing the Japanese communication style as a prototype for all Asian cultures is a stereotype that must be avoided.

In Japan, a person's age and status are of paramount importance, whether in the family unit, the extended family, or a social or business situation. Schoolchildren learn early that the oldest person in the group is to be honored. Older folks are served first and their drinks are poured for them. Greetings in Japan are formal and ritualized. Wait to be introduced because it may be viewed as impolite to introduce yourself, even in a large gathering. Foreigners may shake hands, but the traditional form of greeting is to bow. The deeper you bow, the more respect you show, but at least bow the head slightly in greetings.

In gift giving in Japan, chocolates or small cakes are excellent choices, but do not give lilies, camellias, lotus blossoms, or white flowers because they all are associated with funerals. Do not give potted plants because they encourage sickness, although a bonsai tree is always acceptable. Give items in odd numbers, but avoid the number 9. Gifts are not opened when received. If going to a Japanese home, remove your shoes before entering and put on the slippers left at the doorway. Leave shoes pointing away from the doorway you are about to walk through. If going to the toilet in a Japanese home, put on the toilet slippers and remove them when you exit.

In Japan, when finally seated for dinner, never point the chopsticks. Learn how to use chopsticks before visiting Japan and do not pierce food with chopsticks. Japanese oftentimes slurp their noodles and soup, but mixing other food with rice is inappropriate. Instead of mixing, eat a bit of rice and then a bit of food. To signify that you do not want more rice or drink, leave some in the bowl or glass. Conversation over dinner is generally subdued in Japan because they prefer to savor their food.

Unlike Americans, Japanese prefer to do business on the basis of personal relationships rather than impersonally speaking over the phone or by written correspondence. Therefore, build and maintain relationships by sending greeting, thank you, birthday, and seasonal cards. You need to be a good "correspondent" to effectively do business with the Japanese. Punctuality is important so arrive on time for meetings and be mindful that it may take several meetings to establish a good relationship. The Japanese are looking for a long-term relationship. Always give a small gift as a token of your appreciation, and present it to the most senior person at the end of any meeting.

Like many Asian and African cultures, the Japanese are non-confrontational. They have a difficult time saying "no," so you must be vigilant at observing their nonverbal communication. Rarely refuse a request, no matter how difficult or non-profitable it may appear at the time. In communicating with Japanese, phrase questions so that they can answer *yes*. For example, do you disagree with this? Group decision making and consensus are vitally important. The Japanese often remain silent in meetings for long periods of time and may even close their eyes when they want to listen intently.

Business cards are exchanged in Japan constantly and with excitement. Invest in quality business cards and keep them in pristine condition. Do not write on them. Have one side of your card translated in Japanese and give it to the person with the Japanese side facing the recipient. Business cards are generally given and received with two hands and a slight bow. Examine any business card you receive carefully.

Brazil—Business Culture

In both Brazil and the USA, men greet each other by shaking hands while maintaining steady eye contact. Women greet each other with kisses in Brazil, starting with the left and alternating cheeks. Hugging and backslapping are also common greetings among Brazilian close friends. If a woman wishes to shake hands with a man, she should extend her hand first. Brazilians speak Portuguese. If going to someone's house in Brazil, bring the hostess flowers or a small gift. Orchids are nice, but avoid purple or black, because these are mourning colors. Arrive at least 30 minutes late if your invitation is for dinner and arrive up to an hour late for a party or large gathering. Never arrive early. Brazilians dress with a flair and judge others on their appearance, so even casual dress is more formal than in many other countries. Always err on the side of over-dressing in Brazil rather than under-dressing.

Avoid embarrassing a Brazilian by criticizing an individual publically; that causes that person to lose face with all others at a business meeting, and the person making the criticism also loses face because they have disobeyed the unwritten Brazilian rule. It is considered acceptable, however, to interrupt someone who is speaking. Face-to-face, oral communication is preferred over written communication. As for business agreements, Brazilians insist on drawing up detailed legal contracts. They are more comfortable doing business with and negotiating with people than companies. Therefore, wait for a Brazilian colleagues to raise the business subject. Never rush the prebusiness relationship-building time. Brazilians take their time when negotiating. Use local lawyers and accountants for negotiations because Brazilians resent an outside legal presence.

Appointments are commonly cancelled or changed at the last minute in Brazil, so do not be surprised or get upset. In the cities of Sao Paulo and Brasilia, arrive on time for meetings, but in Rio de Janeiro arrive a few minutes late for a meeting. Do not appear impatient if kept waiting, because relationship building always takes precedence over adhering to a strict schedule. Brazilians pride themselves on dressing well, so men should wear conservative, dark-colored business suits or even three-piece suits for executives. Women should wear suits or dresses that are elegant and feminine with good, quality accessories. And ladies, manicures are expected.

Germany—Business Culture

Business communication in Germany is formal, so the home is a welcome, informal place. Germans take great pride in their home, which is generally neat and tidy inside and out. Only close friends and relatives are invited into the sanctity of a person's house, so consider that an honor if you get that invitation, and bring a gift, such as chocolates or yellow roses or tea roses—but not red roses, which symbolize romantic intentions. Also do not bring carnations, lilies, or chrysanthemums, which in Germany symbolize mourning. If you bring wine to a

German's home, it should be imported, French or Italian. Always arrive on time but never early, and always send a handwritten note the following day to thank your hostess for her hospitality.

When it is time to have dinner, remain standing until invited to sit down. As is custom in many countries, you may be shown to a particular seat. Table manners in Germany are strictly Continental with the fork being held in the left hand and the knife in the right while eating. Do not begin eating until the hostess starts or someone says *guten appetit* ("good appetite"). Wait for the hostess to place her napkin in her lap before doing so yourself and do not rest your elbows on the table. Cut as much of your food with your fork as possible because this compliments the cook by indicating the food is tender. Break bread or rolls apart by hand, but if a loaf is in the middle for all, then touch only what you extract to eat. This sanitary practice is a must in all countries including the USA. Finish everything on your plate and indicate you have finished eating by laying your knife and fork parallel across the right side of your plate, with the fork over the knife.

Germans are like Americans in that they do not need a personal relationship to do business. They are more interested in a businessperson's academic credentials and their company's credentials. A quick, firm handshake is the traditional greeting, even with children. At the office, Germans do not have an open-door policy and often work with their office door closed, so knock and wait to be invited to enter. Appointments are mandatory and should be made one to two weeks in advance. Germans are often direct to the point of bluntness. Punctuality is extremely important in Germany, so if you are going to be delayed, telephone immediately and offer an explanation. It is rude to cancel a meeting at the last minute and this could jeopardize the whole business relationship. German meetings adhere to strict agendas, including starting and ending times. Germans maintain direct eye contact while speaking.

There is a strict protocol to follow in Germany when entering a room—the eldest or highest-ranking person enters first and men enter before women if their age and status are roughly equivalent. Germans are detail oriented and want to understand every innuendo before coming to an agreement. Business decision making is autocratic and held at the top of the company. Final decisions will not be changed and are expected to be implemented by lower-level managers and employees with no questions asked. Americans are more flexible in many respects than Germans.

Egypt—Business Culture

In Egypt, greetings are based on both social class and religion, so follow the lead of others. Handshakes, although limp and prolonged, are the customary greeting among Egyptians of the same sex. Handshakes are always given with a hearty smile and direct eye contact. Once a relationship has developed, it is common to greet with a kiss on one cheek and then the other, while shaking hands, men with men and women with women. In greetings between men and women, the woman will extend her hand first. Otherwise, a man should bow his head in greeting.

If you are invited to an Egyptian's home, remove your shoes before entering, just as you would do in China and Japan. As a gift, bring chocolates, sweets, or pastries to the hostess. Do not give flowers, which are usually reserved for weddings or the ill, unless you know that the host will appreciate them. Always give gifts with the right hand or both hands if the gift is heavy. Gifts are not opened when received. Never sit at a dinner table until the host or hostess tells you where to sit. Eat with the right hand only and compliment the host by taking second helpings. Always show appreciation for the meal. Putting salt or pepper on your food is considered an insult to a cook. This is true to a lesser extent even in the USA. Leave a small amount of food on your plate when you have finished eating. Otherwise your Egyptian host may keep bringing you more food.

Egyptians prefer to do business with those they know and respect, so expect to spend time cultivating a personal relationship before business is conducted. Who you know is more important than what you know in Egypt, so network and cultivate a number of contracts. You should expect to be offered coffee or tea whenever you meet someone in Egypt because this demonstrates hospitality. Even if you do not want the drink, always accept the beverage because declining the offer is viewed as rejecting the person.

In Egypt, appearance is important, so wear, conservative clothes and present yourself well at all times. For Egyptians, direct eye contact is a sign of honesty, so be prepared for overly intense stares. Hierarchy and rank are important. Unlike in Germany, Egyptian business people

do have an open-door policy, even when they are in a meeting, so you may experience frequent interruptions as others wander into the room and start a different discussion. It is best that you not try to bring the topic back to the original discussion until the new person leaves. Business meetings generally start after prolonged inquiries about health, family, and such.

Egyptians must know and like you to conduct business. Personal relationships are necessary for long-term business. The highest-ranking person makes decisions, after obtaining group consensus. Decisions are reached after great deliberation. In Egypt, business moves at a slow pace and society is extremely bureaucratic—even in the post-Hosni Mubarak era. Egyptians respect age and experience and engage in a fair amount of haggling. They are tough negotiators and do not like confrontation or having to say *no*. Egyptian women must be careful to cover themselves appropriately. Skirts and dresses should cover the knee and sleeves should cover most of the arm. Women are daily gaining more rights, however, throughout the Middle East, and that is a good thing. In late 2011, women in Saudi Arabia were finally granted the right to vote, but women still are not allowed to drive cars in that country.

China—Business Culture

In China, greetings are formal and the oldest person is always greeted first. Like in the United States, handshakes are the most common form of greeting. Many Chinese will look toward the ground when greeting someone. The Chinese have an excellent sense of humor. They can easily laugh at themselves if they have a comfortable relationship with the other person. In terms of gifts, a food basket makes an excellent gift, but do not give scissors, knives, or other cutting utensils because these objects indicate severing of the relationship. Never give clocks, handkerchiefs, flowers, or straw sandals because they are associated with funerals. Do not wrap gifts in white, blue, or black paper. In China, the number 4 is unlucky, so do not give four of anything. Eight is the luckiest number, so giving eight of something is a great idea.

If invited to a Chinese person's home, consider this a great honor and arrive on time. Remove your shoes before entering the house and bring a small gift to the hostess. Eat heartily to demonstrate that you are enjoying the food. Use chopsticks and wait to be told where to sit. You should try everything that is offered and never eat the last piece from the serving tray. Hold the rice bowl close to your mouth while eating. Do not be offended if a Chinese person makes slurping or belching sounds; it merely indicates that they are enjoying their food.

The Chinese rarely do business with companies or people they do not know. Your position on an organizational chart is extremely important in business relationships. Gender bias is generally not an issue. Meals and social events are not the place for business discussions. There is a demarcation between business and socializing in China, so try to be careful not to intertwine the two.

Like in the USA and Germany, punctuality is important in China. Arriving late to a meeting is an insult and could negatively affect your relationship. Meetings require patience because mobile phones ring frequently and conversations tend to be boisterous. Never ask the Chinese to turn off their mobile phones because this causes you both to lose face. The Chinese are non-confrontational and virtually never overtly say *no*. Rather, they will say "they will think about it" or "they will see." The Chinese are shrewd negotiators, so an initial offer or price should leave room for negotiation.

India—Business Culture

According to United Nations' statistics, India's rate of female participation in the labor force is 34.2 percent, which is quite low, especially because women make up 42 percent of college graduates in India. But Indian women with a college degree are expected to let their careers take a back seat to caring for their husband, children, and elderly parents. "The measures of daughterly guilt are much higher in Indian women than in other countries," says Sylvia Ann Hewlett, president of the Center for Work-Life Policy, a Manhattan think tank, who headed a recent study on the challenges Indian women face in the workplace.[8] Sylvia says, "Since taking care of elderly parents usually becomes a reality later in a woman's career, it takes them out of the workplace just when they should be entering top management roles." That is why gender disparities at Indian companies unfortunately grow more pronounced at higher levels of management.

Like in many Asian cultures, people in India do not like to say *no*, verbally or nonverbally. Rather than disappoint you, they often will say something is not available, will offer you the

response that they think you want to hear, or will be vague with you. This behavior should not be considered dishonest. Shaking hands is common in India, especially in the large cities among the more educated who are accustomed to dealing with westerners. Men may shake hands with other men and women may shake hands with other women; however, there are seldom handshakes between men and women because of religious beliefs.

Indians believe that giving gifts eases the transition into the next life. Gifts of cash are common, but do not give frangipani or white flowers because they represent mourning. Yellow, green, and red are lucky colors, so use them to wrap gifts. Because Hindus consider cows to be sacred, do not give gifts made of leather to Hindus. Muslims should not be given gifts made of pigskin or alcoholic products. Gifts are usually not opened when received.

Before entering an Indian's house, take off shoes just as you would in China or Japan. Politely turn down the host's first offer of tea, coffee, or snacks. You will be asked again and again. Saying no to the first invitation is part of the protocol. Be mindful that neither Hindus nor Sikhs eat beef, and many are vegetarians. Muslims do not eat pork or drink alcohol. Lamb, chicken, and fish are the most commonly served main courses. Table manners are somewhat formal, but much Indian food is eaten with the fingers. Like most places in the world, wait to be told where and when to sit at dinner. Women in India typically serve the men and eat later. You may be asked to wash your hands before and after sitting down to a meal. Always use your right hand to eat, whether using utensils or your fingers. Leave a small amount of food on your plate to indicate that you are satisfied. Finishing all your food means that you are still hungry, which as true in Egypt, China, Mexico, and many countries.

Indians prefer to do business with those with whom they have established a relationship built on mutual trust and respect. Punctuality is important. Indians generally do not trust the legal system, and someone's word is often sufficient to reach an agreement. Do not disagree publicly with anyone in India.

Titles such as professor, doctor, or engineer are important in India, as is a person's age, university degree, caste, and profession. Use the right hand to give and receive business cards. Business cards need not be translated into Hindi but always present your business card so the recipient may read the card as it is handed to them. This is a nice, expected gesture in most countries around the world.

Nigeria—Business Culture

With the largest population of any country in Africa and the largest city in Africa (Lagos), Nigeria on the west coast bordering the Gulf of Guinea, is a democratic country with English as its official language. Half of Nigeria's population is under age 18. With a growing economy, Nigeria's constitution guarantees religious freedom. Christians in Nigeria live mostly in the south, whereas Muslims live mostly in the north. Native religions in which people believe in deities, spirits, and ancestor worship are spread throughout Nigeria, as are different languages. Christmas and Easter are national holidays. Muslims observe Ramadan, the Islamic month of fasting, and the two Eids. Working hours in the north often vary from the south, primarily because Muslims do not work on their holy day—Friday.

Endowed with vast quantities of natural resources and being the sixth largest oil-producing nation on the planet, Nigeria has a well-educated and industrious people who are proud of their country. Nigerians are fond of the expression, "When Nigeria sneezes, the rest of Africa catches a cold (except South Africa)." Nigeria re-elected its president in 2011, a zoology professor-turned-president, Goodluck Jonathan.

In Nigeria, extended families are still the backbone of social and business systems. Grandparents, cousins, aunts, uncles, sisters, brothers, and in-laws all work as a unit through life. Hierarchy and seniority within extended families are important; the oldest person in a group is revered and honored, and is greeted and served first. In return, however, the most senior person has the responsibility to make good decisions for the extended family.

The most common greeting in Nigeria is a handshake with a warm, welcoming smile. Muslims will not generally shake hands with members of the opposite sex. Nigerians do not use first names readily, so wait to be invited to do this before engaging. Gift giving is common and even expected, but gifts from a man to a woman must be said to come from the man's mother, wife, sister, or other female relative, never from the man himself. Never rush a greeting because that is extremely rude; rather, spend time inquiring about the other person's general well-being.

Foreigners who take the time to get to know a Nigerian as a person are often welcomed into the Nigerian's inner circle of family and close friends. Nigerians are generally outgoing and friendly, especially in the southwest, where the Yoruba often use humor even during business meetings and serious discussions.

To combat the AIDS epidemic in sub-Saharan Africa, the World Bank is now paying young girls cash to stop accepting gifts and cash from older men in exchange for sex. This "sugar daddy" relationship is common in many African countries and is fueling the AIDS problem because the percent of men aged 30–34 that test positive for HIV is upward of 30 percent in countries such as Zimbabwe. The World Bank has a billboard in the Mbare vegetable market in Harare, Zimbabwe, that reads, "Your future is brighter without a sugar daddy."

Business Climate Across Countries/Continents

The World Bank and the International Finance Corporation annually rank 183 countries in terms of their respective ease of doing business (http://www.doingbusiness.org/rankings). The index ranks nations from 1 (best) to 183 (worst). For each nation, the ranking is calculated as the simple average of the percentile rankings on how easy is it to: (1) start a business, (2) deal with construction permits, (3) register property, (4) get credit, (5) protect investors, (6) pay taxes, (7) trade across borders, (8) enforce contracts, (9) resolving insolvency, and (10) get electricity.

Among all countries on the planet, Morocco improved its ranking most in 2012, climbing 21 places to 94, by simplifying the construction permitting process, easing the administrative burden of tax compliance, and providing greater protections to minority shareholders. Table 2-6 reveals the 2012 Ease of Doing Business rankings for the top 10 nations in various regions of the world. Note for example that Norway is rated the sixth best country on the planet for ease of doing business and Chile is the best country in South America.

Union Membership Across Europe

There is great variation in Europe as per levels of union membership, ranging from 74 percent of employees in Finland and 71 percent in Sweden to 9 percent in Lithuania and 8 percent in France. However, percentage of union membership is not the only indicator of strength because in France for example, unions have repeatedly shown that despite low levels of membership they are able to mobilize workers in mass strikes and demonstrations to great effect.

The average level of union membership across the whole of the European Union (EU), weighted by the numbers employed in the different member states, is 23 percent compared to about 11 percent in the USA. The European average is held down by relatively low levels of membership in some of the larger EU states, Germany with 19 percent, France with 8 percent, Spain with 16 percent, and Poland with 15 percent. The three smallest states, Cyprus, Luxembourg, and Malta, have levels well above the average.

TABLE 2-6 The Top 10 Nations to Do Business With Across Continents

Overall Best	East Asia Pacific	East Europe Central Asia	Latin America Caribbean	Mid-East Africa	South Africa
1. Singapore	Singapore	Georgia	Chile	Saudi Arabia	Mauritius
2. Hong Kong	Hone Kong	Latvia	Peru	UAE	S. Africa
3. New Zealand	Thailand	Macedonia	Colombia	Qatar	Rwanda
4. USA	Malaysia	Lithuania	Puerto Rico	Bahrain	Botswana
5. Denmark	Taiwan	Cyprus	St. Lucia	Tunisia	Ghana
6. Norway	Tonga	Kazakhstan	Mexico	Oman	Nambia
7. United Kingdom	Samoa	Armenia	Antiqua	Kuwait	Zambia
8. South Korea	Solomon Isls.	Montenegro	Panama	Morocco	Seychelles
9. Iceland	Vanuatu	Bulgaria	Dominica	Jordan	Kenya
10. Ireland	Fiji	Azerbajan	Trinidad	Yemen	Ethiopia

Source: Based on information at http://www.doingbusiness.org/rankings in November 2012.

The three Nordic countries of Denmark, Sweden, and Finland are at the top of the table with around 70 percent of all employees in unions. In part this is because, as in Belgium, which also has above average levels of union density, unemployment and other social benefits are normally paid out through the union. High union density in the Nordic countries also reflects an approach that sees union membership as a natural part of employment, as shown by the relatively high proportion of employees (around 53 percent) who are union members in Norway, where unemployment benefits are not paid through the unions.

Central and Eastern Europe nations generally have below average levels of union membership. In Poland for example 16 percent of employees are estimated to be union members. Level of union membership is clearly trending downward all over Europe. Only 8 out of the 27 EU states plus Norway—Belgium, Cyprus, Ireland, Italy, Luxembourg, Malta, Norway and Spain—have seen a gain in union members among the employed in recent years, and in most of these countries. This growth has not kept pace with the overall growth in employment, meaning that union density has drifted downward. The two exceptions appear to be Ireland and Italy where union membership is slowly growing.

African Countries

In 2012, 23 African countries held democratic elections, whereas in 1989 only 3 African countries were considered democracies. Currencies in Africa are stabilizing and many countries are fund-raising to build modern highways, ports, and power grids. African countries are winning over investors as indicated by Zambia raising $750 million in bonds recently, followed by Rwanda, Nigeria, and Kenya doing the same. Yields on some African bonds are only slightly higher than the yield on the debt of some troubled European economies, such as Spain. Investors are looking closely at Africa now in the wake of low interest rates and slow growth elsewhere on the planet.[7]

Many African companies are expanding in Africa, such as South Africa's Shoprite Group in 2013 adding 223 stores in 16 African countries other than South Africa. Shoprite is especially targeting Nigeria and the Congo. Dangote Group, based in Nigeria, is building a cement factory in Zambia, and Togo-based Ecobank Transnational now operates in 32 African countries. Domino's recently opened stores in Nigeria, Egypt, Morocco, and Kenya. Reasons companies are opening outlets in Africa is the rapidly growing middle class and an average GDP growth of 5 percent for the continent through 2017 according to the IMF. Also, the World Bank saying food demand across Africa will double between 2012 and 2020.

Financial troubles in Europe, as well as rioting in the Muslim world, are problems for African currencies, such as the Ghana cedi and the Kenya shilling, which depreciated rapidly in 2012. Perennial challenges remain in Africa, such as lack of reliable roads, phone lines, and power grids, but consumer spending in Africa is expected to double from $500 billion in 2012 to $1 trillion in 2020, creating great opportunities for thousands of firms.[8]

Marriott added its first sub-Saharan Africa hotel in 2013, in the capital of Rwanda, which is Kigali. Rwanda's GDP has grown 8 percent annually since 2004 as their president, Paul Kagame, wants to turn the tiny, landlocked equatorial country into an African Singapore. Marriott previously had 7 hotels in northern Africa (Morocco, Algiers, and Egypt), but none below the Sahara desert. Marriott now plans to build 2 hotels in Ghana, 2 in Nigeria, and 2 in Ethiopia between 2013 and 2015. "Most of Africa is a bit of a blank piece of paper for the hospitality industry," says Alex Kyriakidis, chief of Marriott's Middle East and Africa division. South Africa's Protea Hospitality Group plans to add 9 hotels in 2013–2014 to its 36 African properties outside its home country. All total, 208 new, large hotels were added across Africa in 2012 compared to 159 the prior year. Many firms are globally acquiring firms in Africa, such as India's number-2 tire maker, Apollo Tyres, recently buying South Africa's Dunlop Tyres for $62 million. Apollo plans to triple sales to $6 billion by 2015, with 60 percent of that revenue coming from outside India.

Airlines are beginning to really serve Africa, led by Delta in the USA and Persian Gulf carriers such as Qatar Airways, Emirates, and Etihad Airways. The five largest airports in sub-Saharan Africa ranked by available seats in June 2013 were:

Johannesburg, South Africa (278,392)

Addis Ababa, Ethiopia (167,408)

Khartoum, Sudan (142,408)

Nairobi, Kenya (126,729)

Lagos, Nigeria (120,034)

The McKinsey Global Institute reports that approximately 40 percent of Africans now live in urban areas and the number of households with discretionary income should increase 50 percent by the end of this decade.[9] Graham Allan, CEO of Yum Restaurants International, recently said, "A lot of companies, especially Chinese ones, have invested in Africa; we share the general view that Africa over the next 10 to 20 years will have massive potential." McKinsey & Co. says the number of consumers who can spend beyond bare necessities is greater now in Africa than India. From 2000 to 2009, foreign direct investment in Africa increased 600 percent to $58.56 billion.

Walmart recently acquired South African retailer Massmart Holdings for $4.6 billion, providing the company with 290 stores in 13 African countries: Ghana, Nigeria, Zambia, Botswana, Namibia, South Africa, Lesotho, Mozambique, Zimbabwe, Mauritius, Malawi, Tanzania, and Uganda. The Walmart acquisition paves the way for many firms now viewing Africa as a deal-making destination. For example, HSBC Holdings is trying to acquire a majority stake in Nedbank Group, South Africa's fourth-largest bank, and Nippon Telegraph and Telephone in Japan is buying Africa's largest technology company, Dimension Data. Huge purchases such as these have been a wake-up call to the rest of the world, which now views Africa as a growing, attractive new market.

Table 2-7 provides a summary of the economic situation in 12 African countries. Note that Angola is rated lowest in terms of doing business, whereas South Africa is rated highest. Recent regime changes in Egypt, Tunisia, Libya, and Algeria may spur further investment in Africa as democracy and capitalism strengthens. Many multinational companies are now gaining first mover advantages by engaging Africa at all levels. For example, Nokia and Coca-Cola have distribution networks in nearly every African country. Unilever has a presence in 20 of Africa's 50 countries. Nestlé is in 19 African countries, Barclays is in 12, Societe Generale is in 15, and Standard Chartered Bank is in 14. Africa has about 10 percent of the world's oil reserves, 40 percent of its gold ore, and 85 percent of the world's deposits of chromium and platinum. Africa's population is young, growing, and moving into jobs in the cities. Forty percent of Africans today live in the cities, a proportion close to China and India. *The general stereotype*

TABLE 2-7 Sampling of African Countries—Ease-of-Doing-Business Rankings

	Population in Millions	Ease of Doing Business Among all Countries	Capital City
South Africa	49	35 out of 183	Pretoria
Tunisia	11	46 out of 183	Tunis
Ghana	24	63 out of 183	Accra
Morocco	32	94 out of 183	Rabat
Kenya	39	109 out of 183	Nairobi
Egypt	79	110 out of 183	Cairo
Ethiopia	86	111 out of 183	Addis Ababa
Uganda	33	123 out of 183	Kampala
Nigeria	150	133 out of 183	Abuja
Sudan	41	135 out of 183	Khartoum
Mozambique	22	139 out of 183	Maputo
Angola	13	172 out of 183	Luanda

Source: Based on information at http://www.doingbusiness.org/rankings on November 1, 2012.

of Africa is rapidly changing from subsistence farmers avoiding lions, to millions of smartphone carrying consumers in cities purchasing products.

Africa has the world's largest deposits of platinum, chrome, and diamonds—and many Chinese companies in particular are investing there. Africa's largest food retailer, Shoprite Holdings, has more than 1,000 stores in 17 countries. Shoprite is a potential acquisition target being considered by European retailers Carrefour and Tesco. Diageo PLC sells Guinness beer, Smirnoff vodka, Baileys liqueur, and Johnnie Walker whiskey in more than 40 countries across Africa. Nestlé SA now has more than 25 factories in Africa.

Yum Brands recently doubled the number of Kentucky Fried Chicken (KFC) outlets in Africa to 1,200 and increased its revenue from the continent to almost $2 billion. "Africa wasn't even on our radar screen 10 years ago, but now we see it exploding with opportunity" says David Novak, Yum's chairman and CEO. Yum Brands is excited about Africa's growing middle class, vast population, and improving political stability of most African governments. Yum Brands is especially targeting Nigeria, Namibia, Mozambique, Ghana, Zambia, and South Africa. The company says it wants to reach more of Africa's one billion people than its current customer base of 180 million. But KFC currently has about 45 percent of South Africa's fast-food market, followed by Nando's with 6 percent and McDonald's with 5 percent. KFC is opening 25 new outlets in Ghana in 2013-2014, part of the company's 1,200 KFCs in Africa by year-end 2014.

Ghana recently became Africa's newest oil-producing nation when the 1.5-billion-barrel Jubilee field began pumping oil. Although Ghana's estimated 4 billion barrels of reserves are about a third those of Nigeria, Ghana has a stable political and economic situation. Ethiopia is also doing well economically. SABMiller PLC recently invested $20 million in a manufacturing plant in Ethiopia's large city, Ambo. That factory today produces 40,000 glass bottles of mineral water per hour. Ambo sells for about $6 a bottle in New York restaurants. Ambo water is part of the SABMiller portfolio that includes 45 African beers.[10]

Nairobi, Kenya, is the center of several major telecom companies trying to gain market share in the rapidly growing African cellphone business. Vodafone Safaricom Ltd. dominates the Kenyan telecommunications sector with 77 percent market share, but India's Bharti Airtel Ltd. boosted its market share in the last year to almost 20 percent. There are currently more than 440 million mobile subscribers in Africa generating more than $15 billion in telecom revenue annually. All of Africa is coming online, representing huge opportunities for countless companies. McKinsey & Co. estimates that within five years another 220 million Africans that today can meet only basic needs will join the middle class as consumers.[11] There are more than 950 million people who live in Africa.

China

In late 2012, China's economy began to accelerate after nearly two years of slowing growth. China's industrial production grew 9.6 percent in October 2012, up from a 9.2 percent gain in September. China's GDP grew at 7.4 percent in the third quarter of 2012 year-over-year. Analysts expect continued increasing growth, giving a lift to global economic prospects. Although the USA is the world's largest economy with a GDP of over $15 trillion annually, China recently passed Japan to become the world's second-largest economy with a GDP of about $5.75 trillion annually, compared to Japan's $6 trillion. China, however, is still an emerging economy, as indicated by a per-capita GDP of $10,000, compared to the USA and Japan per-capita GDPs of $48,000 and $47,000, respectively. China's economic (GDP) growth of over 9 percent annually for several decades is, however, much faster than either the USA or Japan. Premier Wen Jiabao recently proclaimed that China's annual GDP growth will be held to 7.0 percent if possible to constrain inflation. Goldman Sachs predicts that China will overtake the USA as the world's largest economy by 2027.

China's rapid growth has created substantial pollution, extensive inequality, and deeply embedded corruption. In fact, China's communist government is concerned that political unrest in the Middle East may spread to China in a "Jasmine Revolution" because the masses in China barely make enough to survive. The World Bank estimates that more than 100 million Chinese citizens, nearly the size of Japan's entire population, live on less than $2 a day—but China's middle class is growing rapidly.

For many decades, low wage rates in China helped keep world prices low on hundreds of products—but that is changing, because all 31 Chinese provinces and regions recently boosted

their minimum wage for the second consecutive year. Analysts expect demand for workers in China to outstrip supply by 2014, and this is contributing to rapidly rising wage rates and worldwide inflation. Commercial and industrial development in China's west has turned interior cities such as Chongqing into production centers that compete for labor with coastal factories. According to Credit Suisse in Hong Kong, pay to migrant laborers who fuel China's export industry rose 40 percent in 2010 and 30 percent in 2011, and similar increases are expected in 2012. Average monthly pay in 2009 in Shenzhen on the southern China coast was $235, compared to Seoul's $1,220, Taipei's $888, Ho Chi Minh City's $100, Jakarta's $148, and $47 in Dhaka, Bangladesh.[12]

China has become the biggest trading partner for Australia, Japan, Korea, India, Russia, and South Africa and has replaced the USA as the top export market for Brazil. The world's two fastest-growing major economies, China and India, recently announced that the two countries will more than double their bilateral trade between 2010 and 2015 to $100 billion.[13] China is opening its large consumer markets more to Indian goods. China may soon support India having a permanent seat on the United Nations Security Council. China has long opposed a permanent seat for India. The increased cooperation between China and India is good news for companies worldwide doing business in that part of Asia.

As indicated in Table 2-7, China ranks 91st out of 183 countries in terms of doing business, for a variety of reasons ranging from human rights issues to substantial disregard for copyright, patent, and trademark rules of law. Best Buy and Home Depot are example companies that are closing stores in China. Both firms have not competed well in China as a result of being too "high priced" compared to home-grown, similar businesses. The Chinese are price conscious. In contrast, luxury handbag maker, Coach Inc. has made China the cornerstone of its international strategy as the firm's sales and profits are rising sharply in China. Interestingly, Coach is adding more products for men and opening men's stores in China.

China is gaining a stronger and stronger foothold into Japanese businesses. The five largest recent Chinese investments in Japan are Mitsubishi UFJ Financial (92 billion yen), Canon (74.5 billion yen), Sumitomo Mitsui (57.9 billion yen), Nippon T&T (49.2 billion yen), Mitsubishi (47.8 billion yen), Takeda Pharm (45.4 billion yen), and Sony (41.6 billion yen). The Japanese investment adviser Chibagin Asset Management says China state funds have recently more than doubled their investment in Japan to 1.62 trillion yen in 90 companies.

Note also in Table 2-8 that Singapore is rated the best country on the planet for doing business.

TABLE 2-8 Sampling of Asian Countries—Ease-of-Doing-Business Rankings

	Population in Millions	Ease of Doing Business Among all Countries	Capital City
Singapore	5	1 out of 183	Singapore
South Korea	49	8 out of 183	Seoul
Malaysia	26	18 out of 183	Kuala Lumpur
Thailand	66	19 out of 183	Bangkok
Japan	127	20 out of 183	Tokyo
Taiwan	23	25 out of 183	Taipei
China	1,500	91 out of 183	Beijing
Pakistan	175	105 out of 183	Islamabad
Russia	140	120 out of 183	Moscow
Indonesia	241	129 out of 183	Jakarta
India	1,160	132 out of 183	New Delhi
Philippines	98	136 out of 183	Manila

Source: Based on information at http://www.doingbusiness.org/rankings on November 1, 2012.

Philippines

A highly educated, English speaking country, the Philippines overtook India in early 2011 in call-center jobs, employing 350,000 compared with India's 330,000.[14] Call centers in the Philippines produced $7.4 billion in revenue in 2011, and that figure is growing about 15 percent annually. The Philippines recently also overtook Indonesia as the world's biggest supplier of voice-based call-center services.[15] Citigroup and Chase are just two companies outsourcing customer calls, back-office work, and other operations to the Philippines. A major reason why the Philippines is an attractive place for call centers is the country's overall business culture to "deliver absolutely fantastic service." An associate professor at the City University of Hong Kong, Jane Lockwood, says "Filipinos go out of their way, not just in call centers, but in tourism and events management, to ensure people are well looked after."[16]

As indicated in Table 2-8, the Philippines has about 98 million people, making the country the world's 12th largest in population. Located in Southeast Asia, the Philippines was a founding member of the United Nations and is active in that organization. Filipinos love Americans who rescued them in World War II. Thousands of Filipinos today work all-night shifts to accommodate the normal 8 am-to-5 pm business time zone in the USA. Philippines president Benigno Aquino recently indicated that services outsourced to the Philippines from around the world will generate up to $100 billion in 2020, representing 20 percent of the global offshoring market share.

Unemployment is at 6.9 percent in the Philippines, but under-employment—defined as people who work only part-time or with minimal incomes—is 18 percent. The average per capita income of Filipinos is about $1,790 a year, so hundreds of thousands of Filipinos work outside the country. In fact, the Philippines' economy depends greatly on outside workers sending monies back to the country and also traveling to and from the country.

The television advertising market in the Philippines is nearly $4 billion annually, larger than India's and on par with Indonesia's.[17] Television is the most enjoyed media among the Philippines' 7,100 island people, whereas newspapers are the most important media outlet in India. Television ads comprise 75 percent of advertising spending in the Philippines.

Among major emerging economies, the Philippines has only a 9 percent Internet penetration rate among its population, which is low compared to China (28.9%), Nigeria (28.4%), Mexico (28.3%), and Russia (29.0%). But the Philippines' 9 percent rate is above the Internet penetration rate among Indonesia's population (8.7%) and India's population (5.1%).[18] These percentages reveal the percentage of the country's people that could shop online.

Taiwan

Located off the southeast coast of mainland China, Taiwan has a dynamic, capitalist, export-driven economy with gradually decreasing state involvement in investment and foreign trade. Many large, government-owned banks and industrial firms are being privatized in Taiwan. Real annual growth in GDP has averaged about 8 percent during the past three decades. Exports have provided the primary impetus for industrialization. The trade surplus is substantial, and foreign reserves are the world's fifth largest. As indicated in Table 2-8, Taiwan is rated 25th among all countries in the world for doing business.

Both exports and imports for the year reached record levels, totaling U.S. $274 billion and $251 billion, respectively. Agriculture constitutes only 2 percent of Taiwan's GDP, down from 35 percent in 1952. Some brands from Taiwan that are leaders globally include: Acer, HTC, ASUS, TrendMicro, MasterKong, Want-Want, Maxxis, Giant, Synnex, Transcend, Uni-President, Advantech, D-Link, ZyXel, Merida, Johnson, Gigabyte, CyberLink, Genius, and Depo.

India

India passed a law in late 2011 that for the first time allows foreign firms to own 100 percent of some Indian retail ventures, up from a previous 51 percent. One company taking advantage of this change in the law is IKEA that is opening up 25 new stores in India between 2012 and 2015. Since India's growth in GDP has fallen to below 6 percent, the Indian government began to allow much greater foreign investment especially in Indian retail, airlines, and broadcasting in 2012.[19] The country also greatly reduced the expensive government subsidies on diesel fuel and Indian banks are lowering interest rates also to spur growth.

In late 2012, India instituted a five-year road map to improve it finances, aiming to narrow its budget deficit to 5.3 percent of gross domestic product to 3 percent by 2017. A slowdown in growth to 5 percent in 2012, coupled with massive welfare spending, has led to an unmanageable budget deficit in India. Complicating matters in India are high interest rates and some corruption scandals. The Indian Parliament recently approved higher overseas ownership in their insurance and pension investments sectors of the economy.

The Indian government is slowly improving the country's education system, but an enormous amount of work remains. Only 74 percent of Indian men and 48 percent of Indian women are literate, compared to 96 percent of men and 88 percent of women in China. India's "knowledge economy" employs only about 2.23 million people out of 750 million available.

Prime Minister Manmohan Singh's government has instituted education reforms, so the number of Indian children out of school has dropped greatly from 18 million in 2000. Dropout ratios in primary schools have improved as well. However, at present only 12 percent of India's citizens enter higher education, and the government hopes to increase this to 21 percent by 2017. The Indian Institutes of Technology—a group of universities focused on engineering and technology—are world renowned but offer only a miniscule 7,000 places to students each year. There is elaborate red tape required to establish and operate any business in India. Also, India's tax code is archaic and many new sectors are not even open to foreign direct investment.

India will surpass China as the most populated country in 2030. India's highest density growth and population is in the northwest and east-central areas of the country. India has a literacy rate now of 74 percent, up from 65 percent a decade ago.

Germany

Germany's cars, machinery, and other products are in high demand in Asia, especially China. As Europe's debt crisis has pushed the euro lower, German goods are more competitive abroad. The economic and fiscal crises in Greece, Ireland, Portugal, and Spain have only limited direct impact on Germany's $3.24 trillion economy. There is a growing north-south divide in Europe, with the north doing much better economically than the south. Germany's budget deficit was 3.5 percent in 2010, the first time in years that the country has exceeded the 3 percent limit set by EU budget rules, but that percent is well below the deficit in the USA, the UK, and Japan—so overall the German economy is healthy. Note in Table 2-9 that Germany ranks 22nd out of 183 countries in ease of doing business.

German automobile producers such as Daimler AG, BMW AG, and Volkswagen AG have fallen behind rivals such as GM, Renault SA, and Nissan Motor in mass-producing electric cars. The German companies are playing catch up in this key area of industrial growth, partly because the German government has committed just $688 million in state support for electric battery research and infrastructure projects, such as car-charging stations. That amount is only a small fraction of the U.S. (and Chinese) government support for electric cars. Because one

TABLE 2-9 Sampling of European Countries—Ease-of-Doing-Business Rankings

	Population in Millions	Ease of Doing Business Among All Countries	Capital City
UK	62	7 out of 183	London
Sweden	9	14 out of 183	Stockholm
Germany	83	19 out of 183	Berlin
France	64	29 out of 183	Paris
Czech Republic	11	64 out of 183	Prague
Turkey	77	71 out of 183	Ankara
Italy	59	87 out of 183	Rome
Ukraine	46	152 out of 183	Kiev

Source: Based on information at http://www.doingbusiness.org/rankings on November 1, 2012.

out of seven German jobs is connected to the country's car markers and domestic suppliers, this issue is important. More than 15 percent of German exports stem from the automobile industry. Germany also fallen way behind in electric car lithium-ion battery development and production.

The EU is a single economic bloc with free movement of people, goods, and services among its 27 nations, but in matters such as taxes and labor costs, each country sets its own rules. Businesses entering Europe for the first time need to carefully research the various countries. Belgium, for example, has the highest labor costs in Europe with 53 percent of workers there being unionized, but that percent is only the fifth highest in Europe.

Germany has one of Europe's fastest aging and shrinking populations. Germany now faces shortages of skilled labor and aggressive recruiting from abroad for the country's top engineering and scientific talent.[20] More people emigrate from Germany than relocate to Germany, especially highly educated professionals—partly because Germany has a restrictive labor code and inward-looking hiring practices. Germany might need to follow the lead of Italy, which has the same, albeit more severe, problem but has enacted excellent new laws and incentives to both keep and attract young, highly educated professionals.

Mexico

In late 2012, Mexico elected a new president, Enrique Pena Nieto, who inherits a country with a homicide rate of 24 per 100,000 residents up from 10 per 100,000 in 2006. But homicides in Mexico fell 7 percent in the first nine months of 2012, and Nieto plans to continue his predecessor's war on drug cartels and war on corruption. For example, all 600 municipal policemen in Mexico's business-leading city of Monterrey were fired recently and replaced with Mexican military personnel because of suspected corruption.

Mexico has recently reenergized its automobile manufacturing industry and now is the fourth largest automobile exporter on the planet, behind Germany, Japan, and South Korea. One in 10 cars sold in 2011 in the USA was made in Mexico.[21] Every new taxi in New York City's fleet is made in Mexico. Almost all major automobile producers globally have recently announced plans to build new plants in Mexico, including the upcoming new $1.3 billion Volkswagen plant. An already existing Volkswagen plant in Puebla, Mexico, is the company's largest in North America, with a capacity to produce 2,500 cars a day. "Mexico is extremely competitive," says Carlos Ghosn, Nissan's CEO. Ghosn cites the high productivity of Mexican employees, currency advantages, and the typical $40 per day wage rate for Mexican assembly-line workers, which is approaching the average manufacturing wage in China of $3 per hour. Honda is opening a 3,200-employee factory in 2014 in Mexico to produce its subcompact model Fit. Another key advantage for producing vehicles in Mexico over Europe and Asia is that shipment to the USA takes only a day or two, instead of a few weeks by ship.

No country was hurt more in the last decade by the rise of China than Mexico, but Chinese policy today is to boost wages to boost consumer spending. The Boston Consulting Group estimates that "China's average manufacturing wage exceeded Mexico's in 2012 for the first time, when accounting for differences in productivity; Mexican workers typically produce more per hour than Chinese workers."[22] The average wage plus benefits across Mexico is $3.50 an hour. This fact, coupled with China's rising wages and slowing growth and Mexico's close proximity to the USA, represents a great opportunity for Mexico to recoup some of a lot of the manufacturing prowess it lost in the last decade to China. Viaststems Group, based in St. Louis, recently shifted some of its manufacturing back to Mexico from China. Although Dell Inc. computers are produced by Foxconn in China, U.S. customers can order a customized Dell computer online that is assembled and delivered from a 1,200-acre Foxconn plant near Ciudad Juarez.

Foreign direct investment (FDI) in Mexico in 2013 surged to almost $30 billion, led by automobile manufacturers such as Volkswagen AG building new factories, and auto-parts suppliers such as Delphi Automotive PLC following. Home Depot will soon have 125 stores in Mexico. The FDI surge is expected to last at least through 2018, spurred by low wages, and government policies that allow foreign companies to import raw materials without paying duties or tariffs, a 30 percent corporate tax rate, and rising wages in China. However, note in Table 2-10 that Mexico fell from 35th place to 53rd place in the last two years among all nations in terms of ease of doing business.

TABLE 2-10 Sampling of North and South American Countries—Ease-of-Doing-Business Rankings

	Population in Millions	Ease of Doing Business Among all Countries	Capital City
USA	308	4 out of 183	Washington, DC
Canada	34	13 out of 183	Ottawa
Chile	17	39 out of 183	Santiago
Peru	30	41 out of 183	Lima
Mexico	112	53 out of 183	Mexico City
Argentina	41	113 out of 183	Buenos Aires
Brazil	199	126 out of 183	Brasilia
Ecuador	15	130 out of 183	Quito
Bolivia	10	153 out of 183	La Paz
Venezuela	27	177 out of 183	Caracus

Source: Based on information at http://www.doingbusiness.org/rankings on November 1, 2012.

Mexico is especially attractive for manufacturing products that are bulky or costly to transport, so for example, Nissan Motor and Volkswagen AG are planning to build factories in Mexico. The key variable hurting Mexico is drug-related violence since a 2011 United National report says Mexico's homicide rate was 18.1 people per 100,000 compared with a per capita rate of about 5.0 in the USA and 1.1 in China. If Mexico can improve its security situation as it intends, then hundreds of firms may consider moving back there from China (and India).

Special Note to Students

Even the smallest businesses today regularly serve customers globally and gain competitive advantages and economies of scale doing so. Many iconic U.S. businesses, such as Tupperware, obtain more than 80 percent of their revenue from outside the USA. Therefore, in performing a strategic-management case analysis, you must evaluate the scope, magnitude, and nature of what your company is doing globally compared to rival firms. Then, determine what your company should be doing to garner global business. Continuously throughout your presentation or written report, compare your firm to rivals in terms of global business and make recommendations based on careful analysis. Be "prescriptive and insightful" rather than "descriptive and mundane" with every slide presented to pave the way for your specific recommendations with costs regarding global reach of your firm.

Conclusion

The population of the world has surpassed 7 billion. Just as they did for centuries before Columbus reached America, businesses search for new opportunities beyond their national boundaries for centuries to come. There has never been a more internationalized and economically competitive society than today's model. Some U.S. industries, such as textiles, steel, and consumer electronics, are in disarray as a result of the international challenge.

Success in business increasingly depends on offering products and services that are competitive on a world basis, not just on a local basis. If the price and quality of a firm's products and services are not competitive with those available elsewhere in the world, the firm may soon face extinction. Global markets have become a reality in all but the most remote areas of the world. Certainly throughout the USA, even in small towns, firms feel the pressure of world competitors.

This chapter has provided some basic global information that can be essential to consider in developing a strategic plan for any organization. The advantages of engaging in international business may well offset the drawbacks for most firms. It is important in strategic planning to be effective, and the nature of global operations may be the key component in a plan's overall effectiveness.

Key Terms and Concepts

feng shui (p. 86)
global strategy (p. 82)
globalization (p. 82)
guanxi (p. 84)
international firms (p. 79)
inhwa (p. 84)
multinational corporations (p. 79)
nemaswashio (p. 86)
protectionism (p. 81)
Wa (p. 84)

Issues for Review and Discussion

2-1. Honda Motor Company has been very successful in recent years. What percentage of Honda's revenues comes from the United States versus Europe? How does this percentage compare with rival firms?
2-2. Explain why consumption patterns are becoming similar worldwide. What are the strategic implications of this trend?
2-3. What are the advantages and disadvantages of beginning export operations in a foreign country?
2-4. What are the major differences between U.S. and multinational operations that affect strategic management?
2-5. Why is globalization of industries a common factor today?
2-6. Compare and contrast U.S. versus foreign cultures in terms of doing business.
2-7. List six reasons why strategic management is more complex in a multinational firm.
2-8. Do you feel that protectionism is good or bad for the world economy? Why?
2-9. Why are some industries more "global" than others? Discuss.
2-10. *Wa, guanxi* and *inhwa* are important management terms in Japan, China, and Korea respectively. What would be analogous terms to describe American management practices?
2-11. Why do many Europeans also find the notion of "team spirit" in a work environment difficult to grasp?
2-12. In China, *feng shui*, is important in business, whereas in Japan *nemaswashio*, is important. What are analogous American terms and practices?
2-13. Describe the business culture in Mexico.
2-14. Describe the business culture in Japan.
2-15. Compare tax rates in the United States versus other countries. What impact could these differences have on "keeping jobs at home?"
2-16. Discuss the requirements for doing business in India.
2-17. Select four countries. Evaluate Honda Motor Company's operations in those countries.
2-18. Compare business practices and culture in northern Europe with southern Europe.
2-19. Explain how the Arab Spring movement in the Middle East will likely impact Pfizer.
2-20. What five countries in Asia have the highest GDP? What are its implications for adidas?
2-21. Africa is rapidly joining the world economic community. Give 10 examples to justify this.
2-22. Which six African countries do you feel are most attractive for foreign investment?
2-23. Compare business practice and culture in the USA with your own country.
2-24. Explain in your own words the "Special Note to Students" section at the end of the chapter.
2-25. Select three countries in South America. Prepare a one-page summary for each to reveal their attractiveness for foreign direct investment.
2-26. Compare sexual harassment policies and practice across continents and countries.
2-27. Discuss Australia as a continent for doing business in.
2-28. In terms of presenting flowers as business gifts, compare and contrast the practices and customs across six countries.
2-29. Discuss how business etiquette at dinner varies across countries.

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

2-30. Make a good argument for keeping the statutory corporate tax rate in the United States the highest in the world. Make the counterargument.

2-31. What are the advantages and disadvantages of beginning export operations in a foreign country?

2-32. Mymanagementlab Only—comprehensive writing assignment for this chapter.

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 2A

The adidas Group wants to enter Africa. Help them.

Purpose

More and more companies every day decide to begin doing business in Africa. Research is necessary to determine the best strategy for being the first mover in many African countries (i.e., being the first competitor doing business in various countries).

Step 1 Print a map of Africa.

Step 2 Print demographic data on 10 African countries.

Step 3 Gather competitive information regarding the presence of shoe companies doing business in Africa.

Step 4 List in prioritized order eight countries that you would recommend for adidas to enter. Country 1 is your best, and Country 2 is your next best. Based on your research, indicate how many adidas/Reebok/TaylorMade stores you would recommend building over the next three years in each country. List in prioritized order three cities in each of your eight African countries where you believe adidas should build most of its stores.

EXERCISE 2B

Assessing Differences in Culture Across Countries

Purpose

Americans can be more effective in dealing with businesspeople from other countries if they have some awareness and understanding of differences in culture across countries. This is a fun exercise that provides information for your class regarding some of these key differences.

Instructions

Step 1 Identify four individuals who either grew up in a foreign country or have lived in a foreign country for more than one year. Interview those four persons. Try to have four different countries represented. During each interview, develop a list of eight key differences between American style/custom and that particular country's style/custom in terms of various aspects of speaking, meetings, meals, relationships, friendships, and communication that could impact business dealings.

Step 2 Develop a 15-minute PowerPoint presentation for your class and give a talk summarizing your findings. Identify in your talk the persons you interviewed as well as the length of time those persons lived in the respective countries. Give your professor a hard copy of your PowerPoint presentation.

EXERCISE 2C

Honda Motor Company wants to enter the Vietnamese market. Help them.

Purpose

More and more companies every day decide to begin doing business in Vietnam. Research is necessary to determine the best strategy for being competitive in Vietnam. Review the opening chapter boxed insert and Honda Motor Company's website.

Instructions

Step 1 Print off a map of Vietnam.

Step 2 Print off demographic data on 10 cities in Vietnam.

Step 3 Gather competitive information regarding the presence of automobile companies doing business in Vietnam.

Step 4 List in prioritized order the five cities that you would recommend for Honda to expand their business operations into.

EXERCISE 2D

Does My University Recruit in Foreign Countries?

Purpose

A competitive climate is emerging among colleges and universities around the world. Colleges and universities in Europe and Japan are increasingly recruiting U.S. students to offset declining enrollments. Foreign students already make up more than one-third of the student body at many U.S. universities. The purpose of this exercise is to identify particular colleges and universities in foreign countries that represent a competitive threat to your college.

Instructions

Step 1 Select a foreign country. Conduct research to determine the number and nature of colleges and universities in that country. What are the major educational institutions in that country? What programs are those institutions recognized for offering? What percentage of undergraduate and graduate students attending those institutions are citizens of your country? Do these institutions actively recruit students from your country? Are any of the Schools of Business at the various universities AACSB-International accredited?

Step 2 Prepare a report for the class that summarizes your research findings. Present your report to the class.

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3

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Ethics/ Social Responsibility/ Sustainability

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Discuss the ethics of workplace romance.
2. Explain why concern for wildlife is a strategic issue for firms.
3. Explain why good ethics is good business in strategic management.
4. Explain how firms can best ensure that their code of business ethics guides decision making instead of being ignored.
5. Explain why whistle-blowing is important to encourage in a firm.
6. Discuss the nature and role of corporate sustainability reports.
7. Discuss specific ways that firms can be good stewards of the natural environment.
8. Explain ISO 14000 and 14001.
9. Discuss recent trends in bribery law.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 3A Sustainability and Nestlé

EXERCISE 3B How Does My Municipality Compare To Others on Being Pollution-Safe?

EXERCISE 3C Compare adidas AG versus Nike on Social Responsibility

EXERCISE 3D How Do You Rate adidas AG's Sustainability Efforts?

EXERCISE 3E How Do You Rate Nestlé's Sustainability Efforts?

EXERCISE 3F The Ethics of Spying on Competitors

Although the three sections of this chapter (business ethics, social responsibility, and sustainability) are distinct, the topics are quite related. Many people, for example, consider it unethical for a firm to be socially irresponsible. **Social responsibility** refers to actions an organization takes beyond what is legally required to protect or enhance the well-being of living things. **Sustainability** refers to the extent that an organization's operations and actions protect, mend, and preserve rather than harm or destroy the natural environment. Polluting the environment, for example, is unethical, irresponsible, and in many cases illegal. Business ethics, social responsibility, and sustainability issues therefore are interrelated and impact all areas of the comprehensive strategic-management model, as illustrated in Figure 3-1 with white shading.

Business Ethics

The Institute of Business Ethics (IBE) recently did a study titled "Does Business Ethics Pay?" and concluded that companies displaying a "clear commitment to ethical conduct" consistently outperform companies that do not display ethical conduct. Philippa Foster Black of the IBE stated: "Not only is ethical behavior in business life the right thing to do in principle, it pays off in financial returns." Alan Simpson said: "If you have integrity, nothing else matters. If you don't have integrity, nothing else matters." Table 3-1 provides some results of the IBE study.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Nestlé

Nestlé S.A., headquartered in Vevey, Switzerland, is the largest food company in the world measured by revenues. Nestlé has hundreds of products that include cereals, coffee, dairy products, pet foods, snacks, baby food, and bottled water. Thirty of Nestlé's brands have annual sales of over 1 billion Swiss francs (about $1.1 billion), including Nespresso, Nescafe, Kit Kat, Smarties, Nesquick, Stouffers, Vittel, and Maggi. Nestlé has around 450 factories, operates in 86 countries, and employs around 328,000 people. It is one of the main shareholders of L'Oreal, the world's largest cosmetics company. In April 2012, Nestlé acquired Pfizer's infant-nutrition business for $11.9 billion. In May 2013, Nestlé began a $500 million expansion of its R&D center in Singapore, with a primary focus on health and nutrition.

In order to ensure that various standards within the supply chain maintain a certain level, Nestlé developed the Nestlé Supplier Code. The Code sets out non-negotiable minimum standards which all employees, subcontractors, and suppliers must meet and adhere to whilst doing business with Nestlé. Available in 22 languages on the corporate website, the Nestlé Supplier Code forms an important part of all contracts, orders, and commercial agreements that Nestlé enters into with all 165,000 suppliers and 680,000 farmers that form the Nestlé supply chain. The aim of the Nestlé Supplier Code is to ensure that all the company's suppliers and farmers conduct business in a manner that upholds Nestlé's high values and emphasis on fairness and integrity.

Nestlé's performance for the first half of 2013 was exemplary. The company's profit margins by-region, in the Americas, Europe, and Asia/Oceania/Africa were 17.8, 14.9, and 19.1 percent respectively. The profit margins for Nestle Waters and Nestlé Nutrition were 10 percent and 20 percent respectively. Overall for Nestlé for the first half of 2013, the company generated a positive 4.1 percent organic growth and a 15.1 operating profit margin – both exemplary results.

Regarding Nestlé's by-product financial results for the first of 2013, the company's operating profit margins were all positive, as follows: 1) Powdered and liquid beverages (24%), 2) Water (10.7%), 3) Milk products and ice cream (15.9%), 4) Nutrition & HealthCare (18.6%), 5) Prepared dishes and cooking aids (13.5%), 6) Confectionery (12.7%), and PetCare (19.0%). All of the reported results are also exemplary.

Source: Based on company documents.

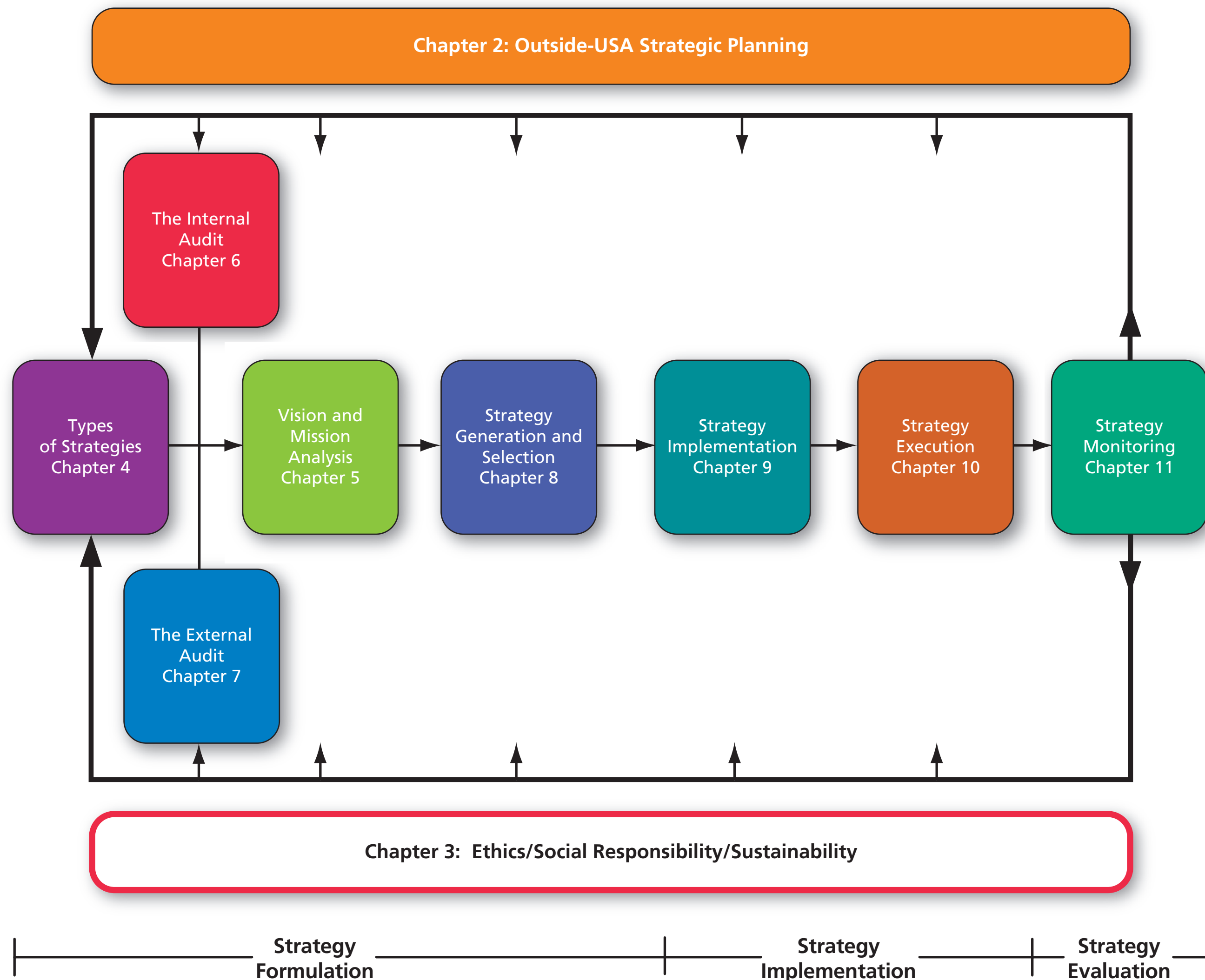

FIGURE 3-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

Good ethics is good business. Bad ethics can derail even the best strategic plans. This chapter provides an overview of the importance of business ethics in strategic management. **Business ethics** can be defined as principles of conduct within organizations that guide decision making and behavior. Good business ethics is a prerequisite for good strategic management; good ethics is just good business!

TABLE 3-1 Seven Principles of Admirable Business Ethics

1. Be trustworthy, because no individual or business wants to do business with an entity they do not trust.
2. Be openminded, continually asking for "ethics-related feedback" from all internal and external stakeholders.
3. Honor all commitments and obligations.
4. Do not misrepresent, exaggerate, or mislead with any print materials.
5. Be visibly a responsible community citizen.
6. Utilize your accounting practices to identify and eliminate questionable activities.
7. Follow the motto: Do unto others as you would have them do unto you.

Source: Based on http://sbinformation.about.com/od/bestpractices/a/businessethics.htm.

A rising tide of consciousness about the importance of business ethics is sweeping the USA and the rest of the world. Strategists such as CEOs and business owners are the individuals primarily responsible for ensuring that high ethical principles are espoused and practiced in an organization. All strategy formulation, implementation, and evaluation decisions have ethical ramifications.

Newspapers and business magazines daily report legal and moral breaches of ethical conduct by both public and private organizations. Being unethical can be expensive. For example, some of the largest payouts for class-action legal fraud suits ever were against Enron ($7.16 billion), WorldCom ($6.16 billion), Cendant ($3.53 billion), Tyco ($2.98 billion), AOL Time Warner ($2.5 billion), Nortel Networks ($2.47 billion), and Royal Ahold ($1.09 billion).

Other business actions considered to be unethical include misleading advertising or labeling, causing environmental harm, poor product or service safety, padding expense accounts, insider trading, dumping banned or flawed products in foreign markets, not providing equal opportunities for women and minorities, overpricing, moving jobs overseas, and sexual harassment.

The Food and Drug Administration (FDA) recently warned both Avon Products and L'Oreal about misleading marketing of certain of its antiwrinkle products. The FDA's position is that Avon and L'Oreal's claims that discuss things like the stimulation of skin cells or reactivating the skin's repair process are not true.

Yahoo!'s CEO Scott Thompson recently was forced to resign as a result of his "resume padding or inflating." J.P. Morgan Chase CEO Jamie Dimon is currently under fire after the investment bank's $2.3 billion trading blunder that has already cost a key deputy her job. Increasingly, executives' and managers' personal and professional decisions are placing them in the cross hairs of angry shareholders, disgruntled employees, and even their own boards of directors—making even the imperious CEO far more vulnerable to personal, public, and corporate missteps than ever before. "Certainly, anybody who is doing something that can be construed as unethical, immoral or greedy is being taken to task," says Paul Dorf of Compensation Resources, a consultant to boards of directors.[1]

Social media and business-centric websites such as glassdoor.com and vault.com as well as disclosure mandates required under Sarbanes-Oxley are just several of many outlets that today quickly spread fact and rumor about the inside dealings of Corporate America, revealing ethical breaches and internal business practices that may never have surfaced before the Internet and a 24/7 media culture. "God forbid anyone who isn't squeaky-clean these days or misrepresents their credentials at the top of the company," says Wendy Patrick, who teaches business ethics at San Diego State University. "Anything embarrassing and you begin to question everything. If they aren't making good decisions in their personal lives, it can bleed over to the way they run their companies."

"The pressure and scrutiny on performance has shortened the tenure of the average CEO from about 10 years to about 5½ years since the 1990s," says John Challenger of consultants Challenger Gray and Christmas. Challenger notes that 42 CEOs were forced out of their jobs in 2011 and that pace is up 5 percent in 2012.[2]

Code of Business Ethics

A new wave of ethics issues related to product safety, employee health, sexual harassment, AIDS in the workplace, smoking, acid rain, affirmative action, waste disposal, foreign business practices, cover-ups, takeover tactics, conflicts of interest, employee privacy, inappropriate gifts, and security of company records has accentuated the need for strategists to develop a clear **code of business ethics**. Internet fraud, hacking into company computers, spreading viruses, and identity theft are other unethical activities that plague every sector of online commerce.

Merely having a code of ethics, however, is not sufficient to ensure ethical business behavior. A code of ethics can be viewed as a public relations gimmick, a set of platitudes, or window dressing. To ensure that the code is read, understood, believed, and remembered, periodic ethics workshops are needed to sensitize people to workplace circumstances in which ethics issues may arise.[3] If employees see examples of punishment for violating the code as well as rewards for upholding the code, this reinforces the importance of a firm's code of ethics. The website www.ethicsweb.ca/codes provides guidelines on how to write an effective code of ethics.

An Ethics Culture

Reverend Billy Graham once said: "When wealth is lost, nothing is lost; when health is lost, something is lost; when character is lost, all is lost." An ethics "culture" needs to permeate organizations! To help create an ethics culture, Citicorp developed a business ethics board game that is played by thousands of employees worldwide. Called "The Word Ethic," this game asks players business ethics questions, such as how do you deal with a customer who offers you football tickets in exchange for a new, backdated IRA? Diana Robertson at the Wharton School of Business believes the game is effective because it is interactive. Many organizations have developed a code-of-conduct manual outlining ethical expectations and giving examples of situations that commonly arise in their businesses.

One reason strategists' salaries are high is that they must take the moral risks of the firm. Strategists are responsible for developing, communicating, and enforcing the code of business ethics for their organizations. Although primary responsibility for ensuring ethical behavior rests with a firm's strategists, an integral part of the responsibility of all managers is to provide ethics leadership by constant example and demonstration. Managers hold positions that enable them to influence and educate many people. This makes managers responsible for developing and implementing ethical decision making. Gellerman and Drucker, respectively, offer some good advice for managers:

> All managers risk giving too much because of what their companies demand from them. But the same superiors, who keep pressing you to do more, or to do it better, or faster, or less expensively, will turn on you should you cross that fuzzy line between right and wrong. They will blame you for exceeding instructions or for ignoring their warnings. The smartest managers already know that the best answer to the question "How far is too far?" is don't try to find out.[4]
>
> A man (or woman) might know too little, perform poorly, lack judgment and ability, and yet not do too much damage as a manager. But if that person lacks character and integrity—no matter how knowledgeable, how brilliant, how successful—he destroys. He destroys people, the most valuable resource of the enterprise. He destroys spirit. And he destroys performance. This is particularly true of the people at the head of an enterprise because the spirit of an organization is created from the top. If an organization is great in spirit, it is because the spirit of its top people is great. If it decays, it does so because the top rots. As the proverb has it, "Trees die from the top." No one should ever become a strategist unless he or she is willing to have his or her character serve as the model for subordinates.[5]

No society anywhere in the world can compete long or successfully with people stealing from one another or not trusting one another, with every bit of information requiring notarized confirmation, with every disagreement ending up in litigation, or with government having to regulate businesses to keep them honest. Being unethical is a recipe for headaches, inefficiency, and waste. History has proven that the greater the trust and confidence of people in the ethics of an institution or society, the greater its economic strength. Business relationships are built mostly on mutual trust and reputation. Short-term decisions based on greed and questionable ethics will preclude the necessary self-respect to gain the trust of others. More and more firms believe that ethics training and an ethics culture create strategic advantage. Max Killan said: "If business is not based on ethical grounds, it is of no benefit to society, and will, like all other unethical combinations, pass into oblivion."

Whistle-Blowing

Harris Corporation and other firms warn managers and employees that failing to report an ethical violation by others could bring discharge. The Securities and Exchange Commission (SEC) recently strengthened its whistle-blowing policies, virtually mandating that anyone seeing unethical activity report such behavior. **Whistle-blowing** refers to policies that require employees to report any unethical violations they discover or see in the firm.

Whistle-blowers in the corporate world receive up to 25 percent of the proceeds of legal proceedings against firms for wrongdoing. Whistle-blower payouts are becoming more and more common. In late 2012, Brad Birkenfeld, the former Zurich-based UBS AG banker who

told the Internal Revenue Service (IRS) how the bank helped thousands of Americans evade taxes, received an IRS award of $104 million, perhaps the largest payout ever for an individual U.S. whistle-blower. The largest bank in Switzerland, UBS's Birkenfeld told IRS agents how UBS bankers came to the USA to woo rich Americans, managed $20 billion of their assets, and helped them cheat the IRS. He pleaded guilty to conspiracy in 2008, a year after reporting the bank's conduct to the Justice Department, U.S. Senate, IRS, and Securities and Exchange Commission. Birkenfeld went briefly to prison for his involvement in the bank scheme, but UBS avoided prosecution in the USA by agreeing to pay $780 million, disclosing data on more than 250 Swiss accounts, and admitting it helped foster tax evasion. It later agreed to hand over data on another 4,450 accounts. Since Birkenfeld came forward, at least 33,000 Americans have voluntarily disclosed offshore accounts to the IRS, generating more than $5 billion.

In October 2012, the IRS in a separate case paid another whistle-blower $38 million which was between 15 and 30 percent of the taxes recovered from another large corporation. The name of this company and the whistle-blower remain completely confidential, proving that the IRS can reward corporate whistle-blowers without ever revealing their identity. Pfizer paid out $2.3 billion in a whistle-blower settlement case and Eli Lilly paid out $1.4 billion. Most firms have internal whistle-blowing incentives and policies and try to keep such matters internal, but recent laws and court cases are shifting disclosure and settlements outside the firm.[6]

An accountant recently tipped off the IRS that his employer was skimping on taxes and received $4.5 million in the first IRS whistle-blower award. The accountant's tip netted the IRS $20 million in taxes and interest from the errant financial-services firm. The award represented a 22 percent cut of the taxes recovered. The IRS program, designed to encourage tips in large-scale cases, mandates awards of 15 to 30 percent of the amount recouped. "It's a win-win for both the government and taxpayers. These are dollars that are being returned to the Treasury that otherwise wouldn't be," said lawyer Eric Young.

Ethics training programs should include messages from the CEO or owner of the business emphasizing ethical business practices, the development and discussion of codes of ethics, and procedures for discussing and reporting unethical behavior. Firms can align ethical and strategic decision making by incorporating ethical considerations into long-term planning, by integrating ethical decision making into the performance appraisal process, by encouraging whistle-blowing or the reporting of unethical practices, and by monitoring departmental and corporate performance regarding ethical issues.

Bribes

Bribery is defined by *Black's Law Dictionary* as the offering, giving, receiving, or soliciting of any item of value to influence the actions of an official or other person in discharge of a public or legal duty. A **bribe** is a gift bestowed to influence a recipient's conduct. The gift may be any money, good, right in action, property, preferment, privilege, emolument, object of value, advantage, or merely a promise or undertaking to induce or influence the action, vote, or influence of a person in an official or public capacity. Bribery is a crime in most countries of the world, including the United States.[7]

The U.S. Foreign Corrupt Practices Act (FCPA) that governs bribery is being enforced more strictly. This act and a new provision in the Dodd-Frank financial-regulation law allows company employees or others who bring cases of financial fraud, such as bribery, to the government's attention to receive up to 30 percent of any sum recovered. Bribery suits against a company also expose the firm to shareholder lawsuits.

In 2012, Pfizer paid $60.2 million to settle a federal investigation into bribery overseas whereby the firm was accused of bribing doctors, hospitals administrators, and regulators in several countries in Europe and Asia to prescribe their medicines. Pfizer allegedly gave doctors in China cellphones and tea sets, while plying Croatian doctors with cash and international trips, and then sought to hide the bribery by recording the payments in accounting records as legitimate expenses.

Avon Products is currently being investigated for bribery charges related to their winning the first direct-sales license awarded by China to a foreign company. Even former Avon CEO Andrea Jung is being interrogated through her attorney Theodore Wells Jr. Avon is also being examined for spending millions of dollars in Brazil and France to consultants hired to assist the company with tax bills in those countries.

A recent (11-15-12) *Wall Street Journal* article titled "Bribery Law Dos and Don'ts" provides a synopsis of the recent 130-page document released by the U.S. Justice Department and the SEC to respond to complaints from companies that ambiguity in the FCPA has forced them to abandon business in high-risk countries and spend millions of dollars investigating themselves.[8] Numerous examples of bribery are given, such as "1) providing a $12,000 birthday trip for a government official from Mexico that incudes visits to wineries and museums" or 2) $10,000 spent on a government official for drinks, dinners, and entertainment."

In mid-2013, the SEC began investigating electronics giant Panasonic for bribery within its subsidiary, Avionics, based in Lake Forest, California. From 2009 to mid-2013, the U.S. Justice Department filed 110 bribery cases and the SEC filed 80 bribery cases.

The United Kingdom's new Bribery Law forbids any company doing any business in the United Kingdom from bribing foreign or domestic officials to gain competitive advantage. The British law is more stringent even than the similar U.S. FCPA. The British Bribery Law carries a maximum 10-year prison sentence for those convicted of bribery. The law stipulates that "failure to prevent bribery" is an offense and stipulates that facilitation payments, or payments to gain access, are not a valid defense to prevent bribery.

Great Britain's Bribery Act applies even to bribes between private businesspersons, and if the individual who makes the payment does not realize the transaction was a bribe, he or she is still liable. The new bribery law is being enforced by Britain's Serious Fraud Office (SFO) and boosts the maximum penalty for bribery to 10 years in prison from 7, and sets no limits on fines. More and more nations are taking a tougher stance against corruption, and companies worldwide are installing elaborate programs to avoid running afoul of the FCPA or the SFO.

Paying bribes is considered both illegal and unethical in the USA, but in some foreign countries, paying bribes and kickbacks is acceptable. Tipping is even considered bribery in some countries. Important antibribery and extortion initiatives are advocated by many organizations, including the World Bank, the International Monetary Fund, the European Union (EU), the Council of Europe, the Organization of American States, the Pacific Basin Economic Council, the Global Coalition for Africa, and the United Nations.

The U.S. Justice Department recently increased its prosecutions of alleged acts of foreign bribery. Businesses have to be much more careful these days. For years, taking business associates to lavish dinners and giving them expensive holiday gifts and even outright cash may have been expected in many countries, such as South Korea and China, but there is now stepped-up enforcement of bribery laws.

The SEC and Justice Department are investigating several pharmaceutical companies, including Merck, AstraZeneca PLC, Bristol-Myers Squibb, and GlaxoSmithKline PLC, for allegedly paying bribes in certain foreign countries to boost sales and speed approvals. Four types of violations are being reviewed: bribing government-employed doctors to purchase drugs; paying company sales agents commissions that are passed along to government doctors; paying hospital committees to approve drug purchases; and paying regulators to win drug approvals. Johnson & Johnson recently paid $70 million to settle allegations that it paid bribes to doctors in Greece, Poland, and Romania to use their surgical implants and to prescribe its drugs. Pfizer paid $60 million to resolve similar probes to win business overseas.

The SEC and the Justice Department are also investigating Hewlett-Packard for allegedly paying Russian government officials bribes to secure a $44.5 million information technology network. Similarly, the engineering giant Siemens AG is being investigated on bribery charges related to a $27 million traffic-control system installed in Moscow, Russia.

The U.S. FCPA prohibits U.S. companies from paying or offering to pay foreign government officials or employees of state companies to gain a business advantage. Under the U.S. Dodd-Frank Act, passed in 2010, employees are encouraged to report possible acts of bribery and whistle-blowers are rewarded between 10 percent and 30 percent of any financial sanctions against companies.

Workplace Romance

Director of the U.S. Central Intelligence Agency (CIA), Gen. David Petraeus abruptly resigned in November 2012, citing workplace romance as the reason. Petraeus wrote in the letter to his staff that he was going to the White House to ask President Obama "for personal reasons" to

resign. "After being married for more than 37 years, I showed extremely poor judgment by engaging in an extramarital affair," Petraeus wrote in his letter. "Such behavior is unacceptable, both as a husband and as a leader of an organization such as ours." Petraeus's wife is Holly Petraeus whom he met when he was a cadet at the U.S. Military Academy at West Point.

Just hours after Petraeus resigned, the CEO of Lockheed Martin Corp., Chris Kubasik, was fired for having a "close personal relationship" with a subordinate. The company said the CEO's "improper conduct" violated the company's code of ethics. Kubasik, who is married, had his relationship revealed by a whistle-blower, at which point Lockheed hired external investigators to examine the allegation. Lockheed manufactures numerous military products, so the firm is perhaps more prudent than most in monitoring relationships because spying is a concern within defense firms.

Workplace romance is an intimate relationship between two truly consenting employees, as opposed to *sexual harassment,* which the Equal Employment Opportunity Commission (EEOC) defines broadly as unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature. Sexual harassment (and discrimination) is illegal, unethical, and detrimental to any organization and can result in expensive lawsuits, lower morale, and reduced productivity.

Workplace romance between two consenting employees simply happens, so the question is generally not whether to allow the practice, and or even how to prevent it, but rather how best to manage the phenomena. An organization probably should not strictly forbid workplace romance because such a policy could be construed as an invasion of privacy, overbearing, or unnecessary. Some romances actually improve work performance, adding a dynamism and energy that translates into enhanced morale, communication, creativity, and productivity.[9]

However, it is important to note that workplace romance can be detrimental to workplace morale and productivity, for a number of reasons that include:

1. Favoritism complaints can arise.
2. Confidentiality of records can be breached.
3. Reduced quality and quantity of work can become a problem.
4. Personal arguments can lead to work arguments.
5. Whispering secrets can lead to tensions and hostilities among coworkers.
6. Sexual harassment (or discrimination) charges may ensue, either by the involved female or a third party.
7. Conflicts of interest can arise, especially when well being of the partner trumps well-being of the company.

In some states, such as California, managers can be held personally liable for damages that arise from workplace romance. Organizations should establish guidelines or policies that address workplace romance, for at least six reasons:

1. Guidelines can enable the firm to better defend itself against and avoid sexual harassment or discrimination charges.
2. Guidelines can specify reasons (such as the seven listed previously) why workplace romance may not be a good idea.
3. Guidelines can specify resultant penalties for romancing partners if problems arise.
4. Guidelines can promote a professional and fair work atmosphere.
5. Guidelines can help assure compliance with federal, state, and local laws and recent court cases.
6. Lack of any guidelines sends a lackadaisical message throughout the firm.

Workplace romance guidelines should apply to all employees at all levels of the firm and should specify certain situations in which affairs are especially discouraged, such as supervisor and subordinate. Company guidelines or policies in general should discourage workplace romance because "the downside risks generally exceed the upside benefits" for the firm. Best Buy CEO Brian Dunn recently resigned when directors learned of his inappropriate relationship with a young subordinate, a violation of that company's code of ethics. Based in Fremont, California, IGate Corp., fired its CEO, Phaneesh Murthy, in May 2013 for allegedly failing to report a workplace romance relationship that turned into a sexual harassment issue with a subordinate.

Flirting is a step down from workplace romance, but a new full-page *Wall Street Journal* article titled "The New Rules of Flirting" reveal the do's and don'ts of flirting.[10] Flirting

is defined by researchers as "romantic behavior that is ambiguous and goal oriented," or said differently, "ambiguous behavior with potential sexual or romantic overtones that is goal-oriented." A few flirting rules given in the article are:

1. Do not flirt with someone you know is looking for a relationship if you are not interested in a new relationship.
2. Do flirt within a relationship that you want to strengthen.
3. Do not flirt to make your partner jealous because this is manipulative behavior.
4. Flirting between power differences, such as boss and employee or professor and student, usually leads to trouble, as many defendants in sexual-harassment complaints know.
5. Do not make physical contact with the person you are flirting with, unless it is within a desired relationship.

Among colleges and universities, the federal Office of Civil Rights (OCR) has stepped up its investigation of sexual harassment cases brought forward by female students against professors. Yale University has been in the news in this regard as well as numerous other institutions currently being investigated. At no charge to the student, the OCR will investigate a female student's claim if evidence is compelling.

A *Wall Street Journal* article recapped U.S. standards regarding boss and subordinate love affairs at work.[11] Only 5 percent of all firms sampled had no restrictions on such relationships; 80 percent of firms have policies that prohibit relationships between a supervisor and a subordinate. Only 4 percent of firms strictly prohibited such relationships, but 39 percent of firms had policies that required individuals to inform their supervisors whenever a romantic relationship begins with a coworker. Only 24 percent of firms required the two persons to be in different departments.

In Europe, romantic relationships at work are largely viewed as private matters and most firms have no policies on the practice. However, European firms are increasingly adopting explicit, U.S.-style sexual harassment laws. The U.S. military strictly bans officers from dating or having sexual relationships with enlistees. At the World Bank, sexual relations between a supervisor and an employee are considered "a de facto conflict of interest which must be resolved to avoid favoritism." World Bank president Paul Wolfowitz recently was forced to resign as a result of a relationship he had with a bank staff person.

A recent *Bloomberg Businessweek* article reports that in the sluggish job market, employees are filing sexual harassment complaints as a way to further their own job security. Many of these filings are increasingly third-party individuals not even directly involved in the relationship but alleging their own job was impacted. Largely the result of the rise of third-party discrimination claims, the EEOC recovers about $500 million on behalf of office romance victims.[12]

Social Responsibility

Fortune annually lists the most admired and least admired companies globally on social responsibility. *Fortune*'s 2012 top three most admired socially responsible companies are GDF Suez, Marquard & Bahls, and RWE. The top three least admired companies are China Railway Group, China Railway Construction, and China State Construction Engineering.[13] Chinese firms dominate the least admired list.

Walmart was socially responsible in the wake of the earthquake and tsunami that devastated Japan in 2011. Following the catastrophe, Walmart quickly mobilized a local relief effort to deliver supplies such as water and flashlights to survivors. Walmart has a history of helping immensely in times of crisis—the retailer was also able to get supplies to people who needed them following Hurricane Katrina.

Some strategists agree with Ralph Nader, who proclaims that organizations have tremendous social obligations. Nader points out, for example, that ExxonMobil has more assets than most countries, and because of this, such firms have an obligation to help society cure its many ills. Other people, however, agree with the economist Milton Friedman, who asserts that organizations have no obligation to do any more for society than is legally required. Friedman may contend that it is irresponsible for a firm to give monies to charity.

Do you agree more with Nader or Friedman? Surely we can all agree that the first social responsibility of any business must be to make enough profit to cover the costs of the future because if this is not achieved, no other social responsibility can be met. Indeed, no social need can be met by the firm if the firm fails.

Strategists should examine social problems in terms of potential costs and benefits to the firm and focus on social issues that could benefit the firm most. For example, should a firm avoid laying off employees so as to protect the employees' livelihood, when that decision may force the firm to liquidate?

Social Policy

The term **social policy** embraces managerial philosophy and thinking at the highest level of the firm, which is why the topic is covered in this textbook. Social policy concerns what responsibilities the firm has to employees, consumers, environmentalists, minorities, communities, shareholders, and other groups. After decades of debate, many firms still struggle to determine appropriate social policies.

The impact of society on business and vice versa is becoming more pronounced each year. Corporate social policy should be designed and articulated during strategy formulation, set and administered during strategy implementation, and reaffirmed or changed during strategy evaluation.[14]

Firms should strive to engage in social activities that have economic benefits. Merck & Co. once developed the drug ivermectin for treating river blindness, a disease caused by a fly-borne parasitic worm endemic in poor tropical areas of Africa, the Middle East, and Latin America. In an unprecedented gesture that reflected its corporate commitment to social responsibility, Merck then made ivermectin available at no cost to medical personnel throughout the world. Merck's action highlights the dilemma of orphan drugs, which offer pharmaceutical companies no economic incentive for profitable development and distribution. Merck did however garner substantial goodwill among its stakeholders for its actions.

Social Policies on Retirement

Some countries around the world are facing severe workforce shortages associated with their aging populations. The percentage of persons age 65 or older exceeds 20 percent in Japan, Italy, and Germany—and will reach 20 percent in 2018 in France. In 2036, the percentage of persons age 65 or older will reach 20 percent in the USA and China. Unlike the USA, Japan is reluctant to rely on large-scale immigration to bolster its workforce. Instead, Japan provides incentives for its elderly to work until ages 65 to 75. Western European countries are doing the opposite, providing incentives for its elderly to retire at ages 55 to 60. The International Labor Organization says 71 percent of Japanese men ages 60 to 64 work, compared to 57 percent of American men and just 17 percent of French men in the same age group.

Sachiko Ichioka, a typical 67-year-old man in Japan, says, "I want to work as long as I'm healthy. The extra money means I can go on trips, and I'm not a burden on my children." Better diet and health care have raised Japan's life expectancy now to 82, the highest in the world. Japanese women are having on average only 1.28 children compared to 2.04 in the USA. Keeping the elderly at work, coupled with reversing the old-fashioned trend of keeping women at home, are Japan's two key remedies for sustaining its workforce in factories and businesses. This prescription for dealing with problems associated with an aging society should be considered by many countries around the world. The Japanese government is phasing in a shift from age 60 to age 65 as the date when a person may begin receiving a pension, and premiums paid by Japanese employees are rising while payouts are falling. Unlike the USA, Japan has no law against discrimination based on age.

Worker productivity increases in Japan are not able to offset declines in number of workers, thus resulting in a decline in overall economic production. Like many countries, Japan does not view immigration as a good way to solve this problem. Japan's shrinking workforce has become such a concern that the government just recently allowed an unspecified number of Indonesian and Filipino nurses and caregivers to work in Japan for two years. The number of working-age

TABLE 3-2 The Best and Worst Companies Globally in Regard to Being Socially Responsible

The Best	The Worst
1. GDF Suez	1. China Railway Group
2. Marquard & Bahls	2. China Railway Construction
3. RWE	3. China State Construction Engineering
4. Altria Group	4. China South Industries Group
5. Starbucks	5. China FAW Group
6. Walt Disney	6. Aviation Industry Corporation of China
7. United Natural Foods	7. Dongfeng Motor
8. Sealed Air	8. MF Global Holdings
9. Chevron	9. China North Industries
10. Whole Foods Market	10. Hon Hai Precision Industry

Sources: Based on http://money.cnn.com/magazines/fortune/most-admired/2012/best_worst/best4.html and http://money.cnn.com/magazines/fortune/most-admired/2012/best_worst/worst4.html.

Japanese—those between ages 15 and 64—is projected to shrink to 70 million by 2030. Using foreign workers is known as *gaikokujin roudousha* in Japanese. Many Filipinos have recently been hired now to work in agriculture and factories throughout Japan.

Fortune's best and worst companies globally in regard to being socially responsible in 2012 are listed in Table 3-2. Note that the 10 worst companies are all based in China.

Environmental Sustainability

In October of every year, three world renowned corporate sustainability rankings are published: (1) the Dow Jones Sustainability Index (DJSI), (2) the Carbon Disclosure Project, and (3) *Newsweek's* "Green" rankings. Regarding the DJSI, some notable companies that were added to the DJSI 2012 Index for being especially sustainable were Microsoft, Target, Hewlett-Packard, and the Canadian National Railway Company. Some notable companies that were kicked out of the 2012 DJSI sustainability rankings were GlaxoSmithKline PLC, Duke Energy, IBM, United Technologies, and Dell.

Launched in 1999, DJSI annually reveals the best corporations in the world in various industries in terms of sustainability. A few of the number-1 (best) companies in the world on sustainability in the DJSI 2012 in their respective industries were: BMW, Unilever NV, Roche Holding AG, Siemens AG, Alcatel-Lucent SA, and Air France-KLM.

The strategies of both companies and countries are increasingly scrutinized and evaluated from a natural environment perspective. Companies such as Walmart now monitor not only the price its vendors offer for products, but also how those products are made in terms of environmental practices, as well as safety and infrastructure soundness particularly of Southeast Asia factories. A growing number of business schools offer separate courses and even a concentration in environmental management.

Businesses must not exploit and decimate the natural environment. Mark Starik at George Washington University says, "Halting and reversing worldwide ecological destruction and deterioration is a strategic issue that needs immediate and substantive attention by all businesses and managers. According to the International Standards Organization (ISO), the word **environment** is defined as "surroundings in which an organization operates, including air, water, land, natural resources, flora, fauna, humans, and their interrelation." This chapter illustrates how many firms are gaining competitive advantage by being good stewards of the natural environment.

Employees, consumers, governments, and society are especially resentful of firms that harm rather than protect the natural environment. Conversely people today are especially appreciative of firms that conduct operations in a way that mends, conserves, and preserves the natural environment. Consumer interest in businesses preserving nature's ecological balance and fostering a clean, healthy environment is high.

No business wants a reputation as being a polluter. A bad sustainability record will hurt the firm in the market, jeopardize its standing in the community, and invite scrutiny by regulators, investors, and environmentalists. Governments increasingly require businesses to behave responsibly and require, for example, that businesses publicly report the pollutants and wastes their facilities produce.

In terms of megawatts of wind power generated by various states in the United States, Iowa's 2,791 recently overtook California's 2,517, but Texas's 7,118 megawatts dwarfs all other states. Minnesota also is making substantial progress in wind power generation. New Jersey recently outfitted 200,000 utility poles with solar panels, which made it the nation's second-largest producer of solar energy behind California. New Jersey is also adding solar panels to corporate rooftops. The state's $514 million solar program doubled its solar capacity to 160 megawatts in 2013. The state's goal is to obtain 3 percent of its electricity from the sun and 12 percent from offshore wind by 2020.

What Is a Sustainability Report?

A sustainability report reveals a firm's operations impact the natural environment. This document discloses to shareholders information about the firm's labor practices, product sourcing, energy efficiency, environmental impact, and business ethics practices.

It is good business for a company to provide a sustainability report annually to the public. With 60,000 suppliers and more than $350 billion in annual sales, Walmart works with its suppliers to make sure they provide such reports. Many firms use the Walmart sustainability report as a benchmark, guideline, and model to follow in preparing their own report.

The Global Reporting Initiative recently issued a set of detailed reporting guidelines specifying what information should go into sustainability reports. The proxy advisory firm Institutional Shareholder Services reports that an increasing number of shareholder groups are pushing firms to provide sustainability information annually. Two companies that released sustainability reports for the first time in 2012 were Hyatt Hotels & Resorts and Las Vegas Sands Corporation. Rival firm Hilton Worldwide does not have a stand-alone sustainability report, but Marriott and Wyndham Worldwide do release annual sustainability reports and of late revealed excellent reductions in energy, water, waste, and carbon dioxide emissions.

Walmart encourages and expects its 1.35 million U.S. employees to adopt what it calls Personal Sustainability Projects, which include such measures as organizing weight-loss or smoking-cessation support groups, biking to work, or starting recycling programs. Employee wellness can be a part of sustainability.

Walmart is installing solar panels on its stores in California and Hawaii, providing as much as 30 percent of the power in some stores. It may go national with solar power if this test works well. Also moving to solar energy is department-store chain Kohl's Corp., which is converting 64 of its 80 California stores to use solar power. There are big subsidies for solar installations in some states.

Home Depot, the world's second largest retailer behind Walmart, recently more than doubled its offering of environmentally friendly products such as all-natural insect repellent. Home Depot has made it much easier for consumers to find its organic products by using special labels similar to Timberland's (the outdoor company) Green Index tags.

Managers and employees of firms must be careful not to become scapegoats blamed for company environmental wrongdoings. Harming the natural environment can be unethical, illegal, and costly. When organizations today face criminal charges for polluting the environment, they increasingly turn on their managers and employees to win leniency. Employee firings and demotions are becoming common in pollution-related legal suits. Managers were fired at Darling International, Inc., and Niagara Mohawk Power Corporation for being indirectly responsible for their firms polluting water. Managers and employees today must be careful not to ignore, conceal, or disregard a pollution problem, or they may find themselves personally liable.

Lack of Standards Changing

A few years ago, firms could get away with placing "green" terminology on their products and labels using such terms as *organic*, *green*, *safe*, *earth-friendly*, *nontoxic*, or *natural* because there were no legal or generally accepted definitions. Today, however, these terms carry much

more specific connotations and expectations. Uniform standards defining environmentally responsible company actions are rapidly being incorporated into the legal landscape. It has become more and more difficult for firms to make "green" claims when their actions are not substantive, comprehensive, or even true. Lack of standards once made consumers cynical about corporate environmental claims, but those claims today are increasingly being challenged in courts. Joel Makower says, "One of the main reasons to truly become a green firm is for your employees. They're the first group that needs assurance than any claims you make hold water."[15]

Around the world, political and corporate leaders now realize that the "business green" topic will not go away and in fact is gaining ground rapidly. Strategically, companies more than ever must demonstrate to their customers and stakeholders that their green efforts are substantive and set the firm apart from competitors. A firm's performance facts and figures must back up their rhetoric and be consistent with sustainability standards.

Managing Environmental Affairs in the Firm

The ecological challenge facing all organizations requires managers to formulate strategies that preserve and conserve natural resources and control pollution. Special natural environment issues include ozone depletion, global warming, depletion of rain forests, destruction of animal habitats, protecting endangered species, developing biodegradable products and packages, waste management, clean air, clean water, erosion, destruction of natural resources, and pollution control. Firms increasingly are developing green product lines that are biodegradable or are made from recycled products. Green products sell well.

Managing as if "health of the planet" matters requires an understanding of how international trade, competitiveness, and global resources are connected. Managing environmental affairs can no longer be simply a technical function performed by specialists in a firm; more emphasis must be placed on developing an environmental perspective among all employees and managers of the firm. Many companies are moving environmental affairs from the staff side of the organization to the line side, thus making the corporate environmental group report directly to the chief operating officer. Firms that manage environmental affairs will enhance relations with consumers, regulators, vendors, and other industry players, substantially improving their prospects of success.

Environmental strategies could include developing or acquiring green businesses, divesting or altering environment-damaging businesses, striving to become a low-cost producer through waste minimization and energy conservation, and pursuing a differentiation strategy through green-product features. In addition, firms could include an environmental representative on their board of directors, conduct regular envrionmental audits, implement bonuses for favorable environmental results, become involved in environmental issues and programs, incorporate environmental values in mission statements, establish environmentally oriented objectives, acquire environmental skills, and provide environmental training programs for company employees and managers.

Preserving the environment should be a permanent part of doing business for the following reasons:

1. Consumer demand for environmentally safe products and packages is high.
2. Public opinion demanding that firms conduct business in ways that preserve the natural environment is strong.
3. Environmental advocacy groups now have more than 20 million Americans as members.
4. Federal and state environmental regulations are changing rapidly and becoming more complex.
5. More lenders are examining the environmental liabilities of businesses seeking loans.
6. Many consumers, suppliers, distributors, and investors shun doing business with environmentally weak firms.
7. Liability suits and fines against firms having environmental problems are on the rise.

More firms are becoming environmentally proactive—doing more than the bare minimum to develop and implement strategies that preserve the environment. The old undesirable alternative of being environmentally reactive—changing practices only when forced to do so by law or

consumer pressure—more often today leads to high cleanup costs, liability suits, reduced market share, reduced customer loyalty, and higher medical costs. In contrast, a proactive policy views environmental pressures as opportunities and includes such actions as developing green products and packages, conserving energy, reducing waste, recycling, and creating a corporate culture that is environmentally sensitive.

ISO 14000/14001 Certification

Based in Geneva, Switzerland, the International Organization for Standardization (ISO) is a network of the national standards institutes of 147 countries, with one member per country. ISO is the world's largest developer of sustainability standards. Widely accepted all over the world, ISO standards are voluntary because ISO has no legal authority to enforce their implementation. ISO itself does not regulate or legislate.

Governmental agencies in various countries, such as the Environmental Protection Agency (EPA) in the USA, have adopted ISO standards as part of their regulatory framework, and the standards are the basis of much legislation. Adoptions are sovereign decisions by the regulatory authorities, governments, or companies concerned.

ISO 14000 refers to a series of voluntary standards in the environmental field. The ISO 14000 family of standards concerns the extent to which a firm minimizes harmful effects on the environment caused by its activities and continually monitors and improves its own environmental performance. Included in the ISO 14000 series are the ISO 14001 standards in fields such as environmental auditing, environmental performance evaluation, environmental labeling, and life-cycle assessment.

ISO 14001 is a set of standards adopted by thousands of firms worldwide to certify to their constituencies that they are conducting business in an environmentally friendly manner. ISO 14001 standards offer a universal technical standard for environmental compliance that more and more firms are requiring not only of themselves but also of their suppliers and distributors.

The ISO 14001 standard requires that a community or organization put in place and implement a series of practices and procedures that, when taken together, result in an **environmental management system (EMS)**. ISO 14001 is not a technical standard and as such does not in any way replace technical requirements embodied in statutes or regulations. It also does not set prescribed standards of performance for organizations. Not being certified with ISO 14001 can be a strategic disadvantage for towns, counties, and companies because people today expect organizations to minimize or, even better, to eliminate environmental harm they cause.[16] The major requirements of an EMS under ISO 14001 include the following:

- Show commitments to prevention of pollution, continual improvement in overall environmental performance, and compliance with all applicable statutory and regulatory requirements.
- Identify all aspects of the organization's activities, products, and services that could have a significant impact on the environment, including those that are not regulated.
- Set performance objectives and targets for the management system that link back to three policies: (1) prevention of pollution, (2) continual improvement, and (3) compliance.
- Meet environmental objectives that include training employees, establishing work instructions and practices, and establishing the actual metrics by which the objectives and targets will be measured.
- Conduct an audit operation of the EMS.
- Take corrective actions when deviations from the EMS occur.

Wildlife

In mid-2012, South Korea announced plans to resume whaling despite a 1986 moratorium on commercial whaling. Many countries are upset at these plans, including Australia where the Prime Minister Julia Gillard said: "We are completely opposed to whaling; there's no excuse for scientific whaling." Only a few countries, such as Norway, Japan, and Russia, favor and engage in commercial whaling.

Fairmont Hotels & Resorts in 2012 instituted a policy removing shark fin soup from its menu, following the lead of Shangri-La Hotels & Resorts. Even the Chinese government has recently stopped serving shark fin soup at most official banquets. Studies reveal that many shark species have been reduced 90 percent in recent decades, largely by overfishing for shark fins. The demand for shark fin soup in Asia is arguably the major cause of the alarming decline of blue sharks off the British coast and much of the Atlantic. Scientists from the United Kingdom and Portugal recently tracked sharks and confirm that sharks are being deliberately targeted by fishermen with long-line fishing that can stretch as long as 100 km. The fins are cut off and the bodies discarded onsite. Blue sharks are the most frequently caught shark species, with drastic population declines. Many shark species are now classified as "near-threatened" on the International Union for Conservation of Nature (IUCN) Red List.[17]

The European Parliament in late 2012 voted with an overwhelming 566–47 margin to force all boats in EU waters and EU-registered boats around the world to land sharks with their fins attached and prove the animal had not been thrown back. Uta Bellion of the Pew Environment Group said: "the parliament's vote is a major milestone in ending the wasteful practice of shark finning." EU fisheries chief Maria Damanaki said the law would "ease control and help us eradicate shark finning," which she called cruel to the animals and a vast waste of resources. Sharks are vulnerable to over-exploitation because they mature late and give birth to small numbers of young at a time. Shark fins are in high demand in Asia for soup and alleged cures. Damanaki said some 75 million sharks a year are killed for the use of their fins only, with the EU being the biggest exporter. As a result, the hammerhead shark is as good as extinct in the Mediterranean Sea. Damanaki has compared shark finning to killing elephants only for their tusks.

Arctic sea ice shrank to a record low of 1.32 million square miles (3.41 million square km) in late 2012 according to the National Oceanic and Atmospheric Agency. However, polar bears' designation as a threatened species is being challenged in a U.S. appeals court. A decision is expected in 2013. Alaska and oil companies have argued that Endangered Species Act protections for polar bears diminish opportunities for Alaska energy development. The state has said in its appeals court filing that bears have survived previous warming periods and most populations have grown or remained stable despite shrinkage of ice. The case is *Safari Club International et al v. Ken Salazar et al and Center for Biological Diversity et al*, No. 11-5219.

According to the Convention on the International Trade in Endangered Species (CITES), more than 25,000 elephants are killed each year for their ivory—even though international trade in ivory has been outlawed since 1989.

A recent *Wall Street Journal* article titled "America Gone Wild" talks about how wildlife populations in the USA have experienced an "astonishing resurgence."[18] A drawback of the resurgence is that the total cost of wildlife damage to U.S. crops, landscaping, and infrastructure now exceeds $28 billion a year, including $1.5 billion from deer-vehicle crashes alone.

Solar Power

The Solar Energy Industries Association reported in late 2012 that the USA is on pace to install as much solar power in 2012 as it did in the prior eleven put together, at least 2,500 megawatts, the equivalent of more than two nuclear-power plants. GTM Research says the U.S. solar-power industry grew 71 percent in 2012 and will grow 20 to 40 percent annually through 2016. To cut greenhouse-gas emissions and fight climate change, states such as California have created subsidies for solar power developers and requirements for utilities to buy solar power. China supplies nearly half of the solar panels used globally but two leading U.S. suppliers of solar panels are Solarcity, which has more than 2,000 employees, and Sunrun Inc. Thousands of companies are looking into install solar panels as part of their sustainability efforts.

Table 3-3 reveals the impact that bad environmental policies have on two of nature's many ecosystems.

TABLE 3-3 Songbirds and Coral Reefs Need Help

Songbirds
Be a good steward of the natural environment to save our songbirds. Bluebirds are one of 76 songbird species in the USA that have dramatically declined in numbers in the last two decades. Not all birds are considered songbirds, and why birds sing is not clear. Some scientists say they sing when calling for mates or warning of danger, but many scientists now contend that birds sing for sheer pleasure. Songbirds include chickadees, orioles, swallows, mockingbirds, warblers, sparrows, vireos, and the wood thrush. "These birds are telling us there's a problem, something's out of balance in our environment," says Jeff Wells, bird conservation director for the National Audubon Society. Songbirds may be telling us that their air or water is too dirty or that we are destroying too much of their habitat. People collect Picasso paintings and save historic buildings. "Songbirds are part of our natural heritage. Why should we be willing to watch songbirds destroyed any more than allowing a great work of art to be destroyed?" asks Wells. Whatever message songbirds are singing to us today about their natural environment, the message is becoming less and less heard nationwide. Listen when you go outside today. Each of us as individuals, companies, states, and countries should do what we reasonably can to help improve the natural environment for songbirds.[19] A recent study concludes that 67 of the 800 bird species in the USA are endangered, and another 184 species are designated of "conservation concern." The birds of Hawaii are in the greatest peril.
Coral Reefs
Be a good steward of the natural environment to save our coral reefs. The ocean covers more than 71 percent of the earth. The destructive effect of commercial fishing on ocean habitats coupled with increasing pollution runoff into the ocean and global warming of the ocean have decimated fisheries, marine life, and coral reefs around the world. The unfortunate consequence of fishing over the last century has been overfishing, with the principal reasons being politics and greed. Trawl fishing with nets destroys coral reefs and has been compared to catching squirrels by cutting down forests because bottom nets scour and destroy vast areas of the ocean. The great proportion of marine life caught in a trawl is "by-catch" juvenile fish and other life that are killed and discarded. Warming of the ocean as a result of carbon dioxide emissions also kills thousands of acres of coral reefs annually. The total area of fully protected marine habitats in the USA is only about 50 square miles, compared to some 93 million acres of national wildlife refuges and national parks on the nation's land. A healthy ocean is vital to the economic and social future of the nation—and, indeed, all countries of the world. Everything we do on land ends up in the ocean, so we all must become better stewards of this last frontier on earth to sustain human survival and the quality of life.[20]

Special Note to Students

No company or individual wants to do business with someone who is unethical or is insensitive to natural environment concerns. It is no longer just cool to be environmentally proactive, it is expected, and in many respects is the law. Firms are being compared to rival firms every day on sustainability and ethics behavior, actually every minute on Facebook, Twitter, Myspace, LinkedIn, and YouTube. Issues presented in this chapter therefore comprise a competitive advantage or disadvantage for all organizations. Thus, you should include in your case analysis recommendations for your firm to exceed stakeholder expectations on ethics, sustainability, and social responsibility. Make comparisons to rival firms to show how your firm can gain or sustain competitive advantage on these issues. Reveal suggestions for the firm to be a good corporate citizen and promote that for competitive advantage. Be mindful that the first responsibility of any business is to stay in business, so use cost/benefit analysis as needed to present your recommendations effectively.

Conclusion

In a final analysis, ethical standards come out of history and heritage. Our predecessors have left us with an ethical foundation to build on. Even the legendary football coach Vince Lombardi knew that some things were worth more than winning, and he required his players to have three kinds of loyalty: to God, to their families, and to the Green Bay Packers, "in that order." Employees, customers, and shareholders have become less and less tolerant of business ethics violations in firms, and more and more appreciative of model ethical firms. Information-sharing across the Internet increasingly reveals such model firms versus irresponsible firms.

Consumers across the country and around the world appreciate firms that do more than is legally required to be socially responsible. But staying in business while adhering to all laws and regulations must be a primary objective of any business. One of the best ways to be socially responsible is for the firm to proactively conserve and preserve the natural environment. For example, to develop a corporate sustainability report annually is not legally required, but such a report, based on concrete actions, goes a long way toward assuring stakeholders that the firm is worthy of their support. Business ethics, social responsibility, and environmental sustainability are interrelated and key strategic issues facing all organizations.

Key Terms and Concepts

bribe (p. 114)
bribery (p. 114)
business ethics (p. 111)
code of business ethics (p. 112)
environment (p. 119)
environmental management system (EMS) (p. 122)
ISO 14000 (p. 122)
ISO 14001 (p. 122)
sexual harrassment (p. 116)
social policy (p. 118)
social responsibility (p. 110)
sustainability (p. 110)
whistle-blowing (p. 113)
workplace romance (p. 116)

Issues for Review and Discussion

3-1. Nestle SA has done really well in 2011–2013. Visit their corporate website and determine if business ethics and sustainability issues may be key reasons for their success.

3-2. If you owned a small business, would you develop a code of business conduct? If yes, what variables would you include? If no, how would you ensure that ethical business standards were being followed by your employees?

3-3. What is the relationship between personal ethics and business ethics? Are they, or should they be the same?

3-4. How can firms best ensure that their code of business ethics is read, understood, believed, remembered, and acted upon?

3-5. Why is it important not to view the concept of "whistleblowing" as "tattle-telling" or "ratting" on another employee?

3-6. List six desired results of "ethics training programs," in terms of recommended business ethics policies or procedures in the firm.

3-7. Discuss bribery. Would actions such as politicians adding earmarks in legislation, or pharmaceutical salespersons giving away drugs to physicians constitute bribery? Identify three business activities that would constitute bribery and three actions that would not.

3-8. How could a strategist's attitude toward social responsibility affect a firm's strategy? On a 1 to 10 scale, ranging from Nader's view to Friedman's view, what is your attitude toward social responsibility?

3-9. How do social policies on retirement differ in various countries around the world?

3-10. Firms should formulate and implement strategies from an environmental perspective. List eight ways firms can do this.

3-11. Discuss the major requirements of an EMS under ISO 14001.

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3-12. Firms should formulate and implement strategies from an environmental perspective. List eight ways firms can do this.

3-13. Discuss the major requirements of an EMS under ISO 14001.

3-14. Mymanagementlab Only—comprehensive writing assignment for this chapter.

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 3A
Sustainability and Nestlé

Purpose

Nestlé is the opening case at the beginning of Chapter 3. Headquartered in Vevey, Switzerland, Nestlé is the largest food company in the world measured by revenues. Nestlé has hundreds of products that include cereals, coffee, dairy products, pet foods, snacks, baby food, and bottled water. Thirty of Nestlé's brands have annual sales of over 1 billion Swiss francs (about $ 1.1 billion), including Nespresso, Nescafé, Kit Kat, Smarties, Nesquick, Stouffers, Vittel, and Maggi. Nestlé has around 450 factories, operates in 86 countries, and employs around 328,000 people.

This exercise can give you practice evaluating a company's sustainability efforts. At the company's website, note the three key sustainability areas the firm engages in are 1) Nutrition, 2) CSV-Water, and 3) Rural Development.

Instructions

Conduct research to evaluate Nestlé's sustainability efforts. Prepare a report for the class giving your assessment of Nestlé's sustainability work versus rival firms.

EXERCISE 3B
How Does My Municipality Compare To Others on Being Pollution-Safe?

Purpose

Sometimes it is difficult to know how safe a particular municipality or county is regarding industrial and agricultural pollutants. A website that provides consumers and businesses excellent information in this regard is http://scorecard.goodguide.com. This type information is often used in assessing where to locate new business operations.

Instructions

Go to http://scorecard.goodguide.com/. Put in your zip code. Print off the information available for your city/county regarding pollutants. Prepare a comparative analysis of your municipality versus state and national norms on pollution issues. Does your locale receive an A, B, C, D, or F?

EXERCISE 3C
Compare adidas AG versus Nike on Social Responsibility

Purpose

This exercise aims to familiarize you with corporate social responsibility programs.

Instructions

Step 1 Go to adidas' Code of Conduct, which is provided within the Corporate Governance section of the corporate website.

Step 2 Go to Nike's corporate website at http://www.nikeinc.com and navigate to the Sustainability section to review Nike's Corporate Responsibility Report.

Step 3 Compare adidas' social responsibility efforts with Nike's. Summarize your findings in a three-page report for your professor.

EXERCISE 3D

How Do You Rate adidas AG's Sustainability Efforts?

Purpose

This exercise aims to familiarize you with corporate sustainability programs.

Instructions

Step 1 Go to http://www.adidas-group.com and click on Sustainability. Review the annual sustainability reports available in this section of the website.

Step 2 On a separate sheet of paper, list six aspects that you like most and six aspects that you like least about adidas' sustainability efforts.

Step 3 Provide a two-page executive summary of your assessment of adidas' sustainability efforts.

EXERCISE 3E

How Do You Rate Nestlé's Sustainability Efforts?

Purpose

This exercise aims to familiarize you with corporate sustainability programs. Review the opening chapter company discussion. Review the material at Nestlé's corporate website. Note that Nestlé recently kept Oxfam's scorecard top slot.

Instructions

Step 1 On a separate sheet of paper, list six aspects that you like most and six aspects that you like least about Nestlé's sustainability efforts.

Step 2 Provide a two-page executive summary of your assessment of Nestlé's sustainability efforts.

EXERCISE 3F

The Ethics of Spying on Competitors

Purpose

This exercise gives you an opportunity to discuss in class ethical and legal issues related to methods being used by many companies to spy on competing firms. Gathering and using information about competitors is an area of strategic management that Japanese firms do more proficiently than American firms.

Instructions

On a separate sheet of paper, write down numbers 1 to 18. For the 18 spying activities that follow, indicate whether or not you believe the activity is ethical or unethical and legal or illegal. Place either an *E* for ethical or *U* for unethical, and either an *L* for legal or an *I* for illegal for each activity. Compare your answers to those of your classmates and discuss any differences.

Step 1 Buying competitors' garbage

Step 2 Dissecting competitors' products

Step 3 Taking competitors' plant tours anonymously
Step 4 Counting tractor-trailer trucks leaving competitors' loading bays
Step 5 Studying aerial photographs of competitors' facilities
Step 6 Analyzing competitors' labor contracts
Step 7 Analyzing competitors' help-wanted ads
Step 8 Quizzing customers and buyers about the sales of competitors' products
Step 9 Infiltrating customers' and competitors' business operations
Step 10 Quizzing suppliers about competitors' level of manufacturing
Step 11 Using customers to buy out phony bids
Step 12 Encouraging key customers to reveal competitive information
Step 13 Quizzing competitors' former employees
Step 14 Interviewing consultants who may have worked with competitors
Step 15 Hiring key managers away from competitors
Step 16 Conducting phony job interviews to get competitors' employees to reveal information
Step 17 Sending engineers to trade meetings to quiz competitors' technical employees
Step 18 Quizzing potential employees who worked for or with competitors

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4

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Types of Strategies

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Define and discuss secondary buyouts and dividend recapitalizations.
2. Identify the benefits and drawbacks of merging with another firm.
3. Discuss the value of establishing long-term objectives.
4. Identify 16 types of business strategies.
5. Identify numerous examples of organizations pursuing different types of strategies.
6. Discuss guidelines when particular strategies are most appropriate to pursue.
7. Discuss Porter's five generic strategies.
8. Describe strategic management in nonprofit, governmental, and small organizations.
9. Discuss the nature and role of joint ventures in strategic planning.
10. Compare and contrast financial with strategic objectives.
11. Discuss the levels of strategies in large versus small firms.
12. Explain the first mover advantages concept.
13. Discuss recent trends in outsourcing and reshoring.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 4A Market Development: Petronas

EXERCISE 4B Alternative Strategies for Petronas

EXERCISE 4C Private-Equity Acquisitions

EXERCISE 4D The strategies of adidas AG: 2013-2015

EXERCISE 4E Lessons in Doing Business Globally

EXERCISE 4F Petronas 2013-2015

EXERCISE 4G What Strategies Are Most Risky?

EXERCISE 4H Exploring Bankruptcy

EXERCISE 4I Examining Strategy Articles

EXERCISE 4J Classifying Some Strategies

Hundreds of companies today, including IBM, Wells Fargo, and General Electric, have embraced strategic planning fully in their quest for higher revenues and profits. Kent Nelson, former chair of UPS, explains why his company has created a new strategic-planning department: "Because we're making bigger bets on investments in technology, we can't afford to spend a whole lot of money in one direction and then find out five years later it was the wrong direction."[1]

This chapter brings strategic management to life with many contemporary examples. Sixteen types of strategies are defined and exemplified, including Michael Porter's generic strategies: cost leadership, differentiation, and focus. Guidelines are presented for determining when each strategy is most appropriate to pursue. An overview of strategic management in nonprofit organizations, governmental agencies, and small firms is provided. As showcased below, Petronas is an example company that for many years has exemplified excellent strategic management.

Long-Term Objectives

Long-term objectives represent the results expected from pursuing certain strategies. Strategies represent the actions to be taken to accomplish long-term objectives. The time frame for objectives and strategies should be consistent, usually from two to five years.

The Nature of Long-Term Objectives

Objectives should be quantitative, measurable, realistic, understandable, challenging, hierarchical, obtainable, and congruent among organizational units. Each objective should also be associated with a timeline. Objectives are commonly stated in terms such as *growth in assets*, *growth in sales*, *profitability*, *market share*, *degree and nature of diversification*, *degree and nature of vertical integration*, *earnings per share*, and *social responsibility*. Clearly established objectives

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Petronas

PETRONAS, short for *Petroliam Nasional Berhad*, is a Malaysian oil and gas company, wholly owned by the Government of Malaysia. Headquartered in Kuala Lumpur, PETRONAS owns the entire oil and gas resources in Malaysia and is responsible for developing and adding value to these resources. In 2013, *Fortune* ranked PETRONAS as the 75th largest company in the world, the 19th most profitable company in the world, and the most profitable company in Asia. PETRONAS has business interests in 35 countries and is engaged in a wide spectrum of petroleum activities, including upstream exploration and production of oil and gas as well as downstream oil refining, marketing, and distribution. Revenue derived from PETRONAS provides roughly 45 percent of the Malaysian government's annual budget. PETRONAS was one of the main sponsors of the BMW Sauber Formula One team before sponsoring the Mercedes Grand Prix team. PETRONAS is the main sponsor for the Malaysian Grand Prix and co-sponsors the Chinese Grand Prix.

Among other strategies, PETRONAS is pursuing backward integration by purchasing its own ships to transport its own oil and gas, especially its liquefied natural gas (LNG). PETRONAS is directly procuring new LNG ships to meet its LNG transportation requirements. The strategy will allow PETRONAS to have direct access to LNG shipping capacity at the lowest possible costs. PETRONAS has engaged MISC Bhd to provide Project Management and Technical Consultancy services for the construction of its new LNG ships; MISC's has extensive experience and expertise in the LNG shipping sector and is familiar with PETRONAS' business needs.

PETRONAS since 1975 has awarded 20,600 Malaysian students scholarships, including a total of 400 deserving students in 2013 to pursue their education under its PETRONAS Education Sponsorship Programme (PESP). Scholarship recipients are chosen during rigorous selection days held across Malaysia, and are offered opportunities to take education at overseas institutions or at the Universiti Teknologi PETRONAS in Perak. The aim of PESP is to develop the skills of a pool of young people who meet PETRONAS' business requirements.

TABLE 4-1 Varying Performance Measures by Organizational Level

Organizational Level	Basis for Annual Bonus or Merit Pay
Corporate	75% based on long-term objectives
	25% based on annual objectives
Division	50% based on long-term objectives
	50% based on annual objectives
Function	25% based on long-term objectives
	75% based on annual objectives

offer many benefits. They provide direction, allow synergy, aid in evaluation, establish priorities, reduce uncertainty, minimize conflicts, stimulate exertion, and aid in both the allocation of resources and the design of jobs. Objectives provide a basis for consistent decision making by managers whose values and attitudes differ. Objectives serve as standards by which individuals, groups, departments, divisions, and entire organizations can be evaluated.

Long-term objectives are needed at the corporate, divisional, and functional levels of an organization. They are an important measure of managerial performance. Many practitioners and academicians attribute a significant part of U.S. industry's competitive decline to the short-term, rather than long-term, strategy orientation of managers in the USA. Arthur D. Little argues that bonuses or merit pay for managers today must be based to a greater extent on long-term objectives and strategies. An example framework for relating objectives to performance evaluation is provided in Table 4-1. A particular organization could tailor these guidelines to meet its own needs, but incentives should be attached to both long-term and annual objectives.

Without long-term objectives, an organization would drift aimlessly toward some unknown end. It is hard to imagine an organization or individual being successful without clear objectives. You probably have worked hard the last few years striving to achieve an objective to graduate with a business degree. Success only rarely occurs by accident; rather, it is the result of hard work directed toward achieving certain objectives. Table 4-2 reveals the desired characteristics of objectives, while Table 4-3 summarizes the benefits of having clear objectives.

Financial versus Strategic Objectives

Two types of objectives are especially common in organizations: financial and strategic objectives. **Financial objectives** include those associated with growth in revenues, growth in earnings, higher dividends, larger profit margins, greater return on investment, higher earnings per share, a rising stock price, improved cash flow, and so on; whereas **strategic objectives** include things such as a larger market share, quicker on-time delivery than rivals, shorter design-to-market times than rivals, lower costs than rivals, higher product quality than rivals, wider geographic coverage than rivals, achieving technological leadership, consistently getting new or improved products to market ahead of rivals, and so on.

Although financial objectives are especially important in firms, oftentimes there is a trade-off between financial and strategic objectives such that crucial decisions have to be made.

TABLE 4-2 The Desired Characteristics of Objectives

1. Quantitative
2. Measurable
3. Realistic
4. Understandable
5. Challenging
6. Hierarchical
7. Obtainable
8. Congruent across departments

TABLE 4-3 The Benefits of Having Clear Objectives

1. Provide direction by revealing expectations
2. Allow synergy
3. Aid in evaluation by serving as standards
4. Establish priorities
5. Reduce uncertainty
6. Minimize conflicts
7. Stimulate exertion
8. Aid in allocation of resources
9. Aid in design of jobs
10. Provide basis for consistent decision making

For example, a firm can do certain things to maximize short-term financial objectives that would harm long-term strategic objectives. To improve financial position in the short run through higher prices may, for example, jeopardize long-term market share. The dangers associated with trading off long-term strategic objectives with near-term bottom-line performance are especially severe if competitors relentlessly pursue increased market share at the expense of short-term profitability. And there are other trade-offs between financial and strategic objectives, related to riskiness of actions, concern for business ethics, need to preserve the natural environment, and social responsibility issues. Both financial and strategic objectives should include both annual and long-term performance targets. Ultimately, the best way to sustain competitive advantage over the long run is to relentlessly pursue strategic objectives that strengthen a firm's business position over rivals. Financial objectives can best be met by focusing first and foremost on achieving strategic objectives that improve a firm's competitiveness and market strength.

Not Managing by Objectives

An unidentified educator once said, "If you think education is expensive, try ignorance." The idea behind this saying also applies to establishing objectives. Strategists should avoid the following alternative ways of "not managing by objectives."

- ***Managing by Extrapolation***—adheres to the principle "If it ain't broke, don't fix it." The idea is to keep on doing the same things in the same ways because things are going well.
- ***Managing by Crisis***—based on the belief that the true measure of a really good strategist is the ability to solve problems. Because there are plenty of crises and problems to go around for every person and every organization, strategists ought to bring their time and creative energy to bear on solving the most pressing problems of the day. Managing by crisis is actually a form of reacting rather than acting and of letting events dictate the what and when of management decisions.
- ***Managing by Subjectives***—built on the idea that there is no general plan for which way to go and what to do; just do the best you can to accomplish what you think should be done. In short, "Do your own thing, the best way you know how" (sometimes referred to as *the mystery approach to decision making* because subordinates are left to figure out what is happening and why).
- ***Managing by Hope***—based on the fact that the future is laden with great uncertainty and that if we try and do not succeed, then we hope our second (or third) attempt will succeed. Decisions are predicated on the hope that they will work and that good times are just around the corner, especially if luck and good fortune are on our side![2]

Types of Strategies

The model illustrated in Figure 4-1 provides a conceptual basis for applying strategic management. Defined and exemplified in Table 4-4, alternative strategies that an enterprise could pursue can be categorized into 11 actions: forward integration, backward integration, horizontal integration, market penetration, market development, product development, related diversification,

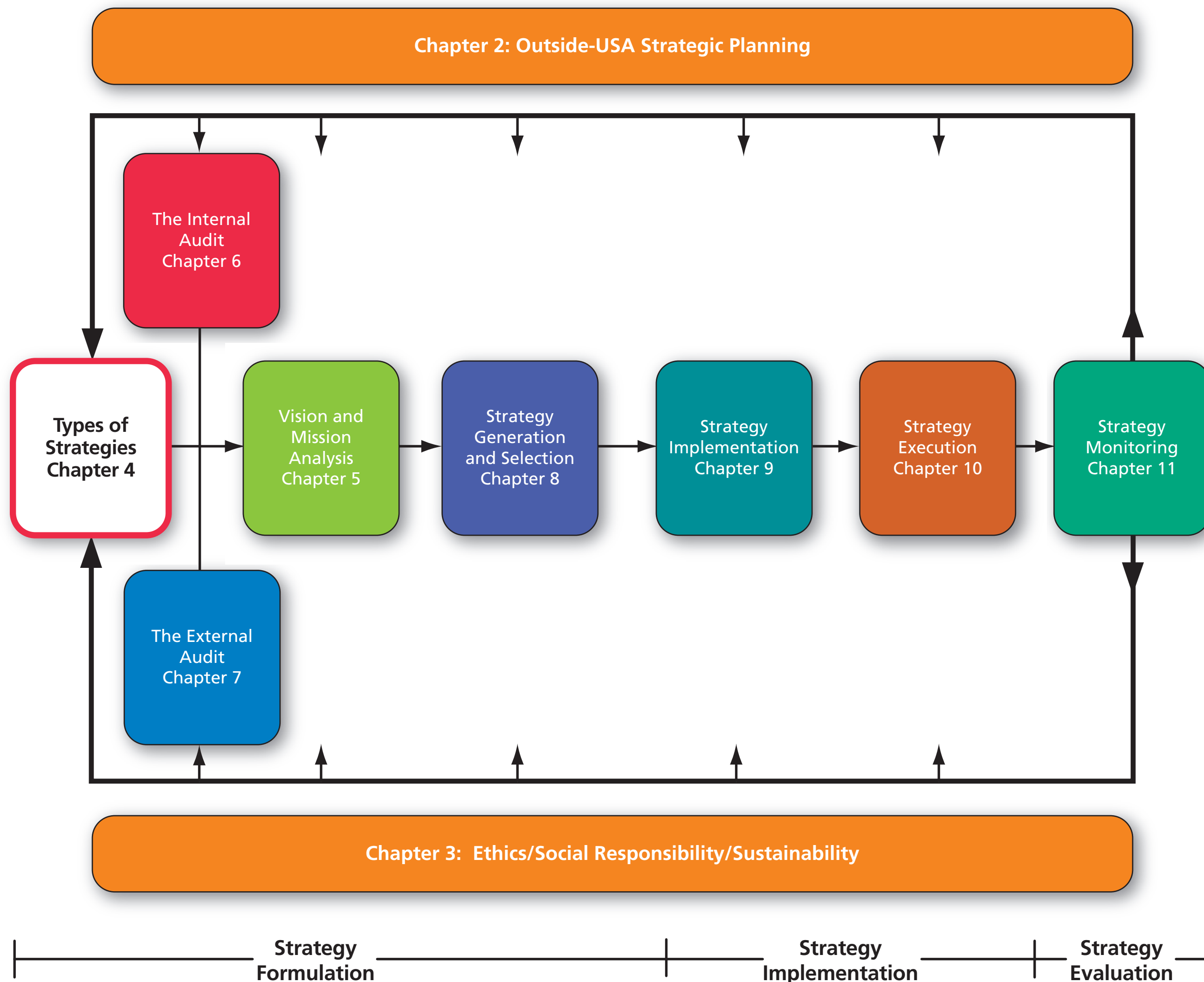

FIGURE 4-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

unrelated diversification, retrenchment, divestiture, and liquidation. Each alternative strategy has countless variations. For example, market penetration can include adding salespersons, increasing advertising expenditures, couponing, and using similar actions to increase market share in a given geographic area.

Many, if not most, organizations simultaneously pursue a combination of two or more strategies, but a **combination strategy** can be exceptionally risky if carried too far. No organization can afford to pursue all the strategies that might benefit the firm. Difficult decisions must be made. Priority must be established. Organizations, like individuals, have limited resources. Both organizations and individuals must choose among alternative strategies and avoid excessive indebtedness.

Hansen and Smith explain that strategic planning involves "choices that risk resources" and "trade-offs that sacrifice opportunity." In other words, if you have a strategy to go north, then you must buy snowshoes and warm jackets (spend resources) and forgo the opportunity of "faster population growth in southern states." You cannot have a strategy to go north and then take a step east, south, or west "just to be on the safe side." Firms spend resources and focus on a finite number of opportunities in pursuing strategies to achieve an uncertain outcome in the future. Strategic planning is much more than a roll of the dice; it is a wager based on predictions

TABLE 4-4 Alternative Strategies Defined and Exemplified

Strategy	Definition	Examples
Forward Integration	Gaining ownership or increased control over distributors or retailers	Forward Integration—PayPal is pushing its service off the Web and into stores via an agreement with Discover card.
Backward Integration	Seeking ownership or increased control of a firm's suppliers	Backward Integration—Fancy Motels Inc. acquiring a furniture manufacturer.
Horizontal Integration	Seeking ownership or increased control over competitors	Horizontal Integration—Britain's GlaxoSmithKline PLC acquired Human Genome Sciences Inc. for $3 billion.
Market Penetration	Seeking increased market share for present products or services in present markets through greater marketing efforts	Market Penetration—PepsiCo is heavily advertising its new Diet Pepsi special-edition silver cans featuring the blue-and-red Pepsi logo in a heart shape.
Market Development	Introducing present products or services into new geographic area	Market Development—China Petrochemical purchased three Canadian oil companies, Daylight Energy, Tanganyika Oil, and Syncrude Canada.
Product Development	Seeking increased sales by improving present products or services or developing new ones	Product Development—General Electric is building new composite material jet engines, whereas rival Pratt & Whitney is developing newly designed jet engines.
Related Diversification	Adding new but related products or services	Related Diversification—The toy retailer, Toys 'R' Us developed a new Wi-Fi tablet computer for children (the Tabeo for $149.99).
Unrelated Diversification	Adding new, unrelated products or services	Unrelated Diversification—Retailer IKEA is opening a chain of motels in Europe.
Retrenchment	Regrouping through cost and asset reduction to reverse declining sales and profit	Retrenchment—Callaway Golf cut 12 percent of its workforce; Deutsche Bank AG cut 1,000 jobs from its investment bank segment.
Divestiture	Selling a division or part of an organization	Divestiture—Dean Foods sold off its WhiteWave-Alpro organic dairy business.
Liquidation	Selling all of a company's assets, in parts, for their tangible worth	Liquidation—Big Sky Farms, one of Canada's biggest hog-producing firms, liquidated.

and hypotheses that are continually tested and refined by knowledge, research, experience, and learning. Survival of the firm itself may hinge on your strategic plan.[3]

Organizations cannot do too many things well because resources and talents get spread thin and competitors gain advantage. In large, diversified companies, a combination strategy is commonly employed when different divisions pursue different strategies. Also, organizations struggling to survive may simultaneously employ a combination of several defensive strategies, such as divestiture, liquidation, and retrenchment.

Levels of Strategies

Strategy making is not just a task for top executives. Middle-and lower-level managers also must be involved in the strategic-planning process to the extent possible. In large firms, there are actually four levels of strategies: corporate, divisional, functional, and operational—as illustrated in Figure 4-2. However, in small firms, there are actually three levels of strategies: company, functional, and operational.

In large firms, the persons primarily responsible for having effective strategies at the various levels include the CEO at the corporate level; the president or executive vice president at the divisional level; the respective chief finance officer (CFO), chief information officer (CIO),

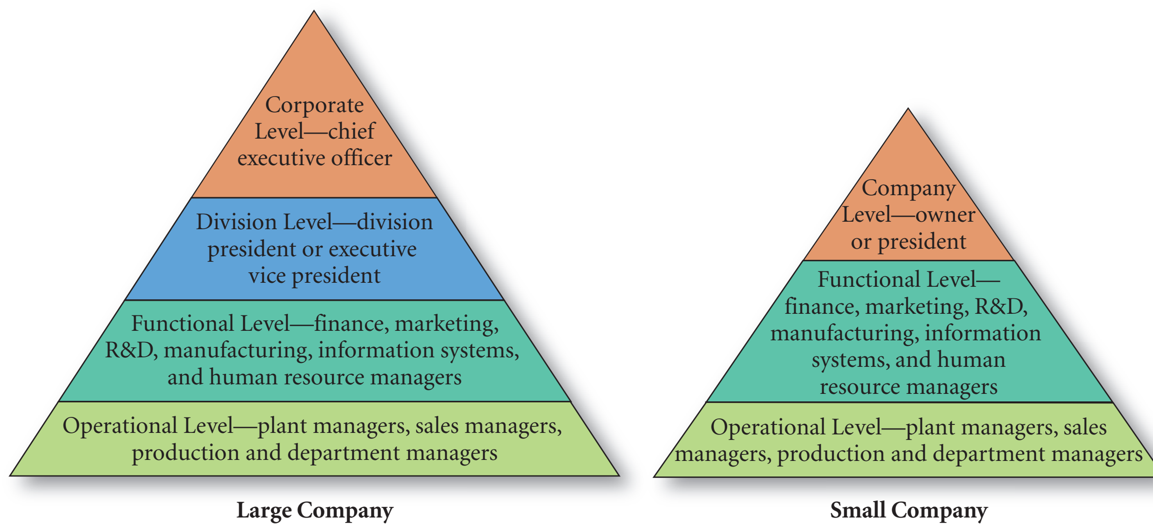

FIGURE 4-2

Levels of Strategies With Persons Most Responsible

human resource manager (HRM), chief marketing officer (CMO), and so on at the functional level; and the plant manager, regional sales manager, and so on at the operational level. In small firms, the persons primarily responsible for having effective strategies at the various levels include the business owner or president at the company level and then the same range of persons at the lower two levels, as with a large firm.

It is important that all managers at all levels participate and understand the firm's strategic plan to help ensure coordination, facilitation, and commitment while avoiding inconsistency, inefficiency, and miscommunication. Plant managers, for example, need to understand and be supportive of the overall strategic plan (game plan), whereas the president and the CEO need to be knowledgeable of strategies being employed in various sales territories and manufacturing plants.

Integration Strategies

The exclusively online men's pants company, Bonobos, now sells menswear wholesale to Nordstrom and in addition is opening its own stores in New York, Palo Alto, Chicago, and other cities. However, shoppers do not walk out of Bonobos stores with anything; the stores are simply for customers to try on the clothing before ordering online.

Forward integration, backward integration, and horizontal integration are sometimes collectively referred to as **vertical integration** strategies. Vertical integration strategies allow a firm to gain control over distributors, suppliers, or competitors.

Forward Integration

Forward integration involves gaining ownership or increased control over distributors or retailers. Increasing numbers of manufacturers (suppliers) today are pursuing a forward integration strategy by establishing websites to directly sell products to consumers. This strategy is causing turmoil in some industries. For example, Amazon is doubling down on forward integration by quietly installing large metal cabinets, called Amazon Lockers, in hundreds of grocery, 7-Eleven, and drugstores that accept the packages for customers for later pickup. This strategy dispels the concern of urban apartment dwellers who fear they will miss an Amazon delivery or have their item stolen. This strategy also combats a growing problem of thieves following UPS and FedEx trucks and stealing packages at doorsteps. Amazon has lockers in the USA and United Kingdom. This strategy entails Amazon emailing customers a code to open the locker holding their merchandise. Curtailing failed deliveries is essential for Amazon because otherwise consumers call

customer service, switch to a competitor, or get a replacement item. Amazon pays a small fee each month to store owners where it has lockers.

To combat Amazon's forward integration, Walmart too is pursuing forward integration by launching its Walmart-to-go service in which the company promises same-day delivery in many cities for orders placed online. With that new service, Walmart ships products from its company's stores rather than a warehouse or distribution center. The new Walmart service costs $10 regardless of size of the order.

Ford Motor in 2014–2015 is opening a nationwide network of exclusive Lincoln dealers in China to promote an image of "luxury with simplicity" to compete with China's heavyweight luxury brands, Volkswagen AG's Audi, BMW AG, and Daimler AG's Mercedes-Benz. Jim Farley, Ford Group VP for Global Marketing Sales and Service says that through extensive interviews and surveys the company knows that: "China is changing. Chinese wants to show off less. They want to consume for themselves, not for other people." Ford is hunting for new dealers in China. The new Lincolns will have large back seats, a must in the Chinese luxury-car market where owners often employ drivers. Ford added 115 new dealers in China in 2012 and will increase its total to 500 by 2015.

Samsung in mid-2013 began adding upfront boutiques in all Best Buy stores. For the first time ever, Samsung is recruiting and training thousands of retail workers to staff their new boutiques. This forward integration strategy is a big move for Samsung, who unlike rivals Apple and Microsoft, currently own no retail stores of their own. Samsung is one of Best Buy's top five vendors (suppliers). Also using forward integration, IKEA, the huge furniture retailer, has recently agreed to begin building hotels, i.e. the Moxy brand, with Marriott. Most Moxy hotels will feature rooms prefabricated offsite and then assembled with IKEA furniture.

An effective means of implementing forward integration is **franchising**. Approximately 2,000 companies in about 50 different industries in the USA use franchising to distribute their products or services. Businesses can expand rapidly by franchising because costs and opportunities are spread among many individuals. Total sales by franchises in the United States are annually about $1 trillion.

The International Franchise Association Educational Foundations reports that there are about 800,000 franchise businesses in the USA. However, a growing trend is for franchisees, who for example may operate 10 franchised restaurants, stores, or whatever, to buy out their part of the business from their franchiser (corporate owner). There is a growing rift between franchisees and franchisers as the segment often outperforms the parent. McDonald's today owns only 67 percent of its restaurants, up from 20 percent a decade ago. Restaurant chains are increasingly being pressured to own fewer of their locations. Companies such as McDonald's are using proceeds from the sale of company stores and restaurants to franchisees to buy back company stock, pay higher dividends, and make other investments to benefit shareholders.

Also, McDonald's franchisees in 2012–2013 are opposing the company's remodeling investments, marketing campaigns, and discounting. Mark Kalinowski, lead restaurant analyst at Janney Capital Markets, recently asked 30 McDonald's franchisees to gauge how they felt about what's going on, and some comments were as follows:

- "We are bankrupting the system in the name of 'rebranding' the system!"
- "Major remodel projects are wiping out our cash flow and our equity."
- "Cash flow is trending up, but not as fast as McDonald's cash flow is."
- "We cannot absorb all these costs, do all this discounting, and still pay to remodel our landlord's (McDonald's) building."

McDonald's ironically gets 67 percent of its sales from company-owned restaurants. However, rival fast-food chain Burger King is converting virtually all of its company-owned outlets to franchised operations, with revenue from franchisees going from 30 percent of sales in 2011 to 90 percent in 2015. This change results in more than a 60 percent drop in Burger King revenues in two years since franchisees show revenues on their own personal income statements, but Burger King's operating profit more than doubled during this time. Burger King already has 45 percent of its stores outside the USA, and the company plans to increase that percentage dramatically. Rival Yum Brands owns virtually all of its outside-U.S. restaurants and says that policy gives greater control and benefits if things go well (or bad). In contrast, Burger King has so much long-term debt it has to rely on franchisees for capital.

The following six guidelines indicate when forward integration may be an especially effective strategy:[4]

- When an organization's present distributors are especially expensive, unreliable, or incapable of meeting the firm's distribution needs.
- When the availability of quality distributors is so limited as to offer a competitive advantage to those firms that integrate forward.
- When an organization competes in an industry that is growing and is expected to continue to grow markedly; this is a factor because forward integration reduces an organization's ability to diversify if its basic industry falters.
- When an organization has both the capital and human resources needed to manage the new business of distributing its own products.
- When the advantages of stable production are particularly high; this is a consideration because an organization can increase the predictability of the demand for its output through forward integration.
- When present distributors or retailers have high profit margins; this situation suggests that a company could profitably distribute its own products and price them more competitively by integrating forward.

Backward Integration

In March 2013, Starbucks purchased its first coffee farm—a 600 acre property in Costa Rica. This backward integration strategy was utilized primarily to develop new coffee varieties and to test methods to combat a fungal disease known as coffee rust that plagues the industry. Both manufacturers and retailers purchase needed materials from suppliers. **Backward integration** is a strategy of seeking ownership or increased control of a firm's suppliers. This strategy can be especially appropriate when a firm's current suppliers are unreliable, too costly, or cannot meet the firm's needs.

Campbell Soup recently acquired one of its primary suppliers, Bolthouse Farms, headquartered in Bakersfield, California, for $1.55 billion in an effort to move more aggressively into fresher foods rather than relying so heavily on canned foods. Canned foods, including Campbell's famous soups, are full of preservatives so they will last a long time on shelves, but for an increasing number of consumers, freshness trumps longevity.

Starbucks in early 2014 will open its first company-owned factory to make soluble products such as its VIA Ready Brew and the coffee base for Frappuccinos and many of the company's ready-to-drink beverages. These products are currently made in Colombia, South America, and in Switzerland by third-party manufacturers. Starbucks says this backward integration strategy will enable the company to save on transportation and ensure better quality. The new Starbucks plant is being built in Augusta, Georgia. In addition, Starbucks recently began producing and selling a single-cup coffee brewing machine that will brew coffee, lattes, and espresso in one machine. Some analysts are concerned that consumers may now make their own Starbucks drink at home for one dollar, rather than going to a Starbucks and buying that drink for four dollars.

Priceline.com Inc., recently acquired Kayak Software for $1.8 billion, representing a 29 percent premium over Kayak's closing stock price. Priceline wanted Kayak because that company makes money by referring customers to online travel agencies such as Priceline and rival Expedia. Kayak operated websites and mobile applications for travelers to compare prices for airline, hotel, and rental-car bookings.

Some industries in the USA, such as the automotive and aluminum industries, are reducing their historical pursuit of backward integration. Instead of owning their suppliers, companies negotiate with several outside suppliers. Ford and Chrysler buy more than half of their component parts from outside suppliers such as TRW, Eaton, General Electric (GE), and Johnson Controls. **De-integration** makes sense in industries that have global sources of supply. Companies today shop around, play one seller against another, and go with the best deal.

Global competition is also spurring firms to reduce their number of suppliers and to demand higher levels of service and quality from those they keep. Although traditionally relying on many suppliers to ensure uninterrupted supplies and low prices, U.S. firms now are following the lead of Japanese firms, which have far fewer suppliers and closer, long-term

relationships with those few. "Keeping track of so many suppliers is onerous," says Mark Shimelonis, formerly of Xerox.

Seven guidelines when backward integration may be an especially effective strategy are:[5]

- When an organization's present suppliers are especially expensive, unreliable, or incapable of meeting the firm's needs for parts, components, assemblies, or raw materials.
- When the number of suppliers is small and the number of competitors is large.
- When an organization competes in an industry that is growing rapidly; this is a factor because integrative-type strategies (forward, backward, and horizontal) reduce an organization's ability to diversify in a declining industry.
- When an organization has both capital and human resources to manage the new business of supplying its own raw materials.
- When the advantages of stable prices are particularly important; this is a factor because an organization can stabilize the cost of its raw materials and the associated price of its product(s) through backward integration.
- When present suppliers have high profit margins, which suggests that the business of supplying products or services in the given industry is a worthwhile venture.
- When an organization needs to quickly acquire a needed resource.

Horizontal Integration

Horizontal integration refers to a strategy of seeking ownership of or increased control over a firm's competitors. One of the most significant trends in strategic management today is the increased use of horizontal integration as a growth strategy. Mergers, acquisitions, and takeovers among competitors allow for increased economies of scale and enhanced transfer of resources and competencies. Kenneth Davidson makes the following observation about horizontal integration:

> The trend towards horizontal integration seems to reflect strategists' misgivings about their ability to operate many unrelated businesses. Mergers between direct competitors are more likely to create efficiencies than mergers between unrelated businesses, both because there is a greater potential for eliminating duplicate facilities and because the management of the acquiring firm is more likely to understand the business of the target.[6]

Pearson PLC's Penguin book publishing business recently merged with Bertelsmann SE's Random House book publishing division to create a new company named Penguin Random House. This horizontal integration strategy for the two parent firms combines Penguin's 10 percent U.S. book market share with Random House's 20 percent market share into the new joint-venture company. Combining forces allows the new firm to gain more heft in negotiating terms with retailers such as Amazon. Combining forces in the publishing industry is also deemed necessary because publishers' revenue coming from e-books is growing rapidly, to about 18 percent now, compared to 6.3 percent in 2010.

Based in Frankfurt, Germany, Bayer AG actively pursues horizontal integration, having just recently acquired vitamins maker Schiff Nutrition for $1.2 billion, as well as AgraQuest, a maker of biological crop protection and Teva Pharmaceutical Industries' U.S. animal health business. Based in Salt Lake City, Utah, Schiff produces Airborne, as well as many vitamin supplements and nutrition bars.

Sherwin-Williams recently acquired Mexico-based coatings maker Consorcio Comex SA for about $2.34 billion. Sherwin-Williams CEO Chris Connor said: "The transaction will significantly increase our presence in markets where our store count is low and it builds upon our strategy to grow our architectural paint business in the Americas."

Two rival Canadian furniture and appliance retailers, Leon's Furniture Ltd. and Brick Ltd, recently merged. Leon's CEO said: "During these economic times where we have seen multiple American corporations make inroads into our country through acquisitions, it is a pleasure to see two successful Canadian retailers reach an agreement that will better serve Canadian consumers."

In the kidney-dialysis market, the second largest manufacturer, Baxter International, recently acquired the third largest manufacturer, Gambro, based in Sweden, for $4 billion. More than two million patients globally receive some form of kidney dialysis, with treatment rates increasing more than 5 percent annually.

These five guidelines indicate when horizontal integration may be an especially effective strategy:[7]

- When an organization can gain monopolistic characteristics in a particular area or region without being challenged by the federal government for "tending substantially" to reduce competition.
- When an organization competes in a growing industry.
- When increased economies of scale provide major competitive advantages.
- When an organization has both the capital and human talent needed to successfully manage an expanded organization.
- When competitors are faltering as a result of a lack of managerial expertise or a need for particular resources that an organization possesses; note that horizontal integration would not be appropriate if competitors are doing poorly because in that case overall industry sales are declining.

Intensive Strategies

Market penetration, market development, and product development are sometimes referred to as **intensive strategies** because they require intensive efforts if a firm's competitive position with existing products is to improve.

Market Penetration

A **market penetration** strategy seeks to increase market share for present products or services in present markets through greater marketing efforts. This strategy is widely used alone and in combination with other strategies. Market penetration includes increasing the number of salespersons, increasing advertising expenditures, offering extensive sales promotion items, or increasing publicity efforts. Chrysler Group LLC recently launched a new marketing campaign for its redesigned Ram pickup truck that features new technology and improved fuel economy. Chrysler desires to make inroads into the market share of the truck sales leader F-150. Chrysler's new ads feature gruff-voiced actor Sam Elliott promoting Ram trucks over the Chevrolet Silverado and the GMC Sierra trucks.

General Motors in 2013 rolled out its global advertising campaign for its Chevrolet brand in hopes of improving the brand's image globally and halting its market-share slide in the United States. The new tagline for the GM campaign is "Find New Roads" that replaces the lackluster "Chevy Runs Deep" slogan. The new ad campaign is designed to support GM introducing 13 new or refreshed Chevrolet vehicles in the United States in 2013 and another 12 in different regions around the world.

In the 2013 Super Bowl, Anheuser-Busch InBev launched a huge new advertising campaign to coincide with its new Black Crown brand of beer. The prior year, the company had used the Super Bowl to launch its Bud Light Platinum brand. The company believes the Super Bowl is the ideal venue to launch something new because viewers of the game surpass 110 million annually. Black Crown is a golden amber lager that is a little bit darker and a little bit more flavorful than tradition Budweiser lager, and Black Crown has a 6 percent alcohol content rather than 5 percent. Anheuser is especially targeting the 21- to 34-year-old-age group with the new ads and brand.

These five guidelines indicate when market penetration may be an especially effective strategy:[8]

- When current markets are not saturated with a particular product or service.
- When the usage rate of present customers could be increased significantly.
- When the market shares of major competitors have been declining while total industry sales have been increasing.
- When the correlation between dollar sales and dollar marketing expenditures historically has been high.
- When increased economies of scale provide major competitive advantages.

Market Development

Market development involves introducing present products or services into new geographic areas. India is a target for numerous firms to expand geographically. For example, Coca-Cola Company and its bottling partners are investing $5 billion in India between 2013 and 2020 because that country has 1.2 billion people who on average only consume 12 eight-ounce bottles of Coke a year compared with 240 in Brazil and 90 bottles globally. PepsiCo is also expanding aggressively into India (the CEO of PepsiCo is Indra Nooyi who was born in India). The Swedish furniture company, IKEA Group, is investing $1.9 billion in India to open 25 new stores between 2013 and 2018. Seattle-based Starbucks Corp. opened its first store in India in late 2012.

PepsiCo is also expanding aggressively into China and just opened its sixth snack plant in that country, in China's landlocked city of Wuhan. CEO Nooyi at Pepsi said: "China will be the largest consumer market in the next decade, and PepsiCo aims to be the largest food-and-beverage company in that market." The snack-food market in China was about $12 billion in 2012, up 44 percent from 2008. PepsiCo's revenue from emerging markets increased from $8 billion in 2008 to over $25 billion in 2013.

China's Dalian Wanda Group Corp. recently acquired all 346 AMC (AMC Entertainment Holdings) multiplex theaters in the USA and Canada. Valued at $2.6 billion, the acquisition was the largest ever between a Chinese company and the U.S. film industry. AMC was the second-largest theater chain in the USA behind Regal Entertainment. Carmike is another competitor in the theater industry.

These six guidelines indicate when market development may be an especially effective strategy:[9]

- When new channels of distribution are available that are reliable, inexpensive, and of good quality.
- When an organization is successful at what it does.
- When new untapped or unsaturated markets exist.
- When an organization has the needed capital and human resources to manage expanded operations.
- When an organization has excess production capacity.
- When an organization's basic industry is rapidly becoming global in scope.

Product Development

Product development is a strategy that seeks increased sales by improving or modifying present products or services. Product development usually entails large research and development expenditures. Walt Disney Company is quickly developing a Disney Baby line of products and services that it expects to become a powerful baby brand for customers ages zero to two. Bob Chapek, president of Disney Consumer Products, recently said: "This gives Disney the opportunity to reach out to moms when magical moments begin; there is no more special occasion than the birth of a baby." The company plans to create Disney Baby sections in its 200-plus Disney Stores in the USA. Disney Baby online will sell everything from $14 Disney Cuddly Bobysuits to $69 Peeking Pooh Premiere Crib Bumpers.

Microsoft Corp. just released Office 365, an Internet-based (or cloud), subscription-based office system, in conjunction with its new Office 2013. Office 365 represents a culture shift for Microsoft, as web-based software such as Google's Chrome, Android, and Doc and mobile devices undermine the strategic importance of PCs and programs install on them.

Ford Motor is set to release its aluminum body F-150 in 2014, which will cut the weight of that truck by 15 percent or 800 pounds and enable 25 percent lower gas mileage and use of a smaller engine. This is a huge strategic bet by Ford because the F-150 truck accounts for up to a third of their $8 billion operating profit globally. The F-250 and F-350 do not fall under the new emission guidelines so are not being redesigned. Aluminum is more expensive than steel and harder to work with, so Ford is betting that this strategy will work, rather than having the vehicle shut down at stoplights to conserve fuel, or investing as GM is doing for its trucks, in designing more efficient engines. GM and Ford rarely take such divergent strategic paths, but in this case they are. Ford is betting on aluminum and GM is not. The F-Series pickup is Ford's top money-maker and has been the top-selling vehicle of any kind in the USA for 30 years.

Merck is testing a new cancer drug that can unleash the body's immune system's power to fight malignancies. The new drug, known as MK-3475, is among a new class of agents called PD-1 inhibitors, than enable the immune system to destroy cancer cells. Also using product development, Burger King is doubling its offerings of coffee, to include ten items, such as flavored iced coffee and vanilla lattes. Burger King is trying to catch up with rival McDonald's whose specialty coffee line, McCafé, is growing rapidly. Burger King also wants to regain the #2 burger chain in the USA in sales, having lost that ranking to Wendy's.

These five guidelines indicate when product development may be an especially effective strategy to pursue:[10]

- When an organization has successful products that are in the maturity stage of the product life cycle; the idea here is to attract satisfied customers to try new (improved) products as a result of their positive experience with the organization's present products or services.
- When an organization competes in an industry that is characterized by rapid technological developments.
- When major competitors offer better-quality products at comparable prices.
- When an organization competes in a high-growth industry.
- When an organization has especially strong research and development capabilities.

Diversification Strategies

For the first time its 129-year history, Cincinnati-based Kroger began adding clothing to its lineup of products. The new Kroger apparel section in its store in Mansfield, Ohio, includes branded shoes, jewelry, outerwear, and undergarments from Levi, Carhartt, Carter, Skechers, Hanes, Maidenform, and other apparel producers. There is only about a 1 percent profit margin in the grocery business, so Kroger is trying to diversify.

There are two general types of **diversification strategies**: **related diversification** and **unrelated diversification**. Businesses are said to be related when their value chains possesses competitively valuable cross-business strategic fits; businesses are said to be unrelated when their value chains are so dissimilar that no competitively valuable cross-business relationships exist.[11] Most companies favor related diversification strategies to capitalize on synergies as follows:

- Transferring competitively valuable expertise, technological know-how, or other capabilities from one business to another.
- Combining the related activities of separate businesses into a single operation to achieve lower costs.
- Exploiting common use of a well-known brand name.
- Cross-business collaboration to create competitively valuable resource strengths and capabilities.[12]

Diversification strategies are becoming less popular because organizations are finding it more difficult to manage diverse business activities. In the 1960s and 1970s, the trend was to diversify to avoid being dependent on any single industry, but the 1980s saw a general reversal of that thinking. Diversification is now on the retreat. Michael Porter, of the Harvard Business School, says, "Management found it couldn't manage the beast." Hence businesses are selling, or closing, less profitable divisions to focus on core businesses. Although many firms are successful operating in a single industry, new technologies, new products, or fast-shifting buyer preferences can decimate a single business.

Diversification must do more than simply spread business risk across different industries, because shareholders could accomplish this by simply purchasing equity in different firms across different industries or by investing in mutual funds. Diversification makes sense only to the extent the strategy adds more to shareholder value than what shareholders could accomplish acting individually. Thus, the chosen industry for diversification must be attractive enough to yield consistently high returns on investment and offer potential across the operating divisions for synergies greater than those entities could achieve alone.

A few companies today, however, pride themselves on being conglomerates, from small firms such as Pentair Inc. and Blount International to huge companies such as Textron, Allied Signal, Emerson Electric, GE, Viacom, and Samsung. Conglomerates prove that focus and diversity are not always mutually exclusive.

Many strategists contend that firms should "stick to the knitting" and not stray too far from the firms' basic areas of competence. However, diversification is still sometimes an appropriate strategy, especially when the company is competing in an unattractive industry. Hamish Maxwell, Philip Morris's former CEO, says, "We want to become a consumer-products company." Diversification makes sense for Philip Morris because cigarette consumption is declining, product liability suits are a risk, and some investors reject tobacco stocks on principle.

Related Diversification

Firms are generally moving away from diversification to focus. For example, ITT recently divided itself into three separate, specialized companies. ITT once owned everything from Sheraton hotels and Hartford Insurance to the maker of Wonder bread and Hostess Twinkies. About the ITT breakup, analyst Barry Knap said, "Companies generally are not very efficient diversifiers; investors usually can do a better job of that by purchasing stock in a variety of companies."

Bucking the trend however is Berkshire Hathaway, a holding company for diverse companies that include Dairy Queen, Burlington Northern Santa Fe Railroad, and Geico Insurance. Also bucking the trend, Amazon.com continues to diversify and is expected in 2013 to enter the smartphone business, to complement its Kindle e-reader and tablet devices. About 675 smartphones were sold in 2012, up 39 percent from 2011, whereas tablet sales increased 75 percent to 113 million. In another related diversification move in 2012, Amazon acquired mapping app maker UpNext. In addition, analysts expect Amazon to soon enter the mobile payments business and compete with offerings from eBay and Square.

Google in late 2012 entered the cable operator business by providing high-speed Internet and TV service in Kansas City, Missouri, and beyond. This new service entails Google supplying Web connections rather than the services that run on them. Google plans to expand this new service to all markets that Verizon has not entered. Google's new service costs $120 a month and provides 100 times faster Internet service than Time Warner. Google provides less money options but the $120 gets users online file storage space and a Nexus 7 computer tablet that they can use as a remote control, as well as DVR storage of 500 hours of shows, including eight shows simultaneously that can be watched on demand, and more.

IBM recently paid a 42 percent premium (42 percent more than the book value) to acquire Kenexa Corp. for about $1.3 billion, to move more deeply into the online business software applications business. Kenexa was a leading supplier of human-resources software and consulting services that help about 9,000 customers recruit, retain, and develop their employees. This acquisition moved IBM into competition with enterprise-software makers such as SAP AG, that recently acquired a company named Success Factors that competes with Kenexa, and with Oracle Corp., that recently bought human-resources software maker Taleo for $1.9 billion.

Starbucks recently made its largest acquisition ever, acquiring Atlanta-based tea retailer Teavana Holdings for a 54 percent premium over Teavana's closing stock price. Teavana customers tend to be to aficionados, so Starbucks plans to bring its tried-and-true strategy to Teavana, with a tea bar offering customized hot and cold tea drinks. Teavana currently sells most of its tea in loose-leaf form for home consumption.

Six guidelines for when related diversification may be an effective strategy are as follows.[13]

- When an organization competes in a no-growth or a slow-growth industry.
- When adding new, but related, products would significantly enhance the sales of current products.
- When new, but related, products could be offered at highly competitive prices.
- When new, but related, products have seasonal sales levels that counterbalance an organization's existing peaks and valleys.
- When an organization's products are currently in the declining stage of the product's life cycle.
- When an organization has a strong management team.

Unrelated Diversification

Based in Memphis, Tennessee, the huge overnight delivery firm FedEx recently entered the computer repair business offering major corporations with overnight computer repair. FedEx's Todd Taylor, manager of the company's TechConnect computer repair division says "What we offer is unparalleled turnaround time." FedEx's new computer repair service is initially focused on the enterprise market, but the company plans to expand the services to small businesses and consumers in the new future.

An unrelated diversification strategy favors capitalizing on a portfolio of businesses that are capable of delivering excellent financial performance in their respective industries, rather than striving to capitalize on value chain strategic fits among the businesses. Firms that employ unrelated diversification continually search across different industries for companies that can be acquired for a deal and yet have potential to provide a high return on investment. Pursuing unrelated diversification entails being on the hunt to acquire companies whose assets are undervalued, companies that are financially distressed, or companies that have high growth prospects but are short on investment capital. An obvious drawback of unrelated diversification is that the parent firm must have an excellent top management team that plans, organizes, motivates, delegates, and controls effectively. It is much more difficult to manage businesses in many industries than in a single industry. However, some firms are successful pursuing unrelated diversification, such as Walt Disney, which owns ABC, and GE, which owns NBC Universal. GE also produces locomotives, airplanes, appliances, and MRI machines and offers consumer finance, media, entertainment, oil, gas, and lighting products and services.

Numerous hotels are entering the beer brewing business to offer their guests a unique experience at "social" and "happy" hours. Specialty (or craft) beer sales are increasing about 15 percent annually. Four Fairmont hotels for example recently created their own microbrews using honey from on-site beehives. The Four Points by Sheraton in Los Angeles has a new director of brewer relations, a new beer advisory board, and customized in-room beer fridges.

Speaking of hotels and unrelated diversification, perhaps the first underwater hotel on the planet is being built in Dubai by Drydocks World in cooperation with BIG InvestConsult AG. The hotel is to be completed in 2015 and will offer 21 underwater rooms, with big windows looking out into the Persian Gulf, and disc-shaped luxury hotel attached above the water line.

Best Buy recently introduced its own tablet computer, the Insignia Flex, for $250. The new product is available only at Best Buy, the new product is 9.7 inches wide, putting it in the same size category as Apple's iPad and Microsoft's Surface. This is Best Buy's first foray into manufacturing its own electronic devices.

Deutsche Bank recently opened the $4 billion, 3,000-room Cosmopolitan casino on the Las Vegas Strip. The huge German bank was originally just funding the project, but when developers defaulted on their loans, Deutsche decided to finish the last two years of work on the project and own and operate the new casino themselves. The Cosmopolitan features a three-story, crystal-strewn bar meant to evoke the inside of a chandelier. Other financial institutions worldwide perhaps should consider unrelated diversification also by taking over some of their gone-bad projects rather than taking huge losses. Many more firms have failed at unrelated diversification than have succeeded as a result of immense management challenges.

Ten guidelines for when unrelated diversification may be an especially effective strategy are:[14]

- When revenues derived from an organization's current products or services would increase significantly by adding the new, unrelated products.
- When an organization competes in a highly competitive or a no-growth industry, as indicated by low industry profit margins and returns.
- When an organization's present channels of distribution can be used to market the new products to current customers.
- When the new products have countercyclical sales patterns compared to an organization's present products.
- When an organization's basic industry is experiencing declining annual sales and profits.
- When an organization has the capital and managerial talent needed to compete successfully in a new industry.
- When an organization has the opportunity to purchase an unrelated business that is an attractive investment opportunity.

- When there exists financial synergy between the acquired and acquiring firm. (Note that a key difference between related and unrelated diversification is that the former should be based on some commonality in markets, products, or technology, whereas the latter is based more on profit considerations.)
- When existing markets for an organization's present products are saturated.
- When antitrust action could be charged against an organization that historically has concentrated on a single industry.

Defensive Strategies

In addition to integrative, intensive, and diversification strategies, organizations also could pursue retrenchment, divestiture, or liquidation.

Retrenchment

Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a *turnaround* or *reorganizational strategy*, retrenchment is designed to fortify an organization's basic distinctive competence. During retrenchment, strategists work with limited resources and face pressure from shareholders, employees, and the media. Retrenchment can entail selling off land and buildings to raise needed cash, pruning product lines, closing marginal businesses, closing obsolete factories, automating processes, reducing the number of employees, and instituting expense control systems.

Cosmetic company Revlon, whose brands include Almay and Mitchum, is closing its manufacturing plant in France and laying off 5 percent of its workforce in 2013 to combat high raw material costs, weakness in Europe, and a slowdown in China. Avon Products Inc. is presently exiting the South Korea and Vietnam markets and laying off 1,500 employees, as new CEO Sheri McCoy tries to stabilize the company, reeling from bribery allegations and falling sales.

In some cases, **bankruptcy** can be an effective type of retrenchment strategy. Bankruptcy can allow a firm to avoid major debt obligations and to void union contracts. There are five major types of bankruptcy: Chapter 7, Chapter 9, Chapter 11, Chapter 12, and Chapter 13.

Chapter 7 bankruptcy is a liquidation procedure used only when a corporation sees no hope of being able to operate successfully or to obtain the necessary creditor agreement. All the organization's assets are sold in parts for their tangible worth. Chapter 7 is also the bankruptcy provision most frequently used by individuals to wipe out many types of unsecured debt. Strauss Auto in 2012 filed Chapter 7 liquidation bankruptcy, after five previous times in its history filing and coming out of Chapter 11 reorganization bankruptcy. This time however, the auto-repair chain is closing its 46 remaining stores and selling its assets for their tangible worth.

Chapter 9 bankruptcy applies to municipalities. Stockton, a river port city of 290,000 in the Central Valley of California, declared Chapter 9 bankruptcy in 2012, to avoid having to close key functions such as their police and fire departments. A judge now, rather than city officials, has control over Stockton's debt-management problems. Stockton has twice in recent years toped *Forbes* magazine's list of "America's most miserable cities." However, the largest municipal (Chapter 9) bankruptcy in U.S. history occurred in 2011 in Birmingham, Alabama (Jefferson County). There were 13 municipal bankruptcies filed in 2011. Detroit, Michigan is eyeing the situation in Stockton to see if it needs to file for bankruptcy.

Chapter 11 bankruptcy allows organizations to reorganize and come back after filing a petition for protection. The Santa Ysabel Resort and Casino located 50 miles north of San Diego filed for Chapter 11 protection in mid-2012 to avoid having to shut down totally. Owned by the local Indian tribe Lipay Nation of Santa Ysabel, the casino owes $9 million to the Yavapai Apache Nation and that tribe needs to collect on their investment. Two military transport airlines declared bankruptcy in 2012, Southern Air and Global Aviation Holdings. Both firms cited the U.S. withdrawal of forces from Afghanistan as the primary reason for their demise.

Based in Mechanicsville, Virginia, the world's largest operator of bowling alleys, AMF Bowling Worldwide, filed for bankruptcy-court protection in late 2012 as the company failed to adapt to customers who shifted from being "blue-collar bowlers in leagues" to middle-class bowlers averse to leagues but who desire attractive amenities and facilities. AMF the last few years was too heavily burdened by debt to financially afford to refurbish its 262 bowling centers

in the USA. Mom-and-pop operators and small bowling chains now operate more than 5,000 bowling alleys in the U.S.

Chapter 12 bankruptcy was created by the Family Farmer Bankruptcy Act of 1986. This law became effective in 1987 and provides special relief to family farmers with debt equal to or less than $1.5 million.

Chapter 13 bankruptcy is a reorganization plan similar to Chapter 11, but it is available only to small businesses owned by individuals with unsecured debts of less than $100,000 and secured debts of less than $350,000. The Chapter 13 debtor is allowed to operate the business while a plan is being developed to provide for the successful operation of the business in the future.

Five guidelines for when retrenchment may be an especially effective strategy to pursue are as follows:[15]

- When an organization has a clearly distinctive competence but has failed consistently to meet its objectives and goals over time.
- When an organization is one of the weaker competitors in a given industry.
- When an organization is plagued by inefficiency, low profitability, poor employee morale, and pressure from stockholders to improve performance.
- When an organization has failed to capitalize on external opportunities, minimize external threats, take advantage of internal strengths, and overcome internal weaknesses over time; that is, when the organization's strategic managers have failed (and possibly will be replaced by more competent individuals).
- When an organization has grown so large so quickly that major internal reorganization is needed.

Divestiture

Selling a division or part of an organization is called **divestiture**. Divestiture often is used to raise capital for further strategic acquisitions or investments. Divestiture can be part of an overall retrenchment strategy to rid an organization of businesses that are unprofitable, that require too much capital, or that do not fit well with the firm's other activities. Divestiture has also become a popular strategy for firms to focus on their core businesses and become less diversified. For example, United Technologies recently sold two divisions of its Hamilton Sundstrand pump and air compressor subsidiary to help pay for the company's $16.5 billion acquisition of Goodrich Corp. Owner of the Atlanta Braves baseball team, Liberty Media Corp., recently divested its Starz television network, but retains its large investments in Sirius XM Radio, Live Nation Entertainment, and Barnes & Noble.

New York Times Company (NYTC) recently sold its About.com how-to-website to a rival company, Answers.com, for $270 million. NYTC divested nearly 20 regional newspapers in the last twelve months and also divested its remaining stake in the Boston Red Sox. In addition, NYTC plans to divest *The Boston Globe*, the twenty third largest newspaper in the USA.

Bank of America just sold its overseas wealth-management operations for $880 million to Swiss private-banking specialist Julius Baer Group AG. Since Brian Moynihan became CEO of Bank of America in 2010, he divested more than $50 billion in what he calls noncore assets, dropping Bank of America below J.P. Morgan Chase as the largest bank in the USA.

Time Warner recently divested its magazine division, soon after News Corp. divested its publishing division. The year 2013 exceeded the prior two years in divestitures as firms used the strategy to increase stock price and overall value.

Six guidelines for when divestiture may be an especially effective strategy to pursue follow:[16]

- When an organization has pursued a retrenchment strategy and failed to accomplish needed improvements.
- When a division needs more resources to be competitive than the company can provide.
- When a division is responsible for an organization's overall poor performance.
- When a division is a misfit with the rest of an organization; this can result from radically different markets, customers, managers, employees, values, or needs.
- When a large amount of cash is needed quickly and cannot be obtained reasonably from other sources.
- When government antitrust action threatens an organization.

Liquidation

Selling all of a company's assets, in parts, for their tangible worth is called **liquidation**. Liquidation is a recognition of defeat and consequently can be an emotionally difficult strategy. However, it may be better to cease operating than to continue losing large sums of money. For example, the New York City–based discount retailer of designer clothing, Daffy's, recently liquidated, closing all its 19 stores and selling all its inventory. A family-run business based in Secaucus, New Jersey and founded in 1961, Daffy's decided it could not compete with T.J. Maxx and Marshalls, which had expanded aggressively into New York City. All 1,300 employees of Daffy's received severance pay of 60 days worth of work.

Delta Airlines recently liquidated its 35-year-old regional carrier Comair and sent termination notices to Comair's 1,700 remaining employees. More than 1,000 Comair employees were in the Cincinnati and northern Kentucky region, some 700 of those in Kentucky. Comair had slashed its fleet, flights and workforce in the last seven years and was down to 290 flights a day. Delta decided however that small regional planes are too expensive to fly because they are not as fuel-efficient and are more costly to maintain as the fleet ages. "We just really couldn't get the cost structure to where we wanted to get it," said Don Bornhorst, senior vice president of Delta Connection and a former Comair president. "It ultimately was a cost issue; it wasn't a quality issue with Comair. They're a good airline, great employees, very innovative . . . we just could not solve the cost issues."

Based in Waltham, Massachusetts, A123 Systems, the electric-car battery manufacturer, filed for bankruptcy recently and then sold all its tangible assets to Johnson Controls. Similarly, solar-panel manufacturer, Solyndra LLC, recently liquidated.

Based in Irving, Texas, Hostess Brands in late 2012 told all 18,000 of its workers that the firm will liquidate in five days unless the union-striking employees returned to work. The union work stoppage basically shut down two-thirds of Hostess' 36 manufacturing plants. Four unions were involved: (1) bakery, (2) confectionary, (3) tobacco workers, and (4) grain millers. The largest union's president, Frank Hurt, said: "I am well aware of the possibility of a liquidation, but our people will only take so much when it comes to cuts to their wages and benefits." The following brands were predicted by the *Wall Street Journal* in May 2013 to disappear in 2014:

J.C. Penney

Barnes & Noble's Nook

Martha Stewart's *Living Magazine*

Living Social (a daily deals website)

Volvo

Olympus cameras

Women's National Basketball Association (WNBA)

Leap Wireless International

Mitsubishi Motors

Road & Track (the automotive magazine)

Thousands of small businesses in Europe and the USA liquidate annually without ever making the news. It is tough to start and successfully operate a small business. In China and Russia, thousands of government-owned businesses liquidate annually as those countries try to privatize and consolidate industries.

These three guidelines indicate when liquidation may be an especially effective strategy to pursue:[17]

- When an organization has pursued both a retrenchment strategy and a divestiture strategy, and neither has been successful.
- When an organization's only alternative is bankruptcy. Liquidation represents an orderly and planned means of obtaining the greatest possible cash for an organization's assets. A company can legally declare bankruptcy first and then liquidate various divisions to raise needed capital.
- When the stockholders of a firm can minimize their losses by selling the organization's assets.

Michael Porter's Five Generic Strategies

Probably the three most widely read books on competitive analysis in the 1980s were Michael Porter's *Competitive Strategy* (1980), *Competitive Advantage* (1985), and *Competitive Advantage of Nations* (1989). According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Porter calls these bases **generic strategies**.

Cost leadership emphasizes producing standardized products at a low per-unit cost for consumers who are price-sensitive. Two alternative types of cost leadership strategies can be defined. Type 1 is a *low-cost* strategy that offers products or services to a wide range of customers at the lowest price available on the market. Type 2 is a *best-value* strategy that offers products or services to a wide range of customers at the best price-value available on the market; the best-value strategy aims to offer customers a range of products or services at the lowest price available compared to a rival's products with similar attributes. Both Type 1 and Type 2 strategies target a large market.

Porter's Type 3 generic strategy is **differentiation**, a strategy aimed at producing products and services considered unique industrywide and directed at consumers who are relatively price-insensitive.

Focus means producing products and services that fulfill the needs of small groups of consumers. Two alternative types of focus strategies are Type 4 and Type 5. Type 4 is a low-cost focus strategy that offers products or services to a small range (niche group) of customers at the lowest price available on the market. Examples of firms that use the Type 4 strategy include Jiffy Lube International and Pizza Hut, as well as local used car dealers and hot dog restaurants. Type 5 is a best-value focus strategy that offers products or services to a small range of customers at the best price-value available on the market. Sometimes called "focused differentiation," the best-value focus strategy aims to offer a niche group of customers products or services that meet their tastes and requirements better than rivals' products do. Both Type 4 and Type 5 focus strategies target a small market. However, the difference is that Type 4 strategies offer products or services to a niche group at the lowest price, whereas Type 5 offers products and services to a niche group at higher prices but loaded with features so the offerings are perceived as the best value. Examples of firms that use the Type 5 strategy include Cannondale (top-of-the-line mountain bikes), Maytag (washing machines), and Lone Star Restaurants (steakhouse), as well as bed-and-breakfast inns and local retail boutiques.

Porter's five strategies imply different organizational arrangements, control procedures, and incentive systems. Larger firms with greater access to resources typically compete on a cost leadership or differentiation basis, whereas smaller firms often compete on a focus basis. Porter's five generic strategies are illustrated in Figure 4-3. Note that a differentiation strategy (Type 3) can be pursued with either a small target market or a large target market. However, it is not effective to pursue a cost leadership strategy in a small market because profits margins are generally too small. Likewise, it is not effective to pursue a focus strategy in a large market because economies of scale would generally favor a low-cost or best-value cost leadership strategy to gain or sustain competitive advantage.

Porter stresses the need for strategists to perform cost-benefit analyses to evaluate "sharing opportunities" among a firm's existing and potential business units. Sharing activities and resources enhances competitive advantage by lowering costs or increasing differentiation. In addition to prompting sharing, Porter stresses the need for firms to effectively "transfer" skills and expertise among autonomous business units to gain competitive advantage. Depending on factors such as type of industry, size of firm, and nature of competition, various strategies could yield advantages in cost leadership, differentiation, and focus.

Cost Leadership Strategies (Type 1 and Type 2)

A primary reason for pursuing forward, backward, and horizontal integration strategies is to gain low-cost or best-value cost leadership benefits. But cost leadership generally must be pursued in conjunction with differentiation. A number of cost elements affect the relative attractiveness of generic strategies, including economies or diseconomies of scale achieved, learning and experience curve effects, the percentage of capacity utilization achieved, and linkages with

Type 1: Cost Leadership—Low Cost
Type 2: Cost Leadership—Best Value
Type 3: Differentiation
Type 4: Focus—Low Cost
Type 5: Focus—Best Value

GENERIC STRATEGIES

SIZE OF MARKET	Cost Leadership	Differentiation	Focus
Large	Type 1 Type 2	Type 3	—
Small	—	Type 3	Type 4 Type 5

FIGURE 4-3

Porter's Five Generic Strategies

Source: Based on Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980), 35–40.

suppliers and distributors. Other cost elements to consider in choosing among alternative strategies include the potential for sharing costs and knowledge within the organization, research and development (R&D) costs associated with new product development or modification of existing products, labor costs, tax rates, energy costs, and shipping costs.

Striving to be the low-cost producer in an industry can be especially effective when the market is composed of many price-sensitive buyers, when there are few ways to achieve product differentiation, when buyers do not care much about differences from brand to brand, or when there are a large number of buyers with significant bargaining power. The basic idea is to underprice competitors and thereby gain market share and sales, entirely driving some competitors out of the market. Companies employing a low-cost (Type 1) or best-value (Type 2) cost leadership strategy must achieve their competitive advantage in ways that are difficult for competitors to copy or match. If rivals find it relatively easy or inexpensive to imitate the leader's cost leadership methods, the leaders' advantage will not last long enough to yield a valuable edge in the marketplace. Recall that for a resource to be valuable, it must be either rare, hard to imitate, or not easily substitutable. To employ a cost leadership strategy successfully, a firm must ensure that its total costs across its overall value chain are lower than competitors' total costs. There are two ways to accomplish this:[18]

1. Perform value chain activities more efficiently than rivals and control the factors that drive the costs of value chain activities. Such activities could include altering the plant layout, mastering newly introduced technologies, using common parts or components in different products, simplifying product design, finding ways to operate close to full capacity year-round, and so on.
2. Revamp the firm's overall value chain to eliminate or bypass some cost-producing activities. Such activities could include securing new suppliers or distributors, selling products online, relocating manufacturing facilities, avoiding the use of union labor, and so on.

When employing a cost leadership strategy, a firm must be careful not to use such aggressive price cuts that their own profits are low or nonexistent. Constantly be mindful of cost-saving technological breakthroughs or any other value chain advancements that could erode or destroy

the firm's competitive advantage. A Type 1 or Type 2 cost leadership strategy can be especially effective under the following conditions:[19]

1. When price competition among rival sellers is especially vigorous.
2. When the products of rival sellers are essentially identical and supplies are readily available from any of several eager sellers.
3. When there are few ways to achieve product differentiation that have value to buyers.
4. When most buyers use the product in the same ways.
5. When buyers incur low costs in switching their purchases from one seller to another.
6. When buyers are large and have significant power to bargain down prices.
7. When industry newcomers use introductory low prices to attract buyers and build a customer base.

A successful cost leadership strategy usually permeates the entire firm, as evidenced by high efficiency, low overhead, limited perks, intolerance of waste, intensive screening of budget requests, wide spans of control, rewards linked to cost containment, and broad employee participation in cost control efforts. Some risks of pursuing cost leadership are that competitors may imitate the strategy, thus driving overall industry profits down; that technological breakthroughs in the industry may make the strategy ineffective; or that buyer interest may swing to other differentiating features besides price. Several example firms that are well known for their low-cost leadership strategies are Walmart, BIC, McDonald's, Black & Decker, Lincoln Electric, and Briggs & Stratton.

Differentiation Strategies (Type 3)

Different strategies offer different degrees of differentiation. Differentiation does not guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible. Durable products protected by barriers to quick copying by competitors are best. Successful differentiation can mean greater product flexibility, greater compatibility, lower costs, improved service, less maintenance, greater convenience, or more features. Product development is an example of a strategy that offers the advantages of differentiation.

A differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product that features the desired attributes. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty because consumers may become strongly attached to the differentiation features. Special features that differentiate one's product can include superior service, spare parts availability, engineering design, product performance, useful life, gas mileage, or ease of use.

A risk of pursuing a differentiation strategy is that the unique product may not be valued highly enough by customers to justify the higher price. When this happens, a cost-leadership strategy easily will defeat a differentiation strategy. Another risk of pursuing a differentiation strategy is that competitors may quickly develop ways to copy the differentiating features. Firms thus must find durable sources of uniqueness that cannot be imitated quickly or cheaply by rival firms.

Common organizational requirements for a successful differentiation strategy include strong coordination among the R&D and marketing functions and substantial amenities to attract scientists and creative people. Firms can pursue a differentiation (Type 3) strategy based on many different competitive aspects. For example, Mountain Dew and root beer have a unique taste; Lowe's, Home Depot, and Walmart offer wide selection and one-stop shopping; Dell Computer and FedEx offer superior service; BMW and Porsche offer engineering design and performance; IBM and Hewlett-Packard offer a wide range of products; and E*Trade and Ameritrade offer Internet convenience. Differentiation opportunities exist or can potentially be developed anywhere along the firm's value chain, including supply chain activities, product R&D activities, production and technological activities, manufacturing activities, human resource management activities, distribution activities, or marketing activities.

The most effective differentiation bases are those that are hard or expensive for rivals to duplicate. Competitors are continually trying to imitate, duplicate, and outperform rivals along any differentiation variable that has yielded competitive advantage. For example, when U.S. Airways cut

its prices, Delta quickly followed suit. When Caterpillar instituted its quick-delivery-of-spare-parts policy, John Deere soon followed suit. To the extent that differentiating attributes are tough for rivals to copy, a differentiation strategy will be especially effective, but the sources of uniqueness must be time-consuming, cost prohibitive, and simply too burdensome for rivals to match. A firm, therefore, must be careful when employing a differentiation (Type 3) strategy. Buyers will not pay the higher differentiation price unless their perceived value exceeds the price they are paying.[20] Based on such matters as attractive packaging, extensive advertising, quality of sales presentations, quality of website, list of customers, professionalism, size of the firm, or profitability of the company, perceived value may be more important to customers than actual value.

A Type 3 differentiation strategy can be especially effective under the following conditions:[21]

1. When there are many ways to differentiate the product or service and many buyers perceive these differences as having value.
2. When buyer needs and uses are diverse.
3. When few rival firms are following a similar differentiation approach.
4. When technological change is fast paced and competition revolves around rapidly evolving product features.

Focus Strategies (Type 4 and Type 5)

A successful focus strategy depends on an industry segment that is of sufficient size, has good growth potential, and is not crucial to the success of other major competitors. Strategies such as market penetration and market development offer substantial focusing advantages. Midsize and large firms can effectively pursue focus-based strategies only in conjunction with differentiation or cost leadership–based strategies. All firms in essence follow a differentiated strategy. Because only one firm can differentiate itself with the lowest cost, the remaining firms in the industry must find other ways to differentiate their products.

Focus strategies are most effective when consumers have distinctive preferences or requirements and when rival firms are not attempting to specialize in the same target segment. For example, Clorox Company, which obtains 80 percent of its revenue from the United States, is focusing on brands viewed as environmentally friendly. To refocus, Clorox just sold its auto-care business and acquired personal care company, Burt's Bees, and expanded its Green Works line of household cleaners and Brita water filters. Clorox's CEO Don Knauss loves the United States and is avoiding a costly push into China, Brazil, or India. Knauss's focus is on natural cleaning products, including bleaches and peroxide-based disinfectants for both consumers and hospitals.

Marriott continues to focus on is hotel business by announcing plans to double its hotels in Asia to 260 by 2016, especially growing its China-based hotels to about 125 from 60 and covering nearly 75 percent of Chinese provinces. Reasoning for Marriott's strategy is than Chinese tourists are traveling at home and abroad in dramatically increased numbers, up 21 percent on average year-over-year.

Risks of pursuing a focus strategy include the possibility that numerous competitors will recognize the successful focus strategy and copy it or that consumer preferences will drift toward the product attributes desired by the market as a whole. An organization using a focus strategy may concentrate on a particular group of customers, geographic markets, or on particular product-line segments to serve a well-defined but narrow market better than competitors who serve a broader market.

A low-cost (Type 4) or best-value (Type 5) focus strategy can be especially attractive under the following conditions:[22]

1. When the target market niche is large, profitable, and growing.
2. When industry leaders do not consider the niche to be crucial to their own success.
3. When industry leaders consider it too costly or difficult to meet the specialized needs of the target market niche while taking care of their mainstream customers.
4. When the industry has many different niches and segments, thereby allowing a focuser to pick a competitively attractive niche suited to its own resources.
5. When few, if any, other rivals are attempting to specialize in the same target segment.

Strategies for Competing in Turbulent, High-Velocity Markets

The world is changing more and more rapidly, and consequently industries and firms themselves are changing faster than ever. Some industries are changing so fast that researchers call them **turbulent, high-velocity markets**, such as telecommunications, medical, biotechnology, pharmaceuticals, computer hardware, software, and virtually all Internet-based industries. High-velocity change is clearly becoming more and more the rule rather than the exception, even in such industries as toys, phones, banking, defense, publishing, and communication.

Meeting the challenge of high-velocity change presents the firm with a choice of whether to react, anticipate, or lead the market in terms of its own strategies. To primarily react to changes in the industry would be a defensive strategy used to counter, for example, unexpected shifts in buyer tastes and technological breakthroughs. The react-to-change strategy would not be as effective as the anticipate-change strategy, which would entail devising and following through with plans for dealing with the expected changes. However, firms ideally strive to be in a position to lead the changes in high-velocity markets, whereby they pioneer new and better technologies and products and set industry standards. Being the leader or pioneer of change in a high-velocity market is an aggressive, offensive strategy that includes rushing next-generation products to market ahead of rivals and being continually proactive in shaping the market to one's own benefit. Although a lead-change strategy is best whenever the firm has the resources to pursue this approach, on occasion even the strongest firms in turbulent industries have to employ the react-to-the-market strategy and the anticipate-the-market strategy.

An example turbulent, high-velocity market is the U.S. defense industry, especially with dramatic cuts looming and a shift to higher technology and space defense systems. Based in Hartford, Connecticut, United Technologies, which produces Blackhawk helicopters and a diverse array of other products such as Carrier air conditioners and Otis elevators, recently reduced is sales forecasts. One strategy to compete in a high turbulent industry is to diversify into less turbulent industries. United Technologies continues to diversify, recently acquiring Goodrich Corp. for $16.5 billion, as well as Rolls Royce Holdings PLC's stake in the company's engine joint venture.

Means for Achieving Strategies

Cooperation Among Competitors

In a recent *Wall Street Journal* article titled "Facebook, Yahoo Kiss and Make-Up," these two rival firms, locked for years in bitter patent litigation, revealed what they called a new strategic alliance, which included a patent cross-license, a new advertising partnership, expanded joint distribution, and joint media event coverage.[23]

Strategies that stress cooperation among competitors are being used more. For collaboration between competitors to succeed, both firms must contribute something distinctive, such as technology, distribution, basic research, or manufacturing capacity. But a major risk is that unintended transfers of important skills or technology may occur at organizational levels below where the deal was signed.[24] Information not covered in the formal agreement often gets traded in the day-to-day interactions and dealings of engineers, marketers, and product developers. Firms often give away too much information to rival firms when operating under cooperative agreements! Tighter formal agreements are needed.

Perhaps the best example of rival firms in an industry forming alliances to compete against each other is the airline industry. Today there are three major alliances: Star, SkyTeam, and Oneworld, but other alliances are forming, such as the trans-Atlantic joint venture among American Air, British Air, and Iberia Air formed by Oneworld. There is also a trans-Pacific joint venture among American, Japan Air, United Continental, and All Nippon Air.

The idea of joining forces with a competitor is not easily accepted by Americans, who often view cooperation and partnerships with skepticism and suspicion. Indeed, joint ventures and cooperative arrangements among competitors demand a certain amount of trust if companies are to combat paranoia about whether one firm will injure the other. However, multinational firms are becoming more globally cooperative, and increasing numbers of domestic firms are joining forces with competitive foreign firms to reap mutual benefits. Kathryn Harrigan at Columbia University says, "Within a decade, most companies will be members of teams that compete

against each other." Once major rivals, Google's YouTube and Vivendi SA's Universal Music Group have formed a partnership called Vevo to provide a new music-video service. Google provides the technology and Universal Music provides the content, and both firms share the revenues. The two firms now operate the stand-alone site Vevo.com.

U.S. companies often enter alliances primarily to avoid investments, being more interested in reducing the costs and risks of entering new businesses or markets than in acquiring new skills. In contrast, *learning from the partner* is a major reason why Asian and European firms enter into cooperative agreements. U.S. firms, too, should place learning high on the list of reasons to be cooperative with competitors. U.S. companies often form alliances with Asian firms to gain an understanding of their manufacturing excellence, but Asian competence in this area is not easily transferable. Manufacturing excellence is a complex system that includes employee training and involvement, integration with suppliers, statistical process controls, value engineering, and design. In contrast, U.S. know-how in technology and related areas can be imitated more easily. U.S. firms thus need to be careful not to give away more intelligence than they receive in cooperative agreements with rival Asian firms.

Joint Venture and Partnering

Renault SA and British racing-car company Caterham Cars recently developed a joint venture to design, develop, and manufacture a family of sports cars that will be available in 2015. The partnership, named Societe des Automobiles Alpine Caterham, gives the British Formula One race-car maker access to Renault's manufacturing clout.

Joint venture is a popular strategy that occurs when two or more companies form a temporary partnership or consortium for the purpose of capitalizing on some opportunity. Often, the two or more sponsoring firms form a separate organization and have shared equity ownership in the new entity. Other types of **cooperative arrangements** include research and development partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia.

Joint ventures and cooperative arrangements are being used increasingly because they allow companies to improve communications and networking, to globalize operations, and to minimize risk. Joint ventures and partnerships are often used to pursue an opportunity that is too complex, uneconomical, or risky for a single firm to pursue alone. Such business creations also are used when achieving and sustaining competitive advantage when an industry requires a broader range of competencies and know-how than any one firm can marshal. Kathryn Rudie Harrigan, summarizes the trend toward increased joint venturing:

> In today's global business environment of scarce resources, rapid rates of technological change, and rising capital requirements, the important question is no longer "Shall we form a joint venture?" Now the question is "Which joint ventures and cooperative arrangements are most appropriate for our needs and expectations?" followed by "How do we manage these ventures most effectively?"[25]

In a global market tied together by the Internet, joint ventures, partnerships, and alliances are proving to be a more effective way to enhance corporate growth than mergers and acquisitions.[26] Strategic partnering takes many forms, including outsourcing, information sharing, joint marketing, and joint research and development. Many companies, such as Eli Lilly, now host partnership training classes for their managers and partners. There are today more than 10,000 joint ventures formed annually, more than all mergers and acquisitions. There are countless examples of successful strategic alliances, such as Internet coverage.

A major reason why firms are using partnering as a means to achieve strategies is globalization. Walmart's successful joint venture with Mexico's Cifra is indicative of how a domestic firm can benefit immensely by partnering with a foreign company to gain substantial presence in that new country. Technology also is a major reason behind the need to form strategic alliances, with the Internet linking widely dispersed partners. The Internet paved the way and legitimized the need for alliances to serve as the primary means for corporate growth. Neiman Marcus and Target recently announced a partnership whereby both firms will offer a limited collection of 50 items from stationery to sporting goods at the same price with all the items carrying both the Target bulls-eye logo and the Neiman Marcus logo. This unusual partnership between a

high-end and low-end retailer benefits Neiman by expanding its reach and notoriety, while benefiting Target by raising its overall perceived quality.

Evidence is mounting that firms should use partnering as a means for achieving strategies. However, the sad fact is that most U.S. firms in many industries—such as financial services, forest products, metals, and retailing—still operate in a merger or acquire mode to obtain growth. Partnering is not yet taught at most business schools and is often viewed within companies as a financial issue rather than a strategic issue. However, partnering has become a core competency, a strategic issue of such importance that top management involvement initially and throughout the life of an alliance is vital.[27]

Joint ventures among once rival firms are commonly being used to pursue strategies ranging from retrenchment to market development. Although ventures and partnerships are preferred over mergers as a means for achieving strategies, certainly they are not all successful. The good news is that joint ventures and partnerships are less risky for companies than mergers, but the bad news is that many alliances fail. There are countless examples of failed joint ventures. A few common problems that cause joint ventures to fail are as follows:

1. Managers who must collaborate daily in operating the venture are not involved in forming or shaping the venture.
2. The venture may benefit the partnering companies but may not benefit customers, who then complain about poorer service or criticize the companies in other ways.
3. The venture may not be supported equally by both partners. If supported unequally, problems arise.
4. The venture may begin to compete more with one of the partners than the other.[28]

Six guidelines for when a joint venture may be an especially effective means for pursuing strategies are:[29]

- When a privately-owned organization is forming a joint venture with a publicly-owned organization; there are some advantages to being privately held, such as closed ownership; there are some advantages of being publicly held, such as access to stock issuances as a source of capital. Sometimes, the unique advantages of being privately and publicly held can be synergistically combined in a joint venture.
- When a domestic organization is forming a joint venture with a foreign company; a joint venture can provide a domestic company with the opportunity for obtaining local management in a foreign country, thereby reducing risks such as expropriation and harassment by host country officials.
- When the distinct competencies of two or more firms complement each other especially well.
- When some project is potentially profitable but requires overwhelming resources and risks.
- When two or more smaller firms have trouble competing with a large firm.
- When there exists a need to quickly introduce a new technology.

Merger/Acquisition

As of December 2012, there were 10,346 merger-and-acquisition deals in the USA for the year, a 9 percent increase over the prior year, but an 8 percent decline in terms of the dollar volume. Late in 2012, ConAgra bought Ralcorp for $5 billion and Equity Residential (and AvalonBay) bought Archstone for $6.5 billion.

Merger and acquisition are two commonly used ways to pursue strategies. A **merger** occurs when two organizations of about equal size unite to form one enterprise. An **acquisition** occurs when a large organization purchases (acquires) a smaller firm, or vice versa. When a merger or acquisition is not desired by both parties, it can be called a **takeover** or **hostile takeover**. In contrast, if the acquisition is desired by both firms, it is termed a **friendly merger**. Most mergers are friendly. For example, two Japanese steel producers, Nippon Steel Corp. and Sumitomo Metal Industries Ltd., recently merged in friendly fashion to form the world's second largest steel producer behind ArcelorMittal.

Despite many investment bankers predicting the demise of hostile takeovers because it is difficult to pull off, the number of hostile takeovers are on the rise. For example, Glaxo recently gave Human Genome a deadline to accept their offer or face a hostile takeover. Genomma recently

TABLE 4-5 Key Reasons Why Many Mergers and Acquisitions Fail

- Integration difficulties
- Inadequate evaluation of target
- Large or extraordinary debt
- Inability to achieve synergy
- Too much diversification
- Managers overly focused on acquisitions
- Too large an acquisition
- Difficult to integrate different organizational cultures
- Reduced employee morale due to layoffs and relocations

made an unsolicited offer to acquire Prestige at $16.60 a share and nominated a full slate of directors for election at Prestige's annual shareholder meeting. Prestige's board is not staggered, so Genomma has the chance to push out a majority of Prestige's board, clearing the way for a takeover. Other recent hostile takeovers or attempts include Martin Marietta trying to takeover Vulcan Materials and Westlake Chemical trying to take over Georgia Gulf and Roche's bid for Illumina.

In a rare example of a Chinese company engaging in a hostile takeover, Shanghai-based Cathy Fortune recently bypassed the board of cooper miner Discovery Metals Ltd. with an offer of 830 million Australian dollars. This was a 51 percent premium over the value of Sydney-based Discovery Metals' common stock. China consumes about 40 percent of the world's copper output but historically avoids hostile takeovers altogether.

White knight is a term that refers to a firm that agrees to acquire another firm when that other firm is facing a hostile takeover by some company. For example, Palo Alto, California–based CV Thereapeutics Inc., a heart-drug maker, was fighting a hostile takeover bid by Japan's Astellas Pharma. Then CVT struck a friendly deal to be acquired by Forest City, California–based Gilead Sciences at a higher price of $1.4 billion in cash. Gilead is known for its HIV drugs, so its move into the heart-drug business surprised many analysts.

Not all mergers are effective and successful. For example, even 12 months after PulteGroup bought rival Centex Corp., for $1.3 billion in stock, creating the largest home builder in the USA, PulteGroup's profits were still negative and the company's stock price was 30 percent lower than the week of the acquisition. PulteGroup's dismal performance is in sharp contrast to rival firms such as Toll Brothers and Lennar Corp., whose stock price is up 22 percent during the same period. So a merger between two firms can yield great benefits, but the price and reasoning must be right. Some key reasons why many mergers and acquisitions fail are provided in Table 4-5.

Among mergers, acquisitions, and takeovers in recent years, same-industry combinations have predominated. A general market consolidation is occurring in many industries, especially banking, insurance, defense, and health care, but also in pharmaceuticals, food, airlines, accounting, publishing, computers, retailing, financial services, and biotechnology. For example, there are many potential benefits of merging with or acquiring another firm, as indicated in Table 4-6.

The volume of mergers completed annually worldwide is growing dramatically and exceeds $1 trillion. There are annually more than 10,000 mergers in the USA that total more

TABLE 4-6 Potential Benefits of Merging With or Acquiring Another Firm

- To provide improved capacity utilization
- To make better use of the existing sales force
- To reduce managerial staff
- To gain economies of scale
- To smooth out seasonal trends in sales
- To gain access to new suppliers, distributors, customers, products, and creditors
- To gain new technology
- To reduce tax obligations

than $700 billion. The proliferation of mergers is fueled by companies' drive for market share, efficiency, and pricing power, as well as by globalization, the need for greater economies of scale, reduced regulation and antitrust concerns, the Internet, and e-commerce.

A **leveraged buyout (LBO)** occurs when a corporation's shareholders are bought (hence *buyout*) by the company's management and other private investors using borrowed funds (hence *leverage*). Besides trying to avoid a hostile takeover, other reasons for initiating an LBO are senior management decisions that particular divisions do not fit into an overall corporate strategy, must be sold to raise cash, or receipt of an attractive offering price. An LBO takes a corporation private.

Private-Equity Acquisitions

As stock prices increased and companies became cash-rich in 2012–2013, private-equity (PE) firms such as Kohlberg Kravis Roberts (KKR) jumped aggressively back into the business of acquiring and selling firms. PE firms have unleashed a wave of new initial public offerings (IPO). Apollo Global Management is a large private-equity firm that owns many companies.

The intent of virtually all PE acquisitions is to buy firms at a low price and sell them later at a high price, arguably just good business. Par Pharmaceutical was recently acquired by PE firm TPG for $184 million in cash. Based in Woodcliff Lake, New Jersey, Par's shareholders received $50 in cash for each share, a premium of about 37 percent over the firm's closing stock price.

PE firms increasingly are buying companies from other PE firms, such as Clayton, Dubilier & Rice recently buying David's Bridal from Leonard Green & Partners LP for $1.05 billion. Such PE to PE acquisitions, called **secondary buyouts**, totaled $30 billion in 2012 in the USA compared to $10.5 billion in 2011.

PE firms especially, but other firms also, in 2012 extensively borrowed money, more than $70 billion, at record low interest rates, simply to fund dividend payouts to themselves, a controversial practice known as **dividend recapitalizations**. The previous annual record for dividend recapitalizations, according to S&P's Capital IQ LCD data service, was $40.5 billion in 2010. Critics say dividend recapitalization saddles a company with debt, burdening its operations. One reason for the high 2012 number was the expectation that taxes on dividends would increase in 2013, so the thinking was pay me now.

For all of 2012, the value of private-equity deals by country of investment is given below (in millions $) for the top seven:

1. USA (99.3)
2. UK (23.9)
3. Germany (9.8)
4. China (9.7)
5. Australia (5.2)
6. Canada (4.1)
7. France (4.1)

First Mover Advantages

First mover advantages refer to the benefits a firm may achieve by entering a new market or developing a new product or service prior to rival firms. As indicated in Table 4-7, some advantages of being a first mover include securing access to rare resources, gaining new knowledge of key factors and issues, and carving out market share and a position that is easy to defend and costly for rival firms to overtake. First mover advantages are analogous to taking the high ground first, which puts one in an excellent strategic position to launch aggressive campaigns and to defend territory. Being the first mover can be an excellent strategy when such actions (a) build a firm's image and reputation with buyers, (b) produce cost advantages over rivals in terms of new technologies, new components, new distribution channels, and so on, (c) create strongly loyal customers, and (d) make imitation or duplication by a rival hard or unlikely.

To sustain the competitive advantage gained by being the first mover, a firm needs to be a fast learner. There are, however, risks associated with being the first mover, such as unexpected and unanticipated problems and costs that occur from being the first firm doing business in the new market. Therefore, being a slow mover (also called *fast follower* or *late mover*) can be effective when a firm can easily copy or imitate the lead firm's products or services. If technology is advancing rapidly, slow movers can often leapfrog a first mover's products with improved

TABLE 4-7 Benefits of a Firm Being the First Mover

1. Secure access and commitments to rare resources
2. Gain new knowledge of critical success factors and issues
3. Gain market share and position in the best locations
4. Establish and secure long-term relationships with customers, suppliers, distributors, and investors
5. Gain customer loyalty and commitments

second-generation products. Samsung is an example in the smartphone business. Apple has always been a good example of a first mover firm, although of late Apple is stumbling a bit as Samsung gains momentum.

First mover advantages tend to be greatest when competitors are roughly the same size and possess similar resources. If competitors are not similar in size, then larger competitors can wait while others make initial investments and mistakes and then respond with greater effectiveness and resources. Lenovo has done this of late, as has Volkswagen.

Outsourcing and Reshoring

Business-process outsourcing (BPO) involves companies hiring other companies to take over various parts of their the functional operations, such as human resources, information systems, payroll, accounting, customer service, and even marketing. Companies choose to outsource their functional operations for several reasons: (a) it is less expensive, (b) it allows the firm to focus on its core businesses, and (c) it enables the firm to provide better services. Other advantages of outsourcing are that the strategy (a) allows the firm to align itself with "best-in-world" suppliers who focus on performing the special task, (b) provides the firm flexibility should customer needs shift unexpectedly, and (c) allows the firm to concentrate on other internal value chain activities critical to sustaining competitive advantage. BPO is a means for achieving strategies that are similar to partnering and joint venturing.

Reshoring is the new term that refers to U.S. companies planning to move some of their manufacturing back to the USA. About 14 to 37 percent of U.S. companies plan to *reshore* in 2012–2014 for the following reasons: a desire to get products to market faster and respond rapidly to customer orders; savings from reduced transportation and warehousing; improved quality and protection of intellectual property; pressure to increase U.S. jobs.[30] For example, Google's new Nexus Q music and video player is being manufactured in the USA, something unusual for consumer electronics. GE's website has an "American Jobs Map" that gives details of 14,500 new GE jobs in the USA. A bill named the "Bring Jobs Home Act" is being considered in Congress.

"Made in the USA" is making a comeback. Even Walmart, which pioneered looking globally for the lowest-cost suppliers, is increasing by $50 billion its spending with U.S. suppliers in this decade. U.S. manufacturing is leading the way on superautomated factories that require less labor but more high-tech machines. For example, the 200,000 sq. ft. GE battery plant in Schenectady, NY has only 370 full-time employees but ships batteries around the world. New, high-tech, U.S. factories are leading to extensive "reshoring" in America.

Many firms, such as Dearborn, Michigan–based Visteon Corp. and J.P. Morgan Chase & Co., outsource their computer operations to IBM, which competes with firms such as Electronic Data Systems and Computer Sciences Corp. in the computer outsourcing business. 3M Corp. is outsourcing all of its manufacturing operations to Flextronics International Ltd. of Singapore or Jabil Circuit in Florida. 3M is also outsourcing all design and manufacturing of low-end standardized volume products by building a new design center in Taiwan.

U.S. and European companies for more than a decade have been outsourcing their manufacturing, tech support, and back-office work, but most insisted on keeping research and development activities in-house. However, an ever-growing number of firms today are outsourcing their product design to Asian developers. China and India are becoming increasingly important suppliers of intellectual property.

The details of what work to outsource, to whom, where, and for how much can challenge even the biggest, most sophisticated companies. And some outsourcing deals do not work out, such as the J.P. Morgan Chase deal with IBM and Dow Chemical's deal with Electronic Data Systems. Both outsourcing deals were abandoned after several years. Lehman Brothers Holdings

and Dell Inc. both recently reversed decisions to move customer call centers to India after a customer rebellion. India has become a booming place for outsourcing. Outsourcing generally aims to achieve one or more of the following benefits:

- Cost savings: Access lower wages in foreign countries.
- Focus on core business: Focus resources on developing the core business rather than being distracted by other functions.
- Cost restructuring: Outsourcing changes the balance of fixed costs to variable costs by moving the firm more to variable costs. Outsourcing also makes variable costs more predictable.
- Improve quality: Improve quality by contracting out various business functions to specialists.
- Knowledge: Gain access to intellectual property and wider experience and knowledge.
- Contract: Gain access to services within a legally binding contract with financial penalties and legal redress. This is not the case with services performed internally.
- Operational expertise: Gain access to operational best practice that would be too difficult or time consuming to develop in-house.
- Access to talent: Gain access to a larger talent pool and a sustainable source of skills, especially science and engineering.
- Catalyst for change: Use an outsourcing agreement as a catalyst for major change that cannot be achieved alone.
- Enhance capacity for innovation: Use external knowledge to supplement limited in-house capacity for product innovation.
- Reduce time to market: Accelerate development or production of a product through additional capability brought by the supplier.
- Risk management: Manage risk by partnering with an outside firm.
- Tax benefit: Capitalize on tax incentives to locate manufacturing plants to avoid high taxes in various countries.

Strategic Management in Nonprofit and Governmental Organizations

Nonprofit organizations are basically just like for-profit companies except for two major differences: (1) nonprofits do not pay taxes and (2) nonprofits do not have shareholders to provide capital. In virtually all other ways, nonprofits are just like for-profits. Nonprofits have competitors that want to put them out of business. Nonprofits have employees, customers, creditors, suppliers, and distributors as well as financial budgets, income statements, balance sheets, cash flow statements, and so on. Nonprofit organizations embrace strategic planning just as much as for-profit firms, and perhaps even more, because equity capital is not an alternative source of financing.

The strategic-management process is being used effectively by countless nonprofit and governmental organizations, such as the Girl Scouts, Boy Scouts, the Red Cross, chambers of commerce, educational institutions, medical institutions, public utilities, libraries, government agencies, and churches. The nonprofit sector, surprisingly, is by far the largest employer in the USA. Many nonprofit and governmental organizations outperform private firms and corporations on innovativeness, motivation, productivity, and strategic management.

Compared to for-profit firms, nonprofit and governmental organizations may be totally dependent on outside financing. Especially for these organizations, strategic management provides an excellent vehicle for developing and justifying requests for needed financial support.

Educational Institutions

The world of higher education is rapidly moving to massive open online courses (MOOC), with many of the courses being free to anyone with an Internet connection. The American Council on Education, an association for higher education presidents, is considering allowing free, online courses to be eligible for credit toward a degree and eligible for transfer credit. Several companies, including edX, Udacity, Coursera, and the Jack Welch Management Institute, are most associated with MOOCs, but the list is growing weekly.

Educational institutions are more frequently using strategic-management techniques and concepts. Richard Cyert, former president of Carnegie Mellon University, said, “I believe we do a far better job of strategic management than any company I know.” Population shifts nationally from the Northeast and Midwest to the Southeast and West are but one factor causing trauma for educational institutions that have not planned for changing enrollments. Ivy League schools in the Northeast are recruiting more heavily in the Southeast and West. This trend represents a significant change in the competitive climate for attracting the best high school graduates each year.

Online college degrees are commonplace and represent a threat to traditional colleges and universities. “You can put the kids to bed and go to law school,” says Andrew Rosen, chief operating officer of Kaplan Education Centers, a subsidiary of the Washington Post Company.

Many U.S. colleges and universities have now established campuses outside the USA. For example, Yale University and the National University of Singapore established a joint campus in Singapore in 2013. The institution is Singapore’s first liberal-arts college and Yale’s first campus outside the Ivy League institution in New Haven, Connecticut.

Medical Organizations

The $200 billion U.S. hospital industry is experiencing declining margins, excess capacity, bureaucratic overburdening, poorly planned and executed diversification strategies, soaring health-care costs, reduced federal support, and high administrator turnover. The seriousness of this problem is accented by a 20 percent annual decline in use by inpatients nationwide. Declining occupancy rates, deregulation, and accelerating growth of health maintenance organizations, preferred provider organizations, urgent care centers, outpatient surgery centers, diagnostic centers, specialized clinics, and group practices are other major threats facing hospitals today. Many private and state-supported medical institutions are in financial trouble as a result of traditionally taking a reactive rather than a proactive approach in dealing with their industry.

Hospitals—originally intended to be warehouses for people dying of tuberculosis, smallpox, cancer, pneumonia, and infectious diseases—are creating new strategies today as advances in the diagnosis and treatment of chronic diseases are undercutting that previous mission. Hospitals are beginning to bring services to the patient as much as bringing the patient to the hospital; health care is more and more being concentrated in the home and in the residential community, not on the hospital campus. Chronic care will require day-treatment facilities, electronic monitoring at home, user-friendly ambulatory services, decentralized service networks, and laboratory testing. A successful hospital strategy for the future will require renewed and deepened collaboration with physicians, who are central to hospitals’ well-being, and a reallocation of resources from acute to chronic care in home and community settings.

Current strategies being pursued by many hospitals include creating home health services, establishing nursing homes, and forming rehabilitation centers. Backward integration strategies that some hospitals are pursuing include acquiring ambulance services, waste disposal services, and diagnostic services. Millions of persons annually research medical ailments online, which is causing a dramatic shift in the balance of power between doctor, patient, and hospitals. The number of persons using the Internet to obtain medical information is skyrocketing. A motivated patient using the Internet can gain knowledge on a particular subject far beyond his or her doctor’s knowledge because no person can keep up with the results and implications of billions of dollars’ worth of medical research reported weekly. Patients today often walk into the doctor’s office with a file folder of the latest articles detailing research and treatment options for their ailments.

Governmental Agencies and Departments

Federal, state, county, and municipal agencies and departments, such as police departments, chambers of commerce, forestry associations, and health departments, are responsible for formulating, implementing, and evaluating strategies that use taxpayers’ dollars in the most cost-effective way to provide services and programs. Strategic-management concepts are generally required and thus widely used to enable governmental organizations to be more effective and efficient.

Strategists in governmental organizations operate with less strategic autonomy than their counterparts in private firms. Public enterprises generally cannot diversify into unrelated businesses or merge with other firms. Governmental strategists usually enjoy little freedom in altering the organizations’ missions or redirecting objectives. Legislators and politicians often have direct or indirect control over major decisions and resources. Strategic issues get discussed and debated

in the media and legislatures. Issues become politicized, resulting in fewer strategic choice alternatives. There is now more predictability in the management of public sector enterprises.

Government agencies and departments are finding that their employees get excited about the opportunity to participate in the strategic-management process and thereby have an effect on the organization's mission, objectives, strategies, and policies. In addition, government agencies are using a strategic-management approach to develop and substantiate formal requests for additional funding.

Strategic Management in Small Firms

The reason why "becoming your own boss" has become a national obsession is that entrepreneurs are role models in the USA. Almost everyone wants to own a business—from teens and college students, who are signing up for entrepreneurial courses in record numbers, to those older than age 65, who are forming more companies every year.

Strategic management is vital for large firms' success, but what about small firms? The strategic-management process is just as vital for small companies. From their inception, all organizations have a strategy, even if the strategy just evolves from day-to-day operations. Even if conducted informally or by a single owner or entrepreneur, the strategic-management process can significantly enhance small firms' growth and prosperity. Because an ever-increasing number of men and women in the United States are starting their own businesses, more individuals are becoming strategists. Widespread corporate layoffs have contributed to an explosion in small businesses and new ideas.

Numerous magazine and journal articles have focused on applying strategic-management concepts to small businesses. A major conclusion of these articles is that a lack of strategic-management knowledge is a serious obstacle for many small business owners. Other problems often encountered in applying strategic-management concepts to small businesses are a lack of both sufficient capital to exploit external opportunities and a day-to-day cognitive frame of reference. Research also indicates that strategic management in small firms is more informal than in large firms, but small firms that engage in strategic management outperform those that do not.

Special Note to Students

There are numerous alternative strategies that could benefit any firm, but your strategic management case analysis should result in specific recommendations that you decide will best provide the firm competitive advantages. Because company recommendations with costs comprise the most important pages or slides in your case project, introduce bits of that information early in the presentation as relevant supporting material is presented to justify your expenditures. Your recommendations page(s) itself should therefore be a summary of suggestions mentioned throughout your paper or presentation, rather than being a surprise shock to your reader or audience. You may even want to include with your recommendations insight as to why certain other feasible strategies were not chosen for implementation. That information too should be anchored in the notion of competitive advantage and disadvantage with respect to perceived costs and benefits. If someone asks "what is the difference between recommendations and strategies," respond saying: "Recommendations are alternative strategies actually selected for implementation."

Conclusion

The main appeal of any managerial approach is the expectation that it will enhance organizational performance. This is especially true of strategic management. Through involvement in strategic-management activities, managers and employees achieve a better understanding of an organization's priorities and operations. Strategic management allows organizations to be efficient, but more important, it allows them to be effective. Although strategic management does not guarantee organizational success, the process allows proactive rather than reactive decision making. Strategic management may represent a radical change in philosophy for some organizations, so strategists must be trained to anticipate and constructively respond to questions and issues as they arise. The strategies discussed in this chapter can represent a new beginning for many firms, especially if managers and employees in the organization understand and support the plan for action.

Key Terms and Concepts

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backward integration (p. 139)
bankruptcy (p. 146)
business-process outsourcing (BPO) (p. 158)
combination strategy (p. 135)
cooperative arrangements (p. 154)
cost leadership (p. 149)
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white knight (p. 156)

Issues for Review and Discussion

4-1. For Petronas, featured at the beginning of the chapter, give a hypothetical strategy for each of the following categories: market penetration, related diversification, divestiture, and retrenchment.
4-2. For Petronas, featured at the beginning of the chapter, give a hypothetical strategy for each of the following categories: market development, unrelated diversification, backward integration, and product development.
4-3. Identify five situations when forward integration is a particularly good strategy.
4-4. What three strategies defined in the chapter do you feel are most widely used by small businesses?
4-5. Should non-profit organizations post their strategic plan on their website? What about corporations? Why?
4-6. Give some guidelines of when divestiture is a particularly effective strategy.
4-7. For adidas, what two strategies do you feel is best for that company to pursue going forward? Why?
4-8. Give some examples of Type 4 and Type 5 focus strategies according to Porter's generic strategy approach.
4-9. List three industries when cooperation among competitors is most likely and explain why.
4-10. Do a Google search on joint ventures. What important new concepts did you learn that were not presented in the chapter?
4-11. Identify three joint ventures that have worked especially well in the past.
4-12. List four important reasons why many mergers and acquisitions fail.
4-13. Explain how strategic management differs in governmental organizations as compared to educational institutions.
4-14. Explain how and why Petronas has been so successful in recent years.
4-15. List six characteristics of objectives and an example of each.
4-16. In order of importance, rank six major benefits of a firm having objectives.
4-17. Give a hypothetical example of forward integration, backward integration, and horizontal integration for Volkswagen.
4-18. Give a hypothetical example of market penetration, market development, and product development for Toyota Motors.

4-19. Give a hypothetical example of related diversification and an example of unrelated diversification for Google.

4-20. Give a hypothetical example of retrenchment and divestiture for Wal-Mart.

4-21. When would market development generally be the preferred strategy over backward or forward integration?

4-22. Why can firms generally not pursue several or many of the strategies presented in this chapter?

4-23. When should a firm diversify?

4-24. List and describe the five types of bankruptcy. If your college or university had to declare bankruptcy, which type would be appropriate?

4-25. Explain why you believe some analysts consider Michael Porter's generic strategies to be too few and too vague.

4-26. Explain the difference between joint ventures and partnerships as a means for achieving various strategies.

4-27. List the pros and cons of a hostile versus friendly takeover of another firm.

4-28. In order of importance, list six reasons why many mergers and acquisitions fail.

4-29. In order of importance, list six potential benefits of two firms merging.

4-30. Give three hypothetical examples of firms being a "first mover."

4-31. List three ways a country could prevent its companies from outsourcing jobs to other countries.

4-32. Explain how strategic planning differs across types and sizes of firms.

4-33. Identify three local businesses in your city. What three strategies do these three firms pursue? List the strategies in order of prevalence.

4-34. What strategies are best for turbulent, high-velocity markets?

4-35. Based on the information given for Petronas, what three strategies are being pursued by the firm?

4-36. Elaborate on this chapter's "Special Note to Students" at the end, in terms of giving a case analysis presentation.

4-37. Identify three companies that use outsourcing effectively. Explain how and why those firms utilize this management approach.

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

4-38. What are the pros and cons of a firm merging with a rival firm?

4-39. Discuss the nature of as well as the pros and cons of a "friendly merger" versus "hostile takeover" in acquiring another firm. Give an example of each.

4-40. Mymanagementlab Only—comprehensive writing assignment for this chapter.

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 4A
Market Development: Petronas

Purpose

Petronas is featured in the opening chapter case as a firm that engages in excellent strategic planning.

The purpose of this exercise is to give you practice extending a company's global strategy into new geographic regions.

Instructions

Step 1 Visit the Petronas website and review the company's latest *Annual Report*. Especially assess where and in what respect does Petronas do business in Asia, Australia, and the Middle East. Identify six countries that Petronas currently does not do business with.

Step 2 Based on your analysis in Step 1, evaluate the six countries identified in terms of their business culture, environment, and attractiveness for Petronas to begin doing business there.

Step 3 Rank order the six countries identified and evaluated in terms of a proposed plan for Petronas to begin doing business in these places. Prepare a two-page executive summary to support your suggested plan.

EXERCISE 4B
Alternative Strategies for Petronas

Purpose

This exercise will give you practice labeling hypothetical strategies that a firm could pursue.

Instructions

For each of the strategies listed below, identify a hypothetical strategy that you believe may be good for Petronas to pursue. Refer to Chapter 4 for a description of the strategies.

Forward Integration
Backward Integration
Horizontal Integration
Market Penetration
Market Development
Product Development
Related Diversification
Unrelated Diversification
Retrenchment
Divestiture
Liquidation

EXERCISE 4C
Private-Equity Acquisitions

Purpose

As stock prices increase and companies become more cash-rich, private-equity firms such as Kohlberg Kravis Roberts (KKR) have jumped aggressively back into the business of acquiring and selling firms. Private-equity firms have unleashed a wave of new initial public offerings (IPOs), such

as the IPO of Nielsen Holdings BV, the largest private-equity-backed IPO in the United States in five years. Apollo Global Management is a large private-equity firms that owns many companies. Some private-equity owned firms expected to go public soon include Bank United Inc., Kinder Morgan Inc., and Toys "R" Us Inc.

The purpose of this exercise is to give you practice identifying and evaluating the nature and role of private-equity acquisitions in Europe.

Instructions

Step 1 Identify the top five IPOs in Europe in the last 12 months.

Step 2 Identify the top five private-equity firms in Europe.

Step 3 Prepare a two-page executive summary of the nature and role of private-equity acquisitions in Europe in the last 12 months. Include your expectations over the next 12 months for this activity to increase or decrease across Europe. Give supporting rationales.

EXERCISE 4D
The strategies of adidas AG: 2013-2015

Purpose

In performing strategic management case analysis, you can find information about the company's actual and planned strategies. Comparing what is planned versus what you recommend is an important part of case analysis. Do not recommend what the firm actually plans, unless in-depth analysis of the situation reveals those strategies to be the best among all feasible alternatives. This exercise gives you experience conducting library and Internet research to determine what adidas AG plans to do in 2013-2015.

Instructions

Step 1 Go to Reebok and TaylorMade's websites. Find some recent articles about these subsidiaries and the parent—adidas AG. Review adidas' website also.

Step 2 Prepare a three-page report titled "Strategies Being Pursued By adidas in 2011–2013."

EXERCISE 4E
Lessons in Doing Business Globally

Purpose

The purpose of this exercise is to discover some important lessons learned by local businesses that do business internationally.

Instructions

Contact several local business leaders by telephone. Find at least three firms that engage in international or export operations. Visit the owner or manager of each business in person. Ask the business person to give you several important lessons that his or her firm has learned in globally doing business. Record the lessons on paper and report your findings to the class.

EXERCISE 4F
Petronas 2013-2015

Purpose

In performing strategic management case analysis, you should find information about the company's actual and planned strategies. Comparing what is planned versus what you recommend is an important part of case analysis. Do not recommend what the firm actually plans, unless in-depth analysis of the situation reveals those strategies to be the best among all feasible alternatives. This exercise gives you experience conducting library and Internet research to determine what Petronas plans to do in 2013-2015.

Instructions

Step 1 Go to the Petronas corporate web site. Study the information provided there.

Step 2 Prepare a three-page report titled "Strategies Being Pursued by Petronas in 2013-2015."

EXERCISE 4G
What Strategies Are Most Risky?

Purpose
This exercise encourages you to think about the relative riskiness of various strategies.

Instructions

Step 1 List the strategies defined in Chapter 4 in order of low risk to high risk.
Step 2 Write a synopsis that explains your rankings.

EXERCISE 4H
Exploring Bankruptcy

Purpose
Bankruptcy is becoming more and more common among business firms. This exercise is designed to enhance your knowledge of bankruptcy.

Instructions
Identify five firms in your country that are operating under bankruptcy. Compare and contrast the nature of the bankruptcy among these firms.

EXERCISE 4I
Examining Strategy Articles

Purpose
Strategy articles can be found weekly in journals, magazines, and newspapers. By reading and studying strategy articles, you can gain a better understanding of the strategic management process. Several of the best journals in which to find corporate strategy articles are: *Advanced Management Journal, Business Horizons, Long Range Planning, Journal of Business Strategy,* and *Strategic Management Journal*. These journals are devoted to reporting the results of empirical research in management. They apply strategic management concepts to specific organizations and industries. They introduce new strategic management techniques and provide short case studies on selected firms. Other good journals in which to find strategic management articles are *Harvard Business Review, Sloan Management Review, California Management Review, Academy of Management Review, Academy of Management Journal, Academy of Management Executive, Journal of Management,* and *Journal of Small Business Management*. In addition to journals, many magazines regularly publish articles that focus on business strategies. Several of the best magazines in which to find applied strategy articles are: *Dun's Business Month, Fortune, Forbes, Business Week, Inc,* and *Industry Week*. Newspapers such as *USA Today, Wall Street Journal, New York Times*, and *Barrons* cover strategy events when they occur—for example, a joint venture announcement, a bankruptcy declaration, a new advertising campaign start, acquisition of a company, divestiture of a division, a chief executive officer's hiring or firing, or a hostile takeover attempt. In combination, journal, magazine, and newspaper articles can make the strategic management course more exciting. These sources provide information about the strategies of for-profit and non-profit organizations.

Instructions

Step 1 Go to your college library and find a recent journal article that focuses on a strategic management topic. Select your article from one of the journals listed previously, not from a magazine. Copy the article and bring it to class.
Step 2 Give a three-minute oral report summarizing the most important information in your article. Include comments giving your personal reaction to the article. Pass your article around in class.

EXERCISE 4J
Classifying Some Strategies

Purpose
This exercise can improve your understanding of various strategies by giving you experience classifying strategies. This skill will help you use the strategy-formulation tools presented later. Consider the following 12 (actual or possible) strategies by various firms:

1. Dunkin' Donuts is increasing the number of its U.S. stores from 5,500 to 15,000.
2. Brown-Forman Corp. sold its Hartmann luggage and leather-goods business.
3. Motorola, which makes TVs, acquired Terayon Communication, a supplier of TV equipment.
4. Macy's department stores is adding bistros and Starbucks coffee shops at many of its stores.
5. Dell just allowed Wal-Mart to begin selling its computers. This was its first move away from direct mail order selling of computers.
6. Motorola cut 7,500 additional jobs.
7. Hilton Hotels is building 55 new properties in Russia, the United Kingdom, and Central America.
8. Video-sharing website YouTube launched its services into nine new countries.
9. Cadbury Schweppes PLC is slashing 7,500 jobs, shedding product variations, and closing factories globally.
10. General Electric sold its plastics division for $11.6 million to Saudi Basic Industries Corp. of Saudi Arabia.
11. Cadbury Schweppes PLC, the maker of Trident gum, just bought Turkish gum maker Intergum.
12. Limited Brands is selling its Express and Limited divisions to focus on its Victoria's Secret and Bath & Body Works divisions.

Instructions

Step 1 On a separate sheet of paper, write down numbers 1 to 12. These numbers correspond to the strategies described.
Step 2 What type of strategy best describes the 12 actions cited? Indicate your answers.
Step 3 Exchange papers with a classmate, and grade each other's paper as your instructor gives the right answers.

Notes

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19. Arthur Thompson Jr., A. J. Strickland III, and John Gamble, *Crafting and Executing Strategy: Text and Readings* (New York: McGraw-Hill/Irwin, 2005), 125–126.
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5

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Vision and Mission Analysis

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Describe the nature and role of vision and mission statements in strategic management.
2. Discuss why the process of developing a mission statement is as important as the resulting document.
3. Identify the components of mission statements.
4. Discuss how clear vision and mission statements can benefit other strategic-management activities.
5. Evaluate mission statements of different organizations.
6. Write good vision and mission statements.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 5A Examining Potential Changes Needed in a Firm's Vision/Mission

EXERCISE 5B Studying an Alternative View of Mission Statement Content

EXERCISE 5C Evaluating Mission Statements

EXERCISE 5D Evaluating the Mission Statement of Under Armour—a Competitor of adidas AG

EXERCISE 5E Selecting the Best Vision and Mission Statements in a Given Industry

EXERCISE 5F Writing an Excellent Vision and Mission Statement for Novartis AG

This chapter focuses on the concepts and tools needed to evaluate and write business vision and mission statements. A practical framework for developing mission statements is provided. Actual mission statements from large and small organizations and for-profit and nonprofit enterprises are presented and critically examined. The process of creating a vision and mission statement is discussed. The recent economic recession resulted in many firms changing direction and thereby altering their entire vision and mission. For example, Microsoft entered the smartphone business with Nokia, and IBM is focusing more on business analytics.

The boxed insert company examined in this chapter is Samsung which has a clear strategic plan.

We can perhaps best understand vision and mission by focusing on a business when it is first started. In the beginning, a new business is simply a collection of ideas. Starting a new business rests on a set of beliefs that the new organization can offer some product or service to some customers in some geographic area using some type of technology at a profitable price. A new business owner typically believes that the management philosophy of the new enterprise will result in a favorable public image and that this concept of the business can be communicated to, and will be adopted by, important constituencies. When the set of beliefs about a business at its inception is put into writing, the resulting document mirrors the same basic ideas that underlie the vision and mission statements. As a business grows, owners or managers find it necessary to revise the founding set of beliefs, but those original ideas usually are reflected in the revised statements of vision and mission.

Vision and mission statements often can be found in the front of annual reports. They often are displayed throughout a firm's premises and are distributed with company information sent to constituencies. The statements are part of numerous internal reports, such as loan requests, supplier agreements, labor relations contracts, business plans, and customer service agreements.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Samsung

Samsung Electronics Co., Ltd., headquartered in Suwon, South Korea, is the world's largest information company. Samsung has assembly plants and sales networks in 88 countries and employs around 270,000 people. Samsung is the leading smartphone manufacturer, as well as a leading producer of lithium-ion batteries, semiconductors chips, flash memory and hard drive devices, as well as tablet computers. Samsung is the world's largest maker of LCD panels, and the world's largest television manufacturer. In 2013, *Fortune* ranked Samsung as the 12th largest firm in the world, the 12th most profitable, and the 35th most admired company outside the United States.

Samsung's vision statement is posted on their website, as: "Samsung is dedicated to developing innovative technologies and efficient processes that create new markets, enrich people's lives and continue to make Samsung a digital leader." The company's mission statement is called a statement of philosophy and also is given on the corporate website. Samsung does an excellent job in strategic management.

In late 2013, Samsung began mass-producing the industry's first three-dimensional (3D) Vertical NAND (V-NAND) flash memory. The new 3D V-NAND is now used for a wide range of consumer electronics and enterprise applications, including embedded NAND storage and solid state drives (SSDs). In September 2013, Samsung launched a massive global advertising campaign to promote the new Galaxy Note 3 and Galaxy Gear products. Samsung has annual sales of about $190 billion.

Headquartered in Ridgefield Park, New Jersey, Samsung Electronics America (SEA) houses the company's Consumer Business Division (CBD) and Enterprise Business Division (EBD).CBD offers scores of digital products, such as LEDs and plasma TVs, home theater systems and camcorders as well as refrigerators, washers and dryers, ranges, dishwashers, microwave ovens and vacuums. Samsung EBD offers printers, desktop monitors, laptop computers, digital signage, and projectors.

Samsung Telecommunications America (STA), headquartered in Dallas, Texas, offers handheld wireless phones, wireless communications infrastructure systems, fiber optics and enterprise communication systems.

Samsung Semiconductor, Inc. (SSI), headquartered in San Jose, California, is the second largest semiconductor manufacturer in the world and the industry leader in DRAM, NAND Flash, SRAM memory and TFT-LCD panels.

Samsung Information Systems America (SISA), located in Southern California, offers hard disk drives, digital TV technologies, printer software, wireless connectivity and software.

Samsung Austin Semiconductor (SAS), located in Austin, Texas, is the company's only semiconductor manufacturing plant outside Korea. SAS produces NAND Flash memory and Mobile SoC chips.

What Do We Want to Become?

It is especially important for managers and executives in any organization to agree on the basic vision that the firm strives to achieve in the long term. A vision statement should answer the basic question, "What do we want to become?" A clear vision provides the foundation for developing a comprehensive mission statement. Many organizations have both a vision and mission statement, but the vision statement should be established first and foremost. The vision statement should be short, preferably one sentence, and as many managers as possible should have input into developing the statement. Where there is no vision, the people perish (Proverbs 29: 18)

Several example vision statements are provided in Table 5-1.

What Is Our Business?

Current thought on mission statements is based largely on guidelines set forth in the mid-1970s by Peter Drucker, who is often called "the father of modern management" for his pioneering studies at General Motors and for his 22 books and hundreds of articles. *Harvard Business Review* has called Drucker "the preeminent management thinker of our time."

Drucker says that asking the question "What is our business?" is synonymous with asking the question "What is our mission?" An enduring statement of purpose that distinguishes one organization from other similar enterprises, the **mission statement** is a declaration of an organization's "reason for being." It answers the pivotal question "What is our business?" A clear mission statement is essential for effectively establishing objectives and formulating strategies.

Sometimes called a **creed statement**, a statement of purpose, a statement of philosophy, a statement of beliefs, a statement of business principles, or a statement "defining our business," a mission statement reveals what an organization wants to be and whom it wants to serve. All organizations have a reason for being, even if strategists have not consciously transformed this reason into writing. As illustrated with white shading in Figure 5-1, carefully prepared statements of vision and mission are widely recognized by both practitioners and academicians as the first step in strategic management. Drucker has the following to say about mission statements (paraphrased):

TABLE 5-1 Vision Statement Examples

Tyson Foods' vision is to be the world's first choice for protein solutions while maximizing shareholder value. *(Author comment: Good statement, unless Tyson provides nonprotein products)*
General Motors' vision is to be the world leader in transportation products and related services. *(Author comment: Good statement)*
PepsiCo's responsibility is to continually improve all aspects of the world in which we operate—environment, social, economic—creating a better tomorrow than today. *(Author comment: Statement is too vague; it should reveal beverage and food business)*
Dell's vision is to create a company culture where environmental excellence is second nature. *(Author comment: Statement is too vague; it should reveal computer business in some manner; the word environmental is generally used to refer to natural environment so is unclear in its use here)*
The vision of First Reliance Bank is to be recognized as the largest and most profitable bank in South Carolina. *(Author comment: This is a small new bank headquartered in Florence, South Carolina, so this goal is not achievable in five years; the statement is too futuristic)*
Samsonite's vision is to provide innovative solutions for the traveling world. *(Author comment: Statement needs to be more specific, perhaps mention luggage; statement as is could refer to air carriers or cruise lines, which is not good)*
Royal Caribbean's vision is to empower and enable our employees to deliver the best vacation experience for our guests, thereby generating superior returns for our shareholders and enhancing the well-being of our communities. *(Author comment: Statement is good but could end after the word "guests")*
Procter & Gamble's vision is to be, and be recognized as, the best consumer products company in the world. *(Author comment: Statement is too vague and readability is not that good)*

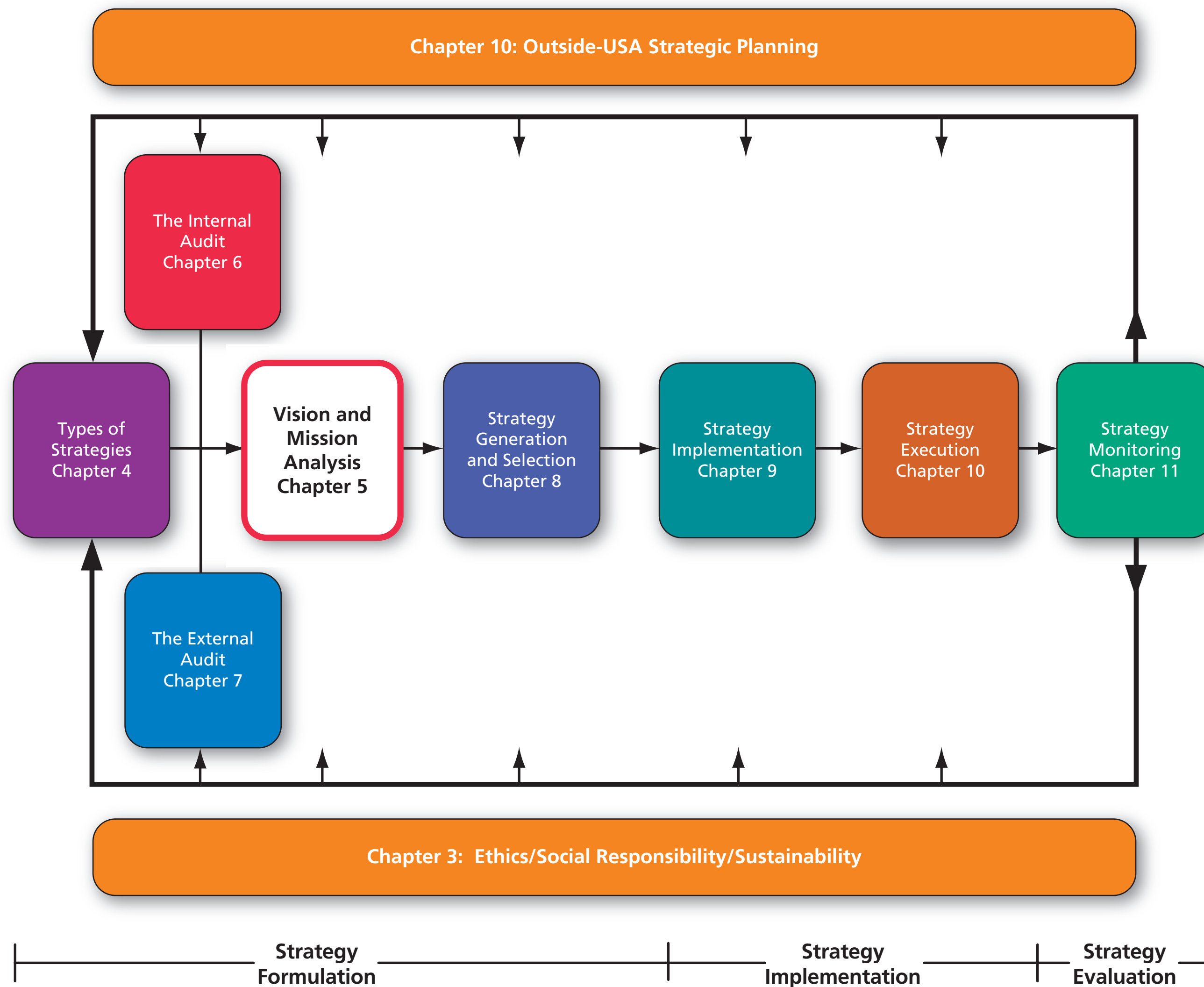

FIGURE 5-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

> A mission statement is the foundation for priorities, strategies, plans, and work assignments. It is the starting point for the design of jobs and organizational structures. Nothing may seem simpler or more obvious than to know what a company's business is. A lumber mill makes lumber, an airline carries passengers and freight, and a bank lends money. But "What is our business?" is almost always a difficult question and the right answer is usually anything but obvious. The answer to this question is the first responsibility of strategists.[1]

Some strategists spend almost every moment of every day on administrative and tactical concerns, and strategists who rush quickly to establish objectives and implement strategies often overlook the development of a vision and mission statement. This problem is widespread even among large organizations. Many corporations in the USA have not yet developed a formal vision or mission statement. An increasing number of organizations are developing these statements.

Some companies develop mission statements simply because they feel it is fashionable, rather than out of any real commitment. However, as described in this chapter, firms that develop and systematically revisit their vision and mission statements, treat them as living documents, and consider them to be an integral part of the firm's culture realize great benefits. Johnson & Johnson (J&J) is an example firm. J&J managers meet regularly with employees to review,

reword, and reaffirm the firm's vision and mission. The entire J&J workforce recognizes the value that top management places on this exercise, and these employees respond accordingly.

Vision versus Mission

Many organizations develop both a mission statement and a vision statement. Whereas the mission statement answers the question "What is our business?" the **vision statement** answers the question "What do we want to become?" Many organizations have both a mission and vision statement.

For many if not most corporations, profit rather than mission or vision is the primary motivator. But profit alone is not enough to motivate people. Profit is perceived negatively by many stakeholders of a firm. For example, employees may see profit as something that they earn and management then uses and even gives away to shareholders. Although this perception is undesired and disturbing to management, it clearly indicates that both profit and vision are needed to motivate a workforce effectively.

When employees and managers together shape or fashion the vision and mission statements for a firm, the resultant documents can reflect the personal visions that managers and employees have in their hearts and minds about their own futures. Shared vision creates a commonality of interests that can lift workers out of the monotony of daily work and put them into a new world of opportunity and challenge.

Vision Statement Analysis

A vision statement should at a minimum reveal the type of business the firm engages. For example, to have a vision that says "to become the best retailing firm in the USA" is not good, because that firm could be selling anything from boats to bunnies.

Starbucks Proposed Vision Statement

"Starbucks strives to ethically find and roast the highest quality Arabica coffee in the world. With stores around the world, we are the premier roaster and retailer of specialty coffee globally."

Starbucks "Improved" Vision Statement

Starbucks' vision is to be the most well-known, specialty coffee, tea, and pastry restaurant in the world, offering sincere customer service, a welcoming atmosphere, and unequaled quality.

Starbucks Vision Statement Analysis

- The existing vision statement does not state what the company wants to become. Nor does it acknowledge the firm's movement into specialty tea offerings.
- The improved vision statement reveals the company's aspirations for the future and acknowledges that upscale tea and pastries complement their premium coffee offerings.

The Process of Developing Vision and Mission Statements

As indicated in the strategic-management model, clear vision and mission statements are needed before alternative strategies can be formulated and implemented. As many managers as possible should be involved in the process of developing these statements because, through involvement, people become committed to an organization.

A widely used approach to developing a vision and mission statement is first to select several articles about these statements and ask all managers to read these as background information. Then ask managers themselves to prepare a vision and mission statement for the organization. A facilitator or committee of top managers should then merge these statements into a single document and distribute the draft statements to all managers. A request for modifications, additions, and deletions is needed next, along with a meeting to revise the document. To the extent that all managers have input into and support the final documents, organizations can more easily obtain managers' support for other strategy formulation, implementation, and evaluation activities. Thus, the process of developing a vision and mission statement represents a great opportunity for strategists to obtain needed support from all managers in the firm.

During the process of developing vision and mission statements, some organizations use discussion groups of managers to develop and modify existing statements. Some organizations hire an outside consultant or facilitator to manage the process and help draft the language. Sometimes an outside person with expertise in developing such statements, who has unbiased views, can manage the process more effectively than an internal group or committee of managers. Decisions on how best to communicate the vision and mission to all managers, employees, and external constituencies of an organization are needed when the documents are in final form. Some organizations even develop a videotape to explain the statements and how they were developed.

An article by Campbell and Yeung emphasizes that the process of developing a mission statement should create an "emotional bond" and "sense of mission" between the organization and its employees.[2] Commitment to a company's strategy and intellectual agreement on the strategies to be pursued do not necessarily translate into an emotional bond; hence, strategies that have been formulated may not be implemented. These researchers stress that an emotional bond comes when an individual personally identifies with the underlying values and behavior of a firm, thus turning intellectual agreement and commitment to strategy into a sense of mission. Campbell and Yeung also differentiate between the terms *vision* and *mission*, saying that vision is "a possible and desirable future state of an organization" that includes specific goals, whereas mission is more associated with behavior and the present.

Importance (Benefits) of Vision and Mission Statements

The importance (benefits) of vision and mission statements to effective strategic management is well documented in the literature, although research results are mixed. Rarick and Vitton found that firms with a formalized mission statement have twice the average return on shareholders' equity than those firms without a formalized mission statement have; Bart and Baetz found a positive relationship between mission statements and organizational performance; *BusinessWeek* reports that firms using mission statements have a 30 percent higher return on certain financial measures than those without such statements; however, some studies have found that having a mission statement does not directly contribute positively to financial performance.[3] The extent of manager and employee involvement in developing vision and mission statements can make a difference in business success. This chapter provides guidelines for developing these important documents. In actual practice, wide variations exist in the nature, composition, and use of both vision and mission statements. King and Cleland recommend that organizations carefully develop a written mission statement in order to reap the following benefits:

1. To make sure all employees/managers understand the firm's purpose or reason for being.
2. To provide a basis for prioritization of key internal and external factors utilized to formulate feasible strategies.
3. To provide a basis for the allocation of resources.
4. To provide a basis for organizing work, departments, activities, and segments around a common purpose.[4]

Reuben Mark, former CEO of Colgate, maintains that a clear mission increasingly must make sense internationally. Mark's thoughts on vision are as follows:

> When it comes to rallying everyone to the corporate banner, it's essential to push one vision globally rather than trying to drive home different messages in different cultures. The trick is to keep the vision simple but elevated: "We make the world's fastest computers" or "Telephone service for everyone." You're never going to get anyone to charge the machine guns only for financial objectives. It's got to be something that makes people feel better, feel a part of something.[5]

A Resolution of Divergent Views

Another benefit of developing a comprehensive mission statement is that divergent views among managers can be revealed and resolved through the process. The question "What is our business?" can create controversy. Raising the question often reveals differences among strategists in the organization. Individuals who have worked together for a long time and who think they know each other suddenly may realize that they are in fundamental disagreement.

For example, in a college or university, divergent views regarding the relative importance of teaching, research, and service often are expressed during the mission statement development process. Negotiation, compromise, and eventual agreement on important issues are needed before people can focus on more specific strategy-formulation activities.

Considerable disagreement among an organization's strategists over vision and mission statements can cause trouble if not resolved. For example, unresolved disagreement over the business mission was one of the reasons for W. T. Grant's bankruptcy and eventual liquidation. Top executives of the firm, including Ed Staley and Lou Lustenberger, were firmly entrenched in opposing positions that W. T. Grant should be like Kmart or JC Penney respectively. W.T. Grant decided to become a bit like both Kmart and JC Penney; this compromise was a huge strategic mistake. In other words, top executives of W. T. Grant never resolved their vision/mission issue, which ultimately led to the firm's disappearance.[6]

Too often, strategists develop vision and business mission statements only when the organization is in trouble. Of course, it is needed then. Developing and communicating a clear mission during troubled times indeed may have spectacular results and even may reverse decline. However, to wait until an organization is in trouble to develop a vision and mission statement is a gamble that characterizes irresponsible management. According to Drucker, the most important time to ask seriously, "What do we want to become?" and "What is our business?" is when a company has been successful:

> Success always obsoletes the very behavior that achieved it, always creates new realities, and always creates new and different problems. Only the fairy tale story ends, "They lived happily ever after." It is never popular to argue with success or to rock the boat. It will not be long before success will turn into failure. Sooner or later, even the most successful answer to the question "What is our business?" becomes obsolete.[7]

In multidivisional organizations, strategists should ensure that divisional units perform strategic-management tasks, including the development of a statement of vision and mission. Each division should involve its own managers and employees in developing a vision and mission statement that is consistent with and supportive of the corporate mission. Ten benefits of having a clear mission and vision are provided in Table 5-2.

An organization that fails to develop a vision statement as well as a comprehensive and inspiring mission statement loses the opportunity to present itself favorably to existing and potential stakeholders. All organizations need customers, employees, and managers, and most firms need creditors, suppliers, and distributors. The vision and mission statements are effective vehicles for communicating with important internal and external stakeholders. The principal benefit of these statements as tools of strategic management is derived from their specification of the ultimate aims of a firm. Vision and mission statements reveal the firm's shared expectations internally among all employees and managers. For external constituencies, the statements reveal the firm's long-term commitment to responsible, ethical action in providing a needed product and/or service for customers.

TABLE 5-2 Ten Benefits of Having a Clear Mission and Vision

1. Achieve clarity of purpose among all managers and employees.
2. Provide a basis for all other strategic planning activities, including internal and external assessment, establishing objectives, developing strategies, choosing among alternative strategies, devising policies, establishing organizational structure, allocating resources, and evaluating performance.
3. Provide direction.
4. Provide a focal point for all stakeholders of the firm.
5. Resolve divergent views among managers.
6. Promote a sense of shared expectations among all managers and employees.
7. Project a sense of worth and intent to all stakeholders.
8. Project an organized, motivated organization worthy of support.
9. Achieve higher organizational performance.
10. Achieve synergy among all managers and employees.

Characteristics of a Mission Statement

A Declaration of Attitude

A mission statement is more than a statement of specific details; it is a declaration of attitude and outlook. It usually is broad in scope for at least two major reasons. First, a good mission statement allows for the generation and consideration of a range of feasible alternative objectives and strategies without unduly stifling management creativity. Excess specificity would limit the potential of creative growth for the organization. However, an overly general statement that does not exclude any strategy alternatives could be dysfunctional. Apple Computer's mission statement, for example, should not open the possibility for diversification into pesticides—or Ford Motor Company's into food processing.

Second, a mission statement needs to be broad to reconcile differences effectively among, and appeal to, an organization's diverse **stakeholders**, the individuals and groups of individuals who have a special stake or claim on the company. Thus, a mission statement should be **reconcilatory**. Stakeholders include employees, managers, stockholders, boards of directors, customers, suppliers, distributors, creditors, governments (local, state, federal, and foreign), unions, competitors, environmental groups, and the general public. Stakeholders affect and are affected by an organization's strategies, yet the claims and concerns of diverse constituencies vary and often conflict. For example, the general public is especially interested in social responsibility, whereas stockholders are more interested in profitability. Claims on any business literally may number in the thousands, and they often include clean air, jobs, taxes, investment opportunities, career opportunities, equal employment opportunities, employee benefits, salaries, wages, clean water, and community services. All stakeholders' claims on an organization cannot be pursued with equal emphasis. A good mission statement indicates the relative attention that an organization will devote to meeting the claims of various stakeholders.

The fine balance between specificity and generality is difficult to achieve, but it is well worth the effort. George Steiner offers the following insight on the need for a mission statement to be broad in scope:

> Most business statements of mission are expressed at high levels of abstraction. Vagueness nevertheless has its virtues. Mission statements are not designed to express concrete ends, but rather to provide motivation, general direction, an image, a tone, and a philosophy to guide the enterprise. An excess of detail could prove counterproductive since concrete specification could be the base for rallying opposition. Precision might stifle creativity in the formulation of an acceptable mission or purpose. Once an aim is cast in concrete, it creates a rigidity in an organization and resists change. Vagueness leaves room for other managers to fill in the details.[8]

As indicated in Table 5-3, in addition to being broad in scope, an effective mission statement should not be too lengthy; recommended length is less than 250 words. An effective mission statement should arouse positive feelings and emotions about an organization; it should be inspiring in the sense that it motivates readers to action. A mission statement should be enduring. All of these are desired characteristics of a statement. An effective mission statement

TABLE 5-3 Characteristics of a Mission Statement

1. Broad in scope; do not include monetary amounts, numbers, percentages, ratios, or objectives
2. Less than 250 words in length
3. Inspiring
4. Identify the utility of a firm's products
5. Reveal that the firm is socially responsible
6. Reveal that the firm is environmentally responsible
7. Include nine components customers, products or services, markets, technology, concern for survival/growth/profits, philosophy, self-concept, concern for public image, concern for employees
8. Reconciliatory
9. Enduring

generates the impression that a firm is successful, has direction, and is worthy of time, support, and investment—from all socioeconomic groups of people.

It reflects judgments about future growth directions and strategies that are based on forward-looking external and internal analyses. A business mission should provide useful criteria for selecting among alternative strategies. A clear mission statement provides a basis for generating and screening strategic options. The statement of mission should be dynamic in orientation, allowing judgments about the most promising growth directions and those considered less promising.

A Customer Orientation

A good mission statement describes an organization's purpose, customers, products or services, markets, philosophy, and basic technology. According to Vern McGinnis, a mission statement should (a) define what the organization is and what the organization aspires to be, (b) be limited enough to exclude some ventures and broad enough to allow for creative growth, (c) distinguish a given organization from all others, (d) serve as a framework for evaluating both current and prospective activities, and (e) be stated in terms sufficiently clear to be widely understood throughout the organization.[9]

A good mission statement reflects the anticipations of customers. Rather than developing a product and then trying to find a market, the operating philosophy of organizations should be to identify customers' needs and then provide a product or service to fulfill those needs.

Good mission statements identify the utility of a firm's products to its customers. This is why AT&T's mission statement focuses on communication rather than on telephones; it is why ExxonMobil's mission statement focuses on energy rather than on oil and gas; it is why Union Pacific's mission statement focuses on transportation rather than on railroads; it is why Universal Studios' mission statement focuses on entertainment rather than on movies. A major reason for developing a business mission statement is to attract customers who give meaning to an organization.

The following utility statements are relevant in developing a mission statement:

Do not offer me things.

Do not offer me clothes. Offer me attractive looks.

Do not offer me shoes. Offer me comfort for my feet and the pleasure of walking.

Do not offer me a house. Offer me security, comfort, and a place that is clean and happy.

Do not offer me books. Offer me hours of pleasure and the benefit of knowledge.

Do not offer me CDs. Offer me leisure and the sound of music.

Do not offer me tools. Offer me the benefits and the pleasure that come from making beautiful things.

Do not offer me furniture. Offer me comfort and the quietness of a cozy place.

Do not offer me things. Offer me ideas, emotions, ambience, feelings, and benefits.

Please, do not offer me *things*.

Mission Statement Components

Mission statements can and do vary in length, content, format, and specificity. Most practitioners and academicians of strategic management feel that an effective statement should include these nine **mission statement components**. Because a mission statement is often the most visible and public part of the strategic-management process, it is important that it includes the nine characteristics as summarized in Table 5-3, as well as the following nine components:

1. ***Customers***—Who are the firm's customers?
2. ***Products or services***—What are the firm's major products or services?
3. ***Markets***—Geographically, where does the firm compete?
4. ***Technology***—Is the firm technologically current?
5. ***Concern for survival, growth, and profitability***—Is the firm committed to growth and financial soundness?
6. ***Philosophy***—What are the basic beliefs, values, aspirations, and ethical priorities of the firm?
7. ***Self-concept***—What is the firm's distinctive competence or major competitive advantage?
8. ***Concern for public image***—Is the firm responsive to social, community, and environmental concerns?
9. ***Concern for employees***—Are employees a valuable asset of the firm?[10]

TABLE 5-4 Examples of the Nine Essential Components of a Mission Statement

1. **Customers**

   We believe our first responsibility is to the doctors, nurses, patients, mothers, and all others who use our products and services. (Johnson & Johnson)

   To earn our customers' loyalty, we listen to them, anticipate their needs, and act to create value in their eyes. (Lexmark International)

2. **Products or Services**

   AMAX's principal products are molybdenum, coal, iron ore, copper, lead, zinc, petroleum and natural gas, potash, phosphates, nickel, tungsten, silver, gold, and magnesium. (AMAX Engineering Company)

   Standard Oil Company (Indiana) is in business to find and produce crude oil, natural gas, and natural gas liquids; to manufacture high-quality products useful to society from these raw materials; and to distribute and market those products and to provide dependable related services to the consuming public at reasonable prices. (Standard Oil Company)

3. **Markets**

   We are dedicated to the total success of Corning Glass Works as a worldwide competitor. (Corning Glass Works)

   Our emphasis is on North American markets, although global opportunities will be explored. (Blockway)

4. **Technology**

   Control Data is in the business of applying micro-electronics and computer technology in two general areas: computer-related hardware; and computing-enhancing services, which include computation, information, education, and finance. (Control Data)

   We will continually strive to meet the preferences of adult smokers by developing technologies that have the potential to reduce the health risks associated with smoking. (RJ Reynolds)

5. **Concern for Survival, Growth, and Profitability**

   In this respect, the company will conduct its operations prudently and will provide the profits and growth which will assure Hoover's ultimate success. (Hoover Universal)

   To serve the worldwide need for knowledge at a fair profit by adhering, evaluating, producing, and distributing valuable information in a way that benefits our customers, employees, other investors, and our society. (McGraw-Hill)

6. **Philosophy**

   Our world-class leadership is dedicated to a management philosophy that holds people above profits. (Johnson Company)

   It's all part of the Mary Kay philosophy—a philosophy based on the golden rule. A spirit of sharing and caring where people give cheerfully of their time, knowledge, and experience. (Mary Kay Cosmetics)

7. **Self-Concept**

   Crown Zellerbach is committed to leapfrogging ongoing competition within 1,000 days by unleashing the constructive and creative abilities and energies of each of its employees. (Crown Zellerbach)

8. **Concern for Public Image**

   To share the world's obligation for the protection of the environment. (Dow Chemical)

   To contribute to the economic strength of society and function as a good corporate citizen on a local, state, and national basis in all countries in which we do business. (Pfizer)

9. **Concern for Employees**

   To recruit, develop, motivate, reward, and retain personnel of exceptional ability, character, and dedication by providing good working conditions, superior leadership, compensation on the basis of performance, an attractive benefit program, opportunity for growth, and a high degree of employment security. (Barnes Corporation)

   To compensate its employees with remuneration and fringe benefits competitive with other employment opportunities in its geographical area and commensurate with their contributions toward efficient corporate operations. (Public Service Electric & Gas Company)

Excerpts from the mission statements of different organizations are provided in Table 5-4 to exemplify the nine essential mission statement components.

Writing and Evaluating Mission Statements

Perhaps the best way to develop a skill for writing and evaluating mission statements is to study actual company missions. Therefore, the mission statements presented in Table 5-5 are evaluated based on the nine desired components. Note in Table 5-5 that numbers provided in each statement reveal what components are included in the respective documents. Among the statements in Table 5-5, note that the Dell mission statement is the best because it lacks only one component, whereas the L'Oreal statement is the worst, lacking six of the nine recommended components.

There is no one best mission statement for a particular organization, so good judgment is required in evaluating mission statements. Realize that some individuals are more demanding than others in assessing mission statements in this manner. For example, if a statement merely includes the word "customers" without specifying who the customers are, is that satisfactory?

TABLE 5-5 Example Mission Statements

Fleetwood Enterprises will lead the recreational vehicle and manufactured housing industries (2, 7) in providing quality products, with a passion for customer-driven innovation (1). We will emphasize training, embrace diversity and provide growth opportunities for our associates and our dealers (9). We will lead our industries in the application of appropriate technologies (4). We will operate at the highest levels of ethics and compliance with a focus on exemplary corporate governance (6). We will deliver value to our shareholders, positive operating results and industry-leading earnings (5). *(Author comment: Statement lacks two components: Markets and Concern for Public Image)*

We aspire to make **PepsiCo** the world's (3) premier consumer products company, focused on convenient foods and beverages (2) We seek to produce healthy financial rewards for investors (5) as we provide opportunities for growth and enrichment to our employees, (9) our business partners and the communities (8) in which we operate. And in everything we do, we strive to act with honesty, openness, fairness and integrity (6). *(Author comment: Statement lacks three components: Customers, Technology, and Self-Concept)*

We are loyal to **Royal Caribbean** and **Celebrity** and strive for continuous improvement in everything we do. We always provide service with a friendly greeting and a smile (7). We anticipate the needs of our customers and make all efforts to exceed our customers' expectations (1). We take ownership of any problem that is brought to our attention. We engage in conduct that enhances our corporate reputation and employee morale (9). We are committed to act in the highest ethical manner and respect the rights and dignity of others. (6). *(Author comment: Statement lacks five components: Products/Services, Markets, Technology, Concern for Survival/Growth/Profits, Concern for Public Image*)

Dell's mission is to be the most successful computer company (2) in the world (3) at delivering the best customer experience in markets we serve (1). In doing so, Dell will meet customer expectations of highest quality; leading technology (4); competitive pricing; individual and company accountability (6); best-in-class service and support (7); flexible customization capability (7); superior corporate citizenship (8); financial stability (5). *(Author comment: Statement lacks only one component: Concern for Employees)*

Procter & Gamble will provide branded products and services of superior quality and value (7) that improve the lives of the world's (3) consumers. As a result, consumers (1) will reward us with industry leadership in sales, profit (5), and value creation, allowing our people (9), our shareholders, and the communities (8) in which we live and work to prosper. *(Author comment: Statement lacks three components: Products/Services, Technology, and Philosophy)*

At **L'Oreal**, we believe that lasting business success is built upon ethical (6) standards which guide growth and on a genuine sense of responsibility to our employees (9), our consumers, our environment and to the communities in which we operate (8). *(Author comment: Statement lacks six components: Customers, Products/Services, Markets, Technology, Concern for Survival/Growth/Profits, Concern for Public Image)*

Note: The numbers in parentheses correspond to the nine components listed on page 178; author comments also refer to those components.

Ideally a statement would provide more than simply inclusion of a single word such as "products" or "employees" regarding a respective component. Why? Because the statement should be informative, inspiring, enduring, and serve to motivate stakeholders to action. Evaluation of a mission statement regarding inclusion of the nine components is just the beginning of the process to assess a statement's overall effectiveness.

Special Note to Students

Recall that gaining and sustaining competitive advantage is the essence of strategic management, so when presenting your vision or mission analysis for the firm, be sure to address the "self-concept" or "distinctive competence" component. Compare your recommended vision or mission statement both with the firm's existing statements and with rival firms' statements to clearly reveal how your recommendations or strategic plan enables the firm to gain and sustain competitive advantage. Thus, your proposed mission statement should certainly include the nine components and nine characteristics, but in your vision or mission discussion, focus on competitive advantage. In other words, be prescriptive, forward-looking, and insightful—couching your vision/mission overview in terms of how you believe the firm can best gain and sustain competitive advantage. Do not be content with merely showing a nine-component comparison of your proposed statement with rival firms' statements, although that would be nice to include in your analysis.

Conclusion

Every organization has a unique purpose and reason for being. This uniqueness should be reflected in vision and mission statements. The nature of a business vision and mission can represent either a competitive advantage or disadvantage for the firm. An organization achieves a heightened sense of purpose when strategists, managers, and employees develop and communicate a clear business vision and mission. Drucker says that developing a clear business vision and mission is the "first responsibility of strategists."

A good mission statement reveals an organization's customers; products or services; markets; technology; concern for survival, growth, and profitability; philosophy; self-concept; concern for public image; and concern for employees. These nine basic components serve as a practical framework for evaluating and writing mission statements. As the first step in strategic management, the vision and mission statements provide direction for all planning activities.

Well-designed vision and mission statements are essential for formulating, implementing, and evaluating strategy. Developing and communicating a clear business vision and mission are the most commonly overlooked tasks in strategic management. Without clear statements of vision and mission, a firm's short-term actions can be counterproductive to long-term interests. Vision and mission statements always should be subject to revision, but, if carefully prepared, they will require infrequent major changes. Organizations usually reexamine their vision and mission statements annually. Effective mission statements stand the test of time.

Vision and mission statements are essential tools for strategists, a fact illustrated in a short story told by Porsche's former CEO Peter Schultz (paraphrased):

> Three guys were at work building a large church. All were doing the same job, but when each was asked what his job was, the answers varied: "Pouring cement," the first replied; "Earning a paycheck," responded the second; "Helping to build a cathedral," said the third. Few of us can build cathedrals. But to the extent we can see the cathedral in whatever cause we are following, the job seems more worthwhile. Good strategists and a clear mission help us find those cathedrals in what otherwise could be dismal issues and empty causes.[11]

Key Terms and Concepts

concern for employees (p. 177)
concern for public image (p. 177)
concern for survival, growth, and profitability (p. 177)
creed statement (p. 171)
customers (p. 177)
markets (p. 177)
mission statement (p. 171)
mission statement components (p. 177)
philosophy (p. 177)
products or services (p. 177)
reconciliatory (p. 176)
self-concept (p. 177)
stakeholders (p. 176)
technology (p. 177)
vision statement (p. 173)

Issues for Review and Discussion

5-1. Develop (or find) a mission statement for Samsung Electronics. Analyze the company's mission statement in light of the guidelines in Chapter 5.

5-2. Summarize Samsung's successful global strategy for the last decade. Can that strategy be as successful in 2014? Explain.

5-3. See if you can find a vision statement for Samsung. If not, write a proposed vision statement for the company.

5-4. Should the mission statement components vary in importance depending on type of business? If yes, how would their relative importance vary for Samsung versus Singapore Airlines?

5-5. List three things you are on a mission to accomplish in the next three years. How relevant is the concept of vision/mission to an individual in their personal and professional life? Explain.

5-6. Conduct a Google search for the key words "mission statement." What are the two best websites in your opinion that provide example mission statements?

5-7. Write a vision statement for your university. Write a vision statement for your School (or College) of Business within the university.

5-8. If you just purchased a 10-employee company, how would you establish a clear vision and mission?

5-9. Identify from the Internet six mission statement examples. Evaluate the six statements and bring your analysis to class.

5-10. How and why could the process of developing a vision and mission statement vary across countries?

5-11. In order of importance, list six benefits of having a clearly defined vision and mission statement.

5-12. Only the fairy story ends "they lived happily ever after." What is the relevance of this statement to the concepts vision and mission statement?

5-13. Explain the meaning, and significance of the term "reconciliatory" in developing mission statements.

5-14. List the nine mission statement components. Give an example of each component for your college or university.

5-15. In order of importance, rank seven characteristics of a mission statement.

5-16. Write a vision and mission statement for a local restaurant in your area.

5-17. Write an excellent sentence for Samsung, which includes four mission statement components.

5-18. Within a given industry, compare the mission statements of three companies in your country versus three competing companies in the United States. How did they differ?

5-19. Does Singapore Airlines have its vision and mission statement posted on its website? Should the company? Why or why not?

5-20. How often do you think a firm's vision and mission statements should be changed? Why?

5-21. Explain how a mission statement can be "reconciliatory." Give an example.

5-22. Do local fast food restaurants need a mission statement posted in their place of business? Why or why not?

5-23. Find 5 mission statements on the Internet. Evaluate the statements in terms of six characteristics.

5-24. Referring to the end of Chapter 5, explain how a team of students should couch their mission statement discussion of slides in a presentation.

5-25. List the four most important characteristics of a mission statement for a small retail store. Explain.

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

5-26. Explain why a mission statement should not include strategies and objectives.

5-27. List seven characteristics of a mission statement.

5-28. Mymanagementlab Only—comprehensive writing assignment for this chapter.

Current Readings

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Restaurant Mission Statements, http://www.missionstatements.com/restaurant_mission_statements.html.

School Mission Statements, http://www.missionstatements.com/school_mission_statements.html.

ASSURANCE OF LEARNING EXERCISES

EXERCISE 5A

Examining Potential Changes Needed in a Firm's Vision/Mission

Purpose

Samsung Electronics is featured in the opening chapter insert as a firm that engages in excellent strategic planning. This exercise gives you practice examining the change or needed change in a company's vision and mission statements, given a change in the company's product offerings. Visit the Samsung corporate website. Samsung's vision statement is posted on their website, as: "Samsung is dedicated to developing innovative technologies and efficient processes that create new markets, enrich people's lives and continue to make Samsung a digital leader." The company's mission statement is called a statement of philosophy and also is given on the corporate website. Samsung does an excellent job in strategic management.

Instructions

Step 1 Evaluate Samsung's vision and mission statements in light of the characteristics and components in Chapter 5.

Step 2 Write improved vision and mission statements for Samsung Electronics given:
a) shortcomings of the statements based on Chapter 5 concepts, and
b) Samsung's new products being rolled out globally.

EXERCISE 5B

Studying an Alternative View of Mission Statement Content

Purpose

This exercise presents a somewhat different view of mission statements as compared to concepts presented in Chapter 5. For example, according to Bart (1997), a mission statement consists of three essential components:

1. Key market – Who is your target client/customer?
2. Contribution – What product or service do you provide to that client?
3. Distinction – What makes your product or service unique, so that the client would choose you?

For example, if you locate McDonald's mission statement on the Internet, Bart's essential components are covered in the following ways:

1. Key Market: the fast food customer world-wide
2. Contribution: tasty and reasonably-priced food prepared in a high-quality manner
3. Distinction: delivered consistently (world-wide) in a low-key décor and friendly atmosphere.

Another example is Courtyard by Marriott, which provides travelers with economy and quality lodging. Its key components are:

1. Key Market: economy and quality mindedtravelers
2. Contribution: moderate priced lodging
3. Distinction: consistently perceived as clean, comfortable, well-maintained, and attractive, staffed by friendly, attentive and efficient people

Instructions

Compare and contrast the guidelines presented by Bart with the guidelines presented in Chapter 5.

Source: Based on information at 1) Christopher K. Bart. "Sex, Lies, and Mission Statements." *Business Horizons*, pp. 9–18, November–December, 1997, and 2) www.wikipedia.com.

EXERCISE 5E

Selecting the Best Vision and Mission Statements in a Given Industry

Purpose

This exercise is designed to get you familiar with existing vision and mission statements in an industry of your choosing.

Instructions

Identify 10 companies in an industry that you are interested in working in one day. Find the companies' vision and mission statements. Keep searching until you have found five vision statements and five mission statements. The statements do not have to be from the same companies. Rank your five vision statements and your five mission statements in order of attractiveness, with 1 being the best and 5 being the worst.

EXERCISE 5F

Writing an Excellent Vision and Mission Statement for Novartis AG

Purpose

This exercise is designed to give you practice developing from scratch or improving an existing vision and mission statement.

Instructions

Step 1 Go to the Novartis AG website and look for the company's vision statement and mission statement. Recall from Chapter 5 that companies use different names or titles for these documents.

Step 2 Prepare an improved vision and mission statement for Novartis AG whether or not you were able to find these statements on the company's website or in the firm's *Annual Report*.

Notes

1. Peter Drucker, *Management: Tasks, Responsibilities, and Practices* (New York: Harper & Row, 1974), 61.
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EXERCISE 5C

Evaluating Mission Statements

Purpose

A business mission statement is an integral part of strategic management. It provides direction for formulating, implementing, and evaluating strategic activities. This exercise will give you practice evaluating mission statements, a skill that is a prerequisite to writing a good mission statement. The mission statement for adidas is given below:

"The adidas Group strives to be the global leader in the sporting goods industry with sports brands built on a passion for sports and a sporting lifestyle. We are dedicated to consistently delivering outstanding financial results. We are innovation and design leaders who seek to help athletes of all skill levels achieve peak performance with every product we bring to market. We are consumer focused and therefore we continuously improve the quality, look, feel and image of our products and our organizational structures to match and exceed consumer expectations and to provide them with the highest value. We are a global organization that is socially and environmentally responsible, creative and financially rewarding for our employees and shareholders. We are committed to continuously strengthening our brands and products to improve our competitive position."

Instructions

Step 1 On a separate sheet of paper, write the nine mission statement components down the left side.

Step 2 Write "yes" or "no" beside each number to indicate whether you feel the adidas mission statement has included the respective component. For any component that you record a "no," write a good sentence to encompass that component.

Step 3 Turn your paper in to your instructor for a classwork grade.

EXERCISE 5D

Evaluating the Mission Statement of Under Armour—a Competitor of adidas AG

Purpose

There is always room for improvement in regard to an existing vision and mission statement. Under Armour was founded in 1996 by former University of Maryland football player Kevin Plank. Under Armour sportswear is designed to keep athletes cool, dry and light throughout the course of a game, practice or workout. The technology behind Under Armour's diverse product assortment is complex, but the advice is simple: wear HeatGear® when it's hot, ColdGear® when it's cold, and AllSeasonGear® between the extremes (www.underarmour.com). Visit the Under Armour website and locate their mission statement.

Instructions

Step 1 On a separate sheet of paper, write the nine mission statement components down the lefthand side.

Step 2 Write "yes" or "no" beside each number to indicate whether you feel the Under Armour mission statement has included the respective component. For any component that you record a "no," write a good sentence to encompass that component.

Step 3 Turn your paper in to your instructor for a classwork grade.

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The Internal Audit

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Explain how the nature and role of chief marketing officer has changed.
2. Be able to work out breakeven analysis business problems.
3. Describe how to perform an internal strategic-management audit.
4. Discuss the resource-based view (RBV) in strategic management.
5. Discuss key interrelationships among the functional areas of business.
6. Identify the basic functions or activities that make up management, marketing, finance and accounting, production and operations, research and development, and management information systems.
7. Explain how to determine and prioritize a firm's internal strengths and weaknesses.
8. Explain the importance of financial ratio analysis.
9. Discuss the nature and role of management information systems in strategic management.
10. Develop an internal factor evaluation (IFE) matrix.
11. Explain cost/benefit analysis, value chain analysis, and benchmarking as strategic-management tools.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 6A Develop a Corporate IFE Matrix for Volkswagen Group

EXERCISE 6B Should VW Deploy More Resources or Less Outside of the USA?

EXERCISE 6C Apply Breakeven Analysis

EXERCISE 6D Performing a Financial Ratio Analysis for adidas AG

EXERCISE 6E Constructing an IFE Matrix for adidas AG

EXERCISE 6F Analyzing Your College or University's Internal Strategic Situation

This chapter focuses on identifying and evaluating a firm's strengths and weaknesses in the functional areas of business, including management, marketing, finance and accounting, production and operations, research and development (R&D), and management information systems (MIS). Relationships among these areas of business are examined. Strategic implications of important functional area concepts are examined. The process of performing an internal audit is described. The resource-based view (RBV) of strategic management is introduced as is the value chain analysis (VCA) concept. Volkswagen has done an excellent job in using its strengths to capitalize on external opportunities. Volkswagen is showcased in the opening chapter boxed insert.

The Nature of an Internal Audit

All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Maytag, for example, is known for excellent production and product design, whereas Procter & Gamble is known for superb marketing. Internal strengths and weaknesses, coupled with external opportunities and threats and clear vision and mission statements, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing on internal strengths and overcoming weaknesses. The internal-audit part of the strategic-management process is illustrated in Figure 6-1 with white shading.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Volkswagen

Volkswagen (VW) Group is a global automobile manufacturer headquartered in Wolfsburg, Lower Saxony, Germany. The largest German automaker and the third largest automaker in the world, VW produces more than 7 million cars, trucks, and vans annually, including the Beatle, Golf, Passat (trade wind), Jetta (jet stream), Rabbit, and Fox. VW also owns luxury carmakers—AUDI, Lamborghini, Bentley, and Bugatti, and other brands such as SEAT (family cars, Spain) and Škoda (family cars, the Czech Republic). VW owns 49.9 percent of Porsche. VW's American and Chinese version of the Passat won the 2012 Motor Trend Car of the Year. The VW Golf won the 2013 European Car of the Year. In 2013, *Fortune* ranked VW as the 9th largest company in the world, the 6th most profitable, and the 33rd most admired company outside the United States.

In an August 2013 study by the Trendence Institute (TI), the VW Group rose from 4th to 2nd place in the rankings of the most attractive employers in Europe, trailing only USA-based Google. In the study, 320,000 students from 24 European countries were interviewed with regard to their career plans and preferred employers. Ralph Linde, Head of the Volkswagen Group Academy, stated that as well as a trainee scheme for university graduates, Volkswagen also takes great pride in the mentoring and individual career development of each of its employees. This result confirms an April 2013 TI survey with 37,000 German students that revealed that companies in the Volkswagen Group are the most sought-after employers among German students.

For the January through August 2013 period, Volkswagen delivered 3.84 (+3.1 percent) million passenger cars worldwide, doing particularly well in China, where 1.56 (+18.4 percent) million units were delivered, and in Mexico, with 92,100 (+18.3 percent) deliveries. For that period, Audi delivered 1.03 million vehicles worldwide, an increase of 7.2 percent, led by China, where 310,300 (+19.5 percent) Audi vehicles were delivered. Audi deliveries during that period in the United States rose 14.7 percent compared with the same prior-year period, with 101,300 cars sold. VW's sports car manufacturer Porsche, which joined Volkswagen Group on August 1, 2012, delivered 106,800 vehicles in the first eight months of 2013 with the 32,500 units sold in the Asia-Pacific region comprising the largest share of Porsche deliveries. Another 31,400 Porsche's were handed over to customers in the North America region. Also during those eight months, VW's ŠKODA delivered 598,400 (−5.5 percent) vehicles worldwide, while SEAT delivered 234,200 (+11.4 percent) vehicles.

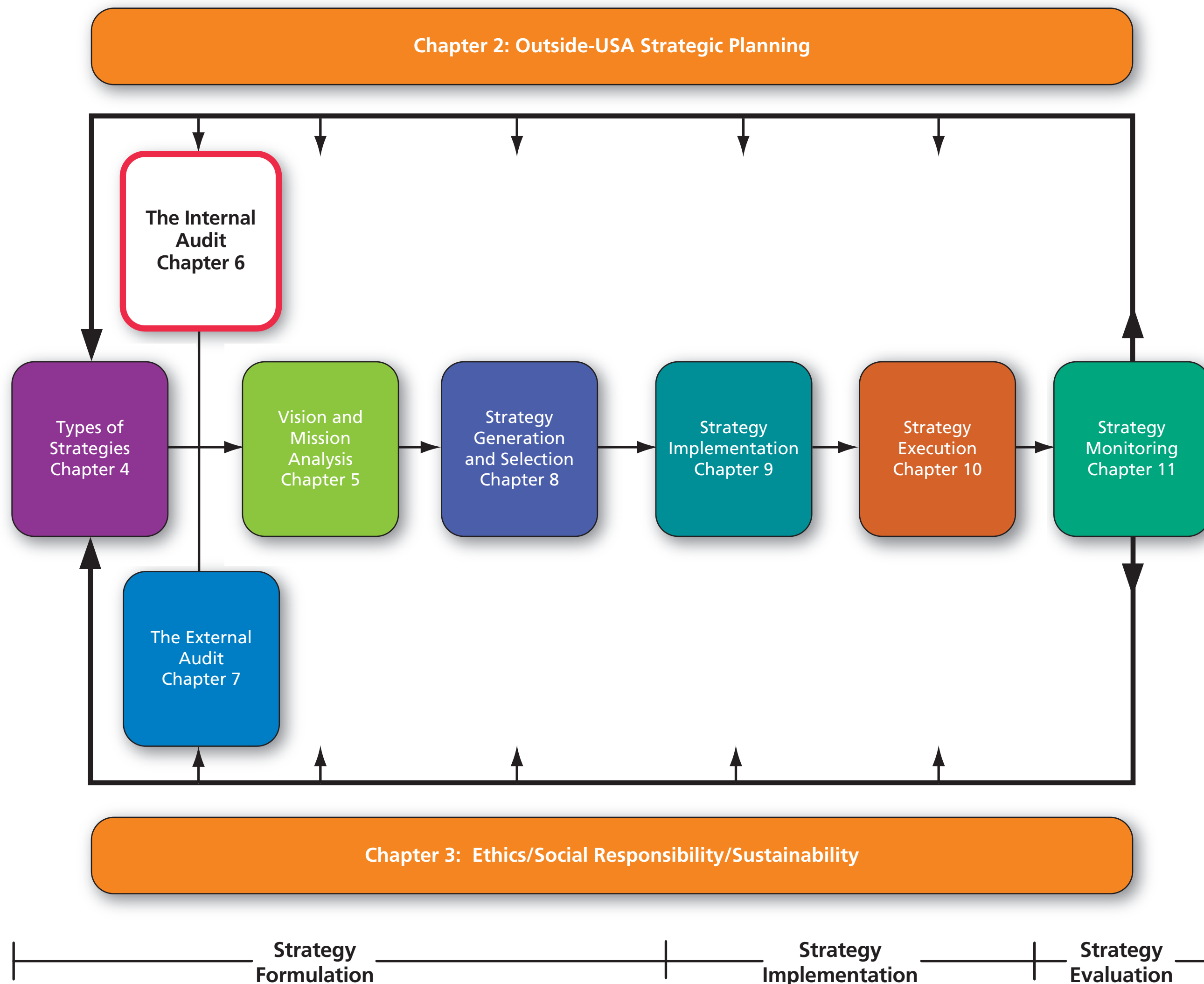

FIGURE 6-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

Key Internal Forces

It is not possible in a strategic-management text to review in depth all the material presented in courses such as marketing, finance, accounting, management, management information systems, and production and operations; there are many subareas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing. But strategic planning must include a detailed assessment of how the firm is doing in all internal areas.

For different types of organizations, such as hospitals, universities, and government agencies, the functional business areas, of course, differ. In a hospital, for example, functional areas may include cardiology, hematology, nursing, maintenance, physician support, and receivables. Functional areas of a university can include athletic programs, placement services, housing, fund-raising, academic research, counseling, and intramural programs. Within large organizations, each division has certain strengths and weaknesses.

A firm's strengths that cannot be easily matched or imitated by competitors are called **distinctive competencies.** Building competitive advantages involves taking advantage of distinctive competencies. Strategies are designed in part to improve on a firm's weaknesses, turning them into strengths—and maybe even into distinctive competencies.

Weaknesses ⇒ Strenghts ⇒ Distinctive Competencies ⇒ Competitive Advantage

FIGURE 6-2

The Process of Gaining Competitive Advantage in a Firm

Figure 6-2 illustrates that all firms should continually strive to improve on their weaknesses, turning them into strengths, and ultimately developing distinctive competencies that can provide the firm with competitive advantages over rival firms.

The Process of Performing an Internal Audit

The process of performing an **internal audit** closely parallels the process of performing an external audit. Representative managers and employees from throughout the firm need to be involved in determining a firm's strengths and weaknesses. The internal audit requires gathering and assimilating information about the firm's management, marketing, finance and accounting, production and operations, R&D, and MIS operations. Key factors should be prioritized as described in Chapter 7 so that the firm's most important strengths and weaknesses can be determined collectively.

Compared to the external audit, the process of performing an internal audit provides more opportunity for participants to understand how their jobs, departments, and divisions fit into the whole organization. This is a great benefit because managers and employees perform better when they understand how their work affects other areas and activities of the firm. For example, when marketing and manufacturing managers jointly discuss issues related to internal strengths and weaknesses, they gain a better appreciation of the issues, problems, concerns, and needs of all the functional areas. In organizations that do not use strategic management, marketing, finance, and manufacturing managers often do not interact with each other in significant ways. Performing an internal audit thus is an excellent vehicle or forum for improving the process of communication in the organization. **Communication** may be the most important word in management.

Performing an internal audit requires gathering, assimilating, and evaluating information about the firm's operations. Key internal factors, consisting of both strengths and weaknesses, can be identified and prioritized in the manner discussed in Chapter 7. According to William King, a task force of managers from different units of the organization, supported by staff, should be charged with determining the 20 most important strengths and weaknesses that should influence the future of the organization. He says:

> The development of conclusions on the 20 most important organizational strengths and weaknesses can be, as any experienced manager knows, a difficult task, when it involves managers representing various organizational interests and points of view. Developing a 20-page list of strengths and weaknesses could be accomplished relatively easily, but a list of the 20 most important ones involves significant analysis and negotiation. This is true because of the judgments that are required and the impact which such a list will inevitably have as it is used in the formulation, implementation, and evaluation of strategies.[1]

Strategic management is a highly interactive process that requires effective coordination among management, marketing, finance and accounting, production and operations, R&D, and MIS managers. Although the strategic-management process is overseen by strategists, success requires that managers and employees from all functional areas work together to provide ideas and information. Financial managers, for example, may need to restrict the number of feasible options available to operations managers, or R&D managers may develop products for which marketing managers need to set higher objectives. A key to organizational success is effective coordination and understanding among managers from all functional business areas. Through involvement in performing an internal strategic-management audit, managers from different departments and divisions of the firm come to understand the nature and effect of decisions in other functional business areas in their firm. Knowledge of these relationships is critical for effectively establishing objectives and strategies.

A failure to recognize and understand relationships among the functional areas of business can be detrimental to strategic management, and the number of those relationships that must be managed increases dramatically with a firm's size, diversity, geographic dispersion, and the number of products or services offered. Governmental and nonprofit enterprises traditionally have not placed sufficient emphasis on relationships among the business functions. Some firms place too great an emphasis on one function at the expense of others. Ansoff explained:

> During the first fifty years, successful firms focused their energies on optimizing the performance of one of the principal functions: production/operations, R&D, or marketing. Today, due to the growing complexity and dynamism of the environment, success increasingly depends on a judicious combination of several functional influences. This transition from a single function focus to a multifunction focus is essential for successful strategic management.[2]

Financial ratio analysis exemplifies the complexity of relationships among the functional areas of business. A declining return on investment or profit margin ratio could be the result of ineffective marketing, poor management policies, R&D errors, or a weak MIS. The effectiveness of strategy formulation, implementation, and evaluation activities hinges on a clear understanding of how major business functions affect one another. For strategies to succeed, a coordinated effort among all the functional areas of business is needed. In the case of planning, George wrote:

> We may conceptually separate planning for the purpose of theoretical discussion and analysis, but in practice, neither is it a distinct entity nor is it capable of being separated. The planning function is mixed with all other business functions and, like ink once mixed with water, it cannot be set apart. It is spread throughout and is a part of the whole of managing an organization.[3]

The Resource-Based View

Some researchers emphasize the importance of the internal audit part of the strategic-management process by comparing it to the external audit. Robert Grant concluded that the internal audit is more important, saying:

> In a world where customer preferences are volatile, the identity of customers is changing, and the technologies for serving customer requirements are continually evolving, an externally focused orientation does not provide a secure foundation for formulating long-term strategy. When the external environment is in a state of flux, the firm's own resources and capabilities may be a much more stable basis on which to define its identity. Hence, a definition of a business in terms of what it is capable of doing may offer a more durable basis for strategy.[4]

The **resource-based view (RBV)** approach to competitive advantage contends that internal resources are more important for a firm than external factors in achieving and sustaining competitive advantage. In contrast to the Industrial Organization (I/O) theory presented in Chapter 7, proponents of the RBV view contend that organizational performance will primarily be determined by internal resources that can be grouped into three all-encompassing categories: physical resources, human resources, and organizational resources.[5] Physical resources include all plant and equipment, location, technology, raw materials, machines; human resources include all employees, training, experience, intelligence, knowledge, skills, abilities; and organizational resources include firm structure, planning processes, information systems, patents, trademarks, copyrights, databases, and so on. RBV theory asserts that resources are actually what helps a firm exploit opportunities and neutralize threats.

The basic premise of the RBV is that the mix, type, amount, and nature of a firm's internal resources should be considered first and foremost in devising strategies that can lead to sustainable competitive advantage. Managing strategically according to the RBV involves developing and exploiting a firm's unique resources and capabilities, and continually maintaining and strengthening those resources. The theory asserts that it is advantageous for a

firm to pursue a strategy that is not currently being implemented by any competing firm. When other firms are unable to duplicate a particular strategy, then the focal firm has a sustainable competitive advantage, according to RBV theorists.

For a resource to be valuable, it must be either (a) rare, (b) hard to imitate, or (c) not easily substitutable. Often called **empirical indicators**, these three characteristics of resources enable a firm to implement strategies that improve its efficiency and effectiveness and lead to a sustainable competitive advantage. The more a resource(s) is rare, nonimitable, and nonsubstitutable, the stronger a firm's competitive advantage will be and the longer it will last.

Rare resources are resources that other competing firms do not possess. If many firms have the same resource, then those firms will likely implement similar strategies, thus giving no one firm a sustainable competitive advantage. This is not to say that resources that are common are not valuable; they do indeed aid the firm in its chance for economic prosperity. However, to sustain a competitive advantage, it is more advantageous if the resource(s) is also rare.

It is also important that these same resources be difficult to imitate. If firms cannot easily gain the resources, say RBV theorists, then those resources will lead to a competitive advantage more so than resources easily imitable. Even if a firm employs resources that are rare, a sustainable competitive advantage may be achieved only if other firms cannot easily obtain these resources.

The third empirical indicator that can make resources a source of competitive advantage is substitutability. Borrowing from Porter's Five-Forces Model, to the degree that there are no viable substitutes, a firm will be able to sustain its competitive advantage. However, even if a competing firm cannot perfectly imitate a firm's resource, it can still obtain a sustainable competitive advantage of its own by obtaining resource substitutes.

RBV has continued to grow in popularity and continues to seek a better understanding of the relationship between resources and sustained competitive advantage in strategic management. However, as alluded to in Chapter 7, one cannot say with any degree of certainty that either external or internal factors will always or even consistently be more important in seeking competitive advantage. Understanding both external and internal factors, and more importantly, understanding the relationships among them, will be the key to effective strategy formulation (discussed in Chapter 8). Because both external and internal factors continually change, strategists seek to identify and take advantage of positive changes and buffer against negative changes in a continuing effort to gain and sustain a firm's competitive advantage. This is the essence and challenge of strategic management, and oftentimes survival of the firm hinges on this work.

Integrating Strategy and Culture

Relationships among a firm's functional business activities perhaps can be exemplified best by focusing on organizational culture, an internal phenomenon that permeates all departments and divisions of an organization. **Organizational culture** can be defined as "a pattern of behavior that has been developed by an organization as it learns to cope with its problem of external adaptation and internal integration, and that has worked well enough to be considered valid and to be taught to new members as the correct way to perceive, think, and feel."[6] This definition emphasizes the importance of matching external with internal factors in making strategic decisions.

Organizational culture captures the subtle, elusive, and largely unconscious forces that shape a workplace. Remarkably resistant to change, culture can represent a major strength or weakness for the firm. It can be an underlying reason for strengths or weaknesses in any of the major business functions.

Defined in Table 6-1, **cultural products** include values, beliefs, rites, rituals, ceremonies, myths, stories, legends, sagas, language, metaphors, symbols, heroes, and heroines. These products or dimensions are levers that strategists can use to influence and direct strategy formulation, implementation, and evaluation activities. An organization's culture compares to an individual's personality in the sense that no two organizations have the same culture and no two individuals have the same personality. Both culture and personality are enduring and can be warm, aggressive, friendly, open, innovative, conservative, liberal, harsh, or likable.

At Google, the culture is informal. Employees are encouraged to wander the halls on employee-sponsored scooters and brainstorm on public whiteboards provided everywhere. In contrast, the culture at Procter & Gamble (P&G) is so rigid that employees jokingly call

TABLE 6-1 Example Cultural Products Defined

Rites	Planned sets of activities that consolidate various forms of cultural expressions into one event.
Ceremonial	Several rites connected together.
Ritual	A standardized set of behaviors used to manage anxieties.
Myth	A narrative of imagined events, usually not supported by facts.
Saga	A historical narrative describing the unique accomplishments of a group and its leaders.
Legend	A handed-down narrative of some wonderful event, usually not supported by facts.
Story	A narrative usually based on true events.
Folktale	A fictional story.
Symbol	Any object, act, event, quality, or relation used to convey meaning.
Language	The manner in which members of a group communicate.
Metaphors	Shorthand of words used to capture a vision or to reinforce old or new values.
Values	Life-directing attitudes that serve as behavioral guidelines.
Belief	An understanding of a particular phenomenon.
Heroes/Heroines	Individuals greatly respected.

Source: Based on H. M. Trice and J. M. Beyer, "Studying Organizational Cultures through Rites and Ceremonials," *Academy of Management Review* 9, no. 4 (October 1984): 655.

themselves "Proctoids." Despite this difference, the two companies are swapping employees and participating in each other's staff training sessions. Why? Because P&G spends more money on advertising than any other company and Google desires more of P&G's $8.7 billion in annual advertising expenses; P&G has come to realize that the next generation of laundry-detergent, toilet-paper, and skin-cream customers now spend more time online than watching TV.

Dimensions of organizational culture permeate all the functional areas of business. It is something of an art to uncover the basic values and beliefs that are deeply buried in an organization's rich collection of stories, language, heroes, and rituals, but cultural products can represent both important strengths and weaknesses. Culture is an aspect of an organization that can no longer be taken for granted in performing an internal strategic-management audit because culture and strategy must work together.

Table 6-2 provides some example (possible) aspects of an organization's culture. Note you could ask employees and managers to rate the degree that the dimension characterizes the firm. When one firm acquires another firm, integrating the two cultures can be important. For example, in Table 6-2, one firm may score mostly 1's (low) and the other firm may score mostly 5's (high), which would present a challenging strategic problem.

The strategic-management process takes place largely within a particular organization's culture. Lorsch found that executives in successful companies are emotionally committed to the firm's culture, but he concluded that culture can inhibit strategic management in two basic ways. First, managers frequently miss the significance of changing external conditions because they are blinded by strongly held beliefs. Second, when a particular culture has been effective in the past, the natural response is to stick with it in the future, even during times of major strategic change.[7] An organization's culture must support the collective commitment of its people to a common purpose. It must foster competence and enthusiasm among managers and employees.

Organizational culture significantly affects business decisions and thus must be evaluated during an internal strategic-management audit. If strategies can capitalize on cultural strengths, such as a strong work ethic or highly ethical beliefs, then management often can swiftly and easily implement changes. However, if the firm's culture is not supportive, strategic changes may be ineffective or even counterproductive. A firm's culture can become antagonistic to new strategies, with the result being confusion and disorientation.

TABLE 6-2 Fifteen Example (Possible) Aspects of an Organization's Culture

Dimension	Low	Degree			High
1. Strong work ethic; arrive early and leave late	1	2	3	4	5
2. High ethical beliefs; clear code of business ethics followed	1	2	3	4	5
3. Formal dress; shirt and tie expected	1	2	3	4	5
4. Informal dress; many casual dress days	1	2	3	4	5
5. Socialize together outside of work	1	2	3	4	5
6. Do not question supervisor's decision	1	2	3	4	5
7. Encourage whistle-blowing	1	2	3	4	5
8. Be health conscious; have a wellness program	1	2	3	4	5
9. Allow substantial "working from home"	1	2	3	4	5
10. Encourage creativity, innovation, and open-mindness	1	2	3	4	5
11. Support women and minorities; no glass ceiling	1	2	3	4	5
12. Be highly socially responsible; be philanthropic	1	2	3	4	5
13. Have numerous meetings	1	2	3	4	5
14. Have a participative management style	1	2	3	4	5
15. Preserve the natural environment; have a sustainability program	1	2	3	4	5

An organization's culture should infuse individuals with enthusiasm for implementing strategies. Allarie and Firsirotu emphasized the need to understand culture:

> Culture provides an explanation for the insuperable difficulties a firm encounters when it attempts to shift its strategic direction. Not only has the "right" culture become the essence and foundation of corporate excellence, it is also claimed that success or failure of reforms hinges on management's sagacity and ability to change the firm's driving culture in time and in time with required changes in strategies.[8]

The potential value of organizational culture has not been realized fully in the study of strategic management. Ignoring the effect that culture can have on relationships among the functional areas of business can result in barriers to communication, lack of coordination, and an inability to adapt to changing conditions. Some tension between culture and a firm's strategy is inevitable, but the tension should be monitored so that it does not reach a point at which relationships are severed and the culture becomes antagonistic. The resulting disarray among members of the organization would disrupt strategy formulation, implementation, and evaluation. In contrast, a supportive organizational culture can make managing much easier.

Internal strengths and weaknesses associated with a firm's culture sometimes are overlooked because of the interfunctional nature of this phenomenon. It is important, therefore, for strategists to understand their firm as a sociocultural system. Success is often determined by linkages between a firm's culture and strategies. The challenge of strategic management today is to bring about the changes in organizational culture and individual mind-sets that are needed to support the formulation, implementation, and evaluation of strategies.

Management

The **functions of management** consist of five basic activities: planning, organizing, motivating, staffing, and controlling. An overview of these activities is provided in Table 6-3. These activities are important to assess in strategic planning because an organization should continually capitalize on its management strengths and improve on its management weak areas.

Planning

The only thing certain about the future of any organization is change, and **planning** is the essential bridge between the present and the future that increases the likelihood of achieving desired results. Planning is the process by which one determines whether to attempt a task, works out the most effective way of reaching desired objectives, and prepares to overcome

TABLE 6-3 The Basic Functions of Management

Function	Description	Stage of Strategic-Management Process When Most Important
Planning	Planning consists of all those managerial activities related to preparing for the future. Specific tasks include forecasting, establishing objectives, devising strategies, developing policies, and setting goals.	Strategy Formulation
Organizing	Organizing includes all those managerial activities that result in a structure of task and authority relationships. Specific areas include organizational design, job specialization, job descriptions, job specifications, span of control, unity of command, coordination, job design, and job analysis.	Strategy Implementation
Motivating	Motivating involves efforts directed toward shaping human behavior. Specific topics include leadership, communication, work groups, behavior modification, delegation of authority, job enrichment, job satisfaction, needs fulfillment, organizational change, employee morale, and managerial morale.	Strategy Implementation
Staffing	Staffing activities are centered on personnel or human resource management. Included are wage and salary administration, employee benefits, interviewing, hiring, firing, training, management development, employee safety, affirmative action, equal employment opportunity, union relations, career development, personnel research, discipline policies, grievance procedures, and public relations.	Strategy Implementation
Controlling	Controlling refers to all those managerial activities directed toward ensuring that actual results are consistent with planned results. Key areas of concern include quality control, financial control, sales control, inventory control, expense control, analysis of variances, rewards, and sanctions.	Strategy Evaluation

unexpected difficulties with adequate resources. Planning is the start of the process by which an individual or business may turn empty dreams into achievements. Planning enables one to avoid the trap of working extremely hard but achieving little.

Planning is an up-front investment in success. Planning helps a firm achieve maximum effect from a given effort. Planning enables a firm to take into account relevant factors and focus on the critical ones. Planning helps ensure that the firm can be prepared for all reasonable eventualities and for all changes that will be needed. Planning enables a firm to gather the resources needed and carry out tasks in the most efficient way possible. Planning enables a firm to conserve its own resources, avoid wasting ecological resources, make a fair profit, and be seen as an effective, useful firm. Planning enables a firm to identify precisely what is to be achieved and to detail precisely the who, what, when, where, why, and how needed to achieve desired objectives. Planning enables a firm to assess whether the effort, costs, and implications associated with achieving desired objectives are warranted.[9] Planning is the cornerstone of effective strategy formulation. But even though it is considered the foundation of management, it is commonly the task that managers neglect most. Planning is essential for successful strategy implementation and strategy evaluation, largely because organizing, motivating, staffing, and controlling activities depend on good planning.

The process of planning must involve managers and employees throughout an organization. The time horizon for planning decreases from two to five years for top-level to less than six months for lower-level managers. The important point is that all managers do planning and should involve subordinates in the process to facilitate employee understanding and commitment.

Planning can have a positive impact on organizational and individual performance. Planning allows an organization to identify and take advantage of external opportunities as well as minimize the impact of external threats. Planning is more than extrapolating from the past and present into the future (long-range planning). It also includes developing a mission, forecasting future events and trends, establishing objectives, and choosing strategies to pursue (strategic planning).

An organization can develop synergy through planning. **Synergy** exists when everyone pulls together as a team that knows what it wants to achieve; synergy is the $2 + 2 = 5$ effect. By establishing and communicating clear objectives, employees and managers can work together toward desired results. Synergy can result in powerful competitive advantages. The strategic-management process itself is aimed at creating synergy in an organization.

Planning allows a firm to adapt to changing markets and thus to shape its own destiny. Strategic management can be viewed as a formal planning process that allows an organization to pursue proactive rather than reactive strategies. Successful organizations strive to control their own futures rather than merely react to external forces and events as they occur. Historically, organisms and organizations that have not adapted to changing conditions have become extinct. Swift adaptation is needed today more than ever because changes in markets, economies, and competitors worldwide are accelerating. Many firms did not adapt to the global recession of late and went out of business.

Organizing

The purpose of **organizing** is to achieve coordinated effort by defining task and authority relationships. Organizing means determining who does what and who reports to whom. There are countless examples in history of well-organized enterprises successfully competing against—and in some cases defeating—much stronger but less-organized firms. A well-organized firm generally has motivated managers and employees who are committed to seeing the organization succeed. Resources are allocated more effectively and used more efficiently in a well-organized firm than in a disorganized firm.

The organizing function of management can be viewed as consisting of three sequential activities: breaking down tasks into jobs (work specialization), combining jobs to form departments (departmentalization), and delegating authority. Breaking down tasks into jobs requires the development of job descriptions and job specifications. These tools clarify for both managers and employees what particular jobs entail. In *The Wealth of Nations*, published in 1776, Adam Smith cited the advantages of work specialization in the manufacture of pins:

> One man draws the wire, another straightens it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head. Ten men working in this manner can produce 48,000 pins in a single day, but if they had all wrought separately and independently, each might at best produce twenty pins in a day.[10]

Combining jobs to form departments results in an organizational structure, span of control, and a chain of command. Changes in strategy often require changes in structure because positions may be created, deleted, or merged. Organizational structure dictates how resources are allocated and how objectives are established in a firm. Allocating resources and establishing objectives geographically, for example, is much different from doing so by product or customer.

The most common forms of departmentalization are functional, divisional, strategic business unit, and matrix. These types of structure are discussed further in Chapter 10.

Delegating authority is an important organizing activity, as evidenced in the old saying "You can tell how good a manager is by observing how his or her department functions when he or she isn't there." Employees today are more educated and more capable of participating in organizational decision making than ever before. In most cases, they expect to be delegated authority and responsibility and to be held accountable for results. Delegation of authority is embedded in the strategic-management process.

Motivating

Motivating can be defined as the process of influencing people to accomplish specific objectives.[11] Motivation explains why some people work hard and others do not. Objectives, strategies, and policies have little chance of succeeding if employees and managers are not motivated to implement strategies once they are formulated. The motivating function of management includes at least four major components: leadership, group dynamics, communication, and organizational change.

When managers and employees of a firm strive to achieve high levels of productivity, this indicates that the firm's strategists are good leaders. Good leaders establish rapport with subordinates, empathize with their needs and concerns, set a good example, and are trustworthy and fair. Leadership includes developing a vision of the firm's future and inspiring people to work hard to achieve that vision. Kirkpatrick and Locke reported that certain traits also characterize effective leaders: knowledge of the business, cognitive ability, self-confidence, honesty, integrity, and drive.[12]Sun Tzu said: "Weak leadership can wreck the soundest strategy."

Research suggests that democratic behavior on the part of leaders results in more positive attitudes toward change and higher productivity than does autocratic behavior. Drucker said:

> Leadership is not a magnetic personality. That can just as well be demagoguery. It is not "making friends and influencing people." That is flattery. Leadership is the lifting of a person's vision to higher sights, the raising of a person's performance to a higher standard, the building of a person's personality beyond its normal limitations.[13]

Group dynamics play a major role in employee morale and satisfaction. Informal groups or coalitions form in every organization. The norms of coalitions can range from being positive to negative toward management. It is important, therefore, that strategists identify the composition and nature of informal groups in an organization to facilitate strategy formulation, implementation, and evaluation. Leaders of informal groups are especially important in formulating and implementing strategy changes.

Communication, perhaps the most important word in management, is a major component in motivation. An organization's system of communication determines whether strategies can be implemented successfully. Good two-way communication is vital for gaining support for departmental and divisional objectives and policies. Top-down communication can encourage bottom-up communication. The strategic-management process becomes a lot easier when subordinates are encouraged to discuss their concerns, reveal their problems, provide recommendations, and give suggestions. A primary reason for instituting strategic management is to build and support effective communication networks throughout the firm.

> The manager of tomorrow must be able to get his people to commit themselves to the business, whether they are machine operators or junior vice-presidents. The key issue will be empowerment, a term whose strength suggests the need to get beyond merely sharing a little information and a bit of decision making.[14]

Staffing

The management function of **staffing**, also called **personnel management** or **human resource management**, includes activities such as recruiting, interviewing, testing, selecting, orienting, training, developing, caring for, evaluating, rewarding, disciplining, promoting, transferring, demoting, and dismissing employees, as well as managing union relations.

Staffing activities play a major role in strategy-implementation efforts, and for this reason, human resource managers are becoming more actively involved in the strategic-management process. It is important to identify strengths and weaknesses in the staffing area.

The complexity and importance of human resource activities have increased to such a degree that all but the smallest organizations now need a full-time human resource manager. Numerous court cases that directly affect staffing activities are decided each day. Organizations and individuals can be penalized severely for not following federal, state, and local laws and guidelines related to staffing. Line managers simply cannot stay abreast of all the legal developments and requirements regarding staffing. The human resources department coordinates staffing decisions in the firm so that an organization as a whole meets legal requirements. This department also

provides needed consistency in administering company rules, wages, policies, and employee benefits as well as collective bargaining with unions.

Human resource management is particularly challenging for international companies. For example, the inability of spouses and children to adapt to new surroundings can be a staffing problem in overseas transfers. The problems include premature returns, job performance slumps, resignations, discharges, low morale, marital discord, and general discontent. Firms such as Ford Motor and ExxonMobil screen and interview spouses and children before assigning persons to overseas positions. 3M Corporation introduces children to peers in the target country and offers spouses educational benefits.

Controlling

The **controlling** function of management includes all of those activities undertaken to ensure that actual operations conform to planned operations. All managers in an organization have controlling responsibilities, such as conducting performance evaluations and taking necessary action to minimize inefficiencies. The controlling function of management is particularly important for effective strategy evaluation. Controlling consists of four basic steps:

1. Establishing performance standards
2. Measuring individual and organizational performance
3. Comparing actual performance to planned performance standards
4. Taking corrective actions

Measuring individual performance is often conducted ineffectively or not at all in organizations. Some reasons for this shortcoming are that evaluations can create confrontations that most managers prefer to avoid, can take more time than most managers are willing to give, and can require skills that many managers lack. No single approach to measuring individual performance is without limitations. For this reason, an organization should examine various methods, such as the graphic rating scale, the behaviorally anchored rating scale, and the critical incident method, and then develop or select a performance-appraisal approach that best suits the firm's needs. Increasingly, firms are striving to link organizational performance with managers' and employees' pay. This topic is discussed further in Chapter 10.

Management Audit Checklist of Questions

The following checklist of questions can help determine specific strengths and weaknesses in the functional area of business. An answer of *no* to any question could indicate a potential weakness, although the strategic significance and implications of negative answers, of course, will vary by organization, industry, and severity of the weakness. Positive or *yes* answers to the checklist questions suggest potential areas of strength.

1. Does the firm use strategic-management concepts?
2. Are company objectives and goals measurable and well communicated?
3. Do managers at all hierarchical levels plan effectively?
4. Do managers delegate authority well?
5. Is the organization's structure appropriate?
6. Are job descriptions and job specifications clear?
7. Is employee morale high?
8. Are employee turnover and absenteeism low?
9. Are organizational reward and control mechanisms effective?

Marketing

Marketing can be described as the process of defining, anticipating, creating, and fulfilling customers' needs and wants for products and services. There are seven basic **functions of marketing**: (1) customer analysis, (2) selling products and services, (3) product and service planning, (4) pricing, (5) distribution, (6) marketing research, and (7) opportunity analysis.[15] Understanding these functions helps strategists identify and evaluate marketing strengths and weaknesses.

Customer Analysis

Customer analysis—the examination and evaluation of consumer needs, desires, and wants—involves administering customer surveys, analyzing consumer information, evaluating market positioning strategies, developing customer profiles, and determining optimal market segmentation strategies. The information generated by customer analysis can be essential in developing an effective mission statement. Customer profiles can reveal the demographic characteristics of an organization's customers. Buyers, sellers, distributors, salespeople, managers, wholesalers, retailers, suppliers, and creditors can all participate in gathering information to successfully identify customers' needs and wants. Successful organizations continually monitor present and potential customers' buying patterns.

Selling Products and Services

Successful strategy implementation generally rests on the ability of an organization to sell some product or service. **Selling** includes many marketing activities, such as advertising, sales promotion, publicity, personal selling, sales force management, customer relations, and dealer relations. These activities are especially critical when a firm pursues a market penetration strategy. The effectiveness of various selling tools for consumer and industrial products varies. Personal selling is most important for industrial goods companies, whereas advertising is most important for consumer goods companies.

For example, the J.M. Smucker Company has $5.5 and 4.8 billion in revenue in 2012 and 2011, respectively, and spent $119 and $115 million in advertising during those two years, comprising 2.1 and 2.4 percent of revenues, respectively. About 3 percent of revenues is normal for companies to spend on advertising although this can vary across industries. J.M. Smucker has a product portfolio that includes coffee, peanut butter, fruit spreads, jams, shortening and oils, baking mixes, canned milk, flour, syrups, pickles, and more. One aspect of ads recently is that they generally take more direct aim at competitors, and this marketing practice is holding true in our bad economic times. Nick Brien at Mediabrands says, "Ads have to get combative in bad times. It's a dog fight, and it's about getting leaner and meaner." Ads are less lavish and glamorous today and are also more interactive. Table 6-4 lists specific characteristics of ads in response to the economic hard times many people nationwide and worldwide are facing.

Marketers spent about $3 million per 30-second advertising spot during the 2012 Super Bowl. Advertising can be expensive, and that is why marketing is a major business function to be studied carefully. Without marketing, even the best products and services have little chance of being successful.

Chief marketing officers (CMOs) such as Eduardo Conrado at Motorola now spend more than 50 percent of their budget on technology to manage activities like online marketing and social media.[16] Marketing is becoming technical with software to track and target customers and manage customer relationships, predict consumer behavior, run online storefronts, analyze social media, manage websites, and craft targeted advertisements. IBM in response to this trend is shifting its attention from CIOs to CMOs as their primary clients.

TABLE 6-4 Desirable Characteristics of Ads Today

1. Take direct aim at competitors; so leaner, meaner, and to the point.
2. Be less lavish and glamorous, requiring less production dollars to develop.
3. Be short and sweet, mostly 10- and 15-second ads rather than longer than 30 seconds.
4. "Make you feel good" or "put you in a good mood" because (a) ads can be more easily avoided than ever and (b) people are experiencing hard times and seek comfort.
5. Be more pervasive such as on buses, elevators, cell phones, and trucks.
6. Appear less on websites as banner ads become the new junk mail.
7. Red will overtake the color orange as the most popular ad color.
8. More than ever emphasize low price and value versus rivals.
9. More than ever emphasize how the product or service will make your life better.

Source: Based on Suzanne Vranica, "Ads to Go Leaner, Meaner in '09," *Wall Street Journal*, January 5, 2009, B8.

The world's largest social network, Facebook may epitomize where the advertising industry is going. Facebook allows a company to "leverage the loyalty" of its best customers. If you have recently gotten engaged and updated your Facebook status, you may start seeing ads from local jewelers who have used Facebook's automated ad system to target you. Facebook enables any firm today to effectively target their exact audience with perfect advertising.[17] In performing a strategic planning analysis, in addition to comparing rival firms' websites, it is important to compare rival firms' Facebook page.

One of the last off-limit advertising outlets has historically been books, but with the proliferation of e-books, marketers are experimenting more and more with advertising to consumers as they read e-books. New ads are being targeted based on the book's content and the demographic profile of the reader. Digital e-book companies such as Wowio and Amazon are trying to insert ads between chapters and along borders of digital pages. Random House says its e-books will soon include ads, but only with author approval.

Determining organizational strengths and weaknesses in the selling function of marketing is an important part of performing an internal strategic-management audit. With regard to advertising products and services on the Internet, a new trend is to base advertising rates exclusively on sales rates. This new accountability contrasts sharply with traditional broadcast and print advertising, which bases rates on the number of persons expected to see a given advertisement. The new cost-per-sale online advertising rates are possible because any website can monitor which user clicks on which advertisement and then can record whether that consumer actually buys the product. If there are no sales, then the advertisement is free.

Product and Service Planning

Product and service planning includes activities such as test marketing; product and brand positioning; devising warranties; packaging; determining product options, features, style, and quality; deleting old products; and providing for customer service. Product and service planning is particularly important when a company is pursuing product development or diversification.

One of the most effective product and service planning techniques is **test marketing.** Test markets allow an organization to test alternative marketing plans and to forecast future sales of new products. In conducting a test market project, an organization must decide how many cities to include, which cities to include, how long to run the test, what information to collect during the test, and what action to take after the test has been completed. Test marketing is used more frequently by consumer goods companies than by industrial goods companies. Test marketing can allow an organization to avoid substantial losses by revealing weak products and ineffective marketing approaches before large-scale production begins.

After extensive test marketing, the chocolate maker Hershey recently launched its first candy in China, a condensed milk candy. The company also opened a new Shanghai-based Asia Innovation Center to test market many potential premium milk type chocolate candies in various Asian countries. Hershey increased its number of stores in China by 32 percent and its sales force by 60 percent in 2013.

Pricing

In late 2012, J.C. Penney abandoned its month-long specials that cut prices of select items by 20 to 29 percent, and instead implemented permanent price cuts on a large amount of merchandise in their stores. Penney's pricing strategy gave consumers two options: everyday low prices and clearance sales on certain items. Penney's price change strategy came as the company's stock price had dropped 40 percent in recent months. To support the new pricing strategy, Penney's began offering free haircuts every Sunday for children aged 5 to 12. Free is a good price and this program exists in 949 of Penney's 1,100 stores totaling about 1 million haircuts per month. "It definitely drove new people and reintroduced J.C. Penney to existing customers who didn't know about the latest changes," said Jan Hodges, senior vice president of Penney's salon services. But in an about-face after losses, Penney's fired CEO Ron Johnson, brought back his predecessor Myron "Mike" Ullman, and began a "we're listening" campaign on Facebook to woo customers back into the stores.

Five major stakeholders affect **pricing** decisions: consumers, governments, suppliers, distributors, and competitors. Sometimes an organization will pursue a forward integration strategy primarily to gain better control over prices charged to consumers. Governments can

impose constraints on price fixing, price discrimination, minimum prices, unit pricing, price advertising, and price controls. For example, the Robinson-Patman Act prohibits manufacturers and wholesalers from discriminating in price among channel member purchasers (suppliers and distributors) if competition is injured.

Competing organizations must be careful not to coordinate discounts, credit terms, or condition of sale; not to discuss prices, markups, and costs at trade association meetings; and not to arrange to issue new price lists on the same date, to rotate low bids on contracts, or to uniformly restrict production to maintain high prices. Strategists should view price from both a short-run and a long-run perspective because competitors can copy price changes with relative ease. Often a dominant firm will aggressively match all price cuts by competitors.

With regard to pricing, as the value of the dollar increases, U.S. multinational companies have a choice. They can raise prices in the local currency of a foreign country or risk losing sales and market share. Alternatively, multinational firms can keep prices steady and face reduced profit when their export revenue is reported in the United States in dollars.

Intense price competition, coupled with Internet price-comparative shopping, has reduced profit margins to bare minimum levels for most companies. For example, when Toys 'R' Us introduced its first tablet for kids (the Tabeo) in late 2012 for $149.99, the company's three main competitors instantly reduced their tablet for kids: the Kurlo 7 by Techno Source, the Lexibook by Lexibook Ltd., and the Meep by Oregon Scientific. To help combat Internet comparative shopping, the Tabeo is available only at Toys 'R' Us stores.

Nike raised its shoe and clothing prices by 5 to 10 percent in late 2012 when the company introduced its new LeBron James basketball shoe that sells for $315. That shoe features embedded motion sensors that can measure how high players jump. Even the price of Nike's venerable Converse All-Star sneaker increased to just slightly more than $50. Nike faces rising labor costs in China, where it manufactures a third of its products.

Target Corp. recently joined Best Buy in offering to match online prices of rival retailers. Both companies are seeking to combat "showrooming" by shoppers who check out products in their stores but buy them on rival's websites. Both Target and Best Buy are matching prices from Amazon.com and Walmart.com and Toysrus.com.

Distribution

Distribution includes warehousing, distribution channels, distribution coverage, retail site locations, sales territories, inventory levels and location, transportation carriers, wholesaling, and retailing. Most producers today do not sell their goods directly to consumers. Various marketing entities act as intermediaries; they bear a variety of names such as wholesalers, retailers, brokers, facilitators, agents, vendors—or simply distributors.

Distribution becomes especially important when a firm is striving to implement a market development or forward integration strategy. Some of the most complex and challenging decisions facing a firm concern product distribution. Intermediaries flourish in our economy because many producers lack the financial resources and expertise to carry out direct marketing. Manufacturers who could afford to sell directly to the public often can gain greater returns by expanding and improving their manufacturing operations.

Successful organizations identify and evaluate alternative ways to reach their ultimate market. Possible approaches vary from direct selling to using just one or many wholesalers and retailers. Strengths and weaknesses of each channel alternative should be determined according to economic, control, and adaptive criteria. Organizations should consider the costs and benefits of various wholesaling and retailing options. They must consider the need to motivate and control channel members and the need to adapt to changes in the future. Once a marketing channel is chosen, an organization usually must adhere to it for an extended period of time.

Marketing Research

Marketing research is the systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services. Marketing research can uncover critical strengths and weaknesses, and marketing researchers employ numerous scales, instruments, procedures, concepts, and techniques to gather information. Marketing research activities support all of the major business functions of an organization. Organizations that possess excellent marketing research skills have a definite strength in pursuing generic strategies. The president of PepsiCo said,

> Looking at the competition is the company's best form of market research. The majority of our strategic successes are ideas that we borrow from the marketplace, usually from a small regional or local competitor. In each case, we spot a promising new idea, improve on it, and then out-execute our competitor.[18]

Cost/Benefit Analysis

The seventh function of marketing is **cost/benefit analysis,** which involves assessing the costs, benefits, and risks associated with marketing decisions. Three steps are required to perform a cost/benefit analysis: (1) compute the total costs associated with a decision, (2) estimate the total benefits from the decision, and (3) compare the total costs with the total benefits. When expected benefits exceed total costs, an opportunity becomes more attractive. Sometimes the variables included in a cost/benefit analysis cannot be quantified or even measured, but usually reasonable estimates can be made to allow the analysis to be performed. One key factor to be considered is risk. Cost/benefit analysis should also be performed when a company is evaluating alternative ways to be socially responsible.

The practice of cost/benefit analysis differs among countries and industries. Some of the main differences include the types of impacts that are included as costs and benefits within appraisals, the extent to which impacts are expressed in monetary terms, and differences in the discount rate. Government agencies across the world rely on a basic set of key cost/benefit indicators, including the following:

1. net present value (NPV)
2. present value of benefits (PVB)
3. present value of costs (PVC)
4. benefit cost ratio (BCR) = PVB / PVC
5. Net benefit = PVB – PVC
6. NPV/k (where k is the level of funds available)[19]

Marketing Audit Checklist of Questions

The following questions about marketing must be examined in strategic planning:

1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Has the firm's market share been increasing?
4. Are present channels of distribution reliable and cost effective?
5. Does the firm have an effective sales organization?
6. Does the firm conduct market research?
7. Are product quality and customer service good?
8. Are the firm's products and services priced appropriately?
9. Does the firm have an effective promotion, advertising, and publicity strategy?
10. Are marketing, planning, and budgeting effective?
11. Do the firm's marketing managers have adequate experience and training?
12. Is the firm's Internet presence excellent as compared to rivals?

Finance and Accounting

Financial condition is often considered the single best measure of a firm's competitive position and overall attractiveness to investors. Determining an organization's financial strengths and weaknesses is essential to effectively formulating strategies. A firm's liquidity, leverage, working capital, profitability, asset utilization, cash flow, and equity can eliminate some strategies as being feasible alternatives. Financial factors often alter existing strategies and change implementation plans.

Especially good websites from which to obtain financial information about firms are provided in Table 6-5.

Finance and Accounting Functions

According to James Van Horne, the **functions of finance/accounting** comprise three decisions: the investment decision, the financing decision, and the dividend decision.[20] Financial ratio analysis is the most widely used method for determining an organization's strengths and weaknesses

TABLE 6-5 Excellent Websites to Obtain Information on Companies, Including Financial Ratios

1. www.money.msn.com
2. http://finance.yahoo.com
3. www.morningstar.com
4. www.hoovers.com
5. http://globaledge.msu.edu/industries/

in the investment, financing, and dividend areas. Because the functional areas of business are so closely related, financial ratios can signal strengths or weaknesses in management, marketing, production, R&D, and MIS activities. Financial ratios are equally applicable in for-profit and nonprofit organizations. Even though nonprofit organizations obviously would not have return-on-investment or earnings-per-share ratios, they would routinely monitor many other special ratios. For example, a church would monitor the ratio of dollar contributions to number of members, whereas a zoo would monitor dollar food sales to number of visitors. A university would monitor number of students divided by number of professors. Therefore, be creative when performing ratio analysis for nonprofit organizations because they strive to be financially sound just as for-profit firms do. Nonprofit organizations need strategic planning just as much as for-profit firms.

The **investment decision,** also called **capital budgeting,** is the allocation and reallocation of capital and resources to projects, products, assets, and divisions of an organization. Once strategies are formulated, capital budgeting decisions are required to successfully implement strategies. The **financing decision** determines the best capital structure for the firm and includes examining various methods by which the firm can raise capital (for example, by issuing stock, increasing debt, selling assets, or using a combination of these approaches). The financing decision must consider both short-term and long-term needs for working capital. Two key financial ratios that indicate whether a firm's financing decisions have been effective are the debt-to-equity ratio and the debt-to-total-assets ratio.

Dividend decisions concern issues such as the percentage of earnings paid to stockholders, the stability of dividends paid over time, and the repurchase or issuance of stock. Dividend decisions determine the amount of funds that are retained in a firm compared to the amount paid out to stockholders. Three financial ratios that are helpful in evaluating a firm's dividend decisions are the earnings-per-share ratio, the dividends-per-share ratio, and the price-earnings ratio. The benefits of paying dividends to investors must be balanced against the benefits of internally retaining funds, and there is no set formula on how to balance this trade-off. For the reasons listed here, dividends are sometimes paid out even when funds could be better reinvested in the business or when the firm has to obtain outside sources of capital:

1. Paying cash dividends is customary. Failure to do so could be thought of as a stigma. A dividend change is considered a signal about the future.
2. Dividends represent a sales point for investment bankers. Some institutional investors can buy only dividend-paying stocks.
3. Shareholders often demand dividends, even in companies with great opportunities for reinvesting all available funds.
4. A myth exists that paying dividends will result in a higher stock price.

In the second quarter of 2012 alone, 505 U.S. companies boosted their dividends, after 677 firms boosted their dividends in the first quarter. In fact, 70 percent of the stocks in the S&P 500 raised their dividend in 2012. S&P companies are on average today paying out 31 percent of their earnings in the form of dividends, but that is down from 52 percent of earnings in some years.[21] For calendar 2013, companies in the S&P 500 are expected to pay at least $300 billion in dividends, topping 2012's $282 billion. Companies are also buying back their own stock (called Treasury stock) at record levels.

Unlike most firms, RadioShack Corp. recently suspended its 12.5 cents-a-share quarterly dividend, saving $50 million annually to avoid a liquidity crunch as the company seeks to lower its debt. The 91-year-old company has 4,700 stores in towns and cities across the United States

and Mexico, but RadioShack is struggling to compete with online-only rivals such as Amazon because customers increasingly order electronics online.

Based in London, BP PLC recently boosted its quarterly dividend 13 percent to $0.09 a share. BP's board, in announcing the increase, said the company has a bright future with its recent $26.8 billion cash-and-shares deal to acquire a 20 percent stake in Russia's state-controlled OAO Rosneft. Despite not yet settling lawsuits related to the Gulf of Mexico Deepwater Horizons oil spill, BP posted a net profit for the three months ended September, 30, 2012, of $5.43 billion, up from $5.04 billion the prior year.

Costco in late 2012 borrowed $3.5 billion just to pay its shareholders a $7 dividend per share, totaling $3 billion. The dividend payout, without the borrowing, would have depleted Costco's cash account. Many companies near the end of 2012 paid "special" dividends, 175 in November 2012 alone or firms paid dividends early, to avoid the expected 2013 substantial increase in taxes on dividends.

Basic Types of Financial Ratios

Financial ratios are computed from an organization's income statement and balance sheet. Computing financial ratios is like taking a picture because the results reflect a situation at just one point in time. Comparing ratios over time and to industry averages is more likely to result in meaningful statistics that can be used to identify and evaluate strengths and weaknesses. Trend analysis, illustrated in Figure 6-3, is a useful technique that incorporates both the time and industry average dimensions of financial ratios. Note that the dotted lines reveal projected ratios. Some websites, such as those provided in Table 6-5, calculate financial ratios and provide data with charts.

Table 6-6 provides a summary of key financial ratios showing how each ratio is calculated and what each ratio measures. However, all the ratios are not significant for all industries and companies. For example, accounts receivable turnover and average collection period are not meaningful to a company that primarily does a cash receipts business. Key financial ratios can be classified into the following five types:

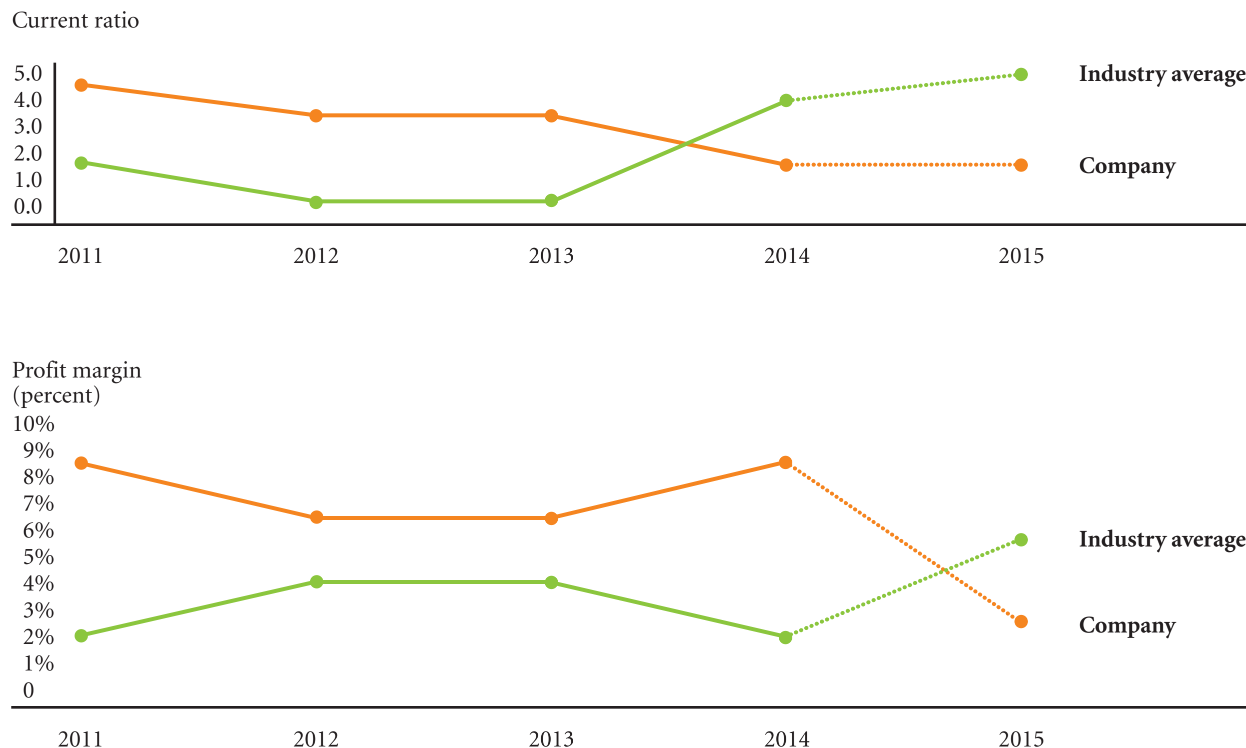

FIGURE 6-3

A Financial Ratio Trend Analysis

TABLE 6-6 A Summary of Key Financial Ratios

Ratio	How Calculated	What It Measures
Liquidity Ratios		
Current Ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	The extent to which a firm can meet its short-term obligations
Quick Ratio	$\frac{\text{Current assets minus inventory}}{\text{Current liabilities}}$	The extent to which a firm can meet its short-term obligations without relying on the sale of its inventories
Leverage Ratios		
Debt-to-Total-Assets Ratio	$\frac{\text{Total debt}}{\text{Total assets}}$	The percentage of total funds that are provided by creditors
Debt-to-Equity Ratio	$\frac{\text{Total debt}}{\text{Total stackholders' equity}}$	The percentage of total funds provided by creditors versus by owners
Long-Term Debt-to-Equity Ratio	$\frac{\text{Long-term debt}}{\text{Total stackholders' equity}}$	The balance between debt and equity in a firm's long-term capital structure
Times-Interest-Earned Ratio	$\frac{\text{Profits before interest and taxes}}{\text{Total interest charges}}$	The extent to which earnings can decline without the firm becoming unable to meet its annual interest costs
Activity Ratios		
Inventory Turnover	$\frac{\text{Sales}}{\text{Inventory of finished goods}}$	Whether a firm holds excessive stocks of inventories and whether a firm is slowly selling its inventories compared to the industry average
Fixed Assets Turnover	$\frac{\text{Sales}}{\text{Fixed assets}}$	Sales productivity and plant and equipment utilization
Total Assets Turnover	$\frac{\text{Sales}}{\text{Total assets}}$	Whether a firm is generating a sufficient volume of business for the size of its asset investment
Accounts Receivable Turnover	$\frac{\text{Annual credit sales}}{\text{Accounts receivable}}$	The average length of time it takes a firm to collect credit sales (in percentage terms)
Average Collection Period	$\frac{\text{Accounts receivable}}{\text{Total credit sales/365 days}}$	The average length of time it takes a firm to collect on credit sales (in days)
Profitability Ratios		
Gross Profit Margin	$\frac{\text{Sales minus cost of goods sold}}{\text{Sales}}$	The total margin available to cover operating expenses and yield a profit
Operating Profit Margin	$\frac{\text{Earnings before interest and taxes EBIT}}{\text{Sales}}$	Profitability without concern for taxes and interest
Net Profit Margin	$\frac{\text{Net income}}{\text{Sales}}$	After-tax profits per dollar of sales
Return on Total Assets (ROA)	$\frac{\text{Net income}}{\text{Total assets}}$	After-tax profits per dollar of assets; this ratio is also called return on investment (ROI)
Return on Stockholders' Equity (ROE)		After-tax profits per dollar of stockholders' investment in the firm
Earnings Per Share (EPS)	$\frac{\text{Net income}}{\text{Number of shares of common stock outstanding}}$	Earnings available to the owners of common stock
Price-Earnings Ratio	$\frac{\text{Market price per share}}{\text{Earnings per share}}$	Attractiveness of firm on equity markets
Growth Ratios		
Sales	Annual percentage growth in total sales	Firm's growth rate in sales
Net Income	Annual percentage growth in profits	Firm's growth rate in profits
Earnings Per Share	Annual percentage growth in EPS	Firm's growth rate in EPS
Dividends Per Share	Annual percentage growth in dividends per share	Firm's growth rate in dividends per share

1. **Liquidity ratios** measure a firm's ability to meet maturing short-term obligations.

   Current ratio
   Quick (or acid-test) ratio

2. **Leverage ratios** measure the extent to which a firm has been financed by debt.

   Debt-to-total-assets ratio
   Debt-to-equity ratio
   Long-term debt-to-equity ratio
   Times-interest-earned (or coverage) ratio

3. **Activity ratios** measure how effectively a firm is using its resources.

   Inventory turnover
   Fixed assets turnover
   Total assets turnover
   Accounts receivable turnover
   Average collection period

4. **Profitability ratios** measure management's overall effectiveness as shown by the returns generated on sales and investment.

   Gross profit margin
   Operating profit margin
   Net profit margin
   Return on total assets (ROA)
   Return on stockholders' equity (ROE)
   Earnings per share (EPS)
   Price-earnings ratio

5. **Growth ratios** measure the firm's ability to maintain its economic position in the growth of the economy and industry.

   Sales
   Net income
   Earnings per share
   Dividends per share

Financial ratio analysis must go beyond the actual calculation and interpretation of ratios. The analysis should be conducted on three separate fronts:

1. ***How has each ratio changed over time?*** This information provides a means of evaluating historical trends. It is important to note whether each ratio has been historically increasing, decreasing, or nearly constant. For example, a 10 percent profit margin could be bad if the trend has been down 20 percent each of the last three years. But a 10 percent profit margin could be excellent if the trend has been up, up, up. Therefore, calculate the percentage change in each ratio from one year to the next to assess historical financial performance on that dimension. Identify and examine large percent changes in a financial ratio from one year to the next.
2. ***How does each ratio compare to industry norms?*** A firm's inventory turnover ratio may appear impressive at first glance but may pale when compared to industry standards or norms. Industries can differ dramatically on certain ratios. For example grocery companies, such as Kroger, have a high inventory turnover whereas automobile dealerships have a lower turnover. Therefore, comparison of a firm's ratios within its particular industry can be essential in determining strength and weakness.

3. ***How does each ratio compare with key competitors?*** Oftentimes competition is more intense between several competitors in a given industry or location than across all rival firms in the industry. When this is true, financial ratio analysis should include comparison to those key competitors. For example, if a firm's profitability ratio is trending up over time and compares favorably to the industry average, but it is trending down relative to its leading competitor, there may be reason for concern.

Financial ratio analysis is not without some limitations. First of all, financial ratios are based on accounting data, and firms differ in their treatment of such items as depreciation, inventory valuation, R&D expenditures, pension plan costs, mergers, and taxes. Also, seasonal factors can influence comparative ratios. Therefore, conformity to industry composite ratios does not establish with certainty that a firm is performing normally or that it is well managed. Likewise, departures from industry averages do not always indicate that a firm is doing especially well or badly. For example, a high inventory turnover ratio could indicate efficient inventory management and a strong working capital position, but it also could indicate a serious inventory shortage and a weak working capital position.

Another limitation of financial ratios in terms of including them as key internal factors in the upcoming IFE Matrix is that financial ratios are not very "actionable" in terms of revealing potential strategies needed, i.e. since they generally are based on performance of the overall firm. For example, to include as a key internal factor that the firm's "current ratio increased from 1.8 to 2.1" is not as "actionable" as "the firm's fragrance division revenues increased 18 percent in Africa in 2013." Chapter 7 discusses the importance of selecting "actionable" key factors, both externally and internally, upon which to formulate strategies. Selecting "actionable" key factors, both externally and internally, upon which to formulate strategies is important.

A firm's financial condition depends not only on the functions of finance, but also on many other factors that include (1) management, marketing, management production and operations, R&D, and MIS; (2) actions by competitors, suppliers, distributors, creditors, customers, and shareholders; and (3) economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends.

Breakeven Analysis

Because consumers remain price sensitive, many firms have lowered prices to compete. As a firm lowers prices, its **breakeven (BE) point** in terms of units sold increases, as illustrated in Figure 6-4. The breakeven point can be defined as the quantity of units that a firm must sell for its total revenues (TR) to equal its total costs (TC). Note that the before and after chart in Figure 6-4 reveals that the TR line rotates to the right with a decrease in price, thus increasing the quantity (Q) that must be sold just to break even. Increasing the breakeven point is thus a huge drawback of lowering prices. Of course when rivals are lowering prices, a firm may have to lower prices anyway to compete. However, the breakeven concept should be kept in mind because it is so important, especially in recessionary times.

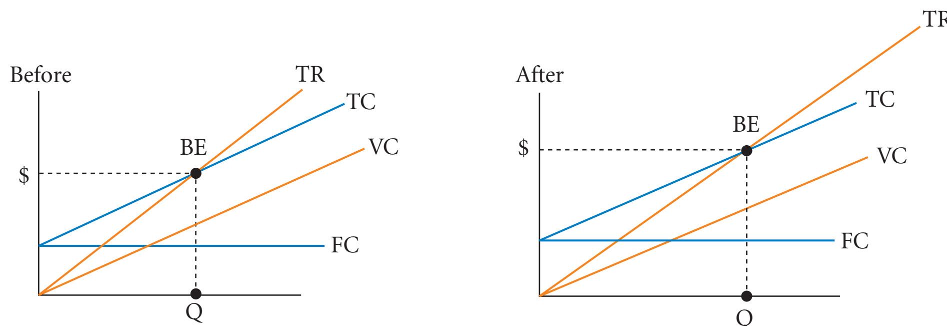

FIGURE 6-4

A Before and After Breakeven Chart When Prices Are Lowered

Notice in Figure 6-5 that increasing fixed costs (FC) also raises a firm's breakeven quantity. Note the before and after chart in Figure 6-5 reveals that adding fixed costs such as more stores, or more plants, or even more advertising as part of a strategic plan raises the TC line, which makes the intersection of the TC and TR lines at a point farther down the Quantity axis. Increasing a firm's FC thus significantly raises the quantity of goods that must be sold to break even. This is not just theory for the sake of theory. Firms with less fixed costs, such as Apple and Amazon.com, have lower breakeven points, which give them a decided competitive advantage in harsh economic times. Figure 6-5 reveals that adding **fixed costs (FC),** such as plant, equipment, stores, advertising, and land, may be detrimental whenever there is doubt that significantly more units can be sold to offset those expenditures.

Firms must be cognizant of the fact that lowering prices and adding fixed costs could be a catastrophic double whammy because the firm's breakeven quantity needed to be sold is increased dramatically. Figure 6-6 illustrates this double whammy. Note how far the breakeven point shifts with both a price decrease and an increase in fixed costs. If a firm does not break-even, then it will of course incur losses, and losses are not good, especially sustained losses.

Finally, note in Figures 6-4, 6-5, and 6-6 that **variable costs (VC),** such as labor and materials, when increased, have the effect of raising the breakeven point, too. Raising VC is reflected by the VC line shifting left or becoming steeper. When the TR line remains constant, the effect of increasing VC is to increase TC, which increases the point at which TR = TC = BE.

The formula for calculating breakeven point is BE Quantity = TFC divided by (price – VC). In other words, the quantity or units of product that need to be sold for a firm to breakeven is total fixed costs divided by (price per unit – variable costs per unit). A breakeven problem is given in Table 6-7.

Suffice it to say here that various strategies can have dramatically beneficial or harmful effects on the firm's financial condition because of the concept of breakeven analysis.

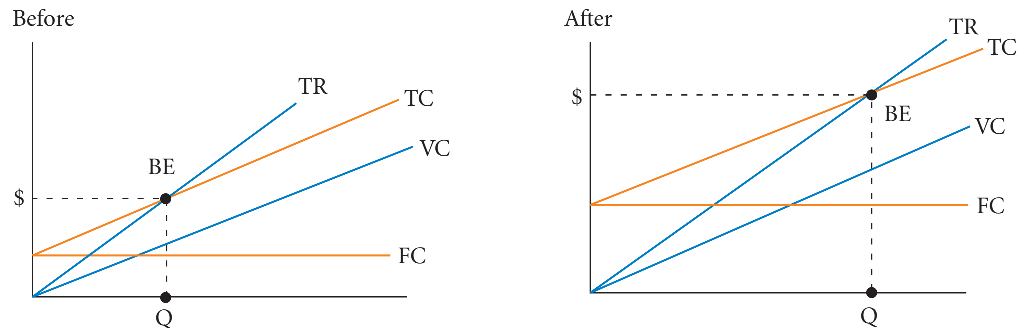

FIGURE 6-5

A Before and After Breakeven Chart When Fixed Costs Are Increased

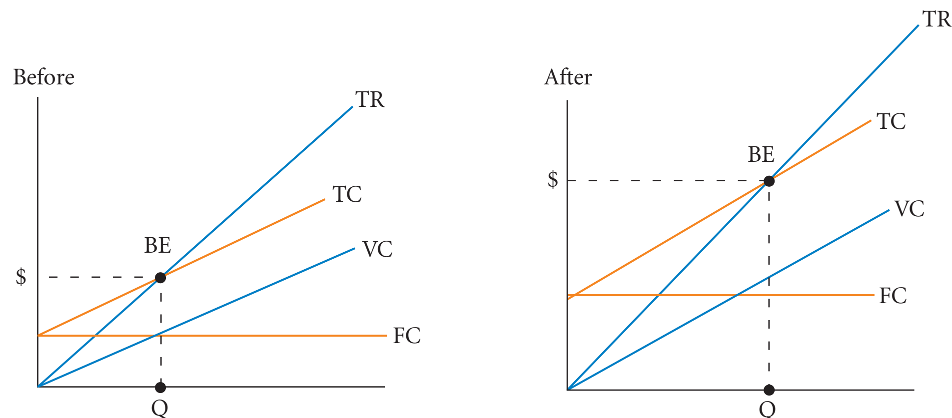

FIGURE 6-6

A Before and After Breakeven Chart When Prices Are Lowered and Fixed Costs Are Increased

TABLE 6-7 Applying Breakeven Analysis for Joy's Day Care

Seeing a need for childcare in her town, Joy is considering opening her own day-care service. Joy's Day Care needs to be affordable, so Joy would like to care for each child for $12 a day. But Joy also wants to make money. Joy needs to know how many children she will have to watch per day to make money. Joy gathered the following information about her potential new business.

- The month of June has 20 workdays, Monday through Friday for 4 weeks.
- Insurance and rent on her business will be $200 and $400, respectively, per month.
- Expenses per student per day will be snacks (2 @ $1.00) + meals (2 @ $3.00).

Joy's Analysis

Breakeven = Operating Expenses ÷ ($12.00 – $8.00)

Breakeven = $600 ÷ $4.00 Breakeven = 150 units (children) in June.

Because there are 20 days in June, Joy must watch 150 ÷ 20 = 7.5 kids, or 8 children every day to make a profit.

Joy's Conclusion

Thanks to breakeven analysis, Joy is pondering whether or not she can care for 8 children daily. Instead of abruptly opening the business, Joy is now considering adding a helper for $50 per day and charging $20 per student per day. How many students now would Joy have to care for to make a profit under this scenario? (Answer 6.6 = 7) What do you think would be an ideal scenario for Joy in planning for her new business?

There are some limitations of breakeven analysis, including the following points:

1. Breakeven analysis is only a supply side (i.e., costs only) analysis because it tells you nothing about what sales are likely to be for the product at various prices.
2. It assumes that fixed costs are constant. Although this is true in the short run, an increase in the scale of production will cause fixed costs to rise.
3. It assumes average variable costs are constant per unit of output, at least in the range of likely quantities of sales.
4. It assumes that the quantity of goods produced is equal to the quantity of goods sold (i.e., there is no change in beginning or ending inventory).
5. In multiproduct companies, it assumes that the relative proportions of each product sold and produced are constant (i.e., the sales mix is constant).[22]

Finance and Accounting Audit Checklist

The following finance and accounting questions, like the similar questions about marketing and management previously, should be examined:

1. Where is the firm financially strong and weak as indicated by financial ratio analyses?
2. Can the firm raise needed short-term capital?
3. Can the firm raise needed long-term capital through debt or equity?
4. Does the firm have sufficient working capital?
5. Are capital budgeting procedures effective?
6. Are dividend payout policies reasonable?
7. Does the firm have good relations with its investors and stockholders?
8. Are the firm's financial managers experienced and well trained?
9. Is the firm's debt situation excellent?

Production and Operations

The extent to which a manufacturing plant's output reaches its potential output is called **capacity utilization,** a key strategic variable. The higher the capacity utilization the better because otherwise equipment may sit idle. The estimated plant capacity utilization in Europe for the major auto producers is Volkswagen (84%), Renault (77%), Peugeot (73%), Ford (66%), GM (60%), and Fiat (55%).[23]

The **production/operations function** of a business consists of all those activities that transform inputs into goods and services. Production and operations management deals with inputs, transformations, and outputs that vary across industries and markets. A manufacturing operation transforms or converts inputs such as raw materials, labor, capital, machines, and facilities into finished goods and services. As indicated in Table 6-8, Roger Schroeder suggested

TABLE 6-8 The Basic Functions (Decisions) Within Production/Operations

Decision Areas	Example Decisions
1. Process	These decisions include choice of technology, facility layout, process flow analysis, facility location, line balancing, process control, and transportation analysis. Distances from raw materials to production sites to customers are a major consideration.
2. Capacity	These decisions include forecasting, facilities planning, aggregate planning, scheduling, capacity planning, and queuing analysis. Capacity utilization is a major consideration.
3. Inventory	These decisions involve managing the level of raw materials, work-in-process, and finished goods, especially considering what to order, when to order, how much to order, and materials handling.
4. Workforce	These decisions involve managing the skilled, unskilled, clerical, and managerial employees by caring for job design, work measurement, job enrichment, work standards, and motivation techniques.
5. Quality	These decisions are aimed at ensuring that high-quality goods and services are produced by caring for quality control, sampling, testing, quality assurance, and cost control.

Source: Based on R. Schroeder, *Operations Management* (New York: McGraw-Hill, 1981), 12.

that production and operations management comprises five functions or decision areas: process, capacity, inventory, workforce, and quality.

Production and operations activities often represent the largest part of an organization's human and capital assets. In most industries, the major costs of producing a product or service are incurred within operations, so production and operations can have great value as a competitive weapon in a company's overall strategy. Strengths and weaknesses in the five functions of production can mean the success or failure of an enterprise.

Many production and operations managers are finding that cross-training of employees can help their firms respond faster to changing markets. Cross-training of workers can increase efficiency, quality, productivity, and job satisfaction. For example, at General Motors' Detroit gear and axle plant, costs related to product defects were reduced 400 percent in 2 years as a result of cross-training workers. As shown in Table 6-9, James Dilworth outlined implications of several types of strategic decisions that a company might make.

A magazine that had been printed since 1933, *Newsweek*, ended its print edition of the magazine on December 31, 2012, after suffering through years of declining profits and falling subscriptions. Now only an all digital-tablet version, *Newsweek Global*, is available with a paid subscription. As a result of this strategic decision, *Newsweek* is laying off employees and closing production facilities both in the USA and abroad. Among the USA's three icon weekly magazines, *Time, Newsweek*, and *U.S. News and World Report*, only *Time* now remains in print version. The weekly cost to publish and distribute the print version of *Newsweek* was $42 million. The top 10 print magazines by circulation in 2012 are:

1. *AARP Magazine* (22,528,478)
2. *AARP Bulletin* (22,283,411)
3. *Game Informer* (8,169,524)
4. *Better Homes and Gardens* (7,617,038)
5. *Reader's Digest* (5,577,717)
6. *Good Housekeeping* (4,346,757)
7. *National Geographic* (4,232,205)
8. *Family Circle* (4,100,977)
9. *People* (3,563,035)
10. *Woman's Day* (3,449,692)

A current trend that is accelerating among U.S. manufacturers is to extend the payment term on monies owed to suppliers. Procter & Gamble is leading the way on this trend, freeing

TABLE 6-9 Implications of Various Strategies on Production and Operations

Various Strategies	Implications
1. Low-cost provider	Creates high barriers to entry
	Creates larger market
	Requires longer production runs and fewer product changes
2. A high-quality provider	Requires more quality-assurance efforts
	Requires more expensive equipment
	Requires highly skilled workers and higher wages
3. Provide great customer service	Requires more service people, service parts, and equipment
	Requires rapid response to customer needs or changes in customer tastes
	Requires a higher inventory investment
4. Be the first to introduce new products	Has higher research and development costs
	Has high retraining and tooling costs
5. Become highly automated	Requires high capital investment
	Reduces flexibility
	May affect labor relations
	Makes maintenance more crucial
6. Minimize layoffs	Serves the security needs of employees and may develop employee loyalty
	Helps to attract and retain highly skilled employees

Source: Based on: J. Dilworth, *Production and Operations Management: Manufacturing and Nonmanufacturing,* 2nd ed. Copyright © 1983 by Random House, Inc.

up nearly $2 billion in cash annually by delaying payments to suppliers. Hundreds of other firms are doing the same, including Unilever and even retailers such as Walmart and Kohl's.

Another trend among U.S. manufacturers and retailers regarding suppliers is to quit doing business with unsafe factories, such as the one in Bangladesh that recently collapsed and killed 1,100 people. Walmart has publicly blacklisted 250 Bangladeshi suppliers found to have safety problems.

Production and Operations Audit Checklist

Questions such as the following should be examined:

1. Are supplies of raw materials, parts, and subassemblies reliable and reasonable?
2. Are facilities, equipment, machinery, and offices in good condition?
3. Are inventory-control policies and procedures effective?
4. Are quality-control policies and procedures effective?
5. Are facilities, resources, and markets strategically located?
6. Does the firm have technological competencies?

Research and Development

The fifth major area of internal operations that should be examined for specific strengths and weaknesses is **research and development (R&D).** Many firms today conduct no R&D, and yet many other companies depend on successful R&D activities for survival. Firms pursuing a product development strategy especially need to have a strong R&D orientation. Founded in 1897 and headquartered in Orrville, Ohio, J.M. Smucker Company had $5.5 and 4.8 billion in revenue in 2012 and 2011, and spent $21.9 and $20.9 million in R&D during those two years, comprising 0.39 and 0.43 percent of revenues, respectively. In contrast, Microsoft had revenues of $73.7 and $69.9 billion in 2012 and 2011 and spent $9.8 and $9.0 billion on R&D, comprising 13.3 and 12.9 percent of revenues respectively. High-tech firms such as Microsoft spend a much larger proportion of their revenues on R&D.

Huawei Technologies, the world's largest supplier of telecom equipment, increased its R&D spending by 25 percent in 2012 to $4.7 billion, almost equal to rival Ericsson's R&D expenditures of $4.8 billion. A key decision for many firms is whether to be a "first mover" or a "late follower," i.e. spending heavily on R&D to be the first to develop radically new products, or alternatively spending less on R&D by imitating/duplicating/improving upon products once rival firms develop them.

Organizations invest in R&D because they believe that such an investment will lead to a superior product or service and will give them competitive advantages. R&D expenditures are directed at developing new products before competitors do, at improving product quality, or at improving manufacturing processes to reduce costs.

Effective management of the R&D function requires a strategic and operational partnership between R&D and the other vital business functions. A spirit of partnership and mutual trust between general and R&D managers is evident in the best-managed firms today. Managers in these firms jointly explore; assess; and decide the what, when, where, why, and how much of R&D. Priorities, costs, benefits, risks, and rewards associated with R&D activities are discussed openly and shared. The overall mission of R&D thus has become broad based, including supporting existing businesses, helping launch new businesses, developing new products, improving product quality, improving manufacturing efficiency, and deepening or broadening the company's technological capabilities.[24]

The best-managed firms today seek to organize R&D activities in a way that breaks the isolation of R&D from the rest of the company and promotes a spirit of partnership between R&D managers and other managers in the firm. R&D decisions and plans must be integrated and coordinated across departments and divisions by having the departments share experiences and information. The strategic-management process facilitates this cross-functional approach to managing the R&D function.

R&D spending in the USA was $418.6 billion in 2012 and is expected to increase only 1.2 percent to $423.7 billion in 2013. The inflation-adjusted R&D spending for 2013 actually is expected to decline 0.7 percent. In comparison, the number-2 R&D spending country, China, spent $197.3 billion in 2012, but it is annually increasing its expenditure 10 to 12 percent. According to the Battelle Memorial Institute, China will achieve parity with the USA in R&D spending in 2022.

Internal and External Research and Development

Cost distributions among R&D activities vary by company and industry, but total R&D costs generally do not exceed manufacturing and marketing start-up costs. Four approaches to determining R&D budget allocations commonly are used: (1) financing as many project proposals as possible, (2) using a percentage-of-sales method, (3) budgeting about the same amount that competitors spend for R&D, or (4) deciding how many successful new products are needed and working backward to estimate the required R&D investment.

R&D in organizations can take two basic forms: (1) internal R&D, in which an organization operates its own R&D department, or (2) contract R&D, in which a firm hires independent researchers or independent agencies to develop specific products. Many companies use both approaches to develop new products. A widely used approach for obtaining outside R&D assistance is to pursue a joint venture with another firm. R&D strengths (capabilities) and weaknesses (limitations) play a major role in strategy formulation and strategy implementation.

Most firms have no choice but to continually develop new and improved products because of changing consumer needs and tastes, new technologies, shortened product life cycles, and increased domestic and foreign competition. A shortage of ideas for new products, increased global competition, increased market segmentation, strong special-interest groups, and increased government regulations are several factors making the successful development of new products more and more difficult, costly, and risky. In the pharmaceutical industry, for example, only one out of every few thousand drugs created in the laboratory ends up on pharmacists' shelves. Scarpello, Boulton, and Hofer emphasized that different strategies require different R&D capabilities:

> The focus of R&D efforts can vary greatly depending on a firm's competitive strategy. Some corporations attempt to be market leaders and innovators of new products, while others are satisfied to be market followers and developers of currently available products. The basic skills required to support these strategies will vary, depending on whether R&D becomes the driving force behind competitive strategy. In cases where new product introduction is the driving force for strategy, R&D activities must be extensive.[25]

Research and Development Audit

Questions such as the following should be asked in performing an R&D audit:

1. Does the firm have R&D facilities? Are they adequate?
2. If outside R&D firms are used, are they cost-effective?
3. Are the organization's R&D personnel well qualified?
4. Are R&D resources allocated effectively?
5. Are management information and computer systems adequate?
6. Is communication between R&D and other organizational units effective?
7. Are present products technologically competitive?

Management Information Systems

Billions of bits of information are now "in the cloud." Information ties all business functions together and provides the basis for all managerial decisions. It is the cornerstone of all organizations. Information represents a major source of competitive management advantage or disadvantage. Assessing a firm's internal strengths and weaknesses in information systems is a critical dimension of performing an internal audit.

A MIS's purpose is to improve the performance of an enterprise by improving the quality of managerial decisions. An effective information system thus collects, codes, stores, synthesizes, and presents information in such a manner that it answers important operating and strategic questions. The heart of an information system is a database containing the kinds of records and data important to managers.

A **management information system (MIS)** receives raw material from both the external and internal evaluation of an organization. It gathers data about marketing, finance, production, and personnel matters internally, and social, cultural, demographic, environmental, economic, political, governmental, legal, technological, and competitive factors externally. Data are integrated in ways needed to support managerial decision making.

There is a logical flow of material in an information system, whereby data are input to the system and transformed into output. Outputs include computer printouts, written reports, tables, charts, graphs, checks, purchase orders, invoices, inventory records, payroll accounts, and a variety of other documents. Payoffs from alternative strategies can be calculated and estimated. **Data** becomes **information** only when it is evaluated, filtered, condensed, analyzed, and organized for a specific purpose, problem, individual, or time.

Management Information Systems Audit

Questions such as the following should be asked when conducting this audit:

1. Do all managers in the firm use the information system to make decisions?
2. Is there a chief information officer or director of information systems position in the firm?
3. Are data in the information system updated regularly?
4. Do managers from all functional areas of the firm contribute input to the information system?
5. Are there effective passwords for entry into the firm's information system?
6. Are strategists of the firm familiar with the information systems of rival firms?
7. Is the information system user-friendly?
8. Do all users of the information system understand the competitive advantages that information can provide firms?
9. Are computer training workshops provided for users of the information system?
10. Is the firm's information system continually being improved in content and user-friendliness?

Value Chain Analysis

According to Porter, the business of a firm can best be described as a value chain, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value. All firms in a given industry have a similar value chain, which includes

activities such as obtaining raw materials, designing products, building manufacturing facilities, developing cooperative agreements, and providing customer service. A firm will be profitable as long as total revenues exceed the total costs incurred in creating and delivering the product or service. Firms should strive to understand not only their own value chain operations but also their competitors', suppliers', and distributors' value chains.

Value chain analysis (VCA) refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products. VCA aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities. VCA can enable a firm to better identify its own strengths and weaknesses, especially as compared to competitors' value chain analyses and their own data examined over time.

Substantial judgment may be required in performing a VCA because different items along the value chain may impact other items positively or negatively, so there exist complex interrelationships. For example, exceptional customer service may be especially expensive yet may reduce the costs of returns and increase revenues. Cost and price differences among rival firms can have their origins in activities performed by suppliers, distributors, creditors, or even shareholders. Despite the complexity of VCA, the initial step in implementing this procedure is to divide a firm's operations into specific activities or business processes. Then the analyst attempts to attach a cost to each discrete activity, and the costs could be in terms of both time and money. Finally, the analyst converts the cost data into information by looking for competitive cost strengths and weaknesses that may yield competitive advantage or disadvantage. Conducting a VCA is supportive of the RBV's examination of a firm's assets and capabilities as sources of distinctive competence.

When a major competitor or new market entrant offers products or services at low prices, this may be because that firm has substantially lower value chain costs or perhaps the rival firm is just waging a desperate attempt to gain sales or market share. Thus, VCA can be critically important for a firm in monitoring whether its prices and costs are competitive. An example value chain is illustrated in Figure 6-7. There can be more than a hundred particular value-creating activities associated with the business of producing and marketing a product or service, and each one of the activities can represent a competitive advantage or disadvantage for the firm. The combined costs of all the various activities in a company's value chain define the firm's cost of doing business. Firms should determine where cost advantages and disadvantages in their value chain occur *relative* to the value chain of rival firms.

Value chains differ immensely across industries and firms. Whereas a paper products company, such as Stone Container, would include on its value chain timber farming, logging, pulp mills, and papermaking, a company such as Hewlett-Packard would include programming, peripherals, software, hardware, and laptops. A motel would include food, housekeeping, check-in and check-out operations, website, reservations system, and so on. However, all firms should use VCA to develop and nurture a core competence and convert this competence into a distinctive competence. A **core competence** is a VCA that a firm performs especially well. When a core competence evolves into a major competitive advantage, then it is called a distinctive competence. Figure 6-8 illustrates this process.

More and more companies are using VCA to gain and sustain competitive advantage by being especially efficient and effective along various parts of the value chain. For example, Walmart has built powerful value advantages by focusing on exceptionally tight inventory control and volume purchasing of products. Computer companies in contrast compete aggressively along the distribution end of the value chain. Price competitiveness is a key component of competitiveness for both mass retailers and computer firms.

Benchmarking

Benchmarking is an analytical tool used to determine whether a firm's VCA are competitive compared to rivals and thus conducive to winning in the marketplace. Benchmarking entails measuring costs of value chain activities across an industry to determine "best practices" among competing firms for the purpose of duplicating or improving on those best practices. Benchmarking enables a firm to take action to improve its competitiveness by identifying (and improving on) value chain activities where rival firms have comparative advantages in cost, service, reputation, or operation.

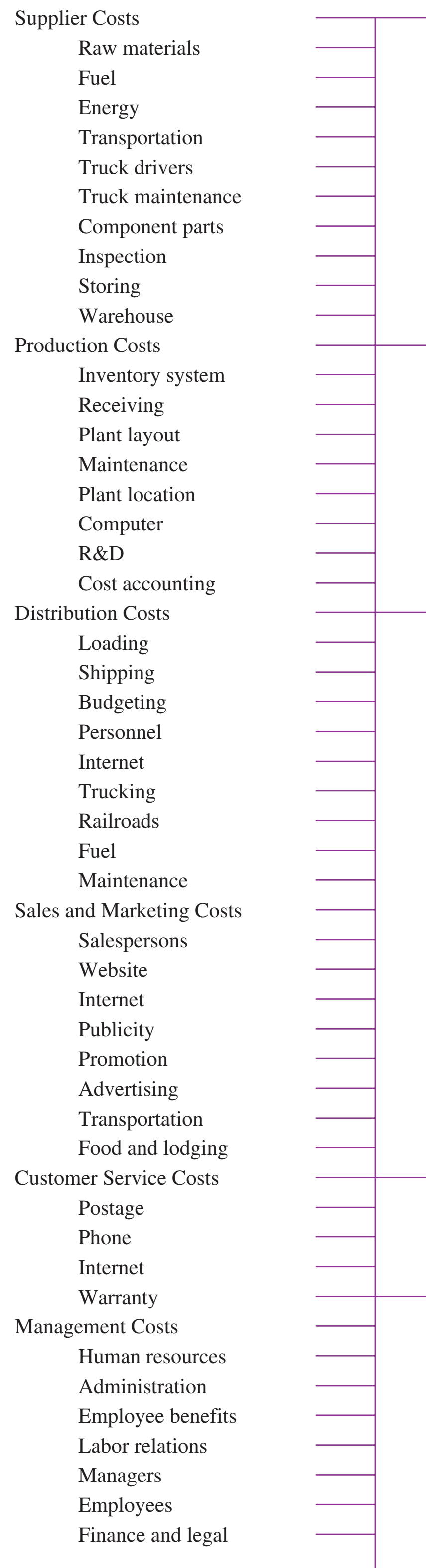

FIGURE 6-7

An Example Value Chain for a Typical Manufacturing Firm

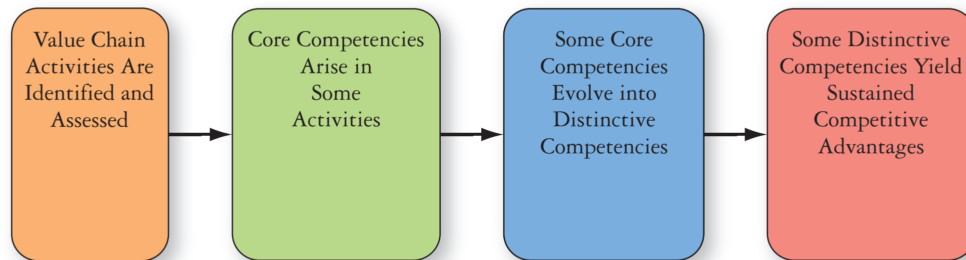

FIGURE 6-8
Transforming Value Chain Activities into Sustained Competitive Advantage

A comprehensive survey on benchmarking was recently commissioned by the Global Benchmarking Network, a network of benchmarking centers representing 22 countries. More than 450 organizations responded from over 40 countries. The results showed that:

1. Mission and vision statements along with customer (client) surveys are the most used (77 percent of organizations) of 20 improvement tools, followed by SWOT analysis (72 percent), and informal benchmarking (68 percent). Performance benchmarking was used by 49 percent and best practice benchmarking by 39 percent.
2. The tools that are likely to increase in popularity the most over the next three years are performance benchmarking, informal benchmarking, SWOT, and best practice benchmarking. More than 60 percent of organizations not currently using these tools indicated they are likely to use them in the next three years.[26]

The hardest part of benchmarking can be gaining access to other firms' VCA with associated costs. Typical sources of benchmarking information, however, include published reports, trade publications, suppliers, distributors, customers, partners, creditors, shareholders, lobbyists, and willing rival firms. Some rival firms share benchmarking data. However, the International Benchmarking Clearinghouse provides guidelines to help ensure that restraint of trade, price fixing, bid rigging, bribery, and other improper business conduct do not arise between participating firms.

Because of the popularity of benchmarking today, numerous consulting firms such as Accenture, AT Kearney, Best Practices Benchmarking & Consulting, as well as the Strategic Planning Institute's Council on Benchmarking, gather benchmarking data, conduct benchmarking studies, and distribute benchmark information without identifying the sources.

The Internal Factor Evaluation Matrix

A summary step in conducting an internal strategic-management audit is to construct an **Internal Factor Evaluation (IFE) Matrix**. This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the functional areas of a business, and it also provides a basis for identifying and evaluating relationships among those areas. Intuitive judgments are required in developing an IFE Matrix, so the appearance of a scientific approach should not be interpreted to mean this is an all-powerful technique. A thorough understanding of the factors included is more important than the actual numbers. Similar to the EFE Matrix and CPM described in Chapter 7, an IFE Matrix can be developed in five steps:

1. List key internal factors as identified in the internal-audit process. Use a total of 20 internal factors, including both strengths and weaknesses. List strengths first and then weaknesses. Be as specific as possible, using percentages, ratios, and comparative numbers. Recall that Edward Deming said: "In God we trust. Everyone else bring data." Include "actionable" factors that can provide insight regarding strategies to pursue. For example, the factor "our Quick Ratio is 2.1 vs. industry average of 1.8" is not actionable, whereas the factor "our chocolate division's ROI increased from 8 to 15 percent in South America" is actionable.
2. Assign a weight that ranges from 0.0 (not important) to 1.0 (all-important) to each factor. The weight assigned to a given factor indicates the relative importance of the factor to being successful in the firm's industry. Regardless of whether a key factor is an internal strength

or weakness, factors considered to have the greatest effect on organizational performance should be assigned the highest weights. The sum of all weights must equal 1.0.

3. Assign a 1-to-4 rating to each factor to indicate whether that factor represents a major weakness (rating = 1), a minor weakness (rating = 2) a minor strength (rating = 3), or a major strength (rating = 4). Note that strengths must receive a 3 or 4 rating and weaknesses must receive a 1 or 2 rating. Ratings are thus company-based, whereas the weights in step 2 are industry-based.
4. Multiply each factor's weight by its rating to determine a weighted score for each variable.
5. Sum the weighted scores for each variable to determine the total weighted score for the organization.

Regardless of how many factors are included in an IFE Matrix, the total weighted score can range from a low of 1.0 to a high of 4.0, with the average score being 2.5. Total weighted scores well below 2.5 characterize organizations that are weak internally, whereas scores significantly above 2.5 indicate a strong internal position. Like the EFE Matrix, an IFE Matrix should include 20 key factors. The number of factors has no effect on the range of total weighted scores because the weights always sum to 1.0.

When a key internal factor is both a strength and a weakness, the factor may be included twice in the IFE Matrix, and a weight and rating assigned to each statement. For example, the Playboy logo both helps and hurts Playboy Enterprises; the logo attracts customers to *Playboy* magazine, but it keeps the Playboy cable channel out of many markets. Be as quantitative as possible when stating factors. Use monetary amounts, percentages, numbers, and ratios to the extent possible.

An example IFE Matrix is provided in Table 6-10 for a retail computer store. Note that the two most important factors to be successful in the retail computer store business are "revenues from repair/service in the store" and "location of the store." Also note that the store is doing best on "average customer purchase amount" and "in-store technical support." The store is having major problems with its carpet, bathroom, paint, and checkout procedures. Note also that the matrix contains substantial quantitative data rather than vague statements; this is excellent. Overall, this store

TABLE 6-10 A Sample Internal Factor Evaluation Matrix for a Retail Computer Store

Key Internal Factors	Weight	Rating	Weighted Score
Strengths			
1. Inventory turnover increased from 5.8 to 6.7	0.05	3	0.15
2. Average customer purchase increased from $97 to $128	0.07	4	0.28
3. Employee morale is excellent	0.10	3	0.30
4. In-store promotions resulted in 20 percent increase in sales	0.05	3	0.15
5. Newspaper advertising expenditures increased 10 percent	0.02	3	0.06
6. Revenues from repair/service segment of store up 16 percent	0.15	3	0.45
7. In-store technical support personnel have MIS college degrees	0.05	4	0.20
8. Store's debt-to-total assets ratio declined to 34 percent	0.03	3	0.09
9. Revenues per employee up 19 percent	0.02	3	0.06
Weaknesses			
1. Revenues from software segment of store down 12 percent	0.10	2	0.20
2. Location of store negatively impacted by new Highway 34	0.15	2	0.30
3. Carpet and paint in store somewhat in disrepair	0.02	1	0.02
4. Bathroom in store needs refurbishing	0.02	1	0.02
5. Revenues from businesses down 8 percent	0.04	1	0.04
6. Store has no website	0.05	2	0.10
7. Supplier on-time delivery increased to 2.4 days	0.03	1	0.03
8. Often customers have to wait to check out	0.05	1	0.05
Total	**1.00**		**2.50**

firm's resources, capabilities, structure, and strategies, with your recommended improvements, can lead the firm to prosperity. Although the numbers absolutely must be there, must be accurate, and must be reasonable, do not bore a live audience or class with overreliance on numbers. Periodically throughout your presentation or written analysis, refer to your recommendations, explaining how your plan of action will improve the firm's weaknesses and capitalize on strengths in light of anticipated competitor countermoves. Keep your audience's attention, interest, and suspense, rather than "reading" to them or "defining" ratios for them.

Conclusion

Management, marketing, finance and accounting, production and operations, R&D, and MIS represent the core operations of most businesses. A strategic-management audit of a firm's internal operations is vital to organizational health. Many companies still prefer to be judged solely on their bottom-line performance. However, an increasing number of successful organizations are using the internal audit to gain competitive advantages over rival firms.

Systematic methodologies for performing strength-weakness assessments are not well developed in the strategic-management literature, but it is clear that strategists must identify and evaluate internal strengths and weaknesses to effectively formulate and choose among alternative strategies. The EFE Matrix, CPM, IFE Matrix, and clear statements of vision and mission provide the basic information needed to successfully formulate competitive strategies. The process of performing an internal audit represents an opportunity for managers and employees throughout the organization to participate in determining the future of the firm. Involvement in the process can energize and mobilize managers and employees.

Key Terms and Concepts

activity ratios (p. 205)
benchmarking (p. 214)
breakeven (BE) point (p. 207)
capacity utilization (p. 209)
capital budgeting (p. 203)
communication (p. 190)
controlling (p. 198)
core competence (p. 214)
cost/benefit analysis (p. 202)
cultural products (p. 192)
customer analysis (p. 199)
data (p. 213)
distinctive competencies (p. 189)
distribution (p. 201)
dividend decisions (p. 203)
empirical indicators (p. 192)
financial ratio analysis (p. 191)
fixed costs (FC) (p. 208)
financing decision (p. 203)
functions of finance/accounting (p. 202)
functions of management (p. 194)
functions of marketing (p. 194)
growth ratios (p. 205)
human resource management (p. 197)
information (p. 213)
internal audit (p. 190)
internal factor evaluation (IFE) matrix (p. 216)
investment decision (p. 203)
leverage ratios (p. 205)
liquidity ratios (p. 205)
management information system (MIS) (p. 213)
marketing research (p. 201)
motivating (p. 197)
organizational culture (p. 192)
organizing (p. 196)
personnel management (p. 197)
planning (p. 194)
pricing (p. 200)
product and service planning (p. 200)
production/operations function (p. 209)
profitability ratios (p. 205)
research and development (R&D) (p. 211)
resource-based view (RBV) (p. 191)
selling (p. 199)
staffing (p. 197)
synergy (p. 196)
test marketing (p. 200)
value chain analysis (VCA) (p. 214)
variable costs (VC) (p. 208)

TABLE 6-11 An Actual IFE Matrix for Fresenius, Inc.

Strengths	Weight	Rating	WScore
1. Sales and earnings per share have not declined a single year for 10 years	0.09	4	0.36
2. Fresenius Medical Care is the market leader in dialysis services and products	0.09	4	0.36
3. Trading volume increased by 17 percent in 2011	0.05	3	0.15
4. Dividends were just raised for the 20th consecutive year	0.06	4	0.24
5. Financial analysts ratings show 23 "buy," 2 "hold," and no "sell"	0.06	3	0.18
6. Has a renown training school for nurses and other health workers	0.03	3	0.09
7. DAX30 ranking in market capitalization steadily improving	0.05	4	0.20
8. Fresenius Medical increased worldwide clinics by 6 percent	0.03	3	0.09
9. Fresenius Helios is the second largest private hospital operators in Germany	0.06	3	0.18
10. Diversified 4 business segments in different healthcare sectors	0.05	3	0.15
Weaknesses			
1. Quick Ratio of 0.65 shows a lack of ability to cover cash needs	0.07	2	0.14
2. Group sales decreased by 4 percent in North America	0.03	2	0.06
3. Group debt increased by 9 percent	0.05	1	0.05
4. Fresenius Biotech has a negative EBIT of approx. $–38.6 million	0.05	2	0.10
5. Decrease of 21% in operating cash flow from 2010 to 2011	0.08	1	0.08
6. Fresenius Helios dropped 3.1 billion euro takeover of rival Rhoen-Klinikum on September 3, 2012, because of rival hospital operators blocking the merger	0.01	2	0.02
7. Fresenius Vamed made no material acquisitions	0.02	2	0.04
8. No racial diversity on management and supervisory boards	0.04	2	0.08
9. Healthcare Group board members and committees comprised of all males	0.04	1	0.04
10. Only one female in all top management	0.04	1	0.04
Total	1.0		2.65

receives a 2.5 total weighted score, which on a 1-to-4 scale is exactly average/halfway, indicating there is definitely room for improvement in store operations, strategies, policies, and procedures.

The IFE Matrix provides important information for strategy formulation. For example, this retail computer store might want to hire another checkout person and repair its carpet, paint, and bathroom problems. Also, the store may want to increase advertising for its repair/services, because that is a really important (weight 0.15) factor to being successful in this business.

Headquartered in Germany and specializing in kidney dialysis, Fresenius provides healthcare products and services in about 100 countries. Fresenius owns and operates 2,800 dialysis clinics and many other healthcare facilities. Table 6-11 provides an actual IFE matrix created for Fresenius in late 2012. As indicated in Table 6-11, Fresenius is financially strong, but needs to include women and minorities in its management.

In multidivisional firms, each autonomous division or strategic business unit should construct an IFE Matrix. Divisional matrices then can be integrated to develop an overall corporate IFE Matrix. Be as divisional as possible when developing a corporate IFE Matrix. Also, in developing an IFE Matrix, do not allow more than 30 percent of the key factors to be financial ratios because financial ratios are generally the result of many other factors so it is difficult to know what particular strategies should be considered based on financial ratios. For example, a firm would have no insight on whether to sell in Brazil or South Africa to take advantage of a high corporate ROI ratio.

Special Note to Students

It can be debated whether external or internal factors are more important in strategic planning, but there is no debate regarding the fact that gaining and sustaining competitive advantage is the essence or purpose of strategic planning. In the internal portion of your case analysis, emphasize how and why your internal strengths and weaknesses can be leveraged to both gain competitive advantage and overcome competitive disadvantage, in light of the direction you are taking the firm. Maintain your project's upbeat, insightful, and forward-thinking demeanor during the internal assessment, rather than being mundane, descriptive, and vague. Focus on how your

Issues for Review and Discussion

6-1. Volkswagen (VW) Group has been very successful in the last decade. Research VW and see if they have strategic planning. Create a report of your findings for your class.

6-2. Visit VW's corporate website. See the list of top executives for VW and create an organizational chart for VW.

6-3. Given the fifteen examples of (possible) aspects of an organization's culture as presented in the chapter, rate a company you are very familiar with in terms of the extent each culture item exists. Explain.

6-4. Rank the seven functions of marketing in order of importance for a small hardware business.

6-5. Develop a quantitative problem to show your understanding of cost/benefit analysis.

6-6. Develop a quantitative problem to show that you understand breakeven analysis.

6-7. For VW, determine their most recent dividend payout amount per share. How has that amount changed over the last 12 months?

6-8. List some advantages and disadvantages of a company paying dividends versus reinvesting that money in the company, and striving for stock price increase as the primary way to reward investors.

6-9. Illustrate a breakeven chart for VW. Explain how it may work for the organization.

6-10. VW has historically spent more on R&D than almost any other automobile company in the world. What are the major advantages and disadvantages of this strategy?

6-11. Perform a value chain analysis for an organization of your choice.

6-12. Discuss the relationship between benchmarking and value chain analysis.

6-13. Explain why the ratings in an IFE Matrix should be 4 or 3 for strengths, and 1 or 2 for weaknesses as compared to the EFE Matrix—where the ratings should be 1, 2, 3, or 4 anywhere among both the opportunities and threats.

6-14. Compare the financial ratio analysis for VW on the four different websites identified in the chapter. Which site do you like best? Why?

6-15. Conduct a Google search for value chain analysis. In a two-page report, expand on the concepts presented in the chapter.

6-16. What competitive advantages would Amazon have over Wal-Mart stores in doing business outside the United States?

6-17. How could the "process of performing an internal audit" differ across countries, given varying global management styles?

6-18. Why is sole reliance on financial ratios an ineffective means of deriving internal strengths and weaknesses?

6-19. Give an example of two resources for a fast-food chain that you believe meet the three "empirical indicators" criteria.

6-20. Prepare a culture assessment table, as presented in the chapter, for a local business that you are familiar with. In other words, rate that business on all 15 culture criteria presented. What are the implications of your ratings on the strategic planning process within that firm?

6-21. Why is human resource management particularly challenging for international firms?

6-22. List some specific characteristics of advertisements, in the wake of a lingering recession in Europe.

6-23. How do changes in the value of the dollar affect pricing of products of global firms?

6-24. Historically, what has been the attitude of technology firms toward paying dividends? Give some examples.

6-25. Describe Singapore as a place to locate or start a business.

6-26. Visit the strategyclub website, and describe the strategic planning products offered.

6-27. Develop a value chain analysis for a large global firm and its primary rival firm.

6-28. Identify four major strengths and weaknesses each, of your college or university. Rank each factor in terms of importance.

6-29. Look up financial information about VW. Identify three financial ratios where the firm is weak and three financial ratios the firm is strong.

6-30. What five cultural products do you feel are most important? Justify your selections.

6-31. Rate the company where you work, or would like to work, on the 15 aspects of culture listed in the chapter.

6-32. Develop a breakeven chart for a company, which simultaneously lays off employees and closes facilities.

6-33. Financial ratio analysis should be conducted on three separate fronts. What are these fronts and which is most important?

6-34. Explain breakeven analysis using three graphs that show changes in breakeven given: 1) a change in price, 2) a change in advertising expenditures, and 3) a change in labor costs.

6-35. Why is breakeven analysis such an important strategic planning concept?

6-36. What are the basic functions of production/operations in a large manufacturing company? Why are these factors important in an internal strategic management audit?

6-37. Explain benchmarking.

6-38. Go to the www.strategyclub.com website and review the benefits of using the free excel template.

6-39. For the adidas Cohesion Case, what do you consider to be the company's four major strengths and four major weaknesses?

6-40. Prepare a financial ratio analysis for adidas. Include comparative ratios for adidas.

6-41. Explain how adidas could utilize breakeven analysis.

6-42. Explain how top executives of adidas could utilize Porter's Five Forces Model to aid the firm in strategic planning.

6-43. Since adidas and Puma are based in the same city, could this close proximity benefit or hinder the two firms 1) cooperating with each other on R&D, or 2)

gathering and assimilating competitive intelligence on the other firm?

6-44. Since adidas is so divisional, how could the company best develop a corporate IFE Matrix for various divisional IFE Matrices?

6-45. When is it more important to capitalize on strengths than improve on weaknesses in strategic planning?

6-46. Explain what 20 internal factors is a recommended number to include in an IFE Matrix, rather than 10 or 40 total.

6-47. Do you think the RBV view or the I/O theorists view is more important/accurate in performing a strategic analysis? What would be important implications for a business?

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

6-48. List three ways that financial ratios should be compared or used. Which of the three comparisons do you feel is most important? Why?

6-49. Would you ever pay out dividends when your firm's annual net profit is negative? Why? What effect could this have on a firm's strategies?

6-50. Mymanagementlab Only—comprehensive writing assignment for this chapter.

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 6A

Develop a Corporate IFE Matrix for Volkswagen Group

Purpose

Volkswagen Group is featured in the opening chapter case as a firm that engages in excellent strategic planning. VW has four major geographic business segments. Each of these divisions of VW would preparetheir own IFE Matrices, which would be assimilated to develop an overall corporate IFE Matrix.

This exercise gives you practice developing divisional IFE Matrices and assimilating those into an overall corporate IFE Matrix.

Instructions

Step 1 Review VW's most recent *Annual Report* in regards to the company's four geographic business segments, which are North America, South America, Asia-Pacific, and Europe.

Step 2 Review the latest S&P *Industry Survey* for companies that produce and market automobiles.

Step 3 Develop a divisional IFE Matrix for each of VW's business segments.

Step 4 Assimilate your divisional IFE Matrices into an overall corporate IFE Matrix for VW.

EXERCISE 6B

Should VW Deploy More Resources or Less Outside of the USA?

Purpose

As indicated in the opening chapter boxed insert, VW receives more revenue from outside its home base of Europe than from inside Europe. This exercise gives you practice analyzing this domestic versus global revenue base so that more effective strategies can be formulated and implemented.

Instructions

Step 1 Go the VW's website and review the company's most recent *Annual Report*. Be careful to note the financial, management, and marketing information available for each geographic region. Let all regions outside Europe, for purposes of this exercise, be referred to as Global, and Europe be referred to as domestic for VW.

Step 2 Go to www.finance.yahoo.com and review the last 45 days of Headlines for VW. Take note of public information related to VW as well as to GM, Ford, Honda, and Toyota.

Step 3 Prepare a 3-page executive summary to reveal whether you feel VW should be placing more or less emphasis on operations outside of Europe. Provide supporting tables, #'s, ratios, and narrative.

EXERCISE 6C

Apply Breakeven Analysis

Purpose

Breakeven analysis is one of the simplest yet underused analytical tools in management. It helps to provide a dynamic view of the relationships between sales, costs and profits. A better understanding of breakeven analysis can enable an organization to formulate and implement strategies more effectively.

This exercise will show you how to calculate breakeven points mathematically. The formula for calculating breakeven point is BE Quantity = TFC/P – VC. In other words, the Quantity (Q) or units of product that need to be sold for a firm to breakeven is Total Fixed Costs divided by (Price per Unit 2 Variable Costs per Unit).

Instructions

Step 1 Lets say an airplane company has Fixed Costs of $100 million and Variable Costs per Unit of $2 million. Planes sell for $3 million each. What is the company's breakeven point in terms of the number of planes that need to be sold just to breakeven?

Step 2 If the airplane company wants to make a profit of $99 million annually, how many planes will it have to sell?

Step 3 If the company can sell 200 airplanes in a year, how much annual profit will the firm make?

EXERCISE 6D

Performing a Financial Ratio Analysis for adidas AG

Purpose

Financial ratio analysis is one of the best techniques for identifying and evaluating internal strengths and weaknesses. Potential investors and current shareholders look closely at firms' financial ratios, making detailed comparisons to industry averages and to previous periods of time. Financial ratio analysis provides vital input information for developing an IFE Matrix.

Instructions

Step 1 On a separate sheet of paper, write down numbers 1 to 20. Referring to adidas AG's income statement and balance sheet, calculate 20 financial ratios for 2013.

Step 2 In a second column, indicate whether you consider each ratio to be a strength, weakness, or neutral factor for adidas.

EXERCISE 6E

Constructing an IFE Matrix for adidas AG

Purpose

This exercise will give you experience developing an IFE Matrix. Identifying and prioritizing factors to include in an IFE Matrix fosters communication among functional and divisional managers.

Preparing an IFE Matrix allows human resource, marketing, production/operations, finance/accounting, R&D, and management information systems managers to articulate their concerns and thoughts regarding the business condition of the firm. This results in an improved collective understanding of the business.

Instructions

Step 1 Join with two other individuals to form a three-person team. Develop a IFE Matrix for adidas. Be sure to include information on Reebok and TaylorMade.

Step 2 Compare your team's IFE Matrix to other teams' IFE Matrices. Discuss any major differences.

Step 3 What strategies do you think would allow adidas to capitalize on its major strengths? What strategies would allow adidas to improve upon its major weaknesses?

EXERCISE 6F

Analyzing Your College or University's Internal Strategic Situation

Purpose

This exercise is excellent for doing together as a class.

Instructions

As a class, determine your college or university's major internal strengths and weaknesses. List 10 strengths and 10 weaknesses. Then, get everyone in class to rank order their factors with 1 being most important and 10 being least important. Then, gather up everyone's paper, count the numbers, and in that manner create a prioritized list of the key internal strengths and weaknesses facing your college.

Notes

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7

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The External Audit

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Discuss the nature and role of labor unions in the USA as a corporate strategic issue.
2. Describe how to conduct an external strategic-management audit.
3. Discuss 10 major external forces that affect organizations: economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive.
4. Describe key sources of external information.
5. Discuss important forecasting tools used in strategic management.
6. Discuss the importance of monitoring external trends and events.
7. Explain how to develop an EFE Matrix.
8. Explain how to develop a Competitive Profile Matrix.
9. Discuss the importance of gathering competitive intelligence.
10. Discuss market commonality and resource similarity in relation to competitive analysis.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 7A Michelin and Africa: An External Assessment

EXERCISE 7B Preparing a CPM for Michelin Based on Countries Rather than Companies

EXERCISE 7C Develop Divisional Michelin EFE Matrices

EXERCISE 7D Developing an EFE Matrix for adidas AG

EXERCISE 7E The External Assessment

EXERCISE 7F Developing a CPM for Michelin

EXERCISE 7G Developing a CPM for adidas AG

EXERCISE 7H Analyzing Your College or University’s External Strategic Situation

This chapter examines the tools and concepts needed to conduct an external strategic management audit (sometimes called **environmental scanning** or **industry analysis**). An **external audit** focuses on identifying and evaluating trends and events beyond the control of a single firm, such as increased foreign competition, population shifts to coastal areas of the USA, an aging society, and taxing Internet sales. An external audit reveals key opportunities and threats confronting an organization so that managers can formulate strategies to take advantage of the opportunities and avoid or reduce the impact of threats. This chapter presents a practical framework for gathering, assimilating, and analyzing external information. The Industrial Organization (I/O) view of strategic management is introduced.

The Chapter 7 boxed insert company pursuing strategies based on an excellent external strategic analysis is Michelin.

The Nature of an External Audit

The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. As the term *finite* suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at identifying key variables that offer actionable responses. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats. Figure 7-1 illustrates with white shading how the external audit fits into the strategic-management process.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Michelin

Michelin is a huge tire manufacturer headquartered in Clemont-Ferrand in the Auvergne region of France. A major rival is Bridgestone. Michelin owns BFGoodrich, Kleber, Riken, Komoran, and the Uniroyal tire brands, as well as the Warrior brand in China. Michelin produces more than 175 million tires annually for all kinds of vehicles, supplying new and replacement tires to the passenger car and truck markets. The company is also a world leader in aircraft and earthmover tires. Additionally, Michelin is also known in the culinary world for its Red Guide reference books and restaurant star awards. The company publishes about 10 million maps and travel guides per year.

In 2014, Michelin will bring to market two new enduro bicycle tires, reentering the bike racing business. To provide mountain bike riders with high-performance tires, Michelin has partnered with two famous bikers: Fabien Barel, three-time world downhill champion, and Pierre Edouard Ferry, free ride champion. These two bikers have worked closely with Michelin Group engineers for two and a half years to design and develop the new Michelin bike tires.

In late 2013, production began on the new Porsche 918 Spyder. Michelin will be the only tire supplier for this new hybrid supercar, of which only 918 units are being produced. Michelin's new Pilot Sport Cup 2 is the only tire certified for two new high-powered sports cars- the Ferrari 458 Speciale and the Porsche 918 Spyder. Michelin's Pilot Sport 3 tires are equip the new Peugeot 308, making that car more energy efficient while delivering outstanding safety, handling and longevity. For the Peugeot 208 HYbrid FE, Michelin developed a range of Tall and Narrow tires with a longer rim diameter and better performance.

In late 2013, Kepler Cheuvreux, Jean-Dominique Senard, Chief Executive Officer of Michelin, revealed the six major Michelin Performance and Responsibility objectives for 2020 (paraphrased):

1. Increase durability and effectiveness of our products by at least 10% compared with 2010, while using fewer raw materials to produce.
2. Become more environmentally friendly by improving the energy efficiency of our plants and reducing our carbon footprint.
3. Annually deliver €1 billion in structural free cash flow per year and generate at least a 15% return on capital.
4. Develop and implement programs to improve employee engagement, well-being and development.
5. Deploy employee-driven outreach programs and create local jobs to continuously improve our public relations in communities.
6. Develop and promote improved recycling solutions to the extent possible.

Source: Based on the company website and press releases.

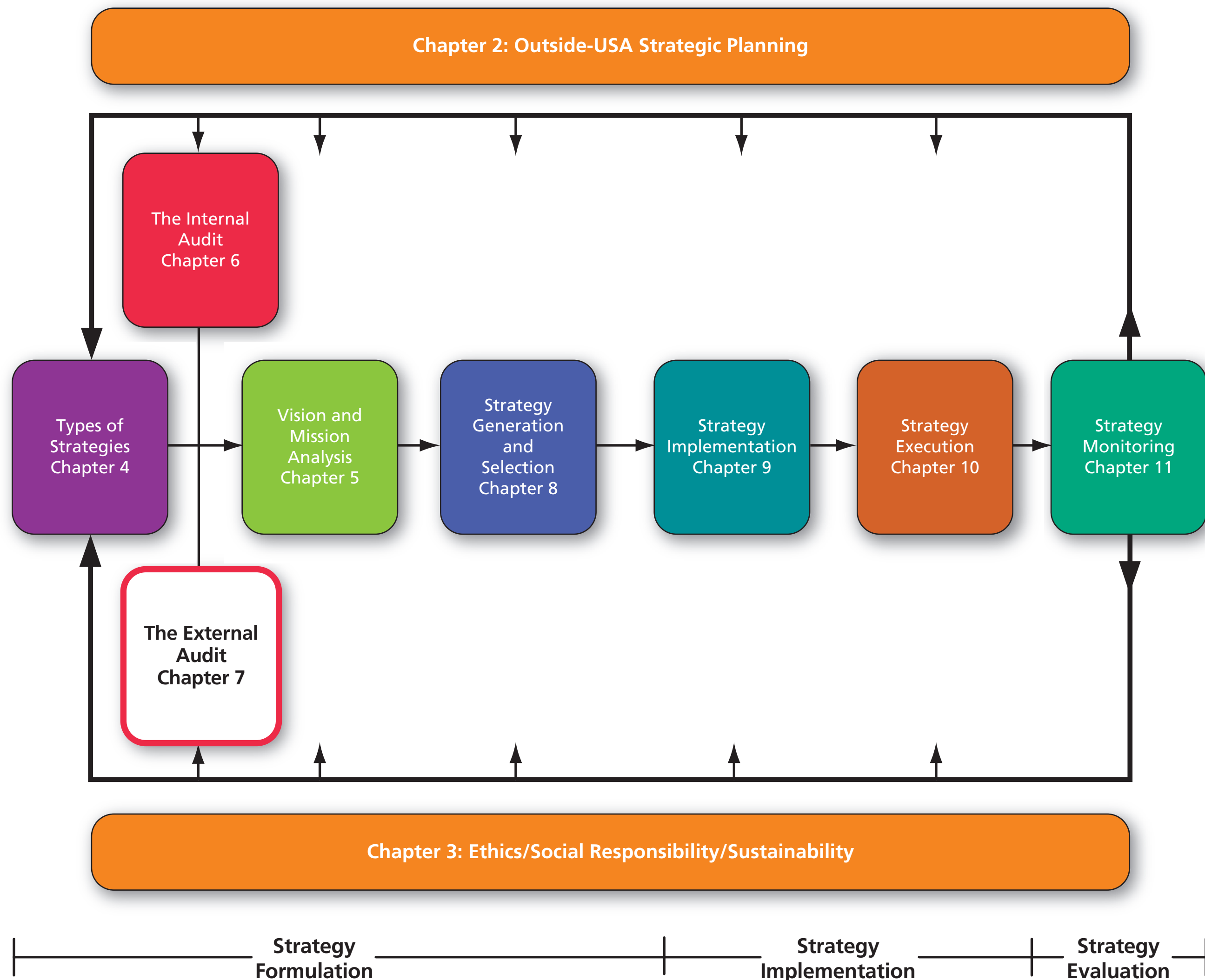

FIGURE 7-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

Key External Forces

External forces can be divided into five broad categories: (1) economic forces; (2) social, cultural, demographic, and natural environment forces; (3) political, governmental, and legal forces; (4) technological forces; and (5) competitive forces. Relationships among these forces and an organization are depicted in Figure 7-2. External trends and events, such as rising food prices and people in African countries coming online, significantly affect products, services, markets, and organizations worldwide. IMPORTANT NOTE: WHEN IDENTIFYING AND PRIORITIZING KEY EXTERNAL FACTORS IN STRATEGIC PLANNING, MAKE SURE THE FACTORS SELECTED ARE SPECIFIC, IE QUANTIFIED TO THE EXTENT POSSIBLE; PERHAPS MORE IMPORTANTLY MAKE SURE THE FACTORS SELECTED ARE *ACTIONABLE*, IE MEANINGFUL IN TERMS OF HAVING STRATEGIC IMPLICATIONS. For example, regarding *actionable*, to say "the stock market is rising" is not actionable because there is no apparent strategy that the firm could formulate to capitalize on that factor. In contrast, a factor such as "the GDP of Brazil is 6.8 percent" is actionable because the firm should perhaps open 100 new stores in Brazil. In other words, select factors that will be helpful in deciding what to recommend the firm to do, rather than selecting nebulous factors.

Changes in external forces translate into changes in consumer demand for both industrial and consumer products and services. External forces affect the types of products developed,

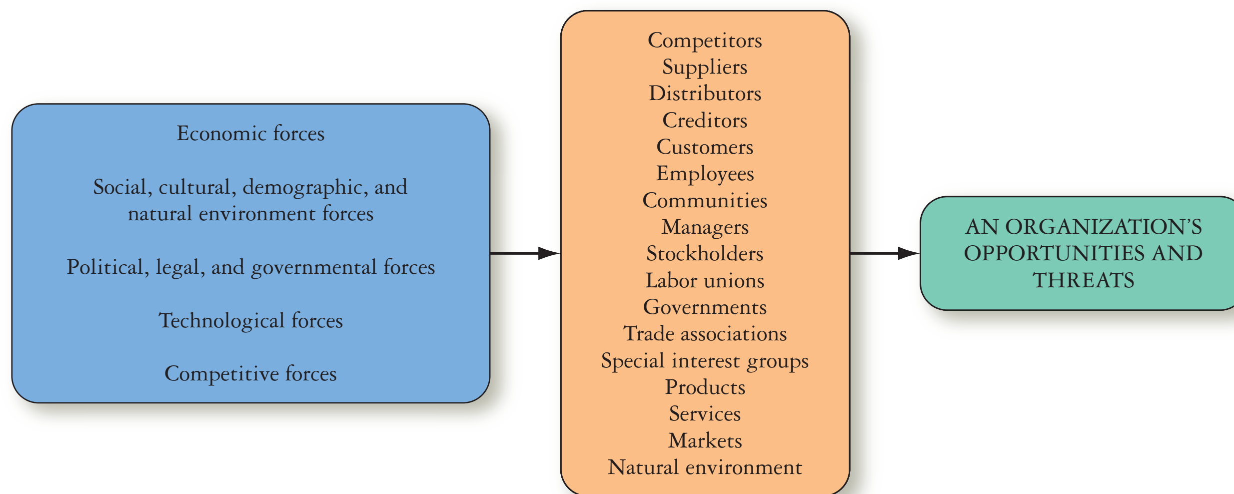

FIGURE 7-2
Relationships Between Key External Forces and an Organization

the nature of positioning and market segmentation strategies, the type of services offered, and the choice of businesses to acquire or sell. External forces directly affect both suppliers and distributors. Identifying and evaluating external opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives.

The increasing complexity of business today is evidenced by more countries developing the capacity and will to compete aggressively in world markets. Foreign businesses and countries are willing to learn, adapt, innovate, and invent to compete successfully in the marketplace. There are more competitive new technologies in Asia today than ever before, as recently introduced for example by Lenovo in China and Samsung in South Korea.

The Process of Performing an External Audit

The process of performing an external audit must involve as many managers and employees as possible. As emphasized in Chapter 1 and Chapter 5, involvement in the strategic-management process can lead to understanding and commitment from organizational members. Individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firm's industry, competitors, and markets.

To perform an external audit, a company first must gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends. Individuals can be asked to monitor various sources of information, such as key magazines, trade journals, and newspapers. These persons can submit periodic scanning reports to a committee of managers charged with performing the external audit. This approach provides a continuous stream of timely strategic information and involves many individuals in the external-audit process. The Internet provides another source for gathering strategic information, as do corporate, university, and public libraries. Suppliers, distributors, salespersons, customers, and competitors represent other sources of vital information.

Once information is gathered, it should be assimilated and evaluated. A meeting or series of meetings of managers is needed to collectively identify the most important opportunities and threats facing the firm. These key external factors should be listed on flip charts or a chalkboard. A prioritized list of these factors could be obtained by requesting that all managers rank the factors identified, from 1 for the most important opportunity or threat to 20 for the least important opportunity or threat. These key external factors can vary over time and by industry. Relationships with suppliers or distributors are often a critical success factor. Other variables commonly used include market share, breadth of competing products, world economies, foreign affiliates, proprietary and key account advantages, price competitiveness, technological advancements, population shifts, interest rates, and pollution abatement.

Freund emphasized that these key external factors should be (a) important to achieving long-term and annual objectives, (b) measurable, (c) applicable to all competing firms, and (d) hierarchical in the sense that some will pertain to the overall company and others will be more narrowly focused on functional or divisional areas. A final list of the most important key external factors should be communicated and distributed widely in the organization. Both opportunities and threats can be key external factors.[1]

The Industrial Organization (I/O) View

The **Industrial Organization (I/O)** approach to competitive advantage advocates that external (industry) factors are more important than internal factors in a firm for achieving competitive advantage. Proponents of the I/O view, such as Michael Porter, contend that organizational performance will be primarily determined by industry forces. Porter's Five-Forces Model, presented later in this chapter, is an example of the I/O perspective, which focuses on analyzing external forces and industry variables as a basis for getting and keeping competitive advantage. Competitive advantage is determined largely by competitive positioning within an industry, according to I/O advocates. Managing strategically from the I/O perspective entails firms striving to compete in attractive industries, avoiding weak or faltering industries, and gaining a full understanding of key external factor relationships within that attractive industry. I/O research provides important contributions to our understanding of how to gain competitive advantage.

I/O theorists contend that external factors and the industry in which a firm competes has a stronger influence on the firm's performance than do the internal functional issues in marketing, finance, and the like. Firm performance, they contend, is based more on industry properties such as economies of scale, barriers to market entry, product differentiation, the economy, and level of competitiveness than on internal resources, capabilities, structure, and operations. The USA's recent economic recovery having such a positive impact on both strong and weak firms adds credence to the notion that external forces are more important than internal.

The I/O view has enhanced the understanding of strategic management. However, it is not a question of whether external or internal factors are more important in gaining and maintaining competitive advantage. Effective integration and understanding of *both* external and internal factors is the key to securing and keeping a competitive advantage. In fact, as discussed in Chapter 8, matching key external opportunities and threats with key internal strengths and weaknesses provides the basis for successful strategy formulation.

Economic Forces

The lingering high underemployment rate in the USA bodes well for discount firms ranging from Dollar Tree to TJ Maxx to Walmart to Subway, but hurts thousands of traditional priced retailers in many industries. The Dow Jones Industrial Average is over 15,000, corporate profits are high, dividend increases are up sharply, and emerging markets are growing. Yet, job growth is still stymied, home prices remain low, and millions of people work for minimum wages or are either unemployed or underemployed. As a result of droughts, commodity prices are up sharply, especially food, which is contributing to rising inflation fears. Many firms are switching to the extent possible to part-time rather than full-time employees to avoid having to pay health benefits. Consumer spending is rebounding. Much of Europe lingers in a recession.

Economic factors have a direct impact on the potential attractiveness of various strategies. For example, with interest rates, funds needed for capital expansion are less costly. As interest rates rise, discretionary income declines, and the demand for discretionary goods falls. When stock prices increase, the desirability of equity as a source of capital for market development increases. When the market rises, consumer and business wealth expands. A summary of economic variables that often represent opportunities and threats for organizations is provided in Table 7-1.

To take advantage of Canada's robust economy and eager-to-spend people, many firms are aggressively expanding operations into Canada, including TJX opening many Marshalls stores, Target opening stores, Walmart opening supercenters, and Tanger Outlet Factory Centers

TABLE 7-1 Key Economic Variables to Be Monitored

Shift to a service economy in the USA	Import/export factors
Availability of credit	Demand shifts for different categories of goods and services
Level of disposable income	Income differences by region and consumer groups
Propensity of people to spend	Price fluctuations
Interest rates	Export of labor and capital from the USA
Inflation rates	Monetary policies
Money market rates	Fiscal policies
Federal government budget deficits	Tax rates
Gross domestic product trend	European Economic Community (EEC) policies
Consumption patterns	Organization of Petroleum Exporting Countries (OPEC) policies
Unemployment trends	Coalitions of Lesser Developed Countries (LDC) policies
Worker productivity levels	
Value of the dollar in world markets	
Stock market trends	
Foreign countries' economic conditions	

opening new stores. "Canada is one of the most economically prosperous countries in the world," said Howard Davidowitz, chairman of Davidowitz & Associates, a retail consultancy and investment banking firm. "It has a stable currency, it did not have a banking crisis and it did not spend itself into insanity."

Trends in the dollar's value have significant and unequal effects on companies in different industries and in different locations. For example, the pharmaceutical, tourism, entertainment, motor vehicle, aerospace, and forest products industries benefit greatly when the dollar falls against the yen and euro. Agricultural and petroleum industries are hurt by the dollar's rise against the currencies of Mexico, Brazil, Venezuela, and Australia. Generally, a strong or high dollar makes U.S. goods more expensive in overseas markets. This worsens the U.S. trade deficit. When the value of the dollar falls, tourism-oriented firms benefit because Americans do not travel abroad as much when the value of the dollar is low; rather, foreigners visit and vacation more in the United States.

A low value of the dollar means lower imports and higher exports; it helps U.S. companies' competitiveness in world markets. A falling dollar makes U.S. goods cheaper to foreign consumers and combats deflation by pushing up prices of imports. A low value of the dollar benefits the U.S. economy in many ways. First, it helps stave off the risks of deflation in the USA and also reduces the U.S. trade deficit. In addition, a low value of the dollar raises the foreign sales and profits of domestic firms, thanks to dollar-induced gains, and encourages foreign countries to lower interest rates and loosen fiscal policy, which stimulates worldwide economic expansion. Some sectors, such as consumer staples, energy, materials, technology, and health care, especially benefit from a low value of the dollar. Manufacturers in many domestic industries in fact benefit because of a weak dollar, which forces foreign rivals to raise prices and extinguish discounts. Domestic firms with big overseas sales, such as McDonald's, greatly benefit from a weak dollar. Table 7-2 lists some advantages and disadvantages of a weak U.S. dollar for U.S. firms.

In contrast to rivals Nissan Motor and Honda Motor, Mazda Motor Corp. based in Hiroshima, Japan, has a strategy to produce more than 80 percent of its vehicles in Japan and export them rather than building manufacturing plants globally. Even if the value of the dollar weakens to 77 yen, Mazda says it can make a profit on its CX-5 vehicles. But with the dollar at 79 yen, Honda and Nissan say they must keep moving production abroad and will do so until or unless the dollar climbs back to at least 100 yen. Thus, value of the dollar versus the Japanese yen is an important factor in strategic planning among Japanese firms.

The value of the dollar changes some every day, but generally in 2012–2013 the value of the dollar was strong and thus profits of U.S. companies with revenue from abroad were lowered on average 6 to 7 percent. Why the lowered profits? Because, for example, 100 euros earned in Europe, when translated back to U.S. dollars for reporting purposes, the 100 euros is worth

TABLE 7-2 Advantages and Disadvantages of a Weak Dollar for Domestic Firms

Advantages	Disadvantages
1. Leads to more exports	1. Can lead to inflation
2. Leads to lower imports	2. Can cause rise in oil prices
3. Makes U.S. goods cheaper to foreign consumers	3. Can weaken U.S. government
4. Combats deflation by pushing up prices of imports	4. Makes it unattractive for Americans to travel globally
5. Can contribute to rise in stock prices in short run	5. Can contribute to fall in stock prices in long run
6. Encourages foreign countries to lower interest rates	
7. Raises the revenues and profits of firms that do business outside the USA	
8. Forces foreign firms to raise prices	
9. Reduces the U.S. trade deficit	
10. Encourages firms to globalize	
11. Encourages foreigners to visit the United States	

maybe $75. To combat this "loss," some companies try to raise prices in their European or Mexican stores, but that carries a risk of alienating shoppers, angering retailers, and giving local competitors a price edge. Some advantages of a strong dollar however are that companies with substantial outside U.S. operations see their overseas expenses, such as salaries paid in euros, become cheaper. Another advantage of a strong dollar is that it gives U.S. companies greater firepower for international acquisitions. Another advantage of a strong dollar is that companies that import benefit from greater buying power because their dollars now go further overseas.

A recent *Wall Street Journal* article (12-4-12, B4) explains the unfavorable foreign-exchange rate environment plaguing U.S. firms. For example, the starch and sweetener maker Ingredion Inc.'s earnings were reduced by 20 cents per share recently by weakness in the Brazilian real, Argentine peso, British pound, and the euro. Similarly, General Motors reported that its third quarter 2012 sales were reduced by about $1.3 billion as a result of weakness in the European euro, Russian ruble, Hungarian forint, South Korean won, South African rand, Canadian dollar, and Mexican pesos.

Social, Cultural, Demographic, and Natural Environment Forces

Asian Americans are now the best-educated, highest-earning, and fastest-growing racial group in the United States.[2] The number of Asian Americans in the United States grew by 46 percent between 2000 and 2010, with Chinese Americans becoming by far the largest group. The median U.S. household income is $49.8K, with Asian American's median being $66K, compared to whites $54K, Hispanics $40K, and African Americans $33.3K.[3]

The U.S. Fish and Wildlife Service reported in late 2012 that 11 percent more Americans (ages 16 and older) fished and 9 percent more hunted in 2011 than in 2006. The report also revealed that among children aged 6 to 15, 13 percent more hunted and 2 percent more fished during the same period. A variety of reasons account for the shift back to "doing outdoor things," but this trend is excellent news for thousands of sporting goods companies.

Social, cultural, demographic, and environmental changes have a major impact on virtually all products, services, markets, and customers. Small, large, for-profit, and nonprofit organizations in all industries are being staggered and challenged by the opportunities and threats arising from changes in social, cultural, demographic, and environmental variables. In every way, the United States is much different today than it was yesterday, and tomorrow promises even greater changes.

The USA is getting older and less white. The oldest among the 76 million baby boomers in the USA plan to retire soon, and this has lawmakers and younger taxpayers deeply concerned about who will pay their Social Security, Medicare, and Medicaid. Individuals age 65 and older in the USA as a percentage of the population, will rise to 18.5 percent by 2025. The oldest USA veteran is Richard Everton of East Austin, Texas, who is 108; the oldest USA woman is 114, Teralean Talley of Inkster, Michigan.

By 2075, the USA will have no racial or ethnic majority. This forecast is aggravating tensions over issues such as immigration and affirmative action. Hawaii, California, and New Mexico already have no majority race or ethnic group

The population of the world recently surpassed 7 billion; the USA has slightly more than 310 million people. That leaves billions of people outside the USA who may be interested in the products and services produced through domestic firms. Remaining solely domestic is an increasingly risky strategy, especially as the world population continues to grow to an estimated 8 billion in 2028 and 9 billion in 2054.

Social, cultural, demographic, and environmental trends are shaping the way Americans live, work, produce, and consume. New trends are creating a different type of consumer and, consequently, a need for different products, different services, and different strategies. There are now more U.S. households with people living alone or with unrelated people than there are households consisting of married couples with children. U.S. households are making more and more purchases online.

The trend toward an older USA is good news for restaurants, hotels, airlines, cruise lines, tours, resorts, theme parks, luxury products and services, recreational vehicles, home builders, furniture producers, computer manufacturers, travel services, pharmaceutical firms, automakers, and funeral homes. Older Americans are especially interested in health care, financial services, travel, crime prevention, and leisure. The world's longest-living people are the Japanese, with Japanese women living to 86.3 years and men living to 80.1 years on average. By 2050, the Census Bureau projects that the number of Americans age 100 and older will increase to over 834,000 from just under 100,000 centenarians in the USA in 2000. Americans age 65 and over will increase from 12.6 percent of the U.S. population in 2000 to 20.0 percent by the year 2050. The aging U.S. population affects the strategic orientation of nearly all organizations.

The historical trend of people moving from the Northeast and Midwest to the Sunbelt and West has dramatically slowed. Hard number data related to this trend can represent key opportunities for many firms and thus can be essential for successful strategy formulation, including where to locate new plants and distribution centers and where to focus marketing efforts.

A summary of important social, cultural, demographic, and environmental variables that represent opportunities or threats for virtually all organizations is given in Table 7-3.

Political, Governmental, and Legal Forces

Figure 7-3 reveals the USA county-by-county presidential election results for the 2012 Barack Obama versus Mitt Romney election, with the red being Republican and the blue being Democratic. The red indicates counties that had a Republican majority vote result, but much of this land is sparsely inhabited. President Obama and the Democrats won both the popular vote and the Electoral College count. Various industries, such as aerospace, and all their supplier firms, typically support and lobby for Republicans, whereas other industries, such as automotive and all their supplier firms, generally support Democrats. National, state, and local elections impact businesses, with ongoing healthy debate concerning the pros and cons of each party's agenda for business. Should firms take stances on political issues?

Political issues and stances do matter for business, especially in today's world of instant tweeting and e-mailing. For example, Starbucks' recent support of same-sex marriage in its home state of Washington was praised by a number of prominent rights activists. Maine, Maryland, Minnesota, Washington, Massachusetts, New York, California, and a few other states all allow same-sex marriage. But the Seattle-based coffee chain's outspoken opponents, such as the National Organization for Marriage (NOM), has vowed to make Starbucks (along with other companies that support same-sex marriage) pay a "price" for this stance. "Middle Eastern countries are hostile to lesbian, gay, bisexual and transgender (LGBT)

TABLE 7-3 Key Social, Cultural, Demographic, and Natural Environment Variables

Childbearing rates	Attitudes toward retirement
Number of special-interest groups	Attitudes toward leisure time
Number of marriages	Attitudes toward product quality
Number of divorces	Attitudes toward customer service
Number of births	Pollution control
Number of deaths	Attitudes toward foreign peoples
Immigration and emigration rates	Energy conservation
Social Security programs	Social programs
Life expectancy rates	Number of churches
Per capita income	Number of church members
Location of retailing, manufacturing, and service businesses	Social responsibility
Attitudes toward business	Attitudes toward careers
Lifestyles	Population changes by race, age, sex, and level of affluence
Traffic congestion	Attitudes toward authority
Inner-city environments	Population changes by city, county, state, region, and country
Average disposable income	Value placed on leisure time
Trust in government	Regional changes in tastes and preferences
Attitudes toward government	Number of women and minority workers
Attitudes toward work	Number of high school and college graduates by geographic area
Buying habits	Recycling
Ethical concerns	Waste management
Attitudes toward saving	Air pollution
Sex roles	Water pollution
Attitudes toward investing	Ozone depletion
Racial equality	Endangered species
Use of birth control	
Average level of education	
Government regulation	

rights. So for example, in Qatar, in the Middle East, we've begun working to make sure that there's some price to be paid for this," Brian Brown of the NOM said. "These are not countries that look kindly on same-sex marriage. And this is where Starbucks wants to expand, as well as India." In essence, the question needs to be asked, should firms take stances on contentious social issues?

Beginning in 2014, U.S. businesses will have to offer workers a minimum level in medical insurance or pay a penalty starting at $2,000 for each worker. This is part of the so-called Obamacare legislation. So, thousands of U.S. businesses, such as Pillar Hotels & Resorts, are transitioning to having a larger percentage of their workforce being comprised of part-time workers rather than full-time employees. Pillar Hotels owns Sheraton, Fairfield Inns, Hampton Inns, and Holiday Inns.

A political debate still rages in the USA regarding sales taxes on the Internet. Walmart, Target, and other large retailers are pressuring state governments to collect sales taxes from Amazon.com. Big brick-and-mortar retailers are backing a coalition called the Alliance for Main Street Fairness, which is leading political efforts to change sales-tax laws in more than a dozen states. Walmart's executive Raul Vazquez says, "The rules today don't allow brick-and-mortar retailers to compete evenly with online retailers, and that needs to be addressed."

Federal, state, local, and foreign governments are major regulators, deregulators, subsidizers, employers, and customers of organizations. Political, governmental, and legal factors, therefore, can represent key opportunities or threats for both small and large organizations. Political unrest in the Middle East threatens to raise oil prices globally, which could cause inflation. The political

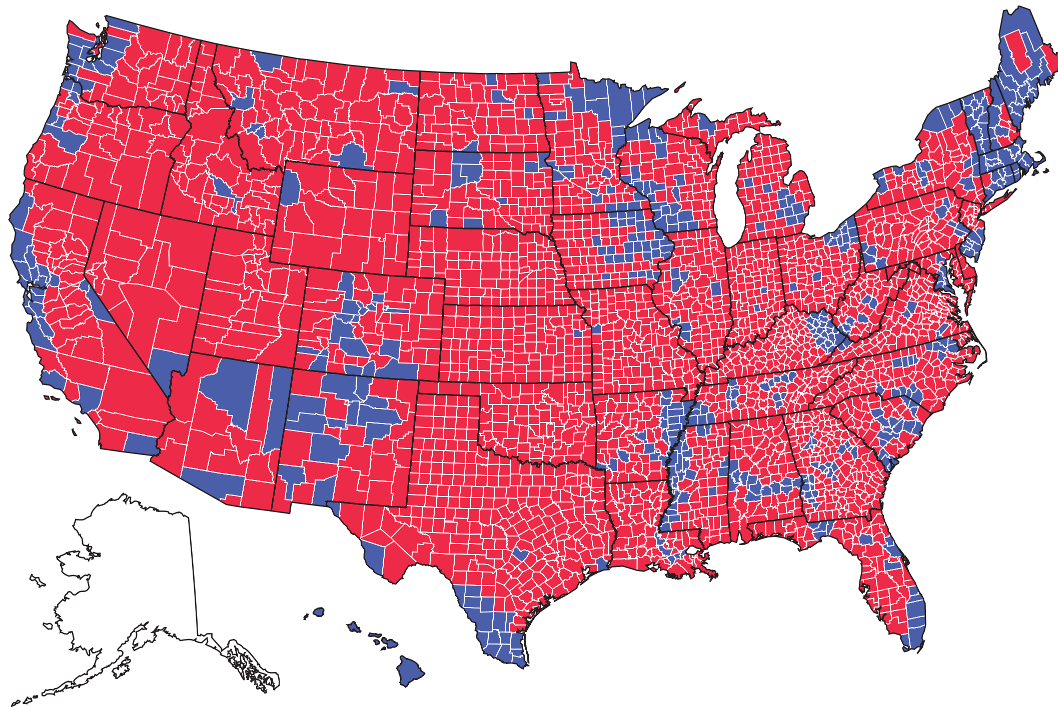

FIGURE 7-3
County-by County USA 2012 Presidential Results (red = Republican; blue = Democrat)

overthrow of monarchies in Egypt, Tunisia, Yemen, and Libya has spread to Syria and even Turkey because people in all nations desire liberty and freedom rather than oppression and suppression.

For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit. Changes in patent laws, antitrust legislation, tax rates, and lobbying activities can affect firms significantly. The increasing global interdependence among economies, markets, governments, and organizations makes it imperative that firms consider the possible impact of political variables on the formulation and implementation of competitive strategies.

The Marketplace Fairness Act (MFA) in the U.S. Senate and the Marketplace Equity Act (MEA) in the U.S. House are likely to pass in 2013, basically reversing the 1992 Supreme Court decision exempting many online retailers from collecting state sales taxes unless they had a physical presence in the state, such as a warehouse. But as online sales boom, states continue to suffer severe budget shortfalls and brick-and-mortar companies cannot compete with online firms, so legislation to tax online sales is expected to pass soon.

Many countries worldwide are resorting to protectionism to safeguard their own industries. European Union (EU) nations, for example, have tightened their own trade rules and resumed subsidies for various of their own industries while barring imports from certain other countries. The EU recently restricted imports of U.S. chicken and beef. India is increasing tariffs on foreign steel. Russia perhaps has instituted the most protectionist measures by raising tariffs on most imports and subsidizing its own exports. Russia even imposed a new toll on trucks from the EU, Switzerland, and Turkmenistan. Despite these measures taken by other countries, the USA has largely refrained from "Buy American" policies and protectionist measures, although there are increased tariffs on French cheese and Italian water. Many economists say trade constraints will make it harder for global economic growth.

Labor Unions

The extent that a state is unionized can be a significant political factor in strategic planning decisions as related to manufacturing plant location and other operational matters. The size of U.S. labor unions has fallen sharply in the last decade as a result in large part of erosion of the U.S. manufacturing base.

Huge declines of late in receipts of federal, state, and municipal governments has contributed to a sharp decline in the membership of public-sector unions. Organized public-sector labor issues are being debated in many state legislatures. State governments seek concessions, the most drastic of which may be the abolition of collective bargaining rights. Wisconsin recently passed a law eliminating most collective-bargaining rights for the state's public-employee unions. That law sets a precedent that many other states may follow to curb union rights as a way to help state budgets become solvent. Ohio is close to passing a similar bill curbing union rights for 400,000 public workers.

According to the U.S. Bureau of Labor Statistics, the union membership rate (the percent of wage and salary workers who were members of a union) in the USA was 11.8 percent in 2011, down slightly from 11.9 percent the prior year. The number of wage and salary workers belonging to unions, at 14.8 million, also showed little movement over the year. By comparison, in 1983, the union membership rate was 20.1 percent and there were 17.7 million union workers. Highlights from the Bureau's 2011 data are as follows:

- Public-sector workers had a union membership rate (37.0 percent) more than five times higher than that of private-sector workers (6.9 percent).
- Workers in education, training, and library occupations had the highest unionization rate, at 36.8 percent, whereas the lowest rate occurred in sales and related occupations (3.0 percent).
- Black workers were more likely to be union members than were white, Asian, or Hispanic workers.
- Among states, New York continued to have the highest union membership rate (24.1 percent) and North Carolina again had the lowest rate (2.9 percent).

In Europe, German-based Lufthansa AG recently cancelled two-thirds of its airline flights as a result of an anticipated strike by its cabin crew. The union UFO represents 18,000 Lufthansa cabin-crew members who want higher wages, but Lufthansa says their average flight attendant' salary is 52,492 euros compared with 23,680 euros at rival firm Air Berlin PLC. Similarly, British Airways recently was hammered by the cabin-crew union Unite, costing the airline about $250 million.

Local, state, and federal laws; regulatory agencies; and special-interest groups can have a major impact on the strategies of small, large, for-profit, and nonprofit organizations. Many companies have altered or abandoned strategies in the past because of political or governmental actions. In the academic world, as state budgets have dropped in recent years, so too has state support for colleges and universities. Resulting from the decline in monies received from the state, many institutions of higher learning are doing more fund-raising on their own—naming buildings and classrooms, for example, for donors. A summary of political, governmental, and legal variables that can represent key opportunities or threats to organizations is provided in Table 7-4.

TABLE 7-4 Some Political, Governmental, and Legal Variables

Government regulations or deregulations	Sino American relationships
Changes in tax laws	Russian American relationships
Special tariffs	European American relationships
Political action committees	African American relationships
Voter participation rates	Import–export regulations
Number, severity, and location of government protests	Government fiscal and monetary policy changes
Number of patents	Political conditions in foreign countries
Changes in patent laws	Special local, state, and federal laws
Environmental protection laws	Lobbying activities
Level of defense expenditures	Size of government budgets
Legislation on equal employment	World oil, currency, and labor markets
Level of government subsidies	Location and severity of terrorist activities
Antitrust legislation	Local, state, and national elections

Technological Forces

The **Internet** has changed the nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets, and changing the historical trade-off between production standardization and flexibility. The Internet has lowered entry barriers and redefined the relationship between industries and various suppliers, creditors, customers, and competitors.

Papa John's International a few years ago received more than 50 percent of all its pizza orders through its website, up from 30 percent in 2011 and far more than the industry average of 10 percent. Technology is a key to Papa John's success as it strives to compete with Domino's Pizza and Pizza Hut. Papa John's new website is interactive, where customers can see a picture of their pizza as they decide upon toppings. Papa John's new loyalty program, called Papa Points, is promoted heavily through its new website.

Google's Nexus 7 tablet computer and Apple's iPhone 5 released in late 2012 worldwide provide a reminder of the kind of competition that has left Japan's consumer electronics makers struggling to survive. Japanese firms such as Sony Corp., Panasonic Corp. and Sharp Corp. once dominated the electronics business. Sharp's new restructuring plan involves the firm cutting more than 10,000 jobs, cutting wages, and selling plants in Mexico, China, and Malaysia.

According to media consultant BIA/Kelsey, small and midsize businesses in the USA spent about $1.3 billion in 2011 on online reputation management tools and services. Those figures grew to about $1.6 billion in 2012 and are expected to grow to $2.5 billion by 2016 according to the firm. Further, the firm says about 57 percent of small and midsize businesses in the USA monitor online content about their businesses, with 71 percent using free, do-it-yourself software. In general, monitoring of online reviews about your business, large or small, has become a burdensome but an essential task, especially given emergence of social-media channels, such as Twitter, that empowers opinionated customers. Research is clear that benign neglect of a company's online reputation could quickly hurt sales, especially given the new normal behavior of customers consulting their smartphones for even the smallest of purchases.[4]

To effectively capitalize on e-commerce, a number of organizations are establishing two new positions in their firms: **chief information officer (CIO)** and **chief technology officer (CTO)**. This trend reflects the growing importance of **information technology (IT)** in strategic management. A CIO and CTO work together to ensure that information needed to formulate, implement, and evaluate strategies is available where and when it is needed. These individuals are responsible for developing, maintaining, and updating a company's information database. The CIO is more a manager, managing the firm's relationship with stakeholders; the CTO is more a technician, focusing on technical issues such as data acquisition, data processing, decision-support systems, and software and hardware acquisition.

Technological forces represent major opportunities and threats that must be considered in formulating strategies. Technological advancements can dramatically affect organizations' products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position. Technological advancements can create new markets, result in a proliferation of new and improved products, change the relative competitive cost positions in an industry, and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills, and result in changing values and expectations of employees, managers, and customers. Technological advancements can create new competitive advantages that are more powerful than existing advantages. No company or industry today is insulated against emerging technological developments. In high-tech industries, identification and evaluation of key technological opportunities and threats can be the most important part of the external strategic-management audit.

Organizations that traditionally have limited technology expenditures to what they can fund after meeting marketing and financial requirements urgently need a reversal in thinking. The pace of technological change is increasing and literally wiping out businesses every day. An emerging consensus holds that technology management is one of the key responsibilities of strategists. Firms should pursue strategies that take advantage of technological opportunities to achieve sustainable, competitive advantages in the marketplace.

In practice, critical decisions about technology too often are delegated to lower organizational levels or are made without an understanding of their strategic implications. Many strategists spend

Competitive Intelligence Programs

What is competitive intelligence? **Competitive intelligence (CI)**, as formally defined by the Society of Competitive Intelligence Professionals (SCIP), is a systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals (SCIP website).

Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats.

Various legal and ethical ways to obtain competitive intelligence include the following:

- Hire top executives from rival firms
- Reverse engineer rival firms' products
- Use surveys and interviews of customers, suppliers, and distributors
- Conduct drive by and on-site visits to rival firm operations
- Search online databases
- Contact government agencies for public information about rival firms
- Systematically monitor relevant trade publications, magazines, and newspapers
- Include gathering competitive intelligence in the job description of salespersons

Many U.S. executives grew up in times when U.S. firms dominated foreign competitors so much that gathering CI did not seem worth the effort. Too many of these executives still cling to these attitudes—to the detriment of their organizations today. Even most MBA programs do not offer a course in competitive and business intelligence, thus reinforcing this attitude. As a consequence, three strong misperceptions about business intelligence prevail among U.S. executives today:

1. Running an intelligence program requires lots of people, computers, and other resources.
2. Collecting intelligence about competitors violates antitrust laws; business intelligence equals espionage.
3. Intelligence gathering is an unethical business practice.[6]

Any discussions with a competitor about price, market, or geography intentions could violate antitrust statutes. However, this fact must not lure a firm into underestimating the need for and benefits of systematically collecting information about competitors for strategic planning purposes. The Internet is an excellent medium for gathering CI. Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants also can make the difference between having superior or just average intelligence and overall competitiveness.

Firms need an effective CI program. The three basic objectives of a CI program are (1) to provide a general understanding of an industry and its competitors, (2) to identify areas in which competitors are vulnerable and to assess the impact strategic actions would have on competitors, and (3) to identify potential moves that a competitor might make that would endanger a firm's position in the market.[7] Competitive information is equally applicable for strategy formulation, implementation, and evaluation decisions. An effective CI program allows all areas of a firm to access consistent and verifiable information in making decisions. All members of an organization—from the CEO to custodians—are valuable intelligence agents and should feel themselves to be a part of the CI process. Special characteristics of a successful CI program include flexibility, usefulness, timeliness, and cross-functional cooperation.

The increasing emphasis on **competitive analysis** in the USA is evidenced by corporations putting this function on their organizational charts under job titles such as Director of Competitive Analysis, Competitive Strategy Manager, Director of Information Services, or Associate Director of Competitive Assessment. The responsibilities of a **director of competitive analysis** include planning, collecting data, analyzing data, facilitating the process of gathering and analyzing data, disseminating intelligence on a timely basis, researching special issues, and recognizing what information is important and who needs to know. CI is not corporate espionage because 95 percent of the information a company needs to make strategic decisions is available and accessible to the public. Sources of competitive information include trade

countless hours determining market share, positioning products in terms of features and price, forecasting sales and market size, and monitoring distributors; yet too often, technology does not receive the same respect.

Not all sectors of the economy are affected equally by technological developments. The communications, electronics, aeronautics, and pharmaceutical industries are much more volatile than the textile, forestry, and metals industries.

Competitive Forces

An important part of an external audit is identifying rival firms and determining their strengths, weaknesses, capabilities, opportunities, threats, objectives, and strategies. George Salk said: “If you’re not faster than your competitor, you’re in a tenuous position, and if you’re only half as fast, you’re terminal.”

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons. Also, privately-held firms do not publish any financial or marketing information. Addressing questions about competitors such as those presented in Table 7-5 is important in performing an external audit.

Competition in virtually all industries can be described as intense—and sometimes as cutthroat. For example, Walgreens and CVS pharmacies are located generally across the street from each other and battle each other every day on price and customer service. Most automobile dealerships also are located close to each other. Dollar General, based in Goodlettsville, Tennessee, and Family Dollar, based in Matthews, North Carolina, compete intensely on price to attract customers away from each other and away from Walmart.

Seven characteristics describe the most competitive companies:

1. Strive to continually increase market share.
2. Use the vision/mission as a guide for all decisions.
3. Realize that the old adage “if it’s not broke, don’t fix it” has been replaced by “whether its broke or not, fix it;” in other words, continually strive to improve everything about the firm
4. Continually adapt, innovate, improve – especially when the firm is successful.
5. Strive to grow through acquisition whenever possible
6. Hire and retain the best employees and managers possible
7. Strive to stay cost-competitive on a global basis.[5]

TABLE 7-5 Key Questions About Competitors

1. What are the major competitors’ strengths?
2. What are the major competitors’ weaknesses?
3. What are the major competitors’ objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new firms entering and old firms leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit rankings of major competitors in the industry changed over recent years? Why have these rankings changed that way?
11. What is the nature of supplier and distributor relationships in this industry?
12. To what extent could substitute products or services be a threat to competitors in this industry?

TABLE 7-6 Competitiveness Across a Few Industries (late 2013 data)

	Profit Margin (%)	EPS ($)
Pharmaceutical	20.5	20.3
Telecommunications	8.0	14.1
Fragrances/Cosmetics	9.8	22.6
Banking	16.1	8.9
Bookstores	2.3	10.5
Food Manufacturers	6.6	19.3
Oil and Gas	6.1	15.7
Airlines	2.5	23.2
Machinery/Construction	7.2	21.6
Paper Products	7.6	10.6

Source: Based on information at www.finance.yahoo.com retrieved on May 10, 2011.

The following three steps for using Porter's Five-Forces Model can indicate whether competition in a given industry is such that the firm can make an acceptable profit:

1. Identify key aspects or elements of each competitive force that impact the firm.
2. Evaluate how strong and important each element is for the firm.
3. Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.

Rivalry Among Competing Firms

Rivalry among competing firms is usually the most powerful of the five competitive forces. The strategies pursued by one firm can be successful only to the extent that they provide competitive advantage over the strategies pursued by rival firms. Changes in strategy by one firm may be met with retaliatory countermoves, such as lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising.

The intensity of rivalry among competing firms tends to increase as the number of competitors increases, as competitors become more equal in size and capability, as demand for the industry's products declines, and as price cutting becomes common. Rivalry also increases when consumers can switch brands easily; when barriers to leaving the market are high; when fixed costs are high; when the product is perishable; when consumer demand is growing slowly or declines such that rivals have excess capacity or inventory; when the products being sold are commodities (not easily differentiated, such as gasoline); when rival firms are diverse in strategies, origins, and culture; and when mergers and acquisitions are common in the industry. As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive. When rival firms sense weakness, typically they will intensify both marketing and production efforts to capitalize on the "opportunity." Table 7-7 summarizes conditions that cause high rivalry among competing firms.

Potential Entry of New Competitors

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms increases. Barriers to entry, however, can include the need to gain economies of scale quickly, the need to gain technology and specialized know-how, the lack of experience, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, possession of patents, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist's job, therefore, is to identify potential new firms entering the market, to monitor the new rival firms' strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities.

journals, want ads, newspaper articles, and government filings, as well as customers, suppliers, distributors, competitors themselves, and the Internet.

Unethical tactics such as bribery, wiretapping, and computer hacking should never be used to obtain information. All the information you could wish for can be collected without resorting to unethical tactics.

Market Commonality and Resource Similarity

By definition, competitors are firms that offer similar products and services in the same market. Markets can be geographic or product areas or segments. For example, in the insurance industry the markets are broken down into commercial/consumer, health/life, or Europe/Asia. Researchers use the terms *market commonality* and *resource similarity* to study rivalry among competitors. **Market commonality** can be defined as the number and significance of markets that a firm competes in with rivals.[8] **Resource similarity** is the extent to which the type and amount of a firm's internal resources are comparable to a rival.[9] One way to analyze competitiveness between two or among several firms is to investigate market commonality and resource similarity issues while looking for areas of potential competitive advantage along each firm's value chain.

Competitive Analysis: Porter's Five-Forces Model

Wayne Calloway said: "Nothing focuses the mind better than the constant sight of a competitor that wants to wipe you off the map." As illustrated in Figure 7-4, **Porter's Five-Forces Model** of competitive analysis is a widely used approach for developing strategies in many industries. The intensity of competition among firms varies widely across industries. Table 7-6 reveals the average gross profit margin and earnings per share for firms in different industries. Note the substantial variation among industries. For example, note that industry profit margins range from 20.5 to 2.3 percent, whereas industry return on equity (ROE) values range from 23.2 to 8.9. Note that bookstores have the lowest average profit margin (2.3), which implies fierce competition in that industry. Intensity of competition is highest in lower-return industries. The collective impact of competitive forces is so brutal in some industries that the market is clearly "unattractive" from a profit-making standpoint. Rivalry among existing firms is severe, new rivals can enter the industry with relative ease, and both suppliers and customers can exercise considerable bargaining leverage. According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces:

1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers

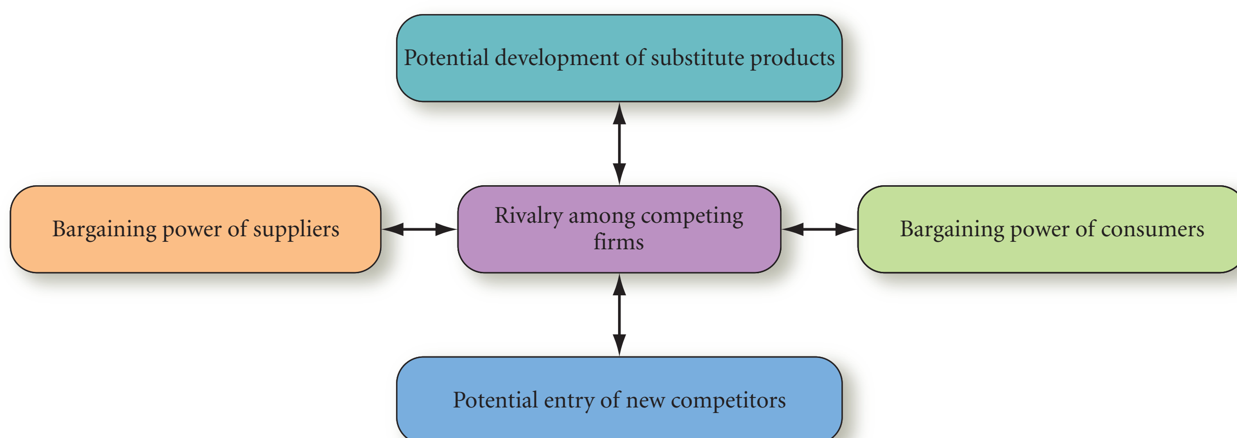

FIGURE 7-4
The Five-Forces Model of Competition

TABLE 7-7 Conditions That Cause High Rivalry Among Competing Firms

1. High number of competing firms
2. Similar size of firms competing
3. Similar capability of firms competing
4. Falling demand for the industry's products
5. Falling product or service prices in the industry
6. When consumers can switch brands easily
7. When barriers to leaving the market are high
8. When barriers to entering the market are low
9. When fixed costs are high among firms competing
10. When the product is perishable
11. When rivals have excess capacity
12. When consumer demand is falling
13. When rivals have excess inventory
14. When rivals sell similar products/services
15. When mergers are common in the industry

When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials.

Walt Disney is rapidly building its Shanghai Disneyland $4.4 billion complex set to open in China in 2016, complete with hotels, restaurants, retail shops and other amenities. However, a rival firm, DreamWorks Animation SKG, is now building a $3.1 billion entertainment district named Dream Center in Shanghai right beside Disneyland and says its facility will also open in 2016. Although expensive to build, theme parks are becoming more popular globally. Time Warner's Warner Brothers is building Harry Potter attractions around the world, including a converted movie studio outside London.

Potential Development of Substitute Products

In many industries, firms are in close competition with producers of substitute products in other industries. Examples are plastic container producers competing with glass, paperboard, and aluminum can producers, and acetaminophen manufacturers competing with other manufacturers of pain and headache remedies. The presence of substitute products puts a ceiling on the price that can be charged before consumers will switch to the substitute product. Price ceilings equate to profit ceilings and more intense competition among rivals. Producers of eyeglasses and contact lenses, for example, face increasing competitive pressures from laser eye surgery. Producers of sugar face similar pressures from artificial sweeteners. Newspapers and magazines face substitute-product competitive pressures from the Internet and 24-hour cable television. The magnitude of competitive pressure derived from the development of substitute products is generally evidenced by rivals' plans for expanding production capacity, as well as by their sales and profit growth numbers.

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers' costs of switching decrease. The competitive strength of substitute products is best measured by the inroads into the market share those products obtain, as well as those firms' plans for increased capacity and market penetration.

For example, circulation of U.S. newspapers continues to drop drastically, with the exception of the *Wall Street Journal, USA Today,* and a few others. The growing popularity of free news on the web and more timely news online are two key factors negatively impacting traditional papers such as the *New York Times*, *Los Angeles Times*, and others.

Bargaining Power of Suppliers

The bargaining power of suppliers affects the intensity of competition in an industry, especially when there are few suppliers, when there are few good substitute raw materials, or when the cost of switching raw materials is especially high. It is often in the best interest of both suppliers and

producers to assist each other with reasonable prices, improved quality, development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned.

Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are unreliable, too costly, or not capable of meeting a firm's needs on a consistent basis. Firms generally can negotiate more favorable terms with suppliers when backward integration is a commonly used strategy among rival firms in an industry.

However, in many industries it is more economical to use outside suppliers of component parts than to self-manufacture the items. This is true, for example, in the outdoor power equipment industry, where producers of lawn mowers, rotary tillers, leaf blowers, and edgers such as Murray generally obtain their small engines from outside manufacturers such as Briggs & Stratton that specialize in such engines and have huge economies of scale.

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to (a) reduce inventory and logistics costs (e.g., through just-in-time deliveries); (b) speed the availability of next-generation components; (c) enhance the quality of the parts and components being supplied and reduce defect rates; and (d) squeeze out important cost savings for both themselves and their suppliers.[10]

Bargaining Power of Consumers

When customers are concentrated or large in number or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry. Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial. Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

The bargaining power of consumers can be the most important force affecting competitive advantage. Consumers gain increasing bargaining power under the following circumstances:

1. If they can inexpensively switch to competing brands or substitutes
2. If they are particularly important to the seller
3. If sellers are struggling in the face of falling consumer demand
4. If they are informed about sellers' products, prices, and costs
5. If they have discretion in whether and when they purchase the product[11]

Sources of External Information

A wealth of strategic information is available to organizations from both published and unpublished sources. Unpublished sources include customer surveys, market research, speeches at professional and shareholders' meetings, television programs, interviews, and conversations with stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. A company website is usually an excellent place to start to find information about a firm, particularly on the Investor Relations web pages.

There are many excellent websites for gathering strategic information, but five that the author uses routinely are:

1. www.money.msn.com
2. http://finance.yahoo.com
3. www.hoovers.com
4. http://globaledge.msu.edu/industries/
5. www.monrningstar.com

An excellent source of industry information is provided by Michigan State University at http://globaledge.msu.edu/industries/. Industry Profiles provided at that site are an excellent source for information, news, events, and statistical data for any industry. In addition to a wealth of indices, risk assessments, and interactive trade information, a wide array of global resources are provided.

Most college libraries subscribe to Standard & Poor's (S&P's) *Industry Surveys.* These documents are exceptionally up-to-date and give valuable information about many different

By identifying future occurrences that could have a major effect on the firm and by making reasonable assumptions about those factors, strategists can carry the strategic-management process forward. Assumptions are needed only for future trends and events that are most likely to have a significant effect on the company's business. Based on the best information at the time, assumptions serve as checkpoints on the validity of strategies. If future occurrences deviate significantly from assumptions, strategists know that corrective actions may be needed. Without reasonable assumptions, the strategy-formulation process could not proceed effectively. Firms that have the best information generally make the most accurate assumptions, which can lead to major competitive advantages.

Industry Analysis: The External Factor Evaluation Matrix

An **external factor evaluation (EFE) matrix** allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. Illustrated in Table 7-8, the EFE Matrix can be developed in five steps:

1. List key external factors as identified in the external-audit process. Include a total of 20 factors, including both opportunities and threats that affect the firm and its industry. List the opportunities first and then the threats. Be as specific as possible, using percentages, ratios, and comparative numbers whenever possible. Recall that Edward Deming said: "In God we trust. Everyone else bring data." In addition, utilize "*actionable*" factors as defined earlier in this chapter.
2. Assign to each factor a weight that ranges from 0.0 (not important) to 1.0 (very important). The weight indicates the relative importance of that factor to being successful in the firm's industry. Opportunities often receive higher weights than threats, but threats can receive high weights if they are especially severe or threatening. Appropriate weights can be determined by comparing successful with unsuccessful competitors or by discussing the factor and reaching a group consensus. The sum of all weights assigned to the factors must equal 1.0.
3. Assign a rating between 1 and 4 to each key external factor to indicate how effectively the firm's current strategies respond to the factor, where 4 = *the response is superior*, 3 = *the response is above average*, 2 = *the response is average*, and 1 = *the response is poor.* Ratings are based on effectiveness of the firm's strategies. Ratings are thus company-based, whereas the weights in Step 2 are industry-based. It is important to note that both threats and opportunities can receive a 1, 2, 3, or 4.
4. Multiply each factor's weight by its rating to determine a weighted score.
5. Sum the weighted scores for each variable to determine the total weighted score for the organization.

Regardless of the number of key opportunities and threats included in an EFE Matrix, the highest possible total weighted score for an organization is 4.0 and the lowest possible total weighted score is 1.0. The average total weighted score is 2.5. A total weighted score of 4.0 indicates that an organization is responding in an outstanding way to existing opportunities and threats in its industry. In other words, the firm's strategies effectively take advantage of existing opportunities and minimize the potential adverse effects of external threats. A total score of 1.0 indicates that the firm's strategies are not capitalizing on opportunities or avoiding external threats.

An example of an EFE Matrix is provided in Table 7-8 for a local 10-theater cinema complex. Note that the most important factor to being successful in this business is "Trend toward healthy eating eroding concession sales" as indicated by the 0.12 weight. Also note that the local cinema is doing excellent in regard to handling two factors, "TDB University is expanding 6 percent annually" and "Trend toward healthy eating eroding concession sales." Perhaps the cinema is placing flyers on campus and also adding yogurt and healthy drinks to its concession menu. Note that you may have a 1, 2, 3, or 4 anywhere down the Rating column. Note also that the factors are stated in quantitative terms to the extent possible, rather than being stated in vague terms. Quantify the factors as much as possible in constructing an EFE Matrix. Note also that all the factors are "actionable" instead of being something like "the economy is bad." Finally, note that the total weighted score of 2.58 is above the average (midpoint) of 2.5, so this cinema business is doing pretty well, taking advantage of the

industries. Each report is authored by a Standard & Poor's industry research analyst and includes the following sections:

1. Current Environment
2. Industry Trends
3. How the Industry Operates
4. Key Industry Ratios and Statistics
5. How to Analyze a Company
6. Glossary of Industry Terms
7. Additional Industry Information
8. References
9. Comparative Company Financial Analysis

Forecasting Tools and Techniques

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events. Managers often must rely on published forecasts to effectively identify key external opportunities and threats.

A sense of the future permeates all action and underlies every decision a person makes. People eat expecting to be satisfied and nourished in the future. People sleep assuming that in the future they will feel rested. They invest energy, money, and time because they believe their efforts will be rewarded in the future. They build highways assuming that automobiles and trucks will need them in the future. Parents educate children on the basis of forecasts that they will need certain skills, attitudes, and knowledge when they grow up. The truth is we all make implicit forecasts throughout our daily lives. The question, therefore, is not whether we should forecast but rather how we can best forecast to enable us to move beyond our ordinarily unarticulated assumptions about the future. Can we obtain information and then make educated assumptions (forecasts) to better guide our current decisions to achieve a more desirable future state of affairs? Assumptions must be made based on facts, figures, trends, and research. Strive for the firm's assumptions to be more accurate than rival firm's assumptions.

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas. Because forecasting is so important in strategic management and because the ability to forecast (in contrast to the ability to use a forecast) is essential, selected forecasting tools are examined further here.

Forecasting tools can be broadly categorized into two groups: quantitative techniques and qualitative techniques. Quantitative forecasts are most appropriate when historical data are available and when the relationships among key variables are expected to remain the same in the future. **Linear regression**, for example, is based on the assumption that the future will be just like the past—which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate.

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own. Key external opportunities and threats can be effectively identified only through good forecasts. Accurate forecasts can provide major competitive advantages for organizations. Accurate forecasts are vital to the strategic-management process and to the success of organizations.

Making Assumptions

Planning would be impossible without assumptions. McConkey defines assumptions as the "best present estimates of the impact of major external factors, over which the manager has little if any control, but which may exert a significant impact on performance or the ability to achieve desired results."[12] Strategists are faced with countless variables and imponderables that can be neither controlled nor predicted with 100 percent accuracy. Wild guesses should never be made in formulating strategies, but reasonable assumptions based on available information must *always* be made.

TABLE 7-8 **EFE Matrix for a Local 10-Theater Cinema Complex**

Key External Factors	Weight	Rating	Weighted Score
Opportunities			
1. Rowan County is growing 8 percent annually in population	0.05	3	0.15
2. TDB University is expanding 6 percent annually	0.08	4	0.32
3. Major competitor across town recently ceased operations	0.08	3	0.24
4. Demand for going to cinema growing 10 percent annually	0.07	2	0.14
5. Two new neighborhoods being developed within 3 miles	0.09	1	0.09
6. Disposable income among citizens grew 5 percent in prior year	0.06	3	0.18
7. Unemployment rate in county declined to 3.1 percent	0.03	2	0.06
Threats			
8. Trend toward healthy eating eroding concession sales	0.12	4	0.48
9. Demand for online movies and DVDs growing 10 percent annually	0.06	2	0.12
10. Commercial property adjacent to cinemas for sale	0.06	3	0.18
11. TDB University installing an on-campus movie theater	0.04	3	0.12
12. County and city property taxes increasing 25 percent this year	0.08	2	0.16
13. Local religious groups object to R-rated movies being shown	0.04	3	0.12
14. Movies rented from local Blockbuster store up 12 percent	0.08	2	0.16
15. Movies rented last quarter from Time Warner up 15 percent	0.06	1	0.06
Total	**1.00**		**2.58**

external opportunities and avoiding the threats facing the firm. There is definitely room for improvement, though, because the highest total weighted score would be 4.0. As indicated by ratings of 1, this business needs to capitalize more on the "two new neighborhoods nearby" opportunity and the "movies rented from Time Warner" threat. Note also that there are many percentage-based factors among the group. Be quantitative to the extent possible! Note also that the ratings range from 1 to 4 on both the opportunities and threats.

An EFE Matrix for Netflix is provided in Table 7-9. Note that the most important external factors for Netflix were the growth in Internet users globally as indicated by a weight of 0.08. Netflix's total weighted score of 2.73 is good but not excellent.

The Competitive Profile Matrix

The **Competitive Profile Matrix (CPM)** identifies a firm's major competitors and its particular strengths and weaknesses in relation to a sample firm's strategic position. The weights and total weighted scores in both a CPM and an EFE have the same meaning. However, *critical success factors* in a CPM include both internal and external issues; therefore, the ratings refer to strengths and weaknesses, where 4 = major strength, 3 = minor strength, 2 = minor weakness, and 1 = major weakness. The critical success factors in a CPM are not grouped into opportunities and threats as they are in an EFE. In a CPM, the ratings and total weighted scores for rival firms can be compared to the sample firm. This comparative analysis provides important internal strategic information. Avoid assigning the same rating to firms included in your CPM analysis.

A sample CPM is provided in Table 7-10. In this example, the two most important factors to being successful in the industry are "advertising" and "global expansion," as indicated by weights of 0.20. If there were no weight column in this analysis, note that each factor then would be equally important. Thus, having a weight column makes for a more robust analysis because it enables the analyst to assign higher and lower numbers to capture perceived or actual levels of importance. Note in Table 7-10 that Company 1 is strongest on "product quality," as indicated by a rating of 4, whereas Company 2 is strongest on "advertising." Overall, Company 1 is strongest, as indicated by the total weighted score of 3.15 and Company 3 is weakest.

TABLE 7-9 **An Actual EFE Matrix for Netflix**

Opportunities	Weight	Rating	WScore
1. Netflix has 30 million members globally. Millions more would like Netflix.	0.07	2	.14
2. Movie ticket prices rose 3 percent in 2012.	0.04	2	.08
3. Blockbuster closed 30 percent of its stores in 2012.	0.06	4	.24
Number of Internet users globally increased from 2.4 billion in mid-2012 to over 3.0 billion in 2013.	0.08	4	.32
4. The introduction of smart TVs is enabling online content to be viewed faster and without gaming consoles.	0.06	3	.18
5. Average cable bills nationwide increased 5.8 percent.	0.05	2	.10
6. The average price of a DVD is $25 and rising.	0.04	2	.08
7. Percentage of Americans who play computer & video games is 72 percent.	0.03	3	.09
8. Once you start a movie stream on Blockbuster, you only have 24 hours to watch as any number of times.	0.05	4	.20
9. Smartphone usage is growing 20 percent annually.	0.02	3	.06
Threats			
1. Unemployment exceeds 10 percent in many areas.	0.04	2	.08
2. Blockbuster has new movie and television titles available 28 days before Redbox and Netflix.	0.05	4	.20
3. Blockbuster offers disc-only plans, stream-only plans, and combination plans.	0.04	3	.12
4. Blockbuster offers unlimited rentals-by-mail *and* in-store exchanges.	0.06	2	.12
5. Redbox installed about 6,000 kiosks in Canada in 2012.	0.05	3	.15
6. Netflix's streaming content licensing costs rose from $180 million in 2010 to a huge $1.98 billion in 2012.	0.06	4	.24
7. Coinstar is partnering with Verizon to enter the streaming market.	0.07	2	.14
8. YouTube has an agreement with Paramount to stream movies through their website.	0.05	2	.10
9. Increase in online activity increases the threat of identity theft.	0.03	1	.04
10. Amazon, Apple, and Hulu enter the movie streaming business.	0.05	3	.15
Total	**1.00**		**2.73**

Other than the critical success factors listed in the example CPM, factors often included in this analysis include breadth of product line, effectiveness of sales distribution, proprietary or patent advantages, location of facilities, production capacity and efficiency, experience, union relations, technological advantages, and e-commerce expertise.

Just because one firm receives a 3.20 overall rating and another receives a 2.80 in a CPM, it does not necessarily follow that the first firm is precisely 14.3 percent better than the second, but it does suggest that the first firm is better in some areas. Regarding weights in a CPM, EFEM, or IFEM, 0.08 is 33 percent higher than 0.06, so even small differences can reveal important perceptions regarding the relative importance of various factors. The aim with numbers is to assimilate and evaluate information in a meaningful way that aids in decision-making.

Another CPM is provided in Table 7-11. Note that Company 2 has the best product quality and management experience; Company 3 has the best market share and inventory system; and Company 1 has the best price as indicated by the ratings. Again, avoid assigning duplicate ratings on any row in a CPM.

TABLE 7-10 An Example Competitive Profile Matrix

		Company 1		Company 2		Company 3	
Critical Success Factors	Weight	Rating	Score	Rating	Score	Rating	Score
Advertising	0.20	1	0.20	4	0.80	3	0.60
Product Quality	0.10	4	0.40	3	0.30	2	0.20
Price Competitiveness	0.10	3	0.30	2	0.20	1	0.10
Management	0.10	4	0.40	3	0.20	1	0.10
Financial Position	0.15	4	0.60	2	0.30	3	0.45
Customer Loyalty	0.10	4	0.40	3	0.30	2	0.20
Global Expansion	0.20	4	0.80	1	0.20	2	0.40
Market Share	0.05	1	0.05	4	0.20	3	0.15
Total	**1.00**		**3.15**		**2.50**		**2.20**

Note: The ratings values are as follows: 1 = major weakness, 2 = minor weakness, 3 = minor strength, 4 = major strength. As indicated by the total weighted score of 2.50, Competitor 2 is weakest. Only eight critical success factors are included for simplicity; this is too few in actuality.

An example CPM for Royal Caribbean Cruises (RCC) is provided in Table 7-12. Note that RCC's main rival is Carnival Corporation. Having 40 ships in its fleet, RCC is the world's second-largest cruise line operator, after Carnival, which has 100 ships. RCC owns Celebrity Cruises, Pullmantur Cruises, Azamara Club Cruises, and CDF Croisieres de France. Carnival recently ordered a brand new ship (being built by Fincantieri) to be the largest cruise ship ever built, having a passenger capacity of 4,000 and a tonnage of 135,000, and scheduled for delivery in 2016. Note in the CPM that Carnival has a much better financial position than RCC, but RCC has the nicest ships as of year 2013, led by its Oasis ship.

Special Note To Students

In developing and presenting your external assessment for the firm, be mindful that gaining and sustaining competitive advantage is the overriding purpose of developing the opportunity and threat lists, value chain, EFEM, and CPM. During this section of your written or oral project, emphasize how and why particular factors can yield competitive advantage for the firm. In

TABLE 7-11 Another Example Competitive Profile Matrix

		Company 1		Company 2		Company 3	
Critical Success Factors	Weight	Rating	Weighted Score	Rating	Weighted Score	Rating	Weighted Score
Market Share	0.15	3	0.45	2	0.30	4	0.60
Inventory System	0.08	2	0.16	1	0.08	4	0.32
Financial Position	0.10	2	0.20	3	0.30	4	0.40
Product Quality	0.08	3	0.24	4	0.32	2	0.16
Consumer Loyalty	0.02	3	0.06	1	0.02	4	0.08
Sales Distribution	0.10	3	0.30	2	0.20	4	0.40
Global Expansion	0.15	3	0.45	2	0.30	4	0.60
Organization Structure	0.05	3	0.15	4	0.20	2	0.10
Production Capacity	0.04	3	0.12	2	0.08	4	0.16
E-commerce	0.10	3	0.30	1	0.10	4	0.40
Customer Service	0.10	3	0.30	2	0.20	4	0.40
Price Competitive	0.02	4	0.08	1	0.02	3	0.06
Management Experience	0.01	2	0.02	4	0.04	3	0.03
Total	**1.00**		**2.83**		**2.16**		**3.69**

TABLE 7-12 A Competitive Profile Matrix for Royal Caribbean Cruises

		RCC		Carnival Corp	
Critical Success Factors	Weight	Rating	Score	Rating	Score
Advertising	0.20	2	0.40	4	0.80
Quality of Ships	0.20	4	0.80	2	0.40
Price Competitiveness	0.15	3	0.45	4	0.60
Management	0.15	3	0.45	2	0.30
Financial Position	0.05	1	0.05	4	0.20
Customer Loyalty	0.15	2	0.30	4	0.60
Global Expansion	0.05	.	.15	3	0.15
Market Share	0.05	1	0.05	4	0.20
Total	**1.00**		**2.65**		**3.25**

other words, instead of robotically going through the weights and ratings (which by the way are critically important), highlight various factors in light of where you are leading the firm. Make it abundantly clear in your discussion how your firm, with your suggestions, can subdue rival firms or at least profitably compete with them. Showcase during this section of your project the key underlying reasons how and why your firm can prosper among rivals. Remember to be *prescriptive*, rather than *descriptive*, in the manner that you present your entire project. If presenting your project orally, be self-confident and passionate rather than timid and uninterested. Definitely "bring the data" throughout your project because "vagueness" is the most common downfall of students in case analyses.

Conclusion

Increasing turbulence in markets and industries around the world means the external audit has become an explicit and vital part of the strategic-management process. This chapter provides a framework for collecting and evaluating economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. Firms that do not mobilize and empower their managers and employees to identify, monitor, forecast, and evaluate key external forces may fail to anticipate emerging opportunities and threats and, consequently, may pursue ineffective strategies, miss opportunities, and invite organizational demise. Firms not taking advantage of e-commerce and social media networks are technologically falling behind.

A major responsibility of strategists is to ensure development of an effective external-audit system. This includes using information technology to devise a competitive intelligence system that works. The external-audit approach described in this chapter can be used effectively by any size or type of organization. Typically, the external-audit process is more informal in small firms, but the need to understand key trends and events is no less important for these firms. The EFE Matrix and Porter's Five-Forces Model can help strategists evaluate the market and industry, but these tools must be accompanied by good intuitive judgment. Multinational firms especially need a systematic and effective external-audit system because external forces among foreign countries vary so greatly.

Key Terms and Concepts

actionable factors (p. 227)
chief information officer (CIO) (p. 236)
chief technology officer (CTO) (p. 236)
competitive analysis (p. 238)
competitive intelligence (CI) (p. 238)
competitive profile matrix (CPM) (p. 245)

director of competitive analysis (p. 238)
environmental scanning (p. 226)
external audit (p. 226)
external factor evaluation (EFE) matrix (p. 244)
external forces (p. 227)
Industrial Organization (I/O) (p. 229)
industry analysis (p. 226)
information technology (IT) (p. 236)
Internet (p. 236)
linear regression (p. 243)
market commonality (p. 239)
Porter's Five-Forces Model (p. 239)
resource similarity (p. 239)

Issues for Review and Discussion

7-1. Michelin has been very successful in the last decade. In your opinion, what strategy changes would Michelin need in 2014?

7-2. Of the many competitors it has, which firm do you think worries Michelin most about? Why? Prepare a CPM that includes Michelin and the rival firm you identified.

7-3. A political debate, raging in the United States, concerns sales taxes on the Internet. Most states do not collect a sales tax. Brick and mortar businesses think this is unfair. How does the situation in Europe compare with the United States, in terms of sales tax on items purchased online? What is the strategic implication for companies?

7-4. The size of American labor unions have fallen sharply in the last decade, mostly due to the erosion of the U.S. manufacturing base. How does the situation in Europe compare to the United States in this regard? What is the strategic implication for companies?

7-5. List four reasons why some countries in Europe are struggling economically in comparison to Asian countries. What is the strategic implication for companies?

7-6. Does the Arab Spring—unfolding in the Middle East—represent more of an opportunity or threat to companies? Explain.

7-7. Identify two companies that you think would have a 1.5 total weighted score on their EFE Matrix. Why? Identify two companies that would have a 3.5 total weighted score on their EFE Matrix. Why?

7-8. Summarize what Chapter 7 says at the end, regarding competitive advantage whenever someone is presenting an EFE Matrix and CPM as part of a case analysis or strategic plan.

7-9. List the 10 key external forces that give rise to opportunities and threats. Give a specific example of each force, for your college or university.

7-10. Give four reasons why you agree or do not agree with I/O theorists.

7-11. Regarding economic variables, list in order of importance six specific factors that you feel greatly impact your college or university.

7-12. Explain why U.S.-based firms, such as McDonald's, greatly benefit from a weak dollar.

7-13. Regarding social, cultural, demographic, and natural environment variables, list in order of importance six specific factors that you feel most greatly impact your college or university.

7-14. Regarding political, governmental, and legal variables, list in order of importance six specific factors that you feel most greatly impact your college or university.

7-15. Explain how wireless technology is impacting four industries.

7-16. Discuss the pros and cons of gathering and assimilating competitive intelligence.

7-17. Using Porter's Five-Forces Model, explain competitiveness for a local fast food restaurant.

7-18. Identify an industry in which "bargaining power of suppliers" is the most important factor among Porter's variables.

7-19. Develop an EFE Matrix for your college or university.

7-20. Distinguish between ratings and weights in an EFE Matrix.

7-21. List 10 external trends or facts pertaining specifically to your country that would impact companies in your city.

7-22. Develop a CPM for a company that you or your parents have been employed.

7-23. Discuss the ethics of gathering competitive intelligence.

7-24. Discuss the ethics of cooperating with rival firms.

7-25. Contact your college library. Ask if they have the S&P Industry Surveys in hardcopy in the library. If they do, print out the relevant report for a company that you familiar with.

7-26. Your boss develops an EFE Matrix that includes 54 factors. How would you suggest reducing the number of factors to 20?

7-27. List the 10 external areas that give rise to opportunities and threats. Give an example of each for IBM.

7-28. Compare the ratings in an EFE Matrix with those in a CPM in terms of meaning and definition.

7-29. Discuss the I/O view or approach to strategic planning.

7-30. List in order of importance what you feel are the six major advantages of a weak dollar for a U.S.-based firm.

7-31. List in order of importance what you feel are the six major advantages of a weak euro for a European-based firm headquartered in a country that has the euro as its currency.

7-32. Cooperating with competitors is becoming more common. What are the advantages and disadvantages of this for a company?

7-33. Regarding sources of external information, visit the www.finance.yahoo.com website and enter IBM; click on Headlines, and identify three major new initiatives the company has undertaken.

7-34. Differentiate between making assumptions and making wild guesses about future opportunities, and threats facing business firms.

7-35. Explain how the external assessment would, or should be different for non-profit organizations versus corporations.

7-36. Apply Porter's Five-Forces Model to IBM. What strategic implications arise in that analysis?

7-37. Compare and contrast competitive intelligence programs across several organizations that you are familiar with.

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Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

7-38. Describe the "process of performing an external audit" in an organization doing strategic planning for the first time.

7-39. Compare and contrast the duties and responsibilities of a CIO with a CTO in a large firm.

7-40. Mymanagementlab Only—comprehensive writing assignment for this chapter.

Current Readings

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 7A

Michelin and Africa: An External Assessment

Purpose

Michelin is featured in the opening chapter case as a firm that engages in excellent strategic planning. This exercise gives you practice conducting an external strategic management audit to determine if Africa is the new, best place for Michelin to produce and market products and services. For example, considerable underground mining occurs in much of Africa. The new MICHELIN XTXL tire is available in 25-inch for underground mining vehicles. The new tires offer enhanced safety and productivity and are available in sizes 26.5R25 and 29.5R25. Tests indicate that the new tires offer increases of 10 percent in longevity, 20 percent in puncture resistance, and 30 percent in load capacity.

Instructions

Step 1 Research the business climate in 10 African countries.

Step 2 Prepare an EFE Matrix for Michelin based solely on the opportunities and threats that Michelin will face in doing business in the 10 African countries you chose.

Step 3 Based on your research, list the 10 African countries you selected in rank order of attractiveness for Michelin to focus efforts upon. Give a one-sentence rationale for each country's ranking.

EXERCISE 7B

Preparing a CPM for Michelin Based on Countries Rather than Companies

Purpose

Countries are similar to companies in that they compete with each other for investment dollars and economic development.

Instructions

Step 1 Revisit the research you collected and analyzed in the above exercise.

Step 2 Prepare a CPM that reveals your assessment of 6 African countries in terms of their relative strengths and weaknesses across what you deem to be the most critical success factors.

EXERCISE 7C

Develop Divisional Michelin EFE Matrices

Purpose

Michelin has five major geographic divisions: Europe, North America, Asia, South America, Africa/India/Middle-East. The company faces fierce but different competitors in each segment.

The external opportunities and threats that Michelin faces are different in each geographic segment, so each segment prepares its own list of key external success factors. This external analysis is critically important in strategic planning because a firm needs to exploit opportunities and avoid or at least mitigate threats.

The purpose of this exercise is to develop divisional EFE Matrices that Michelin could use in developing an overall corporate EFE Matrix.

Instructions

Step 1 Go to Michelin's website. Review the company's most recent *Annual Report*.

Step 2 Determine and review Michelin's major geographic segments.

Step 3 Conduct research to determine what you believe are the four major threats and the four major opportunities critical to strategic planning within Michelin's geographic segments. Review the relevant *Standard and Poor's* Industry Survey documents for each segment.

Step 4 Develop divisional EFE Matrices for Michelin. Work within a team of students if your instructor so requests but you will need an EFE Matrix for each segment.

Step 5 Prioritize the 20 threats and the 20 opportunities developed in the prior step so that corporate Michelin top executives can better develop a corporate EFE Matrix.

Step 6 Let's say Michelin has their operations segmented by Domestic versus Global. Based on your research, prepare an EFE Matrix for Michelin's domestic operations and another EFE Matrix for Michelin's Global Operations. Let Europe be Domestic and all other regions be Global.

EXERCISE 7D

Developing an EFE Matrix for adidas AG

Purpose

This exercise will provide practice developing an EFE Matrix. An EFE Matrix summarizes the results of an external audit. This is an important tool widely used by strategists.

Instructions

Step 1 Join with two other students in class and jointly prepare an EFE Matrix for adidas AG. Refer back to the Cohesion Case and to Exercise 1B, if necessary, to identify external opportunities and threats. Use the information in the *Standard and Poor's* Industry Surveys that you copied as part of Assurance of Learning Exercise 1B. Be sure not to include strategies as opportunities, but do include as many monetary amounts, percentages, numbers, and ratios as possible.

Step 2 All three-person teams participating in this exercise should record their EFE total weighted scores on the board. Put your initials after your score to identify it as your teams.

Step 3 Compare the total weighted scores. Which team's score came closest to the instructor's answer? Discuss reasons for variation in the scores reported on the board.

EXERCISE 7E
The External Assessment

Purpose
This exercise will help you become familiar with important sources of external information available in your college or university library. A key part of preparing an external audit is searching the Internet and examining published sources of information for relevant economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends and events. External opportunities and threats must be identified and evaluated before strategies can be formulated effectively.

Instructions
Step 1 Select an American company or business where you recently purchased a product or previously have worked. Conduct an external audit for this company. Find opportunities and threats in recent issues of newspapers and magazines. Search for information using the Internet. Use the following websites: http://marketwatch.multexinvestor.com; www.hoovers.com; http://moneycentral.msn.com; http://finance.yahoo.com; www.clearstation.com; https://us.etrade.com/e/t/invest/markets

Step 2 On a separate sheet of paper, list 10 opportunities and 10 threats that face this company. Be specific in stating each factor.

Step 3 Include a bibliography to reveal where you found the information.

Step 4 Write a three-page summary of your findings, and submit it to your instructor.

EXERCISE 7F
Developing a CPM for Michelin

Purpose
Monitoring competitors' performance and strategies is a key aspect of an external audit. This exercise is designed to give you practice evaluating the competitive position of organizations in a given industry and assimilating that information in the form of a CPM.

Instructions
Step 1 Gather information about Michelin Corporation. Turn back to the opening chapter boxed insert and review this information.

Step 2 On a separate sheet of paper, prepare a CPM that includes Michelin and its two leading competitors: Bridgestone Corporation, and Goodyear Tire and Rubber Company.

Step 3 Turn in your CPM for a classwork grade.

EXERCISE 7G
Developing a CPM for adidas AG

Purpose
Monitoring competitors' performance and strategies is a key aspect of an external audit. This exercise is designed to give you practice evaluating the competitive position of organizations in a given industry and assimilating that information in the form of a CPM.

Instructions
Step 1 Gather information from Assurance of Learning Exercise 1B. Also, turn back to the Cohesion Case and review the section on competitors.

Step 2 On a separate sheet of paper, prepare a CPM that includes Nike, Puma, Under Armour, and Callaway Golf.

Step 3 Turn in your CPM for a classwork grade.

EXERCISE 7H

Analyzing Your College or University's External Strategic Situation

Purpose

This exercise is excellent for doing together as a class.

Instructions

As a class, determine your college or university's major external opportunities and threats. List 10 opportunities and 10 threats. Then, get everyone in class to rank order their factors with 1 being most important and 10 being least important. Then, gather up everyone's paper, count the numbers, and in that manner create a prioritized list of the key external opportunities and threats facing your college.

Notes

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7. John Prescott and Daniel Smith, "The Largest Survey of 'Leading-Edge' Competitor Intelligence Managers," *Planning Review* 17, no. 3 (May–June 1989): 6–13.
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Strategy Generation and Selection

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Describe a three-stage framework for choosing among alternative strategies.
2. Explain how to develop a Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, Strategic Position and Action Evaluation (SPACE) Matrix, Boston Consulting Group (BCG) Matrix, Internal-External (IE) Matrix, and Quantitative Strategic Planning Matrix (QSPM).
3. Identify important behavioral, political, ethical, and social responsibility considerations in strategy analysis and choice.
4. Discuss the role of intuition in strategic analysis and choice.
5. Discuss the role of organizational culture in strategic analysis and choice.
6. Discuss the role of a board of directors in choosing among alternative strategies.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 8A Should Unilever Penetrate Southeast Asia Further?

EXERCISE 8B Perform a SWOT Analysis for Unilever's Global Operations

EXERCISE 8C Preparing a BCG Matrix for Unilever

EXERCISE 8D Developing a SWOT Matrix for adidas AG

EXERCISE 8E Developing a SPACE Matrix for adidas AG

EXERCISE 8F Developing a BCG Matrix for adidas AG

EXERCISE 8G Developing a QSPM for adidas AG

EXERCISE 8H Developing a SWOT Matrix for Unilever

EXERCISE 8I Developing a SPACE Matrix for Unilever

EXERCISE 8J Developing a BCG Matrix for your College or University

EXERCISE 8K Developing a QSPM for a Company that You Are Familiar With

EXERCISE 8L Formulating Individual Strategies

EXERCISE 8M The Mach Test

Strategy analysis and choice largely involve making subjective decisions based on objective information. This chapter introduces important concepts that can help strategists generate feasible alternatives, evaluate those alternatives, and choose a specific course of action. Behavioral aspects of strategy formulation are described, including politics, culture, ethics, and social responsibility considerations. Modern tools for formulating strategies are described, and the appropriate role of a board of directors is discussed. As showcased below, Unilever is an example company pursuing an excellent strategic plan.

The Nature of Strategy Analysis and Choice

As indicated by Figure 8-1 with white shading, this chapter focuses on generating and evaluating alternative strategies, as well as selecting strategies to pursue. Strategy analysis and choice seek to determine alternative courses of action that could best enable the firm to achieve its mission and objectives. The firm's present strategies, objectives, vision, and mission, coupled with the external and internal audit information, provide a basis for generating and evaluating feasible alternative strategies. This systematic approach is the best way to avoid a crisis. Rudin's Law states: "When a crisis forces choosing among alternatives, most people choose the worst possible one."

Unless a desperate situation confronts the firm, alternative strategies will likely represent incremental steps that move the firm from its present position to a desired future position. Alternative strategies do not come out of the wild blue yonder; they are derived from the firm's vision, mission, objectives, external audit, and internal audit; they are consistent with, or build on, past strategies that have worked well.

The Process of Generating and Selecting Strategies

Strategists never consider all feasible alternatives that could benefit the firm because there are an infinite number of possible actions and an infinite number of ways to implement those actions. Therefore, a manageable set of the most attractive alternative strategies must be developed. The advantages, disadvantages, trade-offs, costs, and benefits of these strategies should be determined. This section discusses the process that many firms use to determine an appropriate set

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Unilever

Unilever, the world's third-largest consumer goods company behind Procter & Gamble and Nestle, is an Anglo–Dutch company whose products include foods, beverages, cleaning agents and personal care products. Unilever is a dual listed company consisting of Unilever N.V. based in Rotterdam, Netherlands, and Unilever PLC based in London – but both companies have the same directors and operate as a single business. Some of Unilever's best selling among its 450 brands are Aviance, Ben & Jerry's, Dove, Flora/Becel, Heartbrand ice creams, Hellmann's, Knorr, Lipton, Lux/Radox, Omo/Surf, Sunsilk, Toni & Guy, VO5, and PG Tips. In December 2012, Unilever began phasing out by 2015 the use of microplastics in their personal care products.

In January 2013, Unilever divested its Skippy peanut butter brand, together with related manufacturing facilities in Little Rock, Arkansas, United States and Weifang, China, to Hormel Foods for approximately $700 million. In July 2013, Unilever increased its stake in its Indian unit, Hindustan Unilever, to 67 percent for around €2.45 billion. In August 2013, Unilever signed an agreement for the sale of its Wish-Bone and Western dressings brands to Pinnacle Foods Inc. for $580 million, subject to regulatory approval. In 2013, *Fortune* ranked Unilever as the 39th most admired company in the world outside the United States.

In September 2013, Unilever acquired T2, a premium Australian tea company that generated sales approaching AUS$57 million for the 12-month period ending June 30 2013. Unilever is the largest tea company in the world. T2 operates 40 stores and its range of fragrant teas and tea wares from around the world are also sold through some of the best restaurants in the country.

in order of attractiveness by all participants, with 1 = should not be implemented, 2 = possibly should be implemented, 3 = probably should be implemented, and 4 = definitely should be implemented. This process will result in a prioritized list of best strategies that reflects the collective wisdom of the group.

A Comprehensive Strategy-Formulation Analytical Framework

Important strategy-formulation techniques can be integrated into a three-stage decision-making framework, as shown in Figure 8-2. The tools presented in this framework are applicable to all sizes and types of organizations and can help strategists identify, evaluate, and select strategies.

Stage 1 of the formulation framework consists of the EFE Matrix, the IFE Matrix, and the Competitive Profile Matrix (CPM). Called the **input stage**, Stage 1 summarizes the basic input information needed to formulate strategies. Stage 2, called the **matching stage**, focuses on generating feasible alternative strategies by aligning key external and internal factors. Stage 2 techniques include the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, the Strategic Position and Action Evaluation (SPACE) Matrix, the Boston Consulting Group (BCG) Matrix, the Internal-External (IE) Matrix, and the Grand Strategy Matrix. Stage 3, called the **decision stage**, involves a single technique, the Quantitative Strategic Planning Matrix (QSPM). A QSPM uses input information from Stage 1 to objectively evaluate feasible alternative strategies identified in Stage 2. A QSPM reveals the relative attractiveness of alternative strategies and thus provides objective basis for selecting specific strategies.

All nine techniques included in the **strategy-formulation framework** require the integration of intuition and analysis. Autonomous divisions in an organization commonly use strategy-formulation techniques to develop strategies and objectives. Divisional analyses provide a basis for identifying, evaluating, and selecting among alternative corporate-level strategies.

Strategists themselves, not analytic tools, are always responsible and accountable for strategic decisions. Lenz emphasized that the shift from a words-oriented to a numbers-oriented planning process can give rise to a false sense of certainty; it can reduce dialogue, discussion, and argument as a means for exploring understandings, testing assumptions, and fostering organizational learning.[1] Strategists, therefore, must be wary of this possibility and use analytical tools to facilitate, rather than to diminish, communication. Without objective information and analysis, personal biases, politics, emotions, personalities, and **halo error** (the tendency to put too much weight on a single factor) unfortunately may play a dominant role in the strategy-formulation process.

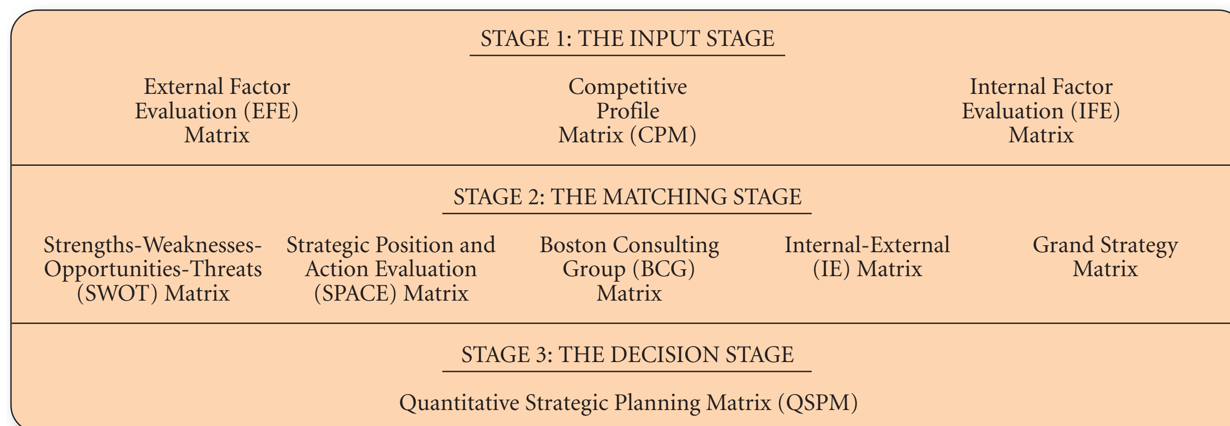


FIGURE 8-2
The Strategy-Formulation Analytical Framework

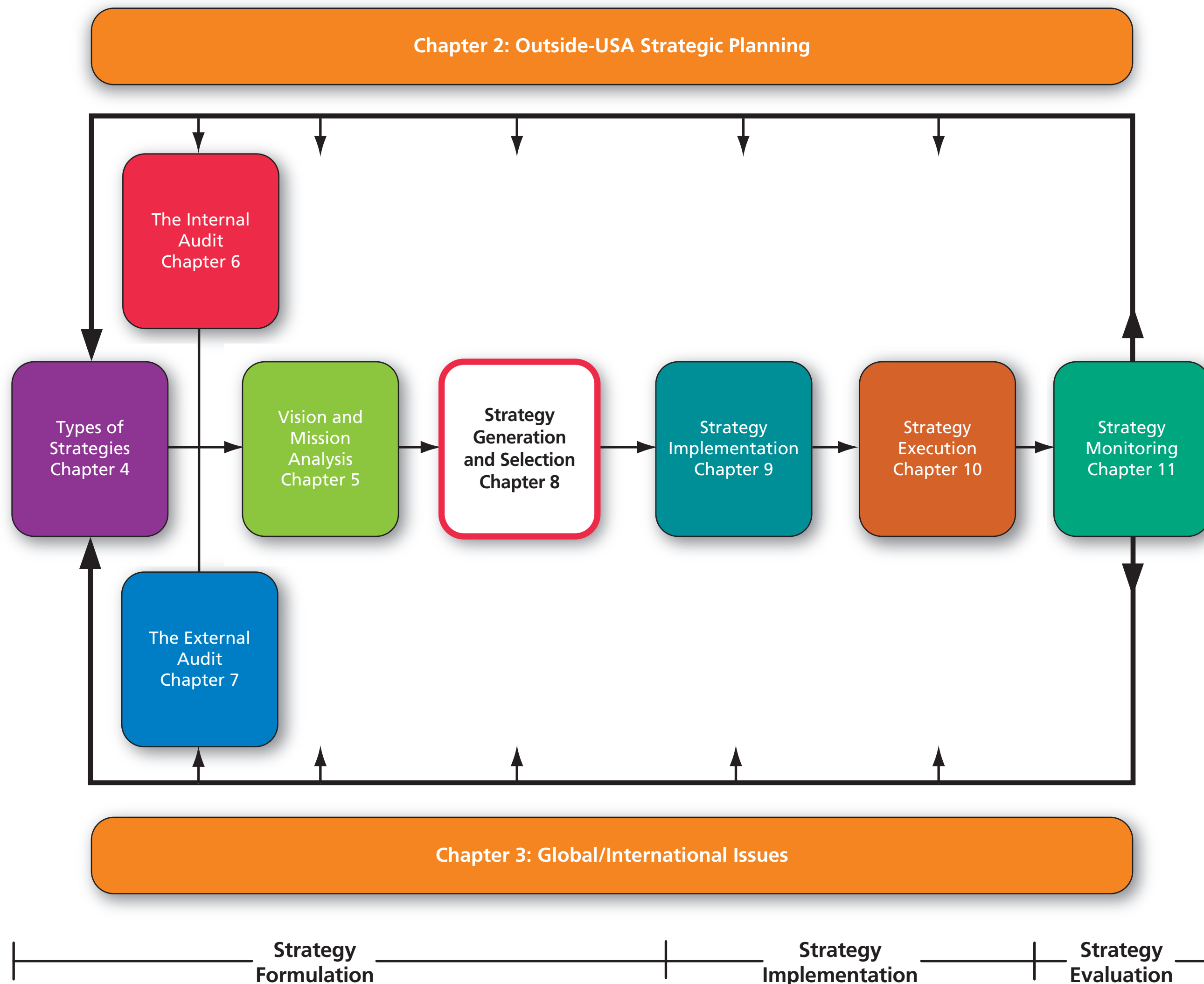


FIGURE 8-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

of alternative strategies. Recommendations (strategies selected to pursue) come from alternative strategies formulated.

Identifying and evaluating alternative strategies should involve many of the managers and employees who previously assembled the organizational vision and mission statements, performed the external audit, and conducted the internal audit. Representatives from each department and division of the firm should be included in this process, as was the case in previous strategy-formulation activities. Recall that involvement provides the best opportunity for managers and employees to gain an understanding of what the firm is doing and why and to become committed to helping the firm accomplish its objectives.

All participants in the strategy analysis and choice activity should have the firm's external and internal audit information available. This information, coupled with the firm's mission statement, will help participants crystallize in their own minds particular strategies that they believe could benefit the firm most. Creativity should be encouraged in this thought process.

Alternative strategies proposed by participants should be considered and discussed in a meeting or series of meetings. Proposed strategies should be listed in writing. When all feasible strategies identified by participants are given and understood, the strategies should be ranked

The Input Stage

Procedures for developing an EFE Matrix, an IFE Matrix, and a CPM were presented in Chapters 6 and 7. The information derived from these three matrices provides basic input information for the matching and decision stage matrices described later in this chapter.

The input tools require strategists to quantify subjectivity during early stages of the strategy-formulation process. Making small decisions in the input matrices regarding the relative importance of external and internal factors allows strategists to more effectively generate and evaluate alternative strategies. Good intuitive judgment is always needed in determining appropriate weights and ratings.

The Matching Stage

Strategy is sometimes defined as the match an organization makes between its internal resources and skills and the opportunities and risks created by its external factors.[2] The matching stage of the strategy-formulation framework consists of five techniques that can be used in any sequence: the SWOT Matrix, the SPACE Matrix, the BCG Matrix, the IE Matrix, and the Grand Strategy Matrix. These tools rely on information derived from the input stage to match external opportunities and threats with internal strengths and weaknesses. **Matching** external and internal critical success factors is the key to effectively generating feasible alternative strategies. For example, a firm with excess working capital (an internal strength) could take advantage of the cell phone industry's 20 percent annual growth rate (an external opportunity) by acquiring Cellfone, Inc., a firm in the cell phone industry. This example portrays simple one-to-one matching. In most situations, external and internal relationships are more complex, and the matching requires multiple alignments for each strategy generated. Successful matching of key external and internal factors depends upon those underlying key factors being both *specific* and *actionable*. The basic concept of matching is illustrated in Table 8-1.

Any organization, whether military, product-oriented, service-oriented, governmental, or even athletic, must develop and execute good strategies to win. A good offense without a good defense, or vice versa, usually leads to defeat. Developing strategies that use strengths to capitalize on opportunities could be considered an offense, whereas strategies designed to improve on weaknesses while avoiding threats could be termed defensive. Every organization has some external opportunities and threats and internal strengths and weaknesses that can be aligned to formulate feasible alternative strategies.

The SWOT Matrix

The **Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix** is an important matching tool that helps managers develop four types of strategies: SO (strengths-opportunities) strategies, WO (weaknesses-opportunities) strategies, ST (strengths-threats) strategies, and WT (weaknesses-threats) strategies.[3] Matching key external and internal factors is the most difficult part of developing a SWOT Matrix and requires good judgment—and there is no one best set of matches. Note in Table 8-1 that the first, second, third, and fourth strategies are SO, WO, ST, and WT strategies, respectively.

TABLE 8-1 Matching Key External and Internal Factors to Formulate Alternative Strategies

Key Internal Factor	Key External Factor	Resultant Strategy
Excess working capital (an internal strength)	+ 20 percent annual growth in the cell phone industry (an external opportunity)	= Acquire Cellfone, Inc.
Insufficient capacity (an internal weakness)	+ Exit of two major foreign competitors from the industry (an external opportunity)	= Pursue horizontal integration by buying competitors' facilities
Strong research and development expertise (an internal strength)	+ Decreasing numbers of younger adults (an external threat)	= Develop new products for older adults
Poor employee morale (an internal weakness)	+ Rising health-care costs (an external threat)	= Develop a new wellness program

SO strategies use a firm's internal strengths to take advantage of external opportunities. All managers would like their organization to be in a position in which internal strengths can be used to take advantage of external trends and events. Organizations generally will pursue WO, ST, or WT strategies to get into a situation in which they can apply SO strategies. When a firm has major weaknesses, it will strive to overcome them and make them strengths. When an organization faces major threats, it will seek to avoid them to concentrate on opportunities.

WO strategies aim at improving internal weaknesses by taking advantage of external opportunities. Sometimes key external opportunities exist, but a firm has internal weaknesses that prevent it from exploiting those opportunities. For example, there may be a high demand for electronic devices to control the amount and timing of fuel injection in automobile engines (opportunity), but a certain auto parts manufacturer may lack the technology required for producing these devices (weakness). One possible WO strategy would be to acquire this technology by forming a joint venture with a firm having competency in this area. An alternative WO strategy would be to hire and train people with the required technical capabilities.

ST strategies use a firm's strengths to avoid or reduce the impact of external threats. This does not mean that a strong organization should always meet threats in the external environment head-on. An example ST strategy occurred when Texas Instruments used an excellent legal department (a strength) to collect nearly $700 million in damages and royalties from nine Japanese and Korean firms that infringed on patents for semiconductor memory chips (threat). Rival firms that copy ideas, innovations, and patented products are a major threat in many industries. This is still a major problem for U.S. firms selling products in China.

WT strategies are defensive tactics directed at reducing internal weakness and avoiding external threats. An organization faced with numerous external threats and internal weaknesses may indeed be in a precarious position. In fact, such a firm may have to fight for its survival, merge, retrench, declare bankruptcy, or choose liquidation.

A schematic representation of the SWOT Matrix is provided in Figure 8-3. Note that a SWOT Matrix is composed of nine cells. As shown, there are four key factor cells, four strategy cells, and one cell that is always left blank (the upper-left cell). The four strategy cells, labeled *SO*, *WO*, *ST*, and *WT*, are developed after completing four key factor cells, labeled *S*, *W*, *O*, and *T*. There are eight steps involved in constructing a SWOT Matrix:

1. List the firm's key external opportunities.
2. List the firm's key external threats.
3. List the firm's key internal strengths.
4. List the firm's key internal weaknesses.
5. Match internal strengths with external opportunities, and record the resultant SO strategies in the appropriate cell.
6. Match internal weaknesses with external opportunities, and record the resultant WO strategies.
7. Match internal strengths with external threats, and record the resultant ST strategies.
8. Match internal weaknesses with external threats, and record the resultant WT strategies.

Some important aspects of a SWOT Matrix are evidenced in Figure 8-3. For example, note that both the internal and external factors and the SO, ST, WO, and WT strategies are stated in quantitative terms to the extent possible. This is important. For example, regarding the second SO number-2 and ST number-1 strategies, if the analyst just said, "Add new repair and service persons," the reader might think that 20 new repair and service persons are needed. Actually only two are needed. Always *be specific* to the extent possible in stating factors and strategies.

It is also important to include the "S1, O2" type notation after each strategy in a SWOT Matrix. This notation reveals the rationale for each alternative strategy. Strategies do not rise out of the blue. Note in Figure 8-3 how this notation reveals the internal and external factors that were matched to formulate desirable strategies. For example, note that this retail computer store business may need to "purchase land to build new store" because a new Highway 34 will make its location less desirable. The notation (W2, O2) and (S8, T3) in Figure 8-3 exemplifies this matching process.

The purpose of each Stage 2 matching tool is to generate feasible alternative strategies, not to select or determine which strategies are best. Not all of the strategies developed in the SWOT Matrix, therefore, will be selected for implementation.

The strategy-formulation guidelines provided in Chapter 4 can enhance the process of matching key external and internal factors. For example, when an organization has both the

	Strengths	Weaknesses
	1. Inventory turnover up 5.8 to 6.7 2. Average customer purchase up $97 to $128 3. Employee morale is excellent 4. In-store promotions = 20 percent increase in sales 5. Newspaper advertising expenditures down 10 percent 6. Revenues from repair and service in store up 16 percent 7. In-store technical support persons have MIS degrees 8. Store's debt-to-total-assets ratio down 34 percent	1. Software revenues in store down 12 percent 2. Location of store hurt by new Hwy 34 3. Carpet and paint in store in disrepair 4. Bathroom in store needs refurbishing 5. Total store revenues down 8 percent 6. Store has no website 7. Supplier on-time-delivery up to 2.4 days 8. Customer checkout process too slow 9. Revenues per employee up 19 percent
Opportunities	**SO Strategies**	**WO Strategies**
1. Population of city growing 10 percent 2. Rival computer store opening one mile away 3. Vehicle traffic passing store up 12 percent 4. Vendors average six new products a year 5. Senior citizen use of computers up 8 percent 6. Small business growth in area up 10 percent 7. Desire for websites up 18 percent by realtors 8. Desire for websites up 12 percent by small firms	1. Add four new in-store promotions monthly (S4, O3) 2. Add two new repair and service persons (S6, O5) 3. Send flyer to all seniors over age 55 (S5, O5)	1. Purchase land to build new store (W2, O2) 2. Install new carpet, paint, and bath (W3, W4, O1) 3. Up website services by 50 percent (W6, O7, O8) 4. Launch mailout to all realtors in city (W5, O7)
Threats	**ST Strategies**	**WT Strategies**
1. Best Buy opening new store in one year nearby 2. Local university offers computer repair 3. New bypass Hwy 34 in 1 year will divert traffic 4. New mall being built nearby 5. Gas prices up 14 percent 6. Vendors raising prices 8 percent	1. Hire two more repair persons and market these new services (S6, S7, T1) 2. Purchase land to build new store (S8, T3) 3. Raise out-of-store service calls from $60 to $80 (S6, T5)	1. Hire two new cashiers (W8, T1, T4) 2. Install new carpet, paint, and bath (W3, W4, T1)

FIGURE 8-3
A SWOT Matrix for a Retail Computer Store

capital and human resources needed to distribute its own products (internal strength) and distributors are unreliable, costly, or incapable of meeting the firm's needs (external threat), forward integration can be an attractive ST strategy. When a firm has excess production capacity (internal weakness) and its basic industry is experiencing declining annual sales and profits (external threat), related diversification can be an effective WT strategy.

Although the SWOT matrix is widely used in strategic planning, the analysis does have some limitations.[4] First, SWOT does not show how to achieve a competitive advantage, so it must not be an end in itself. The matrix should be the starting point for a discussion on how proposed strategies could be implemented as well as cost-benefit considerations that ultimately could lead to competitive advantage. Second, SWOT is a static assessment (or snapshot) in time.

Depending on the type of organization, numerous variables could make up each of the dimensions represented on the axes of the SPACE Matrix. Factors that were included in the firm's EFE and IFE matrices should be considered in developing a SPACE Matrix. Other variables commonly included are given in Table 8-2. For example, return on investment, leverage, liquidity, working capital, and cash flow are commonly considered to be determining factors of an organization's financial strength. Like the SWOT Matrix, the SPACE Matrix should be both tailored to the particular organization being studied and based on factual information as much as possible.

The steps required to develop a SPACE Matrix are as follows:

1. Select a set of variables to define financial position (FP), competitive position (CP), stability position (SP), and industry position (IP).
2. Assign a numerical value ranging from +1 (worst) to +7 (best) to each of the variables that make up the FP and IP dimensions. Assign a numerical value ranging from –1 (best) to –7 (worst) to each of the variables that make up the SP and CP dimensions. On the FP and CP axes, make comparison to competitors. On the IP and SP axes, make comparison to other industries.
3. Compute an average score for FP, CP, IP, and SP by summing the values given to the variables of each dimension and then by dividing by the number of variables included in the respective dimension.
4. Plot the average scores for FP, IP, SP, and CP on the appropriate axis in the SPACE Matrix.
5. Add the two scores on the *x*-axis and plot the resultant point on *X*. Add the two scores on the *y*-axis and plot the resultant point on *Y*. Plot the intersection of the new *xy* point.
6. Draw a **directional vector** from the origin of the SPACE Matrix through the new intersection point. This vector reveals the type of strategies recommended for the organization: aggressive, competitive, defensive, or conservative.

Some examples of strategy profiles that can emerge from a SPACE analysis are shown in Figure 8-5. The directional vector associated with each profile suggests the type of strategies to pursue: aggressive, conservative, defensive, or competitive. When a firm's directional vector is located in the **aggressive quadrant** (upper-right quadrant) of the SPACE Matrix, an organization is in an excellent position to use its internal strengths to (a) take advantage of external opportunities, (b) overcome internal weaknesses, and (c) avoid external threats. Therefore, market penetration, market

TABLE 8-2 Example Factors That Make Up the SPACE Matrix Axes

Internal Strategic Position	External Strategic Position
Financial Position (FP)	*Stability Position (SP)*
Return on investment	Technological changes
Leverage	Rate of inflation
Liquidity	Demand variability
Working capital	Price range of competing products
Cash flow	Barriers to entry into market
Inventory turnover	Competitive pressure
Earnings per share	Ease of exit from market
Price earnings ratio	Price elasticity of demand
	Risk involved in business
Competitive Position (CP)	*Industry Position (IP)*
Market share	Growth potential
Product quality	Profit potential
Product life cycle	Financial stability
Customer loyalty	Extent leveraged
Capacity utilization	Resource utilization
Technological know-how	Ease of entry into market
Control over suppliers and distributors	Productivity, capacity utilization

Source: Based on H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982), 155–156.

A SWOT matrix can be like studying a single frame of a motion picture where you see the lead characters and the setting but have no clue as to the plot. As circumstances, capabilities, threats, and strategies change, the dynamics of a competitive environment may not be revealed in a single matrix. Third, SWOT analysis may lead the firm to overemphasize a single internal or external factor in formulating strategies. There are interrelationships among the key internal and external factors that SWOT does not reveal that may be important in devising strategies.

The Strategic Position and Action Evaluation (SPACE) Matrix

The **Strategic Position and Action Evaluation (SPACE) Matrix**, another important Stage 2 matching tool, is illustrated in Figure 8-4. Its four-quadrant framework indicates whether aggressive, conservative, defensive, or competitive strategies are most appropriate for a given organization. The axes of the SPACE Matrix represent two internal dimensions (**financial position [FP]** and **competitive position [CP]**) and two external dimensions (**stability position [SP]** and **industry position [IP]**). These four factors are perhaps the most important determinants of an organization's overall strategic position.[5]

It is helpful here to elaborate upon the difference between the SP and IP axes. SP refers to the volatility of profits and revenues for firms in a given industry. SP volatility (stability) is based on the expected impact of changes in core external factors such as technology, economy, demographic, seasonality, etc.) The higher frequency and magnitude of the changes the more unstable on SP. An industry can be stable or unstable on SP, yet high or low on IP. The smartphone industry for example would be unstable on SP yet high growth on IP, whereas the carbonated beverage industry would be stable on SP yet low growth on IP.

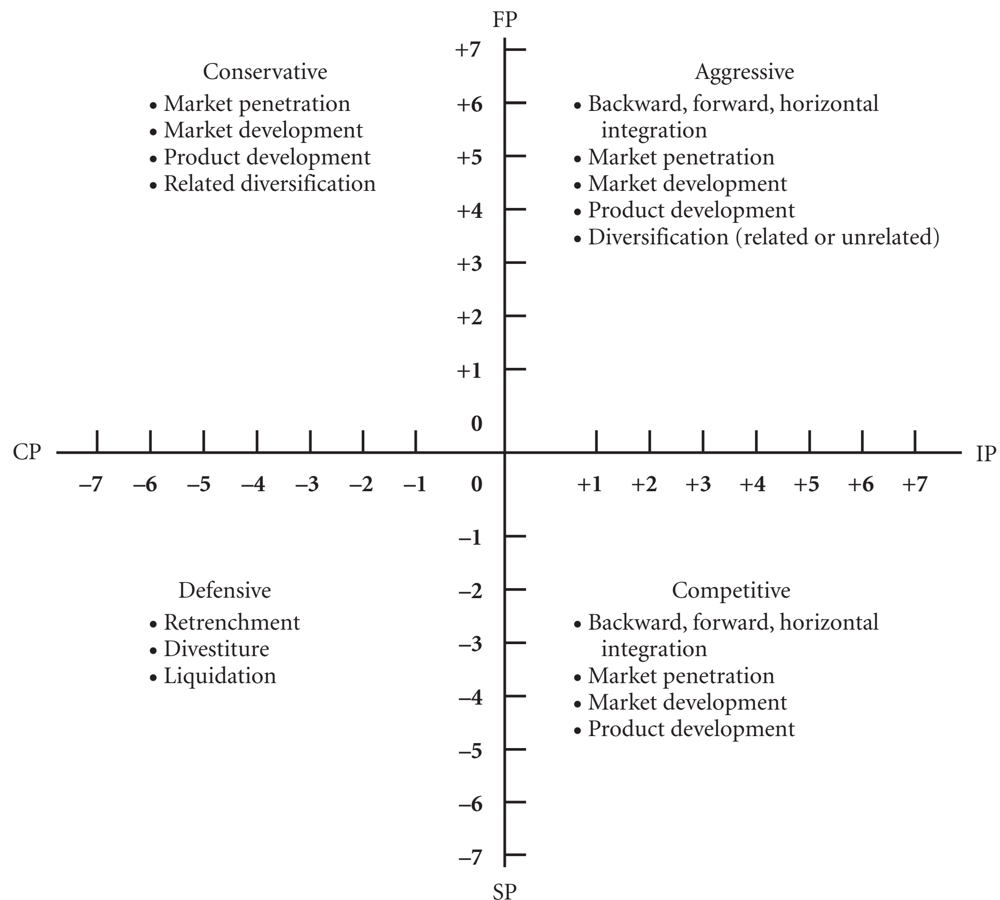


FIGURE 8-4

The SPACE Matrix

Source: Based on H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982), 155.

development, product development, backward integration, forward integration, horizontal integration, or diversification, can be feasible, depending on the specific circumstances that face the firm.

When a particular company is known, the analyst must be much more specific in terms of recommended strategies. For example, instead of saying market penetration is a recommended

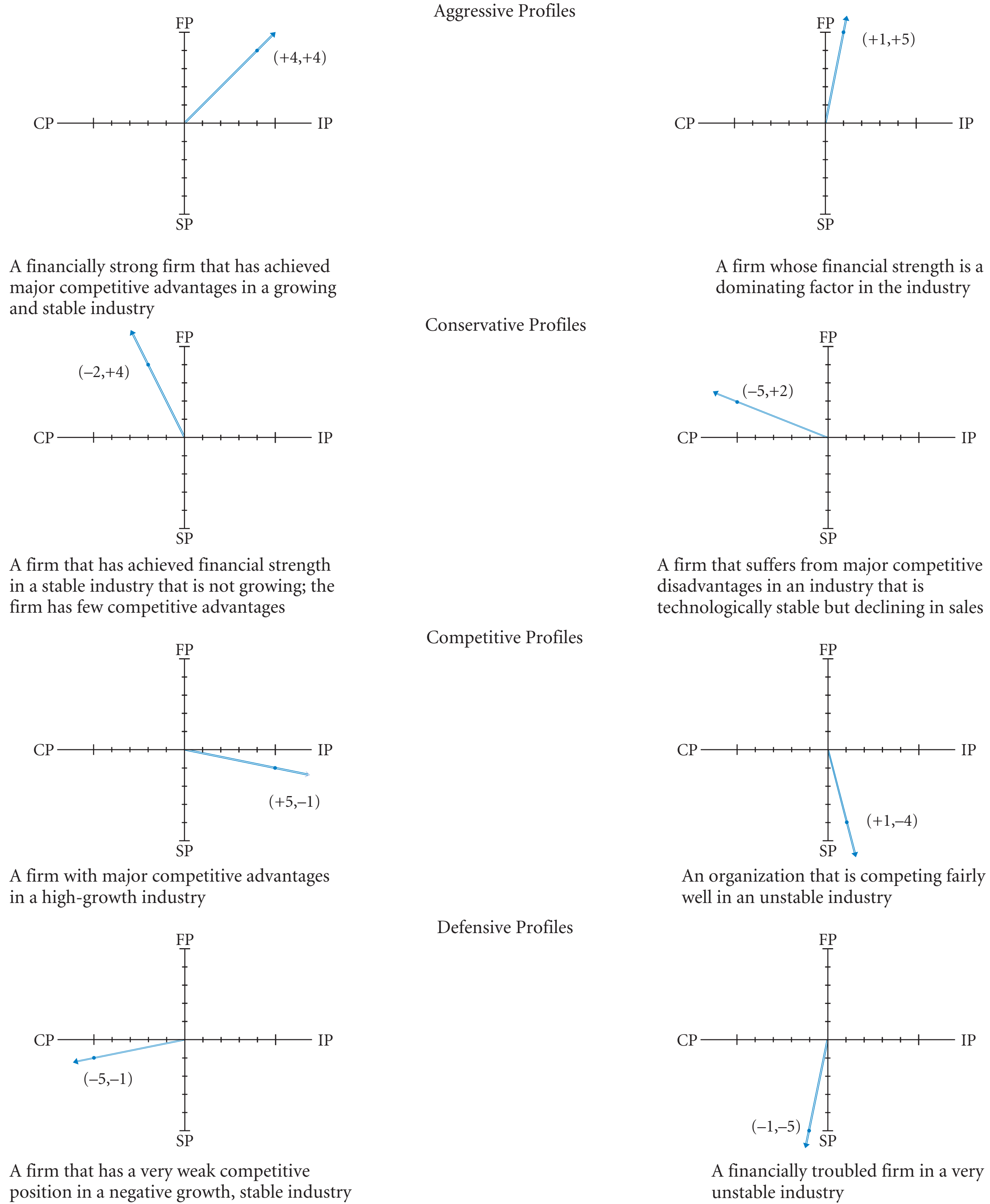


FIGURE 8-5

Example Strategy Profiles

Source: Based on H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982), 155.

strategy when your vector goes in the conservative quadrant, say that adding 34 new stores in India is a recommended strategy. This is an important point for students doing case analyses because a particular company is generally known, and terms such as *market development* are too vague to use. That term could refer to adding a manufacturing plant in Thailand or Mexico or South Africa—*so students—be specific to the extent possible regarding implications of all the matrices presented in this chapter. Not being specific can be disastrous in this course. Avoid terms like expand, increase, decrease, grow—be much more specific than that!*

The directional vector may appear in the **conservative quadrant** (upper-left quadrant) of the SPACE Matrix, which implies staying close to the firm's basic competencies and not taking excessive risks. Conservative strategies most often include market penetration, market development, product development, and related diversification. The directional vector may be located in the lower-left or **defensive quadrant** of the SPACE Matrix, which suggests that the firm should focus on rectifying internal weaknesses and avoiding external threats. Defensive strategies include retrenchment, divestiture, liquidation, and related diversification. Finally, the directional vector may be located in the lower-right or **competitive quadrant** of the SPACE Matrix, indicating competitive strategies. Competitive strategies include backward, forward, and horizontal integration; market penetration; market development; and product development.

A SPACE Matrix analysis for a bank is provided in Table 8-3. Note that competitive type strategies are recommended. A SPACE Matrix for Hewlett-Packard (HP) is given in

TABLE 8-3 A SPACE Matrix for a Bank

Financial Position (FP)	Ratings
The bank's primary capital ratio is 7.23 percent, which is 1.23 percentage points over the generally required ratio of 6 percent.	1.0
The bank's return on assets is negative 0.77, compared to a bank industry average ratio of positive 0.70.	1.0
The bank's net income was $183 million, down 9 percent from a year previously.	3.0
The bank's revenues increased 7 percent to $3.46 billion.	4.0
	9.0
Industry Position (IP)	
Deregulation provides geographic and product freedom.	4.0
Deregulation increases competition in the banking industry.	2.0
Pennsylvania's interstate banking law allows the bank to acquire other banks in New Jersey, Ohio, Kentucky, the District of Columbia, and West Virginia.	4.0
	10.0
Stability Position (SP)	
Less-developed countries are experiencing high inflation and political instability.	−4.0
Headquartered in Pittsburgh, the bank historically has been heavily dependent on the steel, oil, and gas industries. These industries are depressed.	−5.0
Banking deregulation has created instability throughout the industry.	−4.0
	−13.0
Competitive Position (CP)	
The bank provides data processing services for more than 450 institutions in 38 states.	−2.0
Superregional banks, international banks, and nonbanks are becoming increasingly competitive.	−5.0
The bank has a large customer base.	−2.0
	−9.0

Conclusion

SP Average is −13.0 ÷ 3 = −4.33 IP Average is +10.0 ÷ 3 = 3.33

CP Average is −9.0 ÷ 3 = −3.00 FP Average is +9.0 ÷ 4 = 2.25

Directional Vector Coordinates: x-axis: −3.00 + (+3.33) = +0.33

y-axis: −4.33 + (+2.25) = −2.08

The bank should pursue competitive strategies.

TABLE 8-4 An Actual SPACE Matrix for Hewlett-Packard

Internal Analysis		External Analysis	
Financial Position (FP)		Stability Position (SP)	
Return on Investment (ROI)	1	Rate of Inflation	−2
Leverage	4	Technological Changes	−6
Liquidity	2	Price Elasticity of Demand	−3
Working Capital	1	Competitive Pressure	−7
Cash Flow	2	Barriers to Entry into Market	−4
Financial Position (FP) Average	**2**	**Stability Position (SP) Average**	**−4.4**
Internal Analysis		External Analysis	
Competitive Position (CP)		Industry Position (IP)	
Market Share	−7	Growth Potential	6
Product Quality	−2	Financial Stability	2
Customer Loyalty	−3	Ease of Entry into Market	4
Technological Know-how	−4	Resource Utilization	1
Control over Suppliers/Distributors	−5	Profit Potential	2
Competitive Position (CP) Average	**−4.2**	**Industry Position (IP) Average**	**3.0**

2.0 + (−4.4) = −2.4 *y*-axis
3.0 + (−4.2) = −1.2 *x*-axis
Coordinate (−1.2, −2.4)
Conclusion: Vector points in defensive quadrant

Table 8-4 followed by the Krispy Kreme Donuts SPACE diagram in Figure 8-6. Note that HP is in a precarious defensive position, struggling to compete against Apple, Dell, and Amazon.

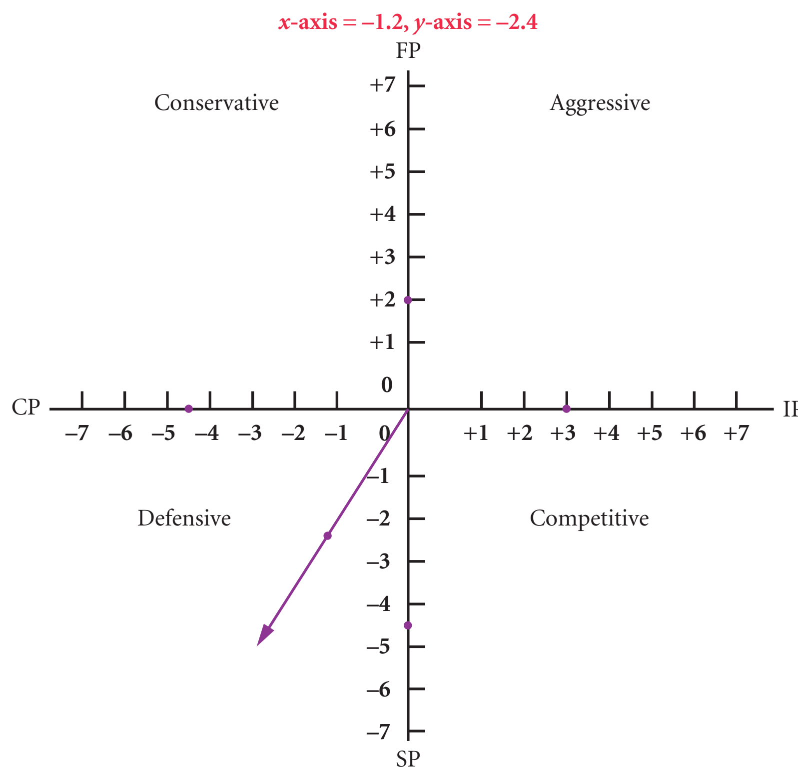


FIGURE 8-6
A SPACE Matrix for Krispy Kreme

The Boston Consulting Group (BCG) Matrix

Based in Boston and having 1,713 employees, the Boston Consulting Group (BCG) is a large consulting firm that endured the recent economic downturn without laying off any employees and in 2010 hired the most new consultants ever. BCG ranks number 2 in *Fortune*'s recent list of the "100 Best Companies To Work For."

Autonomous divisions (or profit centers) of an organization make up what is called a **business portfolio**. When a firm's divisions compete in different industries, a separate strategy often must be developed for each business. The Boston Consulting Group (BCG) Matrix and the Internal-External (IE) Matrix are designed specifically to enhance a multidivisional firm's efforts to formulate strategies. (BCG is a private management consulting firm based in Boston that currently employs about 4,400 consultants in 40 countries.)

In a *Form 10K* or *Annual Report*, some companies do not disclose financial information by segment, in which case a BCG portfolio analysis may not be possible by persons external to the firm. Reasons to disclose by-division financial information in the author's view, however, more than offset the reasons not to disclose, as indicated in Table 8-5.

The BCG Matrix graphically portrays differences among divisions in terms of relative market share position and industry growth rate. The BCG Matrix allows a multidivisional organization to manage its portfolio of businesses by examining the relative market share position and the industry growth rate of each division relative to all other divisions in the organization. **Relative market share position** is defined as the ratio of a division's own market share (or revenues) in a particular industry to the market share (or revenues) held by the largest rival firm in that industry. Note in Table 8-6 that other variables can be used in this analysis besides revenues. For example, number of stores, or number of restaurants, or in the airline industry number of airplanes could be used for comparative purposes to determine relative market share position. Relative market share position for Enterprise Rent-a-Car based on number of locations is 6,187/6,187 = 1.00 as indicated in Table 8-6. Enterprise is the largest rental car company and its circle in a BCG Matrix would be somewhere along the far left axis.

Relative market share position is given on the *x*-axis of the BCG Matrix. The midpoint on the *x*-axis usually is set at 0.50, corresponding to a division that has half the market share of the leading firm in the industry. The *y*-axis represents the industry growth rate in sales, measured in percentage terms. The growth rate percentages on the *y*-axis could range from −20 to +20 percent, with 0.0 being the midpoint. The average annual increase in revenues for several leading firms in the industry would be a good estimate of the value. Also, various sources such as the S&P Industry Survey would provide this value. These numerical ranges on the *x*- and *y*-axes are often used, but other numerical values could be

TABLE 8-5 Reasons to (or Not to) Disclose Financial Information by Segment (by Division)

Reasons to Disclose	Reasons Not to Disclose
1. Transparency is a good thing in today's world of Sarbanes-Oxley	1. Can become free competitive information for rival firms
2. Investors will better understand the firm, which can lead to greater support	2. Can hide performance failures
3. Managers and employees will better understand the firm, which should lead to greater commitment	3. Can reduce rivalry among segments
4. Disclosure enhances the communication process both within the firm and with outsiders	

TABLE 8-6 Market Share Data for Selected Industries

Hard Cider (consumption growing rapidly; has about 5 percent alcohol; consumed 50/50 by men/women versus 80/20 men/women for beer; sweeter than beer); *WSJ*, 8-15-12, B9—Top hard cider brands in the USA in millions of liters sold in 2011.

Brand	Liters	Owner
Woodchuck Cider	14.1	Vermont Hard Cider
Strongbow Cider	6.9	Heineken NV
Hornsby's Cider	6.8	C&C Group PLC
Magners	6.2	C&C Group PLC
Ace Cider	2.1	California Cider Co.
Crispin Cider	1.0	MillerCoors LLC
Michelob Cider	1.0	Anheuser-Busch InBev NV
Angry Orchard Cider	1.0	Boston Beer Co. (maker of Sam Adams lager)
Other Ciders	60.9	
Total	100.0	

USA Car Rental Industry (*USA Today*, 8-28-12, p. 1B)

Brand	Number of Cars	Number of Locations	Airport Market Share (%)
Enterprise	920K	6,187	34
Hertz/Advantage/ Dollar Thrifty	438K	2,945	37
Avis/Budget	285K	2,300	26
Other	106K	978	03
TOTAL	1,749K	2,410	

Smartphones in the USA (*USA Today*, 10-18-12, p. 4B)

Brand	Market Share (%)
Apple	37.3
Samsung	27.0
LG	7.9
Motorola	6.7

Note: Ireland's C&C Group PLC is trying to acquire Vermont Hard Cider, maker of the best-selling Woodchuck cider. For many Americans until the mid-19th century, hard cider was the go-to alcoholic beverage, until drinkers turned to beer. Today in the USA, hard cider represents less than 0.5 percent of beer consumption, compared to the UK where it is closer to 15 percent. But hard cider, which has an alcohol content of about 5 percent like beer, is mounting a comeback in the USA.

established as deemed appropriate for particular organizations, such as -10 to +10 percent on the *y*-axis.

The basic BCG Matrix appears in Figure 8-7. Each circle represents a separate division. The size of the circle corresponds to the proportion of corporate revenue generated by that business unit, and the pie slice indicates the proportion of corporate profits generated by that division. Divisions located in Quadrant I of the BCG Matrix are called "Question Marks," those located in Quadrant II are called "Stars," those located in Quadrant III are called "Cash Cows," and those divisions located in Quadrant IV are called "Dogs."

- ***Question Marks***—Divisions in Quadrant I have a low relative market share position, yet they compete in a high-growth industry. Generally these firms' cash needs are high and their cash generation is low. These businesses are called **question marks** because the organization must decide whether to strengthen them by pursuing an intensive

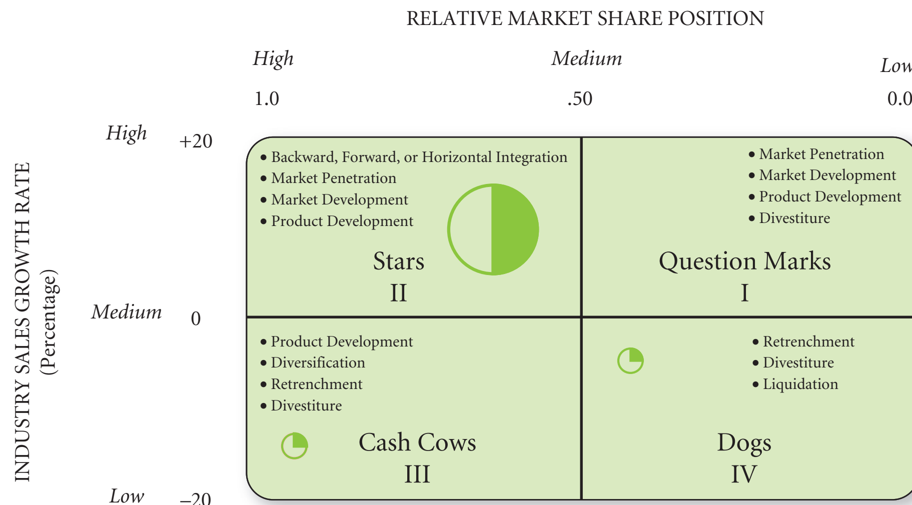


FIGURE 8-7

The BCG Matrix

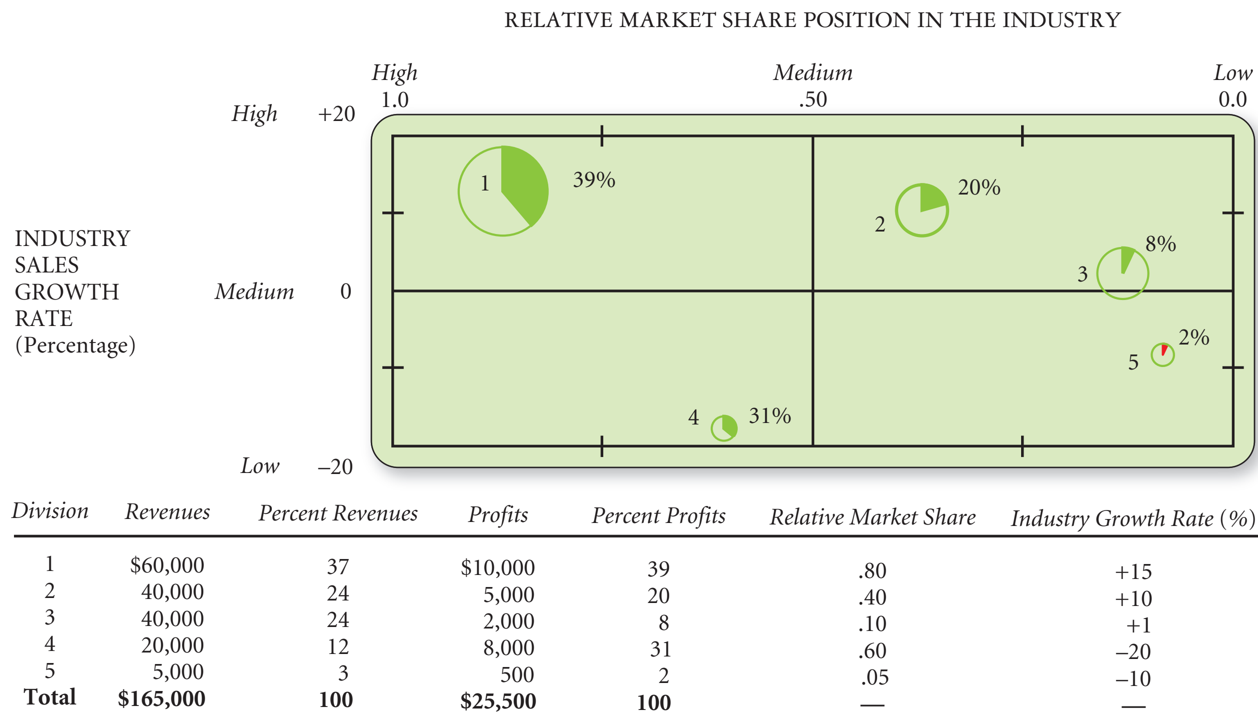
Source: Based on the BCG Portfolio Matrix from the Product Portfolio Matrix, © 1970, The Boston Consulting Group.

strategy (market penetration, market development, or product development) or to sell them.

- ***Stars***—Quadrant II businesses (**stars**) represent the organization's best long-run opportunities for growth and profitability. Divisions with a high relative market share and a high industry growth rate should receive substantial investment to maintain or strengthen their dominant positions. Forward, backward, and horizontal integration; market penetration; market development; and product development are appropriate strategies for these divisions to consider, as indicated in Figure 8-7.
- ***Cash Cows***—Divisions positioned in Quadrant III have a high relative market share position but compete in a low-growth industry. Called **cash cows** because they generate cash in excess of their needs, they are often milked. Many of today's cash cows were yesterday's stars. Cash cow divisions should be managed to maintain their strong position for as long as possible. Product development or diversification may be attractive strategies for strong cash cows. However, as a cash cow division becomes weak, retrenchment or divestiture can become more appropriate.
- ***Dogs***—Quadrant IV divisions of the organization have a low relative market share position and compete in a slow- or no-market-growth industry; they are **dogs** in the firm's portfolio. Because of their weak internal and external position, these businesses are often liquidated, divested, or trimmed down through retrenchment. When a division first becomes a dog, retrenchment can be the best strategy to pursue because many Dogs have bounced back, after strenuous asset and cost reduction, to become viable, profitable divisions.

The major benefit of the BCG Matrix is that it draws attention to the cash flow, investment characteristics, and needs of an organization's various divisions. The divisions of many firms evolve over time: dogs become question marks, question marks become stars, stars become cash cows, and cash cows become dogs in an ongoing counterclockwise motion. Less frequently, stars become question marks, question marks become dogs, dogs become cash cows, and cash cows become stars (in a clockwise motion). In some organizations, no cyclical motion is apparent. Over time, organizations should strive to achieve a portfolio of divisions that are stars.

An example BCG Matrix is provided in Figure 8-8, which illustrates an organization composed of five divisions with annual sales ranging from $5,000 to $60,000. Division 1 has



Division	Revenues	Percent Revenues	Profits	Percent Profits	Relative Market Share	Industry Growth Rate (%)
1	$60,000	37	$10,000	39	.80	+15
2	40,000	24	5,000	20	.40	+10
3	40,000	24	2,000	8	.10	+1
4	20,000	12	8,000	31	.60	–20
5	5,000	3	500	2	.05	–10
Total	**$165,000**	**100**	**$25,500**	**100**	—	—

FIGURE 8-8

An Example BCG Matrix

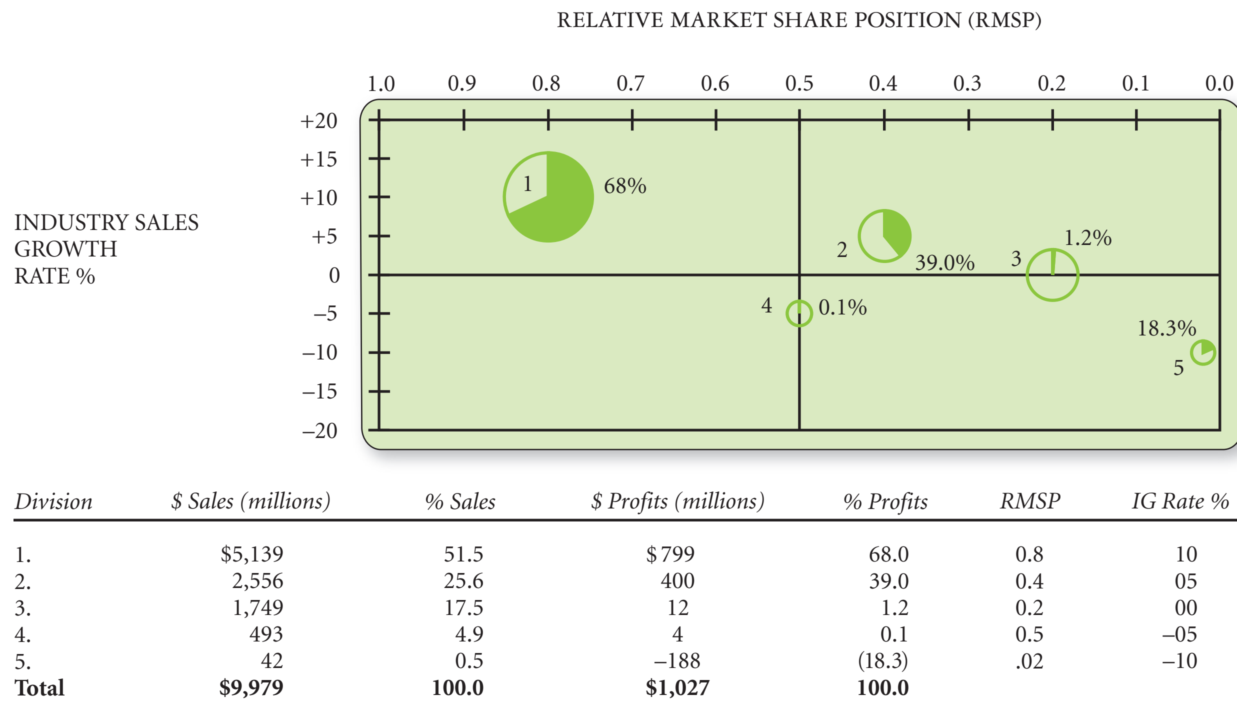
the greatest sales volume, so the circle representing that division is the largest one in the matrix. The circle corresponding to Division 5 is the smallest because its sales volume ($5,000) is least among all the divisions. The pie slices within the circles reveal the percent of corporate profits contributed by each division. As shown, Division 1 contributes the highest profit percentage, 39 percent, as indicated by 39 percent of the area within circle 1 being shaded. Notice in the diagram that Division 1 is considered a star, Division 2 is a question mark, Division 3 is also a question mark, Division 4 is a cash cow, and Division 5 is a dog.

The BCG Matrix, like all analytical techniques, has some limitations. For example, viewing every business as a star, cash cow, dog, or question mark is an oversimplification; many businesses fall right in the middle of the BCG Matrix and thus are not easily classified. Furthermore, the BCG Matrix does not reflect whether or not various divisions or their industries are growing over time; that is, the matrix has no temporal qualities, but rather it is a snapshot of an organization at a given point in time. Finally, other variables besides relative market share position and industry growth rate in sales, such as size of the market and competitive advantages, are important in making strategic decisions about various divisions.

An example BCG Matrix is provided in Figure 8-9. Note in Figure 8-9 that Division 5 had an operating loss of $188 million. Take note how the percent profit column is still calculated because oftentimes a firm will have a division that incurs a loss for a year. In terms of the pie slice in circle 5 of the diagram, note that it is a *different color* from the positive profit segments in the other circles.

The Internal-External (IE) Matrix

The **Internal-External (IE) Matrix** positions an organization's various divisions in a nine-cell display, illustrated in Figure 8-10. The IE Matrix is similar to the BCG Matrix in that both tools involve plotting organization divisions in a schematic diagram; this is why they are both called "portfolio matrices." Also, the size of each circle represents the percentage sales contribution of each division, and pie slices reveal the percentage profit contribution of each division in both the BCG and IE Matrix.



Division	*$ Sales (millions)*	*% Sales*	*$ Profits (millions)*	*% Profits*	*RMSP*	*IG Rate %*
1.	$5,139	51.5	$799	68.0	0.8	10
2.	2,556	25.6	400	39.0	0.4	05
3.	1,749	17.5	12	1.2	0.2	00
4.	493	4.9	4	0.1	0.5	−05
5.	42	0.5	−188	(18.3)	.02	−10
Total	**$9,979**	**100.0**	**$1,027**	**100.0**		

FIGURE 8-9

An Example BCG Matrix

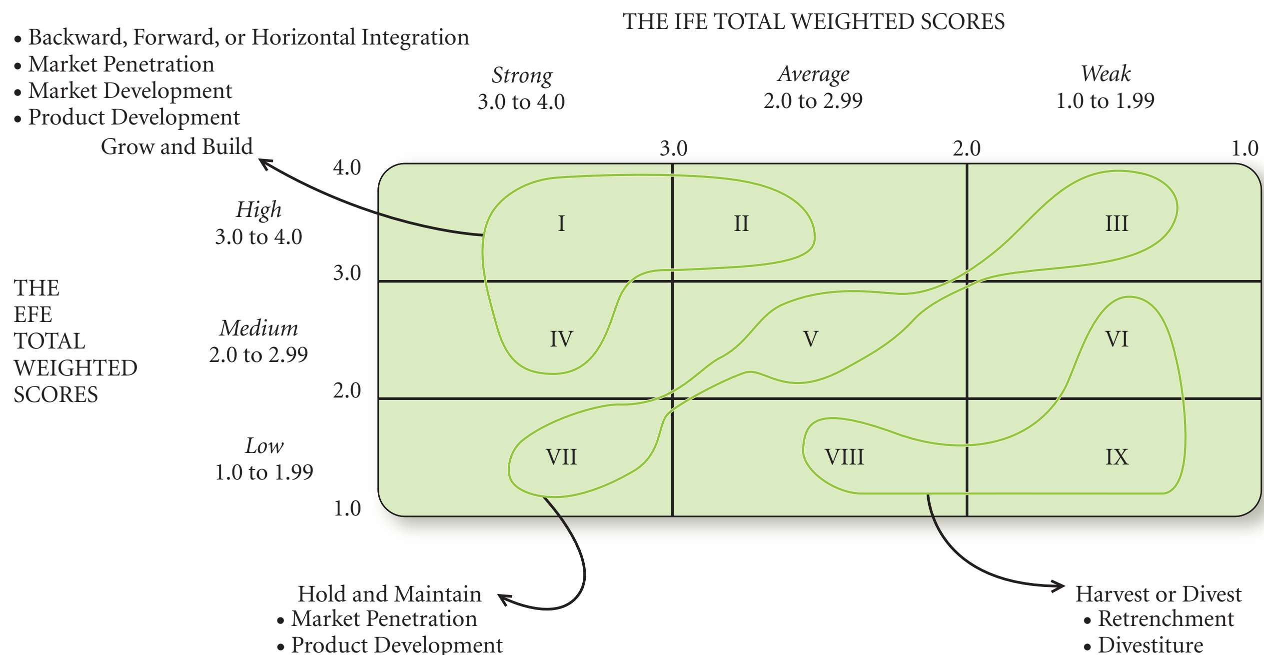


FIGURE 8-10

The Internal–External (IE) Matrix

Source: Based on: The IE Matrix was developed from the General Electric (GE) Business Screen Matrix. For a description of the GE Matrix, see Michael Allen, "Diagramming GE's Planning for What's WATT," in R. Allio and M. Pennington, eds., *Corporate Planning: Techniques and Applications* l par; New York: AMACOM, 1979.

But there are some important differences between the BCG Matrix and the IE Matrix. First, the axes are different. Also, the IE Matrix requires more information about the divisions than the BCG Matrix. Furthermore, the strategic implications of each matrix are different. For these reasons, strategists in multidivisional firms often develop both the BCG Matrix and the IE Matrix in formulating alternative strategies. A common practice is to develop a BCG Matrix and an IE Matrix for the present and then develop projected matrices to reflect expectations of the future. This before-and-after analysis forecasts the expected effect of strategic decisions on an organization's portfolio of divisions.

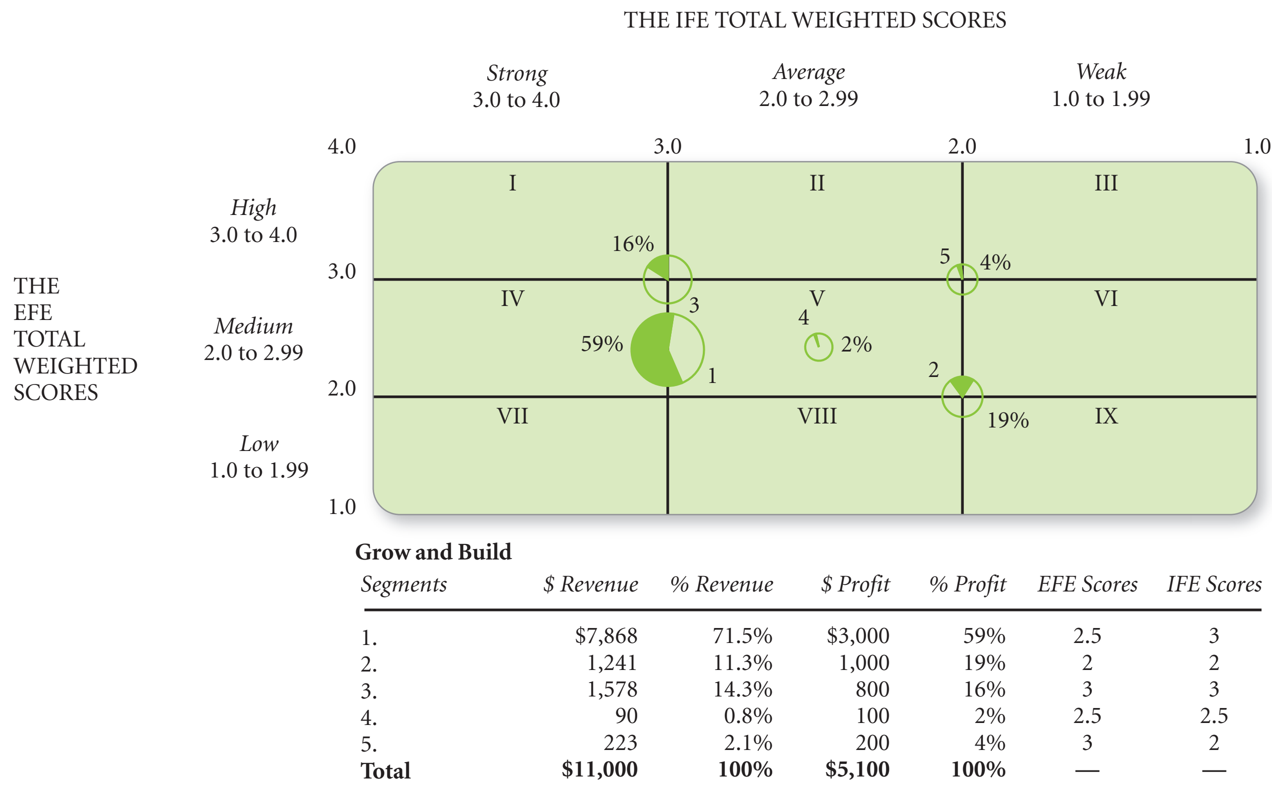
The IE Matrix is based on two key dimensions: the IFE total weighted scores on the *x*-axis and the EFE total weighted scores on the *y*-axis. Recall that each division of an organization should construct an IFE Matrix and an EFE Matrix for its part of the organization. The total weighted scores derived from the divisions allow construction of the corporate-level IE Matrix. On the *x*-axis of the IE Matrix, an IFE total weighted score of 1.0 to 1.99 represents a weak internal position; a score of 2.0 to 2.99 is considered average; and a score of 3.0 to 4.0 is strong. Similarly, on the *y*-axis, an EFE total weighted score of 1.0 to 1.99 is considered low; a score of 2.0 to 2.99 is medium; and a score of 3.0 to 4.0 is high.

The IE Matrix can be divided into three major regions that have different strategy implications. First, the prescription for divisions that fall into cells I, II, or IV can be described as *grow and build*. Intensive (market penetration, market development, and product development) or integrative (backward integration, forward integration, and horizontal integration) strategies can be most appropriate for these divisions. Second, divisions that fall into cells III, V, or VII can be managed best with *hold and maintain* strategies; market penetration and product development are two commonly employed strategies for these types of divisions. Third, a common prescription for divisions that fall into cells VI, VIII, or IX is *harvest or divest*. Successful organizations are able to achieve a portfolio of businesses positioned in or around cell I in the IE Matrix.

An example of a completed IE Matrix is given in Figure 8-11, which depicts an organization composed of four divisions. As indicated by the positioning of the circles, *grow and build* strategies are appropriate for Division 1, Division 2, and Division 3. Division 4 is a candidate for *harvest or divest*. Division 2 contributes the greatest percentage of company sales and thus is represented by the largest circle. Division 1 contributes the greatest proportion of total profits; it has the largest-percentage pie slice.

Division	*Sales*	*Percent Sales*	*Profits*	*Percent Profits*	*IFE Scores*	*EFE Scores*
1	$100	25.0	$10	50	3.6	3.2
2	200	50.0	5	25	2.1	3.5
3	50	12.5	4	20	3.1	2.1
4	50	12.5	1	5	1.8	2.5
Total	**$400**	**100.0**	**$20**	**100**		

FIGURE 8-11
An Example IE Matrix



Grow and Build

Segments	*$ Revenue*	*% Revenue*	*$ Profit*	*% Profit*	*EFE Scores*	*IFE Scores*
1.	$7,868	71.5%	$3,000	59%	2.5	3
2.	1,241	11.3%	1,000	19%	2	2
3.	1,578	14.3%	800	16%	3	3
4.	90	0.8%	100	2%	2.5	2.5
5.	223	2.1%	200	4%	3	2
Total	**$11,000**	**100%**	**$5,100**	**100%**	—	—

FIGURE 8-12
The IE Matrix

As indicated in Figure 8-12, the IE Matrix has five product segments. Note that Division 1 has the largest revenues (as indicated by the largest circle) and the largest profits (as indicated by the largest pie slice) in the matrix. It is common for organizations to develop both geographic and product-based IE Matrices to more effectively formulate strategies and allocate resources among divisions. In addition, firms often prepare an IE (or BCG) Matrix for competitors. Furthermore, firms will often prepare "before and after" IE (or BCG) Matrices to reveal the situation at present versus the expected situation after one year. This latter idea minimizes the limitation of these matrices being a "snapshot in time." In performing case analysis, feel free to estimate the IFE and EFE scores for the various divisions based upon your research into the company and industry—rather than preparing a separate IE Matrix for each division.

The Grand Strategy Matrix

In addition to the SWOT Matrix, SPACE Matrix, BCG Matrix, and IE Matrix, the **Grand Strategy Matrix** has become a popular tool for formulating alternative strategies. All organizations can be positioned in one of the Grand Strategy Matrix's four strategy quadrants. A firm's divisions likewise could be positioned. As illustrated in Figure 8-13, the Grand Strategy Matrix is based on two evaluative dimensions: competitive position and market (industry) growth. Any industry whose annual growth in sales exceeds 5 percent could be considered to have rapid growth. Appropriate strategies for an organization to consider are listed in sequential order of attractiveness in each quadrant of the matrix.

Firms located in Quadrant I of the Grand Strategy Matrix are in an excellent strategic position. For these firms, continued concentration on current markets (market penetration and market development) and products (product development) is an appropriate strategy. It is unwise for a Quadrant I firm to shift notably from its established competitive advantages. When a Quadrant I organization has excessive resources, then backward, forward, or horizontal integration may be effective strategies. When a Quadrant I firm is too heavily committed to a single product, then

FIGURE 8-13

The Grand Strategy Matrix

Source: Based on Roland Christensen, Norman Berg, and Malcolm Salter, *Policy Formulation and Administration* (Homewood, IL: Richard D. Irwin, 1976), 16–18.

related diversification may reduce the risks associated with a narrow product line. Quadrant I firms can afford to take advantage of external opportunities in several areas. They can take risks aggressively when necessary.

Firms positioned in Quadrant II need to evaluate their present approach to the marketplace seriously. Although their industry is growing, they are unable to compete effectively, and they need to determine why the firm's current approach is ineffective and how the company can best change to improve its competitiveness. Because Quadrant II firms are in a rapid-market-growth industry, an intensive strategy (as opposed to integrative or diversification) is usually the first option that should be considered. However, if the firm is lacking a distinctive competence or competitive advantage, then horizontal integration is often a desirable alternative. As a last resort, divestiture or liquidation should be considered. Divestiture can provide funds needed to acquire other businesses or buy back shares of stock.

Quadrant III organizations compete in slow-growth industries and have weak competitive positions. These firms must make some drastic changes quickly to avoid further decline and possible liquidation. Extensive cost and asset reduction (retrenchment) should be pursued first. An alternative strategy is to shift resources away from the current business into different areas (diversify). If all else fails, the final options for Quadrant III businesses are divestiture or liquidation.

Finally, Quadrant IV businesses have a strong competitive position but are in a slow-growth industry. These firms have the strength to launch diversified programs into more promising growth areas: Quadrant IV firms have characteristically high cash-flow levels and limited internal growth needs and often can pursue related or unrelated diversification successfully. Quadrant IV firms also may pursue joint ventures.

Students: Even with the Grand Strategy Matrix, be sure to state your alternative strategies in *specific* terms whenever a particular company is known. Avoid using terms such as divestiture for example. Rather, specify the exact division to be sold. Also, be sure to use the free excel student template at www.strategyclub.com if you like.

The Decision Stage

Analysis and intuition provide a basis for making strategy-formulation decisions. The matching techniques just discussed reveal feasible alternative strategies. Many of these strategies will likely have been proposed by managers and employees participating in the strategy analysis and choice activity. Any additional strategies resulting from the matching analyses could be discussed and added to the list of feasible alternative options. As indicated previously in this chapter, participants could rate these strategies on a 1-to-4-scale so that a prioritized list of the best strategies could be achieved.

The Quantitative Strategic Planning Matrix (QSPM)

Other than ranking strategies to achieve the prioritized list, there is only one analytical technique in the literature designed to determine the relative attractiveness of feasible alternative actions. This technique is the **Quantitative Strategic Planning Matrix (QSPM)**, which comprises Stage 3 of the strategy-formulation analytical framework.[6] This technique objectively indicates which alternative strategies are best. The QSPM uses input from Stage 1 analyses and matching results from Stage 2 analyses to decide objectively among alternative strategies. That is, the EFE Matrix, IFE Matrix, and CPM that comprise Stage 1, coupled with the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix that comprise Stage 2, provide the needed information for setting up the QSPM (Stage 3). The QSPM is a tool that allows strategists to evaluate alternative strategies objectively, based on previously identified external and internal key success factors. Like other strategy-formulation analytical tools, the QSPM requires good intuitive judgment.

The basic format of the QSPM is illustrated in Table 8-7. Note that the left column of a QSPM consists of key external and internal factors (from Stage 1), and the top row consists of feasible alternative strategies (from Stage 2). Specifically, the left column of a QSPM consists of information obtained directly from the EFE Matrix and IFE Matrix. In a column adjacent to the key success factors, the respective weights received by each factor in the EFE Matrix and the IFE Matrix are recorded.

The top row of a QSPM consists of alternative strategies derived from the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix. These matching tools usually generate similar feasible alternatives. However, not every strategy suggested by the matching techniques has to be evaluated in a QSPM. Strategists should compare several viable alternative strategies in a QSPM. Make sure your strategies are stated in specific terms, such

TABLE 8-7 The Quantitative Strategic Planning Matrix—QSPM

		Strategic Alternatives		
Key Factors	Weight	Strategy 1	Strategy 2	Strategy 3
Key External Factors				
Economy				
Political/Legal/Governmental				
Social/Cultural/Demographic/Environmental				
Technological				
Competitive				
Key Internal Factors				
Management				
Marketing				
Finance/Accounting				
Production/Operations				
Research and Development				
Management Information Systems				

as "Open 275 new stores in Indonesia" rather than "Expand globally" or "Open new stores in Africa." In Chapter 9, you will see that a dollar value must be established for each recommended strategy; it would be impossible to establish a dollar value for "expand globally."

Conceptually, the QSPM determines the relative attractiveness of various strategies based on the extent to which key external and internal critical success factors are capitalized on or improved. The relative attractiveness of each strategy within a set of alternatives is computed by determining the cumulative impact of each external and internal critical success factor. Any number of sets of alternative strategies can be included in the QSPM, and any number of strategies can make up a given set, but only strategies within a given set are evaluated relative to each other. For example, one set of strategies may include diversification, whereas another set may include issuing stock and selling a division to raise needed capital. These two sets of strategies are totally different, and the QSPM evaluates strategies only within sets. Note in Table 8-7 that three strategies are included, and they make up just one set.

A QSPM for a retail computer store is provided in Table 8-8. This example illustrates all the components of the QSPM: strategic alternatives, key factors, weights, attractiveness scores (AS), total attractiveness scores (TAS), and the sum total attractiveness score. The three new terms just introduced—(1) attractiveness scores, (2) total attractiveness scores, and (3) the sum total attractiveness score—are defined and explained as the six steps required to develop a QSPM are discussed:

Step 1: ***Make a list of the firm's key external opportunities and threats and internal strengths and weaknesses in the left column of the QSPM.*** This information should be taken directly from the EFE Matrix and IFE Matrix. A minimum of 10 external key success factors and 10 internal key success factors should be included in the QSPM.

Step 2: ***Assign weights to each key external and internal factor.*** These weights are identical to those in the EFE Matrix and the IFE Matrix. The weights are presented in a straight column just to the right of the external and internal critical success factors.

Step 3: ***Examine the Stage 2 (matching) matrices, and identify alternative strategies that the organization should consider implementing.*** Record these strategies in the top row of the QSPM. Group the strategies into mutually exclusive sets if possible.

Step 4: ***Determine the Attractiveness Scores (AS)*** defined as numerical values that indicate the relative attractiveness of each strategy in a given set of alternatives. **Attractiveness Scores (AS)** are determined by examining each key external or internal factor, one at a time, and asking the question "Does this factor affect the choice of strategies being made?" If the answer to this question is yes, then the strategies should be compared relative to that key factor. Specifically, AS should be assigned to each strategy to indicate the relative attractiveness of one strategy over others, considering the particular factor. The range for AS is 1 = not attractive, 2 = somewhat attractive, 3 = reasonably attractive, and 4 = highly attractive. By attractive, we mean the extent that one strategy, compared to others, enables the firm to either capitalize on the strength, improve on the weakness, exploit the opportunity, or avoid the threat. Work row by row in developing a QSPM. If the answer to the previous question is *no*, indicating that the respective key factor has no effect upon the specific choice being made, then do not assign AS to the strategies in that set. Use a dash to indicate that the key factor does not affect the choice being made. *Note:* If you assign an AS score to one strategy, then assign an AS score(s) to the other. In other words, if one strategy receives a dash, then all others must receive a dash in a given row.

Step 5: ***Compute the Total Attractiveness Scores.*** **Total Attractiveness Scores (TAS)** are defined as the product of multiplying the weights (Step 2) by the AS (Step 4) in each row. The TAS indicate the relative attractiveness of each alternative strategy, considering only the impact of the adjacent external or internal critical success factor. The higher the TAS, the more attractive the strategic alternative (considering only the adjacent critical success factor).

TABLE 8-8 A QSPM for a Retail Computer Store

		STRATEGIC ALTERNATIVES			
		1		2	
		Buy New Land and Build New Larger Store		Fully Renovate Existing Store	
Key Factors	*Weight*	*AS*	*TAS*	*AS*	*TAS*
Opportunities					
1. Population of city growing 10 percent	0.10	4	0.40	2	0.20
2. Rival computer store opening one mile away	0.10	2	0.20	4	0.40
3. Vehicle traffic passing store up 12 percent	0.08	1	0.08	4	0.32
4. Vendors average six new products/year	0.05	—		—	
5. Senior citizen use of computers up 8 percent	0.05	—		—	
6. Small business growth in area up 10 percent	0.10	—		—	
7. Desire for websites up 18 percent by realtors	0.06	—		—	
8. Desire for websites up 12 percent by small firms	0.06	—		—	
Threats					
1. Best Buy opening new store nearby in one year	0.15	4	0.60	3	0.45
2. Local university offers computer repair	0.08	—		—	
3. New bypass for Hwy 34 in one year will divert traffic	0.12	4	0.48	1	0.12
4. New mall being built nearby	0.08	2	0.16	4	0.32
5. Gas prices up 14 percent	0.04	—		—	
6. Vendors raising prices 8 percent	0.03	—		—	
Total	**1.00**				
Strengths					
1. Inventory turnover increased from 5.8 to 6.7	0.05	—		—	
2. Average customer purchase increased from $97 to $128	0.07	2	0.14	4	0.28
3. Employee morale is excellent	0.10	—		—	
4. In-store promotions resulted in 20 percent increase in sales	0.05	—		—	
5. Newspaper advertising expenditures increased 10 percent	0.02	—		—	
6. Revenues from repair/service segment of store up 16 percent	0.15	4	0.60	3	0.45
7. In-store technical support personnel have MIS college degrees	0.05	—		—	
8. Store's debt-to-total-assets ratio declined to 34 percent	0.03	4	0.12	2	0.06
9. Revenues per employee up 19 percent	0.02	—		—	
Weaknesses					
1. Revenues from software segment of store down 12 percent	0.10	—		—	
2. Location of store negatively impacted by new Hwy 34	0.15	4	0.60	1	0.15
3. Carpet and paint in store somewhat in disrepair	0.02	1	0.02	4	0.08
4. Bathroom in store needs refurbishing	0.02	1	0.02	4	0.08
5. Revenues from businesses down 8%	0.04	3	0.12	4	0.16
6. Store has no website	0.05	—		—	
7. Supplier on-time delivery increased to 2.4 days	0.03	—		—	
8. Often customers have to wait to check out	0.05	2	0.10	4	0.20
Total	**1.00**		**3.64**		**3.27**

Step 6: ***Compute the Sum Total Attractiveness Score.*** Add TAS in each strategy column of the QSPM. The **Sum Total Attractiveness Scores (STAS)** reveal which strategy is most attractive in each set of alternatives. Higher scores indicate more attractive strategies, considering all the relevant external and internal factors that could affect the strategic decisions. The magnitude of the difference between the STAS in a given set of strategic alternatives indicates the relative desirability of one strategy over another.

In Table 8-8, two alternative strategies—(1) buy new land and build new larger store and (2) fully renovate existing store—are being considered by a computer retail store. Note by sum total attractiveness scores of 3.64 versus 3.27 that the analysis indicates the business should buy new land and build a new larger store. Note the use of dashes to indicate which factors do not affect the strategy choice being considered. If a particular factor affects one strategy but not the other, it affects the choice being made, so AS should be recorded for both strategies. Never rate one strategy and not the other. Note also in Table 8-8 that there are no double 1's, 2's, 3's, or 4's in a row. Never duplicate scores in a row. Never work column by column; always prepare a QSPM working row by row. If you have more than one strategy in the QSPM, then let the AS scores range from 1 to "the number of strategies being evaluated." This will enable you to have a different AS score for each strategy. These are all important guidelines to follow in developing a QSPM. In actual practice, the store did purchase the new land and build a new store; the business also did some minor refurbishing until the new store was operational.

There should be a rationale for each AS score assigned. Note in Table 8-8 in the first row that the "city population growing 10 percent annually" opportunity could be capitalized on best by Strategy 1, "building the new, larger store," so an AS score of 4 was assigned to Strategy 1. AS scores, therefore, are not mere guesses; they should be rational, defensible, and reasonable.

An example QSPM is given in Table 8-9. Note in the actual QSPM for Starbucks in Table 8-9 that many rows are not rated, indicating that the particular factor does not significantly impact the choice to be made. This is good procedure. Also, notice in Table 8-9 that the 3 and 4 ratings given to the Strategy 2 "Open 400 Stores in the Middle East, Asia/Africa" versus Strategy 1 and indicate that Strategy 2 is a better choice given most of the factors. Working row by row is also good procedure. In addition, notice in Table 8-9 that many rows are not rated at all, indicating the particular factor will not impact the choice between Strategy 1 and 2. Leaving perhaps half of the rows blank in this manner is also good procedure. Finally, note in Table 8-9, that Strategy 2 is better for Starbucks as indicated by a STAS of 2.41.

TABLE 8-9 An Actual QSPM for Starbucks (2013)

		Strategy 1		Strategy 2	
		Open 100 Stores on U.S. College Campuses		Open 400 Stores in Middle East Asia/Africa	
	WT.	AS	TAS	AS	TAS
Strengths					
1. 22 percent of revenue comes from its international unit.	0.04	1	0.4	4	0.16
2. Net income grew to $333.1M for the recent quarter.	0.03	–	–	–	–
3. Total revenue grew to $3.30B from $2.92B.	0.04	–	–	–	–
4. Sales at global restaurants open at least 13 months rose 6 percent.	0.04	1	0.04	3	0.12
5. Starbucks earned a 100 percent HRC rating for the fourth consecutive year.	0.03	–	–	–	–
6. Starbucks global comparable store sales also increased 6 percent.	0.04	1	0.04	3	0.12
7. Starbucks revenues reached $166.9M in the Asian-Pacific region for 2011's last quarter (up 38 percent from a year earlier).	0.04	1	0.04	4	0.16
8. Starbucks only buys coffee grown at elevations higher than 2,600 feet because those beans are of better quality.	0.05	–	–	–	–
9. Starbucks employs more than 650 people to provide technology solutions.	0.04	–	–	–	–
10. Starbucks buys Evolution Fresh Inc. (a high end juice maker) for $30M.	0.05	–	–	–	–
11. Starbucks market share is 32.6 percent.	0.04	–	–	–	–
12. Starbucks sells 8.2 million coffee drinks on average each day in the United States.	0.04	4	0.16	1	0.04

(*continued*)

		Strategy 1		Strategy 2	
		Open 100 Stores on U.S. College Campuses		Open 400 Stores in Middle East Asia/ Africa	
	WT.	AS	TAS	AS	TAS
Weaknesses					
13. Starbucks rose prices in the Northeast and Sunbelt by about 1 percent.	0.04	3	0.12	1	0.04
14. Starbucks rose prices in 500 Chinese mainland stores. Coffee prices will increase by 1 to 2 yuan (16 to 32 U.S. cents).	0.04	1	0.04	3	0.12
15. Starbucks reward cardholders protest firm charging for soy milk and flavored syrups.	0.05	–	–	–	–
16. Starbucks does not offer the same type and quality tea as would be served in India.	0.04	1	0.04	2	0.08
17. After 63 Starbucks were opened in France, the firm has never turned a profit there.	0.06	–	–	–	–
18. Sales for Starbucks in Europe open at least 13 months only rose 2 percent whereas in the United States had a 9 percent and Asia had a 20 percent growth.	0.06	–	–	–	–
19. Starbucks reputation takes a big hit among British consumers after a report showed they paid no tax on sales of 1.2 billion pounds in years past after telling the taxman it made no profit but told investors it was a profitable unit.	0.03	–	–	–	–
20. Starbucks comes in second place to Dunkin Donuts on Brand Keys 2012 Customer Loyalty Engagement Index.	0.04	–	–	–	–
Opportunities					
21. 80 percent of U.S. adults are concerned about weight.	0.04	–	–	–	–
22. 45 percent of cell phone users have a smart phone.	0.04	–	–	–	–
23. China's projected GDP is $7.9 trillion.	0.02	2	0.04	4	0.08
24. U.S. projected GDP is $15.6 trillion.	0.02	4	0.08	2	0.04
25. Arabica coffee's futures price fell to a 17-month low after the likelihood of a record global crop in 2012–2013.	0.04	2	0.08	3	0.12
26. Since 2005 China's market for specialized coffee shops has tripled.	0.05	1	0.05	4	0.20
27. Tea is the second most consumed beverage in the world, behind bottled water.	0.04	1	0.04	4	0.16
28. India's tea industry accounts for 31 percent of global production.	0.04	1	0.04	4	0.16
29. Dunkin' Donuts comparable stores sales growth was 5.1 percent in 2011 versus Starbucks 8 percent.	0.02	–	–	–	–
30. The domestic coffee market in India is growing by 25 percent annually.	0.02	–	–	–	–
Threats					
31. The European debt crisis causes the demand for coffee to falter in various countries; down 6.7 percent, 2.6 percent, and 1.6 percent in Britain, Spain, and Italy, respectively.	0.05	2	0.10	4	0.20
32. Consumer confidence index fell to 60.6 in August from 65.4 in July.	0.03	3	0.09	1	0.03
33. China's per capital GDP in 2011 was $5,184.	0.04	1	0.04	4	0.16
34. An estimated 30 to 50 million American adults are lactose intolerant.	0.04	–	–	–	–
35. Dunkin' Donuts opens outlets in the U.S. Northeast, South, and Mid-Atlantic at 10 college campuses.	0.03	4	0.12	1	0.03
36. Dunkin' Donuts announces its company's goal of doubling U.S. store presence over 20 years.	0.03	4	0.12	1	0.03
37. McDonald's Asia/Pacific, Middle East and Africa division had a 1.4 percent increase in comparable sales.	0.04	1	0.04	4	0.16
38. McDonald's had total revenues of $27B for fiscal 2011 compared to Starbucks $11.7B.	0.04	2	0.08	3	0.12
39. McDonald's takes 7th place in Interbrand's Best Global Brands 2012 while Starbucks comes in 88th place.	0.02	1	0.02	4	0.08
40. Select McDonald's stores in the United States and Europe are providing iPads for customers to use while they are in the store.	0.04	–	–	–	–
TOTAL	**1.00**		**1.82**		**2.41**

Positive Features and Limitations of the QSPM

A positive feature of the QSPM is that sets of strategies can be examined sequentially or simultaneously. For example, corporate-level strategies could be evaluated first, followed by division-level strategies, and then function-level strategies. There is no limit to the number of strategies that can be evaluated or the number of sets of strategies that can be examined at once using the QSPM.

Another positive feature of the QSPM is that it requires strategists to integrate pertinent external and internal factors into the decision process. Developing a QSPM makes it less likely that key factors will be overlooked or weighted inappropriately. A QSPM draws attention to important relationships that affect strategy decisions. Although developing a QSPM requires a number of subjective decisions, making small decisions along the way enhances the probability that the final strategic decisions will be best for the organization. A QSPM can be used by small and large, for-profit and nonprofit organizations.

The QSPM is not without some limitations. First, it always requires intuitive judgments and educated assumptions. The ratings and attractiveness scores require judgmental decisions, even though they should be based on objective information. Discussion among strategists, managers, and employees throughout the strategy-formulation process, including development of a QSPM, is constructive and improves strategic decisions. Constructive discussion during strategy analysis and choice may arise because of genuine differences of interpretation of information and varying opinions. Another limitation of the QSPM is that it can be only as good as the prerequisite information and matching analyses upon which it is based.

Cultural Aspects of Strategy Choice

All organizations have a culture. **Culture** includes the set of shared values, beliefs, attitudes, customs, norms, personalities, heroes, and heroines that describe a firm. Culture is the unique way an organization does business. It is the human dimension that creates solidarity and meaning, and it inspires commitment and productivity in an organization when strategy changes are made. All human beings have a basic need to make sense of the world, to feel in control, and to make meaning. When events threaten meaning, individuals react defensively. Managers and employees may even sabotage new strategies in an effort to recapture the status quo.

It is beneficial to view strategic management from a cultural perspective because success often rests on the degree of support that strategies receive from a firm's culture. If a firm's strategies are supported by cultural products such as values, beliefs, rites, rituals, ceremonies, stories, symbols, language, heroes, and heroines, then managers often can implement changes swiftly and easily. However, if a supportive culture does not exist and is not cultivated, then strategy changes may be ineffective or even counterproductive. A firm's culture can become antagonistic to new strategies, and the result of that antagonism may be confusion and disarray.

Strategies that require fewer cultural changes may be more attractive because extensive changes can take considerable time and effort. Whenever two firms merge, it becomes especially important to evaluate and consider culture-strategy linkages.

Culture provides an explanation for the difficulties a firm encounters when it attempts to shift its strategic direction, as the following statement explains:

> Not only has the "right" corporate culture become the essence and foundation of corporate excellence, but success or failure of needed corporate reforms hinges on management's sagacity and ability to change the firm's driving culture in time and in tune with required changes in strategies.[8]

The Politics of Strategy Choice

All organizations are political. Unless managed, political maneuvering consumes valuable time, subverts organizational objectives, diverts human energy, and results in the loss of some valuable employees. Sometimes political biases and personal preferences get unduly embedded in strategy choice decisions. Internal politics affect the choice of strategies in all organizations. The hierarchy of command in an organization, combined with the career aspirations

of different people and the need to allocate scarce resources, guarantees the formation of coalitions of individuals who strive to take care of themselves first and the organization second, third, or fourth. Coalitions of individuals often form around key strategy issues that face an enterprise. A major responsibility of strategists is to guide the development of coalitions, to nurture an overall team concept, and to gain the support of key individuals and groups of individuals.

In the absence of objective analyses, strategy decisions too often are based on the politics of the moment. With development of improved strategy-formation tools, political factors become less important in making strategic decisions. In the absence of objectivity, political factors sometimes dictate strategies, and this is unfortunate. Managing political relationships is an integral part of building enthusiasm and esprit de corps in an organization.

A classic study of strategic management in nine large corporations examined the political tactics of successful and unsuccessful strategists.[9] Successful strategists were found to let weakly supported ideas and proposals die through inaction and to establish additional hurdles or tests for strongly supported ideas considered unacceptable but not openly opposed. Successful strategists kept a low political profile on unacceptable proposals and strived to let most negative decisions come from subordinates or a group consensus, thereby reserving their personal vetoes for big issues and crucial moments. Successful strategists did a lot of chatting and informal questioning to stay abreast of how things were progressing and to know when to intervene. They led strategy but did not dictate it. They gave few orders, announced few decisions, depended heavily on informal questioning, and sought to probe and clarify until a consensus emerged.

Successful strategists generously and visibly rewarded key thrusts that succeeded. They assigned responsibility for major new thrusts to **champions**, the individuals most strongly identified with the idea or product and whose futures were linked to its success. They stayed alert to the symbolic impact of their own actions and statements so as not to send false signals that could stimulate movements in unwanted directions.

Successful strategists ensured that all major power bases within an organization were represented in, or had access to, top management. They interjected new faces and new views into considerations of major changes. This is important because new employees and managers generally have more enthusiasm and drive than employees who have been with the firm a long time. New employees do not see the world the same old way; nor do they act as screens against changes. Successful strategists minimized their own political exposure on highly controversial issues and in circumstances in which major opposition from key power centers was likely. In combination, these findings provide a basis for managing political relationships in an organization.

Because strategies must be effective in the marketplace and capable of gaining internal commitment, the following tactics used by politicians for centuries can aid strategists:

1. Achieving desired results is more important that imposing a particular method, so consider various methods and choose, whenever possible, the one(s) that will afford the greatest commitment from employees/managers.
2. Achieving satisfactory results with a popular strategy is generally better than trying to achieve optimal results with an unpopular strategy.
3. An effective way to gain commitment and achieve desired results is oftentimes to shift from specific to general issues and concerns.
4. An effective way to gain commitment and achieve desired results is oftentimes to shift from short-term to long-term issues and concerns.
5. Middle level managers must be genuinely involved in and supportive of strategic decisions, because successful implementation will hinge on their support.[10]

Governance Issues

A "director," according to Webster's Dictionary, is "one of a group of persons entrusted with the overall direction of a corporate enterprise." A **board of directors** is a group of individuals who are elected by the ownership of a corporation to have oversight and guidance over management and who look out for shareholders' interests. The act of oversight and direction is referred to as **governance**. The National Association of Corporate Directors defines governance as "the

characteristic of ensuring that long-term strategic objectives and plans are established and that the proper management structure is in place to achieve those objectives, while at the same time making sure that the structure functions to maintain the corporation's integrity, reputation, and responsibility to its various constituencies." Boards are being held accountable for the entire performance of the firm. Boards of directors are increasingly sued by shareholders for mismanaging their interests. New accounting rules in the USA and Europe now enhance corporate-governance codes and require much more extensive financial disclosure among publicly held firms. The roles and duties of a board of directors can be divided into four broad categories, as indicated in Table 8-10.

Shareholders today are wary of boards of directors. Shareholders of hundreds of firms are demanding that their boards do a better job of governing corporate America.[11] New compensation policies are needed as well as direct shareholder involvement in some director activities. For example, boards could require CEOs to groom possible replacements from inside the firm because exorbitant compensation is most often paid to new CEOs coming from outside the firm.

Most boards of directors globally have ended their image as rubber-stamping friends of CEOs. Boards are more autonomous than ever and continually mindful of and responsive to legal and institutional-investor scrutiny. Boards are more cognizant of auditing and compliance issues and more reluctant to approve excessive compensation and perks. Boards stay much more abreast today of public scandals that attract shareholder and media attention. Increasingly,

TABLE 8-10 Board of Director Duties and Responsibilities

1. CONTROL AND OVERSIGHT OVER MANAGEMENT
   a. Select the Chief Executive Officer (CEO).
   b. Sanction the CEO's team.
   c. Provide the CEO with a forum.
   d. Ensure managerial competency.
   e. Evaluate management's performance.
   f. Set management's salary levels, including fringe benefits.
   g. Guarantee managerial integrity through continuous auditing.
   h. Chart the corporate course.
   i. Devise and revise policies to be implemented by management.
2. ADHERENCE TO LEGAL PRESCRIPTIONS
   a. Keep abreast of new laws.
   b. Ensure the entire organization fulfills legal prescriptions.
   c. Pass bylaws and related resolutions.
   d. Select new directors.
   e. Approve capital budgets.
   f. Authorize borrowing, new stock issues, bonds, and so on.
3. CONSIDERATION OF STAKEHOLDERS' INTERESTS
   a. Monitor product quality.
   b. Facilitate upward progression in employee quality of work life.
   c. Review labor policies and practices.
   d. Improve the customer climate.
   e. Keep community relations at the highest level.
   f. Use influence to better governmental, professional association, and educational contacts.
   g. Maintain good public image.
4. ADVANCEMENT OF STOCKHOLDERS' RIGHTS
   a. Preserve stockholders' equity.
   b. Stimulate corporate growth so that the firm will survive and flourish.
   c. Guard against equity dilution.
   d. Ensure equitable stockholder representation.
   e. Inform stockholders through letters, reports, and meetings.
   f. Declare proper dividends.
   g. Guarantee corporate survival.

boards of directors monitor and review executive performance carefully without favoritism to executives, representing shareholders rather than the CEO. Boards are more proactive today, whereas in years past they were oftentimes merely reactive. These are all reasons why the chair of the board of directors should not also serve as the firm's CEO.[12]

Shareholders are also upset at boards for allowing CEOs to receive huge end-of-year bonuses when the firm's stock price drops drastically during the year.[13] For example, Chesapeake Energy Corp. and its board of directors came under fire from shareholders for paying Chairman and CEO Aubrey McClendon $112 million as the firm's stock price plummeted. Investor Jeffrey Bronchick wrote in a letter to the Chesapeake board that the CEO's compensation was a "near perfect illustration of the complete collapse of appropriate corporate governance."

Until recently, boards of directors did most of their work sitting around polished wooden tables. However, Hewlett-Packard's directors, among many others, now log on to their own special board website twice a week and conduct business based on extensive confidential briefing information posted there by the firm's top management team. Then the board members meet face-to-face and fully informed every two months to discuss the biggest issues facing the firm. Even the decision of whether to locate operations in countries with low corporate tax rates would be reviewed by a board of directors. New board involvement policies are aimed at curtailing lawsuits against board members. For example, there were 740 lawsuits filed in 2012 against directors regarding merger deals. The Federal Deposit Insurance Corporation (FDIC) filed 23 lawsuits against directors in 2012, compared to 16 in 2011 and just 2 in 2010.

Today, boards of directors are composed mostly of outsiders who are becoming more involved in organizations' strategic management. The trend in the USA is toward much greater board member accountability with smaller boards, now averaging 12 members rather than 18 as they did a few years ago. *BusinessWeek* recently evaluated the boards of most large U.S. companies and provided the following "principles of good governance":

1. Never have more than two of the firm's executives (current or past) on the board.
2. Never allow a firm's executives to be the board's audit, compensation, or nominating committees.
3. Require all board members to own a large amount of the firm's equity.
4. Require all board members to attend at least 75 percent of all meetings.
5. Require the board to meet annually to evaluate its own performance, without the CEO, COO, or top management in attendance.
6. Never allow the CEO to be Chairperson of the Board.
7. Never allow interlocking directorships (where a director or CEO sits on another director's board).[14]

Jeff Sonnerfeld, associate dean of the Yale School of Management, says, "Boards of directors are now rolling up their sleeves and becoming much more closely involved with management decision making." Company CEOs and boards are required to personally certify financial statements; company loans to company executives and directors are illegal; and there is faster reporting of insider stock transactions.

Just as directors place more emphasis on staying informed about an organization's health and operations, they are also taking a more active role in ensuring that publicly issued documents are accurate representations of a firm's status. Failure to accept responsibility for auditing or evaluating a firm's strategy is considered a serious breach of a director's duties. Stockholders, government agencies, and customers are filing legal suits against directors for fraud, omissions, inaccurate disclosures, lack of due diligence, and culpable ignorance about a firm's operations with increasing frequency. Liability insurance for directors has become exceptionally expensive and has caused numerous directors to resign.

The Sarbanes-Oxley Act resulted in scores of boardroom overhauls among publicly traded companies. The jobs of chief executive and chairman are now held by separate persons, and board audit committees must now have at least one financial expert as a member. Board audit committees now meet 10 or more times per year, rather than three or four times as they did

prior to the act. The act put an end to the "country club" atmosphere of most boards and has shifted power from CEOs to directors. Although aimed at public companies, the act has also had a similar impact on privately owned companies.[15]

In Sweden, a new law requires 25 percent female representation in boardrooms. The Norwegian government has passed a similar law that requires 40 percent of corporate director seats to go to women. In the USA, women currently hold about 13 percent of board seats at S&P 500 firms and 10 percent at S&P 1,500 firms. The Investor Responsibility Research Center in Washington, D.C., reports that minorities hold just 8.8 percent of board seats of S&P 1,500 companies. Progressive firms realize that women and minorities ask different questions and make different suggestions in boardrooms than white men, which is helpful because women and minorities comprise much of the consumer base everywhere.

The European Union (EU) Justice Commissioner Viviane Reding introduced in late 2012 contentious legislation requiring publicly traded companies across the EU to fill at least 40 percent of board positions with women by 2020, or be hit with sanctions to be decided by the EU countries.

A direct response to increased pressure on directors to stay informed and execute their responsibilities is that audit committees are becoming commonplace. A board of directors should conduct an annual strategy audit in much the same fashion that it reviews the annual financial audit. In performing such an audit, a board could work jointly with operating management and/or seek outside counsel. Boards should play a role beyond that of performing a strategic audit. They should provide greater input and advice in the strategy-formulation process to ensure that strategists are providing for the long-term needs of the firm. This is being done through the formation of three particular board committees: nominating committees to propose candidates for the board and senior officers of the firm; compensation committees to evaluate the performance of top executives and determine the terms and conditions of their employment; and audit committees to give board-level attention to company accounting and financial policies and performance.

Special Note to Students

Your SWOT, SPACE, BCG, IE, Grand, and QSPM need to be developed accurately, but in covering those matrices in an oral presentation, focus more on the implications of those analyses than the nuts-and-bolts calculations. In other words, as you go through those matrices in a presentation, your goal is not to prove to the class that you did the calculations correctly. They expect accuracy and clarity and certainly you should have that covered. It is the implications of each matrix that your audience will be most interested in, so use these matrices to pave the way for your recommendations with costs, which generally come just a page or two deeper into the project. A good rule of thumb is to spend at least an equal amount of time on the implications as the actual calculations of each matrix when presented. This approach will improve the delivery aspect of your presentation or paper by maintaining the high interest level of your audience. Focusing on implications rather than calculations will also encourage questions from the audience when you finish. Questions on completion are a good thing. Silence on completion is a bad thing because silence could mean your audience was asleep, disinterested, or did not feel you did a good job. Also, utilize the free excel student template at www.strategyclub.com as needed.

Conclusion

The essence of strategy formulation is an assessment of whether an organization is doing the right things and how it can be more effective in what it does. Every organization should be wary of becoming a prisoner of its own strategy because even the best strategies become obsolete sooner or later. Regular reappraisal of strategy helps management avoid complacency. Objectives and strategies should be consciously developed and coordinated and should not merely evolve out of day-to-day operating decisions.

An organization with no sense of direction and no coherent strategy precipitates its own demise. When an organization does not know where it wants to go, it usually ends up some place it does not want to be. Every organization needs to consciously establish and communicate clear objectives and strategies.

Modern strategy-formulation tools and concepts are described in this chapter and integrated into a practical three-stage framework. Tools such as the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and QSPM can significantly enhance the quality of strategic decisions, but they should never be used to dictate the choice of strategies. Behavioral, cultural, and political aspects of strategy generation and selection are always important to consider and manage. Because of increased legal pressure from outside groups, boards of directors are assuming a more active role in strategy analysis and choice. This is a positive trend for organizations.

Key Terms and Concepts

aggressive quadrant (p. 263)
attractiveness scores (AS) (p. 276)
board of directors (p. 281)
Boston Consulting Group (BCG) matrix (p. 267)
business portfolio (p. 267)
cash cows (p. 269)
champions (p. 281)
competitive position (CP) (p. 262)
competitive quadrant (p. 265)
conservative quadrant (p. 265)
culture (p. 280)
decision stage (p. 258)
defensive quadrant (p. 265)
directional vector (p. 263)
dogs (p. 269)
financial position (FP) (p. 262)
governance (p. 281)
Grand Strategy Matrix (p. 273)
halo error (p. 258)
industry position (IP) (p. 262)
input stage (p. 258)
internal-external (IE) matrix (p. 270)
matching (p. 259)
matching stage (p. 258)
Quantitative Strategic Planning Matrix (QSPM) (p. 275)
question marks (p. 268)
relative market share position (p. 267)
SO strategies (p. 260)
stability position (SP) (p. 262)
stars (p. 269)
Strategic Position and Action Evaluation (SPACE) Matrix (p. 262)
strategy-formulation analytical framework (p. 258)
Strengths-Weaknesses Opportunities-Threats (SWOT) Matrix (p. 259)
ST strategies (p. 260)
Sum Total Attractiveness Scores (STAS) (p. 278)
Total Attractiveness Scores (TAS) (p. 276)
WO strategies (p. 260)
WT strategies (p. 260)

Issues for Review and Discussion

8-1. Unilever has done really well for decades. How does Unilever do so well? How can they continue to prosper?

8-2. Give an internal and external strength of Unilever. Show how those two factors are related to reveal a feasible alternative strategy.

8-3. What do you believe are the three major external opportunities that Unilever faces?

8-4. Develop a SPACE Matrix for Unilever. Explain the implications of your Matrix.

8-5. Develop a BCG Matrix for Unilever. Explain the implications of your Matrix.

8-6. Develop a QSPM for Unilever that includes two strategies, six internal factors, and six external factors. What strategy appears to be best for Unilever to pursue?

8-7. Do a Google search using the key terms "boards of directors." What new information did you learn that was not given in the chapter?

8-8. In preparing a SPACE Matrix, which axis would the European political and economic unrest fall under?

8-9. In preparing a BCG Matrix, what would be the best range for the IGR axis as applied to the beverage industry?

8-10. List four reasons why the IE Matrix is widely considered to be superior to the BCG Matrix.
8-11. Is there a limit to the number of strategies that could be examined in a QSPM? Why?
8-12. Go to adidas' website and examine what you can find about the company's board of directors. Evaluate adidas' board based on guidelines presented in the chapter.
8-13. Explain why the CEO of a firm should not also be chairperson of the board of directors.
8-14. In preparing a QSPM, what should be done if the TAS for each strategy turn out to be identical?
8-15. Summarize in your own words the "Special Note to Students" section, given at the end of the chapter.
8-16. Develop a Grand Strategy Matrix for Unilever and include one rival firm.
8-17. Explain what should be done if the SPACE vector coordinate point is (0,0).
8-18. On QSPM, why should you work row by row instead of column by column?
8-19. When constructing a SPACE Matrix, would it be appropriate to use a 1 to 10 scale for all axes?
8-20. If Unilever has the leading market share in Russia, where along the top axis of a BCG would their Russia Operations be plotted?
8-21. Develop a SWOT Matrix for yourself.
8-22. Why is "matching" internal with external factors such an important strategic management activity?
8-23. Illustrate the strategy formulation framework that includes three stages and nine analytical tools. Which stage and tool do you feel is most important? Why?
8-24. Develop an example SWOT Matrix for your college or university with two items in each quadrant. Make sure your strategies clearly exemplify "matching" and show this with (S1, T2) type notation.
8-25. Develop an example SPACE Matrix for a global company that you are familiar with. Include two factors for each of the four axes (SP, IP, SP, and CP).
8-26. What would be an appropriate SP rating for Unilever?
8-27. Discuss the pros and cons of divulging divisional information to stakeholders.
8-28. Develop an example BCG Matrix for a company that has three divisions with revenues of 4, 8, and 12 and profits of 5, 3, and 2, respectively.
8-29. Develop a SPACE Matrix for a firm that is a weak competitor competing in a slow growing and unstable industry. Label axes and quadrants clearly.
8-30. Discuss the limitations of a BCG analysis and the limitations of a SPACE analysis.
8-31. Prepare an IE Matrix for a company with two divisions that have 30 and 60 in revenues to go with 10 and 15 in profits.
8-32. Develop a Grand Strategy Matrix with two example companies in each quadrant, i.e., companies that you know something about and that you would place in those quadrants.
8-33. Develop a QSPM for yourself—given two strategies: 1) go to graduate school or 2) begin working full-time.
8-34. Would a QSPM analysis be useful without the weight column? Why or why not?
8-35. Discuss the characteristics of successful strategists in terms of political factions within the firm.
8-36. In order of attractiveness to you, rank the political tactics presented in Chapter 8.
8-37. For a business in your city, list in order of importance the top eight board-of-director duties and responsibilities listed in the chapter.
8-38. Discuss the pros and cons of Sweden's new board-of-director rule regarding women.
8-39. Develop a SPACE Matrix for your college or university.
8-40. Develop a BCG Matrix for your college or university.
8-41. Explain the limitations of the BCG, SPACE, and SWOT.
8-42. Develop a QSPM for a local company that you are familiar with.
8-43. Write a short essay that reveals your recommendations to firms, regarding disclosure of financial information.
8-44. Explain why a before and after BCG and IE analysis can be useful in presenting a strategic plan for consideration.
8-45. Find an example of a company, on the Internet, which has both a Cash Cow and a Question Mark division.
8-46. Regarding a Grand Strategy Matrix, identify two companies that would be located in your judgment in each quadrant—identify eight firms total.
8-47. For a non-profit company, list in order of importance the top 10 board-of-director duties and responsibilities.
8-48. Regarding the principles of good governance in the chapter, list in order of importance the top seven guidelines.

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

8-49. Explain the steps involved in developing a QSPM.

8-50. How are the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix similar? How are they different?

8-51. Mymanagementlab Only—comprehensive writing assignment for this chapter.

Current Readings

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 8A

Should Unilever Penetrate Southeast Asia Further?

Purpose

Unilever is featured in the opening chapter case as a firm that engages in excellent strategic planning. Unilever is the world's third-largest consumer goods company (behind Procter & Gamble and Nestlé). Some of Unilever's best selling brands are Aviance, Ben & Jerry's, Dove, Flora/Becel, Hellmann's, Knorr, Lipton, Lux/Radox, Omo/Surf, Sunsilk, Toni & Guy, VO5, Wall's, and PG Tips.

The purpose of this exercise is to give you experience investigating a particular region of the world to determine whether a firm should expand more deeply into that region of the world.

Unilever has recently began construction of a new factory in Yangon, Myanmar, and by 2015 expects to provide direct and indirect employment for over 2,000 people in Myanmar. The company currently employs close to 200 Myanmar employees at its factory in Thailand, of which a number are being moved back to Myanmar to help kick-start its operations in the country.

Instructions

Step 1 Go to Unilever's corporate website and download the company's most recent *Annual Report*. Examine the narrative and tables related to their operations in Southeast Asia.

Step 2 Research the competitive climate and business culture of Myanmar and two other countries in Southeast Asia as well as the operations of rival Nestlé.

Step 3 Develop six recommendations for Unilever based on your assessment of their present and potential operations in Southeast Asia.

EXERCISE 8B

Perform a SWOT Analysis for Unilever's Global Operations

Purpose

Unilever's global and domestic business segments could be required annually to submit a SWOT analysis to corporate top executives who merge divisional analyses into an overall corporate analysis. This exercise will give you practice performing a SWOT analysis.

Instructions

Step 1 Review Unilever's global operations as described in the company's most recent *Annual Report*. Unilever recently acquired 82 percent of the Russia-based beauty company Kalina.

Step 2 Review industry and competitive information pertaining to Unilever's global operations, especially as compared to rival Procter & Gamble.

Step 3 Join with two other students in class. Together, develop a global SWOT Matrix for Unilever's global business segment. Follow all the SWOT guidelines provided in the chapter, including (S4, T3)-type notation at the end of each strategy. Include three strategies in each of the four (SO, ST, WT, WO) quadrants. Avoid generic strategy terms such as Forward Integration.

Step 4 Turn in your team-developed SWOT Matrix to your professor for a classwork grade.

EXERCISE 8C

Preparing a BCG Matrix for Unilever

Purpose

This exercise will give you practice preparing both a by-product and a by-region -based BCG Matrix. Unilever has four major product segments of the company: Personal Care, Food, Refreshment, and Home Care. The company also has three major geographic segments: Europe, The Americas, and Asia/AMET/RUB.

Instructions

Step 1 Review Unilever's global operations as described in the company's most recent *Annual Report* and *Form 10K*.

Step 2 Prepare an up-to-date BCG matrices for Unilever's 1) four product categories and 2) three geographic divisions.

Step 3 Write a two-page executive summary to reveal the strategic implications of your analyses.

EXERCISE 8D

Developing a SWOT Matrix for adidas AG

Purpose

The most widely used strategy formulation technique among firms worldwide is the SWOT Matrix. This exercise requires development of a SWOT Matrix for adidas. Matching key external and internal factors in a SWOT Matrix requires good intuitive and conceptual skills. You will improve with practice in developing a SWOT Matrix.

Instructions

Recall from Exercise 1B that you already may have determined adidas' external opportunities/threats and internal strengths/weaknesses. This information could be used to complete this exercise. Follow the steps outlined as follows:

Step 1 On a separate sheet of paper, construct a large nine-cell diagram that will represent your SWOT Matrix. Appropriately label the cells.

Step 2 Appropriately record adidas' opportunities/threats and strengths/weaknesses in your diagram.

Step 3 Match external and internal factors to generate feasible alternative strategies for adidas. Record SO, WO, ST, and WT strategies in appropriate cells of the SWOT Matrix. Use the proper notation to indicate the rationale for the strategies. Try to include four strategies in each of the four strategy cells.

Step 4 Compare your SWOT Matrix to another students' SWOT Matrices. Discuss any major differences.

EXERCISE 8E

Developing a SPACE Matrix for adidas AG

Purpose

Should adidas pursue aggressive, conservative, competitive, or defensive strategies? Develop a SPACE Matrix for adidas to answer this question. Elaborate on the strategic implications of your directional vector. Be specific in terms of strategies that could benefit adidas.

Instructions

Step 1 Join with two other persons in your class and develop a joint SPACE Matrix for adidas.
Step 2 Diagram your SPACE Matrix on the board. Compare your Matrix with other teams' matrices.
Step 3 Discuss the implications of your SPACE Matrix.

EXERCISE 8F

Developing a BCG Matrix for adidas AG

Purpose

Portfolio matrices are widely used by multidivisional organizations to help identify and select strategies to pursue. A BCG analysis identifies particular divisions that should receive fewer resources than others. It may identify some divisions to be divested. This exercise can give you practice developing a BCG Matrix.

Instructions

Step 1 Place the following five column headings at the top of a separate sheet of paper: Divisions, Revenues, Profits, Relative Market Share Position, and Industry Growth Rate. Down the far left of your page, list adidas, Reebok, and TaylorMade. Turn back to the Cohesion Case and find information to fill in all the cells in your data table.
Step 2 Complete two BCG Matrices for adidas: 1) Include Reebok, TaylorMade, and adidas and 2) include Geographic Regions of the World.
Step 3 Compare your BCG Matrix to other students' matrices. Discuss any major differences.

EXERCISE 8G

Developing a QSPM for adidas AG

Purpose

This exercise can give you practice developing a Quantitative Strategic Planning Matrix (QSPM) to determine the relative attractiveness of various strategic alternatives.

Instructions

Step 1 Join with two other students in class to develop a joint QSPM for adidas.
Step 2 Go to the board and record your strategies and their Sum Total Attractiveness Scores. Compare your team's strategies and sum total attractiveness scores to those of other teams. Be sure not to assign the same AS score in a given row. Recall that dashes should be inserted all the way across a given row when used.
Step 3 Discuss any major differences.

EXERCISE 8H

Developing a SWOT Matrix for Unilever

Purpose

The most widely used strategy formulation technique among American firms is the SWOT Matrix. This exercise requires development of a SWOT Matrix for Unilever. Matching key external and internal factors in a SWOT Matrix requires good intuitive and conceptual skills. You will improve with practice in developing a SWOT Matrix.

Instructions

Step 1 On a separate sheet of paper, construct a large nine-cell diagram that will represent your SWOT matrix. Appropriately label the cells.

Step 2 Determine six opportunities and six threats, and six strengths and six weaknesses for Unilever.

Step 3 Match external and internal factors to generate feasible alternative strategies for Unilever. Record SO, WO, ST, and WT strategies in appropriate cells of the SWOT Matrix. Use the proper notation to indicate the rationale for the strategies. Try to include two strategies in each of the four strategy cells. Compare your SWOT Matrix to another student's SWOT Matrix. Discuss any major differences.

EXERCISE 8I
Developing a SPACE Matrix for Unilever

Purpose

Should Unilever pursue aggressive, conservative, competitive, or defensive strategies? Develop a SPACE Matrix for Unilever to answer this question. Elaborate on the strategic implications of your directional vector. Be specific in terms of strategies that could benefit Unilever.

Instructions

Step 1 Join with two other persons in class and develop a joint SPACE Matrix for Unilever.

Step 2 Diagram your SPACE Matrix on the board. Compare your matrix with other teams' matrices.

Step 3 Discuss the implications of your SPACE Matrix.

EXERCISE 8J
Developing a BCG Matrix for your College or University

Purpose

Portfolio matrices are widely used by multidivisional organizations to help identify and select strategies to pursue. A BCG analysis identifies particular divisions that should receive fewer resources than others; or it may identify some divisions to be divested. This exercise can give you practice developing a BCG Matrix for a college or university.

Instructions

Step 1 Place the following five column headings at the top of a separate sheet of paper: Divisions, Revenues, Profits, Relative Market Share Position, and Industry Growth Rate. Down the far left of your page, list Schools at your college.

Step 2 Complete two BCG Matrices for your college or university. Include the School of Business, the School of Education, and the School of Nursing—or any other three Schools.

Step 3 Compare your BCG Matrix to other students' Matrices. Discuss any major differences.

EXERCISE 8K
Developing a QSPM for a Company that You Are Familiar With

Purpose

This exercise can give you practice developing a Quantitative Strategic Planning Matrix (QSPM) to determine the relative attractiveness of various strategic alternatives.

Instructions

Step 1 Join with two other students in class to develop a joint QSPM for a company that all of you are familiar with.

Step 2 Record your strategies and their Sum Total Attractiveness Scores. Compare your team's strategies and sum total attractiveness scores to those of other teams. Be sure not to assign the same AS score in a given row. Recall that dashes should be inserted all the way across a given row when used. Discuss any major differences.

EXERCISE 8L

Formulating Individual Strategies

Purpose

Individuals and organizations are alike in many ways. Each has competitors, and each should plan for the future. Every individual and organization faces some external opportunities and threats and has some internal strengths and weaknesses. Both individuals and organizations establish objectives and allocate resources. These and other similarities make it possible for individuals to use many strategic-management concepts and tools. This exercise is designed to demonstrate how the SWOT Matrix can be used by individuals to plan their futures. As one nears completion of a college degree and begins interviewing for jobs, planning can be particularly important.

Instructions

On a separate sheet of paper, construct a SWOT Matrix. Include what you consider to be your major external opportunities, your major external threats, your major strengths, and your major weaknesses. An internal weakness may be a low grade point average. An external opportunity may be that your university offers a graduate program that interests you. Match key external and internal factors by recording in the appropriate cell of the matrix alternative strategies or actions that would allow you to capitalize upon your strengths, overcome your weaknesses, take advantage of your external opportunities, and minimize the impact of external threats. Be sure to use the appropriate matching notation in the strategy cells of the matrix. Because every individual (and organization) is unique, there is no one right answer to this exercise.

EXERCISE 8M

The Mach Test

Purpose

The purpose of this exercise is to enhance your understanding and awareness of the impact that behavioural and political factors can have on strategy analysis and choice.

Instructions

Step 1 On a separate sheet of paper, write down numbers 1 to 10. For each of the 10 statements given as follows, record a *1, 2, 3, 4,* or *5* to indicate your attitude, where

1 = I disagree a lot.
2 = I disagree a little.
3 = My attitude is neutral.
4 = I agree a little.
5 = I agree a lot.

1. The best way to handle people is to tell them what they want to hear.
2. When you ask someone to do something for you, it is best to give the real reason for wanting it, rather than a reason that might carry more weight.
3. Anyone who completely trusts anyone else is asking for trouble.
4. It is hard to get ahead without cutting corners here and there.
5. It is safest to assume that all people have a vicious streak, and it will come out when they are given a chance.
6. One should take action only when it is morally right.
7. Most people are basically good and kind.
8. There is no excuse for lying to someone else.
9. Most people forget more easily the death of their father than the loss of their property.
10. Generally speaking, people won't work hard unless they're forced to do so.

Step 2 Add up the numbers you recorded beside statements 1, 3, 4, 5, 9, and 10. This sum is Subtotal One. For the other four statements, reverse the numbers you recorded, so a 5 becomes a *1*, *4* becomes *2*, *2* becomes *4*, *1* becomes *5*, and *3* remains *3*. Then add those four numbers to get Subtotal Two. Finally, add Subtotal One and Subtotal Two to get your Final Score.

Your Final Score

Your Final Score is your Machiavellian Score. Machiavellian principles are defined in a dictionary as "manipulative, dishonest, deceiving, and favoring political expediency over morality." These tactics are not desirable, are not ethical, and are not recommended in the strategic management process! You may, however, encounter some highly Machiavellian individuals in your career, so beware. It is important for strategists not to manipulate others in the pursuit of organizational objectives. Individuals today recognize and resent manipulative tactics more than ever before. The National Opinion Research Center used this short quiz in a random sample of U.S. adults and found the national average Final Score to be 25.[1] The higher your score, the more Machiavellian (manipulative) you tend to be. The following scale is descriptive of individual scores on this test:

- Below 16: Never uses manipulation as a tool.
- 16 to 20: Rarely uses manipulation as a tool.
- 21 to 25: Sometimes uses manipulation as a tool.
- 26 to 30: Often uses manipulation as a tool.
- Over 30: Always uses manipulation as a tool.

Test Development

The Mach (Machiavellian) test was developed by Dr. Richard Christie, whose research suggests the following tendencies:

1. Men generally are more Machiavellian than women.
2. There is no significant difference between high Machs and low Machs on measures of intelligence or ability.
3. Although high Machs are detached from others, they are detached in a pathological sense.
4. Machiavellian scores are not statistically related to authoritarian values.
5. High Machs tend to be in professions that emphasize the control and manipulation of individuals—for example law, psychiatry, and behavioral science.
6. Machiavellianism is not significantly related to major demographic characteristics such as educational level or marital status.
7. High Machs tend to come from a city or have urban backgrounds.
8. Older adults tend to have lower Mach scores than younger adults.[2]

Notes

1. Richard Christie and Florence Geis, *Studies in Machiavellianism* (Orlando, FL: Academic Press, 1970). Material in this exercise adapted with permission of the authors and Academic Press.
2. Ibid. 82–83.

Notes

1. R. T. Lenz, "Managing the Evolution of the Strategic Planning Process," *Business Horizons* 30, no. 1 (January–February 1987): 37.

2. Robert Grant, "The Resource-Based Theory of Competitive Advantage: Implications for Strategy Formulation," *California Management Review*, Spring 1991, 114.

3. Heinz Weihrich, "The TOWS Matrix: A Tool for Situational Analysis," *Long Range Planning* 15, no. 2 (April 1982): 61. *Note:* Although Dr. Weihrich first modified SWOT analysis to form the TOWS matrix, the acronym SWOT is much more widely used than TOWS in practice.

4. Greg Dess, G. T. Lumpkin, and Alan Eisner, *Strategic Management: Text and Cases* (New York: McGraw-Hill/Irwin, 2006), 72.

5. Adapted from H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy:*

A Methodological Approach (Reading, MA: Addison-Wesley, 1982), 155–156.

6. Fred David, "The Strategic Planning Matrix—A Quantitative Approach," *Long Range Planning* 19, no. 5 (October 1986): 102; Andre Gib and Robert Margulies, "Making Competitive Intelligence Relevant to the User," *Planning Review* 19, no. 3 (May–June 1991): 21.

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8. Y. Allarie and M. Firsirotu, "How to Implement Radical Strategies in Large Organizations," *Sloan Management Review* 26, no. 3 (Spring 1985): 19. Another excellent article is P. Shrivastava, "Integrating Strategy Formulation with Organizational Culture," *Journal of Business Strategy* 5, no. 3 (Winter 1985): 103–111.

9. James Brian Quinn, *Strategies for Changes: Logical Incrementalism* (Homewood, IL: Richard D. Irwin, 1980), 128–145. These political tactics are listed in A. Thompson and A. Strickland, *Strategic Management: Concepts and Cases* (Plano, TX: Business Publications, 1984), 261.

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11. Joann Lublin, "Corporate Directors' Group Gives Repair Plan to Boards," *Wall Street Journal*, March 24, 2009, B4.

12. http://www.usatoday.com/money/companies/management/story/2012-05-14/ceo-firings/54964476/1.

13. Phred Dvorak, "Poor Year Doesn't Stop CEO Bonuses," *Wall Street Journal*, March 18, 2009, B1.

14. Louis Lavelle, "The Best and Worst Boards," *BusinessWeek*, October 7, 2002, 104–110.

15. Matt Murray, "Private Companies Also Feel Pressure to Clean Up Acts," *Wall Street Journal*, July 22, 2003, B1.

9

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Strategy Implementation

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Develop effective perceptual maps to position rival firms.
2. Develop effective perceptual maps to identify market segments and demand voids.
3. Determine the cash worth of any business.
4. Explain market segmentation and product positioning as strategy-implementation tools.
5. Discuss procedures for determining the worth of a business.
6. Develop projected financial statements to reveal the impact of strategy recommendations.
7. Perform EPS-EBIT analysis to evaluate the attractiveness of debt versus stock as a source of capital to implement strategies.
8. Discuss the nature and role of research and development in strategy implementation.
9. Explain how management information systems can determine the success of strategy-implementation efforts.
10. Explain business analytics and data mining.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 9A Preparing an EPS/EBIT Analysis for Royal Dutch Shell plc

EXERCISE 9B Developing a Product-Positioning Map for adidas AG

EXERCISE 9C Performing an EPS/EBIT Analysis for adidas AG

EXERCISE 9D Preparing Projected Financial Statements for adidas AG

EXERCISE 9E Determining the Cash Value of adidas AG

EXERCISE 9F Developing a Product-Positioning Map for My College

EXERCISE 9G Do Banks Require Projected Financial Statements?

Strategies have no chance of being implemented successfully in organizations that do not market goods and services well, in firms that cannot raise needed working capital, in firms that produce technologically inferior products, or in firms that have a weak information system. This chapter examines marketing, finance and accounting, research and development (R&D), and management information systems (MIS) issues that are central to effective strategy implementation. Special topics include market segmentation, market positioning, evaluating the worth of a business, determining to what extent debt or stock should be used as a source of capital, developing projected financial statements, contracting R&D outside the firm, and creating an information support system. Manager and employee involvement and participation are essential for success in marketing, finance and accounting, R&D, and MIS activities.

The Nature of Strategy Implementation

The quarterback can call the best play possible in the huddle, but that does not mean the play will go for a touchdown. The team may even lose yardage unless the play is executed (implemented) well. Less than 10 percent of strategies formulated are successfully implemented! There are many reasons for this low success rate, including failing to appropriately segment markets, paying too much for a new acquisition, and falling behind competitors in R&D. Royal Dutch Shell implements strategies especially well.

Strategy implementation directly affects the lives of plant managers, division managers, department managers, sales managers, product managers, project managers, personnel managers, staff managers, supervisors, and all employees. In some situations, individuals may not have participated in the strategy-formulation process at all and may not appreciate, understand, or even accept the work and thought that went into strategy formulation. There may even be foot dragging or resistance on their part. Managers and employees who do not understand the business and are not committed to the business may attempt to sabotage strategy-implementation efforts in hopes that the organization will return to its old ways. The strategy-implementation stage of the strategic-management process is highlighted in Figure 9-1 as illustrated with white shading.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Royal Dutch Shell

Royal Dutch Shell plc is the largest oil and gas company in the world and the largest firm globally. *Fortune*, in 2013, also ranked Shell as the 7th most profitable firm in the world. Incorporated in the United Kingdom but headquartered in the Netherlands, Shell has worldwide reserves of the equivalent of 14.2 billion barrels of oil. Most of Shell's crude oil is produced in Nigeria, Oman, and the UK, but Shell is also investing heavily in the Athabasca Oil Sands Project, which converts oil sands in Alberta to synthetic oil. Shell operates 44,000 gas stations, the world's largest retail fuel network, in more than 90 countries. Vertically integrated, Shell explores, produces, refines, transports, and sells oil related products and chemicals.

Shell's CEO, Peter Voser, is to retire at the end of March 2014, marking the end of 29 years with the Company. He is being replaced with Ben van Beurden, age 55, who has been Shell's Downstream Director since January 2013. Ben's promotion came after a comprehensive assessment and review of internal and external candidates led by the Board Nomination and Succession Committee. Ben joined Shell in 1983 and has held a number of positions in both the Upstream and Downstream businesses, working in the Netherlands, Africa, Malaysia, USA and, most recently, the UK. A Dutch national, Ben graduated with a Master's Degree in Chemical Engineering from Delft University of Technology, the Netherlands.

Royal Dutch Shell plc in September 2013 purchased as Treasury Stock 921,881 "B" Shares of its own stock at a price of 2159.15 pence per share. Following the purchase, the remaining number of "A" Shares of Royal Dutch Shell plc was 3,821,611,712 and the remaining number of "B" Shares of Shell plc was 2,509,794,307.

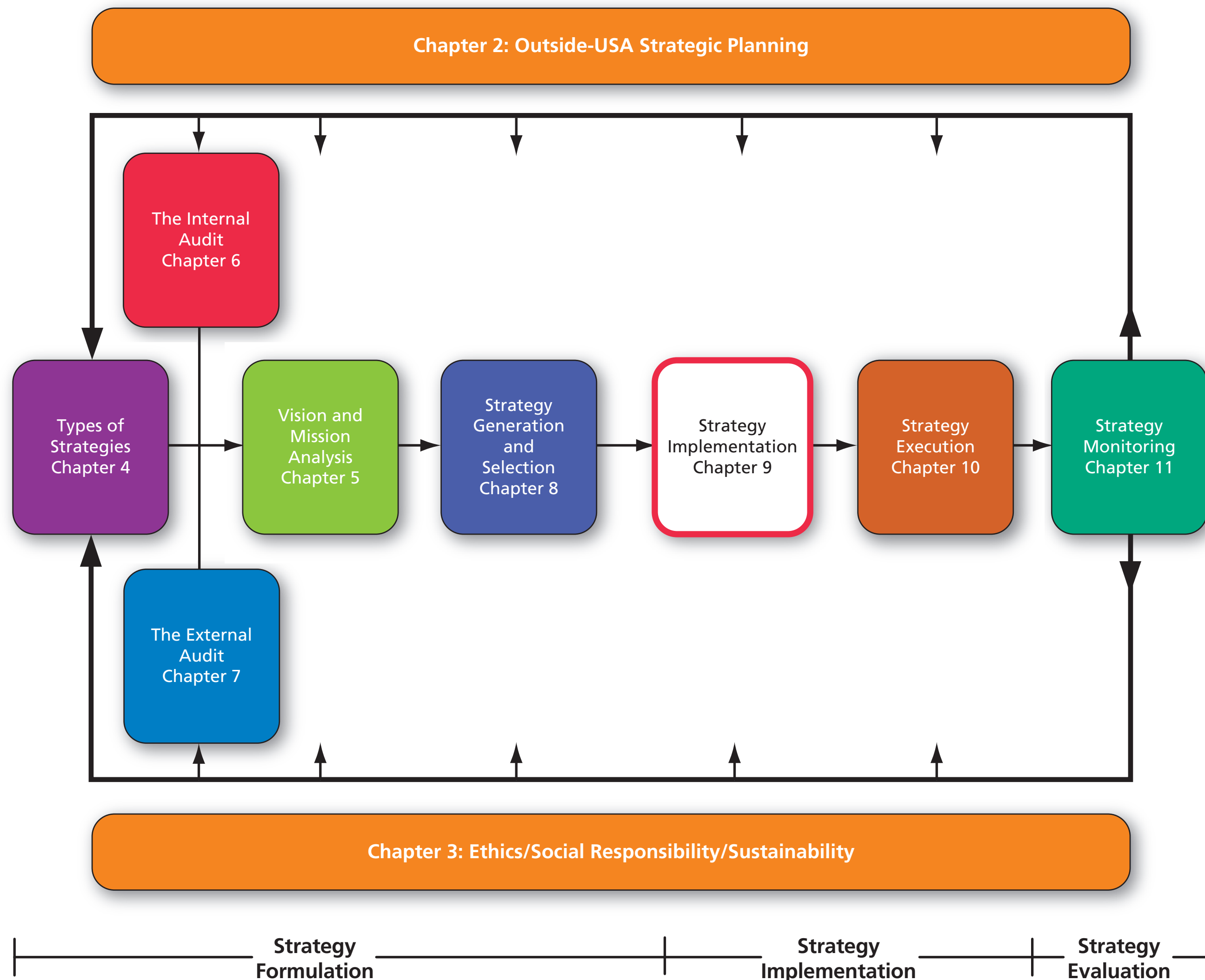


FIGURE 9-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

Current Marketing Issues

Countless marketing variables affect the success or failure of strategy implementation efforts. Some example marketing decisions that may require policies are as follows:

1. How to make advertisements more interactive to be more effective
2. How to best take advantage of Facebook and Twitter conservations about the company and industry
3. To use exclusive dealerships or multiple channels of distribution
4. To use heavy, light, or no TV advertising versus online advertising
5. To limit (or not) the share of business done with a single customer
6. To be a price leader or a price follower
7. To offer a complete or limited warranty
8. To reward salespeople based on straight salary, straight commission, or a combination salary and commission

Marketing is more about building a two-way relationship with consumers than just informing consumers about a product or service. Marketers today must get their customers involved in their company website and solicit suggestions from customers in terms of product development,

customer service, and ideas. The online community is much quicker, cheaper, and effective than traditional focus groups and surveys.

Companies and organizations should encourage their employees to create **wikis**—websites that allow users to add, delete, and edit content regarding frequently asked questions and information across the firm's whole value chain of activities. The most common wiki is Wikipedia, but wikis are user-generated content. Anyone can change the content in a wiki but the group and other editors can change the content submitted.

Firms should provide incentives to customers to share their thoughts, opinions, and experiences on the company website. Encourage customers to network among themselves on topics of their choosing on the company website. So the company website must not be all about the company—it must be all about the customer too. Perhaps offer points or discounts for customers who provide ideas and suggestions. This practice will not only encourage participation but will allow both the company and other customers to interact with "experts."

New Principles of Marketing

A business or organization's website must provide clear and simple instructions for customers to set up a blog or contribute to a wiki. Customers trust each others' opinions more than a company's marketing pitch, and the more they talk freely, the more the firm can learn how to improve its product, service, and marketing. Marketers today monitor blogs daily to determine, evaluate, and influence opinions being formed by customers. Customers must not feel like they are a captive audience for advertising at a firm's website. Table 9-1 provides new principles of marketing according to Parise, Guinan, and Weinberg.[1]

Wells Fargo and Bank of America **tweet** customers, meaning they post messages of 140 characters or less on Twitter.com to describe features of bank products. Some banks are placing marketing videos on YouTube. UMB Financial of Kansas City, Missouri, tweets about everything from the bank's financial stability to the industry's prospects. Steve Furman, Discover's director of e-commerce, says the appeal of social networking is that it provides "pure, instant" communication with customers.[2]

PepsiCo recently established a "Mission Control" staffed with social marketing employees promoting the company's long-time product Gatorade, which had been on a three-year sales slide. PepsiCo staffs Mission Control 24/7 to tweet encouragement to high-school athletes and respond to Facebook questions.[3] Whenever anybody uses Twitter or Facebook to comment on Gatorade, that message pops up on a screen in Mission Control and a PepsiCo employee joins that person's social circle. PepsiCo is a leading company that tracks social media, tracks online-ad traffic, heads off potential crises, builds support for products, and monitors consumer behavior in depth. Gatorade is under intense pressure from Coca-Cola's Powerade, whose sales are increasing in contrast to Gatorade's sales decreasing.

Although the exponential increase in social networking and business online has created huge opportunities for marketers, it also has produced some severe threats. Perhaps the greatest threat is that any kind of negative publicity travels fast online. For example, Taco Bell suffered from its ads that featured asking 50 Cent (aka Curtis Jackson) if he would change his name to 79 Cent or 89 Cent for a day in exchange for a $10,000 donation to charity. Seemingly minor ethical and

TABLE 9-1 The New Principles of Marketing

1. Do not just talk at consumers—work with them throughout the marketing process.
2. Give consumers a reason to participate.
3. Listen to—and join—the conversation outside your company's website.
4. Resist the temptation to sell, sell, sell. Instead attract, attract, attract.
5. Do not control online conversations; let it flow freely.
6. Find a "marketing technologist," a person who has three excellent skill sets (marketing, technology, and social interaction).
7. Embrace instant messaging and chatting.

Source: Based on Salvatore Parise, Patricia Guinan, and Bruce Weinberg, "The Secrets of Marketing in a Web 2.0 World," *Wall Street Journal*, December 15, 2008, R1.

questionable actions can catapult these days into huge public relations problems for companies as a result of the monumental online social and business communications.

In increasing numbers, people living in underdeveloped and poor nations around the world have smartphones but no computers. This is opening up even larger markets to online marketing. People in remote parts of Indonesia, Egypt, and Africa represent the fastest-growing customer base for Opera Software ASA, a Norwegian maker of Internet browsers for mobile devices. Cell phones are widely used now for data transfer, not just for phone calls.[4]

People ages 18 to 27 spend more time weekly on the Internet than watching television, listening to the radio, or watching DVDs or VHS tapes. Companies are rapidly coming to the realization that social networking sites and video sites are better means of reaching their customers than spending so many marketing dollars on traditional yellow pages or television, magazine, radio, or newspaper ads.

New companies such as Autonet Mobile based in San Francisco are selling new technology equipment for cars so that everyone in the vehicle can be online except, of course, the driver. This technology is accelerating the movement from hard media to web-based media. With this technology, when the vehicle drives into a new location, information on shows, museums, hotels, and other attractions in the location can be instantly downloaded.

Internet advertising is growing so rapidly that marketers are more and more allowed to create bigger, more intrusive ads that take up more space on the web page. Websites are allowing lengthier ads to run before short video clips play. And blogs are creating more content that doubles also as an ad. Companies are also waiving minimum ad purchases. Companies are redesigning their websites to be much more interactive and are building new sponsorship programs and other enticements on their sites. Editorial content and advertising content are increasingly being mixed on blogs.

A recent report by BIA/Kelsey reveals that social media ad spending should double in the USA between 2012 and 2016 from $4.8 billion to $9.6+ billion by 2016. BIA/Kelsey says about one-third of that ad spending will be from local advertisers, with their ad spending in the USA growing from $1.2 billion in 2012 to $3.1 billion in 2016.

According to the Interactive Advertising Bureau and Pricewaterhouse Coopers, mobile advertising grew 95 percent in the first half of 2012. The industry as a whole grew to an all-time high of $17 billion in revenues in the first half of 2012, up 14 percent over the prior year. Another marketing sector that grew rapidly in the first half of 2012 was digital video, a component of display advertising. Digital video grew 18 percent in 2012 from the prior year.

Google and Facebook are by far the dominant players in display advertising, together comprising 30 percent of the overall market in 2012. An eMarketer report predicts those two companies alone will sell 37 percent of all display ads by the end of 2014. Google had 15.4 percent of the market in 2012 ($2.31 billion) compared to Facebook's 14.4 percent ($2.16 billion). Yahoo! once dominated the display ad market but is on the decline with 9.3 percent of the market ($1.39 billion).

Market Segmentation

Two variables are of central importance to strategy implementation: **market segmentation** and **product positioning**. Market segmentation and product positioning rank as marketing's most important contributions to strategic management.

Market segmentation is widely used in implementing strategies, especially for small and specialized firms. Market segmentation can be defined as the subdividing of a market into distinct subsets of customers according to needs and buying habits.

EBay recently initiated a new market segmentation strategy to target consumers under 18 years old. "We're definitely looking at ways to legitimately bring younger people in," said Devin Wenig at eBay. "We won't allow a 15-year-old unfettered access to the site. We would want a parent, an adult as a ride-along." The under 18-age group are an increasingly savvy and desirable consumer segment for many businesses.

Market segmentation is an important variable in strategy implementation for at least three major reasons. First, strategies such as market development, product development, market penetration, and diversification require increased sales through new markets and products. To implement these strategies successfully, new or improved market-segmentation approaches are required. Second, market segmentation allows a firm to operate with limited resources because

mass production, mass distribution, and mass advertising are not required. Market segmentation enables a small firm to compete successfully with a large firm by maximizing per-unit profits and per-segment sales. Finally, market segmentation decisions directly affect **marketing mix variables**: product, place, promotion, and price, as indicated in Table 9-2.

Perhaps the most dramatic new market-segmentation strategy is the targeting of regional tastes. Firms from Pizza Hut to Honda Motors are increasingly modifying their products to meet different regional preferences of customers around the world. Campbell's has a spicier version of its nacho cheese soup for the Southwest, and Burger King offers breakfast burritos in New Mexico but not in South Carolina. Geographic and demographic bases for segmenting markets are the most commonly employed, as illustrated in Table 9-3.

Evaluating potential market segments requires strategists to determine the characteristics and needs of consumers, to analyze consumer similarities and differences, and to develop consumer group profiles. Segmenting consumer markets is generally much simpler and easier than segmenting industrial markets, because industrial products, such as electronic circuits and forklifts, have multiple applications and appeal to diverse customer groups.

Segmentation is a key to matching supply and demand, which is one of the thorniest problems in customer service. Segmentation often reveals that large, random fluctuations in demand actually consist of several small, predictable, and manageable patterns. Matching supply and demand allows factories to produce desirable levels without extra shifts, overtime, and subcontracting. Matching supply and demand also minimizes the number and severity of stock-outs. The demand for hotel rooms, for example, can be dependent on foreign tourists, businesspersons, and vacationers. Focusing separately on these three market segments, however, can allow hotel firms to more effectively predict overall supply and demand.

Banks now are segmenting markets to increase effectiveness. "You're dead in the water if you aren't segmenting the market," says Anne Moore, president of a bank consulting firm in Atlanta. The Internet makes market segmentation easier today because consumers naturally form "communities" on the Web.

Retention-Based Segmentation

To aid in more effective and efficient deployment of marketing resources, companies commonly tag each of their active customers with three values:

Tag 1: Is this customer at high risk of canceling the company's service? One of the most common indicators of high-risk customers is a drop off in usage of the company's service. For example, in the credit card industry this could be signaled through a customer's decline in spending on his or her card.

Tag 2: Is this customer worth retaining? This determination boils down to whether the postretention profit generated from the customer is predicted to be greater than the cost incurred to retain the customer. Customers need to be managed as investments.

Tag 3: What retention tactics should be used to retain this customer? For customers who are deemed "save-worthy," it is essential for the company to know which save tactics are most likely

TABLE 9-2 The Marketing Mix Component Variables

Product	Place	Promotion	Price
Quality	Distribution channels	Advertising	Level
Features and options	Distribution coverage	Personal selling	Discounts and allowances
Style	Outlet location	Sales promotion	Payment terms
Brand name	Sales territories	Publicity	
Packaging	Inventory levels and locations		
Product line	Transportation carriers		
Warranty			
Service level			
Other services			

Source: Based on E. Jerome McCarthy, *Basic Marketing: A Managerial Approach,* 9th ed. (Homewood, IL: Richard D. Irwin, Inc., 1987), 37–44. Used with permission.

TABLE 9-3 Alternative Bases for Market Segmentation

Variable	Typical Breakdowns
Geographic	
Region	Pacific, Mountain, West North Central, West South Central, East North Central, East South Central, South Atlantic, Middle Atlantic, New England
County Size	A, B, C, D
City Size	Under 5,000; 5,000–20,000; 20,001–50,000; 50,001–100,000; 100,001–250,000; 250,001–500,000; 500,001–1,000,000; 1,000,001–4,000,000; 4,000,001 or over
Density	Urban, suburban, rural
Climate	Northern, southern
Demographic	
Age	Under 6, 6–11, 12–19, 20–34, 35–49, 50–64, 65+
Gender	Male, female
Family Size	1–2, 3–4, 5+
Family Life Cycle	Young, single; young, married, no children; young, married, youngest child under 6; young, married, youngest child 6 or over; older, married, with children; older, married, no children under 18; older, single; other
Income	Under $10,000; $10,001–$15,000; $15,001–$20,000; $20,001–$30,000; $30,001–$50,000; $50,001–$70,000; $70,001–$100,000; over $100,000
Occupation	Professional and technical; managers, officials, and proprietors; clerical and sales; craftspeople; foremen; operatives; farmers; retirees; students; housewives; unemployed
Education	Grade school or less; some high school; high school graduate; some college; college graduate
Religion	Catholic, Protestant, Jewish, Islamic, other
Race	White, Asian, Hispanic, African American
Nationality	American, British, French, German, Scandinavian, Italian, Latin American, Middle Eastern, Japanese
Psychographic	
Social Class	Lower lowers, upper lowers, lower middles, upper middles, lower uppers, upper uppers
Personality	Compulsive, gregarious, authoritarian, ambitious
Behavioral	
Use Occasion	Regular occasion, special occasion
Benefits Sought	Quality, service, economy
User Status	Nonuser, ex-user, potential user, first-time user, regular user
Usage Rate	Light user, medium user, heavy user
Loyalty Status	None, medium, strong, absolute
Readiness Stage	Unaware, aware, informed, interested, desirous, intending to buy
Attitude Toward Product	Enthusiastic, positive, indifferent, negative, hostile

Source: Adapted from Philip Kotler, *Marketing Management: Analysis, Planning and Control,* © 1984: 256. Adapted by permission of Prentice-Hall, Inc., Upper Saddle River, New Jersey.

to be successful. Tactics commonly used range from providing "special" customer discounts to sending customers communications that reinforce the value proposition of the given service.[5]

The basic approach to tagging customers is to use historical retention data to make predictions about active customers regarding:

- Whether they are at high risk of canceling their service
- Whether they are profitable to retain
- What retention tactics are likely to be most effective

The idea with retention-based segmentation is to match up active customers with customers from historic retention data who share similar attributes. Using the theory that "birds of a feather flock together," the approach is based on the assumption that active customers will have similar retention outcomes as those of their comparable predecessor. This whole process is possible through business analytics or data mining (discussed later in this chapter).

Does the Internet Make Market Segmentation Easier?

Yes. The segments of people whom marketers want to reach online are much more precisely defined than the segments of people reached through traditional forms of media, such as television, radio, and magazines. People all over the world are congregating into virtual communities on the web by becoming members, customers, and visitors of websites that focus on an endless range of topics. People in essence segment themselves by nature of the websites that comprise their "favorite places," and many of these websites sell information regarding their "visitors." Businesses and groups of individuals all over the world pool their purchasing power in websites to get volume discounts.

Through its Connect feature, Facebook recently introduced a type of mobile advertising that targets consumers based on the apps they use from their phone. Connect lets users log into millions of websites and apps with their Facebook identity, so the company then targets ads based on that data. Facebook can also track what people do on their apps. Although Apple and Google also track users' mobile apps, those two firms disclose to users in their privacy policy that they can target ads based on apps the person has downloaded from its App Store and iTunes. Facebook charges advertisers every time an app is installed on a users' smartphone.[6] Privacy advocates contend that Facebook should provide ways for users to opt out of the mobile ad targeting.

Product Positioning/Perceptual Mapping

After markets have been segmented so that the firm can target particular customer groups, the next step is to find out what customers want and expect. This takes analysis and research. A severe mistake is to assume the firm knows what customers want and expect. Countless research studies reveal large differences between how customers define service and rank the importance of different service activities and how producers view services. Many firms have become successful by filling the gap between what customers and producers see as good service. What the customer believes is good service is paramount, not what the producer believes service should be.

Identifying target customers on which to focus marketing efforts sets the stage for deciding how to meet the needs and wants of particular consumer groups. Product positioning is widely used for this purpose. Positioning entails developing schematic representations that reflect how products or services compare to competitors' on dimensions most important to success in the industry. The following steps are required in product positioning (sometimes called perceptual mapping):

1. Select key criteria that effectively differentiate products or services in the industry.
2. Diagram a two-dimensional product-positioning map with specified criteria on each axis.
3. Plot major competitors' products or services in the resultant four-quadrant matrix.
4. Identify areas in the positioning map where the company's products or services could be most competitive in the given target market. Look for vacant areas (niches).
5. Develop a marketing plan to position the company's products or services appropriately.

Because just two criteria can be examined on a single product-positioning (perceptual) map, multiple maps are often developed to assess various approaches to strategy implementation. **Multidimensional scaling** could be used to examine three or more criteria simultaneously, but this technique requires computer assistance and is beyond the scope of this text.

Some rules for using product positioning as a strategy-implementation tool are the following:

1. Look for the hole or **vacant niche**. The best strategic opportunity might be an unserved segment.
2. Do not serve two segments with the same strategy. Usually, a strategy successful with one segment cannot be directly transferred to another segment.
3. Do not position yourself in the middle of the map. The middle usually means a strategy that is not clearly perceived to have any distinguishing characteristics. This rule can vary with the number of competitors. For example, when there are only two competitors, as in U.S. presidential elections, the middle becomes the preferred strategic position.[7]

An effective product-positioning strategy meets two criteria: (1) it uniquely distinguishes a company from the competition, and (2) it leads customers to expect slightly less service than a company can deliver. Network Equipment Technology is an example of a company that keeps customer expectations slightly below perceived performance. This is a constant challenge for marketers. Firms need to inform customers about what to expect and then exceed the promise. Underpromise and then overdeliver is the key!

The product positioning map, or **perceptual map**, in Figure 9-2, shows consumer perceptions of various automobiles on the two dimensions of sportiness and conservative and classy and affordable. This sample of consumers felt Porsche was the sportiest and classiest of the cars in the study (top right corner). They felt Plymouth was most practical and conservative (bottom left corner). Car manufacturers could focus their marketing efforts on various target groups, or even redesign features in their vehicles, based on research and survey information illustrated in perceptual maps. Perceptual maps can aid marketers in being more effective in spending money to promote products. Products, brands, or companies positioned close to one another are perceived as similar on the relevant dimensions. For example, in Figure 9-2, consumers see Buick, Chrysler, and Oldsmobile as similar. They are close competitors and form a competitive grouping. A company considering the introduction of a new or improved model may look for a vacant niche on a perceptual map. Some perceptual maps use different size circles to indicate the sales volume or market share of the various competing products.

Perceptual maps may also display consumers' ideal points. These points reflect ideal combinations of the two dimensions as seen by a consumer. Figure 9-3 reveals the results of a study of consumers' ideal points in the alcohol and spirits product space. Each dot represents one respondent's ideal combination of the two dimensions. Areas where there is a cluster of ideal points (such as A) indicates a **market segment**. Areas without ideal points are sometimes referred to as **demand voids**. A company considering introducing a new product will look for areas with a high density of ideal points. They will also look for areas without competitive rivals (a vacant niche), perhaps best done by placing both the (1) ideal points and (2) competing products on the same map.

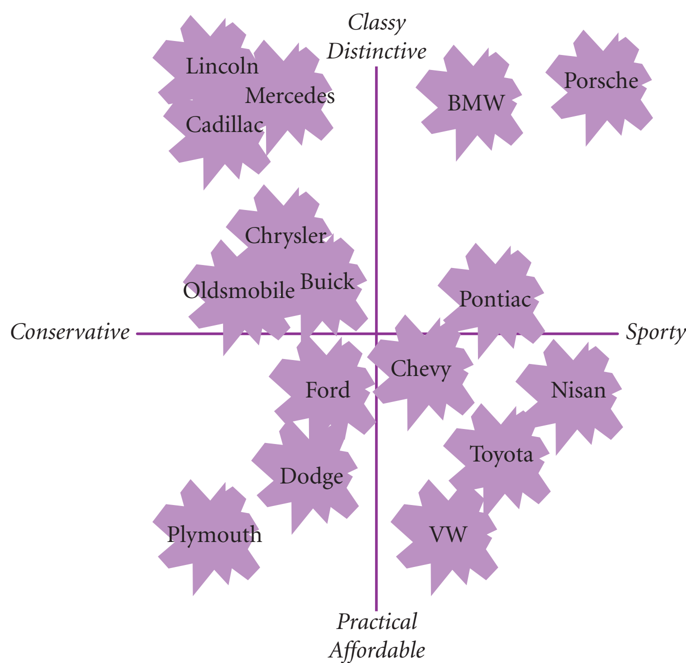


FIGURE 9-2

A Perceptual Map for the Automobile Industry

Source: Based on info at http://en.wikipedia.org/wiki/Perceptual_mapping.

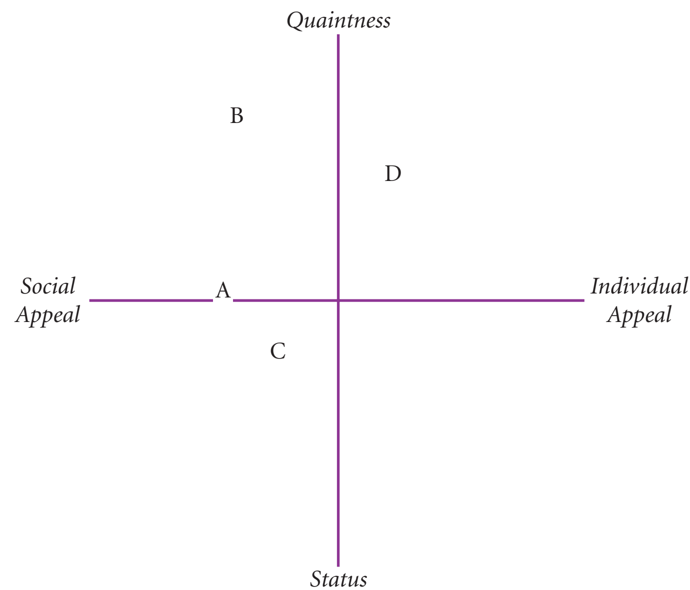


FIGURE 9-3

A Perceptual Map for the Alcohol and Spirits Industry

Source: Based on info at http://en.wikipedia.org/wiki/Perceptual_mapping.

Finance and Accounting Issues

In terms of "Financial Soundness," *Fortune* recently ranked the following companies as best in the world:

Rank	Company
1	Apple
2	McDonald's
3	Exxon Mobil
4	Philip Morris International
5	Intel
6	Google
7	GDF Suez
8	Procter & Gamble
9	Walmart Stores
10	Altria Group

Source: Based on http://money.cnn.com/magazines/fortune/mostadmired/2012/best_worst/best6.html.

Several finance and accounting concepts central to strategy implementation are acquiring needed capital, developing projected financial statements, preparing financial budgets, and evaluating the worth of a business. Some examples of decisions that may require finance and accounting policies are these:

1. To raise capital with short-term debt, long-term debt, preferred stock, or common stock
2. To lease or buy fixed assets
3. To determine an appropriate dividend payout ratio
4. To use last-in, first-out (LIFO), first-in, first-out (FIFO), or a market-value accounting approach
5. To extend the time of accounts receivable
6. To establish a certain percentage discount on accounts within a specified period of time
7. To determine the amount of cash that should be kept on hand

Acquiring Capital to Implement Strategies

When students complete their recommendations page as part of a case analysis, or in actual company practice when a firm decides what strategies to pursue, it is necessary to address the questions: 1) Should the company obtain needed capital via stock or debt? 2) What would the firm's expected/projected EBIT values be given our recommendations?

Successful strategy implementation often requires additional capital. Besides net profit from operations and the sale of assets, two basic sources of capital for an organization are debt and equity. Determining an appropriate mix of debt and equity in a firm's capital structure can be vital to successful strategy implementation. An **earnings per share/earnings before interest and taxes (EPS/EBIT) analysis** is the most widely used technique for determining whether debt, stock, or a combination of debt and stock is the best alternative for raising capital to implement strategies. This technique involves an examination of the impact that debt versus stock financing has on earnings per share under various expectations for EBIT given specific recommendations (strategies to be implemented).

Theoretically, an enterprise should have enough debt in its capital structure to boost its return on investment by applying debt to products and projects earning more than the cost of the debt. In low-earning periods, too much debt in the capital structure of an organization can endanger stockholders' returns and jeopardize company survival. Fixed debt obligations generally must be met, regardless of circumstances. This does not mean that stock issuances are always better than debt for raising capital. When the cost of capital (interest rates) is low, such as in 2012/2013, debt may be better than stock to obtain capital, but the analysis still must be performed because high stock prices usually accompany low interest rates, making stock issuances attractive for obtaining capital. Some special concerns with stock issuances are dilution of ownership, effect on stock price, and the need to share future earnings with all new shareholders. Facebook's initial public offering in early 2012 was for $38 per share, but several months later the stock was selling for $21, so it is no guarantee even with an IPO that a firm's stock price will rise.

Another popular way for a company to raise capital is to issue corporate bonds, which is analogous to going to the bank and borrowing money, except that with bonds the company obtains the funds from investors rather than banks. Through the first seven months of 2012, companies sold almost $584 billion of bonds in the USA, according to Dealogic, up 6.5 percent from the same period in 2011.[8] For example, Bristol-Myers Squibb, a company with single-A investment credit ratings, sold $2 billion of bonds that paid 3.35 percent interest. Many foreign companies also issue bonds in the USA as a way to raise capital. Especially when a company's balance sheet is strong and its credit rating excellent, issuing bonds can be an effective, and certainly an alternative way to raise needed capital.

Before explaining EPS/EBIT analysis, it is important to know that EPS is earnings per share, which is net income divided by number of shares outstanding. Another term for shares outstanding is shares issued. Also know that EBIT is earnings before interest and taxes. Another name for EBIT is operating income. EBT is earnings before tax. EAT is earnings after tax

The purpose of EPS/EBIT analysis is to determine whether all debt, or all stock, or some combination of debt and stock yields the highest EPS values for the firm. EPS is perhaps the best measure of success of a company, so it is widely used in making the capital acquisition decision. EPS reflects the common "maximizing shareholders' wealth" overarching corporate objective. By chance if profit maximization is the company's goal, then in performing an EPS/EBIT analysis, you may focus more on the EAT row more than the EPS row. Large companies may have millions of shares outstanding, so even small differences in EPS across different financing options can equate to large sums of money saved by using that highest EPS value alternative. Any number of combination debt/stock (D/S) scenarios, such as 70/30 D/S or 30/70 D/S, may be examined in an EPS/EBIT analysis.

EPS/EBIT analysis may best be explained by working through an example for the XYZ Company, as provided in Table 9-4. Note that 100 percent stock is the best financing alternative as indicated by the EPS values of 0.0279 and 0.056. An EPS/EBIT chart can be constructed to determine the break-even point, where one financing alternative becomes more attractive than another. Figure 9-4 reveals that issuing common stock is the best financing alternative for the XYZ Company. As noted in Figure 9-4, the top row (EBIT) on the *x*-axis is graphed with the bottom row (EPS) on the *y*-axis, and the highest plotted line reveals the best method. Sometimes the

TABLE 9-4 EPS/EBIT Analysis for the XYZ Company

Input Data	The Number	How Determined
$Amount of Capital Needed	$100 million	Estimated $cost of recommendations
EBIT Range	$20 to $40 million	Estimate based on prior year EBIT and recommendations for the coming year(s)
Interest Rate	5 percent	Estimate based on cost of capital
Tax Rate	30 percent	Use prior year %: taxes divided by income before taxes, as given on income statement
Stock Price	$50	Use most recent stock price
#Shares Outstanding	500 million	For the debt columns, enter the existing #shares outstanding. For stock columns, use the existing #shares outstanding + the #new shares that must be issued to raise the needed capital, i.e., based on stock price. So divide the stock price into the $amount of capital needed.

	100% Debt		100% Stock		50/50 Debt/Stock Combo	
$ EBIT	20,000,000	40,000,000	20,000,000	40,000,000	20,000,000	40,000,000
$ Interest	5,000,000	5,000,000	0	0	2,500,000	2,500,000
$ EBT	15,000,000	35,000,000	20,000,000	40,000,000	17,500,000	37,500,000
$ Taxes	4,500,000	10,500,000	6,000,000	12,000,000	5,250,000	11,250,000
$ EAT	10,500,000	24,500,000	14,000,000	28,000,000	12,250,000	26,250,000
# Shares	500,000,000	500,000,000	502,000,000	502,000,000	501,000,000	501,000,000
$ EPS	0.0210	0.049	0.0279	0.056	0.0245	0.0523

Conclusion—the best financing alternative is 100% stock because the EPS values are largest; the worst financing alternative is 100% debt because the EPS values are lowest.

plotted lines will interact, so a graph is especially helpful in making the capital acquisition decision, rather than solely relying on a table of numbers.

It is important to note some limitations of EPS-EBIT analysis. First, flexibility is a limitation. As an organization's capital structure changes, so does its flexibility for considering future capital needs. Using all debt or all stock to raise capital in the present may impose fixed obligations, restrictive covenants, or other constraints that could severely reduce a firm's ability to raise additional capital in the future. Second, control is a limitation. When additional stock is issued to finance strategy implementation, ownership and control of the enterprise are diluted. This can be a serious concern in today's business environment of hostile takeovers, mergers, and acquisitions. Dilution of ownership could be a problem, and if so, debt could be better than stock regardless of determined EPS values in the analysis. Third, interest rates are a limitation. If rates are expected to rise, as they are doing in 2013/2014, then debt could be better than stock, regardless of the determined EPS values in the analysis. Fourth, if the firm is already too highly leveraged vs. industry average ratios, then stock may be best regardless of determined EPS values in the analysis. A fifth limitation is that the analysis assumes stock price, tax rate, and interest rates to be the same over all economic conditions. A sixth limitation is that the estimated EBIT low and high values are based on the prior year plus the impact of strategies to be implemented. But considering these six potential limitations, unless you have a compelling reason to overturn the highest last row EPS values dictating the EPS-EBIT analysis, then indeed those values should dictate the financing decision, because EPS is arguably the best measure of organizational performance.

IBM declared a third quarter 2012 cash dividend of $0.85 per common share, marking the third consecutive quarterly payout at that rate. IBM also authorized another $5 billion in additional funds to be used for its share repurchase program on top of the $6.7 billion remaining available for buybacks. That was $11.7 billion for its stock repurchase program in total or about 5.3 percent of its outstanding shares. IBM and thousands of other firms lately have significantly increased their share repurchases.

Tables 9-5 and 9-6 provide EPS/EBIT analyses for two companies—Gateway Computers and Boeing. Notice in those analyses that the combination stock/debt options vary from 30/70 to 70/30. Any number of combinations could be explored. However, sometimes in preparing the EPS/EBIT graphs, the lines will intersect, thus revealing break-even points at which one financing alternative becomes more or less attractive than another. The slope of these lines will be determined by a combination of factors including stock price, interest rate, number of shares, and amount of capital needed. Also, it should be noted here that the best financing alternatives are indicated by the highest EPS values. In Tables 9-5 and 9-6, note that the tax rates for the companies vary considerably and should be computed from the respective income statements by dividing taxes paid by income before taxes.

In Table 9-5, the higher EPS values indicate that Gateway should use stock to raise capital in recession or normal economic conditions but should use debt financing under boom conditions. Stock is the best alternative for Gateway under all three conditions if EAT (profit maximization) were the decision criteria, but EPS (maximize shareholders' wealth) is the better ratio to make this decision. Firms can do many things in the short run to maximize profits, so investors and creditors consider maximizing shareholders' wealth to be the better criteria for making financing decisions.

In Table 9-6, note that Boeing should use stock to raise capital in recession (see 0.92) or normal (see 2.29) economic conditions but should use debt financing under boom conditions (see 5.07). Let us calculate here the number of shares figure of 1014.68 given under Boeing's stock alternative. Divide $10,000 M funds needed by the stock price of $53 = 188.68 M new shares to be issued + the 826 M shares outstanding already = 1014.68 M shares under the stock scenario. Along the final row, EPS is the number of shares outstanding divided by EAT in all columns.

TABLE 9-5 EPS/EBIT Analysis for Gateway (M = in millions)

Amount Needed: $1,000 M
EBIT Range: – $500 M to + $100 M to + $500 M
Interest Rate: 5%
Tax Rate: 0% (because the firm has been incurring a loss annually)
Stock Price: $6.00
# of Shares Outstanding: 371 M

	Common Stock Financing			Debt Financing		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	(500.00)	100.00	500.00	(500.00)	100.00	500.00
Interest	0.00	0.00	0.00	50.00	50.00	50.00
EBT	(500.00)	100.00	500.00	(550.00)	50.00	450.00
Taxes	0.00	0.00	0.00	0.00	0.00	0.00
EAT	(500.00)	100.00	500.00	(550.00)	50.00	450.00
#Shares	537.67	537.67	537.67	371.00	371.00	371.00
EPS	**(0.93)**	**0.19**	**0.93**	**(1.48)**	**0.13**	**1.21**
	70 Percent Stock—30 Percent Debt			**70 Percent Debt—30 Percent Stock**		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	(500.00)	100.00	500.00	(500.00)	100.00	500.00
Interest	15.00	15.00	15.00	35.00	35.00	35.00
EBT	(515.00)	85.00	485.00	(535.00)	65.00	465.00
Taxes	0.00	0.00	0.00	0.00	0.00	0.00
EAT	(515.00)	85.00	485.00	(535.00)	65.00	465.00
#Shares	487.67	487.67	487.67	421.00	421.00	421.00
EPS	**(1.06)**	**0.17**	**0.99**	**(1.27)**	**0.15**	**1.10**

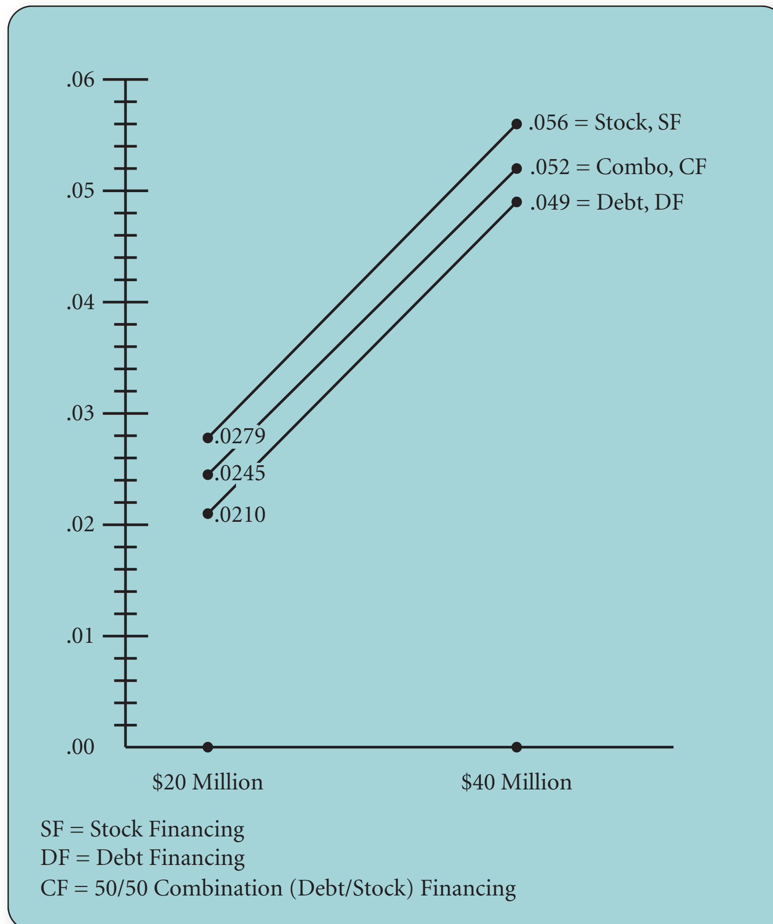


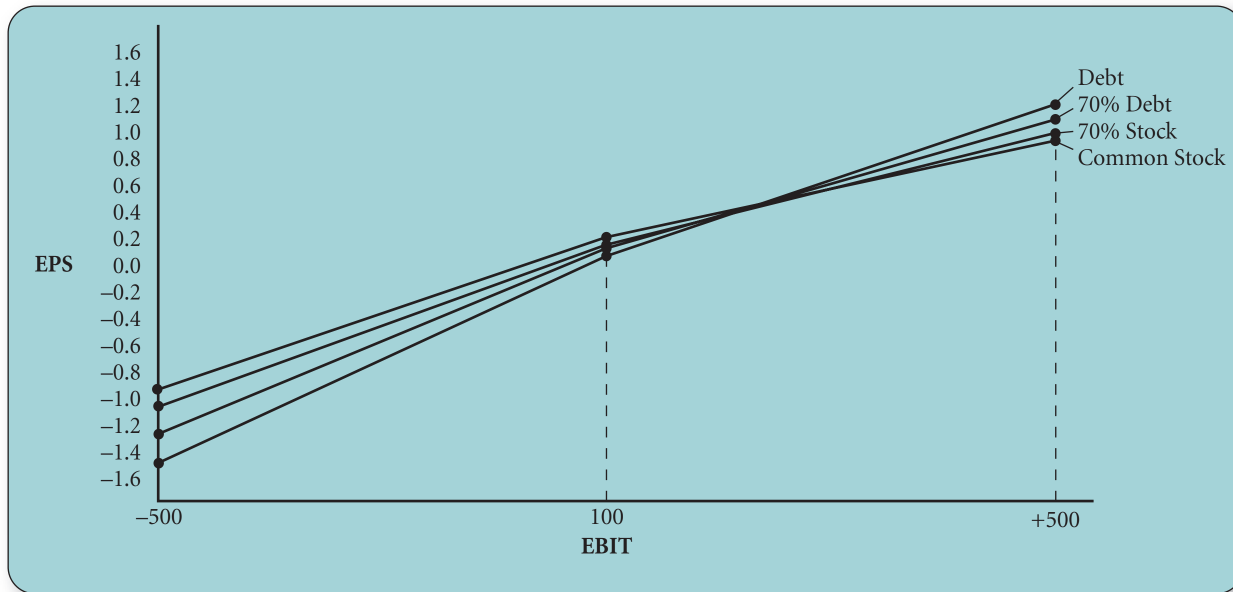
FIGURE 9-4

An EPS/EBIT Chart for the XYZ Company

Lowe's Companies is aggressively buying its own stock, increasing its **Treasury Stock** on its balance sheets. Many analysts say stock buybacks reflect optimism among companies and say it is a good sign. However, other analysts argue that buybacks eat cash that a firm could better use to grow the firm. Intel in late 2012 borrowed $6 billion to buy back more of its own stock. The low interest rate environment has spurred this activity. Even though Intel had the cash on its balance sheet to cover the transaction, the firm, like many large U.S. firms, have most of their cash in overseas accounts (that is, a large percentage of their revenues were derived in foreign countries). Many such firms prefer to leave their cash outside the USA because to use those funds to pay dividends or purchase treasury stock, for example, would trigger a big U.S. corporate income tax payment.

When using EPS/EBIT analysis, timing in relation to movements of stock prices, interest rates, and bond prices becomes important. In times of high stock prices, such as in 2013/2014, stock may prove to be the best alternative from both a cost and a demand standpoint. However, when cost of capital (interest rates) is low, debt is more attractive.

The USA has $9.7 trillion in outstanding debt, equal to 63 percent of gross domestic product (GDP). Based on that percentage, S&P lowered the U.S.'s AAA credit rating. It is interesting, however, that 147 of the S&P 500 companies have total debt that is 63 percent or greater than the company's revenue. For example, GE, Lennar, and Harley-Davidson have debt that is 300, 131, and 116 percent greater than their revenues, respectively. A key difference of course is that companies generate money whereas governments consume money. The U.S. government pays $210 billion in interest annually, about 10 percent of the $2.1 trillion it collects annually in taxes. Only 24 companies in the S&P 500 however incur interest payments that total at least 10 percent of their revenue.



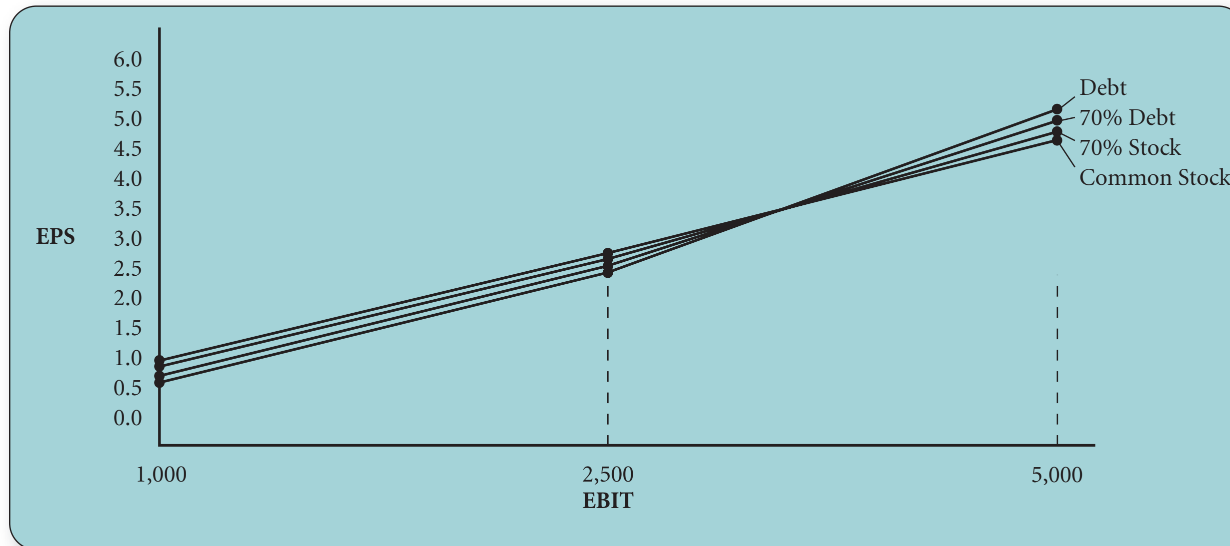
Conclusion: Gateway should use common stock to raise capital in recession or normal economic conditions but should use debt financing under boom conditions. Note that stock is the best alternative under all three conditions according to EAT (profit maximization), but EPS (maximize shareholders' wealth) is the better ratio to make this decision.

TABLE 9-6 EPS/EBIT Analysis for Boeing (M = in millions)

Amount Needed: $10,000 M
Interest Rate: 5%
Tax Rate: 7%
Stock Price: $53.00
# of Shares Outstanding: 826 M

	Common Stock Financing			Debt Financing		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	1,000.00	2,500.00	5,000.00	1,000.00	2,500.00	5,000.00
Interest	0.00	0.00	0.00	500.00	500.00	500.00
EBT	1,000.00	2,500.00	5,000.00	500.00	2,000.00	4,500.00
Taxes	70.00	175.00	350.00	35.00	140.00	315.00
EAT	930.00	2,325.00	4,650.00	465.00	1,860.00	4,185.00
# Shares	1,014.68	1,014.68	1,014.68	826.00	826.00	826.00
EPS	**0.92**	**2.29**	4.58	**0.56**	**2.25**	**5.07**

	70% Stock—30% Debt			70% Debt—30% Stock		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	1,000.00	2,500.00	5,000.00	1,000.00	2,500.00	5,000.00
Interest	150.00	150.00	150.00	350.00	350.00	350.00
EBT	850.00	2,350.00	4,850.00	650.00	2,150.00	4,650.00
Taxes	59.50	164.50	339.50	45.50	150.50	325.50
EAT	790.50	2,185.50	4,510.50	604.50	1,999.50	4,324.50
# Shares	958.08	958.08	958.08	882.60	882.60	882.60
EPS	**0.83**	**2.28**	**4.71**	**0.68**	**2.27**	**4.90**



Conclusion: Boeing should use common stock to raise capital in recession (see 0.92) or normal (see 2.29) economic conditions but should use debt financing under boom conditions (see 5.07). Note that a dividends row is absent from this analysis. The more shares outstanding, the more dividends to be paid (if the firm pays dividends), which would lower the common stock EPS values.

Note in Table 9-5 and Table 9-6 that a dividends row is absent from both the Gateway and Boeing analyses. The more shares outstanding, the more dividends to be paid (if the firm indeed pays dividends). To consider dividends in an EPS/EBIT analysis, simply insert another row for "Dividends" right below the "EAT" row and then insert an "Earnings After Taxes and Dividends" row. Considering dividends would make the analysis more robust.

Note in both the Gateway and Boeing graphs, there is a breakeven point between the normal and boom range of EBIT where the debt option overtakes the 70/30 D/S option as the best financing alternative. A break-even point is where two lines cross each other. A break-even point is the EBIT level where various financing alternative represented by lines crossing are equally attractive in terms of EPS. Both the Gateway and Boeing graphs indicate that EPS values are highest for the 100 percent debt option at high EBIT levels. The two graphs also reveal that the EPS values for 100 percent debt increase faster than the other financing options as EBIT levels increase beyond the break-even point. At low levels of EBIT however, both the Gateway and Boeing graphs indicate that 100 percent stock is the best financing alternative because the EPS values are highest.

Projected Financial Statements

Projected financial statement analysis is a central strategy-implementation technique because it allows an organization to examine the expected results of various actions and approaches. This type of analysis can be used to forecast the impact of various implementation decisions (for example, to increase promotion expenditures by 50 percent to support a market-development strategy, to increase salaries by 25 percent to support a market-penetration strategy, to increase research and development expenditures by 70 percent to support product development, or to sell $1 million of common stock to raise capital for diversification). Nearly all financial institutions require at least three years of projected financial statements whenever a business seeks capital. A projected income statement and balance sheet allow an organization to compute projected financial ratios under various strategy-implementation scenarios. When compared to prior years and to industry averages, financial ratios provide valuable insights into the feasibility of various strategy-implementation approaches.

Primarily as a result of the Sarbanes-Oxley Act, companies today are being much more diligent in preparing projected financial statements to "reasonably rather than too optimistically" project future expenses and earnings. There is much more care not to mislead shareholders and other constituencies.

A 2015 projected income statement and a balance sheet for the Litten Company are provided in Table 9-7. The projected statements for Litten are based on five assumptions: (1) The company

needs to raise $45 million to finance expansion into foreign markets; (2) $30 million of this total will be raised through increased debt and $15 million through common stock; (3) sales are expected to increase 50 percent; (4) three new facilities, costing a total of $30 million, will be constructed in foreign markets; and (5) land for the new facilities is already owned by the company. Note in Table 9-7 that Litten's strategies and their implementation are expected to result in a sales increase from $100 million to $150 million and in a net increase in income from $6 million to $9.75 million in the forecasted year.

TABLE 9-7 A Projected Income Statement and Balance Sheet for the Litten Company (in millions)

	Prior Year 2014	Projected Year 2015	Remarks
PROJECTED INCOME STATEMENT			
Sales	$100	$150.00	50% increase
Cost of Goods Sold	70	105.00	70% of sales
Gross Margin	30	45.00	
Selling Expense	10	15.00	10% of sales
Administrative Expense	5	7.50	5% of sales
Earnings Before Interest and Taxes	15	22.50	
Interest	3	3.00	
Earnings Before Taxes	12	19.50	
Taxes	6	9.75	50% rate
Net Income	**6**	**9.75**	
Dividends	2	5.00	
Retained Earnings	4	4.75	
PROJECTED BALANCE SHEET			
Assets			
Cash	5	7.75	Plug figure
Accounts Receivable	2	4.00	100% increase
Inventory	20	45.00	
Total Current Assets	27	56.75	
Land	15	15.00	
Plant and Equipment	50	80.00	Add three new plants at $10 million each
Less Depreciation	10	20.00	
Net Plant and Equipment	40	60.00	
Total Fixed Assets	55	75.00	
Total Assets	**82**	**131.75**	
Liabilities			
Accounts Payable	10	10.00	
Notes Payable	10	10.00	
Total Current Liabilities	20	20.00	
Long-term Debt	40	70.00	Borrowed $30 million
Additional Paid-in-Capital	20	35.00	Issued 100,000 shares at $150 each
Retained Earnings	2	6.75	$2 + $4.75
Total Liabilities and Net Worth	**82**	**131.75**	

There are six steps in performing projected financial analysis:

1. Prepare the projected income statement before the balance sheet. Start by forecasting sales as accurately as possible. Be careful not to blindly push historical percentages into the future with regard to revenue (sales) increases. Be mindful of what the firm did to achieve those past sales increases, which may not be appropriate for the future unless the firm takes similar or analogous actions (such as opening a similar number of stores, for example). If dealing with a manufacturing firm, also be mindful that if the firm is operating at 100 percent capacity running three eight-hour shifts per day, then probably new manufacturing facilities (land, plant, and equipment) will be needed to increase sales further.
2. Use the percentage-of-sales method to project cost of goods sold (CGS) and the expense items in the income statement. For example, if CGS is 70 percent of sales in the prior year (as it is in Table 9-7), then use that same percentage to calculate CGS in the future year—unless there is a reason to use a different percentage. Items such as interest, dividends, and taxes must be treated independently and cannot be forecasted using the percentage-of-sales method.
3. Calculate the projected net income.
4. Subtract from the net income any dividends to be paid for that year. This remaining net income is retained earnings (RE). Bring this retained earnings amount for that year (NI – DIV = RE) over to the balance sheet by adding it to the prior year's RE shown on the balance sheet. In other words, every year a firm adds its RE for that particular year (from the income statement) to its historical RE total on the balance sheet. Therefore, the RE amount on the balance sheet is a cumulative number rather than money available for strategy implementation! Note that RE is the first projected balance sheet item to be entered. As a result of this accounting procedure in developing projected financial statements, the RE amount on the balance sheet is usually a large number. However, it also can be a low or even negative number if the firm has been incurring losses. The only way for RE to decrease from one year to the next on the balance sheet is (1) if the firm incurred an earnings loss that year or (2) the firm had positive net income for the year but paid out dividends more than the net income. Be mindful that RE is the key link between a projected income statement and balance sheet, so be careful to make this calculation correctly.
5. Project the balance sheet items, beginning with retained earnings and then forecasting stockholders' equity, long-term liabilities, current liabilities, total liabilities, total assets, fixed assets, and current assets (in that order). Use the cash account as the plug figure—that is, use the cash account to make the assets total the liabilities and net worth. Then make appropriate adjustments. For example, if the cash needed to balance the statements is too small (or too large), make appropriate changes to borrow more (or less) money than planned.
6. List comments (remarks) on the projected statements. Any time a significant change is made in an item from a prior year to the projected year, an explanation (remark) should be provided. Remarks are essential because otherwise pro formas are meaningless.

Projected Financial Statement Analysis for Whole Foods Market

Because so many strategic management students have limited experience developing projected financial statements, let us apply the steps outlined on the previous pages to Whole Foods Market.

Whole Foods Market opened 16 stores in fiscal 2010. The projected statements given on the next page(s) are based on the following recommendations:

1. Whole Foods opens 40 new stores in 2011 and 60 new stores in 2012.
2. Whole Foods uses a 50/50 debt/stock combination to finance the 100 new stores.
3. After paying almost no dividends in 2010, Whole Foods starts paying dividends at $1.00 per share in 2011 and 2012.
4. Whole Foods boosts its advertising expenses by $20 million per year.
5. Whole Foods installs a new inventory control system that increases the company's low gross margin from 34.8 percent to 40.0 percent.
6. Whole Foods' per store revenues will increase 10 percent annually in 2011–2013 resulting from the new ad campaign and the improving economy.
7. Total cost of recommendations for two years are $800 million = $200 million per year to be raised through both debt and equity.

Whole Foods' actual consolidated income statements and balance sheets are provided in Table 9-8 and Table 9-9, respectively. The projected statements, based on the aforementioned recommendations, are provided in Table 9-10 and 9-11, respectively. Read carefully the notes (a through f), which reveal the rationale for various changes and exemplify the pro forma process. Note in Table 9-10 that Whole Foods' operating margin with the proposed strategic plan increases from 4.9 percent in 2010 to 16.9 percent in 2012. Note in Table 9-11 that Whole Foods' current ratio would be $3,580.3/$400 = 8.95, which is high. Thus, in 2012 the company could better use that money to perhaps pay down some of its $908 million in long-term debt.

The projected financial statements were prepared using the six steps outlined on prior pages and the above seven strategy statements. Note the cash account is used as the plug figure, and it is too high, so Whole Foods could reduce this number and concurrently reduce a liability or equity account the same amount to keep the statement in balance. Rarely is the cash account perfect on the first pass through, so adjustments are needed and made. However, these adjustments are *not* made on the projected statements given in Tables 9-10 and 9-11, so that the five strategy statements can be more readily seen on respective rows. Note the author's comments on Tables 9-10 and 9-11 that help explain changes in the numbers.

The U.S. Securities and Exchange Commission (SEC) conducts fraud investigations if projected numbers are misleading or if they omit information that's important to investors. Projected statements must conform with generally accepted accounting principles (GAAP) and must not be designed to hide poor expected results. The Sarbanes-Oxley Act requires CEOs and CFOs of corporations to personally sign their firms' financial statements attesting to their accuracy. These executives could thus be held personally liable for misleading or inaccurate statements. The collapse of the Arthur Andersen accounting firm, along with its client Enron, fostered a "zero-tolerance" policy among auditors and shareholders with regard to a firm's financial statements. But plenty of firms still "inflate" their financial projections and call them "pro formas," so investors, shareholders, and other stakeholders must still be wary of different companies' financial projections.[9]

On financial statements, different companies use different terms for various items, such as *revenues* or *sales* used for the same item by different companies. For net income, many firms use the term *earnings*, and many others use the term *profits.*

Financial Budgets

A **financial budget** is a document that details how funds will be obtained and spent for a specified period of time. Annual budgets are most common, although the period of time for a budget can range from one day to more than 10 years. Fundamentally, financial budgeting is a method

TABLE 9-8 Actual Whole Foods Market Income Statements (in millions)

	2010	2009
Revenue (a)	$9,005.8	$8,031.6
Cost of Goods Sold	5,870.4	5,277.3
Gross Profit	3,135.4	2,754.3
Gross Profit Margin	34.8%	34.3%
SG&A Expense	2,697.4	2,470.0
Depreciation & Amortization	275.6	266.7
Operating Income	438.0	284.3
Operating Margin	4.9%	3.5%
Nonoperating Income	6.9	3.4
Nonoperating Expenses	(33.0)	(36.9)
Income Before Taxes	411.8	250.9
Income Taxes (b)	165.9	104.1
Net Income After Taxes	245.8	146.8
Net Income	$245.8	$146.8

(a) Note that the 16 news stores in 2010 resulted in ($9,005.8 – 8,031.6 = 974.2 revenue increase = an average of $974.2 / 16 = $60.89) $60.89 million as the average revenue per new store.
(b) Note Whole Foods' effective tax rate is $165.9 / 411.8 = 40.3%.

TABLE 9-9 Actual Whole Foods Market Balance Sheets (in millions)

	2010	2009
Assets		
Current Assets		
Cash	$132.0	$430.1
Net Receivables	133.3	104.7
Inventories	323.5	310.6
Other Current Assets	572.7	209.9
Total Current Assets	1,161.5	1,055.4
Net Fixed Assets (a)	1,886.1	1,897.9
Other Noncurrent Assets	938.9	830.2
Total Assets	**3,986.5**	**3,783.4**
Liabilities		
Current Liabilities		
Accounts Payable	213.2	189.6
Short-Term Debt	0.4	0.4
Other Current Liabilities	534.3	494.0
Total Current Liabilities	747.9	684.0
Long-Term Debt	508.3	738.8
Other Noncurrent Liabilities	357.0	732.6
Total Liabilities	**1,613.2**	**2,155.5**
Shareholders' Equity		
Common Stock	500	400
Additional-paid-in-capital	1,274.7	869.7
Retained Earnings (b)	598.6	358.2
Total Shareholders' Equity	2,373.3	1,627.9
Total Liabilities and SE	**$3,986.5**	**$3,783.4**
Shares Outstanding (thou.)	172,033	140,542

(a) Since Whole Foods operated 300 stores in 2010, we can estimate cost per store = $1,886 / 300 = $6.3 million and use that cost # for each new store to be built.
(b) Note that Whole Foods reinvested back into the company $240.4 million of its total $245.8 million in net income, so in 2010 the company paid out only $5.4 million in dividends. We know that because $598.6 – $358.2 = $240.4.

for specifying what must be done to complete strategy implementation successfully. Financial budgeting should not be thought of as a tool for limiting expenditures but rather as a method for obtaining the most productive and profitable use of an organization's resources. Financial budgets can be viewed as the planned allocation of a firm's resources based on forecasts of the future.

There are almost as many different types of financial budgets as there are types of organizations. Some common types of budgets include cash budgets, operating budgets, sales budgets, profit budgets, factory budgets, capital budgets, expense budgets, divisional budgets, variable budgets, flexible budgets, and fixed budgets. When an organization is experiencing financial difficulties, budgets are especially important in guiding strategy implementation.

Perhaps the most common type of financial budget is the **cash budget**. The Financial Accounting Standards Board (FASB) has mandated that every publicly held company in the USA must issue an annual cash-flow statement in addition to the usual financial reports. The statement includes all receipts and disbursements of cash in operations, investments, and financing. It supplements the Statement on Changes in Financial Position formerly included in the annual reports of all publicly held companies. A cash budget for the year 2015 for the Toddler Toy Company is provided in Table 9-12. Note that Toddler is not expecting to have surplus cash until November 2015.

TABLE 9-10 Projected Whole Foods Market Income Statements (in millions)

	2010	2011	2012
Revenue (a)	$9,005.8	12,584.0	17,860.0
Cost of Goods Sold	5,870.4	7,550.0	10,716.0
Gross Profit	3,135.4	5,034.0	7,144.0
Gross Profit Margin (b)	34.8%	40%	40%
SG&A Expense (c)	2,697.4	3,782.0	4,109.0
Depreciation & Amortization	275.6	290	310.0
Operating Income	438.0	1,252.0	3,035.0
Operating Margin	4.9%	9.9%	16.9%
Nonoperating Income	6.9	0	0
Nonoperating Expenses	(33.0)	0	0
Income Before Taxes	411.8	1,252.0	3,035.0
Income Taxes (d)	165.9	504.0	1,223.0
Net Income After Taxes	245.8	748.0	1,812.0
Net Income	$245.8	748.0	1,812.0
Dividends	5.4	175.0	180.0
Retained Earnings	$240.4	573.0	1,632.0

(a) $60.89 million per new store + 10% increase for all stores, so in 2011 we have $60.89 × 40 = $2,435 + 9,005 = $11,440 + 10% = $12,584. In 2012 we have $60.89 × 60 = 3,653 + 12,584 = $16,237 + 10% = $17,860.
(b) increases to 40% due to better inventory control; note that 5,034/12,584 = 40% and 7,144/17,860 = 40%.
(c) same 29.9% of revenue + $20 million per year, new ad campaign; note that $12,584 × .299 + $20 = $3,782.
(d) same 40.3% rate as in 2010.

Financial budgets have some limitations. First, budgetary programs can become so detailed that they are cumbersome and overly expensive. Overbudgeting or underbudgeting can cause problems. Second, financial budgets can become a substitute for objectives. A budget is a tool and not an end in itself. Third, budgets can hide inefficiencies if based solely on precedent rather than on periodic evaluation of circumstances and standards. Finally, budgets are sometimes used as instruments of tyranny that result in frustration, resentment, absenteeism, and high turnover. To minimize the effect of this last concern, managers should increase the participation of subordinates in preparing budgets.

Company Valuation

Evaluating the worth of a business is central to strategy implementation because integrative, intensive, and diversification strategies are often implemented by acquiring other firms. Other strategies, such as retrenchment and divestiture, may result in the sale of a division of an organization or of the firm itself. Thousands of transactions occur each year in which businesses are bought or sold in the USA. In all these cases, it is necessary to establish the financial worth or cash value of a business to successfully implement strategies.

All the various methods for determining a business's worth can be grouped into three main approaches: what a firm owns, what a firm earns, or what a firm will bring in the market. But it is important to realize that valuation is not an exact science. The valuation of a firm's worth is based on financial facts, but common sense and intuitive judgment must enter into the process. It is difficult to assign a monetary value to some factors—such as a loyal customer base, a history of growth, legal suits pending, dedicated employees, a favorable lease, a bad credit rating, or good patents—that may not be reflected in a firm's financial statements. Also, different valuation methods will yield different totals for a firm's worth, and no prescribed approach is best for a certain situation. Evaluating the worth of a business truly requires both qualitative and quantitative skills.

TABLE 9-11 Projected Whole Foods Market Balance Sheets (in millions)

	2010	2011	2012
Assets			
Current Assets			
Cash	$132.0	$1,55.3	$3,260.3
Net Receivables	133.3	140.0	160.0
Inventories	323.5	330.0	360.0
Other Current Assets	572.7	0	0
Total Current Assets	1,161.5	2,020.3	3,580.3
Net Fixed Assets (a)	1,886.1	2,138.0	2,516.0
Other Noncurrent Assets	938.9	0	0
Total Assets	**$3,986.5**	**$4,159.3**	**$6,296.3**
Liabilities			
Current Liabilities			
Accounts Payable	213.2	300.0	400.0
Short-Term Debt	0.4	0	0
Other Current Liabilities	534.3	0	0
Total Current Liabilities	747.9	300.0	400.0
Long-Term Debt (b)	508.3	708.0	908.0
Other Noncurrent Liabilities	357.0	0	0
Total Liabilities	1,613.2	1,008.0	1,308.0
Shareholders' Equity			
Common Stock (c)	500.0	505.0	510.0
Additional-paid-in-capital (d)	1,247.7	1,474.7	1,674.7
Retained Earnings (e)	598.6	1,171.6	2,803.6
Total Shareholders' Equity	2,373.3	3151.3	4,988.3
Total Liabilities and SE	**$3,986.5**	**$4,159.3**	**$6,296.3**
Shares Outstanding (in thousands) (f)	172,033	177,033	182,033

(a) $6.3 M per store × 40 stores = 252 + 1,886 = 2,138; 6.3 × 60 = 378 + 2,139 = 2,516
(b) $200 M to be raised by debt annually
(c) add 5 M new shares annually since $40 per share and need $200 M to be raised by equity annually
(d) add $200 M annually thru stock issuance
(e) $ 598.6 + $ 573.0 = $1,171.6 + 1,632.0 = $2,803.6
(f) stock price = $40, $200 M needed per year thru equity, so 5 M new shares to be issued annually; thus 172,033 + 5 M = 177,033

The first approach in evaluating the worth of a business is determining its net worth or stockholders' equity. Net worth represents the sum of common stock, additional paid-in capital, and retained earnings. After calculating net worth, subtract an appropriate amount for goodwill and intangibles. Whereas intangibles include copyrights, patents, and trademarks, goodwill arises only if a firm acquires another firm and pays more than the book value for that firm.

It should be noted that FASB Rule 142 requires companies to admit once a year if the premiums they paid for acquisitions, called **goodwill**, were a waste of money. Goodwill is not a good thing to have on a balance sheet. Note in Table 9-13 that J.M. Smucker's $Goodwill to $Total Assets is a really high 33.5 percent, indicating that a third of the company's assets are "Goodwill," which is not good.

The second approach to measuring the value of a firm grows out of the belief that the worth of any business should be based largely on the future benefits its owners may derive through net profits. A conservative rule of thumb is to establish a business's worth as five times the firm's current annual profit. A five-year average profit level could also be used. When using this approach, remember that firms normally suppress earnings in their financial statements to minimize taxes.

TABLE 9-12 Six-Month Cash Budget for the Toddler Toy Company in 2015

Cash Budget (in thousands)	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
Receipts							
Collections	$12,000	$21,000	$31,000	$35,000	$22,000	$18,000	$11,000
Payments							
Purchases	14,000	21,000	28,000	14,000	14,000	7,000	
Wages and Salaries	1,500	2,000	2,500	1,500	1,500	1,000	
Rent	500	500	500	500	500	500	
Other Expenses	200	300	400	200	—	100	
Taxes	—	8,000	—	—	—	—	
Payment on Machine	—	—	10,000	—	—	—	
Total Payments	$16,200	$31,800	$41,400	$16,200	$16,000	$8,600	
Net Cash Gain (Loss) During Month	–4,200	–10,800	–10,400	18,800	6,000	9,400	
Cash at Start of Month if No Borrowing Is Done	6,000	1,800	–9,000	–19,400	-600	5,400	
Cumulative Cash (Cash at start plus gains or minus losses)	1,800	–9,000	–19,400	–600	5,400	14,800	
Less Desired Level of Cash	–5,000	–5,000	–5,000	–5,000	–5,000	–5,000	
Total Loans Outstanding to Maintain $5,000 Cash Balance	$3,200	$14,000	$24,400	$5,600	—	—	
Surplus Cash	—	—	—	—	400	9,800	

TABLE 9-13 Company Worth Analysis for J.M. Smucker, Microsoft Corp., and Zale Corp. (in millions, except stock price and EPS)

Input Data	J.M. Smucker	Microsoft Corp.	Zale Corp.
$ Shareholders' Equity (SE)	5,163	66,363	178
$ Net Income (NI)	460	17,000	–27
$ Stock Price (SP)	80	30	7
$ EPS	4.08	2.00	–.90
# of Shares Outstanding	109	8,330	32
$ Goodwill	3,050	13,542	100
$ Intangibles	3,190	3,170	0
$ Total Assets	9,115	121,271	1,171
Company Worth Analyses			
1. SE – Goodwill – Intangibles	$977	$49,741	$78
2. Net Income x 5	2,300	85,000	0
3. (SP / EPS) x NI	9,019	225,000	0
4. # of Shares Out x Stock Price	8,720	251,400	224
5. Four Method Average	$4,765	$161,285	$151
$ Goodwill / $ Total Assets	33.5%	11.1%	8.5%

The third approach is called the **price-earnings ratio method**. To use this method, divide the market price of the firm's common stock by the annual earnings per share and multiply this number by the firm's average net income for the past five years.

The fourth method can be called the **outstanding shares method**. To use this method, simply multiply the number of shares outstanding by the market price per share. If the purchase price

is more than this amount, the additional dollars are called a **premium**. The outstanding shares method may be called the "**market value**" or "**market capitalization**" or "**book value**" of the firm. The premium is a per-share dollar amount that a person or firm is willing to pay beyond the book value of the firm to control (acquire) the other company. Bristol-Myers Squibb recently offered $31 a share to acquire Amylin Pharmaceuticals and that offer represented a 9.9 percent premium over Amylin's closing stock price the day of the offer. WellPoint, the second-largest insurer in the USA, recently acquired Amerigroup for $92 per share in cash, which was a whopping 43 percent premium to Amerigroup's closing stock price of $64.34. Amerigroup's stock soared 38 percent to $88.79 the day after the offer.

Table 9-13 provides the cash value analyses for three companies—J.M. Smucker, Microsoft Corp., and Zale Corp.—for fiscal year-end 2012. Notice that there is significant variation among the four methods used to determine cash value. For example, the worth of J.M. Smucker ranged from minus $1,077 to $9.019 billion. Obviously, if you were selling your company, you would seek the larger values, whereas if purchasing a company you would seek the lower values. In practice, substantial negotiation takes place in reaching a final compromise (or averaged) amount. Also recognize that if a firm's net income is negative, theoretically the approaches involving that figure would result in a negative number, implying that the firm would pay you to acquire them. Of course, you obtain all of the firm's debt and liabilities in an acquisition, so theoretically this would be possible.

Hewlett-Packard, Boston Scientific, Frontier Communications, and Republic Services (unfortunately for them) carry more goodwill on their balance sheet than their market (or book) value. This is a signal that their goodwill should be "written down," which means "reduced and recorded as an expense on the income statement." Nasdaq OMX Group's $5.1 billion in goodwill exceeds its $3.9 billion market capitalization by a precarious 31 percent. Jack Ciesielski, publisher of Analyst's Accounting Observer, says: "Writing down goodwill is an admission that the company screwed up when it budgeted what an acquired firm is worth." Sometimes it is OK to pay more for a company than its book value if the firm has technology or patents you need or economies of scale you desire or even to reduce competitive pricing pressure, but, like buying a house, paying a "premium" for a company is almost always not a good thing. Acquiring at a "discount" is far better for shareholders.

Because goodwill write-down accounting rules involve projections and judgments, companies have leeway for when to write down goodwill, and by how much. Microsoft for example in 2012 wrote down (reduced) their goodwill $6.2 billion, basically admitting that their previous acquisition of online-advertising firm aQuantive Inc. for $6.3 billion was ill advised—now recording that amount as an expense. Analysts expect Hewlett-Packard to soon write down some (or all) of the $6.6 billion in goodwill among the $10.1 billion total that they recently paid for British software maker Autonomy PLC.[10]

If the purchase price is less than the stock price times number of shares outstanding, rather than more, that difference is called a **discount**. For example, when Clayton Doubilier & Rice LLC recently acquired Emergency Medical Services (EMS) Corp. for $2.9 billion, a 9.4 percent discount below EMS's stock price of $64.00.

Business evaluations are becoming routine in many situations. Businesses have many strategy-implementation reasons for determining their worth in addition to preparing to be sold or to buy other companies. Employee plans, taxes, retirement packages, mergers, acquisitions, expansion plans, banking relationships, death of a principal, divorce, partnership agreements, and IRS audits are other reasons for a periodic valuation. It is just good business to have a reasonable understanding of what a firm is worth. This knowledge protects the interests of all parties involved.

Ryan Brewer, an assistant professor of finance at Indiana University-Purdue University Columbus, recently calculated the monetary value of top college football teams. Brewer examined each program's revenues and expenses and made cash-flow adjustments, risk assessments and growth projections for each school. Brewer's results for 69 college programs are provided in Table 9-14. Note that Texas was the most valuable college football program in 2012, followed by Michigan. Interestingly, all of these programs are "nonprofit." As a point of reference, the NFL's Jacksonville Jaguars sold in late 2011 for about $760 million.

Research and Development (R&D) Issues

In terms of "Innovation," *Fortune* recently ranked the following companies as best in the world. Note that Apple retained its number-1 ranking from the prior year.

Rank	Company
1	Apple
2	Sistema
3	GDF Suez
4	Limited Brands
5	Qualcomm
6*	Enterprise Products Partners
6*	Koc Holding
8	Amazon.com
9	Sealed Air
10	Nike

Source: Based on http://money.cnn.com/magazines/fortune/most-admired/2012/best_worst/best1.html.

Research and development (R&D) personnel can play an integral part in strategy implementation. These individuals are generally charged with developing new products and improving old products in a way that will allow effective strategy implementation. R&D employees and managers perform tasks that include transferring complex technology, adjusting processes to local raw materials, adapting processes to local markets, and altering products to particular tastes and specifications. Strategies such as product development, market penetration, and related diversification require that new products be successfully developed and that old products be significantly improved.

Technological improvements that affect consumer and industrial products and services shorten product life cycles. Companies in virtually every industry are relying on the development of new products and services to fuel profitability and growth.[11] Surveys suggest that the most successful organizations use an R&D strategy that ties external opportunities to internal strengths and is linked with objectives. Well-formulated R&D policies match market opportunities with internal capabilities. R&D policies can enhance strategy implementation efforts to:

1. Emphasize product or process improvements.
2. Stress basic or applied research.
3. Be leaders or followers in R&D.
4. Develop robotics or manual-type processes.
5. Spend a high, average, or low amount of money on R&D.
6. Perform R&D within the firm or to contract R&D to outside firms.
7. Use university researchers or private-sector researchers.

R&D policy among rival firms often varies dramatically. For example, Pfizer spends only about $5 billion annually on R&D even though the firm has about $70 billion in annual revenues, whereas rival Merck spends about $10 billion annually on R&D with annual revenue of about $50 billion. Underlying this difference in strategy between the two pharmaceutical giants is a philosophical disagreement over the merits of heavy investment to discover new drugs versus waiting for others to spend the money and discover and then follow up with similar products. Pfizer and Merck "are going in different directions," said Les Funtleyder, portfolio manager of the Miller Tabak Health Care Transformation mutual fund.

There must be effective interactions between R&D departments and other functional departments in implementing different types of generic business strategies. Conflicts between marketing, finance and accounting, R&D, and information systems departments can be minimized with clear policies and objectives. Table 9-15 gives some examples of R&D activities that could be required for successful implementation of various strategies. Many U.S. utility, energy, and automotive companies are employing their R&D departments to determine how the firm can effectively reduce its gas emissions.

TABLE 9-14 The Monetary Value of Various College Football Programs

Sticker Shock The value, in millions, of major-conference college-football programs, plus Notre Dame and BYU:

Rank	SCHOOL	VALUE	Rank	SCHOOL	VALUE	Rank	SCHOOL	VALUE	Rank	SCHOOL	VALUE
1	Texas	$761.7	19	Oregon	$264.6	37	Virginia	$146.3	55	Mississippi St.	$99.3
2	Michigan	$731.9	20	Washington	$259.9	38	Purdue	$145.1	56	Maryland	$96.0
3	Florida	$599.7	21	Michigan St.	$224.8	39	N.C. State	$143.0	57	California	$92.6
4	Notre Dame	$597.4	22	Texas Tech	$211.0	40	Indiana	$142.7	58	Syracuse	$91.4
5	Ohio St.	$586.6	23	Oklahoma St.	$209.1	41	lowa St.	$140.3	59	Texas Christian	$76.6
6	Auburn	$508.1	24	Kansas St.	$207.1	42	Minnesota	$139.7	60	Louisville	$75.4
7	Georgia	$481.8	25	Colorado	$202.9	43	BYU	$136.1	61	Washington St.	$73.4
8	Alabama	$476.0	26	Kentucky	$202.7	44	Arizona	$126.8	62	Baylor	$71.3
9	LSU	$471.7	27	Clemson	$201.8	45	UCLA	$125.8	63	Rutgers	$64.1
10	Oklahoma	$454.7	28	USC	$197.8	46	Utah	$119.7	64	Duke	$62.0
11	lowa	$384.4	29	Georgia Tech	$188.4	47	Oregon St.	$118.8	65	Pittsburgh	$59.6
12	Tennessee	$364.6	30	Virginia Tech	$171.5	48	Illinois	$117.3	66	Vanderbilt	$57.3
13	Nebraska	$360.1	31	Arizona St.	$164.6	49	Mississippi	$111.7	67	Missouri	$56.4
14	Arkansas	$332.0	32	West Virginia	$159.4	50	Boston College	$110.2	68	Cincinnati	$48.9
15	S.Carolina	$311.9	33	Florida St.	$159.0	51	Kansas	$103.4	69	Temple	$46.9
16	Penn St.	$300.8	34	Miami(Fla.)	$157.7	52	Connecticut	$101.8			
17	Wisconsin	$296.1	35	Northwestern	$148.8	53	South Florida	$101.2			
18	Texas A&M	$278.5	36	Stanford	$148.7	54	North Carolina	$99.8			

Source: Ryan Brewer, Indiana University-Purdue University Columbus.
Note: Excludes Wake Forest; based on information at http://online.wsj.com/article/SB10001424127887324391104578225802183417888.html.

Deciding Whether to Go Public

Hundreds of companies in 2012 held **initial public offerings (IPOs)** to move from being private to being public. These firms took advantage of high stock market prices. For example, some recent IPOs include computer-network-security firm Palo Alto Networks Inc., search engine Kayak Software Corp., guitar maker Fender Musical Instruments, discount retailer Five Below, and pharmaceutical developer Durata Therapeutics, health-food retailer Natural Grocers by vitamin Cottage, software firm E2open, and Chuy's Holdings, a U.S.-based operator of Mexican restaurants. MGM Holdings, parent of the film studio Metro-Goldwyn-Mayer, just hired Goldman Sachs Group to develop a public stock offering for the company. MGM hopes its new "Hobbit" and "Skyfall" movies will help its pending IPO.

Groupon, the firm that offers daily deals on services, went public in November 2011 at $20 per share or $13 billion in market capitalization, but less than a year later Groupon stock was selling for $6.00 per share and the company's market capitalization had dropped to less than $5 billion. Zynga and Facebook's recent IPO's also turned sour quite quickly.

Going public means selling off a percentage of a company to others to raise capital; consequently, it dilutes the owners' control of the firm. Going public is not recommended for companies with less than $10 million in sales because the initial costs can be too high for the firm to generate sufficient cash flow to make going public worthwhile. One dollar in four is the average total cost paid to lawyers, accountants, and underwriters when an initial stock issuance is under $1 million; $1 in $20 will go to cover these costs for issuances over $20 million.

In addition to initial costs involved with a stock offering, there are costs and obligations associated with reporting and management in a publicly held firm. For firms with more than $10 million in sales, going public can provide major advantages. It can allow the firm to raise capital to develop new products, build plants, expand, grow, and market products and services more effectively.

TABLE 9-15 Research and Development Involvement in Selected Strategy-Implementation Situations

Type of Organization	Strategy Being Implemented	R&D Activity
Pharmaceutical company	Product development	Test the effects of a new drug on different subgroups.
Boat manufacturer	Related diversification	Test the performance of various keel designs under various conditions.
Plastic container manufacturer	Market penetration	Develop a biodegradable container.
Electronics company	Market development	Develop a telecommunications system in a foreign country.

Many firms wrestle with the decision to acquire R&D expertise from external firms or to develop R&D expertise internally. The following guidelines can be used to help make this decision:

1. If the rate of technical progress is slow, the rate of market growth is moderate, and there are significant barriers to possible new entrants, then in-house R&D is the preferred solution. The reason is that R&D, if successful, will result in a temporary product or process monopoly that the company can exploit.
2. If technology is changing rapidly and the market is growing slowly, then a major effort in R&D may be risky because it may lead to the development of an ultimately obsolete technology or one for which there is no market.
3. If technology is changing slowly but the market is growing quickly, there generally is not enough time for in-house development. The prescribed approach is to obtain R&D expertise on an exclusive or nonexclusive basis from an outside firm.
4. If both technical progress and market growth are fast, R&D expertise should be obtained through acquisition of a well-established firm in the industry.[12]

There are at least three major R&D approaches for implementing strategies. The first strategy is to be the first firm to market new technological products. This is a glamorous and exciting strategy but also a dangerous one. Even Apple found this to be dangerous as per Samsung. Firms such as 3M and General Electric have been successful with this approach, but many other pioneering firms have fallen, with rival firms seizing the initiative.

A second R&D approach is to be an innovative imitator of successful products, thus minimizing the risks and costs of start-up. This approach entails allowing a pioneer firm to develop the first version of the new product and to demonstrate that a market exists. Then, laggard firms develop a similar product. This strategy requires excellent R&D and marketing personnel.

A third R&D strategy is to be a low-cost producer by mass-producing products similar to but less expensive than products recently introduced. As a new product is accepted by customers, price becomes increasingly important in the buying decision. Also, mass marketing replaces personal selling as the dominant selling strategy. This R&D strategy requires substantial investment in plant and equipment but fewer expenditures in R&D than the two approaches described previously. Dell and Lenovo have utilized this third approach to gain competitive advantage.

R&D activities among U.S. firms need to be more closely aligned to business objectives. There needs to be expanded communication between R&D managers and strategists. Corporations are experimenting with various methods to achieve this improved communication climate, including different roles and reporting arrangements for managers and new methods to reduce the time it takes research ideas to become reality.

Perhaps the most current trend in R&D management has been lifting the veil of secrecy whereby firms, even major competitors, are joining forces to develop new products. Collaboration is on the rise as a result of new competitive pressures, rising research costs, increasing regulatory issues, and accelerated product development schedules. Companies not only are working more closely with each other on R&D, but they are also turning to consortia at universities for their R&D needs. More than 600 research consortia are now in operation in the USA.

Management Information Systems (MIS) Issues

Firms that gather, assimilate, and evaluate external and internal information most effectively are gaining competitive advantages over other firms. Having an effective **management information system (MIS)** may be the most important factor in differentiating successful from unsuccessful firms. The process of strategic management is facilitated immensely in firms that have an effective information system.

Information collection, retrieval, and storage can be used to create competitive advantages in ways such as cross-selling to customers, monitoring suppliers, keeping managers and employees informed, coordinating activities among divisions, and managing funds. Like inventory and human resources, information is now recognized as a valuable organizational asset that can be controlled and managed. Firms that implement strategies using the best information will reap competitive advantages in the twenty-first century.

A good information system can allow a firm to reduce costs. For example, online orders from salespersons to production facilities can shorten materials ordering time and reduce inventory costs. Direct communications between suppliers, manufacturers, marketers, and customers can link together elements of the value chain as though they were one organization. Improved quality and service often result from an improved information system.

Firms must increasingly be concerned about computer hackers and take specific measures to secure and safeguard corporate communications, files, orders, and business conducted over the Internet. Thousands of companies today are plagued by computer hackers who include disgruntled employees, competitors, bored teens, sociopaths, thieves, spies, and hired agents. Computer vulnerability is a giant, expensive headache.

Headquartered in Short Hills, New Jersey, Dun & Bradstreet is an example company that has an excellent information system. Every D&B customer and client in the world has a separate nine-digit number. The database of more than 200 million businesses worldwide contains of information associated with each number. The D-U-N-S # has become so widely used that it is like a business Social Security number. D&B reaps great competitive advantages from its information system.

In many firms, information technology is doing away with the workplace and allowing employees to work at home or anywhere, anytime. The mobile concept of work allows employees to work the traditional 9-to-5 workday across any of the 24 time zones around the globe. Affordable desktop videoconferencing software allows employees to "beam in" whenever needed. Any manager or employee who travels a lot away from the office is a good candidate for working at home rather than in an office provided by the firm. Salespersons or consultants are good examples, but any person whose job largely involves talking to others or handling information could easily operate at home with the proper MIS.[13]

Business Analytics

Business analytics is a MIS technique that involves using software to mine huge volumes of data to help executives make decisions. Sometimes called predictive analytics, machine learning, or data mining, this software enables a researcher to assess and use the aggregate experience of an organization, a priceless strategic asset for a firm. The history of a firm's interaction with its customers, suppliers, distributors, employees, rival firms, and more can all be tapped with **data mining** to generate predictive models. Business analytics is similar to the actuarial methods used by insurance companies to rate customers by the chance of positive or negative outcomes. Every business is basically a risk management endeavor! Therefore, like insurance companies, all businesses can benefit from measuring, tracking, and computing the risk associated with hundreds of strategic and tactical decisions made everyday. Business analytics enables a company to benefit from measuring and managing risk.

As more and more products become commoditized (so similar as to be indistinguishable), competitive advantage more and more hinges on improvements to business processes. Business analytics can provide a firm with proprietary business intelligence regarding, for example, which segment(s) of customers choose your firm versus those who defer, delay, or defect to a competitor and why. Business analytics can reveal where competitors are weak so that marketing and sales activities can be directly targeted to take advantage of resultant opportunities (knowledge).

In addition to understanding consumer behavior better, which yields more effective and efficient marketing, business analytics also is being used to slash expenses by, for example, withholding retention offers from customers who are going to stay with the firm anyway, or managing fraudulent transactions involving invoices, credit care purchases, tax returns insurance claims, mobile phone calls, online ad clicks, and more.

A key distinguishing feature of business analytics is that it is predictive rather than retrospective, in that it enables a firm to learn from experience and to make current and future decisions based on prior information. Deriving robust predictive models from data mining to support hundreds of commonly occurring business decisions is the essence of learning from experience. The mathematical models associated with business analytics can dramatically enhance decision making at all organizational levels and all stages of strategic management. In a sense, art becomes science with business analytics resulting from the mathematical generalization of thousands, millions, or even billions of prior data points to discover patterns of behavior for optimizing the deployment of resources.

IBM's former CEO Samuel Palmisano announced that IBM is moving aggressively into business analytics, trying to overtake Oracle's market share lead.[14] IBM's annual business analytics revenues of about $40 billion are growing about 15 percent every quarter compared to the industry growing about 15 percent annually. IBM's acquisition of SPSS for $1.2 billion, among other recent acquisitions, launched the firm heavily into the business analytics consulting business. Microsoft currently has a software program called PowerPivot that offers data-mining capability in a spreadsheet-like way, but this is not nearly as powerful as business analytics software. IBM recently completed a business analytics project for the New York City Fire Department whereby buildings in the city were assessed for risk.

Special Note to Students

Regardless of your business major, be sure to capitalize on that special knowledge in delivering your strategic management case analysis. Whenever the opportunity arises in your oral or written project, reveal how your firm can gain and sustain competitive advantage using your marketing, finance and accounting, or MIS recommendations. Continuously compare your firm to rivals and draw insights and conclusions so that your recommendations come across as well conceived. Never shy away from the EPS/EBIT or projected financial statement analyses because your audience must be convinced that what you recommend is financially feasible and worth the dollars to be spent. Spend sufficient time on the nuts-and-bolts of those analyses, so fellow students (and your professor) will be assured that you did them correctly and reasonably. Too often, when students rush at the end, it means their financial statements are overly optimistic or incorrectly developed—so avoid that issue. The marketing, finance and accounting, and MIS aspects of your recommended strategies must ultimately work together to gain and sustain competitive advantage for the firm—so point that out frequently. By the way, the free student excel template at www.strategyclub.com can help immensely in performing EPS-EBIT analysis.

Conclusion

Successful strategy implementation depends on cooperation among all functional and divisional managers in an organization. Marketing departments are commonly charged with implementing strategies that require significant increases in sales revenues in new areas and with new or improved products. Finance and accounting managers must devise effective strategy-implementation approaches at low cost and minimum risk to that firm. R&D managers have to transfer complex technologies or develop new technologies to successfully implement strategies. Information systems managers are being called upon more and more to provide leadership and training for all individuals in the firm. The nature and role of marketing, finance and accounting, R&D, and MIS activities, coupled with the management activities described in Chapter 10, largely determine organizational success.

Key Terms and Concepts

book value (p. 318)
business analytics (p. 322)
cash budget (p. 314)
data mining (p. 322)
demand void (p. 303)
discount (p. 318)
EPS/EBIT analysis (p. 305)
financial budget (p. 313)
goodwill (p. 316)
initial public offering (IPO) (p. 319)
management information system (MIS) (p. 322)
market capitalization (p. 318)
market segment (p. 303)
market segmentation (p. 299)
market value (p. 318)
marketing mix variables (p. 300)
multidimensional scaling (p. 302)
outstanding shares method (p. 317)
perceptual mapping (p. 303)
premium (p. 318)
price-earnings ratio method (p. 317)
product positioning (p. 299)
projected financial statement analysis (p. 310)
research and development (R&D) (p. 320)
treasury stock (p. 307)
tweet (p. 298)
vacant niche (p. 302)
wikis (p. 298)

Issues for Review and Discussion

9-1. Royal Dutch Shell plc has been successful for decades. Analyze their year-end 2013 financials. List six points that best summarize Shell's performance in 2013.

9-2. Explain how to develop an advertising strategy.

9-3. Illustrate a product-positioning map for Royal Dutch Shell. Include three rival firms in your matrix.

9-4. Illustrate a product-positioning map for your college or university.

9-5. List and explain the advantages and disadvantages of using debt versus equity, as a means of raising capital.

9-6. In order of importance, list the limitations of the EPS/EBIT analysis.

9-7. Consider the Cohesion Case on adidas AG. Calculate that company's tax rate, which is a common calculation needed in performing EPS/EBIT analysis.

9-8. Review the website of a company that you are familiar with. Discuss the extent to which that organization has instituted the new principles of marketing according to Parise, Guinan, and Weinberg.

9-9. For companies in general, identify and discuss three opportunities and three threats associated with social networking activities on the Internet.

9-10. Do you agree or disagree with the following statement? Explain your reasoning. "Television viewers are passive viewers of ads whereas Internet users take an active role in choosing what to look at—so customers on the Internet are tougher for marketers to reach."

9-11. How important or relevant do you believe purpose-based marketing is for organizations today?

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

9-37. Why is it essential for organizations to segment markets and target particular groups of consumers?

9-38. Explain how you would estimate the total worth of a business.

9-39. Mymanagementlab Only—comprehensive writing assignment for this chapter.

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 9A

Preparing an EPS/EBIT Analysis for Royal Dutch Shell plc

Purpose

Shell is featured in the opening chapter case as a firm that engages in excellent strategic planning. Shell is both the largest oil and gas company in the world and the largest firm globally, according to *Fortune*, who in 2013 also ranked Shell as the 7th most profitable firm in the world. Incorporated in the United Kingdom but headquartered in the Netherlands, Shell has worldwide reserves of 14.2 billion barrels of oil equivalent.

An important part of effective strategic management is wisely using debt versus equity for raising capital. This exercise gives you practice preparing an EPS/EBIT analysis for a company to determine whether debt versus equity or some combination of the two is best for the firm to expand and grow.

Instructions

Step 1 Shell needs to raise $1billion to acquire a rival firm in Southeast Asia.

Step 2 Prepare an EPS/EBIT analysis to determine whether Shell should use stock or debt to raise the needed capital.

Step 3 Prepare a two-page executive summary to provide justification for your financing decision.

9-12. Why is it essential for organizations to segment markets and target particular groups of consumers?

9-13. Explain how, and why the Internet makes market segmentation easier?

9-14. A product-positioning rule given in the chapter is that "when there are only two competitors, the middle becomes the preferred strategic position." Illustrate this for the cruise ship industry where two firms, Carnival and Royal Caribbean, dominate. Illustrate this for the commercial airliner building industry where Boeing and Airbus dominate.

9-15. How would dividends affect an EPS/EBIT analysis? Would it be correct to refer to "earnings after taxes, interest, and dividends" as retained earnings for a given year?

9-16. In performing an EPS/EBIT analysis, where does the first row of (EBIT) numbers come from?

9-17. In performing an EPS/EBIT analysis, where does the tax rate percentage come from?

9-18. What amount of dividends did Royal Dutch Shell pay in 2013? How much of 2013's earnings did Shell reinvest back into the company?

9-19. Show algebraically that the price earnings ratio formula is identical to the number of shares outstanding multiplied by the stock price formula. Why are the values obtained from these two methods sometimes different?

9-20. In accounting terms, distinguish between intangibles and goodwill on a balance sheet. Why do these two items generally stay the same on projected financial statements?

9-21. What are the three major R&D approaches to implementing strategies? Which approach would you prefer as owner of a small software company? Why?

9-22. Explain in your own words the process of developing projected financial statement analysis.

9-23. In developing projected financial statements, why should the preparer not use historical percentages too heavily?

9-24. Explain five methods for determining the cash value of a company.

9-25. Given the seven R&D policies mentioned in the chapter, which four do you feel would be best for Audi to utilize? Why?

9-26. Illustrate an EPS/EBIT chart that reflects negative EPS values.

9-27. Define a vacant niche using an example.

9-28. Define and give an example of wikis and tweets.

9-29. List the marketing mix variables. Give an example of each.

9-30. Show algebraically that the price earnings ratio method of calculating the cash value of a company is identical to the number of shares outstanding multiplied by the stock price method.

9-31. Define, and give an example of, goodwill and intangibles.

9-32. Differentiate between capital surplus and additional paid in capital on a balance sheet.

9-33. What transaction is the link between the projected income statement and the projected balance sheet?

9-34. Explain the benefits of a before-and-after product-positioning map.

9-35. Explain how HP should conduct market segmentation.

9-36. Determine the cash value of HP using the methods described in this chapter.

EXERCISE 9B
Developing a Product-Positioning Map for adidas AG

Purpose

Organizations continually monitor how their products and services are positioned relative to competitors. This information is especially useful for marketing managers, but is also used by other managers and strategists.

Instructions

Step 1 On a separate sheet of paper, develop two product-positioning maps that include Reebok, adidas, Nike, Puma, Converse, and Under Armour. Let one map focus on athletic footwear and one map focus on apparel.

Step 2 At the board, diagram your product-positioning maps.

Step 3 Compare your product-positioning maps with those diagrammed by other students. Discuss any major differences.

EXERCISE 9C
Performing an EPS/EBIT Analysis for adidas AG

Purpose

An EPS/EBIT analysis is one of the most widely used techniques for determining the extent that debt and/or stock should be used to finance strategies to be implemented. This exercise can give you practice performing EPS/EBIT analysis.

Instructions

In order to expand into Africa, adidas needs to raise $1 billion. Determine whether adidas should use all debt, all stock, or a 50–50 combination of debt and stock to finance this market-development strategy. Assume a 20 percent tax rate, 5 percent interest rate, adidas stock price of $30 per share, and an annual dividend of $0.50 per share of common stock. The EBIT range for 2011 is between $1.0 billion and $2 billion. A total of 500 million shares of common stock are outstanding. Develop an EPS/EBIT chart to reflect your analysis.

EXERCISE 9D
Preparing Projected Financial Statements for adidas AG

Purpose

This exercise is designed to give you experience preparing projected financial statements. Pro forma analysis is a central strategy-implementation technique because it allows managers to anticipate and evaluate the expected results of various strategy-implementation approaches.

Instructions

Step 1 Work with a classmate. Develop a 2014 projected income statement and balance sheet for adidas. Assume that adidas plans to raise $900 million in 2014 to begin serving Africa, and plans to obtain 50 percent financing from a bank and 50 percent financing from a stock issuance. Make other assumptions as needed, and state them clearly in written form. Use adidas' website as needed.

Step 2 Compute adidas' current ratio, debt-to-equity ratio, and return on investment for 2012 and 2013. How do your 2014 projected ratios compare to the 2012 and 2013 ratios? Why is it important to make this comparison?

Step 3 Bring your projected statements to class and discuss any problems or questions you encountered.

Step 4 Compare your projected statements to the statements of other students. What major differences exist between your analysis and the work of other students?

EXERCISE 9E

Determining the Cash Value of adidas AG

Purpose

It is simply good business practice to periodically determine the financial worth or cash value of your company. This exercise gives you practice determining the total worth of a company using several methods. Use data as given in the Cohesion Case or the data from the adidas website.

Instructions

Step 1 Calculate the financial worth of adidas based on four methods: 1) the net worth or stockholders' equity, 2) the future value of adidas' earnings, 3) the price-earnings ratio, and 4) the outstanding shares method. In dollars, how much is adidas worth?

Step 2 Compare your analyses and conclusions with those of other students.

EXERCISE 9F

Developing a Product-Positioning Map for My College

Purpose

Organizations continually monitor how their products and services are positioned relative to competitors. This information is especially useful for marketing managers, but is also used by other managers and strategists.

Instructions

Step 1 On a separate sheet of paper, develop a product-positioning map for your college or university.

Step 2 At the board, diagram your product-positioning map. Compare your product-positioning map with those diagrammed by other students. Discuss any major differences.

EXERCISE 9G

Do Banks Require Projected Financial Statements?

Purpose

This exercise will allow you to explore the practical importance and use of projected financial statements among banks in your city.

Instructions

Contact several local banks and ask managers about the nature and role of projected financial statements in determining whether to make commercial loans to businesses. Report back to your class on your findings.

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10

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Strategy Execution

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Construct an effective organizational chart.
2. Explain why corporate wellness has become so important in strategic planning.
3. Explain why strategy implementation is more difficult than strategy formulation.
4. Discuss the importance of annual objectives and policies in achieving organizational commitment for strategies to be implemented.
5. Explain why organizational structure is so important in strategy implementation.
6. Compare and contrast restructuring and reengineering.
7. Describe the relationship between production/operations and strategy implementation.
8. Explain how a firm can effectively link performance and pay to strategies.
9. Discuss employee stock ownership plans (ESOPs) as a strategic-management concept.
10. Describe how to modify an organizational culture to support new strategies.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 10A Developing an Organizational Chart for Accenture plc

EXERCISE 10B Assessing Accenture's Philanthropy Efforts

EXERCISE 10C Revising adidas AG's Organizational Chart

EXERCISE 10D Exploring Objectives

EXERCISE 10E Understanding My University's Culture

The strategic-management process does not end on deciding what strategy or strategies to pursue. There must be a translation of strategic thought into strategic action. This translation is much easier if managers and employees of the firm understand the business, feel a part of the company, and through involvement in strategy-formulation activities have become committed to helping the organization succeed. Without understanding and commitment, strategy-implementation efforts face major problems. Vince Lombardi said: "The best game plan in the world never blocked or tackled anybody."

Implementing strategy affects an organization from top to bottom, including all the functional and divisional areas of a business. This chapter focuses on management issues most central to implementing strategies in 2014–2015 and Chapter 9 focuses on marketing, finance/accounting, R&D, and management information systems issues. Accenture is an example firm with excellent management practices.

> Even the most technically perfect strategic plan will serve little purpose if it is not implemented. Many organizations tend to spend an inordinate amount of time, money, and effort on developing the strategic plan, treating the means and circumstances under which it will be implemented as afterthoughts! Change comes through implementation and evaluation, not through the plan. A technically imperfect plan that is implemented well will achieve more than the perfect plan that never gets off the paper on which it is typed.[1]

The Nature of Strategy Implementation

The strategy-implementation stage of strategic management is revealed in Figure 10-1, as illustrated with white shading. Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation)! Although inextricably linked, strategy

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Accenture

Accenture plc, headquartered in Dublin, Ireland, is the world's largest consulting firm measured by revenues. As of August 2013, the company has approximately 266,000 employees serving clients in more than 120 countries. India is the single largest employee base for Accenture, with the headcount being close to 100,000, compared to about 50,000 in the United States.

In 2013, *Fortune* ranked Accenture as the 44th most admired company in the world outside the United States. As most consulting firms, Accenture operates in a matrix structure. The first axis is dedicated to the operating groups, or industries of its clients. Accenture's has five Operating Groups that comprise 39 industry subgroups.

The five Operating Groups are:

- Communications, Media & Technology
- Financial Services
- Products
- Resources
- Health & Public Service.

In September 2013, Accenture acquired AMS Research headquartered in Fairfax, Virginia. Accenture made the acquisition to strategically expand its U.S. defense business in the growing military health market, especially desiring to better serve the U.S. Department of Defense (DoD). Accenture offers DoD extensive experience in providing electronic health records, healthcare integration, interoperability. AMS has more than three decades of government experience and expertise in healthcare IT, information solutions and services, data analytics, cloud, data warehousing, human capital management and benefit solutions and agile software development.

Also in September 2013, YSPay, one of the leading payment services providers in China, began using a new mobile payments solution developed with Accenture. The new product allows YSPay customers – consumers, banks and merchants – to process payments with any type of mobile phone. YSPay is using the Accenture Mobility platform to connect with banks via China Union Pay – China's bank card association. Accenture is also providing application outsourcing services to YSPay, including the ongoing maintenance of the platform and any future enhancements agreed by both parties, allowing YSPay to keep its internal resources focused on core business activities.

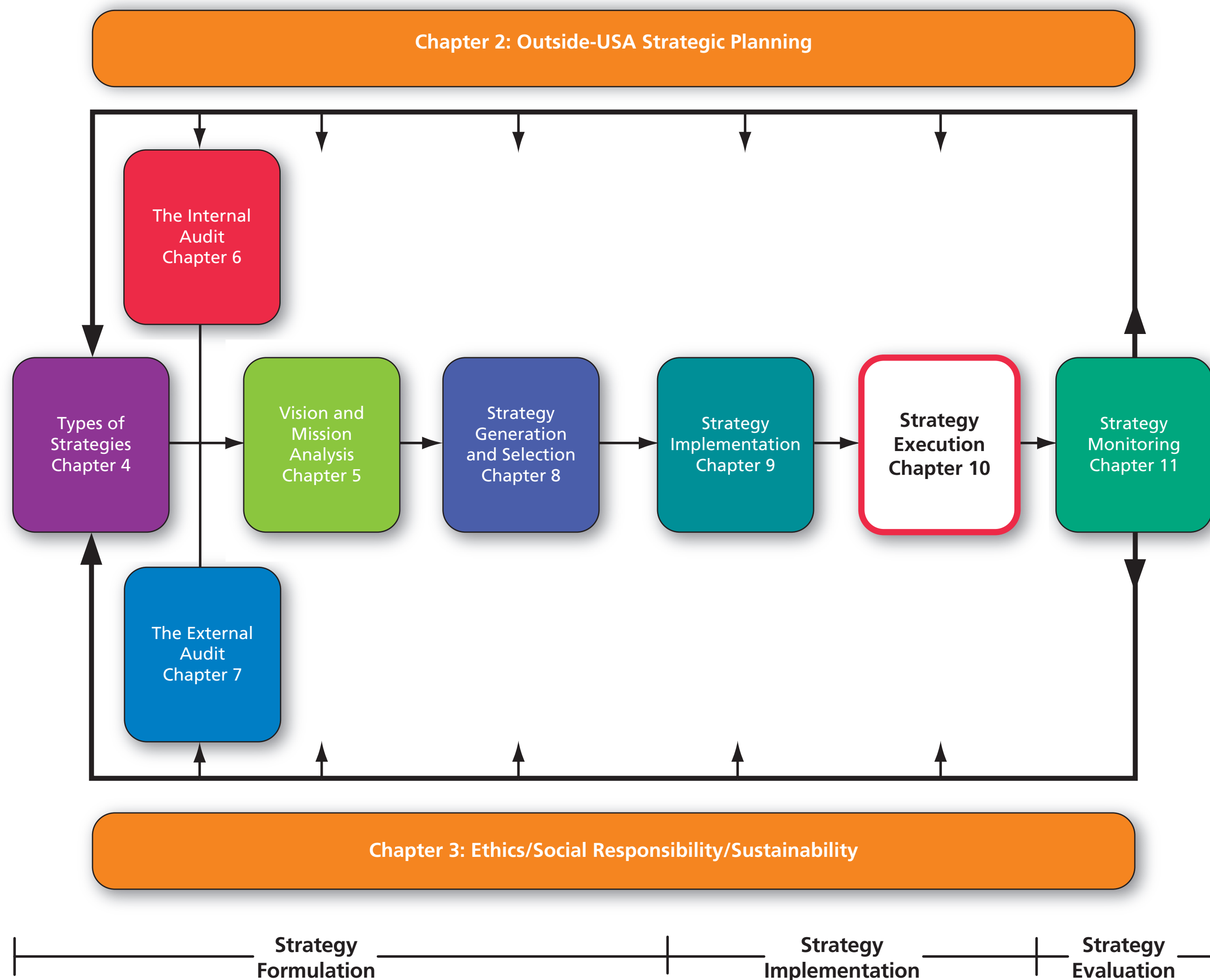


FIGURE 10-1

Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

implementation is fundamentally different from strategy formulation. Strategy formulation and implementation can be contrasted in the following ways:

- Strategy formulation is positioning forces before the action.
- Strategy implementation is managing forces during the action.
- Strategy formulation focuses on effectiveness.
- Strategy implementation focuses on efficiency.
- Strategy formulation is primarily an intellectual process.
- Strategy implementation is primarily an operational process.
- Strategy formulation requires good intuitive and analytical skills.
- Strategy implementation requires special motivation and leadership skills.
- Strategy formulation requires coordination among a few individuals.
- Strategy implementation requires coordination among many individuals.

Strategy-formulation concepts and tools do not differ greatly for small, large, for-profit, or nonprofit organizations. However, strategy implementation varies substantially among different types and sizes of organizations. Implementing strategies requires such actions as altering

sales territories, adding new departments, closing facilities, hiring new employees, changing an organization's pricing strategy, developing financial budgets, developing new employee benefits, establishing cost-control procedures, changing advertising strategies, building new facilities, training new employees, transferring managers among divisions, and building a better management information system. These types of activities obviously differ greatly among manufacturing, service, and governmental organizations.

Management Perspectives

In terms of "Quality of Management," *Fortune* recently ranked the following companies as best in the world:

Rank	Company
1	Koc Holding
2	McDonald's
3	Apple
4	Philip Morris International
5	Costco Wholesale
6	JP Morgan Chase
7	Wyndham Worldwide
8	Sysco
9	Walt Disney
10	TJX

Source: Based on: http://money.cnn.com/magazines/fortune/mostadmired/2012/best_worst/best5.html.

In all but the smallest organizations, the transition from strategy formulation to strategy implementation requires a shift in responsibility from strategists to divisional and functional managers. Implementation problems can arise because of this shift in responsibility, especially if strategy-formulation decisions come as a surprise to middle- and lower-level managers. Managers and employees are motivated more by perceived self-interests than by organizational interests, unless the two coincide. This is a primary reason why divisional and functional managers should be involved as much as possible in strategy-formulation and strategy-implementation activities.

As indicated in Table 10-1, management issues central to strategy implementation include establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans,

TABLE 10-1 Some Management Issues Central to Strategy Implementation

Establish annual objectives
Devise policies
Allocate resources
Alter an existing organizational structure
Restructure and reengineer
Revise reward and incentive plans
Minimize resistance to change
Match managers with strategy
Develop a strategy-supportive culture
Adapt production and operations processes
Develop an effective human resources function
Downsize and furlough as needed
Link performance and pay to strategies

minimizing resistance to change, matching managers with strategy, developing a strategy-supportive culture, adapting production and operations processes, developing an effective human resources function, and, if necessary, downsizing. Management changes are necessarily more extensive when strategies to be implemented move a firm in a major new direction.

Managers and employees throughout an organization should participate early and directly in strategy-implementation decisions. Their role in strategy implementation should build on prior involvement in strategy-formulation activities. Strategists' genuine personal commitment to implementation is a necessary and powerful motivational force for managers and employees. Too often, strategists are too busy to actively support strategy-implementation efforts, and their lack of interest can be detrimental to organizational success. The rationale for objectives and strategies should be understood and clearly communicated throughout an organization. Major competitors' accomplishments, products, plans, actions, and performance should be apparent to all organizational members. Major external opportunities and threats should be clear, and managers' and employees' questions should be answered. Top-down flow of communication is essential for developing bottom-up support.

Firms need to develop a competitor focus at all hierarchical levels by gathering and widely distributing competitive intelligence; every employee should be able to benchmark her or his efforts against best-in-class competitors so that the challenge becomes personal. For example, Starbucks Corp. recently instituted "lean production/operations" at its 11,000+ U.S. stores. This system eliminates idle employee time and unnecessary employee motions, such as walking, reaching, and bending. Starbucks says 30 percent of employees' time is motion and the company wants to reduce that. They say "motion and work are two different things."

Annual Objectives

Establishing annual objectives is a decentralized activity that directly involves all managers in an organization. Active participation in establishing annual objectives can lead to acceptance and commitment. **Annual objectives** are essential for strategy implementation because they (a) represent the basis for allocating resources; (b) are a primary mechanism for evaluating managers; (c) are the major instrument for monitoring progress toward achieving long-term objectives; and (d) establish organizational, divisional, and departmental priorities. Considerable time and effort should be devoted to ensuring that annual objectives are well conceived, consistent with long-term objectives, and supportive of strategies to be implemented. Approving, revising, or rejecting annual objectives is much more than a rubber-stamp activity. The purpose of annual objectives can be summarized as follows:

> Annual objectives serve as guidelines for action, directing and channeling efforts and activities of organization members. They provide a source of legitimacy in an enterprise by justifying activities to stakeholders. They serve as standards of performance. They serve as an important source of employee motivation and identification. They give incentives for managers and employees to perform. They provide a basis for organizational design.[2]

Clearly stated and communicated objectives are critical to success in all types and sizes of firms. Annual objectives, stated in terms of profitability, growth, and market share by business segment, geographic area, customer groups, and product, are common in organizations. Figure 10-2 illustrates how the Stamus Company could establish annual objectives based on long-term objectives. Table 10-2 reveals associated revenue figures that correspond to the objectives outlined in Figure 10-2. Note that, according to plan, the Stamus Company will slightly exceed its long-term objective of doubling company revenues between 2012 and 2014.

Figure 10-2 also reflects how a hierarchy of annual objectives can be established based on an organization's structure. Objectives should be consistent across hierarchical levels and form a network of supportive aims. **Horizontal consistency of objectives** is as important as **vertical consistency of objectives**. For instance, it would not be effective for manufacturing to achieve more than its annual objective of units produced if marketing could not sell the additional units.

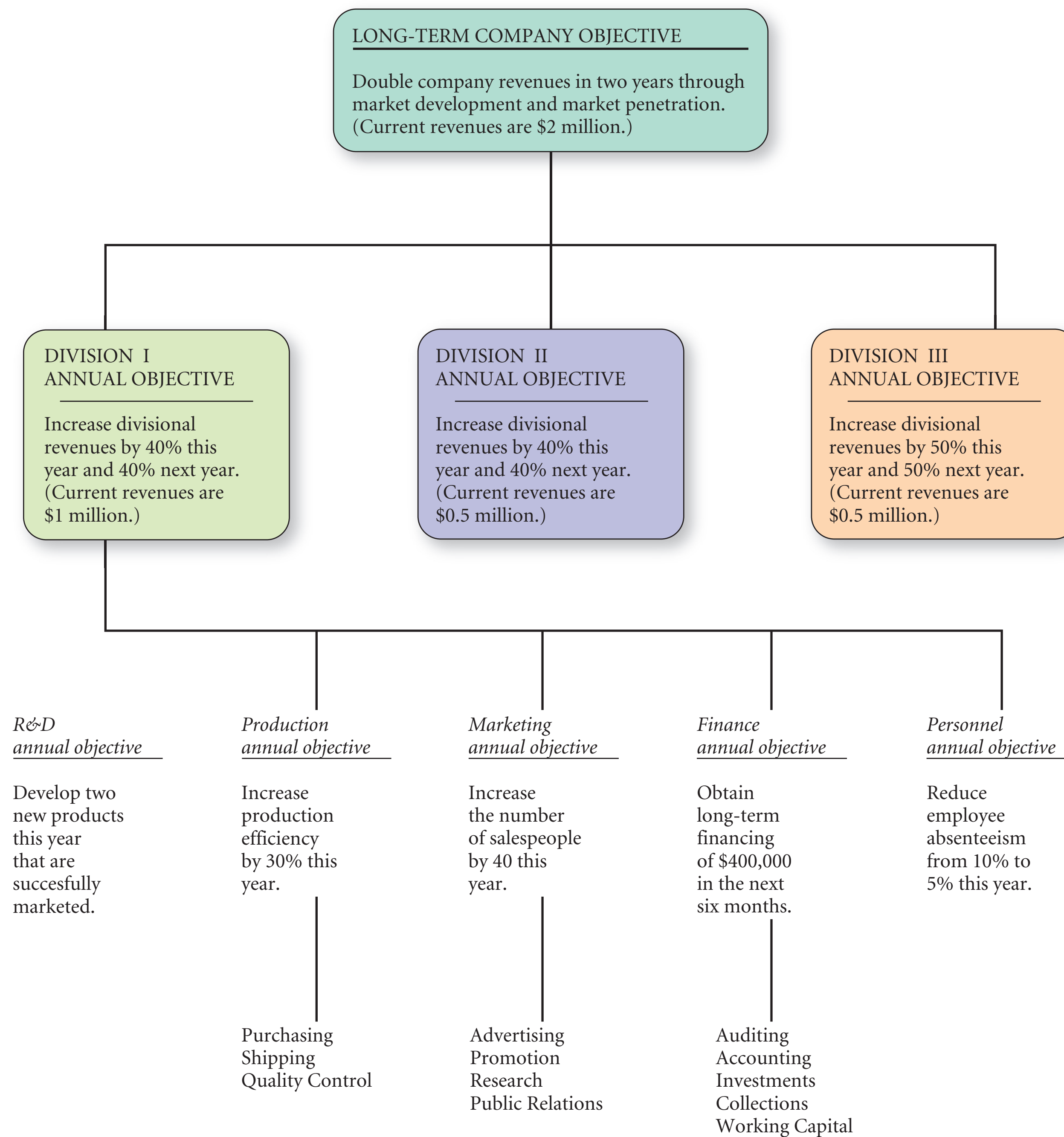


FIGURE 10-2

The Stamus Company's Hierarchy of Aims

Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organization, characterized by an appropriate time dimension, and accompanied by commensurate rewards and sanctions. Too often, objectives are stated in generalities, with little operational usefulness. Annual objectives, such as "to improve communication" or "to improve performance," are not clear, specific, or measurable. Objectives should state quantity, quality, cost, and time—and also be verifiable. Terms and phrases such as *maximize*, *minimize*, *as soon as possible*, and *adequate* should be avoided.

Annual objectives should be compatible with employees' and managers' values and supported by clearly stated policies. More of something is not always better. Improved quality or

TABLE 10-3 A Hierarchy of Policies

Company Strategy
Acquire a chain of retail stores to meet our sales growth and profitability objectives.
Supporting Policies
1. "All stores will be open from 8 a.m. to 8 p.m. Monday through Saturday." (This policy could increase retail sales if stores currently are open only 40 hours a week.)
2. "All stores must submit a Monthly Control Data Report." (This policy could reduce expense-to-sales ratios.)
3. "All stores must support company advertising by contributing 5 percent of their total monthly revenues for this purpose." (This policy could allow the company to establish a national reputation.)
4. "All stores must adhere to the uniform pricing guidelines set forth in the Company Handbook." (This policy could help assure customers that the company offers a consistent product in terms of price and quality in all its stores.)

Divisional Objective
Increase the division's revenues from $10 million in 2014 to $15 million in 2015.
Supporting Policies
1. "Beginning in January 2014, each one of this division's salespersons must file a weekly activity report that includes the number of calls made, the number of miles traveled, the number of units sold, the dollar volume sold, and the number of new accounts opened." (This policy could ensure that salespersons do not place too great an emphasis in certain areas.)
2. "Beginning in January 2014, this division will return to its employees 5 percent of its gross revenues in the form of a Christmas bonus." (This policy could increase employee productivity.)
3. "Beginning in January 2014, inventory levels carried in warehouses will be decreased by 30 percent in accordance with a just-in-time (JIT) manufacturing approach." (This policy could reduce production expenses and thus free funds for increased marketing efforts.)

Production Department Objective
Increase production from 20,000 units in 2014 to 30,000 units in 2015.
Supporting Policies
1. "Beginning in January 2014, employees will have the option of working up to 20 hours of overtime per week." (This policy could minimize the need to hire additional employees.)
2. "Beginning in January 2014, perfect attendance awards in the amount of $100 will be given to all employees who do not miss a workday in a given year." (This policy could decrease absenteeism and increase productivity.)
3. "Beginning in January 2014, new equipment must be leased rather than purchased." (This policy could reduce tax liabilities and thus allow more funds to be invested in modernizing production processes.)

TABLE 10-4 Some Issues That May Require a Management Policy

- To offer extensive or limited management development workshops and seminars
- To centralize or decentralize employee-training activities
- To recruit through employment agencies, college campuses, or newspapers
- To promote from within or to hire from the outside
- To promote on the basis of merit or on the basis of seniority
- To tie executive compensation to long-term or annual objectives
- To offer numerous or few employee benefits
- To negotiate directly or indirectly with labor unions
- To delegate authority for large expenditures or to centrally retain this authority
- To allow much, some, or no overtime work
- To establish a high- or low-safety stock of inventory
- To use one or more suppliers
- To buy, lease, or rent new production equipment
- To greatly or somewhat stress quality control
- To establish many or only a few production standards
- To operate one, two, or three shifts
- To discourage using insider information for personal gain
- To discourage sexual harassment
- To discourage smoking at work
- To discourage insider trading
- To discourage moonlighting

TABLE 10-2 The Stamus Company's Revenue Expectations (in $millions)

	2012	2013	2014
Division I Revenues	1.0	1.400	1.960
Division II Revenues	0.5	0.700	0.980
Division III Revenues	0.5	0.750	1.125
Total Company Revenues	**2.0**	**2.850**	**4.065**

reduced cost may, for example, be more important than quantity. It is important to tie rewards and sanctions to annual objectives so that employees and managers understand that achieving objectives is critical to successful strategy implementation. Clear annual objectives do not guarantee successful strategy implementation, but they do increase the likelihood that personal and organizational aims can be accomplished. Overemphasis on achieving objectives can result in undesirable conduct, such as faking the numbers, distorting the records, and letting objectives become ends in themselves. Managers must be alert to these potential problems.

Policies

Changes in a firm's strategic direction do not occur automatically. On a day-to-day basis, policies are needed to make a strategy work. Policies facilitate solving recurring problems and guide the implementation of strategy. Broadly defined, **policy** refers to specific guidelines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals. Policies are instruments for strategy implementation. Policies set boundaries, constraints, and limits on the kinds of administrative actions that can be taken to reward and sanction behavior; they clarify what can and cannot be done in pursuit of an organization's objectives. For example, Carnival's *Paradise* ship has a no smoking policy anywhere, anytime aboard ship. It was the first cruise ship to ban smoking comprehensively. Another example of corporate policy relates to surfing the Web while at work. About 40 percent of companies today do not have a formal policy preventing employees from surfing the Internet, but software is being marketed now that allows firms to monitor how, when, where, and how long various employees use the Internet at work.

Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully. They provide a basis for management control, allow coordination across organizational units, and reduce the amount of time managers spend making decisions. Policies also clarify what work is to be done and by whom. They promote delegation of decision making to appropriate managerial levels where various problems usually arise. Many organizations have a policy manual that serves to guide and direct behavior. Walmart has a policy that it calls the "10 Foot" Rule, whereby customers can find assistance within 10 feet of anywhere in the store. This is a welcomed policy in Japan, where Walmart is trying to gain a foothold; 58 percent of all retailers in Japan are mom-and-pop stores and consumers historically have had to pay "top yen" rather than "discounted prices" for merchandise.

Policies can apply to all divisions and departments (for example, "We are an equal opportunity employer"). Some policies apply to a single department ("Employees in this department must take at least one training and development course each year"). Whatever their scope and form, policies serve as a mechanism for implementing strategies and obtaining objectives. Policies should be stated in writing whenever possible. They represent the means for carrying out strategic decisions. Examples of policies that support a company strategy, a divisional objective, and a departmental objective are given in Table 10-3.

Some example issues that may require a management policy are provided in Table 10-4.

Resource Allocation

Resource allocation is a central management activity that allows for strategy execution. In organizations that do not use a strategic-management approach to decision making, resource allocation is often based on political or personal factors. Strategic management enables resources to be allocated according to priorities established by annual objectives.

All organizations have at least four types of resources that can be used to achieve desired objectives: financial resources, physical resources, human resources, and technological resources. Allocating resources to particular divisions and departments does not mean that strategies will be successfully implemented. A number of factors commonly prohibit effective resource allocation, including an overprotection of resources, too great an emphasis on short-run financial criteria, organizational politics, vague strategy targets, a reluctance to take risks, and a lack of sufficient knowledge.

Below the corporate level, there often exists an absence of systematic thinking about resources allocated and strategies of the firm. Yavitz and Newman explain why:

> Managers normally have many more tasks than they can do. Managers must allocate time and resources among these tasks. Pressure builds up. Expenses are too high. The CEO wants a good financial report for the third quarter. Strategy formulation and implementation activities often get deferred. Today's problems soak up available energies and resources. Scrambled accounts and budgets fail to reveal the shift in allocation away from strategic needs to currently squeaking wheels.[3]

The real value of any resource allocation program lies in the resulting accomplishment of an organization's objectives. Effective resource allocation does not guarantee successful strategy implementation because programs, personnel, controls, and commitment must breathe life into the resources provided. Strategic management itself is sometimes referred to as a "resource allocation process."

Managing Conflict

Interdependency of objectives and competition for limited resources often leads to conflict. **Conflict** can be defined as a disagreement between two or more parties on one or more issues. Establishing annual objectives can lead to conflict because individuals have different expectations and perceptions, schedules create pressure, personalities are incompatible, and misunderstandings between line managers (such as production supervisors) and staff managers (such as human resource specialists) occur. For example, a collection manager's objective of reducing bad debts by 50 percent in a given year may conflict with a divisional objective to increase sales by 20 percent.

Establishing objectives can lead to conflict because managers and strategists must make trade-offs, such as whether to emphasize short-term profits or long-term growth, profit margin or market share, market penetration or market development, growth or stability, high risk or low risk, and social responsiveness or profit maximization. Trade-offs are necessary because no firm has sufficient resources to pursue all strategies that would benefit the firm. Table 10-5 reveals some important management trade-off decisions required in strategy implementation.

Conflict is unavoidable in organizations, so it is important that conflict be managed and resolved before dysfunctional consequences affect organizational performance. Conflict is not always bad. An absence of conflict can signal indifference and apathy. Conflict can serve to energize opposing groups into action and may help managers identify problems. General George Patton once said: "If everyone is thinking alike, then somebody isn't thinking."

Various approaches for managing and resolving conflict can be classified into three categories: avoidance, defusion, and confrontation. **Avoidance** includes such actions as ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals (or groups). **Defusion** can include playing down differences between conflicting parties while accentuating similarities and common interests, compromising so that there is neither a clear winner nor loser, resorting to majority rule, appealing to a higher authority, or redesigning present positions. **Confrontation** is exemplified by exchanging members of conflicting parties so that each can gain an appreciation of the other's point of view or holding a meeting at which conflicting parties present their views and work through their differences.

TABLE 10-5 Some Management Trade-Off Decisions Required in Strategy Implementation

To emphasize short-term profits or long-term growth
To emphasize profit margin or market share
To emphasize market development or market penetration
To lay off or furlough
To seek growth or stability
To take high risk or low risk
To be more socially responsible or more profitable
To outsource jobs or pay more to keep jobs at home
To acquire externally or to build internally
To restructure or reengineer
To use leverage or equity to raise funds
To use part-time or full-time employees

Matching Structure with Strategy

Changes in strategy often require changes in the way an organization is structured, for two major reasons. First, structure largely dictates how objectives and policies will be established. For example, objectives and policies established under a geographic organizational structure are couched in geographic terms. Objectives and policies are stated largely in terms of products in an organization whose structure is based on product groups. The structural format for developing objectives and policies can significantly impact all other strategy-implementation activities.

The second major reason why changes in strategy often require changes in structure is that structure dictates how resources will be allocated. If an organization's structure is based on customer groups, then resources will be allocated in that manner. Similarly, if an organization's structure is set up along functional business lines, then resources are allocated by functional areas. Unless new or revised strategies place emphasis in the same areas as old strategies, structural reorientation commonly becomes a part of strategy implementation.

Alfred Chandler promoted the notion that "changes in strategy lead to changes in organizational structure." Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, follow strategy. Without a strategy or reasons for being (mission), companies find it difficult to design an effective structure. Chandler found a particular structure sequence to be repeated often as organizations grow and change strategy over time.

There is no one optimal organizational design or structure for a given strategy or type of organization. What is appropriate for one organization may not be appropriate for a similar firm, although successful firms in a given industry do tend to organize themselves in a similar way. For example, consumer goods companies tend to emulate the divisional structure-by-product form of organization. Small firms tend to be functionally structured (centralized). Medium-sized firms tend to be divisionally structured (decentralized). Large firms tend to use a **strategic business unit (SBU) structure** or matrix structure. As organizations grow, their structures generally change from simple to complex as a result of concatenation, or the linking together of several basic strategies.

Numerous external and internal forces affect an organization; no firm could change its structure in response to every one of these forces because to do so would lead to chaos. However, when a firm changes its strategy, the existing organizational structure may become ineffective. As indicated in Table 10-6, symptoms of an ineffective organizational structure include too many levels of management, too many meetings attended by too many people, too much attention being directed toward solving interdepartmental conflicts, too large a span of control, and too many unachieved objectives. Changes in structure can facilitate strategy-implementation efforts, but changes in structure should not be expected to make a bad strategy good, to make bad managers good, or to make bad products sell.

TABLE 10-8 Advantages and Disadvantages of a Divisional Organizational Structure

Advantages	Disadvantages
1. Accountability is clear	1. Can be costly
2. Allows local control of local situations	2. Duplication of functional activities
3. Creates career development chances	3. Requires a skilled management force
4. Promotes delegation of authority	4. Requires an elaborate control system
5. Leads to competitive climate internally	5. Competition among divisions can become so intense as to be dysfunctional
6. Allows easy adding of new products or regions	6. Can lead to limited sharing of ideas and resources
7. Allows strict control and attention to products, customers, or regions	7. Some regions, products, or customers may receive special treatment

services, facilities, and personnel; for instance, functional specialists are also needed centrally (at headquarters) to coordinate divisional activities. Third, managers must be well qualified because the divisional design forces delegation of authority; better-qualified individuals require higher salaries. A divisional structure can also be costly because it requires an elaborate, headquarters-driven control system. Fourth, competition between divisions may become so intense that it is dysfunctional and leads to limited sharing of ideas and resources for the common good of the firm. Table 10-8 summarizes the advantages and disadvantages of divisional organizational structure.

Ghoshal and Bartlett, two leading scholars in strategic management, note the following:

> As their label clearly warns, divisions divide. The divisional model fragments companies' resources; it creates vertical communication channels that insulate business units and prevents them from sharing their strengths with one another. Consequently, the whole of the corporation is often less than the sum of its parts. A final limitation of the divisional design is that certain regions, products, or customers may sometimes receive special treatment, and it may be difficult to maintain consistent, companywide practices. Nonetheless, for most large organizations and many small firms, the advantages of a divisional structure more than offset the potential limitations.[5]

A *divisional structure by geographic area* is appropriate for organizations whose strategies need to be tailored to fit the particular needs and characteristics of customers in different geographic areas. This type of structure can be most appropriate for organizations that have similar branch facilities located in widely dispersed areas. A divisional structure by geographic area allows local participation in decision making and improved coordination within a region. Hershey Foods is an example company organized using the divisional-by-region type of structure, as illustrated in Figure 10-4. Analysts contend that this type of structure may not be best for Hershey because consumption patterns for candy are quite similar worldwide. An alternative—and perhaps better—type of structure for Hershey would be divisional by product because the company produces, and sells three types of products worldwide: (1) chocolate, (2) nonchocolate, and (3) grocery.

The *divisional structure by product (or services)* is most effective for implementing strategies when specific products or services need special emphasis. Also, this type of structure is widely used when an organization offers only a few products or services or when an organization's products or services differ substantially. The divisional structure allows strict control over and attention to product lines, but it may also require a more skilled management force and reduced top management control. General Motors, DuPont, Microsoft, and Procter & Gamble use a divisional structure by product to implement strategies. Microsoft introduced its new Surface Tablet for $499 in late 2012. The Surface is being sold online and in Microsoft retail stores, but not in stores such as Best Buy or Walmart, or even Amazon. Microsoft's divisional-by-product organizational structure is illustrated in Figure 10-5.

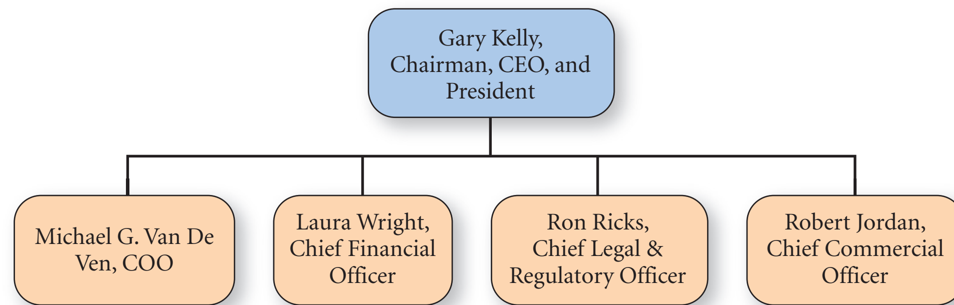


FIGURE 10-3

Southwest Airlines' Functional Organizational Chart

Source: Based on company documents.

The Divisional Structure

The **divisional structure** or **decentralized structure** is the second most common type used by U.S. businesses. As a small organization grows, it has more difficulty managing different products and services in different markets. Some form of divisional structure generally becomes necessary to motivate employees, control operations, and compete successfully in diverse locations. The divisional structure can be organized in one of four ways: *by geographic area*, *by product* or *service*, *by customer*, or *by process*. With a divisional structure, functional activities are performed both centrally and in each separate division.

Sun Microsystems recently reduced the number of its business units from seven to four. Kodak recently reduced its number of business units from seven by-customer divisions to five by-product divisions. As consumption patterns become increasingly similar worldwide, a by-product structure is becoming more effective than a by-customer or a by-geographic type divisional structure. In the restructuring, Kodak eliminated its global operations division and distributed those responsibilities across the new by-product divisions.

A divisional structure has some clear advantages. First and perhaps foremost, accountability is clear. That is, divisional managers can be held responsible for sales and profit levels. Because a divisional structure is based on extensive delegation of authority, managers and employees can easily see the results of their good or bad performances. As a result, employee morale is generally higher in a divisional structure than it is in a centralized structure. Other advantages of the divisional design are that it creates career development opportunities for managers, allows local control of situations, leads to a competitive climate within an organization, and allows new businesses and products to be added easily.

The divisional design is not without some limitations, however. Perhaps the most important limitation is that a divisional structure is costly, for a number of reasons. First, each division requires functional specialists who must be paid. Second, there exists some duplication of staff

TABLE 10-7 Advantages and Disadvantages of a Functional Organizational Structure

Advantages	Disadvantages
1. Simple and inexpensive	1. Accountability forced to the top
2. Capitalizes on specialization of business activities such as marketing and finance	2. Delegation of authority and responsibility not encouraged
3. Minimizes need for elaborate control system	3. Minimizes career development
4. Allows for rapid decision making	4. Low employee and manager morale
	5. Inadequate planning for products and markets
	6. Leads to short-term, narrow thinking
	7. Leads to communication problems

TABLE 10-6 Symptoms of an Ineffective Organizational Structure

1. Too many levels of management
2. Too many meetings attended by too many people
3. Too much attention being directed toward solving interdepartmental conflicts
4. Too large a span of control
5. Too many unachieved objectives
6. Declining corporate or business performance
7. Losing ground to rival firms
8. Revenue or earnings divided by number of employees or number of managers is low compared to rival firms

Structure undeniably can and does influence strategy. Strategies formulated must be workable, so if a certain new strategy required massive structural changes it would not be an attractive choice. In this way, structure can shape the choice of strategies. But a more important concern is determining what types of structural changes are needed to implement new strategies and how these changes can best be accomplished. There are seven basic types of organizational structure: functional, divisional by geographic area, divisional by product, divisional by customer, divisional process, strategic business unit (SBU), and matrix.

The Functional Structure

The most widely used structure is the functional or centralized type because this structure is the simplest and least expensive of the seven alternatives. A **functional structure** groups tasks and activities by business function, such as production and operations, marketing, finance and accounting, research and development, and management information systems. A university may structure its activities by major functions that include academic affairs, student services, alumni relations, athletics, maintenance, and accounting. Besides being simple and inexpensive, a functional structure also promotes specialization of labor, encourages efficient use of managerial and technical talent, minimizes the need for an elaborate control system, and allows rapid decision making.

Some disadvantages of a functional structure are that it forces accountability to the top, minimizes career development opportunities, and is sometimes characterized by low employee morale, line or staff conflicts, poor delegation of authority, and inadequate planning for products and markets.

A functional structure often leads to short-term and narrow thinking that may undermine what is best for the firm as a whole. For example, the research and development department may strive to overdesign products and components to achieve technical elegance, whereas manufacturing may argue for low-frills products that can be mass produced more easily. Thus, communication is often not as good in a functional structure. Schein gives an example of a communication problem in a functional structure:

> The word "marketing" will mean product development to the engineer, studying customers through market research to the product manager, merchandising to the salesperson, and constant change in design to the manufacturing manager. Then when these managers try to work together, they often attribute disagreements to personalities and fail to notice the deeper, shared assumptions that vary and dictate how each function thinks.[4]

Most large companies have abandoned the functional structure in favor of decentralization and improved accountability. However, a large company that still operates from a functional type organizational design is Southwest Airlines, headquartered in Dallas, Texas. As illustrated in Figure 10-3, Southwest has only five top executives and no divisions, even though the firm operates 700 aircraft serving 72 cities in 37 states.

Table 10-7 summarizes the advantages and disadvantages of a functional organizational structure.

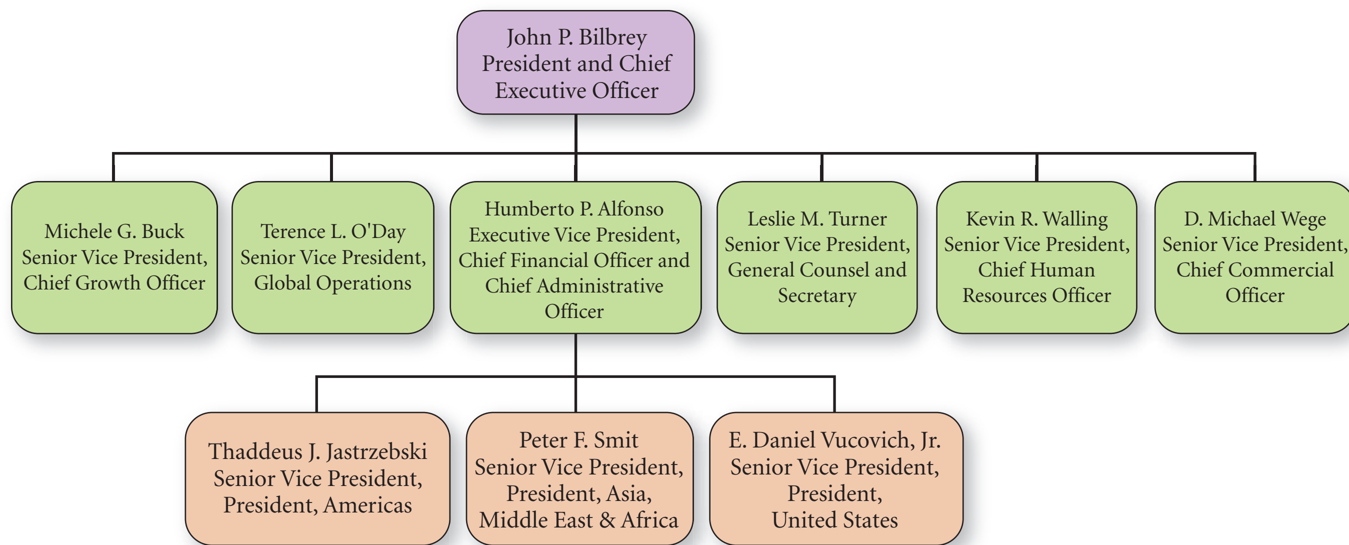


FIGURE 10-4

Hershey Foods' Divisional-by-Region Organizational Chart

Source: Based on company documents.

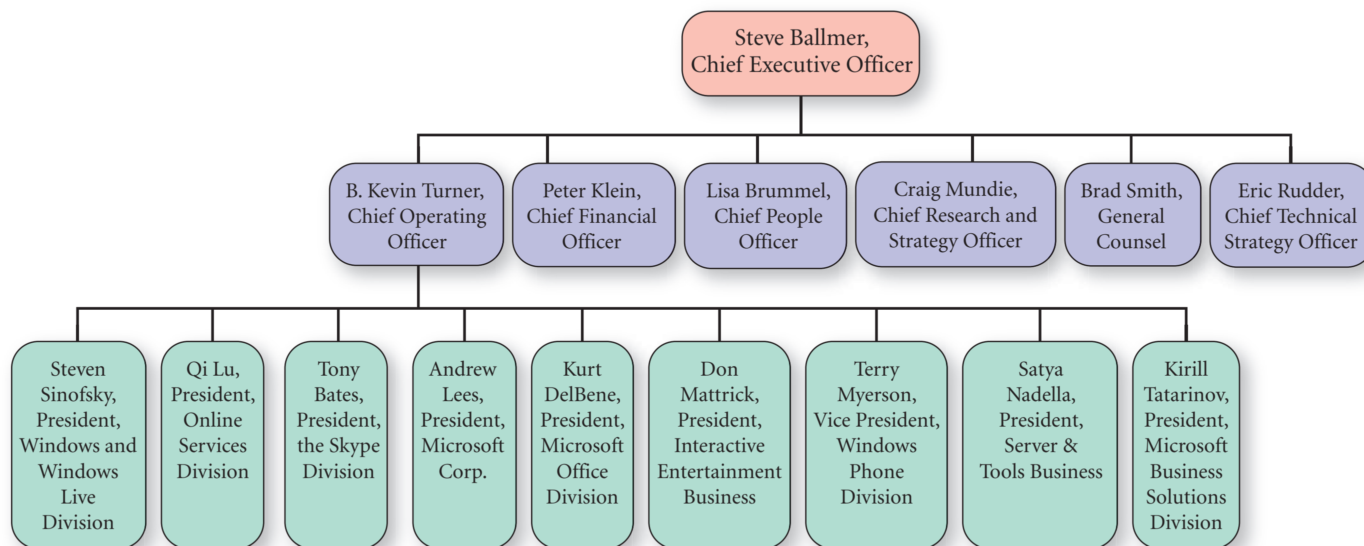


FIGURE 10-5

Microsoft's Divisional-by-Product Organizational Structure

Source: Based on company documents.

When a few major customers are of paramount importance and many different services are provided to these customers, then a *divisional structure by customer* can be the most effective way to implement strategies. This structure allows an organization to cater effectively to the requirements of clearly defined customer groups. For example, book publishing companies often organize their activities around customer groups, such as colleges, secondary schools, and private commercial schools. Some airline companies have two major customer divisions: passengers and freight or cargo services. Utility companies often use (1) commercial, (2) residential, and (3) industrial as their divisions by customer.

A *divisional structure by process* is similar to a functional structure, because activities are organized according to the way work is actually performed. However, a key difference between these two designs is that functional departments are not accountable for profits or revenues, whereas divisional process departments are evaluated on these criteria. An example of a divisional structure by process is a manufacturing business organized into six divisions: electrical work, glass cutting, welding, grinding, painting, and foundry work. In this case, all operations related to these specific processes would be grouped under the separate divisions. Each process (division) would be responsible for generating revenues and profits. The divisional structure by process can be particularly effective in achieving objectives when distinct production processes represent the thrust of competitiveness in an industry. Halliburton's organizational chart illustrated on the next page features aspects of the division-by-process design.

The Strategic Business Unit (SBU) Structure

As the number, size, and diversity of divisions in an organization increase, controlling and evaluating divisional operations become increasingly difficult for strategists. Increases in sales often are not accompanied by similar increases in profitability. The span of control becomes too large at top levels of the firm. For example, in a large conglomerate organization composed of 90 divisions, such as ConAgra, the chief executive officer could have difficulty even remembering the first names of divisional presidents. In multidivisional organizations, an SBU structure can greatly facilitate strategy-implementation efforts. ConAgra has put its many divisions into three primary SBUs: (1) food service (restaurants), (2) retail (grocery stores), and (3) agricultural products.

The SBU structure groups similar divisions into SBUs and delegates authority and responsibility for each unit to a senior executive who reports directly to the chief executive officer. This change in structure can facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units. In a 100-division conglomerate, the divisions could perhaps be regrouped into 10 SBUs according to certain common characteristics, such as competing in the same industry, being located in the same area, or having the same customers.

Two disadvantages of an SBU structure are that it requires an additional layer of management, which increases salary expenses. Also, the role of the group vice president is often ambiguous. However, these limitations often do not outweigh the advantages of improved coordination and accountability. Another advantage of the SBU structure is that it makes the tasks of planning and control by the corporate office more manageable.

News Corp. recently reorganized its operations into two SBUs: (1) Entertainment, which includes 20th Century Fox, Fox Broadcast News, and the Fox News Channel, and (2) Publishing, which includes The *Wall Street Journal*, *Times of London*, *The Sun* newspaper, *The Australian* newspaper, and HarperCollins book publishing. News Corp.'s Chairman and CEO, Rupert Murdoch, is retaining his family's 40 percent voting stake in what may result in two separate companies. Estimated 2014 revenue in billions of dollars by division within the Publishing SBU is as follows:

Australia newspapers (2.19)
Dow Jones (2.07)
U.K. newspapers (1.34)
Book publishing (1.25)
Marketing services (0.97)
Fox Sports (0.62)
REA Group (0.37)
NY Post, other (0.30)
Education business (0.12)

Apparently to groom a new CEO, Coca-Cola recently streamlined its organizational structure by converting to three SBUs: (1) The Americas Beverages headed by Cahillane, (2) Outside-The-Americas Beverages headed by Bozer, and (3) Outside-The-Americas Bottlers headed by Finan. Coke CEO Muhtar Kent said "Consolidating leadership under the three groups

TABLE 10-9 Advantages and Disadvantages of a Matrix Structure

Advantages	Disadvantages
1. Project objectives are clear	1. Requires excellent vertical and horizontal flows of communication
2. Employees can clearly see results of their work	2. Costly because creates more manager positions
3. Shutting down a project is easily accomplished	3. Violates unity of command principle
4. Facilitates uses of special equipment, personnel, and facilities	4. Creates dual lines of budget authority
5. Functional resources are shared instead of duplicated as in a divisional structure	5. Creates dual sources of reward and punishment
	6. Creates shared authority and reporting
	7. Requires mutual trust and understanding

matrix structure are that project objectives are clear, there are many channels of communication, workers can see the visible results of their work, and shutting down a project can be accomplished relatively easily. Another advantage of a matrix structure is that it facilitates the use of specialized personnel, equipment, and facilities. Functional resources are shared in a matrix structure, rather than duplicated as in a divisional structure. Individuals with a high degree of expertise can divide their time as needed among projects, and they in turn develop their own skills and competencies more than in other structures.

A typical matrix structure is illustrated in Figure 10-7. Note that the letters (A through Z4) refer to managers. For example, if you were manager A, you would be responsible for financial aspects of Project 1, and you would have two bosses: the Project 1 Manager on site and the CFO off site.

For a matrix structure to be effective, organizations need participative planning, training, clear mutual understanding of roles and responsibilities, excellent internal communication, and mutual trust and confidence. The matrix structure is being used more frequently by U.S. businesses because firms are pursuing strategies that add new products, customer groups, and technology to their range of activities. Out of these changes are coming product managers, functional managers, and geographic-area managers, all of whom have important strategic responsibilities. When several variables, such as product, customer, technology, geography, functional area, and line of business, have roughly equal strategic priorities, a matrix organization can be an effective structural form.

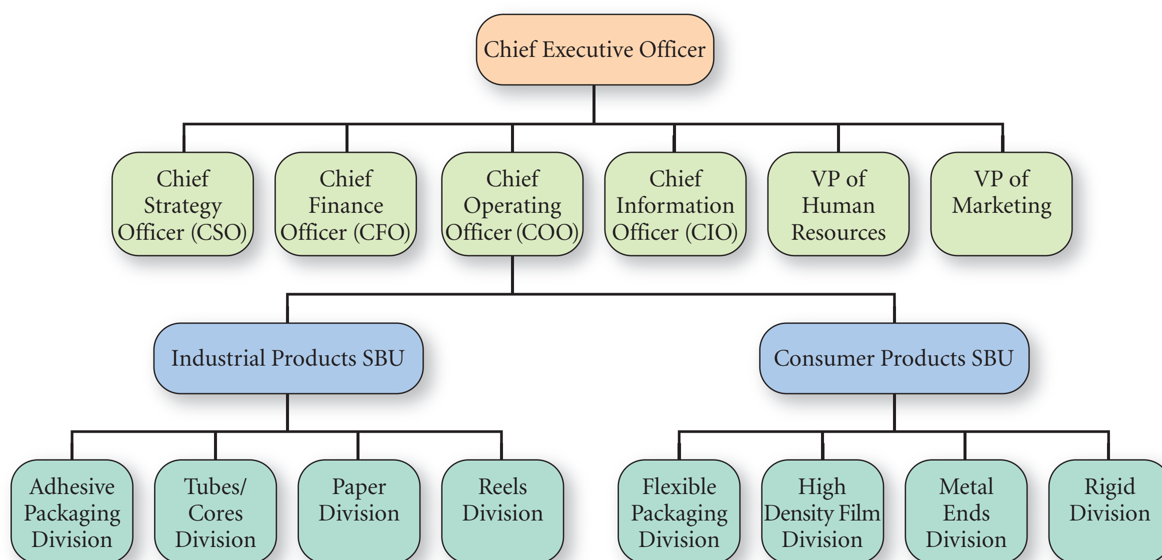


FIGURE 10-7
An Example Matrix Structure

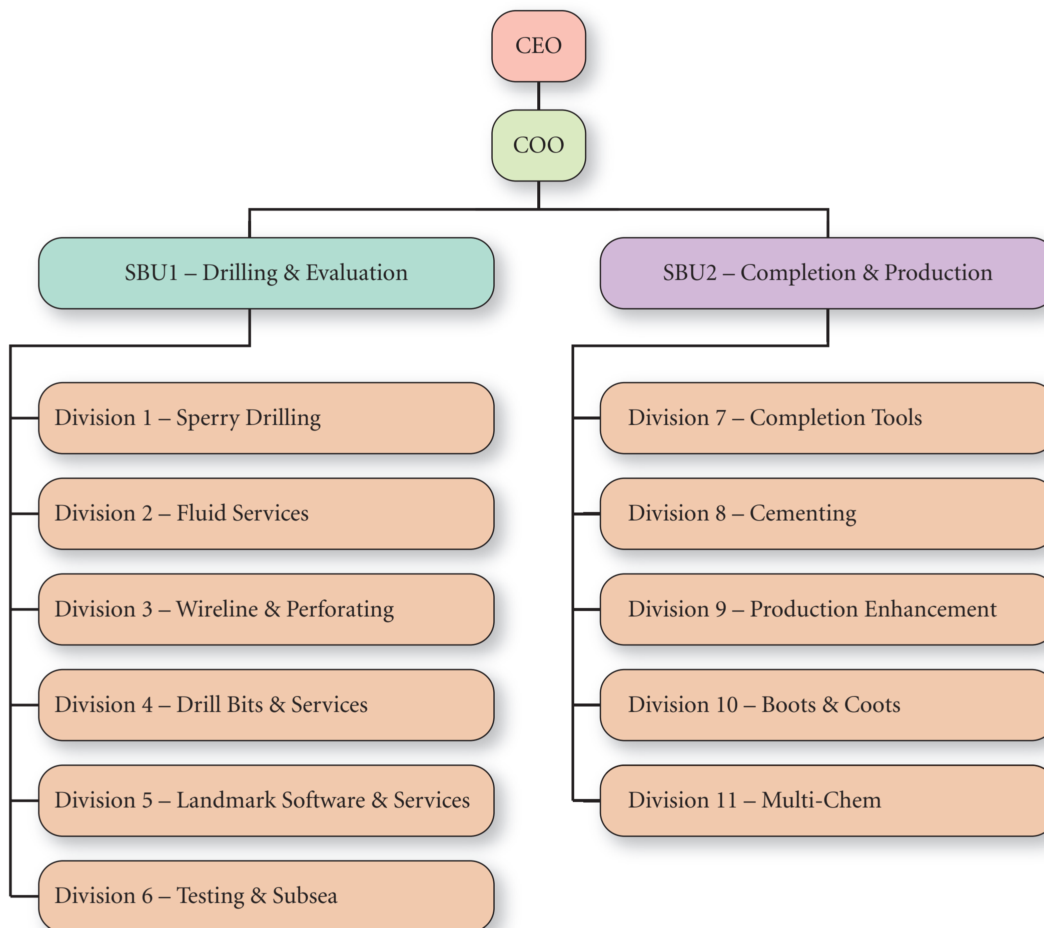


FIGURE 10-6

Halliburton Company's SBU Organizational Chart

Source: Based on http://www.halliburton.com/AboutUs/default.aspx?pageid=2458&navid=966.

will streamline reporting lines and intensify our focus on key markets." Either Mr. Cahillane and Mr. Bozer are expected to replace Mr. Kent as CEO sometime in the future, although Mr. Kent says: "As long as I'm having fun, my health allows me to continue and I'm generating good returns for our shareholders, and importantly as long as I'm smiling, which is important in anything you do, then I will continue."[6]

An excellent example of an SBU organizational chart is the one posted at the Halliburton Company website and shown in Figure 10-6. Note that six division executives report to the Drilling and Evaluation top executive, whereas five division heads report to the Completion and Production top executive. It is interesting and somewhat unusual that the 11 Halliburton divisions are organized by process rather than by geographic region or product.

The Matrix Structure

A **matrix structure** is the most complex of all designs because it depends on both vertical and horizontal flows of authority and communication (hence the term *matrix*). In contrast, functional and divisional structures depend primarily on vertical flows of authority and communication. A matrix structure can result in higher overhead because it creates more management positions. Other disadvantages of a matrix structure that contribute to overall complexity include dual lines of budget authority (a violation of the unity-of-command principle), dual sources of reward and punishment, shared authority, dual reporting channels, and a need for an extensive and effective communication system.

Despite its complexity, the matrix structure is widely used in many industries, including construction, health care, research, and defense. As indicated in Table 10-9, some advantages of a

Some Do's and Don'ts in Developing Organizational Charts

Students analyzing strategic-management cases are often asked to revise and develop a firm's organizational structure. This section provides some basic guidelines for this endeavor. There are some basic do's and don'ts in regard to devising or constructing organizational charts, especially for midsize to large firms. First of all, reserve the title CEO for the top executive of the firm. Don't use the title "president" for the top person; use it for the division top managers if there are divisions within the firm. Also, do not use the title "president" for functional business executives. They should have the title "chief," or "vice president," or "manager," or "officer," such as "Chief Information Officer," or "VP of Human Resources." Further, do not recommend a dual title (such as "CEO and president") for just one executive. Do not let a single individual be both chairman of the board, although Pfizer's CEO, Ian Read, is also chairman of the board. And Comverse Technology recently named Charles Burdick its president, chief executive officer, and chairman of the board. Actually, "chairperson" is much better than "chairman" for this title.

A significant movement among corporate America is to split the chairperson of the board and the CEO positions in publicly held companies.[7] The movement includes asking the New York Stock Exchange and Nasdaq to adopt listing rules that would require separate positions. About 50 percent of companies in the S&P 500 stock index have separate positions, up from 22 percent in 2002, but this still leaves plenty of room for improvement. Among European and Asian companies, the split in these two positions is much more common. For example, 79 percent of British companies split the positions, and all German and Dutch companies split the position. South Korea's Samsung Electronics in mid-2013 dissolved its COO position in favor of dual CEO's—but this practice in not common or popular in the USA.

Directly below the CEO, it is best to have a COO (chief operating officer) with any division presidents reporting directly to the COO. On the same level as the COO and also reporting to the CEO, draw in your functional business executives, such as a CFO (chief financial officer), VP of human resources, a CSO (chief strategy officer), a CIO (chief information officer), a CMO (chief marketing officer), a VP of R&D, a VP of legal affairs, an investment relations officer, maintenance officer, and so on. Note in Figure 10-8 that these positions are labeled and placed appropriately. Note that a controller or treasurer would normally report to the CFO.

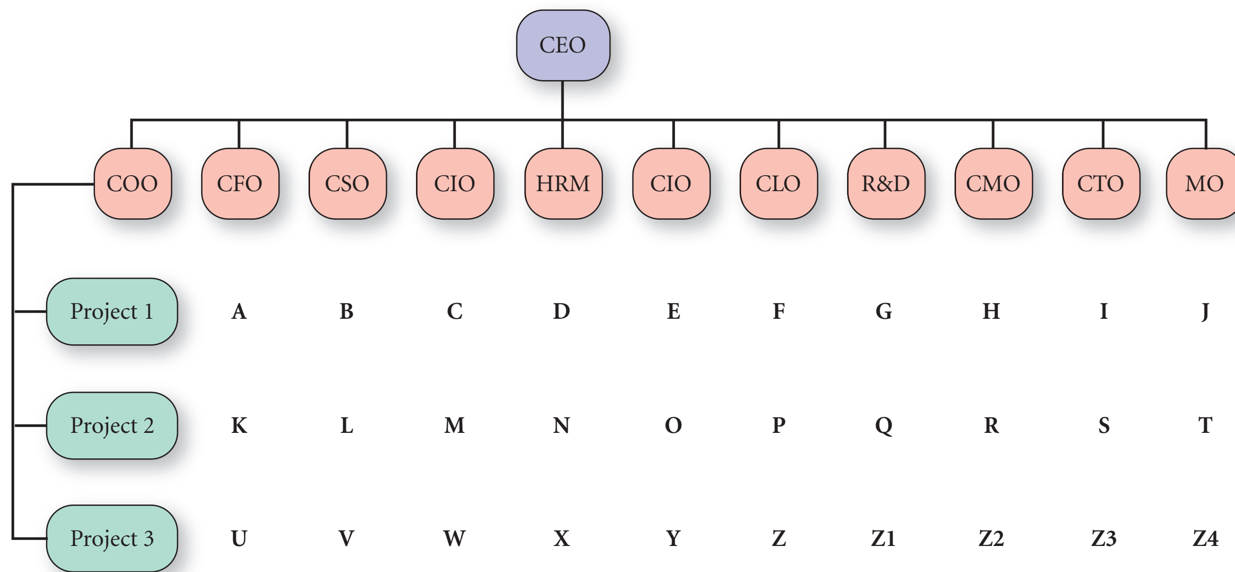
In developing an organizational chart, avoid having a particular person reporting to more than one person in the chain of command. This would violate the unity-of-command principle of management that "every employee should have just one boss." Also, do not have the CFO, CIO, CSO, human resource officer, or other functional positions report to the COO. All these positions report directly to the CEO.

A key consideration in devising an organizational structure concerns the divisions. Note whether the divisions (if any) of a firm presently are established based on geography, customer, product, or process. If the firm's organizational chart is not available, you often can devise a chart based on the titles of executives. An important case analysis activity is for you to decide how the divisions of a firm should be organized for maximum effectiveness. Even if the firm presently has no divisions, determine whether the firm would operate better with divisions. In other words, which type of divisional breakdown do you (or your group or team) feel would be best for the firm in allocating resources, establishing objectives, and devising compensation incentives? This important strategic decision faces many midsize and large firms (and teams of students analyzing a strategic-management case).

As consumption patterns become more and more similar worldwide, the divisional-by-product form of structure is increasingly the most effective. Be mindful that all firms have functional staff below their top executive and often readily provide this information, so be wary of concluding prematurely that a particular firm uses a functional structure. If you see the word *president* in the titles of executives, coupled with financial-reporting segments, such as by product or geographic region, then the firm is divisionally structured.

If the firm is large with numerous divisions, decide whether an SBU type of structure would be more appropriate to reduce the span of control reporting to the COO. One never knows for sure if a proposed or actual structure is indeed most effective for a particular firm. Declining financial performance signals a need for altering the structure.

Some important guidelines to follow in devising organizational charts for companies are provided in Table 10-10.



Note: Titles spelled out as follows.

Chief Executive Officer (CEO)
Chief Finance Officer (CFO)
Chief Strategy Officer (CSO)
Chief Information Officer (CIO)
Human Resources Manager (HRM)
Chief Operating Officer (COO)
Chief Legal Officer (CLO)
Research & Development Officer (R&D)
Chief Marketing Officer (CMO)
Chief Technology Officer (CTO)
Competitive Intelligence Officer (CIO)
Maintenance Officer (MO)

FIGURE 10-8

Typical Top Managers of a Large Firm

TABLE 10-10 Fifteen Guidelines for Developing an Organizational Chart

1. Instead of chairman of the board, make it chairperson of the board.
2. Make sure the board of directors reveals diversity in race, ethnicity, gender, and age.
3. Make sure the chair of the board is not also the CEO or president of the company.
4. Make sure the CEO of the firm does not also carry the title *president*.
5. Reserve the title *president* for the division heads of the firm.
6. Make sure the firm has a COO.
7. Make sure only presidents of divisions report to the COO.
8. Make sure functional executives such as CFO, CIO, CMO, CSO, R&D, CLO, CTO, and HRM report to the CEO, not the COO.
9. Make sure every executive has one boss, so lines in the chart should be drawn accordingly, assuring unity of command.
10. Make sure span of control is reasonable, probably no more than 10 persons reporting to any other person.
11. Make sure diversity in race, ethnicity, gender, and age is well represented among corporate executives.
12. Avoid a functional type structure for all but the smallest firms.
13. Decentralize, using some form of divisional structure, whenever possible.
14. Use an SBU type structure for large, multidivisional firms.
15. Make sure executive titles match product names as best possible in division-by-product and SBU-designated firms.

Restructuring

Restructuring and reengineering are becoming commonplace on the corporate landscape across the USA and Europe. **Restructuring**—also called **downsizing**, **rightsizing**, or **delayering**—involves reducing the size of the firm in terms of number of employees, number of divisions or units, and number of hierarchical levels in the firm's organizational structure. This reduction in size is intended to improve both efficiency and effectiveness. Restructuring is concerned primarily with shareholder well-being rather than employee well-being.

The lingering recession in Europe has forced many companies there to downsize, laying off managers and employees. This practice was historically rare in Europe because labor unions and laws required lengthy negotiations or huge severance checks before workers could be terminated. In contrast to the USA, labor union executives of large European firms sit on most boards of directors.

Job security in European companies is slowly moving toward a U.S. scenario, in which firms lay off almost at will. From banks in Milan to factories in Mannheim, European employers are starting to show people the door in an effort to streamline operations, increase efficiency, and compete against already slim and trim U.S. firms. Massive U.S.-style layoffs are still rare in Europe, but unemployment rates throughout the continent are rising quite rapidly. European firms still prefer to downsize by attrition and retirement rather than by blanket layoffs because of culture, laws, and unions.

In contrast, reengineering is concerned more with employee and customer well-being than shareholder well-being. **Reengineering**—also called *process management*, *process innovation*, or *process redesign*—involves reconfiguring or redesigning work, jobs, and processes for the purpose of improving cost, quality, service, and speed. Reengineering does not usually affect the organizational structure or chart, nor does it imply job loss or employee layoffs. Whereas restructuring is concerned with eliminating or establishing, shrinking or enlarging, and moving organizational departments and divisions, the focus of reengineering is changing the way work is actually carried out. Reengineering is characterized by many tactical (short-term, business-function-specific) decisions, whereas restructuring is characterized by strategic (long-term, affecting all business functions) decisions.

Developed by Motorola in 1986 and made famous by CEO Jack Welch at General Electric and more recently by Robert Nardelli, former CEO of Home Depot, **Six Sigma** is a quality-boosting process improvement technique that entails training several key persons in the firm in the techniques to monitor, measure, and improve processes and eliminate defects. Six Sigma has been widely applied across industries from retailing to financial services. CEO Dave Cote at Honeywell and CEO Jeff Immelt at General Electric spurred acceptance of Six Sigma, which aims to improve work processes and eliminate waste by training "select" employees who are given judo titles such as Master Black Belts, Black Belts, and Green Belts. Target Corp. claims more than $100 million in savings over the past six years resulting from its Six Sigma program.

Six Sigma was criticized in a *Wall Street Journal* article that cited many example firms whose stock price fell for a number of years after adoption of Six Sigma. The technique's reliance on the special group of trained employees is problematic and its use within retail firms such as Home Depot has not been as successful as in manufacturing firms.[8]

Restructuring

Firms often employ restructuring when various ratios appear out of line with competitors as determined through benchmarking exercises. Recall that **benchmarking** simply involves comparing a firm against the best firms in the industry on a wide variety of performance-related criteria. Some benchmarking ratios commonly used in rationalizing the need for restructuring are headcount-to-sales-volume, or corporate-staff-to-operating-employees, or span-of-control figures.

The primary benefit sought from restructuring is cost reduction. For some highly bureaucratic firms, restructuring can actually rescue the firm from global competition and demise. But the downside of restructuring can be reduced employee commitment, creativity, and innovation that accompanies the uncertainty and trauma associated with pending and actual employee layoffs. Avon Products recently restructured partly as a result of corruption investigations in its

Russia and Brazil operations. The company reduced its six commercial business units down to two—(1) Developed Markets and (2) Developing Markets—in essence going to a divisional by geographic region type structure. Avon has been reporting lower sales and profits amid missteps in key markets. Former CEO Andrea Jung installed five new regional heads and new presidents in Avon's U.S. and Russia markets.

Employers today are looking for people who can do things, not for people who make other people do things. Restructuring in many firms has made a manager's job an invisible, thankless role. More workers today are self-managed, entrepreneurs, interpreneurs, or team-managed. Managers today need to be counselors, motivators, financial advisors, and psychologists. They also run the risk of becoming technologically behind in their areas of expertise. "Dilbert" cartoons sometimes portray managers as enemies or as morons.

Linking Performance and Pay to Strategies

With so many people out of work and executive salaries so large, politicians are more and more giving shareholders greater control over executive pay. The Dodd-Frank Wall Street Reform and Consumer Protection Act grants shareholders advisory votes on compensation. A recent *Bloomberg Businessweek* article says companies should install five policies to improve their compensation practices:

1. Provide full transparency to all stakeholders. Novartis does an excellent job on this.
2. Reward long-term performance with long-term pay, rather than annual incentives. ExxonMobil does an excellent job on this.
3. Base executive compensation on actual company performance, rather than on stock price. Target, for example, bases executive pay on same-store sales growth rather than stock price.
4. Extend the time-horizon for bonuses. Replace short-term with long-term incentives. Goldman Sachs does an excellent job on this.
5. Increase equity between workers and executives. Delete many special perks and benefits for executives. Be more consistent across levels, although employees with greater responsibility must receive greater compensation.[10]

As firms acquire other firms in other countries, these pay differences can cause resentment and even turmoil. Larger pay packages of U.S. CEOs are socially less acceptable in many other countries. For example, in Japan, seniority rather than performance is the key factor in determining pay, and harmony among managers is emphasized over individual excellence.

How can an organization's reward system be more closely linked to strategic performance? How can decisions on salary increases, promotions, merit pay, and bonuses be more closely aligned to support the long-term strategic objectives of the organization? There are no widely accepted answers to these questions, but a dual bonus system based on both annual objectives and long-term objectives is becoming common. The percentage of a manager's annual bonus attributable to short-term versus long-term results should vary by hierarchical level in the organization. It is important that bonuses not be based solely on short-term results because such a system ignores long-term company strategies and objectives.

Many companies have recently instituted policies to allow their shareholders to vote on executive compensation policies. Aflac was the first U.S. corporation to voluntarily give shareholders an advisory vote on executive compensation. Aflac did this back in 2007. Apple did this in 2008, as did H&R Block. Several companies that instituted say-on-pay policies more recently were Ingersoll-Rand, Verizon, Motorola, Occidental Petroleum, and Hewlett-Packard. These new policies underscore how the financial crisis and shareholder outrage about top executive pay has affected compensation practice. None of the shareholder votes are binding on the companies, however, at least not so far. The U.S. House of Representatives recently passed a bill to formalize this shareholder tactic, which is gaining steam across the country as a means to combat exorbitant executive pay.

In an effort to cut costs and increase productivity, more and more Japanese companies are switching from seniority-based pay to performance-based approaches. Toyota has switched to a full merit system for 20,000 of its 70,000 white-collar workers. Fujitsu, Sony, Matsushita

Electric Industrial, and Kao also have switched to merit pay systems. This switching is hurting morale at some Japanese companies, which have trained workers for decades to cooperate rather than to compete and to work in groups rather than individually.

Richard Brown, CEO of Electronic Data Systems (EDS), once said,

> You have to start with an appraisal system that gives genuine feedback and differentiates performance. Some call it ranking people. That seems a little harsh. But you can't have a manager checking a box that says you're either stupendous, magnificent, very good, good, or average. Concise, constructive feedback is the fuel workers use to get better. A company that doesn't differentiate performance risks losing its best people.[11]

Profit sharing is another widely used form of incentive compensation. More than 30 percent of U.S. companies have profit-sharing plans, but critics emphasize that too many factors affect profits for this to be a good criterion. Taxes, pricing, or an acquisition would wipe out profits, for example. Also, firms try to minimize profits in a sense to reduce taxes.

For employee (rather than executive) bonuses and incentives, only 16 percent of U.S. companies are now using stock price, down from 29 percent in 2009.[12] Instead, companies are using profit in order to more closely link employees' incentives to spending and budget decisions. PepsiCo, for example, recently began using profit and cash flow instead of stock price to focus managers on profit and cash-flow targets. PepsiCo's CFO, Hugh Johnston, said: "The change allows our employees to make decisions about spending and profit trade-offs themselves, rather than simply being handed a budget to follow; it's something they can wrap their arms around and say, 'Now I understand how I can impact PepsiCo's stock price.'" PepsiCo's new compensation system based on profit enabled the company to lower its capital spending to 4.5 percent of sales in 2012, down from an historical average of about 5.5 percent. For upper-level executives, stock price is still the major variable used for compensation incentives, but for mid-and-lower level managers and employees, stock price is dependent on too many extraneous variables for it to be an effective compensation variable.

The good news for shareholders is that in 2013, over 50 percent of CEO compensation was directly associated with the performance of the firm, rather than salary—up from 35 percent in 2009 (*WSJ*, 3-21-13, p. B1). Note below that Indra Nooyi of PepsiCo was the third highest paid women CEO in 2012 in the USA:

1. Irene Rosenfeld at Kraft ($21.9M)
2. Debra Cafaro at Ventas ($18.5M)
3. Indra Nooyi at PepsiCo ($17.1M)
4. Meg Whitman at HP ($16.5M)
5. Ellen Kullman at DuPont ($15.9M)
6. Angela Braly at WellPoint ($13.3M)

Still another criterion widely used to link performance and pay to strategies is gain sharing. **Gain sharing** requires employees or departments to establish performance targets; if actual results exceed objectives, all members get bonuses. More than 26 percent of U.S. companies use some form of gain sharing; about 75 percent of gain-sharing plans have been adopted since 1980. Carrier, a subsidiary of United Technologies, has had excellent success with gain sharing in its six plants in Syracuse, New York; Firestone's tire plant in Wilson, North Carolina, has experienced similar success with gain sharing.

Criteria such as sales, profit, production efficiency, quality, and safety could also serve as bases for an effective **bonus system**. If an organization meets certain understood, agreed-on profit objectives, every member of the enterprise should share in the harvest. A bonus system can be an effective tool for motivating individuals to support strategy-implementation efforts. BankAmerica, for example, recently overhauled its incentive system to link pay to sales of the bank's most profitable products and services. Branch managers receive a base salary plus a bonus based both on the number of new customers and on sales of bank products. Every employee in each branch is also eligible for a bonus if the branch exceeds its goals. Thomas Peterson, a top BankAmerica executive, says, "We want to make people responsible for meeting their goals, so we pay incentives on sales, not on controlling costs or on being sure the parking lot is swept."

Five tests are often used to determine whether a performance-pay plan will benefit an organization:

1. ***Does the plan capture attention?*** Are people talking more about their activities and taking pride in early successes under the plan?
2. ***Do employees understand the plan?*** Can participants explain how it works and what they need to do to earn the incentive?
3. ***Is the plan improving communication?*** Do employees know more than they used to about the company's mission, plans, and objectives?
4. ***Does the plan pay out when it should?*** Are incentives being paid for desired results—and being withheld when objectives are not met?
5. ***Is the company or unit performing better?*** Are profits up? Has market share grown? Have gains resulted in part from the incentives?[13]

In addition to a dual bonus system, a combination of reward strategy incentives, such as salary raises, stock options, fringe benefits, promotions, praise, recognition, criticism, fear, increased job autonomy, and awards, can be used to encourage managers and employees to push hard for successful strategic implementation. The range of options for getting people, departments, and divisions to actively support strategy-implementation activities in a particular organization is almost limitless. Merck, for example, recently gave each of its 37,000 employees a 10-year option to buy 100 shares of Merck stock at a set price of $127. Steven Darien, Merck's vice president of human resources, says, "We needed to find ways to get everyone in the workforce on board in terms of our goals and objectives. Company executives will begin meeting with all Merck workers to explore ways in which employees can contribute more."

Managing Resistance to Change

No organization or individual can escape change. But the thought of change raises anxieties because people fear economic loss, inconvenience, uncertainty, and a break in normal social patterns. Almost any change in structure, technology, people, or strategies has the potential to disrupt comfortable interaction patterns. For this reason, people resist change. The strategic-management process itself can impose major changes on individuals and processes. Reorienting an organization to get people to think and act strategically is not an easy task.

Resistance to change can be considered the single greatest threat to successful strategy implementation. Resistance regularly occurs in organizations in the form of sabotaging production machines, absenteeism, filing unfounded grievances, and an unwillingness to cooperate. People often resist strategy implementation because they do not understand what is happening or why changes are taking place. In that case, employees may simply need accurate information. Successful strategy implementation hinges on managers' ability to develop an organizational climate conducive to change. Change must be viewed as an opportunity rather than as a threat by managers and employees.

Resistance to change can emerge at any stage or level of the strategy-implementation process. Although there are various approaches for implementing changes, three commonly used strategies are a force change strategy, an educative change strategy, and a rational or self-interest change strategy. A **force change strategy** involves giving orders and enforcing those orders; this strategy has the advantage of being fast, but it is plagued by low commitment and high resistance. The **educative change strategy** is one that presents information to convince people of the need for change; the disadvantage of an educative change strategy is that implementation becomes slow and difficult. However, this type of strategy evokes greater commitment and less resistance than does the force change strategy. Finally, a **rational change strategy** or **self-interest change strategy** is one that attempts to convince individuals that the change is to their personal advantage. When this appeal is successful, strategy implementation can be relatively easy. However, implementation changes are seldom to everyone's advantage.

The rational change strategy is the most desirable, so this approach is examined a bit further. Managers can improve the likelihood of successfully implementing change by carefully designing change efforts. Jack Duncan described a rational or self-interest change strategy as

consisting of four steps. First, employees are invited to participate in the process of change and in the details of transition; participation allows everyone to give opinions, to feel a part of the change process, and to identify their own self-interests regarding the recommended change. Second, some motivation or incentive to change is required; self-interest can be the most important motivator. Third, communication is needed so that people can understand the purpose for the changes. Giving and receiving feedback is the fourth step: everyone enjoys knowing how things are going and how much progress is being made.[14]

Because of diverse external and internal forces, change is a fact of life in organizations. The rate, speed, magnitude, and direction of changes vary over time by industry and organization. Strategists should strive to create a work environment in which change is recognized as necessary and beneficial so that individuals can more easily adapt to change. Adopting a strategic-management approach to decision making can itself require major changes in the philosophy and operations of a firm.

Strategists can take a number of positive actions to minimize managers' and employees' resistance to change. For example, individuals who will be affected by a change should be involved in the decision to make the change and in decisions about how to implement the change. Strategists should anticipate changes and develop and offer training and development workshops so that managers and employees can adapt to those changes. They also need to effectively communicate the need for changes. The strategic-management process can be described as a process of managing change.

Organizational change should be viewed today as a continuous process rather than as a project or event. The most successful organizations today continuously adapt to changes in the competitive environment, which themselves continue to change at an accelerating rate. It is not sufficient today to simply react to change. Managers need to anticipate change and ideally be the creator of change. Viewing change as a continuous process is in stark contrast to an old management doctrine regarding change, which was to unfreeze behavior, change the behavior, and then refreeze the new behavior. The new "continuous organizational change" philosophy should mirror the popular "continuous quality improvement philosophy."

Creating a Strategy-Supportive Culture

Strategists should strive to preserve, emphasize, and build on aspects of an existing **culture** that support proposed new strategies. Aspects of an existing culture that are antagonistic to a proposed strategy should be identified and changed. Substantial research indicates that new strategies are often market-driven and dictated by competitive forces. For this reason, changing a firm's culture to fit a new strategy is usually more effective than changing a strategy to fit an existing culture. As indicated in Table 10-11, numerous techniques are available to alter

TABLE 10-11 Ways and Means for Altering an Organization's Culture

1. Recruitment
2. Training
3. Transfer
4. Promotion
5. Restructuring
6. Reengineering
7. Role modeling
8. Positive reinforcement
9. Mentoring
10. Revising vision and/or mission
11. Redesigning physical spaces/facades
12. Altering reward system
13. Altering organizational policies, procedures, and practices

an organization's culture, including recruitment, training, transfer, promotion, restructure of an organization's design, role modeling, positive reinforcement, and mentoring.

Schein indicated that the following elements are most useful in linking culture to strategy:

1. Formal statements of organizational philosophy, charters, creeds, materials used for recruitment and selection, and socialization
2. Designing of physical spaces, facades, and buildings
3. Deliberate role modeling, teaching, and coaching by leaders
4. Explicit reward and status system and promotion criteria
5. Stories, legends, myths, and parables about key people and events
6. What leaders pay attention to, measure, and control
7. Leader reactions to critical incidents and organizational crises
8. How the organization is designed and structured
9. Organizational systems and procedures
10. Criteria used for recruitment, selection, promotion, leveling off, retirement, and "excommunication" of people[15]

When Volkswagen AG acquired Porsche in late 2012, there was concern that the 75-year-old Volkswagen Chairman and patriarch, Ferdinand Piech's autocratic style would be at odds with Porsche's corporate culture. Porsche had for a long time placed a premium on individual effort among its engineers and designers, often encouraging competition among groups to come up with new design ideas and innovations. Time will tell if Volkswagen and Porsche can meld their cultures into a competitive advantage.

In the personal and religious side of life, the impact of loss and change is easy to see.[16] Memories of loss and change often haunt individuals and organizations for years. Ibsen wrote, "Rob the average man of his life illusion and you rob him of his happiness at the same stroke."[17] When attachments to a culture are severed in an organization's attempt to change direction, employees and managers often experience deep feelings of grief. This phenomenon commonly occurs when external conditions dictate the need for a new strategy. Managers and employees often struggle to find meaning in a situation that changed many years before. Some people find comfort in memories; others find solace in the present. Weak linkages between strategic management and organizational culture can jeopardize performance and success. Deal and Kennedy emphasized that making strategic changes in an organization always threatens a culture:

> People form strong attachments to heroes, legends, the rituals of daily life, the hoopla of extravaganza and ceremonies, and all the symbols of the workplace. Change strips relationships and leaves employees confused, insecure, and often angry. Unless something can be done to provide support for transitions from old to new, the force of a culture can neutralize and emasculate strategy changes.[18]

Production and Operations Concerns When Implementing Strategies

Apple employs thousands of its own workers in China, but about 700,000 assembly workers at manufacturing contractors like Foxconn put together Apple products. It would be almost impossible to bring those jobs to the USA for at least three reasons. First of all, Foxconn—China's largest private employer and the manufacturer of an estimated 40 percent of the world's consumer electronic devices—pays its assembly workers far less than U.S. labor laws would allow. A typical salary is about $18 a day. Secondly, unlike U.S. plants, Foxconn and other Chinese manufacturing operations house employees in dormitories and can send hundreds of thousands of workers to the assembly lines at a moment's notice. On the lines, workers are subjected to what most Americans would consider unbearable long hours and tough working conditions. That system gives tech companies the efficiency needed to race products out the door, so speed is a bigger factor than pay. Finally, most of the component suppliers for Apple and other technology giants are also

TABLE 10-13 Labor Cost-Saving Tactics

Salary freeze
Hiring freeze
Salary reductions
Reduce employee benefits
Raise employee contribution to health-care premiums
Reduce employee 401(k)/403(b) match
Reduce employee workweek
Mandatory furlough
Voluntary furlough
Hire temporary instead of full-time employees
Hire contract employees instead of full-time employees
Volunteer buyouts (Walt Disney is doing this)
Halt production for three days a week (Toyota Motor is doing this)
Layoffs
Early retirement
Reducing or eliminating bonuses

Source: Based on Dana Mattioli, "Employers Make Cuts Despite Belief Upturn Is Near," *Wall Street Journal*, April 23, 2009, B4.

when that firm signed a new union contract recently that creates a tier of "casual workers" with no benefits and no minimum number of hours, allowing Harley to call up workers only as needed.[20] Table 10-13 lists ways that companies today are reducing labor costs to stay financially sound.

A well-designed strategic-management system can fail if insufficient attention is given to the human resource dimension. Human resource problems that arise when businesses implement strategies can usually be traced to one of three causes: (1) disruption of social and political structures, (2) failure to match individuals' aptitudes with implementation tasks, and (3) inadequate top management support for implementation activities.[21]

Strategy implementation poses a threat to many managers and employees in an organization. New power and status relationships are anticipated and realized. New formal and informal groups' values, beliefs, and priorities may be largely unknown. Managers and employees may become engaged in resistance behavior as their roles, prerogatives, and power in the firm change. Disruption of social and political structures that accompany strategy execution must be anticipated and considered during strategy formulation and managed during strategy implementation.

A concern in matching managers with strategy is that jobs have specific and relatively static responsibilities, although people are dynamic in their personal development. Commonly used methods that match managers with strategies to be implemented include transferring managers, developing leadership workshops, offering career development activities, promotions, job enlargement, and job enrichment.

A number of other guidelines can help ensure that human relationships facilitate rather than disrupt strategy-implementation efforts. Specifically, managers should do a lot of chatting and informal questioning to stay abreast of how things are progressing and to know when to intervene. Managers can build support for strategy-implementation efforts by giving few orders, announcing few decisions, depending heavily on informal questioning, and seeking to probe and clarify until a consensus emerges. Key thrusts that succeed should be rewarded generously and visibly.

Perhaps the best method for preventing and overcoming human resource problems in strategic management is to actively involve as many managers and employees as possible in the process. Although time consuming, this approach builds understanding, trust, commitment, and ownership and reduces resentment and hostility. The true potential of strategy formulation and implementation resides in people.

TABLE 10-12 Production Management and Strategy Implementation

Type of Organization	Strategy Being Implemented	Production System Adjustments
Hospital	Adding a cancer center (Product Development)	Purchase specialized equipment and add specialized people.
Bank	Adding 10 new branches (Market Development)	Perform site location analysis.
Beer brewery	Purchasing a barley farm operation (Backward Integration)	Revise the inventory control system.
Steel manufacturer	Acquiring a fast-food chain (Unrelated Diversification)	Improve the quality control system.
Computer company	Purchasing a retail distribution chain (Forward Integration)	Alter the shipping, packaging, and transportation systems.

in China or other Asian countries. That geographic clustering gives companies the flexibility to change a product design at the last minute and still ship on time.

Production and operations capabilities, limitations, and policies can significantly enhance or inhibit the attainment of objectives. Production processes typically constitute more than 70 percent of a firm's total assets. A major part of the strategy-implementation process takes place at the production site. Production-related decisions on plant size, plant location, product design, choice of equipment, kind of tooling, size of inventory, inventory control, quality control, cost control, use of standards, job specialization, employee training, equipment and resource utilization, shipping and packaging, and technological innovation can have a dramatic impact on the success or failure of strategy-implementation efforts.

Examples of adjustments in production systems that could be required to implement various strategies are provided in Table 10-12 for both for-profit and nonprofit organizations. For instance, note that when a bank formulates and selects a strategy to add 10 new branches, a production-related implementation concern is site location. The largest bicycle company in the USA, Huffy, recently ended its own production of bikes and now contracts out those services to Asian and Mexican manufacturers. Huffy focuses instead on the design, marketing, and distribution of bikes, but it no longer produces bikes itself. The Dayton, Ohio, company closed its plants in Ohio, Missouri, and Mississippi.

Just-in-time (JIT) production approaches have withstood the test of time. JIT significantly reduces the costs of implementing strategies. With JIT, parts and materials are delivered to a production site just as they are needed, rather than being stockpiled as a hedge against later deliveries. Harley-Davidson reports that at one plant alone, JIT freed $22 million previously tied up in inventory and greatly reduced reorder lead time.

Factors that should be studied before locating production facilities include the availability of major resources, the prevailing wage rates in the area, transportation costs related to shipping and receiving, the location of major markets, political risks in the area or country, and the availability of trainable employees. Some of these factors explain why many manufacturing operations in China are moving back to Mexico, or to Vietnam, or even back to the USA.

Human Resource Concerns When Implementing Strategies

More and more companies are instituting furloughs to cut costs as an alternative to laying off employees. **Furloughs** are temporary layoffs and even white-collar managers are being given furloughs, once confined to blue-collar workers. A few organizations furloughing professional workers include Gulfstream Aerospace, Media General, Gannett, the University of Maryland, Clemson University, and Spansion. Most companies are still using temporary and part-time workers rather than hiring full-time employees, which suggests that high unemployment rates may be a long-term trend. More and more companies may follow Harley-Davidson's lead

TABLE 10-13 Labor Cost-Saving Tactics

Salary freeze
Hiring freeze
Salary reductions
Reduce employee benefits
Raise employee contribution to health-care premiums
Reduce employee 401(k)/403(b) match
Reduce employee workweek
Mandatory furlough
Voluntary furlough
Hire temporary instead of full-time employees
Hire contract employees instead of full-time employees
Volunteer buyouts (Walt Disney is doing this)
Halt production for three days a week (Toyota Motor is doing this)
Layoffs
Early retirement
Reducing or eliminating bonuses

Source: Based on Dana Mattioli, "Employers Make Cuts Despite Belief Upturn Is Near," *Wall Street Journal*, April 23, 2009, B4.

when that firm signed a new union contract recently that creates a tier of "casual workers" with no benefits and no minimum number of hours, allowing Harley to call up workers only as needed.[20] Table 10-13 lists ways that companies today are reducing labor costs to stay financially sound.

A well-designed strategic-management system can fail if insufficient attention is given to the human resource dimension. Human resource problems that arise when businesses implement strategies can usually be traced to one of three causes: (1) disruption of social and political structures, (2) failure to match individuals' aptitudes with implementation tasks, and (3) inadequate top management support for implementation activities.[21]

Strategy implementation poses a threat to many managers and employees in an organization. New power and status relationships are anticipated and realized. New formal and informal groups' values, beliefs, and priorities may be largely unknown. Managers and employees may become engaged in resistance behavior as their roles, prerogatives, and power in the firm change. Disruption of social and political structures that accompany strategy execution must be anticipated and considered during strategy formulation and managed during strategy implementation.

A concern in matching managers with strategy is that jobs have specific and relatively static responsibilities, although people are dynamic in their personal development. Commonly used methods that match managers with strategies to be implemented include transferring managers, developing leadership workshops, offering career development activities, promotions, job enlargement, and job enrichment.

A number of other guidelines can help ensure that human relationships facilitate rather than disrupt strategy-implementation efforts. Specifically, managers should do a lot of chatting and informal questioning to stay abreast of how things are progressing and to know when to intervene. Managers can build support for strategy-implementation efforts by giving few orders, announcing few decisions, depending heavily on informal questioning, and seeking to probe and clarify until a consensus emerges. Key thrusts that succeed should be rewarded generously and visibly.

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Employee Stock Ownership Plans (ESOPs)

An ESOP is a tax-qualified, defined-contribution, employee-benefit plan whereby employees purchase stock of the company through borrowed money or cash contributions. ESOPs empower employees to work as owners; this is a primary reason why the number of ESOPs have grown dramatically to more than 10,000 firms covering more than 14 million employees. ESOPs now control more than $600 billion in corporate stock in the USA.

Some ESOP companies include:

- W. L. Gore & Associates—maker of medical and industrial products as well as Gore-Tex
- Herman Miller—famous for making innovative office furniture
- KCI—a civil engineering firm
- HCSS—a software manufacturer for the heavy construction industry

Besides reducing worker alienation and stimulating productivity, ESOPs allow firms other benefits, such as substantial tax savings. Principal, interest, and dividend payments on ESOP-funded debt are tax deductible. Banks lend money to ESOPs at interest rates below prime. This money can be repaid in pretax dollars, lowering the debt service as much as 30 percent in some cases. “The ownership culture really makes a difference, when management is a facilitator, not a dictator,” says Corey Rosen, executive director of the National Center for Employee Ownership. Fifteen employee-owned companies are listed in Table 10-14.

If an ESOP owns more than 50 percent of the firm, those who lend money to the ESOP are taxed on only 50 percent of the income received on the loans. ESOPs are not for every firm, however, because the initial legal, accounting, actuarial, and appraisal fees to set up an ESOP are about $50,000 for a small or midsized firm, with annual administration expenses of about $15,000. Analysts say ESOPs also do not work well in firms that have fluctuating payrolls and profits. Human resource managers in many firms conduct preliminary research to determine the desirability of an ESOP, and then they facilitate its establishment and administration if benefits outweigh the costs.

Wyatt Cafeterias, a southwestern U.S. operator of 120 cafeterias, also adopted the ESOP concept to prevent a hostile takeover. Employee productivity at Wyatt greatly increased since the ESOP began, as illustrated in the following quote:

> The key employee in our entire organization is the person serving the customer on the cafeteria line. We now tell the tea cart server, “Don’t wait for the manager to tell you how to do your job better or how to provide better service. You take care of it.” Sure,

TABLE 10-14 Fourteen Example ESOP Firms

Firm	Headquarters Location
Publix Supermarkets	Florida
Tribune Company	Illinois
Lifetouch	Minnesota
John Lewis Partnership	United Kingdom
Mondragon Cooperative	Spain
Houchens Industries	Kentucky
Amsted Industries	Illinois
Mast General Store	North Carolina
HDR, Inc.	Nebraska
Yoke’s Fresh Market	Washington
SPARTA, Inc.	California
Hy-Vee	Iowa
Bi-Mart	Washington
Ferrellgas Partners	Kansas

we're looking for productivity increases, but since we began pushing decisions down to the level of people who deal directly with customers, we've discovered an awesome side effect—suddenly the work crews have this "happy to be here" attitude that the customers really love.[22]

Balancing Work Life and Home Life

More women earn both undergraduate and graduate degrees in the USA than men, but a wage disparity still persists between men and women at all education levels.[23] Women on average make 25 percent less than men. The average age today for women to get married in the USA is 30 for those with a college degree, and 26 for those with just a high school degree. About 29 percent of both men and women in the USA today have a college degree, whereas in 1970 only 8 percent of women and 14 percent of men had college degrees.

A recent article in *Wall Street Journal* (12-5-12, A3) revealed that in the USA, women now hold 33.4 percent of legal jobs, including lawyers, judges, magistrates, and other judicial employees, up from 29.2 percent in 2000. Also, the percentage of women physicians and surgeons rose to 32.4 percent from 26.8 percent during that time. This is great news; however, the bad news is that the median salary for women lawyers is $90,000 versus $122,000 for men, and the median salary for female physicians is $112,128 versus $186,916 for men.

Globally, it is widely acknowledged that the best countries for working women are Norway, Sweden, Finland, and Denmark—that often rate above the USA. According to the World Economic Forum's 2012 report on the global gender gap overall, the USA ranked number 22 overall, and on wage equality, the USA ranked number 61 behind Madagascar, Cambodia, and Guyana. In that report, women in the USA make on average 67 percent of what men make, compared, for example, to 73 percent in Canada. Unmarried women in fact make more than men in many countries. Married women with children, however, usually make considerably lower than men.

Work and family strategies have become so popular among companies today that the strategies now represent a competitive advantage for those firms that offer such benefits as elder care assistance, flexible scheduling, job sharing, adoption benefits, an on-site summer camp, employee help lines, pet care, and even lawn service referrals. New corporate titles such as work and life coordinator and director of diversity are becoming common.

Working Mother magazine annually published its listing of "The 100 Best Companies for Working Mothers" (www.workingmother.com). Three especially important variables used in the ranking were availability of flextime, advancement opportunities, and equitable distribution of benefits among companies. Other important criteria are compressed weeks, telecommuting, job sharing, childcare facilities, maternity leave for both parents, mentoring, career development, and promotion for women. *Working Mother's* top 10 best companies for working women in 2012 are provided in Table 10-15. *Working Mother* also conducts extensive research to determine the best U.S. firms for women of color.

A corporate objective to become more lean and mean must today include consideration for the fact that a good home life contributes immensely to a good work life. The work and family issue is no longer just a women's issue. Some specific measures that firms are taking to address this issue are providing spouse relocation assistance as an employee benefit; providing company resources for family recreational and educational use; establishing employee country clubs, such as those at IBM and Bethlehem Steel; and creating family and work interaction opportunities. A study by Joseph Pleck of Wheaton College found that in companies that do not offer paternity leave for fathers as a benefit, most men take short, informal paternity leaves anyway by combining vacation time and sick days.

Some organizations have developed family days, when family members are invited into the workplace, taken on plant or office tours, dined by management, and given a chance to see exactly what other family members do each day. Family days are inexpensive and increase the employee's pride in working for the organization. Flexible working hours during the week are another human resource response to the need for individuals to balance work life and home life. The work and family topic is being made part of the agenda at meetings and thus is being discussed in many organizations.

TABLE 10-15 Top Ten Companies for Working Women

1. Bank of America—allows employees to define how they work.
2. Deloitte—grants employees four unpaid weeks off annually.
3. Ernst & Young (E&Y)—up to 75 percent of its employees work outside E&Y offices. Breastfeeding moms may rely on lactation rooms at most sites.
4. General Mills—women head five of the seven U.S. retail divisions.
5. Grant Thornton—offers 8 weeks of paid maternity leave and numerous flexible work options.
6. IBM—offers outstanding assistance to children of employees through its Special Care for Children program.
7. KPMG—employees may take 26 (job guaranteed, partially paid) weeks off following the birth or adoption of a child.
8. Procter & Gamble (P&G)—all P&G office employees may adjust the times that they start or finish work by two hours either way; 47 percent of all P&G hires in 2011 were women. Breastfeeding moms may rely on lactation rooms at most sites.
9. PricewaterhouseCoopers—many female partners go through the Breakthrough Leadership Development Program and achieve top executive positions.
10. WellStar Health System—has an in-house concierge service to help moms get things done.

Source: Based on 2012: http://www.workingmother.com/best-company-list/129110/7271.

There is great room for improvement in removing the glass ceiling domestically, especially considering that women make up 47 percent of the U.S. labor force. **Glass ceiling** refers to the invisible barrier in many firms that bars women and minorities from top-level management positions. The USA is a leader globally in promoting women and minorities into mid- and top-level managerial positions in business. Only 4.0 percent of Fortune 500 firms have a woman CEO. Table 10-16 gives the 21 Fortune 500 Women CEOs in 2013. These women are wonderful role models for women around the world.

TABLE 10-16 Fortune 500 Women CEOs in 2013

CEO	Company
Angela Braly	WellPoint
Patricia Woertz	Archer Daniels Midland
Marissa Mayer	Yahoo!
Indra Nooyi	PepsiCo
Irene Rosenfeld	Kraft Foods
Carol Meyrowitz	TJX
Virginia Rometty	IBM
Debra Reed	Sempra Energy
Deanna Mulligan	Guardian Life Insurance
Sherilyn McCoy	Avon Products
Denise Morrison	Campbell Soup
Maggie Wilderotter	Frontier Communications
Meg Whitman	Hewlett-Packard
Ilene Gordon	Corn Products
Heather Bresch	Mylan
Gracia Martore	Gannett
Ellen Kullman	DuPont
Ursula Burns	Xerox
Kathleen Mazzarella	Graybar Electric
Beth Mooney	Key Corp
Marillyn Hewson	Lockheed Martin Corp

Benefits of a Diverse Workforce

CEO Rosalind Brewer, the first African American and first woman to lead a Walmart business unit, is turning Walmart's SAM's Club into a $100 billion business. After taking over of SAM'S in 2012, Brewer says SAM's is raising membership fees, building stores in metropolitan areas instead of rural towns, adding brands like Eddie Bauer, Nautica, and Lucky Brand Jeans that differential SAM's from Walmart and other discount retailers. Brewer is also opening SAM's stores earlier to capture small businesspersons who buy the morning of their day's business. CEO Brewer is doing a great job trying to gain ground on Costco Wholesale, which logged nearly double the sales of SAM's Club in 2012.

In late 2012, when CEO Chris Kubasik at Lockheed Martin was fired for having an "improper" relationship with a fellow employee, a long-time Lockheed Martin female executive, Marillyn Hewson, was appointed as the company's new CEO. Three of the six largest Pentagon contractors now have female CEO's. Lockheed Martin is the world's largest defense contractor.

Advertising agencies are an example industry transitioning from being specialist Hispanic, African American, and Asian agencies to becoming multicultural, generalist agencies. Leading executives of culturally specialized agencies are defecting in large numbers to generalist agencies as companies increasingly embrace multicultural marketing using multicultural ad agencies. Companies such as Burger King are shifting their Hispanic and African American ad agencies to generalist firms such as Crispin. Church's Chicken says pooling everything at a generalist agency helps reinforce the multicultural component of its overall market strategy.[24]

In Latin and South America, the number of women in high office has increased dramatically in recent years. Brazil recently elected its first woman president, Dilma Rouseff. Both Argentina and Chile already have a woman president, Cristina Kirchner and Michelle Bachelet, respectively. Regarding the percent of national congressional seats held by women, Argentina has 38.3 percent followed by Honduras with 23.4 percent, as compared to Europe with 20.0 percent, Nordic countries at 41.6 percent, and Arab states at 11.1 percent.[25] Women now make up 53 percent of the work force in Latin and South America.

A recent study by McKinsey & Co. in Asia revealed that Asian companies' average return on equity improves from 15 percent to 22 percent when more and more women hold high-level positions.[26] Wang Jin at McKinsey says: "Women tend to be stronger in terms of collaboration and people development, while men tend to be stronger in individual decision making. By having more women at the senior level, companies are helping to improve organizational health as well as financial performance."[27] The percentage of women on corporate boards in Australia increased from 8.3 in 2010 to 14 percent in 2012.[28] Malaysia and South Korea are also making excellent progress integrating women into upper levels of management and subsidizing companies that build child-care facilities and help women juggle work and family life. In contrast, women in India still are expected to care for their family and extended family; also in India women often unfortunately have an abortion if they know their fetus is a girl. Overall in Asia, women comprise only 6 percent of corporate board seats, compared to 17 percent in Europe and 15 percent in the USA.

An organization can perhaps be most effective when its workforce mirrors the diversity of its customers. For global companies, this goal can be optimistic, but it is a worthwhile goal.

Corporate Wellness Programs

Recent articles detail how companies such as Johnson & Johnson (J&J), Lowe's Home-Improvement, the supermarket chain H-E-B, and Healthwise report impressive returns on investment of comprehensive, well-run employee wellness programs, sometimes as high as six to one.[29] A recent study by Fidelity Investments and the National Business Group on Health reports that nearly 90 percent of employers today offer some kind of wellness incentives or prizes to employees who "get healthier," up from 59 percent in 2009. For example, JetBlue Airways offers employees money—$25 for teeth cleanings and $400 for completing an Ironman triathlon, etc. Furniture company, KI, has all its employees divided into four groups based on

"healthiness" with the most-healthy people paying $1,000 less on health insurance premiums than the least-healthy employees.

According to the 2013 National Survey of Employer-Sponsored Health Plans, the percentage of large employers (500+ employees) that offer lower health insurance premiums to nonsmokers increased from 9 percent in 2009 to 15 percent in 2012 (*WSJ,* 2-10-R5). In addition, 42 percent of large firms now offer onsite exercise or yoga classes, and 35 percent offer onsite Weight Watchers programs. J&J estimates that wellness programs have cumulatively saved the company $250 million on health-care costs over the past decade. All J&J facilities around the world are tobacco free. At the software firm SAS Institute headquartered in Cary, North Carolina, voluntary turnover of employees has dropped to just 4 percent, largely, the firm says, due to its effective wellness program. On the SAS main campus, 70 percent of employees use the recreation center at least twice a week. SAS is number 3 among *Fortune*'s "100 Best Companies to Work For." At Healthwise, CEO Don Kemper's personal commitment to wellness permeates the entire culture of the firm, from monthly staff meetings to an annual Wellness Day. Lowe's offers employees a monthly $50 discount on medical insurance if they pledge that they and covered dependents will not use any tobacco products.

Chevron is also a model corporate wellness company that sponsors many internal and external wellness activities. Chevron and other companies such as Biltmore that provide exemplary wellness programs think beyond diet and exercise and focus also on stress management by assisting employees with such issues as divorce, serious illness, death and grief recovery, child rearing, and care of aging parents. Biltmore's two-day health fairs twice a year focus on physical, financial, and spiritual wellness. At Lowe's headquarters, an impressive spiral staircase in the lobby makes climbing the stairs more appealing than riding the elevator. Such practices as "providing abundant bicycle racks," "conducting walking meetings," and "offering five minute stress breaks" are becoming common at companies to promote a corporate wellness culture.

Whole Foods Market headquartered in Austin, Texas, is another outstanding corporate wellness company with their employees receiving a 30 percent discount card on all products sold in their stores "if they maintain and document a healthy lifestyle." In addition, Wegman's Food Markets, headquartered in Rochester, New York, is another supermarket chain with an excellent corporate wellness program. More than 11,000 of Wegman's 39,000 employees recently took part in a challenge to eat five cups of fruit and vegetables and walk up to 10,000 steps a day for eight weeks. Wegman recently ranked number 4 among *Fortune*'s "100 Best Companies to Work For."

Firms are striving to lower the accelerating costs of employees' health-care insurance premiums. Many firms such as Scotts Miracle-Gro Company (based in Marysville, Ohio), IBM, and Microsoft are implementing wellness programs, requiring employees to get healthier or pay higher insurance premiums. Employees that do get healthier win bonuses, free trips, and pay lower premiums; nonconforming employees pay higher premiums and receive no "healthy" benefits. Wellness of employees has become a strategic issue for many firms. Most firms require a health examination as a part of an employment application, and healthiness is more and more becoming a hiring factor. Michael Porter, coauthor of *Redefining Health Care*, says, "We have this notion that you can gorge on hot dogs, be in a pie-eating contest, and drink every day, and society will take care of you. We can't afford to let individuals drive up company costs because they're not willing to address their own health problems."

Wellness programs provide counseling to employees and seek lifestyle changes to achieve healthier living. For example, trans fats are a major cause of heart disease. Near elimination of trans fats in one's diet will reduce one's risk for heart attack. Saturated fats are also bad, so one should avoid eating too much red meat and dairy products, which are high in saturated fats. Seven key lifestyle habits listed in Table 10-17 may significantly improve health and longevity. Boston Market recently removed all salt shakers off tables in its 476 restaurants. The company is also reducing salt by 20 percent in its rotisserie chicken, macaroni and cheese, and mashed potatoes. CEO George Michel says Boston Market will reduce salt levels by 15 percent menu-wide by the end of 2014. Pepper shakers remain on tables at Boston Market.

TABLE 10-17 The Key to Staying Healthy, Living to 100, and Being a "Well" Employee

1. Eat nutritiously—eat a variety of fruits and vegetables daily because they have ingredients that the body uses to repair and strengthen itself.
2. Stay hydrated—drink plenty of water to aid the body in eliminating toxins and to enable body organs to function efficiently; the body is mostly water.
3. Get plenty of rest—the body repairs itself during rest, so get at least seven hours of sleep nightly, preferably eight hours.
4. Get plenty of exercise—exercise vigorously at least 30 minutes daily so the body can release toxins and strengthen vital organs.
5. Reduce stress—the body's immune system is weakened when one is under stress, making the body vulnerable to many ailments, so keep stress to a minimum.
6. Do not smoke—smoking kills, no doubt about it anymore.
7. Take vitamin supplements—consult your physician, but because it is difficult for diet alone to supply all the nutrients and vitamins needed, supplements can be helpful in achieving good health and longevity.

Source: Based on Lauren Etter, "Trans Fats: Will They Get Shelved?" *Wall Street Journal*, December 8, 2006, A6; Joel Fuhrman, MD, *Eat to Live* (Boston: Little, Brown, 2003).

Special Note to Students

An integral part of managing a firm is continually and systematically seeking to gain and sustain competitive advantage through effective planning, organizing, motivating, staffing, and controlling. Rival firms engage in these same activities, so emphasize in your strategic-management case analysis how your firm implementing your recommendations will outperform rival firms. Remember to be prescriptive rather than descriptive on every page or slide in your project, meaning to be insightful, forward-looking, and analytical rather than just describing operations. It is easy to *describe* a company but is difficult to *analyze* a company. Strategic-management case analysis is about *analyzing* a company and its industry, uncovering ways and means for the firm to best gain and sustain competitive advantage. So communicate throughout your project how your firm, and especially your recommendations, will lead to improved growth and profitability versus rival firms. Avoid vagueness and generalities throughout your project, as your audience or reader seeks great ideas backed up by great analyses. Be analytical and prescriptive rather than vague and descriptive in highlighting every slide you show an audience.

Conclusion

Successful strategy formulation does not at all guarantee successful strategy implementation. Although inextricably interdependent, strategy formulation and strategy implementation are characteristically different. In a single word, strategy implementation means *change*. It is widely agreed that "the real work begins after strategies are formulated." Successful strategy implementation requires the support of, as well as discipline and hard work, from motivated managers and employees. It is sometimes frightening to think that a single individual can irreparably sabotage strategy-implementation efforts.

Formulating the right strategies is not enough because managers and employees must be motivated to implement those strategies. Management issues considered central to strategy implementation include matching organizational structure with strategy, linking performance and pay to strategies, creating an organizational climate conducive to change, managing political relationships, creating a strategy-supportive culture, adapting production and operations processes, and managing human resources. Establishing annual objectives, devising policies, and allocating resources are central strategy-implementation activities common to all organizations. Depending on the size and type of the organization, other management issues could be equally important to successful strategy implementation.

Key Terms and Concepts

annual objectives (p. 335)
avoidance (p. 339)
benchmarking (p. 350)
bonus system (p. 352)
conflict (p. 339)
confrontation (p. 339)
culture (p. 354)
decentralized structure (p. 342)
defusion (p. 339)
delayering (p. 350)
divisional structure by geographic area, product, customer, or process (p. 342)
downsizing (p. 350)
educative change strategy (p. 353)
employee stock ownership plans (ESOP) (p. 358)
establishing annual objectives (p. 335)
force change strategy (p. 353)
functional structure (p. 341)
furloughs (p. 356)
gain sharing (p. 352)
glass ceiling (p. 360)
horizontal consistency of objectives (p. 335)
just-in-time (JIT) (p. 356)
matrix structure (p. 346)
policy (p. 337)
profit sharing (p. 352)
rational change strategy (p. 353)
reengineering (p. 350)
resistance to change (p. 353)
resource allocation (p. 339)
restructuring (p. 350)
rightsizing (p. 350)
self-interest change strategy (p. 353)
Six Sigma (p. 350)
strategic business unit (SBU) structure (p. 340)
vertical consistency of objectives (p. 335)

Issues for Review and Discussion

10-1. Accenture is a strong firm, globally. What are the three major threats you see that face Accenture in your country?
10-2. In order of importance, list the six management issues you feel are most central to strategy implementation. Briefly explain your answer.
10-3. List the five major benefits of a firm that has clearly defined its annual objectives.
10-4. Which approach to conflict resolution would you use to resolve a disagreement between top-level managers, regarding a firm's strategic plan?
10-5. Illustrate a functional organizational chart.
10-6. Create a diagram for a divisional organizational chart.
10-7. Draw a strategic business unit organizational chart.
10-8. Illustrate a matrix organizational chart.
10-9. List ten "do's and don'ts" regarding development of organizational charts.
10-10. Compare and contrast restructuring and reengineering.
10-11. Describe five ways a firm could link performance and pay, to strategies.
10-12. List, in order of importance, eight ways and means for altering an organization's culture. Explain your answer.
10-13. Why are so many firms today installing corporate wellness programs?
10-14. Discuss how business attitudes towards "balancing work life and home life" vary across three countries that you are familiar with.
10-15. Discuss the glass ceiling in your country versus the United States.
10-16. Discuss ESOPs in your country compared to the United States.
10-17. In order of importance, in your opinion, list six advantages of a matrix organizational structure.

10-18. Determine whether your college or university has a corporate wellness program. Provide examples of policies that could be used to implement such a program.
10-19. Do you think horizontal consistency of objectives is as important as vertical consistency? Explain using an example.
10-20. Define policies. Give four examples of policies for a bank.
10-21. Discuss your preference on each of the trade-off decisions required for strategy implementation. Explain why.
10-22. List three categories or approaches for conflict resolution. Which approach would you use for a salesperson who has had a disagreement with a client, regarding value of a property to be listed for sale?
10-23. In order of importance, list six symptoms of an ineffective organizational structure.
10-24. Explain why the functional organizational structure is the most widely used around the world.
10-25. List the advantages and disadvantages of a functional versus divisional structure.
10-26. How should a firm decide between a divisional-by-product versus divisional-by-geographic region type organizational chart?
10-27. A divisional-structure-by-process organizational chart is quite uncommon. Give two examples of the type of companies where this would be appropriate.
10-28. Illustrate a matrix-type structure for a hospital.
10-29. Compare and contrast restructuring with reengineering.
10-30. Explain why it is so important to link performance and pay to strategies.
10-31. Describe five tests that are often used to determine whether a performance-pay plan will benefit an organization.
10-32. Describe three commonly used strategies to minimize employee resistance to change. Which approach would you most often use? Why?
10-33. Give a hypothetical example of each labor cost-saving tactic listed in the chapter.
10-34. Use the Internet to find five companies in your country, which operate based on an ESOP. Present your list to the class.
10-35. Provide the advantages and disadvantages of a firm operating based on an ESOP.
10-36. Visit www.workingmother.com and find five examples of firms, which are best suited for working mothers, and that have business locations in your city.
10-37. There were only 12 *Fortune* 500 women CEOs in 2009. Conduct an Internet research to identify five companies in your country that have women CEOs. Why are there so few women CEOs?
10-38. List four benefits of having a diverse workforce.
10-39. Explain why corporate wellness programs are becoming increasingly popular.
10-40. Define and give an example of Six Sigma.
10-41. Define a glass ceiling. Provide an example.
10-42. How many divisions would a firm have to have for you to recommend an SBU type structure? Why?
10-43. Explain when a matrix type structure may be the most effective for an organization.
10-44. How would you link compensation of your employees to performance of your business?

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

10-45. What are the two major disadvantages of an SBU-type organizational structure? What are the two major advantages? At what point in a firm's growth do you feel the advantages offset the disadvantages? Explain.
10-46. Would you recommend a divisional structure by geographic area, product, customer, or process for a medium-sized bank in your local area? Why?
10-47. Mymanagementlab Only—comprehensive writing assignment for this chapter.

Current Readings

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 10A

Developing an Organizational Chart for Accenture plc

Purpose

Accenture is featured in the opening chapter case as a firm that engages in excellent strategic planning. Accenture plc, headquartered in Dublin, Ireland, is the world's largest consulting firm measured by revenues. As of August 2013, the company has approximately 266,000 employees serving clients in more than 120 countries. India is the single largest employee base for Accenture, with the headcount being close to 100,000, compared to about 50,000 in the United States.

This exercise gives you practice developing an organizational chart.

Instructions

Step 1 Visit Accenture's website. Review the company's most recent *Annual Report*. Note the list of top managers of the firm.

Step 2 Develop an organizational chart for Accenture based on the titles of their top executives.

Step 3 Develop a recommended organizational chart for Accenture based on the guidelines presented in Chapter 10.

EXERCISE 10B
Assessing Accenture's Philanthrophy Efforts

Purpose

Accenture recently awarded Quest Alliance India an additional grant of US$623,000 to help Quest provide approximately 3,000 disadvantaged young people with career and workplace skills. The grant brings Accenture's direct support to Quest Alliance India to more than US$950,000 since 2009. This exercise gives you practice comparing a company's philanthrophy efforts vs its major rivals.

Instructions

Step 1 Visit Accenture's website and click on the Citizenship and Values hotlink. Review Accenture's sustainability efforts.

Step 2 Identify Accenture's major competitors.

Step 3 Compare and contrast Accenture's sustainability efforts versus its two major competitors.

EXERCISE 10C
Revising adidas AG's Organizational Chart

Purpose

Developing and altering organizational charts is an important skill for strategists to possess. This exercise can improve your skill in altering an organization's hierarchical structure in response to new strategies being formed.

Instructions

Step 1 Develop an organizational chart for adidas. On a separate sheet of paper, answer the following questions:

1. What type of organizational chart have you illustrated for adidas?
2. What improvements could you recommend for the adidas organizational chart?

Give your reasoning for each suggestion.

Step 2 Now consider the following:

1. What aspects of your adidas chart do you especially like?
2. What type of organizational chart do you believe would best suit adidas? Why?

EXERCISE 10D
Exploring Objectives

Purpose

The purpose of this exercise is to bridge the gap between key topics in Chapter 10 versus what companies are doing in your area with regard to having clearly defined objectives.

Instructions

Do sufficient research to discover five businesses in your local area that have clearly defined objectives. Discuss the nature and role of objectives in these firms.

EXERCISE 10E

Understanding My University's Culture

Purpose

It is something of an art to uncover the basic values and beliefs that are buried deeply in an organization's rich collection of stories, language, heroes, heroines, and rituals. Yet culture can be the most important factor in implementing strategies.

Instructions

Step 1 On a separate sheet of paper, list the following terms: hero/heroine, belief, metaphor, language, value, symbol, story, legend, saga, folktale, myth, ceremony, rite, and ritual.

Step 2 For your college or university, give examples of each term. If necessary, speak with faculty, staff, alumni, administration, or fellow students of the institution to identify examples of each term.

Step 3 Report your findings to the class. Tell the class how you feel regarding cultural products being consciously used to help implement strategies.

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11

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Strategy Monitoring

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Describe a practical framework for evaluating strategies.
2. Explain why strategy evaluation is complex, sensitive, and yet essential for organizational success.
3. Discuss the importance of contingency planning in strategy evaluation.
4. Explain the role of auditing in strategy evaluation.
5. Describe and develop a Balanced Scorecard.
6. Discuss three 21st-century challenges in strategic management.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

EXERCISE 11A Evaluating BHP Billiton's Strategies

EXERCISE 11B Preparing a Strategy-Evaluation Report for adidas AG

EXERCISE 11C Preparing a Balanced Scorecard for adidas AG

EXERCISE 11D Evaluate My University's Strategies

The best formulated and best implemented strategies become obsolete as a firm's external and internal environments change. It is essential, therefore, that strategists systematically review, evaluate, and control the execution of strategies. This chapter presents a framework that can guide managers' efforts to evaluate strategic-management activities, to make sure they are working, and to make timely changes. Guidelines are presented for formulating, implementing, and evaluating strategies. BHP Billiton is an example company that has reinvented itself a number of times by continually evaluating its strategies and taking bold corrective actions to continue growing.

The Nature of Strategy Evaluation

The strategic-management process results in decisions that can have significant, long-lasting consequences. Erroneous strategic decisions can inflict severe penalties and can be exceedingly difficult, if not impossible, to reverse. Most strategists agree, therefore, that strategy evaluation is vital to an organization's well-being; timely evaluations can alert management to problems or potential problems before a situation becomes critical. Strategy evaluation includes three basic activities: (1) examining the underlying bases of a firm's strategy, (2) comparing expected results with actual results, and (3) taking corrective actions to ensure that performance conforms to plans. The strategy-evaluation stage of the strategic-management process is illustrated in Figure 11-1 with white shading.

Adequate and timely feedback is the cornerstone of effective strategy evaluation. Strategy evaluation can be no better than the information on which it is based. Too much pressure from top managers may result in lower managers contriving numbers they think will be satisfactory.

Strategy evaluation can be a complex and sensitive undertaking. Too much emphasis on evaluating strategies may be expensive and counterproductive. No one likes to be evaluated too closely! The more managers attempt to evaluate the behavior of others, the less control they have. Yet too little or no evaluation can create even worse problems. Strategy evaluation is essential to ensure that stated objectives are being achieved.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

BHP Billiton

BHP Billiton is a large Australian multinational mining and petroleum company headquartered in Melbourne. BHP has major offices in London. BHP is arguably the world's largest mining company and among the top ten largest companies in the world measured by market capitalization. *Fortune* in 2013 ranked BHP as the 115th largest company in the world and the 20th most profitable. The Melbourne side of the firm is BHP Billiton Limited; the London side is BHP Billiton Plc.

BHP is among the world's top producers of iron ore, coal, aluminum, copper, manganese, nickel, silver, uranium, and potash. BHP also has crude oil and natural gas holdings. BHP may soon divest its diamond assets. BHP recently paid $4.75 billion in cash to Chesapeake Energy for all of the company's shale assets and 487,000 acres (1,970 km^2) of mineral rights leases and 420 miles (680 km) of pipeline located in north central Arkansas in the USA. The wells on the mineral leases are producing about 415 million cubic feet of natural gas per day. BHP plans to spend $800 million to $1 billion a year over 10 years to develop the field and triple production.

BHP recently acquired Petrohawk Energy in the USA for $12.1 billion in cash, considerably expanding its shale natural gas resources.

In 2012, BHP ceased operations at its $20 billion Olympic Dam copper and uranium mine expansion project in South Australia, as a result of falling commodity prices and slowing global economic growth. The company just sold its Yeelirrie Uranium Project to Canadian Cameco for about $430 million as part of a broader move to step away from resource expansion in Australia.

In August 2013, BHP announced the vesting outcomes for the five-year long-term incentive plan (LTIP) awards for their top executives. For awards to be granted, BHP had to deliver a total shareholder return (TSR) that exceeded the TSR of a group of peer companies by an average of 5.5 percent per year for five years, or 30.7 percent in total compounded over a five year performance period. For the performance period that ended June 30, 2013, the TSR for peer companies was negative 44.0 percent, compared to BHP's negative 9.4 percent. Thus, BHP top executives received the awards.

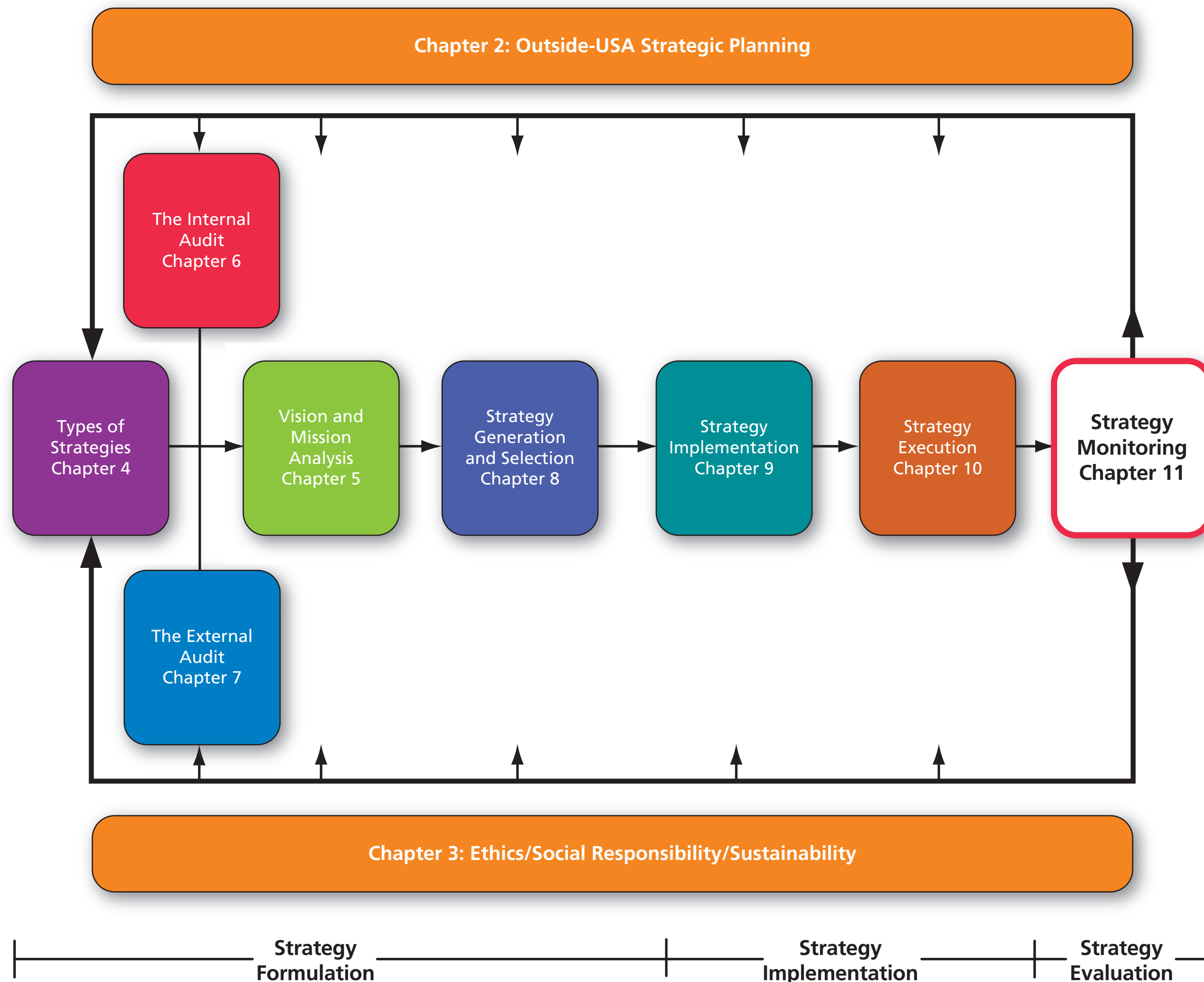

FIGURE 11-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

In many organizations, strategy evaluation is simply an appraisal of how well an organization has performed. Have the firm's assets increased? Has there been an increase in profitability? Have sales increased? Have productivity levels increased? Have profit margin, return on investment, and earnings-per-share ratios increased? Some firms argue that their strategy must have been correct if the answers to these types of questions are affirmative. Well, the strategy or strategies may have been correct, but this type of reasoning can be misleading because strategy evaluation must have both a long-run and short-run focus. Strategies often do not affect short-term operating results until it is too late to make needed changes.

It is impossible to demonstrate conclusively that a particular strategy is optimal or even to guarantee that it will work. One can, however, evaluate it for critical flaws. Richard Rumelt offered four criteria that could be used to evaluate a strategy: consistency, consonance, feasibility, and advantage. Described in Table 11-1, **consonance** and **advantage** are mostly based on a firm's external assessment, whereas **consistency** and **feasibility** are largely based on an internal assessment.

Strategy evaluation is important because organizations face dynamic environments in which key external and internal factors often change quickly and dramatically. Success today is no guarantee of success tomorrow! Joseph Stalin was a ruthless leader (from 1928 on) and premier

TABLE 11-1 Rumelt's Criteria for Evaluating Strategies

Consistency

A strategy should not present inconsistent goals and policies. Organizational conflict and interdepartmental bickering are often symptoms of managerial disorder, but these problems may also be a sign of strategic inconsistency. Three guidelines help determine if organizational problems are the result of inconsistencies in strategy:

- If managerial problems continue despite changes in personnel and if they tend to be issue-based rather than people-based, then strategies may be inconsistent.
- If success for one organizational department means, or is interpreted to mean, failure for another department, then strategies may be inconsistent.
- If policy problems and issues continue to be brought to the top for resolution, then strategies may be inconsistent.

Consonance

Consonance refers to the need for strategists to examine *sets of trends*, as well as individual trends, in evaluating strategies. A strategy must represent an adaptive response to the external environment and to the critical changes occurring within it. One difficulty in matching a firm's key internal and external factors in the formulation of strategy is that most trends are the result of interactions among other trends. For example, the daycare explosion came about as a combined result of many trends that included a rise in the average level of education, increased inflation, and an increase in women in the workforce. Although single economic or demographic trends might appear steady for many years, there are waves of change going on at the interaction level.

Feasibility

A strategy must neither overtax available resources nor create unsolvable subproblems. The final broad test of strategy is its feasibility; that is, can the strategy be attempted within the physical, human, and financial resources of the enterprise? The financial resources of a business are the easiest to quantify and are normally the first limitation against which strategy is evaluated. It is sometimes forgotten, however, that innovative approaches to financing are often possible. Devices, such as captive subsidiaries, sale-leaseback arrangements, and tying plant mortgages to long-term contracts, have all been used effectively to help win key positions in suddenly expanding industries. A less quantifiable, but actually more rigid, limitation on strategic choice is that imposed by individual and organizational capabilities. In evaluating a strategy, it is important to examine whether an organization has demonstrated in the past that it possesses the abilities, competencies, skills, and talents needed to carry out a given strategy.

Advantage

A strategy must provide for the creation or maintenance of a competitive advantage in a selected area of activity. Competitive advantages normally are the result of superiority in one of three areas: (1) resources, (2) skills, or (3) position. The idea that the positioning of one's resources can enhance their combined effectiveness is familiar to military theorists, chess players, and diplomats. Position can also play a crucial role in an organization's strategy. Once gained, a good position is defensible—meaning that it is so costly to capture that rivals are deterred from full-scale attacks. Positional advantage tends to be self-sustaining as long as the key internal and environmental factors that underlie it remain stable. This is why entrenched firms can be almost impossible to unseat, even if their raw skill levels are only average. Although not all positional advantages are associated with size, it is true that larger organizations tend to operate in markets and use procedures that turn their size into advantage, whereas smaller firms seek product or market positions that exploit other types of advantage. The principal characteristic of good position is that it permits the firm to obtain advantage from policies that would not similarly benefit rivals without the same position. Therefore, in evaluating strategy, organizations should examine the nature of positional advantages associated with a given strategy.

Source: Adapted from Richard Rumelt, "The Evaluation of Business Strategy," in W. F. Glueck (ed.), *Business Policy and Strategic Management* (New York: McGraw-Hill, 1980), 359–367. Used with permission.

(from 1941 on) of the Soviet Union until his death in 1953. A famous quote from Stalin was: *History shows that there are no invincible armies.* This quote reveals that even the mightiest, most successful firms must continually evaluate their strategies and be wary of rival firms. An organization should never be lulled into complacency with success. Countless firms have thrived one year only to struggle for survival the following year. Peter Drucker said: Unless strategy evaluation is performed seriously and systematically, and unless strategists are willing to act on the results, energy will be used up defending yesterday."

Demise can come quickly. For example, the large clothing retailer J.C. Penney, based in Plano, Texas, was profitable and fine, until they hired CEO Ron Johnson in November 2011. Johnson implemented a new strategic plan at Penney's that included doing away with coupons, promotions, and discounting in favor of his "fair and square pricing" policy, building branded boutiques stores-within stores, replacing their chief marketing officer, Michael Francis, with himself, adding more celebrity brands and high-tech features to attract younger customers, exiting from the outlet

business, and extensive, expensive remodeling. Johnson envisioned all Penney stores to have tables with iPads for customers to use, and activities for kids such as making greeting cards, and even Pilates and yoga classes within stores.[1] Moody's Investors Service downgraded Penney's long-term debt two notches to Ba3 from Ba1 in August 2012; Penney's is still unprofitable in late 2013.

Another example of quick demise is Hewlett-Packard, which delivered an $8.9 billion loss in its fiscal third quarter of 2012 as the firm's revenue dropped to $29.7 billion. Consumers are flocking in the millions to tablets and away from desktop and laptop computers, crushing HP who had not anticipated such as swift switch in consumer preferences. This consumer trend is also crushing another U.S. icon company, Intel, which reported a 14-percent drop in third-quarter 2012 profits.

Strategy evaluation is becoming increasingly difficult with the passage of time, for many reasons. Domestic and world economies were more stable in years past, product life cycles were longer, product development cycles were longer, technological advancement was slower, change occurred less frequently, there were fewer competitors, foreign companies were weak, and there were more regulated industries. Other reasons why strategy evaluation is more difficult today include the following trends:

1. A dramatic increase in the environment's complexity
2. The increasing difficulty of predicting the future with accuracy
3. The increasing number of variables
4. The rapid rate of obsolescence of even the best plans
5. The increase in the number of both domestic and world events affecting organizations
6. The decreasing time span for which planning can be done with any degree of certainty[2]

A fundamental problem facing managers today is how to control employees effectively in light of modern organizational demands for greater flexibility, innovation, creativity, and initiative from employees.[3] How can managers today ensure that empowered employees acting in an entrepreneurial manner do not put the well-being of the business at risk? The potential costs to companies in terms of damaged reputations, fines, missed opportunities, and diversion of management's attention are enormous.

When empowered employees are held accountable for and pressured to achieve specific goals and are given wide latitude in their actions to achieve them, there can be dysfunctional behavior. For example, Nordstrom, the upscale fashion retailer known for outstanding customer service, was subjected to lawsuits and fines when employees underreported hours worked to increase their sales per hour—the company's primary performance criterion.

The Process of Evaluating Strategies

Strategy evaluation is necessary for all sizes and kinds of organizations. Strategy evaluation should initiate managerial questioning of expectations and assumptions, should trigger a review of objectives and values, and should stimulate creativity in generating alternatives and formulating criteria of evaluation.[4] Regardless of the size of the organization, a certain amount of **management by wandering around** at all levels is essential to effective strategy evaluation. Strategy-evaluation activities should be performed on a continuing basis, rather than at the end of specified periods of time or just after problems occur. Waiting until the end of the year, for example, could result in a firm *closing the barn door after the horses have already escaped*.

Evaluating strategies on a continuous rather than on a periodic basis allows benchmarks of progress to be established and more effectively monitored. Some strategies take years to implement; consequently, associated results may not become apparent for years. Successful strategies combine patience with a willingness to promptly take corrective actions when necessary. There always comes a time when corrective actions are needed in an organization! Centuries ago, a writer (perhaps Solomon) made the following observations about change:

> There is a time for everything,
>
> A time to be born and a time to die,
>
> A time to plant and a time to uproot,
>
> A time to kill and a time to heal,
>
> A time to tear down and a time to build,

A time to weep and a time to laugh,
A time to mourn and a time to dance,
A time to scatter stones and a time to gather them,
A time to embrace and a time to refrain,
A time to search and a time to give up,
A time to keep and a time to throw away,
A time to tear and a time to mend,
A time to be silent and a time to speak,
A time to love and a time to hate,
A time for war and a time for peace.[5]

Managers and employees of the firm should be continually aware of progress being made toward achieving the firm's objectives. As key success factors change, organizational members should be involved in determining appropriate corrective actions. If assumptions and expectations deviate significantly from forecasts, then the firm should renew strategy-formulation activities, perhaps sooner than planned. In strategy evaluation, like strategy formulation and strategy implementation, people make the difference. Through involvement in the process of evaluating strategies, managers and employees become committed to keeping the firm moving steadily toward achieving objectives.

A Strategy-Evaluation Framework

Table 11-2 summarizes strategy-evaluation activities in terms of key questions that should be addressed, alternative answers to those questions, and appropriate actions for an organization to take. Notice that corrective actions are almost always needed except when (1) external and internal factors have not significantly changed and (2) the firm is progressing satisfactorily toward achieving stated objectives. Relationships among strategy-evaluation activities are illustrated in Figure 11-2.

Reviewing Bases of Strategy

As shown in Figure 11-2, **reviewing the underlying bases of an organization's strategy** could be approached by developing a revised EFE Matrix and IFE Matrix. A **revised IFE Matrix** should focus on changes in the organization's management, marketing, finance and accounting, production and operations, research and development (R&D), and management information systems (MIS) strengths and weaknesses. A **revised EFE Matrix** should indicate how effective

TABLE 11-2 A Strategy-Evaluation Assessment Matrix

Have Major Changes Occurred in the Firm's Internal Strategic Position?	Have Major Changes Occurred in the Firm's External Strategic Position?	Has the Firm Progressed Satisfactorily Toward Achieving Its Stated Objectives?	Result
No	No	No	Take corrective actions
Yes	Yes	Yes	Take corrective actions
Yes	Yes	No	Take corrective actions
Yes	No	Yes	Take corrective actions
Yes	No	No	Take corrective actions
No	Yes	Yes	Take corrective actions
No	Yes	No	Take corrective actions
No	No	Yes	Continue present strategic course

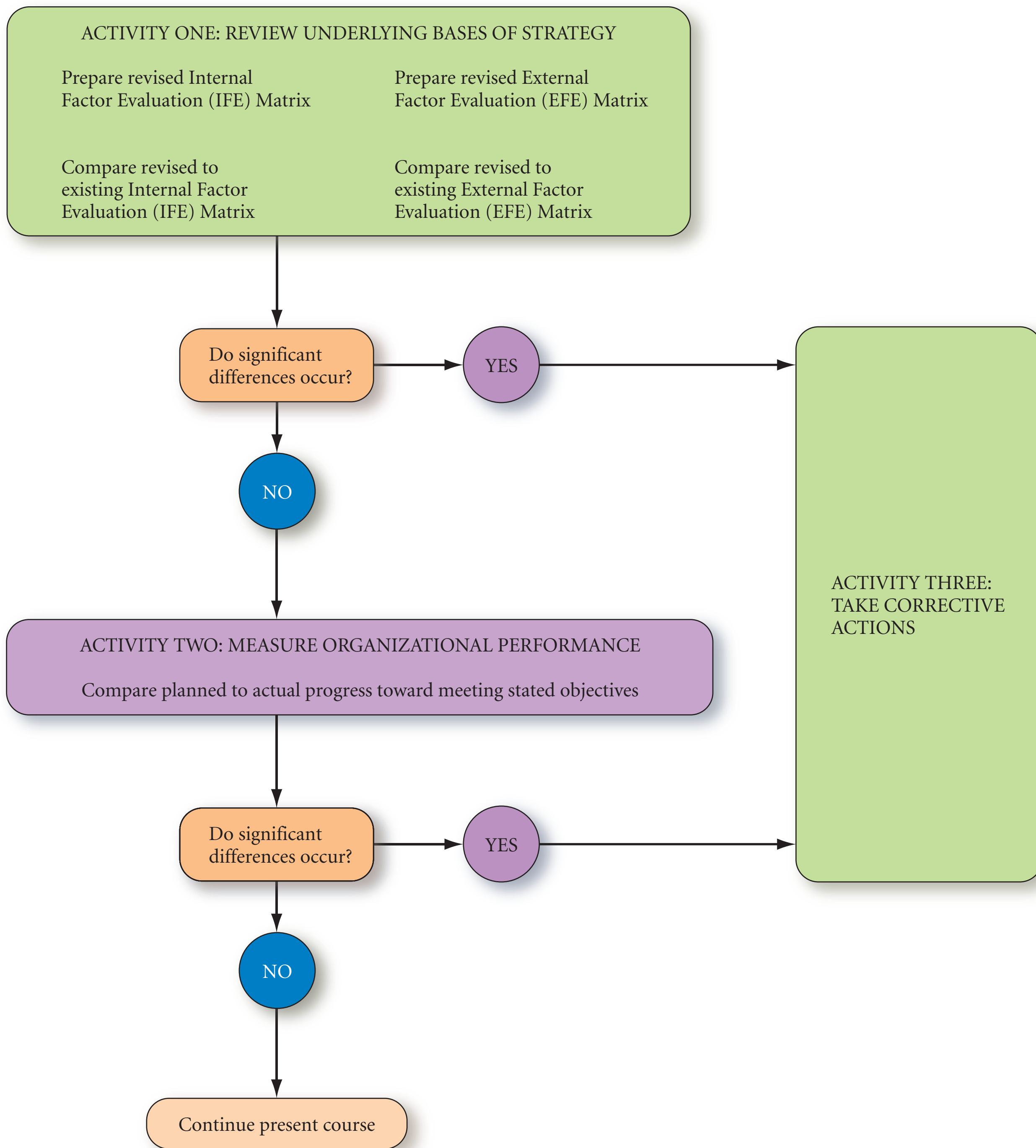

FIGURE 11-2

A Strategy-Evaluation Framework

a firm's strategies have been in response to key opportunities and threats. This analysis could also address such questions as the following:

1. How have competitors reacted to our strategies?
2. How have competitors' strategies changed?
3. Have major competitors' strengths and weaknesses changed?
4. Why are competitors making certain strategic changes?
5. Why are some competitors' strategies more successful than others?
6. How satisfied are our competitors with their present market positions and profitability?
7. How far can our major competitors be pushed before retaliating?
8. How could we more effectively cooperate with our competitors?

Numerous external and internal factors can prevent firms from achieving long-term and annual objectives. Externally, actions by competitors, changes in demand, changes in technology, economic changes, demographic shifts, and governmental actions may prevent objectives from being accomplished. Internally, ineffective strategies may have been chosen or implementation activities may have been poor. Objectives may have been too optimistic. Thus, failure to achieve objectives may not be the result of unsatisfactory work by managers and employees. All organizational members need to know this to encourage their support for strategy-evaluation activities. Organizations desperately need to know as soon as possible when their strategies are not effective. Sometimes managers and employees on the front lines discover this well before strategists.

External opportunities and threats and internal strengths and weaknesses that represent the bases of current strategies should continually be monitored for change. It is not really a question of *whether* these factors will change but rather *when* they will change and in what ways. Here are some key questions to address in evaluating strategies:

1. Are our internal strengths still strengths?
2. Have we added other internal strengths? If so, what are they?
3. Are our internal weaknesses still weaknesses?
4. Do we now have other internal weaknesses? If so, what are they?
5. Are our external opportunities still opportunities?
6. Are there now other external opportunities? If so, what are they?
7. Are our external threats still threats?
8. Are there now other external threats? If so, what are they?
9. Are we vulnerable to a hostile takeover?

Measuring Organizational Performance

Another important strategy-evaluation activity is **measuring organizational performance**. This activity includes comparing expected results to actual results, investigating deviations from plans, evaluating individual performance, and examining progress being made toward meeting stated objectives. Both long-term and annual objectives are commonly used in this process. Criteria for evaluating strategies should be measurable and easily verifiable. Criteria that predict results may be more important than those that reveal what already has happened. For example, rather than simply being informed that sales in the last quarter were 20 percent under what was expected, strategists need to know that sales in the next quarter may be 20 percent below standard unless some action is taken to counter the trend. Really effective control requires accurate forecasting.

Failure to make satisfactory progress toward accomplishing long-term or annual objectives signals a need for corrective actions. Many factors, such as unreasonable policies, unexpected turns in the economy, unreliable suppliers or distributors, or ineffective strategies, can result in unsatisfactory progress toward meeting objectives. Problems can result from ineffectiveness (not doing the right things) or inefficiency (poorly doing the right things).

Many variables can and should be included in measuring organizational performance. As indicated in Table 11-3, typically a favorable or unfavorable variance is recorded monthly, quarterly, and annually, and resultant actions needed are then determined.

Determining which objectives are most important in the evaluation of strategies can be difficult. Strategy evaluation is based on both quantitative and qualitative criteria. Selecting the exact set of criteria for evaluating strategies depends on a particular organization's size, industry, strategies, and management philosophy. An organization pursuing a retrenchment strategy, for example, could have an entirely different set of evaluative criteria from an organization pursuing a market-development strategy. Quantitative criteria commonly used to evaluate strategies are financial ratios, often monitored for each segment of the firm. Strategists use ratios to make three critical comparisons: (1) comparing the firm's performance over different time periods, (2) comparing the firm's performance to competitors', and (3) comparing the firm's performance to industry averages.

Some potential problems are associated with using only quantitative criteria for evaluating strategies. First, most quantitative criteria are geared to annual objectives rather than long-term objectives. Also, different accounting methods can provide different results on

TABLE 11-3 A Sample Framework for Measuring Organizational Performance

Factor	Actual Result	Expected Result	Variance	Action Needed
Corporate Revenues				
Corporate Profits				
Corporate ROI				
Region 1 Revenues				
Region 1 Profits				
Region 1 ROI				
Region 2 Revenues				
Region 2 Profits				
Region 2 ROI				
Product 1 Revenues				
Product 1 Profits				
Product 1 ROI				
Product 2 Revenues				
Product 2 Profits				
Product 2 ROI				

ROI, return on investment.

many quantitative criteria. Third, intuitive judgments are almost always involved in deriving quantitative criteria. Thus, qualitative criteria are also important in evaluating strategies. Human factors such as high absenteeism and turnover rates, poor production quality and quantity rates, or low employee satisfaction can be underlying causes of declining performance. Marketing, finance and accounting, R&D, or MIS factors can also cause financial problems.

Some additional key questions that reveal the need for qualitative or intuitive judgments in strategy evaluation are as follows:

1. How good is the firm's balance of investments between high-risk and low-risk projects?
2. How good is the firm's balance of investments between long-term and short-term projects?
3. How good is the firm's balance of investments between slow-growing markets and fast-growing markets?
4. How good is the firm's balance of investments among different divisions?
5. To what extent are the firm's alternative strategies socially responsible?
6. What are the relationships among the firm's key internal and external strategic factors?
7. How are major competitors likely to respond to particular strategies?

Taking Corrective Actions

The final strategy-evaluation activity, **taking corrective actions**, requires making changes to competitively reposition a firm for the future. As indicated in Table 11-4, examples of changes that may be needed are altering an organization's structure, replacing one or more key individuals, selling a division, or revising a business mission. Other changes could include establishing or revising objectives, devising new policies, issuing stock to raise capital, adding additional salespersons, differently allocating resources, or developing new performance incentives. Taking corrective actions does not necessarily mean that existing strategies will be abandoned or even that new strategies must be formulated.

> The probabilities and possibilities for incorrect or inappropriate actions increase geometrically with an arithmetic increase in personnel. Any person directing an overall undertaking must check on the actions of the participants as well as the results that they have achieved. If either the actions or results do not comply with preconceived or planned achievements, then corrective actions are needed.[6]

TABLE 11-4 Corrective Actions Possibly Needed to Correct Unfavorable Variances

1. Alter the firm's structure
2. Replace one or more key individuals
3. Divest a division
4. Alter the firm's vision or mission
5. Revise objectives
6. Alter strategies
7. Devise new policies
8. Install new performance incentives
9. Raise capital with stock or debt
10. Add or terminate salespersons, employees, or managers
11. Allocate resources differently
12. Outsource (or rein in) business functions

The largest office-supplies chain in the USA with 2,295 stores globally and 1,500 in the USA, Staples, is taking corrective actions to try to survive in the big-box office-supply store business. Many analysts say it is too little too late, but Staples is reducing its U.S. store space by 15 percent between 2013 and 2015 and is opening smaller stores more focused on mobile applications. Especially hurting Staples (and OfficeMax and Office Depot) are trends such as: (a) consumers prefer to purchase office supplies online (cheaper) from rivals such as Amazon, and (b) there is falling demand for office supplies since handheld devices such as the iPad have reduced demand for personal computers, printers, and even paper. Staples does own a fleet of vehicles that can deliver orders for free the next day, as compared to Amazon that only offers free two-day deliveries to members paying $79 a year to be part of Amazon Prime.

No organization can survive as an island; no organization can escape change. Taking corrective actions is necessary to keep an organization on track toward achieving stated objectives. In his thought-provoking books *Future Shock* and *The Third Wave*, Alvin Toffler argued that business environments are becoming so dynamic and complex that they threaten people and organizations with **future shock**, which occurs when the nature, types, and speed of changes overpower an individual's or organization's ability and capacity to adapt. Strategy evaluation enhances an organization's ability to adapt successfully to changing circumstances.

Taking corrective actions raises employees' and managers' anxieties. Research suggests that participation in strategy-evaluation activities is one of the best ways to overcome individuals' resistance to change. According to Erez and Kanfer, individuals accept change best when they have a cognitive understanding of the changes, a sense of control over the situation, and an awareness that necessary actions are going to be taken to implement the changes.[7]

Strategy evaluation can lead to strategy-formulation changes, strategy-implementation changes, both formulation and implementation changes, or no changes at all. Strategists cannot escape having to revise strategies and implementation approaches sooner or later. Hussey and Langham offered the following insight on taking corrective actions:

> Resistance to change is often emotionally based and not easily overcome by rational argument. Resistance may be based on such feelings as loss of status, implied criticism of present competence, fear of failure in the new situation, annoyance at not being consulted, lack of understanding of the need for change, or insecurity in changing from well-known and fixed methods. It is necessary, therefore, to overcome such resistance by creating situations of participation and full explanation when changes are envisaged.[8]

Corrective actions should place an organization in a better position to capitalize on internal strengths; to take advantage of key external opportunities; to avoid, reduce, or mitigate external threats; and to improve internal weaknesses. Corrective actions should have a proper time horizon and an appropriate amount of risk. They should be internally consistent and socially responsible. Perhaps most important, corrective actions strengthen an organization's competitive

position in its basic industry. Continuous strategy evaluation keeps strategists close to the pulse of an organization and provides information needed for an effective strategic-management system. Carter Bayles described the benefits of strategy evaluation as follows:

> Evaluation activities may renew confidence in the current business strategy or point to the need for actions to correct some weaknesses, such as erosion of product superiority or technological edge. In many cases, the benefits of strategy evaluation are much more far-reaching, for the outcome of the process may be a fundamentally new strategy that will lead, even in a business that is already turning a respectable profit, to substantially increased earnings. It is this possibility that justifies strategy evaluation, for the payoff can be very large.[9]

The Balanced Scorecard

Developed in 1993 by Harvard Business School professors Robert Kaplan and David Norton, and refined continually through today, the Balanced Scorecard is a strategy evaluation and control technique. **Balanced Scorecard** derives its name from the perceived need of firms to "balance" financial measures that are oftentimes used exclusively in strategy evaluation and control with nonfinancial measures such as product quality and customer service. An effective Balanced Scorecard contains a carefully chosen combination of strategic and financial objectives tailored to the company's business.

As a tool to manage and evaluate strategy, the Balanced Scorecard is currently in use at Sears, United Parcel Service, 3M Corporation, Heinz, and hundreds of other firms. For example, 3M Corporation has a financial objective to achieve annual growth in earnings per share of 10 percent or better, as well as a strategic objective to have at least 30 percent of sales come from products introduced in the past four years. The overall aim of the Balanced Scorecard is to "balance" shareholder objectives with customer and operational objectives. Obviously, these sets of objectives interrelate and many even conflict. For example, customers want low price and high service, which may conflict with shareholders' desire for a high return on their investment. The Balanced Scorecard concept is consistent with the notions of continuous improvement in management (CIM) and total quality management (TQM).

The Balanced Scorecard basic premise is that firms should establish objectives and evaluate strategies on criteria other than financial measures. Financial measures and ratios are vitally important in strategic planning, but of equal importance are factors such as customer service, employee morale, product quality, pollution abatement, business ethics, social responsibility, community involvement, and other such items. In conjunction with financial measures, these "softer" factors comprise an integral part of both the objective-setting process and the strategy-evaluation process. A Balanced Scorecard for a firm is simply a listing of all key objectives to work toward, along with an associated time dimension of when each objective is to be accomplished, as well as a primary responsibility or contact person, department, or division for each objective.

The Balanced Scorecard is an important strategy-evaluation tool. It is a process that allows firms to evaluate strategies from four perspectives: financial performance, customer knowledge, internal business processes, and learning and growth. The *Balanced Scorecard* analysis requires that firms seek answers to the following questions and use that information, in conjunction with financial measures, to adequately and more effectively evaluate strategies being implemented:

1. How well is the firm continually improving and creating value along measures such as innovation, technological leadership, product quality, operational process efficiencies, and so on?
2. How well is the firm sustaining and even improving on its core competencies and competitive advantages?
3. How satisfied are the firm's customers?

A sample Balanced Scorecard is provided in Table 11-5. Notice that the firm examines six key issues in evaluating its strategies: (1) Customers, (2) Managers/Employees, (3) Operations/Processes, (4) Community/Social Responsibility, (5) Business Ethics/Natural Environment, and (6) Financial. The basic form of a Balanced Scorecard may differ for different organizations. The Balanced Scorecard approach to strategy evaluation aims to balance long-term with short-term concerns, to balance financial with nonfinancial concerns, and to balance internal

TABLE 11-5 An Example Balanced Scorecard

Area of Objectives	Measure or Target	Time Expectation	Primary Responsibility
Customers			
1.			
2.			
3.			
4.			
Managers/Employees			
1.			
2.			
3.			
4.			
Operations/Processes			
1.			
2.			
3.			
4.			
Community/Social Responsibility			
1.			
2.			
3.			
4.			
Business Ethics/Natural Environment			
1.			
2.			
3.			
4.			
Financial			
1.			
2.			
3.			
4.			

with external concerns. The Balanced Scorecard would be constructed differently, that is, adapted to particular firms in various industries with the underlying theme or thrust being the same, which is to evaluate the firm's strategies based on both key quantitative and qualitative measures.

The Balanced Scorecard Institute has a Certification Program that includes two levels of certification: Balanced Scorecard Master Professional (BSMP) and Balanced Scorecard Professional (BSP), both of which are offered in association with George Washington University and are achievable through public workshop participation. The website for this program is http://www.balancedscorecard.org/.

Published Sources of Strategy-Evaluation Information

A number of publications are helpful in evaluating a firm's strategies. For example, *Fortune* annually identifies and evaluates the Fortune 1,000 (the largest manufacturers) and the Fortune 50 (the largest retailers, transportation companies, utilities, banks, insurance companies, and diversified financial corporations in the USA). *Fortune* ranks the best and worst

TABLE 11-6 The Most and Least Admired Companies in Management Quality in Various Industries in 2012

Most Admired	Least Admired
Koc Holding	Sears Holdings
McDonald's	China South Industries Group
Apple	MF Global Holdings
Philip Morris International	NewPage Holding
Costco Wholesale	Gas Natural Fenosa
J.P. Morgan Chase	Yahoo!
Wyndham Worldwide	AMR
Sysco	GDF Suez
Walt Disney	Dongfeng MG
	China FAW Group

Source: Based on information accessed November 1, 2012 at http://money.cnn.com/magazines/fortune/most-admired/2012/best_worst/best5.html.

performers on various factors, such as return on investment, sales volume, and profitability. *Fortune* annually publishes its strategy-evaluation research in an article titled "World's Most Admired Companies." Nine key attributes serve as evaluative criteria: people management; innovativeness; products quality; financial soundness; social responsibility; use of assets; long-term investment; global competitiveness; and quality of management. *Fortune's* 2012 evaluation in Table 11-6 reveals the firms most admired (best managed) in their industry.

Businessweek, *Industry Week*, and *Dun's Business Month* periodically publish detailed evaluations of U.S. businesses and industries. Although published sources of strategy-evaluation information focus primarily on large, publicly held businesses, the comparative ratios and related information are widely used to evaluate small businesses and privately owned firms as well.

Characteristics of an Effective Evaluation System

Strategy evaluation must meet several basic requirements to be effective. First, strategy-evaluation activities must be economical; too much information can be just as bad as too little information, and too many controls can do more harm than good. Strategy-evaluation activities also should be meaningful; they should specifically relate to a firm's objectives. They should provide managers with useful information about tasks over which they have control and influence. Strategy-evaluation activities should provide timely information; on occasion and in some areas, managers may daily need information. For example, when a firm has diversified by acquiring another firm, evaluative information may be needed frequently. However, in an R&D department, daily or even weekly evaluative information could be dysfunctional. Approximate information that is timely is generally more desirable as a basis for strategy evaluation than accurate information that does not depict the present. Frequent measurement and rapid reporting may frustrate control rather than give better control. The time dimension of control must coincide with the time span of the event being measured.

Strategy evaluation should be designed to provide a true picture of what is happening. For example, in a severe economic downturn, productivity and profitability ratios may drop alarmingly, although employees and managers are actually working harder. Strategy evaluations should fairly portray this type of situation. Information derived from the strategy-evaluation process should facilitate action and should be directed to those individuals in the organization who need to take action based on it. Managers commonly ignore evaluative reports that are provided only for informational purposes; not all managers need to receive all reports. Controls need to be action-oriented rather than information-oriented.

The strategy-evaluation process should not dominate decisions; it should foster mutual understanding, trust, and common sense. No department should fail to cooperate with another in evaluating strategies. Strategy evaluations should be simple, not too cumbersome, and not too

When strategy-evaluation activities reveal the need for a major change quickly, an appropriate contingency plan can be executed in a timely way. Contingency plans can promote a strategist's ability to respond quickly to key changes in the internal and external bases of an organization's current strategy. For example, if underlying assumptions about the economy turn out to be wrong and contingency plans are ready, then managers can make appropriate changes promptly.

In some cases, external or internal conditions present unexpected opportunities. When such opportunities occur, contingency plans could allow an organization to quickly capitalize on them. Linneman and Chandran reported that contingency planning gave users, such as DuPont, Dow Chemical, Consolidated Foods, and Emerson Electric, three major benefits: (1) It permitted quick response to change, (2) it prevented panic in crisis situations, and (3) it made managers more adaptable by encouraging them to appreciate just how variable the future can be. They suggested that effective contingency planning involves a five-step process:

1. Identify both good and bad events that could jeopardize strategies.
2. Determine when the good and bad events are likely to occur.
3. Determine the expected pros and cons of each contingency event.
4. Develop contingency plans for key contingency events.
5. Determine early warning trigger points key contingency events.[11]

Auditing

A frequently used tool in strategy evaluation is the audit. **Auditing** is defined by the American Accounting Association (AAA) as "a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between these assertions and established criteria, and communicating the results to interested users."[12]

Auditors examine the financial statement of firms to determine whether they have been prepared according to *generally accepted accounting principles* (**GAAP**) and whether they fairly represent the activities of the firm. Independent auditors use a set of standards called *generally accepted auditing standards (***GAAS***)*. Public accounting firms often have a consulting arm that provides strategy-evaluation services.

The new era of *international financial reporting standards (***IFRS***)* appears unstoppable, and businesses need to go ahead and get ready to use IFRS. Many U.S. companies now report their finances using both the old GAAP and the new IFRS. "If companies don't prepare, if they don't start three years in advance," warns business professor Donna Street at the University of Dayton, "they're going to be in big trouble." GAAP standards comprised 25,000 pages, whereas IFRS comprises only 5,000 pages, so in that sense IFRS is less cumbersome.

This accounting switch from GAAP to IFRS in the United States is going to cost businesses millions of dollars in fees and upgraded software systems and training. U.S. CPAs need to study global accounting principles intensely, and business schools should go ahead and begin teaching students the new accounting standards. Most large accounting firms and multinational firms favor the switch to IFRS saying it will simplify accounting, make it easier for investors to compare firms across countries, and make it easier to raise capital globally. But many smaller firms oppose the upcoming change say it will be too costly; some firms are uneasy about the idea of giving an international body the authority to write accounting rules for the USA. Some firms also would pay higher taxes because last in, first out (LIFO) inventory methods are not allowed under IFRS.[13] The International Accounting Standards Board (IASB) has publicly expressed "regret" over the USA's slowness in adopting IFRS.

The U.S. Chamber of Commerce supports a change, saying it will lead to much more cross-border commerce and will help the USA compete in the world economy. Already the European Union and 113 nations have adopted or soon plan to use international rules, including Australia, China, India, Mexico, and Canada. So the USA likely will also adopt IFRS rules, but this switch could unleash a legal and regulatory nightmare. A few U.S. multinational firms already use IFRS for their foreign subsidiaries, such as United Technologies (UT). UT derives more than 60 percent of its revenues from abroad and is already training its entire staff to use IFRS.

Movement to IFRS from GAAP encompasses a company's entire operations, including auditing, oversight, cash management, taxes, technology, software, investing, acquiring,

merging, importing, exporting, pension planning, and partnering. Switching from GAAP to IFRS is also likely to be plagued by gaping differences in business customs, financial regulations, tax laws, politics, and other factors. One critic of the upcoming switch is Charles Niemeier of the Public Company Accounting Oversight Board, who says the switch "has the potential to be a Tower of Babel," costing firms millions when they do not even have thousands to spend.

Others say the switch will help U.S. companies raise capital abroad and do business with firms abroad. Perhaps the biggest upside of the switch is that IFRS rules are more streamlined and less complex than GAAP. Lenovo is a big advocate of IFRS as they desire to be a world company rather than a U.S. or Chinese company, so the faster the switch to IFRS, the better for them. The bottom line is that IFRS is coming to the United States, sooner rather than later, so we all need to gear up for this switch as soon as possible.

21st-Century Challenges in Strategic Management

Three particular challenges or decisions that face all strategists today are (1) deciding whether the process should be more an art or a science, (2) deciding whether strategies should be visible or hidden from stakeholders, and (3) deciding whether the process should be more top-down or bottom-up in their firm.[14]

The Art or Science Issue

This textbook is consistent with most of the strategy literature in advocating that strategic management be viewed more as a science than an art. This perspective contends that firms need to systematically assess their external and internal environments, conduct research, carefully evaluate the pros and cons of various alternatives, perform analyses, and then decide on a particular course of action. In contrast, Mintzberg's notion of "crafting" strategies embodies the artistic model, which suggests that strategic decision making be based primarily on holistic thinking, intuition, creativity, and imagination.[15] Mintzberg and his followers reject strategies that result from objective analysis, preferring instead subjective imagination. "Strategy scientists" reject strategies that emerge from emotion, hunch, creativity, and politics. Proponents of the artistic view often consider strategic planning exercises to be time poorly spent. The Mintzberg philosophy insists on informality, whereas strategy scientists (and this text) insist on more formality. Mintzberg refers to strategic planning as an "emergent" process whereas strategy scientists use the term *deliberate* process.[16]

The answer to the art-versus-science question is one that strategists must decide for themselves, and certainly the two approaches are not mutually exclusive. In deciding which approach is more effective, however, consider that the business world today has become increasingly complex and more intensely competitive. There is less room for error in strategic planning. Recall that Chapter 1 discussed the importance of intuition, experience, and subjectivity in strategic planning, and even the weights and ratings discussed in Chapters 6, 7, and 8 certainly require good judgment. But the idea of deciding on strategies for any firm without thorough research and analysis, at least in the mind of these authors, is unwise. Certainly, in smaller firms there can be more informality in the process compared to larger firms, but even for smaller firms, a wealth of competitive information is available on the Internet and elsewhere and should be collected, assimilated, and evaluated before deciding on a course of action on which survival of the firm may hinge. The livelihood of countless employees and shareholders may hinge on the effectiveness of strategies selected. Too much is at stake to be less than thorough in formulating strategies. It is not wise for a strategist to rely too heavily on gut feeling and opinion instead of research data, competitive intelligence, and analysis in formulating strategies.

The Visible or Hidden Issue

An interesting aspect of any competitive analysis discussion is whether strategies themselves should be secret or open within firms. The Chinese warrior Sun Tzu and military leaders today strive to keep strategies secret because war is based on deception. However, for a business organization, secrecy may not be best. Keeping strategies secret from employees and stakeholders at large could severely inhibit employee and stakeholder communication, understanding, and commitment and also forgo valuable input that these persons could have regarding formulation or implementation of that strategy. Thus, strategists in a particular firm must decide for themselves whether the risk of rival firms easily knowing and exploiting a firm's strategies is worth the benefit of improved employee

and stakeholder motivation and input. Most executives agree that some strategic information should remain confidential to top managers, and that steps should be taken to ensure that such information is not disseminated beyond the inner circle. For a firm that you may own or manage, would you advocate openness or secrecy in regard to strategies being formulated and implemented?

There are certainly good reasons to keep the strategy process and strategies themselves visible and open rather than hidden and secret. There are also good reasons to keep strategies hidden from all but top-level executives. Strategists must decide for themselves what is best for their firms. This text comes down largely on the side of being visible and open, but certainly this may not be best for all strategists and all firms. As pointed out in Chapter 1, Sun Tzu argued that all war is based on deception and that the best maneuvers are those not easily predicted by rivals. Business and war are analogous.

Some reasons to be completely open with the strategy process and resultant decisions are these:

1. Managers, employees, and other stakeholders can readily contribute to the process. They often have excellent ideas. Secrecy would forgo many excellent ideas.
2. Investors, creditors, and other stakeholders have greater basis for supporting a firm when they know what the firm is doing and where the firm is going.
3. Visibility promotes democracy, whereas secrecy promotes autocracy. Domestic firms and most foreign firms prefer democracy over autocracy as a management style.
4. Participation and openness enhance understanding, commitment, and communication within the firm.

Reasons why some firms prefer to conduct strategic planning in secret and keep strategies hidden from all but the highest-level executives are as follows:

1. Free dissemination of a firm's strategies may easily translate into competitive intelligence for rival firms who could exploit the firm given that information.
2. Secrecy limits criticism, second guessing, and hindsight.
3. Participants in a visible strategy process become more attractive to rival firms who may lure them away.
4. Secrecy limits rival firms from imitating or duplicating the firm's strategies and undermining the firm.

The obvious benefits of the visible versus hidden extremes suggest that a working balance must be sought between the apparent contradictions. Parnell says that in a perfect world all key individuals both inside and outside the firm should be involved in strategic planning, but in practice particularly sensitive and confidential information should always remain strictly confidential to top managers.[17] This balancing act is difficult but essential for survival of the firm.

The Top-Down or Bottom-Up Approach

Proponents of the top-down approach contend that top executives are the only persons in the firm with the collective experience, acumen, and fiduciary responsibility to make key strategy decisions. In contrast, bottom-up advocates argue that lower- and middle-level managers and employees who will be implementing the strategies need to be actively involved in the process of formulating the strategies to ensure their support and commitment. Recent strategy research and this textbook emphasize the bottom-up approach, but earlier work by Schendel and Hofer stressed the need for firms to rely on perceptions of their top managers in strategic planning.[18] Strategists must reach a working balance of the two approaches in a manner deemed best for their firms at a particular time, while cognizant of the fact that current research supports the bottom-up approach, at least among U.S. firms. Increased education and diversity of the workforce at all levels are reasons why middle- and lower-level managers—and even nonmanagers—should be invited to participate in the firm's strategic planning process, at least to the extent that they are willing and able to contribute.

Special Note to Students

Just Google the words *balanced scorecard images* and you will see more than 100 actual Balanced Scorecards being used as a tool by various organizations to gain and sustain competitive advantage. Note the variation in format. In performing your case analysis, develop and present a Balanced Scorecard that you recommend to help your firm monitor and evaluate progress

toward stated objectives. Effective, timely evaluation of strategies can enable a firm to adapt quickly to changing conditions, and a Balanced Scorecard can assist in this endeavor. Couch your discussion of the Balanced Scorecard in terms of competitive advantage versus rival firms.

Conclusion

This chapter presents a strategy-evaluation framework that can facilitate accomplishment of annual and long-term objectives. Effective strategy evaluation allows an organization to capitalize on internal strengths as they develop, to exploit external opportunities as they emerge, to recognize and defend against threats, and to mitigate internal weaknesses before they become detrimental.

Strategists in successful organizations take the time to formulate, implement, and then evaluate strategies deliberately and systematically. Good strategists move their organization forward with purpose and direction, continually evaluating and improving the firm's external and internal strategic positions. Strategy evaluation allows an organization to shape its own future rather than allowing it to be constantly shaped by remote forces that have little or no vested interest in the well-being of the enterprise.

Although not a guarantee for success, strategic management allows organizations to make effective long-term decisions, to execute those decisions efficiently, and to take corrective actions as needed to ensure success. Computer networks and the Internet help to coordinate strategic-management activities and to ensure that decisions are based on good information. A key to effective strategy evaluation and to successful strategic management is an integration of intuition and analysis:

> A potentially fatal problem is the tendency for analytical and intuitive issues to polarize. This polarization leads to strategy evaluation that is dominated by either analysis or intuition, or to strategy evaluation that is discontinuous, with a lack of coordination among analytical and intuitive issues.[19]

Strategists in successful organizations realize that strategic management is first and foremost a people process. It is an excellent vehicle for fostering organizational communication. People are what make the difference in organizations.

The real key to effective strategic management is to accept the premise that the planning process is more important than the written plan, that the manager is continuously planning and does not stop planning when the written plan is finished. The written plan is only a snapshot as of the moment it is approved. If the manager is not planning on a continuous basis—planning, measuring, and revising—the written plan can become obsolete the day it is finished. This obsolescence becomes more of a certainty as the increasingly rapid rate of change makes the business environment more uncertain.[20]

Key Terms and Concepts

advantage (p. 373)
auditing (p. 385)
Balanced Scorecard (p. 381)
consistency (p. 373)
consonance (p. 373)
contingency plans (p. 384)
feasibility (p. 373)
future shock (p. 380)
GAAS, GAAP, and IFRS (p. 385)
management by wandering around (p. 375)
measuring organizational performance (p. 378)
reviewing the underlying bases of an organization's strategy (p. 376)
revised EFE Matrix (p. 376)
revised IFE Matrix (p. 376)
taking corrective actions (p. 379)

Issues for Review and Discussion

11-1. BHP Billiton has been very successful in the last decade. What is the major reason for its success?

11-2. Visit BHP Billiton's website and evaluate the firm's strategies, which are currently being implemented.

11-3. Discuss the nature and implications of the upcoming accounting switch from GAAP to IFRS, in the United States.

11-4. Ask the following question to an accounting professor at your college or university, and report your findings back to the class—"To what extent would my learning the IFRS standards, on my own, give me a competitive advantage in the job market?"

11-5. Give an example of "consonance," other than the one provided by Rumelt in this Chapter.

11-6. "Evaluating strategies on a continuous rather than a periodic basis is desired." Discuss the pros and cons of this statement.

11-7. How often should an organization's vision or mission be changed, in light of strategy evaluation activities?

11-8. Compare Mintzberg's notion of "crafting" strategies with the notion of "gathering and assimilating information" to formulate strategies, mentioned in this book.

11-9. Do you believe strategic management is more of an art or science? Explain.

11-10. Do you feel strategic management should be more a top-down or bottom-up process in a firm? Briefly explain your answer.

11-11. Do you think strategic management should be more visible or hidden, as a process in a firm? Explain.

11-12. Develop a balanced scorecard for BHP Billiton.

11-13. Create a balanced scorecard for your college or university.

11-14. Discuss contingency planning.

11-15. Identify some important financial ratios, which are useful in evaluating a firm's strategies.

11-16. How often should a firm formally evaluate its strategies?

11-17. Under what conditions are corrective actions not required in the strategy-evaluation process?

11-18. Define and discuss auditing, as it relates to strategy evaluation.

11-19. List 10 characteristics of an effective evaluation system.

11-20. Go to *Fortune* magazine's website and identify several firms in your city, which are listed among the most admired companies in the world according to *Fortune*.

11-21. Ask the dean of your school to describe how their department evaluates strategies. Present your findings to the class.

11-22. Identify four firms that provide their strategic plans on their websites, and four that do not. Should firms do this? Explain your answer.

MyManagementLab®

Go to **mymanagementlab.com** for the following Assisted-graded writing questions:

11-23. Why is the Balanced Scorecard an important topic both in devising objectives and in evaluating strategies?

11-24. Do you believe strategic management should be more visible or hidden as a process in a firm? Explain.

11-25. Mymanagementlab Only—comprehensive writing assignment for this chapter.

Current Readings

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ASSURANCE OF LEARNING EXERCISES

EXERCISE 11A

Evaluating BHP Billiton's Strategies

Purpose

BHP Billiton is featured in the opening chapter example as a firm that engages in excellent strategic planning. BHP is a large Australian multinational mining and petroleum company headquartered in Melbourne, Australia. BHP also has major offices in London. BHP is arguably the world's largest mining company and among the top ten largest companies in the world measured by market capitalization. *Fortune* in 2013 ranked BHP as the 115th largest company in the world and the 20th most profitable. BHP is among the world's top producers of iron ore, coal, aluminum, copper, manganese, nickel, silver, uranium, and potash. BHP also has crude oil and natural gas holdings. BHP may soon divest its diamond assets.

This exercise can give you practice evaluating a company's strategies.

Instructions

Step 1 Go to BHP Billiton's corporate website and navigate to the Investors & Media section. Review recent news releases for BHP Billiton.

Step 2 Determine what new strategies BHP is pursuing.

Step 3 Evaluate BHP's newest strategies based on concepts presented in Chapter 11.

Step 4 Prepare a strategy evaluation report for BHP.

EXERCISE 11B

Preparing a Strategy-Evaluation Report for adidas AG

Purpose

This exercise can give you experience locating strategy-evaluation information. Use of the Internet coupled with published sources of information can significantly enhance the strategy-evaluation process. Performance information on competitors, for example, can help put into perspective a firm's own performance.

Instructions

Step 1 Search the Internet for information on adidas. Prepare a strategy-evaluation report for your instructor. Include in your report a summary of adidas' strategies and performance in 2013 and a summary of your conclusions regarding the effectiveness of adidas' strategies.

Step 2 Based on your analysis, do you feel that adidas is pursuing effective strategies? What recommendations would you offer to adidas' chief executive officer?

EXERCISE 11C

Preparing a Balanced Scorecard for adidas AG

Purpose

This exercise can give you experience developing a Balanced Scorecard for a corporation.

Instructions

Step 1 Compile all information that you have collected on adidas.

Step 2 Join with three other students in class. Jointly develop a 20-item Balanced Scorecard for the company.

Step 3 Appoint a spokesperson for your team to give a three-minute overview to the class regarding the substance of your Balanced Scorecard.

EXERCISE 11D

Evaluate My University's Strategies

Purpose

An important part of evaluating strategies is determining the nature and extent of changes in an organization's external opportunities/threats and internal strengths/weaknesses. Changes in these underlying critical success factors can indicate a need to change or modify the firm's strategies.

Instructions

As a class, discuss positive and negative changes in your university's external and internal factors during your college career. Begin by listing on the board new or emerging opportunities and threats. Then identify strengths and weaknesses that have changed significantly during your college career. In light of the external and internal changes that were identified, discuss whether your university's strategies need modifying. Are there any new strategies that you would recommend? Make a list to recommend to your department chair, dean, president, or chancellor.

Notes

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APPENDIX 1

GUIDELINES FOR CASE ANALYSIS

Source: Africa Studio/Fotolia

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Guidelines for Case Analysis

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Describe the case method for learning strategic-management concepts.
2. Identify the steps in preparing a comprehensive written case analysis.
3. Describe how to give an effective oral case analysis presentation.
4. Discuss special tips for doing a case analysis.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

Oral Presentation—Step 1 Introduction (2 minutes)

Oral Presentation—Step 2 Mission and Vision (4 minutes)

Oral Presentation—Step 3 Internal Assessment (8 minutes)

Oral Presentation—Step 4 External Assessment (8 minutes)

Oral Presentation—Step 5 Strategy Formulation (14 minutes)

Oral Presentation—Step 6 Strategy Implementation (8 minutes)

Oral Presentation—Step 7 Strategy Evaluation (2 minutes)

Oral Presentation—Step 8 Conclusion (4 minutes)

The purpose of this section is to help you analyze strategic-management cases. Guidelines for preparing written and oral case analyses are given, and suggestions for preparing cases for class discussion are presented. Steps to follow in preparing case analyses are provided. Guidelines for making an oral presentation are described.

What Is a Strategic-Management Case?

A *strategic-management case* describes an organization's external and internal conditions and raises issues concerning the firm's mission, strategies, objectives, and policies. Most of the information in a strategic-management case is established fact, but some information may be opinions, judgments, and beliefs. Strategic-management cases are more comprehensive than those you may have studied in other courses. They generally include a description of related management, marketing, finance and accounting, production and operations, research and development (R&D), management information systems (MIS), and natural environment issues. A strategic-management case puts the reader at the scene of the action by describing a firm's situation at some point in time. Strategic-management cases are written to give you practice applying strategic-management concepts. The case method for studying strategic management is often called *learning by doing*.

Guidelines for Preparing Case Analyses

The Need for Practicality

There is no such thing as a complete case, and no case ever gives you all the information you need to conduct analyses and make recommendations. Likewise, in the business world, strategists never have all the information they need to make decisions: information may be unavailable or too costly to obtain, or it may take too much time to obtain. So in analyzing strategic-management cases, do what strategists do every day—make reasonable assumptions about unknowns, clearly state assumptions, perform appropriate analyses, and make decisions. *Be practical.* For example, in performing a projected financial analysis, make reasonable assumptions, appropriately state them, and proceed to show what impact your recommendations are expected to have on the organization's financial position. Avoid saying, "I don't have enough information." Always supplement the information provided in a case with Internet and library research.

The Need for Justification

The most important part of analyzing cases is not what strategies you recommend but rather how you support your decisions and how you propose that they be implemented. There is no single best solution or one right answer to a case, so give ample justification for your recommendations. This is important. In the business world, strategists usually do not know if their decisions are right until resources have been allocated and consumed. Then it is often too late to reverse a decision. This cold fact accents the need for careful integration of intuition and analysis in preparing strategic management case analyses.

The Need for Realism

Avoid recommending a course of action beyond an organization's means. *Be realistic.* No organization can possibly pursue all the strategies that could potentially benefit the firm. Estimate how much capital will be required to implement what you recommended. Determine whether debt, stock, or a combination of debt and stock could be used to obtain the capital. Make sure your recommendations are feasible. Do not prepare a case analysis that omits all arguments and information not supportive of your recommendations. Rather, present the major advantages and disadvantages of several feasible alternatives. Try not to exaggerate, stereotype, prejudge, or overdramatize. Strive to demonstrate that your interpretation of the evidence is reasonable and objective.

The Need for Specificity

Do not make broad generalizations such as "The company should pursue a market penetration strategy." Be specific by telling *what, why, when, how, where*, and *who.* Failure to use specifics is the single major shortcoming of most oral and written case analyses. For example, in

an internal audit say, "The firm's current ratio fell from 2.2 in 2013 to 1.3 in 2014, and this is considered to be a major weakness," instead of "The firm's financial condition is bad." But recall from the chapters that selected external and internal factors need to be "*actionable*" to the extent possible, and financial ratios in general are not actionable. Rather than concluding from a Strategic Position and Action Evaluation (SPACE) Matrix that a firm should be defensive, be more specific, saying, "The firm should consider closing three plants, laying off 280 employees, and divesting itself of its chemical division, for a net savings of $20.2 million in 2014." Use ratios, percentages, numbers, and dollar estimates. Businesspeople dislike generalities and vagueness.

The Need for Originality

Do not necessarily recommend the course of action that the firm plans to take or actually undertook, even if those actions resulted in improved revenues and earnings. The aim of case analysis is for you to consider all the facts and information relevant to the organization at the time, to generate feasible alternative strategies, to choose among those alternatives, and to defend your recommendations. Put yourself back in time to the point when strategic decisions were being made by the firm's strategists. Based on the information available then, what would you have done? Support your position with charts, graphs, ratios, analyses, and the like—not a revelation from the library. You can become a good strategist by thinking through situations, making management assessments, and proposing plans yourself. *Be original.* Compare and contrast what you recommend versus what the company plans to do or did.

The Need to Contribute

Strategy formulation, implementation, and evaluation decisions are commonly made by a group of individuals rather than by a single person. Therefore, your professor may divide the class into three- or four-person teams and ask you to prepare written or oral case analyses. Members of a strategic-management team, in class or in the business world, differ on their aversion to risk, their concern for short-run versus long-run benefits, their attitudes toward social responsibility, and their views concerning globalization. There are no perfect people, so there are no perfect strategies. Be open-minded to others' views. *Be a good listener and a good contributor.*

Preparing a Case for Class Discussion

Your professor may ask you to prepare a case for class discussion. Preparing a case for class discussion means that you need to read the case before class, make notes regarding the organization's external opportunities and threats and internal strengths and weaknesses, perform appropriate analyses, and come to class prepared to offer and defend some specific recommendations.

The Case Method versus Lecture Approach

The case method of teaching is radically different from the traditional lecture approach, in which little or no preparation is needed by students before class. The *case method* involves a classroom situation in which students do most of the talking; your professor facilitates discussion by asking questions and encouraging student interaction regarding ideas, analyses, and recommendations. Be prepared for a discussion along the lines of "What would you do, why would you do it, when would you do it, and how would you do it?" Prepare answers to the following types of questions:

- What are the firm's most important external opportunities and threats?
- What are the organization's major strengths and weaknesses?
- How would you describe the organization's financial condition?
- What are the firm's existing strategies and objectives?
- Who are the firm's competitors, and what are their strategies?
- What objectives and strategies do you recommend for this organization? Explain your reasoning. How does what you recommend compare to what the company plans?
- How could the organization best implement what you recommend? What implementation problems do you envision? How could the firm avoid or solve those problems?

The Cross-Examination

Do not hesitate to take a stand on the issues and to support your position with objective analyses and outside research. Strive to apply strategic-management concepts and tools in preparing your case for class discussion. Seek defensible arguments and positions. Support opinions and judgments with facts, reasons, and evidence. Crunch the numbers before class! Be willing to describe your recommendations to the class without fear of disapproval. Respect the ideas of others, but be willing to go against the majority opinion when you can justify a better position.

Strategic-management case analysis gives you the opportunity to learn more about yourself, your colleagues, strategic management, and the decision-making process in organizations. The rewards of this experience will depend on the effort you put forth, so do a good job. Discussing business policy cases in class is exciting and challenging. Expect views counter to those you present. Different students will place emphasis on different aspects of an organization's situation and submit different recommendations for scrutiny and rebuttal. Cross-examination discussions commonly arise, just as they occur in a real business organization. Avoid being a silent observer.

Preparing a Written Case Analysis

In addition to asking you to prepare a case for class discussion, your professor may ask you to prepare a written case analysis. Preparing a written case analysis is similar to preparing a case for class discussion, except written reports are generally more structured and more detailed. There is no ironclad procedure for preparing a written case analysis because cases differ in focus; the type, size, and complexity of the organizations being analyzed also vary.

When writing a strategic-management report or case analysis, avoid using jargon, vague or redundant words, acronyms, abbreviations, sexist language, and ethnic or racial slurs. And watch your spelling! Use short sentences and paragraphs and simple words and phrases. Use quite a few subheadings. Arrange issues and ideas from the most important to the least important. Arrange recommendations from the least controversial to the most controversial. Use the active voice rather than the passive voice for all verbs; for example, say "Our team recommends that the company diversify" rather than "It is recommended by our team to diversify." Use many examples to add specificity and clarity. Tables, figures, pie charts, bar charts, timelines, and other kinds of exhibits help communicate important points and ideas. Sometimes a picture *is* worth a thousand words.

The Executive Summary

Your professor may ask you to focus the written case analysis on a particular aspect of the strategic-management process, such as (1) to identify and evaluate the organization's existing vision, mission, objectives, and strategies; or (2) to propose and defend specific recommendations for the company; or (3) to develop an industry analysis by describing the competitors, products, selling techniques, and market conditions in a given industry. These types of written reports are sometimes called *executive summaries*. An executive summary usually ranges from three to five pages of text in length, plus exhibits.

The Comprehensive Written Analysis

Your professor may ask you to prepare a *comprehensive written analysis*. This assignment requires you to apply the entire strategic-management process to the particular organization. When preparing a comprehensive written analysis, picture yourself as a consultant who has been asked by a company to conduct a study of its external and internal environment and to make specific recommendations for its future. Prepare exhibits to support your recommendations. Highlight exhibits with some discussion in the paper. Comprehensive written analyses are usually about 10 pages in length, plus exhibits. Throughout your written analysis, emphasize how your proposed strategies will enable the firm to gain and sustain competitive advantage. Visit www.strategyclub.com for examples.

Steps in Preparing a Comprehensive Written Analysis

In preparing a *written* case analysis, you could follow the steps outlined here, which correlate to the stages in the strategic-management process and the chapters in this text. (Note—The steps in presenting an *oral* case analysis are given on pages 401–403, are more detailed, and could be used here).

Step 1 Identify the firm's existing vision, mission, objectives, and strategies.

Step 2 Develop vision and mission statements for the organization.

Step 3 Identify the organization's external opportunities and threats.

Step 4 Construct a Competitive Profile Matrix (CPM).

Step 5 Construct an External Factor Evaluation (EFE) Matrix.

Step 6 Identify the organization's internal strengths and weaknesses.

Step 7 Construct an Internal Factor Evaluation (IFE) Matrix.

Step 8 Prepare a Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, Strategic Position and Action Evaluation (SPACE) Matrix, Boston Consulting Group (BCG) Matrix, Internal-External (IE) Matrix, Grand Strategy Matrix, and Quantitative Strategic Planning Matrix (QSPM) as appropriate. Give advantages and disadvantages of alternative strategies.

Step 9 Recommend specific strategies and long-term objectives. Show how much your recommendations will cost. Clearly itemize these costs for each projected year. Compare your recommendations to actual strategies planned by the company.

Step 10 Specify how your recommendations can be implemented and what results you can expect. Prepare forecasted ratios and projected financial statements. Present a timetable or agenda for action.

Step 11 Recommend specific annual objectives and policies.

Step 12 Recommend procedures for strategy review and evaluation.

Making an Oral Presentation

Your professor may ask you to prepare a strategic-management case analysis, individually or as a group, and present your analysis to the class. Oral presentations are usually graded on two parts: content and delivery. *Content* refers to the quality, quantity, correctness, and appropriateness of analyses presented, including such dimensions as logical flow through the presentation, coverage of major issues, use of specifics, avoidance of generalities, absence of mistakes, and feasibility of recommendations. *Delivery* includes such dimensions as audience attentiveness, clarity of visual aids, appropriate dress, persuasiveness of arguments, tone of voice, eye contact, and posture. Great ideas are of no value unless others can be convinced of their merit through clear communication. The guidelines presented here can help you make an effective oral presentation.

Organizing the Presentation

Begin your presentation by introducing yourself and giving a clear outline of topics to be covered. If a team is presenting, specify the sequence of speakers and the areas each person will address. At the beginning of an oral presentation, try to capture your audience's interest and attention. You could do this by displaying some products made by the company, telling an interesting short story about the company, or sharing an experience you had that is related to the company, its products, or its services. You could develop or obtain a video to show at the beginning of class; you could visit a local distributor of the firm's products and tape a personal interview with the business owner or manager. A light or humorous introduction can be effective at the beginning of a presentation.

Be sure the setting of your presentation is well organized, with seats for attendees, flip charts, a transparency projector, and whatever else you plan to use. Arrive at the classroom at least 15 minutes early to organize the setting, and be sure your materials are ready to go. Make sure everyone can see your visual aids well.

Controlling Your Voice

An effective rate of speaking ranges from 100 to 125 words per minute. Practice your presentation aloud to determine if you are going too fast. Individuals commonly speak too fast when nervous. Breathe deeply before and during the presentation to help yourself slow down. Have a cup of water available; pausing to take a drink will wet your throat, give you time to collect your thoughts, control your nervousness, slow you down, and signal to the audience a change in topic.

Avoid a monotone voice by placing emphasis on different words or sentences. Speak loudly and clearly, but do not shout. Silence can be used effectively to break a monotone voice. Stop at the end of each sentence, rather than running sentences together with *and* or *uh.*

Managing Body Language

Be sure not to fold your arms, lean on the podium, put your hands in your pockets, or put your hands behind you. Keep a straight posture, with one foot slightly in front of the other. Do not turn your back to the audience; doing so is not only rude, but it also prevents your voice from projecting well. Avoid using too many hand gestures. On occasion, leave the podium or table and walk toward your audience, but do not walk around too much. Never block the audience's view of your visual aids.

Maintain good eye contact throughout the presentation. This is the best way to persuade your audience. There is nothing more reassuring to a speaker than to see members of the audience nod in agreement or smile. Try to look everyone in the eye at least once during your presentation, but focus more on individuals who look interested than on those who seem bored. To stay in touch with your audience, use humor and smiles as appropriate throughout your presentation. A presentation should never be dull!

Speaking from Notes

Be sure not to read to your audience because reading puts people to sleep. Perhaps worse than reading is merely reciting what you have memorized. Do not try to memorize anything. Rather, practice unobtrusively using notes. Make sure your notes are written clearly so you will not flounder when trying to read your own writing. Include only main ideas on your note cards. Keep note cards on a podium or table if possible so that you will not drop them or get them out of order; walking with note cards tends to be distracting.

Constructing Visual Aids

Make sure your visual aids are legible to individuals in the back of the room. Use color to highlight special items. Avoid putting complete sentences on visual aids; rather, use short phrases and then orally elaborate on issues as you make your presentation. Generally, there should be no more than four to six lines of text on each visual aid. Use clear headings and subheadings. Be careful about spelling and grammar; use a consistent style of lettering. Use masking tape or an easel for posters—do not hold posters in your hand. Transparencies and handouts are excellent aids; however, be careful not to use too many handouts or your audience may concentrate on them instead of you during the presentation.

Answering Questions

It is best to field questions at the end of your presentation, rather than during the presentation itself. Encourage questions, and take your time to respond to each one. Answering questions can be persuasive because it involves you with the audience. If a team is giving the presentation, the audience should direct questions to a specific person. During the question-and-answer period, be polite, confident, and courteous. Avoid verbose responses. Do not get defensive with your answers, even if a hostile or confrontational question is asked. Staying calm during potentially disruptive situations, such as a cross-examination, reflects self-confidence, maturity, poise, and command of the particular company and its industry. Stand up throughout the question-and-answer period.

Tips for Success in Case Analysis

Strategic-management students who have used this text over 14 editions offer you the following tips for success in doing case analysis. The tips are grouped into two basic sections: (1) Content Tips and (2) Process Tips. Content tips relate especially to the content of your case analysis, whereas the Process tips relate mostly to the process that you and your group mates undergo in preparing and delivering your case analysis/presentation.

Content Tips

1. Use the www.strategyclub.com website resources. The free excel student template provided there is especially useful as are the sample PowerPoint case analyses on a couple of companies.
2. In preparing your external assessment, use the S&P *Industry Survey* material in your college library.
3. Go to http://finance.yahoo.com or http://money.msn.com and enter your company's stock symbol.
4. View your case analysis and presentation as a product that must have some competitive factor to favorably differentiate it from the case analyses of other students.
5. Develop a mind-set of *why*, continually questioning your own and others' assumptions and assertions.
6. Because strategic management is a capstone course, seek the help of professors in other specialty areas when necessary.
7. Read your case frequently as work progresses so you do not overlook details.
8. At the end of each group session, assign each member of the group a task to be completed for the next meeting.
9. Become friends with the library and the Internet.
10. Be creative and innovative throughout the case analysis process.
11. A goal of case analysis is to improve your ability to think clearly in ambiguous and confusing situations; do not get frustrated that there is no single best answer.
12. Do not confuse symptoms with causes; do not develop conclusions and solutions prematurely; recognize that information may be misleading, conflicting, or wrong.
13. Work hard to develop the ability to formulate reasonable, consistent, and creative plans; put yourself in the strategist's position.
14. Develop confidence in using quantitative tools for analysis. They are not inherently difficult; it is just practice and familiarity you need.
15. Strive for excellence in writing and in the technical preparation of your case. Prepare nice charts, tables, diagrams, and graphs. Use color and unique pictures. No messy exhibits! Use PowerPoint.
16. Do not forget that the objective is to learn; explore areas with which you are not familiar.
17. Pay attention to detail.
18. Think through alternative implications fully and realistically. The consequences of decisions are not always apparent. They often affect many different aspects of a firm's operations.
19. Provide answers to such fundamental questions as *what*, *when*, *where*, *why*, *who*, and *how*.
20. Do not merely recite ratios or present figures. Rather, develop ideas and conclusions concerning the possible trends. Show the importance of these figures to the corporation.
21. Support reasoning and judgment with factual data whenever possible.
22. Your analysis should be as detailed and specific as possible.
23. A picture speaks a thousand words, and a creative picture gets you an A in many classes.
24. Emphasize the Recommendations and Strategy Implementation sections. A common mistake is to spend too much time on the external or internal analysis parts of your paper or presentation. The recommendations and implementation sections are the most important part.
25. Throughout your case analysis, emphasize how your proposed strategic plan will enable the firm to gain and sustain competitive advantage.

Process Tips

1. When working as a team, encourage most of the work to be done individually. Use team meetings mostly to assimilate work. This approach is most efficient.
2. If allowed to do so, invite questions throughout your presentation.
3. During the presentation, keep good posture, eye contact, and voice tone, and project confidence. Do not get defensive under any conditions or with any questions.
4. Prepare your case analysis in advance of the due date to allow time for reflection and practice. Do not procrastinate.
5. Maintain a positive attitude about the class, working *with* problems rather than against them.
6. Keep in tune with your professor, and understand his or her values and expectations.
7. Other students will have strengths in functional areas that will complement your weaknesses, so develop a cooperative spirit that moderates competitiveness in group work.
8. When preparing a case analysis as a group, divide into separate teams to work on the external analysis and internal analysis.
9. Have a good sense of humor.
10. Capitalize on the strengths of each member of the group; volunteer your services in your areas of strength.
11. Set goals for yourself and your team; budget your time to attain them.
12. Foster attitudes that encourage group participation and interaction. Do not be hasty to judge group members.
13. Be prepared to work. There will be times when you will have to do more than your share. Accept it, and do what you have to do to move the team forward.
14. Think of your case analysis as if it were really happening; do not reduce case analysis to a mechanical process.
15. To uncover flaws in your analysis and to prepare the group for questions during an oral presentation, assign one person in the group to actively play the devil's advocate.
16. Do not schedule excessively long group meetings; two-hour sessions are about right.
17. Push your ideas hard enough to get them listened to, but then let up; listen to others and try to follow their lines of thinking; follow the flow of group discussion, recognizing when you need to get back on track; do not repeat yourself or others unless clarity or progress demands repetition.
18. Develop a case-presentation style that is direct, assertive, and convincing; be concise, precise, fluent, and correct.
19. Have fun when at all possible. Preparing a case is frustrating at times, but enjoy it while you can; it may be several years before you are playing CEO again.
20. In group cases, do not allow personality differences to interfere. When they occur, they must be understood for what they are—and then put aside.
21. Get things written down (drafts) as soon as possible.
22. Read everything that other group members write, and comment on it in writing. This allows group input into all aspects of case preparation.
23. Adaptation and flexibility are keys to success; be creative and innovative.
24. Neatness is a real plus; your case analysis should look professional.
25. Let someone else read and critique your presentation several days before you present it.
26. Make special efforts to get to know your group members. This leads to more openness in the group and allows for more interchange of ideas. Put in the time and effort necessary to develop these relationships.
27. Be constructively critical of your group members' work. Do not dominate group discussions. Be a good listener and contributor.
28. Learn from past mistakes and deficiencies. Improve on weak aspects of other case presentations.
29. Learn from the positive approaches and accomplishments of classmates.

Sample Case Analysis Outline

There are musicians who play wonderfully without notes and there are chefs who cook wonderfully without recipes, but most of us prefer a more orderly cookbook approach, at least in the first attempt at doing something new. Therefore the following eight steps may serve as a basic

outline for you in presenting a strategic plan for your firm's future. This outline is not the only approach used in business and industry for communicating a strategic plan, but this approach is time-tested, it does work, and it does cover all of the basics. You may amend the content, tools, and concepts given to suit your own company, audience, assignment, and circumstances, but it helps to know and understand the rules before you start breaking them.

Depending on whether your class is 50 minutes or 75 minutes and how much time your professor allows for your case presentation, the following outlines what generally needs to be covered. A recommended time (in minutes) as part of the presentation is given for an overall 50-minute event. Even if you do not have time to cover all areas in your oral presentation, you may be asked to prepare these areas and give them to your professor as a written case analysis. Be sure in an oral presentation to manage time knowing that your recommendations and associated costs are the most important part. You should go to www.strategyclub.com and use that information and software in preparing your case analysis. Good luck.

Current Readings

Kearney, Eric, Diether Gebert, and Sven Voelpel. "When Diversity Benefits Teams: The Importance of Team Members' Need for Cognition." *Academy of Management Journal*, June 2009, 581–598.

STEPS IN PRESENTING AN ORAL CASE ANALYSIS

ORAL PRESENTATION—STEP 1

Introduction (2 minutes)

a. Introduce yourselves by name and major. Establish the time setting of your case and analysis. Prepare your strategic plan for the three years 2014–2016.
b. Introduce your company and its products or services; capture interest.
c. Show the outline of your presentation and tell who is doing what parts.
d. Let your audience know that the primary motivation, rationale, or intent of every slide is to reveal how the firm can best gain and sustain competitive advantage.

ORAL PRESENTATION—STEP 2

Mission and Vision (4 minutes)

a. Show existing mission and vision statements if available from the firm's website, annual report, or elsewhere.
b. Show your "improved" mission and vision and tell why it is improved.
c. Compare your mission and vision to a leading competitor's statements.
d. Comment on your vision and mission in terms of how they support the strategies you envision for your firm.

ORAL PRESENTATION—STEP 3

Internal Assessment (8 minutes)

a. Give your financial ratio analysis. Highlight especially good and bad ratios. Do not give definitions of the ratios and do not highlight all the ratios.
b. Show the firm's organizational chart found or "created based on executive titles." Identify the type of chart as well as good and bad aspects. Unless all white males comprise the chart, peoples' names are generally not important because positions reveal structure as people come and go.
c. Present your improved or recommended organizational chart. Tell why you feel it is improved over the existing chart.
d. Show a market positioning map with firm and competitors. Discuss the map in light of strategies you envision for firm versus competitors' strategies.
e. Identify the marketing strategy of the firm in terms of good and bad points versus competitors and in light of strategies you envision for the firm.

f. Show a map locating the firm's operations. Discuss in light of strategies you envision. Also, perhaps show a value chain analysis chart.
g. Discuss (and perhaps show) the firm's website and Facebook page in terms of good and bad points compared to rival firms.
h. Show your "value of the firm" analysis.
i. List 20 of the firm's strengths and weaknesses. Go over each one listed without "reading" them verbatim.
j. Show and explain your Internal Factor Evaluation (IFE) Matrix.

ORAL PRESENTATION—STEP 4

External Assessment (8 minutes)

a. Identify and discuss major competitors. Use pie charts, maps, tables, or figures to show the intensity of competition in the industry.
b. Show your Competitive Profile Matrix. Include at least 12 factors and two competitors.
c. Summarize key industry trends citing Standard & Poor's *Industry Survey* or Chamber of Commerce statistics, and so on. Highlight key external trends as they impact the firm, including trends that are economic, social, cultural, demographic, geographic, technological, political, legal, governmental, and to do with the natural environment.
d. List 20 of the firm's opportunities and threats. Make sure your opportunities are not stated as strategies. Go over each one listed without "reading" them verbatim.
e. Show and explain your External Factor Evaluation (EFE) Matrix.

ORAL PRESENTATION—STEP 5

Strategy Formulation (14 minutes)

a. Show and explain your SWOT Matrix, highlighting each of your strategies listed.
b. Show and explain your SPACE Matrix, using half of your "space time" on calculations and the other half on implications of those numbers. Strategy implications must be specific rather than generic. In other words, use of a term such as *market penetration* is not satisfactory alone as a strategy implication.
c. Show your Boston Consulting Group (BCG) Matrix. Again focus on both the numbers and the strategy implications. Do multiple BCG Matrices if possible, including domestic versus global, or another geographic breakdown. Develop a product BCG if at all possible. Comment on changes to this matrix as per strategies you envision. Develop this matrix even if you do not know the profits per division and even if you have to estimate the axes information. However, make no wild guesses on axes or revenue/profit information.
d. Show your Internal-External (IE) Matrix. Because this analysis is similar to the BCG, see the preceding comments.
e. Show your Grand Strategy Matrix. Again focus on implications after giving the quadrant selection. Reminder: Use of a term such as *market penetration* is not satisfactory alone as a strategy implication. Be more specific. Elaborate.
f. Show your Quantitative Strategic Planning Matrix (QSPM). Be sure to explain your strategies to start with here. Do not go back over the internal and external factors. Avoid having more than one 4, 3, 2, or 1 in a row. If you rate one strategy, you need to rate the other because that particular factor is affecting the choice. Work row by row rather than column by column on preparing the QSPM.
g. Present your recommendations page. This is the most important page in your presentation. Be specific in terms of both strategies and estimated costs of those strategies. *Total your estimated costs.* You should have 10 or more strategies. Divide your strategies into two groups: (1) Existing Strategies to Be Continued and (2) New Strategies to Be Started.

ORAL PRESENTATION—STEP 6

Strategy Implementation (8 minutes)

a. Show and explain your earnings per share/earnings before interest and taxes (EPS/EBIT) analysis to reveal whether stock, debt, or a combination is best to finance your recommendations. Graph the analysis. Decide which approach to use if there are any given limitations of the analysis.

b. Show your projected income statement. Relate changes in the items to your recommendations rather than blindly going with historical percentage changes.
c. Show your projected balance sheet. Relate changes in your items to your recommendations. Be sure to show the retained earnings calculation and the results of your EPS/EBIT decision.
d. Show your projected financial ratios and highlight several key ratios to show the benefits of your strategic plan.

ORAL PRESENTATION—STEP 7

Strategy Evaluation (2 minutes)

a. Prepare a Balanced Scorecard to show your expected financial and nonfinancial objectives recommended for the firm.

ORAL PRESENTATION—STEP 8

Conclusion (4 minutes)

a. Compare and contrast your strategic plan versus the company's own plans for the future.
b. Thank audience members for their attention. Genuinely seek and gladly answer questions.

Strategic Management Cases

Ryanair Holdings, plc — 2011

Charles M. Byles
Virginia Commonwealth University

RYAAY

http://www.ryanair.ie

In October 2011, Ryanair began "Child Free" flights in response to a Europe-wide passenger survey showing that over half would pay higher fares to avoid other people's children. Ryanair's director of communications, Stephen McNamara, stated, "When it comes to children, we all love our own but would clearly prefer to avoid other people's little monsters while traveling." According to McNamara, it was not operationally possible to divide the cabins into "adult" and "family" areas as some of the survey respondents had suggested. The child-free flights would be on high-frequency routes only.

Ryanair recently proposed removing rows of seats to be replaced by 15 rows of vertical seats. At the time, Stephen McNamara invoked a poll of 120,000 passengers, 80,000 of whom responded they would opt for "standing room" if the tickets were free, while 40 percent would opt for the service for half-price tickets. An earlier proposal would remove two toilets on short-haul aircraft and charge passengers one Euro for using the remaining third toilet. Even more surprising was CEO O'Leary's proposal that one of the two pilots on Ryanair aircraft be replaced by a computer and one member of the cabin crew on all flights be trained to land the plane. But, despite frequent, seemingly ludicrous suggestions, the airline outperforms its competitors, and many actions that appeared risky or foolhardy at the time (such as ordering new planes when the market collapsed after the 9/11 attacks) later turned out to be quite astute.

History

Ryanair was founded in 1985 and has its headquarters at the Dublin Airport in Ireland. Flights began between Ireland and the United Kingdom in 1986 as the new airline's Dublin-London route challenged the British Airways-Aer Lingus duopoly. After severe financial losses in 1990, Ryanair restructured, adopting the Southwest Airlines business model, and became the pioneer of the low-fares model in Europe. The next years showed growth from 745,000 passengers in 1990 to 72.1 million as of March 31, 2011. Ryanair Holdings was incorporated in 1996 as a holding company for Ryanair Limited. Today, Ryanair operates more than 1,500 flights per day from 44 bases and across 27 countries, connecting 160 destinations throughout Europe and Morocco.

Ryanair grew from 51 employees in 1985 to more than 8,000 employees today. Based on passengers carried, Ryanair is Europe's largest low-cost carrier and second-largest airline. It is also the world's largest carrier of international passengers and the fifth-largest carrier of both international and domestic passengers. As it continues to grow, Ryanair faces challenges in its use of ancillary fees as a means of maintaining revenue growth while keeping ticket prices low. Externally, increasing legislation and financial distress in Europe threaten to adversely affect its business model and raise the cost of operations.

Throughout this case, "Ryanair" refers to both Ryanair Holdings and Ryanair Limited, which are managed as an integrated unit with the same board of directors and executive officers. The fiscal year for the company means the 12 month period ending on March 31. The *Annual Report* refers to Form 20F filed with the Securities and Exchange Commission and covers the fiscal year ending March 31, 2010. Updated financial and operating information is given in *Ryanair Full Year Results 2011*, which contains data for the fiscal year ending March 31, 2011 (preliminary and unaudited).

Internal Factors

Mission and Vision

Ryanair has no published mission or vision statement, but its *Annual Report* and website statements imply a vision and mission. A vision statement is what a company wants to become, which for Ryanair is to "firmly establish itself as Europe's leading scheduled passenger airline through continued improvements and expanded offerings of its low-fares service."

A mission statement answers the question "What is our business?" Ryanair answers by stating that "Ryanair seeks to offer low fares that generate increased passenger traffic while maintaining a continuous focus on cost-containment and operating efficiencies." The extensive statements of its strategy (Exhibit 1) and its charter (Exhibit 2) explain the main elements of its business model and its relationship with customers.

EXHIBIT 1 Key Elements of Ryanair's Strategy

1. **Low Fares**—targets fare-conscious leisure and business travelers who might otherwise use a substitute form of transportation
2. **Customer Service**—emphasis on better punctuality, fewer lost bags, and fewer cancellations than rivals
3. **Frequent Point-to-Point Short-Haul**—secondary airports near major metropolitan areas with "no-frills"
4. **Low Operating Cost**—use of single aircraft type, productive work force, use of contractors, choice of airports with competitive costs
5. **Use of the Internet**—all ticket purchases and check-in via Internet
6. **Commitment to Safety and Quality**—low-cost operating strategy does not extend to safety, maintenance, or quality assurance
7. **Ancillary Services**—revenues are enhanced with hotel bookings, car rentals, and other nonticket revenues as well as baggage and other charges
8. **Focused Criteria for Growth**—growth based on an explicit plan with a focus in Europe
9. **Responding to Current Challenges**—responses to increasing fuel costs and reduced economic growth

Source: Annual Report, Ryanair Holdings PLC (Form 20F filed with U.S. Securities and Exchange Commission), July 20, 2010, http://www.ryanair.com/doc/investor/2010/20F_2010.pdf.

EXHIBIT 2 Ryanair Passenger Fares, Punctuality, and Service Commitment (Charter)

1. Offer the lowest fares at all times on all routes.
2. No fuel surcharge imposed on any fare.
3. Honor the agreed fare after payment.
4. Notify passengers of known delays, cancellations, and diversions.
5. Minimize the number of passengers facing delays.
6. Allow reservation changes.
7. Respond quickly to passenger complaints and provide prompt refunds.
8. Take measures to speed up check-in.
9. Minimize the number of passengers who are involuntarily denied boarding.
10. Provide passenger information through its website.
11. Provide the following information at the time of booking: scheduled departure and arrival time, airport/terminal of departure/arrival, and the terms and conditions attached to the fare to be paid.

Source: "Ryanair Passenger Charter," Ryanair website, http://www.ryanair.com/en/about/passenger-charter.

Code of Ethics

Ryanair's "Code of Business Conduct & Ethics 2010" gives ethical guidelines about the company's work environment, business activities, financial reporting, company property, conflict of interest, law and regulations, disciplinary action, and reporting procedures. The code is summarized as follows:

> Ryanair is committed to conducting business in an ethical fashion that complies with all laws and regulations in the countries in which Ryanair operates. As employees and representatives of Ryanair, we must consider how our actions affect the integrity and credibility of the Company as a whole. This Code of Business Conduct & Ethics sets out the principles that constitute our way of doing business.

Over the years, Ryanair has been accused of questionable practices, particularly its use of controversial or misleading advertisements that appear to violate its ethics code, specifically its statement of "Fair Dealing" (below), which is part of that code.

> Ryanair does not seek competitive advantage through illegal or unethical business practices. All employees/directors should endeavour to deal fairly with customers, competitors and employees. No employee/director should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any unfair dealing practice.

Several complaints have been filed against Ryanair with the Advertising Standards Authority (ASA), the U.K.'s independent regulator of advertising. *BBC News* reported that in 2008, Ryanair faced an ASA probe asserting that it made exaggerated claims about the availability of flights at advertised prices that did not include taxes and fees. Other allegations were that Ryanair:

- Claimed that its flight from London to Brussels was faster and cheaper than traveling by the Eurostar train.
- Played down the effect of aviation on the environment by claiming that the industry accounts for just 2 percent of carbon dioxide emissions (its code of ethics states that the airline will do business in an environmentally responsible way).
- Suggested that people buying tickets via online agent Lastminute.com were being ripped off.
- Used a model in schoolgirl-style clothes with the headline "hottest back to school fares."

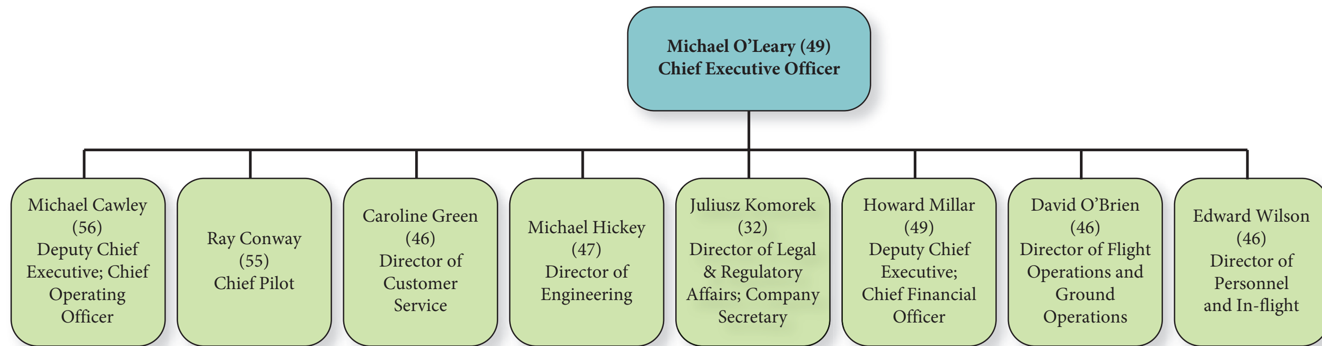
Even Ryanair acknowledges its controversial advertisements by its website statement that it engages in "punchy advertising that sometimes gets us in trouble." In 2011, the ASA criticized a Ryanair advertisement featuring a bikini-clad woman promoting trips to a "place in the sun." The ASA argued that some of these places had as little as three hours of sunshine per day. Would these advertisements be appropriate given Ryanair's own policy against "misrepresentation of the facts?"

Top Management

There are 10 directors of Ryanair, including CEO Michael O'Leary. Nine directors are independent under the standards set forth in the NASDAQ rules. Essentially, an independent director has no material interest in the company (for example, being an employee or manager in that company, or having any direct business relationship with the company such as being a customer or supplier).

There are nine executive officers as illustrated in Exhibit 3. Mr. O'Leary has served as a director since November 1988, deputy chief executive from 1991 to 1994, and CEO since January 1, 1994. O'Leary restructured Ryanair around the Southwest Airlines model. In 1991, he went to Dallas to meet Southwest executives and took the lessons back to Ryanair. While he embraced a few central aspects of Southwest's model (a single aircraft, secondary airports), he went much further with the constant drive to keep costs down. In particular, the extensive use of ancillary fees to balance the low ticket prices became a trademark of Ryanair and now forms a core element of its low-cost strategy.

EXHIBIT 3 **Ryanair's Executive Officers**



Source: *Annual Report,* Ryanair Holdings PLC (Form 20F filed with U.S. Securities and Exchange Commission), July 20, 2010, http://www.ryanair.com/doc/investor/2010/20F_2010.pdf.

O'Leary is known for his aggressiveness, outrageous public statements, and insults to almost any group or individual who gets in the way of Ryanair, including customers who complain about poor service. He has been accused of making outlandish suggestions (for example, to have standing passengers on aircraft or to replace one of the pilots with a computer) to gain publicity. But, despite giving the impression of being a loose cannon, industry experts say he is an astute strategist who has created a singular focus on cost control that competitors have been unable to imitate. He leads by example—stays in budget motels, has no Blackberry, and flies on Ryanair. His office is sparse and the company headquarters in Dublin is a drab 15,000-square-foot building. Prior to becoming CEO, O'Leary was a conventional dresser who avoided the limelight. On becoming CEO, however, he changed his wardrobe to jeans and became more outspoken and flamboyant.

O'Leary's gross salary in 2010 was €595,000 plus a bonus payment of €241,000. O'Leary's contract may be terminated by either party with 12 months notice.

Strategy

Ryanair's primary means of achieving its objective to become Europe's leading scheduled passenger airline is to offer lower fares than competitors. The nine elements of its strategy are shown in Exhibit 1. While Ryanair's leading strategy is lower cost (through its operations), it also seeks to differentiate itself (through certain aspects of customer service) and raise revenues on nonticket items (through ancillary services) as a means of offsetting the lower fares. Its strategy has generated some controversy, especially with respect to ancillary fees (which the airline has been accused of concealing) and customer service (which has been reduced in some areas, or which may only be available for a fee).

Five key value chain activities make up the main elements of strategy: 1) operations, 2) human resource management, 3) customer service, 4) use of the Internet, and 5) ancillary revenues. These value chain activities show how Ryanair organizes its internal activities to implement its strategy.

Operations

The primary method of cost control is the use of a single model of aircraft (the Boeing 737-800), which allows minimization of training and maintenance costs, efficient management of spare parts inventory, and more flexible scheduling of flight crews. Because this model aircraft is widely used, flight crews are more readily available for hire. In addition, because Ryanair purchases a large number of aircraft from Boeing, it can negotiate price concessions.

Other cost saving aspects of operations are the use of secondary and regional airports that offer competitive prices, the use of outdoor boarding stairs instead of jetways, having all passengers check in on the Internet, and the introduction of a checked-bag fee, which reduces the number of bags carried by passengers, handling costs, and the number of check-in desks. Ryanair frequently has agreements with secondary and regional airports that its fees be based on traffic volume. Airports are chosen because of low costs of operating out of that airport rather than for market reasons.

Ryanair's short-haul focus also enhances the low-cost strategy as it allows flights to be conducted without meals, movies, and other in-flight services that would be expected on longer flights. While some aspects of operations have a negative effect on customer service (e.g., the distance of the secondary airport from the main cities and the cost of checked baggage), there are positive aspects such as less congested regional airports, which permit more frequent on-time arrivals, quicker turnarounds, and more frequent on-time departures. Quicker turnarounds and more frequent on-time departures are also enhanced because the airline offers neither connecting flights nor the transfer of baggage to other flights, whether operated by Ryanair or not.

Human Resource Management

A second activity contributing to lower costs is the productivity-based incentive system. Flight attendants receive commissions for onboard sales and, along with pilots, payments based on the number of hours or sectors flown. For the 2010 fiscal year, productivity-based incentives accounted for approximately 39 percent of a typical flight attendant's total earnings and 37 percent of a typical pilot's total compensation. The cost of customer service is reduced by outsourcing ticketing and other services at airports. For these services, Ryanair has been successful in negotiating fixed-price, multi-year contracts.

Under the Irish Aviation Authority (IAA) rules, pilots are limited to 100 flight-hours per 28-day cycle, 300 flight-hours every three months, and 900 flight-hours per fiscal year. For fiscal 2010, the average flight-hours for Ryanair's pilots were approximately 64 hours per month and approximately 758 for the complete year. There is a risk to the productivity-based incentive system if these standards are made more stringent (i.e., if the allowed flight hours are reduced).

Most Ryanair employees are represented by unions, and the company currently has a negotiated pay freeze for fiscal 2011 affecting all employee groups. In addition, certain positions may be eliminated in the future, which could lead to deterioration in labor relations and affect the airline's operations.

Customer Service

Ryanair's stated approach to customer service is the deliberate reduction of services in some areas (e.g., free checked bags, meals, flights to major airports) while raising it in others (e.g., on-time departures and arrivals, fewer lost bags). Ryanair claims on its website and in its *Annual Report* that, according to the Association of European airlines, it has better punctuality, fewer lost bags, and fewer cancellations than its peer group in Europe. This achievement is attributed to Ryanair's focus on these services and its operations from uncongested secondary airports. The airline believes that customers prefer fewer services plus extra fees as needed for meals and other items in exchange for low fares. Exhibit 2 summarizes the "Ryanair Passenger Fares, Punctuality, and Service Commitment" (Charter) published on its website.

The Air Transport Users' Council, however, claims that in 2009, Easy Jet and Ryanair had the most complaints of any major European airline and cancellations, missing bags, and denied boarding were top complaints. In addition, other observers view Ryanair's customer service as poor. For example, in a recent *Businessweek* article entitled "Ryanair's O'Leary: The Duke of Discomfort," even CEO O'Leary suggests that customer service is poor:

> In exchange for cheap fares, he [O'Leary] says, passengers will put up with just about anything. On Ryanair, that can include high luggage fees, relentless in-flight sales pitches for smokeless cigarettes and scratch-off lottery games; minimal customer service; bad, expensive food; cramped seats; and flights to secondary city airports that are sometimes hours from the actual city.

In the same article, O'Leary criticizes competitors for treating budget travelers with a level of courtesy that they do not receive elsewhere, nor expect when traveling. O'Leary believes that customers will endure discomfort and indignity as long as they get to their destination cheaply and with their suitcases.

Ancillary Revenues

The emphasis on ancillary revenues sets Ryanair's strategy apart from other low-cost carriers. It is central to the low-cost strategy as it allows the airline to make up the revenues lost through

lower ticket prices. Ancillary revenues are defined as revenues beyond the sale of a ticket and include sales of related items such as hotel reservations or car rental, as well as charges for food, checked baggage, priority boarding, and other items. Ryanair has been particularly creative in coming up with new means of generating ancillary revenues. For example, in 2009, the company announced the sale of smokeless cigarettes to ensure that passengers get their "fix" of nicotine without lighting up.

The company's website contains offers for car hire, travel insurance, hotels, airport transfer, credit cards, hostels and bed and breakfasts, cruise holidays, villas and apartments, campsite holidays, and others. Ryanair has contracts with companies to handle the services marketed on the website and receives a fee from these companies. For example, in the contract with Hertz Corporation, Hertz handles all rentals marketed through Ryanair's website in exchange for a per-passenger fee paid to Ryanair. Recently, Ryanair teamed up with a travel-media company to sell targeted advertising that will appear on its boarding passes.

Ancillary revenues are also generated by charging fees for just about anything. For example, there are fees for priority boarding, reserved seats, for airport boarding card reissue, checked baggage, excess baggage, infant equipment, sports equipment, musical instruments, and many others. A recent new fee is a £2 charge to cover the cost of cancellations and delays in 2010 such as the Icelandic volcanic ash, heavy snow, and strikes in Spain and France. One controversial fee is the boarding pass reissue fee (charging €40/£40 for a passenger who fails to print out his boarding pass), which has been ruled illegal by a judge in Barcelona. Without the charge, Ryanair argues that it would have to employ numerous handling agents to reissue boarding passes.

The *2010 Amadeus Guide to Ancillary Revenue* categorizes Ryanair as one of the "Ancillary Revenue Champs" and estimates that for 2010, worldwide ancillary revenues would be $22.6 billion. *The Irish Examiner* newspaper reported that Ryanair's ancillary revenues for 2009 were €663 million, more than any European airline, and in the top five ranking of airlines around the world (the top three are United, American, and Delta). Ryanair's ancillary revenues grew by 21 percent to €802 million for fiscal 2011.

Use of the Internet—Booking, Check-in, and Boarding

Passengers must book and pay for fares on the Ryanair website or call center. An administrative fee applies to all bookings made through the call center and also to web bookings made without using Ryanair's free payment method (MasterCard Prepaid Debit Card). Flights are booked one-way only and tickets may be changed for a fee but cannot be cancelled. Passengers must check in online from 15 days before the flight up to four hours before departure time. An online check-in fee applies to all tickets booked (€6/£6 for flights booked online and €12/£12 for those made via the call center or at the airport). After checking in, the boarding pass must be printed and presented at boarding. No changes can be made to passenger name(s), flight dates, times, or route once the check-in is completed. Seating is not assigned unless "Reserved Seating" has been purchased (on the website) or where passengers have indicated that they need special assistance. Passengers who have purchased "Priority Boarding" (also from the website) may board before others provided they arrive at the gate no later than 30 minutes before boarding. Refunds are possible only in the event of a flight cancellation or the death of an immediate family member (within 14 days of the travel date).

Fleet—Environmental Issues and Safety

Ryanair has a fleet of 272 Boeing 737-800 jets. It is one of the youngest fleets, with an average age of 2.94 years and none older than 8 years (as of March 31, 2010). Each aircraft has a capacity of 189 passengers, is capable of longer flights, and has more sophisticated avionics than the previous 737-200 aircraft. Winglets are installed wingtips to reduce fuel consumption. The company has orders for 56 new aircraft expected to be delivered over the next two years.

Ryanair boasts that its modern fleet contributes to less fuel use, pollution, and noise, and the airline is strongly opposed to a charge on emissions. The airline believes that a charge on emissions will increase air fares, reduce competition, and help the larger carriers, which have less efficient aircraft and fly into more congested airports (which have longer taxiing times and holding of flights), which contribute to fuel waste and pollution.

There have been no passenger or flight crew fatalities in 25 years of operation. The company's board has an air safety committee to oversee safety practices. The airline trains its flight crews using programs approved by the Irish Aviation Authority. Each Boeing 737-800 is equipped with an Operational Flight Data Monitoring system, which provides reports on deviations from normal operating procedures on any flight.

Operating Performance

Revenue Passenger Miles (RPMs) is the total number of passengers multiplied by the miles flown and is a useful measure of an airline's market share. Ryanair's RPMs increased 14.4 percent from 39,202.3 million in the 2009 fiscal year to 44,841.1 million in the 2010 fiscal year.

Available Seat Miles (ASMs) is the number of seats in the active fleet multiplied by the number of miles flown and is a capacity measure. ASMs are a function of the fleet size, mix of seats (first, business, and economy seats), the average length of flights, and the turnaround time of the aircraft. Ryanair's ASMs increased 13.5 percent from 47,102.5 million in the 2009 fiscal year to 53,469.6 million in the 2010 fiscal year.

The load factor is RPM divided by ASM and measures the percentage of available capacity that is taken by revenue paying passengers. Once the load factor exceeds the break-even point (which varies by airline), the airline becomes profitable. Ryanair's load factor for fiscal 2009 was 81 percent (break-even 79 percent), and for fiscal 2010 was 82 percent (break-even 73 percent).

Average yield per RPM (frequently referred to as just "yield") is the average passenger revenue received for each revenue passenger flown. Airlines should only be compared on the basis of yields if their mix of flights is similar. International flights tend to have lower yields but tend to be more profitable (because of lower costs), while domestic flights might have higher yields but be less profitable (because costs are higher). Also, airlines with a higher proportion of first class and business seats will have higher yields than a low-cost carrier, which will tend to have only one seat class. For Ryanair, yield decreased from €0.060 in 2009 to €0.052 in 2010, attributable to an increase in seat capacity, poor economic conditions, increased price promotions, and the adverse strengthening of the U.K. pound sterling against the Euro.

Cost per Available Seat Mile (CASM) is expressed as the number of cents to operate each ASM (operating costs divided by ASMs) and is frequently used to compare costs across airlines. For Ryanair, CASM was €0.058 for fiscal 2009 and €0.047 for fiscal 2010.

Finally, the average booked passenger fare was €40.02 in 2009 and €34.95 in 2010. Ancillary revenues per booked passenger were €10.21 in 2009 and €9.98 in 2010.

Financial Performance

Balance sheets and income statements for the last two years are given in Exhibits 4 and 5. Note that for the year ended March 31, 2011, Ryanair reported a 26 percent increase in profits to €400.7 million, compared to €318.8 million in the year ended March 31, 2010. Total operating revenues increased by 21 percent to €3,629.5 million, primarily due to a 12 percent increase in average fares, an 8 percent increase in passenger numbers, and a 21 percent increase in ancillary fees. Gross cash increased by €127.2 million to €2,940.6 million. Adjusted basic EPS rose to 26.97 from 21.59 as of March 31, 2010.

EXHIBIT 4 Ryanair Holdings plc and Subsidiaries Condensed Consolidated Preliminary Balance Sheet as of March 31, 2011 (000,000 omitted)

	Mar. 31, 2011	Mar. 31, 2010
	€	€
Noncurrent assets		
Property, plant and equipment	4,933.7	4,314.2
Intangible assets	46.8	46.8
Available for sale financial assets	114.0	116.2
Derivative financial instruments	23.9	22.8
Total noncurrent assets	5,118.4	4,500.0

EXHIBIT 4 Continued

	Mar. 31, 2011	Mar. 31, 2010
	€	€
Current assets		
Inventories	2.7	2.5
Other assets	99.4	80.6
Current tax	0.5	–
Trade receivables	50.6	44.3
Derivative financial instruments	383.8	122.6
Restricted cash	42.9	67.8
Financial assets: cash > 3 months	869.4	1,267.7
Cash and cash equivalents	2,028.3	1,477.9
Total current assets	3,477.6	3,063.4
Total assets	8,596.0	7,563.4
Current liabilities		
Trade payables	150.8	154.0
Accrued expenses and other liabilities	1,217.0	1,088.2
Current maturities of debt	333.8	265.5
Current tax	–	0.9
Derivative financial instruments	125.4	41.0
Total current liabilities	1,827.0	1,549.6
Noncurrent liabilities		
Provisions	96.9	102.9
Derivative financial instruments	8.3	35.4
Deferred tax	267.7	199.6
Other creditors	126.6	136.6
Noncurrent maturities of debt	3,315.6	2,690.7
Total noncurrent liabilities	3,815.1	3,165.2
Shareholders' equity		
Issued share capital	9.5	9.4
Share premium account	659.3	631.9
Capital redemption reserve	0.5	0.5
Retained earnings	1,967.6	2,083.5
Other reserves	317.0	123.3
Shareholders' equity	2,953.9	2,848.6
Total liabilities and shareholders' equity	8,596.0	7,563.4

Source: "Ryanair Full Year Results 2011," Ryanair website, http://www.ryanair.com/doc/investor/2011/q4_2011_doc.pdf.

EXHIBIT 5 Ryanair Holdings plc and Subsidiaries Condensed Consolidated Preliminary Income Statement for the Year Ended March 31, 2011 (000,000 omitted)

	Mar. 31, 2011	Mar. 31, 2010
	€	€
Operating revenues		
Scheduled revenues	2,827.9	2,324.5
Ancillary revenues	801.6	663.6
Total operating revenues - continuing operations	3,629.5	2,988.1

(*Continued*)

EXHIBIT 5 Continued

	Mar. 31, 2011	Mar. 31, 2010
	€	€
Operating expenses		
Staff costs	371.5	335.0
Depreciation	273.0	235.4
Fuel & oil	1,226.7	893.9
Maintenance, materials, & repairs	93.9	86.0
Aircraft rentals	95.2	95.5
Route charges	410.5	336.3
Airport & handling charges	490.9	459.1
Marketing, distribution, & other	151.6	144.8
Icelandic ash–related cost	–	–
Total operating expenses	3,113.3	2,586.0
Operating profit - continuing operations	516.2	402.1
Other income/(expenses)		
Finance income	27.2	23.5
Finance expense	(92.2)	(72.1)
Foreign exchange loss	(0.6)	(1.0)
Loss on impairment of available for sale financial asset	–	–
Gain on disposal of property, plant, & equipment	–	2.0
Total other expenses	(65.6)	(47.6)
Profit before tax	450.6	354.5
Tax on profit on ordinary activities	(49.9)	(35.7)
Profit for the year - all attributable to equity holders of parent	400.7	318.8
Earnings per ordinary share (in € cent)		
Basic	26.97	21.59
Diluted	26.89	21.52
Weighted average no. of ordinary shares (in Ms)		
Basic	1,485.7	1,476.4
Diluted	1,490.1	1,481.7

Source: "Ryanair Full Year Results 2011," Ryanair website, http://www.ryanair.com/doc/investor/2011/q4_2011_doc.pdf.

Total operating expenses rose by 20 percent to €3,113.3 million, primarily as a result of increased fuel prices but also because of increased hours flown. Fuel costs (39 percent of total operating costs) increased by 37 percent to €1,226.7 million. Unit costs excluding fuel increased by 3 percent and including fuel rose by 11 percent. The operating margin rose 1 percent to 14 percent, while operating profit increased by 28 percent to €516.2 million. The income statement (Exhibit 5) shows all operating expenses for the airline.

These figures represent unaudited consolidated financial information prepared in accordance with International Financial Reporting Standards (IFRS) principles. The figures exclude exceptional items of €29.7 million (pretax) reflecting the closure of airspace in April and May 2010 because of the volcanic eruptions in Iceland. The exceptional items for the year ended March 31, 2011, amounted to €13.5 million, reflecting the impairment of the Aer Lingus shareholding. For this reason, the income statement is labeled "Pre Exceptional Results" in accordance with the way in which Ryanair presented its operating and financial results.

External Factors

Government Regulation

COMMISSION FOR AVIATION REGULATION (CAR) The CAR is responsible for issuing operators licenses subject to EU law, and the CAR may revoke licenses. Ryanair's current operator's license became effective on December 1, 1993. The CAR is also responsible for deciding whether an airport should be "fully coordinated," effectively granting it control over the issuing of slots (a time reserved for arrival and departure of a particular airline flight). Ryanair has in the past challenged the CAR's decision to designate Dublin Airport as fully slot-coordinated.

IRISH AVIATION AUTHORITY (IAA) The IAA is responsible for overseeing the safety and technical aspects of aviation in Ireland and issuing operator's certificates to carriers. The IAA's regulatory authority includes the following: air safety; aircraft certification; personnel licensing and training; maintenance, manufacture, repair, air worthiness, and operation of aircraft; implementation of EU legislation; aircraft noise; and ground services. Each of Ryanair's aircraft must have a Certificate of Airworthiness issued by the IAA, and this certificate may be amended or withdrawn if the airline fails to comply with statutes, rules, and regulations relevant to the industry.

DEPARTMENT OF TRANSPORTATION (DOT) The DOT is responsible for implementation of EU and Irish legislation and international standards relating to air transportation. Of importance to Ryanair, in 2005 the DOT enacted legislation in response to EU legislation requiring compensation and assistance to passengers in the event of denied boarding, flight cancellation, and long delays (EU 261).

Ryanair views the EU 261 regulations as "unfair and discriminatory" because they force airlines to pay compensation to passengers as well as cover other costs in circumstances beyond the control of the airline, such as air traffic control strikes or failure by airports to clear snow from runways. Ryanair argues that compensation in such circumstances should be limited to the ticket price paid as is required for train, coach, and ferry operations. (The regulation itself states that airlines are not responsible for passenger compensation for events beyond the airline's control.) In the case of denied boarding, cancellation, or long delay (which is deemed the same as a cancellation), short-haul airlines such as Ryanair would be required to pay €250 per passenger (for inconvenience to that passenger). Airlines are also required to reroute or refund the ticket and may be required to provide meals, accommodation, and other amenities to passengers. Ryanair has already paid out claims of £88 million related to the above events last year and justifies its added £2 fee by the costs associated with EU 261. The airline, however, stands to earn up to £150 million per year from this fee, nearly twice the £88 million already paid out.

Fuel

Fuel represented 34.1 percent of total operating expenses for fiscal 2010 (43.8 percent in 2009). Ryanair actively engages in fuel hedging (for example, purchasing future fuel supplies at a set price to minimize losses should prices increase). It is limited in its ability to pass on fuel increases to passengers and has made a commitment in its charter not to impose a fuel surcharge on any fare.

Ryanair is 90 percent hedged for fiscal year 2012 at $820 per metric ton (1,000 kilograms or 2,204.62 lb.), or about $82 per barrel. This represents a 12 percent price increase over last year but is below current prices. The airline anticipates higher oil prices next winter coupled with the refusal of some airports to offer lower charges. This may result in the grounding of aircraft rather than risk financial losses. Although Ryanair expects traffic to grow overall in fiscal 2012, it does anticipate a reduction in the winter. It expects its full year fuel costs to increase by approximately €350 million.

Airline Industry and Competition

The European airline industry is highly competitive with a number of low-fare (e.g., easyJet, Air Berlin, and Germanwings), traditional (e.g., British Airways, Lufthansa, and Air France), and charter airlines (e.g., Monarch Airlines and Titan Airways). Charter flights are offered by low-fare as well as traditional airlines, and some charter airlines (e.g., Monarch) offer scheduled services. Airlines compete on fares, time and frequency of services, service quality (e.g., number of on-time

departures and arrivals, frequency of lost baggage, and frequency of involuntary denied boardings), amenities such as frequent flyer programs, and reputation. Ryanair believes that state-owned competitors have advantages because of subsidies and other state aid provided to them. In addition, the EU-U.S. Open Skies Agreement that took effect in 2008 allows U.S. carriers to offer services in the intra-EU market, which results in increased competition.

Although Ryanair boasts having the lowest fares, a survey in May 2011 by *The Telegraph* showed how the cost of a flight on a low-cost carrier can escalate when all fees are added and make prices on a traditional carrier such as British Airways more competitive. The survey was of return flights for a family of four from London to Madrid traveling on the same dates in August with two checked bags, golf clubs, and a cot, and paying with a debit card. The fares were as follows: Ryanair £271.92; easyJet £275.92; and British Airways £476.20. While Ryanair had the lowest fare, the costs went up substantially once all fees were added. To Ryanair's ticket cost would be added an online check-in fee (£48), luggage fees (£80 plus £80 for golf clubs and £20 for the travel cot), administration fees (£48), and the new delay/cancellation fee (£16) for a total cost of £563.92, the highest of the three carriers.

Exhibit 6 gives the full breakdown of all costs. While this survey represents a snapshot of a particular trip and might not be applicable to all trips, it makes the point that Ryanair is not always the cheapest way to travel and passengers must consider the added fees before making the ticket purchase. To the extent that passengers become more familiar with the complex Ryanair fee structure, it may place Ryanair at a disadvantage compared to low-fare and traditional airlines, as illustrated in this survey.

Airlines face competition from ground transportation such as high-speed rail systems that are quite extensive in Europe and sea transportation (which in Ryanair's case would be more relevant to travel between Britain, Ireland, and continental Europe, as well as travel to Morocco).

The Single European Sky proposal (SES) launched by the European Commission in 1999 could have broad effects on the European airline industry. According to *The Wall Street Journal*, in 39 European countries there are 39 national agencies plus Eurocontrol, with 64 control centers. The European system has twice as many bureaucrats and support staff than in the United States and operating costs are 75 percent higher than the FAA's, largely because of labor costs. Ryanair's £2 fee that was recently added was in part to cover costs that it incurred because of a strike in 2010 by Spanish air traffic controllers. These controllers were earning an average of half a million dollars and went on strike after an attempt by the Spanish government to cut those salaries to below $300,000. Resistance to a Europe-wide system similar to the FAA in the United States is in part explained by the desire to protect pay systems such as in Spain. EU officials state that the SES will end such pay abuses, cut delays, and reduce fuel consumption and pollution.

EXHIBIT 6 Cost Comparison of Ryanair, easyJet, and British Airways for Family of Four, London to Madrid, in August 2011

Cost Item	British Airways	Ryanair	easyJet
Ticket price	£479.20	£271.92	£275.92
Online check-in	n/a	£48	n/a
Delay/cancellation*	n/a	£16	n/a
Administration fee	n/a	£48**	£8
Two checked bags	free up to 23kg	£80 up to 15kg	£44 up to 20kg
Travel cot	free	£20	free
Golf clubs	free	£80	£50
Total cost of trip	**£479.20**	**£563.92**	**£387.17**

*£2 fee per passenger per flight added to compensate claims for last year's flight delays and cancellations due to volcanic ash, heavy snow, and ATC strikes

**Avoidable if use MasterCard Prepaid Booking Card otherwise £6 per passenger per flight (Ryanair), avoidable for easyJet if use Visa Electron

Source: Oliver Smith, "Ryanair to earn £1.25 billion from extra charges," *The Telegraph,* May 6, 2011, http://www.telegraph.co.uk/travel/travelnews/8497343/Ryanair-to-earn-1.25bn-from-extra-charges.html.

The Future

On May 23, 2011, the airline released the *Ryanair Full Year's Results 2011*, in which CEO Michael O'Leary pointed out the following highlights:

- Profits rose 26 percent to €401 million
- Traffic grew 8 percent to 72 million
- 40 new aircraft (year-end fleet was 272 aircraft)
- 8 new bases: El Prat, Gran Canaria, Kaunas, Lanzarote, Malta, Seville, Tenerife, Valencia (total 44 bases)
- 328 new routes (total of over 1,300 routes)
- Customer service further improved (number one on-time airline)
- Dividend of €500 million paid to shareholders (€846 million returned to shareholders over the last three years)

The highlights show an airline that has grown, been profitable, and made returns to its shareholders. But, are there risks associated with rapid growth? If passenger numbers do not materialize to keep up with the fleet expansion, Ryanair could experience overcapacity and be forced to lower its prices to attract more passengers. It would also face difficulties to pay for its expanded fleet of aircraft. Fuel prices are expected to rise in 2012. Increasing legislation, in particular EU 261, could have continuing adverse effects on Ryanair. One new piece of legislation taking effect in January 2012 is the European Union's emissions trading scheme. Under this requirement, airlines must pay for the carbon dioxide they emit. Estimates are that airlines are likely to pay about €1.4 billion for carbon permits in 2012, rising to €7 billion by 2020. A certain number of permits will be issued free to each airline, but they will have to buy permits on the open market for emission beyond the allowed amount. Other challenges faced by Ryanair are:

1. How sustainable is the strategy of low ticket price plus extensive fees as consumers become more educated about Ryanair's fee structure?
2. Will customers continue to put up with the poor overall customer service in exchange for lower ticket prices, faster turnarounds, and a higher percentage of on-time departures and arrivals?
3. Will increasing customer complains about the airline's services and advertising bring more restrictive legislation for the airline?
4. Does Ryanair's strategy provide an opportunity for a "differentiated" low-cost entrant, perhaps a low-fare carrier with a softer touch?

On May 24, 2011, Ryanair deliberately flew an aircraft (without passengers) through Scottish airspace that was closed because of a recent volcanic eruption in Iceland. Ryanair's reason was to demonstrate that there was no safety threat to aircraft in this area and the designation of it as a "red zone" by the U.K.'s Civil Aviation Office was flawed. In response, the U.K.'s transportation secretary stated that radar tracking of the aircraft showed that it did not fly though any part of the designated red zone. Is this another in a series of publicity stunts by Ryanair, or does it have a point that the flight restrictions were unnecessary?

Prepare a three-year strategic plan for CEO O'Leary at Ryanair.

The Emirates Group, 2014

www.theemiratesgroup.com

Based in Dubai, United Arab Emirates (UAE), Emirates Group (Emirates) includes (a) Emirates (the airlines) and (b) Dnata, a company specializing in aviation ground-handling services and operating at 20 airports. The largest airline in the Middle East, Emirates flies to more than 130 destinations in 70 countries on six continents and offers direct flights from Dubai to Washington, DC, San Francisco, Los Angeles, and Seattle. Emirates services the world from Beijing to San Francisco and more than 100 markets in between. More than 1,200 Emirates flights depart Dubai each week, accounting for about 40 percent of all air traffic out of Dubai International Airport.

Emirates carries 40 million passengers and 2.0 million tons of cargo annually, using a fleet of more than 170 aircraft. The company has another 230 aircraft on order (worth about $84 billion) and is the world's largest operator of both the Airbus 380 and Boeing 777. Using large planes such as the Airbus 380 and Boeing 777 provides extra space and luxury for wealthy and business passengers alike. Most of the company's planes even include spacious private suites, and some planes provide a spa with showers. Emirates is well known for providing excellent service for high-end passengers in first class, but it also provides excellent service in business class and economy class. Economy-class customers receive well-thought-out meals consisting of many courses, e-mail, SMS services, telephone, and personal TV monitors with more than 1,400 channel options. Singapore Air is considered the closest competitor based on overall business model of top service at a premium price and markets served.

Emirates has more than 67,000 employees and annual revenues of more than 73.1 billion Dirham (the United Arab Emirates currency). The Dirham is pegged to the U.S. dollar so currency fluctuations are not significant. Emirates is owned by the government of Dubai operating under the Investment Corporation of Dubai name, but the company and the government of Dubai are quick to point out the airline has grown in scale not by way of protectionism but through competition. The government of Dubai treats Emirates as a wholly independent business entity on its own and attributes this to the firm's success. Dubai has an open-skies policy and more than 60 percent of all flights in Dubai are by companies other than Emirates.

In August 2013, Emirates became the first airline in the Middle East to provide Google Now cards for their passengers who book via Emirates.com. A feature of the Google Search app, Google Now is available and fully integrated for Android (devices running Android 4.1 and above) and iOS (iPhones and iPads). This new product enables Emirates' customers to see and monitor their upcoming flight, providing flight times and departure terminal. Google Now gives passengers relevant information on their destination (for example weather conditions locally, currency, local landmarks, accommodations, and attractions).

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History

Dubai is a city-state in the UAE, located within the emirate of the same name, one of the seven emirates that make up the UAE. Dubai has the largest population in the UAE (2,104,895) and the second-largest land territory by area (4,114 km^2) after Abu Dhabi. Dubai and Abu Dhabi, the national capital, are the only two emirates to have veto power over critical matters of national importance in the UAE legislature. The city of Dubai is located on the emirate's northern coastline and is often misperceived as a country or city-state and, in some cases, the UAE as a whole has been described as Dubai.

When the British pulled out of Dubai in the late 1950s, Sheikh Saeed bin Maktoum (the current CEO of Emirates) decreed open-seas, open-skies, and open-trade policies to develop the country. He also required that all government agencies make a profit. Dubai was aiming to eliminate its dependence on its finite oil reserves within 50 years and thus has operated under a free market society for decades. Emirates Group started in 1959 as the Dubai National Air

Transport Association (Dnata), with Dnata airport operations, Dnata cargo, and Dnata agencies as segments. After Gulf Air began cutting back service to Dubai in the 1980s, Dubai's royal family provided funding for Dnata to obtain two planes and the company became known as Emirates Group. The company's first flight was in 1985 on a leased Airbus plane. After being in operation for four years, Emeritus was serving 12 destinations, and by 1994 the airline was serving 32 destinations but still only operated 15 aircraft and was the sixth largest airline in the Middle East. During this time, 92 rival firms were serving Dubai Airport, which provided intense competition for Emirates.

The late 1990s was a time of rapid expansion for Emirates; it ordered 16 Airbus 330-200s at a cost of $2 billion, and in 1997, it ordered an additional six Boeing 777-200s. The company followed that by opening a $65-million training center with simulators for training pilots and crew. The company continued to expand, ordering an additional 22 Airbus A380s, the largest plane in the world, and six additional Boeing 777s in 2001. The 2000s saw considerable expansion in the number of planes operated and destinations served, including new flights being added every month to various places around the world. Emirates received 22 new aircraft in fiscal year 2012, the most ever obtained in a single year by the company. Emirates is perhaps the world's fastest growing and most profitable airline in the industry.

Dubai is one of the fastest-growing countries in the world because thousands of people migrate to Dubai monthly, often because there is no tax on the personal wages in Dubai. The living standard is great, the climate is great, the infrastructure is impressive, business is growing leaps and bounds, and the schools in Dubai are international and provide a great learning environment for kids of all nationalities. However, an expatriate (foreigner) may work in Dubai only if sponsored by an employer.

Internal Issues

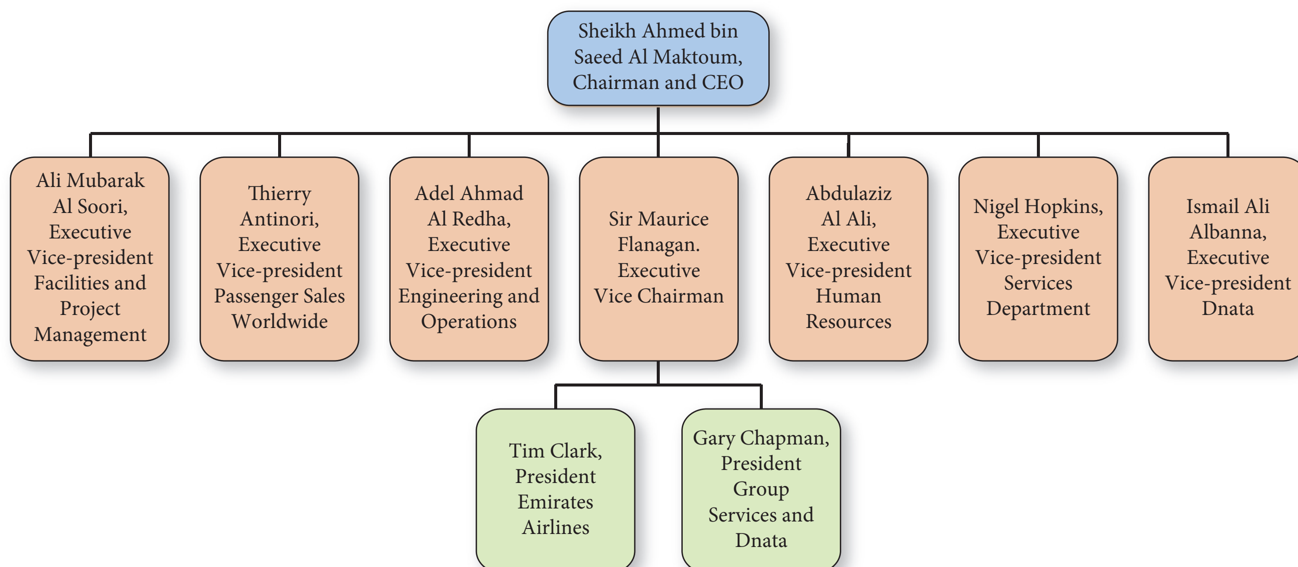
Mission and Vision

Emirates' mission is "to become one of the top lifestyle brands in the world."

Organizational Structure

As indicated in Exhibit 1, Emirates operates from a divisional-by-product organizational design. Note that no women are among the company's top management team, which comes as no surprise given Middle Eastern culture. However, Emirates could set an example soon by promoting

EXHIBIT 1 Emirates' Organizational Structure



Source: Based on company documents.

one or more women to top management, to exemplify that women are as capable as men to manage business operations. The Executive Vice Chairman position perhaps is analogous to the traditional Chief Operations Officer.

Emirates Luxury

First-class passengers on Emirates flights enjoy their own private suites on Airbus 380, Airbus 350, and Boeing 777 planes. The Emirates first-class experience starts with a personal chauffeur picking up a passenger and driving him or her to the airport for a seamless check in. Customers are then able to enjoy the first-class lounge while they wait for the plane to arrive before the boarding process begins. First-class passengers have an allowance for two carry on items totaling 25 pounds combined and unlimited checked bags up to 170 pounds total weight. Once on board, the customer enjoys suites that include a personal mini-bar, vanity table, mirror, wardrobe, 23-inch TV with more than 1,400 channels including the latest movies, sliding door for extra privacy, SMS, Internet, and much more. If desired, the flight crew can covert the seat to a fully flat bed with mattress. To complement the bed, pajamas, slippers, and toiletries with Bulgari lotions are provided. First-class customers have exquisite free food and drink options, including Dom Perignon, martinis, Iranian caviar, stir-fried lobster, glazed duck breast, Arabic mezze (appetizers), and much more. First-class customers have access to the first-class lounge to mingle with other first-class passengers and enjoy hors d'oeuvres prepared by some of the world's best chefs. First-class customers can enjoy one of the two onboard shower spas as part of their experience on the Emirates Airbus 380. The spas are marketed as having walnut and marble designs with fine linens and provide complimentary massages in addition to a shower. The price in 2009 for a first-class ticket from Dubai to Melbourne, Australia was around $16,000.

Business-class travel on Emirates is possibly the best in the world. Business-class passengers enjoy many amenities, such as seats turning into a 79-inch flat bed at the push of a button, power supply for laptops, extra large tables, large screen TVs with more than 1,400 channels, SMS, Internet, mini-bar built into every seat, and privacy dividers. These amenities are provided on A380 and most Boeing 777 aircraft. Business-class passengers also enjoy delicious food and many drink options. Complimentary champagne and vintage wines are the norm, and all food is presented on Royal Doulton fine-bone china. Business-class customers also have access to the business-class lounge on the second level of all A380 aircraft where chefs fix snacks and hors d'oeuvres. Emirates' economy-class customers enjoy more than 1,400 channels on their personal TV, meals, and Internet, phone, and SMS capabilities at their seats.

Finance

Emirates' fiscal year ends on March 31st, and all financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) and are reviewed by an unaffiliated institution as any publicly traded company would be subject to. Emirates reported a profit for the 25th consecutive year in fiscal year 2013 with revenues up 17.4 percent from the previous year, and the best year ever for Dnata, which had revenues of 6.62 million AED. Rising fuel prices hurt overall profits because fuel accounts for more than 40 percent of all costs for Emirates. The Arab Spring and the instability in Africa also hurt profits, but the company's net profit for fiscal year 2013 was 7.83 billion AED, up 57 percent from the previous year. Emirates increased total passenger volume by 15.9 percent in fiscal year 2013 and maintained a passenger seat factor of 80 percent.

Emirates' recent income statements and balance sheets are provided in Exhibits 2 and 3, respectively. Note the strong financial position of this company.

Segments

The Emirates Group has two primary divisions, Emirates and Dnata. Emirates is the airline, whereas Dnata includes (a) cargo and ground handing, (b) travel services, (c) catering, and (d) freight forwarding.

EXHIBIT 2 Emirates' Income Statement (in millions of AED)

	2013 AED m	2012 AED m	2011 AED m
Revenue	71,159	61,508	52,945
Other operating income	1,954	779	1,286
Operating costs	(70,274)	(60,474)	(48,788)
Operating profit	**2,839**	**1,813**	**5,443**
Other gains and losses	—	—	(4)
Finance income	406	414	521
Finance costs	(900)	(657)	(506)
Share of results in associates and joint ventures	127	103	91
Profit before income tax	**2,472**	**1,673**	**5,545**
Income tax expense	(64)	(53)	(78)
Profit for the year	**2,408**	**1,620**	**5,467**
Profit attributable to non-controlling interests	**125**	**118**	**92**
Profit attributable to Emirates' owner	**2,283**	**1,502**	**5,375**
Profit for the year	**2,408**	**1,620**	**5,467**
Currency translation differences	9	(9)	38
Cash flow hedges	56	(259)	(282)
Actuarial losses on retirement benefit obligations	(70)	(116)	(57)
Other comprehensive income	**(5)**	**(384)**	**(301)**
Total comprehensive income for the year	**2,403**	**1,236**	**5,166**
Total comprehensive income attributable to non-controlling interests	**125**	**118**	**92**
Total comprehensive income attributable to Emirates' Owner	**2,278**	**1,118**	**5,074**

Source: Based on page 8, 2013 *Annual Report*.

EXHIBIT 3 Emirates' Balance Sheets (in millions of AED)

	2013 AED m	2012 AED m	2011 AED m
ASSETS			
Non-current assets			
Property, plant and equipment	57,039	49,198	39,848
Intangible assets	910	902	901
Investments in associates and joint ventures	485	430	386
Advance lease rentals	807	370	384
Loans and other receivables	508	917	1,704
Derivative financial instruments	92	69	—
Deferred income tax asset	15	10	—
		51,896	**43,223**
Current assets			
Inventories	1,564	1,469	1,290
Trade and other receivables	8,744	8,126	6,481
Derivative financial instruments	67	8	123
Short term bank deposits	18,048	8,055	3,777
Cash and cash equivalents	6,524	7,532	10,196
	34,447	**25,190**	**21,867**
Total assets	**94,803**	**77,086**	**65,090**

(continued)

EXHIBIT 3 Continued

	2013 AED m	2012 AED m	2011 AED m
EQUITY AND LIABILITIES			
Capital and reserves			
Capital	17	801	801
Retained earnings	22,729	21,256	20,370
Other reserves	(768)	(833)	(565)
Attributable to Emirates' owner	**22,762**	**21,224**	**20,606**
Non-controlling interests	**270**	**242**	**207**
Total equity	**23,032**	**21,466**	**20,813**
Non-current liabilities			
Borrowings and lease liabilities	35,752	26,843	20,502
Retirement benefit obligations	—	631	479
Deferred revenue	1,460	1,074	930
Deferred credits	294	350	401
Deferred income tax liability	—	—	2
Trade and other payables	—	—	31
Derivative financial instruments	1,016	957	642
		29,855	**22,987**
Current liabilities			
Trade and other payables	25,013	20,601	17,551
Income tax liabilities	24	36	22
Borrowings and lease liabilities	5,042	4,037	2,728
Deferred revenue	1,147	915	792
Deferred credits	87	136	136
Derivative financial instruments	6	40	61
	31,319	25,765	21,290
Total liabilities	**71,771**	**55,620**	**44,277**
Total equity and liabilities	**94,803**	**77,086**	**65,090**

Source: Based on page 9, 2013, *Annual Report*.

Emirates

Passenger revenue is the largest overall revenue generator as revealed in Exhibit 4. Substantial revenue also is derived from cargo, which produces 15 percent of the segment's total revenue, whereas sale of goods produces 3 percent. All other sources contribute less than 1 percent of the segment's revenues. This segment includes several maritime and mercantile holdings,

EXHIBIT 4 Emirates Revenues by Segment (in millions of AED)

REVENUE

	2013 AED m	2011–12 AED m	2010–11 AED m
Passenger	57,477	48,950	41,415
Cargo	10,346	9,546	8,803
Excess baggage	388	332	293
Other	767		
Transport revenue	**68,978**	**58,828**	**50,511**
Sale of goods	1,196	2,017	1,774
Food	502	245	226
Other	483	418	434
Total	**71,159**	**61,508**	**52,945**

Source: Page 13, 2013, *Annual Report*.

a 49 percent ownership in a wine and spirit business in Thailand, and hotels in UAE, Australia, and Seychelles.

This segment operates more than 180 aircraft with approximately 120 on operating lease, 55 on financial lease, and 6 being fully owned by Emirates. Out of the 180 planes the company operates, 98 are Boeing's 777, one of Boeing's largest planes and the largest twin-engine plane in the world. An additional 21 aircraft are Airbus 380s, the four-engine double-decker plane that is the largest in the world. Emirates is the largest operator of Airbus 380 aircraft in the world. The company has on order 223 additional aircraft broken down to 84 Boeing 777s, 69 Airbus 380s, and 70 Airbus 350-900s. The Airbus 350s are wide-bodied, long-range planes designed to compete with Boeing's Dreamliner. Although the 350s are considered large capacity, they hold significantly less passengers than the 777 and 380 models. On average, Emirates wide-body planes are 77 months old compared to the industry average of 136 months. With 223 new planes on order, the average age of planes in the fleet should drop substantially.

More than 40 percent of all expenses are related to jet fuel. Employment expenses account for 13 percent of revenue and operating leases account for 8 percent. Maybe surprising to some, aircraft maintenance only amounted for AED 1,296 million or 2 percent of total revenues, about the same as parking and landing fees. Exhibit 4 details a revenue breakdown within the Emirates segment.

Exhibit 5 reveals the geographic breakdown of Emirates' flights. No single market accounts for more than 30 percent of revenues, creating a well-diversified company with respect to regions served. The Americas market grew at the highest rate in the most recent fiscal year, but East Asia and Australasia regions had the largest overall AED growth. Note that the Americas segment grew from last place to fourth place.

Dnata

Dnata's profits and revenues for fiscal year-end March 31, 2013 were at all time records of 6.5 billion AED and 815 million AED respectively, as revealed in Exhibit 6. Much of the revenue growth can be attributed to recent acquisitions Dnata made including Travel Republic Ltd., the largest privately-held online travel company in the United Kingdom, in 2011.

EXHIBIT 5 Geographic Breakdown of Emirates' Revenues (in millions of AED)

Year	East Asia and Australasia	Europe	West Asia and Indian Ocean	Americas	Middle East	Africa	Total
2012–2013	20,884	20,140	8,031	8,275	7,117	6,712	71,159
2011–12	18,227	17,058	7,083	6,696	6,314	6,130	61,508
2010–11	15,503	14,433	6,405	5,518	5,488	5,598	52,945

Source: Page 14, 2012–2013 *Annual Report*.

EXHIBIT 6 Dnata's Revenues by Segment (in millions of AED)

Revenue	2012–2013 AED m	2011–12 AED m	2010–11 AED m	% change
In-flight Catering	1,686	2,452	576	325.7
Airport operations	2,474	2,321	1,980	17.2
Cargo	1,077	993	882	12.6
Information Technology	755	649	546	18.9
Travel services	544	319	243	31.3
Other	—	173	100	73.0
Total	6,536	6,907	4,327	59.6

Source: Based on company documents.

EXHIBIT 7 Geographical Revenue in Percent

	2011–2012	2010–2011	2009–2010
UAE	77%	62%	45%
International	23%	38%	55%

Source: Based on page 54, 2012 *Annual Report*.

In late 2010, Dnata acquired Alpha Flight Group's in-flight catering business. This is why the segment's revenues increased so much in 2011–2012 because Travel Republic's revenues first appeared on the income statement.

In-flight catering was both the largest revenue gainer and the largest revenue percent increase by 325 percent; however, the 2010–2011 fiscal year represents only three months of providing this service in house, resulting in the large percent increase. In-flight catering through the acquisition of Alpha Flight Group provided more than 48 million meals to customers in fiscal year 2012. Note all revenue streams in the Dnata segment experienced significant increases over the two years reported. Exhibit 7 provides a breakdown of Dnata services in UAE and internationally. For the first time ever, revenues in international markets were greater than domestic revenues.

Competition

Factors impacting the airline industry include global unrest, volatility of fuel prices, mergers and acquisitions, strategic alliances, video conferencing, and entry of discount airlines such as Ryanair. More than 100 different airlines provide service to Dubai International Airport, which is projected to become the world's busiest airport by 2016. Opening for passenger travel by the end of 2013 will be the new Al Maktoum Airport in Dubai. In fiscal year 2012 alone, Emirates started long-haul flights to Seattle, Dallas–Fort Worth, Rio de Janeiro, Buenos Aries, Washington DC, Geneva, Baghdad, and St. Petersburg (Russia), among others. Emirates' largest direct competitors are Singapore Airlines, British Airways, Delta, Middle East Airlines, and flydubai. Dubai is located eight hours by air from 75 percent of the world's population.

Singapore Airlines Group

Singapore Air dates back to1947 when the company was known as Malayan Airways Limited, operating flights to cities in and around Singapore. But in 1971 Malayan Airways split into Singapore Airlines and Malaysian Airline System, and the Singapore Airlines brand took off. Singapore Air now operates 101 planes that average six years and seven months and have 30 more planes on order. Like Emirates, Singapore Air operates the Airbus 380 (19 in operation) and the Boeing 777 (58 in operation). The Group operates 20 subsidiaries within the air travel industry, including SIA Cargo, SIA Engineering Company, SilkAir, Scoot, and Tradewinds Tours and Travel. Both SilkAir and Scoot are airlines that compliment the service of Singapore Air. Singapore Air predominantly serves Europe, Asia, and Australia, but it also flies to four cities in the United States and three in Africa.

Singapore Airline Group's fiscal year, like Emirates', ends on March 31. For fiscal year 2012, the company's profits were down $756 million to $336 million or 69 percent reduction, whereas revenues grew by $333 million to $14.8 billion, up 2 percent from the previous year. Both Singapore Air and Emirates are luxury airlines using Suites (separate from first class), first class, business class, and economy class. First-class passengers can enjoy 23-inch TVs, dining with food served on tableware designed by Givenchy, wines, and champagne. Singapore Air markets that they are the only airline to offer a stand-alone bed, not a converted seat. To complement the stand-alone bed, a sleeper suit, bedroom slippers, and linens also designed by Givenchy are provided. Soft lighting options and premium skin care products and toiletries are also provided.

Customers in first, business, and economy classes also enjoy amenities that exceed most all competing airlines. Hot, moist, hand towels are provided after meals to customers, even those in economy class. Serving all passengers since 1972 is the distinguished "Singapore Girl" that according to the company "is an enduring symbol of our impeccable service standards."

flydubai

flydubai was started by the government of Dubai in 2008 and was supported by Emirates during the firm's establishing phase, but flydubai is not part of the Emirates Group. With the backing of the Dubai government, flydubai ordered 50 Boeing 737-800s at a total price of $3.74 billion. The first planes were delivered in 2009, and flydubai was air bound for Beirut, the first market served. The company quickly grew as additional planes on order arrived. As of early 2013, the company served 52 markets, mostly in the Middle East but also a few select markets in Eastern Europe and India. In contrast to Emirates, flydubai is a discount airline provider much like a Spirit Airlines or AirTran in the USA or Ryanair or easyJet in Europe. flydubai operates 28 planes and 800 flights per week. The average age of aircraft is less than two years. The company does not currently provide financial information to the public.

Middle East Airlines

Middle East Airlines (MEA) began in 1945 in Beirut and served cities in Syria, Cyprus, Egypt, and later Saudi Arabia. The airline provides a local alternative for customers in the Middle East. In 1963, MEA merged with Air Liban and added destinations in the Middle East, West Africa, and Europe. In 2010, MEA accepted delivery of two new Airbus 320 aircrafts and resumed flights to Berlin and Brussels. In 2012, MEA joined SkyTeam and currently serves Europe, Persian Gulf, Middle East, and Africa. Notable destinations include four flights a day to Paris, London, Frankfurt, and Brussels; they also have flights to Rome, Milan, Athens, Geneva, Istanbul, and others in Europe and flights to several cities in Saudi Arabia, Amman, Iraq, Cairo, and Sharm el Sheikh. In total, MEA operates 19 aircraft with an average age of less than four years, has 10 planes on order, and serves 31 markets. The company offers Cedar Class (first class) and economy class. In 2011, MEA had revenues of $637 million with profits of $62 million.

British Airways

British Airways is a member of the Oneworld Alliance and is the largest carrier based on fleet size in the United Kingdom. The airline currently operates more than 250 aircraft with 50 more on order and serves the entire world. The airline has alliances with several airlines including Comair of South Africa and Sun Air of Scandinavia. The company had revenues of $14.8 billion in 2011. British Airways offers economy class, premium-economy class, business clas, and first class.

Delta

Headquartered in Atlanta and a member of the Sky Team Alliance, Delta is a major U.S. airline. Delta has hubs in several U.S. cities as well as in Amsterdam, Tokyo, and Paris. Operating more than 5,000 flights a day and an additional 2,500 flights through Delta Connection, Delta is one of the largest airlines in the world, and one of only a select few to provide service to all six inhabited continents. The airline provides business elite, first class, economy comfort, and economy class. Delta reported revenues of $14 billion and net income of $854 million in 2011.

Strategic Alliances

Airlines started forming strategic alliances in the 1990s to better compete with rival firms. Historically, if an airline did not serve a select market, a customer would either find an airline that did or be forced to purchase two separate tickets. Alliances largely resolve this problem because airlines can jointly benefit having a competitor (now also an alliance member) provide service for that leg of the flight. Other benefits of alliances are more efficient marketing and advertising exposure and frequent-flier programs, which attempt to hook passengers on to one particular airline for all their flying needs.

Three of the largest alliances in the world are SkyTeam, Star Alliance, and Oneworld. SkyTeam is based out of Amsterdam and was created in 2000 by founding members: Delta, Air France, Aeromexico, and Korean Air. The Sky Team Alliance consists of 19 carriers from five continents and carries more than 550 million passengers each year. Based out of New York City, Oneworld was formed in 1999 with founding members: American Airlines, British Airways, Canadian Airlines, Cathay Pacific, and Qantas. Today, 11 airlines operate within the Oneworld alliance and carry more than 335 million passengers annually. The Star Alliance was founded in 1997 by Air Canada, Lufthansa, Scandinavian Airlines, Thai Airways International, and United Airlines.

Based in Frankfurt, Germany, the Star Alliance has 28 member airlines and serves 193 different countries with annual passenger numbers more than 670 million, making Star Alliance the largest alliance in terms of passengers served.

Alliance with Quantas

Emirates is not a member of any airline alliance, whereas Quantas is a member of Oneworld. However in January 2013, Emirates and Quantas, two rival firms, formally entered into a partnership allowing Quantas Airbus 380 customers to depart from Concourse A at Dubai Airport, the world's only concourse designed for the Airbus 380. Quantas customers can enjoy the concourse, while waiting for their connecting flights to Europe. In exchange, Quantas moved their hub for European flights from Singapore to Dubai. Neither airline owns shares of the other, but they work together to better coordinate price, sales, and schedules. Quantas CEO Alan Joyce believes the partnership is a first of its kind and different from traditional alliances.

Dubai Business Culture

To be successful in business in Dubai, their culture and religion must be respected and rules must be followed. For example, a colleague should never be embarrassed or criticized in public. Women in Dubai should dress conservatively. Alcohol should never be consumed on the street, and it should be taken home only if one has a license to purchase it. Singles of the opposite sex may not live together in Dubai; gay marriages and relationships are not accepted in Dubai. If an unmarried woman becomes pregnant, then she must leave the country immediately. Other important rules to follow in Dubai include: do not cross your legs in front of someone of higher authority because it is seen as disrespectful; do not hold onto a handshake for a long time because it signifies a brotherly bond instead of a friendly gesture; do not use your left hand because it is considered dirty so use only the right hand to offer drinks, food, and so on; do not turn down a drink offer because it might insult the host; do not engage in friendly talk in pubic with any females; do not shake hands with women unless they come forward to do so; do not flirt, hug, and have other physical contact with a member of the opposite sex; do not make eye contact with women; do not ask a male Arab about any female because that is bad manners; do not point the soles of shoes at an Arab because the soles are dirty; do not refuse any gifts (if offered) but open them in private not in public; do not express a desire to communicate with any member of the opposite sex.

In Dubai, the workday starts at 8 A.M. until 1 P.M., but employees return at 7 P.M. to work more. During the Muslim Festival Ramadan, working hours in offices become shorter by two hours. In Arab cultures, clothes should be worn on all body parts including limbs. On Friday, Muslims pray and rest, so business should not be conducted on that day. During the month of Ramadan, Muslims avoid eating, smoking. and drinking during daylight.

The Future

Ironically for Emirates, the flydubai discount airline may pose the largest threat to the firm because demand for low price flights is growing rapidly globally. Flying with Emirates is high dollar, and competitors see great potential to take market share from Emirates with lower prices. It is important, therefore, for Emirates' Chairman and CEO, Sheikh Ahmed bin Saeed Al Maktoum, to have a clear strategic plan for the next three years.

Design a business strategy for the Emirates Group for the next three years.

United Parcel Service, Inc., 2013

www.ups.com, UPS

Headquartered in Atlanta, Georgia, United Parcel Service (UPS) is the largest logistics company in the world based on revenue and package volume. Operating in the air delivery and freight services industry, UPS delivers packages up to 150 pounds across the USA and to 220 countries worldwide. Serving customers since 1907, UPS operates a fleet of more than 100,000 cars, vans, trucks, tractors, and motorcycles and more than 530 aircraft and uses 35,000 transport cargo containers. In addition, UPS has 39,100 drop boxes, 2,100 customer centers, 4,700 independently owned UPS stores, and perhaps most importantly, 83,900 drivers.

UPS's Q2 of 2013 revenue increased 1.2 percent as the company's daily international package volume improved 5 percent and domestic volume grew 1.9 percent from the prior year. For Q2, UPS delivered 15.7 million packages per day, an increase of 2.3 percent over the prior-year period. The company's domestic Q2 revenue improved to $8.24 billion, up 2.3 percent; domestic revenue per piece was up 0.3 percent. The company's daily package volume improved 1.9 percent, compared to the same period last year, driven by residential shipments from e-commerce customers. Declining letter volume led to a 1.5 percent drop in Next Day Air. For Q2 of 2013, UPS's international daily package volume grew 5.0 percent and revenue increased 1.6 percent to $3.06 billion. Daily Export shipments increased 5.0 percent, led by Europe and Asia. Customers globally continue to trade down to slower moving solutions, resulting in a 3.4 percent decline in UPS's export revenue per piece.

UPS global air network is headquartered in Louisville, Kentucky, where the company can process 416,000 packages per hour! UPS has numerous other airport hubs across the USA and in Germany, Canada, Hong Kong, Singapore, Taiwan, and China. A member of both the Dow Jones 30 Composite and Dow Transportation indexes, UPS employs 399,000 full-time employees (323,000 in the USA and 76,000 outside of the USA). A total of 349,000 of these employees were members of a union. UPS operates under three principle segments: (1) U.S. Domestic Package, (2) International Package, and the newer and much smaller (3) Supply Chain and Freight segment. UPS's major competitors are FedEx and the United States Postal Service.

Although UPS's primary business is the timely delivery of packages and documents, the company has extended its capabilities in recent years to encompass the broader spectrum of services known as supply chain solutions, such as freight forwarding, customs brokerage, fulfillment, returns, financial transaction, and even repairs. UPS is also a leading provider of less-than-truckload transportation services.

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History

UPS was founded in 1907 by teenagers Claude Ryan and Jim Casey as the American Messenger Company in Seattle, Washington. The teenagers saw an opportunity with the limited telephone and automobile options to run errands, carry notes, and make home deliveries for drugstores. The early strategy of UPS was to compete on cost by offering the best prices while maintaining dependable and courtesy service.

By 1913, the telephone was more common, reducing the need for messenger services, so the American Messenger Company changed its name to Merchant's Parcel Delivery and merged with Evert McCabe's to focus almost exclusively on package delivery of drugstore and grocery store packages to people's homes. The acquisition of Evert McCabe's added motorcycles and a single Ford Motel T to the business, so by 1916 "UPS" had an expanding fleet of delivery vehicles. Soon the company expanded its business to also deliver department store packages to homes in the Seattle area.

Geographic expansion continued throughout the 1920s, including air service, and the company expanded into cities along the entire Pacific coast. The company changed its name to United Parcel Service and moved its headquarters to New York. UPS continued to grow over the years, and in 1975 the company began serving Toronto, Canada, marking the first time UPS served customers outside the USA. The following year, UPS began operations in Germany, and then in 1989, with the purchase of a British document company, UPS was serving customers virtually worldwide.

The 1990s saw UPS adapt well to the growing presence of electronic data and package tracking. The company moved its headquarters to Atlanta, Georgia, in 1994. Operating as a private company for the first 90 years, UPS offered 10 percent of its stock to the public in 1999, giving the company the ability to raise capital through equity and make acquisitions more easily.

UPS's 1999 acquisitions of Challenge Air resulted in UPS becoming the largest air cargo carrier in Latin America. Other acquisitions in the United Kingdom and Poland expanded UPS's global reach throughout Europe. UPS has to date acquired more than 40 companies ranging from shipping and trucking to finance and international trade services.

UPS's supply chain solutions capabilities are available to clients in over 220 countries and territories. UPS's 2012 revenues increased 1.9 percent to $54.1 billion, but net income decreased 78.8 percent to $807 million. The company's 2012 return on assets (ROA) dropped to 2.2 percent, from 11.1 percent the prior year. In 2013, UPS is trying to close on its acquisition of the European firm, TNT Express, for $6.8 billion, which will expand its presence in the European and Asian markets.

Internal Issues

Vision and Mission

The UPS vision is provided on the company website, as follows:

> Our goal is to synchronize the world of commerce by developing business solutions that create value and competitive advantages for our customers.

The company provides the following mission statement on its website:

Mission: What We Seek to Achieve

- Grow our global business by serving the logistics needs of customers, offering excellence and value in all that we do.
- Maintain a financially strong company—with broad employee ownership—that provides a long-term competitive return to our shareowners.
- Inspire our people and business partners to do their best, offering opportunities for personal development and success.
- Lead by example as a responsible, caring, and sustainable company making a difference in the communities we serve.

UPS describes the nature of its business in the following way:

> As the world's largest package delivery company and a leading global provider of specialized transportation and logistics services, UPS continues to develop the frontiers of logistics, supply chain management, and e-Commerce … combining the flows of goods, information, and funds.

Sustainability

UPS provides an elaborate Sustainability Report on its website, after giving the following sustainability statement:

> UPS is committed to operating our business in a socially, environmentally and economically responsible manner. We publish annual programs on goal attainment.

UPS was recently recognized as one of only 10 U.S. corporations to receive an A+ for superior transparency from companies registered with the Global Reporting Initiative (GRI). "One of the guiding principles to UPS's sustainability strategy is our commitment to transparency," UPS Chairman and CEO Scott Davis wrote in the organization's 2011 Sustainability Report. "We are disclosing more information than ever . . . . We have reported our five-year progress, successes and challenges. Now, we are focused ahead." Chief Sustainability Officer Scott Wicker reported that UPS now uses a "materiality matrix" to track how the company's interests match or differ from those of other stakeholders. A recent GRI report recognized UPS for (a) driving 85 million fewer miles, saving 8.4 million gallons of fuel and 83,000 metric tons of carbon dioxide emissions using advanced route-planning technology, (b) expanding telematics technology to eliminate more than 98 million minutes of engine idling time, saving 653,000 gallons of fuel, and (c) earning the highest Carbon Disclosure Project score among all U.S. companies, and tying with three others for the top score in the world.

Speaking at *Fortune's* Brainstorm Green 2012, UPS Chief Operations Officer (COO) David Abney said: "Sustainability is a way of life. It's always high on our radar screen." The UPS Foundation, the charitable arm of the firm, recently started a long-term effort to support employee volunteer activities to plant more than 1 million trees around the world, beginning with tree-planting initiatives in China, Canada, Haiti, the Netherlands, Norway, Russia, Uganda, and the United States by the end of 2013. UPS was rated #1 in *Fortune* Magazine's 2012 "World's Most Admired" for the Delivery Industry.

Culture and Ethics

The company code of ethics is provided at on the UPS website under Governance Documents (http://www.investors.ups.com/phoenix.zhtml?c=62900&p=irol-govhighlights).

Additionally, UPS has what it refers to on its website as a "distinctive culture." The statement reads as follows:

> We believe that the dedication of our employees results in large part from our distinctive "employee-owner" concept. Our employee stock ownership tradition dates from 1927, when our founders, who believed that employee stock ownership was a vital foundation for successful business, first offered stock to employees. To facilitate employee stock ownership, we maintain several stock-based compensation programs.

The company's brown-clothed drivers and employees and brown trucks symbolize the firm's commitment to a distinctive culture, anchored by employee ownership of a large part of the firm. UPS is highly unionized.

After donating $150,000 to the Irving-based Boy Scouts of America, UPS announced recently that the company will no longer fund them, until gay scouts and leaders are allowed to be members. The *Atlanta Business Chronicle* reported that the Gay & Lesbian Alliance Against Defamation (GLADD) said it was told by UPS that under revised guidelines of The UPS Foundation, it will not support organizations that are unable to attest to having a policy that aligns with the foundation's nondiscrimination policy.

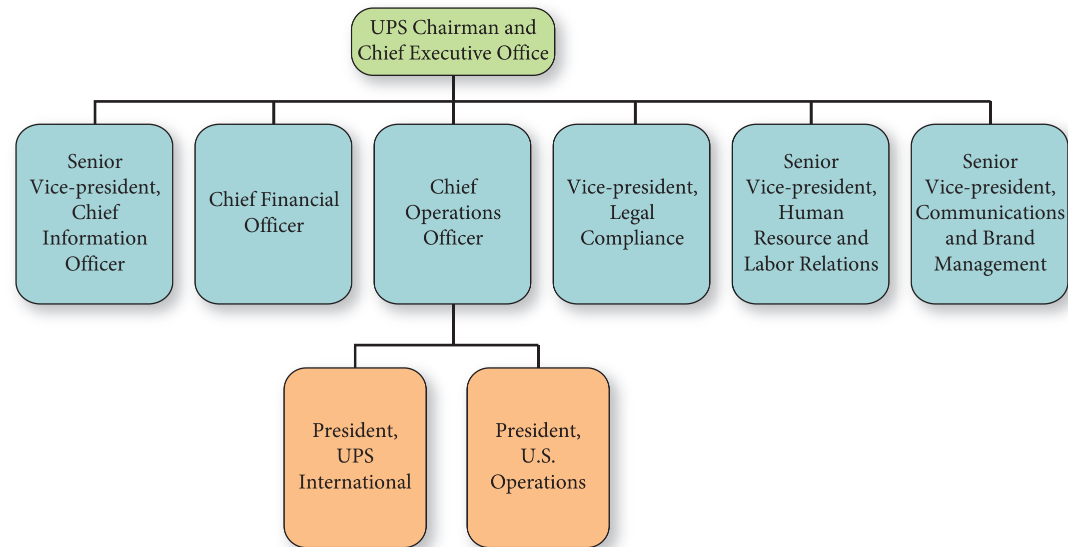
Organizational Structure

Among UPS's top eight corporate executives, there are two women and one African American. Exhibit 1 reveals UPS's current organizational chart. Note the company uses a divisional-by-geographic region structure.

Strategy

During calendar 2012, UPS opened 12 new dedicated health care facilities on four continents, bringing the company total to 37. UPS strives daily to provide customers competitive prices and excellent services worldwide. UPS benefits from several key trends in the marketplace, including (a) expansion of global trade, (b) growth in emerging markets,

EXHIBIT 1 UPS's Organizational Structure



Source: Based on information on the company's website.

(c) outsourcing, (d) retail commercial growth, and (e) increasing trade across borders. These are reasons why UPS recently acquired Italy-based Pieffe Group, a pharmaceutical logistics company that helps enhance the trust that European-based pharmaceutical and biotech companies have for UPS to handle the delivery of its products and services. UPS's principle strategy is to identify successful businesses outside the USA and form alliances with them in the hope of eventually acquiring them. China remains the key emerging market with air hubs in Shanghai and Shenzhen. Recent UPS Chinese investments include adding intra-Asia and around-the-world flight frequencies, striving to serve customers more efficiently in Asia, Europe, and around the world. UPS already services more than 40 Asian nations through more than 20 alliances. In Vietnam alone, since a 2010 alliance, UPS's volume in that country has doubled.

UPS plans to increase its market share in Europe, where half of all its international revenue derives from; strong growth is expected to continue in Germany, the United Kingdom, France, Italy, Spain, and the Netherlands. Despite lingering economic troubles in Europe, UPS is expanding its European Air hub in Cologne, Germany, by 70 percent to a total capacity of 190,000 packages per hour. For reference, this is still well short of the hub in Louisville, Kentucky, that processes more than 400,000 packages per hour. The expansion of the Cologne hub was completed in 2013. In addition, the 2012 acquisition of Belgium-based Kiala S.A. enables e-commerce retailers to offer its customers timely delivery to retail locations or people's homes.

UPS's 2009 acquisition of Turkey-based Unsped Paket Servisi has led to double-digit growth to and from that country. South and Central America economies are growing along with Mexico, and UPS is currently well positioned in those countries as well.

Effective December 31, 2012, UPS instituted a 4.5 percent rate increase for UPS Air and U.S.-originating International Services shipments. UPS breaks the rate increase into two parts: a 6.5 percent base rate on UPS Air and International Services minus a two percentage point reduction in fuel surcharges on such shipments. UPS Ground base rates also increased on that date, by 5.9 percent, mitigated by a single percentage point reduction in the fuel surcharge, resulting in an average 4.9 percent price hike. UPS Next Day Air Freight, Second Day Air Freight, and Three-Day Freight rates for shipments among U.S., Canadian, and Puerto Rican locations also rose by 4.9 percent.

UPS recently closed on its $6.58 billion deal to acquire TNT Express N.V., an international courier delivery-services company with headquarters in Hoofddorp, Netherlands. Competing primarily with FedEx and DHL, TNT Express has fully owned operations in 65 countries and delivers documents, parcels, and pieces of freight to more than 200 countries. The company recorded sales of more than €7.2 billion in 2011. As part of the deal, UPS is seeking to avoid concessions that would hinder the company's plan to double its operations in Europe through the acquisition of TNT whose air operations were at issue because companies outside the European Union cannot hold stakes of more than 49 percent in airlines. The TNT Express deal will mark the largest acquisition ever for UPS.

To expand its global healthcare distribution facility network in the Asia Pacific region, UPS recently opened new facilities in Hangzhou and Shanghai, China, and Sydney, Australia. These openings bring the total number of UPS dedicated healthcare facilities around the globe to 36, encompassing more than a half-million square meters of space. The UPS strategy is to invest in its global healthcare network to become the largest medical products transporter in the world. Increased globalization and growing healthcare consumption in emerging markets are the impetus for this strategy. The new distribution centers serve multinational and regional healthcare manufacturers across the Asia Pacific region.

Segments

UPS's top 20 customers account for less than 10 percent of the company's revenue. UPS has major air hubs in Hartford, CN; Ontario, CA; Philidalphia, PA; Rockford, IL and outside of the United States in Hamilton, Ontario; Cologne, Germany; Shanghai China; Shenzhen, China; Raipei, Taiwan; Incheon, South Korea; Hong Kong, and Singapore. UPS reports revenues and operating profits in three different segments: (1) U.S. Domestic Package, (2) International Package, and (3) Supply Chain and Freight. Exhibit 2 reveals that UPS's Supply Chain and Freight division accounts for about 17 percent of all revenue and 10 percent of all operating profits. Also note that more than half of UPS's profits come from its U.S. operations, so there is a lot of room for growth globally, which is another reason for the TNT Express acquisition. But South America, Australia, and to a lesser degree, Asia, are not UPS strongholds to say the least.

EXHIBIT 2 **Selected Income Statement Data**

	Years Ended December 31,				
	2012	2011	2010	2009	2008
Revenue:					
U.S. Domestic Package	$ 32,856	$ 31,717	$ 29,742	$ 28,158	$ 31,278
International Package	12,124	12,249	11,133	9,699	11,293
Supply Chain & Freight	9,147	9,139	8,670	7,440	8,915
Total revenue	**54,127**	**53,105**	**49,545**	**45,297**	**51,486**
Operating expenses:					
Compensation and benefits	33,102	27,575	26,557	25,933	29,826
Other	19,682	19,450	17,347	15,856	20,041
Total operating expenses	52,784	47,025	43,904	41,789	49,867
Operating profit (loss):					
U.S. Domestic Package	459	3,764	3,238	1,919	823
International Package	869	1,709	1,831	1,279	1,246
Supply Chain and Freight	15	607	572	310	(450)
Total operating profit	1,343	6,080	5,641	3,508	1,619

Source: 2012 *Form 10K*, p. 21.

EXHIBIT 3 **U.S. Domestic Package Operations**

	Year Ended December 31,			% Change
	2012	2011	2010	2012/2011
Average Daily Package Volume (in thousands):				
Next Day Air	1,277	1,206	1,205	5.9%
Deferred	1,031	975	941	5.7%
Ground	11,588	11,230	11,140	3.2%
Total Avg. Daily Package Volume	13,896	13,411	13,286	3.6%
Average Revenue Per Piece:				
Next Day Air	$ 19.93	$ 20.33	$ 19.14	(2.0)%
Deferred	13.06	13.32	12.50	(2.0)%
Ground	7.89	7.78	7.43	1.4%
Total Avg. Revenue Per Piece	$ 9.38	$ 9.31	$ 8.85	0.8%
Operating Days in Period	252	254	253	
Revenue (in millions):				
Next Day Air	$ 6,412	$ 6,229	$ 5,835	2.9%
Deferred	3,392	3,299	2,975	2.8%
Ground	23,052	22,189	20,932	3.9%
Total Revenue	$ 32,856	$ 31,717	$ 29,742	3.6%

Source: UPS 2012 *Form 10K,* p. 24.

U.S. Domestic Package Segment

UPS's U.S. Domestic Package division reported revenues of $32.8 billion in 2012, up from $31.7 billion in 2011, a 3.6 percent increase. Operating profits decreased around 87.8 percent during this same time period. This division of UPS focuses on timely delivery of small packages across the USA offers customers same-, next-, two-, and three-day alternatives or standard shipping depending on how fast the delivery is needed. UPS delivers more than 11 million packages daily in the USA with most being delivered between one to three business days. Within this segment, UPS has an alliance with the United States Postal Service (USPS) called SurePost, a service for customers who are sending or receiving nonurgent lightweight shipments in which UPS handles the long haul ground transportation and USPS makes the final home delivery. Note in Exhibit 3, UPS's "Next Day Air" and their "Deferred" business reported declines in business in 2012 versus 2011. Note in Exhibit 2 the 88 percent drop in UPS's 2012 operating profit in their domestic segment.

International Package Segment

UPS's International Package Reporting Segment includes all package operations outside the USA. This segment offers a wide selection of price and delivery options, such as Express Plus, Express, and Express Saver for urgent shipments. More traditional shipments that do not require express service can use UPS Worldwide. In addition, customers in the USA, Mexico, Canada, and Europe can use UPS Transborder Standard delivery services for its shipments.

Among the international regions served, Europe is the largest UPS customer and accounts for around half of the company's international revenue. UPS expects Europe to continue being a large revenue source in the future because of the fragmented nature of the market in Europe and the fact that exports make up a large part of Europe's gross domestic product (GDP). Additionally, UPS's TNT Express acquisition will nearly double UPS's business in Europe.

Asia is somewhat of a new frontier for UPS, but that continent offers the fastest growth opportunities. Note in Exhibit 4 that UPS's international segment reported quite a few negative numbers in 2012 versus 2011.

EXHIBIT 4 International Package Operations

	Year Ended December 31,			% Change
	2012	2011	2010	2012/2011
Average Daily Package Volume (In Thousands):				
Domestic	1,427	1,444	1,403	(1.2)%
Export	972	942	885	3.2%
Total Avg. Daily Package Volume	2,399	2,386	2,288	0.5%
Average Revenue Per Piece:				
Domestic	$ 7.04	$ 7.17	$ 6.66	(1.8)%
Export	36.88	37.85	36.77	(2.6)%
Total Avg. Revenue Per Piece	$ 19.13	$ 19.28	$ 18.31	(0.8)%
Operating Days in Period	252	254	253	
Revenue (In Millions):				
Domestic	$ 2,531	$ 2,628	$ 2,365	(3.7)%
Export	9,033	9,056	8,234	(0.3)%
Cargo	560	565	534	(0.9)%
Total Revenue	$12,124	$12,249	$11,133	(1.0)%
Operating Expenses (In Millions):				
Operating Expenses	$11,255	$10,540	$ 9,302	6.8%
Defined Benefit Plan Mark-to-Market Charge	(941)	(171)	(42)	
Adjusted Operating Expenses	$10,314	$10,369	$ 9,260	(0.5)%
Operating Profit (In Millions) and Operating Margin:				
Operating Profit	$ 869	$ 1,709	$ 1,831	(49.2)%

Source: UPS's 2012 *Form 10K*, p. 28.

Supply Chain and Freight

UPS's Supply Chain and Freight segment includes logistics services, UPS freight business, and financial offerings through UPS Capital. As of December 2012, UPS managed supply chains in more than 195 countries and territories with more than 35 million square feet of distribution space. Because of the complex nature of supply chains, UPS offers the following services: freight forwarding, customs brokerage, logistics and distribution, UPS freight, and UPS capital.

UPS is the second-largest freight forwarding company in the USA and is among the top six internationally. A freight forwarder or forwarding agent is a person or company that organizes shipments for individuals or companies to get large orders from the manufacturer to market or final point of distribution. A forwarder is not typically a carrier but is an expert in supply chain management. In other words, a freight forwarder is a "travel agent" for the cargo industry, or a third-party logistics provider. Thus, instead of transporting cargo, UPS oftentimes just facilitates the movement of cargo ranging from raw agricultural products to manufactured goods. Cargo can travel on a variety of carrier types, including ships, airplanes, trucks, railroads, or all of these modes, and oftentimes not on UPS-owned assets.

UPS Freight is the long-haul segment of UPS providing long distance transportation of packages in all 50 states, several U.S. territories, and Mexico. UPS Capital aids customers in export and import financing, as well as protecting goods and payment solutions.

Finance

For calendar 2012, UPS's overall volume grew 2.8 percent. The company's business-to-business volume showed no growth, partly due to the increasing migration of traditional retail to online retail. UPS's income statements are provided in Exhibit 5. Balance sheets are provided in Exhibit 6.

EXHIBIT 5 UPS's Income Statements (in millions, except per share amounts)

	Years Ended December 31,		
	2012	2011	2010
Revenue	$ 54,127	$ 53,105	$ 49,545
Operating Expenses:			
Compensation and benefits	33,102	27,575	26,557
Repairs and maintenance	1,228	1,286	1,131
Depreciation and amortization	1,858	1,782	1,792
Purchased transportation	7,354	7,232	6,640
Fuel	4,090	4,046	2,972
Other occupancy	902	943	939
Other expenses	4,250	4,161	3,873
Total Operating Expenses	52,784	47,025	43,904
Operating Profit	1,343	6,080	5,641
Other Income and (Expense):			
Investment income	24	44	3
Interest expense	(393)	(348)	(354)
Total Other Income and (Expense)	(369)	(304)	(351)
Income Before Income Taxes	974	5,776	5,290
Income Tax Expense	167	1,972	1,952
Net Income	$ 807	$ 3,804	$ 3,338
Basic Earnings Per Share	$ 0.84	$ 3.88	$ 3.36
Diluted Earnings Per Share	$ 0.83	$ 3.84	$ 3.33

Source: UPS's 2012 *Form 10K*, p. 58.

EXHIBIT 6 UPS's Balance Sheets (in millions)

	December 31,	
	2012	2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,327	$ 3,034
Marketable securities	597	1,241
Accounts receivable, net	6,111	6,246
Deferred income tax assets	583	611
Other current assets	973	1,152
Total Current Assets	15,591	12,284
Property, Plant and Equipment, Net	17,894	17,621
Goodwill	2,173	2,101
Intangible Assets, Net	603	585
Investments and Restricted Cash	307	303
Derivative Assets	535	483
Deferred Income Tax Assets	684	118
Other Non-Current Assets	1,076	1,206
Total Assets	$ 38,863	$ 34,701

EXHIBIT 6 Continued

	December 31,	
	2012	2011
LIABILITIES AND SHAREOWNERS' EQUITY		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	$ 1,781	$ 33
Accounts payable	2,278	2,300
Accrued wages and withholdings	1,927	1,843
Self-insurance reserves	763	781
Other current liabilities	1,641	1,557
Total Current Liabilities	8,390	6,514
Long-Term Debt	11,089	11,095
Pension and Postretirement Benefit Obligations	11,068	5,505
Deferred Income Tax Liabilities	48	1,900
Self-Insurance Reserves	1,980	1,806
Other Non-Current Liabilities	1,555	773
Shareowners' Equity:		
Class A common stock (225 and 240 shares issued in 2012 and 2011)	3	3
Class B common stock (729 and 725 shares issued in 2012 and 2011)	7	7
Additional paid-in capital	—	—
Retained earnings	7,997	10,128
Accumulated other comprehensive loss	(3,354)	(3,103)
Deferred compensation obligations	78	88
Less: Treasury stock (1 and 2 shares in 2012 and 2011)	(78)	(88)
Total Equity for Controlling Interests	4,653	7,035
Noncontrolling Interests	80	73
Total Shareowners' Equity	4,733	7,108
Total Liabilities and Shareowners' Equity	$ 38,863	$ 34,701

Source: UPS's 2012 *Form 10K,* p. 57.

External Issues

Changing Consumer Behavior

More and more people are no longer willing to pay more for an overnight delivery service. They would rather wait another day for the goods to be delivered, instead of paying a premium for quicker delivery. This change in customer preferences and attitude appears to be permanent, regardless of the economy.

Companies Exporting More

UPS anticipates that most high-tech companies expect to export more cell phones, tablets, and other electronics over the next several years to growing middle-class populations in developing nations. The Barack Obama administration has a goal to double exports by 2015. Scott Davis, UPS chief executive officer, is on the President's Export Council and has touted free trade agreements as critical for boosting U.S. exports and the economy. A free trade agreement between the USA and Panama will soon go into effect, following on the heels of such agreements with Colombia and South Korea. Some analysts expect that high-tech product sales and shipments are expected to grow by 22 percent in India, the Middle East, and Africa

over the next three to five years. Those same analysts expect such sales increases to range from 18 percent in Brazil and 19 percent in the rest of South America to 15 percent in Eastern Europe, 13 percent in Korea, and 8 percent in China and in other Asian nations.

Many executives are planning to modify its distribution networks to handle more volume at East Coast ports once a wider Panama Canal is opened to bigger ships around 2015. Quite a few companies plan to shift from air to ocean freight when that happens, so many East Coast ports are heavily investing in dredging and other projects to be able to accept bigger ships. Both FedEx and UPS have already seen a shift in demand for shipping products cheaper, such as by sea, rather than premium-priced express air services, because of the weakening global economy.

Internet and Catalog Purchasing

About 40 percent of total UPS shipments are from businesses-to-consumers, compared with about one-third from a few years ago. It expects these shipments, typically from large catalog or Internet retailers, to grow to half of all packages during the holiday season. Consumers are expected to do more and more online shopping. UPS and its smaller rival FedEx can benefit twice when consumers shop online: UPS ships the gift to the receiver, and it also ships the unwanted presents that are later returned. Online sales are expected to grow at four times the pace of traditional retail sales in 2012. This trend is helping UPS's earnings despite weakness in trade between businesses. Business-to-business shipments are typically between a manufacturer and a retailer, and are closely tied to industrial production.

Competitors

As indicated in Exhibit 7, UPS competes with USPS and FedEx. Another large competitor is DHL International. Exhibit 6 reveals that UPS generates more revenue per employee than either the USPS or FedEx. Note how low the USPS is on revenue per employee.

USPS

USPS incurred a record loss of $15.9 billion for its fiscal year 2012, which it blamed primarily on a mandate to set aside billions of dollars for a retirement heath fund. The USPS loss included $11.1 billion in defaulted payments it owes to "prefund" health benefits for future retirees. Postal officials have complained for years about these prepayments, which are required by Congress, to pay for future retirees. The USPS points out that other federal agencies do not have similar mandates for prefunding.

The $15.9 billion loss was more than triple the $5.1 billion in loss the USPS posted in the prior year. Fredric Rolando, president of the National Association of Letter Carriers, recently blamed the congressionally mandated prefunding for the bulk of USPS's financial woes. The USPS is highly unionized.

USPS has been struggling with declines in mail revenue for a variety of reasons, including everyone's transition to e-mail. To combat massive losses, USPS plans to cut 150,000 workers through 2015, reduce existing staffers' work hours and hike the price on first-class stamps by 3 cents to 49 cents. USPS officials are considering a scale back of delivery service to five days, ceasing its low-volume, low-revenue, Saturday service. The notion of five-day service however is intensely unpopular in Congress and unlikely to prevail.

EXHIBIT 7 Comparing UPS to Rivals

	USPS	UPS	FedEx
Number of Employees	551K	222K	230K
Net Income ($)	—	3.26B	2.02B
Revenue ($)	65.7B	53.66B	42.95B
Revenue ($)/Employee	119K	241K	187K
EPS Ratio ($)	—	3.38	6.40
Market Capitalization	—	66.8B	27.1B

EPS, earnings per share.

Unlike other federal agencies, the USPS does not technically receive taxpayer support, though it has borrowed $15 billion from the U.S. Treasury.

FedEx

Headquartered in Memphis, Tennessee, FedEx is the world's number-1 express transportation provider, delivering about 3.5 million packages daily to more than 220 countries and territories from about 2,000 FedEx Office shops. FedEx owns and operates a fleet of about 690 aircraft and more than 50,000 motor vehicles and trailers. To complement its express delivery business, FedEx Ground provides small-package ground delivery in North America, and less-than-truckload (LTL) carrier FedEx Freight hauls larger shipments. FedEx Office Stores offer a variety of document-related and other business services and serve as retail hubs for other FedEx units.

FedEx is spending $100 million to build a new 134,000-square-meter international express and cargo hub, to be up and running at the airport in Pudong, China, by 2017. FedEx said it will be capable of handling 36,000 parcels and documents per hour. The new facility's annual sorting capacity may reach more than 90 million items, meeting the demand in the next 20 years.

Shanghai is forecast to become the world's top air cargo hub by 2015, with a throughput of more than more than 5 million tons. Major domestic airlines have based 80 percent of its freight capacities at the Pudong airport, which now ranks number 3 by cargo turnover, after Hong Kong and Memphis.

FedEx is expanding its services across the USA, Canada, and Mexico. The company is expanding its Priority next-day services in its FedEx Freight segment by opening a new service center in Rochester, New York, that will cater to 13 U.S. and Canadian markets dealing in cross-border shipments to and from Toronto and Montreal. In Mexico, FedEx recently added two new service centers—one each in Culiacán and Silao—to strengthen its freight network in northwestern and north central part of Mexico. FedEx is building a new hub in Guangzhou, China, for catering to 100 new Chinese cities within the next five years.

As for acquisitions, FedEx completed the take over of Polish courier company, Opek Sp. z o.o., and French B2B Express transportation company, TATEX, both in mid-2012. Then FedEx acquired Rapidão Cometa, a Brazilian transportation and logistics company. These acquisitions should provide FedEx greater operational efficiencies, provide a competitive edge, generate significant long-term synergies, support international business growth, and drive higher profitability.

DHL

Headquartered in Germany and privately held, DHL is a gigantic package delivery company that constitutes the express delivery and logistics business segments of its parent, Deutsche Post. DHL is a leader in the worldwide market for express delivery services, operating through four divisions: Express, Global Forwarding and Freight Forwarding, Mail, and Supply Chain. (Mail service in Germany is handled by the Deutsche Post brand; DHL handles all of the Global Mail business). DHL's Express courier service network spans more than 220 countries and territories using a fleet of 32,000 vehicles and about 250 aircraft. DHL's supply chain division maintains some 23 million square meters (almost 250 million square feet) of warehouse space.

The Future

UPS is on the hunt for businesses similar to TNT Express in Europe that it recently acquired. Similar businesses in Asia, Australia, South America, and Africa would enable UPS to extend its services globally. More than half of UPS's revenues still comes from the USA, yet 95 percent of the world's population lives outside the USA. More and more people are buying and selling online, which is a key positive trend for UPS in the future. A key threat however is that rival FedEx is aggressive and savvy and also on the hunt to make acquisitions. FedEx does not like being number 2 in the global packaging business.

UPS needs a clear strategic plan going forward.

Amazon.com, Inc. — 2011

M. Jill Austin and Ralph I. Williams Jr.
Middle Tennessee State University

AMZN

http://www.amazon.com

Twenty-six-year-old Amanda Hocking grew tired of trying to find a traditional publisher for her young adult paranormal novels, so she began self-publishing her novels and selling them as e-books or print on demand books through Amazon.com and Barnesandnoble.com. She sold 164,000 downloads in 2010, and by January 2011, Hocking had sold more than 450,000 copies (99 percent were e-books). Amanda's e-book prices range from 99 cents to $2.99 (paperbacks cost $8.99) and she keeps 70 percent of what she sells of $2.99 books and 30 percent for each 99 cent book sold. Hocking changed her self-publishing strategy in April 2011 when she agreed to sell her books through a traditional book publishing company. She signed a $2 million deal with St. Martin's Press to publish four of her novels. Amazon.com was among six bidders for Ms. Hocking's books, the first time Amazon entered the bidding against traditional book publishing companies for an author's work. Some insiders say Amazon actually bid more than St. Martin's for Hockings work, but stipulated that all e-book sales must be through Kindle. St. Martin's Press will make deals with all e-book sellers, giving Hocking a larger audience for her e-books. Russ Grandinetti, the Kindle Content VP for Amazon, says of Hocking's success: "Digital publishing gives a chance to a great book that otherwise might have been overlooked." These are just two examples of a world drastically changed by the way consumers choose to read books. The stories also illustrate Amazon's power in the marketplace and its competitive business approach.

Based in Seattle, Washington, Amazon continues to change the landscape of online selling in general and book selling in particular. Amazon for 2010 was named the world's top brand ahead of common names like Coca-Cola, Microsoft, and McDonalds. Amazon's revenue increased to more than $34 billion in 2010 with income of $1.15 billion. Nearly 80 million people visit Amazon.com every month. The company's two most recent services launched in 2011 are its controversial cloud technology that allows customers to store and access music and its entry into the Netflix world of movie streaming.

Amazon added 13 new fulfillment centers in 2010 and another 15 new centers in the first six months of 2011 to total 52 centers. Amazon's sales reached $9.91 billion in the 2nd quarter of 2011, a 51 percent increase from 2010's 2nd quarter sales of $6.5 billion. The increasing availability of the Internet to people globally has changed the way consumers purchase products and the way consumers receive information about products. The United States has more than half of the world's Internet users. The portion of U.S. households connected to the Internet is expected to increase to 80 percent in 2013. In the five-year period between 2010 and 2014, online sales are expected to grow 10 percent per year. Online consumer sales will likely total $249 billion by the end of 2014. It is expected that information gathered from the Internet will influence 53 percent of all U.S. retail purchases by 2014. Amazon is positioned perfectly to capitalize on all these trends.

Amazon's manufacturing partner Quanta Computer, expects to ship 3 million new Amazon tablet computers in the 3rd of 2011. Amazon's new 10.1-inch "Hollywood" tablet may become a major competition to Apple's table computers.

History—1995 to 2011

While Jeff Bezos worked for Shaw & Co. from 1990 to 1994, he was asked to investigate Internet business opportunities. Bezos recommended that Shaw & Co. enter the business of selling books online, but his idea was rejected by company management. Bezos decided to resign from the company and pursue the idea on his own under the company name of Cadabra, Inc.

Bezos quickly renamed the new venture Amazon, after the largest river in the world, the Amazon River. The Amazon logo has an arrow pointing from the first "A" to the "Z," indicative of the wide scope of materials available from Amazon.com, everything from A to Z.

Amazon.com opened for business in July 1995, and went public in May of 1997 with an initial public offering of three million shares ($18 each). In 1996, the company first exceeded $10 million in book sales. However, Amazon did not make a profit until 2003. The first decade of operations did not always run smoothly, and industry critics predicted several times that Amazon would fail, especially during the dot-com industry collapse in the late 1990s. By the end of 1997, Amazon had served more than 1.5 million customers (a 738 percent increase from the 180,000 customers served the year before). That same year, the company also established long-term relationships with strategic partners such as Yahoo!, Prodigy, America Online, Excite, Alta Vista, and Netscape.

In 1998, Amazon.com acquired Internet Movie Database, a British-based source of information on movies and entertainment programs dating from 1892 to the present. This was Amazon's first step toward selling videos online and was a major entry into the international market. Shop the Web, a service that linked other retailers to the Amazon site and allowed Amazon to act as a middleman, was introduced in 1998. After only 45 days of sales of DVDs and videos, Amazon became the number one video retailer online at the end of 1998. Amazon acquired several companies in 1998 (Internet Movie Database, Bookpages, Telebook, Junglee, and PlanetAll).

Electronics were introduced for sale on the company website in 1999 and later become one of the company's largest businesses. However, even with this new successful product line, Amazon had two challenging years in 2000 and 2001. Shortly after being named *Time* magazine's "Person of the Year" on December 27, 1999, Bezos laid-off 150 workers and reported a larger than expected $323 million loss for the holiday season. Losses were $1.4 billion in 2000, but by the end of 2001, the firm had generated a $5 million profit.

Through its approach to operations, Amazon revolutionized the book selling industry by providing sales rankings of books that were previously guarded by publishers and by providing readers' comments to a wide audience so customers do not have to rely on book critics for reviews. During the last several years, Amazon managers have continued to expand the number of products offered on their websites, develop new services, and expand into new markets. During 2006, Amazon announced the opening of the Emergency Preparedness Store (within the Tools & Hardware Store). This store offers checklists for both preparation and recovery from natural disasters and one-stop shopping for tools, first aid supplies, communication devices, and safety equipment. Customers can also find resources from the National Weather Service, National Hurricane Center, Federal Emergency Management Agency, and American Red Cross on the store site. Amazon launched its Grocery Store as a market test in May 2006 and officially launched the business in July 2006. The store offers more than 1,200 brands (Kashi, Nestle, Kellogg, Kraft, Procter & Gamble) of non-perishable items. About half of the current product selection is natural and organic products such as Wild Oats, Newman's Own, and Nature's Gate.

The Toy and Baby Store opened in July 2006. A baby registry is available so customers can purchase the perfect gifts for their friends' babies. The products offered at this store are available from companies such as Target, eToys, Discovery Channel Store, and Babystyle. The grand opening of the Automotive Parts and Accessories Store was held in October 2006. The Automotive Store offers more than a million parts from 250 leading parts and accessories retailers such as Auto Barn, HorsepowerFreaks, and Summit Racing Equipment. Some of the brands offered through the site include: Fram, Holley, Lund, Raybestos, and Schumacher. A service called Part Finder allows customers to find the correct parts to fit their vehicles (for approximately 10,000 different American cars or trucks).

Amazon introduced the Kindle, a wireless reading device, for use in the United States in 2007. Customers download books, magazines, and newspapers to read on Kindle, and they can store these downloaded materials on other devices such as the iPad. Most Kindle books cost between $9.99 and $12.99, but other books are much less expensive (less than $5, and some are free). Amazon began offering Kindle International in more than 100 countries in October of 2009. Amazon reported in 2010 that customers were buying more Kindle books than hardcover books, even as hardcover books sales at Amazon continued to grow. By January 2011, Kindle

book sales were greater than the company's paperback book sales. The Kindle does face strong competition from multi-functional devices such as Apple's iPad and other book readers such as Nook, a Barnes and Noble product. By 2011, Amazon completed agreements so Kindle books can be loaned from libraries to Kindle owners.

Amazon continues to expand into new product and service areas. In 2009, Amazon announced a strategic alliance with textbook publisher McGraw-Hill to target sales in the higher education market. McGraw-Hill distributes hundreds of Kindles in colleges and universities, exposing a new generation to wireless reading devices.

Some other new services/products offered include: shoes/apparel (through Zappos, which was purchased in 2009 for $1.1 billion); the Denim Shop (2010), and web services such as Amazon Relational Database Services, Elastic MapReduce, and Virtual Private Cloud. Perhaps the most talked about new service is the music cloud service that was started in 2011. Users can upload music to Amazon data storage systems on the web and play them back on any PC or Apple computer. The music can also be accessed by cell phones and tablet computers through the Android operating system. Customers can purchase space on the web for $20 a year after they have used the free 5 gigabytes of storage (about 1,200 songs). Bill Carr, Amazon's VP for Music and Movies, said that with the service customers can "store it [music] in the cloud and play it anywhere." There are possible legal issues with this new service. Record label managers want music services to negotiate licenses with record companies to store and make digital music available, while Amazon managers believe that additional licensing is not necessary. Amazon says their Cloud Player/Cloud Drive technology is not unlike Google Docs or Microsoft's Windows Media Player.

Amazon's strength in selling consumer products was demonstrated in its 2009 jewelry sales. As expected, given the sluggish U.S. economy, the majority of jewelry retailers saw their sales drop. However, while Neiman Marcus and J.C. Penney were experiencing jewelry sales drops in excess of 20 percent, Amazon increased its jewelry sales by 13 percent. Quidsi, a company that sells bulk consumer items over two websites (diapers.com and soap.com) was acquired in 2010. This acquisition allows Amazon to increase its presence in a new customer category. Amazon anticipates the customers who make frequent website visits to buy consumer staples could be enticed through promotion to buy higher margin goods.

Mission

The mission of Amazon.com is:

> to be the Earth's most customer-centric company, where customers can find and discover anything they might want to buy online, and endeavor to offer customers the lowest possible prices.

Competition

Direct competitors for Amazon include: brick-and-mortar retailers; online e-commerce websites; book publishers; and distributors, manufacturers, and producers of products sold by Amazon. Major brick-and-mortar retailers include stores such as Best Buy, Wal-Mart, Target, Sears, and Office Depot. Hybrid retailers' success in the e-commerce market is demonstrated by the 8 percent reduction of pure e-tailers' share of total online sales between 2004 and 2010. Researchers sight consumers' inherent trust in a brick-and-mortar physical presence as an advantage hybrid retailers have over pure e-tailers.

Internationally, companies are being founded based on business models similar to that of Amazon. Chinese companies are positioning themselves to compete for the more than 400 million Chinese Internet users (more than any other nation). The Chinese company 360buy.com was founded in 2004 and expects to report 2010 revenues in excess of $1.5 billion as it sells a wide range of products. In 2010, Wal-Mart invested more than $500 million in 360buy.com. Another Chinese web-based retailer, China Dangdang, Inc, raised $272 million through a 2010 public stock offering and plans to use the proceeds to upgrade and enhance both its technology and fulfillment. Beirut based neelwafurat.com was launched in 1998 and sells books, music, and DVDs to the Middle Eastern world.

Amazon also has a number of indirect competitors, including companies that provide e-commerce services such as website development, third-party fulfillment companies, and customer-service companies that provide infrastructure web services. Other indirect competitors are media companies, comparison shopping websites, and web search engines. Examples of e-commerce competitors include eBay.com, Toysrus.com, and Target.com. Download service competitors include Apple Computer, Google.com, and other DVD rental services such as Netflix and Blockbuster that provide video downloading.

The major competitors in the book sales market that was revolutionized by Amazon include Barnes & Noble, Borders, and Books-A-Million. Information about these companies is provided in the following sections.

Barnes & Noble

The typical Barnes & Noble store offers 60,000 to 200,000 titles, and most stores have Starbucks cafes and music departments that sell more than 30,000 music titles. Barnes & Noble is the nation's largest brick-and-mortar bookseller with 1,357 total stores operating in 50 states, including 720 Barnes & Noble superstores and 637 B & N College Booksellers on college campuses. These bookstores serve approximately four million students and faculty. Only 10 percent of sales were made by customers online in 2010, while college sales were more than 14 percent of sales. About 90 stores were closed from 2007 to 2011, and the company expects more consolidation in the future. The company invests heavily in its version of the e-reader (launched in 2009), called Nook, that competes with Amazon's Kindle and Apple's iPad. The company announced in 2011 that Nook will be sold in Staples stores in an attempt to get the device into more customers' hands; Nook is also sold at Best Buy and Wal-Mart. In December 2010, the company put itself on the market to be sold, but no buyers have shown interest. Financial information for Barnes & Noble is shown in Exhibit 1.

Borders Group

Borders is the number two U.S. bookseller and offers up to 170,000 book, music, and movie titles for sale in its stores. Most stores also have a Seattle's Best coffee shop. In 2010, the company had 511 Borders stores in 45 states and Puerto Rico and 175 smaller stores with the names Waldenbooks, Borders Express, or Borders Outlets. The company also had 29 Borders airport stores in 2010. In February 2011, unable to gain traction in the digital book market, and after having three CEOs in three years, Borders filed Chapter 11 bankruptcy. Borders plans to close 226 superstores in 2011 and is likely to close more. The company received $505 million from GE Capital for its reorganization and has also negotiated rent reductions of more than $30 million with some landlords. A new Borders strategy is to stock more nonbook items such as games and stationery, and company managers are considering selling food items from local sources and wine in Borders cafes. Managers hope that through reorganization and closing of some stores, the company can be profitable again. Financial information for Borders Group is shown in Exhibit 2.

EXHIBIT 1 Financial Information for Barnes & Noble ($ in millions)

	Fiscal 2010	Thirteen Weeks Ended May 2, 2009	Fiscal 2008
Net Sales	$5,810.56	$1,105.12	$ 5,121.80
Operating Income	73.25	(3.24)	143.33
Net Earnings	36.64	(2.72)	75.89
	May 1, 2010	May 2, 2009	January 2009
Total Assets	3,706.68	2,664.28	2,877.86
Long-Term Debt	260.40	–	–
Stockholders' Equity	903.37	911.82	923.23

Note: Barnes & Noble, Inc. changed its fiscal year-end from January to April effective on September 30, 2009. (The year 2009 is a 13-week transition period ended May 2, 2009.)
Source: Barnes & Noble, 2010, *Form 10K*.

EXHIBIT 2 Financial Information for Borders Group ($ in millions)

	2010	2009	2008
Net Sales	$2,791.1	$3,242.1	$3,555.1
Operating Income	(94.9)	(149.2)	4.1
Net Earnings	(109.4)	(186.7)	(157.4)
Total Assets	1,425.2	1,609.0	2,147.1
Long-Term Debt	4.8	6.6	5.6
Stockholders' Equity	158.3	263.1	479.1

Source: Borders Group, 2010, *Form 10K,* p. 20.

Books-A-Million

Books-A-Million was founded in 1917 as a street-corner newsstand in Florence, Alabama, and is currently the third-largest book retailing chain in the United States. The company has 223 stores that are located in 22 states and Washington, DC. The company offers two retail store formats: Books-A-Million superstores with over 20,000 square feet (named Books-A-Million or Book & Co.) and traditional bookstores with 3,500 to 4,000 square feet (called Books-A-Million or Bookland). Books-A-Million also has a wholesale and distribution division, an e-commerce division, and an Internet development and services company called Net Central that is located in Nashville, Tennessee. Although Books-A-Million suffered a 7.5 percent reduction in sales in the years from 2007 through 2010, the company has remained profitable. Financial information for Books-A-Million is shown in Exhibit 3.

Internal Issues

By-Segment Finances

Amazon considers its business as two geographic segments, North America and International. In 2010, North America sales produced approximately 55 percent of the company's total revenue, and approximately 45 percent came from international sales. Over the last three years, net sales have increased more in North America than in international markets, as indicated in Exhibit 4. More than 50 percent of Amazon sales are made in North America.

Amazon's mix of products falls into three categories: media, electronics and other general merchandise, and other services. Other services include nonretail activities, such as Amazon Web Services, other seller sites, and co-branded credit card agreements. Electronics/other general merchandise and other sales have increased significantly from 2009 to 2010 in both the North America and International segments, while media sales have either decreased (in International segment) or increased by only a few percentage points (North America). Media makes up 43 percent of all net sales in 2010, while electronics is 54 percent, and "other" is only 3 percent of net sales. Overall, media sales declined from 2009 to 2010, while sales of electronics and other general merchandise increased, as indicated in Exhibit 5.

Marketing

Amazon's marketing strategy is designed to increase customer traffic on the company's websites, to promote repeat purchases, to build awareness of products and services that are available, and to

EXHIBIT 3 Financial Information for Books-A-Million ($ in thousands)

	2010	2009	2008
Net Sales	$508,667	$515,357	$536,054
Operating Income	$21,677	18,890	27,420
Net Earnings	$13,836	10,574	16,522
Total Assets	$273,498	279,292	284,833
Long-Term Debt	$6,360	6,720	6,975
Stockholders' Equity	$114,708	104,484	99,051

Source: 2010 *Annual Report,* http://www.booksamillion.com.

EXHIBIT 4 **Amazon.com Net Sales by Geographic Area (in millions)**

	Year Ended December 31		
	2010	2009	2008
Net Sales			
North America	$18,707	$12,828	$10,228
International	15,497	11,681	8,938
Consolidated	$34,204	$24,509	$19,166
Year-Over-Year Percentage Growth			
North America	46%	25%	26%
International	33	31	33
Consolidated	40	28	29
Year-Over-Year Percentage Growth, Excluding Effect of Exchange Rates			
North America	46%	26%	26%
International	34	33	31
Consolidated	40	29	28
Net Sales Mix			
North America	55%	52%	53%
International	45	48	47
Consolidated	100%	100%	100%

Source: Amazon.com, 2010, *Form 10K*.

EXHIBIT 5 **Amazon.com Net Sales by Geographic Area and Product Type (in millions)**

	Year Ended December 31		
Amazon.com Inc.	2010	2009	2008
Net Sales			
North America			
Media	$6,881	$5,964	$5,350
Electronics and other general merchandise	10,998	6,314	4,430
Other	828	550	448
Total North America	$18,707	$12,828	$10,228
International			
Media	$8,007	$6,810	$5,734
Electronics and other general merchandise	7,365	4,768	3,110
Other	125	103	94
Total International	$15,497	$11,681	$8,93 8
Consolidated			
Media	$14,888	$12,774	$11,084
Electronics and other general merchandise	18,363	11,082	7,540
Other	953	653	542
Total consolidated	$34,204	$24,509	$19,166
Year-Over-Year % Growth			
North America			
Media	15%	11%	16%
Electronics and other general merchandise	74	43	41
Other	50	23	38
Total North America	46	25	26

(Continued)

EXHIBIT 5 continued

	Year Ended December 31		
Amazon.com Inc.	2010	2009	2008
International			
Media	18%	19%	24%
Electronics and other general merchandise	54	53	50
Other	22	9	65
Total International	33	31	33
Consolidated			
Media	17%	15%	20%
Electronics and other general merchandise	66	47	45
Other	46	20	42
Total consolidated	40	28	29
Year-Over-Year % Growth			
Excluding the effect of exchange rates			
International			
Media	18%	20%	22%
Electronics and other general merchandise	57	56	49
Other	24	19	67
Total International	34	33	31
Consolidated			
Media	16%	16%	19%
Electronics and other general merchandise	67	48	44
Other	46	22	42
Total consolidated	40	29	28
Consolidated Net Sales Mix			
Media	43%	52%	58%
Electronics and other general merchandise	54	45	39
Other	3	3	3
Total consolidated	100%	100%	100%

Source: Amazon.com, Inc., *Form 10K* SEC Filing 2011; Amazon.com.

strengthen the Amazon.com brand. Amazon uses e-mail campaigns, portal advertising, and sponsored searches as their primary means of advertising. Amazon also markets its products through their Associates Program, where they contract with other websites to direct customers to Amazon websites to purchase products. Amazon pays commissions to participants in the program for customer referrals that result in sales. Target, Office Depot, Shutterfly, Fidelity Investments, Weight Watchers, and many small retailers have stores on the Amazon.com website. Advertising and other promotional costs were $890 million in 2010, a significant increase from the $593 million expense in 2009.

Excellent customer service is an essential component of Amazon's marketing strategy. Amazon's culture is focused on serving customers. Amazon was ranked as the number one provider of customer service by *Business Week* in 2010. Normally, Amazon customers never talk with a company employee. But when a problem develops, Amazon's employees get involved. One might find it ironic that an online company that has immense technical prowess emphasizes using employee contact to solve customer problems.

Company managers also focus on continuous innovation to provide convenience for customers. Specifically, the management team wants to ensure fast and reliable fulfillment, efficient customer service, easy-to-use functionality, and a trusted online transaction environment. Conveniences such as One-Click purchases, Look Inside the Book features, and Search Inside the Book features provide an information rich environment. Amazon also offers customer reviews,

gift guides, web pages tailored to individual customer preferences, wish lists, buying guides, and wedding and baby registries. Amazon provides a best gifts list during the holiday season that includes the company's most wished for items, favorite gift products, best selling products, and the most positively reviewed products of the year. Currently, the company has more than 130 million customer accounts and more than 2 million active seller accounts.

A fee-based membership program called Amazon Prime was introduced in October 2006. This program costs $79 per year and allows members to receive express two-day shipping for free without a minimum purchase requirement. Some people consider Amazon Prime the most effective customer loyalty program in all of e-commerce. Occasional Amazon shoppers who are enticed by the prospect of receiving products in two days and motivated to get all they can from their membership have become Amazon loyalists and purchase a variety of different types of products from Amazon. During 2010, the four million Prime members increased their Amazon purchases by 150 percent after they joined the program; this increase in purchases could explain the 20 percent increase in Amazon sales. Analysts attribute Prime as a major contributing factor for the 30 percent growth in sales that occurred during the recent recession (between 2008 and 2010). Rivals Wal-Mart, Target, Best Buy, and J.C. Penney are attempting to copy the Prime model. However, given Amazon's wide selection of products, competitive prices, third-party merchants, and strong distribution system, competitors will have a challenge matching the success of Amazon's Prime program.

Distribution

Amazon.com recently moved its offices into a new 11-building campus in the South Lake Union neighborhood of Seattle. Other facilities such as fulfillment and warehouse centers and customer service offices are located throughout the United States, primarily in Arizona, California, Delaware, Indiana, Kansas, Kentucky, Nevada, North Dakota, Pennsylvania, Virginia, Washington, and West Virginia. The company leases a corporate office, fulfillment and warehouse operations, customer service, and other facilities outside of the United States. The international offices are primarily located in China, France, Germany, India, Ireland, Japan, Luxembourg, and the United Kingdom. During the 2010 holiday season, orders were shipped to more than 178 million countries worldwide. Thirteen new distribution centers were opened during 2010, bringing the total to 52 distribution centers. Fulfillment capacity was expanded in 2006 to 12 million square feet, and by the end of 2010, capacity was 26.1 million square feet.

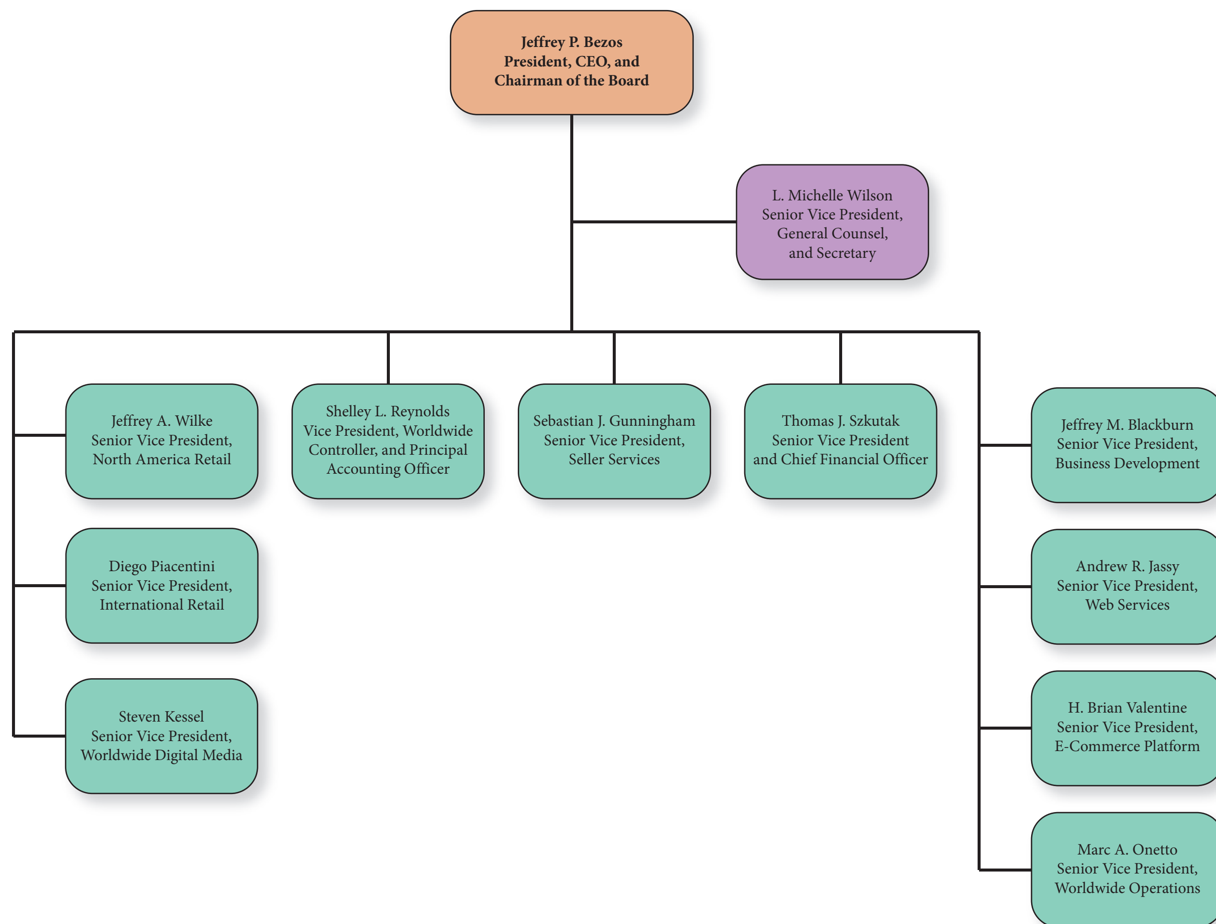
Technology

Amazon.com has been a pioneer in its website design, testing, and optimization and has excelled in the use of technology to personalize the customers' shopping experiences. Amazon has its own proprietary technology and licenses technology from other companies. The company's current strategy is to focus its development efforts on innovation by creating and enhancing its proprietary software and by licensing or acquiring commercially-developed technology for other applications when it is needed. Amazon invests in several areas of technology, including digital initiatives, seller platforms, and web services. These computer applications are needed for such activities as fulfillment, customer service operations, order tracking, managing inventory, ensuring proper shipment of orders, and facilitating payment transactions.

Industry experts list trust by customers as critical to Amazon's success. The company has a history of providing secure transactions, being reliable and efficient in the fulfillment of orders, and emphasizing price discounts. Amazon managers work continually to improve the shopping experience for customers through development of intuitive and simple website navigation. Amazon was at the forefront of connecting potential buyers with information from peers related to a specific product being considered. The Amazon.com website provides the kind of shopping experience customers relied on years ago when business owners knew their customers' preferences and desires and dealt with them on a personal level.

Some new developments in customer service include the release of an "app" for the iPhone and development of a subscription for TV viewing. In November of 2010, Amazon released an iPhone application that allows users to scan a bar code of a product in a retail store, connect to Amazon.com, and find out if Amazon can beat the retailer's price. The use of smartphone technology to comparison shop is expected to grow as more consumers carry these devices. Along with Apple and Google, Amazon is also working on a new subscription service for the

EXHIBIT 6 Organizational Chart for Amazon.com



Source: Amazon.com, Inc. *Form 10K* SEC Filing 2011; Amazon.com

TV viewing market. In late 2010, Amazon executives met with media companies NBC, Time Warner, and Viacom to explore the possibility of delivering content to TV viewers over the Internet. Amazon's push in this direction could challenge Internet players such as Netflix and Hulu, and also traditional cable and satellite providers.

Management

Since the company's inception, Bezos has hired the best professionals he could find. He lured executives from Wal-Mart, Microsoft, Barnes & Noble, and Symantec to work in areas such as marketing, software development, financing, and distribution. Amazon.com employed approximately 33,700 people (including both full-time and part-time employees) at the end of December 2010. The company hires independent contractors and temporary workers to supplement its workforce, particularly during the holiday season, when 35 percent to 40 percent of Amazon's annual revenue is sold. None of the company's employees are represented by unions. Amazon depends on quality personnel to maintain and improve its technology systems. Jeff Bezos has been CEO since the company was founded in 1995. An organizational chart for the company is shown in Exhibit 6.

Finance

Amazon's income statements in Exhibit 7 reveal an increase in sales from 2009 to 2010 of $24.5 billion to $34.2 billion and an increase of net income of $900 million in 2010 and $1.15 billion in 2010. The Amazon.com balance sheet in Exhibit 8 reveals increases in total assets from 2009 to 2010 $13.8 billion to $18.8 billion.

EXHIBIT 7 Amazon.com, Inc. Consolidated Statement of Operations (in millions, except per share data)

	Year Ended December 31		
Amazon.com, Inc.	2010	2009	2008
Net sales	$34,204	$24,509	$19,166
Operating expenses			
Cost of sales	26,561	18,978	14,896
Fulfillment	2,898	2,052	1,658
Marketing	1,029	680	482
Technology and content	1,734	1,240	1,033
General and administrative	470	328	279
Other operating expense (income), net	106	102	(24)
Total operating expenses	32,798	23,380	18,324
Income from operations	1,406	1,129	842
Interest income	51	37	83
Interest expense	(39)	(34)	(71)
Other income (expense), net	79	29	47
Total non-operating income (expense)	91	32	59
Income before income taxes	1,497	1,161	901
Provision for income taxes	(352)	(253)	(247)
Equity-method investment activity, net of tax	7	(6)	(9)
Net income	$1,152	$902	$645
Basic earnings per share	$2.58	$2.08	$1.52
Diluted earnings per share	$2.53	$2.04	$1.49
Weighted Average Shares Used in Computation of Earnings per Share			
Basic	447	433	423
Diluted	456	442	432
(1) Includes stock-based compensation as follows:			
Fulfillment	$90	$79	$61
Marketing	27	20	13
Technology and content	223	182	151
General and administrative	84	60	50

Source: Amazon.com, Inc. *Form 10K* SEC Filing 2011; Amazon.com

EXHIBIT 8 Amazon.com, inc. Consolidated Balance Sheet (in millions, except per share data)

	December 31	
Amazon.com Inc.	2010	2009
ASSETS		
Current assets		
Cash and cash equivalents	$3,777	$3,444
Marketable securities	4,985	2,922
Inventories	3,202	2,171
Accounts receivable, net and other	1,587	988
Deferred tax assets	196	272
Total current assets	13,747	9,797
Fixed assets, net	2,414	1,290

(*Continued*)

2. Who are the likely competitors of Amazon.com in the future? How can the company ensure that it can compete effectively in its diverse businesses?
3. How should the company prioritize its opportunities for entering new international markets? How much emphasis should be placed on this strategy?
4. How can the company keep up with technology developments? Should it consider acquiring companies that have proprietary technology that might be useful to the company in offering its services? Or are partnerships through contract an adequate means of gaining the necessary emerging technologies for company operations?
5. Should Amazon continue to plan on scale (growth) as part of its strategy? What risks are associated with basing strategies on continued significant growth?
6. Amazon focuses its strategy on goals related to customer issues, with little attention on financial goals. Should financial issues play a larger role in Amazon's goals?
7. What can Amazon do to lessen the likelihood that the company and its customers are damaged by cyber attacks?

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EXHIBIT 8 Continued

	December 31	
Amazon.com Inc.	2010	2009
Deferred tax assets	22	18
Goodwill	1,349	1,234
Other assets	1,265	1,474
TOTAL ASSETS	$18,797	$13,813
Liabilitiesand Stockholders' Equity		
Current liabilities		
Accounts payable	$8,051	$5,605
Accrued expenses and other	2,321	1,759
Total current liabilities	10,372	7,364
Long-term liabilities	1,561	1,192
TOTAL LIABILITIES	11,933	8,556
Stockholders' equity		
Preferred stock, $0.01 par value		
Authorized shares—500		
Issued and outstanding shares—none	—	—
Common stock, $0.01 par value		
Authorized shares—5,000		
Issued shares—468 and 461 million		
Outstanding shares—451 and 444 million	5	5
Treasury stock, at cost	(600)	(600)
Additional paid-in capital	6,325	5,736
Accumulated other comprehensive income (loss)	(190)	(56)
Retained earnings	1,324	172
TOTAL STOCKHOLDERS' EQUITY	6,864	5,257
Total Liabilities and Stockholders' Equity	$18,797	$13,813

Source: Amazon.com, Inc., *Form 10K* SEC Filing 2011; Amazon.com.

The Future

Amazon's first quarter 2011 profits decreased 33 percent to $201 million as the company has hired 45 percent more employees over the last 12 months—to 37,900 employees presently. And Amazon is building nine new distribution centers, called fulfillment centers, in 2011. Revenue for the first quarter of 2011 rose 38 percent to $9.86 billion. Amazon spent $855 million on fulfillment in the first quarter, up from $546 million the prior year. Amazon's spending that first quarter on technology and content rose to $579 million from $366 million the prior year. Amazon is building data centers for its Amazon Web Service business. For that first quarter, Amazon's revenue increases still are mainly driven by strong sales of electronics and general merchandise, with sales in North America rising faster than international sales. Amazon is aggresively expanding its cloud computing business.

As Amazon deals with challenges in the e-commerce world and tries to continue developing new services, product offerings, and partnerships while continuing to establish existing services, several issues must be considered:

1. What portion of the business should be focused on sales of products, sales of services to consumers, business partnerships for sales, and partnerships for order fulfillment/web services? Is it possible for the company to become too diversified or to get too far away from its initial business of selling books?

Netflix, Inc. — 2011

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NFLX

http://www.netflix.com

It is mid-2011 and Netflix is preparing to offer subscribers a "family plan" to expand its presence on Facebook. The family plan will allow Netflix customers to add multiple users to a single account at a discounted price, similar to a cell phone family plan. Warner Brothers already offers streaming movie rentals via Facebook. Headquartered in Los Gatos, California, Netflix competes in the fiercely contested web/cable/television industry that is technologically changing faster than any on the planet. Distinctions among web, cable, and television are blurring rapidly as content is delivered seamlessly across all media channels via streaming. Netflix's stock price was $304 in July 2011 but dropped to $240 the next month amid worries about the economy, heightened competition, and S&P downgrade U.S. Treasury bonds.

Bold strategic moves by Reed Hastings, chairman and CEO of Netflix, and aggressive bartering to acquire rights to air original series programs, have ballooned Netflix's subscriber base, earnings, and stock price. Netflix's stock price jumped to $175 at the end of 2010 from $55 at the beginning of 2010. If Netflix's subscriber base continues growing at current rates then content manufacturers may soon be compelled to seek Netflix as their primary content distributor for movies and TV, similar to Apple Inc. in the music industry. Even Apple now uses Netflix to stream movies to its Apple TV, iPhone, and iPad.

Consumer pressure for on-demand, instant-gratification video is changing the media industry landscape and causing competitors in the media industry to become concerned about Netflix becoming a 400-pound gorilla. Cable and satellite TV service providers offer low-cost, pay-per-view movie rentals without the necessity of a computer or Internet access, but TVs now have Internet access and video streaming capabilities. A concern among rival firms is that Netflix is removing the reason for consumers to pay for expensive cable TV.

History

Netflix, Inc. was incorporated in Delaware on August 29, 1997, and completed its initial public offering in May 2002. By 2007, Netflix began streaming content over the Internet and is now the world's largest Internet subscription service to offer streaming movies and TV episodes over the Internet. With over 100,000 DVD titles for rental by mail and more than 20 million members in the United States and Canada, Netflix subscribers can instantly watch streaming content without commercial interruption on their PCs, Macs, Internet-connected TVs, home theater systems, digital video recorders, and Internet video players; Apple's iPhone, iPad, and iPod touch, as well as Apple TV and Google TV. Streaming is delivered using Netflix software that runs on more than 200 "Netflix ready devices" including: Blu-ray disc players, Internet-connected TVs, digital video players, and game consoles such as Microsoft's Xbox 360, Nintendo's Wii, and Sony's PS3 consoles. For traditional movie viewing, subscribers receive DVDs by mail and return them via prepaid mailers. Upon receipt of a returned DVD, Netflix mails the next available DVD on a subscriber's list.

Netflix employed 2,180 full-time employees and 2,197 part-time employees as of December 2010 and had revenues of $2.4 billion. In contrast, much larger Amazon had 33,700 full-time employees and generated $34 billion in sales in 2010. Unlike rival companies, Netflix offers several subscription plans with no due dates, no fees for late returns, and no shipping or pay-per-view fees. Subscribers choose from a growing library of movie titles that can be viewed instantly and a large selection of DVDs. Customer satisfaction is assured with the customer experience being

EXHIBIT 1 Netflix Pricing Plans

Pricing Plans as of December 31, 2010	Price per month
Unlimited Streaming without DVDs	$7.99
1 DVD out - Unlimited Plan	9.99
2 DVDs out - Unlimited Plan	14.99
HD (High Definition) Blu-ray Disc Surcharges	1.00 to 4.00
All Other Unlimited Plans	Prices Vary

Source: Netflix, Inc. *10K* SEC Filing 2011; Netlix.com

enhanced by a proprietary recommendation and merchandising technology software that automatically customizes selections to user preferences. Netflix plan prices vary based upon the number of DVDs that a subscriber retains out at any given point and whether the plan has limited or unlimited usage. Most Netflix subscribers choose a 1, 2, or 3 DVD-out unlimited plan. Subscription prices as of December 2010 are provided in Exhibit 1.

Vision/Mission/Strategy

Netflix is a global streaming business that offers DVDs by mail, but the company focus is subscription-based, commercial-free streaming of TV shows and movies. Currently the company has no publically available vision statement or mission statement. The company does provide a general strategy statement as follows:

> *Netflix's core strategy is to grow a large subscription business consisting of streaming and DVD-by-mail content. By combining streaming and DVD as part of the Netflix subscription, we are able to offer subscribers a uniquely compelling selection of movies for one low monthly price. We believe this creates a competitive advantage as compared to a streaming only subscription service. This advantage will diminish over time as more content becomes available over the Internet from competing services, by which time we expect to have further developed our other advantages such as brand, distribution, and our proprietary merchandising platform. Despite the growing popularity of Internet delivered content, we expect that the standard definition DVD, along with its high definition successor, Blu-ray (collectively referred to as "DVD"), will continue to be the primary means by which a majority of Netflix subscribers view content for the foreseeable future. However, at some point in the future, we expect that Internet delivery of content to the home will surpass DVD as the primary means by which most Netflix subscribers view content. (Source: Company documents)*

Strategy

Netflix aggressively pursues new content deals. In August 2010, the company negotiated a $1 billion, five-year agreement with Epix, a premium TV channel provider, for access to an expansive library of titles that pay TV cannot offer. Although Netflix gains access to newly released content, Netflix must wait 90 days after the title's release on pay TV. In another strategic move, Netflix negotiated with cable channel provider Starz to provide over 2,500 movies and shows from Disney, Sony Pictures, and other sources. The deal is seen as a big win with such offerings as *Grey's Anatomy*, *Desperate Housewives*, *Lost*, *Scrubs*, *Reaper*, *Phineas and Ferb*, *The Suite Life on Deck*, *Wizards of Waverly Place*, *Hannah Montana*, the *High School Musical* series, *Camp Rock*, and many more. TV content streamed from Netflix is immensely popular, but rival firms are feverously battling. For example, HBO has recently locked in content deals with 20th Century Fox, Universal, Warner Brothers, New Line Cinema, and DreamWorks, which restricts Netflix's access to content for a decade.

With regard to TV, Netflix is pursuing streaming rights to current-season shows for prices of $100,000 or more per episode. The adage "Content is King" appears to be the driving force behind strategic moves of Netflix and its competitors. However, a new streaming content requires deep cash pockets, and Netflix's deal with Disney and Sony expires in 2011. Furthermore, speculation abounds as to what will happen if Netflix does not renegotiate its deal with Starz and decides to buy content directly from media producers.

Netflix is continually examining new ways to improve the subscriber's experience. For example, single user accounts allow single movie streaming to one location; however, Netflix is exploring ways to allow subscribers to watch multiple, simultaneous streams. Alternatively, Netflix is considering a family price that would encourage multiple accounts in one household for greater customization of viewing. Ultimately, Netflix's goal is for each user to have a personal account—an option that is in line with the increased use of mobile devices.

Global Expansion

Netflix expanded internationally in September 2010 by offering an unlimited streaming plan without DVD rentals in Canada. A recent five-year licensing agreement with Paramount Pictures in Canada has increased Netflix's title library by providing streaming access to classic hits from 350 movie titles and new Paramount Pictures movies.

Although expansion into Canada has surpassed initial growth estimates, internationalization requires significant resources, greater management attention, and exposes the company to regulatory, economic, and political risks. Specific risks include cultural adaptation of content and interfaces; international financial operations; greater political, social, and economic instability, additional legal complexities of international trade and local laws; greater environmental turbulence and regulatory change; less favorable intellectual property laws; complex tax effects; fluctuations in currencies and exchange rate risk; greater competition, and varying degrees of reliable Internet penetration and connectivity. In the international marketplace in particular, Netflix will face the challenge of content licensing and identifying the most effective marketing channels.

Marketing

Netflix has earned high online retail customer satisfaction ratings by independent research firms, such as Nielsen. Over 90 percent of subscribers would recommend Netflix to a friend. High levels of customer satisfaction and a loyal subscriber base make it expensive and difficult for competitors to displace Netflix as a subscription segment leader.

Netflix uses multiple marketing channels. Traditional advertising is undertaken using regional and national TV, radio stations, package inserts, direct mail, and newspaper print. Netflix also uses partnerships with consumer electronic companies and cooperative advertising agreements with studios, whereby Netflix receives cash for featuring studios' movies in Netflix promotions. Word-of-mouth advertising and subscriber referrals are also believed to significantly enhance sales. Online advertising by Netflix encompasses search listings, banner ads, text links and permission-based e-mails, and third-party web-based banner ads.

Technology

Netflix's proprietary technology enhances consumers' search process and also manages and integrates operations, the Netflix website, order processing, fulfillment operations, and customer service. Netflix software also serves as the user interface on Netflix-ready devices. This technology maximizes the content library utilization and fulfillment with minimal capital to deliver superior service and efficient inventory management. Netflix owns patents, trademark, copyrights, and confidentiality agreements to protect its proprietary software and website to maintain a competitive advantage.

Netflix's proprietary technology customizes and enhances each subscriber's Netflix experience. Data from more than 3 billion subscriber ratings are used to provide recommendations that are tailored to specific user preferences to create demand and maximize content utilization. By creating demand and balancing subscriber requests for new and older content while maintaining high customer satisfaction levels, Netflix maintains a stable client base, keeps subscriber acquisition costs low, and increases lifetime subscriber profit.

Superior Service

Netflix offers convenient and quick access to titles for multiple viewing options including delivery to over 200 Netflix ready devices. The customer's experience is uniquely customized for ease of website use, title selection, and fast and convenient delivery. Netflix creates a unique experience for subscribers by generating user interfaces on its website and Netflix-ready devices that are tailored to subscribers' individual rental and ratings history. A large

EXHIBIT 2 Netflix Marketing Expenses (in thousands, except percentages and subscriber acquisition cost)

	Year ended December 31		Change
Marketing Expenses	2010	2009	2010 vs. 2009
Marketing	$293,839	$237,744	23.6%
As a percentage of revenues	13.6%	14.2%	
Other Data			
Gross subscriber additions	16,301	9,332	74.7%
Subscriber acquisition cost	$ 18.03	$ 25.48	(29.2)%

Source: Netflix, Inc. *10K* SEC Filing 2011; Netflix.com

DVD title inventory coupled with nationwide distribution centers and streaming titles available for viewing without commercial interruption provides fast delivery and high customer satisfaction. In December 2010, the American Customer Satisfaction Index (ACSI) named Netflix the number one e-commerce company for customer satisfaction.

Market Segments

Netflix revenues are derived from monthly subscription fees in two business segments, 1) the United States and 2) the international market. In September 2010, Netflix expanded internationally by offering an unlimited streaming plan without DVDs in Canada. Netflix does not break out the Canadian international sales yet in their financials. Instead, the company indicates that the venture has not generated a profit yet and will begin reporting the two separate geographic revenue streams individually in the future.

Netflix's subscriber growth is seasonal, being greatest October through March. A summary of Netflix's marketing expenses is provided in Exhibit 2.

Competitors

Netflix has traditionally been a competitor in the subscription segment of the in-home entertainment video market but has expanded its business model to include streaming content over the Internet. The market for streaming video consists of three segments: 1) video-on-demand (VOD), 2) ad supported, and 3) subscription. The U.S. home entertainment subscription service is currently a $66 billion business and is expected to grow to $84 billion by 2013.

Competitors in the VOD segment include Amazon, Apple, and Microsoft; while key players in the ad-supported segment are Hulu and YouTube. Currently, Netflix is the primary provider in the subscription segment, but competition will increase as consumers shift to Internet delivery of videos. According to Standard and Poor's, Amazon, a provider of VOD, currently ranks 10th among the top 25 Internet properties with a 36.5 percent reach in the Internet marketspace (Kessler 2010). In addition, 75 percent of U.S. households had access to the Internet in 2008, and this rate is expected to reach 80 percent by 2013. According to Nielsen estimates, there are 116 million households with at least one TV and Netflix has achieved a penetration rate of 14.5 percent (Downing 2011). Among online video content providers, Hulu ranks second behind Google as of mid-year 2010 in the number of videos viewed. Netflix did not even rank in the top ten. Warner Brothers has also initiated a trial offering of movie titles available for rental and streaming via Facebook. Competition is heating up!

Moreover, the online streaming business is still in its formative years. According to eMarketer, two-thirds of Internet users, or 147.5 million people, in the United States watch online videos, and this number is expected to reach 193.1 million by 2014. Product substitution, however, is high, since consumers use multiple entertainment sources in the same month, such as subscribing to a cable provider, renting a RedBox or Blockbuster DVD, buying DVDs from Wal-Mart or Amazon, downloading a movie from Apple iTunes, and watching a TV show on Hulu.com. Industry barriers to entry are low since start-ups can be launched at a relatively low cost. Furthermore, innovation and growth of existing technologies pose

a threat, as does the development of new technologies for viewing entertainment videos. In summary, key competitors of Netflix include:

- DVD rental outlets, such as Blockbuster and RedBox
- Pay-per-view and VOD content cable providers—Time Warner and Comcast
- Direct broadcast satellite providers—DIRECTV
- Telecommunication providers—AT&T and Verizon
- Online DVD subscription rental websites—Blockbuster Online
- Retailers—Best Buy, Wal-Mart, and Amazon.com
- Internet providers—Amazon.com, Apple iTunes, Hulu.com, and YouTube

On the video streaming front, there are rumors that RedBox will join the fight for the online streaming business. RedBox is a supermarket-based DVD Kiosk business owned and operated by Coinstar (ticker = CSTR). RedBox generates $1.5 billion in annual sales. RedBox rents movies for 28 days for $1 a day. Blockbuster was just acquired by Dish Network. CEO Joe Clayton says Dish will now use its library and studio connections to offer a streaming alternative to Netflix. Clayton plans to keep 1500 to 1700 of Blockbuster stores open. However Netflix is worried most about Amazon.

Amazon

Why should Netflix be concerned with Amazon? Amazon has strong brand recognition, an established online history, a large customer base, and greater financial, marketing, and human resources. If consumer preferences shift to VOD, a key provider of VOD is Amazon. Coincidentally, Amazon also provides the software, data processing, and storage (also known as cloud computing services) for Netflix. Netflix relies upon Amazon for a majority of its computing and has stated that it cannot easily switch to another cloud provider.

Amazon is a 400-pound gorilla in the media business. With its expanded offerings and one-stop destination format, Amazon's business is forecasted to generate a 30 percent average annual earnings growth over the next three to five years. Amazon reported an impressive 39 percent year-over-year revenue growth of late. In 2008, Amazon launched an expansive online library of titles ranging from the 1939 famous classic *Gone with the Wind* and Alfred Hitchcock's 1959 title *North by Northwest* to the most recent releases. Amazon Instant Video, also known as VOD (Videos on Demand), offers over 6,400 TV shows and 37,000 movies in an instant streaming or commercial-free download format. Prices start as low as 99 cents. Amazon also offers unlimited free video streaming to Amazon Prime customers who pay $79 per year for special rates on shipping. In comparison, Netflix charges a higher annualized fee of $95 for their lowest-priced plan of unlimited streaming without DVDs. The cost increases when subscribers include rentals of DVD titles.

Currently, Amazon's media (books, music, and videos) represents 52 percent of sales, with 48 percent of Amazon's sales obtained internationally. Amazon plans to expand its online video streaming business and has greater access to financial resources generated from its diversified business services. If Amazon chooses to aggressively increase its customer base by offering a lower-priced VOD service, Netflix may not be able to withstand the competition against a giant with deeper pockets. Amazon has committed to the expansion of 10 additional fulfillment centers to support growing demand. Amazon's business segments and growth rates by geographic sales region are provided in Exhibit 3.

Industry Issues

Entertainment service providers are affected by sales of home electronics, which continued to increase through 2011. Standard and Poor's forecasts that movie ticket and music/video retail sales will increase by $0.7 billion and $3.4 billion respectively through 2014. The home video rental business industry is changing dramatically with advances in technology and new video streaming capabilities.

If Netflix is unable to acquire preferred content or sufficient DVD titles, subscriber satisfaction and operations will be negatively affected. If the costs to fulfill the demand for new titles are not funded by increased subscriber profits or improved operating margins, Netflix's service may be devalued and demand may disappear. If the cost to manufacture DVDs falls and the retail price for DVDs declines to a level where consumers prefer to purchase DVDs, again the value of Netflix's service dissipates.

Netflix acquires content by direct purchases, revenue sharing agreements, and license agreements with studios and distributors. DVDs may be purchased in volume discounts or at

EXHIBIT 3 **Amazon's Segment Info (in millions)**

	Year Ended December 31		
	2010	2009	2008
Net Sales			
North America			
Media	$6,881	$5,964	$5,350
Electronics and other general merchandise	10,998	6,314	4,430
Other (1)	828	550	448
Total North America	$18,707	$12,828	$10,228
International			
Media	$8,007	$6,810	$5,734
Electronics and other general merchandise	7,365	4,768	3,110
Other	125	103	94
Total International	$15,497	$11,681	$8,938
Consolidated			
Media	$14,888	$12,774	$11,084
Electronics and other general merchandise	18,363	11,082	7,540
Other	953	653	542
Total consolidated	$34,204	$24,509	$19,166
Year-Over-Year % Growth			
North America			
Media	15%	11%	16%
Electronics and other general merchandise	74	43	41
Other	50	23	38
Total North America	46	25	26
International			
Media	18%	19%	24%
Electronics and other general merchandise	54	53	50
Other	22	9	65
Total International	33	31	33
Consolidated			
Media	17%	15%	20%
Electronics and other general merchandise	66	47	45
Other	46	20	42
Total consolidated	40	28	29
Year-Over-Year % Growth			
Excluding the effect of exchange rates			
International			
Media	18%	20%	22%
Electronics and other general merchandise	57	56	49
Other	24	19	67
Total International	34	33	31
Consolidated			
Media	16%	16%	19%
Electronics and other general merchandise	67	48	44
Other	46	22	42
Total consolidated	40	29	28
Consolidated Net Sales Mix			
Media	43%	52%	58%
Electronics and other general merchandise	54	45	39
Other	3	3	3
Total consolidated	100%	100%	100%

Source: Company documents.

rebates based upon Netflix selling at specified levels. DVDs and streaming content purchased through revenue sharing agreements are obtained for a low initial cost in exchange for a percentage of subscriber revenues or a fee for a period ranging from six to twelve months. The initial cost may require an up-front, nonrefundable payment of future revenue sharing obligations. As of December 31, 2010, Netflix had contracted more than $1.2 billion due over the next several years and is expected to increase these levels.

Supply Chain

Netflix relies upon channel providers for delivery of content. Netflix is also subject to possible nonrenewal or renegotiation of revenue sharing contracts with distributors upon expiration. Channel providers may also offer the same service as Netflix, which would eliminate Netflix's access to a delivery channel. In addition, regulations similar to a "do not call" restriction may limit the use of channels. Similarly, amendments to copyright laws or release and distribution may adversely affect Netflix.

Subscriber value is also a function of the availability and timing of the release of videos to distributors or competitors as well as release on DVD. Current licensing agreements typically require that Netflix not offer new DVD releases until 28 days after the retail sale date. Delays in the availability of DVDs or streaming content offered by Netflix would negatively affect subscription revenues. Currently DVDs enjoy a competitive advantage over distribution channels such as pay-per-view and VOD due to early distribution. Recently, major studios have shortened the release time and simultaneously released movies on DVD and VOD. If other distributors receive priority or equal DVD release dates, Netflix demand could be reduced.

Netflix has contractual agreements lasting one to three years with several electronics partners to offer streaming content on Netflix ready devices. If Netflix is unable to maintain these relationships or create new partnerships, Netflix's growth will be hampered. In addition, partners must update devices in order to remain compatible with Netflix technology. With regard to DVDs delivered via the U.S. Postal Service, increases in postage rates would reduce profit margins and may lead to an increase in subscription fees.

Political/Legal Issues

The growth of online commerce may lead to more regulation, which may require that Netflix alter its business model. If U.S. copyright laws are amended to allow studios to delay the availability of new DVD releases for rental yet permit release of DVDs for retail sale, Netflix would be harmed since retailers would have primary access to new releases. Currently Universal Studios and Twentieth Century Fox are involved in litigation with Redbox for this type of practice. Furthermore, content owners have begun to negotiate exclusive deals with a limited number of outlets, such as when Blockbuster exclusively received content on DVDs. To the extent that content is exclusively distributed, Netflix's value proposition could dissipate if competitors gained exclusive access to highly valued entertainment content.

Infringements on Netflix's patents, trademarks, and proprietary assets by competitors may decrease the Netflix brand value. Competitors every day are trying to duplicate Netflix's service and business model. There are numerous patents that broadly claim the means and methods of conducting business on the Internet.

Netflix is involved in long-term contractual agreements with distributors and suppliers of viewing content and technology computing services. If Netflix's revenue, subscriber base, or profit margins decline, Netflix may not be able to meet contractual obligations.

Security/Privacy Issues

Breaches in data security are on the rise. Significant resources are needed to maintain security and insurance policies to cover potential losses in the event of a breach of security. Netflix is dependent upon the reliability of its computer systems and third parties. Interruptions in service, such as in August 2008, impact Netflix's ability to ship and receive DVDs and stream movies. Netflix also relies upon its own engineering and software development teams for software and computer systems performance. Netflix's website periodically experiences direct attacks intended to disrupt service. Current insurance does not cover expenses related to attacks.

Netflix also collects data from subscribers. Some firms have received criticism for linking personal identities with data collected on the users' browsing and other habits. Increased regulation of

data utilization practices would affect Netflix's ability to use its proprietary merchandising technology to provide a valuable Netflix search experience.

Netflix is subject to liability for negligence as well as copyright, patent, or trademark infringement of content it distributes as well as content uploaded from subscribers, such as movie reviews. Legislation has been proposed to prohibit sharing of information over the Internet, such as comments provided by customers in a feedback forum. This limitation would adversely affect Netflix's ability to provide a customer referral service, which would reduce Netflix's appeal and the value of its proprietary technology. Although Netflix is also the object of complaints for patent infringement regarding client-server communications protocol and collusion with Wal-Mart and Blockbuster, Netflix does not anticipate losses from these or any other filings.

Netflix Finances

Rapid expansion of Netflix in the United States and internationally places a significant strain on management, operations, and financial resources. Netflix has never paid a cash dividend and plans to retain future earnings to finance growth and development of the firm. The company's consolidated statement of operations, percentage of revenues statement, and consolidated balance sheet are provided in Exhibits 4, 5, and 6 respectively.

EXHIBIT 4 Netflix's Consolidated Statements of Operations (in thousands, except per share data)

	Year ended December 31		
Netflix, Inc.	2010	2009	2008
Revenues	$2,162,625	$1,670,269	$1,364,661
Cost of Revenues			
Subscription	1,154,109	909,461	761,133
Fulfillment expenses	203,246	169,810	149,101
Total cost of revenues	1,357,355	1,079,271	910,234
Gross profit	805,270	590,998	454,427
Operating Expenses			
Technology and development	163,329	114,542	89,873
Marketing	293,839	237,744	199,713
General and administrative	70,555	51,333	49,662
Gain on disposal of DVDs	(6,094)	(4,560)	(6,327)
Total operating expenses	521,629	399,059	332,921
Operating income	283,641	191,939	121,506
Other Income (Expense)			
Interest expense	(19,629)	(6,475)	(2,458)
Interest and other income	3,684	6,728	12,452
Income before income taxes	267,696	192,192	131,500
Provision for income taxes	106,843	76,332	48,474
Net Income	$160,853	$115,860	$83,026
Net Income per Share			
Basic	$3.06	$2.05	$1.36
Diluted	$2.96	$1.98	$1.32
Weighted-average Common Shares Outstanding			
Basic	52,529	56,560	60,961
Diluted	54,304	58,416	62,836

Source: Netflix *10K* SEC Filing 2011; Netflix.com

EXHIBIT 5 Netflix's Financial Operations Results (as a percentage of revenues)

	Year Ended December 31		
Netflix, Inc.	2010	2009	2008
Revenues	100.0%	100.0%	100.0%
Cost of Revenues			
Subscription	53.4	54.4	55.8
Fulfillment expenses	9.4	10.2	10.9
Total cost of revenues	62.8	64.6	66.7
Gross margin	37.2	35.4	33.3
Operating Expenses			
Technology and development	7.6	6.9	6.6
Marketing	13.6	14.2	14.6
General and administrative	3.3	3.1	3.6
Gain on disposal of DVDs	(0.4)	(0.3)	(0.4)
Total operating expenses	24.1	23.9	24.4
Operating income	13.1	11.5	8.9
Other Income (Expense)			
Interest expense	(0.9)	(0.4)	(0.2)
Interest and other income	0.2	0.4	0.9
Income before income taxes	12.4	11.5	9.6
Provision for income taxes	5.0	4.6	3.5
Net income	7.4%	6.9%	6.1%

Source: Netflix, Inc. *10K* SEC Filing 2011; Netflix.com

Netflix revenues are derived from monthly subscription fees. As of December 31, 2010, approximately 85 percent of Netflix subscribers purchase the unlimited streaming plan without DVDs at $7.99 per month or a one or two DVD-out unlimited plan, priced at $9.99 and $14.99 per month, respectively (Netflix.com 2011). Customers purchasing high definition Blu-ray discs pay a surcharge from $1 to $4 for plans. Increased revenues are primarily due to a 41.3 percent growth in the number of subscribers. Detailed subscription information is provided in Exhibits 7 and 8.

Growth in subscriptions was offset by an 8.3 percent decline in the average monthly revenue per subscriber, resulting from growth in the low-priced subscription plans. Subscriptions in the one- and two-out plans grew by 69.8 percent while all other plans declined by 15.0 percent over the 2010 year. In the fourth quarter of 2010, more than one-third of new subscribers chose an unlimited streaming plan without DVDs when this option was introduced. Some critics argue that the DVD rental business is a maturing industry. Exhibit 9 provides a breakdown of library content values.

The Future

International expansion opportunities appear attractive, but can Netflix extend its business model contentwise and simultaneously expand internationally? Netflix management has undertaken a commitment to grow its streaming entertainment business to fuel future revenue growth. Content deals are becoming more expensive and competitors are becoming more adept at imitating and duplicating Netflix products and services less expensively. Amazon is still a major concern.

In 2010, *Fortune* named Netflix CEO Reed Hastings "Business Person of the Year" and *Barron's* added Reed to its 30 most respected CEOs list. It is a daily challenge for Mr. Hastings to keep Netflix on track, however, amidst a sea of competing firms and technology convergence blurring the differences among cable, TV, and the Internet. Reports are that Walt Disney Company will soon extend its reach into the content delivery industry.

Prepare a three-year strategic plan for Mr. Hastings and his management team that is illustrated in Exhibit 10.

EXHIBIT 6 **Netflix's Consolidated Balance Sheet**

	As of December 31	
	2010	2009
ASSETS		
Current Assets		
Cash and cash equivalents	$194,499	$134,224
Short-term investments	155,888	186,018
Current content library, net	181,006	37,329
Prepaid content	62,217	26,741
Other current assets	47,357	26,701
Total current assets	640,967	411,013
Content library, net	180,973	108,810
Property and equipment, net	128,570	131,653
Deferred tax assets	17,467	15,958
Other non-current assets	14,090	12,300
Total Assets	$982,067	$679,734
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$222,824	$92,542
Accrued expenses	36,489	33,387
Current portion of lease financing obligations	2,083	1,410
Deferred revenue	127,183	100,097
Total current liabilities	388,579	227,436
Long-term debt	200,000	200,000
Lease financing obligations, excluding current portion	34,123	36,572
Other non-current liabilities	69,201	16,583
Total Liabilities	691,903	480,591
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, $0.001 par value; 10,000,000 shares authorized at December 31, 2010 and 2009; no shares issued and outstanding at December 31, 2010 and 2009	—	—
Common stock, $0.001 par value; 160,000,000 shares authorized at December 31, 2010 and 2009; 52,781,949 and 53,440,073 issued and outstanding at December 31, 2010 and 2009, respectively	53	53
Additional paid-in capital	51,622	—
Accumulated other comprehensive income	750	273
Retained earnings	237,739	198,817
Total Stockholders' Equity	290,164	199,143
Total Liabilities And Stockholders' Equity	$982,067	$679,734

Source: Netflix, Inc. *10K* SEC Filing 2011; Netflix.com

EXHIBIT 7 Netflix Subscriber Info 1 (in thousands, except subscriber acquisition cost)

	As of Year Ended December 31		
Netflix, Inc.	2010	2009	2008
Other Data			
Total subscribers at end of period	20,010	12,268	9,390
Gross subscriber additions during period	16,301	9,332	6,859
Net subscriber additions during period	7,742	2,878	1,911
Subscriber acquisition cost*	$18.03	$25.48	$29.12

*Subscriber acquisition cost is defined as total marketing expenses divided by total gross subscriber additions.
Source: Netflix, Inc. *10K* SEC Filing 2011; Netflix.com

EXHIBIT 8 Netflix Subscriber Info 2 (in thousands, except percentages and average monthly revenue per paying subscriber)

	As of December 31	
Netflix, Inc.	2010	2009
Free subscribers	1,742	376
As a percentage of total subscribers	8.7%	3.1%
Paid subscribers	18,268	11,892
As a percentage of total subscribers	91.3%	96.9%
Total subscribers	20,010	12,268
Percentage change over prior period	63.1%	30.6%
Revenues	$2,162,625	$1,670,269
Average number of paying subscribers	14,786	10,464
Average monthly revenue per paying subscriber	$ 12.19	$ 13.30
Cost of subscription	$1,154,109	$909,461
As a percentage of revenues	53.4%	54.4%
Fulfillment expenses	$203,246	$169,810
As a percentage of revenues	9.4%	10.2%
Gross profit	$805,270	$590,998
Gross margin	37.2%	35.4%
Average monthly gross profit per paying subscriber	$4.54	$4.71

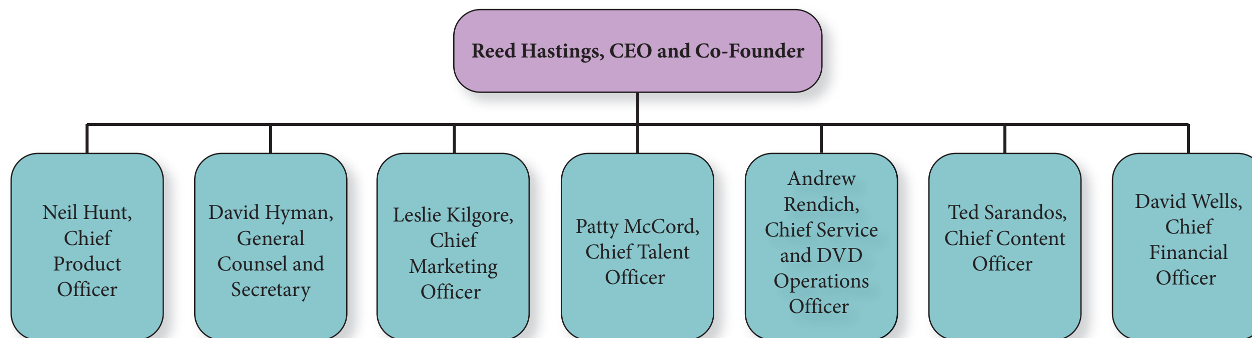
Source: Netflix, Inc. *10K* SEC Filing 2011; Netflix.com

EXHIBIT 9 Netflix's Content Library Composition (in thousands)

	As of December 31	
	2010	2009
DVD content library	$627,392	$638,006
Streaming content library	441,637	104,796
Content library	1,069,029	742,802
Less: accumulated amortization	(707,050)	(596,663)
	361,979	146,139
Less: Current content library, net	181,006	37,329
Content library, net	$180,973	$108,810

Source: Netflix, Inc. *10K* SEC Filing 2011; Netflix.com

EXHIBIT 10 Netflix's Organizational Structure



Gap Inc. — 2011

Sharynn M. Tomlin
Angelo State University

GPS

http://www.gapinc.com
Headquartered in San Francisco, Gap Inc. opened its first stores in Serbia and Ukraine in 2011, broadening the clothing chain's reach into Eastern Europe. Gap stores just opened in Belgrade and Kiev. Stephen Sunnucks, Gap's international president, said in a statement that the Ukraine is the fastest-growing retail market in Eastern Europe, while Serbia has many young customers who enjoy shopping. Gap now has stores in 24 countries throughout Asia, Europe, Latin America, the Middle East, and Australia. The retailer has about 180 franchise stores and plans to increase that to 400 by fiscal 2015. Gap Inc. has divisional presidents based in London, Tokyo, Shanghai, and San Francisco. The company also operates Banana Republic and Old Navy stores.

Gap (often referred to as "The Gap") is a popular retailer providing clothing, accessories, and personal care products for men, women, children, and babies under the Gap, Old Navy, Banana Republic, Piperlime, and Athleta brands. Stores are located in the United States, Canada, China, the United Kingdom, France, Ireland, and Japan. On January 30, 2011, the company employed about 134,000 people with 3,231 store locations. Additionally, it has agreements with unaffiliated franchisees to operate Gap and Banana Republic stores in other countries around the world. Under these agreements, third parties operate or will operate stores that sell apparel purchased from the company under its brand names. Also, customers can shop online at gap.com, oldnavy.com, bananarepublic.com, piperlime.com, and athleta.com. Other Gap-owned retail outlets include GapBody, GapKids, and babyGap. The company provides a wide range of family clothing products, including denim, khakis, T-shirts, fashion apparel, shoes, accessories, intimate apparel, and personal care products. All Gap clothing is private-label merchandise made specifically for the company. From the design board to store displays, Gap controls all aspects of its trademark casual look.

Gap's July 2011 revenue at stores open at least a year fell 5 percent, worse than analysts expected. Total revenue for the four weeks that ended July 30 was almost flat at $949 million, compared with $948 million a year earlier. Gap Inc. includes the Banana Republic and Old Navy chains, outlets and smaller retail concerns, and is the country's biggest clothing seller. Gap's July 2011 revenue at stores open at least a year dropped 10 percent for its overseas business. In North America, revenue fell by 6 percent at Gap stores open at least a year, fell 4 percent at Banana Republic and fell 3 percent at Old Navy. Second-quarter 2011 revenue from stores open at least a year dropped 2 percent but total quarterly revenue rose 2 percent to $3.39 billion. The company needs a clear strategic plan for 2012–2014.

History

In 1969, Doris and Don Fisher entered the clothing retail business with the vision of creating a unique shopping experience and offered a wide selection of styles. The idea behind the first Gap store, founded in San Francisco, was to provide fresh, casual, American style. By 1970, sales reached $2 million and the company opened its second store in San Jose, California. Six years later, in 1976, the company underwent some major changes and initiated its first public offering of 1.2 million shares of stock on the New York and Pacific Stock Exchange.

The 1980s was a period of major growth and expansion. In 1980, Gap Inc. dropped Levis and other brands and began focusing on its own private label. In 1983, Gap expanded

horizontally by acquiring Banana Republic, as well as expanding its product line and introducing GapKids with the opening of its first store in San Mateo, California. A year later Gap Inc. burst into the international market and established its presence in London, England, and Vancouver, British Colombia. The same year Gap entered the European market and Gap's annual sales reached $1 billion.

From 1990 to 1999, Gap continued its progressive expansion efforts. At the turn of the decade in 1990, Gap opened babyGap and debuted the GapKids store in San Francisco. Two years later, Gap became the second-largest-selling apparel brand in the world. In 1993, Gap continued its global expansion by entering the French marketplace. The following year Gap introduced Old Navy, with the first store opening in Colma, California. Gap Inc. opened its 20,000-square-foot Gap stores in Tokyo in 1996. In 1998 Gap launched its first store in Alaska and established a firm foothold in all 50 states.

In 2005, Gap revamped its online stores, offering more convenience and interactive shopping. That same year, Gap introduced Forth & Towne in Chicago and New York. The store caters to baby-boomer women, offering stylish, age-appropriate clothing that is especially appealing to their femininity and individuality. The following year, Gap added PiperLime to its online brands. In 2007, Glenn Murphy became Gap's CEO and, within months, closed all 19 Forth & Towne stores. In 2008, the company acquired all the capital stock of Athleta Inc., a women's sports and active apparel company based in Petaluma, California, for $148 million. For the last few years, Gap has added stores in four new countries annually.

Vision/Mission

Gap has no formal vision or mission statement, but the company does have philosophy and ethics statements.

Corporate Philosophy

Gap strives to be a leader in the specialty family clothing industry and has strongly espoused the importance of its customers and employees. Its statement of corporate philosophy exemplifies this concern as shown in the 2010 *Annual Report*: "At Gap Inc., we seek to make lasting, positive impressions on the people and communities where we operate—because we believe that doing what's right is good for business. That means delivering value to our shareholders while working to lessen our impact on the planet, advance the rights of garment workers and ensure that our company culture is one our employees can be proud of."[1]

Code of Business Ethics

Gap has a well established code of ethics, translated in 65 different languages, that addresses the different aspects and guidelines about its purpose, responsibilities, laws, reporting code violations, retaliation, policy changes, and waivers. The code proposes a responsible and ethical work environment for all Gap Inc. employees and directors and addresses the following most common ethical problems: conflict of interest, discrimination or harassment, workplace violence, complaints to government agencies, international trade regulations, bribes and improper payments, antitrust laws and selling practices, product integrity, commerical transactions, brand protection, and political contributions and activities.

Organizational Structure

Gap operates from a hybrid divisional structure by geographic region and by product, as illustrated in Exhibit 1. Some analysts think an SBU structure by region would be more effective. The total number of stores by region and brand as of January 2011 is shown in Exhibit 2. Note there are 3,231 stores, and counting.

External Issues

Demographic/Economic Trends

Most trends affecting the $14 trillion apparel retail industry are driven by demand from the various demographic groups and their consumer preferences. While much of the boom in retail sales is attributable to the 77 million baby boomers, there has been a shift in their purchasing

EXHIBIT 1 The Gap's Organizational Chart

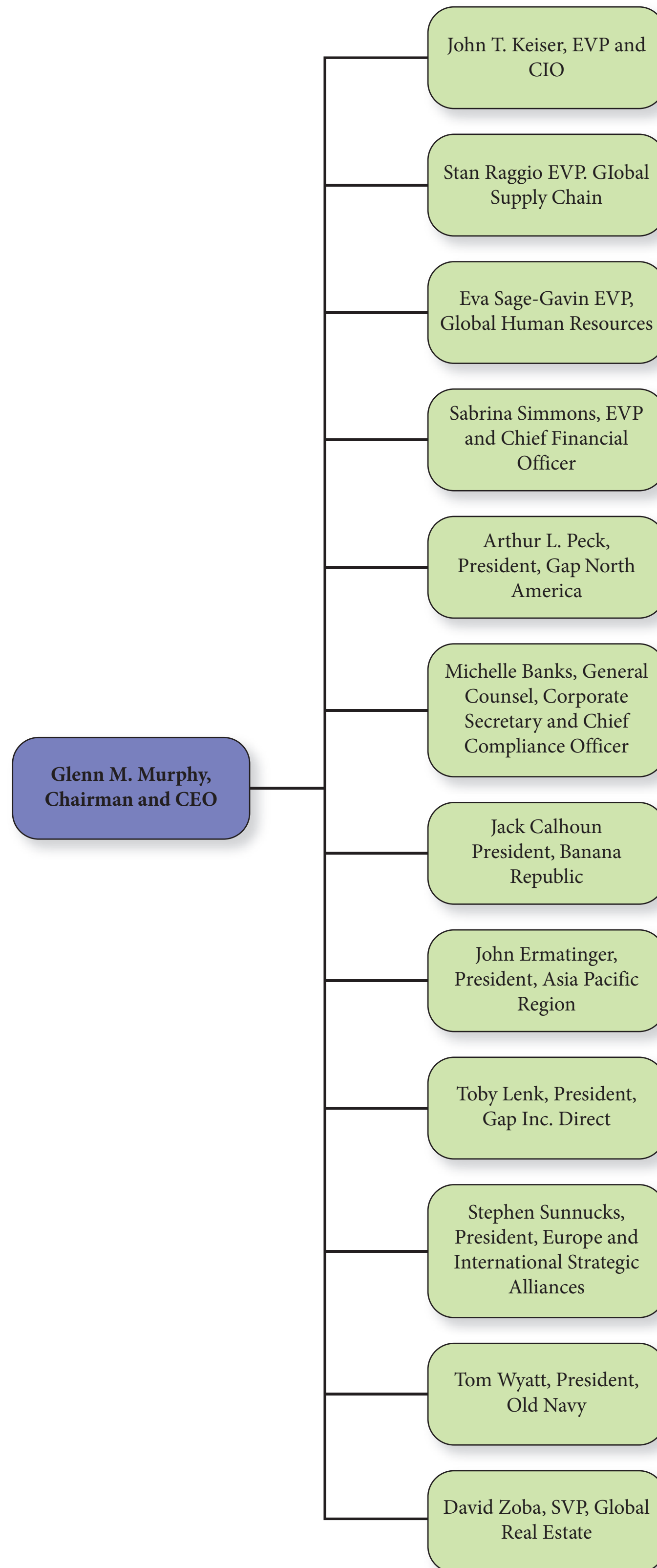


EXHIBIT 2 Number of GAP Stores, 2011

Store	# of Store Locations
Gap North America	1,152
Gap Europe	178
Gap Asia	120
Old Navy North America	1,039
Banana Republic North America	576
Banana Republic Asia	27
Banana Republic Europe	3
Athleta North America	1
Company-operated total stores	3,095
Franchise	136
Total	**3,231**

Source: Company documents.

priorities to children's educational costs, retirement, elder care, health care, housing, and leisure activities. Although this group spends less disposable income on clothing, they still remain the biggest per capita consumers of apparel. The teen market age 15 to 19, which represents about 7.1 percent of the market, is also a powerful purchasing group for Gap and its closest competitors. Retailers that appeal to teens are struggling to keep them as customers as they enter young adulthood. Today, those roughly 71 million teens in the U.S. market, the "Generation Y" or "Millenials", is the maturing market attracting the eye of retailers.

Consumers age 20–34 accounted for 24 percent of the apparel spending in the first part of 2009, up 23 percent from the previous year. The United States still is suffering from relatively high unemployment rates and very low home prices, which has translated into increased levels of job insecurity among the working population. Unemployment rates in 2010 averaged 9.7 percent but are much higher in many locations, and are not expected to decline much in the next few years.

The Conference Board's Consumer Confidence Index released in the latter part of 2010 was relatively low at 54.1 but reflected a steady growth trend, and Standard & Poor's has projected an inflation-adjusted growth of 2.6 percent for 2011. Additionally of interest to the apparel sector is the projection that disposable personal income increased 3.2 percent in 2010. One often overlooked factor is the impact that rising energy prices can inflict on the apparel industry. Rising oil prices can naturally impact transportation costs, but additionally, increases in natural gas prices can affect the cost of producing pulp, which is used in the manufacturing of plastics used for packaging.[2]

Even though the economy may be struggling, green products appear to be maintaining their position, with the apparel and retailing industry experiencing an increase in the number of green products. Additionally, "natural" and "organic" products appear to be favorably received by consumers, but are strictly regulated by the U.S. Department of Agriculture under the standards of the National Organic Program (NOP), which states that 95 percent of the product's content must be organic and also extends to the manufacturing process. Apparel companies continue to devote substantial sums of profits to the research and development of new and appealing products.

Global Trends

As of March 2011, the United States has a consumer goods trade deficit of approximately $62.1 billion, an export growth rate of 5 percent, and an import growth of 5 percent, compared to countries such as China and Vietnam that have export growth rates in excess of 20 percent and strong trade surpluses. Trade restrictions, including increased tariffs or quotas, embargoes, safeguards, and customs restrictions against apparel items, as well as U.S. or foreign labor strikes, work stoppages, or boycotts, could increase the cost or reduce the supply of apparel available to the United States and adversely affect business, financial conditions, and operations. Products currently manufactured in foreign countries may be subject to additional trade restrictions imposed

by the U.S. and/or foreign governments, including the likelihood, type, or effect of any such restrictions.[3] During 2010, the value of the U.S. dollar relative to other international currencies was volatile, which impacts companies such as Gap that have substantial revenue from outside the United States.

In the apparel industry, low labor cost in manufacturing is not enough to be successful for companies involved in fashion. Companies must have "sufficient product differentiation and global branding in order to demand a higher price. They must also take into consideration how much of their product to supply, since economies of scale make it less costly and more profitable to produce a greater amount; however, by producing less they can create a sense of exclusivity and additional value."[4] Given these conditions, companies such as NIKE, Inc., VF Corporation, and Levi Strauss appear to be fairing better than the average. Another concern is the rising cost of cotton and the impact on prices, particularly at Old Navy and the outlets, where there is less flexibility on pricing compared with more upscale businesses.

Pricing

In mature industries like apparel, acquisitions is the only path to sales growth from the purchaser's point of view. They also enable the acquirer to combat pricing pressures by developing multiple brands and maximizing operating efficiencies. Additionally, licensing has become a more common practice and provides a source of revenues and cost savings in manufacturing and distribution.

Many consumers are obsessed with promotional pricing. For many apparel products, the consumer is willing to wait for price reductions before purchasing. Vendors, consequently, have to lower the prices at introduction and need even larger end-of-season markdowns, when they try to move inventory out of the stores to make way for new assortments. There is an increasing number of discounters and outlet stores that let prices decline, as already mentioned above.[5]

In the past, retailers would stock merchandise well in advance of the season in which they would be worn. Today, consumers tend to purchase as the need arises, with little consideration of advance purchases, requiring companies to be more informed about changing attitudes and preferences. Furthermore, while the benefit of offshore production has been greater cost efficiency, the increased lead time necessary for production has made it more difficult for manufacturers to respond to immediate customer needs. Therefore, domestic production is required to fill these more immediate changes, small orders, and seasonal or special items.

Distribution

Distribution is a key factor for an apparel manufacturer. Customers demand immediate availability of apparel products and when that availability is not present, the customer will often not delay the purchase but rather will purchase substitute products. This immediacy or quick response time translates into maintaining higher levels of inventory. However, companies realize that lean inventories result in cost efficiencies that can be passed on to the customer. Accordingly, companies are developing new point-of-sale technologies that enable better tracking of inventory and communication between the retailer and vendor in order to supply inventory as needed. Other new technologies in the planning stage include improvements for custom production, mass customization, and Internet-based communications networks linking manufacturers to suppliers, allowing retailers to better tailor their products to the needs of the shopper.

In general, there is a tendency for women's apparel to be sold in department stores and men's apparel in discount stores. However, as Internet applications continue to grow, it is forecast that sales through the traditional channels will decrease. The biggest issue is still that Internet purchases are intangible purchases, in that consumers cannot see, touch, and try on products they are considering buying.

With the economic recovery gaining traction, the industry should benefit from resurgent consumer spending. It is expected that companies with strong brand recognition that offer fashion-right products at attractive prices will outperform the overall industry in the next years.

Competitors

Gap faces strong competition from Abercrombie & Fitch Co., American Eagle, V.F. Corp., Nordstrom's, and TJX Companies (Marshalls and TK Maxx). Additional competition is being felt from international competitors such as H & M (Sweden) and Spain's Industrial del Diseno

EXHIBIT 3 GAP's Competitors

Family Clothing Retail Competitors – 2011

Company	Revenues	Gross Margin	Net Income	PE Ratio
TJX Companies	$21.9B	26.90%	$1.3B	16.22%
Gap Inc.	14.6B	40.16	1.20B	12.24
Nordstrom	9.7B	39.21	613M	17.55
Abercrombie & Fitch	3.4B	63.77	150M	63.40
American Eagle Outfitters	2.9B	39.46	140M	16.67

Textil SA, which owns Zara and others. Other competitors for Gap and their associated subsidiaries (Banana Repuplic and Old Navy) include Eddie Bauer, J. Crew, Limited Brands, Inc., Steinmart, Ann Taylor, Talbots, and Target. A summary of the major competitors and relevant financial data is shown in Exhibit 3.

Abercrombie & Fitch Co. (A&F)

Founded in 1892 and headquartered in New Albany, Ohio, A&F and its subsidiaries operate as a specialty retailer in the United States and Canada. Its stores sell casual apparel, such as knit shirts, graphic T-shirts, jeans, woven shirts, and shorts, as well as personal care and other accessories for men, women, and kids under the Abercrombie & Fitch, Abercrombie, Hollister, and RUEHL brands. In addition, the company's stores offer films, photos, postcards, desktop images, and screen savers. A&F sells upscale men's, women's, and kids' casual clothes and accessories—quite a change from when the company outfitted Ernest Hemingway and Teddy Roosevelt for safaris. A&F operates about 1,100 stores in the United States, Canada, and Europe, and also sells apparel via its catalog and online. A&F's carefully selected college-age sales staff and use of 20-something models imbues its stores with an upscale fraternity house feel. A&F runs a fast-growing chain of some 525 teen stores called Hollister Co., and a chain targeted at boys and girls ages 7 to 14 called abercrombie kids. Its just-for-women brand, Gilly Hicks, launched in 2008 and has about 15 stores. A&F is a major rival to Gap.

American Eagle Outfitters (AEQ)

Headquartered in Pittsburgh, AEQ is a mall-based retailer that sells casual apparel and accessories (polos, khakis, shirts, jeans, shorts, sweaters, skirts, footwear, belts, bags) aimed at men and women ages 15–25. AEQ operates about 1,100 stores in all 50 U.S. states, Puerto Rico, Canada, and now in the Middle East. Virtually all of AEQ's products bear its private-label brand names: American Eagle Outfitters, aerie, and 77kids. Direct sales come from the company's website and its *AE* magazine, a lifestyle publication that doubles as a catalog.

TJX Companies, Inc.

TJX operates eight retail chains, including the two largest off-price clothing retailers in the United States, T.J. Maxx and Marshalls. T.J. Maxx sells brand-name family apparel, accessories, women's shoes, domestics, giftware, and jewelry at discount prices at some 890 stores nationwide. Marshalls offers a full line of shoes and a broader selection of menswear through 800-plus stores. TJX also owns and operates the HomeGoods chain of about 325 stores nationwide that focuses entirely on home furnishings, as well as about 160 A.J. Wright clothing stores that aim for lower-income shoppers. T.K. Maxx is the company's European retail arm with about 265 stores in the United Kingdom, Ireland, Germany, and now Poland. TJX is the industry's third-largest leader in sales and is widely considered the world's number one off-price family clothing store with operations in the United States and internationally.

Nordstrom, Inc.

Another industry leader is Nordstrom, Inc. Founded in 1901 by the Nordstrom family in Seattle, Washington, the company started out in the shoe business. Nordstrom's corporate culture is anchored by the motto "Service with a Smile." One of the nation's largest upscale apparel and

shoe retailers, Nordstrom sells clothes, shoes, and accessories through about 110 Nordstrom stores and about 70 off-price outlet stores (Nordstrom Rack) in some 30 states. It also operates a pair of Jeffrey luxury boutiques and a "Last Chance" clearance store, and sells goods online and through catalogs. Nordstrom recently sold its Façonnable boutiques. With its easy-return policy and touches such as thank-you notes from employees, Nordstrom has earned a reputation for top-notch customer service. Members of the Nordstrom family closely supervise the company and together own more than 15 percent of the company's stock.

Internal Issues

Gap Inc. operates over 3,200 stores worldwide and over the years has expanded through the urban-chic chain Banana Republic, budgeteer Old Navy, online-only retailer Piperlime, and Athleta, a purveyor of activewear via catalog. Other brand extensions include GapBody, GapKids, and babyGap, each with its own online incarnation. All Gap clothing is private-label merchandise made exclusively for the company.

Product Segments

GAP Gap products are sold through three channels: full-price retail stores, online, and outlet. Gap stores offer an extensive selection of classically styled, high quality, casual apparel at moderate price points. Products range from wardrobe basics such as denim, khakis, and T-shirts, to fashion apparel, accessories, and personal care products for men and women.

BANANA REPUBLIC Banana Republic products are sold through three channels: full-price retail stores, online, and outlet. Acquired in 1983 with two stores, Banana Republic offers sophisticated, fashionable collections of casual and tailored apparel, shoes, accessories, and personal care products for men and women at higher price points than Gap. It operates Banana Republic Factory Stores, which carry similar categories of products at lower price points. In 1999, the company introduced Banana Republic Online, an online store found at bananarepublic.com, which offers products comparable to those carried in the store collections, as well as extended sizes not found in stores.

OLD NAVY Old Navy products are sold through two channels: full-price retail stores and online. The company launched Old Navy in 1994 to address the market for value-priced family apparel. Old Navy offers a broad selection of apparel, shoes, and accessories for adults, children, and babies, as well as other items, including a maternity line, consumables, and personal care products. In 2000, it established Old Navy Online, an online store found at oldnavy.com. Old Navy Online offers apparel and accessories comparable to those carried in the store collections, as well as a plus-size line not found in stores.

PIPERLIME In 2006, the company launched Piperlime, an online-only store found at piperlime.com. Piperlime offers customers an assortment of the leading brands in footwear, handbags, apparel, and jewelry for women and footwear for men and kids, as well as tips, trends, and advice from leading style authorities.

ATHLETA Athleta products are sold through two channels: full-price retail stores and online. Acquired in September 2008, Athleta offers customers high quality and performance-driven women's sports and active apparel and footwear that is stylish and functional for a variety of activities, including golf, running, skiing and snowboarding, tennis, and yoga. In May 2010, the company opened a test store in Mill Valley, California, and in January 2011, it opened a flagship store in San Francisco, California. Customers can purchase Athleta products, as well as an assortment of products from leading brands in women's active wear, online at athleta.com, through the catalog, or in the stores.

Finance

Gap's earnings per share for 2010 improved by 19 percent, with net sales increasing by 3 percent. In 2010, the company invested more in infrastructure for growth, yet still achieved the highest operating margin in a decade at 13.4 percent. Its commitment to return cash to shareholders through share repurchases and dividends resulted in the distribution of $2.2 billion in 2010.

Gap reported an 8 percent increase in same-store sales for the four-week period ended April 30, 2011. Results for that month compared favorably with same-store sales for the four-week period the prior year, which were 2 percent less. Gap reported an improvement in same-store sales in every region where it operates. The company's same-store sales in the regions such as Old Navy North America and Banana Republic North America saw a double-digit growth of 14 percent and 11 percent for that month. Gap's North America region reported a positive 2 percent growth in same-store sales versus a negative 6 percent in the prior-year period. The company's same-store sales from the international region reported a negative 1 percent growth versus negative 5 percent last year. Net sales for the four-week period ended April 30, 2011, were up 9.5 percent to $1.15 billion compared with net sales of $1.05 billion for the same four-week period the prior year.

Gap completed its first-quarter 2011 with a decline of 3 percent in same-store sales compared with an increase of 5 percent in the prior-year quarter. During that first 2011 quarter, Gap has reported a decline in same-store sales in every region where it operates. The company's same-store sales in the regions North America, Banana Republic North America, Old Navy North America, and International all reported a negative growth of 3 percent, 1 percent, 2 percent, and 6 percent, respectively. Gap's sales for the first quarter of 2011 were down 1 percent to $3.30 billion compared with sales of $3.33 billion in the prior-year quarter. Gap's recent income statements and balance sheets are provided in Exhibit 4 and 5 respectively. Gap's by-segment revenues for 2011 by brand and region are provided in Exhibit 6.

EXHIBIT 4 **GAP Income Statement 2009–2011 (000 omitted)**

	01/29/2011	01/30/2010	01/31/2009
Net sales	$14,664,000	14,197,000	14,526,000
Cost of goods sold & occupancy expenses	8,775,000	8,473,000	9,079,000
Gross profit	5,889,000	5,724,000	5,447,000
Operating expenses	3,921,000	3,909,000	3,899,000
Operating income	1,968,000	1,815,000	1,548,000
Interest expense (reversal)	(8,000)	6,000	1,000
Interest income	6,000	7,000	37,000
Earnings from continuing operations before income taxes - United States	1,686,000	1,511,000	1,209,000
Earnings from continuing operations before income taxes - foreign	296,000	305,000	375,000
Earnings from continuing operations before income taxes	1,982,000	1,816,000	1,584,000
Current provision (benefit) for income taxes - federal	476,000	572,000	440,000
Current provision (benefit) for income taxes - state	75,000	78,000	43,000
Current provision (benefit) for income taxes - foreign	134,000	114,000	124,000
Total current provision (benefit) for income taxes	685,000	764,000	607,000
Deferred provision (benefit) for income taxes - federal	94,000	(43,000)	5,000
Deferred provision (benefit) for income taxes - state	(5,000)	(10,000)	5,000
Deferred provision (benefit) for income taxes - foreign	4,000	3,000	–
Total deferred provision (benefit) for income taxes	93,000	(50,000)	10,000
Income taxes	778,000	714,000	617,000
Earnings (loss) from continuing operations, net of income taxes	–	1,102,000	967,000
Net earnings (loss)	$1,204,000	1,102,000	967,000
Weighted average shares outstanding - basic	636,000	694,000	716,000
Weighted average shares outstanding - diluted	641,000	699,000	719,000
Year-end shares outstanding	588,000	676,000	694,000

(*continued*)

EXHIBIT 4 continued

	01/29/2011	01/30/2010	01/31/2009
Earnings (loss) per share - continuing operations - basic	–	1.59	1.35
Net earnings (loss) per share – basic	1.89	1.59	1.35
Earnings (loss) per share - continuing operations - diluted	–	1.58	1.34
Net earnings (loss) per share - diluted	1.88	1.58	1.34
Cash dividends declared & paid per share	0.4	0.34	0.34
Total number of employees	134,000	135,000	134,000
Number of common stockholders	8,644,000	8,903,000	9,236,000

Source: Company documents.

EXHIBIT 5 GAP Balance Sheet 2009–2011 (000 omitted)

	01/29/2011	01/30/2010	01/31/2009
ASSETS			
Cash	$957,000	1,279,000	1,195,000
Domestic commercial paper	75,000	590,000	275,000
Bank certificates of deposit & time deposits	529,000	479,000	245,000
Total cash equivalents	604,000	1,069,000	520,000
Cash & cash equivalents	1,561,000	2,348,000	1,715,000
Short-term investments	100,000	225,000	–
Restricted cash	–	18,000	41,000
Merchandise inventory	1,620,000	1,477,000	1,506,000
Accounts receivable	205,000	–	–
Current portion of deferred tax assets	190,000	193,000	–
Prepaid minimum rent & occupancy expenses	142,000	140,000	–
Restricted cash	7,000	–	–
Prepaid catalog expenses	3,000	1,000	–
Derivative financial instruments	2,000	–	–
Prepaid expenses	–	119,000	–
Other current assets	96,000	143,000	–
Other current assets	645,000	596,000	–
Other current assets	–	–	743,000
TOTAL CURRENT ASSETS	3,926,000	4,664,000	4,005,000
Leasehold improvements	3,066,000	3,013,000	3,026,000
Furniture & equipment	2,431,000	2,417,000	2,377,000
Land & buildings	–	–	988,000
Land, buildings, & building improvements	1,093,000	1,086,000	–
Software	909,000	832,000	774,000
Construction-in-progress	74,000	79,000	80,000
Property & equipment, at cost	7,573,000	7,427,000	7,245,000
Less: accumulated depreciation	5,010,000	4,799,000	4,312,000
Property & equipment, net	2,563,000	2,628,000	2,933,000
Long-term tax-related assets	259,000	392,000	326,000
Goodwill	99,000	99,000	99,000
Trade name	54,000	54,000	54,000

	01/29/2011	01/30/2010	01/31/2009
Deferred compensation plan assets	27,000	21,000	18,000
Lease rights & key money, gross	–	–	156,000
Less: accumulated amortization - lease rights & key money	–	–	125,000
Lease rights & key money, net	20,000	26,000	31,000
Restricted cash	11,000	–	–
Intangible assets subject to amortization	3,000	7,000	13,000
Derivative financial instruments	2,000	–	–
Other long-term assets	101,000	94,000	85,000
Other long-term assets	576,000	693,000	626,000
TOTAL ASSETS	$7,065,000	7,985,000	7,564,000
LIABILITIES			
Current maturities of long-term debt	–	–	50,000
Accounts payable	1,049,000	1,027,000	975,000
Accrued compensation & benefits	280,000	340,000	327,000
Unredeemed gift cards, gift certificates, & credit vouchers, net of breakage	233,000	244,000	255,000
Short-term deferred rent & tenant allowances	99,000	105,000	105,000
Workers' compensation liability	50,000	46,000	39,000
Derivative financial instruments	35,000	27,000	41,000
Accrued advertising	25,000	29,000	15,000
General insurance liability	22,000	23,000	25,000
Sales return allowance	22,000	22,000	21,000
Credit card reward certificates liability	17,000	16,000	16,000
Other accrued expenses & current liabilities	213,000	211,000	232,000
Accrued expenses & other current liabilities	996,000	1,063,000	1,076,000
Income taxes payable	50,000	41,000	57,000
TOTAL CURRENT LIABILITIES	2,095,000	2,131,000	2,158,000
Long-term deferred rent & tenant allowances	717,000	716,000	772,000
Long-term tax-related liabilities	100,000	181,000	174,000
Asset retirement obligations	37,000	33,000	33,000
Deferred compensation plan liabilities	27,000	22,000	18,000
Derivative financial instruments	2,000	–	11,000
Other long-term liabilities	7,000	11,000	11,000
LONG-TERM LIABILITIES	890,000	963,000	1,019,000
TOTAL LIABILITIES	2,985,000	3,094,000	3,177,000
SHAREHOLDERS' EQUITY			
Common stock	55,000	55,000	55,000
Additional paid-in capital	2,939,000	2,935,000	2,895,000
Retained earnings	11,767,000	10,815,000	9,947,000
Foreign currency translation, net of tax	205,000	168,000	109,000
Accumulated changes in fair value of derivative financial instruments, net of tax	(20,000)	(13,000)	14,000
Accumulated other comprehensive earnings (loss)	185,000	155,000	123,000
Treasury stock, at cost	10,866,000	9,069,000	8,633,000
Total stockholders' equity	4,080,000	4,891,000	4,387,000
TOTAL LIABILITIES & SE	$7,065,000	7,985,000	7,564,000

Source: Company documents.

EXHIBIT 6 **GAP Revenues by Product Brand and Region**

Fiscal Year 2010			($ in millions)			
Brand	GAP	Old Navy	Banana Republic	Other	Total	Percentage of Net Sales
Region						
U.S.	$3,454	$4,945	$2,084	-0-	$10,483	71%
Canada	341	427	190	-0-	958	7
Europe	703	-0-	36	47	786.5	5
Asia	872	-0-	118	59	1,049	7
Other Regions	-0-	-0-	-0-	89	89	1
Total Stores reportable segment	5,370	5,372	2,428	195	13,365	91
Direct reportable sement	365	533	155	246	1,299	9
Total	$5,735	$5,905	$2,583	$ 441	$14,664	100%

Source: Gap *Annual Report*, 2010.

Marketing

Gap's marketing strategy is to reconnect with customers globally across each brand through product, place, price, and promotion. An example is the recent announcement that Visa Inc., a global leader in payments, is working with Gap to deliver real-time discounts and promotions to consumers via SMS text messages. Gap customers who opt-in to participate in the service are notified of money-saving discounts or promotions in real-time while shopping.[6] Additional technology-based marketing includes Facebook, which has created a platform for retailers, including the Gap, to offer deals to customers who are in the vicinity of store locations. The new "Deals" feature builds on the recently launched Places—which lets users broadcast their location, among other things—and allows merchants to direct special offers to Facebook mobile users who check in within the vicinity of their stores.[7]

Gap's marketing strategy is to continue reaching new customers by expanding locally and internationally. Over the past five years, Gap's European and franchise store base has more than doubled from 165 to 367 in 31 countries, with online sales available to customers in over 90 countries.[8] One major area of interest is exploring opportunities in China and pursuing franchising options in more fragmented markets such as those in Central and Eastern Europe.

Promotionally, Gap is well known for its inventive marketing using black-and-white images and celebrities in both print and visual media and sponsoring commercial projects such as Bravo Network's Project Runway and Sony Film's *Memoirs of a Geisha*. Old Navy stores were upgraded, along with their visual merchandising, and supported by creative marketing. Gap stores have enhanced their lighting and added new fixtures. Another major improvement is the new online system, which was reported by the *New York Times* as one of "the best e-commerce sites in retail." The concept was quickly adopted by customers and became one of the largest online apparel retailers in the United States. The websites offer more interactive experience for shoppers, including a service that will recommend clothing choices based on an individual customer's preferences and size. Gap continues to enhance its websites and launch new features.

The Future

"We have to be more of a consistent performer," CEO Glenn Murphy said, speaking at Gap's annual shareholder meeting in San Francisco in 2011. In fiscal 2010, which ended in January, Gap North America was the only division of the company to experience a decline in same-store sales, which declined 1 percent. In the first quarter of 2011, same-store sales were negative at all Gap divisions, including Old Navy and Banana Republic. Gap's sales in 2010 totaled $14.7 billion, or 7.9 percent below 2006 levels, leading the company to increasingly turn to overseas

markets for growth. Only 328 out of its 3,095 stores as of January were outside the United States. Gap opened stores in China in 2010 and opened another 10 stores that country in 2011. The company introduced its outlet concept to Italy in 2011 and China in 2012.

Gap, Inc. needs a clear strategic plan. Rival companies are doing considerably better than Gap, Inc.

Prepare a strategic plan for Mr. Murphy.

Notes

1. GAP *Annual Report*, 2010.
2. Standard & Poor's, *Industry Surveys – Household Nondurables,* December 30, 2010.
3. http://www.researchandmarkets.com/reports.
4. Ibid.
5. Standard & Poor's Industry Surveys: Apparel and Footwear, 2004.
6. *Marketing Weekly News*, May 7, 2011, p 333.
7. *Billboard*, Nov 13, 2010, v122, i45, p. 5(1).
8. Gap *Annual Report*, 2010.

Walt Disney Company, 2013

www.disney.com, DIS

Headquartered in Burbank, California, Walt Disney Company (Disney) and its subsidiaries compete in the entertainment and media broadcasting industry worldwide. Serving customers for nearly 100 years, Disney is a diversified conglomerate, owning ABC, ESPN, theme parks, cruise lines, and more. As a member of the DOW 30 and the world's largest media conglomerate, Disney owns ABC television and cable networks such as ABC Family, Disney Channel, and ESPN (80 percent). Disney owns 8 television stations and 35 radio stations as well as Walt Disney Studios that produces films through Walt Disney Pictures, Disney Animation, and Pixar. Disney's Marvel Entertainment is a top comic book publisher and film producer. Disney owns and operates huge cruise boats, as well as 14 popular theme parks around the world.

Disney's earnings in Q3 of 2013 equaled the prior year's number, while revenue increased 4 percent, led by Disney's theme parks, resorts, and cable networks such as ESPN. For Q3 of 2013, Disney earned $1.85 billion, on revenue of $11.6 billion, up from $11.1 billion. Revenue at Disney's parks and resorts grew 7 percent to $3.7 billion. Cable networks revenue grew 8 percent to $3.9 billion, led by ESPN, A&E and U.S. Disney channels. A laggard, Disney's broadcast revenue was unchanged at nearly $1.5 billion. Overall, Disney's media networks business grew 5 percent to $5.4 billion. For Q3 of 2013, Disney's movie studio revenue fell 2 percent to $1.6 billion, due to poor results from the movies "The Lone Ranger" and "Iron Man 3."

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History

Walt Disney and his brother Roy arrived in California in the summer of 1923 to sell a cartoon called *Alice's Wonderland*. A distributor named M. J. Winkler contracted to distribute the *Alice Comedies* on October 16, 1923, and the Disney Brothers Cartoon Studio was founded. Over the years, the company produced many cartoons, from *Oswald the Lucky Rabbit* (1927) to *Silly Symphonies* (1932), *Snow White and the Seven Dwarfs* (1937), and *Pinocchio* and *Fantasia* (1940). The company name was changed to Walt Disney Studio in 1925. Mickey Mouse emerged in 1928 with the first cartoon in sound. In 1950, Disney completed its first live action film, *Treasure Island*, and in 1954, the company began television with the Disneyland anthology series. In 1955, Disney's most successful series, *The Mickey Mouse Club*, began, and the new Disneyland Park opened in Anaheim, California.

Disney created a series of releases from 1950s through 1970s, including *The Shaggy Dog*, *Zorro*, *Mary Poppins*, and *The Love Bug*. Walt Disney died in 1966. In 1969, Disney started its educational films and materials. Another important time of Disney's history was opening Walt Disney World in Orlando, Florida, in 1971. In 1982, the Epcot Center opened as part of Walt Disney World. The following year, Tokyo Disneyland opened.

After leaving network television in 1983, Disney introduced its cable network, The Disney Channel. In 1985, Disney's Touchstone division began the successful *Golden Girls* and Disney Sunday Movie. In 1988, Disney opened Grand Floridian Beach and Caribbean Beach Resorts at Walt Disney World along with three new gated attractions: the Disney/MGM Studios Theme Park, Pleasure Island, and Typhoon Lagoon. Filmmaking soon hit new heights as Disney led Hollywood studios in box-office gross for the first time. Some of the successful films were: *Who Framed Roger Rabbit*, *Good Morning Vietnam*, *Three Men and a Baby*, and later, *Honey, I Shrunk the Kids*, *Dick Tracy*, *Pretty Woman*, and *Sister Act*. Disney moved into new areas by starting Hollywood Pictures and acquiring the Wrather Corp. (owner of the Disneyland Hotel) and television station KHJ (Los Angeles), which was renamed KCAL. In merchandising, Disney purchased Childcraft and opened numerous highly successful and profitable Disney Stores.

By 1992, Disney's animation reached new heights with *The Little Mermaid*, *Beauty and the Beast*, and *Aladdin*. Also that year, Disneyland Paris opened. During the 1990s, Disney introduced Broadway shows, opened 725 Disney Stores, acquired the California Angels baseball team to add to its hockey team, opened Disney's Wide World of Sports in Walt Disney World, and acquired Capital Cities/ABC.

From 2000 to 2007, Disney created new attractions in its theme parks, produced many successful films, opened new hotels, and built Hong Kong Disneyland. Disney acquired Pixar in 2006, Marvel in 2009, and launched *Disney Dream*, a new cruise liner in 2011. Newer Disney initiatives include the April 2011 groundbreaking of Shanghai Disney Resort at a price tag of $4.4 billion and expected opening day slated for sometime in 2015. In February 2012, Disney finalized acquisition of UTV Software Communications, an Indian entertainment company. In October of 2012, Disney announced plans to acquire Lucasfilm, producers of the popular *Star Wars* movies. The acquisition is expected to cost $4.05 billion. Disney plans to release *Star Wars Episode VII* in 2015.

Internal Issues

Vision and Mission

Disney's vision is "to make people happy."

Organizational Structure

As indicated in Exhibit 1, Disney operates using a strategic business unit (SBU) organizational structure that consists of five diverse, but all family entertainment segments: (1) media networks, (2) parks and resorts, (3) studio entertainment, (4) consumer products, and (5) interactive media. The president, chief executive officer, and director of Walt Disney is Robert Iger. There is no chief operations officer (COO) in the Disney hierarchy, but Andy Bird, Chairman of Walt Disney International, functions like a COO.

Segments

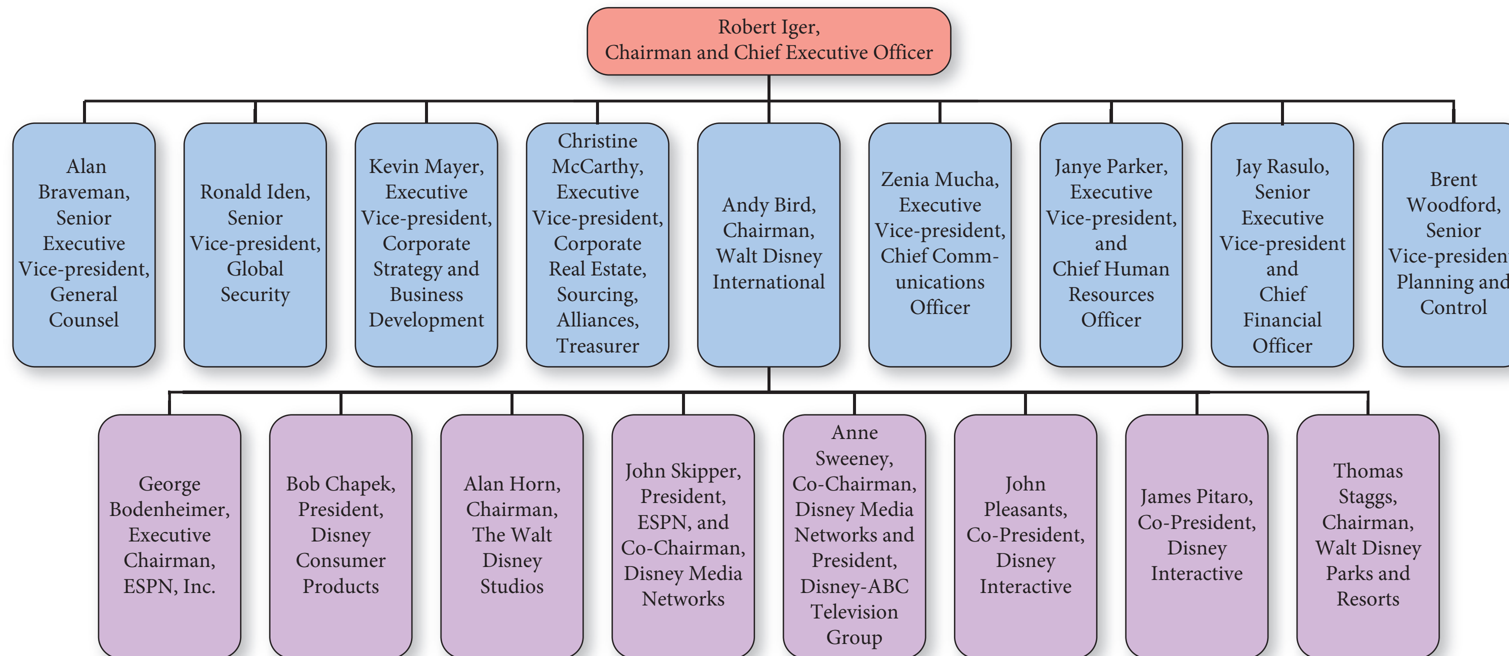
Disney provides segment revenue and operating income for each of their five SBUs. Exhibit 2 displays the three most recent years of revenue and operating income per Disney SBU, along with a percentage change for each of the last two years. Note that total consolidated revenues and operating income increased in 2012 and 2011, albeit at a decreasing rate during the most recent period. Note that the consumer products and the interactive media segments are small compared to media networks and parks and resorts.

Media Networks

Media networks is the largest Disney SBU in both revenues and operating income, accounting for 45 percent of all revenues in 2012. Revenue growth in 2012 came from increased affiliate fees, higher advertising rates, increased viewership of ESPN programs and the shows *Castle*, *Once Upon a Time*, and *Revenge*. The positive growth was limited by lower home entertainment revenues from programs such as *Lost* and lower Disney Channel viewership. Production costs increased as college sports, as well as NFL, MLB, NBA, and Wimbledon were able to negotiate more lucrative contracts. For example, the Southeastern Conference (SEC) signed a deal with ESPN in 2008 for $2 billion for 15-year rights to broadcast football and men's and women's basketball games. However, with the 2012 additions of Texas A&M and Missouri to the SEC, the previous contract is contractually renegotiable and a new, much more expensive, contract is expected in the near future.

With media networks, Disney owns and operates the ABC Television Network that reaches 99 percent of all U.S. households. This segment also includes ABC-owned Television Stations Group, ABC Studios, Disney Channels Worldwide, ABC Family, SOAPnet, Disney ABC Domestic Television, Disney Media Distribution, Hyperion, and Radio Disney network. The ABC Television Network operates more than 220 affiliated stations across the USA. Disney channels worldwide consists of 94 kids and family entertainment channels available in 169 countries and 33 languages. ABC Family is a mixture of series and movies. SOAPnet owns character-driven

EXHIBIT 1 **Disney's Organizational Chart**



Source: Based on information in company documents.

EXHIBIT 2 A Breakdown of Disney Revenues by SBU

(in millions)	2012	2011	2010	Change (%) 2012 vs. 2011	Change (%) 2011 vs. 2010
Revenues:					
Media Networks	$19,436	$18,714	$17,162	4%	9%
Parks and Resorts	12,920	11,797	10,761	10%	10%
Studio Entertainment	5,825	6,351	6,701	(8)%	(5)%
Consumer Products	3,252	3,049	2,678	7%	14%
Interactive Media	845	982	761	(14)%	29%
Total Consolidated Revenues	$42,278	$40,893	$38,063	3%	7%
Segment operating income:					
Media Networks	$6,619	$6,146	$5,132	8%	20%
Parks and Resorts	1,902	1,553	1,318	22%	18%
Studio Entertainment	722	618	693	17%	(11)%
Consumer Products	937	816	677	15%	21%
Interactive Media	(216)	(308)	(234)	30%	(32)%
Total segment operating income	$9,964	$8,825	$7,586	13%	16%

Source: Company documents. 2012 *Annual Report,* p. 31.

soapy drama, from daytime and primetime soaps, to reality shows and movies. Disney ABC Domestic Television provides motion pictures and TV programming to U.S.-based media platforms. Disney Media Distribution is an international distributor of branded and nonbranded content to all platforms. Hyperion publishes fiction and nonfiction titles for adults. Radio Disney is available in more than 40 U.S. markets, and on satellite radio, mobile apps, and the Web.

Exhibit 3 reveals a further breakdown of Disney's media networks' revenues and operating profits. Note the recent gains.

Parks and Resorts

Disney's parks and resorts segment includes 10 divisions: (1) Disneyland Resorts in California, (2) Tokyo Disney Resort, (3) Disneyland Resort Paris, (4) Hong Kong Disneyland, (5) Walt Disney World Resort in Florida, (6) Disney Cruise Line, (7) Adventures by Disney, (8) Disney Vacation Club, (9) Walt Disney Imagineering, and (10) Aluani, a Disney Resort and Spa in Hawaii. Disney has a 51 percent ownership in Disneyland Resort Paris and a 47 percent ownership in Hong Kong Disneyland. Disney's newest theme park will be in the Pudong

EXHIBIT 3 A Breakdown of Media Networks Revenues (in millions)

	2012	2011	Change (%)
Revenues:			
Cable Networks	13,621	12,877	6
Broadcasting	5,815	5,837	—
	19,436	18,714	4
Operating Income:			
Cable Networks	5,704	5,233	9
Broadcasting	915	913	—
	6,619	6,146	8

Source: 2012 *Annual Report*, p. 33.

EXHIBIT 4

	Domestic			International			Total		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
Parks									
Increase in attendance	3%	1%	(1)%	6%	6%	1%	4%	2%	(1)%
Increase in Per Capital Guest Spending	7%	8%	3%	1%	2%	3%	5%	6%	3%
Hotels									
Occupancy	81%	82%	82%	85%	88%	85%	——	83%	82%
Available Room Nights (in thousands)	9,850	9,625	9,629	2,468	$2,466	2,466	12,318	12,091	12,095
Per Room Guest Spending	$257	$241	$224	$317	$294	$273	$270	$251	$234

[a]Per capita guest spending and per room guest spending include the impact of foreign currency translation. Guest spending statistics for Disneyland Paris were converted from euros into U.S. dollars at weighted average exchange rates of 1.36 and 1.35 for fiscal 2010 and 2009, respectively.
[b]Per room guest spending consists of the average daily hotel room rate as well as guest spending on food, beverages, and merchandise at the hotels. Hotel statistics include rentals of Disney Vacation Club units.

Source: Walt Disney Company, *Annual Report,* page 34 (2012).

district of Shanghai opening in 2015. Exhibit 2 revealed that Disney's parks and resorts revenue for 2012 increased 10 percent to $12.9 billion, and operating income increased 22 percent to $1.9 billion. Results for 2012 reflected increases at nearly all theme parks, except a decrease at Disneyland Paris.

The new 4,000-passenger ship, *Disney Dream*, was christened at Port Canaveral in 2011 and was designed especially for families. *Disney Dream* joins *Disney Magic* and *Disney Wonder*. Another new ship, *Disney Fantasy*, joined the Disney fleet in 2012. *Disney Dream* will sail to Disney's private island, Castaway Cay.

Revenue in this segment is generated primarily from the sale of admissions tickets to the theme parks, as well as hotel room charges per night and sales from merchandise, food, and beverages. Revenue also comes from rentals and sales from vacation club properties and sales of cruise vacations.

Exhibits 4 and 5 reveal that Disney domestic revenues from its parks and resorts division increased 11 percent in 2011, to $12.9 billion, resulting from customers spending 6 percent more, mainly from higher ticket and hotel prices. Revenue growth was 6 percent in international operations stemming from 4 percent in higher spending, a 3-percent volume increase, and a 3-percent gain on foreign currency appreciation.

Studio Entertainment

Disney produces live-action and animated motion pictures, direct-to-video programming, musical recordings, and live-stage plays. Disney motion pictures are distributed under the names: Theatrical Market, Home Entertainment Market, Television Market, Disney Music Group, and

EXHIBIT 5 Parks and Resorts: Revenue and Operating Income

(in millions)	2012	2011	2010	Change (%)
Revenues:				
Domestic	$10,339	$9,302	$8,404	11%
International	$2,581	2,495	2,357	3%
	$12,920	$11,797	$10,761	10%
Segment operating income:				
	$1,902	$1,553	$1,318	22%

Source: Walt Disney Company, *Annual Report,* page 33 (2012).

EXHIBIT 6 Studio Entertainment: Revenue and Operating Income

(in millions)	2012	2011	2010	Change (%)
Revenues:				
Theatrical Distribution	$1,470	$1,733	$2,050	(15)%
Home Entertainment	$2,221	2,435	2,666	(9)%
Television Distribution and Other	$2,134	2,183	1,985	(2)%
Total Revenues	$5,825	$6,351	$6,701	(8)%
Segment operating income:				
	$722	$618	$693	+17%

Source: Walt Disney Company, *Annual Report,* page 34 (2012).

Disney Theatrical Productions. Disney has also licensed the rights to produce and distribute features films such as *Spider-man*, *The Fantastic Four*, and *X-Men* to third-party studios. Disney earns a licensing fee on these films, whereas the third-party studio incurs the cost to produce and distribute the films. Currently Disney has a diverse business line in the studio entertainment SBU consisting of: Marvel, Touchstone, Pixar, Disneynature, Disney Studios Motion Pictures, and more Disney-branded services. Disney's studio entertainment revenues for 2012 decreased 8 percent to $5.8 billion and segment operating income increased 17 percent to $722 million. Exhibit 6 reveals a revenue breakdown for this segment.

Consumer Products

Disney's consumer products segment partners with licenses, manufacturers, publishers, and retailers worldwide who design, promote, and sell a wide variety of products based on new and existing Disney characters. Product offerings are: (a) character merchandise and publications licensing, (b) books and magazines, and (c) The Disney Store. Disney released in mid-2011 a new toy line that captured the fantasy, action, and adventure of *Pirates of the Caribbean: On Stranger Tides*. Disney is perhaps the largest worldwide licensor of character-based merchandise and producer and distributor of children's film-related products based on retail sales. Disney's consumer products revenues for 2012 increased 7 percent to $3.25 billion; operating income increased 15 percent to $937 million.

Interactive Media

Disney's interactive media segment creates and delivers games and media for smartphones and tablets. Interactive media revenues for 2012 decreased 14 percent to $845 million and operating income incurred a loss of $216 million. As indicated in Exhibit 8, games and subscription revenue increased 36 percent in 2011, but the segment has incurred losses for several years, as revealed in Exhibit 2.

EXHIBIT 7 Consumer Products: Revenue and operating income

(in millions)	2012	2011	2010	Change (%)
Revenues:				
Licensing and Publishing	$2,056	$1,933	$1,725	6%
Retail and Other	1,196	1,116	953	7%
Total Revenues	$3,252	$3,049	$2,678	7%
Segment operating income:				
	$937	$816	$677	15%

Source: Walt Disney Company, *Annual Report,* page 35.

EXHIBIT 8 Interactive: Revenue and Operating Income

(in millions)	2012	2011	2010	Change (%)
Revenues:				
Games Sales and Subscriptions	$613	$768	$563	(20)%
Advertising and Other	232	214	198	8%
Total Revenues	845	982	$761	(14)%
Segment operating income:				
	$(216)	$(308)	$(234)	(30)%

Finance

Income Statement

Disney's 2012 income statement is provided in Exhibit 9. Note the 17.4 percent increase in net income.

Balance Sheets

Disney's 2012 balance sheets are provided in Exhibit 10. Note that Disney has $2.45 billion of "projects in progress." Also, note the $25 billion in goodwill, fully one-third of total assets, which is not a good thing. Long-term debt is staying about the same at $10 billion, which is a lot of debt to service.

Competition

Disney competes directly with NBC Universal, Paramount Pictures, Time Warner, CBS Corp., News Corp., Carnival Corp., and Royal Caribbean and indirectly with all family entertainment oriented businesses globally. In essence, all hotels, restaurants, water parks, and attractions anywhere near Disney's 14 theme parks, are rival businesses, such as Sea World, Marineland, and Silver Springs in Florida. There is a large, new (China state run) theme park scheduled to open in 2014 right beside the Disney theme park (also slated for opening in 2014) in Shanghai, China, so that will be a major competitor.

EXHIBIT 9 Disney's Recent Income Statements (in millions of dollars, except EPS)

Income Statement	2012	2011
Revenues	42,278	40,893
Costs and expenses	(33,415)	(33,112)
Restructuring	(100)	(55)
Other revenue	239	75
Net interest expense	(369)	(343)
Equity in the income	627	585
Income before taxes	9,260	8,043
Income taxes	(3,087)	(2,785)
Net income	6,173	5,258
Noncontrolling interests	(491)	(451)
Net income	$5,682	$4,807
EPS	3.13	2.52
Shares outstanding (in thousands)	1,818	1,909

EPS, earnings per share.
Source: Company documents.

EXHIBIT 10 **Disney's Unaudited Balance Sheets (in millions)**

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents	3,387	3,185
Receivables	6,540	6,182
Inventories	1,537	1,595
Television costs	676	674
Deferred income taxes	765	1,487
Other current assets	804	634
Total current assets	13,709	13,757
Film and television costs	4,541	4,357
Investments	2,723	2,435
Parks, resorts and other property	38,582	35,515
Accumulated depreciation	(20,687)	(19,572)
	17,895	15,943
Projects in progress	2,453	2,625
Land	1,164	1,127
	21,512	19,695
Intangible assets	5,015	5,121
Goodwill	25,110	24,145
Other assets	2,288	2,614
Total Assets	**74,898**	**72,124**
Liabilities and Equity		
Current Liabilities		
Accounts payable	6,393	6,362
Current portion of borrowings	3,614	3,055
Unearned royalties	2,806	2,671
Total current liabilities	12,813	12,088
Borrowings	10,697	10,922
Deferred income taxes	2,251	2,866
Other long-term liabilities	7,179	6,795
Preferred Stock, $.01 par value, 100 million shares authorized but none issued		
Common Stock, 4.6 billion shares, 2.8 and 2.7 billion shares issues respectively	31,731	30,296
Retained earnings	42,965	38,375
Accumulated other loss	(3,266)	(2,630)
	71,430	66,041
Treasury Stock, 1.0 billion shares	(31,671)	(28,656)
Total Equity	39,759	37,385
Noncontrolling interests	2,199	2,068
Total Equity	41,958	39,453
Total Liabilities and Shareholders' Equity	**74,898**	**72,124**

Source: Company documents.

CBS Corp.

Headquartered in New York City, CBS is a large media conglomerate with operations in television, radio, online content, and publishing. CBS Broadcasting operates the number-1 rated CBS television network, along with a group of local TV stations. CBS also owns cable network Showtime and produces and distributes TV programming through CBS Television Studios and CBS Television Distribution. Also competing with Disney, other operations include CBS Radio, CBS Interactive, and book publisher Simon & Schuster. In addition, CBS Outdoor is a leading operator of billboards and outdoor advertising. Chairman Sumner Redstone controls CBS through National Amusements.

Time Warner, Inc.

Headquartered in New York City, Time Warner is the world's third-largest media conglomerate behind Walt Disney and News Corp., with operations spanning television, film, and publishing. Time Warner owns Turner Broadcasting that runs a portfolio of popular cable TV networks including CNN, TBS, and TNT. Time Warner also operates pay-TV channels HBO and Cinemax, all of which compete with Disney. Time Warner owns Warner Bros. Entertainment that includes films studios (Warner Bros. Pictures, New Line Cinema), TV production units (Warner Bros. Television Group), and comic book publisher DC Entertainment.

News Corp.

Headquartered in New York City, News Corp. is the second largest media conglomerate in the world, trailing only Walt Disney. News Corp. owns film, TV, and publishing businesses that make and distribute movies through Fox Filmed Entertainment. Owned by News Corp., FOX Broadcasting has more than 200 affiliate stations in the USA and owns and operates about 25 TV stations, as well as a portfolio of cable networks. Publishing assets of News Corp. include newspaper publishers Dow Jones (*The Wall Street Journal*) and News International (*The Times*, *The Sun*), and book publisher HarperCollins. News Corp. has stakes in British Sky Broadcasting (BSkyB) and Sky Deutschland. The company has recently split into two parts.

Carnival Corp.

Headquartered in Miami, Florida, Carnival is the world's number-1 cruise operator, owning and operating a dozen cruise lines and about 100 ships with a total passenger capacity of more than 190,000. Carnival operates in North America primarily through its Princess Cruise Line, Holland America, and Seabourn luxury cruise brand, as well as its flagship Carnival Cruise Lines unit. Brands such as AIDA, P&O Cruises, and Costa Cruises offer services to passengers in Europe, and the Cunard Line runs luxury trans-Atlantic liners. Carnival's cruise boats compete with the Disney cruise boats wherever Disney sails. Another large cruise line company, Royal Caribbean, also competes with Disney ships wherever they sail.

Paramount Pictures Corp.

Headquartered in Hollywood, California, and a subsidiary of Viacom, Paramount produces and distributes films through Paramount Pictures (*Tranformers: Dark of the Moon*) and Paramount Vantage (*Capitalism: A Love Story*). The Paramount Pictures library consists of some 3,500 films, including classic hits from the *Star Trek*, *Godfather*, and *Indiana Jones* series, and releases about a dozen new titles annually. Competing with Disney, Paramount Pictures distributes movies on video and DVD through Paramount Home Entertainment.

Lucasfilm

In October 2012, Disney acquired Lucasfilm for a whopping $4.05 billion, with Disney paying approximately half of that money in cash and issuing approximately 40 million shares at closing. Headquartered in San Francisco, California, and founded by George Lucas in 1971, Lucasfilm is a large, privately held, entertainment company that has motion-picture and television production operations. Lucasfilm's global activities include (a) Industrial Light & Magic and Skywalker Sound that serves the digital needs of the entertainment industry for visual-effects and audio post-production, (b) LucasArts, a leading developer and publisher of interactive entertainment software worldwide, (c) Lucas Licensing that manages the global merchandising activities for Lucasfilm's entertainment properties, (d) Lucasfilm Animation, (e) Lucas Online that creates Internet-based content for Lucasfilm's entertainment properties and businesses, and

(f) Lucasfilm Singapore that produces digital animated content for film and television, as well as visual effects for feature films and multi-platform games.

With the Lucasfilm acquisition, Disney obtains a substantial portfolio of cutting-edge entertainment technologies that have kept audiences enthralled for many years. Kathleen Kennedy, current co-chairman of Lucasfilm, will become President of Lucasfilm, reporting to Walt Disney Studios Chairman Alan Horn. Additionally she will serve as the brand manager for *Star Wars*, working directly with Disney's global lines of business to build, further integrate, and maximize the value of this global franchise. Kennedy will serve as executive producer on new *Star Wars* feature films, with George Lucas serving as creative consultant. *Star Wars Episode 7* is targeted for release in 2015, with more feature films expected to continue the *Star Wars* saga and grow the franchise well into the future.

The Future

Disney is busy completing its Shanghai theme park while at the same time integrating the Lucasfilm acquisition into its operations. Analysts ponder whether the Lucasfilm acquisition added more goodwill to the Disney balance sheet that already is too laden with that burden. As the world comes online, the opportunities, as well as the threats, abound for Disney. Strategic decisions have to be made in terms of what segments to bolster and what segments to focus on improving. The interactive media segment has not turned a profit in a number of years.

Kevin Mayer is Disney's Executive Vice-president for Corporate Strategy and Business Development. Help Mr. Mayer by preparing a draft three-year strategic plan for Disney.

Staples, Inc. — 2011

William J. Donoher
Missouri State University

SPLS

http://www.staples.com

Headquartered just outside Boston, Massachusetts, in the town of Farmington, Staples, Inc. is the largest office supply retailer in the United States. The company's 2010 financials revealed disappointing results with only a 1.1 percent increase in sales to $24.55 billion. Staples' stock price fell 7 percent during 2010, when most stocks were rising much higher. Despite dismal results, Staples' CEO's pay package for 2010 increased 41 percent to $15.1 million. CEO Ron Sargent received a base salary of $1.1 million plus a performance-based bonus of $2.4 million that was 82 percent more than the $1.3 million performance bonus he received the prior year. He also received in 2010 stock and option awards that totaled $11.1 million, up from $7.9 million the prior year. Staples, Inc. perhaps needs a new executive compensation plan and a new strategic plan.

Staples' International segment operates in 24 countries, including Australia, China, United Kingdom, and Germany, although about 1,900 of Staples' 2,200 stores are located in North America. In recent quarters, Staples' North American stores have had better margins than their International operations, but International stores have posted stronger revenue growth. The future for Staples may well be outside the United States since price competition within this United States is very intense, and many countries of the world have a much higher expected growth in GDP than the USA. Staples perhaps needs to assess where in the world are their competitors not located, and take the high ground in those countries.

Like many retailers, Staples' fiscal year ends the end of January. Staples' quarterly net income reported April 30, 2011 dropped 28 percent from the prior quarter to $198.2 million while revenues dropped 3.8 percent to $6.17 billion. Staples has over $4 billion in goodwill on its balance sheet which is not good. In addition to its retail outlets, Staples sells office products via the Internet and through its catalog and direct sales operations, including subsidiary Quill Corporation. Staples also provides document management and copying services as well as promotional products. It targets customers worldwide through its Corporate Express business.

Office supplies represent almost 50 percent of Staples' revenue, while business machines account for another 30 percent. The remaining revenue comes from computers and office furniture. Staples pays a quarterly stock dividend, but at a relatively low payout ratio of just 29 percent. Some analysts contend that Staples stores have a "museum" feel as the company has not adapted well to the global shift to a paperless, ie digital, society.

The company faces intense competition from OfficeMax, Office Depot, Wal-Mart, KMart, Target, Walgreens, and many other office supply retailers.

History

Founded in 1985 by Thomas G. Stemberg and Leo Kahn, Staples opened its first store in 1986 in Brighton, Massachusetts. In 1987, Staples constructed a 136,000-square-foot distribution and processing center in Putnam, Connecticut. This facility was intended to permit Staples stores to carry less on-site inventory even as the company as a whole offered a more comprehensive selection. Goods could then be shipped to individual stores rapidly as demand necessitated. Staples grew from its initial three stores to 16 by the middle of 1988, and to 23 by the beginning of 1989. The company then raised an additional $32 million in capital for additional expansion. The company soon introduced a new store format called Staples Express, which featured a smaller physical footprint and roughly half the typical inventory of its regular stores. The new

stores were aimed at urban markets, where rents were higher. These innovations provided the company with three different distribution outlets.

Staples has acquired or partnered with companies in Australia, India, and China, as well as with a broad array of regional European players. An important acquisition for the company occurred in 2008, when Staples acquired Corporate Express NV of the Netherlands. Corporate Express is a business services enterprise that significantly expands Staples' array of business offerings in Europe. Staples also completed an acquisition of Corporate Express Australia in 2010, giving it a significant presence there as well.

Staples today has more than 2,200 stores worldwide (1,900 of them in North America) and 125 distribution centers. A list of the company's stores and distribution centers by state and region is provided in Exhibit 1.

EXHIBIT 1 Staples Stores and Distribution Centers

Country/State/Province/Region/Territory	Number of Stores/Centers
United States	
Alabama	12/0
Arizona	43/2
Arkansas	8/1
California	218/7
Colorado	21/2
Connecticut	39/2
Delaware	7/1
District of Columbia	2/0
Florida	102/2
Georgia	40/3
Idaho	8/1
Illinois	56/3
Indiana	30/1
Iowa	16/1
Kansas	4/1
Kentucky	17/0
Louisiana	1/0
Maine	13/0
Maryland	44/2
Massachusetts	77/2
Michigan	42/1
Minnesota	7/2
Mississippi	2/0
Missouri	11/0
Montana	8/0
Nebraska	5/0
Nevada	6/0
New Hampshire	23/0
New Jersey	89/2
New Mexico	10/0
New York	142/2
North Carolina	50/2
North Dakota	2/0
Ohio	62/1
Oklahoma	17/0

(continued)

EXHIBIT 1 continued

Country/State/Province/Region/Territory	Number of Stores/Centers
Oregon	21/3
Pennsylvania	94/2
Rhode Island	10/0
South Carolina	21/1
South Dakota	1/0
Tennessee	21/1
Texas	58/6
Utah	14/0
Vermont	7/0
Virginia	43/1
Washington	30/1
West Virginia	6/0
Wisconsin	11/2
Wyoming	4/0
Total United States	1,575/58
Canada	
Alberta	37/3
British Columbia	42/2
Manitoba	10/1
New Brunswick	10/0
Newfoundland	4/1
Nova Scotia	13/2
Northwest Territories	1/0
Ontario	126/2
Prince Edward Island	2/0
Quebec	70/2
Saskatchewan	9/0
Yukon	1/0
Total Canada	325/13
Austria	0/1
Belgium	6/2
Denmark	0/2
Finland	7/1
Germany	59/2
Ireland	0/2
Italy	0/1
The Netherlands	47/1
Norway	21/3
Portugal	35/1
Spain	0/1
Sweden	18/1
United Kingdom	139/4
China	28/4
Argentina	2/3
Australia	19/24
Total Other	**362/53**

Source: Staples.com

Internal Issues

Business Segments

Staples is organized around three business segments: 1) North American Retail, 2) North American Delivery, and 3) International Operations. An overview of each segment's activities and subunits is provided in Exhibit 3. Financial information by segment is presented in Exhibit 4. Note that North American Delivery is the company's most consistent segment over the past two years, overtaking North American Retail in 2009 as the largest of the three. Staples' International Operations segment delivered rapid sales growth in 2009, but contracted in 2010. Note that unit's profits as a percentage of sales increased, largely due to improved cost efficiencies in its supply chain.

Significant country-based units within the International Operations segment include Staples China, a joint venture in India, and Corporate Express. Staples China began as a joint venture and now operates on a multichannel platform in Beijing, Shanghai, and Shenzhen/Guangzhou. The unit operates 27 stores, two Staples UPS Express stores, and two furniture stores, as well as a dedicated website. A contract business unit, similar in nature to the company's Staples Contract operation, serves larger businesses as well as various governmental agencies. The company also is rapidly expanding its presence in India, a $10 billion market, through its partnership with Pantaloon Retail Ltd., the largest retailer in India.

The Corporate Express unit, operating in the Netherlands, New Zealand, and Australia, is one of the more promising individual business units operated by Staples. As the company describes it, Corporate Express works with customers "on the 'little things' that matter to them, allowing them to get on with running their business." The unit has secured valuable contracts in janitorial services recently, among other similar basic office operations, and provides a range of services including technology solutions, printing functions, promotional marketing, furniture, facility and kitchen supplies, and even catering.

The role of Corporate Express also happens to fit nicely with both the Staples Contract and Quill units, housed within the North American Delivery segment. Within the Delivery segment, Staples Contract, the company's business-to-business products and services operation, is the fastest-growing component. This unit provides an array of customized services to medium-sized and large companies, including interiors, technology, facility solutions, print solutions, and promotional products. Quill (and its Quill.com website) serves small to medium-sized businesses as a direct-order and delivery business, and the unit enjoys a significant presence serving the legal, educational, and medical

EXHIBIT 3 Staples' Three Business Segments

1. North American Retail
   - Retail store operations throughout the United States and Canada
   - Average store: 20,000 sq. ft., 7000–8000 products
   - In-store kiosks offer access to Staples.com and full selection of more than 30,000 products
   - Copy & Print Centers
   - UPS Ship Centers
   - Staples EasyTech computer services
2. North American Delivery
   - Staples Contract
     - Staples Business Advantage: serves small- and medium-sized businesses
     - Staples National Advantage: serves large companies
   - Staples Business Delivery: catalogs and Staples.com
   - Quill: Direct marketing (catalogs and Quill.com) to small- and medium-sized businesses
3. International
   - Asia/Pacific: China, Taiwan, India, Australia, New Zealand
   - European Catalog
   - European Contract
   - European Retail
   - South America

Source: Staples.com.

Vision/Mission/Soul

Staples does not have a written vision statement. The company's mission is "to make it easy to buy office products." Through a unique "Staples Soul" program, the company emphasizes that its goal is to provide superior value to customers through a combination of low prices, a broad selection of products including eco-conscious choices, high-quality and innovative Staples brand products, convenient store locations, easy-to-use websites, reliable and fast order delivery, and excellent customer service. Eco-consciousness has become more than a slogan at Staples. "Staples Soul" reflects the company's commitment to diversity, the environment, community, ethics, and reporting. Staples integrates the process into its annual reports, featuring an extensive "Soul Report." The program includes ethical sourcing and climate change responses that consider the environmental impacts of supplier operations and the company's facilities and transportation system. Staples requires suppliers of its company-brand products to adhere to a code of conduct emphasizing compliance with applicable labor and environmental laws and regulations, and it audits their facilities and operations. The "Staples Soul" program is described in Exhibit 2.

EXHIBIT 2 The Staples Soul Program and Critical Initiatives

What is Staples Soul?

Staples Soul recognizes the close connection between our success and our ability to make a positive impact on our customers, our associates and the planet. We believe Staples Soul helps to make us an employer and neighbor of choice, differentiates our brand, and allows us to grow profitably and responsibly.

Staples Soul — it's what moves us.

The Pillars of Staples Soul

Ethics

We strive to model integrity in all that we do and strictly adhere to our Code of Ethics and corporate governance practices. We seek to work with suppliers who share our values and expect them to follow our Supplier Code of Conduct.

Environment

We work to make it easy for our customers and associates to make a difference by offering more sustainable products and services, operating our business in an environmentally efficient way, and helping our customers and associates take action to protect the environment.

Community

We reach out to and support the communities in which our customers and associates live and work. We generate economic benefit through our stores and operations, and provide support for important community initiatives through Staples Foundation for Learning® and other company giving.

Diversity

We seek to develop a workforce that reflects the diversity of the communities and customers we serve all over the world by embracing diversity in all its forms—race, gender, thought, and experience. We promote a culture of inclusion within our workforce and source products and services from diverse minority and women-owned businesses.

Critical Initiatives:

- Climate change
- Sustainable Procurement and Ethical Sourcing
- Community Development
- Employee Satisfaction
- Diversity
- Product Quality
- Sustainable Offerings
- Packaging

Source: Staples.com.

EXHIBIT 4 Staples Business Segment Financial Data (000 omitted)

Sales:	2010	2009	2008	2010 Increase (Decrease) From Prior Year	2009 Increase (Decrease) From Prior Year
North American Delivery	$9,849,218	$9,640,390	$8,929,924	2.2%	8.0%
North American Retail	9,529,757	9,364,190	9,489,510	1.8%	(1.3%)
International Operations	5,166,138	5,270,871	4,664,341	(2.0%)	13.0%
Total sales	$24,545,113	$24,275,451	$23,083,775	1.1%	5.2%

Net Income:	2010	2009	2008	2010 % of Sales	2009 % of Sales	2008 % of Sales
North American Delivery	$841,429	$786,723	$802,523	8.5%	8.2%	9.0%
North American Retail	770,122	774,529	769,695	8.1%	8.3%	8.1%
International Operations	166,606	122,028	153,886	3.2%	2.3%	3.3%
Business unit income	$1,778,157	$1,683,280	$1,726,104	7.2%	6.9%	7.5%
Stock-based compensation	(146,879)	(174,691)	(180,652)	(0.6%)	(0.7%)	(0.8%)
Total income	$1,631,278	$1,508,589	$1,545,452	6.6%	6.2%	6.7%

Source: Staples *10K, 2010.*

professions. Together, these service-oriented units offer Staples the potential synergy of leveraged operations and cross-selling opportunities, not only domestically but internationally as well.

Distribution/Inventory

Staples operates from a hub-and-spoke distribution network that enables the company to ship quickly and efficiently to individual stores without having those stores accumulate significant inventory stocks. Most stores average 20,000 square feet and stock more than 7,000 products, making inventory management, in addition to distribution, a critical operational function at Staples. Staples has invested in technology to create and maintain a customer database, which helps the company identify purchase trends by customer, customer type, and region. In this industry, store sizes are decreasing, as is the product count. Targeting specific product trends to ensure adequate inventory without overstocking is imperative. At Staples, this trend has been implemented as part of the company's shift toward corporate and other high-volume purchasers, where store-level throughput can be maximized in conjunction with specifically-targeted merchandise.

The product mix itself is changing at Staples in conjunction with the overall decrease in store and inventory size. The company is seeking to expand its product line into digital devices other than computer hardware. For example, Staples is teaming with Barnes & Noble to offer Barnes' NOOK color reader as of May 2011. The NOOK, which competes with Amazon.com's Kindle and, of course, the Apple iPad, features a 7-inch screen and access to more than 2 million titles. Given the competition in this fast-evolving market, the success of this venture from Staples' perspective is not assured, particularly since the device is not exclusive to Staples. The move, while important, is emblematic of Staples' concern with the long-term viability and growth prospects of its existing product mix.

Also relevant to the issue of product mix is Staples' continuing development of store-branded products. Currently, the company offers more than 2,000 Staples-brand products, which compete

with major brands across a wide variety of different product categories. The retail industry at large has seen this trend emerge over the course of several years, and its main attraction for the retailer typically is the higher margins resulting from more favorable purchase contracts than those obtainable from major brand manufacturers, as well as a greater degree of control over supply, design, and manufacturing. Staples has a number of contractual agreements with various manufacturers who supply the company with its store-branded product line.

A key ingredient in Staples' management of its product lines, distribution, and inventory system is the company's website, Staples.com. While the company is attempting to minimize physical inventory accumulation at its stores, more than 30,000 products are available via Staples.com. Product orders are processed and products are typically shipped to a local store for customer pickup, free of charge. In the alternative, customers can choose to have their purchase delivered directly to their place of business or home, and Staples provides free delivery on purchases exceeding $50.

The newest development in Staples' delivery system is its purchase of a small fleet of electric trucks in the fourth quarter of 2010. The trucks, manufactured by Smith Electric Vehicles, offer a 16,000-pound capacity and a lithium-ion battery that can travel up to 100 miles between charges. The manufacturer estimates that the trucks will achieve a 75 percent reduction in fuel costs compared to diesel vehicles, but the electric trucks are more expensive. Investment payback times thus are fairly lengthy. Staples plans to deploy 30 trucks in southern California, and an additional 11 in Ohio and Missouri.

The unifying theme of all of these aspects of the company's operations is, of course, efficiency and cost minimization. This has been Staples' primary focus throughout its history, and it enables the company to offer lower prices to customers. But in a set of incidents eerily reminiscent of alleged problems at similar cost-based organizations, such as Wal-Mart, Staples has been sued for misclassifying employees as exempt under the Fair Labor Standards Act, thus permitting the company to avoid paying overtime. The initial claim in 2009 (more are in process) awarded close to $2.5 million in damages. In a separate incident, another employee was convicted of embezzlement in a scheme in which fictitious vendor accounts were established and paid, ultimately, to the account of the employee. While the amounts in question are, for the moment, fairly small for a company the size of Staples, the bigger question posed is whether adequate incentives and procedural safeguards, including direct oversight, are in place and effective to facilitate internal control.

Marketing

Marketing has long been a part of Staples' success. The company has successfully created and embedded in popular culture various catch phrases such as "Yeah, we've got that," and more famously and recently, "That was easy." The latter phrase was accompanied by development of the ubiquitous "Easy Button," a hockey puck-sized device that, when pushed, verbalizes the catch phrase. Brand visibility also is enhanced via mechanisms such as product placement in popular shows, such as *The Office,* and various publicity vehicles, such as the company's sponsorship of the Staples Center in Los Angeles.

Beyond this kind of broad and thematic brand-building, the company also seeks to tailor its message to individual companies and customers. Its database enables targeted ads and coupon or discount offers. Store openings also are used as a vehicle to capture attention, in conjunction with which, Staples typically identifies businesses within a given radius of the new store and sends them advertisements and offers. The company also utilizes a rewards program to build loyalty and encourage volume purchases.

In early 2011, Staples revamped its international marketing team to ensure brand consistency across all of its channels and across all international boundaries. Recognizing the problem is an important step in its solution, but its existence also suggests that the company is struggling to integrate its now far-flung operations, many of which were acquired rather than developed organically, and to deliver a consistent theme and message through its marketing efforts.

Finance

Staples' financial statements are provided in Exhibits 5 and 6. Note that the company's debt has remained relatively high, but long-term debt decreased from 2010 to 2011, when 20 percent of the amount owed by the company was shifted into current maturities. Still, the amount coming due is less than annual net income. The company's cash flows reveal two significant trends for the year ended January 29, 2011: a marked decrease in cash from operations and a substantial

EXHIBIT 5 Staples Income Statements (000 omitted)

Income Statement	Jan 29, 2011	Jan 30, 2010	Jan 31, 2009
Total Revenue	**$24,545,113**	**$24,275,451**	**$23,083,775**
Cost of Revenue	17,938,958	17,801,548	16,836,839
Gross Profit	**6,606,155**	**6,473,903**	**6,246,936**
Operating Expenses			
Research Development	–	–	–
Selling General and Administrative	4,913,188	4,907,236	4,631,219
Nonrecurring	57,765	84,244	173,524
Others	61,689	100,078	70,265
Total Operating Expenses	5,032,642	5,091,558	4,875,008
Operating Income or Loss	**1,573,513**	**1,382,345**	**1,371,928**
Income from Continuing Operations			
Total Other Income/Expenses Net	(2,094)	10,574	20,930
Earnings Before Interest and Taxes	1,571,419	1,392,919	1,392,858
Interest Expense	214,824	237,025	149,774
Income Before Tax	1,356,595	1,155,894	1,243,084
Income Tax Expense	468,026	398,783	428,863
Minority Interest	(6,621)	(18,440)	(8,957)
Net Income	**881,948**	**738,671**	**805,264**

Source: Company documents

EXHIBIT 6 Staples Balance Sheets (000 omitted)

	Jan 29, 2011	Jan 30, 2010	Jan 31, 2009
Assets			
Current Assets			
Cash and Cash Equivalents	$1,461,257	$1,415,819	633,774
Short-Term Investments	–	–	–
Net Receivables	2,249,380	2,164,694	2,122,332
Inventory	2,359,173	2,261,149	2,404,174
Other Current Assets	398,357	333,105	636,978
Total Current Assets	**6,468,167**	**6,174,767**	**5,797,258**
Long-Term Investments	–	–	67,200
Property Plant and Equipment	2,147,771	2,164,533	2,290,626
Goodwill	4,073,162	4,084,122	3,780,169
Intangible Assets	522,722	579,923	701,918
Accumulated Amortization	–	–	–
Other Assets	699,845	713,989	476,153
Deferred Long-Term Asset Charges	–	–	26,931
Total Assets	**13,911,667**	**13,717,334**	**13,073,055**
Liabilities			
Current Liabilities			
Accounts Payable	3,706,237	3,715,050	3,372,306
Short/Current Long-Term Debt	587,356	67,269	1,473,248
Other Current Liabilities	–	–	457,606
Total Current Liabilities	**4,293,593**	**3,782,319**	**4,845,554**

(*continued*)

EXHIBIT 6 continued

Long-Term Debt	2,014,407	2,500,329	1,968,928
Other Liabilities	652,486	579,746	636,142
Deferred Long-Term Liability Charges	–	–	–
Minority Interest	7,471	83,054	58,224
Negative Goodwill	–	–	–
Total Liabilities	**6,967,957**	**6,945,448**	**7,508,848**
Stockholders' Equity			
Misc. Stocks Options Warrants	–	–	–
Redeemable Preferred Stock	–	–	–
Preferred Stock	–	–	–
Common Stock	545	538	529
Retained Earnings	6,492,340	5,869,138	5,367,341
Treasury Stock	(3,786,977)	(3,388,395)	(3,357,734)
Capital Surplus	4,334,735	4,379,942	4,048,398
Other Stockholders' Equity	(96,933)	(89,337)	(494,327)
Total Stockholders' Equity	**6,943,710**	**6,771,886**	**5,564,207**
Total Liabilities and SE	**$13,911,667**	**13,717,334**	**13,073,055**

Source: Company documents.

increase in funds used for stock repurchases. Significantly, during 2010 the company's stock dramatically underperformed the NASDAQ Composite Index.

Management

Staples' top executives are listed in Exhibit 7. An organizational chart for the company is also provided. (Circles 16 and 17, on the lower right side of the chart, comprise North American Retail)

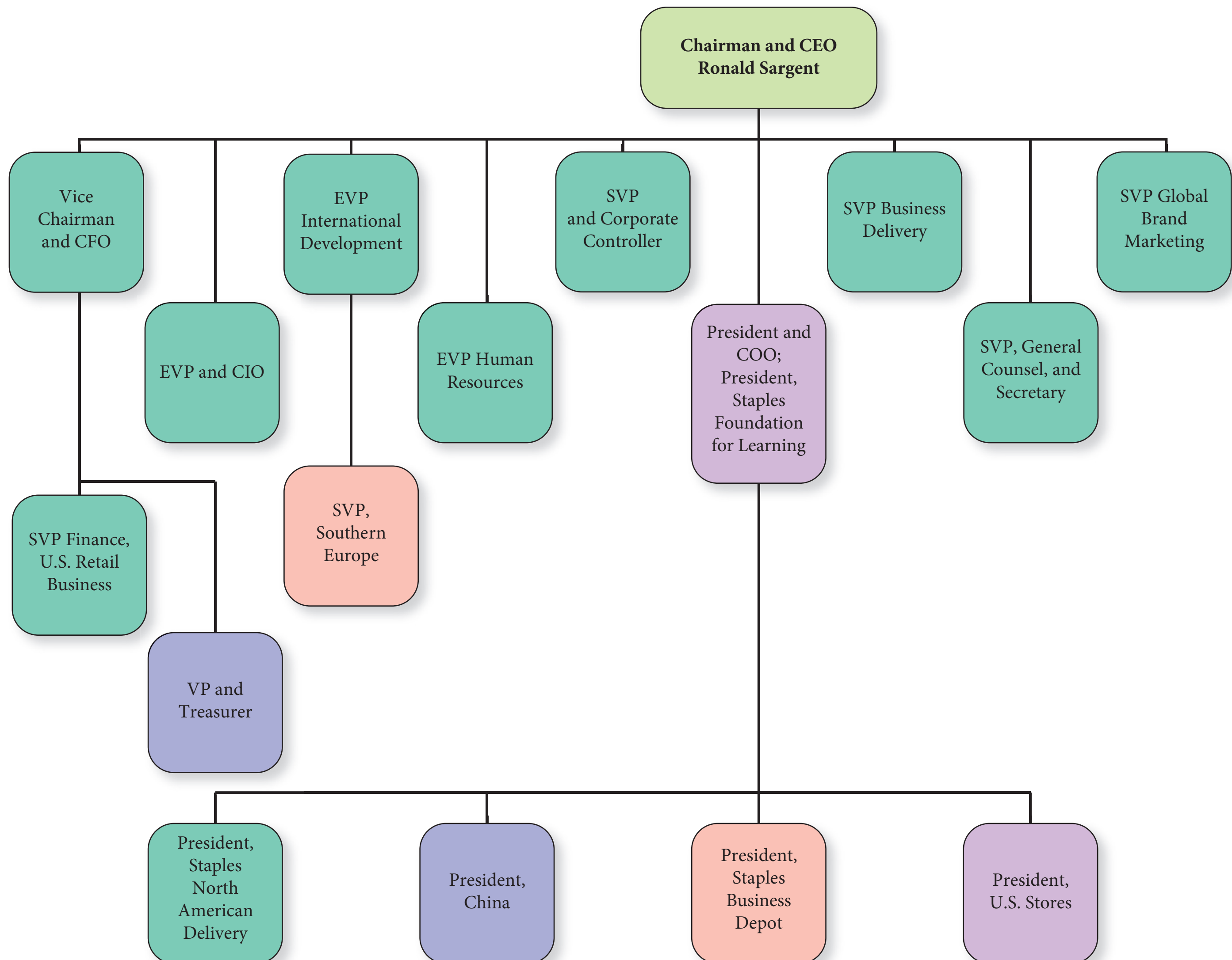
External Issues

The United States stock market dropped 512 points in one day in August 2011 and S&P for the first time ever downgraded the country's credit rating from AAA to AA. Federal Reserve economists predict U.S. growth of 3.1–3.3 percent in 2011, and some economists predict at least 3.8 percent growth in 2012, but gross domestic product growth actually slowed to 1.8 percent in the first quarter of 2011. Forecasts for the unemployment rate range from 8.3 to 9.2 percent by the end of 2011 and 7.6 to 8.5 percent by the end of 2012. Consumer confidence, and therefore spending, remains speculative for the balance of 2011 and 2012 and may be adversely affected by federal and state fiscal difficulties. With federal stimulus money being depleted, states are likely to face continuing severe cuts in spending. For the time being, most states and Congress appear unlikely to implement tax increases, which would further limit disposable income. But other factors, notably rising oil and commodities prices worldwide, are expected to exert continuing pressure on consumer and business budgets for the foreseeable future. Spending is likely to be restrained, and consumers and businesses are likely to remain very price sensitive.

Although the "paperless office" has yet to become the pervasive reality predicted in popular media, it is still true that more and more technological innovations have been adopted to reduce the consumption of paper and other traditional office supply products. Record-keeping, in particular, is moving rapidly into the digital realm, and document delivery is as well. But recent figures suggest that traditional paper archival systems still account for 60 percent of document storage. Advances in mobile technologies, including devices such as the NOOK, Kindle, iPad, and iPhone are negatively impacting the office supply business.

Perhaps the most persistent trend that relates to paper usage in particular, and indeed business practice in general, is the increasing sensitivity to and interest in environmental sustainability. All of the office supply industry competitors have undertaken various "green" initiatives in recent

EXHIBIT 7 Staples' Top Management Team and Organizational Chart



years, not only with respect to potential waste products, including paper usage, but also in a number of supply chain or distribution functions. The broader business community is responding in a similar fashion and is likely to increase both the size and scope of such initiatives in the years to come. Inevitably, these practices will result in a shift in the pattern of demand for office supply products and equipment.

The United States office supply industry produces revenues exceeding $80 billion annually. Growth is forecast to reach almost $88 billion by 2013, reflecting a five-year average growth rate of less than 1 percent. This figure is somewhat misleading given the effects of the recession, which resulted in a decrease in industry sales, but using the recessionary low as a base still produces only an approximate 1.5 percent annual growth rate based on the 2013 forecast, a marked decrease from the previous five-year compound growth rate of 3 percent observed in the 2004–2008 period. In light of these prospects, most companies in the industry have undertaken substantial international expansion programs and have attempted to broaden the range of products and services offered.

Companies in the industry tend to do business on a similar basis, buying in volume and attempting to move mass quantities of merchandise as quickly as possible. Purchases are made from a wide variety of manufacturers, the actual number and nature of which varies with the product in question. Inventory management and distribution are critical factors for success in the industry, because no company can afford to have substantial inventory stocks in local

EXHIBIT 8 Comparative Data for Office Supply Industry Competitors

	Staples	Office Depot	OfficeMax
Revenue (billions)	$24.55	$11.63	$7.15
Net Income (millions)	881.95	–81.74	68.63
Total Assets (billions)	13.91	4.65	4.08
Total Debt (billions)	6.97	3.52	2.78
Store Count	2281	1602	1050
Distribution Centers	125	39	44
Employees (approx., thousands)	89	40	35

Sources: Staples, Office Depot, OfficeMax *10Ks*; Staples.com; OfficeDepot.com; OfficeMax.com.

stores. Companies thus have made significant investments in warehousing and fulfillment centers, permitting them to stockpile inventories in centralized locations that can service regional stores with products tailored to local demand. This trend has been accelerating in recent years as industry competitors have decreased store sizes, opting instead to achieve flexibility in their distribution systems.

Competitors

Comparative financial data and key statistics for rival firms in this industry are presented in Exhibit 8. Brief discussions of the history and operations of Office Depot and OfficeMax follow. Note that Staples is larger than Office Depot and OfficeMax combined.

Office Depot

The second-largest office supply company, Office Depot opened its first store in Boca Raton, Florida, in 1986. Today the company boasts annual revenues of nearly $12 billion and operates over 1,100 stores in the United States and Canada, with an additional 400 stores overseas. Office Depot followed much the same pattern of rapid expansion that Staples had undertaken, and briefly overtook Staples for the lead in the industry in 1989. Both companies continued to expand, Staples more rapidly. Most of Office Depot's efforts of late have been in the international arena and the continuing development of its online presence.

Office Depot, like Staples, is organized into three divisions: 1) North American Retail, 2) North American Business Solutions, and 3) International. Its Retail division offers the standard range of products, and most stores also offer copying and printing services. The company also offers PC support and a network installation service. The Business Solutions Division focuses on providing small- and mid-sized companies with supplies, technology, services, and furniture through catalogs, the Internet, and a dedicated sales force. There is also a contract business that serves medium to large companies, offering contract pricing rather than item-by-item retail pricing. The International division operates in 55 countries in Europe, Asia, and Latin America.

Office Depot's total revenue of $2,973.0 million the first quarter of 2011 fell short of the Zacks Consensus Estimate of $2,979.0 million and dropped 3.2 percent from the prior-year quarter, registering sales declines in each business segment. Reflective of engrained problems facing the industry, Office Depot is struggling.

OfficeMax

The third-largest office supply company, OfficeMax was incorporated in 1988 and enjoyed rapid success. The company has about 1,000 superstores across the United States, Puerto Rico, and Mexico. The stores offer about 11,000 name-brand and OfficeMax-branded products, including paper, pens, forms, and organizers, as well as office furniture and a wide range of technology products. Much like Staples and Office Depot, OfficeMax also provides printing and document services through its ImPress store-within-a-store. In addition to its

retail outlets, the firm's contract division (51 percent of sales) sells directly to business and government customers by phone, catalogs, and the Internet. OfficeMax's annual revenues actually declined from $8.267 billion in 2008 to $7.212 billion in 2009, and fell again to $7.150 billion in 2010. This whole industry is really struggling, with the whole world going paperless.

The Future

The big three office supply firms, including Staples, operate very similar business models, which means the firm with the best strategic plan and operational efficiencies will ultimately survive. There exists very intense price competition among the big three firms, and secondary firms such as Wal-Mart, Kmart, and Target are always vying for additional market share. Online competitors are also taking market share from the big three. Maybe the big three should diversify away from selling traditional office products. For example in May 2011, Staples began selling the Barnes & Noble e-reader, the NOOK, for the same $249 price as B&N.

Maybe the big three office supply firms should focus more on emerging economies and global expansion. For example, Staples just formed a new strategic alliance with one of the leading Swiss office products companies, Büro Schoch Direct AG. Within Switzerland, Staples and Büro Schoch Direct will work together exclusively on international accounts and collaborate to exchange best practices. According to Rob Vale, president of Staples Europe, "With Staples' commitment to serving our multi-national clients across the globe, this alliance represents an opportunity for the company to serve both new and existing accounts that are looking for Staples' expertise and industry-leading service levels in the Swiss market. Schoch has a long and successful presence in the Swiss market and shares Staples' passion for making it easy for customers to buy office products and services. We look forward to working with the Büro Schoch Direct team. According to Thomas Schoch, owner and CEO of Büro Schoch Direct, "With a 130 year history of customer service, we have built strong capabilities. Our new alliance with the world's largest office products company will further develop our capabilities and knowledge. We in turn will provide the local market know-how and service that will bring our shared customers sustainable added value." The Schoch Group is a leading office products company in Switzerland, offering a full range of office and computer supplies, facility products, and related services. Founded in 1882, the company has operations in Winterthur, Ohringen, and Aarburg.

CEO Ron Sargent of Staples is well paid as indicated at the beginning of this case. Thousands of employees, customers, and shareholders of Staples are counting on him to formulate and implement an effective strategic plan for the company. Give Mr. Sargent some help in that regard.

Office Depot, Inc. — 2011

Wayne E. Smith
Argosy University – Dallas campus

ODP

www.officedepot.com

Office Depot was chosen by readers of TheStreet.com as the most likely retail takeover target in 2011. Office Depot's CEO Steve Odland left the company in 2010 after a SEC investigation for inappropriately revealing confidential information. Office Depot lost $15 million in the first quarter of 2011, compared to a $20 million profit the first quarter the prior year. The company's first quarter 2011 revenue fell 3 percent to $2.97 billion from $3.07 billion a year ago. Revenue at the 1,115 Office Depot stores in the United States and Canada that have been open more than a year fell 1 percent. New Office Depot CEO Neil Austrian desperately needs a clear strategic plan to reverse declining revenues and profits. As the whole world shifts to paperless transactions, Office Depot's historical business model is questionable.

Second Quarter of 2011

Office Depot's second quarter 2011 sales totaled $2.7 billion, almost the same as the prior year. The company however reported a loss of $29 million for the second quarter, compared to a loss of $25 million in the same period a year ago. The company's North America Retail division reported sales the second quarter of $1.1 billion, down 2 percent versus one year ago, led by a sharp decline in computer sales. Furniture sales however increased as did sales for storage items, printers, writing instruments and cleaning and breakroom supplies. Office Depot's Tech Depot Services segment reported double-digit sales gains versus the prior year. Copy & Print Depot sales grew positively for the sixth consecutive quarter.

Office Depot's North American store count at the end of the second quarter was 1,131 stores. During that quarter, the company opened 4 new stores and closed 14 stores, including closure of their remaining 10 stores in Canada. During that quarter, Office Depot remodeled 5 stores and relocated 4, successfully reducing the square footage in those 9 locations by about 30 percent on average. The company's North American Retail segment reported operating profit of $15 million in the second quarter of 2011, compared to $9 million the prior year.

Office Depot's North American Business Solutions Division (BSD) reported second quarter 2011 sales of $803 million, down 2 percent versus the same period last year. Positive sales growth was reported though in seating and cleaning and breakroom supplies. However, paper sales declined as did ink and toner sales. Second quarter sales in Texas and Florida were better than the overall BSD rate, but sales in California stores was worse. Second quarter operating profit for BSD was $45 million, up significantly from the $14 million reported in the same period one year ago.

The company's International division reported second quarter 2011 sales of $827 million, an increase of 6 percent compared to the prior year in U.S. dollars and a decrease of 5 percent in constant currency. These results include the negative impacts of the company divesting its stores in Japan, Israel, and India in 2010 and the positive impact from acquiring Svanströms in Sweden during the first quarter of 2011. Geographically, BSD sales in France were relatively flat compared to the prior year, while the U.K. and Germany reported small declines in sales. Company stores in Asia reported high single-digit growth in the second quarter. The International division reported operating profit of $13 million for the second quarter compared to $19 million the prior year. Office Depot de Mexico reported sales of $272 million and net income of just over $14 million in the second quarter of 2011.

If you are interested in purchasing a tablet computer, Office Depot stores currently offer 8 tablets with complete accessories: the HP TouchPad, the ASUS Transformer, the BlackBerry Playbook, the Toshiba Thrive, the Acer Iconia, the Lenovo IdeaPad, the ViewSonic G-Tablet and the Velocity Micro Cruz.

History

The first three Office Depot stores opened in 1986 in Florida with company sales of $2 million. By its 10th anniversary, Office Depot had 570 stores in North America, $6 billion in sales, and 31,000 employees. When it reached its 20th year, Office Depot had 50,000 employees, sales of $15 billion, and accolades as "Humanitarian of the Year" and one of America's top corporations for women's business enterprises for the fifth year. Office Depot's corporate social responsibility continued to grow and in April 2011, Office Depot partnered with Local Governments for Sustainability USA (ICLEI) to launch the 2011 Green Business Challenge. Office Depot is a very "green" company, as indicated in Exhibit 1. All that is the good news. The bad news is that Office Depot is an unprofitable company competing in an unprofitable industry.

Vision/Values/Ethics/Mission

As provided in Exhibit 2, Office Depot has a five-point vision statement. To fulfill this vision, Office Depot has a values statement as given in Exhibit 3. The company has a one-sentence code of business ethics, as follows: "We earn the trust and confidence of associates, customers, suppliers and shareholders by being open, honest and truthful in all that we do." Office Depot does not have a written mission statement, but two analysts recently suggested the mission statement provided in Exhibit 4.

EXHIBIT 1 Office Depot's 2010 "Green" Accolades and Accomplishments

- Launched "Recycling Rules" program to reward schools
- Recognized as America's greenest large retailer in *Newsweek* magazine's annual Green Ranking
- Named "Best New Product" award winner with Lil' Drug Store Products by *Convenience Store News*
- Showcased 40 new "green" initiatives in honor of the 40th anniversary of Earth Day
- Awarded LEED Gold Certification for Existing Buildings for corporate headquarters
- Announced nationwide rollout of United States Postal Service offerings
- Opened first LEED for Commercial Interiors registered retail store
- Announced Forest Stewardship Council (FSC) Certification of Office Depot® Green™ 30% Recycled EnviroCopy™ Paper
- Selected as one of America's Top Corporations for Women's Business Enterprises by the Women's Business Enterprise National Council (WBENC) for the ninth consecutive year
- Recognized as a Top Company Dedicated to the Advancement of Women by National Association for Female Executives (NAFE)
- Appointed one of the Top Organizations for Multicultural Business Opportunities for 10th consecutive year
- Celebrated successful second season as sponsor of Tony Stewart, driver of the No. 14 Office Depot Chevrolet in the NASCAR Sprint Cup Series™
- Launched Greener Shipping solution for business customers
- Teamed up with Lexmark and Operation Homefront to provide military families with free printers
- Released second annual Historically Underutilized Businesses (HUB) catalog
- Announced new partnership with National Intergovernmental Purchasing Alliance
- Launched "Document Shredding While You Wait," an in-store shredding service
- Became an ENERGY STAR® Commercial Buildings Partner

Source: www.officedepot.com.

EXHIBIT 2 Office Depot's Vision Statement

Delivering Winning Solutions That Inspire Worklife™

- *Delivering*—Our actions speak louder than words. We are accountable: doing what we say we're going to do—efficiently and on time.
- *Winning*—We act with confidence. We're proud to win. We push ourselves to greater heights. And we don't settle for less than being the best.
- *Solutions*—We listen to our customers and understand their needs. We offer products, services and innovative thinking that enable our customers to achieve success.
- *Inspire*—Our inspiration is contagious and enables us to unleash creativity to help people achieve their goals. Our motivation and enthusiasm inspire others to succeed.
- *Worklife*™—We combine our energy for work with our passion for life — creating a fuller, more enriched lifestyle. We share the desire to maximize human potential to achieve personal dreams.

Source: www.officedepot.com.

EXHIBIT 3 Office Depot's Values Statement

- *Integrity*—We earn the trust and confidence of associates, customers, suppliers and shareholders by being open, honest and truthful in all that we do.
- *Innovation*—With a culture of creativity and a thirst for intelligent risk-taking, we aspire to do what has never been done.
- *Inclusion*—We approach all opportunities and challenges by respecting the diverse thoughts, beliefs, backgrounds, cultures and energies of all associates, customers and suppliers.
- *Customer Focus*—We fuel our customers' dreams by anticipating and listening to their needs and passionately delivering on our promises. Failure is not an option, as we promise to "wow" on recovery.
- *Accountability*—We are responsible for achieving and sustaining unprecedented results that create extraordinary value to our shareholders, customers, and employees.

Source: www.officedepot.com.

EXHIBIT 4 A "Proposed" Mission Statement for Office Depot

Our mission at Office Depot is to be a global, leading innovator as a supplier of office products and services for consumers and businesses of all sizes while creating a positive impact on the environment. We continually strive to deliver our customers favorably-priced products, beneficial services, and the latest in digital imaging and printing technology. We will earn the trust of our stakeholders by being open, honest, and faithful in all that we do. We will also be responsible for achieving and sustaining unprecedented results that create value to our customers, employees, and stakeholders through personal commitment, sensible thrift, collaboration, and shared leadership.

Source: Used by permission of Ryan Sealey and Terrence Jones.

Office Depot even goes on to explain that they not only follow the letter of the law, but the spirit of the law as well. They clearly state that they are responsible for knowing the law, rules, and regulations in each venue in which they conduct business and that all employees should strive to not only uphold same, but avoid even the appearance of questionable conduct.

Internal Issues

Business Segments

Office Depot operates in three divisions or segments. The first, the company's North American Retail division, sells an assortment of merchandise, such as general office supplies, computer supplies, business machines and related supplies, and office furniture under various labels, including Office Depot, Viking Office Products, Foray, Ativa, Break Escapes, Niceday, and Worklife through its chain of office supply stores. It also provides printing, reproduction, mailing, shipping, and other services, as well as personal computer support and network installation service. This division operates 1,147 office supply stores in the United States and Canada.

The company's second division, North American Business Solutions, Division (BSD) sells nationally branded and private-brand office supplies, technology products, furniture, and services to small- to medium-sized customers through a dedicated sales force, catalogs, and the Internet.

The company's third division, International, sells office products and services through direct-mail catalogs, contract sales forces, Internet sites, and retail stores using a mix of company-owned operations, joint ventures, licensing and franchise agreements, alliances, and other arrangements. Office Depot sold office products to customers in 53 countries in North America, Europe, Asia, and Latin America. This division operated, through wholly-owned or majority-owned entities, 97 retail stores in France, Hungary, South Korea, and Sweden and participates under licensing and merchandise arrangements in South Korea, Thailand, India, Israel, Japan, and the Middle East.

Financial performance data for Office Depot's three divisions is provided in Exhibit 5. Notice all the negative numbers that indicate falling revenue and profit totals.

Management

Neil R. Austrian is Office Depot's chairman and CEO. Mr. Austrian's top management team, which oversees more than 50,000 employees, is illustrated in Exhibit 6. Exhibit 7 reveals year-end 2010 information about the 1,147 Office Depot stores in the United States and Canada and the 97 company stores outside North America.

Finance

Office Depot lost less money in 2010 than in the prior two years but continues to lose money every quarter in 2011. The company's income statements and balance sheets are provided in Exhibits 8 and 9 respectively. As indicated in Exhibit 10, Office Depot has an extensive information system

EXHIBIT 5 Office Depot—Performance by Division ($ in millions)

OFFICE DEPOT'S DIVISION INFORMATION

North American Retail Division

	Fourth Quarter		Year-to-Date	
	2010	2009	2010	2009
Sales	$1,234.3	$1,262.8	$4,962.8	$5,113.6
% change	–2.0%	–9.0%	–3.0%	–16.0%
Division operating profit	$16.2	$2.2	$127.5	$105.5
% of sales	1.3%	0.2%	2.6%	2.1%

North American Business Solutions Division (BSD)

	Fourth Quarter		Year-to-Date	
	2010	2009	2010	2009
Sales	$797.8	$821.1	$3,290.4	$3,483.7
% change	–3.0%	–11.0%	–6.0%	–16.0%
Division operating profit	$37.1	$21.3	$96.5	$98.2
% of sales	4.7%	2.6%	2.9%	2.8%

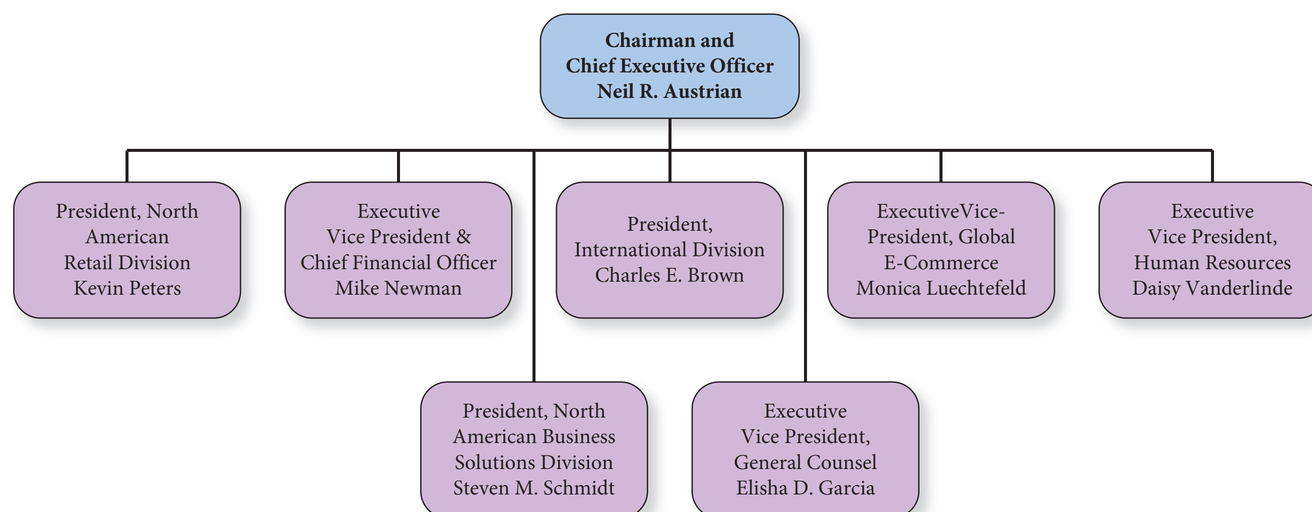
International Division

	Fourth Quarter		Year-to-Date	
	2010	2009	2010	2009
Sales	$929.9	$982.0	$3,379.8	$3,547.2
% change	–5.0%	2.0%	–5.0%	–16.0%
% change in local currency sales	0.0%	–6.0%	–2.0%	–9.0%
Division operating profit	$20.6	$63.8	$110.8	$119.6
% of sales	2.2%	6.5%	3.3%	3.4%

Division operating profit excludes charges from the division performance, as those charges are evaluated at a corporate level.

Source: Office Depot, Inc. *Form 10K*, 2010.

EXHIBIT 6 Office Depot—Top Executives and Organizational Chart



Source: www.officedepot.com

EXHIBIT 7 Office Depot Store Data

	13 Weeks Ended		52 Weeks Ended	
	Dec. 25, 2010	Dec. 26, 2009	Dec. 25, 2010	Dec. 26, 2009
Store Statistics				
United States and Canada:				
Store count:				
Stores opened	3	2	17	6
Stores closed	6	8	22	121
Stores relocated	4	1	6	6
Total U.S. and Canada stores	1,147	1,152	1,147	1,152
North American Retail Division square footage	27,559,184	28,109,844		
Average square footage per store	24,027	24,401		
International Division company-owned:				
Store count:				
Stores opened	1	1	7	4
Stores closed/deconsolidated	45	2	47	29
Stores acquired	–	–	–	–
Total International company-owned stores	97	137	97	137

Source: Company documents.

EXHIBIT 8 Office Depot's Income Statements (in thousands)

Period Ending	Dec. 26, 2010	Dec. 26, 2009	Dec. 27, 2008
Total Revenue	$11,633,094	12,144,467	14,495,544
Cost of Revenue	$8,275,957	$8,752,283	$10,489,785
Gross Profit	3,357,137	3,392,184	4,005,759
Operating Expenses			
Research Development	–	–	–
Selling General and Administrative	3,343,133	3,631,014	4,065,836

Period Ending	Dec. 26, 2010	Dec. 26, 2009	Dec. 27, 2008
Nonrecurring	51,295	26,175	1,484,964
Others	–	–	–
Total Operating Expenses	3,394,428	3,657,189	5,550,800
Operating Income or Loss	(37,291)	(265,005)	(1,545,041)
Income from Continuing Operations			
Total Other Income/Expenses Net	39,114	19,481	35,744
Earnings Before Interest and Taxes	1,823	(245,524)	(1,509,297)
Interest Expense	58,498	65,628	68,286
Income Before Tax	(56,675)	(311,152)	(1,577,583)
Income Tax Expense	(10,470)	287,572	(98,645)
Minority Interest	1,582	2,259	–
Net Income from Continuing Ops	(44,623)	(596,465)	(1,478,938)
Nonrecurring Events			
Discontinued Operations	–	–	–
Extraordinary Items	–	–	–
Effect of Accounting Changes	–	–	–
Other Items	–	–	–
Net Income	(44,623)	(596,465)	(1,478,938)
Preferred Stock and Other Adjustments	(37,113)	(30,506)	–
Net Income Applicable to Common Shares	$(81,736)	$(626,971)	$(1,478,938)

Source: Company documents.

EXHIBIT 9 Office Depot's Balance Sheets (in thousands)

Period Ending	Dec. 26, 2010	Dec. 26, 2009	Dec. 27, 2008
Assets			
Current Assets			
Cash and Cash Equivalents	$627,478	$659,898	$155,745
Short-Term Investments	–	–	–
Net Receivables	963,787	1,121,160	1,451,927
Inventory	1,233,657	1,252,929	1,331,593
Other Current Assets	203,020	172,342	183,122
Total Current Assets	3,027,942	3,206,329	3,122,387
Long-Term Investments	–	–	–
Property Plant and Equipment	1,157,013	1,277,655	1,557,301
Goodwill	19,431	19,431	19,431
Intangible Assets	21,840	25,333	28,311
Accumulated Amortization	–	–	–
Other Assets	309,892	279,892	540,796
Deferred Long-Term Asset Charges	33,319	81,706	–
Total Assets	4,569,437	4,890,346	5,268,226
Liabilities			
Current Liabilities			
Accounts Payable	$2,271,077	$2,368,360	$2,433,812
Short/Current Long-Term Debt	72,368	59,845	191,932
Other Current Liabilities	–	–	–
Total Current Liabilities	2,343,445	2,428,205	2,625,744

(continued)

EXHIBIT 9 continued

Period Ending	Dec. 26, 2010	Dec. 26, 2009	Dec. 27, 2008
Long-term Debt	659,820	662,740	688,788
Other Liabilities	–	–	–
Deferred Long-term Liability Charges	514,218	654,851	585,861
Minority Interest	479	2,827	4,883
Negative Goodwill	–	–	–
Total Liabilities	$3,517,962	$3,748,623	$3,905,276
Stockholders' Equity			
Misc. Stocks Options Warrants	–	–	–
Redeemable Preferred Stock	355,979	355,308	–
Preferred Stock	–	–	–
Common Stock	2,831	2,807	2,808
Retained Earnings	(634,818)	(590,195)	6,270
Treasury Stock	(57,733)	(57,733)	(57,947)
Capital Surplus	1,161,409	1,193,157	1,194,622
Other Stockholders' Equity	223,807	238,379	217,197
Total Stockholders' Equity	695,496	786,415	1,362,950
Total Liabilities and SEquity	$4,569,437	$4,890,346	$5,268,226

Source: Company documents.

EXHIBIT 10 Office Depot's Public Websites Outside of North America

- Austria: www.officedepot.at and www.vikingdirekt.at
- Belgium: www.officedepot.be (Dutch), www.office-depot.be (French); www.vikingdirect.be (Dutch) and www.viking-direct.be (French)
- Canada: http://www.officedepot.ca
- China: www.officedepot.com.cn and www.officedepot.cn
- Costa Rica: www.officedepot.co.cr
- Czech Republic: www.officedepot.cz
- El Salvador: www.officedepot.com.sv
- Europe: www.officedepot.eu
- France: www.officedepot.fr, www.office-depot.fr, and www.vikingdirect.fr
- Germany: www.officedepot.de, www.viking.de, and www.techdepot.de
- Guatemala: www.officedepot.com.gt
- Hungary: www.officedepot.hu
- Ireland: www.officedepot.ie and www.vikingdirect.ie
- Israel: www.officedepot.co.il
- Italy: www.office-depot.it and www.vikingop.it
- Japan: www.officedepot.co.jp
- Luxembourg: www.officedepot.lu (French) and www.viking-direct.lu
- Mexico: www.officedepot.com.mx
- The Netherlands: www.officedepot.nl, www.techdepot.nl, and www.vikingdirect.nl
- Poland: www.officedepot.pl
- Slovakia: www.officedepot.sk
- South Korea: www.bestoffice.co.kr

• Spain:	www.officedepot.es and www.vikingdirect.es
• Switzerland:	www.officedepot.ch (German), www.office-depot.ch (French), www.vikingdirekt.ch (French), and www.viking-direkt.ch (Germany)
• United Kingdom:	www.officedepot.co.uk, www.viking-direct.co.uk, and www.techdepot.co.uk

Source: www.officedepot.com.

that links each store in the global network. The company utilizes websites in 40+ countries outside of North America. Each website provides extensive service offering all products and many payment methods.

Competition

Staples

Headquartered in Farmingham, Massachusetts, Staples is the largest office products supply company in the world with about 2,240 stores in the United States, Canada, Belgium, Denmark, Germany, Ireland, the Netherlands, Norway, and other countries. The company also operates 125 distribution centers and sells products through a catalog, its website, and a sales force.

Staples' sales for 2010 increased 1.1 percent to $24.5 billion. Cost controls helped push operating income up 13.8 percent to $1.6 billion, and net income jumped 19.4 percent to $881.9 million. However, the company's operating cash flow fell nearly 31 percent due to 1) the need to spend to rebuild inventories and 2) higher receivables, meaning the company was less able to collect payment from customers. Exhibit 11 compares Staples to Office Depot.

OfficeMax

Headquartered in Naperville, Illinois, OfficeMax operates 44 distribution centers and just over 1,000 office products stores in the United States, Mexico, Canada, Australia, New Zealand, and Puerto Rico. OfficeMax's first-quarter 2011 net income fell to $11.4 million, or 13 cents a share, from $24.8 million, or 29 cents a share, a year earlier. Sales that quarter fell 2.8 percent to $1.86 billion. Sales at OfficeMax's contract segment, which caters to business customers, fell 3.9 percent. Same-store sales fell 1.2 percent.

OfficeMax has begun to sell additional goods to business customers, such as furniture and cleaning products, as well as print services to offset declines in the traditional office product category. The company plans to close 15 stores in the United States in 2011 and has seen its stock price drop continuously to below $10 per share. Mexico is a bright spot for OfficeMax as the company plans to open nine stores in that country in 2011 compared to closing nine stores in the United States.

EXHIBIT 11 Office Depot's Competitors

Office Products Companies

	Office Depot	Office Max	Staples	Wal-Mart	Industry
$Market Cap:	1.18B	1.10B	14.86B	187.06B	259.52M
#Employees:	40,000	19,000	52,919	2,100,000	2.85K
%Qtrly Rev Growth:	–3.40%	–2.40%	0.10%	2.40%	4.30%
$Revenue:	11.63B	7.15B	24.55B	421.85B	442.08M
%Gross Margin:	28.86%	25.87%	30.15%	25.26%	35.82%
$EBITDA:	247.32M	266.45M	2.13B	33.18B	29.49M
%Operating Margin:	0.34%	2.32%	6.65%	6.06%	6.24%
$Net Income:	–81.74M	68.63M	881.95M	15.36B	N/A
$EPS:	–0.30	0.79	1.21	4.46	0.17

Source: Company documents.

The Future

The big three office supply firms, including Office Depot, operate very similar business models, which means the firm with the best strategic plan and operational efficiencies will ultimately survive. There exists very intense price competition among the big three firms, and secondary firms such as Wal-Mart, Kmart, and Target are always vying for additional market share. Online competitors are also taking market share from the big three. Maybe the big three should diversify away from selling traditional office products or move more aggressively toward becoming a mostly online business, or focus more on South America or Africa.

Maybe the big three office supply firms should focus more on emerging economies and global expansion. For example, Staples just formed a new strategic alliance with one of the leading Swiss office products companies, Büro Schoch Direct AG. Within Switzerland, Staples and Büro Schoch Direct will work together exclusively on international accounts and collaborate to exchange best practices. Maybe Office Depot could emulate OfficeMax's success in Mexico.

Celebrating 25 years as a leading global provider of office supplies and services, Office Depot received the Corporate Business Achievement Award from the U.S. Postal Service (USPS) at the National Postal Forum held May 1–4, 2011, in San Diego, California. Office Depot was honored for its commitment to a successful business partnership with the USPS, offering postal services and products within the company's retail store locations nationwide. Through this partnership, Office Depot became the first national retailer to offer USPS shipping products and services at the same prices as the post office. Services offered in every Office Depot include: Priority Mail Flat Rate Service; Priority Mail Service; Express Mail Service; First-Class Mail Service; and stamp purchases in books or large coils.

Office Depot recently teamed up with 3M and NASCAR stars Tony Stewart, driver of the No. 14 Office Depot/Mobil 1 Chevrolet, and Greg Biffle, driver of the No. 16 3M Ford, to offer the exciting possibility of a $1 million payday for one small business owner through the "Official Small Business of NASCAR, Courtesy of Office Depot" sweepstakes. Do you think this marketing expense will be worth the money Office Depot is spending?

Prepare a three-year strategic plan for Office Depot's CEO Neil Austrian.

Domino's Pizza, Inc., 2013

www.dominos.com, DPZ

Based in Ann Arbor, Michigan, Domino's is the largest pizza delivery company in the USA having a 22.5 percent share of the pizza delivery market. Domino's digital ordering channels include online ordering at www.dominos.com, mobile ordering at http://mobile.dominos.com, and ordering on iPhone, Kindle Fire, and Android apps. More than $2 billion of Domino's pizza is ordered online annually. There are more than 10,300 Domino's stores in over 70 countries. Domino's had sales of over $7.4 billion in 2012, with $3.6 billion of that coming from the USA.

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History

Growing up in foster homes most of their childhood, Tom Monaghan and his brother James borrowed $900 in 1960 to purchase a mom-and-pop pizza store in Ypsilanti, Michigan, named Domi-Nick's. After trading his brother James a Volkswagen Beetle for his half of the business in 1961, Tom changed the store name in 1965 from Domi-Nick's to Domino's Pizza Inc. The company experienced steady growth during the 1960s, and by 1978, there were 200 Domino's stores in the USA. During the 1980s, the company expanded rapidly both in the USA and internationally. By the end of the decade, Domino's had more than 5,000 stores in the USA, Canada, United Kingdom, Japan, Australia, and Colombia. By 1998, there were more than 6,000 Dominos, with 1,500 located outside the USA. Tom Monaghan retired in 1998 and sold 93 percent of the company (worth $1 billion) to Bain Capital Inc. In the six years following the sale, Domino's enjoyed great success under Bain Capital and in 2004 Domino's became a publically traded company on the New York Stock Exchange under the ticker symbol DPZ. The initial stock price was $16 per share and placed a value on the company at more than $2 billion (double the price Bain paid).

Domino's changed its 49-year-old recipe at year end 2009 and started a heavily advertised marketing campaign called "new inspired pizza." Domino's stock price appreciated from around $8 a share at the start of 2010 to $60 in mid-2003. Fueled by the new recipe and new products, Domino's celebrated its 50th anniversary in 2010 and was awarded best pizza chain in 2010 and 2011 by *Pizza Today* magazine, marking the first time ever that the same pizza chain had received the award in consecutive years. Domino's CEO Patrick Doyle was named the best CEO of 2011 by CNBC. Domino's was recently ranked number 1 in *Forbes* magazine's "Top 20 Franchises for the Money" list.

About 96 percent of Domino's stores are owned by franchisees. There are very few company-owned Domino's stores.

Corporate Philosophy and Mission Statement

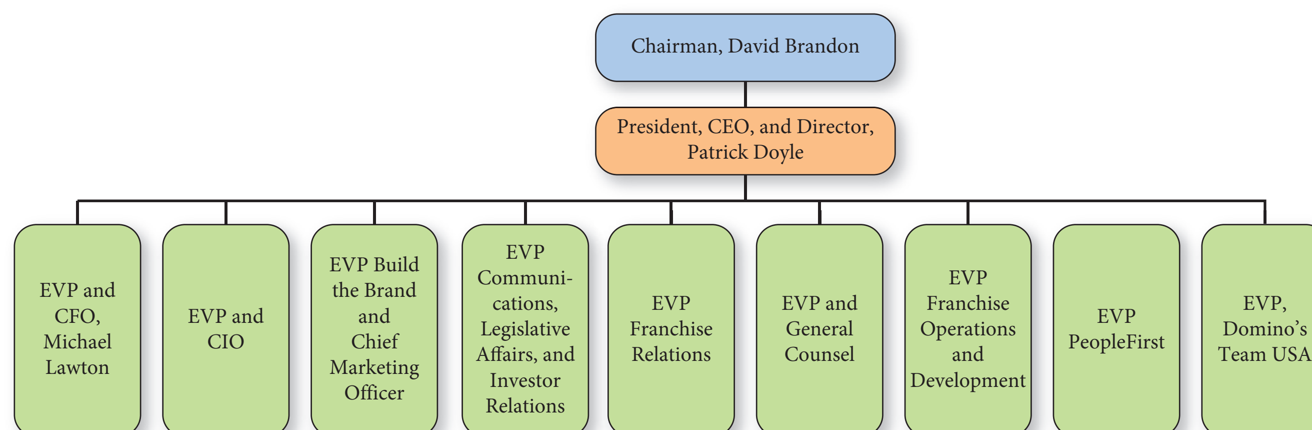
Domino's does not have a stated vision statement, but the company mission statement is as follows: "Exceptional franchisees and team members on a mission to be the best pizza delivery company in the world." Domino's "guiding principles" are based on the concept of one united brand, system and team:

- putting people first;
- striving to make every customer a loyal customer;
- delivering with smart hustle and positive energy; and
- winning by improving results every day. (2012 *Annual Report*)

Organizational Structure

As indicated in Exhibit 1, Domino's has 11 top executives, mostly executive vice-presidents (EVPs). It appears that Domino's operates from a functional organizational structure with Doyle being "where the buck stops," although for a firm of this size, a divisional or strategic business

EXHIBIT 1 Domino's Organizational Chart



unit type structure by region (or by franchised versus company owned) may be more effective in promoting delegation of authority, responsibility, and accountability.

Business Segments

Domino's provides financial information for four key business segments: (1) domestic company-owned stores, (2) domestic franchise stores, (3) domestic supply chain, and (4) international. Note in Exhibit 2 that the largest revenue-generating segment is the domestic supply chain with more than 50 percent of all revenue. Note also the large revenue numbers for the relatively few company owned stores, because each Domino's domestic franchisee owns his or her own store(s) and reports their revenues on their own personal financial statements rather than Domino's. From franchisees, Domino's reports only the royalties and advertising fees it receives from franchisees as revenue. The financial data for the international supply chain centers are included in the international division, not under the domestic supply chain division. Also note in Exhibit 2 the slight revenue decline in 2012 for domestic company-owned stores.

Exhibit 3 reveals that for 2012, Domino's international stores had the highest growth in revenue, followed by U.S. company-owned stores. However the sales growth among all three segments slowed in 2012.

Exhibit 4 reveals that Domino's growth in number of stores is highest outside the USA, with the actual number of company-owned stores in the USA falling to 388. About 10,000 employees work for Domino's, but counting all workers for all franchisees, this number is closer to 205,000.

EXHIBIT 2 Finances by Segment (in millions)

Business Segment	Revenue, 2012	Revenue, 2011	Revenue, 2010	Revenue Increase (%)
Domestic company-owned stores	$324	$336	$345	(3.6)
Domestic franchise	195	187	173	4.3
Domestic supply chain	942	928	876	1.5
International	217	201	176	8.0
TOTAL	$1,678	$1,652	$1,571	1.6

Source: Company documents.
Note: Domino's 2012 year ended 1-31-13.

EXHIBIT 3 Same Store Sales Growth (Percent)

	U.S. company-owned stores	U.S. franchise-owned stores	International stores
2008	–2.2	–5.2	6.2
2009	–0.9	0.6	4.3
2010	9.7	10.0	6.9
2011	4.1	3.4	6.8
2012	1.3	3.2	5.2

Source: Company documents.

EXHIBIT 4 Growth: Total Number of Domino's Stores

	U.S. company-owned stores	U.S. franchise-owned stores	International stores
2008	489	4,558	3,736
2009	466	4,461	4,072
2010	454	4,475	4,422
2011	394	4,513	4,835
2012	388	4,540	5,327

Source: Company documents.

Domestic Supply Chain

Domino's domestic supply chain supplies franchisees with dough, vegetables, ovens, uniforms, and much more, enabling better control, pizza consistency, and timely delivery of products. This backward integration strategy enables Domino's to offer pizza at lower prices and allows store managers to focus on store operations rather than mixing dough on site, prepping vegetables, and bargaining with independent suppliers for ingredients. Domino's has 16 regional dough-manufacturing and supply chain centers and leases a fleet of more than 400 trucks to aid in delivering products to stores twice a week. However, Dominos' franchisees are not required to purchase supplies from Domino's, but interestingly more than 99 percent do purchase all its supplies from the company's domestic supply chain segment. To ensure this division remains viable, Domino's provides profit-sharing incentives to franchisees to buy its products from Domino's. In addition to the 16 domestic supply chain centers, Domino's also operates 6 supply chain centers outside the USA.

Domestic Stores

The company's domestic stores division includes a network of 4,540 stores operated by 1,026 franchisees and 388 company-owned stores in the USA. Domino's desires to have all of its stores owned and operated by franchisees, but if certain stores are underperforming, Domino's often will purchase these stores in hopes of turning them around and then refranchising them at a later date. Domino's uses company-owned stores as test sites for new products, promotions, new potential store layout improvements, and as test sites for prospective new franchisees.

Although the typical franchisee of Domino's operates 4 stores, the nine largest franchisees operate more than 50 stores, including the largest domestic franchisee that operates 135 stores. Currently, Domino's has 1,077 different domestic franchisees with the average franchisee being in Domino's system for an impressive 14 years. Much of this longevity can be attributed to Domino's requiring prospective franchisees to manage a store for 1 year before entering into a long-term contract with Domino's. Domino's feels this system is unique to the pizza industry and provides a competitive advantage over rival pizza firms.

International Division

Domino's has 5,327 franchise stores outside the USA. The company's international revenues as a percent of total revenues increased to 13.0 percent in 2012, up from 11.2 percent in 2010. Exhibit 5 provides is a breakdown of Domino's stores in the top 10 markets, which account for

EXHIBIT 5 Top 10 Countries Where Domino's Are Located

Country	Number of Stores, 2011	Number of Stores, 2012	% Change
United Kingdom	670	720	7.5
Mexico	577	581	0.7
Australia	450	464	3.1
India	439	522	25.7
South Korea	358	372	3.9
Canada	354	368	3.9
Turkey	220	284	29.0
Japan	205	245	19.5
France	195	215	10.3
Taiwan	141	140	–

Source: Company documents.

more than 75 percent of all Domino's international stores. Note that the United Kingdom has the most Domino's of all countries, followed by Mexico. Among the company's six "international" supply chain centers, four of these are in Canada, one is in Alaska, and one is in Hawaii. (It is unclear why Domino's categorizes Alaska and Hawaii as international). As with Domestic franchisee stores, most of the company's revenue in the international division comes from royalty payments and advertising, as well as the sales of food and supplies to certain markets (predominantly Canada, Alaska, and Hawaii). Note in Exhibit 5 the rapid growth in Domino's stores in India, Turkey, and Japan. The largest Domino's franchisee outside the USA operates 911 stores.

Internal Issues

Domino's has a vertically integrated supply chain where they have backward control to some extent over many of its supplies such as dough, veggies, equipment, and uniforms and forward control over around 400 retail stores that are company owned. Domino's offers little to nothing in terms of healthy food options on the menu, such as salads or fruit. Although this approach enables Domino's to focus exclusively on pizza, this practice also increases the firm's vulnerability to the increasingly health-minded customer and possible government mandates for fast-food restaurants to stop using certain ingredients and preservatives, and potentially forcing all restaurants to label all nutrition information on the menu at the point of sale. Such a law would not be favorable to Domino's.

Domino's attributes much of its success to an incentive-based system for franchisees in which it actively shares in profits through increasing demand for new stores and through purchasing supplies from the Domino's supply chain. Domino's individual franchisee stores and company-owned stores also enjoy a simple and effective store layout enabling pizza delivery and carryout orders to be processed and executed efficiently as compared to many competitors. Unlike Domino's, many rival pizza firms use a dine-in business model, which is much more costly than Domino's strategy. Competitive advantages such as these make Domino's an attractive franchisee option in the quick-service restaurant (QSR) market because overhead and investment is generally cheaper than competing firms.

Sustainability

Sustainability refers to the extent that an organization's operations and actions protect, mend, and preserve rather than harm or destroy the natural environment. Many firms today develop an annual sustainability report, similar to an annual report, to reveal to stakeholders its actions and commitment to sustainability. However, Domino's does not produce an annual sustainability report nor does the company have a sustainability statement on its website.

Advertising and Sales Force

Dominos domestic stores contributed 5.5 percent of all retail sales to support national and local advertising campaigns. Domino's expects this rate to remain unchanged for the foreseeable future. Much of those monies are devoted to mass-mail flyers promoting specials at the local Domino's.

Domino's Pulse Point-of-Sale System

To maximize efficiencies and provide timely financial and marketing data, Domino's requires all stores to install and use its PULSE system that now exists in all company-owned stores and 98 percent of franchisee-owned stores. The system enables touch-screen ordering that improves order accuracy and efficiency and provides the driver with directions and the best route to take for multiple deliveries, saving time and money. In addition, the PULSE system better enables Domino's to ensure it receives full royalties from all transactions in what is often a cash business, assuming the franchisees are honest and always use the PULSE system when receiving orders.

Finance

Domino's recent income statements and balance sheets are provided in Exhibits 6 and 7, respectively. Note that Domino's revenues increased 2.6 percent in 2012 and the firm's long-term debt rose slightly to $1.53 billion. Note the company has zero goodwill on its balance sheet.

EXHIBIT 6 Domino's Pizza, Statements of Income (In thousands, except per share amounts)

	2010	2011	2012
REVENUES:			
Domestic company-owned stores	$ 345,636	$ 336,349	$ 323,652
Domestic franchise	173,345	187,007	195,000
Domestic supply chain	875,517	927,904	942,219
International	176,396	200,933	217,568
Total revenues	1,570,894	1,652,193	1,678,439
COST OF SALES:			
Domestic company-owned stores	278,297	267,066	247,391
Domestic supply chain	778,510	831,665	843,329
International	75,498	82,946	86,381
Total cost of sales	1,132,305	1,181,677	1,177,101
OPERATING MARGIN	438,589	470,516	501,338
GENERAL AND ADMINISTRATIVE	210,887	211,371	219,007
INCOME FROM OPERATIONS	227,702	259,145	282,331
INTEREST INCOME	244	296	304
INTEREST EXPENSE	(96,810)	(91,635)	(101,448)
OTHER	7,809	–	–
INCOME BEFORE PROVISION FOR INCOME TAXES	138,945	167,806	181,187
PROVISION FOR INCOME TAXES	51,028	62,445	68,795
NET INCOME	$ 87,917	$ 105,361	$ 112,392
EARNINGS PER SHARE:			
Common Stock—basic	$ 1.50	$ 1.79	$ 1.99
Common Stock—diluted	$ 1.45	$ 1.71	$ 1.91

Source: 2012 *Form 10K,* p. 50.

EXHIBIT 7 Continued

	2011	2012
LONG-TERM LIABILITIES:		
Long-term debt, less current portion	$ 1,450,369	$ 1,536,443
Insurance Reserves	21,334	24,195
Deferred income taxes	5,021	7,001
Other accrued liabilities	16,383	16,583
Total long-term liabilities	1,493,107	1,584,222
Total liabilities	1,690,282	1,813,720
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT:		
Common stock, par value $0.01 per share; 170,000,000 shares authorized; 57,741,208 in 2011 and 56,313,249 in 2012 issued and outstanding	577	563
Preferred stock, par value $0.01 per share; 5,000,000 shares authorized, none issued	–	–
Additional paid-in capital	–	1,664
Retained deficit	(1,207,915)	(1,335,364)
Accumulated other comprehensive loss	(2,401)	(2,386)
Total stockholders' deficit	(1,209,739)	(1,335,523)
Total liabilities and stockholders' deficit	$ 480,543	$ 478,197

Source: 2012 *Form 10K,* pp 48-49.

Competitors

Competition in both the USA and international pizza-delivery and carry-out business is extremely intense, with Pizza Hut (owned by Yum Brands) being the largest competitor in the industry. Pizza Hut's revenues are more than 60 percent greater than Domino's. Papa John's and Little Caesars are also fierce rivals in the industry. In fact, Little Caesars was listed as the fastest-growing pizza chain in 2010, with revenues up 13.6 percent over 2009, followed by Pizza Hut's 8 percent increase and Domino's 7.2 percent increase. In addition to the three main rivals, Domino's faces intense competition from many local mom-and-pop pizza stores, frozen pizzas from the grocery store, as well as hundreds of non-pizza fast-food options. Pizza Hut, Domino's, and Papa John's account for 51 percent of all consumer spending on pizza delivery stores in the USA, with the other 49 percent coming from regional or mom-and-pop establishments.

Internationally, Pizza Hut and Domino's are the main players in the industry, but various countries have numerous national companies and thousands of mom-and-pop pizza and Italian restaurants vie for business as well. As with the domestic market, some customers consider local pizza stores to offer better quality products than large chains and are willing to pay marginally higher prices for this perceived quality.

Another competitor is Pizza Inn Holdings, Inc., based in The Colony, Texas. Pizza Inn owns 10 stores and franchises out 300 more stores.

Pizza Hut

A division of Yum Brands, Pizza Hut is based in Plano, Texas, and operates more than 7,200 restaurants in the USA and more than 5,600 restaurants internationally in more than 90 countries. In contrast to Domino's, almost all Pizza Huts are dine-in restaurants. Pizza Huts serve pan pizza, as well as its thin n' crispy, stuffed crust, hand tossed, and sicilian. Other menu items include pasta, salads, and sandwiches. Pizza Huts offer dine-in service at its famous red-roofed restaurants, as well as carryout and delivery service. About 15 percent of all Pizza Huts are company-operated, whereas the remaining stores are franchised. The world's largest fast food company, YUM Brands also owns and operates Kentucky Fried Chicken (KFC), Long John Silvers, and Taco Bell. Pizza Hut is Domino's major pizza rival outside of the USA.

EXHIBIT 7 Domino's Pizza, Balance Sheets (In thousands except share and per share amounts)

	2011	2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 50,292	$ 54,813
Restricted cash and cash equivalents	92,612	60,015
Accounts receivable, net of reserves of $5,446 in 2011 and $5,906 in 2012	87,200	94,103
Inventories	30,702	31,061
Notes receivable, net of reserves of $324 in 2011 and $630 in 2012	945	1,858
Prepaid expenses and other	12,232	11,210
Advertising fund assets, restricted	36,281	37,917
Deferred income taxes	16,579	15,290
Total current assets	326,843	306,267
PROPERTY, PLANT AND EQUIPMENT:		
Land and buildings	23,714	24,460
Leasehold and other improvements	79,518	80,279
Equipment	171,726	168,452
Construction in Process	6,052	9,967
	281,010	283,158
Accumulated depreciation and amortization	(188,610)	(191,713)
Property, plant and equipment, net	92,400	91,445
OTHER ASSETS:		
Investments in marketable securities, restricted	1,538	2,097
Notes receivable, less current portion, net of reserves of $1,735 in 2011 and $814 in 2012	5,070	3,028
Deferred financing costs, net of accumulated amortization of $25,590 in 2011 and $5,201 in 2012	16,051	34,787
Goodwill	16,649	16,598
Capitalized software, net of accumulated amortization of $51,274 in 2011 and $48,381 in 2012	8,176	11,387
Other assets, net of accumulated amortization of $4,070 in 2011 and $4,404 in 2012	8,958	8,635
Deferred income taxes	4,858	3,953
Total other assets	61,300	80,485
Total assets	$ 480,543	$ 478,197
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES:	2011	2012
Current portion of long-term debt	$ 904	$ 24,349
Accounts payable	69,714	77,414
Accrued compensation	21,691	21,843
Accrued interest	15,775	15,035
Insurance reserves	13,023	12,964
Legal reserves	10,069	5,025
Advertising fund liabilities	36,281	37,917
Other accrued liabilities	29,718	34,951
Total current liabilities	$ 197,175	$ 229,498

Papa John's International, Inc.

Headquartered in Louisville, Kentucky, and founded in 1985, Papa John's operates 3,883 pizza restaurants with 3,255 of these being franchisee-owned and 628 being company-owned stores. Papa John's has restaurants in all 50 U.S. states and 32 foreign markets. The company currently has 16,500 full-time employees and markets its pizza under the slogan "better ingredients, better pizza." Between 2001 and 2012, Papa John's was ranked number one (by the American Customer Satisfaction Index) among national pizza chains for 10 of the 11 years during this period. The company reported revenue of more than $1.2 billion for year-end 2011, and consistent with the industry, it shows no revenue allocated to research and development. Papa John's carries $75 million in goodwill on its balance sheet; founder and CEO John Schnatter owns more than 20 percent of the chain. Papa John's offers several different pizza styles and topping choices, as well as a few specialty pies such as The Works and The Meats. Papa John's stores typically offer delivery and carryout service only.

Exhibit 8 provides a comparison between Domino's and Papa John's. Note that Domino's appears to generate more revenue with less employees, but that is not true because employees at franchised stores are not Domino's employees. Pizza Inn's 57 employees work at company-owned restaurants, not franchised stores.

Pizza Inn Holdings, Inc.

Pizza Inn is a relatively small chain of franchised quick-service pizza restaurants, with more than 300 locations in the USA and the Middle East. Pizza Inns offer pizzas, pastas, and sandwiches, along with salads and desserts. Most locations offer buffet-style and table service, whereas other units are strictly delivery and carryout units. The chain also has limited-menu express carryout units in convenience stores and airport terminals, and on college campuses. Pizza Inn's domestic locations are concentrated in more than 15 southern states, with about half located in Texas and North Carolina.

Little Caesars

Headquartered in Detroit, Michigan, and privately held, Little Caesars is famous for its advertising slogan, "Pizza! Pizza!" which was introduced in 1979. The phrase refers to two pizzas being offered for the comparable price of a single pizza from competitors. In November 2010, Little Caesars introduced Pizza! Pizza! Pantastic, denying that the return of "Pizza! Pizza!" had any relationship to the recent success of Domino's. Little Caesars operates under its parent Little Caesars Enterprises and is estimated to be the fourth largest pizza chain in the USA. Little Caesars operates in 30 foreign countries.

External Issues

Domino's competes in the Quick Service Restaurant (QSR) pizza category, which consists of two categories: 1) delivery and 2) carry-out. Delivery revenues for the industry in 2012 were $9.6 billion, up only slightly the last few years. The delivery portion accounts for 30 percent

EXHIBIT 8 A Comparison Between Domino's and Papa John's

	Domino's	Papa John's	Pizza Inn Holdings
Revenue	1.65B	1.24B	43.5M
Market Capitalization	1.76B	1.16B	20.1M
Gross Margin	0.29	0.31	0.12
Net Income	98.99M	55.97M	888K
EPS	1.63	2.24	0.10
Price/Earnings Ratio	18.67	21.69	24.51
Number of Employees	10K	16.5K	57

EPS, earnings per share.
Source: Company documents.

of the total QSP pizza revenues. However, the carry-out portion of the industry grew revenues from $14.1 billion in 2011 to $14.6 billion in 2012. Domino's is the market leader in delivery and second largest in carry-out. Outside of the USA, pizza delivery is underdeveloped, with Domino's and one rival being the only firms.

Nutrition Concerns

An area of concern for all fast-food establishments, including pizza stores, is the growing health-minded customer, as well as the growing pressure from government agencies to label all products with nutrition information. There have been battles between the restaurant industry and government agencies for many years, but much like the tobacco industry (in respect to labeling its products). It appears the war is close to being lost for the restaurant industry. Domino's itemizes nutrition information on its website, but forces the customer to add the calories for crust, sauce, cheese, and topping, and then divide by the number of slices to derive the total calorie count per slice. After doing the calculations, one large slice of hand-tossed pepperoni pizza for example has 300 calories and 12 grams of fat, and there are 8 slices in a pizza. To complicate matters for restaurants such as Domino's, it is difficult to provide accurate nutrition labels when there can be an almost endless combination of ingredients on a pizza. For example, someone may order a large sausage pizza with onions and olives whereas someone else might order extra cheese and tomatoes. Having to print out nutrition labels for all these combinations would be quite costly as opposed to a restaurant like McDonald's where it can print the nutrition label on the Big Mac because there is uniformity in ingredients and the label is understood to be for the base item. However, Domino's PULSE system could possibly be adjusted to resolve this potential issue.

Chipotle Mexican Grill claims to only use meat and dairy products from free-ranging cattle, as opposed to cattle injected with growth hormones. Domino's Pizza markets its pizzas as having gluten-free crust. This is an attempt to win over health-conscious customers, comply with government regulations, and make current customers feel a little less guilty about eating pizza. The tug of war between customers, governments, lawyers, and the restaurant industry on health issues is likely to continue for some time.

In response to these challenges, many restaurants have opted for healthy menu options. Wendy's, for example, has promoted several meal combinations that contain less than 10 grams of fat. All of these items were originally on its menu, just not marketed in that manner. Wendy's has added side salads and fruit to help cut down on calories, fat, and sodium. Subway is also famous for marketing its products as healthy alternatives to other fast-food options. Domino's, and many pizza competitors, offer few to no menu options for the health-conscious consumer.

Barriers to Entry

Barriers to entry are relatively low for the restaurant industry, but rivalry (competitiveness) among firms is exceptionally high. One large contributing factor for the low barriers to entry is many small entrepreneurs can open mom-and-pop establishments and bypass the franchise fees, royalties, selection process, and so on of owning a franchised restaurant and lease an existing building relatively cheap. However, even avoiding high fixed costs, variable costs are often high and small-scale entrepreneurs are not able to compete with larger franchise stores, who can better negotiate pricing on food, packaging, and other supplies. In the QSR industry, the bargaining power of consumers is quite powerful, availability of restaurant options in most places is abundant, and consequently there is intense price competitiveness among rival firms. Even if you are sure you want pizza for lunch or dinner, you likely have many options.

Economic Factors

The current landscape in the QSR business is a bimodal population distribution with a large population of bargain-minded customers seeking deals on cheaper end fast food options, and another population of more affluent consumers targeting middle to higher-end restaurants. Domino's is well positioned strategically to target the first group of consumers because there are many more of them; Domino's often has excellent sales and discounts to target this group.

Among the subset of customers who are value shoppers, many of these are also shoppers of quality and are willing to wait in line a little longer or pay a little more for better quality

food products. Domino's has recently capitalized on this well with the introduction of its artisan pizzas and new recipes (or higher quality products) for its crust, sauce, and cheeses. In addition, Domino's offers many pick up specials. Although an inconvenience over delivery, many customers in today's climate are willing to tolerate a degree of inconvenience that they historically were not if they can get a better deal.

Similar to Domino's, many restaurant owners in the fast-food industry have experienced stronger growth in international markets than domestic markets. This trend is expected to continue, especially in China and other developing nations because many U.S. fast-food options are still novel, even in Europe. According to the S&P Industry Surveys, QSRs are expected to see a sales increase of 3 percent in 2012 and orders to increase 1.5 percent as a result in large part of consumers trading down to cheaper restaurant alternatives. There also is a steadily growing international appetite for U.S. fast food and an improving global economy. These positive trends are expected to continue into 2013 and should bode well for Domino's with its strong international presence.

Ethics and Corporate Citizenship

Domino's has two extensive "Code of Ethics" documents on its website: one statement for its employees and one statement for its executives. The documents outline matters such as: conflicts of interest, how to report unethical conduct, fair dealing with all employees, compliance with laws, proper way to use company assets, and much more.

In addition to Domino's Code of Ethics statements, the company is noted for its corporate citizenship record in particular with St. Jude Children's Research Hospital. Since 2006, Domino's has donated more than $12 million to St. Jude and has hosted pizza parties for patients and its families on St. Jude properties.

In 1986, Domino's launched its Pizza Partners Foundation with a mission of "team members helping team members." The foundation is 100-percent funded by team member and franchise contributions and has disbursed nearly $12 million to aid team members facing crisis situations such as fire, illness, or other personal tragedies.

The Future

As CEO Doyle and his management team contemplate the future direction of Domino's, it has much to consider. Should the firm continue its aggressive market development strategies and accept the risk associated with expanding into markets it has little expertise operating within? What new geographic locations or regions should Domino's focus? Should Domino's simply follow Pizza Hut's international rollout of stores? How would this expansion affect the corporate structure of Domino's? Would restructuring by geographic division and thus establishing offices in Asia, the Middle East, and South America better enable them to manage these more risky environments? Can Domino's afford this financially? Should Domino's consider offering salads or a line of healthy menu options? Should Domino's purchase trucks to deliver its products rather than incurring such heavy leasing expenses?

Domino's needs a clear three-year strategic plan. Prepare this document for the company.

Royal Caribbean Cruises Ltd. — 2011

Mary R. Dittman
Francis Marion University

RCL

http://www.royalcaribbean.com

Royal Caribbean Cruises (RCC) is the world's second-largest cruise line. The company operates a fleet of 40 cruise ships (with two more under construction and slated for delivery in 2012 and 2014) under five brands: Royal Caribbean International, Celebrity Cruises, Pullmantur, Azamara Cruises, and CDF Croisieres de France. RCC also holds a 50 percent ownership interest in TUI Cruises, which caters to German-speaking customers. RCC's passenger capacity is approximately 92,300, but the two new ships under construction will bring total capacity to approximately 100,000.

The cruise industry is a multi-billion-dollar global entertainment and leisure industry that caters to multiple customer bases, from middle-class families to high-end socialites. In spite of recent economic downturns, the North American cruise market has grown—albeit slowly (only 0.9 percent 2006–2010). The real growth opportunity appears to be Europe, which has seen an increase of 12.4 percent. RCC is well-poised to compete in this growing European market, owning three separate cruise lines, which specifically cater to Spanish and Portuguese, French, and German passengers.

The advent of "short" cruises (as short as three days) and activities that appeal to specific age groups have helped make cruising one of the most popular forms of vacation. "Mega ships" and low prices have been instrumental in attracting families to the cruise industry, and high-end travelers still have plenty of choices when it comes to "luxury" cruising.

RCC offers land-tour vacations in Alaska, Asia, Australia, New Zealand, Canada, Europe, and South America. Incorporated in the Republic of Liberia, a country that has zero corporate income taxes, RCC is headquartered in Miami, Florida, and has offices around the world to service customers who wish to travel to the 420 destinations that RCL visits on all seven continents.

Fiscal 2011 Second Quarter Results

For the second quarter of 2011, RCC's net income rose 74 percent to $93.5 million versus $53.7 million in the same quarter a year earlier. RCC has reported double-digit year-over-year percentage revenue growth for the past five quarters. Over that span, the company has averaged growth of 13.8 percent, with the biggest boost coming in the second quarter of their 2010 fiscal year when revenue rose 18.7 percent from the year earlier quarter.

Total RCC revenue in the second quarter of 2011 increased 10.4 percent year-over-year to $1,767.9 million. At quarter-end, RCC had total assets worth $19.9 billion versus $19.7 billion at the end of 2010. RCC's net debt was 49.1 percent of capital, compared with 52.5 percent as of December 31, 2010. RCC declared a quarterly dividend of 10 cents per share payable on August 30, 2011. For the full-year 2011, RCC management expects earnings per share (EPS) in the range of $2.85 to $2.95, down from $3.10 to $3.30 projected the prior quarter. Net revenue yield is expected to be up 5 percent for the full-year.

Vision/Mission

RCC'S vision statement is as follows:

> Our vision is to empower and enable our Employees to deliver the best vacation experience for our Guests, thereby generating superior returns for our Shareholders and enhancing the well-being of our Communities.
>
> *Source:* Company documents.

RCC's mission statement is as follows:

We always provide service with a friendly greeting and a smile.
We anticipate the needs of our customers.
We make all efforts to exceed our customers' expectations.
We take ownership of any problem that is brought to our attention.
We engage in conduct that enhances our corporate reputation and employee morale.
We are committed to act in the highest ethical manner and respect the rights and dignity of others.
We are loyal to Royal Caribbean and Celebrity and strive for continuous improvement in everything we do.

RCC Brands or Segments

RCC has six primary cruise line brands: Royal Caribbean International, Celebrity Cruises, Azamara Club Cruises, Pullmantur, CDF Croisieres de France, and TUI Cruises.

Royal Caribbean International (RCL)

RCL comprises 22 ships with 62,000 berths. This is the ship's passenger capacity based on double occupancy. Many cabins will accommodate three or four passengers, but cruise lines use the term "berth" to quantify capacity based on two passengers per cabin. RCI cruises are marketed to adults and families who are looking for a quality cruise at a value price. The ships include family-friendly amenities such as rock-climbing walls, ice skating rinks, and surf simulators. One of the unique offerings of the RCI brand is that it is the first cruise line to serve Starbucks coffee onboard. RCI cruises visit approximately 100 ports of call globally.

RCI obtains customers through the brand's website (www.royalcaribbean.com), social media, and traditional print and broadcast advertising. Repeat bookings are encouraged through the brand's loyalty program, the Crown and Anchor Society. RCL's five million members of this loyalty program may earn points that can be used for future cruises, upgrades, and onboard amenities.

Celebrity Cruises

The Celebrity Cruise brand consists of 10 ships with 20,500 berths and calls on a variety of global ports. Celebrity is the only cruise line to operate a ship in the Galapagos Islands; this offering is typical of the Celebrity Cruises reputation for being a premium destination cruise line. Celebrity operates "Solstice-class" ships, which are wide-body ships that offer between 2,800 and 3,000 berths. Two new Solstice-class ships are on order and will be delivered in 2012 and 2014.

Celebrity prides itself on offering highly personalized service, including a 2:1 guest-to-staff ratio and high-end dining experiences. Also, many Celebrity cabins have private verandas. Celebrity Cruises is an authorized Apple computer reseller, allowing passengers to purchase Apple computers and other electronic devices while at sea.

The target market for Celebrity Cruises is experienced cruisers and affluent vacationers who want a high-end vacation at premium destinations with luxurious accommodations. The company communicates with customers via its website (www.celebritycruises.com), social media, and traditional print and broadcast media.

Celebrity Cruises offers the Captain's Club loyalty program to encourage repeat cruising with the line. The Captain's Club program currently has more than one million members.

Azamara Club Cruises (ACC)

ACC was launched in 2007 by Royal Caribbean Cruises to reach high-end travelers. The ACC line has two ships, offering 1,400 berths, and features 187 ports of call. The only U.S. departure ports are New York, New York; Boston, Massachusetts; and Miami, Florida. ACC is an affluent, luxury brand. Ships offer private butlers for each suite, and many of the

"standard" amenities onboard are considered "extras" on other ships. For example, wine, bottled water, sodas, gratuities, and self-service laundry facilities are all included in the cruise base price.

The smaller capacity ACC ships have a more intimate feel and cater primarily to high-end guests in North America, the United Kingdom, Germany, and Australia. ACC utilizes a website (www.azamaraclubcruises.com), print advertising in trade publications geared toward travel agencies, and trade advertising. The line also offers a loyalty program, Le Club Voyage, which features exclusive member invitations, spa treatments, and special wine tastings. Promoting these luxury benefits rather than promoting the accumulation of points appeals to the affluent vacationer target market.

Pullmantur

Pullmantur, a Madrid-based cruise line, operates five ships with 7,650 berths and caters to customers in Spain, Portugal, and Latin America. Pullmantur offers seven-night cruises in the Mediterranean, Caribbean, Baltic, and Atlantic arenas. The line is focused on Spanish- and Portuguese-speaking customers. All employees who have contact with customers are fluent in Spanish; those who work within the Portuguese-speaking markets are fluent in Portuguese.

Pullmantur owns a 49 percent interest in Pullmantur Air, which services the cruise line and provides the opportunity for passengers to book air travel and cruise accommodations through one website. Pullmantur promotes exclusively in Spanish and Portuguese. The company's website (www.pullmantur.es) is offered in Spanish.

CDF Croisieres de France (CDF)

Based in France, the CDF line targets French contemporary customers, and French is the only language spoken onboard. CDF has one ship, the Bleu de France, which has been sold to the British cruise line Saga. CDF is leasing the ship back from Saga until 2012, when CDF will receive L'Horizon, transferred from Pullmantur.

CDF cruises from Marseilles, France, to the Mediterranean in the summer, and from the Dominican Republic to the Caribbean in the winter. The Bleu de France has 750 berths, but the L'Horizon is slightly larger and will offer just over 900 berths.

CDF markets exclusively to French-speaking passengers and travel agents. The website (www.cdfcroisieresdefrance.com) is offered only in French.

TUI Cruises

In 2009, Royal Caribbean Cruises formed a joint venture with German-based TUI AG. TUI Cruises' first ship, the *Mein Schiff 1* (translated to "My Ship 1"), was originally the *Celebrity Galaxy*, built for Celebrity Cruises. In May 2011, the *Mein Schiff 2* entered into service. This ship was originally the *Celebrity Mercury*, built for Celebrity Cruises, but was renovated and transferred to TUI. Each ship has approximately 900 berths.

RCC's Finances

The only geographic reporting from RCC is that "55 percent of passenger ticket revenues originate in the United States, and 45 percent originate in all other countries." RCC does not break out North America, Europe, etc. Regarding brand reporting, the only statement in the *Form 10K* is as follows: "We operate five wholly-owned cruise brands, Royal Caribbean International, Celebrity Cruises, Pullmantur, Azamara Club Cruises and CDF Croisières de France. The brands have been aggregated as a single reportable segment based on the similarity of their economic characteristics, types of customers, regulatory environment, maintenance requirements, supporting systems and processes as well as products and services provided."

RCC's income statements and balance sheets are provided in Exhibits 1 and 2 respectively.

TUI Cruises (www.tuicruises.com) has ports of call in Nordic, Baltic, Mediterranean, and Caribbean destinations and caters to German-speaking passengers. Onboard dining, entertainment, and amenities are all focused on the contemporary German-speaking passenger, and German is the primary language used onboard.

EXHIBIT 1 RCC'S Consolidated Statements of Operations

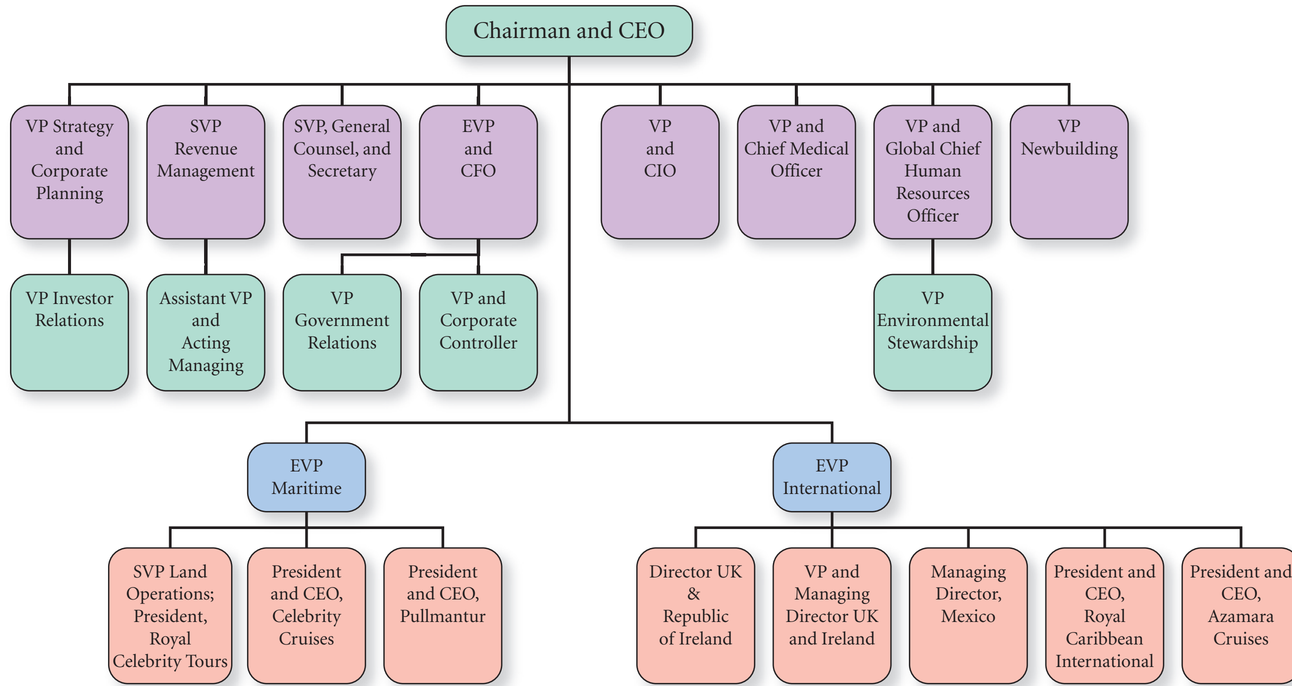
	Year Ended Dec. 31		
(in thousands of U.S. dollars, except per share data)	2010	2009	2008
Passenger ticket revenues	$ 4,908,644	$ 4,205,709	$ 4,730,289
Onboard and other revenues	1,843,860	1,684,117	1,802,236
Total revenues	6,752,504	5,889,826	6,532,525
Cruise operating expenses			
Commissions, transportation and other	1,175,522	1,028,86	1,192,316
Onboard and other	480,564	457,772	458,385
Payroll and related	767,586	681,852	657,721
Food	388,205	345,272	342,620
Fuel	646,998	600,203	722,007
Other operating	999,201	957,136	1,030,617
Total cruise operating expenses	4,458,076	4,071,102	4,403,666
Marketing, selling, and administrative expenses	848,079	761,999	776,522
Depreciation and amortization expenses	643,716	568,214	520,353
	5,949,871	5,401,315	5,700,541
Operating income	802,633	488,511	831,984
Other income (expense)			
Interest income	9,243	7,016	14,116
Interest expense, net of interest capitalized	(339,393)	(300,012)	(327,312)
Other income (expense)	74,984	(33,094)	54,934
	(255,166)	(326,090)	(258,262)
Net income	$547,467	$162,421	$ 573,722
Basic earnings per share			
Net income	$2.55	$0.76	$2.69
Diluted earnings per share			
Net income	$2.51	$0.75	$2.68

Source: Company documents.

EXHIBIT 2 RCC's Consolidated Balance Sheets

	As of Dec. 31	
(in thousands of U.S. dollars, except share data)	2010	2009
Assets		
Current assets		
Cash and cash equivalents	$419,929	$284,619
Trade and other receivables, net	266,710	338,804
Inventories	126,797	107,877
Prepaid expenses and other assets	145,144	180,997
Derivative financial instruments	56,491	114,094
Total current assets	1,015,071	1,026,391
Property and equipment, net	16,769,181	15,268,053
Goodwill	759,328	792,373
Other assets	1,151,324	1,146,677
TOTAL ASSETS	$19,694,904	$18,233,494

EXHIBIT 3 An RCC Organizational Chart



being placed into service in the European market to accommodate the growth. While cruising is a small part of the European vacation industry, more consumers are booking cruise vacations each year.

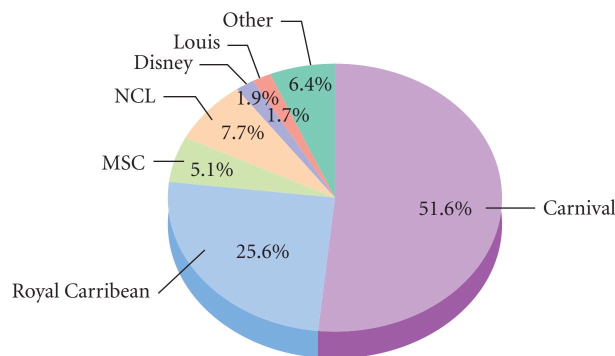
There has been speculation within the industry that Asia could become another significant cruise market, but there has been little growth in this segment, and many analysts disagree as to whether it is a viable market in the foreseeable future. For now, the indications seem to point toward growth in Europe.

Customers

Only 45 percent of the United States population has ever taken a cruise. Cruisers tend to be 45 years old or older; have higher household incomes (average is $93,000); and have at least a college degree. Most cruisers vacation with a spouse, and many bring children under the age of 18. They are more likely to vacation in general than noncruisers. Cruise passengers spend an average of $1,880 per person for the cruise, airfare, and onboard expenses.

Estimated 2011 average cruise revenue and expense per passenger for all cruise lines worldwide shows a profit per passenger of approximately 10 percent, as indicated in Exhibits 5.

EXHIBIT 4 Cruise Line Comparative Market Share Data



Source: www.cruisemarketwatch.com.

EXHIBIT 2 continued

	As of Dec. 31	
(in thousands of U.S. dollars, except share data)	2010	2009
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	1,198,929	756,215
Accounts payable	249,047	264,554
Accrued interest	160,906	147,547
Accrued expenses and other liabilities	552,543	521,190
Customer deposits	1,283,073	1,059,524
Total current liabilities	3,444,498	2,749,030
Long-term debt	7,951,187	7,663,555
Other long-term liabilities	356,717	321,192
TOTAL LIABILITIES	11,752,402	10,733,777
Shareholders' equity		
Preferred stock ($0.01 par value; 20,000,000 shares authorized; none outstanding)		
Common stock ($0.01 par value; 500,000,000 shares authorized; 226,211,731 and 224,258,247 shares issued, December 31, 2010, and December 31, 2009, respectively)	2,262	2,243
Paid-in capital	3,027,130	2,973,495
Retained earnings	5,301,748	4,754,950
Accumulated other comprehensive income	25,066	182,733
Treasury stock (10,308,683 common shares at cost, December 31, 2010, and December 31, 2009)	(413,704)	(413,704)
Total shareholders' equity	7,942,502	7,499,717
TOTAL LIABILITIES and SE	$19,694,904	18,233,494

Source: Company documents.

RCC's Organizational Structure

A list of RCC's top executives and an organizational chart for the company is provided in Exhibit 3.

The Cruise Industry

The global cruise industry carried approximately 17.3 million passengers in 2009 and approximately 18.7 million passengers in 2010. The worldwide cruise industry is estimated to be $29.34 billion for 2011. Specific market share percentage data is provided in Exhibit 4. Note that Carnival is the largest in this industry.

Royal Caribbean holds the second-largest market share, but Carnival still holds almost twice the share of Royal Caribbean. In 1990–2011, the cruise industry reported a compound annual growth rate of 7.67 percent. New "mega-ships" have created additional publicity for the cruise industry, and as cruise lines bring in the larger ships, smaller ships offering "short" cruises are able to serve the smaller ports—thus increasing the accessibility of cruising to more passengers. Having more ships also increases each line's economies of scale, which brings down the per-passenger cruise cost, thus making cruising more affordable.

North America is still the largest market for the cruise industry. However, growth rates for cruising have slowed significantly (less than 1 percent 2006–2009), most likely due to economic downturns. Europe is a significant growth market—during 2006–2010, the cruise industry grew by 12.4 percent. While the number of passengers in Europe remains at or below 50 percent of the number of passengers in North America, many cruise lines are investing in the European market. New ships are

EXHIBIT 5 Cruise Revenue and Expense Data

	Revenue	Expenses	
Ticket	$1,155		
Onboard spending			
Casino & bar	$206		
Shore excursions (cruise line portion of revenue)	$75		
Spa	$37		
All other onboard spending	$56		
Total onboard spending	$375		
TOTAL REVENUE	$1,530		
Corporate operating costs		$474	31.0%
Shipboard payroll		$169	11.0%
Agent commission		$162	10.6%
Depreciation & amortization		$153	10.0%
Ship fuel costs		$107	7.0%
Victualing (subsistence supplies)		$96	6.3%
Interest expense		$76	5.0%
Other ship expenses (port fees, etc.)		$69	4.5%
Other onboard operating costs		$67	4.4%
TOTAL EXPENSES		$1,424	
Profit before taxes		$157	**10.3%**

Source: www.cruisemarketwatch.com.

Travel Agency vs. Direct Booking

Consumers are increasingly more comfortable booking vacations online, either through a third-party site (Expedia, Hotwire, Orbitz, and others) or directly from the provider (airline, rental car, hotel, or cruise line). Perhaps surprisingly, travel agencies still generate the majority of Royal Caribbean's bookings. Royal Caribbean offers a website for travel agents (cruisingpower.com) and invests in extensive training and communication with agencies. The company also prioritizes maintaining a competitive commission and incentive structure to motivate travel agents to book passengers on Royal Caribbean ships.

Cruisers use Facebook and Twitter to connect with people and companies. Facebook has more than 500 million users, and 70 percent of Facebook's users are outside the United States. In April 2011, Carnival had more than twice the number of Twitter followers and Facebook fans as Royal Caribbean had.

Marketing through social media networks such as Twitter and Facebook is replacing many traditional forms of marketing. Consumers expect to see promotions and special offers and deals on a company's Facebook page. For the company, advertising on Facebook is less expensive than traditional media outlets, and since the consumer is already online, he or she is one click away from the company's website. In the case of Royal Caribbean, this means a Royal Caribbean Facebook "fan" clicks one link and is directed to the portion of the website where he or she may locate and book a cruise.

Environmental Impact Issues

Cruise ships are heavily regulated and are subject to laws and regulations in many areas: the country in which the ship is registered, the port where the ship is stationed, international law, and their own company policies. The International Maritime Organization (IMO) adopted the MARPOL 73/78 Convention (short for two "Marine Pollution" treaties that were adopted in 1973 and 1978). MARPOL addresses six areas of marine pollution:

ANNEX I – Oil

ANNEX II – Noxious Liquid Substances Carried in Bulk

ANNEX III – Harmful Substances Carried in Packaged Form

ANNEX IV – Sewage

ANNEX V – Garbage

ANNEX VI – Air Pollution

MARPOL regulates merchant ships as well as cruise ships. Some areas of MARPOL legislation do not apply to cruise ships, but waste from sewage, food preparation, and emissions are issues for cruise ships. With any large ship, there is also the danger of oil spills or release of other harmful substances resulting from an accident or from a mechanical failure. Obviously, these situations are harmful to marine life. Another area for concern with respect to marine life is marine life colliding with the ships; for example, there have been instances where whales have run into ships. This can be harmful to the ship and fatal to the marine life.

Royal Caribbean has a comprehensive program to manage environmental issues. RCL has the Save the Waves program, which carries environmental awareness into daily ship operations. There are four components to the Save the Waves program:

1. Reduce, Reuse, Recycle—reuse and recycle where possible, reduce waste material, and dispose of waste properly.
2. Practice Pollution Prevention—“Nothing may be thrown overboard. Nothing.”
3. Go Above and Beyond Compliance (ABC)—the company has policies that require more than what is required by law.
4. Continuous Improvement—a commitment to innovate and incorporate new ideas for reducing environmental impact.

Royal Caribbean provides copious amounts of information and has very detailed policies regarding environmental issues. Every employee, regardless of rank or job description (including port employees), is trained extensively in the company’s policies as well as the legalities surrounding the issues of environment.

For the industry, one of the topics of discussion is the future of cruise ship design—is it possible to manufacture a truly “green” cruise ship? Furthermore, would there be enough demand for such a cruise, and how much more would passengers be willing to pay for such an experience? Most cruise lines have internal policies to reduce environmental impact, including recycling while on board, opportunities for passengers to reuse towels, and the use of flow-restrictive shower heads.

Competition

Carnival Corporation & plc

The largest cruise line in the world, Carnival holds more than 50 percent of the cruise market share and had revenues of more than $14.5 billion in 2010. Approximately 8.5 million people vacation with Carnival every year. In North America, Carnival holds the Carnival Cruise Lines, Princess Cruises (featured in the popular TV series *The Love Boat*), Holland America Line, The Yachts of Seabourn, Cunard Line (which holds the world’s largest ocean liner, the *Queen Mary 2*), and Costa Cruises brands.

Carnival’s European brands include Costa Cruises (Italy), Aida Cruises (Germany), and Ibero Cruises (Spain). In the United Kingdom, Carnival holds the P&O Cruises, Princess Cruises, Ocean Village, and Cunard Line brands. Many of Carnival’s brands are considered luxury or premium cruise lines; however, the U.S.-focused Carnival Cruise Line focuses on affordable family cruises. Carnival is intent on holding and growing market share in North America, the largest cruise industry market. Carnival is also growing market share in other markets, including Europe, the United Kingdom, Asia, and Australia.

Carnival spends approximately $500 million per year on advertising, marketing, and promotion. The company makes use of social networking sites (such as Facebook and Twitter), which reach more people and cost significantly less than traditional advertising methods.

Disney Cruise Line

Disney’s ocean liners are designed to appeal to families—both the children and the parents. The cruises are popular with families hosting multigenerational family reunions. Unlike other cruise

lines, Disney's ships have neither casinos nor libraries. The ships do have three primary public spaces: Diversions, for sports enthusiasts; Cove Café, the adults-only coffee bar; and a new teen-centric coffee bar gathering place for teenagers.

Disney Cruise Line was the first to introduce the "soda card," a prepaid card that allows the cardholder to order unlimited sodas while onboard. Many cruise lines have adopted this idea, and it is a highly popular offering. Soda cards will typically run $4–$6 per day, but individual sodas may cost between $1.25 and $2.50.

Disney does not report cruise line revenues separately; the corporation includes cruise revenue in "Parks and Resorts," a segment which brought in revenues of $10,761,000,000 in 2010. Disney's new 4,000-passenger ship *Disney Dream* was christened at Port Canaveral in 2011 and was designed especially for families. *Disney Dream* joins *Disney Magic* and *Disney Wonder*, with another new ship, *Disney Fantasy,* scheduled to join the Disney fleet in 2012. *Disney Dream* will sail to Disney's private island, Castaway Cay.

Norwegian Cruise Line (NCL)

Norwegian Cruise Line has 11 cruise ships and positions itself as an innovator in the cruise industry. The ships feature new types of accommodations, including one ship with 60 suites and villas located on two private decks on the top of the ship. NCL also offers studio staterooms for solo travelers. NCL boasts name-brand entertainment at sea, such as the Blue Man Group, Cirque de Soleil, and others. They also feature unique nightlife options—some of which are offered day and night.

NCL is not only a high-end innovator, it also caters to families, offering a water park, rock-climbing walls, rappelling (the first ever on a cruise ship), two bowling alleys, as well as separate activity areas for kids and teens. NCL reported total revenues of $2.012 billion in 2010, up from $1.855 billion in 2009. Total operating expenses were higher in 2010, and NCL's net income fell from $67 billion in 2009 to $22 billion in 2010.

Some comparative information about rival cruise lines is given below:

	Carnival	Disney	NCL	Royal Caribbean
2009 Revenue	$13.16 billion	Not available	$1.85 billion	$5.89 billion
2010 Revenue	$14.5 billion	Not available	$2.01 billion	$6.75 billion
Passenger Capacity	214,590	11,000	33,534	100,030
Number of Ships	104	4	11	42

The Future

RCC has two new Solstice-class ships on order (delivery slated for 2012 and 2014). Existing ships are maintained and upgraded, sometimes being shifted between segments to meet fluctuating market demand. Differentiating RCC lines from competing cruise lines is a priority. Consumers are always on the lookout for the unique, new twist on a familiar vacation. RCC's commitment to continuous improvement in the areas of social media marketing, technological advances, and onboard experiences will be critical as the company moves into the future.

Fuel is one of the largest components of cruise line expenses, representing 14.1 percent of the total for the first quarter of 2011, up from 13.6 percent for the same quarter the prior year. Fuel prices are going up. Cruise ships typically burn a low grade of fuel called "bunker" fuel, the price for which rose from $497 per metric ton last year to $543 for Q1 this year. A metric ton contains 302 gallons, so the cost per gallon for Q1 was $1.80, much lower than gasoline.

Political unrest in the Mediterranean has reduced demand for cruising in that area. Piracy off the African coast has reduced demand for cruising there. Carnival is using its more than double revenue base and more than double berth capacity to gain economies of scale on RCC.

Prepare a three-year strategic plan for RCC that will enable the firm to cruise into 2012–2013 in calm waters.

Carnival Corporation & plc — 2011

Mernoush Banton
Adjunct Professor/Consultant

CCL

www.carnivalcorp.com

Headquartered in Miami, Florida, Carnival Corporation is the largest and one of the most successful cruise lines in the world, carrying more passengers than any other cruise line. On April 27, 2011, Carnival added its 100th ship to its collection, called *Carnival Magic*. The 130,000-ton new cruise ship offers RedFrog Pub, a colorful Caribbean-inspired watering hole featuring its own private label draught beer; Cucina del Capitano, a family-style Italian restaurant that brings the heritage of Carnival's captains to the table; and SportSquare, an expansive open-air recreation complex with the first ropes course and outdoor fitness area at sea.

In ceremonies at the Fincantieri shipyard in Monfalcone, Italy, where Carnival Magic was built, and in recognition of this achievement, on April 29, 2011 all guests sailing aboard Carnival's 100 ships enjoyed a complimentary champagne toast at dinner to commemorate this historic milestone. More than 227,000 guests across the company's 10 cruise brands participated in the toast, believed to be the largest celebration of its kind at sea. Following the traditional maritime handover ceremony in Italy, Carnival Magic began its first sailing on May 1 with a nine-day Mediterranean cruise from Venice to Barcelona.

On Monday, August 8, 2011 the U.S. stock market dropped 612 points following a 512 point drop the prior Thursday. Carnival Corp. & plc on August 8 reached agreements for construction of three new cruise ships—a 132,500-ton vessel for its Costa Cruises brand and two 125,000-ton ships for its AIDA Cruises brand. The ships will be the largest ever constructed for these two cruise lines. Italian shipbuilder Fincantieri is building Carnival's new 3,700-passenger ship for Costa that is scheduled for delivery in October 2014. The total cost for this vessel will be approximately euro 150,000 per lower berth.

Also on August 8, Carnival signed an agreement with Japan's Mitsubishi Heavy Industries to build two 3,250-passenger ships for AIDA to be delivered in March 2015 and March 2016. The total cost for these vessels will be approximately euro 140,000 per lower berth. This order marks a return by Carnival to Mitsubishi Heavy Industries which built two highly successful ships for Princess Cruises, both of which were delivered in 2004. The contract with Fincantieri continues the company's longstanding and successful relationship with the Italian shipbuilder, which dates back nearly 20 years.

Carnival's new ship orders also mark a continuation of the company's strategy of introducing two to three ships per year. Including the new orders for Costa and AIDA, Carnival Corp. & plc currently has 10 ships on order—three for 2012, two for 2013, two for 2014, two for 2015, and one for 2016. Delivery of the new Costa ship in fall 2014 is expected to replace capacity from the sale of certain older Costa ships beginning with the sale of Costa Marina, which will depart the fleet in November 2011.

Carnival is the largest cruise vacation group in the world, with a portfolio of cruise brands in North America, Europe, Australia and Asia, comprised of Carnival Cruise Lines, Holland America Line, Princess Cruises, Seabourn, AIDA Cruises, Costa Cruises, Cunard, Ibero Cruises, P&O Cruises (UK) and P&O Cruises (Australia). Together, these brands operate 101 ships totaling approximately 200,000 lower berths with 10 new ships scheduled to be delivered between May 2012 and March 2016. Carnival Corp. & plc also operates Holland America Princess Alaska Tours, the leading tour company in Alaska and the Canadian Yukon.

History

Basically for tax reasons, Carnival Corp. is incorporated in Panama and Carnival plc is incorporated in England and Wales. Carnival Corp. and Carnival plc operate as a dual listed company ("DLC"). The Carnival Corp. was created in 1993, but the core of the cruise line was created when its flagship brand Carnival Cruise Lines was formed in 1972.

Carnival acquired Holland America Line in 1989; the Windstar Cruises and Alaskan/Canadian tour operator Holland America Tours; luxury brand Seabourn Cruise Line in 1992; contemporary operator Costa Cruises, Europe's leading cruise company, in 1997; and premium/luxury operator Cunard Line in 1998, which built the world's largest ocean liner, the 150,000-ton *Queen Mary 2*.

In 2003, an agreement was made to merge Carnival Corp. with P&O Princess Cruises. This merger developed a global vacation leader with 12 brands of 66 ships and over 100,000 lower berths, creating one of the largest leisure travel companies in the world. In 2004, The Cousteau Society and Carnival Corp. reached an agreement to restore the *Calipso* (a research and expedition vessel of Captain Jacques Yves Cousteau). The *Calipso* became an exhibit representing science and the environment. This was a unique opportunity for Carnival Corporation to preserve a small part of history and maintain a world-famous icon for marine research and environmental preservation. Funding this restoration by Carnival Corp. was a tribute to the Cousteau organization. Restoring the *Calipso* would continue to educate the public on the importance of protecting our precious natural resources.

In 2007, Carnival acquired Ibero, which operates four contemporary cruise ships, including *Grand Holiday* (formally Carnival Cruise Lines' *Holiday*), which entered Ibero service in May 2010. Substantially, all of Ibero's guests are sourced from Spain, Brazil, and Argentina. Ibero's ships are especially tailored to the Spanish market, including Spanish-speaking crew as well as Mediterranean and Spanish-style food and entertainment. Exhibit 1 reveals Carnival's past, present, and future company plans through 2014.

Mission/Vision

Per the company's website, the mission statement reads: "Our mission is to deliver exceptional vacation experiences through the world's best-known cruise brands that cater to a variety of different lifestyles and budgets, all at an outstanding value unrivaled on land or at sea." The company does not have a vision statement.

EXHIBIT 1 Recent Timeline for Carnival Corp.

2001	Carnival introduces a new class of vessel with the launch of the 88,500-ton Carnival *Spirit*, the first new "Fun Ship" ever positioned in the Alaska and Hawaii markets.
2002	A second "Spirit-class" vessel, the Carnival *Pride*, is launched.
	Carnival's third "Spirit-class" ship, Carnival *Legend*, enters service.
	Debut of the 110,000-ton Carnival *Conquest*, the largest "Fun Ship" ever constructed.
2003	Second 110,000-ton "Conquest-class" ship, the Carnival *Glory*, begins year-round, seven-day cruises from Port Canaveral, Florida, July 19.
2004	Carnival *Miracle*, the fourth in Carnival's "Spirit-class," begins a series of 12 voyages from Jacksonville, Florida—the first "Fun Ship" sailing from that port—Feb. 27, 2004.
	A third 110,000-ton "Conquest-class" ship, the Carnival *Valor*, begins year-round, seven-day service from Miami Dec. 19, 2004, becoming the largest "Fun Ship" ever based at that port.
2005	A fourth 110,000-ton "Conquest-class" vessel, Carnival *Liberty*, debuts July 20, 2005, operating Carnival's first-ever Mediterranean cruises.
2007	Carnival *Freedom*, the line's fifth 110,000-ton vessel, debuts in Europe, operating 12-day voyages to the Mediterranean, Greek Isles, and Turkey.
	In 2007, Carnival acquired Ibero, which operates four contemporary cruise ships, including *Grand Holiday* (formally Carnival Cruise Lines' *Holiday*), which entered Ibero service in May 2010.
2008	The 113,300-ton Carnival *Splendor* is slated to debut in July 13, 2008, operating Carnival's first Northern Europe cruise program.
2009	Carnival *Dream*, a 130,000-ton vessel, to be the largest "Fun Ship" ever constructed, is scheduled to enter service in October 2009, beginning a new class of vessel for the line.
2011	A second 130,000-ton SuperLiner, Carnival *Magic*, is slated to debut in June 2011.

Source: www.carnival.com.

Management

Carnival's objectives are to use its brands to reach every tier of the cruise market. Carnival is focused on providing services to travelers regardless of the vacationers' budget, itinerary, geography, demographics, or psychographics. This is part of the uniqueness of its North American cruise market, if not in the world. The company recognizes that vacationers, more than anything else, want to have fun, and they recognize that Carnival offers them the ultimate fun experience. Carnival's goal is to meet the needs of vacationers seeking luxury, elegance, shorter vacations, exotic destinations, or land/sea packages. A focus in its other brands—Holland America, Windstar, Seabourn, Costa, and Airtour's Sun Cruises—is to provide vacations that charm virtually every potential cruise customer, a strategy that has made it the leader in every market and the most popular choice among consumers who are thinking about a cruise vacation.

Key people at Carnival are Micky Arison, chairman & CEO, and Howard S. Frank, vice chairman & COO. As shown in Exhibit 2, the key executives oversee all businesses of the company, which are: AIDA Cruises, Carnival Cruise Lines, Carnival Australia, Carnival UK, Costa Crociere S.p.A., Cunard Line, Holland America Line, Princess Cruises, and Seabourn Cruise Line.

Finance

Traded on both the New York and London Stock Exchanges, Carnival is the largest cruise vacation group in the world, operating 100 cruise ships with 200,000+ passenger capacity in North America, Europe, the United Kingdom, Germany, Australia, and New Zealand. In fiscal year 2010, Carnival reported record revenues of $11 billion and net income of $1.978 billion. The company carried 9.1 million passengers on its ships in 2010, up from 8.5 million in 2009. Exhibits 3 and 4 provide the company's consolidated financial statements. The company is heavily invested in ships it owns, as well as other assets such as buildings, land, and leasehold improvements. Note the money committed to ships under construction as indicated in Exhibit 5.

EXHIBIT 2 Organizational Chart for Carnival Corp. & plc

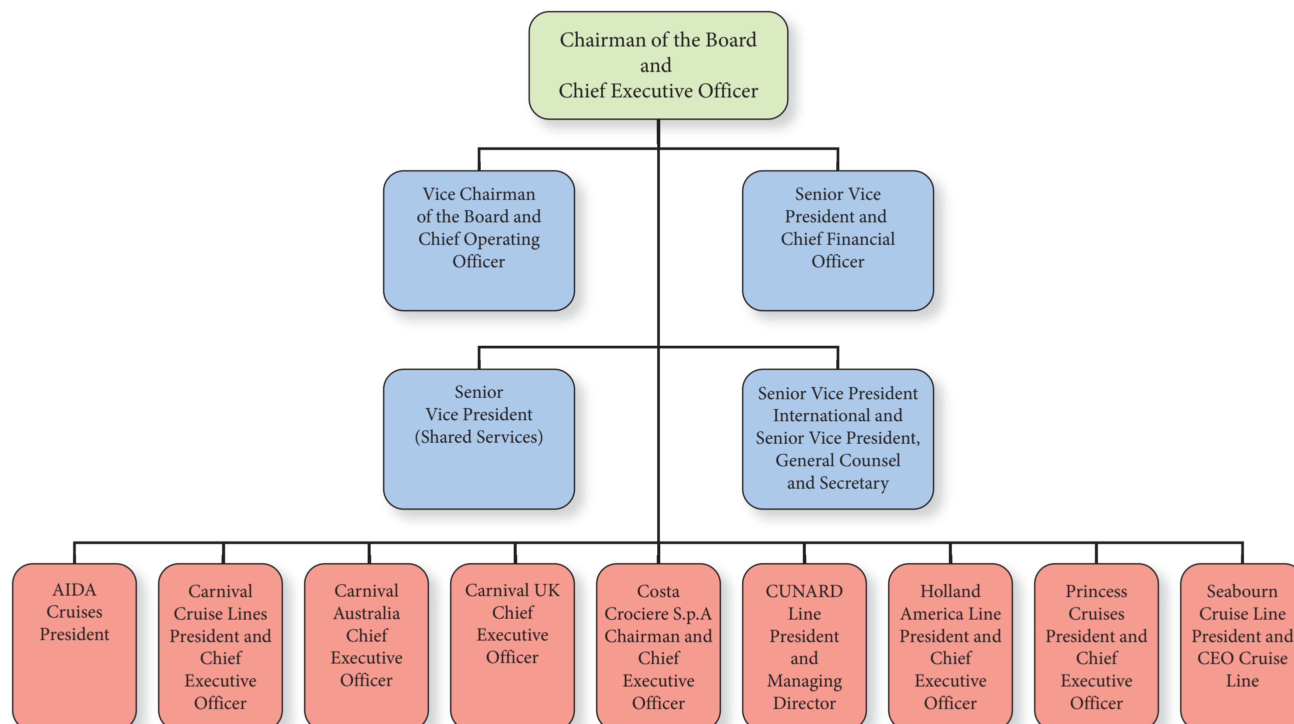


EXHIBIT 3 Carnival Corp. & plc, Consolidated Statements of Operations (in millions, except per share data)

	Year Ended Nov. 30		
	2010	2009	2008
Revenues			
Cruise			
Passenger tickets	$11,084	$10,288	$11,511
Onboard and other	3,104	2,885	3,044
Tour and other	281	287	392
	14,469	13,460	14,947
Costs and Expenses			
Operating			
Cruise			
Commissions, transportation, and other	2,272	2,220	2,533
Onboard and other	474	461	501
Payroll and related	1,611	1,498	1,470
Fuel	1,622	1,156	1,774
Food	869	839	856
Other ship operating	2,032	1,997	1,913
Tour and other	212	236	293
Total	**9,092**	**8,407**	**9,340**
Selling and administrative	1,614	1,590	1,629
Depreciation and amortization	1,416	1,309	1,249
	12,122	11,306	12,218
Operating Income	**2,347**	**2,154**	**2,729**
Nonoperating (expense) income			
Interest income	12	14	35
Interest expense, net of capitalized interest	(378)	(380)	(420)
Other (expense) income, net	(2)	18	27
	(368)	(348)	(358)
Income Before Income Taxes	1,979	1,806	2,371
Income tax expense, net	(1)	(16)	(47)
Net Income	**$1,978**	**$1,790**	**$2,324**
Earnings per share			
Basic	$2.51	$2.27	$2.96
Diluted	$2.47	$2.24	$2.90
Dividends Declared Per Share	$0.40		$1.60

Source: Carnival Corp. & plc, *Form10K*, 2010 (p. F-1).

EXHIBIT 4 Carnival Corp. & plc, Consolidated Balance Sheet (in millions)

	Nov. 30	
	2010	2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 429	$ 538
Trade and other receivables, net	248	362
Inventories	320	320
Prepaid expenses and other	247	298
Total current assets	1,244	1,518

(*continued*)

EXHIBIT 4 continued

	Nov. 30	
	2010	2009
Property and equipment, net	30,967	29,870
Goodwill	3,320	3,451
Other Intangibles	1,320	1,346
Other Assets	639	650
TOTAL ASSETS	**$37,490**	**$36,835**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term borrowings	$ 740	$ 135
Current portion of long-term debt	613	815
Accounts payable	503	568
Accrued liabilities and other	1,094	874
Customer deposits	2,805	2,575
Total current liabilities	5,755	4,967
Long-Term Debt	8,011	9,097
Other long-term liabilities and deferred income	693	732
TOTAL LIABILITIES	**14,459**	**14,796**
Shareholders' Equity		
Common stock of Carnival Corporation, $0.01 par value; 1,960 shares authorized; 646 shares at 2010 and 644 shares at 2009 issued	6	6
Ordinary shares of Carnival plc, $1.66 par value; 214 shares at 2010 and 213 shares at 2009 issued	355	354
Additional paid-in capital	8,094	7,920
Retained earnings	17,224	15,561
Accumulated other comprehensive (loss) income	(254)	462
Treasury stock, 39 shares at 2010 and 24 shares at 2009 of Carnival Corporation and 31 shares at 2010 and 46 shares at 2009 of Carnival plc, at cost	(2,394)	(2,264)
Total shareholders' equity	23,031	22,039
TOTAL LIABILITIES AND SE	**$37,490**	**$36,835**

Source: Carnival Corp. & plc, *Form 10K*, 2010 (p. F-2).

EXHIBIT 5 Property and equipment (in millions)

	Nov. 30, 2010	Nov. 30, 2009
Ships	$37,348	$35,187
Ships under construction	696	770
	38,044	35,957
Land, buildings and improvements, including leasehold improvements and port facilities	858	864
Computer hardware and software, transportation equipment, and other	934	913
Total property and equipment	39,836	37,734
Less accumulated depreciation and amortization	(8,869)	(7,864)
TOTAL	$30,967	$ 29,870

Source: Carnival Corp. & plc, *Form 10K*, 2010 (p. F-9).

Marketing

Carnival is in the service business and thus invests heavily in customer service for their passengers as well as assisting travel agents. The company sells its cruises and vacation packages mainly through travel agents, including wholesalers and tour operators. Travel agents generally receive standard commissions of 10 percent, plus the potential of additional commissions based on sales volume. During fiscal 2010, no controlled group of travel agencies accounted for 10 percent or more of its revenues.

Various Carnival marketing activities and techniques include websites, seminars and videos, direct-response marketing, and a vast variety of media such as television, magazine, newspaper, radio, and other promotional campaigns. The company also has a partnership with major airline computer reservation systems such as SABRE, Galileo, Amadeus, and Worldspan. Although the vast majority of cruises are booked through travel agents, Carnival also accepts telephone and Internet bookings direct from customers.

Carnival has developed an excellent interactive website, which offers vacationers the opportunity to scan locations, packages, prices, promotions, etc. As an enticement to vacationers, features offered on the website include discounted cruises, singles cruises, resident discounts, different departure locations, VIP savings, free personal customer service via telephone, elderly packages, special meals, and holiday deals. Carnival also has expanded its promotional campaign online and through social media such as Facebook, Twitter, YouTube, and many others. In January 2011, one of the North American cruise brands started accepting cruise bookings via Facebook, which has over 500 million users. Carnival's Advertising expenses totaled $507 million, $508 million, and $524 million, in fiscal 2010, 2009, and 2008, respectively.

Carnival has signed agreements with shipyards for providing 10 additional cruise ships to be released between March 2010 and June 2014. These additions are expected to increase the passenger capacity by 26,300, or 13.7 percent. Note the high occupancy rates revealed in Exhibit 6. Note the various divisions of Carnival and its respective number of ships in service as revealed in Exhibit 7.

Industry Overview

In recent years, the multinight cruise industry has had significant growth, but it still remains a small part of the wider global vacation market. Since this market is sensitive to consumer's discretionary income, consumers aggressively look for deals, discounts, and other substitute vacation categories or locations. Based on a report published by Florida-Caribbean Cruise Association, over 13.445 million passengers cruised in 2009, approximately 3.5 percent more than 2008. In

EXHIBIT 6 Passengers, Capacity, and Occupancy

Fiscal Year	Cruise Passengers (a)	Year-End Passenger Capacity (b)	Occupancy (c)
2005	6,848,000	136,960	105.6%
2006	7,008,000	143,676	106.0%
2007	7,672,000	158,352	105.6%
2008	8,183,000	169,040	105.7%
2009	8,519,000	180,746	105.5%
2010	9,147,000	191,464	105.6%

a. The number of cruise passengers we carried as a percentage of the global cruise industry's cruise passengers is estimated to have grown to 49.2 percent in 2010 from 47.7 percent in 2005.

b. Our passenger capacity has grown from 136,960 berths at November 30, 2005, to 191,464 berths at November 30, 2010, net of disposals, primarily because of the deliveries of 24 new cruise ships during this five-year period.

c. In accordance with cruise industry practice, occupancy is calculated using a denominator of two passengers per cabin, even though some cabins can accommodate three or more passengers. Percentages in excess of 100 percent indicate that, on average, more than two passengers occupied some cabins.

Source: Carnival Corp. & plc, *10K*, 2010 (p. 7).

EXHIBIT 8 Growth in the Global Cruise Business

Year	Global Cruise Passengers	Weighted-Average Supply of Berths Marketed Globally	North American Cruise Passengers	Weighted-Average Supply of Berths Marketed in North America	European Cruise Passengers	Weighted-Average Supply of Berths Marketed in Europe
2006	15,309,000	304,000	10,078,000	201,000	3,460,000	97,000
2007	16,586,000	327,000	10,247,000	212,000	4,080,000	105,000
2008	17,184,000	347,000	10,093,000	219,000	4,500,000	120,000
2009	17,340,000	363,000	10,198,000	222,000	5,000,000	131,000
2010	18,740,000	388,000	10,450,000	232,000	5,448,000	142,000

Source: Royal Caribbean Cruises, Ltd., *10K*, 2010 (p. 4).

(56 to 44), and there is a recent surge of interest from those aged 25 years or older with household earnings of $40,000+. This segment represents 43 percent of the total population. Within this segment, 44.6 percent indicate that they have taken a cruise, and 22.7 percent have traveled on a cruise in the past three years. Most cruise vacationers travel with their spouse (75 percent), while some travel with children under 18 (25 percent), friends (23 percent), and other family members (21 percent). It is reported that approximately 19.9 percent of the total U.S. population has traveled with a cruise ship and, within this group, 9.9 percent have been on a cruise within the last three years.

On average, individuals spend $1,770 per person per week, whereas noncruise vacationers spend an average of $1,200 per week. Typically, cruise passengers who are 50 years of age have a household income of $109,000, of which 69 percent have graduate or post-graduate degrees. Within this group, 86 percent are married and 62 percent are employed full-time. Exhibit 9 provides an overview as to why many vacationers would consider cruise travel versus noncruise traveling. Many potential cruise travelers prefer to travel less and be somewhat close to embarkation points (72 percent), and they claim that they prefer cruise travel because of convenience to drive to the port (71 percent), cost savings (67 percent), and fewer airport hassles and plane delays (64 percent). Exhibit 10 reveals the most appealing destinations to cruise. The dominant factors that influence someone to choose a cruise vacation are: 1) destination websites (39 percent), 2) word-of-mouth referrals (33 percent), 3) spouses (32 percent), and 4) cruise websites (28 percent).

Barriers to Entry

The industry has a relatively high entry barrier but has a low penetration level. To get into this industry, it requires a large sum of investment, waiting period for the ship to be built, many legal

EXHIBIT 9 Reasons for Vacationing via Cruise versus Noncruise

Reasons for Cruise Travel	Cruisers	Noncruisers
Explore a vacation area to return later	62%	30%
Good value for the money	53%	22%
Offers something for everyone	59%	31%
Reliable	49%	22%
Safe	45%	18%
Relax/get away from it all	63%	37%
Hassle-free	58%	32%
Fun vacation	53%	28%

Source: Florida-Caribbean Cruise Association, 2011.

EXHIBIT 7 Carnival's Brands, Number of Ships, Passenger Capacity, Primary Market (November 2010)

Cruise Brand	Passenger Capacity (a)	Number of Cruise Ships	Primary Market
North America			
Carnival Cruise Lines	54,480	22	North America
Princess Cruises ("Princess")	37,608	17	North America
Holland America Line	23,492	15	North America
Seabourn	1,524	5	North America
North America Cruise Brands	117,104	59	
Europe, Australia, & Asia ("EAA")			
Costa Cruises ("Costa")	29,202	14	Italy, France, & Germany
P&O Cruises (U.K.) (b)	15,098	7	United Kingdom ("U.K.")
AIDA Cruises ("AIDA")	12,054	7	Germany
Cunard	6,676	3	U.K. and North America
P&O Cruises (Australia)	6,322	4	Australia
Ibero Cruises ("Ibero")	5,008	4	Spain and South America
EAA Cruise Brands	74,360	39	
	191,464	98	

(a) In accordance with cruise industry practice, passenger capacity is calculated based on two passengers per cabin, even though some cabins can accommodate three or more passengers.

(b) Includes the 1,200-passenger-capacity *Artemis*, which was sold in October 2009 to an unrelated entity and is being operated by P&O Cruises (U.K.) under a bareboat charter agreement until April 2011.

Source: Carnival Corp. & plc, *10K*, 2010 (p. F-7).

2009, 14 new ships debuted in the world's waters for the first time. These ships, which carried from 82 to 5,400 passengers, were: AMA Waterways, Avalon Waterways, Carnival Cruise Lines, Celebrity, Costa, MSC Cruises, Royal Caribbean International, and a few more.

Utilization or occupancy of most cruise ships is 100 percent, which means the ships are often full to the capacity before departure. Also, the Caribbean seems to be the number-one destination for many cruise ships, with 37.02 percent of capacity in 2009. By 2012, it is estimated that 26 new ships are contracted or planned to be added to the North American fleet, at a cost of nearly $15 billion. These ships are equipped with state-of-the art technology, entertainment facilities, restaurants, shops, and casinos.

The industry has been growing annually at an average of 7.4 percent. Although many take 2+ day cruises, on average passengers book trips of seven days in length. There is significant growth opportunity in Europe, Asia, Australia, New Zealand, and South America. It is reported by Ocean Shipping Consultants (a London-based independent economic consultancy) that the number of cruise guests sailing in the Asia-Pacific region grew 40+ percent, from 1.07 million in 2005 to 1.5 million by 2010. As such, cruise ship companies are ordering and adding new fleets to their portfolio to meet growing demand. Note in Exhibit 8 that in 2010, over 18 million vacationers globally traveled with a cruise ship.

Worldwide, the total cruise industry is estimated to generate revenues of $29.34 billion, an increase of 9.5 percent from 2009. Within the industry, Carnival has the highest market share (52.9 percent) and the runner up is Royal Caribbean (27.6 percent), followed by NCL (9.8 percent), and Disney (3.3 percent). An industry website, Cruisemarketwatch.com, reveals this information quarterly.

Cruise Passenger Demographics

The cruise industry appeals to a broad range of demographic groups. The industry demographics are as follows: the average age of cruise passengers has been falling steadily in the past 10 years

EXHIBIT 10 Most Appealing Destinations to Cruise

Destination	Appeal Percentage
Caribbean	43%
Alaska	25%
Bahamas	25%
Hawaii	15%
Mediterranean/Greek Islands/Turkey	14%
Bermuda	11%
Europe	9%
Panama Canal	8%
West Coast of Mexico	8%

Source: CLIA 2008 Market Profile Study.

obstacles and challenges related to international laws, financing, foreign currency, fuel hedging and contracts, marketing and promotion, and staffing. In regions such as the United Kingdom and others, the cruising industry is at an early stage of development and has far lower penetration rates.

Environmental Issues

Cruise liners generate domestic wastewater in the course of accommodating their passengers and crew. Combined domestic wastewater, or "graywater," is comprised of galley, scullery, laundry, bath/shower, and sink combined domestic wastewater drainage. It does not include sewage, or "blackwater," which is exclusively human waste from toilets and urinals, plus medical facility sink drainage. Graywater is typically collected in tanks aboard cruise ships and held for recycling, transfer, or discharge. U.S. Federal and international regulations allow discharge of graywater and properly treated blackwater virtually anywhere except in the Great Lakes, including in-port locations. However, cruise ship operators who are members of the International Council of Cruise Lines (ICCL) have voluntarily agreed to discharge graywater and treated blackwater only while ships are underway and not while in port. The International Maritime Organization (IMO), the United States, and other maritime nations have developed consistent and uniform international standards that apply to all vessels engaged in international commerce. These standards are set forth in the International Convention for the Prevention of Pollution from Ships (MARPOL).

The cruise ship industry has experienced explosive growth in terms of size and popularity in recent years. Newer, bigger, and more capable ships are coming into service to meet the demands of the cruising population. Passengers are drawn to cruising by the adventure, relaxation, and entertainment afforded by the shipboard experience and by the serenity and beauty of the cruise locales. The laws governing competition, including antitrust and consumer protection laws, have a significant impact on the cruise industry.

All oceangoing vessels engaged in international commerce must have a country of registry in order to operate in international waters. Accordingly, most countries, including the United States, provide these registration services or flags of registry. Because of the many restrictions outlined on U.S. flag registry, nearly 90 percent of the commercial vessels calling on U.S. ports fly a non-U.S. flag. Therefore, vessels operating with international registries are not unique to the cruise industry.

Risks

There are a variety of risks and concerns that impact cruise companies, such as:

1. Seasonality: The demand for travelers varies, but in general demand is highest in the northern hemisphere summer.
2. Natural Disasters: Hurricanes impact the industry.
3. Government Regulations: Each country registry conducts periodic inspections along with changes in the regulations in the areas of ports, customs, labor, immigration, gambling, security, safety, and such.

4. Environmental and Health Concerns: Ships must be in compliance with all the environmental concerns such as waste, pollution, and such. Furthermore, any epidemic health concerns in the regions in which the company does business could deter travelers from completing their travel plans.
5. Economic Condition: The cruise ship business is sensitive to economic conditions such as unemployment, reduction in discretionary income, inflation or recession, interest rates, foreign exchange, and such.
6. Increase in Fuel Price: If oil prices continue to increase, companies may have to charge more for their services, which may reduce the number of passengers willing to take a cruise for their vacation.
7. Terrorism and Security: In order to maintain and ensure passengers and staff a safe and secure journey, the cruise industry has strict ship security procedures outlined in internationally agreed-upon measures set forth by the International Maritime Organization (IMO). Recently, worldwide security regulations known as the International Ship and Port Facility Security (ISPS) Code were implemented as amendments to the International Convention for the Safety of Life at Sea (SOLAS). Through the IMO, these regulations require all ships, port facilities, and governments to have formal security plans, screening measures, access control, waterside security, and communications between ships and ports. The United States has similar requirements in the Maritime Transportation Security Act (MTSA).

Competition

Competition is intense among cruise lines as each company tries to promote its cruise packages differently and uniquely. Cruise ship companies have expanded itineraries to include diverse ports (to make it more convenient and approachable to vacationers) and also have introduced innovative onboard amenities, facilities, and entertainment programs such as cell phone access, Internet cafes and wireless zones, rock-climbing walls, bowling alleys, surfing pools, multiroom villas, multiple themed restaurants, expensive spas, health and fitness facilities, and a variety of programs for evenings. Basically however, this is a two-horse race—Carnival and Royal Caribbean—as indicated in Exhibit 11.

Royal Caribbean

Royal Caribbean Cruises Ltd. (RCC) is a global cruise vacation company that operates Royal Caribbean International, Celebrity Cruises, Pullmantur, and Azamara Cruises. The company has 38 ships at sea and there are six under construction. Royal Caribbean's brand offers a range of onboard activities, services, and amenities to travelers such as swimming pools, beauty salons, exercise and spa facilities, sun decks, ice skating rinks, in-line skating, rock-climbing walls, surf machines, basketball courts, bungee jumping trampolines, miniature golf courses, waterparks, gaming facilities, lounges, bars, restaurants, and cinemas. The company also offers unique land-tour vacations in Alaska, Asia, Australia, Canada, Europe, Latin America, and New Zealand.

EXHIBIT 11 **Carnival versus Royal Caribbean (April 2011)**

	Carnival	Royal Carib
$Market Cap	30.15B	8.60B
#Employees	85,200	57,200
%Qtrly Rev Growth	7.60%	10.50%
$Revenue	14.71B	6.75B
%Gross Margin	36.74%	33.98%
$EBITDA	3.76B	1.45B
%Operating Margin	15.82%	11.89%
$Net Income	1.96B	547.47M
$EPS	2.44	2.51

EXHIBIT 12 Passengers and Capacity—Royal Caribbean Cruises Ltd.

	Year Ended Dec. 31				
	2010	2009	2008	2007	2006
Passengers Carried	4,585,920	3,970,278	4,017,554	3,905,384	3,600,807
Passenger Cruise Days	32,251,217	28,503,046	27,657,578	26,594,515	23,849,606
Available Passenger Cruise Days (APCD)	30,911,073	27,821,224	26,463,637	25,155,768	2,392,478
Occupancy	104.3%	102.5%	104.5%	105.7%	106.5%

Source: Royal Caribbean Cruises, Ltd., *Form 10K*, 2010 (p. 14).

In 2007, RCC opened in Singapore its Asia-Pacific headquarters, named Royal Caribbean Cruises (Asia) Pte. Ltd. This regional headquarters supports the marketing efforts of the Asia-Pacific region of three of the company's cruise brands: Royal Caribbean International, Celebrity Cruises, and Azamara Cruises. For 2010, RC's revenue surpassed $6.7 billion with net earnings of approximately $547 million. Compared to the previous year, revenue increased approximately $862 million (14.65 percent) and net income increased of $385 million (337 percent). In April 2011, RCC's stock was upgraded due to higher-than-expected earnings for the first quarter of 2011.

RCC's first quarter 2011 revenue rose to $1.7 billion from $1.5 billion as bookings picked up with an improving economy. RCC made $91.6 million in posting an EPS of $0.42, above year-ago readings of $87 million and $0.40 cents respectively. RCC's per share profit of $0.31 ex-items was an impressive $0.20 ahead of average analyst estimates. Rising oil prices are a risk, but RCC is strategically hedged (58 percent for 2011 and 56 percent in 2012, according to CEO Richard Fain). Exhibit 12 reveals the scope of RCC, which aims to take as much market share as possible away from Carnival.

The Future

The average age of a cruise passenger is 50, but that number is declining. Selecting a cruise vacation is much cheaper than a land-based vacation, both for senior citizens and young folks. For example, Carnival offers a 16-day cruise from Barcelona, Spain, to Galveston, Texas, with day stops in Spain, the Canary Islands, and the Grand Turks, for $699. That's $43 a day, with food, lodging, regional transportation, and transportation stateside included in the price. There is no comparable land vacation, especially in Europe, for $43 a day. The more expensive cruises, such as Carnival's Princess Cruises, charge around $150 per day per person. Even that is cheap, since a Courtyard Marriott can run about $300 a night in the summer in Europe, or $150 per person, with no food included at the hotel. The inexpensive nature of a cruise is the major reason cruising passengers have grown annually at 5.3 percent worldwide, and 12.1 percent outside of North America, since 2005.

It is actually amazing that Carnival makes money cruising people all over the world at such cheap fares. In 2010, Carnival made $2 billion, which was more than Marriott International, Host Hotels and Resorts, Hyatt, Wynn Resorts, and Las Vegas Sands combined. Even in 2008, when oil hit $145 per barrel, Carnival still made $2.3 billion. Why? Because Carnival's operating margins are very high, being 16.2 percent in 2010, whereas Marriott's was 5.9 percent, Host Hotels and Resorts' was 5 percent, and Hyatt's was 3.1 percent.

Despite the stock market crash in August 2011, Carnival is focused on building and/or obtaining bigger and bigger ships to satisfy "economies of scale" and consumer preferences. Some analysts, however, predict overcapacity in the future.

Prepare a three-year strategic plan for Carnival's CEO Micky Arison.

JPMorgan Chase & Co., 2013

www.jpmorganchase.com, JPM

Headquartered in New York City, JPMorgan & Chase (JPM) is a financial holding company that competes worldwide, serving customers for more than 200 years, making it one of the oldest financial intuitions in the USA. Considered to be the largest bank in the USA, JPM has total assets of more than $2.3 trillion and employs more than 240,000 people in more than 60 countries around the globe. JPM's stock is one of the 30 components of the Dow Jones Industrial Average. The hedge fund unit of JPM is one of the largest in the USA.

JPM in mid-2013 announced plans to stop trading in physical commodities, but in August 2013, JPM purchased the over-the-counter business in commodity derivatives of Switzerland's UBS AG. The deal excluded precious metals and index-based trades, but included hedge positions on financial exchanges. Zurich-based UBS is closing the majority of its commodities "flow" trading business involving raw materials and financial derivatives as part of its slimming down and laying off 10,000 employees.

JPM operates under two principle brands, (1) JPMorgan and (2) Chase. The JPMorgan brand focuses on large multinational corporations, governments, wealthy individuals, and institutional investors. The Chase brand is further divided into two distinct segments: (1) consumer business and (2) commercial banking business. The Chase consumer business includes such businesses as traditional bank branches, ATMs, credit cards, home finance, retirement and investing, and merchant services among others. The Chase commercial banking business includes such areas as business credit, corporate client banking, commercial term lending, and community development. The two JPM brands overlap so much in terms of regions and products that the company does not report revenues or income by the two brands.

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History

Dating back to 1799, JPM is one of the oldest financial institutions in the world. The heritage of the House of Morgan traces its roots to the partnership of Drexel, Morgan & Co., which in 1895 was renamed J.P. Morgan & Co. Arguably the most influential financial institution of its era, J.P. Morgan & Co. financed the formation of the United States Steel Corporation, which took over the business of Andrew Carnegie and others and was the world's first billion-dollar corporation. In 1895, J.P. Morgan & Co. supplied the United States government with $62 million in gold to float a bond issue and restore the treasury surplus of $100 million. In 1892, the company began to finance the New York, New Haven, and Hartford Railroad and led it through a series of acquisitions that made it the dominant railroad transporter in New England. Although his name was big, Morgan owned only 19 percent of Morgan assets. The rest was owned by the Rothschild family following a series of bailouts and rescues attributed by some to Morgan's stubborn will and seemingly "nonexistent" investment savvy.

In 2004, JPM merged with Chicago-based Bank One Corp., bringing on board current chairman and Chief Executive Officer (CEO) Jamie Dimon as president and Chief Operating Officer and designating him as CEO William Harrison, Jr.'s successor. Dimon's pay was pegged at 90 percent of Harrison's. Dimon quickly made his influence felt by embarking on a cost-cutting strategy, and replaced former JPMorgan Chase executives in key positions with Bank One executives—many of whom were with Dimon at Citigroup. Dimon became CEO and chairman of JPM in 2006.

JPM has acquired more than 1,200 financial institutions over its life. Several key acquisitions during the last 20 years include in 1991 Chemical Banking Corp., the second largest bank in the USA and in 1995, First Chicago Corp., the largest bank in the Midwest. The acquisition responsible for the current name of the company was in 2000 when J.P. Morgan & Co. merged with The Chase Manhattan Corp. In 2010, JPM acquired Cazenove, an advisory and underwriting joint venture established in 2004 in the United Kingdom. Since 2010, JPM has refrained from making acquisitions that had historically been its trademark.

Internal Issues

Vision and Mission

JPM does not list a formal mission statement, but the company vision statement is:

> At JPMorgan Chase, we want to be the best financial services company in the world. Because of our great heritage and excellent platform, we believe this is within our reach.

Organizational Structure

Some analysts contend that JPM has organizational design problems because there are numerous CEOs, no presidents, dual-title individuals, lack of a clear JP Morgan-versus-Chase dichotomy, and overall, too many top-level executives. As best as can be determined, the existing organizational chart for JPM is given in Exhibit 1. Note that Jamie Dimon is both chairman of the board and CEO, a practice being shunned by more and more by corporations.

In 2013, the company replaced its Chief Financial Officer, Doug Braunstein, with Marianne Lake, who is now one of the most powerful women on Wall Street. Lake joins asset-management chief Mary Erdoes as the only two women on the bank's elite 14-member operating committee.

Ethics Issues

JPM has an extensive Code of Conduct and Code of Ethics posted on its website. Part of the company's code of conduct says in part: "The Code is based on our fundamental understanding that no one at JPMorgan Chase should ever sacrifice integrity—or give the impression that they have—even if they think it would help the firm's business." The company's code of ethics is more lengthy, and says in part: "The purpose of this Code of Ethics is to promote honest and ethical conduct and compliance with the law, particularly as related to the maintenance of the firm's financial books and records and the preparation of its financial statements."

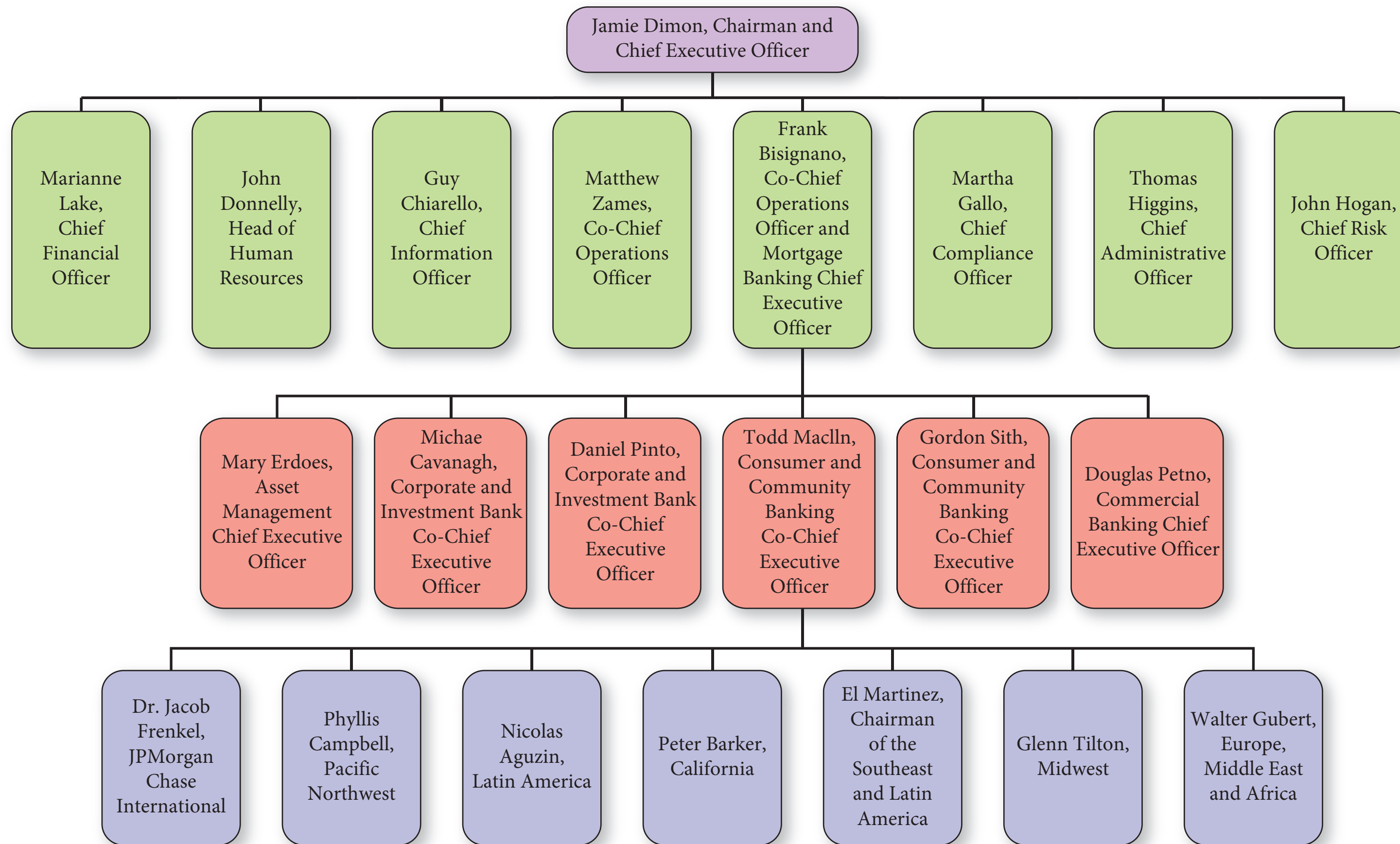
Despite having extensive ethical-based statements, JPM has had its fair share of ethical issues over the years. In January 2011, JPM admitted that it wrongly overcharged several thousand military families for their mortgages, including active-duty personnel in Afghanistan. The bank also admitted it improperly foreclosed on more than a dozen military families; both actions were in clear violation of the Service Members Civil Relief Act, which automatically lowers mortgage rates to 6 percent and bars foreclosure proceedings of active-duty personnel. The overcharges may have never come to light were it not for legal action taken by Marine Capt. Jonathan Rowles, a fighter pilot. Both Captain Rowles and his spouse Julia accused Chase of violating the law and harassing the couple for nonpayment.

In April 2012, hedge fund insiders became aware that the market in credit default swaps was possibly being affected by the activities of Bruno Iksil, a trader for JPM, referred to as "the London whale" in reference to the huge positions he was taking. Heavy opposing bets to his positions are known to have been made by traders, including another branch of JPM that purchased the derivatives offered by JPM in such high volume. Early reports were denied and minimized by the firm in an attempt to minimize exposure. Major losses of $2 billion were reported by the firm in May 2012 in relationship to these trades and updated to $4.4 billion on July 13, 2012. The disclosure, which resulted in headlines in the media, did not disclose the exact nature of the trading involved, which remains in progress and as of June 28, 2012, was continuing to produce losses that could total as much as $9 billion under worst case scenarios. The item traded, possibly related to CDX IG 9, an index based on the default risk of major U.S. corporations, has been described as a "derivative of a derivative." On the company's emergency conference call, JPM CEO Jamie Dimon said the strategy was "flawed, complex, poorly reviewed, poorly executed, and poorly monitored." The episode is being investigated by the Federal Reserve, the Securities and Exchange Commission (SEC), and the FBI.

Strategy

JPM strategies revolve around the areas of (a) international expansion of its wholesale business and global corporate bank, (b) small business growth, (c) commodities, (d) growth in branch network, and (e) growth in private client business.

EXHIBIT 1 JPM's Organizational Chart



Source: Extrapolated based on executive titles given on the corporate website.

JPM's international expansion strategy aims to increase the firm's global presence through an aggressive international expansion plan. JPM is focused on expanding its asset management, investment bank, and treasury and securities services segments in Asia, Latin America, Africa, and the Middle East. Additionally, slowly expanding into newly emerging or even frontier markets, JPM's clients in this expansion plan include multinational corporations, sovereign wealth funds, and public entities. In 2008, JPM had approximately 200 clients in Brazil, China, and India combined, but by 2012, the number of clients in these nations had expanded to 800. By 2017, JPM is expected to have more than 2,000 clients in these nations.

U.S. small businesses remain a central focus of the Chase arm of JPM. In 2011 alone, Chase provided more than $17 billion of credit to domestic small businesses, up 52 percent from 2010, indicating Chase believes the economic recovery is robust enough to tolerate any short-term downward pressures. The $17 billion of credit in 2011 makes Chase the number-1 Small Business Administration (SBA) leader nationwide for the second straight year. In addition, JPM is also the number-1 SBA lender to women- and minority-owned businesses. To help facilitate growth in the small business arm, JPM has added more than 1,200 relationship managers and business bankers since 2009 and anticipates an aggressive hiring of bankers for the foreseeable future.

With the 2011 acquisition of Sempra, JPM is currently one of the top-three firms in the world in commodity dealings. Growth from 2011 to 2012 grew by 10 percent to bring total commodity clients to more than 2,200, as well as increased commodity packaging and selling to existing clients. JPM expects commodity demand to increase with the growth of emerging markets and anticipates increased business in the various commodity asset classes the firm currently offers.

Surprising to some, JPM is actively growing its physical branches despite many predictions from outside pundits who suggest that brick-and-mortar branches are a relic of the past. JPM's own research suggests however that although 17 million JPM customers do much of their banking business online, they still value a face-to-face conversation when it comes to taking out a mortgage, applying for a credit card, or seeking general financial advice in a physical branch location. Currently 45 percent of Chase credit cards and 50 percent of retail mortgages are sold on site at branch locations.

Segments

Within its two brands, JPM operates under seven major business segments as indicated in Exhibit 2, with respective revenues given. Note that JPM's revenues have been declining in three of the seven segments.

Exhibit 3 provides a breakdown of JPM revenues and net income over the geographic regions where the bank does business. Note that North America accounts for 81 percent of revenues and 86 percent of net income. Note also the dramatic drop in North American revenues in 2011 associated with a dramatic increase in associated net income.

Investment Bank

Within JPM's investment bank segment, $8,303 million of the $26,274 million was derived from noninterest sources, with the balance of $17,971 derived from interest sources. Clients of the investment bank division include corporations, financial institutions, and government and institutional investors. Investment bank activities include advising on business strategy and structure, raising capital though debt or equity, derivative instruments, prime brokerage, and research.

Exhibit 4 provides a geographic breakdown of JPM's investment bank segment. Note the decline in revenue from North America and Asia and Pacific, but the increase in revenue from other areas globally. Total 2011 net income from this division totaled $1,678 million.

Bonds trading is an important part of JPM's Investment Bank. A *Wall Street Journal* article (11-2-12, p. C3) reported that JPM's 12.3 percent market share in the USA in bonds trading was the largest among all banks, followed by Deutsche Bank (10.5 percent), Barclays (9.9 percent), Bank of America (9.6 percent), and Goldman Sachs (8.3 percent). A part of fixed-income operations, bond-trading is risky business. That is why UBS AG recently exited the bond-trading business to focus its investment bank on less-risky businesses such as advising on mergers and stock underwriting.

Retail Financial Services

JPM's retail financial services segment accounts for about 27 percent of 2011 net revenues with $10,405 million of the segments, $26,538 million being derived from noninterest sources, with the balance of $16,133 derived from interest sources. The retail financial services segment includes: bank branches, ATMs, mortgages, real estate, among others. JPM customers have access to more than 17,200 ATMs and 5,500 bank branches. The Chase business segment currently services more than 8 million loans in 23 states and services more than $150 billion of mortgage originations each year.

Exhibit 5 provides a breakdown of businesses within JPM's financial services segment. Note the decreases in both revenue and net income in 2011.

Card Services and Auto

JPM's credit card services and auto segment accounted for about 19 percent of 2011 net revenues with $4,892 million of the segments, $19,141 million being derived from noninterest sources with the balance of $14,249 derived from interest sources. The segment accounts for more than $132 billion in credit card loans with over 65 million open credit card accounts, making JPM one of the largest credit card issuers in the USA. JPM customers can also obtain financing through 17,200 auto dealerships and 2,000 schools and universities. Exhibit 6 provides a breakdown of businesses within JPM's credit card and auto segment. Note the reduction in revenues but increase in net income over the last three years.

Finance

JPM earned an all-time record of $19 billion in net income in 2011, up 9 percent from the previous record of $17.4 billion the prior year. The company's net income would have been considerably more, except for losses from the JPM mortgage business. Mortgage losses are expected to continue for a while longer, but the bulk of JPM bad mortgages have already been absorbed.

JPM's recent income statements are provided in Exhibit 7. Note the unusual decline in revenue associated with the increase in net income.

JPM reinstated its annual dividend of $1.00 per share in April of 2011 and increased it to $1.20 a share in April of 2012. Although JPM's goodwill has remained the same over the last

EXHIBIT 5 JPM's Retail Financial Services Revenue Breakdown by Product (in millions)

	2011	2010	2009
Lending- and deposit-related fees	$3,190	$3,061	$3,897
Asset management, administration, and commissions	1,991	1,776	1,665
Mortgage fees and related income	2,714	3,855	3,794
Credit card income	2,025	1,955	1,634
Other income	485	580	424
Net Revenue	$26,538	$28,447	$29,797
Net Income	$1,678	$1,728	$(335)

Source: 2011 *Annual Report*, page 85.

EXHIBIT 6 A Breakdown of JPM's Credit Card Business (in millions)

	2011	2010	2009
Credit card revenue	$4,127	$3,514	$3,613
Other income	765	764	93
Total revenue	$19,141	$20,472	$23,199
Net income/(loss)	$4,544	$2,872	$(1,793)

Source: 2011 *Annual Report,* page 94.

EXHIBIT 2 JPM's Financial Results by Segment (in millions $)

Revenue by Product	2012	%Change	2011	2010
Consumer & Community Banking	49,945	+9	45,687	48,927
Corporate & Investment Bank	34,326	+1	33,984	33,477
Commercial Banking	6,825	+6	6,418	6,040
Asset Management	9,946	+4	9,543	8,984
Corporate/Private Equity	(1,152)	−128	4,135	7,414
Total	99,890	0	99,767	104,842
Net Income by Product	**2012**		**2011**	**2010**
Consumer & Community Banking	10,611	+71	6,202	4,578
Corporate & Investment Bank	8,406	+05	7,993	7,718
Commercial Banking	2,646	+12	2,367	2,084
Asset Management	1,703	+07	1,592	1,710
Corporate/Private Equity	(2,082)	−353	822	1,280
Total	21,284	+12	18,976	17,370
Return on Equity (%) by Product	**2012**		**2011**	**2010**
Consumer & Community Banking	25		15	11
Corporate & Investment Bank	18		17	17
Commercial Banking	28		30	26
Asset Management	24		25	26
Corporate/Private Equity	NM		NM	NM
Total				

EXHIBIT 3 JPM's Revenues and Net Income by Region Globally (in millions)

	Revenue				Net Income			
	2012	2011	2010	2009	2012	2011	2010	2009
Europe, Middle East. and Africa	$10,522	$16,212	$14,135	$16,294	$1,508	$4,844	$3,635	$5,212
Asia and Pacific	5,605	5,992	6,073	5,429	$1,048	1,380	1,614	1,286
Latin America and Caribbean	2,328	2,273	1,750	1,867	$454	340	362	463
Total International	18,455	24,477	21,958	23,590	$3,010	6,564	5,611	6,961
North America	78,576	72,757	80,736	76,844	$18,274	12,412	11,759	4,767
Total JPM	$97,031	$97,234	$102,694	$100,434	$21,284	$18,976	$17,370	$11,728

Source: Annual Report, page 300.

EXHIBIT 4 JPM's Investment Bank Revenue Breakdown by Region (in millions)

	2011	2010	2009
Europe, Middle East, and Africa	8,418	7,380	9,164
Asia and Pacific	3,334	3,809	3,470
Latin America and Caribbean	1,079	897	1,157
North America	13,443	14,131	14,318
Net Revenue	$26,724	$26,212	$28,109
Net Income	$6,789	$6,639	$6,899

Source: 2011 *Annual Report*, page 84.

EXHIBIT 7 JPM's Income Statement (in millions)

	2012	2011	2010
Interest Income, Bank	56,063.0	61,293.0	63,782.0
Total Interest Expense	11,153.0	13,604.0	12,781.0
Non-Interest Income, Bank	52,121.0	49,545.0	51,693.0
Total Revenue	**97,031.0**	**97,234.0**	**102,694.0**
Loan Loss Provision	3,385.0	7,574.0	16,639.0
Non-Interest Expense, Bank	64,729.0	62,911.0	61,196.0
Income Before Tax	**28,917.0**	**26,749.0**	**24,859.0**
Income Tax Total	7,633.0	7,773.0	7,489.0
Income After Tax	**21,284.0**	**18,976.0**	**17,370.0**
Minority Interest	0.0	0.0	0.0
Equity In Affiliates	0.0	0.0	0.0
U.S. GAAP Adjustment	0.0	0.0	0.0
Net Income Before Extra Items	**21,284.0**	**18,976.0**	**17,370.0**
Total Extraordinary Items	0.0	0.0	0.0
Net Income	**21,284.0**	**18,976.0**	**17,370.0**

Source: Company documents.

three years, total goodwill of $48 billion indicates a history of paying more than fair market value for many acquisitions. JPM's long-term debt is declining as shown in Exhibit 8.

Competition

Banks are seemingly everywhere on every corner and online. Some analysts say bank products and services are becoming more and more like commodities, all being similar. An interesting note is that foreign banks have not yet penetrated into the U.S. marketplace. But online banks are proliferating.

JPM competes with literally hundreds of banks but a few key rivals are showcased in Exhibit 9. Note that JPM has higher revenue per employee and earnings per share (EPS) than Bank of America or Citigroup.

Bank of America

Headquartered today in Charlotte, North Carolina, and having total assets exceeding $2.5 billion, Bank of America is the second largest U.S. bank, trailing only JPM, and is the largest bank according to number of employees. Bank of America has a relationship with 99 percent of the *Fortune* 500 companies and 83 percent of the *Fortune Global* 500. The 2008 acquisition of Merrill Lynch made Bank of America the world's largest wealth management corporation and a major player in the investment banking market.

As of May 2012, Bank of America served more than 5,700 banking centers and had more than 17,000 ATMs serving customers in more than 150 countries and had branches in more than 40 countries. During 2011, Bank of America began laying off an estimated 36,000 people, contributing to intended savings of $5 billion per year by 2014. In December 2011, *Forbes* ranked Bank of America's financial health 91st out of the nation's largest 100 banks and thrift institutions. Bank of America will cut around 16,000 jobs in a quicker fashion by the end of 2012 as revenue continues to decline because of new regulations and a slow economy. This will put a plan one year ahead of time to eliminate 30,000 jobs under a cost-cutting program called Project New BAC. Bank of America generates 90 percent of its revenues in its domestic market and continues to buy businesses in the USA. The core of Bank of America's strategy is to be the number-one bank in its domestic market. It has achieved this through key acquisitions.

EXHIBIT 8 JPM's Balance Sheets (in millions)

	2012	2011	2010
Assets			
Cash & Due From Banks	53,723	59,602	27,567
Other Earning Assets, Total	1,358,307	1,271,811	1,174,042
Net Loans	711,860	696,111	660,661
Property/Plant/Equipment, Total - Net	14,519	14,041	13,355
Goodwill, Net	48,175	48,188	48,854
Intangibles, Net	9,849	10,430	17,688
Long Term Investments	0	0	0
Other Long Term Assets, Total	0	0	0
Other Assets, Total	162,708	165,609	175,438
Total Assets	**2,359,141**	**2,265,792**	**2,117,605**
Liabilities and Shareholders' Equity			
Accounts Payable	195,240	202,895	170,330
Payable/Accrued	0	0	0
Accrued Expenses	0	0	0
Total Deposits	1,193,593	1,127,806	930,369
Other Bearing Liabilities, Total	0	0	0
Total Short Term Borrowings	392,762	362,048	415,551
Policy Liabilities	0	0	0
Notes Payable/Short Term Debt	0	0	0
Current Port. of LT Debt/Capital Leases	0	0	0
Other Current Liabilities, Total	0	0	0
	312,215	322,752	348,302
Total Long Term Debt			
Deferred Income Tax	0	0	0
Minority Interest	0	0	0
Other Liabilities, Total	61,262	66,718	76,947
Total Liabilities	**2,155,072**	**2,082,219**	**1,941,499**
Redeemable Preferred Stock	0	0	0
Preferred Stock - Non Redeemable, Net	9,058	7,800	7,800
Common Stock	4,105	4,105	4,105
Additional Paid-In Capital	94,604	95,602	97,415
Retained Earnings (Accumulated Deficit)	104,223	88,315	73,998
Treasury Stock—Common	–12,002	–13,155	–8,160
ESOP Debt Guarantee	0	0	0
Unrealized Gain (Loss)	0	0	0
Other Equity, Total	4,081	906	948
Total Equity	**204,069**	**183,573**	**176,106**
Total Liabilities & Shareholders' Equity	**2,359,140**	**2,265,792**	**2,117,605**
Total Common Shares Outstanding	3,803.95	3,772.7	3,910.3

Source: Company documents.

Citigroup

Citigroup was formed on October 9, 1998, following the $140 billion merger of Citicorp and Travelers Group to create the world's largest financial services organization. The history of the company is comprised of many acquired firms such as the City Bank of New York (later named

EXHIBIT 9 A Synopsis of Large Banks

	JPM	Bank of America	Citigroup
Number of Employees	261K	279K	263K
Net Income ($)	17.5B	–1.31B	10.7B
Revenue ($)	90.5B	76.8B	66.3B
Revenue ($)/Employee	346K	275K	252K
EPS Ratio ($)	4.5	–0.13	3.59
Market Capitalization	129B	80.6B	74.1B

Source: Company documents.

Citibank) in 1812; Bank Handlowy in 1870; Smith Barney in 1873, Banamex in 1884; and Salomon Brothers in 1910.

Based today in New York City, Citigroup is a diversified financial services holding company broken down into two segments, Citicorp and Citi Holdings, providing global banking, advisory services, derivative services, brokerage, and much more. Citigroup today is the largest banking enterprise in the world based on geographic coverage with operations in 140 nations and more than 16,000 offices worldwide.

On Tuesday, March 13, 2012, the Federal Reserve reported Citigroup as one of the 4 financial institutions, out of 19, that have failed its stress tests. The tests make sure banks have enough capital to withstand huge losses in a financial crisis like one Citigroup faced in 2008 and early 2009 when it almost collapsed. The 2012 stress tests determine whether banks could withstand a financial crisis with unemployment at 13 percent, stock prices cut in half, and home prices decreased by 21 percent from current levels. According to Citi and the Federal Reserve stress test report, Citi failed the stress tests because of Citi's high capital return plan and its international loans rated by the Federal Reserve to be at higher risk than its domestic U.S. loans. Citi gets half their revenues from its international businesses. In comparison, Bank of America, which passed the stress test and did not ask for a capital return to investors, gets 78 percent of its revenue in the USA.

Wells Fargo & Co.

Founded in 1852 and headquartered in San Francisco, Wells Fargo is a nationwide, diversified, community-based financial services company with $1.4 trillion in assets. Wells Fargo provides banking, insurance, investments, mortgage, and consumer and commercial finance through more than 9,000 stores, 12,000 ATMs, the Internet, and has offices in more than 35 countries to support the bank's customers who conduct business in the global economy. With more than 265,000 employees, Wells Fargo serves one in three households in the USA. Wells Fargo was ranked number 26 on *Fortune's* 2012 rankings of the largest corporations in the USA. Wells Fargo's vision is to satisfy all our customers' financial needs and help them succeed financially.

As most large banks retreat from the trading business, Wells Fargo is expanding. The fourth-largest U.S. bank says it can earn solid returns in investment banking while taking little risk for itself. It is focusing on services that its corporate lending customers need, such as stock and bond underwriting and merger advice. For investors, it is looking at areas such as processing futures and swaps trades.

The Wells Fargo Securities unit is relatively small now, but in a few years, the unit could account for twice as much of the firm's revenue, an estimated 10 percent compared to its current 5 percent, Deutsche Bank analyst Matt O'Connor wrote in a report in May 2012. For JPM, Bank of America, and Citigroup, that percentage is closer to 20 to 25 percent. A much bigger proportion of Wells Fargo's revenue comes from traditional commercial and retail banking businesses: residential mortgages, lines of credit for corporations, and so on.

Online Banks

Online banks are growing rapidly in number and taking market share from large banks. The website http://www.mybanktracker.com/best-online-banks rates more than 30 online banks in

EXHIBIT 10 The Best Online U.S. Banks (1= best, 18 = least best)

1. Ally	10. Discover Bank
2. Bank of Internet	11. UFB Bank
3. ING Direct	12. Simple
4. Charles Schwab Bank	13. Incredible Bank
5. Sallie Mae Bank	14. Nationwide Bank
6. USAA	15. First Internet Bank
7. TIAA Direct	16. One United Bank
8. Barclays Bank	17. Presidential Online Bank
9. State Farm Bank	18. E*TRADE

Source: Based on info at http://www.mybanktracker.com/best-online-banks.

the USA in terms of having low fees, low interest rates, excellent technology, and great customer service. Exhibit 10 reveals in rank order the top 18 Internet Banks in the USA. Note that Ally is number 1 and E*TRADE is number 18.

External Issues

Regulatory Reform

Following the 2007 to 2009 financial crisis, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 that affects all aspects of the financial industry. Provisions include: prohibition of proprietary trading, restrictions on who can own hedge funds, establishing the Financial Stability Oversight Council, elimination of the Office of Thrift Supervision, and much more. The new regulations are expected to greatly increase the fees all financial institutions must pay. Provisions of Dodd-Frank aim to avoid situations in which large banks (such as AIG and Citigroup) are bailed out by the government because they are "too big to fail." Dodd-Frank did ease public perception and opinion of the financial crisis and may in fact apply to middle-size firms. However, recent research reveals that the largest institutions are so interconnected worldwide that, should a similar financial situation arise again, world governments again would be forced to save these behemoths. It is expected that there will be more than 14,000 new regulatory requirements enacted by 2015.

Mobile Payments

One of the hottest topics and business challenges facing banks today is the advent of mobile payment systems and the new competitors that enter the market associated with these payment systems. *Bank Technology News* even stated in 2012 that credit and debit cards used today are soon headed to the museum to be replaced by a linkage of mobile, Web, and point of sale options. As of 2012, there were more than five billion mobile phone users in the world, with more than 70 percent of the world's population having a mobile phone, yet only half the world's population having a bank account. Juniper Research reports that the market for global payments should exceed $600 billion by 2013. Businesses such as Intuit's GoPayment are already available for the Apple iPhones and Android platforms.

Near Field Communications (NFC) is allowing customers to pay for products using their mobile phones at retail stores. Big players such as MasterCard, American Express, Visa, eBay, and Google are also establishing mobile payment systems. Traditional banks such as JPM perhaps need to form strategic alliances to participate in this new arena because less people will be using cash, checks, and plastic cards to perform their business transactions.

Mortgage Business

As of 2012 there were 76 million homes in the USA with 52 million of these homes having a mortgage, and 4.7 million of these homes in a delinquent state. Around 2.5 million of the delinquent homes are worth less than their mortgage and around 10 million homeowners who are not delinquent are paying mortgage notes that are worth less than their home. About

Procter & Gamble Company — 2011

Alen Badal
The Union Institute

PG

www.pg.com
Procter & Gamble (P&G) in April 2011 sold its Pringles line of snacks to Diamond Foods for $1.5 billion. P&G manufactures and markets consumer packaged goods in the United States and abroad, but the company, with that divestiture, finally ends being in the food business in order to focus on beauty and personal-care products. P&G once owned Jif peanut butter, Crisco shortening, Sunny Delight orange drink, and Folgers coffee—but no longer. A recent *Harvard Business Review* article (April 2011) interviews former P&G CEO A.G. Lafley, who says, "P&G learns much more from failed new brands and products like Dryel at-home dry cleaning and Fit Fruit & Vegetable Wash than we do from huge successes like Febreze and Swiffer."

In *Fortune*'s Most Admired Company rankings released in February 2011, P&G ranked number one in the Soaps and Cosmetics industry. P&G changed CEO in July 2010, going from Mr. Lafley, who focused on innovation, to Mr. McDonald, who focuses on lower-end products aimed at consumers looking for discounts. Founded in 1837 in Cincinnati, Ohio, by William Procter and James Gamble, P&G achieved sales and earnings of $78.9 billion and $12.7 billion respectively in 2010. P&G recently donated $300,000 to the NFL Play 60 and Youth Health and Wellness programs and pursues LEED certification (green buildings) for all new global sites.

Internal Factors

P&G operates in three strategic business units (SBUs), which they call global business units (GBUs): 1) Beauty and Grooming, 2) Health and Well-Being, and 3) Household Care. P&G products are sold through thousands of retail operations, including mass merchandisers, grocery stores, membership club stores, drug stores, department stores, salons, and high-frequency stores. Twenty-three P&G products are annual billion-dollar sellers, including Fusion, Always/Whisper, Braun, Bounty, Charmin, Crest, Downy/Lenor, Gillette, Iams, Olay, Pampers, Pantene, Tide, and Wella. P&G also makes pet food and water filters and produces a soap opera. In March 2011, P&G's air freshener product, Febreze, became the company's 24th product to achieve $1 billion in revenues. In the United States, Febreze currently has a 17 percent market share in versus competing products such as Glade and Air Wick, up from 14.8 percent in 2010. P&G has 250 brand products, but the 24 $billion+ products account for about 70 percent of the company's $79 billion+ annual revenues. Pampers diapers are P&G's best selling product at $9+ billion annually followed by Tide detergent at $5+ billion.

Vision/Mission

As of mid-2011, P&G does not have a vision statement. The company mission is:

> "We will provide branded products and services of superior quality and value that improve the lives of the world's consumers, now and for generations to come. As a result, consumers will reward us with leadership sales, profit and value creation, allowing our people, our shareholders, and the communities in which we live and work to prosper."

25 percent of these homes are expected to go into default because homeowners either cannot afford to continue paying or are simply unwilling to pay more for a home than it is worth.

The Future

Going up and up on fees much like the U.S. Postal Service Office, are large banks on permanent decline? The *Wall Street Journal* (9-12-12, p. A1) reported that the percentage of Americans who own checking accounts dropped from 92 to 88 percent between 2010 and 2011, whereas the number of Americans who own a major credit card dropped from 74 to 67 percent, and those who own a major debit or check card dropped from 78 to 66 percent. In other words, Americans are using traditional banks less and less. In fact, the article reports that 8.2 percent of the nation's households, nearly 12 million, are managing their finances without a bank. Bank overdraft fees, according to the article, cost Americans $31.6 billion in 2011. Consumer behavior is definitely shifting from bank credit and debit cards to prepaid debit cards offered by both NetSpend and Green Dot. Pew Charitable Trusts estimates the total dollars that flow through prepaid debit cards will reach $201.9 billion in 2013, up from $28.6 billion in 2009.

A movement called "Bank Transfer Day" emerged in November 2011. In February 2012, J.D. Power & Associates reported that customers of large, regional, and mid-sized banks were defecting at a higher rate because of frustration over factors such as fees and poor customer service. According to their survey, 9.6 percent of customers said they had switched to a new banking provider within the last year, compared to 8.7 and 7.7 percent in the previous two years. The main beneficiaries of the defections are credit unions and smaller banks, which experienced an average increase of 10.3 percent in the acquisition of new customers, versus 8.1 percent a year previously. In March 2012, the National Credit Union Administration reported that credit unions added 1.3 million members in 2011, hitting a record 91.8 million. Online banks are also gaining and increasingly sustaining competitive advantage over large banks.

Cash Advance Centers Inc. is the largest payday lending company in the USA and is widely being used now in lieu of doing business with a bank. That company reports that 22 percent of its customers earn more than $75,000, so the point here is that avoiding bank fees and such is becoming popular not only with individuals of lower incomes but also with people of medium incomes.

JPM needs a clear strategic plan for the future. Help JPM's top managers by preparing a recommended strategic plan for the company.

Growth Strategy

To grow, P&G has historically acquired many smaller businesses such as the pet-food company Natura Pet Products, Inc. and Sara Lee Corporation's Ambi Pur air refresher. P&G is reducing its fabric-care business to about 40 products, down from 60 lines in 2007. Also, the company desires to reduce its packaging ink colors from 4,000 plastic colors to 1,500 and 10,000 print-ink colors to 200, which is projected to save approximately $60 million. P&G desires to accelerate its growth in developing markets, such as Brazil and India, which analysts have nicknamed "walled cities" because Unilever and Colgate-Palmolive have historically dominated the markets. Consumers in developing markets are increasingly willing and able to purchase pricey items, such as P&G's Gillette Fusion ProGlide razor.

P&G invested nearly $2 billion in research & development in 2010, which was nearly 50 percent more than their closest competitor. P&G strives to continue innovating and introducing new products on an international basis such as the new Tide Stain Release and Ariel Professional in laundry additives. P&G has 50 brands that account for 90 percent of the company's total sales and profits. P&G reports that 99 percent of U.S. and Canadian households use at least one of its products. North America represents about 42 percent of P&G's revenues.

Finance

P&G's financial objectives include:

- Increasing sales 1 percent to 2 percent faster than market growth in all categories and geographies.
- Delivering earnings per share (EPS) growth of high single digits to low double digits.
- Generating free cash flow productivity of at least 90 percent.

In addition, P&G is focusing on improving in the following domains:

- More consumers: P&G's aim is to focus on more consumers by innovating product lines and business portfolios. It is also to focus on and serve price-conscious consumers with lower-priced products, offering superior performance compared to competing products.
- In more parts of the world: Market and enter new markets, while increasing presence in developing markets and sales in respective developing markets, with a focus on "affordability, accessibility, and brand awareness."
- More completely: Improve existing product lines by focusing on consumer needs. Also, increase consumers into existing brand franchises and broaden products, with a focus to "build scale and reduce costs, while increasing profitability and market share."

P&G's income statements and balance sheets are provided in Exhibits 1 and 2. Note that the company's 2010 revenues increased 2.9 percent to $78.9 billion, but profits declined 5.2 percent to $12.7 billion. Notice also that P&G had $95 billion in goodwill and intangibles, which is not good.

EXHIBIT 1 P&G's 2010 Income Statement (figures in thousands)

Period Ending	Dec. 30, 2010	Dec. 30, 2009	Dec. 30, 2008
Total Revenue	78,938,000	76,694,000	83,503,000
Cost of Revenue	37,919,000	38,690,000	40,695,000
Gross Profit	**41,019,000**	**38,004,000**	**42,808,000**
Selling, General, & Admin Exp.	24,998,000	22,630,000	25,725,000
Operating Income	**16,021,000**	**15,374,000**	**17,083,000**
Total Other Inc/Exp.	(28,000)	397,000	462,000
EBIT	15,993,000	15,771,000	17,545,000
Interest Expense	946,000	1,358,000	1,467,000
Income Before Tax	15,047,000	14,412,000	16,078,000
Income Tax Expense	-	4,032,000	4,003,000
Net Inc. from Cont. Ops.	10,946,000	10,680,000	12,075,000
Discontinue Operations	1,790,000	2,756,000	-
Net Earnings	**12,736,000**	**13,436,000**	**12,075,000**

Source: Company documents.

EXHIBIT 2 **Procter & Gamble Balance Sheet (000 omitted)**

Period Ending	Jun. 30, 2010	Jun. 30, 2009	Jun. 30, 2008
ASSETS			
Current Assets			
Cash	$2,879,000	4,781,000	3,313,000
Short-Term Investment	-	-	228,000
Net Receivables	6,325,000	7,045,000	8,773,000
Inventory	6,384,000	6,880,000	8,416,000
Other Current Assets	3,194,000	3,199,000	3,785,000
Total Current Assets	**18,782,000**	**21,905,000**	**24,515,000**
Property/Plant/Equipment	19,244,000	19,462,000	20,640,000
Goodwill	54,012,000	56,512,000	59,767,000
Intangible Assets	31,636,000	32,606,000	34,233,000
Other Assets	4,498,000	4,348,000	4,837,000
Total Assets	128,172,000	134,833,000	143,992,000
LIABILITIES			
Current Liabilities			
Accounts Payable	15,810,000	14,581,000	7,977,000
Short/Long-term Debt	8,472,000	16,320,000	13,084,000
Other Current Liabilities	-	7,768,000	9,897,000
Total Current Liabilities	**24,282,000**	**30,901,000**	**30,958,000**
Long-term Debt	21,360,000	20,652,000	23,581,000
Other Liabilities	10,189,000	9,146,000	8,154,000
Deferred Long-term Liability	10,902,000	10,752,000	11,805,000
Minority Interest	324,000	283,000	-
Total Liabilities	**67,057,000**	**71,734,000**	**74,498,000**
Stockholders' Equity			
Preferred Stock	1,277,000	1,324,000	1,366,000
Common Stock	4,008,000	4,007,000	4,002,000
Retained Earnings	64,614,000	57,309,000	48,986,000
Treasury Stock	(61,309,000)	(55,961,000)	(47,588,000)
Capital Surplus	61,697,000	61,118,000	60,307,000
Other Stockholder's Equity	(9,172,000)	(4,698,000)	2,421,000
Total Stockholder's Equity	61,439,000	63,382,000	69,494,000
Total Liabilities and SE	**$128,172,000**	**134,833,000**	**143,992,000**

Source: Company Documents.

Global Business Units (GBUs)

Note in Exhibit 3 that P&G's Beauty and Grooming GBU consists of two divisions, Beauty and Grooming. That GBU contributes 34 percent of the company's revenues and 36 percent of profits. Note that P&G's Health and Well-Being GBU contributes 18 percent of revenues and 19 percent of the company's profits. P&G's Household Care GBU is the largest among the three; its Fabric/Home Care division contributes 30 percent of company sales, and its Baby/Family Care division contributes 18 percent. Exhibit 4 reveals sales increases across every single P&G business segment in 2010 as compared to 2009.

GBU #1—Beauty and Grooming

P&G's beauty and grooming GBU was overhauled in 2009 with each brand at that time being categorized into "his" or "her" categories. Expansion efforts in this GBU have included entering more department stores with Dolce & Gabbana makeup counters, and expanding into new

EXHIBIT 3 P&G's 2010 % Sales/Earnings by Segment Within GBUs

GBU	Segment	%Sales	%Profit	A Few $Billion Brands
Beauty & Grooming	Beauty Grooming	24%	23%	Head & Shoulders, Olay, Pantene
		10%	13%	Braun, Fusion, Gillette, Mach 3
Total		34%	36%	
Health & Well- Being	Health Care	14%	16%	Always, Crest, Oral-B
	Snacks/			Iams, Pringles
	Pet Care	4%	3%	
Total		18%	19%	
Household	Fabric/			Ace, Dawn, Downy, Duracell, Tide
Care	Home Care	30%	28%	Bounty, Charmin, Pampers
	Baby/Family Care	18%	17%	
Total		48%	45%	

Source: www.pg.com.

EXHIBIT 4 GBU Net Sales/Earnings Comparisons

Beauty ($ millions)	2010	2009
Net Sales	$19,491	$18,924
Net Earnings	$2,712	$2,664
Grooming		
Net Sales	$7,631	7,408
Net Earnings	$1,477	$1,359
Health Care		
Net Sales	$11,493	$11,288
Net Earnings	$1,860	$1,835
Snacks and Pet Care		
Net Sales	$3,135	$3,114
Net Earnings	$326	$234
Fabric Care/Home Care		
Net Sales	$23,805	$23,186
Net Earnings	$3,339	$3,032
Baby Care/Family Care		
Net Sales	$14,736	$14,103
Net Earnings	$2,049	$1,770

Source: www.pg.com

markets with Olay skin cream, jointly advertised with Pantene hair-care products. Ultimately, Olay skin cream is destined to enter 150 countries where Pantene is already being sold. Profits have improved in this GBU and sales growth has outperformed the rest of the company.

Among female cosmetics products such as razor blades and skin care crèmes, Olay (facial skin care) is the strongest brand holding an approximate 10 percent of the global market share. P&G holds a 20 percent share of the retail hair care market share, headed by brands such as Pantene and Head & Shoulders shampoo. Fragrances such as Dolce & Gabbana, Gucci, and Hugo Boss represent the fragrance lines.

Regarding grooming products, Gillette's Fusion and Mach 3 are top producers, representing 70 percent of the global male razor blade market. Male deodorants, shaving cream, and hair/skin products are among other products that P&G markets. The electronic shaver Braun has been a successful brand, with the company holding approximately 30 percent of the male shaver market and 50 percent of the female epilator market.

GBU #2—Health and Well-Being

In the health care segment of this GBU, P&G has about 35 percent of the global feminine care products business. Personal health nonprescription products, such as heartburn medication Prilosec (OTC) and Vicks, are successful P&G brands. In the Snacks/Pet Care division, P&G's Pringles potato chips achieved a 10 percent share of the global market share before being divested. The pet care segment's Iams and Eukanuba brands have helped capture an approximate 10 percent market share, with the majority of the business being in North America.

GBU #3—Household Care

P&G's family care and home care brands, including Ace, Ariel, Dawn, Downy, Duracell, Gain, and Tide, achieved net sales of $23.8 billion in 2010. The fabric care product lines include laundry detergents, fabric enhancers, and home care products/batteries. The division has a 30 percent global share. However, the global home care market share is about 15 percent across the categories, and the Duracell battery brand yields about a 25 percent global market share for P&G. Some of P&G's household products, such as alkaline batteries, liquid detergent/cleaners, bleach, diapers, and paper towels, incurred declining sales during the 4th quarter of 2010, with bleach revenues dropping 11.3 percent and battery revenues dropping 7 percent.

P&G has a Baby Care and Family Care division. The baby care business, which consists of diapers and baby wipes, has about 35 percent of the global market share, making P&G either the number one or two manufacturer of baby care products globally. Pampers is the company's most successful brand ever and achieved net sales of approximately $9 billion in 2010. P&G's family care business includes Bounty paper towels and Charmin toilet paper, which generate about 45 percent and 25 percent of the U.S. market share respectively.

Global Operations

P&G's does business in North America, Western Europe, Central and Eastern Europe/Middle East/Africa (CEEMEA), Latin America, and Asia, which consists of Japan, China, and ASEAN/Australia/India/Korea (AAIK). P&G products are sold in approximately 180 different countries around the globe. Exhibit 5 lists the respective revenues stemming from each global region. Note that North America is the primary source of revenues ($33.1 billion), followed by Western Europe ($16.6 billion). The approximate population of North America is 528,720,588, whereas Western Europe's is about 397,475,574. In comparison, North America's revenues were approximately 25 percent greater than Western Europe's revenues.

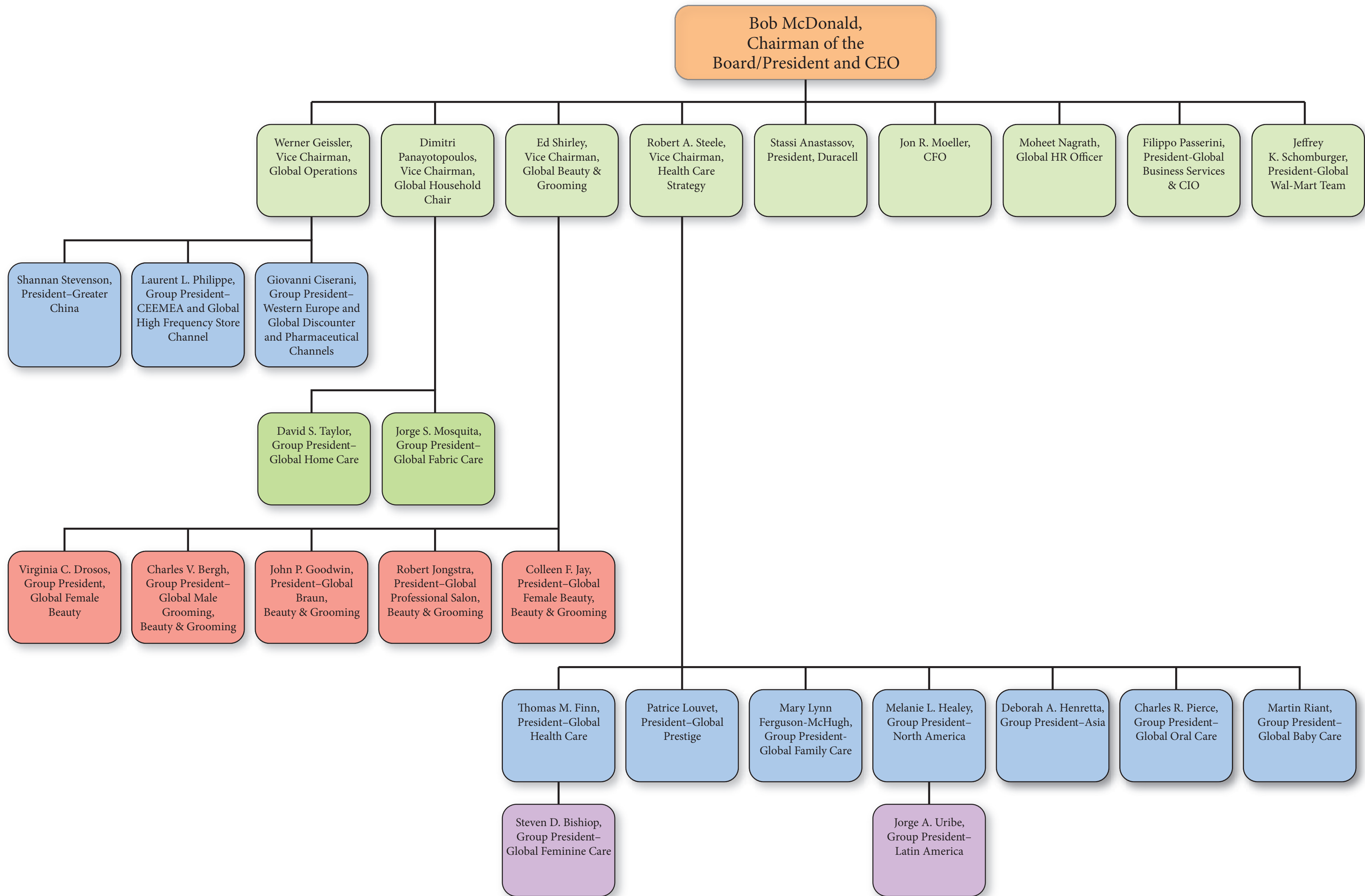
Olay is a big success in Mexico with an 8 percent market share of the facial moisturizing market. Latin America and the Middle East & Africa comprise the smallest portion of P&G's global business, but Asia as a primary target for growth, with the continent being home to some of the fastest-growing economies in the world. Over three billion consumers populate Asia, representing more than half of the world's population. During the last decade, P&G has more than doubled the number of brands in its Asian portfolio (from 10 to 22).

P&G has sold products in Latin America for approximately 60 years. P&G is one of the largest consumer goods companies in the region, across 14 countries with 19 manufacturing sites, 12 distribution centers, and one service site. The largest markets are Mexico, Brazil, Venezuela, and Argentina. Exhibit 6 includes P&G's executives, and Figure 1 provides an organizational chart for the company. Note that Werner Geissler is the company's vice chairman of global operations.

EXHIBIT 5 P&G's 2010 Regional Revenues

Region	%	Revenues
North America	42%	$33.1
Western Europe	21%	$16.6
Central & Eastern-Europe/Middle-East/& Africa	13%	$10.3
Latin America	9%	$7.1
Asia	15%	$11.8
Totals	100%	$78.9 billion

EXHIBIT 6 P&G Executive Officers



North America is the largest division (sales) of P&G. In Western Europe, P&G markets over 100 brands, dating back to 1930 in the United Kingdom. As of 2011, P&G products are marketed in every Western European country, which together account for about 25 percent of total company sales. P&G has about 35 manufacturing plants in Western Europe.

Competitors

Johnson & Johnson (J&J), Colgate-Palmolive, Kimberly-Clark, Unilever, and Clorox are major competitors to P&G in the personal products industry. Exhibit 7 provides select competitors' performance as compared to the industry. Note J&J's net income was $13.2 billion compared to P&G's $10.9 billion. J&J employs approximately 114,000 associates worldwide, operating in over 60 countries with three business segments: 1) consumer; 2) medical devices and diagnostics; and 3) pharmaceutical. J&J had $61.5 billion in revenues in fiscal 2010, but its consumer division is the one that primarily competes with P&G. Particular products include J&J baby shampoo, Liquid Neutrogena, Band-Aid, and Tylenol aspirin. J&J utilizes more than 29,000 Internet domains, such as KY.com and JJ.com. J&J has an impressive history with 27 consecutive years' adjusted earnings growth and 48 consecutive years of dividend increases. Similar to P&G, J&J continues to introduce new products in the market, but during fiscal year 2010, J&J encountered two major recalls.

Colgate-Palmolive

Colgate-Palmolive is a global manufacturer and marketer of oral care personal care, home care, and pet nutrition products. The company markets its products in over 200 countries under the brands Colgate, Palmolive, Mennen, Softsoap, Irish Spring, Protex, Sorriso, Kolynos, Elmex, Tom's of Maine, Ajax, Axion, Soupline, Suavitel, and Hill's Science Diet and Hill's Prescription Diet. Founded in 1806 and headquartered in New York City, the company achieved net income of $2.2 in fiscal 2010. The company operates 280 international facilities, of which 76 are owned in various countries, such as Australia, Brazil, China, Colombia, France, Guatemala, Italy, Mexico, Poland, South Africa, Thailand, and Venezuela. While the company has been exponentially phasing out and closing select production facilities since 2004, it has also built state-of-the-art plants that manufacture toothpaste in the United States and Poland. The company employs approximately 36,000 employees globally.

Kimberly-Clark

Kimberly-Clark was founded in 1872 and operates four business segments: 1) Personal Care, 2) Consumer Tissue, 3) K-C Professional & Other, and 4) Health Care. The Personal Care division manufactures and markets products such as disposable diapers, baby wipes, and feminine and incontinence care products under such brand names as Huggies, Pull-Ups, Little Swimmers, GoodNites, Kotex, Lightdays, Depend, and Poise.

EXHIBIT 7 Direct Competitor Comparison

	P&G	J&J	KC	Industry
$ Market Cap	176B	165B	26B	1B
# Employees	127K	114K	N/A	2.24K
% Qtrly Rev Growth	1.50	-5.50	1.90	11.00
$ Revenue	79B	61B	19B	406M
% Gross Margin	51.29	69.49	33.27	46.91
% Oper Margins	19.70	26.84	14.64	10.40
$ Net Income	10.95B	13.33B	1.84B	N/A
$ EPS	3.67	4.78	4.45	0.94
KC = Kimberly-Clark				
Industry = Personal Products				

Source: Based on www.finance.yahoo.com.

The Consumer Tissue division manufactures and markets products such as facial and bathroom tissue, paper towels, and napkins. Products in this division are marketed as Kleenex, Scott, Cottonelle, Viva, Andrex, Scottex, Hakle, and Page. The K-C Professional & Other division markets such products as facial and bathroom tissue, paper towels, napkins, and wipes sold under the brands Kimberly-Clark, Kleenex, Scott, WypAll, Kimtech, KleenGuard, Kimcare, and Jackson.

The Health Care segment markets disposable health care products such as surgical drapes and gowns, infection control products, face masks, exam gloves, respiratory products, and pain management products under Kimberly-Clark, Ballard, and ON-Q brands. The company has 56,000 employees and 27 facilities in the United States, one in Canada, 20 in Europe, and 64 in Asia, Latin America, and other countries, with many of the facilities producing multiple production items/products (synergy). The company achieved $19.7 billion in total revenues in 2010.

Unilever

Unilever is a privately-held British corporation headquartered in London that markets more than 400 brands, such as Lipton tea, Dove, and Aviance. However, the company's main focus is on what are called "billion-dollar brands," which are 12 brands achieving annual sales in excess of €1 billion. Unilever's top 25 brands account for more than 70 percent of sales. They are categorized into food and beverage, home, and personal care divisions. The company achieved net profits of €4,597 in 2010, up from €3,659 in 2009.

Unilever's Asia Pacific segment yielded double-digit volume growth in 2010, with strong performance in Vietnam, the Philippines, Pakistan, and China. The competitive market existing in India yielded a double-digit volume growth for Unilever. The company experienced weaker market conditions in Central and Eastern Europe. Increases of volume growth were achieved as a result of growth in Latin America and performances in North America. In particular, North America achieved a 3 percent volume growth, while Latin America's growth increased above 4 percent, with the assistance of increased pricing.

Unilever directly competes with P&G's personal and home care segments. The company witnessed strong sales in deodorants due in part to strong sales by brands such as Dove Men+Care and Rexona. Its home care segment's laundry products have had strong volume growth in India, due in part to the relaunching of Rin and Wheel laundry detergents. In order to shrink the market share gap in China, the company launched Omo liquids, which achieved double-digit growth.

Clorox

Clorox manufacturers and markets consumer products under such brands as its namesake bleach and cleaning products, Green Works natural home care products, Pine-Sol cleaners, Poett home care products, Fresh Step cat litter, Kingsford charcoal, Hidden Valley and K C Masterpiece dressings and sauces, Brita water-filtration products, Glad bags and wraps and containers, and Burt's Bees natural personal care products. Founded in 1980 and employing approximately 8,300 employees globally, Clorox achieved revenues of $5.2 billion in fiscal 2010. Clorox manufactures products in over 24 countries and markets them in 100 different countries around the world.

Clorox operates in four respective segments: international, cleaning, household, and lifestyle. International sales constituted 21 percent of sales. The household segment achieved 32 percent of sales in 2010, followed by cleaning with 31 percent, and lifestyle with 17 percent. A sample of the company's products and brands sold under such categories as home care products include Pine-sol, Tilex, 404, and Liquid Plumr, which constituted 17 percent of sales. Charcoal achieved 11 percent of sales, with such brands as Match Light and Kingsford. The Glad brand produced 13 percent of net sales, while laundry-related Clorox produced 11 percent, and the company's dressings and sauces, such as Hidden Valley and Masterpiece, achieved 9 percent of net sales, among other brands/products represented within the company's business segments. Exhibit 8 lists leading household product companies as determined by sales, led by P&G and followed by Unilever in fiscal 2010.

Retailers, such as giant Wal-Mart, continue to place heavier emphasis on their own brands. High unemployment rates across the country have caused manufacturers to place greater

EXHIBIT 8 Leading Household Products/Personal Care Companies (ranked by sales)

Company	Fiscal Year End	Sales (Mil.$/£/€)
Procter & Gamble	June '10	$78.9
Unilever	Dec. '10	£44.3
L'Oreal	Dec. '10	€4.9
Kimberly-Clark	Dec. '10	$19.8
Colgate-Palmolive	Dec. '10	$15.6
Kao	Mar. '10	$12,730
Reckitt Benckiser	Dec. '10	£8.5
Avon	Dec. '10	$10.9
Estee Lauder	Jun. '10	$7,796
Shiseido	Mar. '10	$6,951
Clorox	Jun. '10	$5.5
Church & Dwight	Dec. '10	$2.6
Alberto-Culver	Sept. '10	$1,597
Revlon	Dec. '10	$1.3

Source: Standard and Poor's, December 30, 2010, www.finance.yahoo.com/company reports.

emphasis on "value-priced" products, such as P&G's Tide Basic, Charmin Basic, Bounty Basic, and Papers Basic. Church & Dwight Company offer their own "value" products, such as Arm & Hammer laundry detergent and Xtra laundry detergent.

P&G spends as much on advertising as any company. Exhibit 9 lists the leading national advertisers during the first quarter of 2010, led by P&G's $772.6 million. Individual item market share percentages remain tight in the industry among key products. P&G holds a slight market share advantage with Duracell (40.2 percent) over Energizer (38.8 percent). Sales of batteries fell 6.2 percent in 2010. P&G is the industry leader with the razor (65.3 percent) and blades (83.2 percent). Energizer's Schick holds a second ranking of market share with 28.5 percent in razors and 13.8 percent in cartridges.

P&G holds 60.2 percent of the laundry detergent market share and 40.4 percent of the toothpaste share, compared to Colgate-Palmolive's 29.7 percent share of the toothpaste market. Disposable diapers market share is led by P&G with 48.2 percent and Kimberly-Clark with 34.2 percent. However, sales of private-label brands rose 13.5 percent, while private-label market share increased to 16.8 percent in 2010. In deodorants, P&G holds a 35.5 percent share, Unilever's share is 28.7 percent, and Colgate-Palmolive's share is 10.5 percent. P&G holds a leading 37.3 percent of the shampoo market share, followed by L'Oreal's 13.1 percent. Koch

EXHIBIT 9 Top Ten Advertisers of Q1 2010

Company	Jan–March 2010 ($ Millions)
Procter & Gamble Co.	$772.6
AT&T	$576.4
General Motors Corp.	$533.7
Verizon Communications	$517.2
Pfizer Inc.	$396.4
Johnson & Johnson	$366.8
Time Warner Inc.	$304.3
Walt Disney Co.	$267.6
General Electric Co.	$264.6

Source: www.businesswire.com.

Industries leads in the toilet tissue market share with 26.7 percent, followed by Kimberly-Clark's 25.1 percent and P&G's 24.1 percent. Industry analysts believe continued new product development will be the key to increasing market share/sales.

The Future

Company reports have indicated volume growth opportunities exist across the business landscape, but industry reports suggest consumers are more cash-strapped than before. Given the varying political and economic conditions globally, as well as the August 2011 stock market crash, what strategy should P&G implement by taking advantage of the opportunities that exist in the industry, while utilizing its strengths? How can the company optimally manage its weaknesses while avoiding potential threats imposed by competitors and/or the industry? Will the future continue to be bright for P&G?

Identify particular strategies for CEO McDonald to consider in order for P&G to continue surpassing its rivals while increasing revenues and market shares across product categories and regions.

Avon Products, Inc., 2013

www.avon.com, AVP

Headquartered in New York City, Avon is one of the world's largest direct-seller firms, and is by far the largest direct seller of cosmetics and beauty-related items. Avon is the fifth-largest cosmetics and fragrance firm in the world. The company receives sales from catalogs and a website, but the vast majority of its sales come from its 6.4 million independent sales representatives in some 110 countries. These women are all independent contractors. Avon has 39,100 employees, but only 4,800 are employed in the USA. Since 1892, Avon has been on the forefront of empowering women to be their own boss and be independent and become leaders in communities and business.

Avon products include cosmetics, fragrances, toiletries, jewelry, apparel, home furnishings, watches, footwear, children's products, skin care, and gift and decorative products, nutritional products, housewares, and entertainment and leisure products. Avon owns and sells Silpada jewelry. A few well-recognized company brand names include Avon Color, ANEW, Skin-So-Soft, Advance Techniques, and *mark*. Although a large U.S. iconic corporation, Avon is struggling today to recover from poor management strategies that led to CEO Jung resigning over global bribery investigations. The direct-selling business model has waned in the USA, but it is effective in many emerging economies globally. Avon obtains 85 percent of its revenue from outside the USA. Millions of motivated direct sellers in many countries is Avon's key competitive advantage going forward, but the company needs a clear strategic plan.

Avon reported a loss of $38.2 million in 2012 compared to a net income of $517.8 million the prior year. Avon's second-quarter 2013 net income declined 48 percent but that was above Wall Street expectations and so Avon's stock price hit a new high for the year. Avon has made an offer to settle its overseas bribery allegations for $12 million; the offer has been rejected by U.S. authorities. Avon's beauty products earned $31.9 million for Q2, down from $61.6 million a year ago. Revenue slipped 2 percent to $2.51 billion due to currency rates and North American sales. Avon's sales in North America during Q2 2013 declined 12 percent, hurt by a 13 percent drop in the number of active sales representatives. Avon's Asia-Pacific sales fell 9 percent, but the company's sales in Latin America and Europe, the Middle East and Africa rose. For the quarter, Avon's prices rose and their average order size increased.

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History

David McConnell started a business in 1886 that eventually came to be named Avon Products. A traveling book salesman, McConnell did not originally intend to create a beauty company, but he realized that his female customers were far more interested in the free perfume samples he offered than in his books. McConnell had also noticed that many of his female customers were isolated at home while their husbands went off to work. So, McConnell purposely recruited female sales representatives and believed they had a natural ability to network with and market to other women. At a time of limited employment options for women, the Avon earnings opportunity for women historically was a revolutionary concept for mankind. It marked the start of the company's long and rich history of empowering women around the globe.

In 1892, McConnell changed the company name when his business partner, who was living in California, suggested that he name his business the California Perfume Company, because of the great abundance of flowers in California. In 1916, the California Perfume Company was incorporated in the state of New York and filed its first trademark application for Avon on June 3, 1932. The document described the company's goods and services as perfumes, toilet waters, powder and rouge compacts, lipsticks, and other toiletry products.

Avon entered the Chinese market in 1990, but legal changes in 1998 forced Avon to sell only through physical stores called Beauty Boutiques. The company received China's first license for direct selling in 2006. Avon purchased Silpada, a direct seller of silver jewelry, in 2010 for $650 million. Brazil is the company's largest market, passing the USA in 2010. Avon closed its Atlanta distribution center in 2013 and is closing its Pasadena distribution center in 2014. Avon's revenue dropped 5 percent to $10.72 billion in 2012.

Internal Issues

Vision and Mission

Avon has stated vision and mission statements on its corporate website. Avon's vision is: "To be the company that best understands and satisfies the product, service and self-fulfillment needs of women—globally." Avon's mission statement is quite lengthy, but in summary it says: Avon's mission is focused on six core aspirations the company continually strives to achieve: (1) leader in global beauty, (2) women's choice for buying, (3) premier direct-selling company, (4) most-admired company, (5) best place to work, and (6) to have the largest foundation dedicated to women's causes.

Marketing and R&D

Avon uses both door-to-door sales people ("Avon ladies," primarily, but a growing number of men) and brochures to advertise its products. Avon training centers help women who want to become Avon representatives selling beauty products, jewelry, accessories, and clothing. The Avon training centers have a small retail section with skin care products, such as creams, serums, makeup, and washes. There are classroom areas in which the representatives learn about the products and sales techniques. Avon representative are each independent sole proprietors running their own business.

Avon spent $253.6 million on advertising in 2012, down from $311.2 million the prior year. Avon spent $75.2 million on R&D in 2012, down from $77.7 million the prior year. Avon's primary R&D facility is located in Suffern, New York.

Sustainability and Philanthropy

Avon has extensive information on its corporate website about its sustainability and philanthropy programs and operations. Avon is a huge advocate for women's rights and works tirelessly through its Foundation for Women to combat violence against women, breast cancer, and more. For example the recent 10th Annual New York Avon Walk for Breast Cancer raised more than $8.3 million. Avon is also on a mission to help prevent deforestation worldwide.

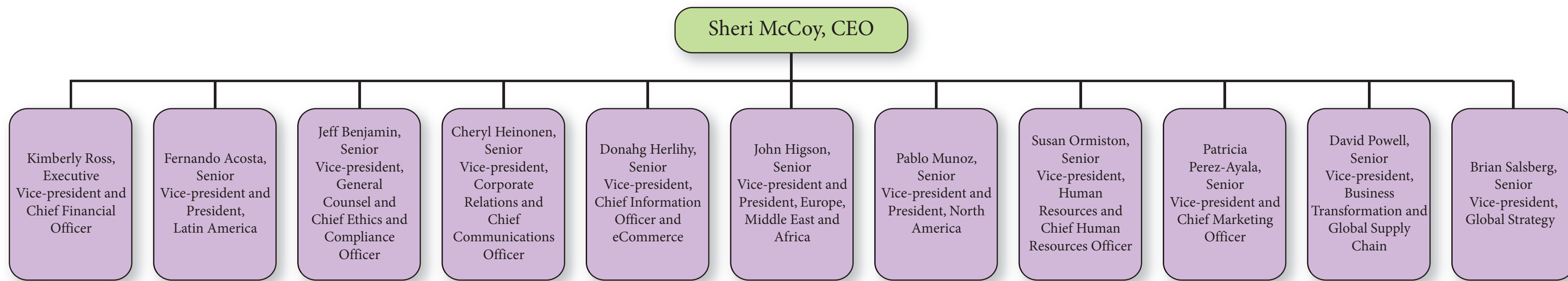
Founded in 1955, the Avon Foundation for Women is the largest corporate-affiliated philanthropic organization for women in the world. Avon has always been committed to helping women achieve their highest potential of economic opportunity and self-fulfillment by empowering them through scholarships and support for other forms of educational and occupational training and advancement. The Avon Foundation awards scholarships for Avon Sales Representatives and their families, as well as for the children of Avon associates. The Avon Foundation is currently focused on two key causes: breast cancer and domestic violence. The foundation approved $38 million in grants in 2011. In 2012, Avon launched its first global fundraising drive.

Organizational Structure

Avon's CEO is Sheri McCoy, who previously was a top executive at Johnson & Johnson. The former Avon CEO, Andrea Jung, was the longest-tenured female CEO among *Fortune* 500 companies. Jung stepped down as CEO in April 2012 and relinquished her Avon board seat at year-end 2012.

As indicated in Exhibit 1, Avon operates from a divisional-by-geographic region organizational structure. Note there is no chief operations officer (COO) so apparently all top executives report to the CEO. In fact, there has been no COO at Avon since 2006, a potential strategic mistake by CEO Jung (and McCoy).

EXHIBIT 1 **Avon's Organizational Chart**



Source: Based on company information.

EXHIBIT 2 Avon's Revenue and Profits By Region

Years ended December 31	2012		2011		2010	
	Total Revenue	Operating Profit (Loss)	Total Revenue	Operating Profit (Loss)	Total Revenue	Operating Profit
Latin America	$4,993.7	$443.9	$5,161.8	$634.0	$4,640.0	$613.3
Europe, Middle East & Africa	2,914.2	312.8	3,122.8	478.9	3,047.9	474.3
North America	1,906.8	(214.9)	2,064.6	(188.0)	2,193.5	147.3
Asia Pacific	902.4	5.1	942.4	81.4	981.4	82.6
Total from operations	10,717.1	546.9	11,291.6	1,006.3	10,862.8	1,317.5
Global and other expenses	–	(232.1)	–	(151.7)	–	(244.4)
Total	**$10,717.1**	**$314.8**	**$11,291.6**	**$854.6**	**$10,862.8**	**$1,073.1**

Source: 2012 *Annual Report,* p. 33.

Segments

Comparing 2012 to 2011, Avon's geographic results are provided in Exhibit 2. Note the percent revenue decline in every geographic region, although a few particular countries with regions reported increases.

Avon's reportable segments are sometimes noted to be: (a) beauty, (b) fashion, and (c) home. Beauty consists of color cosmetics, fragrances, skin care, and personal care. Fashion consists of fashion jewelry, watches, apparel, footwear, accessories, and children's products. Home consists of gift and decorative products, housewares, entertainment and leisure products, and nutritional products. Avon's sales in its Beauty, Fashion, and Home segments decreased 5, 5, and 4 percent respectively in 2012 from the prior year. For 2012, the Beauty segment accounted for 72 percent of company sales, followed by Fashion at 18 percent and Home at 10 percent. Specifically within the Beauty segment, 2012 Fragrance, Color, Skincare, and Personal Care revenues were down 4, 6, 7, and 6 percent respectively.

Finance

Avon's cash dividends paid out dropped to $0.75 per share in 2012 from $0.92 the prior year. The company's long-term debt increased to $2.62 billion from $2.45 billion the prior year.

Avon's recent income statements and balance sheets are provided in Exhibits 3 and 4, respectively. Note that Avon's revenue and net income decreased in 2012.

Competitors

As indicated in Exhibit 3, Avon's earnings per share (EPS) and profit margin are negative. L'Oreal leads the beauty industry, but other firms also compete with Avon, especially Mary Kay, Revlon, Estee Lauder, Coty, and Procter & Gamble. A synopsis of some of these rival firms is provided.

EXHIBIT 3 Avon versus Rival Firms

	Avon	L'Oreal	Revlon
Number of Employees	39.1K	68.3K	5.2K
Revenue ($)	10.7B	27.7B	1.4B
Net income ($)	(42.5)M	3.36B	40.6M
Profit Margin (%)	—	12.1	2.9
Revenue ($)/employee	273K	406K	269K
EPS	—	1.12	0.78
Market capitalization	10.5B	83.1B	775.9M

EPS, earnings per share.

L'Oreal SA

Headquartered in France, L'Oreal is a large, global, cosmetic conglomerate with annual sales of about $30 billion and net income of about $3.5 billion. L'Oreal is structured into three segments: (1) Cosmetics, (2) The Body Shop, and (3) Dermatology. The Cosmetics unit is divided into four sectors: Consumer Products, Professional Products, Luxury Products, and Active Cosmetics. Consumer Products are marketed under L'Oreal Paris, Garnier, Maybelline New York (Maybelline NY), and Softsheen-Carson brands. Professional Products, including hair care products for use by professional hairdressers, are marketed under Kerastase, Redken, Matrix, and L'Oreal Professionnel. Luxury Products are sold under such international brands as Lancome, Diesel, Giorgio Armani, and Cacharel among others. Active Cosmetics, which consists of products under Vichy and La Roche Posay brands, are for sale mainly in pharmacies. The Body Shop segment is focused on cosmetics on the basis of natural ingredients. The Dermatology segment consists of Galderma, a joint venture between L'Oreal and Nestle.

Mary Kay, Inc.

Headquartered in Addison (outside of Dallas), Texas, Mary Kay is a privately-owned cosmetic and fragrance direct-selling company. Mary Kay is the sixth-largest direct selling company in the world, with annual sales of about $3 billion. Mary Kay's business model is similar to the Avon business model. Founded by Mary Kay Ash in 1963, the company is famous for its pink Cadillacs, given to high-selling representatives. Richard Rogers, Mary Kay's son, is the chairman of the board. Mary Kay products are sold in more than 35 markets worldwide, and the global Mary Kay independent sales force exceeds 2.4 million women.

In 1968, Mary Kay Ash purchased the first pink Cadillac and had it repainted to match the Mountain Laurel Blush in the Mary Kay compact. Since the Cadillac program's inception, more than 100,000 independent sales force members have qualified for the use of a Career Car or elected the cash compensation option. GM estimates that it has built 100,000 pink Cadillacs for Mary Kay. For 2012, high-sellers may select other Career Cars, including the Chevrolet Malibu, Chevrolet Equinox, Toyota Camry, and the Cadillac CTS, SRX, and Escalade Hybrid—or most recently, a black Ford Mustang.

Estee Lauder Companies, Inc.

Headquartered in New York City, Estee Lauder has sales of about $10 billion annually and income of about $1 billion. Estee Lauder manufactures and markets skin care, makeup, fragrance, and hair care products. The company's products are sold in more than 150 countries and territories under a number of brand names, including Estee Lauder, Aramis, Clinique, Origins, M.A.C, Bobbi Brown, La Mer, and Aveda. The company is also the global licensee for fragrances or cosmetics sold under brand names, such as Tommy Hilfiger, Donna Karan, Michael Kors, Tom Ford, and Coach. The company sells its products at more than 30,000 points of sale, consisting of upscale department stores, specialty retailers, upscale perfumeries and pharmacies, and prestige salons and spas.

Revlon, Inc.

Headquartered in New York City, Revlon is a cosmetics leader with brands such as Almay and Revlon ColorSilk hair color, Mitchum antiperspirants and deodorants, Charlie and Jean Naté fragrances, and Ultima II and Gatineau skin care products. Revlon's beauty aids are distributed in more than 100 countries, though the USA is its largest market, generating about 55 percent of sales. Walmart is Revlon's biggest single customer, accounting for some 22 percent of sales.

Revlon manufactures, markets, and sells cosmetics, women's hair color, beauty tools, antiperspirant deodorants, fragrances, skin care, and other beauty care products. Revlon products are sold and marketed under brand names, such as Revlon, including the Revlon ColorStay, Revlon Super Lustrous, and Revlon Age Defying franchises; Almay, including the Almay Intense i-Color and Almay Smart Shade franchises; Sinful Colors in cosmetics; Revlon ColorSilk in women's hair color; Revlon in beauty tools; Mitchum in antiperspirant deodorants; Charlie and Jean Nate in fragrances, and Ultima II and Gatineau. Revlon also owns certain assets of Sinful Colors cosmetics, Wild and Crazy cosmetics, freshMinerals cosmetics, and freshcover cosmetics.

Coty, Inc.

Headquartered in New York City, Coty is one of the world's leading makers of beauty products for men and women. Led by CEO Bernd Beetz, Coty is a $4.1 billion beauty company, and the biggest seller of nail care, nail polish, and fragrances in the USA. Sarah Jessica Parker, Jennifer Lopez, Celine Dion, Gwen Stefani, Katy Perry, and Thomas Dutronc are several celebrities that promote Coty. Founder of the company, François Coty created his first perfume, La Rose Jacqueminot, in 1904.

Coty's product lineup today ranges from moderately priced scents sold globally by mass retailers to prestige fragrances and nail polishes found in department stores. Coty's brands include adidas, philosophy, Rimmel, and Sally Hansen. Cody's prestige perfume labels are led by Calvin Klein. Coty's shimmery blue nail polish and Lady Gaga's perfume are high-selling products. Thomas Dutronc is the face of Coty's new Cerruti fragrance for men that was launched in the Spring 2013.

Coty's Rimmel Scandaleyes mascara, which debuted in early 2012, is another big seller. Over-the-top lashes are hot these days because false eye lashes have made a comeback and are "almost mainstream." Promotional material for Scandaleyes urges women to "ditch those falsies." Mascara makers today compete with eyelash lengthening drugs such as Latisse.

Nail care generated $735 million in sales in U.S. discount stores, pharmacy chains, and supermarkets in 2011, up 6.5 percent from 2010. Lipstick sales rise even as a nation's economy falters, partly because the economy has put the consumer in charge of her own beauty treatments without having to go to the nail bar. Sally Hansen Salon Effects nail polish strips also brings "nail art," which has been trending at beauty salons nationwide, to everyday drugstore shoppers at a mere $8 to $10. Vivienne Rudd, head of beauty and personal care for market research firm Mintel, says "the nail-art trend is largely being driven by younger shoppers; it takes a little courage to wear stripes and spots." Still, women of all ages are experimenting with the strips as they look for inexpensive fun.

Overall, nail care product sales have been booming in today's shaky economic climate. Women have been skipping the salon and playing at-home manicurist, whereas consumer products companies have been injecting innovation into the business with products like Salon Effects and the hologram, crackle, and magnetic nail finishes on the market, analysts say. The strips are available in funky prints and patterns such as leopard, florals, and tie dye.

EXHIBIT 4 Avon's Recent Income Statement (in millions)

	%Change				
				2012 vs.	2011 vs.
	2012	2011	2010	2011	2010
Total revenue	$10,717.1	$11,291.6	$10,862.8	(5)%	4%
Cost of sales	4,169.3	4,148.6	4,041.3	–%	3%
Selling, general and administrative expenses	5,980.0	6,025.4	5,748.4	(1)%	5%
Impairment of goodwill and intangible asset	253.0	263.0	–	(4)%	*
Operating profit	314.8	854.6	1,073.1	(63)%	(20)%
Interest expense	104.3	92.9	87.1	12%	7%
Interest income	(15.1)	(16.5)	(14.0)	(8)%	18%
Other expense, net	7.0	35.6	54.6	(80)%	(35)%
Net (loss) income attributable to Avon	(42.5)	513.6	606.3	(108)%	(15)%
Diluted (loss) earnings per share attributable to Avon	$(.10)	$1.18	$1.39	(108)%	(15)%
Advertising expenses	$253.6	$311.2	$400.4	(19)%	(22)%
Gross margin	61.1%	63.3%	62.8%	(2.2)	.5

Source: 2012 *Annual Report,* p. 29.

The Future

Avon announced in late 2012 that it is cutting about 1,500 jobs globally and will exit the South Korea and Vietnam markets as part of a turnaround plan. The global beauty industry is growing at the rate of 6 percent, good news for Avon. The company's current ratio and debt service coverage ratios indicate that it has enough liquidity to survive in the near future, but a clear strategic plan is needed to survive.

The general feeling about Avon is negative because of the sliding profits, four-year pending legal probe related to bribery and ineffective business strategies. However, Avon has a popular global brand with a high market share in emerging markets. Although door-to-door selling may be an outdated business model in the USA, direct selling remains effective in emerging markets such as Brazil. Direct selling grew about 30 percent between 2006 and 2012 into a $150 billion global market. Many of the more than 100 countries in which Avon competes do not have good retail infrastructure, so Avon's 6.5 million person global sales force is its biggest advantage over its competitors. Avon's stock price hit a 52-week high in June 2013 of $24.30.

EXHIBIT 5 **Avon's Balance Sheets**

	December 31,	
(In millions, except per share data)	2012	2011
Assets		
Current Assets		
Cash, including cash equivalents of $762.9 and $623.7	$ 1,209.6	$ 1,245.1
Accounts receivable (less allowances of $161.4 and $174.5)	751.9	761.5
Inventories	1,135.4	1,161.3
Prepaid expenses and other	832.0	930.9
Total current assets	**$ 3,928.9**	**$ 4,098.8**
Property, plant and equipment, at cost		
Land	66.6	65.4
Buildings and improvements	1,165.9	1,150.4
Equipment	1,479.3	1,493.0
	2,711.8	2,708.8
Less accumulated depreciation	(1,161.6)	(1,137.3)
	1,550.2	1,571.5
Goodwill	374.9	473.1
Other intangible assets, net	120.3	279.9
Other assets	1,408.2	1,311.7
Total assets	**$ 7,382.5**	**$ 7,735.0**
Liabilities and Shareholders' Equity		
Current Liabilities		
Debt maturing within one year	$ 572.0	$ 849.3
Accounts payable	920.0	850.2
Accrued compensation	266.6	217.1
Other accrued liabilities	661.0	663.6
Sales and taxes other than income	211.4	212.4
Income taxes	73.6	98.4
Total current liabilities	**2,704.6**	**2,891.0**
Long-term debt	2,623.9	2,459.1
Employee benefit plans	637.6	603.0
Long-term income taxes	52.0	67.0
Other liabilities	131.1	129.7
Total liabilities	**$ 6,149.2**	**$ 6,149.8**

EXHIBIT 5 Continued

(In millions, except per share data)	December 31, 2012	2011
Commitments and contingencies		
Shareholders' Equity		
Common stock, par value $.25 – authorized 1,500 shares; issued 746.7 and 744.9 shares	$ 188.3	$ 187.3
Additional paid-in capital	2,119.6	2,077.7
Retained earnings	4,357.8	4,726.1
Accumulated other comprehensive loss	(876.7)	(854.4)
Treasury stock, at cost (314.5 and 314.1 shares)	(4,571.9)	(4,566.3)
Total Avon shareholders' equity	1,217.1	1,570.4
Noncontrolling interests	16.2	14.8
Total shareholders' equity	**$ 1,233.3**	**$ 1,585.2**
Total liabilities and shareholders' equity	**$ 7,382.5**	**$ 7,735.0**

Source: 2012 *Annual Report,* p. F5.

Revlon, Inc. — 2011

M. Jill Austin and Laura M. Buckner
Middle Tennessee State University

REV

www.revlon.com

In the quest for beauty and attractiveness, perhaps no one is immune. The desire to look attractive seems to be a fundamental element of human behavior because cosmetics have been around since antiquity. Looking better in a mirror translates into feeling better. The desire to enhance one's appearance generates over $200 billion in sales worldwide, with an estimated $6 to $8 billion spent annually on beauty products in the United States alone.

Revlon manufactures color cosmetics, women's hair color, skin care, fragrances, antiperspirants, deodorants, and beauty tools and sells primarily through large mass retailers and chain drug stores. The company competes with consumer goods companies such as Procter & Gamble, Unilever, and Colgate Palmolive as well as beauty companies such as L'Oreal, Avon, Mary Kay, and Estée Lauder. For the last 20 years, Revlon has been losing the competitive battles. The company desperately needs an effective strategic plan going forward.

Revlon's global market share in the cosmetics business has consistently declined, from 4 percent in 2009 to 3 percent in 2010. After years of losses and management upheaval, 2008 was the first year since 1997 that Revlon posted a positive net income. Revlon is trying to remedy its bad track record by maintaining its debt levels and leveraging its reputation as one of the leading players of color cosmetics. However, fierce competition, limited presence in emerging markets, and relatively small R&D and advertising budgets severely hamper Revlon.

Revlon products are sold in more than 100 countries around the world with sales outside the United States accounting for approximately 55 percent of sales in 2010. Some of the company's most recognized brand names include Revlon, Ultima II, ColorStay, Age Defying, Almay, Charlie, Mitchum, Jean Nate, Gatineau, and ColorSilk. Two new Revlon products are Revlon Custom Eyes (a mascara with adjustable bristles) and Colorburst (a lip gloss with "5x the shine of patent leather"). Other new products are Revlon PhotoReady makeup, Almay Smart Shade Smart Balance (a patented technology with shade sensing microbeads that adjust to match skin tone), Revlon Top Speed (a nail enamel available in 32 colors that sets in 60 seconds), and Colorstay Aqua (a mineral makeup with the hydrating effects of coconut water). Revlon products fall into six strategic business categories or units: Cosmetics, Hair, Beauty, Fragrance, Anti-Perspirants/Deodarants, and Skin Care.

By-Segment Finances

Revlon's sales in the second quarter of 2011 were $351.2 million, an increase of 4 percent versus the second quarter the prior year. In the United States, Revlon's sales increased $15.6 million, or 8.7 percent primarily due to increased sales of Sinful Colors, Revlon color cosmetics, and Revlon ColorSilk hair color. In the Asia Pacific region, Revlon's sales increased $4.2 million, or 8.6 percent, primarily due to higher sales of Revlon color cosmetics in China and Australia. In Europe, Middle East and Africa, Revlon sales decreased $3.4 million, or 6.8 percent, led down by weak sales in the United Kingdom and Italy. Also in Latin America, Revlon's sales decreased $1 million, or 3.5 percent, led down by lower sales in Mexico and Venezuela, but sales in Argentina were good. In Canada, Revlon's second quarter sales decreased $2.24 million, or 11.5 percent, primarily due to lower net sales of Revlon color cosmetics. These financial results reveal some problem areas for the company.

Revlon's sales, broken down by geographic and product categories, by calendar year are provided in Exhibit 1. Note that 55 percent of company sales are inside the United States. Note that 62 percent of company sales are from cosmetics/skin care/fragrances.

is wholly owned by Ronald Perelman. Mr. Perelman owned, by the end of 2010, approximately 78 percent of Revlon, Inc.'s outstanding Class A and Class B Common stock. As a result, MacAndrews and Forbes is able to control the election of the entire board of directors of Revlon, Inc. and controls the vote on all matters submitted to a vote of Revlon, Inc.

Revlon has historically dealt with extraordinary levels of debt. In 2008, the company reduced debt by $100 million by using the proceeds from the sales of its Brazilian cosmetics division and a stock offering. Also in 2008, Revlon introduced ColorStay Mineral foundation, Custom Creations foundation, and Beyond Natural Makeup. Almay Pure Blends, a hypoallergenic, natural formula was also taken to market. Coming in a wide collection of shades, Pure Blends integrated recycled packaging and was sold in more environmentally-friendly hang tags instead of traditional packaging.

Vision/Mission

Revlon's vision statement is as follows:

> Revlon is a global color cosmetics, hair color, beauty tools, fragrances, skincare, antiperspirant/deodorants, and beauty care products company whose vision is Glamour, Excitement and Innovation through High-quality Products at Affordable Prices.
>
> (Source: Company documents.)

Revlon's mission statement is as follows:

> Revlon's mission is to emerge as the leader in cosmetic and personal care throughout the world. Revlon takes pride in manufacturing the top skin care products and strives to please young and older woman alike.
>
> (Source: Company documents.)

External Factors

Demographic Trends

Two major changes in the demographic composition of the United States are the aging population and the change in proportions of racial and ethnic populations. Aging baby boomers make up a significant proportion of the adult U.S. population. The 75 million Americans born between 1946 and 1964 are a significant market for the cosmetics/personal care industry. Many baby boomers have high levels of disposable income, are brand-loyal consumers, and are sensitive concerning their looks. In 2010, 16 percent of the U.S. population was Hispanic, numbering 50.5 million. Between 2000 and 2010, the U.S. Hispanic population grew by 43 percent. The increase in the Hispanic population during this 10-year period made up over half of the total population increase in the United States.

International sales of cosmetics/skin care products are also impacted by ethnic/racial issues. There are significant opportunities for companies in Asian countries (60 percent of world's population). The youthful, increasingly affluent Latin American countries also represent a growth opportunity. Since the majority of personal care products are currently sold in the United States, Japan, Canada, and European countries (less than 20 percent of world's population), the potential for sales of personal care products around the world is excellent. In the Middle East and North Africa, newly won freedoms also are leading to more women desiring cosmetics.

More and more consumers are seeking out natural products and showing concern for the amount of chemicals in cosmetics. In addition, there has been a growth in "cosmeceutical" offerings, meaning products that claim to be backed by science and work at a cellular level to promote more rapid cell turnover, which will improve overall skin appearance. While most of these type products are offered at specialty or medical outlets, this has had an impact on customers' expectations of product effectiveness.

Social media have become an incredibly important tool in consumer relationship development in the cosmetics/skin care industry. While many companies are still trying to determine the tactics best employed online, there have been several examples of online social media campaigns within the industry. P&G's Old Spice Guy told his audience about "The Man Your Man Could

EXHIBIT 1 Revlon Sales by Geographic Area and Product Category ($ in millions)

	Year Ended Dec. 31					
	2008		2009		2010	
Geographic area						
Net sales						
United States	$ 782.6.	*58%*	$ 747.9	*58%*	$ 729.1	*55%*
International	564.2	*42%*	548.0	*42%*	592.3	*45%*
	$ 1346.8		$ 1295.9		$1321.4	
	Year Ended Dec. 31					
	2008		**2009**		**2010**	
Classes of similar products						
Net sales						
Cosmetics, skin care, and fragrances	$ 831.0	*62%*	$ 785.5	*61%*	$ 816.1	*62%*
Personal care	515.8	*38%*	510.4	*39%*	505.3	*38%*
	$ 1346.8		$ 1295.5		$ 1321.4	

Source: Revlon, Inc. 2010, Form *10K*, p. F-61.

History

Revlon, Inc. was formed in 1932 by brothers Charles and Joseph Revson and Charles Lachmann with a $300 investment. Charles Lachmann was a nail polish supplier who is most notably remembered for his contribution of the “l” in the Revlon name. Charles Revson was the primary force behind the success of Revlon until his death in 1968. In the early years, Revson developed a near monopoly on beauty parlor sales by selling nail polish door-to-door at salons. He expanded into the lipstick market with the slogan “Matching Lips and Fingertips.” Revlon was a hard taskmaster, expecting the same whole-life devotion of his workers that he gave to Revlon. He would hold meetings until two o’clock in the morning, call employees at home to discuss business, curse at employees, and pretend to fall asleep during some presentations.

Revlon has an 80-year history of providing high-quality products at affordable prices to women. The company started with only one product—nail enamel. Revlon nail enamel was manufactured with pigments instead of the dyes typically used in nail enamel manufacturing. This approach allowed Revlon to market a large number of color options to consumers relatively quickly. It took the three company founders just six years to transform their small nail enamel company into a multi-million dollar organization. This successful collaboration launched one of the most recognizable brands and companies in the world.

After the death of Charles Revson, Michel Bergerac took control of the company and built up the pharmaceutical side of the business. By 1985, two-thirds of Revlon’s sales were health care products such as TUMS and Oxy acne medications, and the company was losing ground in cosmetics. Millionaire Ronald Perelman made five offers to purchase Revlon and eventually took over the company for $1.8 billion in a leveraged buyout. Perelman returned the company to its roots and sold off the health care products. He refocused Revlon to become an internationally known manufacturer and seller of cosmetics and fragrances. Perelman took the company private in 1987 by buying the stock of all public shareholders.

Despite financial struggles, Revlon continued to launch or reintroduce new product lines. The 33-year old Ultima II brand was reintroduced in 2001, and Charlie perfume was reintroduced in 2002. Revlon and Pacific World Corporation agreed in October 2002 to jointly manufacture a line of nail and nail care products. Moisturous Lipcolor (24 shades of hydrating lipstick) was sold beginning in 2002, and the Moonlit Mauve color collection and Almay Bright Eyes products were introduced in fall 2003. In February 2003, the company received cash in the amount of $150 million from MacAndrews and Forbes Holdings, Inc. so the company could implement some of its growth and stabilization plans. MacAndrews and Forbes Holdings, Inc.

Smell Like" on TV, You Tube, Twitter, and Facebook in 2010. Unilever's "Campaign for Real Beauty" included an award winning, web-based video entitled "Dove Evolution," which shows how an average woman can be made to look like a supermodel with the help of makeup artists and computer graphics. Both L'Oreal and Estée Lauder utilize Facebook, highlighting new products, demonstrating application techniques, publicizing events, and soliciting consumer comments.

Increasingly, cosmetics/personal care is not an industry for women only; there has been impressive growth in the sales of male oriented grooming and hygiene products, including appearance-enhancing products such as hair color products. Another area that male grooming habits have impacted is deodorant sales. Worldwide demand for deodorants is expected to reach $12.6 billion by 2015. Men are also interested in products that improve and enhance the shaving process. And, of course, the youth market is still a vibrant consumer of cosmetics, hair care products, and fragrances since the U.S. teen market (ages 15–19) was estimated at almost 10.5 million teens by 2010.

Economic Issues

In an economy with high unemployment, high gas prices, and high food prices, U.S. consumers cut back on spending, trading down from prestige cosmetic brands in favor of value brands. This trend plays to Revlon's strength because the company offers cosmetics at prices more affordable than many rival company options. In weak economic times, more consumers do their own beauty treatments at home, such as nail care and hair color, rather than pay a salon for these services.

International economics provide unique challenges for companies in the cosmetics/skin care industry. Many emerging economies in Asia and Eastern Europe are eager to have mass marketers enter operations in their countries, but operating situations are generally uncertain. The economies in Japan, Latin America, and many European countries have slowed in recent years, and economies in developing nations are somewhat unstable. High inflation, the strength of the dollar in international markets, and the fluctuation of foreign currency exchange rates all pose difficulties for companies operating in international markets. The populations of countries outside the United States are growing more rapidly than the U.S. population, so there are opportunities for growth in sales in these international markets. An emerging middle class in Asia, Africa, Eastern Europe, and Latin America offers companies a chance to tap into a new market for personal care products. Companies that address these emerging middle-class buyers can create inroads to loyalty among this growing group. Sales of personal care products in Brazil, Russia, India, and China are expected to grow 40 percent from 2009 to 2014. Newly won freedoms in Tunisia, Egypt, Libya, and Algeria open up more interest among women in those countries wanting to look pretty and show that they are pretty.

Competition

It is very difficult to gain and sustain competitive advantage in the cosmetics/skin care industry that offers hundreds of products. Sales of cosmetics in specialty stores and department stores feature beauty consultants providing service. Large numbers of women prefer purchasing these items at mass-volume retailers such as K-Mart and Wal-Mart, from door-to-door sellers such as Avon, and from drug stores, supermarkets, and on the Internet. Revlon's major competitors include Procter & Gamble (P&G), Avon, Estée Lauder, L'Oreal, and Unilever. Other competitors include small companies such as Urban Decay; specialty stores such as Bath and Body Works and Sephora; and retailers selling their own brands such as Gap, Banana Republic, and Victoria's Secret. Competition for the African American market is also increasing, with brands such as Fashion Fair and cosmetics lines launched by Iman and Patti LaBelle.

P&G

One of the world's largest companies, P&G serves 4.2 billion people in more than 180 countries. P&G segments its offerings into three major brand categories: beauty and grooming, health and well-being, and household care. Products included in the beauty and grooming category are cosmetics and skin care, hair care, fragrances, and personal care products such as deodorant and body soap. Products not in the beauty and grooming category include laundry products, oral care products, diapers, over-the-counter health care products, and several home cleaning products, such as Swiffer branded products.

P&G offers hair care products through its Pantene, Pert, Head & Shoulders, Herbal Essences, and Fekkai brands. Hair color brands include Natural Instinct and Nice 'N Easy.

Fragrance lines sold by P&G include Dolce and Gabbana, Escada, Gucci, Hugo Boss, Old Spice, Naomi Campbell, and Lacoste. P&G's Olay brand offers skin care alternatives ranging from basic skin care alternatives to anti-aging regiments. The P&G CoverGirl cosmetics line includes eight different makeup collections and dozens of products. P&G brought the Olay and CoverGirl brands together to create the Simply Ageless line of makeup, which is aimed at more mature users. Additionally, the CoverGirl website offers easy makeup color matching to department store brands in order to ease brand switching. In total, the beauty care brands contributed $19.5 billion in sales and $2.7 billion to profit for P&G in 2010. Currently, Drew Barrymore, Ellen DeGeneres, Queen Latifah, Taylor Swift, and Dania Ramirez promote CoverGirl products. Selected financial information for P&G is shown in Exhibit 2.

L'Oreal

L'Oreal is the world's largest cosmetics firm. L'Oreal owns Maybelline and The Body Shop. L'Oreal competes directly with Revlon in cosmetics (L'Oreal Paris, Maybelline, and Garnier) and hair color (several L'Oreal brands such as Excellence, Superior Preference, Feria, Garnier, Dark and Lovely, and Redken). In their Luxury Products category, L'Oreal offers fragrances (Giorgio Armani, Ralph Lauren perfumes, and several Lancome scents). L'Oreal has a children's line of hair care products and two lines aimed at male consumers: Vive Pro for Men and the Men's Expert label, offering "custom technology for Every Man's skin." Spokes models include Beyonce Knowles, Gwen Stefani, Eva Longoria, Andi McDowell, Kerry Washington, Frieda Pinto, and Diane Keaton. Financial information for L'Oreal is shown in Exhibit 3.

Unilever

Unilever is an Anglo-Dutch firm that saw its best volume growth in 30 years in 2010. Providing products to more than 180 countries, Unilever organizes its brands into four categories: Savory Dressings and Spreads (brands such as Knorr and Hellman's), Ice Cream and Beverages (Lipton, Ben & Jerry's), Home Care (Surf, Comfort), and Personal Care brands. It was the strength of the Personal Care brands and the growth in emerging markets that resulted in Unilever's 2010 sales growth. Select Unilever brands include those for mass skin care (Dove, Ponds, and Vaseline) and hair care (Dove and Sunsilk). Other personal care brands include Close Up toothpaste, Lifebuoy soaps and gels, and Axe (body sprays, deodorants, and shower gels that "help males keep a step

EXHIBIT 2 P&G Financial Information ($ in millions)

	2008	2009	2010
Net Sales	$79,257	76,694	78,938
Gross Margin	39,996	38,004	41,019
Operating Income	15,979	15,374	16,021
Net Earnings	12,075	14,436	12,736
Long-term Debt	23,581	20,652	21,360
Shareholders' Equity	69,784	63,382	61,439

Source: http://www.pg.com.

EXHIBIT 3 L'Oreal, Some Financials (Euros in millions)

	2008	2009	2010
Sales	€17,542	17,473	19,496
Operating Profit	2,725	2,578	3,057
Noncurrent Assets	16,380	17,350	17,048
Current Assets	6,526.5	5,941.1	6,996.3
Loans and Debt	4,777	3,131	1,591
Shareholders' Equity	11,559.6	13,595.2	14,862.9

Source: http://www.loreal.com.

ahead in the mating game”). In late 2010, Unilever purchased Alberto Culver, makers of such hair and skin care brands as TRESemme, Nexxus, and St. Ives, for $3.7 billion. The same year, the company also launched Dove Men+Care in more than 30 countries. Promotion for the Dove Men+Care launch was aggressive and included the first ever iAd for Apple devices and Super Bowl advertising. The company leads the hair care market in Africa, the Middle East, Latin America, and Asia/Pacific. Unilever skin care products lead the market in North America, Africa, Latin America, Asia/Pacific, and the Middle East. Financial results for Unilever are shown in Exhibit 4.

Avon Products

Avon is the number one direct seller of cosmetics and beauty products in the world, with over $10 billion in annual revenue produced by 6.5 million Avon representatives. Avon’s direct sales force currently numbers about 6.5 million people in more than 100 countries. Some brand names for Avon products include Avon Color, Avon Clearskin Skin Solutions, Anew, Skin-So-Soft, and Silpada (a direct seller of silver jewelry acquired in 2010). In October 2009, Reese Witherspoon loaned her name to a new fragrance: In Bloom by Reese Witherspoon. Other celebrity fragrance brands include Derek Jeter Driven, Spotlight (featuring the face of Courtney Cox), Unscripted Patrick Dempsey, Outspoken by Fergie, and Today, Tomorrow and Always fragrances, which feature Salma Hayek.

In response to slow sales growth in 2010, Avon is undergoing a major realignment of management and a focus on key areas: restoring growth in skin care lines, improving and strengthening its direct sales model, and focusing on developing markets (including launching Avon Care, targeted at women in developing countries). The company’s products can be purchased through its website, but the majority of Avon revenue is generated by sales representatives. In an attempt to address the sales representatives’ concerns that Internet sales would take away their sales, Avon is allowing sales representatives to have their own websites. In October 2010, it was rumored that L’Oreal was considering acquiring Avon for a reported $19 billion. Selected financial information is provided in Exhibit 5.

Estée Lauder

Estée Lauder manufactures and markets cosmetics, fragrances, skin care products, and hair care products for sale in 150 countries and territories. Some of the company’s cosmetics/skin care brands include Estée Lauder and Clinique. Estée Lauder holds the worldwide license for

EXHIBIT 4 Unilever, Some Financials (Euros in millions)

	2008	2009	2010
Net Profit	€5,285	3,659	4,598
Total Noncurrent Assets	24,967	26,205	28,683
Total Assets Less Current Liabilities	22,342	25,417	27,561
Total Noncurrent Liabilities	11,970	12,881	12,483
Shareholders’ Equity	9,948	12,065	14,485

Source: http://www.unilever.com.

EXHIBIT 5 Avon Products, Some Financials ($ in millions)

	2008	2009	2010
Total Revenue	$10,508	10,205	10,863
Operating Profit	1,325	1,006	1,073
Net Income	875	626	606
Total Assets	6,074	6,823	7,874
Long-Term Debt	1,456	2,307	2,409
Stockholders’ Equity	712	1,313	1,673

Source: http://www.avon.com.

fragrances and cosmetics with the brand names Tommy Hilfiger and Donna Karan (DKNY). In 2010, Estée Lauder purchased Smashbox, a line aimed at twenty-something users. There are 28 listed Estée Lauder brands, including Bobbi Brown Essentials, M-A-C, Bobbi Brown, La Mer, Donna Karan, Aveda, Jo Malone, Bumble and bumble, Darphin, Michael Kors, American Beauty, Sean John, Flirt!, Good Skin, and Grassroots. Estée Lauder pulled the Prescriptives brand from retail distribution in early 2010, but decided to offer the most popular items online only. Some of the famous spokespersons for the company include models Liya Kebede, Carolyn Murphy, Liu Wen, and actresses Elizabeth Hurley and Gwyneth Paltrow. In 2010, the company issued its second corporate responsibility report entitled "The Beauty of Responsibility." The report highlights Estée Lauder activities in the areas of environmental stewardship, employee health and safety, and global philanthropy.

Selected financial information for Estée Lauder is shown in Exhibit 6.

Internal Factors

Social Responsibility

At the core of the Revlon organization is the belief in individual values and the integrity of the firm and its actions. Revlon and its employees are active in supporting women's health programs and other community efforts, investing over $65 million in medical research programs, awareness and education programs, and doctor training. Revlon supports "Look Good…Feel Better," an organization designed to help women deal with the harsh toll cancer treatment takes on their personal appearance. Revlon helps fund a cancer center at UCLA, well known for the treatment and research of breast cancer. Continued support of this work is provided through the Revlon Walk/Run for Women, held annually in New York City and Los Angeles. Halle Berry, Jessica Biel, and Jessica Alba participated in the 2010 event.

Management

In April 2009, Alan Ennis became president and the fourth CEO of Revlon since 2000. He came to Revlon in 2005 from Ingersoll-Rand, where he served in senior financial positions. Before being named CEO, Ennis had the position of senior vice president and CFO. Mr. Ennis has implemented a worldwide organizational realignment at Revlon designed to take advantage of more efficient processes and workflows, eliminate management layers, streamline certain functions, and consolidate more operations into the company's New Jersey facility. About 400 positions were eliminated. The restructuring saved the company $30 million, with $15 million quickly benefitting the 2009 results. The company's organizational chart is provided in Exhibit 7.

Marketing/R&D

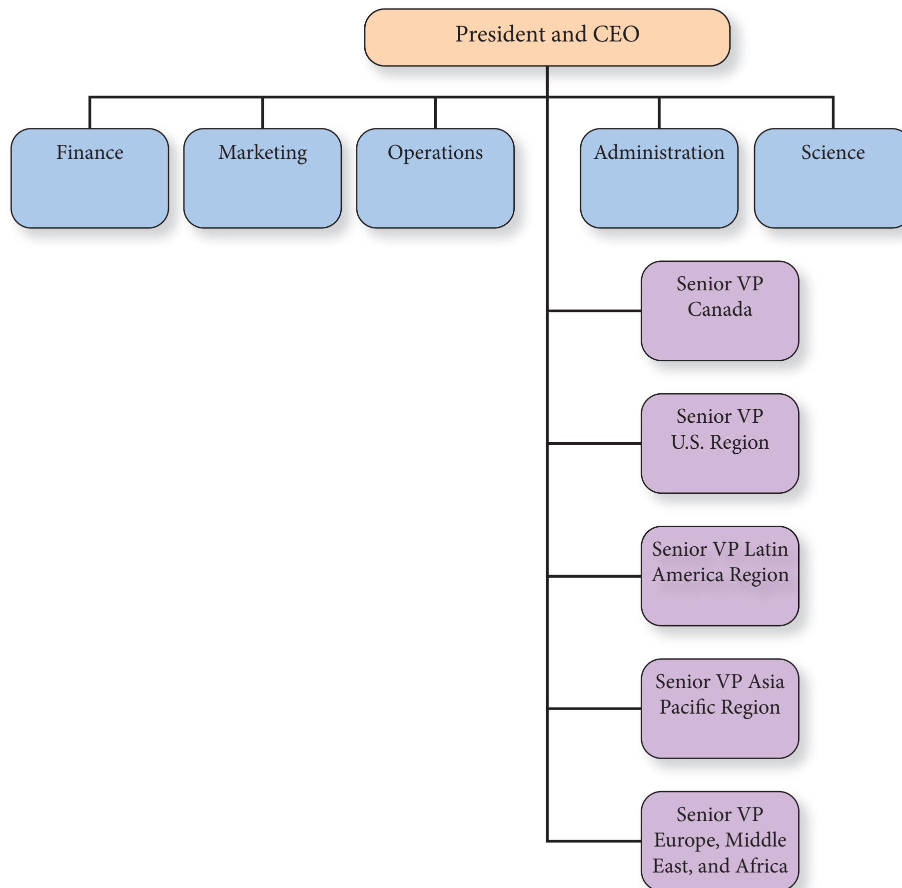
The primary customers for Revlon products are large mass merchandisers and chain drug stores, including Walgreens, Wal-Mart, Target, K-Mart, and CVS. Revlon provides point of sale displays and samples for these stores. Wal-Mart sales were 22 percent of Revlon sales in 2010. Revlon's products are also sold through its websites http://www.revlon.com and http://www.almay.com. New product development continues to be a primary objective of Revlon. Revlon spent $24 million on research and development efforts in 2010 and employed 140 people in this effort.

EXHIBIT 6 Estée Lauder, Some Financials ($ in millions)

	2008	2009	2010
Net Sales	$7,911	7,324	7,796
Operating Income	811	418	790
Net Earnings	484	227	482
Total Assets	5,011	5,177	5,336
Long-Term Debt	1,078	1,388	1,205
Stockholders' Equity	1,653	1,640	1,948

Source: http://www.elcompanies.com.

EXHIBIT 7 Organization Chart for Revlon, Inc.



Revlon employs spokespersons Halle Berry, Jessica Alba, and Jessica Biel in its advertising campaigns. Advertising (print, broadcast, and Internet), along with sales promotions (coupons and sampling) and in-store promotion support, is important. Revlon's Facebook page had almost 278,000 people who "liked" the site in April 2011. The site is used to discuss products, solicit comments, launch video, and highlight Revlon's charitable activities. In 2010, the Mitchum brand hosted a contest in which entrants told stories about their lives and jobs that "tested" the deodorant. The winning entrant was featured in the documentary *More Than a Paycheck: Mitchum Presents America's Hardest Workers*, which was featured on the Sundance Channel.

Manufacturing/Distribution

Globalization of the company's manufacturing and distribution efforts has enabled the consolidation of production facilities, which has led to increased operating efficiency and better use of capital assets. The number of production facilities has been reduced and centralized to cover core regions. Revlon has U.S. production facilities in Oxford, North Carolina, and Irvington, New Jersey, as well as in Venezuela and South Africa. Additional warehousing operations are located in Canada, Australia, South Africa, and the United Kingdom. Several of the company's plants have ISO-9000 certification signifying their commitment to quality manufacturing standards. Planning for long-term growth includes a focus on and utilization of top-notch production facilities and distribution systems. The Revlon Phoenix site distribution center handles components and raw materials as well as finished stocks of cosmetics and personal care products.

Finance

Revlon had a large debt load of $1.1 billion by the end of 2010. Not only is the company at risk that operating revenues will not meet required payments, but there is also a risk that the company will be unable to refinance the debt or that the company will face less favorable refinancing terms in the future. Revlon's consolidated statement of operations and consolidated balance sheets are shown in Exhibits 8 and 9 respectively.

EXHIBIT 8 Revlon's Consolidated Statement of Operations ($ in millions, except per share data)

	12/2010	12/2009	12/2008	12/2007
Operating Revenue	**$1,321.40**	**1,295.90**	**1,346.80**	**1,400.10**
Total Revenue	1,321.40	1,295.90	1,346.80	1,400.10
Adjustment to Revenue	0.00	0.00	0.00	0.00
Cost of Sales	389.70	408.10	404.60	425.50
Cost of Sales With Depreciation	455.30	474.70	490.90	522.90
Gross Margin	931.70	887.80	942.20	974.60
Gross Operating Profit	**931.70**	**887.80**	**942.20**	**974.60**
R&D	0.00	0.00	0.00	0.00
SG&A	666.60	629.10	709.30	748.90
Advertising	0.00	0.00	0.00	0.00
Operating Profit	199.80	170.80	155.00	121.00
Operating Profit Before Depreciation (EBITDA)	**265.10**	**258.70**	**232.90**	**225.70**
Depreciation	65.60	66.60	86.30	100.70
Depreciation Unreconciled	0.00	0.00	0.00	0.00
Amortization	0.00	0.00	0.00	3.30
Amortization of Intangibles	0.00	0.00	0.00	0.00
Operating Income After Depreciation	199.50	192.10	146.60	125.00
Interest Income	0.50	0.50	0.70	2.00
Earnings From Equity Interest	0.00	0.00	0.00	0.00
Other Income, Net	−23.60	−21.50	−6.80	8.60
Income Acquired in Process R&D	0.00	0.00	0.00	0.00
Interest Restructuring and M&A	0.30	−21.30	8.40	−7.30
Other Special Charges	0.00	0.00	0.00	−0.10
Total Income Avail for Interest Expense (EBIT)	176.70	149.80	148.90	128.20
Interest Expense	96.90	93.00	119.70	136.30
Income Before Tax (EBT)	**79.80**	**56.80**	**29.20**	**−8.10**
Income Taxes	−247.20	8.30	16.10	8.00
Minority Interest	0.00	0.00	0.00	0.00
Preferred Securities of Subsidiary Trust	0.00	0.00	0.00	0.00
Net Income From Continuing Operations	327.00	48.50	13.10	−16.10
Net Income From Discontinued Operations	0.30	0.30	44.80	0.00
Net Income From Total Operations	327.30	48.80	57.90	−16.10

Source: Marketwatch.com, Revlon Inc. *Form 10K.*

EXHIBIT 9 **Revlon's Consolidated Balance Sheets ($ in millions, except per share data)**

	12/2010	12/2009	12/2008	12/2007
ASSETS				
Cash and Equivalents	$76.70	54.50	52.80	45.10
Restricted Cash	0.00	0.00	0.00	0.00
Marketable Securities	0.00	0.00	0.00	0.00
Accounts Receivable	197.50	181.70	169.90	196.20
Loans Receivable	0.00	0.00	0.00	0.00
Other Receivable	0.00	0.00	0.00	0.00
Receivables	197.50	181.70	169.90	196.20
Raw Materials	39.70	42.70	57.60	58.60
Work In Progress	9.90	12.00	16.60	17.40
Purchased Components	0.00	0.00	0.00	0.00
Finished Goods	65.40	64.50	80.00	89.70
Inventories -Adj Allowances	0.00	0.00	0.00	0.00
Inventories	115.00	119.20	154.20	165.70
Prepaid Expenses	47.30	44.30	51.60	47.60
Current Deferred Income Taxes	39.60	3.90	0.00	0.00
Other Current Assets	0.00	0.00	0.00	16.60
Total Current Assets	**476.10**	**403.60**	**428.50**	**471.20**
Gross Fixed Assets (Plant, Prop. & Equip.)	301.00	324.80	310.10	311.70
Accumulated Depreciation & Depletion	194.80	213.10	197.30	199.00
Net Fixed Assets	106.20	111.70	112.80	112.70
Intangibles	0.00	0.00	0.00	0.00
Cost in Excess	182.70	182.60	182.60	182.70
Noncurrent Deferred Income Taxes	229.40	4.80	0.00	0.00
Other Noncurrent Assets	92.30	91.50	89.50	122.70
Total Noncurrent Assets	**$610.60**	**390.60**	**384.90**	**418.10**
Total Assets	**1,086.70**	**794.20**	**813.40**	**889.30**
LIABILITIES				
Accounts Payable	$88.30	82.40	78.10	88.50
Notes Payable	0.00	0.00	0.00	0.00
Short Term Debt	11.70	13.90	19.40	8.20
Accrued Expenses	0.00	0.00	0.00	243.00
Accrued Liabilities	218.50	213.00	225.90	0.00
Deferred Revenues	0.00	0.00	0.00	0.00
Current Deferred Income Taxes	0.00	0.00	0.00	0.00
Other Current Liabilities	0.00	0.00	0.00	9.00
Total Current Liabilities	**318.50**	**309.30**	**323.40**	**348.70**
Long-Term Debt	1,159.30	1,186.20	1,310.20	1,432.40
Capital Lease Obligations	0.00	0.00	0.00	0.00
Deferred Income Taxes	0.00	0.00	0.00	0.00
Other Noncurrent Liabilities	257.20	284.30	292.60	190.20
Minority Interest	0.00	0.00	0.00	0.00
Preferred Securities of Subsidiary Trust	0.00	0.00	0.00	0.00
Preferred Equity outside Stock Equity	48.10	48.00	0.00	0.00
Total Noncurrent Liabilities	**1,464.60**	**1,518.50**	**1,602.80**	**1,622.60**
Total Liabilities	**$1,783.10**	**1,827.80**	**1,926.20**	**1,971.30**

(continued)

EXHIBIT 9 continued

	12/2010	12/2009	12/2008	12/2007
Stockholders' Equity				
Preferred Stock Equity	0.00	0.00	0.00	0.00
Common Stock Equity	–696.40	–1,033.60	–1,112.80	–1,082.00
Common Par	0.50	0.50	0.50	0.50
Additional Paid In Capital	1,012.00	1,007.20	1,000.90	994.10
Cumulative Translation Adjustment	0.00	0.00	0.00	0.00
Retained Earnings	–1,551.40	–1,878.70	–1,927.50	–1,985.40
Treasury Stock	–7.20	–4.70	–3.60	–2.50
Other Equity Adjustments	–150.30	–157.90	–183.10	–88.70
Total Equity	**$–696.40**	**–1,033.60**	**–1,112.80**	**–1,082.00**
Total Capitalization	462.90	152.60	197.40	350.40
Total Liabilities & SEquity	**$ 1,086.70**	**794.20**	**813.40**	**889.30**

Source: Marketwatch.com, Revlon, Inc. 2010, *Form 10K*.

The Future

CEO Ennis plans to continue to build the company's strong brands Revlon and Almay, strengthen international business operations, develop employees' skills, and reduce company debt. Perhaps all of these strategies will help improve cash flow and operating profit over time. Critics suggest that Perelman could decide to cash out of Revlon, but other critics believe that Perelman has too much personal money involved to fail and that Perelman likes the glamour of the cosmetics business.

Develop a three-year strategic plan for CED Ennis.

L'Oréal SA, 2013

www.loréal.com, LRLCF or LRLCY or OR (Paris Exchange)

Headquartered in Clichy, France, just outside Paris, L'Oréal is the world's largest beauty products company, with brands that include L'Oréal Paris and Maybelline (mass-market), Lancôme (luxury), and Redken and SoftSheen/Carson (retail and salon). L'Oréal owns Dallas-based SkinCeuticals that conducts cosmetology and dermatology research. With more than 50 percent of sales generated outside Europe, L'Oréal has focused on acquiring brands globally. L'Oréal owns UK-based natural cosmetics retailer The Body Shop International, which has about 2,550 retail stores worldwide. L'Oréal's dermatology unit, Galderma S.A., is a joint venture with Nestlé.

L'Oréal SA is structured into three branches: (1) Cosmetics, (2) The Body Shop, and (3) Dermatology. The Cosmetics branch is divided into four sectors: Consumer Products, Professional Products, Luxury Products, and Active Cosmetics. Consumer Products are marketed under L'Oréal Paris, Garnier, Maybelline, Softsheen, and Carson brands. The company's Professional Products segment includes hair care products for use by professional hairdressers, such as Kerastase, Redken, and Matrix. L'Oréal's Luxury Products are sold globally under such brands as Lancome, Diesel, Giorgio Armani, and Cacharel. The firm's Active Cosmetics division, which consists of products under Vichy and La Roche Posay brands, are for sale mainly in pharmacies.

L'Oréal has a portfolio of 27 international, diverse, and complementary brands. With sales amounting to 22.5 billion euros in 2012, L'Oréal employs 72,600 people worldwide, has 43 production plants worldwide, 146 distribution centers, more than 20,000 employees in industrial operations worldwide, and 5.8 billion units produced. The world's largest cosmetics firm by sales, L'Oréal in August 2013 offered to buy a Chinese facial mask company for about US $840m. The company, Magic Holdings International, a Hong Kong-listed cosmetics producer based in Guangzhou, is known for its facial masks, one of the fastest-growing segments in China's cosmetics market. Magic Holdings generated revenues of about €150m in 2012, up 29 percent from the previous year. L'Oréal, which makes Lancôme creams and Garnier shampoo, said it would offer $HKD6.3 (HKD = Hong Kong Dollar) per share for the Chinese company. The offer represents a 25 percent premium on the previous day's closing price. L'Oréal already has won approval from six shareholders representing 62.3 percent of Magic Holding's shares. The deal requires approval from Chinese authorities.

History

In 1907, Eugene Schueller, a young French chemist, working with La Cagoule, developed a hair dye formula called *Auréale*. Schueller formulated and manufactured his own products, which he then sold to Parisian hairdressers. In 1919, Schueller registered his company as the French Society of Inoffensive Tinctures for Hair, which became L'Oréal. The guiding principles of the company were research and innovation in the field of beauty. In 1920, L'Oréal employed three chemists. By 1950, the research teams were 100 strong; that number reached 1,000 by 1984 and is nearly 2,000 today.

L'Oréal got its start in the hair-color business, but the company soon branched out into other cleansing and beauty products. L'Oréal currently markets more than 500 brands and many thousands of individual products in all sectors of the beauty business: hair color, permanents, hair styling, body and skin care, cleansers, makeup and fragrances. The company's products are found in a wide variety of distribution channels, from hair salons and perfumeries to hyper- and supermarkets, health/beauty outlets, pharmacies, and direct mail.

L'Oréal today has five worldwide research and development centers located in: (1) Aulnay, France, (2) Chevilly, France, (3) Clark, New Jersey, (4) Kawasaki, Japan, and (5) Shanghai, China. A future facility in the USA will be in Berkeley Heights, New Jersey.

L'Oréal has recently faced discrimination lawsuits in France related to the hiring of various spokespersons and institutional racism. In the United Kingdom, L'Oréal has faced widespread condemnation from the Office of Communications regarding truth in their advertising and marketing campaigns concerning the product performance of one of their mascara brands.

Protest group Naturewatch states that L'Oréal continues to test new ingredients on animals. L'Oréal has the largest factory in the Jababeka Industrial Park, Cikarang, Indonesia. L'Oréal does significant business in Indonesia.

Financially, L'Oréal is strong and is excelling globally in developing, producing, and marketing cosmetics, fragrances, and personal care products. For Q1 of 2013, L'Oréal reported sales of 5.93 billion euros, up 6.5 percent overall, including 8.5 percent up in North America and 11.8 percent up in Africa and the Middle East.

Internal Issues

Vision and Mission

L'Oréal does not have a vision statement, but the company's mission statement is provided on the corporate website, as follows:

> Beauty for all—For more than a century, L'Oréal has devoted itself solely to one business: beauty. It is a business rich in meaning, as it enables all individuals to express their personalities, gain self-confidence and open up to others.
>
> Beauty is a language—L'Oréal has set itself the mission of offering all women and men worldwide the best of cosmetics innovation in terms of quality, efficacy and safety. It pursues this goal by meeting the infinite diversity of beauty needs and desires all over the world.
>
> Beauty is universal. Since its creation by a researcher, the group has been pushing back the frontiers of knowledge. Its unique Research arm enables it to continually explore new territories and invent the products of the future, while drawing inspiration from beauty rituals the world over.
>
> Beauty is a science. Providing access to products that enhance well-being, mobilizing its innovative strength to preserve the beauty of the planet and supporting local communities. These are exacting challenges, which are a source of inspiration and creativity for L'Oréal.
>
> Beauty is a commitment. By drawing on the diversity of its teams, and the richness and the complementarity of its brand portfolio, L'Oréal has made the universalisation of beauty its project for the years to come.
>
> L'Oréal, offering beauty for all.

Sustainability

Regarding sustainable development, Corporate Knights, a Global Responsible Investment Network, has selected L'Oréal for its 2012 ranking of the Global 100 Most Sustainable Corporations in the World. L'Oréal has received this distinction for the fifth consecutive year. L'Oréal has more than 84 percent of its production globally being manufactured in compliance with the ISO 9001 (quality), ISO 14001 (environment), OHSAS 18001 (safety) certifications.

In San Luis Potosi, Mexico, L'Oréal opened the largest hair color production plant in the world in 2012, the firm's second plant in Mexico. L'Oréal views Mexico as the gateway between both North and South America. The new plant is in the process of becoming LEED certified and features advanced technologies for water treatment and solar-powered equipment. L'Oréal Mexico has reduced water consumption per unit by 60 percent and carbon dioxide emissions per unit by 60 percent in recent years.

On November 12, 2012, for its 10th anniversary, Vigeo European rating agency revealed a new range of environmental-social-governance (ESG) indices measuring companies' corporate and social responsibility on a global or European level, and more specifically in France and the United Kingdom. Vigeo's France index ranks L'Oréal as "the leading company in social responsibility" among 20 companies. The France index is based on 35 criteria, consolidated in an overall score covering six areas of social responsibility: human rights, human resources,

EXHIBIT 2 L'Oréal's Sales by Operational Division and Geographic Zone (000,000 euros omitted)

By division	Q1 2012	Q1 2013	% Change
Professional Products	755.6	752.6	–0.4%
Consumer Products	2,769.5	2,920.8	5.5%
L'Oréal Luxe	1,315.5	1,422.0	8.1%
Active Cosmetics	468.6	497.6	6.2%
Cosmetics total	**5,309.1**	**5,593.0**	**5.3%**
BY GEOGRAPHIC ZONE			
Western Europe	1,953.9	1,990.4	1.9%
North America	1,263.4	1,371.4	8.5%
New Markets, of which:	2,091.7	2,231.1	6.7%
- Asia, Pacific	*1,124.3*	*1,188.4*	*5.7%*
- Latin America	*433.5*	*458.7*	*5.8%*
- Eastern Europe	*360.0*	*389.7*	*8.2%*
- Africa, Middle East	*173.8*	*194.3*	*11.8%*
Cosmetics total	**5,309.1**	**5,593.0**	**5.3%**
The Body Shop	180.4	181.9	0.8%
Dermatology	153.5	156.7	2.1%
Group total	**5,643.0**	**5,931.6**	**5.1%**

Source: Company documents.

2. Consumer Products: L'Oréal Paris, Garnier, Maybelline New York, Le Club Des Createurs, and Essie. In the first quarter of 2013, sales were up 5.5 percent.
3. Professional Products: L'Oréal Professionnel, INOA, Serie Expert, Serie Nature, L'Oréal Prefessionnel Homme, Tecni.art, Play ball, and Texture Expert. In quarter one of 2013, sales were down 0.4 percent.
4. Active Cosmetics: Vichy, La Roche Posay, Skinceuticals, Inmeov, Roger&Gallet, and Sanoflore. In the first quarter of 2013, sales were up 6.2 percent.
5. The Body Shop: Dermablend Coverage Cosmetics are sensitivity tested, non-comedogenic, non-acnegenic, fragrance free, water-resistant, smudge-resistant, long lasting and easy to use. For the third quarter of 2012, The Body Shop recorded like-for-like sales growth at 5.3 percent as shown in Exhibit 3. The Body Shop is growing strongly, especially in the Middle East and in South East Asia. Several important new product innovations include *BB Cream All-in-One*, a one-of-a-kind texture that transforms on application, as well as *Pore Minimiser* in its iconic *Tea Tree* range featuring Community Fair Trade organic tea tree oil from Kenya. The Body Shop continues to recruit new customers through its e-commerce channel, with 20 sites now live. The brand is rolling out its innovative Pulse boutique concept globally. In the first quarter of 2013 sales were up 0.8 percent.

Notice in Exhibit 2 that L'Oréal did especially well in the first quarter of 2013 in their L'Oréal Luxe segment and in their Africa/Middle East region.

Finance

Note in Exhibit 3 that L'Oréal's revenues and net income have increased nicely in recent years.

Note in Exhibit 4 that L'Oréal's goodwill increased almost €5 billion in 2011 which is not good, but the company has been paying off its long-term debt nicely, which is good.

Competitors

Exhibit 5 provides an overview of L'Oréal as compared to some of its leading competitors. Note that L'Oréal is by far the largest cosmetics and fragrances firm in terms of revenue, number of employees, and net income. L'Oréal also has the highest profit margin and revenue per

environment, business behavior, corporate governance, and community involvement. L'Oréal ranks fourth in Vigeo's Europe index (120 companies) and fifth in Vigeo's World index (120 companies).

Organizational Structure

L'Oréal's organizational chart is provided in Exhibit 1. Note there is no chief operations officer (COO), but perhaps Jean-Philippe Blanpain serves that role. Note the divisional-by-geographic-region structure in conjunction with divisional-by-product. This could prove problematic in the sense that, for example, professional products operations in the Africa, Middle East Zone could report to either Geoff Skinsley or An Verbulst-Santos.

Advertising

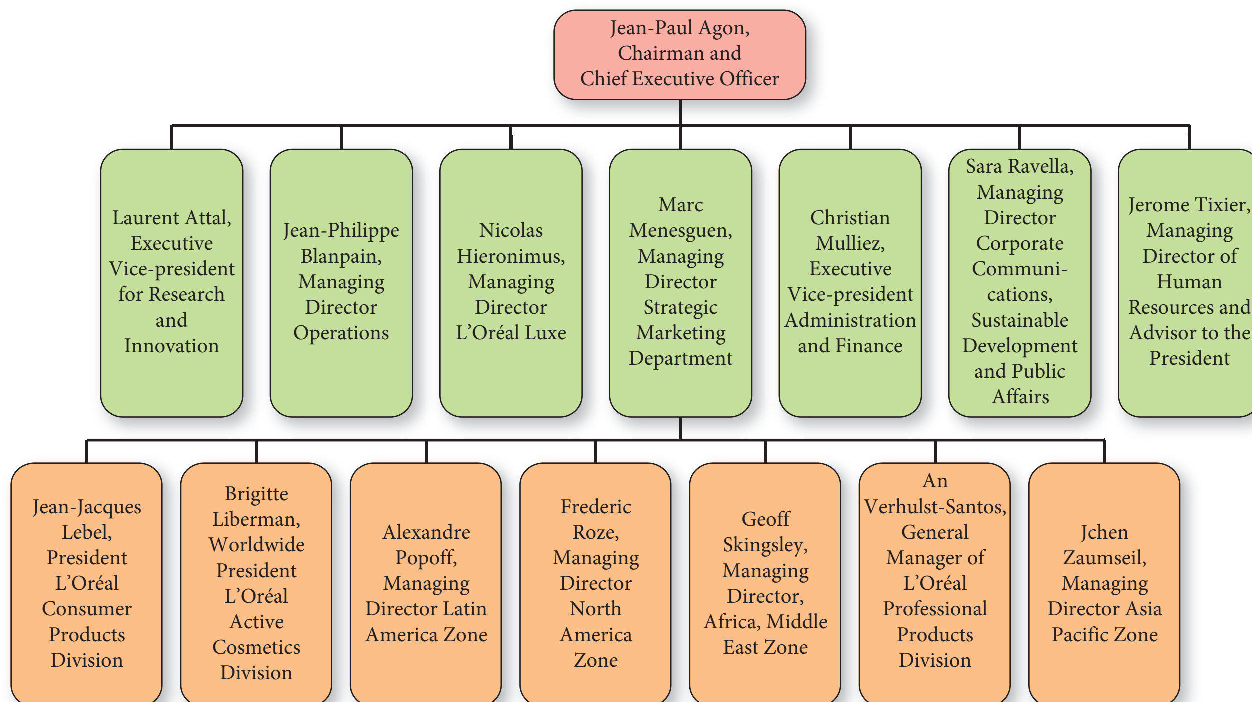
L'Oréal's famous advertising slogan was "Because I'm worth it." In the mid-2000s, this slogan was replaced by "Because you're worth it." In late 2009, the slogan was changed again to "Because we're worth it." The shift to "we" was made to create stronger consumer involvement in L'Oréal philosophy and lifestyle and provide more consumer satisfaction with L'Oréal products. L'Oréal owns a Hair and Body products line for kids called L'Oréal Kids, the slogan for which is "Because we're worth it too."

Segments

L'Oréal has five product groupings:

1. L'Oréal LUXE (Luxury): Lancome, Giorgio Armani, YSL Beaute, Biotherm, Kiehl's, Ralph Lauren, Shu Uemura, Cacharel, Helena Rubinstein, Diesel, Viktod&Rolf, Stella McCartney, and Maison Martin Margiela. As indicated in Exhibit 2, L'Oréal Luxe sales grew in the first quarter of 2013 by 8.1 percent, largely as a result of the acquisition of *Clarisonic*. In a market that has slowed slightly, L'Oréal Luxe is continuing to increase market share worldwide.

EXHIBIT 1 L'Oréal's Organizational Structure



Source: Based on company documents.

EXHIBIT 3 **L'Oréal's Income Statement (000,000 euros omitted)**

	2012	2011	2010	2009
Revenue	22,462.7	20,343.1	19,495.8	17,472.6
Other Revenue, Total	0.0	0.0	0.0	0.0
Total Revenue	**22,462.7**	**20,343.1**	**19,495.8**	**17,472.6**
Cost of Revenue, Total	6,587.7	5,851.5	5,696.5	5,161.6
Gross Profit	**15,875.0**	**14,491.6**	**13,799.3**	**12,311.0**
Selling, General, Administrative Expenses, Total	11,387.2	10,478.5	10,077.7	9,124.2
Research and Development	790.5	720.5	664.7	609.2
Depreciation and Amortization	0.0	0.0	0.0	0.0
Interest Expense (Income), Net Operating	0.0	0.0	0.0	0.0
Unusual Expense (Income)	93.7	108.1	74.0	277.6
Other Operating Expenses, Total	30.1	−11.8	79.2	0.0
Operating Income	**3,753**	**3,196.3**	**2,903.7**	**2,300.0**
Interest Income (Expense), Net Nonoperating	0.0	0.0	0.0	0.0
Gain (Loss) on Sale of Assets	0.0	0.0	0.0	0.0
Other, Net	−7.8	−5.6	−9.0	−13.1
Income Before Tax	**3,875.9**	**3,466.7**	**3,151.9**	**2,471.0**
Income Tax, Total	1,005.5	1,025.8	909.9	676.1
Income After Tax	**2,870.4**	**2,440.9**	**2,242.0**	**1,794.9**
Minority Interest	−2.7	−2.5	−2.3	−2.7
Equity In Affiliates	0.0	0.0	0.0	0.0
U.S. GAAP Adjustment	0.0	0.0	0.0	0.0
Net Income Before Extraordinary Items	**2,867.7**	**2,438.4**	**2,239.7**	**1,792.2**
Total Extraordinary Items	0.0	0.0	0.0	0.0
Net Income	**2,867.7**	**2,438.4**	**2,239.7**	**1,792.2**

GAAP, generally accepted accounting principles.
Source: Based on company documents.

employee. But every day is another day, and all of these rivals strive to overtake L'Oréal anywhere and everywhere they can.

Estée Lauder Companies, Inc.

Headquartered in New York City, Estée Lauder has annual sales of about $10 billion and net income of about $1 billion. Estée Lauder manufactures and markets skin care, makeup, fragrance, and hair care products. The company's products are sold in more than 150 countries and territories under a number of brand names, including Estee Lauder, Aramis, Clinique, Origins, M.A.C, Bobbi Brown, La Mer, and Aveda. The company is also the global licensee for fragrances or cosmetics sold under brand names, such as Tommy Hilfiger, Donna Karan, Michael Kors, Tom Ford, and Coach. The company sells its products in more than 30,000 points of sale, consisting of upscale department stores, specialty retailers, upscale perfumeries and pharmacies, and prestige salons and spas.

Avon

Headquartered in New York City, Avon Products is the world's largest direct-seller firm, and by far the largest direct seller of cosmetics and beauty-related items. Avon is the fifth-largest cosmetics and fragrance firm in the world. The company receives sales from catalogs and a website, but the vast majority of its sales come from its 6.4 million independent sales representatives in some 110 countries. Since 1892, Avon has been on the forefront of empowering women to be their own boss and be independent and become leaders in communities and business.

Avon products include cosmetics, fragrances, toiletries, jewelry, apparel, home furnishings, watches, footwear, children's products, skin care, and gift and decorative products, nutritional

EXHIBIT 4 L'Oréal's Balance Sheets (000,000 euros omitted)

	2012	2011	2010	2009
Assets				
Cash and Short-Term Investments	1,823.2	1,652.2	1,550.4	1,173.1
Total Receivables, Net	3,682.8	3,423.3	3,100.7	2,826.8
Total Inventory	2,033.8	2,052.0	1,810.1	1,476.7
Prepaid Expenses	234.3	231.3	208.9	168.1
Other Current Assets, Total	435.5	363.6	326.2	296.4
Total Current Assets	**8,209.6**	**7,722.4**	**6,996.3**	**5,941.1**
Property, Plant, and Equipment, Total (Net)	2,962.9	2,880.8	2,677.5	2,599.0
Goodwill, Net	6,478.2	6,204.6	5,729.6	5,466.0
Intangibles, Net	2,625.4	2,477.3	2,177.4	2,042.4
Long-Term Investments	8,445.3	6,901.0	5,837.5	6,672.2
Note Receivable, Long Term	86.0	0.0	0.0	0.0
Other Long-Term Assets, Total	717.8	671.5	626.2	570.8
Other Assets, Total	0.0	0.0	0.0	0.0
Total Assets	**29,525.2**	**26,857.6**	**24,044.5**	**23,291.5**
Liabilities and Shareholders' Equity				
Accounts Payable	3,318.0	3,247.7	3,153.5	2,603.1
Payable/Accrued	0.0	0.0	0.0	0.0
Accrued Expenses	0.0	1,039.0	986.8	918.2
Notes Payable and Short-Term Debt	20.8	806.0	119.0	151.5
Current Portability of Long-Term Debt and Capital Leases	180.3	284.8	648.0	238.2
Other Current Liabilities, Total	2,850.4	1,752.4	1,674.8	1,475.5
Total Current Liabilities	**6,369.5**	**7,129.9**	**6,582.1**	**5,386.5**
Total Long-Term Debt	46.9	57.5	824.3	2,741.6
Deferred Income Tax	764.4	677.7	462.0	418.0
Minority Interest	4.8	3.1	2.9	3.1
Other Liabilities, Total	1,407.9	1,355.0	1,310.3	1,147.1
Total Liabilities	**8,593.5**	**9,223.2**	**9,181.6**	**9,696.3**
Redeemable Preferred Stock	0.0	0.0	0.0	0.0
Preferred Stock, Nonredeemable, Net	0.0	0.0	0.0	0.0
Common Stock	121.8	120.6	120.2	119.8
Additional Paid-In Capital	1,679.0	1,271.4	1,148.3	996.5
Retained Earnings (Accumulated Deficit)	20,035.3	16,886.8	14,445.3	13,550.5
Treasury Stock, Common	−904.5	−644.4	−850.9	−1,071.6
ESOP Debt Guarantee	0.0	0.0	0.0	0.0
Unrealized Gain (Loss)	0.0	0.0	0.0	0.0
Other Equity, Total	0.0	0.0	0.0	0.0
Total Equity	**20,931.6**	**17,634.4**	**14,862.9**	**13,595.2**
Total Liabilities and Shareholders' Equity	**29,525.1**	**26,857.6**	**24,044.5**	**23,291.5**
Total Common Shares Outstanding	598.36	594.39	589.66	584.74
Total Preferred Shares Outstanding	0.0	0.0	0.0	0.0

ESOP, employee stock option plan.
Source: Based on company documents.

products, housewares, and entertainment and leisure products. Avon owns and sells Silpada jewelry. A few well-recognized company brand names include Avon Color, ANEW, Skin-So-Soft, Advance Techniques, Avon Naturals, and *mark*. Although a large U.S. iconic corporation, Avon is today struggling to recover from poor management strategies that led to CEO Jung resigning amid global bribery investigations. The direct-selling business model has waned in the USA, but

EXHIBIT 5 L'Oréal versus Rival Firms (in U.S. dollars)

	L'Oréal	Revlon	Avon	Estée Lauder
Number employees	72.6K	5.2K	40.6K	38.5K
Revenue ($)	27.7B	1.4B	10.7B	9.8B
Net income ($)	3.36B	40.6M	115.5M	877M
Profit Margin (%)	12.1	2.9	1.1	8.9
Revenue per employee	406K	269K	263K	255K
EPS	1.12	0.78	0.27	2.22
Market capitalization	83.3B	775.9M	6.35B	23.2B

EPS, earnings per share.
Source: Based on company documents.

it is effective in many emerging economies globally. Millions of motivated direct sellers in many countries are Avon's key competitive advantage going forward, but the company needs a clear strategic plan.

Mary Kay, Inc.

Headquartered in Addison, Texas, (outside Dallas) Mary Kay is a privately-owned cosmetic and fragrance direct-selling company. Mary Kay is the sixth-largest direct-selling company in the world, with annual sales of about $3.0 billion. Mary Kay's business model is similar to the Avon business model. Founded by Mary Kay Ash in 1963, the company is famous for the pink Cadillacs, given to high-selling representatives. Richard Rogers, Mary Kay's son, is the chairman of the board. Mary Kay products are sold in more than 35 markets worldwide, and the global Mary Kay independent sales force exceeds 2.4 million women.

In 1968, Mary Kay Ash purchased the first pink Cadillac and had it repainted to match the Mountain Laurel Blush in the Mary Kay compact. Since the Cadillac program's inception, more than 100,000 independent sales force members have qualified for the use of a Career Car or elected the cash compensation option. GM estimates that it has built 100,000 pink Cadillacs for Mary Kay. For 2012, high-sellers may select other Career Cars, including the Chevrolet Malibu, Chevrolet Equinox, Toyota Camry, and the Cadillac CTS, SRX & Escalade Hybrid, or most recently, a black Ford Mustang.

Revlon, Inc.

Headquartered in New York City, Revlon is a cosmetics leader with brands such as Almay and Revlon ColorSilk hair color, Mitchum antiperspirants and deodorants, Charlie and Jean Naté fragrances, and Ultima II and Gatineau skincare products. Revlon's beauty aids are distributed in more than 100 countries, though the USA is its largest market, generating about 55 percent of sales. Walmart is Revlon's biggest single customer, accounting for some 22 percent of sales.

Revlon manufactures, markets, and sells cosmetics, women's hair color, beauty tools, antiperspirant deodorants, fragrances, skincare, and other beauty care products. Revlon products are sold and marketed under brand names, such as Revlon, including the Revlon ColorStay, Revlon Super Lustrous, and Revlon Age Defying franchises; Almay, including the Almay Intense i-Color and Almay Smart Shade franchises; Sinful Colors in cosmetics; Revlon ColorSilk in women's hair color; Revlon in beauty tools; Mitchum in antiperspirant deodorants; Charlie and Jean Nate in fragrances, and Ultima II and Gatineau. Revlon also owns certain assets of Sinful Colors cosmetics, Wild and Crazy cosmetics, freshMinerals cosmetics, and freshcover cosmetics.

Coty, Inc.

Headquartered in New York City, Coty is one of the world's leading makers of beauty products for men and women. Led by CEO Michele Scannavini, Coty is a $4.1 billion beauty company, and the biggest seller of nail care, nail polish, and fragrances in the USA. Sarah Jessica Parker, Jennifer Lopez, Celine Dion, Gwen Stefani, Katy Perry, and Thomas Dutronc are several

celebrities that promote Coty. Founder of the company, François Coty created his first perfume, La Rose Jacqueminot, in 1904.

Coty's product lineup today ranges from moderately-priced scents sold globally by mass retailers to prestige fragrances and nail polishes found in department stores. Coty's brands include Adidas, Philosophy, Rimmel, and Sally Hansen. Cody's prestige perfume labels are led by Calvin Klein. Coty's shimmery blue nail polish and Lady Gaga's perfume are high-selling products. Thomas Dutronc is the face of Coty's new Cerruti fragrance for men, which launched in 2013.

Coty's Rimmel Scandaleyes mascara, which debuted in early 2012, is another big seller. Over-the-top lashes are hot these days because false eye lashes have made a comeback and are "almost mainstream." Promotional material for Scandaleyes urges women to "ditch those falsies." Mascara makers today compete with eyelash lengthening drugs such as Latisse.

The Future

On November 14, 2012, in the Kingdom of Saudi Arabia, L'Oréal created L'Oréal KSA, a new subsidiary based on a joint venture with Al Naghi Group. L'Oréal brands have been distributed in the Kingdom of Saudi Arabia for two decades and since 2000, Al Naghi Group has been the company's sole distributor for its Consumer Products, Active Cosmetics, and Professional Products Divisions. However, L'Oréal KSA will manage a portfolio of brands including, among others, L'Oréal Professional, Kerastase, L'Oréal Paris, Garnier, Maybelline New York, and Vichy. L'Oréal KSA's will enable the company to better understand and to meet needs of woman in one of the most male-dominated countries in the world. There are other countries globally, especially in Africa and South America, that L'Oréal could engage in a similar manner. Brazil, for example, is where Avon derives most of its revenue, more even that from the USA.

There are numerous firms that could be acquired by L'Oréal to further expand and penetrate globally. Even a firm such as Avon that is struggling financially, but has a business model that is especially suited to emerging economies, may be interested in an offer from L'Oréal. Another firm could be Coty, Inc. that could fit well with the L'Oréal portfolio. And then there are cosmetic and fragrance divisions of large firms such as Procter & Gamble that could be available if L'Oréal deemed that to be attractive.

L'Oréal needs a clear strategic plan for the future. Perhaps the firm could vastly improve its selling operations online. Being the biggest and the best at year-end 2012 does not guarantee prosperity in the years to come.

Develop an effective three-year strategic plan for L'Oréal.

Dr Pepper Snapple Group, Inc. — 2011

Joseph S. Harrison
University of Richmond

DPS

www.drpeppersnapple.com
Based in Plano, Texas, Dr Pepper Snapple (DPS) is the leading producer of flavored beverages in North America and the Caribbean, offering more than 50 brands. DPS has six of the top 10 noncola soft drinks. Nine of DPS's 12 leading brands are No. 1 in their flavor categories. In addition to their famous Dr Pepper and Snapple brands, DPS also offers Sunkist soda, 7UP, A&W, Canada Dry, Crush, Mott's, Squirt, Hawaiian Punch, Penafiel, Clamato, Schweppes, Venom Energy, Rose's, and Mr. & Mrs. T mixers.

Larry Young, president and CEO of DPS, was recently named 2010 Beverage Executive of the Year by *Beverage Industry Magazine* for leading DPS through three very difficult economic years since the company separated from the London-based food and beverage giant Cadbury Schweppes. Reflecting on that time, he chuckled, "There couldn't have been a worse year to go public." DPS, as of mid-2011, does not have a written vision or mission statement.

Perhaps most satisfying of all is the recent turnaround of the Snapple Brand, which had been struggling for many years. Sales volume for the brand grew 10 percent in 2010, fueled by new products, packages, and distribution. In addition, Dr Pepper, Canada Dry, Crush, Mott's, and Hawaiian Punch all experienced increases in demand. A healthy cash flow allowed the company to pay down its debt, increase dividends, and repurchase shares. Although DPS sales were up almost 2 percent in 2010, profits were lower than in 2009. In comparison, Coca-Cola Company experienced growth in revenues of 13.3 percent in 2010, with operating income increasing by 2.7 percent. During the same time period, PepsiCo had revenue growth of 33.8 percent and growth in operating profit of 3.6 percent.

For the second quarter 2011, DPS's volume declined 3 percent, but Dr Pepper Fountain volume grew 5 percent on new distribution gains. Sale of DPS's Sun Drop and CREST brands grew 1 percent while Canada Dry sales grew 10+ percent. Sun Drop continued to gain distribution adding 2 million incremental cases. Since its national launch in January 2011, Sun Drop volume grown by almost 90 percent, adding 5 million incremental cases. Sun Drop now has a 4 percent market share of the highly competitive Citrus CSD category, up almost 2 share points.

Snapple volume sales was up 8 percent as the company continued to gain distribution in that brand's 6-pack glass and 64-ounce containers. The company's Hawaiian Punch volume was flat due to a 9 percent price increase that took effect June 1.2011. The company's Mott's brand of apple juice declined 10 percent in the second quarter as DPS raised its price early in the year to cover apple juice concentrate inflation. During the quarter, DPS increased its tea and juice placement in both grocery and convenience. In grocery, DPS made great progress in cold drinks with 14,000 net new placements so far in 2011. During the quarter, Dr Pepper's tie-in with Thor resulted in over 1 billion media impressions, and Snapple's integration in The Amazing Race generated over 400 million impressions.

On May 18, 2011, DBS's Board of Directors raised the quarterly dividend 28 percent to $0.32. Company management said this as an initial step towards being able to consistently raise the company's dividend over time. Through June of 2011, total distributions to shareholders were $436 million, $325 million in share repurchases and $111 million in dividends.

EXHIBIT 1 The DPS Strategy

The key elements of our business strategy are to:
Build and enhance leading brands.
Focus on opportunities in high growth and high margin categories.
Increase presence in high margin channels and packages.
Leverage our integrated business model.
Strengthen our route-to-market through acquisitions.
Improve operating efficiency.

Source: 2011 Strategy, http://investor.drpeppersnapple.com/index.cfm?pagesect=strategy, March 11.

History

The original Dr Pepper soft drink was invented in 1885 by a young pharmacist named Charles Alderton. At the time, Alderton was working at Morrison's Old Corner Drug Store in Waco, Texas, which served carbonated soft drinks from a soda fountain. Using that resource, Alderton began to experiment with his own recipes and soon discovered that one particular drink, referred to as "the Waco," was gaining popularity among his customers. As demand grew, Alderton and Morrison brought in a third partner to help with the manufacture and bottling of the soft drink. The partner was Robert S. Lazenby, owner of the Circle "A" Ginger Ale Company. Alderton left the business shortly thereafter, but Morrison and Lazenby continued on to form what would come to be known as the Dr Pepper Company, named after a friend of Morrison. The company was introduced to the general public in 1904 at the World's Fair Exposition in St. Louis. From its humble beginnings in Morrison's Old Corner Drug Store, the company Alderton and Morrison started has become one of the largest beverage manufacturers in North America.

DPS is in a difficult competitive situation in 2011 as the company is a distant third in an industry dominated by Coca-Cola Company and PepsiCo. Both of those competitors grew briskly in 2010, while DPS had less than 2 percent growth in sales and experienced a loss. DPS is strong in the noncola carbonated beverage segment and has also had success with noncarbonated beverages such as Snapple. Approximately 40 percent of the company's volume is distributed through company-owned networks, another 40 percent through third-party distributers in the Coca-Cola, PepsiCo, and independent bottler systems, and the remaining portion is split between warehouse direct and foodservice distributors. This distribution arrangement is a key strategic issue in this case because it means DPS must cooperate well with the very competitors that make it difficult for the company to prosper. The DPS distribution strategy, as described in Exhibit 1, may be dangerous for the company.

DPS Internal Affairs

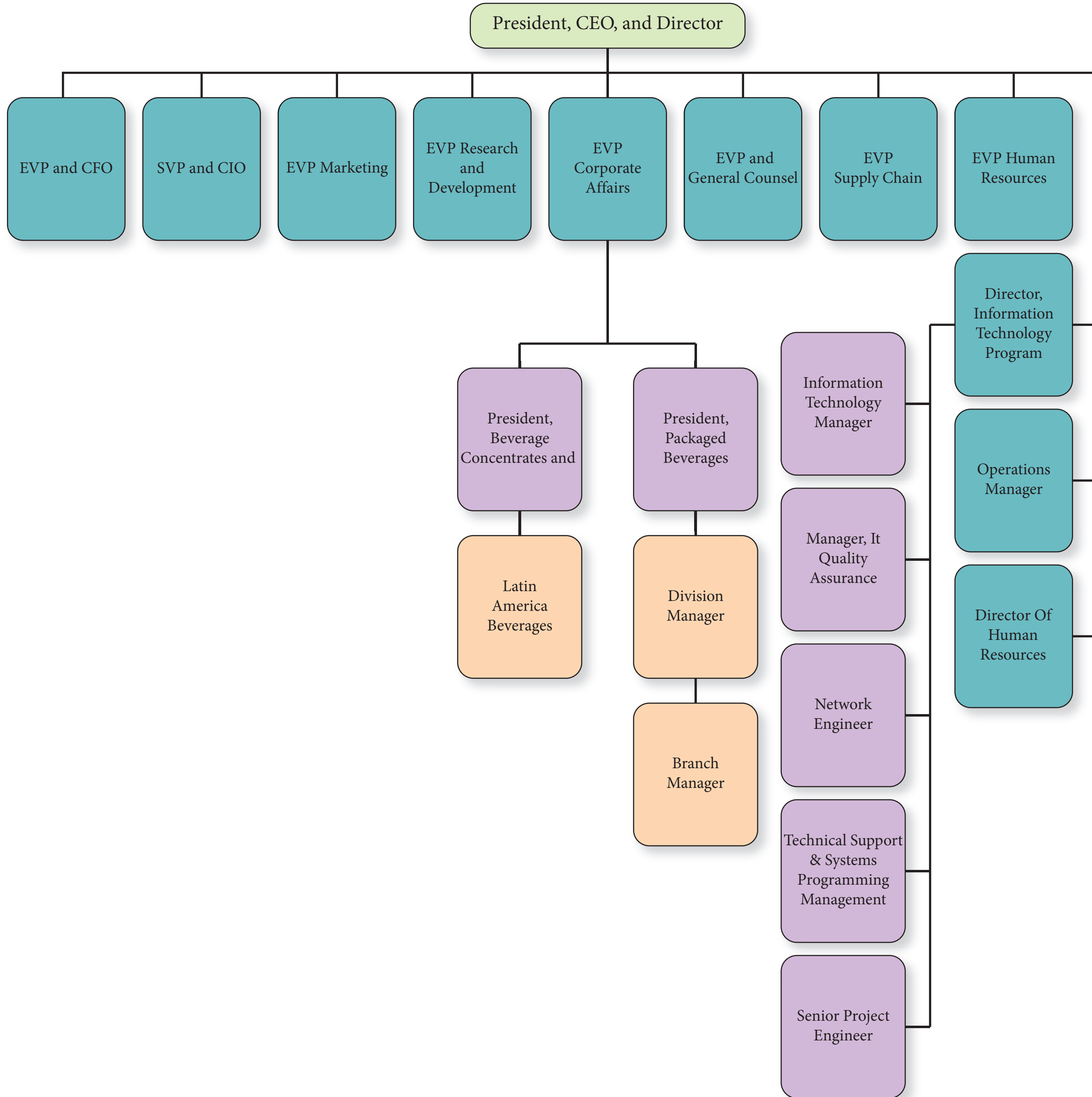
Management and Sustainability

DPS recently released its first-ever corporate social responsibility report, detailing its sustainability efforts since our spinoff from Cadbury in 2008. It isn't just a look back; it's also a roadmap for the way forward. The document, available at the company website, establishes clear goals for environmental sustainability, health and wellness, philanthropy, workplace environment, and ethical sourcing. Responsible for this document is DPS's top management team as revealed in the organizational chart shown in Exhibit 2. Note that Larry Young is president, CEO, and director.

Marketing

BRAND DEVELOPMENT. Despite slow sales in the overall noncola carbonated soft drink market, flavored soft drinks show room for growth. DPS's CEO says "while consumers are growing tired of colas, flavored soft drinks are the "sweet spot" in the industry." By developing flavored brands like Dr Pepper, Sunkist, and A&W, DPS believes it has the potential to gain market share over its rivals.

EXHIBIT 2 The DPS Top Management Team



DPS has made a number of changes to its soft drink brands, including the addition of a new Green Tea Ginger Ale to the Canada Dry line, the extension of a 7UP line with added antioxidants, an updated recipe for A&W Root Beer that includes aged vanilla, and the development of Dr Pepper Cherry, for consumers who prefer a lighter tasting Dr Pepper. In addition to soft drink development, DPS has invested in Hydrive Energy LLC, a small energy drink maker, and created Snapple Antioxidant water to compensate for the loss of Vitaminwater to Coca-Cola. Also, DPS created Venom, a new energy drink to recover losses from two previous brands.

Snapple now includes new formulations for its teas to increase consumer interest, and it began to focus on the health benefits of the product. DPS also began to distribute Snapple juices and lemonades in sleek, 16-ounce glass bottles with labels indicating their health benefits.[1]

EXHIBIT 3 DPS Consolidated Income Statements (In millions, except per share data)

For the Year Ended December 31, 2010, 2009, and 2008

	For the Year Ended December 31		
	2010	2009	2008
Net sales	**$5,636**	**$5,531**	**$5,710**
Cost of sales	2,243	2,234	2,590
Gross profit	3,393	3,297	3,120
Selling, general, and administrative expenses	2,233	2,135	2,075
Depreciation and amortization	127	117	113
Impairment of goodwill and intangible assets	—	—	1,039
Restructuring costs	—	—	57
Other operating expense (income), net	8	(40)	4
Income (loss) from operations	1,025	1,085	(168)
Interest expense	128	243	257
Interest income	(3)	(4)	(32)
Loss on early extinguishment of debt	100	—	—
Other income, net	(21)	(22)	(18)
Income (loss) before provision for income taxes and equity in earnings of unconsolidated subsidiaries	821	868	(375)
Provision for income taxes	294	315	(61)
Income (loss) before equity in earnings of unconsolidated subsidiaries	527	553	(314)
Equity in earnings of unconsolidated subsidiaries, net of tax	1	2	2
Net income (loss)	**$528**	**$555**	**$(312)**
Earnings (loss) per common share:			
Basic	2.19	2.18	(1.23)
Diluted	2.17	2.17	(1.23)
Weighted average common shares outstanding:			
Basic	240.4	254.2	254.0
Diluted	242.6	255.2	254.0
Cash dividends declared per common share	0.90	0.15	—

EXHIBIT 4 DPS Consolidated Balance Sheets (in millions, except share and per share data)

As of December 31, 2010 and 2009

	December 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 315	$ 280
Accounts receivable:		
Trade, net	536	540
Other	35	32
Inventories	244	262
Deferred tax assets	57	53
Prepaid expenses and other current assets	122	112
Total current assets	1,309	1,279

(*continued*)

These and other changes paid off, as sales of Snapple actually increased in 2010, in spite of a poor economic climate.

INCREASING ADVERTISING AND AVAILABILITY. Many DPS brands, such as Mott's, A&W, and Canada Dry, have not received any serious advertising investment since the end of the 1990s. DPS has a new television commercial campaign including celebrities like the rapper/producer Dr. Dre and Gene Simmons of the rock band Kiss. In the commercials, the celebrities endorse Dr Pepper by referring to its superior taste and flavor and then simply stating, "Trust me, I'm a doctor."

The DPS marketing budget for Sunkist is targeted toward teenagers, and 20 percent of the budget for Dr Pepper is allocated to Internet advertising.

To supplement the increase in advertising, DPS is focusing more attention on distribution. One of the major methods for increasing distribution is by investing in coolers, vending machines, and fast-food fountains containing DPS products. In 2008, DPS added 31,000 fountain placements in fast-food restaurants throughout the United States. In 2009, the company added its products to 14,000 McDonald's franchises in order to increase its availability in that chain from 60 to 100 percent. In that same year, the company also outlined a strategy that would add 175,000 coolers and vending machines throughout the country over a five-year period. DPS's Marketing Manager Trebilcock commented on the strategy:

> If you have people drinking your products at work, at play, when they go into the grocery store, they're going to buy that product and take it home with them. Our fountain/foodservice team has done an excellent job of getting Dr Pepper and some of the other brands on fountain equipment.[2]

DPS agreements with Pepsi Bottling Group in New York and PepsiAmericas in Minnesota have more than doubled the availability of Crush, making it the second-best-selling orange-flavored soft drink behind Sunkist, which DPS also owns. DPS signed a $715-million-dollar deal in 2010 that gives Coke the rights to distribute Dr Pepper and Canada Dry in the United States.

Operations

DPS employs approximately 20,000 people throughout North America and the Caribbean. It operates 24 production plants and more than 200 distribution centers in those areas. Almost all beverage concentrates are produced in a plant in St. Louis, Missouri. The business model includes both company-owned, direct-store-delivery (DSD) distribution, and third-party distribution. Within the model, approximately 40 percent of the company's volume is distributed through company-owned networks, another 40 percent through third-party distributers in the Coca-Cola, Pepsi-Cola, and independent bottler systems, and the remaining portion is split between warehouse direct and foodservice distributors.

A good example of DPS's operations is its largest hub located in Northlake, Illinois, which distributes to Chicago and its surrounding areas. The facility comprises about one million square feet and employs 1,250 people, 750 of which work on-site and the rest in the field. On-site operations consist of nine manufacturing lines, including plastic bottle, can, and a hot-fill glass lines for DSD distribution, and a bag-in-box line for soda fountains at foodservice locations. Most of the lines are versatile, allowing for variations in batches, but some also have unique capabilities. For example, Line 1 produces cold-fill glass and plastic bottles, while the Snapple line produces hot-fill products. The Northlake facility produces about 220,000 cases of product a day, which are stored in the company's 25-dock warehouse until they are loaded onto one of the 140 to 150 trucks in a fleet owned by the facility.[3]

DPS Finances

While many DPS brands experienced moderate-to-high growth in 2010, Sunkist, 7UP, and A&W declined, leading to overall company sales of $5.6 billion, up about 2 percent from 2009. However, profits were down approximately 5 percent from the prior year. The company experienced a huge loss in 2008. DPS's detailed financial statements are provided in Exhibits 3 and 4. DPS's by-segment results are provided in Exhibit 5.

EXHIBIT 4 continued

As of December 31, 2010 and 2009		
	December 31, 2010	December 31, 2009
Property, plant, and equipment, net	1,168	1,109
Investments in unconsolidated subsidiaries	11	9
Goodwill	2,984	2,983
Other intangible assets, net	2,691	2,702
Other noncurrent assets	552	543
Noncurrent deferred tax assets	144	151
Total assets	**$8,859**	**$8,776**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$851	$850
Deferred revenue	65	—
Current portion of long-term obligations	404	—
Income taxes payable	18	4
Total current liabilities	1,338	854
Long-term obligations	1,687	2,960
Noncurrent deferred tax liabilities	1,083	1,038
Noncurrent deferred revenue	1,515	—
Other noncurrent liabilities	777	737
Total liabilities	6,400	5,589
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value, 15,000,000 shares authorized, no shares issued	—	—
Common stock, $.01 par value, 800,000,000 shares authorized, 223,936,156 and 254,109,047 shares issued and outstanding for 2010 and 2009, respectively	2	3
Additional paid-in capital	2,085	3,156
Retained earnings	400	87
Accumulated other comprehensive loss	(28)	(59)
Total stockholders' equity	2,459	3,187
Total liabilities and stockholders' equity	**$8,859**	**$8,776**

EXHIBIT 5 DPS Segment Results (000 omitted)

	For the Year Ended December 31	
	2010	2009
Net sales		
Beverage concentrates	$1,156	$1,063
Packaged beverages	4,098	4,111
Latin America beverages	382	357
Net sales	$5,636	$5,531

EXHIBIT 5 continued

	For the Year Ended December 31	
	2010	2009
Segment operating profit (SOP)		
Beverage concentrates	$745	$683
Packaged beverages	536	573
Latin America beverages	40	54
Total SOP	1,321	1,310
Unallocated corporate costs	288	265
Other operating expense (income), net	8	(40)
Income from operations	$1,025	$1,085
Interest expense, net	125	239
Loss on early extinguishment of debt	100	—
Other income, net	(21)	(22)
Income before provision for income taxes and equity in earnings of unconsolidated subsidiaries	$821	$868

Source: Dr Pepper Snapple Group, Inc. 2010 *Form 10K*.

The Beverage Industry

DPS competes in the U.S. beverage manufacture and bottling industry (NAICS: 42119). The industry is made up of about 3,000 companies, including manufacturers, bottlers, and distributers of nonalcoholic beverages. Despite the vast number of companies in the industry, revenues are highly concentrated. Over 90 percent of the combined $70 billion in annual industry revenues are generated by the three largest companies—Coca-Cola, PepsiCo, and DPS—and their subsidiaries. The major products in the industry are carbonated soft drinks, including colas and other flavors, bottled waters, juices, and a variety of syrups and mixes.

Factors such as economic stability, consumer tastes and preferences, commodities prices, and seasonality are of great importance to beverage company managers, who develop and implement strategies to respond to changes in the industry. Perhaps the most significant factor influencing food and beverage companies is economic stability. Since carbonated soft drinks are a discretionary item, sales are considerably impacted by weakness in the economy. Between 2008 and 2010, the economy was the major problem facing beverage companies like DPS, Coke, and Pepsi. United States with high unemployment and tight credit comes reduced, consumer spending.

As discretionary spending decreased, consumers turn from flavored soft drinks and colas to less expensive alternatives, including tap water. Also of importance in the beverage industry are prices for aluminum, natural gas, resins, corn, pulp, and other commodities. These types of commodities are used in the production of beverages, exerting a considerable amount of pressure on industry margins. For instance as, the price of sugar on the U.S. commodity market rises, DPS is hurt.

One of the most significant trends affecting the beverage industry is an increased concern about health and wellness. As consumers reduce caloric intake and look for products richer in vitamins, the less-healthy sectors of the beverage industry are expected to shrink. As soft drink sales decline, however, demand for healthier alternatives like low- or no-calorie soft drinks and noncarbonated drinks such as sports drinks, ready-to-drink teas, and flavored and regular bottled water are projected to grow.[4] Through 2013, bottled water was projected to grow by 9 percent, ready-to-drink teas by 24 percent, and flavored and functional waters by 71 percent. Beverage sales tend to be higher during the summer months and holidays. Sales are slower during the winter months.

Market Channels

Although the final consumer governs demand for beverages, DPS's direct customers are bottlers/distributers and retailers. Building strong relationships with these customers is an important part of succeeding in the beverage industry.

EXHIBIT 6 Selected Competitor Financial Data (in millions)

Coca-Cola Company and Subsidiaries			
Year Ended December 31,	2010	2009	2008
Net Operating Revenues	$35,119	$30,990	$31,944
Cost of Goods Sold	12,693	11,088	11,374
Selling, General and Administrative Expenses	13,158	11,358	11,774
Other Operating Charges	819	313	350
Operating Income	8,449	8,231	8,446
Net Income After Taxes	11,809	6,824	5,807
Total Current Assets	21,579	17,551	12,176
Total Assets	72,921	48,671	40,519
Total Current Liabilities	18,508	13,721	12,988
Total Long-Term Debt and Other Liabilities	23,096	9,604	7,059
Total Equity	31,317	25,346	20,472
PepsiCo, Inc.			
Fiscal Years Ended December 26 and 27,	2010	2009	2008
Net Operating Revenues	$57,838	$43,232	$43,251
Cost of Goods Sold	26,575	20,099	20,351
Selling, General and Administrative Expenses	22,814	15,026	15,877
Amortization of Intangible Assets	117	63	64
Operating Profit	8,332	8,044	6,959
Net Income After Taxes	6,320	5,946	5,142
Total Current Assets	17,569	12,571	10,806
Total Assets	68,153	39,848	35,994
Total Current Liabilities	15,892	8,756	8,787
Total Long-Term Debt and Other Liabilities	30,785	13,650	14,625
Total Equity	21,476	17,442	12,582

Source: Coca-Cola Company, 2009 and 2010 *Form 10K*; PepsiCo, Inc. 2009 and 2010 *Annual Reports*.

PepsiCo

Based in North Carolina, Pepsi is divided into three major business units—PepsiCo Americas Foods, PepsiCo Americas Beverages, and PepsiCo International. These business units manufacture, market, and sell a variety of convenient, salty, sweet, and grain-based snacks, carbonated soft drinks and noncarbonated beverages, and other foods in approximately 200 countries throughout the world. Some of the company's key brands include its flagship Pepsi, Pepsi One, and Diet Pepsi, and Mug, Mountain Dew, Sierra Mist, Frito-Lay, Doritos, Cheetos, Tostitos, Sunchips, SoBe and SoBe Lifewater, Propel, Quaker, and Tropicana. Pepsi also holds licenses to use trademarks for many valuable products, including Lipton, Starbucks, Dole, and Ocean Spray.

Pepsi's goal is to be the world's best consumer products company in convenient foods and beverages. The company seeks to accomplish its goal by producing "financial rewards to investors as we provide opportunities for growth and enrichment to our employees, our business partners and the communities in which we operate." An important part of Pepsi's mission statement is its socially responsible approach, concentrating on improving all aspects of the world in which it operates—the environment, societies, and economies. The company puts its vision into action through meeting consumer needs, environmental stewardship initiatives, society benefits, employee support and organizational programs, and operations that increase shareholder value.

Like Coke, Pepsi strategies maintain an international focus and include improvements in product development and marketing. The company has recently made significant changes to packaging, redesigning Pepsi-brand products, Sierra Mist, and others. Additionally, Pepsi introduced a new advertising campaign that put a modern twist on the "Pepsi Generation" campaign

Bottling and distribution companies buy beverage concentrates from beverage brand companies, from which they manufacture, bottle, and distribute finished beverages. Additionally, bottlers manufacture and distribute syrups and mixes used in soda fountains for the foodservice industry. Major beverage bottling companies include Coca-Cola Enterprises, PepsiAmericas, the Pepsi Bottling Group, and the Dr Pepper/Snapple Bottling Group. For DPS, a substantial portion of net sales in beverage concentrates is generated through bottlers not owned by the company. As much as two-thirds of DPS volume in concentrates is sold to third-party bottlers. Some of these are owned by competitors such as PepsiCo and Coke. In 2010, 71 percent of Dr Pepper volumes were distributed through Coca-Cola- and PepsiCo-affiliated bottlers.[5] Productive relationships with these bottlers are possible because of the strength and position of the Dr Pepper brand.

Retail companies buy finished beverages from distributers for mass merchandise and sale to the final consumer. Recent trends in the industry have caused many retailers to consolidate, resulting in a smaller number of large, sophisticated retailers with more buying power. Major retailers associated with the beverage industry include Wal-Mart, Target, Kroger, SuperValu, and Safeway. In addition to these retailers, beverage manufacturers also depend greatly on foodservice customers, which buy syrups for fountain drinks. Major foodservice companies include McDonalds, Burger King, and Yum! Brands like KFC, Pizza Hut, and Taco Bell.

Competitors

Competitive position is most effectively attained through brand recognition, based on factors such as price, quality, taste, selection, and availability. Major competitors in the manufacturing segment include the Coca-Cola Company (Coke), PepsiCo, Inc. (Pepsi), Nestlé, S.A., and Kraft Foods, Inc. Major competitors in the bottling and distribution segment include Coca-Cola Enterprises, Pepsi Bottling Group, and numerous smaller bottlers and distributors.

DPS is the third-largest beverage business in North America, behind Coke and Pepsi, which collectively account for 63 percent of the sales in the industry.

Besides having problems gaining market share in the United States, DPS also has difficulty competing internationally. The company generates about 89 percent of its revenues in the U.S. market, 80 percent of which comes from carbonated soft drinks. In comparison, Coke collects about 74 percent of its sales outside of North America, and Pepsi generates over 40 percent of its sales internationally. Still, DPS management intends to maintain a focus on North America. In general, while DPS has strong brands and distribution, the company struggles to compete head- to-head with industry leaders Coke and Pepsi.

Coca-Cola Company

Based in Atlanta, Georgia, the Coca-Cola (Coke) is the largest manufacturer, distributer, and marketer of nonalcoholic beverage concentrates and syrups in the world. Coke markets four of the world's top five carbonated soft drinks—Coca-Cola, named the world's most valuable brand, Diet Coke, Fanta, and Sprite. Coke also owns and licenses nearly 500 other brands, including diet and light beverages, enhanced waters, juice drinks, teas, coffees, and sports and energy drinks. Coke is primarily a brand owner and manufacturer, selling its concentrates and syrups to bottling and canning companies, fountain wholesalers and retailers, and distributers.

The three-phase mission of Coke is "to refresh the world, to inspire moments of optimism and happiness, and to create value and make a difference." Consistent with its mission statement, Coke maintains an international focus, marketing and distributing its products in over 200 countries throughout the world. To facilitate its international focus, Coke spends a significant amount of capital on technological development and marketing. For example, Coke introduced a new fountain beverage machine that used "micro-dosing" technology to dispense over 120 beverages from one machine. The machine takes up the same space as the eight-valve machine currently being used by foodservice businesses. The combination among international sales, technology development, and marketing has made Coke one of the most widely recognized and profitable companies in the world. Selected financial data on the Coca-Cola Company is provided in Exhibit 6.

used in the '60s. The campaign combined footage from the old advertisements with current images to express the new tagline, "Every Generation Refreshes the World." By focusing on social responsibility and diversifying its brand and product portfolio, Pepsi has become one of the most successful global food and beverage companies in history. Selected financial data for PepsiCo is provided in Exhibit 6.

The Future

How can DPS continue to grow at levels that will satisfy shareholders? To what extent should acquisitions, joint ventures, licensing agreements, and/or internal growth tactics be pursued? Should DPS diversify into other product markets such as snacks, which PepsiCo is using to create competitive advantage? What geographic growth options are best for DPS to pursue? Should any products or brands be divested?

Soft drink companies face an ever-changing world and market. The current trends are away from high-calorie, carbonated soft drinks, as people look to healthier options. Thus companies are developing or acquiring new products to meet the new market whims, and low-calorie options are springing up alongside an increase in fruit juices and milk options. Coca-Cola and PepsiCo are working hard to get their names established in new places and reach their existing public in new ways. As companies expand their presence into the faster-growing emerging markets, they have new tastes to cater to. Coke is changing its worldwide Fanta campaign and showed its new advertisement during *American Idol* on March 30, 2011. DPS recently linked up with CBS to promote its new Snapple flavors through advertising during the popular TV show *The Amazing Race*.

To what extent should DPS continue to rely on Coke and PepsiCo to distribute its products? Prepare a three-year strategic plan for CEO Larry Young.

Notes

1. This case is intended for classroom use and is not intended to illustrate good or bad management practices. I would like to acknowledge the helpful assistance of Dr. Jeffrey S. Harrison in preparing this case. I am also grateful to the Robins School of Business at the University of Richmond for providing me with the resources I used to research this company and its competitive environment.
2. Ibid.
3. Ibid, 17.
4. Ibid.
5. Dr Pepper Snapple Group, Inc. *2009 Annual Report*.
6. Dr Pepper Snapple Group, Inc., *2010 Annual Report*, 6.

Coca-Cola Company — 2011

Alen Badal
The Union Institute

KO

www.coca-cola.com

Headquartered in Atlanta, Georgia, and founded in 1886, Coca-Cola Company (Coke) is the world's largest beverage company with products that include Coca-Cola, Diet Coke, Sprite, and Fanta. Coke produces about 400 brands consisting of over 3,000 beverage products, including water, juice, juice drinks, sports drinks, energy drinks, teas, coffees, soy milk, and Bacardi mixers sold in over 200 countries. Coke products are distributed virtually everywhere worldwide through restaurants, grocery stores, street vendors, and other outlets. People consume in excess of 1.4 billion Coke product servings daily. Coke employs approximately 71,000 people worldwide and has approximately 22 million fans on Facebook. Coke is the number-one most-followed food/beverage brand on Twitter.

Coke owns four of the top five soft-drink brands in the world: Coca-Cola, Diet Coke, Fanta, and Sprite. Its other brands include Minute Maid, Powerade, and Dasani water. In North America, Coke sells Groupe Danone's Evian. Coke also sells brands from Dr Pepper Snapple Group (Crush, Dr Pepper, and Schweppes) outside Australia, Europe, and North America. In late 2010, Coke bought out its leading bottler, Coca-Cola Enterprises (CCE), and renamed it Coca-Cola Refreshments USA.

A relatively new product, Coke Zero has sold more than 600 million cases and is available in over 130 countries. Recently, the 1.25-liter size of Coke Zero was introduced, but in limited markets (Alabama, South Carolina, and Georgia).

Finance

As the stock market dropped 1,000 points in early August 2011, Coca-Cola stock dropped only 5 percent from its 52-week high. This has put Coca-Cola stock in exclusive company among the Dow Jones Industrials being only one among five Dow members that remained above its June lows during the August selloff (IBM, Microsoft, Kraft, and McDonald's were the other four stocks).

Coca-Cola second-quarter 2011 profit rose 18 percent to $2.8 billion on strong growth overseas and the acquisition of a bottler. The company's second quarter revenue climbed 47 percent to $12.74 billion, largely on its bottler acquisition. Coke reported excellent gains in emerging markets such as Latin America, India and China, coupled with steady sales in established markets. Coke CEO Muhtar Kent said the second quarter results "are a testament to the company's strong brands and business fundamentals. Our focus is on maintaining a long-term vision of where the world is headed and in turn, where the Coca-Cola Company wants to go." With more than 500 brands, including Fanta, Sprite, Dasani and Minute Maid, the company's global sales volume increased 6 percent in that quarter. The company's sales volume rose 4 percent in North America and 6 percent internationally. Revenue gains the second quarter of 2011 were largest in North America, but company revenue also jumped 15 percent in Africa, 10 percent in Europe, 13 percent in Latin America, and 21 percent in Asia.

Coke posted revenues of $35.1 billion in 2010, compared to $30.9 in 2009. Net income was $11.8 billion, up from $6.8 billion in 2009. Coke's income statements and balance sheets are provided in Exhibits 1 and 2.

EXHIBIT 1 Coca-Cola Company—2010 Income Statement (figures in thousands)

	Dec. 31, 2010	Dec. 31, 2009	Dec. 31, 2008
Total Revenue	$35,119,000	30,990,000	31,944,000
Cost of Revenue	12,693,000	11,088,000	11,374,000
Gross Profit	**22,426,000**	**19,902,000**	**20,570,000**
Operating Expenses	—	—	—
Research Development	—	—	—
Selling Gen & Admin	13,977,000	11,671,000	11,774,000
Nonrecurring	—	—	350,000
Others	—	—	—
Total Operating Exp.	—	—	—
Operating Income or Loss	**8,449,000**	**8,231,000**	**8,446,000**
Income from Cont Oper.	—	—	—
Total Other Inc/Exp Net	5,502,000	289,000	305,000
EBIT	14,976,000	9,301,000	7,877,000
Interest Expense	733,000	355,000	438,000
Income Before Tax	14,243,000	8,946,000	7,439,000
Income Tax Expense	2,384,000	2,040,000	1,632,000
Minority Interest	—	—	—
Net Inc. from Cont. Ops	12,834,000	7,605,000	5,807,000
Nonrecurring Events	—	—	—
Net Income	**11,809,000**	**6,824,000**	**4,807,000**

Source: Company documents.

EXHIBIT 2 Coca-Cola Company—2010 Balance Sheet (in thousands)

	Dec. 31, 2010	Dec. 31, 2009	Dec. 31, 2008
ASSETS			
Current Assets			
Cash & Cash Equiv	$8,379,000	6,959,000	4,701,0000
Short-term Invest	2,820,000	2,192,000	278,000
Net Receivables	4,430,000	3,758,000	3,090,000
Inventory	2,650,000	2,354,000	2,187,000
Other Current Assets	3,162,000	2,226,000	1,920,000
Total Current Assets	**21,579,000**	**17,551,000**	**12,176,000**
Long-term Investments	7,585,000	6,755,000	5,779,000
Property Plant & Equip	14,727,000	9,561,000	8,326,000
Goodwill	11,665,000	4,224,000	4,029,000
Intangible Assets	15,244,000	8,604,000	8,476,000
Accumulated Amortization	—	—	—
Other Assets	2,121,000	1,976,000	1,733,000
Def Long-term Asset Charges	—	—	—
Total Assets	**72,921,000**	**48,671,000**	**40,519,000**
LIABILITIES			
Current Liabilities			
Accounts Payable	9,132,000	6,921,000	6,152,000
Short-term Debt	9,376,000	6,800,000	6,531,000
Other Current Liabilities	—	—	305,000
Total Current Liabilities	**18,508,000**	**13,721,000**	**12,988,000**

EXHIBIT 2 continued

	Dec. 31, 2010	Dec. 31, 2009	Dec. 31, 2008
Long-term Debt	14,041,000	5,059,000	2,781,000
Other Liabilities	4,794,000	2,965,000	3,401,000
Deferred Long-term Liability Charges	4,261,000	1,580,000	877,000
Minority Interest	314,000	547,000	–
Negative Goodwill	–	–	–
Total Liabilities	**41,918,000**	**23,872,000**	**20,047,000**
Stockholders' Equity			
Misc Stock Opt Warrants			
Redeemable Pref Stock			
Preferred Stock			
Common Stock	880,000	880,000	880,000
Retained Earnings	49,278,000	41,537,000	38,513,000
Treasury Stock	(27,762,000)	(25,398,000)	(24,213,000)
Capital Surplus	10,057,000	8,537,000	7,966,000
Other Stockholders' Equity	(1,450,000)	(757,000)	(2,674,000)
Total Stockholders' Equity	**31,003,000**	**24,799,000**	**20,472,000**
Total Liab and SE	**$72,921,000**	**48,671,000**	**40,519,000**

Source: Company documents.

Vision/Mission

Coca-Cola's vision statement is:

People: Be a great place to work where people are inspired to be the best they can be.
Portfolio: Bring to the world a portfolio of quality beverage brands that anticipate and satisfy people's desires and needs.
Partners: Nurture a winning network of customers and suppliers, together we create mutual, enduring value.
Planet: Be a responsible citizen that makes a difference by helping build and support sustainable communities.
Profit: Maximize long-term return to shareowners while being mindful of our overall responsibilities.
Productivity: Be a highly effective, lean and fast-moving organization.

Source: Company documents.

Coca-Cola's mission statement is:

To refresh the world.
To inspire moments of optimism and happiness.
To create value and make a difference.

Source: Company documents.

Operating Groups

Coke has six main operating segments: 1) North America, 2) Latin America, 3) Europe, 4) Eurasia & Africa, 5) Pacific, and 6) Bottling Investments. Not all soft drink products/flavors of the company are available in all the operating segments. North America generates 31.7 percent of revenues, as noted in Exhibit 3. Coke's organizational structure is provided in Exhibit 4.

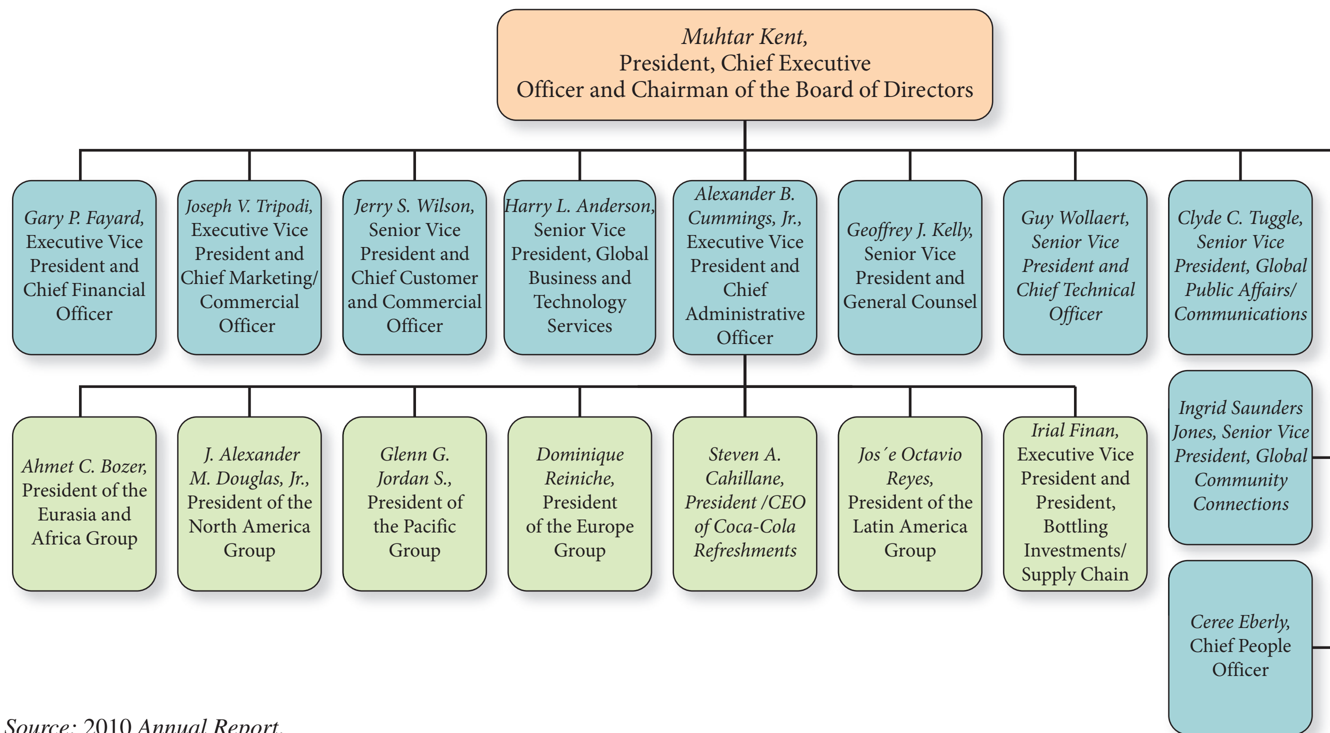
EXHIBIT 3 Coca-Cola Company Net Operating Revenues by Segment (%)

Year Ended Dec. 31	2010	2009	2008
Eurasia & Africa	6.9%	6.4%	6.7%
Europe	12.6	13.9	15.0
Latin America	11.0	12.0	11.3
North America	31.7	26.4	25.7
Pacific	14.1	14.6	13.7
Bottling Investments	23.4	26.4	27.3
Corporate	0.3	0.3	0.3

Source: www.thecoca-colacompany.com.

Note: The operating segment is shown as a percentage of the company net operating revenues as of the date/years above.

EXHIBIT 4 Coca-Cola Company Executive Officers



Source: 2010 *Annual Report*.

Pacific

Coke's Pacific sector delivered a 6 percent increase in unit case volume in 2010. Coke's NARTD beverage is popular in Japan. Korea's unit case volume grew 6 percent; Coke's Eurasia & Asia segment reported the highest percentage (12 percent) increase in 2010 volume, as shown in Exhibit 5.

China has achieved impressive unit case volume growth of double digits for the past eight years partly due to impressive Coca-Cola, Sprite, and Minute Maid Pulpy sales. The Coca-Cola brand grew 27 percent in Vietnam in 2010. Coke also made significant volume and value share gains in sparkling beverages in Thailand, although Thailand achieved the lowest case volume growth in the sector (5 percent), with China the highest at 41 percent.

In Japan, Coke has been testing the health-tea water product. Coke's ready-to-drink tea has achieved higher increases than any similar ready-to-drink beverage, with a volume shares increase of 15.6 percent.

EXHIBIT 5 Operating Segments Volume Sold

	Percentage Change			
	2010 vs. 2009		2009 vs. 2008	
Year Ended Dec. 31	Unit Cases/Concentrate	Sales	Unit Cases/Concentrate	Sales
Worldwide	5%	5%	3%	3%
Eurasia & Africa	12	12	4	5
Europe	–	–	(1)	(2)
Latin America	5	7	6	7
North America	2	2	(2)	(2)
Pacific	6	6	7	7
Bottling Investments	(6)	N/A	2	N/A

Source: www.thecoca-colacompany.com.

Note: Bottling Investments segment data reflects unit case volume growth for consolidated bottlers only. Geographic segment data reflects unit case volume growth for all bottlers in the applicable geographic areas, both consolidated and unconsolidated.

Europe

The European market has been a challenge for Coke. In 2010, Coke's unit case volume achieved zero-percent growth; however, volume increased in some Western European countries, such as a 4 percent increase in France, 4 percent in Great Britain, and 2 percent in Italy. France and Italy's unit case volumes were the lowest among the European sectors (each at 9 percent), while Eastern Europe represented 19 percent volume of Coke products sold.

A few of Coke's successful brands in Europe include Aquarius, Nestea, and Powerade. Coke's recent acquisitions include mineral water company Apollinaris (Germany) and Traficante (Italy), to add to Coke's existing five water brands: Ciel, Valser, Toppur, Kropla Beskidu, and Dasani, which is available in four flavors. Additionally, Coke implemented marketing strategies, such as collaborating with Apple.

Latin America

Coke's products sold in Latin America in 2010 achieved a case volume growth of 6 percent, with share gains across all beverage categories. This sector has been Coke's largest operating case volume group for three consecutive years. Coke's top three markets include: #1 USA; #2 Mexico; and #3 Brazil. Recent Coke acquisitions included Jugos del Valle, S.A.B de C.V. to strengthen its presence in Latin America with more juice beverages.

Coke has recently focused on more nutritional offerings, such as Minute Maid Forte in Mexico, flavored water in Colombia, and 100 percent Cepita Juice in Argentina. Coke is relying on its digital marketing platform in Latin America to build and strengthen its relationship with consumers, which has registered more than 5 million visitors in Mexico and Brazil.

North America

Coke experienced continued growth in 2010 in both volume and value share thanks in part to the success of Coke Zero. The product yielded double-digit volume growth for the fourth consecutive year! Additionally, Coke expanded the availability of the Coca-Cola contour package in single-drink and 2-liter bottles, and the still brands, led by Glacéau, Powerade, and Simply, outperformed the total still category for the second consecutive year. As Coke continues into 2011, the focus is on building healthy brands, further developing customer relationships, and operating efficiently.

Eurasia & Africa

This division increased its case volume overall by 12 percent in 2010, led by a 13 percent growth rate in India and South Africa and a 12 percent growth rate in East & Central Africa and Turkey. Success is partly due to launching 150 products in fiscal 2009. Additional success stems from continuous packing and production efficiency/innovations, to include Maaza® Pulpy in India, Fruitopia® in Kenya, Dobriy® Apple Vanilla Cinnamon in Russia, and Cappy Lemonade in Turkey. Also, the introduction of Burn to five African markets has gone over well for Coke.

Coke in this area of the world expects continued growth in juices and juice drinks, sparkling beverages, and energy drinks. Coke is investing $12 billion during the next 10 years in Africa and $1 billion over the next three to five years in Russia. In 2010, Nigeria (5 percent), Egypt (5 percent), the Middle East (7 percent), and Southern Eurasia (7 percent) achieved the lowest levels of unit case volume, geographically, within this sector.

Coke is Africa's largest private-sector employer with 55,000 employees. Coke receives annual awards as the favorite drink in South Africa. Headquartered in Johannesburg, South Africa, this Coke segment also has a large office in Cairo, Egypt.

Bottling Investments

Coke has increased investment in its bottling business, front-end capability, equipment, and people/training. This segment has performed well for Coke in recent years. Coke's additional achievements and acquisitions include recently becoming the number-one German bottler. Coke has focused on route-to-market design and optimization of the infrastructure in its bottling operations in India. It has also acquired Kerry Beverages Limited and Apollinaris GmbH.

In 2010, Coke grew 10 percent in unit case volume in the key bottling markets of Norway and Sweden. The company also opened 500,000 new outlets in fiscal 2010—adding 268,000 new coolers, with many being new energy-efficient models—with a focus to ensure consumers have available access to Coke products. Coke's long-term bottling strategy has been to reduce ownership interests in bottlers and/or sell the company's interests to investee bottlers. Prime investees where Coke has no controlling ownership interest at year-end 2010 included:

1. Coca-Cola FEMSA, S.A.B. de C.V. (Coca-Cola FEMSA)—Coke owns about 32 percent of this company. Some countries served include Colombia, Mexico, Argentina, and Brazil. The division provides about 10 percent of worldwide unit case volume.
2. Coca-Cola Hellenic Bottling Company S.A. (Coca-Cola HBC)—Coke owns about 23 percent of this company, which bottles Coke products in Armenia, Austria, Bulgaria, Nigeria, Poland, and other countries. This division yields about an 8 percent worldwide unit case volume.
3. Coca-Cola Amatil Limited (Coca-Cola Amatil)—Coke owns about 30 percent of this company and it is the largest independent Coca-Cola bottler in the Pacific region. Some countries served by this division include: New Zealand, South Korea, and Australia—representing about a 2 percent worldwide unit case volume.

In recent years, Coke acquired Odwalla at a bargain price of $186 million and purchased Fuze for $250 million. Fuze is a popular noncarbonated drink.

Competitors

Coca-Cola has two major rivals: PepsiCo and Dr Pepper Snapple. Due to its food business, PepsiCo has more than double the employees than Coca-Cola, as indicated in Exhibit 6. Groupe Danone competes to a lesser degree with Coke. The number three soft drink producer, Dr Pepper Snapple, produces and markets nonalcoholic beverages in the United States, Canada, Mexico, and the Caribbean.

EXHIBIT 6 Coke's Biggest Rivals

	Coke	Dr Pep	Pepsi
Market Capitalization	153.9B	8.38B	103.79B
# of Employees	139,600	19,000	294,000
Revenue	35.12B	5.64B	57.84B
Gross Margin	63.86%	60.20%	54.74%
EBITDA	10.45B	1.23B	11.83B
Operating Margin	25.65%	18.19%	16.42%
Net Income	11.81B	528.00M	6.31B
EPS	5.06	2.18	3.92
P/E	13.26	17.05	16.71

PepsiCo

PepsiCo is Coca-Cola's major rival in two fastest growing categories: water and sports drinks. Pepsi's portfolio contains the number-one water brand, Aquafina, and the leading sports drink brand, Gatorade. PepsiCo leads in the bottled tea market with Brisk, co-marketed with Lipton. PepsiCo has its own coffee product, Frappuccino, marketed in a joint venture with Starbucks. PepsiCo's Gatorade brand has been a successful product for decades.

Unlike Coca-Cola, PepsiCo has a huge snack business and plans to expand these operations globally. A special focus is to introduce localized snacks to different respective markets. Pepsi also intends to further develop low- and zero-calorie nutritional beverages utilizing its research & development.

One strategy PepsiCo is implementing is entitled "Power of One," whereby the company is incorporating a synergy marketing approach to blend/offer incentives to consumers of both snacks and beverages. PepsiCo has expanded its "Good-for-you" portfolio of products such as Tropicana, Naked juice, Lebedyansky, Sandora, Aquafina, Quaker Oats, and Gatorade. The aim is to improve its lineup of nutritional products for undernourished people globally.

PepsiCo obtains approximately 60 percent of its revenues from its food division. Approximately 48 percent of revenues are a result of international sales, with Mexico, the United Kingdom, and Canada comprising 16 percent of the revenues, internationally. PepsiCo has succeeded in these health-conscious times with a campaign called "Smart Spot" that emphasizes "better for you" products. These products meet the Food and Drug Administration and the National Academy of Sciences nutritional criteria.

PepsiCo has tailored brands that have been very successful in different countries, such as crab- and duck-flavored chips available in China and lentil-based snacks available in India. Emerging markets, such as Mexico, China, Russia, and Brazil, are targeted by the company to provide affordable snacks.

PepsiCo is routinely ranked among the largest companies by *Fortune* and America's Most Reputable Companies by *Forbes*. PepsiCo had 2010 revenues of approximately $57.8 billion. PepsiCo owns Frito-Lay North America, PepsiCo Beverages North America, PepsiCo International, and Quaker Foods North America. The company's brands are available in about 200 countries.

PepsiCo's Tropicana carton makeover gained orange juice market share in 2010, where Coca-Cola is still the leader. The rationale for the gain is consumer preference to "see" the juice in plastic carafes, whereas it's not possible in cartons. This has caused Coca-Cola to file a lawsuit against PepsiCo in a Texas federal court, where Coke alleges the design is too similar to Coke's brand "Simply."

Even though domestic sales have declined for PepsiCo, overseas revenues have been particularly strong in the Middle East, Argentina, China, and Brazil. Frito-Lay is the largest profit source of late for the company. Mexico and Russia have been two strong contributing markets for PepsiCo in recent years, with the United States comprising 53 percent of sales in 2010.

PepsiCo's Latin America Foods division's volume increased 4 percent in 2010. The 2010 unit case volume for the division was led by Mexico (43 percent), followed by Brazil (26 percent), South Latin America (17 percent), and Central Latin America (14 percent).

Dr Pepper Snapple Group, Inc. (DPS)

DPS manufactures and markets nonalcoholic beverages, ready-to-drink teas, juices, and mixes in the United States, Canada, Mexico, and the Caribbean. The company offers brands such as: 7-UP, A&W Root Beer, Snapple, Canada Dry, Schweppes, Sunkist, Squirt, RC Cola, Motts, and Hawaiian Punch. This company produces and sells some old favorites too, including Vernors, Squirt, and Royal Crown Cola. The company achieved sales of $5,636 million in 2010, up from $5,531 million in 2009. DPS has approximately 19,000 employees and operates 24 bottling and manufacturing facilities along with 200 distribution centers.

Groupe Danone

Headquartered in France, Groupe Danone is the #1 producer of yogurt in the world, the #2 bottled water and baby nutrition manufacturer, the #1 manufacturer of fresh dairy products, and the European leader in medical nutrition. Danone's primary brand in bottled water is Evian. Danone sells flavored waters and focuses on health-conscious consumers. One brand is Levite, a big success in Mexico. Groupe Danone continues to add new drinks in different markets, such as Taillefine Fiz in France, which is a zero-calorie soda that has achieved a number two ranking in the French low-calorie segment. Groupe Danone achieved [[euro]]2.5 billion in sales in 2010, a 6.9 percent rise as compared to 2009, attributed to increased sales in markets such as the United States, Russia, and Brazil.

Hansen Natural Corporation

Founded in 1985 and based in Corona, California, Hansen Natural manufactures, markets, and distributes in not only the United states, but internationally as well. They offer such products as natural sodas, fruit juice, energy drinks (Monster), multivitamin juice drinks for children, and flavored sparkling beverages under the Hansens brand name. The company posted net revenues of $1.3 in 2010, an increase from $1.1 in 2009. Hansen has reduced its cash conversion cycle (CCC) compared to competitors, such as Coke. In 2010 the company's CCC was 66 days, compared to Coke's 67.

Soft Drink Industry

PepsiCo and Coke continue to add companies to their portfolios. PepsiCo recently acquired a Russian drinks firm, while Coke purchased the largest North American operations of its bottler, Coca-Cola Enterprises. Both firms continue to expand into emerging markets. Thirty percent of Coke's revenues come from the United States, as noted in Exhibit 7.

Health issues revolving around soft drinks have recently created challenges for beverage manufacturers. The Obama Administration has pushed for a healthier society, with the fight against obesity. The United States remains one of the most obese societies in the world. Mrs. Obama's "Let's Move" initiative provides a venue for soft-drink manufacturers to help society improve on overall health. Selling snacks (junk food) and sodas in vending machines is being banned in public education institutions by 2012.

The European Commission is reducing artificial colorings, especially "sunset yellow, quinoline yellow and ponceau4R," due to linkage to hyperactivity in children. PepsiCo discontinued Pepsi Raw, a soft drink containing cane sugar as opposed to HFCS.

High commodity food prices and high unemployment have forced manufacturers to offer low prices to cost-conscious consumers. Exhibit 8 displays leading global export destinations for Coke products, led by China and Canada. A majority of Coke's revenues come from its international division. China, Japan, Philippines, Australia, and Thailand were among the top case volume markets for Coke in 2010. Coca-Cola continues to lead in market share, with 42 percent compared to Pepsi's 29.3 in 2010, as indicated in Exhibit 9.

EXHIBIT 7 **Coca-Cola Company Geographic Net Operating Revenues ($ in millions)**

Year Ended Dec. 31	2010	2009	2008
Unites States	$10,629	$8,011	$8,014
International	24,490	22,979	23,930
Net Operating Revenues	$35,119	$30,990	$31,944

Source: www.thecoca-cola.com.

EXHIBIT 8 **Leading U.S. Agricultural Export Destinations (in millions of dollars)**

Country	**2010**	**2009**
Canada	$16.8	$15.7
China	$17.5	$13.1
Mexico	$14.5	$12.9
Japan	$11.8	$11.0
European Union	$8.8	$7.4
South Korea	$5.3	$3.9
Taiwan	$3.1	$2.9
Hong Kong	$2.8	$2.0
Indonesia	$2.2	$1.7
Turkey	$2.1	$1.4

Source: USDA-Economic Research Service, April 12, 2011 (http://www.ers.usda.gov/data/fatus/).

EXHIBIT 9 **2010 vs. 2009 Beverage Company Market Share**

Brand		2010 Share (%)	2009 Share (%)	Share Change (%)
1.	Coca-Cola	42.0	41.9	+.01
2.	PepsiCo	29.3	29.9	–0.6
3.	Dr Pepper Snapple	16.7	16.4	+0.3
4.	Cott Corp.	4.8	4.9	–0.1
5.	National Beverage	2.8	2.7	+0.1
6.	Hansen Natural	1.0	0.9	+0.1
7.	Red Bull	.08	0.7	+0.1
8.	Big Red	.05	0.5	flat
9.	Rockstar	.05	0.4	+0.1
10.	Private label & other	1.6	1.7	–0.1

Source: Beverage-Digest, March 17, 2011, V.59/No.5.

"Payday" is a strategy PepsiCo is utilizing to provide coupons/promotions toward the end of the month to cash-strapped consumers looking at less expensive private-label beverages. Green production will continue in 2011 and beyond; Coke and Pepsi both utilize extensive plastic bottling. PepsiCo has placed kiosks in select locations to help recycle; Coca-Cola Company aims to be 100 percent hydrofluorocarbon-free (FHC-free) by 2015.

Achievements

Coke is investing more than $5 million in bottling operations in Mexico over the next five years. Coke has introduced the "contour packaging" of two litter bottles in the United States market of 2-liter bottles. Coke has been named the "best company to work for women in Mexico." Chile has ranked Coke as their best employer. Coke recently opened the first Leadership in Energy and Environment Design (LEED), which is a certified bottling plant in Latin America, producing and bottling Leao Junior products in Brazil.

A long-awaited introduction is the Coca-Cola Freestyle fountain in select U.S. markets, dispensing more than 100 beverages. Additionally, the 4-ounce Burn energy shots are now available in 10 European markets. Coke also recently launched Sprite express packs in India, targeting the "on-the-go" youth consumer, which yielded a 36 percent case volume growth in India. The Indonesian market welcomed the launch of Frestea Green my body, while in China, Minute Maid Pulpy Super Milky, which is a dairy fruit beverage with coconut bits, was introduced.

In 2010, more than 2.5 billion of Coke's new PlantBottle packages were available across nine countries. For 2011, that number is expected to double to more than 5 billion PlantBottle packages in more than 15 countries. Coke's Scott Vitters, general manager of PlantBottle Packaging Platform, said in mid-2011: "It's our goal to make traditional plastic bottles a thing of the past and ensure that every beverage we produce is available in 100 percent plant-based, fully recyclable packaging. The national launch of Dasani PlantBottle packaging represents an important step toward reducing our carbon footprint, and the up to 100 percent plant-based, recyclable packaging used for Odwalla is the first of its kind in the beverage industry."

The Future

Coke's CEO Muhtar Kent stated in mid-2011 that his company "met or exceeded all of our long-term growth targets for both the quarter and the year." The latest market capitalization of Coke is $154.7 billion, P/E ratio is 13.35, and EPS growth is 19.98 percent over the last five years. With a profit margin of 33.7 percent, Coke had a dividend yield of 2.8 percent in 2010. Under the leadership of Muhtar Kent, Coke increased its most recent quarterly dividend by 3 cents.

Coke's shareholders are accustomed to and expect sustained growth. Therefore, should Coke strive to enter the snack or food business in order to remain competitive with PepsiCo? Conduct an internal and external analysis to determine the best strategic direction for Coke. Develop a three-year strategic plan for CEO Kent.

Starbucks Corporation — 2011

Marlene M. Reed and Rochelle R. Brunson
Baylor University

SBUX

http://www.starbucks.com

In early 2011, it became apparent that Starbucks' $9.1 billion in 2010 domestic sales had leapfrogged the company past Burger King ($8.7 billion) and Wendy's ($8.3 billion), trailing only McDonald's ($32.4 billion) and Subway ($10.5 billion) as the nation's third-largest chain restaurant. Compared to the prior year, Starbucks' 2010 sales were up 8.7 percent, versus 4.4 percent for McDonald's, 6.0 percent for Subway, and declines of 2.5 percent for Burger King and 0.6 percent for Wendy's.

Headquartered in Seattle, Washington, and the world's largest coffee company, Starbucks has entered into a strategic partnership with the maker of Keurig brewers, Green Mountain Coffee Roasters, to deliver coffee to the fast-growing single-serve coffee market. Given the success and popularity of Starbucks VIA instant coffee, the coffee companies are expanding VIA abroad. Starbucks now offers its VIA instant brew in its Chinese stores and other countries. Starbucks currently has locations in 35 cities in China, and CEO Howard Schultz said the company plans to double the number of cities soon. The success of VIA in those Chinese stores exceeded expectations. Starbucks plans to open nearly 1,500 stores in China in the next four years—more than tripling the number of stores there. Estimates project Chinese consumption of Arabica at 15 percent per year, making Starbucks a major player in the years to come, at least when it comes to coffee.

Starbucks is aggressively expanding its coffee line in the United States, where it sees a potential $377 million market for flavored coffee. Starbucks already dominates the domestic coffee market, having a staggering coffee market share of about 75 percent. Along with expanding its instant coffee business, Starbucks has also started a mobile payment plan in about 6,800 Starbucks stores and close to 1,000 Starbucks at Target stores. Through this payment plan, Apple iPod touch and iPhone users and select Research In Motion BlackBerry users can make purchases at the stores through their smartphones. All users would have to do is to download the Starbucks app from the stores in order to use this service.

It has been rumored that Starbucks might acquire rival coffee provider Peet's Coffee & Tea Inc. Peet's reported first quarter 2011 earnings per share was 41 cents, up 58 percent versus 2010. Peets says there has been a significant rise in the cost of coffee during the last three months. Peets' net revenue for that first quarter climbed 9 percent to $88.5 million from $81.2 million for the corresponding period of fiscal 2010. With excellent overall cost management, Peets' first quarter operating margin was 9.8 percent and its EPS growth was 58 percent. Peets expects its 2011 total revenue growth to be 9 percent.

Starbucks recently ended its licensing agreements with Kraft wherein Kraft distributed Starbucks products. Starbucks is opening more than 100 new stores in 2011 in Brazil, the second-largest coffee-consuming country in the world. In early 2011, Starbucks has a total of 16,635 stores in 50 countries, including 500 stores in Tokyo and 500 in London. There is a Starbucks in Beijing's Forbidden City and on the boulevards of Paris. Of the existing stores, 8,832 are company-operated stores, and 7,803 are licensed stores.

History

Starbucks was founded in Seattle in 1971 as a roaster and retailer of whole bean and ground coffee, tea, and spices in a single store in Seattle's Pike Place Market. The company was named after the first mate in Herman Melville's *Moby Dick*. The Starbuck logo was inspired by the sea and

features a twin-tailed mermaid from Greek mythology. The company was incorporated under the laws of the State of Washington in Olympia, Washington, on November 4, 1985. Starbucks went public on June 26, 1992, at a price of $17 per share (or $0.53 per share, adjusted for subsequent stock splits) and closed trading that first day at $21.50 per share. In 2007, Starbucks' shares fell 50 percent as its United States sales slowed as both Dunkin' Donuts and McDonald's marketed low price coffee. However, by 2011, Starbucks was again a boomingly successful business.

In January 2011, Starbucks unveiled an alliance with India's flagship conglomerate—Tata Group. Tata is a wide-ranging company that owns everything from Jaguar cars to steel mills and tea plantations. Its Tata Coffee Ltd. Unit owns the Eight O'Clock Coffee Company in the United States. Starbucks Chairman Howard Schultz, in commenting on this alliance, suggested that India could one day rival China. He said one of the reasons for the alliance is to raise the profile and use of Indian premium Arabica beans in Starbucks stores elsewhere.

Internal Issues

Vision/Mission

Starbucks' vision is: "Starbucks is committed to ethically sourcing and roasting the highest quality Arabica coffee in the world. With stores around the globe, we are the premier roaster and retailer of specialty coffee in the world."

Starbucks' mission is: "To inspire and nurture the human spirit—one person, one cup, and one neighborhood at a time." The principles by which Starbucks operates are found in Exhibit 1, entitled "Starbucks Principles."

EXHIBIT 1 Starbucks Principles

Our Coffee

It has always been, and will always be, about quality.

We're passionate about ethically sourcing the finest coffee beans,
roasting them with great care,
and improving the lives of people who grow them.

We care deeply about all of this; our work is never done.

Our Partners

We're called partners, because it's not just a job, it's our passion.

Together, we embrace diversity to create a place where each of us can be ourselves.

We always treat each other with respect and dignity.

And we hold each other to that standard.

Our Customers

When we are fully engaged,

We connect with, laugh with, and uplift the lives of our customers—even if just for a few moments.

Sure, it starts with the promise of a perfectly made beverage, but our work goes far beyond that.

It's really about human connection.

Our Stores

When our customers feel this sense of belonging, our stores become a haven, a break from the worries outside, a place where you can meet with friends. It's about enjoyment at the speed of life—sometimes slow and savored, sometimes faster.

Always full of humanity.

Our Neighborhood

Every store is part of a community, and we take our responsibility to be good neighbors seriously. We want to be invited in wherever we do business. We can be a force for positive action—bringing together our partners, customers, and the community to contribute every day. Now we see that our responsibility—and our potential for good—is even larger. The world is looking to Starbucks to set the new standard, yet again. We will lead.

Our Shareholders

We know that as we deliver in each of these areas, we enjoy the kind of success that rewards our shareholders. We are fully accountable to get each of these elements right so that Starbucks—and everyone it touches—can endure and thrive.

Management

The founder of Starbucks, Howard Schultz, serves as the chairman of the board, president, and chief executive officer of the company. Exhibit 2 provides an organizational chart for the company. Starbucks employees are called "partners" and they are considered to be the heart of the "Starbucks Experience." Its store partners are committed to coffee knowledge, product expertise, and customer service.

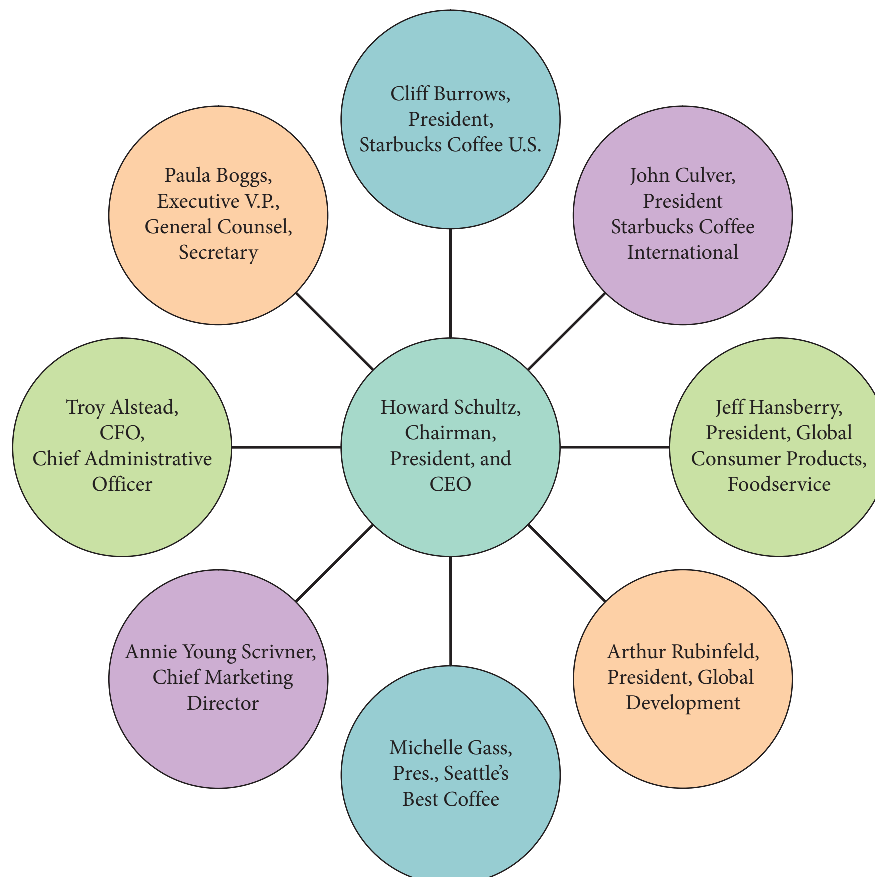
Products

Starbucks has as a primary goal—the delivery of the best coffee available. Operationally, that involves purchasing coffee grown under the highest standards of quality, using ethical trading and responsible growing practices. Starbucks' coffee buyers personally travel to coffee farms in Latin America, Africa, and Asia to select the highest quality Arabica beans. These beans represent 30 blends and single-origin premium Arabica coffees. When these beans arrive at their roasting plants, Starbucks experts bring out the balance and flavor of the beans through the trademark "Starbucks Roast."

Starbucks offers 100 percent Fair Trade Certified whole bean coffee from Rwanda as a limited edition coffee across the United Kingdom Starbucks. Starbucks has an ongoing investment of nearly $9 million in loans to farmers in East Africa, which helps more than 85,000 farmers develop their businesses.

Additional beverages served by Starbucks are hot and iced espresso beverages, coffee and noncoffee blended beverages, Vivanno Smoothies, and tea. The company's brand portfolio of beverages consists of Tazo tea, Ethos water, Seattle's Best coffee, and Torrefazione Italia coffee. Starbucks also sells related merchandise such as home espresso machines, coffee brewers and grinders, coffee mugs and accessories, packaged goods, music, books, and gift items. For customers desiring food items with their drinks, Starbucks provides baked pastries, sandwiches, salads, oatmeal, yogurt, parfaits, and fruit cups.

EXHIBIT 2 Starbucks Executives



On February 17, 2011, Starbucks signaled plans for further expansion in the single-serve coffee market by signing a deal with Courtesy Products, a provider of in-room coffee service to hotels. Starbucks had already made a foray into single-serve coffee in 2009 with the development of its VIA instant coffee. Because of the alliance with Courtesy Products, Starbucks coffee will now be available in as many as 500,000 luxury hotel rooms nationwide. Single-serve coffee is seen as attractive because it is still a relatively new market with big growth potential. Single-serve coffee pods rang up $180 million in sales at supermarkets, drug stores, and mass merchandisers, excluding Wal-Mart, Inc., in the 52 weeks ending October 3, 2010. Analyst Mitchell Pinheiro in commenting on Starbucks' chances of competing with Green Mountain's Keurig division, which produces home-brewing machines, suggested:

> While Starbucks could decide to launch its own brewer or partner with someone other than Keurig, the quickest and most effective way for Starbucks to gain traction in the single-cup coffee segment is through Keurig.[1]

Marketing

A Morgan Stanley study of people drinking coffee at least once a week recently showed that the average Starbucks customer earns over $75,000 per year, but 17 percent make less than $30,000. On Starbucks' 40th Anniversary in 2011, the company unveiled a new logo with no words entitled "Starbucks Logo." The newest logo drops the green band that says "Starbucks Coffee" and leaves the iconic mermaid/sea nymph all alone. In explaining why Starbucks is eliminating its name from the logo, CEO Schultz explained:

> This new evolution of the logo does two things that are very important: It embraces and respects our heritage, and at the same time evolves us to a point where we feel it's more suitable for the future…. What I think we've done is we've allowed her (the mermaid) to come out of the circle in a way that I think gives us the freedom and flexibility to think beyond coffee.

Starbucks has a credit card program called My Starbucks Rewards Program. Gold Level members earn a free drink after 15 purchases at participating Starbucks stores. Starbucks' cards are accepted at all company-owned stores and most licensed stores. Company-owned stores generate 84 percent of Starbucks' revenues worldwide.

Finance

Exhibits 3 and 4 provide Starbucks' recent income statements and balance sheets, respectively. Note the dramatic improvement from 2009, when the company closed 600 unprofitable stores in the United States. The net effect was that it closed more stores than it opened that year. Founder Howard Schultz said this decision was part of a plan to revitalize the chain, which was struggling during the recession, when consumers cut back their spending on expensive coffee.

By-Segment Financials

Starbucks operates within three segments or divisions: 1) USA, 2) International, and 3) Global Consumer Products Group. The company has both company-owned retail stores and licensed (called specialty) retail stores. Starbucks' international specialty operations are in nearly 40 countries, with special emphasis in Canada, the United Kingdom, and Japan. The company's Global Consumer Products Group includes packaged coffee and tea, Starbucks VIA Ready Brew, and other branded products sold in grocery stores and convenience stores. Starbucks' by-segment financials are provided in Exhibits 5, 6, 7, and 8.

Claims of Water Waste

Starbucks has been criticized by environmental experts for pouring millions of gallons of water down the drain at its coffee shops. The company has a policy of keeping a tap running nonstop at all of its outlets worldwide, which has been estimated to waste 6.2 million gallons a day. Critics suggest that amount would provide enough water for the entire two million population of

EXHIBIT 3 **Starbucks' Income Statements, 2008–2010 (in millions, except earnings per share)**

Fiscal Year Ended	Sep. 2010	Sep. 2009	Sep. 2008
Net Revenues			
Company-operated retail	$8,963.5	$8,180.1	$8,771.9
Specialty			
Licensing	1,340.9	1,222.3	1,171.6
Foodservice and other	403.0	372.2	439.5
Total specialty	1,743.9	1,594.5	1,611.1
Total net revenues	**10,707.4**	**9,774.6**	**10,383.0**
Cost of sales including occupancy	4,458.6	4,324.9	4,645.3
Store operating expenses	3,551.4	3,425.1	3,745.1
Other operating expenses	293.2	264.4	330.1
Depreciation & amortization	510.4	534.7	549.3
Gen. & admin. expenses	569.5	453.0	456.0
Restructuring charges	53.0	332.4	266.9
Total operating expenses	9,436.1	9,334.5	9,992.7
Income from equity investees	148.1	121.9	113.6
Operating income	$1,419.4	562.0	503.9
Interest income and other, net	50.3	36.3	9.0
Interest expense	(32.7)	(39.1)	(53.4)
Earnings before income tax	1,437.0	559.2	459.5
Income taxes	488.7	168.4	144.0
Net Earnings	**$948.3**	**$390.8**	**$315.5**
Per common share			
Net earnings—diluted	$1.24	$0.52	$0.43

EXHIBIT 4 **Starbucks' Balance Sheets, 2008–2010 (in millions, except per share data)**

	Sep. 2010	Sep. 2009	Sep. 2008
ASSETS			
Current Assets			
Cash and cash equivalents	$1,164.0	$599.8	$269.9
Accounts receivable, net	302.7	271.0	329.5
Inventories	543.3	664.9	692.8
Other current assets	746.4	500.1	455.9
Total current assets	2,756.4	2,035.8	1,748.0
Net fixed assets	2,416.5	2,536.4	2,956.4
Other noncurrent assets	1,213.0	1,004.6	968.2
TOTAL ASSETS	**$6,385.9**	**$5,576.8**	**$5,672.6**
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable	$282.6	$267.1	$324.9
Short-term debt	—	0.2	713.7
Other current liabilities	1,496.5	1,313.7	1,151.1
Total current liabs.	1,779.1	1,581.0	2,189.7
Long-term debt	549.4	549.3	549.6
Other noncurrent liabs.	382.7	400.8	442.4
TOTAL LIABILITIES	**$2,711.2**	**$2,531.1**	**$3,181.7**

	Sep. 2010	Sep. 2009	Sep. 2008
Shareholders' equity			
Preferred stock equity	—	—	—
Common stock equity	3,674.7	3,045.7	2,490.9
TOTAL EQUITY	**3,674.7**	**3,045.7**	**2,490.9**
TOTAL LIABILITIES and SE	**$6,385.9**	**$5,576.8**	**$5,672.6**
Shares outstanding (thousands)	740,100	742,900	730,600

Source: Company documents.

EXHIBIT 5 Starbucks' Company-operated and Licensed Retail Store Summary as of Oct. 3, 2010

	US	AS a % of Total US Stores	International	As a % of Total International Stores	Total	As a % of Total Stores
Company-operated stores	6,707	60%	2,126	37%	8,833	52%
Licensed stores	4,424	40%	3,601	63%	8,025	48%
Total	11,131	100%	5,727	100%	16,858	100%

Source: Starbucks' *Form 10k*, 2010, P.6.

EXHIBIT 6 Starbucks' Total Company-operated Retail Store Data for the Periods Indicated

	Net Stores Opened (Closed) During the Financial Year Ended		Stores Opened as of	
	Oct. 3, 2010	Sep. 27, 2009	Oct. 3, 2010	Sep. 27, 2009
	(57)	(474)	6,707	6,764
US International				
Canada	24	44	799	775
United Kingdom	(65)	2	601	666
China	29	13	220	191
Germany	(2)	13	142	144
Thialand	2	4	133	131
Others(2)	(3)	27	231	234
Total International	(15)	103	2,126	2,141
Total company-operated	(72)	(371)	8,833	8,905

Source: Starbucks' *Form 107*, 2010, P.6.

Store openings are reported net of closures. In the U.S., 13 and 121 Company-operated stores were opened during 2010 and 2009, respectively, and 70 and 595 stores were closed during 2010 and 2009 respectively.

EXHIBIT 7 Starbucks' Retail Sales Mix by Product Type for Company-operated

Financial year ended	Oct. 3, 2010	Sep. 27, 2009	Sep. 28, 2008
Beverages	75%	76%	76%
Food	19%	18%	17%
Whole bean and soluble coffees	4%	3%	3%
Coffee-making equipment and other merchandise	2%	3%	4%
Total	100%	100%	100%

Source: Starbucks' *Form 10K*, 2010, P. 7.

EXHIBIT 8 Starbucks' Total Licensed Retail Stores by Region and Country at Fiscal Year End 2010

Asia pacific		Europe/Middle East/Africa		Americas	
Japan	892	Turkey	137	U.S.	4,424
Greater China	525	U.K.	102	Canada	274
South Korea	315	United Arab Emirates	95	Mexico	283
Philippines	168	Spain	75	other	63
Malaysia	117	Saudi Arabia	69		
Indonesia	85	Knwait	66		
New Zealand	39	Greece	60		
		Switzerland	47		
		Russia	37		
		Others	152		
Total	2,141	Total	840	Total	5,044

Note: In the U.S., 166 and 286 licensed stores were opened during 2010 and 2009, respectively, and 106 and 251 stores were closed during 2010 and 2009, respectively. Internationally, 335 and 375 licensed stores were opened during 2010 and 2009, respectively, and 100 and 84 stores were closed during 2010 and 2009 respectively.

Source: starbucks' *Form 10K*, 2010, P.8.

drought-hit Namibia in Africa, or fill an Olympic-sized pool every 53 minutes. Every Starbucks branch has a cold tap behind the counter providing water for a sink called a "dipper well," which is used for washing spoons and utensils. This practice has angered environmentalist groups, who have applauded many of Starbucks' programs to protect the environment.

In response to these criticisms, the Starbucks website suggests that in 2009 they began implementing new alternatives to the dipper well system, which include water-saving technology in its equipment specifications. For example, the company states that its mechanical dishwashers in the U.S. company-owned stores use less than one gallon of water per cycle through high-pressure spray arms. Starbucks' stated goal is: "We're committed to reducing our water usage by 15 percent in company-owned stores by 2012."[2]

Competitors

Starbucks competes against whole bean and ground packaged coffees sold through supermarkets, club stores, and specialty retailers. Starbucks specialty operations face significant competition from established wholesale and mail-order suppliers. The company states that some of these have greater financial and marketing resources than they do. Starbucks also faces competition from both restaurants and other specialty retailers for prime retail locations and qualified personnel to operate both new and existing stores. Perhaps Starbucks' major competitor is Dunkin' Brands Group.

Dunkin' Brands, Inc.

Coffee, doughnuts, and ice cream are delicious at Dunkin' Brands, Inc. The company is a quick-service restaurant franchisor that operates both the Dunkin' Donuts and Baskin-Robbins chains. It has more than 16,000 franchise locations operating in about 55 countries. With some 9,800 units in about 30 countries (including approximately 6,800 in the United States), Dunkin' Donuts is the world's leading doughnut chain. Baskin-Robbins is a top ice cream and frozen snacks outlet with nearly 6,500 locations in 45 countries (2,500 in the United States).

Dunkin' Brands announced in May 2011 that the company will soon be going public. Dunkin' has focused intently on expanding throughout the world, opening its first store in India in February 2011. It's also expanded beyond the coffee-and-doughnuts menu in recent years, adding egg-white sandwiches to appeal to the health-conscious. Even though it was a private company, Dunkin' Brands released 2010 financial statements as a prelude to the company going public.

In fiscal 2010, Dunkin' Brands reported operating income of $193.5 million on sales of $577.1 million—an operating margin of nearly 34 percent. Dunkin' is a franchise-based business, which means that it doesn't take on the kind of capital risk some retailers do. And the franchisee economics are excellent: new stores opened in 2010 generated annualized revenues of $855,000, with capital expenditure costs of just $474,000. The fact that 90 percent of 2010 openings were made by existing franchisees suggests that it not only treats its partners well, but the majority of those partners are expanding their number of owned stores.

Dunkin' has international growth plans—from China to Russia to India—but there's still big opportunity in the United States. In New York and New England for example, there is a Dunkin' restaurant for every 9,700 people. In the western United States, that ratio stands at just one for every 1,193,000 folks.

For the first quarter of 2011, Dunkin' Brands lost $1.7 million, a big difference from $5.9 million in net income the year before. About 60 percent of Dunkin' Donuts stores' revenue comes from coffee drinks, which offer high profit margins because they're relatively cheap to make. Over the past several years, it has positioned itself as something of an "anti-Starbucks," a place to get a good cup of coffee at a low price. Dunkin' Brands is going public and will soon trade on the Nasdaq Global Select Market under the ticker "DNKN."

The Future

Starbucks' second quarter 2011 earnings reached $261.6 million, or 34 cents per share. That was an increase of 20.4 percent over the $217.3 million, 28 cents per share, reported a year ago. Starbucks' revenue rose 10.3 percent, to $2.79 billion, on a 7 percent increase in same-store sales. Starbucks says it expects full-year fiscal 2011 earnings-per-share in a range of $1.46 to $1.48. In that second quarter, Starbucks booked comparable same-store sales—or sales at stores open at least one year, a closely watched metric in the restaurant industry—with growth of 7 percent, driven by a 6 percent increase in traffic and a 1 percent increase in average ticket.

Starbucks reported excellent fiscal third quarter 2011 results that ended July 3, 2011. Company earnings were $279.1 million for the quarter, up from $207.9 million in the same quarter last year. Company revenue rose 12 percent to $2.93 billion, beating analysts' expectations. Starbucks is aggressively expanding abroad, reporting that revenue from its U.S. operations rose 9 percent to $2 billion while revenue from its international business rose 20 percent to $658.5 million in that fiscal third quarter. That quarter was the company's first full quarter with complete control over distribution of its consumer products after ending a contract with Kraft Inc. Revenue from that business unit rose more than 25 perent to $218.4 million as a result of the change. Starbucks plans to add 800 stores in the 2012 fiscal year.

Starbucks executives attributed the fiscal third quarter success to the company having upgraded the customer experience with new products and improved service. Fiscal third quarter revenue at Starbucks stores open at least a year rose 8 percent in North America and 5 percent internationally. This comparison is a key measure of a retailer's performance because it excludes stores that recently opened or closed. Also during the quarter, Starbucks announced it has acquired full ownership of its retail operations in Switzerland and Austria. This follows an agreement in May with joint-venture partner Maxim's Caterers Ltd. to buy its stores in Central, South and Western China in a broader strategy in which China will be its largest market outside the U.S. According to Starbucks' CEO Howard Schultz: "Starbucks has never been healthier, more connected to our customers and partners, or better positioned to go after the tremendous business opportunities that lie ahead." Analysts are reminded however that Dunkin Brands and McDonald's plan to gain and attract customers globally who otherwise may go to the pricier Starbucks stores.

CEO Schultz at Starbucks needs a clear strategic plan for the future. Help Mr. Schultz out in light of the many opportunities, threats, strengths, and weaknesses that face the company.

Notes

1. Julie Jargon. (February 17, 2011). "Starbucks Signs Deal for Hotel Coffee Machines," *Wall Street Journal*, p. B7.
2. http://www.starbucks.com/responsibility/environment/water.

Pearson PLC, 2013

www.pearson.com, PSORF or PSON (London exchange)

Headquartered in London, United Kingdom, Pearson is the largest education company and the largest book publisher in the world. Pearson is organized into three main business groupings: (1) Pearson Education (digital learning, education publishing and services including Poptropica and eCollege; (2) Financial Times (FT) Group (business information, including the *Financial Times* newspaper); and (3) Penguin Group (consumer publishing, including the Dorling Kindersley and Penquin Classics imprints). In late 2011, Pearson acquired Global Education and Technology Group. In 2012, Pearson acquired Certiport, Inc., Author Solutions, Inc. (ASI), and EmbanetCompass.

In late 2012, Pearson agreed to merge its Penguin Books division with Bertelsmann's Random House to create the world's biggest book publisher, a newly created joint venture named Penguin Random House. Bertelsmann will own 53 percent of the joint venture and Pearson will own 47 percent. The joint venture excludes Bertelsmann's trade publishing business in Germany and Pearson retains rights to use the Penguin brand in education markets worldwide. The newly formed company is subject to customary regulatory and other approvals but is expected to complete in the second half of 2013.

In October 2013, Harish Manwani joined the board of directors of Pearson. Harish is Chief Operating Officer of the global consumer products company Unilever. Harish is a graduate from Bombay University and holds a Masters degree in management studies. Pearson chairman Glen Moreno said: "Harish brings to Pearson a deep knowledge of emerging markets, an understanding of the rapidly growing middle class in those countries, and senior experience in a successful global organization. This background is very relevant to our transformation of Pearson into the world's leading learning company." Harish replaces Dr. Susan Fuhrman on the Pearson board; Susan is President of Teachers College, Columbia University. Pearson also recently announced another appointment to its board, Linda Lorimer, Vice President of Yale University.

History

Founded by Samuel Pearson in 1844, Pearson originally was a building and engineering firm operating under the name of *S. Pearson & Son*. In 1880, control passed to grandson Weetman Pearson, an engineer later known as Lord Cowdray, who in 1890 moved the business to London and turned it into one of the world's largest construction companies. Pearson was listed on the London Stock Exchange in 1969. Pearson acquired Penguin Books in 1970 and Ladybird Books in 1972.

During the 1990s, Pearson acquired a number of TV production and broadcasting assets and sold most of its nonmedia assets, under the leadership of future U.S. Congressman Bob Turner. Pearson acquired the education division of Simon & Schuster in 1998 from Viacom and merged it with its own education unit, Addison-Wesley Longman, to form Pearson Education.

In 2000, Pearson acquired National Computer Systems and entered the educational assessment and school management systems market in the United States. That same year, Pearson acquired Dorling Kindersley, the illustrated reference publisher and integrated it within Penguin. In 2006, Pearson acquired National Evaluation Systems, Inc. (NES; Amherst, MA), a provider of customized state assessments for teacher certification in the USA. Pearson completed the acquisition of Harcourt Assessment in 2008, merging the acquired businesses into Pearson Assessment & Information. In that same year, Pearson acquired eCollege, a digital learning technology group for $477M. In 2011, Pearson created the Pearson College, a British degree provider based in London and Manchester. Also that year, Pearson acquired Connections Education.

In late 2012, Pearson acquired KEV Group, the North American leader in the management and accounting of school activity funds and online payments. KEV Group's *School Cash Suite* of products manage all aspects of every dollar that comes into secondary schools. Whether cash, check, or an online transaction, KEV's products help more than 4,000 schools reduce fraud

and significantly decrease their workload. Limiting cash in a school system and increasing transparency of cash that does come in decreases the risk of bullying, reduces classroom distractions, and ensures maximum efficiency for all users.

Internal Issues

Vision and Mission

Pearson has no clearly stated vision or mission statement. However, there is a statement at the Pearson website, under the Strategy icon, that may be the firm's mission statement. It reads: "Pearson's goal is to help people make progress in their lives through learning. We aim to be the world's leading learning company, serving the citizens of a brain-based economy wherever and whenever they are learning."

Strategy

Pearson's strategy, as stated on the company website, consists of four initiatives, paraphrased as follows to focus on:

1. Long-term organic investment in content,
2. Digital products and services businesses—Add services to our content, usually enabled by technology; Pearson's digital revenues were £2bn or 33 percent of total sales.
3. International expansion—Pearson sells in more than 70 countries, but desires new particular emphasis on fast-growing markets in China, India, Africa and Latin America. In 2011, Pearson generated $1bn of revenue in developing markets for the first time, accounting for 11 percent of total sales and 22 percent of employees.
4. Efficiency—Pearson profit margins have increased to 16.1 percent and the ratio of average working capital to sales has improved from 20.1 percent to 16.9 percent.

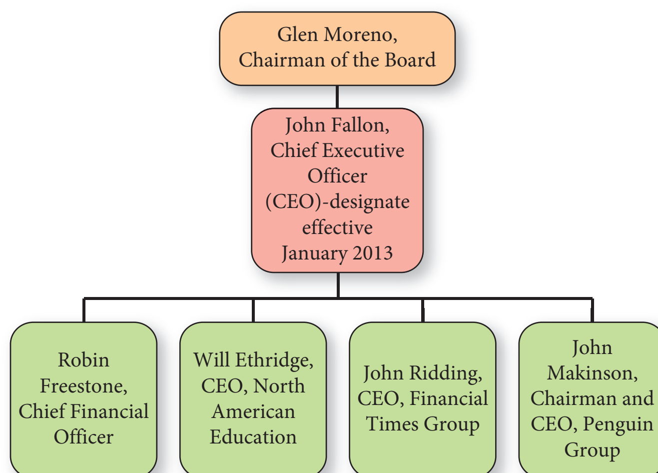
Organizational Structure

On the Pearson website, the top management team is listed under the Board of Directors icon. Pearson's organizational chart is provided in Exhibit 1. Chief executive officer (CEO) John Fallon replaced CEO Marjorie Scardino on January 1, 2013.

Segments

Pearson is organized into four main business groupings: (1) Pearson International Education, (2) Pearson North American Education, and (3) Professional Education and FT Group. In 2012 Pearson generated total revenues of £5.059 billion, as indicated in Exhibit 2. £2.658

EXHIBIT 1 Pearson's Organizational Structure



Source: Based on company documents.

EXHIBIT 2 Pearson's Segment

All figures in £ millions	North American Education	International Education	Professional	FT Group	Corporate	Discontinued operations	Group
	2012						
Continuing operations							
Sales (external)	2,658	1,568	390	443	—	—	5,059
Sales (inter-segment)	5	1	12	—	—	—	18
Adjusted operating profit	536	216	37	49	—	—	838
Intangible charges	(66)	(73)	(37)	(4)	—	—	(180)
Acquisition costs	(7)	(8)	(1)	(4)	—	—	(20)
Other net gains and losses	—	—	(123)	—	—	—	(123)
Operating profit	**463**	**135**	**(124)**	**41**	—	—	**515**

All figures in £ millions	North American Education	International Education	Professional Education	FT Group	Corporate	Discontinued Operations	Group
	2011						
Continuing operations							
Sales (external)	2,584	1,424	382	427	—	—	4,817
Sales (inter-segment)	3	—	9	—	—	—	12
Adjusted operating profit	493	196	66	76	—	—	831
Intangible charges	(57)	(60)	(11)	(8)	—	—	(136)
Acquisition costs	(2)	(9)	—	(1)	—	—	(12)
Other net gains and losses	29	(6)	—	412	—	—	435
Operating profit	**463**	**121**	**55**	**479**	—	—	**1,118**

billion were from North America, £1.568 billion from International, £390 million were from Professional, and £443 million from Financial Times (FT) Group—as indicated in Exhibit 2. Note in Exhibit 3 that Pearson had 2012 revenue declines in three regions, but sales were up in the USA slightly.

Pearson Education

Pearson Education provides textbooks and digital technologies to teachers and students across all ages. Pearson's education brands include Bug Club, Edexcel, Financial Times Publishing, Fronter, MyEnglishLab, and BBC Active. Pearson's education brands in North America include eCollege, Poptropica, FT Press, MyLabs/Mastering, SAMS Publishing, and Que Publishing. Pearson generates about 60 percent of its education sales in North America but operates in more than 70 countries. Pearson publishes across the curriculum under a range of brand names including Scott Foresman, Prentice Hall, Addison-Wesley, Allyn and Bacon, Benjamin Cummings, and Longman.

Pearson's Prentice Hall division is the market leader in higher education publishing across all discipline areas; Pearson's Addison Wesley and Benjamin Cummings are premier publishers in computing, economics, finance, mathematics, science, and statistics; Pearson's Longman brand focuses on materials in English, history, philosophy, political science, and religion; and Allyn and Bacon focuses on the social sciences, humanities, and education disciplines.

In 2013, Pearson Education reorganized into three main divisions: Pearson International Education, Pearson North American Education, and Professional Education. Pearson International is headquartered in London, with offices across Europe, Asia, and South America. Pearson North America is headquartered in Upper Saddle River, New Jersey, with major business units based

EXHIBIT 3 Pearson's Revenues By Region

	Sales	
All figures in £ millions	2012	2011
Continuing operations		
UK	705	713
Other European countries	391	394
USA	2,800	2,707
Canada	145	150
Asia Pacific	647	514
Other countries	371	339
Total continuing	**5,059**	**4,817**
Discontinued operations		
UK	160	152
Other European countries	78	77
USA	603	606
Canada	56	59
Asia Pacific	139	132
Other countries	17	19
Total discontinued	**1,053**	**1,045**
Total	**6,112**	**5,862**

in San Francisco, Boston, Columbus, Indianapolis, and Chandler (Arizona). In 2012, Pearson International Education had revenues of £1,568 million, Pearson North American Education had revenues of £2,658 million, and Professional Education had revenues of £443 million.

The North American segment had 2012 operating profits of £536 million. Student registration for MyLab grew 11 percent to almost 10 million. Student registrations in 2012 at Pearson's eCollege grew 3 percent to 8.7 million. Also in North America, Pearson's Connection Education, which operates online K-12 schools in 22 states, served more than 43,000 students, up 31 percent from 2011.

Pearson's International Education segment reported 2012 operating profits of £216 million, partly due to student enrollments in China at Wall Street English (WSE), increasing 15 percent to 61,000. WSE is Pearson's worldwide chain of English language centers for professionals with 11 new WSE centers opened in 2012. Pearson did especially well in 2012 in India with its TutorVista program and in Mexico with the launch of UTEL, a new university enabling Mexicans to enroll in online business courses. Also in the International segment, Pearson VUE test volumes grew 7 percent in 2012 to almost 8 million.

Financial Times Group

The FT Group provides business and financial news, data, comment, and analysis in print and online. FT Publishing includes: the *Financial Times* newspaper and FT.com website; a range of specialist financial magazines and online services; and Mergermarket, a financial data vendor. The FT Group also has shareholdings in *Business Day* and *Financial Mail* (BDFM) of South Africa (50 percent stake) and *The Economist* (50 percent stake). Pearson's FT group reported 2012 operating profits of £49 million, with digital subscriptions increasing 18 percent to almost 316,000 and with 3.5 million FT web app users. The *Economist* (50% owned by Pearson) reported in 2012 a 2 percent increase in worldwide printed digital circulation.

Penguin Group

Penguin Group is an international consumer publisher, which includes imprints such as Allen Lane, Avery, Berkley Books, dial, Dutton, Dorling Kindersley, Grosset & Dunlap, Hamish Hamilton, Ladybird, Plume, Puffin, Penguin, Putnam, Michael Joseph, Riverhead, rough Guides, and Viking. Penguin publishes around 4,000 titles every year and its range of titles

includes classics, reference volumes, and children's titles. In October 2012, Pearson agreed to merge Penguin Group with Bertelsmann's Random House to create the world's biggest trade book publisher—Penguin Random House. Bertelsmann will own 53 percent and Pearson will own 47 percent. Penguin reported 2012 revenue of £1,053 million and operating profits of £98 million. E-book revenue grew strongly and accounted for 17 percent of Penguin's global revenue.

Pearson now owns 47 percent of the new Penguin/Random House publishing company. In 2012, Penguin published 255 *New York Times* bestsellers.

Finance

Note in the income statements in Exhibit 4 that Pearson reported increasing revenues but declining profits in 2012. The decline in earnings resulted in a decline in 2012 retained earnings on the Pearson balance sheets, as shown in Exhibit 5.

External

Total U.S. college enrollments declined 2 percent in 2012 while the overall higher education publishing market declined 6 percent, according to the Association of American Publishers (AAP). AAP also reported a 15 percent decline in the textbook publishing market in 2012.

Competitors

The world of book publishing is changing rapidly as e-books, renting books, sharing books, avoiding books, photocopying books, scanning books, creating custom books, using e-readers

EXHIBIT 4 Pearson's Income Statements

Year ended 31 December 2012		
All figures in £ millions	2012	2011
Sales	5,059	4,817
Cost of goods sold	(2,224)	(2,072)
Gross profit	2,835	2,745
Operating expenses	(2,216)	(2,072)
Profit on sale of associate	—	412
Loss on closure of subsidiary	(113)	—
Share of results of joint ventures and associates	9	33
Operating profit	515	1,118
Finance costs	(113)	(96)
Finance income	32	25
Profit before tax	434	1,047
Income tax	(148)	(162)
Profit for the year from continuing operations	286	885
Profit for the year from discontinued operations	43	71
Profit for the year	329	956
Attributable to:		
Equity holders of the company	326	957
Non-controlling interest	3	(1)
Earnings per share for profit from continuing and discontinued operations attributable to equity holders of the company during the year (expressed in pence per share)		
Basic	40.5p	119.6p
Diluted	40.5p	119.3p

EXHIBIT 5 Pearson's Balance Sheets

As of 31 December 2012

All figures in £ millions	2012	2011
Assets		
Non-current assets		
Property, plant and equipment	327	383
Intangible assets	6,218	6,342
Investments in joint ventures and associates	15	32
Deferred income tax assets	229	287
Financial assets–Derivative financial instruments	174	177
Retirement benefit assets	—	25
Other financial assets	31	26
Trade and other receivables	79	151
	7,073	7,423
Current assets		
Intangible assets–Pre-publication	666	650
Inventories	261	407
Trade and other receivables	1,104	1,386
Financial assets–Derivative financial instruments	4	—
Financial assets–Marketable securities	6	9
Cash and cash equivalents (excluding overdrafts)	1,062	1,369
	3,103	3,821
Assets classified as held for sale	1,172	—
Total assets	**11,348**	**11,244**
Liabilities		
Non-current liabilities		
Financial liabilities–Borrowings	(2,010)	(1,964)
Financial liabilities–Derivative financial instruments	—	(2)
Deferred income tax liabilities	(601)	(620)
Retirement benefit obligations	(172)	(166)
Provisions for other liabilities and charges	(110)	(115)
Other liabilities	(282)	(325)
	(3,175)	(3,192)
Current liabilities		
Trade and other liabilities	(1,556)	(1,741)
Financial liabilities–Borrowings	(262)	(87)
Financial liabilities–Derivative financial instruments	—	(1)
Current income tax liabilities	(291)	(213)
Provisions for other liabilities and charges	(38)	(48)
	(2,147)	(2,090)
Liabilities directly associated with assets classified as held for sale	(316)	—
Total liabilities	**(5,638)**	**(5.282)**
Net assets	**5,710**	**5,962**

(continued)

EXHIBIT 5 Continued

All figures in £ millions	2012	2011
Equity		
Share capital	204	204
Share premium	2,555	2,544
Treasury shares	(103)	(149)
Translation reserve	128	364
Retained earnings	2,902	2,980
Total equity attributable to equity holders of the company	**5,686**	**5,943**
Non-controlling interest	24	19
Total equity	**5,710**	**5,962**
Total Liabilities and Equity	**11,348**	**11,244**

permeate today's publishing landscape. The historical day of students carrying around encyclopedic size books is drawing to an end. Although great news for students and customers, this changing environment makes book publishing much more risky for both publishers and authors.

The situation described leads to increased competition daily on many fronts such as price, e-commerce, new entrants, ancillary offerings, acquisitions, divestitures, and weakened players. A few of Pearson's major rivals in this turbulent environment are McGraw-Hill, John Wiley, Houghton Mifflin, and Thomson Reuters, but even online book publishers such as iUniverse are attacking from new directions. Pearson is the largest and most profitable book publisher, which in a sense makes Pearson most vulnerable to competitor's duplicating and imitating their product offerings, and continually examining Pearson for potential weaknesses that can be exploited.

A financial comparison of each rival firm is provided in Exhibit 6, followed by a brief overview of each firm. Note in Exhibit 4 that Pearson's earnings per share (EPS) is lower than both McGraw-Hill and John Wiley.

McGraw-Hill Companies, Inc. (NYSE: MPH)

Headquartered in New York City, McGraw-Hill is a leading producer of textbooks, tests, and related materials, serving the elementary, secondary, and higher education markets through McGraw-Hill Education (MHE). Other businesses include S&P Ratings (indexes and credit ratings); S&P Capital IQ and S&P Indices (financial and business information); and Commodities and Commercial (Platts, J.D. Power and Associates, McGraw-Hill Construction, and Aviation Week).

EXHIBIT 6 A Comparison of Publishers

	Pearson	McGraw-Hill	John Wiley	Thomson Reuters
Sales ($)	5.09B£	6.35B	1.75B	13.45B
Net Income ($)	329M£	789M	190M	–877M
Profit Margin (%)	6.46	13.01	10.89	–6.45
Debt-to-Equity Ratio	0.41	0.67	0.64	0.43
EPS ($)	0.40£	3.03	3.14	–1.06
Market Capitalization ($)	10.6B£	14.97B	2.27B	23.83B
Number of Shares Out	817M	277M	60.15M	826M

EPS, earnings per share.
Source: Based on company documents.

McGraw-Hill announced in late 2012 that it is divesting its education division for $2.5 billion to Apollo Global Management LLC (APO). McGraw-Hill's education division had been reporting shrinking revenues over recent years, partly as a result of reduced spending on textbooks by the government (and students). Also, McGraw-Hill was facing difficulty with its plans to develop its education division into a subscription-based model through digital delivery. The new McGraw-Hill, without the education division, is being renamed McGraw-Hill Financial and will primarily focus on capital and commodities markets and include iconic brands like S&P Ratings, S&P Capital IQ, and S&P Indices. McGraw-Hill Companies expected revenues of approximately $4.4 billion from McGraw-Hill Financial in 2012, with approximately 40 percent of it coming from international avenues.

John Wiley & Sons (NYSE: JW-A)

Headquartered in Hoboken, New Jersey, John Wiley publishes scientific, technical, and medical works, including journals and reference works such as *Current Protocols* and *Kirk-Othmer Encyclopedia of Chemical Technology*. Wiley publishes more than 1,600 journal titles, produces professional and nonfiction trade books, and is a publisher of college textbooks. Wiley also publishes the *For Dummies* how-to series, the travel guide brand Frommer's, and CliffsNotes study guides, as well. Wiley has publishing, marketing, and distribution centers on four continents: North America, Europe, Asia, and Australia. For second quarter of 2012 that ended October 31, 2012, Wiley reported a slight decline in revenue compared to the same period in the previous fiscal year, and a 15-percent decrease in net income. Wiley has a market capitalization of $2.3 billion.

Houghton Mifflin Harcourt Publishing Company

Headquartered in Boston Massachusetts, Houghton Mifflin is a publisher of pre-K through grade 12 educational material, as well as textbooks and printed materials. The company provides digital content online and via CD-ROM and publishes fiction (including J. R. R. Tolkien's *The Lord of the Rings* series), as well as nonfiction titles and reference materials, and offers professional resources and educational services to teachers. Although founded back in 1832, Houghton Mifflin today is owned by private-equity concerns, including hedge fund Paulson & Co. The company filed for bankruptcy in 2012.

Thomson Reuters (NYSE: TRI)

Headquartered in New York City, Thomson Reuters is the market leader in financial data (ahead of rival information provider Bloomberg), providing electronic information and services to businesses and professionals worldwide, serving the financial services, media, legal, tax and accounting, and science markets. Nearly all Thomson Reuters' revenues come from subscription sales to its plethora of offerings.

For the third quarter of 2012, Thomson Reuters reported revenues of $3.2 billion, a 7-percent decline from the same period last year. Its net profit rose, however, by 24 percent, to $474 million. Thomson Reuters' best performing division is tax and accounting, but the firm reports flat or declining revenues in all its other divisions. Rumors circulated in 2012 that Thomson Reuters was maneuvering to buy Pearson's *Financial Times* newspaper.

The Future

The digital world is rapidly eroding Pearson's traditional book publishing business model. Luyen Chou, chief product officer for Pearson's K–12 technology group, summed it up best, when he recently said: "Pearson needs to become an 'Electronic Arts' [EA] for education. To keep up with the changing environment, we can't just digitize the static textbooks of the past; we need to excel at producing high-quality, interactive digital learning experiences and get them into the hands of students. That includes digital studios, animators, illustrators, producers, and 3-D artists. We need to build that capacity from within and we need the whole supply chain to take that from the studio to the actual users. The folks that have done that well are the Electronic Arts type companies of the world, digital studios. That's not a core competency for companies like Pearson. We have to make sure that we're complementing our data and platform with high-quality interactive learning content."

In late 2012, Blackboard Inc. and Pearson reached an agreement to expand the availability of Pearson's leading learning solution—MyLab & Mastering—with Blackboard Learn, the market-leading learning management system (LMS). Previously available in North America, the integration is now available in most markets worldwide.

The systems integration includes state-of-the-art web services that enable instructors to find and access MyLab & Mastering within their Blackboard learning system. For example, faculty can synchronize grade books, transfer information and create corresponding links in both systems, and customize courses by choosing content and rearranging items in the content area and course navigation bar. For example, Dr. Salim M. Salim, head of the Mathematics Department at Qatar University said: "The integration of MyLab & Mastering and Blackboard Learn has created not only a more enriched teaching and learning experience, but it also makes my job much more convenient. The single sign on, grade book synchronization, personalized study paths and real-time evaluations allow me and my students to easily benefit from the powerful tools both systems offer."

Given the changing world of textbook publishing and publishing in general, Pearson is engaged is a competitive fight with rival McGraw-Hill for market share in the USA and indeed globally. McGraw-Hill's Connect software competes fiercely with Pearson's MyLab. Prepare a three-year strategic plan for Pearson.

Bayerische Motoren Werke (BMW) Group, 2013

www.bmwgroup.com, BMW.DE

Headquartered in Munich, Bavaria, Germany, BMW Group is a world famous German automobile-, motorcycle-, and engine-manufacturing company. In June 2012, BMW was listed in *Forbes* magazine as the number-one most reputable company in the world. Rankings were based on aspects such as "people's willingness to buy, recommend, work for, and invest in a company." The rankings were based 60 percent on public perceptions of the company and 40 on public perceptions of their products.

BMW owns and produces the Mini marque and is the parent company of Rolls-Royce Motor Cars. BMW produces motorcycles under the Motorrad and Husqvarna brands led by the K 1200 GT, R 1200 RT, and F 800 S models. BMW Group operates 29 production and assembly facilities in 14 countries and has a global dealer network in more than 140 countries. BMW's premium lineup includes sedans, coupés, convertibles, and sport wagons in the 1, 3, 5, 6, and 7 Series, as well as the M3 coupe and convertible, the X5 sport active, and the Z4 roadster. BMW has a profitable financial services segment that provides purchase financing and leasing, asset management, dealer financing, and corporate fleets. About 3,000 dealers worldwide sell BMWs.

In calendar year 2012, BMW Group sold 1.85 million cars and nearly 117,000 motorcycles worldwide, the highest annual total ever for the company and an increase of 10.6 percent over the previous record year in 2011. BMW sales in the month of January 2013 were the highest ever in a January for the company; sales grew 11.5 percent to 107,276 units and it was the first time that more than 100,000 BMW vehicles were delivered worldwide to customers in that month.

In early 2013, BMW Group and Toyota Motor Corporation extended their long-term collaboration agreement for the joint development of a fuel-cell system, joint development of architecture and components for a sports vehicle, joint research and development of lightweight technologies, and collaborative research on lithium-air batteries with a post-lithium-battery solution. BMW Group had a workforce of approximately 105,000 employees.

BMW Group reported the best-ever May 2013 sales with 166,397 BMW, MINI, and Rolls-Royce automobiles delivered to customers worldwide, up 5.8 percent from the previous May. BMW Motorrad also had a successful May 2013 with sales up 14.2 percent to 13,081 vehicles delivered. However, in August 2013, BMW customers around the world were complaining intensely about not being able to obtain spare parts for their BMW. The world's biggest maker of luxury cars, BMW has struggled from June to September 2013 to ship components on time because of a new supply-management system being introduced in its central warehouse in Germany. BMW's 40 parts-distribution centers originate at the main warehouse in Dingolfing that also directly supplies about 300 repair shops in Germany. Raimund Nestler—who lives in Ingolstadt, Germany, the home base of rival Audi AG (NSU)—has been waiting six weeks for a new part that controls engine speed. "I have always been a die-hard BMW driver and am currently driving my seventh BMW, but will consider which brand I'll buy the next time," he said by phone. "For a premium carmaker like BMW, this is particularly disappointing." BMW's stock has declined 2.5 percent in 2013 through August, valuing the company at 45.7 billion euros ($61 billion).

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History

BMW was established in 1917 following a restructuring of the Rapp Motorenwerke aircraft manufacturing company. At the end of World War I, BMW was forced to cease aircraft engine production by the terms of the Versailles Armistice Treaty. The company shifted to motorcycle production in 1923 and once the restrictions of the treaty started to be lifted, began producing automobiles in 1928–1929. The first car produced by BMW was the Dixi, a vehicle whose design was based on the Austin 7, from the Austin Motor Company in Birmingham, England.

BMW's circular blue and white logo, or roundel, evolved from the circular Rapp Motorenwerke logo, but as BMW grew, that emblem was combined with the blue and white colors of the flag of Bavaria. The BMW logo has also been portrayed as the movement of an aircraft propeller with the white blades cutting through a blue sky—first used in a BMW advertisement in 1929, 12 years after the roundel was created.

BMW's first significant aircraft engine was the BMW IIIa inline-six liquid-cooled engine of 1918, much preferred for its high-altitude World War I performance. With German rearmament in the 1930s, the company again began producing aircraft engines for the Luftwaffe. Especially successful World War II aircraft engines were the BMW 132 and BMW 801 air-cooled radial engine, and eventually the BMW 003 axial-flow turbojet that powered Germany's 1944- and 1945-era jets, such as the Heinkel He 162 and eventually the Messerschmitt Me 262.

After outselling Lexus in 2011 and 2012, BMW and Mercedes are vying to be the top luxury auto brand in the USA. Lexus was the top-selling luxury car brand in the USA from 1999 to 2010. Sales of the Toyota Lexus rose 32 percent to 16,211 in January 2013, led by the ES sedan, which more than doubled to 5,186 deliveries.

Internal Issues

Year 2012

In calendar year 2012, BMW sales rose 11.6 percent to 1,540,085 vehicles, the best sales level in the history of the company. Success was led by the highly successful BMW 1 Series, with a total of 226,829 vehicles sold in 2012, an increase of 28.6 percent over the previous year. The BMW X1 also did great in 2012 with a total of 147,776 vehicles sold, up 16.9 percent over the prior year. The BMW 3 Series Sedan did best with 294,039 vehicles delivered, an increase of 22.4 percent over 2011. Sales of the BMW X3 grew 27.1 percent to 149,853 units sold, whereas the BMW 5 Series reported that 337,929 vehicles were delivered to customers in 2012, up 9.0 percent from the prior year. Even sales of the BMW 6 Series grew 146.8 percent, with 23,193 vehicles being delivered to customers.

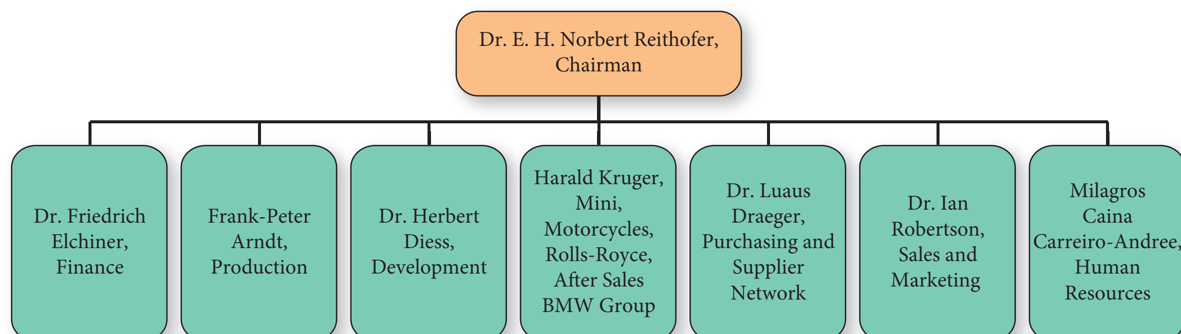
Also for 2012, global sales of the BMW MINI were a record 301,526 vehicles, up 5.8 percent. The USA remained the largest market for the MINI, with a record-breaking 66,123 cars sold in 2012, followed by the United Kingdom, with 50,367 cars sold. In the ultra-luxury-class segment, Rolls-Royce sales for the full year 2012 reached record sales result of 3,575 motor cars, the highest annual sales in the 108-year history of Rolls-Royce and the third consecutive record.

Additionally, a record total of 106,358 BMW Motorrad motorcycles were sold in 2012.

Organizational Structure

BMW operates using an autocratic, functional structure with no apparent Chief Executive Officer or Chief Operations Officer and divisional presidents. As indicated in Exhibit 1, if executives with these titles exist, they are neither listed on the corporate website nor in the *Annual Report*.

EXHIBIT 1 BMW's Organizational Structure



Source: Based on company documents

Segments

BMW reports their revenues by region and by brand and is doing exceptionally well in all regions and brands. For example, BMW reported its strongest January ever as sales climbed 11.5 percent to 107,276 units for January 2013, the first time ever that more than 100,000 BMW vehicles were delivered worldwide to customers in a January. There were 29,053 BMW 3 Series sold, up 27.9 percent, as well as 11,753 BMW X1 vehicles sold, up 57.8 percent. The BMW X3 continued to be popular with 10,230 vehicles delivered to customers, up 9.4 percent. Sales of the BMW 1 Series were up 8.8 percent to 14,222 units sold, and the BMW 5 Series sales grew 6.4 percent to 23,049. Sales of the BMW 6 Series grew 22.4 percent to 1,354 units. Also in January 2013, worldwide sales of the MINI reached 15,864 vehicles, up 0.6 percent, which was a new all-time high for any January ever.

As indicated in Exhibits 2 and 3, BMW's sales in January 2013 increased in all regions and all brands, except Motorrad motorcycles. Despite BMW's record January 2013, rival Audi (owned by Volkswagen AG) beat BMW in 2013 luxury-car market January sales, propelled by a 39-percent jump in Audi deliveries in China, its biggest national market. Audi sold 111,750 cars and sport utility vehicles (SUVs) worldwide in January, a 16-percent increase from a year prior, compared to BMW brand's 12-percent gain to 107,276 deliveries. Global sales at Mercedes (owned by Daimler AG) rose 9 percent in January 2013 to 94,895 vehicles, helped by demand for the A- and B-class compacts and its SUV line-up.

Exhibit 4 reveals BMW's 2012 year-end segment data by region for automobiles. Note the 2.8 percent decline in motorcycle revenues, and the decline in United Kingdom revenues.

EXHIBIT 2 BMW's January 2013 Sales by Region (units sold)

	2013	2012	Change (%)
Asia	43,114	36,422	+ 18.4
China	30,397	26,505	+ 14.7
Japan	3,250	—	+ 19.0
South Korea	2,790	—	+ 32.9
Americas	25,021	24,419	+ 2.5
United States	20,195	19,739	+ 2.3
Europe	50,594	46,831	+ 8.0
Germany	18,709	17,028	+ 9.9
Russia	2,311	1,653	+ 39.8
Africa*	37,649	32,890	+ 14.5
Oceania*	23,000	21,297	+ 8.0

*For all of 2012
Source: Based on company documents.

EXHIBIT 3 BMW's January 2013 Sales by Brand (units sold)

	2013	2012	Change (%)
BMW Group Automobiles	123,276	112,164	+ 9.9
BMW	107,276	96,184	+11.5
MINI	15,864	15,768	+ 0.6
BMW Motorrad	4,818	5,237	– 8.0
Husquarna Motorcycles	587	544	+ 7.9

Source: Based on company documents.

EXHIBIT 4 BMW's Revenues By Segment

Revenues in € million	2012	2011
Automobiles	50,165	46,681
Motorcycles	980	1,008
Other revenues	7,660	7,318
	58,805	55,007
Germany	11,974	12,494
United Kingdom	4,059	4,061
Rest of Europe	12,303	12,766
North America	12,991	10,903
Asia	14,436	12,042
Other markets	3,042	2,741
	58,805	55,007

Source: Company documents.

Finance

Exhibit 5 shows the income statement for BMW Group.

EXHIBIT 5 BMW's Income Statements

(in € million)	2012	2011
Revenues	58,805	55,007
Cost of sales	–46,252	–43,320
Gross profit	**12,553**	**11,687**
Selling expenses	–3,684	–3,381
Administrative expenses	–1,701	–1,410
Research and development expenses	–3,573	–3,045
Other operating income and expenses	703	670
Result on investments	598	181
Financial result	–99	–665
Profit from ordinary activities	**4,797**	**4,037**
Extraordinary income	—	29
Income taxes	–1,635	–2,073
Other taxes	–31	–23
Net profit	**3,131**	**1,970**
Transfer to revenue reserves.	–1,491	–462
Unappropriated profit available for distribution	**1,640**	**1,508**

Source: Company documents

EXHIBIT 6 BMW's Balance Sheets

(in € million)	2012	2011
Assets		
Intangible assets	178	161
Property, plant and equipment	7,806	6,679
Investments	3,094	2,823
Tangible, intangible and investment assets	**11,078**	**9,663**

EXHIBIT 6 Continued

(in € million)	2012	2011
Inventories	3,749	3,755
Trade receivables	858	729
Receivables from subsidiaries	6,297	5,827
Other receivables and other assets	2,061	1,479
Marketable securities	2,514	3,028
Cash and cash equivalents	4,618	2,864
Current assets	**20,097**	**17,682**
Prepayments	118	120
Surplus of pension and similar plan assets over liabilities	672	43
Total assets	**31,965**	**27,508**
Equity and liabilities		
Subscribed capital	656	655
Capital reserves	2,053	2,035
Revenue reserves	5,515	4,024
Unappropriated profit available for distribution	1,640	1,508
Equity	**9,864**	**8,222**
Registered profit-sharing certificates	32	32
Pension provisions	56	84
Other provisions	7,406	7,651
Provisions	**7,462**	**7,735**
Liabilities to banks	1,408	911
Trade payables	3,900	2,940
Liabilities to subsidiaries	8,451	6,923
Other liabilities	800	741
Liabilities	**14,559**	**11,515**
Deferred income	48	4
Total equity and liabilities	**31,965**	**27,508**

Source: Based on company documents.

Competitors

The combined sales for Toyota's Lexus, Daimler's Mercedes-Benz, BMW, Honda's Acura, GM's Cadillac, Volkswagen's Audi, and Nissan's Infiniti, which are the seven best-selling luxury brands automobiles in the world, rose 15 percent in the USA in 2012 through November. Growth in sales of luxury vehicles exceeds growth in all other automobile categories, and these brands are fiercely competitive globally.

Exhibit 7 provides a financial summary of leading luxury-car manufacturers. Note that BMW is the smallest firm in terms of number of employees, but it has the second highest earnings per share (EPS).

Volkswagen

Headquartered in Wolfsburg, Lower Saxony, Germany, Volkswagen (VW) is the largest German automobile manufacturer and the second- or third-largest automaker in the world behind GM or Toyota. The word *volkswagen* means "people's car" in German and is pronounced *folks wagen*. VW aims to double its U.S. market share from 2 percent to 4 percent by 2014 and aims to be the world's largest carmaker by 2018. VW introduced diesel-electric hybrid versions of its most popular models in 2012, including the Jetta, followed by the Golf Hybrid and the Passat. VW also owns Porsche.

Mercedes-Benz

Headquartered in Stuttgart, Baden-Wuttemberg, Germany, Mercedes-Benz is a division of the German automobile manufacturer Daimler AG. Mercedes-Benz is active in three forms of motorsport racing: Formula Three, DTM, and Formula One. The parent, Daimler AG, holds

EXHIBIT 7 A Financial Comparison of BMW with Rival Firms (in U.S. dollars)

	BMW	VW	Daimler	GM	Toyota	Nissan
Revenue ($)	76.1B	251B	153B	151B	243B	102B
Net Income ($)	5.1B	30B	7.5B	4.5B	8.3B	3.3B
Profit Margin (%)	6.65	11.9	4.9	3.0	3.4	3.2
Debt-to-Equity Ratio	1.47	1.24	1.85	0.40	1.15	1.45
EPS ($)	7.27	12.82	7.03	2.67	2.60	0.79
Number of Employees	106K	549K	275K	213K	325K	157K
Revenue per Employee ($)	717K	457K	556K	708K	747K	680K

EPS, earnings per share.
Source: Based on company information.

a 60 percent stake in Formula One team Mercedes-Benz Grand Prix, as well as a 22 percent stake in aerospace and defense consortium EADS. Daimler sells its vehicles in 40 countries, but Europe represents 40 percent of its sales.

Mercedes-Benz's U.S. sales surged 11 percent in January 2013, in its effort to overtake BMW in luxury-auto deliveries for all of 2013. Mercedes sold 22,501 vehicles in January 2013, its best January ever, and helped the C-Class sedan's 11 percent climb to 7,214 units sold. In comparison, sales for BMW increased 0.7 percent to 16,513 units, boosted by a 56 percent gain for its X5 SUV.

Toyota Motor Corporation

Headquartered in Toyota, Aichi, Japan, Toyota runs neck and neck with GM as the largest automobile company in the world. Toyota's U.S. operations are headquartered in Torrence, California. Popular Toyota models include the Camry, Corolla, Land Cruiser, and Lexus, as well as the Tundra truck. The Lexus competes directly with BMW. Lexus sales were up 23 percent in the USA in 2012 through November and are expected to gain at least 10 percent in 2013.

Volvo Car Corporation

Headquartered in Gothenburg, Sweden, Volvo, or *Volvo Personvagnar AB*, is owned by Zhejiang Geely Holding Group China, headquartered in Hangzhou, China. Geely acquired Volvo in 2010 from Ford Motor Company. Volvo manufactures and markets a wide range of vehicles, some that compete with BMW. With approximately 2,300 local dealers from around 100 national sales companies worldwide, Volvo's largest markets are the USA, Sweden, China, Germany, the United Kingdom, and Belgium. In 2011, Volvo recorded global sales of 449,255 cars, an increase of 20.3 percent compared to 2010. In 2012, Volvo signed NBA star Jeremy Lin to an endorsement agreement. Over the next two years Lin will participate in Volvo's corporate and marketing activities as a "brand ambassador" for Volvo.

Audi

Headquartered in Ingolstadt, Bavaria, Germany, Audi Aktiengesellschaft (Audi) designs, engineers, manufactures, and markets automobiles and motorcycles. Audi-branded vehicles are produced in seven production facilities worldwide. AUDI AG has been a majority owned (99.55 percent) subsidiary of VW since 1966. In September 2012, Audi began construction of its first North American manufacturing plant in Puebla, Mexico, expected to be operative in 2016 and produce the successor to the Q5.

In 2012, Audi again won the 24 Hours of Le Mans, a historic first Le Mans victory for a hybrid, which was captured by Audi's R18 e-tron quattro. Audi's other R18 hybrid took second, whereas R18 ultras took third and fifth. This sports car racing success followed Audi R18's victory at the 2011 24 Hours of Le Mans. The Audis finished in front of three Peugeot 908s by 13.8 seconds to claim victory.

Audi offers a computerized control system for its cars, called multimedia interface (MMI). This advancement came amid criticism of BMW's iDrive control, a rotating control knob and "segment" buttons—designed to control all in-car entertainment devices (radio, CD changer,

iPod, TV tuner), satellite navigation, heating and ventilation, and other car controls with a screen. Some believe MMI is a considerable improvement on BMW's iDrive, although BMW has since improved their iDrive.

Business Culture in Germany

Germany survived the 2008 recession in good position thanks to their strong economy and manufacturing base. Unemployment in Germany is lower now than it was in 2008. German companies are generally run by individuals specializing in various technical areas. For example, a car company is more likely to be run by an expert mechanical engineer in Germany than an expert accountant or finance individual. This technical nature often extends down the chain of command for other key positions as well. For example, responsibility is often delegated to another technically sound individual, who then expects his or her manager to leave them alone to perform the task with little oversight. People from other cultures often view this approach as distant and cold. In addition, socializing is much more common at the peer level than up or down the hierarchy in Germany.

Meetings in Germany generally start on time with all members in attendance having well researched any aspects of the meeting that touch on their area of expertise. It is often assumed by people outside Germany that "German businesspeople have their minds made up before the meeting even starts," but this is not the case. Germans take a sense of pride in their subject matter and want to be as well prepared as possible, so they can contribute and make key points during the meeting. During a meeting, it is expected that individuals will contribute when the discussion touches on their area of expertise. This is an overriding theme in German business, where well-prepared specialists are groomed and preferred to generalists. This line of thinking also extends into teamwork in Germany. Each team member answers to the leader, but each tends to focus on his or her individual technical task, with little overlapping conversations, at least in technical nature, with other team members.

Communication in Germany tends to be direct and to the point. Supervisors tend not to sugarcoat their reviews or requirements for subordinates, instead informing them in direct words their performance reviews, expectations, and so forth. In addition, when interviewing a German worker for a job, they will tend to describe in clear terms what they are capable of doing, rather than speaking in vague terms like in other cultures. German workers tend not to oversell themselves in an interview; if they claim they are capable of a task, you can generally bet they are capable.

Dress in Germany is professional but not as clearly defined as in the United Kingdom, USA, or many Asian nations. Women often wear dress pants, rather than dresses or skirts, and men often wear sport jackets, as opposed to black or blue suits. Despite having a woman president as leader of Germany, women in Germany still lag behind women in other European nations in securing top-level management opportunities, partly because women are not majoring in the technical fields as commonly as men; senior-level jobs generally go to individuals heavily trained in key technical areas.

The Future

China overtook the USA in 2012 as BMW's biggest international market, with the company's sales in China rising 14 percent to 28,597 automobiles and motorcycles. "Looking ahead, we expect the headwinds in Europe to remain," said Ian Robertson, BMW's head of sales and marketing. "However, we are confident of healthy sales growth in other regions, especially Asia and the Americas."

BMW borrowed a new retail concept from Apple stores, which was tested in the United Kingdom, by rolling out its version on the Apple "Genius Bar" across Europe. The iPad-equipped, specially trained "BMW Genius Everywhere" staff will give customers information about vehicles and features, but they will not sell cars. The new BMW employees wear a white polo shirt that says "BMW Genius," but they are paid a salary, not a commission on sales. A pilot program for the "BMW Genius Everywhere" program began in the USA in late 2013, with a full launch by early 2014, which is when the new BMW i3 electric car is set to go on sale.

Apple, Inc. — 2011

Mernoush Banton
Adjunct Professor/Consultant

AAPL

www.apple.com

Based in Cupertino, California, Apple sold 4.69 million iPads the first quarter of 2011, to reach 20 million iPads since the product's April 2010 debut. At 7.3-inches wide, with a color screen and many popular downloadable games like "Angry Birds," applications for watching movies and reading magazines, and software for word processing and spreadsheets, the iPad is siphoning off more PC sales than anyone ever predicted. For example, HP's PC sales plunged 23 percent that quarter and the company cut $1 billion off its annual sales forecast. Dell's sales to consumers declined 7.5 percent for the quarter.

More than 70 million tablets like the Apple iPad will be sold in 2011, a total that is expected to balloon to 246 million in three years. Global shipments of PCs fell 3.2 percent that first quarter of 2011, hurt in part because many consumers bought tablets instead. Microsoft Windows sales fell 4.4 percent to $4.45 billion that first quarter of 2011. Microsoft's net income of $5.23 billion in 2010 was eclipsed by Apple's $5.99 billion, the first time that had happened in 20 years. Success of Apple's iPad, iPhone and new versions of the Mac helped Apple replace Microsoft as the world's most valuable technology company in 2010.

Apple designs, manufactures, and markets a range of personal computers, mobile communication and media devices, and portable digital music players and sells a range of related software, services, peripherals, networking solutions, and third-party digital content and applications. Apple products and services include Macintosh (Mac) computers, iPhone, iPad, iPod, Apple TV, Xserve, a portfolio of consumer and professional software applications, the Mac OS X and iOS operating systems, third-party digital content and applications through the iTunes Store, and a range of accessory, service, and support offerings. Apple sells its products globally through its retail stores, online stores, and direct sales force and third-party cellular network carriers, wholesalers, retailers, and value-added resellers. As Apple's fiscal 2010 ended on September 25, 2010, the company operated 317 retail stores, including 233 in the United States and 84 internationally.

Apple opened its two newest stores on August 13, 2011—in Anchorage, Alaska and Murrary, Utah. Also on that day, Apple became the must valuable company in the world, surpassing ExxonMobil. Some analysts are asking whether Apple has more cash than the USA.

History

Steve Wozniak and Steve Jobs established Apple after they dropped out of college in April 1976. Their coworker relationship started when Wozniak successfully created building boxes to make free long-distance phone calls, which was a huge invention at that time. Wozniak extended his invention again when he made another box that was called the Apple I computer. Contrary to today's computers, this Apple computer had no keyboard or power supply. Wozniak and Jobs were able to sell 50 units of computers in the San Francisco Bay area for $666 total.

In 1978, Apple became one of the most rapid-growing companies in the United States. It was spread across the nation through 100 dealers. Soon came the Apple 2e and the Apple 2c. In the mid-1980s, Apple launched Macintosh, which initially sold very well but soon declined due to its high price and limited range of software titles. In the early 1990s, Apple introduced

PowerBook, a 17-pound machine with a 12-hour battery life. During this early era, Apple continued producing products such as digital cameras, portable CD audio players, speakers, video consoles, and TV appliances. At the time, John Sculley was Apple's CEO, but in 1996, Apple brought back Steve Jobs as interim CEO.

Apple's iPhone spurred a revolution in cell phones and mobile computing. Apple continues to innovate its core Mac desktop and laptop computers—all of which feature its OS X operating system—including the iMac all-in-one desktop and MacBook portable for the consumer and education markets, and the high-end Mac Pro and MacBook Pro for consumers and professionals involved in design and publishing. Apple's digital music players (iPod) and online music store (iTunes) make millions for the company. Apple's iPad tablet computer is a blockbuster success. Apple gets more than half of its sales from outside the United States.

In 2010, for the first time, the company's market capitalization surpassed Microsoft. In January 2011, Steve Jobs announced that he would once again take a medical leave of absence and Timothy Cook, the company's COO, would be managing day-to-day operations of Apple. When Steve Jobs ultimately resigned due to health reasons in August 2011, Tim Cook was announced as CEO.

Vision/Mission

Apple does not have a formal vision statement, but some publications provide the following as the company's vision statement:

> Apple ignited the personal computer revolution in the 1970s with the Apple II and reinvented the personal computer in the 1980s with the Macintosh. Apple is committed to bringing the best personal computing experience to students, educators, creative professionals, and consumers around the word through its innovative hardware, software, and Internet offerings.

Apple does not have a formal mission statement, but the common theme seems to be the following statement, with nominal variations:

> Apple Computer is committed to protecting the environment, health, and safety of our employees, customers, and the global communities where we operate. We recognize that by integrating sound environmental, health, and safety management practices into all aspects of our business, we can offer technologically innovative products and services while conserving and enhancing recourses for future generations. Apple strives for continuous improvement in our environmental, health, and safety management systems and in the environmental quality of our products, processes, and services. (Source: Company documents.)

Internal Issues

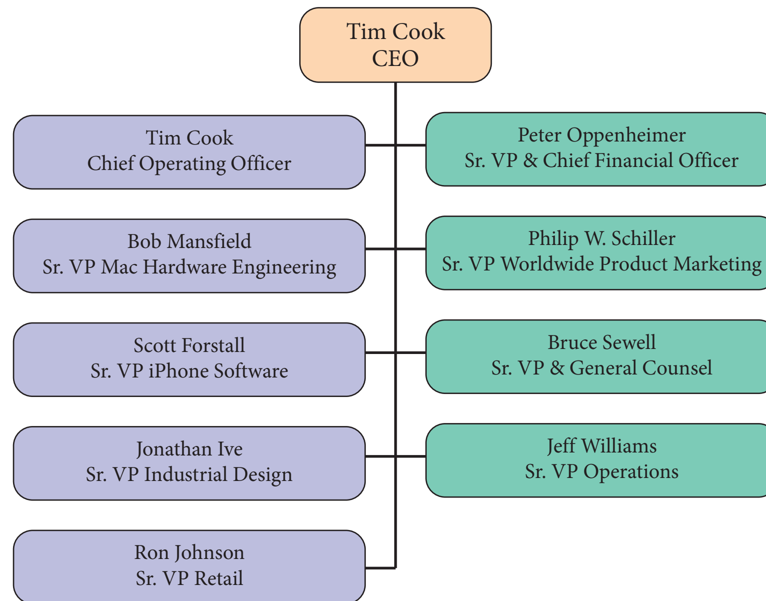
Organizational Structure

Apple has no presidents of divisions and no SBUs. The company is organized functionally with financially reportable segments being the Americas (North and South), Europe (including the Middle East and Africa), Japan, Asia-Pacific, and Retail (U.S. and international markets). Tim Cook is the company's CEO. Apple's organizational structure is given in Exhibit 1.

Products

Apple offers a wide range of products as indicated in Exhibit 2. These include iPads, iPods, iPhones, iTunes, PCs, and more. Apple is perhaps the best-known "first mover" company ever, as the firm has a 35-year history of being the first to introduce blockbuster, successful new products.

EXHIBIT 1 Apple's Organizational Chart – 2011



Source: Company documents.

EXHIBIT 2 Apple Products – 2011

Mac Hardware Products	1. Personal computing products including desktop and portable computers, Xserve servers, related devices and peripherals, and various third-party hardware products. 2. Desktop computers include iMac, Mac Pro, and Mac mini. 3. Portable computers include MacBook, MacBook Pro, and MacBook Air. MacBook is a portable computer designed for consumer and education users. MacBook Pro is a portable computer designed for professionals and consumers.
iTunes	iTunes digital music management software ("iTunes") is an application for playing, downloading, and organizing digital audio and video files and is available for both Mac and Windows-based computers. iTunes 10 features Ping, a music-oriented social network, AirPlay wireless music playback, Genius Mixes, Home Sharing, and improved syncing functionality with the company's mobile communication and media devices.
iPhone	iPhone combines a mobile phone, a widescreen iPod with touch controls, and an Internet communications device in a single handheld product.
iPad	iPad, a multi-purpose mobile device for browsing the web, reading and sending e-mail, viewing photos, watching videos, listening to music, playing games, reading e-books, and more.
iPod	Line of portable digital music and media players is comprised of iPod touch, iPod nano, iPod shuffle, and iPod classic.
Displays & Peripheral Products	Apple Cinema High Definition Display and a variety of Apple-branded and third-party Mac-compatible peripheral products, including printers, storage devices, computer memory, digital video and still cameras, and various other computing products and supplies.
Apple TV	Apple TV is a device that allows customers to rent and watch movies and television shows on their television. Content from Netflix, YouTube, Flickr, and MobileMe, as well as music, photos, and videos from a Mac- or Windows-based computer can be wirelessly treamed to a television through Apple TV.
Operating System Software	1. Mac OS X is built on an open-source, UNIX-based foundation. Mac OS X Snow Leopard is the seventh major release of Mac OS X and became available in August 2009. 2. iOS is the company's mobile operating system that serves as the foundation for iPhone, iPad, and iPod touch.
Application Software	1. iLife '11 is the latest version of the company's consumer-oriented digital lifestyle application suite included with all Mac computers. 2. iWork '09 is the latest version of the company's integrated productivity suite designed to help users create, present, and publish documents, presentations, and spreadsheets.

Finance

Apple's consolidated income statements and balance sheets are provided in Exhibits 3 and 4 respectively. Note that Apple's revenues increased a whopping 52 percent in 2010, while its net income increased 70 percent. Also notice that Apple has zero long-term debt on its balance sheet.

EXHIBIT 3 Apple's Statement of Operations—2010 (in millions except EPS)

Three years ended Sep. 25, 2010	2010	2009	2008
Net sales	**$65,225**	**$42,905**	**$37,491**
Cost of sales	39,541	25,683	24,294
Gross margin	25,684	17,222	13,197
Operating expenses:			
Research and development	1,782	1,333	1,109
Selling, general, & administrative	5,517	4,149	3,761
Total operating expenses	7,299	5,482	4,870
Operating income	18,385	11,740	8,327
Other income and expense	155	326	620
Income before provision for income taxes	18,540	12,066	8,947
Provision for income taxes	4,527	3,831	2,828
Net income	**$14,013**	**$8,235**	**$6,119**
Earnings per common share			
Basic	$15.41	$9.22	$6.94
Diluted	$15.15	$9.08	$6.78

Source: Apple Inc., *Form 10K*, 2010, p. 46.

EXHIBIT 4 Apple's Consolidated Balance Sheet—2010 (in millions, except share amounts)

	Sep. 25, 2010	Sep. 26, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$11,261	$5,263
Short-term marketable securities	14,359	18,201
Accounts receivable, less allowances of $55 and $52, respectively	5,510	3,361
Inventories	1,051	455
Deferred tax assets	1,636	1,135
Vendor nontrade receivables	4,414	1,696
Other current assets	3,447	1,444
Total current assets	41,678	31,555
Long-term marketable securities	25,391	10,528
Property, plant, and equipment, net	4,768	2,954
Goodwill	741	206
Acquired intangible assets, net	342	247
Other assets	2,263	2,011
Total assets	**$75,183**	**$47,501**

(continued)

EXHIBIT 4 continued

	Sep. 25, 2010	Sep. 26, 2009
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$12,015	$5,601
Accrued expenses	5,723	3,852
Deferred revenue	2,984	2,053
Total current liabilities	20,722	11,506
Deferred revenue - noncurrent	1,139	853
Other noncurrent liabilities	5,531	3,502
Total liabilities	27,392	15,861
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value;1,800,000,000 shares authorized; 915,970,050 and 899,805,500 shares issued and outstanding, respectively	10,668	8,210
Retained earnings	37,169	23,353
Accumulated other comprehensive (loss)/income	(46)	77
Total shareholders' equity	**47,791**	**31,640**
Total liabilities and shareholders' equity	**$75,183**	**$47,501**

Source: Apple Inc., *Form 10K*, 2010, p. 47.

Marketing

Apple markets its products many ways, such as through its own retail stores, online, and some retail channels. It also sells direct to small and mid-sized businesses, educational institutions, enterprises, governments, and creative organizations. At the end of fiscal 2010, Apple had over 317 retail stores (233 stores in the United States and 84 stores internationally). The stores come in various sizes and locations, such as high-traffic shopping malls or urban shopping districts; suitable to the need and the demand of that specific market.

Apple invests heavily in marketing and promotional campaigns using direct mail, print media, TV commercials, Internet advertising, product placements, and social networking websites. Despite its heavy advertising campaign, Apple believes providing direct contact with its targeted customers is the best way to demonstrate the advantages of its products over those of its competitors. The stores employ experienced and knowledgeable personnel who provide product advice, service, and training. The stores offer a wide selection of third-party hardware, software, and various other accessories and peripherals.

By-Segment Results

Apple reports its segment sales geographically as indicated in Exhibit 5. Note that the company's sales from the Americas increased 29 percent in fiscal 2010, while sales from Europe increased 58 percent. Apple generates greater sales from the Americas but generates greater profits from Europe. Note also that the company's retail sales from its own stores increased 47 percent in fiscal 2010.

Apple also reports results by product as revealed in Exhibit 6. Note that the product line that had the highest increase in sales was iPhone by 93 percent, followed by desktops by 43.4 percent, and then peripherals and other hardware by 23 percent. Note also that 38 percent of the total sales is driven from iPhone and related portable products, whereas desktops and portables, combined, contribute only 26 percent to the company's total sales (desktops by 10 percent and portables by 16 percent). A graphic display of the percent contribution of various products is provided in Exhibit 7.

EXHIBIT 5 Apple's Sales, Operating Income, and Assets by Region (in millions)

	2010	2009	2008
Americas:			
Net sales	$24,498	$18,981	$16,552
Operating income	$7,590	$6,658	$4,901
Depreciation, amortization, and accretion	$12	$12	$10
Segment assets (a)	$2,809	$1,896	$1,693
Europe:			
Net sales	$18,692	$11,810	$9,233
Operating income	$7,524	$4,296	$3,022
Depreciation, amortization, and accretion	$9	$7	$6
Segment assets	$1,926	$1,352	$1,069
Japan:			
Net sales	$3,981	$2,279	$1,728
Operating income	$1,846	$961	$549
Depreciation, amortization, and accretion	$3	$2	$2
Segment assets	$991	$483	$272
Asia-Pacific:			
Net sales	$8,256	$3,179	$2,686
Operating income	$3,647	$1,100	$748
Depreciation, amortization, and accretion	$3	$3	$3
Segment assets	$1,622	$529	$390
Retail:			
Net sales	$9,798	$6,656	$7,292
Operating income	$2,364	$1,677	$1,661
Depreciation, amortization, and accretion (b)	$163	$146	$108
Segment assets (b)	$1,829	$1,344	$1,139

Source: Apple Inc., *Form 10K*, 2010, p. 80.

a. The Americas asset figures do not include fixed assets held in the U.S. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate and retail assets figures below.

b. Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure.

EXHIBIT 6 Apple's Net Sales by Product (in millions)

	2010	2009	2008
Desktops (a)	$6,201	$4,324	$5,622
Portables (b)	11,278	9,535	8,732
Total Mac net sales	17,479	13,859	14,354
iPod	8,274	8,091	9,153
Other music-related products and services (c)	4,948	4,036	3,340
iPhone and related products and services (d)	25,179	13,033	6,742
iPad and related products and services (e)	4,958	0	0
Peripherals and other hardware (f)	1,814	1,475	1,694
Software, service, and other net sales (g)	2,573	2,411	2,208
Total net sales	$65,225	$42,905	$37,491

Source: Apple Inc., *Form 10K*, 2010, p. 81.

a. Includes iMac, Mac mini, Mac Pro, and Xserve product lines.

b. Includes MacBook, MacBook Air, and MacBook Pro product lines.

c. Includes iTunes Store sales, iPod services, and Apple-branded and third-party iPod accessories.

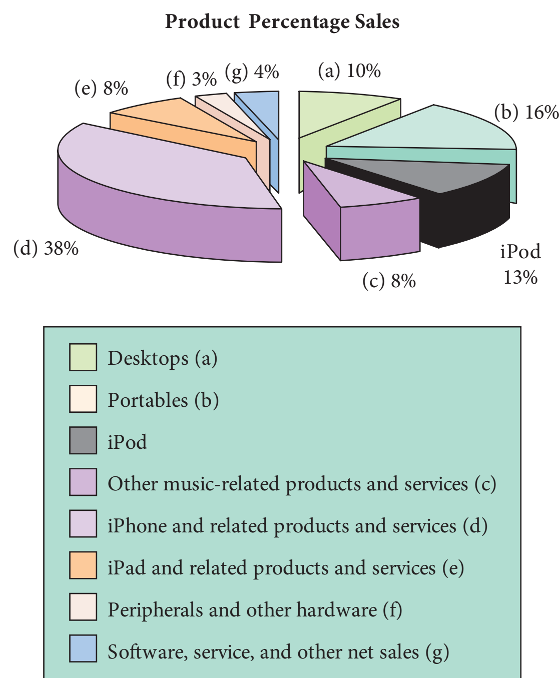
d. Includes revenue recognized from iPhone sales, carrier agreements, services, and Apple-branded and third-party iPhone accessories.

e. Includes revenue recognized from iPad sales, services, and Apple-branded and third-party iPad accessories.

f. Includes sales of displays, wireless connectivity and networking solutions, and other hardware accessories.

g. Includes sales of Apple-branded operating system and application software, third-party software, and Mac and Internet services.

EXHIBIT 7 Percentage Sales of Products (2010)



Source: Company documents.

Competitors

Apple's *Annual Report* indicates that its business industry is Computer Hardware and its sector is Technology. Yet, many analysts consider Apple as being a direct competitor with other hardware manufacturers such as Hewlett-Packard (another hardware manufacturer) and even Google (with no hardware manufacturing capacity), yet there is no comparison between Apple and other phone-related manufacturers or devices, through 38 percent of its business is driven by iPhone and related products, in Exhibit 8. This is always a challenge when companies have wide product lines with a different marketing mix in each line.

For hardware product lines, direct competitors to Apple include Hewlett-Packard, Dell, Xerox, NCR, and IBM, as indicated in Exhibit 9.

EXHIBIT 8 Apple Competitors at a Glance

	APPLE	GOOGLE	HP	RIMM	Industry
$Market Cap	320.89B	174.48B	89.80B	23.40B	320.58B
#Employees	46,600	26,316	324,600	17,500	100.30K
%Qtrly Rev Growth	82.70%	26.60%	3.60%	36.20%	24.30%
$Revenue	87.45B	31.12B	127.16B	19.91B	87.45B
%Gross Margin	39.07%	64.97%	24.14%	44.33%	39.07%
$EBITDA	26.73B	12.16B	18.25B	5.57B	26.73B
%Operating Margin	29.02%	34.35%	10.49%	23.30%	31.92%
$Net Income	19.55B	8.85B	9.12B	3.41B	N/A
$EPS	20.99	27.29	3.92	6.34	20.99

Source: Based on information at finance.yahoo.com (April 2011).
Industry = Personal Computers

EXHIBIT 9 Computer Hardware (U.S.) Company Comparisons

Company	Price	Market Cap	P/E
IBM	$170.12	206.05B	14.28
HP	41.50	89.80B	10.59
Dell	16.36	31.18B	12.11
Cisco Systems	17.86	98.76B	13.51
Xerox	10.46	14.66B	16.45
Seagate Technology PLC	17.69	7.61B	10.99
Apple Inc.	347.00	320.89B	16.53
NCR Corp.	19.83	3.15B	19.29
EMC Corp.	27.23	56.03B	29.66
Toshiba Corp.	5.58	23.63B	22.14

Source: Based on information at finance.yahoo.com (April 2011).

Hewlett-Packard

HP offers many products and services that compete with Apple. HP is organized into seven business segments as indicated in Exhibit 10. HP's personal systems segment group, which competes with Apple computers, is the second-largest contributing segment to the organization yet ranks as the fifth-most-profitable segment in 2010.

Dell Inc.

Dell offers a broad range of products (PCs, laptops, software, and peripherals) and services (enterprise solutions, IT transactional, outsourcing, and project-based consulting for IT infrastructure, applications, and business processes) that compete with Apple products. In the United States, as part of its services, Dell offers customers financial service solutions through Dell Financial Services L.L.C. The company's consolidated total revenue for 2011 was $61.4 billion, and products contributed 81 percent of its total revenue, as indicated in Exhibit 11.

Dell's greatest strength is its ability to drive down costs through its direct sales approach. Dell computers are manufactured once an order has been received, thus reducing inventory and

EXHIBIT 10 HP Revenue and Earnings per Segment (in millions)

	Total Net Revenue			Earnings (Loss) from Operations		
	2010	2009	2008	2010	2009	2008
Services[1]	$34,935	$34,693	$20,977	$5,609	$5,044	$2,518
Enterprise Storage and Servers	18,651	15,359	19,400	2,402	1,518	2,577
HP Software	3,586	3,572	4,220	759	684	499
HP Enterprise Business	57,172	53,624	44,597	8,770	7,246	5,594
Personal Systems Group	40,741	35,305	42,295	2,032	1,661	2,375
Imaging and Printing Group	25,764	24,011	29,614	4,412	4,310	4,559
HP Financial Services	3,047	2,673	2,698	281	206	192
Corporate Investments[2]	1,863	768	965	132	(56)	49
Segment total	$128,587	$116,381	$120,169	$15,627	$13,367	1$2,769

Source: Hewlett-Packard Company and Subsidiaries, *Form 10K*, 2010 (p. 151).

1. Includes the results of EDS, which was acquired on August 26, 2008, from the date of acquisition.
2. Includes the results of 3Com and Palm acquisitions completed in April 2010 and July 2010, respectively.

EXHIBIT 11 Dell's Summary of Consolidated Results of Operations (in millions)

	Fiscal Year Ended		
	Jan. 28, 2011		
	Dollars	% of Revenue	Change
Net revenue			
Product	$50,002	81.3%	14%
Services, including software related	11,492	18.7%	25%
Total net revenue	61,494	100%	16%
Gross margin			
Product	7,934	15.9%	29%
Services, including software related	3,462	30.1%	12%
Total gross margin	11,396	18.5%	23%
Operating expenses	7,963	12.9%	12%
Operating income	3,433	5.6%	58%
Net income	2,635	4.3%	84%

Source: Dell, Inc., *Form 10K*, 2011, p. 24.

warehousing expenses. Dell has nearly perfected the cost and quality-control aspects of just-in-time manufacturing, and thereby has enjoyed a tremendous advantage over its rivals in quality and production costs. It is not as clear as it once was that the title of low-cost producer belongs to Dell.

Microsoft Corp.

Microsoft develops, manufactures, licenses, and supports a range of software products and services for various computing devices worldwide. Other than its popular Windows operating system and Microsoft Office, the company offers consulting services for business and computing solutions along with business applications such as Microsoft Dynamics ERP and CRM, as well as Microsoft Office Web Apps. The company's Entertainment and Devices Division segment develops, produces, and markets the Xbox 360 platform; PC software games; online games and services; Mediaroom, an Internet protocol television software; Windows Phone and Windows Embedded device platforms; the Zune digital music and entertainment platform; and application software for Apple's computers.

Most computers run on Windows operating system applications, whereas Apple's computers run on its own operating system applications. Many consider John Sculley's decision not to license the Macintosh operating system to Bill Gates as one of the great miscalculations in business. On the other hand, many today, with its innovative and unique technologically advanced products and software, consider Mac's operating system far superior to Windows, even though Mac software has a very nominal share of the market.

Microsoft has continued to be a serious competitor to Apple. The Windows Media Player comes bundled with the Windows operating system that is sold on almost every computer in the world. Media Player includes a link to Microsoft's own music site, and sales at Microsoft's site are steadily gaining on Apple's iTunes. Virus threats are becoming an increasing burden to all companies who have computers. In fact, information technology (IT) professionals are taking a second look at Apple because of the growing frustration with the Microsoft monoculture and its all-too-common worm attacks, which gum up corporate networks and leave all Windows-based computers vulnerable to future attacks. Although few IT departments have considered eliminating their Windows systems altogether, many are starting to incorporate a few Mac products to effectively manage their networks. Is it possible that one day Mac's operating system will surpass Microsoft's Windows operating system? This remains to be seen.

The Future

As Apple gets ready for the 10th anniversary of having its own stores, a major revamp of its stores is getting underway. For example, all the company's retail employees are getting iPads instead of iPod Touches to help customers. All Apple stores are being outfitted with new interactive signage and displays, and developers are working on a new Apple Stores smartphone application. The app will help users book meetings with the "Genius Bar" after automatically detecting the store as the customer enters. Apple has grown its retail outlets to 300+ stores, more than two-thirds of which are in the United States. The stores, including two in Austin, Texas, brought in $3.9 billion in revenue in the fourth quarter 2010 alone.

Apple is once again getting the best of bitter rival Google, since Apple has signed a deal with EMI Music and is reportedly close to signing deals with Universal Music Group and Sony Music Entertainment for cloud music licensing for its iPhone and iPad. Apple already has an agreement with Warner Music Group, so Apple is close to having all four of the major record companies in its cloud music portfolio. Google has secured the cooperation of the major record labels for its cloud music service, Music Beta, which was introduced in May 2011. Although Apple may lag Amazon and Google in the race to the music cloud, the company will be free of licensing restrictions that could hamper its rivals. Apple will likely charge a subscription fee for its cloud music service, although fee-based music services have a mediocre record of attracting and retaining subscribers. Still, if Apple is able to procure good deals with the four major labels, it will have a significant advantage over Amazon and Google.

Apple is arguably the most successful company ever in many respects. But there are major financial risks with being the premier "first mover" in any industry. Rival firms across the globe are getting better and better at quickly duplicating successful Apple products and offering those newly enhanced products at lower prices.

Develop a good three-year strategic plan for Apple Inc.

Microsoft Corporation, 2013

www.microsoft.com, MSFT

Headquartered in Redmond, Washington, Microsoft is the world's largest software company and had record revenues of $73 billion in fiscal year 2012 that ended on June 30, 2012. Microsoft develops a variety of software and hardware products and services for customers around the world, including its Windows Office, Windows 8 operating system for personal computers (PCs), Windows Phone 7 operating systems for mobile phones, Windows Server operating systems, Windows Azure, Microsoft SQL, Visual Studio, Silverlight, and the popular Xbox gaming and entertainment console. Many PC makers such as Acer, Lenovo, Dell, Hewlett-Packard, and Toshiba pre-install Microsoft software on devices. The firm also offers consulting services, cloud-based services, and training certifications as well as online products such as Bing, MSN, adCenter, and Atlas. Microsoft has strategic alliances with Nokia, NIIT, and Dominion Enterprises. The company owns Skype and recently introduced a Windows Phone and a Windows tablet computer named "Surface."

Microsoft's third quarter of fiscal 2013 results reported April 2013 were outstanding, with its Business Division's revenues up 8 percent to $6.32 billion, its Server and Tools' revenues of $5.04 billion up 11 percent, its Windows' division revenues of $5.07 billion up 23 percent, its Online Services segment revenues up 18 percent to $832 million, and its Entertainment and Devices segment revenues up 56 percent to $2.53 billion.

In August 2013, CEO Ballmer announced he would resign from Microsoft within 12 months, so the firm is scurrying to determine who will be a good replacement. The month prior, Microsoft revamped its organizational structure, dissolving its eight business lines up in favour of four new segments to focus on engineering and encourage collaboration across the company. Basically the company is now structured as a division-by-function type of structure. The divisions are expected to focus on operating systems, apps, cloud technology and devices. The move largely reversed the strategy and structure put in place by CEO Ballmer in 2005. Microsoft's stock price jumped in response the Ballmer announcing that he would resign soon.

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History

Founded by Bill Gates and Paul Allen in 1975, Microsoft was established to develop and sell BASIC Interpreters for the Altair 8800. The company rose to dominate the PC operating system market in the mid-1980s with their MS-DOS software, followed by the Microsoft Windows operating system, which was a graphical extension of MS-DOS. Microsoft went public in 1986, instantly creating three billionaires and 12,000 millionaires from Microsoft employees. In 1990, Microsoft introduced its software office suite, Microsoft Office that bundled MS Word and MS Excel together.

Microsoft acquired Skype Technologies for $8.6 billion in 2011 in its largest-ever acquisition. Following the release of Windows Phone 7, Microsoft underwent a gradual rebranding of its product range throughout 2011 and 2012. Its logos, products, services, and websites adopted the principles and concepts of the Metro design language. Microsoft in early 2012 introduced Windows 8, an operating system designed to power both PCs and tablet computers. Then in May 2012, Microsoft introduced its own tablet computer, the Microsoft Surface. As the company continued to diversify away from operating systems, it paid $1.2 billion to buy the social network firm Yammer and then launched its Windows Phone 8. To cope with the potential increase in demand for products and services, Microsoft is slowly but surely opening its own Microsoft Stores across the USA. Bill and Melinda Gates are today one of the richest couples on the planet, and one of the most giving couples in terms of philanthropic endeavors through the Bill and Melinda Gates Foundation.

Internal Issues

Vision and Mission

A statement at the corporate website says: "At Microsoft, our mission and values are to help people and businesses throughout the world realize their full potential."

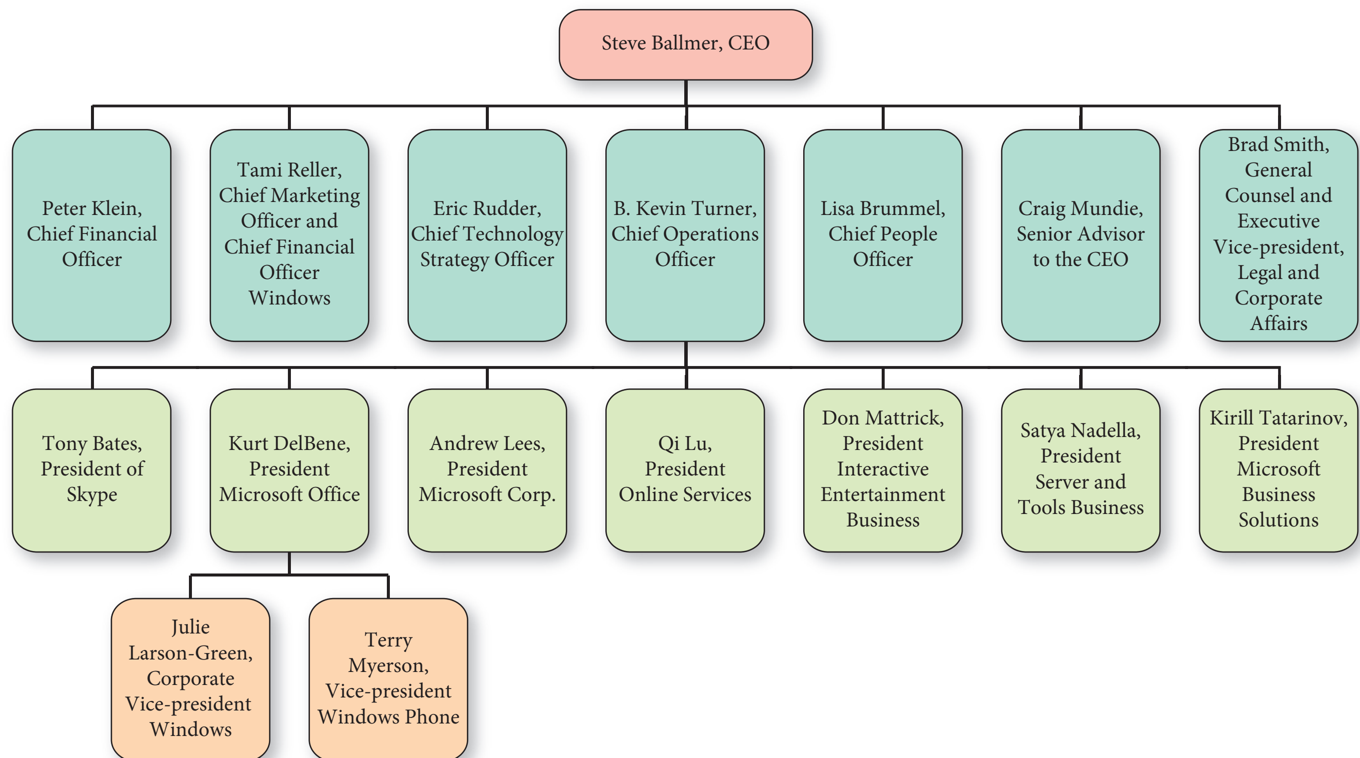
Organizational Structure

Among the 17 executives listed in Exhibit 1, there are three women in Microsoft's management hierarchy. Note in Exhibit 1 that Microsoft uses a division-by-product organizational structure, with Steve Ballmer being chief executive officer (CEO) and Kevin Turner being chief operations officer (COO). Some analysts say that executive titles could be more effectively named. For example, President of Microsoft Corp. versus President of Microsoft Business is unclear to some observers. It is unclear from the structure where Microsoft Phone and Microsoft Tablet and Microsoft Stores reports. Such items would ideally be clear in executive titles. Perhaps a strategic business unit (SBU) structure would be more effective.

The Surface Tablet

Sales of Microsoft's Surface tablet are not good; analysts expect the company to sell between 500,000 and 600,000 Surface tablets in their second quarter of fiscal 2013, much lower than the company's original estimate of 1 to 2 million. Introducing a tablet is a good idea for three reasons: (1) Microsoft has the cash to invest heavily in research and development (R&D) for its own tablet; (2) the tablet market has been booming; and (3) the PC market is declining. But the problem perhaps is that Microsoft priced the Surface too high at $499 and up, roughly the same price as the competing Apple iPad. Microsoft likely should compete on price, not luxury, when up against Apple products. Microsoft could undercut Apple's price, and even if it *loses money* on Surface, the initial loss could be worth it if it revitalizes sales of other company products. The success of Windows 8 largely hinges on widespread adoption of the Surface tablet. The whole

EXHIBIT 1 Organizational Chart



Source: Based on company documents.

point of Windows 8 was to launch Microsoft into the world of tablet computing, and with weak sales of its tablet, Microsoft's transition away from the faltering PC market may be a difficult one. Microsoft should perhaps consider McDonald's successful strategy of offering and heavily marketing inexpensive products (for example, the Dollar Menu) and by promoting low-grade items.

Segments

Microsoft has five reportable business segments as listed in Exhibit 2. Note that Microsoft Business is the largest segment in both revenues and operating income, whereas both the Windows and Windows Line (called Windows Division from here on), and Server and Tools segment, contribute greatly to the company's financial position. A sixth segment, titled Corporate Level Activity, includes all financial dealings not allocated to specific segments. The division includes costs related to marketing, product support services, legal, finance, and other business activities. Some analysts contend that the company's segments could be more effectively named to reveal their nature.

The Windows Division receives approximately 75 percent of its revenue from the Windows operating system, with the bulk of this revenue coming from equipment manufacturers such as Dell, Sony, Toshiba, and others pre-installing Windows on their machines for customers. The division in addition to providing Windows also provides related software, online services, and PC hardware products. This division could be vulnerable if worldwide PC sales continue to slump, as they did in 2012 with a 3.2-percent decline. Windows 8, launched in October 2012, provides better communication with cloud services and enables tablets and phones to run with near PC power. The whole world is becoming less dependent on traditional PCs, which historically has been Microsoft's bread and butter and is a key reason why the firm is looking to diversify.

Microsoft's Server and Tools Division is Microsoft's third most profitable division, producing name brand products such as Windows Server, Microsoft SQL, Windows Azure, Visual Studio, Enterprise Services, and others. Enterprise Services include product support and consulting services and account for 20 percent of the division's revenues. The division also offers developer tools, training, and certifications. Around 55 percent of Server and Tools revenues are derived from multiyear licensing agreements, with the remaining 25 percent coming from transactional volume licensing programs. In 2012, revenues increased by 12 percent in the division mainly attributed to growth in the SQL and Windows servers, although Enterprise

EXHIBIT 2 Microsoft's Revenues by Segment (in millions)

	2012	2011	2010
Windows Division			
Revenues	$18,373	$19,033	$19,491
Operating Income	11,460	12,211	12,895
Server and Tools			
Revenues	18,686	16,680	15,109
Operating Income	7,431	6,290	5,381
Online Services			
Revenues	2,867	2,607	2,294
Operating Income	(8,121)	(2,657)	(2,408)
Microsoft Business			
Revenues	23,991	22,514	19,256
Operating Income	15,719	14,657	11,849
Entertainment and Devices			
Revenues	9,593	8,915	6,079
Operating Income	364	1,257	517
Corporate Level Activity	(5,090)	(4,597)	(4,136)

Source: Based on 2012 *Annual Report*, p. 21–25.

Services grew 18 percent over the same period from an increase in both product support and consulting services. Overall operating income still increased 17 percent.

The company's Online Services Division designs products that aid customers in simplifying tasks and making more informed decisions online. Products include Bing and MSN, which generate sales through advertising. In fiscal year 2012, advertising revenues grew 13 percent in this segment to $2.6 billion. Online advertising revenues grew 13 percent over the fiscal year to $2.6 billion; however, operating losses totaled $8 billion resulting from $6 billion in goodwill impairment from fourth quarter of fiscal year 2012, resulting from the 2007 acquisition of aQuantive. Expectations of future sales growth and profitability are significantly lower for aQuantive than anticipated.

The company's Microsoft Business Division produced 32 percent of total companywide revenues and 72 percent of operating income in fiscal year 2012. The segment derives revenues from software and online servers that help to increase personal team and organizational productivity. Microsoft's most notable product, its Microsoft Office System, makes up more than 90 percent of this division's revenues. However, future reliance on this segment is somewhat tenuous because Google and other competitors are now offering Web-based products that work much the same as Microsoft Office products work.

The company's Entertainment and Devices Division generated 13 percent of total revenues in fiscal year 2012, led by the Xbox 360 entertainment platform. The division includes Xbox, Skype, and Windows Phone. Skype is a free popular video chat platform and for-pay phone service. Sales from Skype and Windows Phone increased 6.5 percent in fiscal year 2012, but Xbox sales declined $113 million even though Xbox LIVE revenue increased. Skype reported revenues of $860 million, net losses of $7 million, and long-term debt of $686 million in 2011, leading some analysts to say Microsoft paid too much for Skype. Overall, Microsoft has a history of using poor judgments in acquisitions, as indicated by the company's goodwill being more than $13 billion. Skype does overlap considerable with Windows Live Messenger in that both offer free chat, voice chat, and video chat. Windows Messenger though has around three times the users as Skype, but Skype offers a more refined platform for video chats. The one key difference between Microsoft's existing products and Skype is that about 8 million Skype users pay for the service through telephone connectivity, making it easy for many customers across the globe to buy phone numbers in foreign markets affordably. With the purchase price of $8.5 billion, Microsoft is in essence paying around $1,000 for each customer who is worth around $30 each, assuming most of Skype's income is from call charges, leaving much to be made up on possible advertisements or some synergy with existing Microsoft products. Compounding problems for Skype, it is estimated a large percentage of their customers come from emerging markets and do not have much money to spend. However for Microsoft, preventing Google and Facebook from obtaining Skype also played a role in the purchase.

Exhibit 3 reveals that approximately 52 percent of Microsoft's 2012 revenues are derived from the USA. Note that international revenues have increased as a percent of total revenues in each of the three years provided.

Finance

Microsoft's fiscal year ends on June 30 of each year. As indicated in the financial statements provided in Exhibits 4 and 5, Microsoft's revenues have been growing annually in recent years, a good thing. However, note in Exhibit 4 that the company's net income dropped 26.7 percent in

EXHIBIT 3 Microsoft's Revenues by Geographic Region (in millions)

	2012	2011	2010
USA	$38,846	$38,008	$36,173
Outside USA	$34,877	$31,935	$26,311
Total	$73,723	$69,943	$62,484

Source: Based on 2012 *Annual Report*, p. 80.

EXHIBIT 4 Microsoft's Income Statements (in millions)

	2012	2011	2010
Revenue	**73,723.0**	**69,943.0**	**62,484.0**
Other Revenue, Total	0.0	0.0	0.0
Total Revenue	73,723.0	69,943.0	62,484.0
Cost of Revenue, Total	17,530.0	15,577.0	12,395.0
Gross Profit	56,193.0	54,366.0	50,089.0
Selling/General/Administrative Expenses, Total	18,426.0	18,162.0	17,218.0
Research and Development	9,811.0	9,043.0	8,714.0
Depreciation and Amortization	0.0	0.0	0.0
Interest Expense (Income), Net Operating	0.0	0.0	0.0
Unusual Expense (Income)	5,895.0	-80.0	-10.0
Other Operating Expenses, Total	0.0	0.0	0.0
Operating Income	22,061.0	27,241.0	24,167.0
Interest Income (Expense),	0.0	0.0	0.0
Gain (Loss) on Sale of Assets	0.0	0.0	0.0
Other, Net	1.0	-31.0	14.0
Income Before Tax	22,267.0	28,071.0	25,013.0
Income Tax, Total	5,289.0	4,921.0	6,253.0
Income After Tax	16,978.0	23,150.0	18,760.0
Minority Interest	0.0	0.0	0.0
Equity in Affiliates	0.0	0.0	0.0
U.S. GAAP Adjustment	0.0	0.0	0.0
Net Income Before Extraordinary Items	16,978.0	23,150.0	18,760.0
Total Extraordinary Items	0.0	0.0	0.0
Net Income	**16,978.0**	**23,150.0**	**18,760.0**
Total Adjustments to Net Income	0.0	0.0	0.0
Basic Weighted Average Shares	8,396.0	8,490.0	8,813.0
Basic EPS Excluding Extraordinary Items	2.02	2.73	2.13
Basic EPS Including Extraordinary Items	2.02	2.73	2.13

EPS, earnings per share; GAAP, generally accepted accounting procedures.
Source: Based on company documents.

fiscal year 2012 and that the company's R&D expenditures have held at 13 percent of revenue for the last three years. Microsoft's sales and marketing expenditures for the last three years have dropped from 21 to 20 to 19 percent of revenues.

Note in Exhibit 5 that Microsoft's goodwill increased another $900 million to $13.4 billion in fiscal year 2012. Goodwill represents the cumulative amount the company has historically paid "above book value" for acquisitions, so such a high number is not good.

EXHIBIT 5 Microsoft's Balance Sheets (in millions)

	2012	2011	2010
Assets			
Cash and Short-Term Investments	63,040.0	52,772.0	36,788.0
Total Receivables, Net	15,780.0	14,987.0	13,014.0
Total Inventory	1,137.0	1,372.0	740.0
Prepaid Expenses	0.0	0.0	0.0
Other Current Assets, Total	5,127.0	5,787.0	5,134.0
Total Current Assets	**85,084.0**	**74,918.0**	**55,676.0**

EXHIBIT 5 Continued

	2012	2011	2010
Property, Plant, and Equipment	8,269.0	8,162.0	7,630.0
Goodwill, Net	13,452.0	12,581.0	12,394.0
Intangibles, Net	3,170.0	744.0	1,158.0
Long-Term Investments	9,776.0	10,865.0	7,754.0
Note Receivable, Long Term	0.0	0.0	0.0
Other Long-Term Assets, Total	1,520.0	1,434.0	1,501.0
Other Assets, Total	0.0	0.0	0.0
Total Assets	**121,271.0**	**108,704.0**	**86,113.0**
Liabilities and Shareholders' Equity			
Accounts Payable	4,175.0	4,197.0	4,025.0
Payable/Accrued	0.0	0.0	0.0
Accrued Expenses	3,875.0	3,575.0	3,283.0
Notes Payable and Short-Term Debt	0.0	0.0	1,000.0
Current Portability of Long-Term Debt Capital Leases	1,231.0	0.0	0.0
Other Current Liabilities, Total	23,407.0	21,002.0	17,839.0
Total Current Liabilities	32,688.0	28,774.0	26,147.0
Total Long-Term Debt	10,713.0	11,921.0	4,939.0
Deferred Income Tax	1,893.0	1,456.0	229.0
Minority Interest	0.0	0.0	0.0
Other Liabilities, Total	9,614.0	9,470.0	8,623.0
Total Liabilities	54,908.0	51,621.0	39,938.0
Redeemable Preferred Stock	0.0	0.0	0.0
Preferred Stock, Nonredeemable, Net	0.0	0.0	0.0
Common Stock	65,797.0	63,415.0	62,856.0
Additional Paid-In Capital	0.0	0.0	0.0
Retained Earnings (Accumulated Deficit)	–856.0	–8,195.0	–17,736.0
Treasury Stock, Common	0.0	0.0	0.0
ESOP Debt Guarantee	0.0	0.0	0.0
Unrealized Gain (Loss)	1,523.0	1,658.0	1,231.0
Other Equity, Total	–101.0	205.0	–176.0
Total Equity	**66,363.0**	**57,083.0**	**46,175.0**
Total Liabilities and Shareholders' Equity	**121,271.0**	**108,704.0**	**86,113.0**

ESOP, employee stock ownership plan.
Source: Based on company documents.

Competition

Being so diversified, Microsoft has different competitors in different segments. The company's Windows Operating System faces competition from Apple and Google who have their own operating systems. Microsoft's server products face stiff competition from Hewlett-Packard, IBM, and Oracle, who all offer preinstalled operating systems on their server hardware. Microsoft's cloud-based services compete with Amazon, Google, and Salesforce.com, whereas Microsoft's SQL Azure faces intense competition from IBM, Oracle, and many other firms.

The Microsoft Office package (Word, Excel, Access, and other products) faces heavy competition from Adobe, Apple, Cisco, Google, SAP, and many other Web-based competitors offering word processing, spreadsheets, and databases. The company's Entertainment and Devices segment, producer of Xbox360, faces intense competition from heavyweights Nintendo and Sony. The average life of an entertainment console is surprisingly long at 5+ years, and game selection is one of the largest factors in deterring the success of a gaming console.

EXHIBIT 6 A Financial Comparison of Microsoft to Rival Companies

	Microsoft	Apple	Google	Oracle
Number of employees	94,000	72,800	53,546	115,000
Revenue	$72.4B	$156.5B	$47.5B	$37B
Net Income	$15.7B	$41.7B	$10.6B	$10.6B
Net Profit Margin	21.7%	26.7%	22.2%	28.7%
EPS	$1.85	$44.15	$31.91	$2.13
Market Capitalization	228B	457M	237.9B	$164B
Shares Outstanding	8.42B	940M	228M	4.7B

EPS, earnings per share.
Source: Based on company documents.

Microsoft's new Windows Phone competes with market share leader Apple with their iPhone and Google with their Android platform powering Samsung and other phones. Also, Research in Motion is revitalizing their once-popular Blackberry. Microsoft's alliance with Nokia to power Nokia phones with Windows 8 hopes to inch away at market share in the phone industry.

Exhibit 6 provides a financial comparison of Microsoft with three competitors. Note that Microsoft has the lowest earnings per share (EPS) among the firms included, partly as a result of having by far the most shares of stock outstanding.

Apple

Headquartered in Cupertino, California, Apple produces PCs, digital music players, iPhones, and other communication media to customers around the world. Some of their most popular products include the iPhone, iPad, MacBook Pro, and iPod. Apple has their own operating system for all of their products. The iPhone is the world leader in market share for all mobile phones, but Samsung is the world leader in smartphone unit volume (most phones sold) because they produce multiple options for customers, rather then a one-size-fits-all as Apple does with their current iPhone. In addition, Google's Android platform, which Samsung and other phone manufacturers use on their phones, powers more phones than Apple's operating system, which is only used to power Apple iPhones.

Apple also provides many software products with their operating system such as iLife, iWork, Final Cut Pro, Logic Studio, and of late Apple TV. Apple provides their products through online stores, retail stores such as Walmart, Best Buy, Apple Stores, and others. Apple operates about 250 Apple Stores in the USA and 140 stores internationally.

Apple's stock price fell from $700 around the launch of iPhone 5 in 2012 to $485 in early 2013. Some analysts suggest products by Samsung powered by Google's Android software are taking significant market share away from Apple. Apple launched a new phone in the middle of 2013 called the iPhone 5S, reportedly to sell at a significant discount to the iPhone 5. To be targeted at large emerging markets in which many customers have no phone and less money, the 5S phone is likely to have a polycarbonate construction instead of the glass and aluminum the iPhone 5 sports. In addition, there will be no retina display and the phone will not be compatible with newer LTE markets and will thus run on 3G. Running on 3G however, is adequate because many emerging markets will not have LTE for a number of years into the future. The iPhone 5S follows the line of thinking of the iPad Mini, providing a discounted item for customers on a limited budget. Although the 5S may hurt profit margins, producing the phone is an attempt to win market share in emerging markets before Samsung, Dell, Nokia, and other competitors win legions of fans over to their products.

Google

Headquartered in Mountain View, California, Google provides the world's most popular search engine as well as cloud computing, Google Chrome, Google Maps for GPS users, Google Earth, Google Analytics for keeping track of hits and traffic on websites, and YouTube. Many

of Google's products are supported by heavy advertisements, helping to produce record revenues of $38 billion for year end 2011. Google produces Android, the world's most popular smartphone platform.

About 96 percent of all Google revenues are derived from advertising programs, with the balance coming predominantly from licensing agreements. Using technology from a firm named DoubleClick, Google can better determine user interest and effectively target advertisements, thus enabling Google to charge more for their service.

Google's Android operating system used for touch-screen smartphones and tablets currently enjoys a 75-percent market share in the smartphone marketplace. One of the key benefits of using Android products is that they are open source, meaning the software can be modified and distributed to anyone. Phone manufacturers such as Samsung or wireless carriers such as Verizon can alter the software to meet their specific needs. In addition, enthusiasts who enjoy developing applications for use in mobile devices can also alter the platform to fit their needs. The popularity and open source nature of Android has led it to becoming the top choice in the world for smartphones and tablets. The future of Android's use may eventually extend away from solely phones and tablets into television, games, and consoles and virtually any electronic device. This could potentially put further pressure on Microsoft with their Windows 8 operating system and Xbox consoles.

Oracle Corp.

Headquartered in Redwood City, California, Oracle is a producer of middleware software, application software, application server and cloud application, data integration, development tools, Java, and much more. Oracle also provides consulting services in business and information technology (IT), strategy alignment, and ongoing product enhancements. In 2012, Oracle acquired RightNow Technologies, Inc. (RightNow) and Taleo Corporation (Taleo). Oracle's stock hit a new 52-week high of $35 in January 2013.

As an example of Oracle's software products that compete with Microsoft, one of the largest Australian Supermarket chains is Coles with more than 100,000 employees and 2,000 stores throughout Australia. Coles recently installed Oracle's Exadata Database Machine and Oracle Enterprise Manager 12c running on Oracle Linux to enable critical trend reporting during retail seasonal spikes. By implementing the Oracle Exadata Database Machine, Coles's processes improved three to four times out of the box, with four to six times faster query performance so that Coles's can now meet SLAs and drive customer satisfaction. With the Oracle software, Coles can now also store 20+ TB of trending historical data, enabling new, complex analytical reports to help better predict the needs and potential issues for Coles's stores.

Nintendo

Headquartered in Kyoto, Japan, Nintendo is the world's largest video game company by revenues. Translated into English the company name is: "leave luck to heaven." Nintendo is Japan's third most valuable publically traded company and has a market value of more than $85 billion and revenues of more than $12 billion. Based in Redmond, Washington, near Microsoft's headquarters, Nintendo North America is the majority owner of the Seattle Mariners Major League Baseball team. Nintendo is a market share leader position with products such as the Nintendo 3DS and Nintendo's Wii products including the new Wii U, which features touch-screen controllers. Nintendo's European division is based in Frankfurt, Germany. Nintendo has a joint venture in China now produces and markets the iQue Player, a modified version of the Nintendo 64.

External

Smartphone Growth

Smartphone shipments have risen dramatically since 2005 from 50 million phones shipped worldwide to more than 650 million phones shipped in 2012. Shipments by 2016 are expected to be more than 1,200 million phones. Most of the growth is expected to come from emerging markets, with China leading the way. In 2012, China surpassed the USA as the world's largest smartphone market, yet there are millions of untapped customers remaining in China. India, Brazil, and other emerging markets offer millions of customers. Aside from traditional phone

providers, companies such as Apple, Dell, and others are all continually offering new products and features to differentiate their handsets. Google and Microsoft are teaming up with existing phone producers to provide new and better operating systems for their respective phones.

Nokia Migrates to Windows 8

Nokia unveiled in late 2012 their latest Lumia 920 and 820 model smartphones, Nokia's first set of smartphones to run off the new Windows 8 operating system. A main advantage gained for Nokia using Windows 8 resides in the compatibility of file-sharing capabilities because both the 920 and 820 devices will sync with PCs and tablets with Windows 8. Nokia hopes the switch to Windows 8 will differentiate its products and aid in improving sales which declined 37 percent from the second quarter 2011 to the second quarter 2012.

Cloud Computing

Cloud computing, supplying computing services via the Internet without having to use hardware or platform support, continues to grow in its use and offerings. Many businesses employ the technology to save on costs because they can lease data storage and computing capacity from web-based providers. Advantages for businesses using cloud technology include reduced capital investments in equipment and software, while allowing for payments only for the capacity needed. Traditionally, firms would buy their own in-house capacity and have to forecast future needs, often resulting in purchasing more capacity than was needed. Google is the lead company using cloud technology to support many of their offerings. However, there is still some concern among businesses that cloud computing offers less security, and increased dependability on a third-party vender such as Google to continually provide the service at an appropriate network speed is questionable. Nevertheless, cloud services are expected to yield revenues of $100 billion in 2016, up from $40 billion in 2011.

The Future

Microsoft is developing technologies that increasingly enable touch screen and voice to be more readily understood by PCs, tablets, and phones. Microsoft CEO Ballmer envisions that technology will soon act on people's behalf rather than at their command, so he has directed Microsoft R&D staff to develop cloud services that enhance the experience for both businesses and individuals. Microsoft plans to better align the communication between PCs, tablets, phones, and servers by developing improved operating systems with Windows 8 delivering preliminary results in this arena.

High-definition TVs and tablets of today are expected to soon lose market share to gadgets than can read human emotions and to eye gaze technology that will allow for automatic scrolling and opening of apps. Even "skin stretch feedback" on devices will take into account people's emotions. Tom Wilson, CEO of emotions3D, for example recently remarked that such devices will "interpret moods and give consumers a more helpful and rewarding experience." Some analysts predict that the audio quality alone on smartphones will increase 16 times from 2013 to 2018. Also, as the tablet's video gaming experience increases and becomes closer to the experience on an Xbox, PlayStation or Nintendo's market share for traditional gaming consoles may decline. More useable devices for people on the go are being developed in part to reduce accidents while driving and using mobile devices.

Microsoft in early 2013 introduced its new Office 365 product, a subscription service for $99.99 or $9.99 per month pay-as-you-go option. Office 365 constantly updates itself every time you open a program. The product works great on Apple Macs and virtually all companies' computers, tablets, smartphones, and more.

Microsoft's $2 billion investment to finance part of Dell computer's buyout in early 2013 is an attempt by the firm to support the ailing PC industry—which saw shipments fall 14 percent in the first quarter of 2013 alone. Millions of consumers globally are skipping over PCs altogether and going straight to mobile devices.

Technology is changing so rapidly everyday, and new rival firms arising globally in the industry, that Microsoft needs a clear strategic plan going forward.

Develop a new strategic plan for the upcoming new CEO of Microsoft.

Lenovo Group Limited, 2013

www.lenovo.com, LNVGY

Headquartered in Beijing, China, Lenovo designs, produces, and markets ThinkPad personal computers, notebook computers, tablet computers, desktop computers, mobile phones, workstations, servers, electronic storage, information technology (IT) management software, and smart televisions. Lenovo is the world's second-largest PC vendor (behind Hewlett-Packard [HP]), and markets the ThinkPad line of notebook computers and ThinkCentre line of desktops. Lenovo's U.S. headquarters is in Morrisville, North Carolina, and its registered office is in Hong Kong. Lenovo has operations in more than 60 countries and sells its products in around 160 countries. Lenovo ranks fourth in the global tablet market by volume. Lenovo's fiscal year ends on March 31 every year. For fiscal 2012/2013 ending March 31, 2013, Lenovo's revenues increased 14.5 percent to $33.8 billion while net income increased 33 percent to $631 million.

Lenovo sells directly to consumers and businesses through online sales, company-owned stores, chain retailers, and other distributors. Lenovo's principal facilities are in Beijing, Morrisville, and Singapore, with research centers in those locations, as well as Shanghai, Shenzhen, Xiamen, and Chengdu in China, and Yamato in Kanagawa Prefecture, Japan. Lenovo operates factories in Chengdu and Hefei, China and recently started production in Argentina.

In July 2012, Lenovo and the National Football League (NFL) announced that Lenovo had become the NFL's "Official Laptop, Desktop and Workstation Sponsor." Lenovo said that this was its largest sponsorship deal ever in the United States. Lenovo will receive advertising space in NFL venues and events and be allowed to use the NFL logo on its products and ads. Lenovo said that this sponsorship would boost its efforts to market to the key 18-to-35-year-old male demographic.

Lenovo entered the smartphone market in 2012 and quickly became a huge vendor of smartphones in the Chinese market. Entry into the smartphone market was accompanied by a change of strategy from "the one-size-fits-all LePhone strategy" to a diverse portfolio of devices. In 2012, Lenovo passed Apple to become the number 2 provider of smartphones in China with about a 15-percent market share, behind Xiaomi. In late 2013, Xiaomi was a growing smartphone rival to Lenovo, both firms being valued at $10 billion. Chinese-made smartphones are becoming serious competitors to Apple and Samsung both at home and overseas. In the second quarter of 2013, Xiaomi overtook Apple within China and became the sixth-largest smartphone maker globally with 5 percent market share compared to Apple's 18 percent. Xiaomi also derives revenue from its own digital game platform and social messaging app, MiLiao. Lenovo is contemplating making a move to acquire Xiaomi—or it could it be the other way around if Lenovo falters?

Lenovo has invested U.S. $793 million in the construction of a mobile phone manufacturing and research-and-development facility in Wuhan, China. Lenovo has expanded sales of its smartphones into Russia, Indonesia, and India, with further expansion intended. The LePhone smartphone is offered at a low price point and is customized for the Chinese market. It has benefited from strong support from Chinese mobile phone companies and content providers such as Baidu, Alibaba, and Tencent.

A 7,500-square foot flagship Lenovo store opened in Beijing in February 2013. At the same time in the USA, Lenovo introduced the ThinkPad X131e Chromebook—a rugged PC designed for K–12 education. This product simplifies software and security management for school administrators and provides students and teachers with quick access to thousands of apps, education resources, and storage.

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History

Liu Chuanzhi founded Lenovo in 1984 with a group of 10 engineers in Beijing. For the first 20 years of its existence, the company's English name was "Legend" but in April 2003, the company publicly announced its new name, "Lenovo," with a large media campaign involving huge outdoor billboards and primetime television advertisements. Lenovo's first successful product was the Han-card,

an add-on card for PCs that allowed them to efficiently process Chinese characters. Lenovo became a publicly traded company after listing in Hong Kong in 1994, raising nearly $30 million.

Lenovo acquired IBM's PC business in 2005 amid a backlash in Congress against Chinese companies trying to purchase U.S. businesses. Lenovo's acquisition of IBM's PC division accelerated access to foreign markets while improving both its branding and technology. Lenovo paid $1.25 billion for IBM's computer business and assumed an additional U.S. $500 million of IBM's debt. This acquisition made Lenovo the third largest computer maker worldwide by volume.

In January 2011, Lenovo formed a PC joint venture with NEC, a Japanese IT company. The venture is named Lenovo NEC Holdings B.V., which is registered in the Netherlands. Lenovo owns a 51 percent stake in the joint venture, whereas NEC holds a 49 percent stake. Lenovo has a five-year option to expand its stake in the joint venture. This joint venture is intended to boost Lenovo's worldwide sales by expanding its presence in Japan, a key market for PCs. NEC spun off its PC business into the joint venture, so Lenovo is now the largest PC seller in Japan.

Lenovo recently acquired Medion, a German electronics manufacturing company, doubling its share of the German computer market to 14 percent and making it the third-largest vendor by sales after Acer and HP. The deal was the first in which a Chinese company acquired a well-known German company.

The Year 2012: Expanding Globally

Lenovo had acquired the Brazil-based electronics company CCE that sells products under the brand name Digibras for a base price of 300 million reais (U.S. $148 million) in a combination of stock and cash and an additional 400 million reais dependent on performance benchmarks. Before this acquisition, Lenovo already established a $30 million factory in Brazil, but Lenovo desired a local partner to maximize regional growth. Lenovo realizes that the 2014 World Cup that will be hosted by Brazil as well as the 2016 Summer Olympics and CCE has a reputation for quality.

Lenovo acquired the U.S.-based software company Stoneware, in its first software acquisition to date. Lenovo desires to improve and expand its cloud-computing services. For the two years before its acquisition, Stoneware partnered with Lenovo to sell its software. During this period, Stoneware's sales doubled. Stoneware was founded in 2000. Stoneware is based in Carmel, Indiana, and has 67 employees.

Lenovo has made an investment in Vertex, a technology-oriented venture capital firm in Israel. Lenovo's Chief Executive Officer (CEO), Yang Yuanging, said that this investment was just the beginning. He said, "Definitely we are interested in Israel's technology, to grow our company, to grow our business."

Lenovo recently introduced the more powerful desktop computer IdeaCentre A720, with a 27-inch touch-screen display and running Windows 8. With a TV tuner and HDMI, the A720 is also a multimedia hub of sorts. In 2013, Lenovo added a table computer to the IdeaCentre line. Lenovo sells tablet computers under the IdeaPad and ThinkPad product lines abroad and as the LePad in Mainland China. The LePad is part of an effort by Lenovo in the market for mobile Internet devices. Lenovo has established a Mobile Internet and Digital Home Business Group to compete in this space.

Lenovo is developing a new smart television product called LeTV. The PC, communications, and TV industries are currently undergoing a "smart" transformation. Lenovo recently offered a new cloud computing service that will allow users to share content between multiple devices, in addition to managing their personal information and social networking.

Internal Issues

Vision and Mission

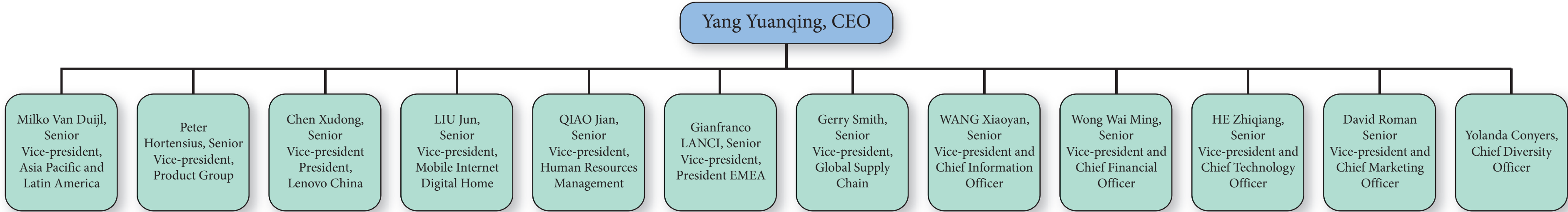
Lenovo's vision statement reads as follows: "To create personal devices more people are inspired to own, a culture more people aspire to join and an enduring, trusted business that is well respected around the world."

Lenovo's mission statement reads as follows: "To become one of the world's great personal technology companies."

Organizational Structure

Lenovo's organizational chart is depicted in Exhibit 1. Note that there is no chief operations officer (COO), and the structure appears to be divisional by region because the only two presidents head geographic regions. There are three females among the top 13 executives. Lenovo's

EXHIBIT 1 **Lenovo's Organizational Chart**



Note: EMEA = Europe/Middle East/Africa; APLA = Asia/Pacific/Latin America

Source: Based on company information provided at the corporate website.

new geographic based structure became effective in April 2012 with the creation of new reporting business units as follows: (1) China, (2) Asia-Pacific/Latin America (APLA), (3) Europe-Middle East-Africa (EMEA), and (4) North America. The new geographical structure, according to Lenovo, enables the firm to stay as close to its customers as possible.

Strategy

Lenovo is still primarily a PC company, but demand for PCs is falling; however, demand for smartphones is rapidly growing, so Lenovo is shifting gears. In smartphones, Lenovo is competing with Chinese rivals, such as Huawei Technologies Co Ltd. and ZTE Corp., that are already among the top-five smartphone companies globally. Although the second-biggest smartphone vendor in China, Lenovo has begun selling smartphones in Russia, Indonesia, the Philippines, and Vietnam, but the company faces stiff competition globally from Samsung Electronics Co. Ltd. and Apple Inc.

Lenovo's manufacturing operations are a departure from the usual industry practice of outsourcing to contract manufacturers. Lenovo instead focuses on vertical integration to avoid excessive reliance on suppliers and to keep down costs. Speaking on this topic, Yuanqing said, "Selling PCs is like selling fresh fruit. The speed of innovation is very fast, so you must know how to keep up with the pace, control inventory, to match supply with demand and handle very fast turnover." Lenovo benefited from its vertical integration after flooding affected hard-drive manufacturers in Thailand in 2011 because the company could continue manufacturing operations by shifting production toward products for which hard drives were still available.

Lenovo began to accentuate vertical integration after a meeting in 2009 in which Yuanqing, and the head of Lenovo's supply chain, analyzed the costs versus the benefits of in-house manufacturing and decided to make at least 50 percent of Lenovo's manufacturing in-house. Lenovo Chief Technology Officer George He said that vertical integration has an important role in product development. He stated, "If you look at the industry trends, most innovations for PCs, smartphones, tablets and smart TVs are related to innovation of key components—display, battery and storage. Differentiation of key parts is so important. So we started investing more … and working very closely with key parts suppliers."

Lenovo has partially moved production of its ThinkPad line of computers to Japan. ThinkPads are produced by NEC in Yamagata Prefecture. Akaemi Watanabe, president of Lenovo Japan, said, "As a Japanese, I am glad to see the return to domestic production and the goal is to realize full-scale production as this will improve our image and make the products more acceptable to Japanese customers." Lenovo recently started manufacturing computers in Whitsett, North Carolina.

For Lenovo's third quarter of 2012 that ending December 2012, the company reported a quarterly profit of $200.0 million, up 30 percent from a year previously. That amount exceeded its previous record of $163 million, on strong sales of smartphones and tablet computers. For the third quarter, Lenovo's revenue grew 12 percent from a year previously to $9.4 billion, but the bulk of that still came from its PC business. Lenovo shipped 9.4 million smartphones in the third quarter, all but about 400,000 of them however in China. CEO Yang says "the smartphone business outside China is 'still in the first stage' and Lenovo needs to invest to gain market share before focusing on profitability." The company's third-quarter revenues in the bigger but slower-growing PC market rose 7 percent to $7.9 billion.

Lenovo's global market share in PCs increased to 15.9 percent in the third quarter, trailing HP's 17.0 percent, but well ahead of both Dell and Acer. Lenovo's 15.9 percent was the average of their 11.1 percent market share in EMEA, 9 percent in North America, and 36.7 percent in China. Lenovo has rapidly gained market share in the PC sector and in early 2013 trails HP only by a slim margin in PC shipments. However, as PC demand growth slows, Lenovo has been diversifying into the mobile device sector to tap robust demand for smartphones and tablets, particularly at home in China, the world's biggest market for mobile phones and PCs.

About a one-tenth of Lenovo's third-quarter revenues in 2012 came from its mobile Internet and digital home (MIDH) business—mainly consisting of its smartphone sales in China, which jumped 77 percent to $998 million, although that was only 11 percent of total revenue. The company's third-quarter shipments of media tablets rose 77 percent to 800,000 units. MIDH now contributes 11 percent of Lenovo's overall revenue. At the end of the third quarter in 2012, Lenovo is number-three worldwide in Smart Connected Devices (PC's, tablets, and smartphones).

Lenovo basically has what it calls a two prong strategy: (1) Protect its commercial global PC business and its China business and (2) attack three high-growth opportunities in emerging markets with smartphones, tablets, and smart TVs. For quarter ending January 31, 2013, Lenovo's "attack" businesses delivered 50 percent of the company's revenues, a significant increase from four years ago when the company first launched the strategy and attack revenues were 32 percent. Lenovo's MIDH revenues include its smartphone, tablet, and smart TV businesses and accounted for a record 11 percent of total Lenovo revenue in the third quarter, up 77 percent year-over-year. And for the first time ever, Lenovo's smartphone business in China became profitable in third quarter.

Ethics

In fiscal 2012, Lenovo CEO Yang received a $3 million bonus as a reward for record profits, which he in-turn redistributed to about 10,000 Lenovo's employees. According to Lenovo spokesman, Jeffrey Shafer, Yang felt that it would be the right thing to "redirect [the money] to the employees as a real tangible gesture for what they done." Shafer also said that Yang, who owns about eight percent of Lenovo's stock, "felt that he was rewarded well simply as the owner of the company." The bonuses were mostly distributed among staff working in positions such as production and reception who received an average of 2,000 yuan or about U.S. $314. This was almost equivalent to a month's pay for the typical Lenovo worker in China. According to Lenovo's annual report, Yang earned $14 million, including $5.2 million in bonuses, during the fiscal year that ended in March 2012.

Finance

Lenovo's recent income statements and balance sheets are provided in Exhibits 2 and 3, respectively. Note in Exhibit 2 the 14.6 percent increase in revenues for fiscal 2012/2013, as well as the 33 percent increase in net income.

EXHIBIT 2 Lenovo's Income Statements (U.S. $ 000,000 omitted)

	FY2012/13	FY2011/12
Revenue	33,873	29,574
Cost of sates	(29,800)	(26,128)
Gross profit	**4,073**	**3,446**
Other income, net	20	1
Selling and distribution expenses	(1,888)	(1,691)
Administrative expenses	(847)	(730)
Research and development expenses	(623)	(453)
Other operating income - net	65	11
Operating profit	**800**	**584**
Finance income	44	43
Finance costs	(42)	(44)
Share of losses of associated companies	(1)	(1)
Profit before taxation	801	582
Taxation	(170)	(107)
Profit for the period	631	475
Profit attributable to:		
Equity holders of the company	635	473
Non-controlling interests	(4)	2
Dividend	248	183
Earnings per share (U.S. cents)		
Basic	**6.16**	**4.67**
Diluted	**6.07**	**4.57**

Source: Based on company documents.

EXHIBIT 3 Lenovo Balance Sheet (in millions of U.S. dollars)

	As of Mar 31, 2013	As of Mar 31, 2012
Non-current assets	4,492	4,040
Property, plant and equipment	480	392
Intangible assets	3,326	3,092
Others	686	556
Current assets	12,390	11,820
Bank deposits and cash	3,573	4,172
Trade, notes and other receivables	6,694	6,297
Inventories	1,965	1,218
Others	158	133
Current liabilities	12,091	11,809
Short-term bank loans	176	63
Trade, notes and other payables	10,576	11,251
Others	1,339	495
Net current assets	299	11
Non-current liabilities	2,111	1,603
Total equity	**2,680**	**2,448**

Source: Based on company documents.

Segments

Lenovo does an excellent job of reporting segment financial information both by geographic region and by product. Exhibit 4 reveals geographic segment information for Lenovo's 2012/2013 fiscal year that ended March 31, 2013. Note the high revenue growth in Europe/Middle East/Africa (EMEA) and the high profit margin in China. At March 31, 2013, Lenovo's worldwide personal computer (PC) market share grew from 13.0 percent to 15.3 percent, trailing only HP's 15.7 percent, and above Dell's 13.2 percent.

Competitors

A financial comparison of various Lenovo competitors is provided in Exhibit 5. Note that Apple crushes all competitors, including Lenovo, on profit margin and earnings per share (EPS). Note that HP is struggling and that Lenovo does not have that many shares outstanding versus most rival firms. Apple is the second-largest publicly traded corporation in the world by market capitalization with its $424 billion figure. Lenovo is also concerned about China's ZTE Corp., which plans to become one of the world's top-three smartphone brands. ZTE was struggling financially as 2012 ended, but the company has aggressive plans and a good product.

Apple, Inc.

Headquartered in Cupertino, California, Apple's best-known products are the Mac line of computers, the iPod, iPhone, iPad, iTunes, iLife, and iWork. Apple software includes the OS X and iOS operating systems and the Safari web browser. Apple is the world's second-largest information technology company by revenue after Samsung Electronics. Apple is also the world's third-largest mobile phone make after Samsung and Nokia. As of November 2012, Apple has 394 retail stores in 14 countries and an online Apple Store and iTunes Store. For its fiscal year that ended in September 2012, Apple posted revenue of $22.5 billion in China, Taiwan, and Hong Kong, nearly double the amount from the prior year. However, partly as a result of Lenovo, Apple's market share dropped to 4.2 percent of the China smartphone market in the quarter ended September 2012, from 5.8 percent the prior year. Another problem for Apple in China is that the China's largest mobile carrier, China Mobile Ltd., does not sell the iPhone, although that company had 87.9 million subscribers to high-cost, third-generation mobile services at year end 2012.

EXHIBIT 4 Lenovo's Sales and Profit by Region (in U.S. dollars)

Including MIDH and non-PC revenue & results	Revenue US$ Million		Segment Operating Profit/ (Loss) US$ Million		Segment Operating Profit Margin	
	FY13	Y/Y	FY13	FY12^	FY13	FY12^
China	14,539	17%	678	569	4.7%	4.6%
China - PC	11,751	6%	733	638	6.2%	5.8%
APLA	6,860	8%	24	0	0.3%	0.0%
EMEA	7,535	20%	147	83	2.0%	1.3%
North America	4,939	9%	168	161	3.4%	3.5%

Note: EMEA = Europe/Middle East/Africa; APLA = Asia/Pacific/Latin America.

EXHIBIT 5 A Financial Comparison of Lenovo with Rival Firms (in U.S. dollars)

	Lenovo	Apple	Dell	HP	Toshiba	Fujitsu
Sales ($)	34 B	165 B	58 B	120 B	63 B	49 B
Income ($)	631 M	42 B	2.7B	–12.6 B	1.3 B	279 M
Profit Margin	1.86%	25.35%	4.44%	–10.5%	2.27%	0.55%
Market Capitalization ($)	11.07 B	424 B	24 B	32.5 B	18.5 B	8.5 B
Shares Outstanding	518 M	939 B	1.75 B	1.95 B	4.25 B	414 M
EPS ($)	1.10	44.10	1.47	–6.45	0.30	0.64

Note: EPS, earnings per share.
Source: Developed in February 2013 from a variety of sources.

An increasing number of companies are interested in purchasing Mac computers for all or part of their global operations. Apple focuses its business toward consumers and does not aggressively develop products and services for global enterprise customers. Organizations that have multiple-country operations oftentimes have to make separate arrangements in each region, with local partners making global deployments more complex. Apple has outstanding product design and innovation as well as financial stability, but the company lacks consistent global service and support. In September 2012, Apple unveiled the iPhone5, featuring an enlarged screen, more powerful processors, and running iOS6. The phone also includes a new mapping application (replacing Google Maps) that has attracted some criticism.

Dell, Inc.

Headquartered in Round Rock, Texas, Dell is the third-largest PC vendor in the world after HP and Lenovo. Dell employs more than 103,300 people worldwide and is a strong corporate PC supplier with good global coverage and capabilities. Dell is positioning itself beyond its PC roots however and as such is becoming less competitive on PC pricing. To diversify away from PCs—although that product, like Lenovo, is still Dell's best seller—Dell in 2012 acquired Wyse Technology and Quest Software and Gale Technologies and Credant Technologies. These acquired firms produce and market other high-technology products and services, but not PCs, smartphones, or tablets.

Fujitsu

Headquartered in Tokyo, Japan, Fujitsu is the world's third-largest IT services provider measured by revenues after IBM and HP. Fujitsu executes on a global basis and provides a good option for corporate purchasing for many organizations. Although its U.S. operations are still weak, Fujitsu has added desktops and bolstered its North American capabilities. Fujitsu is also a strong supplier of pen tablet PCs, an important segment with Windows 8. Fujitsu has a good desktop service portfolio across Europe and is strong in the Middle East, Africa, and Japan. In May 2011, Fujitsu entered the mobile phone market again and released various Windows Phone devices. Fujitsu offers a public cloud service delivered from data centers in Japan, Australia, Singapore, the United States, the United Kingdom, and Germany based on its Global Cloud Platform strategy. The platform delivers Infrastructure-as-a-Service (laaS) virtual information and communication technology (ICT) infrastructure, such as servers and storage functionality.

Hewlett-Packard

Headquartered in Palo Alto, California, HP has a strong global PC presence and portfolio of services and products and is a viable supplier for global enterprise customers, regardless of business size. In May 2012, HP announced plans to lay off approximately 27,000 employees, after posting a profit decline of 31 percent in the second quarter of 2012. The profit decline is largely as a result of the growing popularity of smartphones, tablets, and other mobile devices that have slowed the sale of PCs. HP recently merged its printing and PC businesses under one executive, Todd Bradley. In November 2012, HP recorded a write down of around $8.8 billion related to its $11.3 billion acquisition of the U.K.-based software maker Autonomy Corp. HP accused Autonomy of deliberately inflating the value of the company before its takeover, but Autonomy flatly rejected the charge. The FBI is investigating but HP's stock has fallen to a decades' low.

Toshiba Corporation

Headquartered in Tokyo, Japan, Toshiba provides a wide range of notebook computers targeted at businesses, but its global focus has shifted increasingly toward the consumer and small-business markets. Toshiba remains strong in Canada and Australia in commercial sales, but a lack of desktop offerings makes Toshiba inappropriate if a sole PC vendor is desired for a company. Toshiba's focus has shifted toward the nonenterprise notebook market. Toshiba is no longer a major concern for Lenovo because the two firms' product lines overlap less and less every day.

Acer

Headquartered in Taiwan, Acer plans to build up its smartphone business, raising sales from 500,000 units in 2012 to 1.5 million in 2013, and 5 million in 2014. Acer is targeting specific operators individually instead of trying to offer models across entire markets. Acer has suffered two consecutive (2011 and 2012) annual losses, still struggling from its bad acquisitions of Gateway, Packard Bell, and eMachines. Of late however, Acer has posted strong sales of notebooks using Google's Chrome platform.

Nokia Corporation

Nokia is a communications and IT corporation headquartered in Keilaniemi, Espoo, Finland. Its principal products are mobile phones and portable IT devices. Nokia was the world's largest vendor of mobile phones from 1998 to 2012 but over the past five years, the company has suffered declining market share as a result of the growing use of smartphones from other vendors, principally the Apple iPhone and devices running on Google's Android operating system. As a result, its share price has fallen from a high of U.S. $40 in 2007 to under U.S. $3 in 2012. Since February 2011, Nokia has had a strategic partnership with Microsoft whereby Nokia smartphones will incorporate Microsoft's Windows Phone operating system (replacing Symbian). Nokia unveiled its first Windows Phone handsets, the Lumia 710 and 800 in October 2011 but sales subsequently dropped and Nokia made six consecutive loss-making quarters from second quarter 2011 to third quarter 2012.. The fourth quarter of 2012 saw Nokia return to profit after strong sales of its new Windows Phone 8 handsets, particularly the high-end Lumia 920. In October 2012, Nokia said its high-end Lumia 820 and 920 phones, which will run on Windows Phone 8 software, will soon be available across Europe and in Russia. In December 2012, Nokia introduced two new smartphones, the Lumia 620 and 920T. In January 2013, Nokia reported 6.6 million smartphone sales for the fourth quarter in 2012, consisting of 2.2 million Symbian and 4.4 million sales of Lumia devices (Windows Phone 7 and 8). In North America, only 700,000 mobile phones have been sold including smartphones.

Samsung Electronics

Based in Seoul, South Korea, Samsung makes the popular Galaxy smartphone. Samsung also makes DVD players, digital TVs, and digital still cameras; computers, color monitors, LCD panels, and printers; semiconductors such as DRAMs, static RAMs, flash memory, and display drivers; and communications devices ranging from wireless handsets and smartphones to networking gear; microwave ovens, refrigerators, air conditioners, and washing machines. Galaxy runs on Google's android mobile-operating software.

The Future

Lenovo's diverse product brands overlap more and more, which is becoming confusing to many customers. The company's current aggressive pricing may not be profitable in future years. The differentiation provided by Lenovo's ThinkVantage software tools is eroding. Alternative offerings from Microsoft and third parties are improving, and are often free, reducing the value of Lenovo's unique tools. Even for a strong firm such as Lenovo, rivals await at every turn to seize market share and customer loyalty. The global smartphone market increased by 39 percent in 2012 in terms of units shipped, according to International Data Corporation.

In the summer of 2013, Lenovo introduced another new product, a table PC that weighs 17 pounds and runs off Windows 8 and is called the Lenovo Idea Centre Horizon Table PC. The new product does everything and features a 27-inch high-definition display panel. Hundreds of fun games and educational apps come preloaded on the new product. Lenovo is engaged in discussions to acquire the maker of the BlackBerry smartphone, but a larger concern for the company perhaps is Xiaomi.

Develop a clear strategic plan for Lenovo that will enable the company to continue its historical success.

Netgear, Inc., 2013

www.netgear.com, NTGR

Headquartered in San Jose, California, Netgear develops and markets Ethernet switches, wireless controllers, storage devices, routers, media services, and other products associated with connecting users with the Internet. All Netgear products are produced through third-party manufacturers and marketed through thousands of retailers worldwide. Netgear prides itself on developing and marketing high performance devices that are dependable and easy to operate in homes. But this "desired competitive advantage" is difficult to maintain because consumers widely believe such products are a commodity (like gasoline). For businesses, Netgear provides networking, storage, and security devices that are cheaper and easier to use than comparable products offered by rival firms. Netgear products are sold in more than 28,000 retail locations around the world and through about 42,000 resellers. Netgear has operations in 25 nations and has 850 employees, of which 352 are in sales, marketing and technical support, 251 in research and development (R&D), 128 in finance, and 119 in operations.

Netgear's revenues for 2012 were $1.27 billion, up 7.6 percent from 2011. The company reported revenue for Q2 of 2013 of $357.7 million, up from $320.7 million the prior year when the company's new acquisition, AirCard, was not in the numbers. Q2 2013 net income was $14.0 million, down from $21.5 million the prior year. During Q2, Netgear grew its Retail Business Unit (RBU), led by its 802.11ac upgrade cycle, as well as the rollout of the Smart Home for developed markets. The integration of the AirCard business into the company's Service Provider Business Unit (SPBU) went well. On a year-over-year basis, Netgear's RBU revenue was up 3 percent. The company's strong Q2 2013 year-on-year growth for RBU in North America and Asia was offset by weakness in the European region. The company's SPBU revenue was up 58 percent sequentially, and up 20 percent over the prior year quarter. The company's Commercial Business Unit (CBU) revenue was up 25 percent sequentially, and up 10 percent over the prior year quarter.

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History

Netgear was incorporated in 1996 as a subsidiary of Bay Networks and was purchased by Nortel in 1998. The company became fully independent from Nortel in 2002 and remains independent today. Back in 1996, the Internet was in its infancy, especially high speed and wireless devices. As an industry pioneer, Netgear has kept tight inventory controls and used off-the-shelf hardware and software products from existing companies. Founder, chairman, and CEO Patrick Lo was quoted in 2004 as saying: "We do the system integration and let the contracted firms do the grunt work of designing circuit boards." Netgear went public in 2003. Since then, the company has grown into a $1.2 billion in sales firm. In 2011, Netgear combined its North, Central, and South U.S. salesforces to form a new Americas territory as a means to increase operational efficiencies. Today, the company operates in three distinct geographic territories: (1) Americas, (2) Europe, and (3) Middle East and Asia Pacific.

To get a flavor of what Netgear develops and markets, in late 2012, the company introduced its CG4500TM Voice/Data Gateway that received the CableLabs® DOCSIS® 3.0 certification. This unit has the capability for 24 × 4-channel bonding and is the firm's most advanced DOCSIS 3.0 Voice/Data Gateway integrating in one device. The new product allows concurrent 802.11n dual-band wireless networking that provides up to 900 Mbps (450 + 450 Mbps) aggregate speed and with simultaneous dual-band technology helps mitigate interference ensuring sustained throughput and reliable connections. With integrated MoCA, the CG4500TM Gateway enables seamless data and video distribution over the in-home coax network.

Internal Issues

Vision and Mission

Netgear's mission statement is: "To be the innovative leader in connecting the world to the Internet," recently changed from, "To be the preferred customer-driven provider of innovative networking solutions for small businesses and homes." There is a statement on the company's website that may be their vision: "Our goal is to be the leading provider of innovative networking products to the consumer, business, and service provider markets."

Location

Netgear's primary administrative, sales, marketing, and R&D facilities consist of 142,700 square feet in an office complex in San Jose, California, under a lease that expires in 2018. Netgear's international headquarters comprise 10,000 square feet of office space in Cork, Ireland, under a lease that expires in 2026. Netgear's international salespersons are based out of local sales offices or home offices in Austria, Australia, Brazil, Canada, China, Czech Republic, Denmark, France, Germany, Hong Kong, India, Italy, Japan, Korea, Mexico, New Zealand, Poland, Russia, Singapore, Spain, Sweden, Switzerland, the Netherlands, the United Arab Emirates, and the United Kingdom. Netgear has operations personnel in Hong Kong, and R&D facilities in Atlanta, Chicago, Beijing, Guangzhou, Nanjing, and Shanghai, China, and in Taipei, Taiwan.

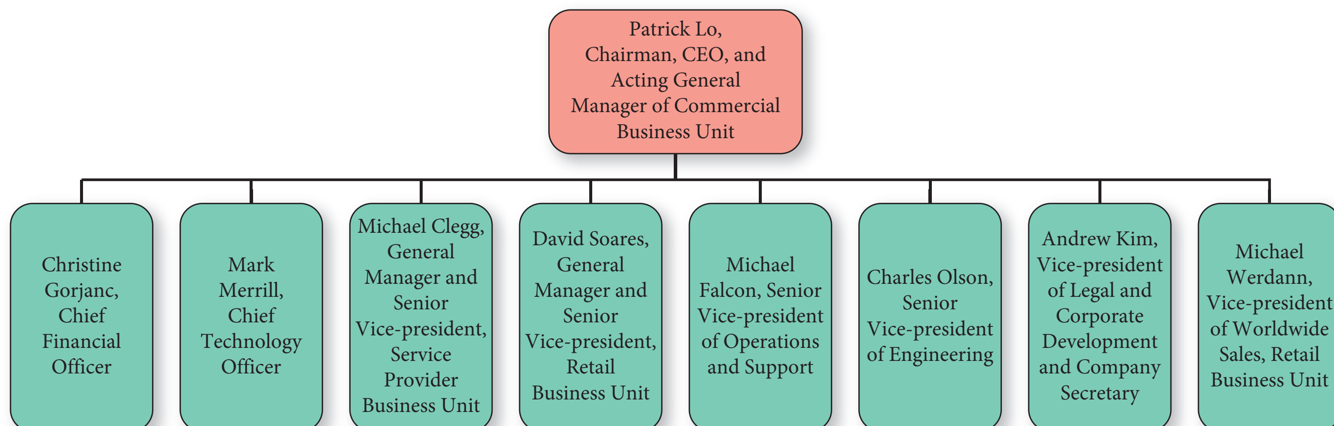
Organizational Structure

Netgear is managed in three specific business units: (1) retail, (2) commercial, and (3) service provider. The retail business unit consists of home networking, storage, and digital media products to connect users with the Internet and their content and devices. The commercial business unit consists of relatively low-cost business networking, storage, and security solutions. The service provider business unit consists of made-to-order and retail proven, whole-home networking solutions sold to service providers for sale to their customers.

Netgear recently combined their North American, Central American, and South American sales forces to form the Americas territory. Thus, the firm is today organized into the following three geographic territories: (1) Americas, (2) Europe, Middle-East, and Africa (EMEA) and (3) Asia, Pacific (APAC).

Exhibit 1 provides a diagram of Netgear's existing organizational structure. Note there is no Chief Operations Officer. Some analysts contend that the company is too dependent on Lo, with no other person being groomed as an eventual successor.

EXHIBIT 1 Organizational Chart



Source: Based on company documents.

Products

Netgear products that target businesses are designed with metal cases and are capable of faster speeds, up to 10 gigabits per second, and higher port counts to allow more users. Products targeting homes are designed with more pleasing aesthetics and are often offered at much lower prices than the more robust higher security business models. Netgear plans to develop a home network that will enable all devices to be connected to the Internet at all times.

Netgear's products can be grouped into three categories: (1) commercial business networking, (2) broadband access, and (3) network connectivity. Commercial business networking products include (a) Ethernet switches and wireless controllers such as routers used in WiFi applications, (b) Internet security appliances that enable Internet access with capabilities such as anti-virus and firewalls, and (c) network-attached storage, which provides file sharing with multiple PCs over a businesses own local area network.

Netgear's broadband access enables customers to move digital content over high-speed networks rather than traditional low-speed telephone lines. Products in this segment include: (a) routers, which allow the home or office networks to connect wireless to the Internet via a broadband modem, (b) gateways, which are routers integrated into a modem, (c) Internet Protocol (IP) telephony products, which enable voice communications over a network, and (d) media servers, which store multimedia content for use on PCs laptops, smartphones, and other devices.

Netgear's connectivity products enable resource sharing and include wireless access points, wireless network interface cards, Ethernet network interface cards, media adapters, and power line adapters.

R&D

High technology firms spend anywhere from 5 to 15 percent of revenue on R&D. In 2012, Netgear spent $61 million, up 25.5 percent, on R&D to develop new and improved products and respond to changing technology in a timely manner. The $61 million was 4.8 percent of Netgear's revenues, up from 4.1 percent the prior year. Netgear works closely with their technology suppliers to develop products using a methodology such as Original Design Manufacturer (ODM) or In-House Development. Under ODM, Netgear defines the product and specifications and coordinates with suppliers who develop the product. On development of a prototype, debugging and testing begins, and the product is ultimately released for production after passing final measures. The In-House Development model is similar to ODM, except entire development is coordinated by Netgear engineers.

Manufacturing

Like Apple, Inc., Netgear outsources all of their manufacturing to third parties, such as Cameo Communications, Delta Networks, Hon Hai Precision (more commonly known as Foxconn Corporation), and several others. Almost all Netgear products are manufactured on mainland China or in Vietnam. Products are sometimes tested in a pilot basis in Taiwan. Netgear component parts such as connector jacks, plastic casings, and physical layer transceivers are all purchased from a few sources, making reliance on a few suppliers a threat. If any third-party manufacturers experience any delay, disruption, or quality control problems in their operations, Netgear could lose market share and the Netgear brand could suffer. Netgear outsources warehousing and distribution logistics to five third-party providers, located in California, Hong Kong, Netherlands, and Australia. Netgear does not have long-term contracts with any of their third-party manufacturers, some of whom produce products for competitors.

Marketing

Netgear's global sales channel includes thousands of value added resellers (VARs), direct market resellers (DMRs), such as CDW, and 37,000 traditional retailers worldwide, such as Best Buy, Walmart, Fry's Electronics, and Staples in North America; PC World in the United Kingdom; and MediaMarket in Germany, as well as online retailers such as Amazon.

com, Dell.com, and NewEgg.com. Netgear also sells its products through broadband service providers such as BSkyB, Virgin Media UK, YouSee Denmark, Telecom Denmark, Time-Warner Cable, Comcast, TV Cabo Portugal, Telkom South Africa, J:Com of Japan, and Comhem of Sweden.

Best Buy and Ingram Micro each account for 10 percent or greater of Netgear revenues. Netgear works closely with customers on market development activities, such as co-advertising, in-store promotions and demonstrations, instant rebate programs, event sponsorship, and sales associate training. It also participates in major industry trade shows and marketing events. Netgear marketing managers work closely with the company's sales and R&D people to align product development roadmaps to meet customer technology demands.

Finance

Netgear's net income declined in 2012 to $86.5 million from the year before value of $91.4 million.

Income Statements

Netgear's recent income statements are provided in Exhibit 2. Note the steady increases in revenues but recent drop in net income.

EXHIBIT 2

NETGEAR, INC.
STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended December 31,		
	2012	2011	2010
Net revenue	**$1,271,921**	**$1,181,018**	**$902,052**
Cost of revenue	888,368	811,572	602,805
Gross profit	383,553	369,446	299,247
Operating expenses:			
Research and development	61,066	48,699	39,972
Sales and marketing	149,766	154,562	131,570
General and administrative	45,027	39,423	36,220
Restructuring and other charges	1,190	2,094	(88)
Litigation reserves, net	390	(201)	211
Total operating expenses	257,439	244,577	207,885
Income from operations	126,114	124,869	91,362
Interest income	498	477	426
Other income (expense), net	2,670	(1,136)	(564)
Income before income taxes	129,282	124,210	91,224
Provision for income taxes	42,743	32,842	40,315
Net income	**$86,539**	**$91,368**	**$50,909**
Net income per share:			
Basic	$2.27	$2.46	$1.44
Diluted	$2.23	$2.41	$1.41
Weighted average shares outstanding used to compute net income per share:			
Basic	38,057	37,121	35,385
Diluted	38,747	37,932	36,124

Source: 2012 *Form 10K,* p. 54.

Balance Sheets

Netgear's recent balance sheets are provided in Exhibit 3. Note the zero long-term debt.

Segments

Netgear reports operating income by geographic region. Before 2011, the company's operations in Central and South America were categorized under the APAC segment. Note in Exhibit 4 that Netgear's APAC segment was the largest gainer in 2012 versus the prior year, whereas EMEA reported a decline in revenues.

EXHIBIT 3 Netgear's Balance Sheet

NETGEAR, INC.
BALANCE SHEETS
(In thousands, except per share data)

	December 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$149,032	$208,898
Short-term investments	227,845	144,797
Accounts receivable, net	256,014	261,307
Inventories	174,903	163,724
Deferred income taxes	22,691	23,088
Prepaid expenses and other current assets	33,724	32,415
Total current assets	**864,209**	**834,229**
Property and equipment, net	19,025	15,884
Intangibles, net	27,621	20,956
Goodwill	100,880	85,944
Other non-current assets	22,834	14,357
Total assets	**$1,034,569**	**$971,370**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$87,310	$117,285
Accrued employee compensation	18,338	26,896
Other accrued liabilities	126,255	120,480
Deferred revenue	27,645	40,093
Income taxes payable	1,382	4,207
Total current liabilities	**260,930**	**308,961**
Non-current income taxes payable	13,735	18,657
Other non-current liabilities	5,293	4,995
Total liabilities	**279,958**	**332,613**
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: $0.001 par value; 5,000,000 shares authorized; none issued or outstanding	—	—
Common stock: $0.001 par value; 200,000,000 shares authorized; shared issued and outstanding:		
38,341,644 and 37,646,872 at December 31, 2012 and 2011, respectively	38	38
Additional paid-in capital	394,427	364,243
Cumulative other comprehensive income	4	23
Retained earnings	360,142	274,453
Total stockholders' equity	**754,611**	**638,757**
Total liabilities and stockholders' equity	**$1,034,569**	**$971,370**

Source: 2012 *Form 10K,* p. 53.

EXHIBIT 4 Revenues by Geographic Segment

	Year End December (in thousands)							
	2012		2011		2010		Percent Change	
	$	%	$	%	$	%	2012	2011
Americas	$679,419	53.4	$587,056	49.7	$466,542	51.7	15.7	25.8
EMEA	$457,724	36%	$477,713	40.4	$340,249	37.7	(4.2)	40.4
APAC	$134,778	10.6	$116,249	9.9	$95,261	10.6	15.9	22.0
Total	$1,271,921	100%	$1,181,018	100%	$902,052	100%		

APAC, Asia Pacific; EMEA, Europe, Middle East, Africa.
Source: 2012 *Form 10K*, page 41.

Competition

Netgear operates in an extremely competitive industry, with many products being viewed by consumers as commodities, proper position on store floors being critically important, and competitive pricing being essential. Many Netgear products, such as media adapters, Ethernet, and routers, are also made by rivals Cisco Systems, Roku, Western Digital, and Apple in the USA, and by many foreign competitors such as AVM in Europe, Corega in Japan, and TP-Link in China. Netgear also develops and markets networking and streaming products, competing against rivals LG, Microsoft, Samsung, and Sony. Also competing against Netgear are many cable companies that now provide modems, and those companies may soon provide their own routers as part of their service offerings. If Netgear cannot form contracts with various cable providers, then those firms may also become competitors.

Netgear's principal competitors in the commercial business market include Allied Telesys, Barracuda, Buffalo, Data Robotics, Dell, D-Link, Fortinet, Hewlett-Packard, Huawei, Cisco Systems, the Linksys division of Cisco Systems, QNAP Systems, Seagate Technology, SonicWALL, Synology, WatchGuard, and Western Digital. Netgear's principal competitors in the home market for networking devices and television connectivity products include Apple, Belkin, D-Link, the Linksys division of Cisco Systems, Roku, and Western Digital. Netgear's principal competitors in the broadband service provider market include Actiontec, ARRIS, Comtrend, D-Link, Hitron, Huawei, Motorola, Pace, Sagem, Scientific Atlanta (a Cisco company), SMC Networks, TechniColor, Ubee, Compal Broadband, ZTE, and ZyXEL. Other current and potential competitors that Netgear considers include numerous local vendors such as Devolo, LEA, and AVM in Europe; Corega and Melco in Japan; and TP-Link in China. Even consumer electronics vendors are rivals, including LG Electronics, Microsoft, Panasonic, Samsung, Sony, Toshiba, and Vizio, who could integrate networking and streaming capabilities into their line of products, such as televisions, set top boxes, and gaming consoles.

Exhibit 5 provides a comparative summary of Netgear versus four leading competitors. Note that Netgear is a bit larger than D-Link, but much smaller than most rival firms.

EXHIBIT 5 Comparative Data for Netgear versus Rival Firms

	Netgear	Cisco Systems	D-Link	Alcatel Lucent	Western Digital
Number of Employees	791	71.8K	500	76K	103K
Net Income ($)	95.3M	7.36B	41.5M	1.4B	1.9B
Revenue ($)	1.23B	45.6B	1.15B	19.8B	13.8B
Revenue ($)/Employee	1,554K	635K	2,300K	260.5K	134K
EPS Ratio ($)	2.49	1.36	0.06	0.54	7.61
Market Capitalization	1.26B	87.64B	—	—	10.1B
Headquarters	California	California	Taiwan	France	California

EPS, earnings per share.
Source: Based on company information.

Cisco Systems, Inc.

Nearly 40 times the size of Netgear, Cisco is headquartered in the same city as Netgear, San Jose, California. Like Netgear, Cisco structures its operations in the same three geographic segments, with its European and Middle East headquarters in the Netherlands and the Asia Pacific headquarters in Singapore. Also like Netgear, Cisco produces Internet protocol networking and other related devices to support communications and information technology. Cisco's sales by geographic region reported in its fiscal year end June 2012 were 65, 21, and 14 percent respectively for Americas, EMEA, and APAC. Also like Netgear, Cisco produces cable modems, video software, encoders, decoders, and many more products. Cisco's Linksys wireless routers compete directly with Netgear routers. As of year-end 2012, Cisco had 66,000 employees, annual revenues of $46 billion, and net income of $8 billion. Also like Netgear, Cisco relies exclusively on contract manufacturers for all their manufacturing needs.

Cisco spends about 12 percent of net sales on R&D compared to only 4 percent for Netgear. Cisco contains around $17 billion in goodwill on the balance sheet resulting in approximately 40 percent of total stockholders' equity residing from intangible assets, which is not good, versus Netgear's 17 percent.

Western Digital Corporation

Headquartered in Irvine, California, Western Digital creates and markets storage devices, home entertainment devices, and networking devices, similar to Netgear. Western Digital is known for their 2.5- and 3.5-inch form factor hard drives under the Ultrastart, XE, WD, and SiliconDrive brand names. Western Digital also produces a wide range of external hard drives in 500-gb sizes, FireWire, and Ethernet connections.

Western Digital is structured based on the same geographic regions both Netgear and Cisco. One notable exception, Western Digital, with $12.5 billion of revenue in fiscal 2012 that ended June 2012, reported that about 58 percent of their revenues come from Asian markets with 23 and 19 percent coming from the Americas and EMEA, respectively, providing the company a significantly more Asian presence than both Netgear and Cisco. The company currently spends 8 percent of revenues on R&D. The firm has $2 billion in goodwill and around 37 percent of all current assets are in inventory.

As of December 2012, Western Digital has a price-to-earnings (P/E) ratio of five, below the S&P 500 P/E ratio of 17.7, and its stock price was up 22.9 percent year-to-date. Western Digital has numerous strengths, such as robust revenue growth, reasonable debt levels, solid stock price performance, impressive record of earnings per share growth, and compelling growth in net income. Western Digital has no glaring weaknesses.

Western Digital recently acquired the hard disk drive operations of Hitachi, greatly increasing its capacity and sales volume. Like rival Seagate Technology, Western Digital has been targeting some acquisitions upstream to better control input costs. Seagate recently acquired the hard disk operations of Samsung.

D-Link Corporation

Headquartered in Taipei, Taiwan, D-Link develops, produces, and markets networking, connectivity, and data communications hardware, offering hubs and switches, adapters, print servers, routers, and transceivers. Other D-Link products include broadband modems, virtual private network/firewall devices, data-storage systems, videoconferencing equipment, Web cameras, and business phones. D-Link sells to individuals and businesses, but the firm specializes in wi-fi and Ethernet components for the small to medium-sized office market. D-Link sells its products through distributors in more than 100 countries, but generates most of its sales in Asia.

The Future

In July 2012, Netgear acquired AVAAK, Inc., a privately-held company that develops wire-free video networking products for a total purchase consideration of $24.0 million in cash. This acquisition bolstered the company's retail business unit product offerings and expanded their presence in the smart home market. Some analysts however contend that the fate of Netgear's industry is inexorably tied to the PC and that PCs are in decline as users switch to tablets, which

will not need hard disk drives. But there are external storage needs for hard-disk drives that seem to be growing and conventional storage is still cheaper than flash memory.

Every few months or so, Netgear introduces a new or improved product, including the recently introduced Netgear ProSecure® UTM25S Unified Threat Management Firewall, which provides two modular slots that fit optional interface cards, enabling IT administrators to custom tailor the firewall to their specific connectivity requirements. In addition, like other members of the ProSecure UTM family of security appliances, the UTM25S integrates with Netgear ReadyNAS® network-attached storage systems, giving businesses almost unlimited activity log and quarantine capacity for forensic, regulatory and legal requirements.

Netgear also recently introduced the CentriaTM, a powerful, all-in-one automatic backup/media server and high-speed wi-fi router. Centria is a dual-band high-performance router with the added convenience of automatic data backup for both PCs and Macs. The backup capability of the Centria router gives a consumer peace of mind knowing that data is always backed up. If a PC or Mac goes down or is lost, a consumer can still access data from Centria using another computer. Routers are excellent for data backup because they are always on and are the central point of connection for all computers in the home. Centria can also be used as a storage repository for photos, media, and documents that may take up too much space on your computer. Centria uses an internal SATA drive or external USB drives to backup and store data.

There are companies such as Western Digital or Cisco that may be interested in acquiring Netgear. Even D-Link desires a greater market share in the USA. And Netgear itself has a history of making acquisitions. What would be some good acquisition targets for Netgear, to help solidify its competitive position and gain economies of scale.

To remain attractive in this rapidly changing industry, Netgear needs a clear strategic plan going forward.

Glossary

Acquisition When a large organization purchases (acquires) a smaller firm; a merger.

Actionable factors Meaningful in terms of having strategic implications; reveal potential strategies to capitalize or compensate.

Activity ratios Inventory turnover and average collection period measure how effectively a firm is using its resources.

Advantage A way to evaluate strategies, i.e. to determine if a particular strategy creates or extends a firm's competitive superiority in a selected area of activity.

Aggressive quadrant In a SPACE matrix analysis, when the firm's directional vector points in the upper right quadrant, the firm should pursue aggressive strategies.

Annual objectives Desired targets to achieve; used to focus/direct/channel efforts and activities of organization members. They (1) represent the basis for allocating resources; (2) are a primary mechanism for evaluating managers; (3) are the major instrument for monitoring progress toward achieving long-term objectives; and (4) establish organizational, divisional, and departmental priorities.

Annual objectives Short-term milestones, usually one year, that organizations must achieve to reach long-term targets/goals.

Attractiveness scores (AS) In a QSPM, the numerical value (rating) that indicates the relative attractiveness of each strategy given a single internal or external factor.

Auditing The accounting process that firms undertake to have their financial statements reviewed for accuracy in order to assure compliance with the law and IRS code.

Avoidance A method for reducing conflict through such actions as ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals (or groups).

Backward integration A strategy seeking ownership or increased control of a firm's suppliers, such as a manufacturer acquiring its raw material source firms.

Balanced scorecard A framework of desired objectives; derives its name from the need of firms to "balance" quantitative (such as financial ratios and percentages) with qualitative (such as for employee morale and business ethics) objectives that are oftentimes used in strategy evaluation.

Balanced Scorecard A strategy evaluation tool utilized to establish, monitor, and evaluate both qualitative and quantitative (hence the word balanced) objectives in order to improve organizational effectiveness and performance.

Bankruptcy A legal document that allows a firm to avoid major debt obligations and void union contracts in order to survive and regroup as a firm. There are five major types: Chapter 2, Chapter 10, and Chapter 11.

Benchmarking A management technique associated with value chain analysis, whereby a firm compares itself on a wide variety of performance-related criteria against the best firms in the industry, thus establishing standards of excellence.

Benchmarking An analytical tool used to determine how a firm's value chain activities compare to rival firms in order to better gain and sustain competitive advantages.

Board of directors A group of individuals above the CEO, who have oversight and guidance over management and who care for shareholders' interests.

Bonus system A form of incentive compensation whereby employees and/or managers receive a year-end or period-end reward, usually cash, based on some organizational performance criteria such as sales, profit, production efficiency, quality, and safety; used to motivate individuals to support strategy-implementation efforts.

Book value Number of shares outstanding times stock price.

Boston Consulting Group (BCG) Matrix A four quadrant, strategic planning analytical tool that places an organization's various divisions as circles in a display (similar to the IE Matrix) based on two key dimensions: 1) relative market share position and 2) industry growth rate. The diagram's four quadrants (Stars, Question Marks, Cash Cows, Question Marks) each have different strategy implications.

Breakeven (BE) point The quantity of units that a firm must sell in order for its total revenues (TR) to equal its total costs (TC).

Bribe A gift bestowed to influence a recipient's conduct.

Bribery Offering, giving, receiving, or soliciting of any item of value to influence the actions of an official or other person in discharge of a public or legal duty.

Business analytics An MIS technique designed to analyze huge volumes of data to help executives make decisions; sometimes called predictive analytics or data mining.

Business ethics Principles of behavior/conduct a firm may institute to minimize wrongdoing among employees/managers.

Business portfolio Autonomous divisions (or profit centers or segments) of an organization as represented by circles in a BCG and IE matrices.

Business-Process Outsourcing (BPO) When a firm contracts with an outside firm(s) to take over some of their functional operations, such as human resources, information systems, payroll, accounting, or customer service.

Capacity utilization The extent to which a manufacturing plant's output reaches its potential output; the higher the capacity utilization the better, because otherwise equipment may sit idle.

Capital budgeting A basic function of finance; the allocation and reallocation of capital and resources to projects, products, assets, and divisions of an organization.

Cash budget The most common type of financial budget; developed to forecast future receipts and disbursements of cash in operations, investments, and financing.

Cash cows A quadrant in the BCG Matrix for divisions that have a high relative market share position but compete in a low-growth industry; they generate cash in excess of their needs, they are often milked, this is the lower left quadrant.

Champions Individuals most strongly identified with a firm's new idea/product/service, and whose futures are linked to its success.

Chief Information Officer (CIO) Is more an external manager compared to a CTO; focuses on the firm's technical, information gathering, and social media relationship with diverse external stakeholders.

Chief Technology Officer (CTO) Is more of an internal manager than the CIO; focuses on technical issues such as data acquisition, data processing, decision-support systems, and software and hardware acquisition.

Code of business ethics A written document specifying expected employee/manager behavior/conduct in an organization.

Combination strategy The pursuit of a combination of two or more strategies simultaneously.

Communication Perhaps the most important word in strategic management, because gathering, assimilating, and evaluating information in an interactive, effective manner can lead to enhanced understanding and commitment so vital in strategic planning.

Competitive advantage Anything a firm does especially well, compared to rival firms. For example, when a firm can do something that rival firms cannot do, or owns something that rival firms desire, that can represent a competitive advantage.

Competitive analysis The process of gathering and analyzing data about competitors and disseminating the data (intelligence) on a timely basis to who needs to know in order to gain and sustain a firm's competitive advantages.

Competitive Intelligence (CI) "A systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals" (SCIP website).

Competitive Position (CP) One of four dimensions/axes of the SPACE Matrix; determines an organization's competitiveness, using such factors as market share, product quality, product life cycle, customer loyalty, capacity utilization, technological know-how and control over suppliers and distributors.

Competitive Profile Matrix (CPM) A widely used strategic planning analytical tool designed to identify a firm's major competitors and its particular strengths and weaknesses in relation to a sample firm's strategic position.

Competitive quadrant In a SPACE Matrix analysis, when the firm's directional vector points in the lower right quadrant it suggests that the firm should pursue competitive strategies such as horizontal integration.

Concern for employees A component of the mission statement; are employees a valuable asset to the firm?

Concern for public image A component of the mission statement; is the firm responsive to social, community, and environmental concerns?

Concern for survival, growth, and profitability A component of the mission statement; does the firm strive to survive, grow, and (if for-profit) be profitable?

Conflict A disagreement between two or more parties on one or more issues.

Confrontation A method for reducing conflict exemplified by exchanging members of conflicting parties so that each can gain an appreciation of the other's point of view, or holding a meeting at which conflicting parties present their views and work through their differences.

Conservative quadrant In a SPACE Matrix analysis, when the firm's directional vector points in the upper left quadrant it suggests that the firm should pursue conservative strategies such as market penetration.

Consistency A way to evaluate strategies, i.e. to determine if a particular strategy is supportive of overall strategies/objectives/policies of the firm.

Consonance Refers to the need for strategists to examine sets of trends, as well as individual trends, in evaluating strategies.

Contingency plans Alternative plans that can be put into effect if certain key events do not occur as expected.

Controlling A basic function of management; includes all of those activities undertaken to ensure that actual operations conform to planned operations.

Cooperative arrangements Includes joint ventures, research and development partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia.

Core competence A value chain activity that a firm performs especially well.

Cost leadership One of Michael Porter's strategy dimensions that involves a firm producing standardized products at a very low per-unit cost for consumers who are price-sensitive.

Cost/benefit analysis An activity that involves assessing the costs, benefits, and risks associated with marketing decisions. Three steps are required to perform this: (1) compute the total costs associated with a decision, (2) estimate the total benefits from the decision, and (3) compare the total costs with the total benefits.

Creed statement Another name for mission statement; a declaration of an organization's "reason for being." It answers the pivotal question, "What is our business?"

Cultural products Include values, beliefs, rites, rituals, ceremonies, myths, stories, legends, sagas, language, metaphors, symbols, heroes, and heroines. These products are levers that strategists can use to influence and direct strategy formulation, implementation, and evaluation activities.

Culture The set of shared values, beliefs, attitudes, customs, norms, personalities, heroes, and heroines that describe a firm.

Culture The set of shared values, beliefs, attitudes, customs, norms, personalities, heroes, and heroines that describe a firm. Strategists should strive to preserve, emphasize, and build upon these aspects.

Customer analysis Examination and evaluation of consumer needs, desires, and wants; involves administering customer surveys, analyzing consumer information, evaluating market positioning strategies, developing customer profiles, and determining optimal market segmentation strategies.

Customers A component of the mission statement; individuals who purchase a firm's products/services.

Data mining Analyzing huge volumes of information in order to determine trends and garner information to make decision making more effective.

Data Raw facts and figures; "data" becomes "information" only when they are evaluated, filtered, condensed, analyzed, and organized for a specific purpose, problem, individual, or time.

De-integration Reducing the pursuit of backward integration; instead of owning suppliers, companies negotiate with several outside suppliers.

Decentralized structure Also called a divisional structure, this type of organizational design is based on having various profit centers or segments by geographic area, by product or service, by customer, or by process. With a divisional structure, functional activities are performed both centrally and in each separate division.

Decision stage Stage 3 of the strategy formulation analytical framework that involves development of the Quantitative Strategic Planning Matrix (QSPM). A QSPM uses input information from Stage 1 to objectively evaluate feasible alternative strategies identified in Stage 2. A QSPM reveals the relative attractiveness of alternative strategies and thus provides objective basis for selecting specific strategies.

Defensive quadrant In a SPACE Matrix analysis, when the firm's directional vector into the lower left quadrant it suggests that the firm should pursue defensive strategies such as retrenchment.

Defusion A method for reducing conflict includes playing down differences between conflicting parties while accentuating similarities and common interests, or compromising so that there is neither a clear winner nor loser, or resorting to majority rule, or appealing to a higher authority, or redesigning present positions.

Delayering Reducing the number of divisions or units or hierarchical levels in a firm's organizational structure.

Demand void Areas in a perceptual map where there is not a cluster of ideal points indicating an unattractive group of potential customers.

Differentiation One of Michael Porter's strategy dimensions that involves a firm producing products and services considered unique industry-wide and directed at consumers who are relatively price-insensitive.

Directional vector In a SPACE Matrix analysis, this line begins at the origin and goes into one of four quadrants, revealing the type of strategies recommended for the organization: aggressive, competitive, defensive, or conservative.

Director of competitive analysis The person who gathers and analyzes data about competitors, and disseminates data (intelligence) on a timely basis to who needs to know in order to gain and sustain a firm's competitive advantages.

Discount If an acquiring firm pays less for another firm than the firm's stock price times its # of shares of stock outstanding (book value or market value), then that # less the actual purchase price is called a discount.

Distinctive competencies A firm's strengths that cannot be easily matched or imitated by competitors.

Distribution The process of getting goods and services to market; includes warehousing, distribution channels, distribution coverage, retail site locations, sales territories, inventory levels and location, transportation carriers, wholesaling, and retailing.

Diversification strategies When a firm enters a new business/industry, either related and unrelated to their existing business/industry. Related diversification is when the old vs. new business value chains possesses competitively valuable cross-business strategic fits; unrelated diversification is when the old vs. new business value chains are so dissimilar that no competitively valuable cross-business relationships exist.

Divestiture Selling a division or part of an organization.

Dividend decision A basic function of finance; concerns issues such as the percentage of earnings paid to stockholders, the stability of dividends paid over time, and the repurchase or issuance of stock.

Dividend recapitalizations When private-equity firms especially, but other firms also, borrow money to fund dividend payouts to themselves.

Divisional structure This type of organizational design is based on having various profit centers or segments by geographic area, by product or service, by customer, or by process. With a divisional structure, functional activities are performed both centrally and in each separate division.

Dogs A quadrant in the BCG Matrix for divisions that have a low relative market share position and compete in a low-growth industry, this is the lower right quadrant.

Downsizing Reducing the number of employees, number of divisions or units, and/or number of hierarchical levels in the firm's organizational structure.

Educative change strategy A management technique to facilitate a firm adapting to new strategies/policies/situations by presenting to employees/managers information that reveals why the firm needs to do what is to be done; this approach can be slow but oftentimes yields high commitment.

Empirical indicators Refers to three characteristics of resources (rare, hard to imitate, not easily substitutable) that enable a firm to gain and sustain competitive advantage.

Employee Stock Ownership Plans (ESOP) A tax-qualified, defined-contribution, employee-benefit plan whereby employees purchase stock of the company through borrowed money or cash contributions.

Empowerment The act of strengthening employees' sense of shared ownership by encouraging them to participate in decision making and rewarding them for doing so.

Environment The surroundings in which an organization operates, including air, water, land, natural resources, flora, fauna, humans, and their interrelation.

Environmental Management System (EMS) When a firm or municipality operates utilizing "green" policies/practices/procedures as outlined by ISO 14001.

Environmental scanning Another term for external audit; conducting research to gather and assimilate external information.

Environmental scanning Process of conducting research and gathering and assimilating external information.

EPS/EBIT analysis A financial technique to determine whether debt, stock, or a combination of debt and stock is the best alternative for raising capital to implement strategies.

Establishing annual objectives The managerial activity that determines appropriate/desired targets to achieve by region/product/service.

External audit Process of identifying and evaluating trends and events beyond the control of a single firm, in areas such as social, cultural, demographic technology, economic, political, and competition; reveals key opportunities and threats confronting an organization, so managers can better formulate strategies.

External Factor Evaluation (EFE) Matrix A widely used strategic planning analytical tool designed to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information.

External forces (1) Economic forces; (2) social, cultural, demographic, and natural environment forces; (3) political, governmental, and legal forces; (4) technological forces; and (5) competitive forces.

External opportunities Economic, social, cultural, demographic, environmental, political, legal, governmental, technological, and competitive trends/events/facts that could significantly benefit an organization in the future.

External threats Economic, social, cultural, demographic, environmental, political, legal, governmental, technological, and competitive trends/events/facts that could significantly harm an organization in the future.

Feasibility A way to evaluate strategies, i.e. to determine if a strategy is capable of being carried out within the physical, human, and financial resources of the firm.

Feng shui In China, this term refers to the practice of harnessing natural forces, which can impact how you arrange office furniture.

Financial budget A financial document that details/reveals how funds will be obtained and spent for a specified period of time in the future.

Financial objectives Include desired results growth in revenues, growth in earnings, higher dividends, larger profit margins, greater return on investment, higher earnings per share, a rising stock price, improved cash flow, and so on.

Financial Position (FP) One of four dimensions/axes of the SPACE Matrix that determines an organization's financial strength, considering such factors as return on investment, leverage, liquidity, working capital, and cash flow.

Financial ratio analysis Quantitative calculations that reveal the financial condition of a firm and exemplify the complexity of relationships among the functional areas of business. For example, a declining return on investment or profit margin ratio could be the result of ineffective marketing, poor management policies, research and development errors, or a weak management information system. Ratios are usually compared to industry averages, or to prior time periods, or to rival firms.

Financing decision A basic function of finance; determines the best capital structure for the firm and includes examining various methods by which the firm can raise capital (for example, by issuing stock, increasing debt, selling assets, or using a combination of these approaches).

First mover advantages The benefits a firm may achieve by entering a new market or developing a new product or service before rival firms.

Fixed Costs (FC) A key variable in breakeven analysis; includes costs such as plant, equipment, stores, advertising, and land.

Focus One of Michael Porter's strategy dimensions that involves a firm producing products and services that fulfill the needs of small groups of consumers.

Force change strategy A management technique to facilitate a firm adapting to new strategies/policies/situations by simply giving orders and enforcing those orders; this approach has the advantage of being fast, but it is plagued by low commitment.

Forward integration A strategy that involves gaining ownership or increased control over distributors or retailers, such as a manufacturer opening its own chain of stores.

Franchising An effective means of implementing forward integration whereby a franchisee purchases the right to own one or more stores/restaurants of a chain firm.

Friendly merger If the merger/acquisition is desired by both firms.

Functional structure A type of organizational design that groups tasks and activities by business function, such as production/operations, marketing, finance/accounting, research and development, and management information systems.

Functions of finance/accounting The basic activities performed by finance managers; consists of three decisions: the investment decision, the financing decision, and the dividend decision.

Functions of management Consist of five basic activities: planning, organizing, motivating, staffing, and controlling.

Functions of marketing The basic activities performed by marketing managers, including (1) customer analysis, (2) selling products/services, (3) product and service planning, (4) pricing, (5) distribution, (6) marketing research, and (7) opportunity analysis.

Furloughs Temporary layoffs.

Future shock High anxiety that results when the nature, types, and speed of changes overpower an individual's or organization's ability and capacity to adapt.

GAAS, GAAP, and IFRS Generally accepted auditing standards, generally accepted accounting principles, and international financial reporting standards.

Gain sharing A form of incentive compensation whereby employees and/or managers receive bonuses when actual results exceed some pre-determined performance targets.

Generic strategies Michael Porter's strategy breakdown; consists of three strategies: cost leadership, differentiation, and focus.

Glass ceiling A term used to refer to the artificial barrier that women and minorities face in moving into upper levels of management.

Global strategy Designing, producing, and marketing products with global needs in mind, instead of solely considering individual countries.

Globalization A process of doing business worldwide, so strategic decisions are made based on global profitability of the firm rather than just domestic considerations.

Goodwill If a firm acquires another firm and pays more than the book value (market value), then the additional amount paid is called a premium, and becomes goodwill, which is a line item on the assets portion of a balance sheet.

Governance The act of oversight and direction, especially in association with the duties of a board of directors.

Grand Strategy Matrix A four-quadrant, two axis tool for formulating alternative strategies. All organizations can be positioned in one of this matrix's four strategy quadrants, based on their position on two evaluative dimensions: competitive position and market (industry) growth. Strategy suggestions ensue depending on which quadrant the firm is located.

Growth ratios Measures such as the percent increase/decrease in revenue or profit from one period to the next are important comparisons.

Guanxi In China, business behavior is based on "personal relations".

Halo error The human tendency to put too much weight on a single factor.

Horizontal consistency of objectives Objectives need to be compatible across functions; for example if marketing wants to sell 10% more than production must produce 10% more.

Horizontal integration Acquiring a rival firm.

Hostile takeover If the merger/acquisition is not desired by both firms.

Human resource management Also called personnel management; a basic function of management; includes activities such as recruiting, interviewing, testing, selecting, orienting, training, developing, caring for, evaluating, rewarding, disciplining, promoting, transferring, demoting, and dismissing employees, as well as managing union relations.

Industrial Organization (I/O) An approach to competitive advantage that advocates that external (industry) factors are more important than internal factors for a firm in striving to achieve competitive advantage.

Industry analysis Another term for external audit; conducting research to gather and assimilate external information.

Industry Position (IP) One of four dimensions/axes of the SPACE Matrix that determines how strong/weak a firm's industry is, considering such factors as growth potential, profit potential, financial stability, extent leveraged, resource utilization, ease of entry into market, productivity and capacity utilization.

Information Technology (IT) The development, maintenance, and use of computer systems, software, and networks for the processing and distribution of data.

Information Data that has been evaluated, filtered, condensed, analyzed, and organized for a specific purpose, problem, individual, or time.

Inhwa A South Korean term for activities that involve concern for harmony based on respect of hierarchical relationships, including obedience to authority.

Initial public offering When a private firm goes public by selling its shares of stock to the public in order to raise capital.

Input stage Stage 1 of the strategy-formulation analytical framework that summarizes the basic input information needed to formulate strategies; consists of an EFEM, CPM, and IFEM.

Integration strategies Includes forward integration, backward integration, and horizontal integration (sometimes collectively referred to as vertical integration strategies).

Intensive strategies Includes market development, market penetration, and product development.

Internal audit The process of gathering and assimilating information about the firm's management, marketing, finance/accounting, production/operations, R&D, and MIS operations. The purpose is to identify/evaluate/prioritize a firm's strengths and weaknesses.

Internal Factor Evaluation (IFE) Matrix A strategy-formulation tool that summarizes and evaluates a firm's major strengths and weaknesses in the functional areas of a business, and provides a basis for identifying and evaluating relationships among those areas.

Internal strengths An organization's controllable activities that are performed especially well, such as in areas that include finance, marketing, management, accounting, MIS, across a firm's products/regions/stores/facilities.

Internal weaknesses An organization's controllable activities that are performed especially poorly, such as in areas that include finance, marketing, management, accounting, MIS, across a firm's products/regions/stores/facilities.

Internal-External (IE) Matrix A nine quadrant, strategic planning analytical tool that places an organization's various divisions as circles in a display (similar to the BCG Matrix) based on two key dimensions: 1) the segment's IFE total weighted scores on the x-axis and 2) the segment's EFE total weighted scores on the y-axis. The diagram is divided into three major regions that have different strategy implications: 1) grow and build or 2) hold and maintain, or 3) harvest or divest.

International firms Firms that conduct business outside their own country.

Internet A global system of interconnected computers that serve billions of users worldwide; provides a vast range of information resources and services; enables billions of businesses and individuals globally to communicate instantly with each other by email, tweets, etc.

Intuition Using one's cognition without evident rational thought or analysis; based on past experience, judgment, and feelings; essential to making good strategic decisions but must not relied upon heavily in lieu of objective analysis.

Investment decision Also called capital budgeting; a basic function of finance; the allocation and reallocation of capital and resources to projects, products, assets, and divisions of an organization.

ISO 14000 A series of voluntary standards in the environmental field whereby a firm minimizes harmful effects on the environment caused by its activities and continually monitors and improves its own environmental performance.

ISO 14001 A set of standards adopted by thousands of firms worldwide to certify to their constituencies that they are conducting business in an environmentally friendly manner. These standards offer a universal technical standard for environmental compliance that more and more firms are requiring not only of themselves but also of their suppliers and distributors.

Joint venture A strategy that occurs when two or more companies form a temporary partnership/consortium/business for the purpose of capitalizing on some opportunity.

Just-In-Time (JIT) A production approach in which parts and materials are delivered to a production site just as they are needed, rather than being stockpiled as a hedge against late deliveries.

Leverage ratios The debt-to-equity ratio and debt-to-total assets ratio measure the extent to which a firm has been financed by debt.

Leveraged Buyout (LBO) When the outstanding shares of a corporation are bought by the company's management and other private investors using borrowed funds.

Linear regression A quantitative statistical technique often used for forecasting, but based on the assumption that the future will be just like the past. To the extent that historical relationships are unstable, linear regression is less accurate.

Liquidation Selling all of a company's assets, in parts, for their tangible worth.

Liquidity ratios The current ratio and quick ratio measure a firm's ability to meet short-term cash obligations.

Long-range planning Deciding upon future actions/objectives/policies with the aim to optimize for tomorrow the trends of today; less effective and comprehensive than strategic planning.

Long-term objectives Specific results that an organization seeks to achieve (in more than one year) in pursuing its basic vision/mission/strategy.

Long-term objectives The specific results expected from pursuing various strategies.

Management by wandering around A part of strategy evaluation whereby managers simply walk around facilities and operations in order to observe and talk with employees, thus garnering information useful in evaluating strategies.

Management Information System (MIS) A system that gathers, assimilates, and evaluates external and internal information to facilitate decision-making.

Management information system A computer-based process for obtaining and utilizing external and internal facts/figures/trends to support managerial decision-making. Includes gathering and utilizing data about marketing, finance, production, and personnel matters internally, and social, cultural, demographic, environmental, economic, political, governmental, legal, technological, and competitive factors externally.

Market capitalization Number of shares outstanding times stock price.

Market commonality The number and significance of markets that a firm competes in with rivals.

Market development Introducing present products or services into new geographic areas.

Market penetration Increasing market share for present products or services in present markets through greater marketing efforts.

Market segment Areas in a perceptual map where there is a cluster of ideal points indicating an attractive group of potential customers to target.

Market segmentation The marketing technique of subdividing consumers into distinct subsets according to needs and buying habits in order to more effectively and economically direct marketing efforts.

Market value Number of shares outstanding times stock price.

Marketing research The systematic gathering, recording, and analyzing of data about problems/practices/issues related to the marketing of goods and services.

Markets A component of the mission statement; geographic locations where a firm competes.

Marking mix variables Product, place, promotion, and price.

Matching stage Stage 2 of the strategy-formulation framework that focuses upon generating feasible alternative strategies by aligning internal with external factors by utilizing five matrices: BCG, IE, SWOT, GRAND, SPACE.

Matching When an organization matches its internal strengths and weaknesses with its external opportunities and threats using, for example, the SWOT, SPACE, BCG, IE, or GRAND Matrices.

Matrix structure This type of organizational design places functional activities along the top row and divisional projects/units along the left side to create a rubric where managers have two bosses – both a functional boss and a project boss, thus creating the need for extensive vertical and horizontal flows of authority and communication.

Measuring organizational performance Activity # 2 in the strategy evaluation process; includes comparing expected results to actual results, investigating deviations from plans, evaluating individual performance, and examining progress being made toward meeting stated objectives.

Merger When two organizations of about equal size unite to form one enterprise; an acquisition.

Mission statement components 1) Customers, 2) products and services, 3) markets, 4) technology, 5) concern for survival, growth, and profitability, 6) philosophy, 7) self-concept, 8) concern for public image, 9) concern for employees.

Mission statement A declaration of an organization's "reason for being." It answers the pivotal question, "What is our business?" Is essential for effectively establishing objectives and formulating strategies; consists of nine components.

Mission statement An enduring statement of purpose that distinguish one business from other similar firms; several sentence statement that identifies the scope of a firm's operations in product and market terms and addresses the question "What is our business?"

Motivating A basic function of management; the process of influencing and leading people to accomplish specific objectives.

Multidimensional scaling The same as product positioning (perceptual mapping), except encompasses three or more evaluative criteria simultaneously.

Multinational corporations Firms that conduct business outside their own country.

Nemaswashio U.S. managers in Japan have to be careful about this phenomenon, whereby Japanese workers expect supervisors to alert them privately of changes rather than informing them in a meeting.

Organizational culture A pattern of behavior developed by an organization over time as it learns to cope with its problem of external adaptation and internal integration, and that has worked well enough to be considered valid and to be taught to new members as the correct way to perceive, think, and feel in the firm.

Organizing A basic function of management; the process of arranging duties and responsibilities in a coherent manner in order to determine who does what and who reports to whom.

Outstanding shares method A method for determining the cash worth of a firm by multiplying the number of shares outstanding by the market price per share; also called book value, market value, or market capitalization.

Perceptual map Also called product-positioning map; a two-dimensional, four quadrant marketing tool designed to position a firm vs. its rival firms in a schematic diagram in order to better determine effective marketing strategies.

Personnel management Also called human resource management; a basic function of management; includes activities such as recruiting, interviewing, testing, selecting, orienting, training, developing, caring for, evaluating, rewarding, disciplining, promoting, transferring, demoting, and dismissing employees, as well as managing union relations.

Philosophy A component of the mission statement; the basic beliefs, values, aspirations, and ethical priorities of the firm.

Planning A basic function of management; the process of deciding ahead of time strategies to be pursued and actions to be taken in the future.

Policies The means by which annual objectives will be achieved. Policies include guidelines, rules, and procedures established to support efforts to achieve stated objectives. Policies are guides to decision making and address repetitive or recurring situations.

Policy Specific guidelines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals.

Porter's Five-Forces Model A theoretical model devised by Michael Porter, who suggests that the nature of competitiveness in a given industry can be viewed as a composite of five forces: 1) Rivalry among competing firms, 2) Potential entry of new competitors, 3) Potential development of substitute products, 4) Bargaining power of suppliers, and 5) Bargaining power of consumers.

Premium If an acquiring firm pays more for another firm than that firm's stock price times its # of shares of stock outstanding (book value or market value), then the overage is called a premium.

Price-earnings ratio method This method involves dividing the market price of the firm's common stock by the annual earnings per share and multiplying this number by the firm's average net income for the past five years.

Pricing A basic function of marketing; determining the appropriate value for products and services to be charged to customers, given associated costs and competitor's prices.

Product and service planning A basic function of marketing; includes activities such as test marketing; product and brand positioning; devising warranties; packaging; determining product options, features, style, and quality; deleting old products; and providing for customer service.

Product development Increased sales by improving or modifying present products or services.

Product positioning Also called perceptual mapping; a two-dimensional, four quadrant marketing tool designed to position a firm vs. its rival firms in a schematic diagram in order to better determine effective marketing strategies.

Production/operations function Consists of all those activities that transform inputs into goods and services; including issues such as inventory control and capacity utilization.

Products or services A component of the mission statement; commodities or benefits provided by a firm.

Profit sharing A form of incentive compensation whereby some of a firm's earnings are distributed to employees/managers based on some pre-determined formula; used to motivate individuals to support strategy-implementation efforts.

Profitability ratios The profit margin ratio and return on investment ratio measure the profitability of a firm's operations.

Projected financial statement analysis A financial technique that enables a firm to forecast the expected financial results of various strategies and approaches; involves developing income statements and balance sheets for future periods of time.

Protectionism When countries impose tariffs, taxes, and regulations on firms outside the country to favor their own companies and people.

Quantitative Strategic Planning Matrix (QSPM) An analytical technique designed to determine the relative attractiveness of feasible alternative actions. This technique comprises Stage 3 of the strategy-formulation analytical framework; it objectively indicates which alternative strategies are best.

Question marks A quadrant in the BCG Matrix for divisions that have a low relative market share position but compete in a high-growth industry; this is the upper right quadrant; firm's generally must decide whether to strengthen such divisions or sell them (hence a question is at hand).

Rational change strategy A management technique to facilitate a firm adapting to new strategies/policies/situations, whereby employees/managers are given incentives to be supportive while at the same time are educated as to the need to change.

Reconciliatory In regard to mission statements, the need for the statement to be sufficiently broad to "reconcile" differences effectively among diverse stakeholders, ie appeal to a firm's customers, employees, shareholders, creditors – rather than alienate any group.

Reengineering Reconfiguring or redesigning work, jobs, and processes in a firm, for the purpose of improving cost, quality, service, and speed.

Related diversification When a firm acquires a new business whose value chain possesses competitively valuable cross-business strategic fits.

Relative market share position It is the horizontal axis in a BCG Matrix, which is the firm's particular segment's market share (or revenues or #stores) divided by the industry leader's analogous number

Research and Development (R&D) Spending money to develop new and improved products and services.

Research and development Monies spent by firms to enhance existing products/services and/or create new and improved ones.

Reshoring Refers to American companies planning to move some of their manufacturing back to the USA.

Resistance to change A natural human tendency to be wary of new policies/strategies due to potential negative consequences; if not managed then this could result in sabotaging production machines, absenteeism, filing unfounded grievances, and an unwillingness to cooperate.

Resource allocation A central strategy implementation activity that entails distributing financial, physical, human, and technological assets to allow for strategy execution.

Resource similarity The extent to which the type and amount of a firm's internal resources are comparable to a rival.

Resource-Based View (RBV) An approach that suggests internal resources to be more important for a firm than external factors in achieving and sustaining competitive advantage.

Restructuring Modifying the firm's chain of command and reporting channels to improve efficiency and effectiveness.

Retreats Formal meetings commonly held off-premises to discuss and update a firm's strategic plan; done away from the work site to encourage more creativity and candor from participants.

Retrenchment When an organization regroups through cost and asset reduction to reverse declining sales and profits.

Reviewing the underlying bases of an organization's strategy Activity #1 in the strategy evaluation process; entails a firm developing a revised EFE Matrix and IFE Matrix to determine if corrective actions are needed.

Revised EFE Matrix Part of activity #1 in the strategy evaluation process whereby a firm reassesses its previously determined external opportunities and threats.

Revised IFE Matrix Part of activity #1 in the strategy evaluation process whereby a firm reassesses its previously determined internal strengths and weaknesses.

Rightsizing Reducing the number of employees, number of divisions or units, and/or number of hierarchical levels in the firm's organizational structure; also called downsizing.

Secondary buyouts When private-equity firms buying companies from other private-equity firms.

Self-concept A component of the mission statement; the firm's distinctive competence or major competitive advantage.

Self-interest change strategy A management technique to facilitate a firm adapting to new strategies/policies/situations by attempts to convince individuals that the change is to their personal advantage. When this appeal is successful, strategy implementation can be relatively easy. However, implementation changes are seldom to everyone's advantage.

Selling A basic function of marketing; includes activities such as advertising, sales promotion, publicity, personal selling, sales force management, customer relations, and dealer relations.

Sexual harassment (and discrimination) Unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature; this activity is illegal, unethical, and detrimental to any organization, and can result in expensive lawsuits, lower morale, and reduced productivity.

Six Sigma A quality-boosting process improvement technique that entails training several key persons in techniques to monitor, measure, and improve processes and eliminate defects in a firm; trained persons can earn black belts.

SO strategies Strategies that result from matching a firm's internal strengths with its external opportunities.

Social policy Guidelines and practices a firm may institute to guide its behavior towards employees, consumers, environmentalists, minorities, communities, shareholders, and other groups.

Social responsibility Refers to actions an organization takes beyond what is legally required to protect or enhance the well-being of living things

ST strategies Strategies that result from matching a firm's internal strengths with its external threats.

Stability position (SP) One of four dimensions/axes of the SPACE Matrix that determines how stable/unstable a firm's industry is, considering such factors as technological changes, rate of inflation, demand of variability, price range of competing products, barriers to entry into market, competitive pressure, ease of exit from market, price elasticity of demand and risk involved in business.

Staffing Includes activities such a recruiting, interviewing, testing, selecting, orienting, training, developing, caring for, evaluating, rewarding, disciplining, promoting, transferring, demoting, and dismissing employees.

Stakeholders The individuals and groups of individuals who have a special stake or claim on the company, such as a firm's customers, employees, shareholders, and creditors.

Stars A quadrant in the BCG Matrix for divisions that have a high relative market share position and compete in a high-growth industry; this is the upper left quadrant.

Strategic Business Unit (SBU) Structure This type of organizational design groups similar divisions together into units; widely used when a firm has many divisions/segments in order to reduce span of control reporting to a COO.

Strategic management The art and science of formulating, implementing, and evaluating cross-functional decisions that enable an organization to achieve its objectives.

Strategic objectives Desired results such as a larger market share, quicker on-time delivery than rivals, shorter design-to-market times than rivals, lower costs than rivals, higher product quality than rivals, wider geographic coverage than rivals, achieving technological leadership, consistently getting new or improved products to market ahead of rivals.

Strategic planning The process of formulating an organization's game plan; in a corporate setting, this term may refer to the whole strategic-management process.

Strategic Position and Action Evaluation (SPACE) Matrix Indicates whether aggressive, conservative, defensive, or competitive strategies are most appropriate for a given organization. The axes of this matrix represent two internal dimensions (financial position [FP] and competitive position [CP]) and two external dimensions (stability position [SP] and industry

position [IP]). These four factors are perhaps the most important determinants of an organization's overall strategic position.

Strategic-management model A framework or illustration of the strategic-management process; a clear and practical approach for formulating, implementing, and evaluating strategies.

Strategic-management process The process of formulating, implementing, and evaluating strategies as revealed in the comprehensive model, that begins with vision/mission development and ends with strategy evaluation and feedback.

Strategies The means by which long-term objectives will be achieved. Business strategies may include geographic expansion, diversification, acquisition, product development, market penetration, retrenchment, divestiture, liquidation, and joint ventures.

Strategists The person(s) responsible for formulating and implementing a firm's strategic plan, including the CEO, President, Owner of a Business, Head Coach, Governor, Chancellor, and/or the top management team in a firm.

Strategy evaluation Stage 3 in the strategic-management process. The three fundamental strategy-evaluation activities are (1) review external and internal factors that are the bases for current strategies, (2) measure performance, and (3) take corrective actions; strategies need to be evaluated regularly because external and internal factors constantly change.

Strategy formulation Stage 1 in the strategic-management process; includes developing a vision/mission, identifying an organization's external opportunities/threats, determining internal strengths/weaknesses, establishing long-term objectives, generating alternative strategies, and choosing particular strategies to pursue.

Strategy implementation Stage 2 of the strategic-management process. Activities include establish annual objectives, devise policies, motivate employees, allocating resources, developing a strategy-supportive culture, creating an effective organizational structure, redirecting marketing efforts, preparing budgets, developing and utilizing information systems, and linking employee compensation to organizational performance.

Strategy-formulation analytical framework A three stage, nine matrix, array of tools widely used for strategic planning as a guide: (stage 1: input stage; stage 2: matching stage; stage 3: decision stage).

Strengths-Weaknesses Opportunities-Threats (SWOT) Matrix The most widely used of all strategic planning matrices; matches a firm's internal strengths/weaknesses with its external opportunities/threats to generate four types of strategies: SO (strengths-opportunities) Strategies, WO (weaknesses-opportunities) Strategies, ST (strengths-threats) Strategies, and WT (weaknesses-threats) Strategies.

Sum Total Attractiveness Scores (STAS) In a QSPM, this is the sum of the Total Attractiveness Scores in each strategy column; value reveals which strategy is most attractive in each set of alternatives.

Sustainability The extent that an organization's operations and actions protect, mend, and preserve, rather than harm or destroy, the natural environment.

Sustained competitive advantage Maintaining what a firm does especially well, compared to rival firms – by (1) continually adapting to changes in external trends and events and internal capabilities, competencies, and resources; and (2) effectively formulating, implementing, and evaluating strategies that capitalize upon those factors.

Synergy The 1 + 1 = 3 effect; when everyone pulls together as a team, the results can exceed individuals working separately.

Takeover If the merger/acquisition is not desired by both firms.

Taking corrective actions Activity # three in the strategy evaluation process; involves a firm making changes to competitively reposition a firm for the future.

Technology A component of the mission statement; the firm technologically current?

Test marketing An activity to determine ahead of time whether a certain product or service or selling approach will be cost effective; also used to forecast future sales of new products.

Total Attractiveness Scores (TAS) In a QSPM, the product of multiplying the weights by the Attractiveness Scores in each row. The values indicate the relative attractiveness of each alternative strategy, considering only the impact of the adjacent external or internal critical success factor.

Treasury stock An item in the equity portion of a balance sheet that reveals the dollar amount of the firm's common stock owned by the company itself.

Turbulent, high-velocity markets Industries that are changing very fast, such as telecommunications, medical, biotechnology, pharmaceuticals, computer hardware, software, and virtually all Internet-based industries).

Tweet Posted messages of 140 characters or less on Twitter.com.

Unrelated diversification When a firm acquires a new business whose value chains are so dissimilar that no competitively valuable cross-business relationships exist.

Vacant niche In product/market positioning (perceptual map), this is an area in the perceptual map that reveals a customer segment not being served by the firm or rival firms.

Value Chain Analysis (VCA) The process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products, and compares these costs to rival firms using benchmarking.

Value chain The business of a firm, where total revenues minus total costs of all activities undertaken to develop, produce, and market a product or service yields value.

Variable Costs (VC) A key variable in breakeven analysis; includes costs such as labor and materials.

Vertical consistency of objectives Compatibility of objectives from the CEO (corporate level) down to the Presidents (divisional level) on down to the Managers (functional level).

Vertical integration A combination of three strategies: backward, forward, and horizontal integration, allowing a firm to gain control over distributors, suppliers, and/or competitors respectively.

Vision statement A one sentence statement that answers the question, "What do we want to become?"

Vision statement Answers the question, "What do we want to become?"

Wa In Japan, this stresses group harmony and social cohesion.

Whistle-blowing The act of telling authorities about some unethical or illegal activities occurring within an organization of which you are aware.

White knight When a firm agrees to acquire another firm at a point in time when that other firm is facing a hostile takeover by some company.

Wikis Websites that allows users to add, delete, and edit content regarding frequently asked questions and information across the firm's whole value chain of activities.

WO strategies Strategies that result from matching a firm's internal weaknesses with its external opportunities.

Workplace romance An intimate relationship between two truly consenting employees, as opposed to sexual harassment, which the EEOC defines broadly as unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature.

WT strategies Strategies that result from matching a firm's internal weaknesses with its external threats.

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