GLOBAL EDITION

STRATEGIC MANAGEMENT

A Competitive Advantage Approach

Concepts and Cases

17th Edition

Fred R. David, Forest R. David, and Meredith E. David

STRATEGIC MANAGEMENT
Concepts and Cases

A COMPETITIVE ADVANTAGE APPROACH

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SEVENTEENTH EDITION
GLOBAL EDITION

A COMPETITIVE ADVANTAGE APPROACH

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Brief Contents

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Preface

New to This Edition

With this edition we have updated 40 percent of the chapter material, 11 end-of-chapter mini-cases, and virtually all new examples in the chapters. Specifically, new material includes the following items outlined in this section.

Chapter 1 Cohesion Case on Coca-Cola Company (2018)

Students apply strategy concepts to Coca-Cola through 25 new, innovative Assurance-of-Learning Exercises provided at the end of chapters. Coca-Cola is one of the most successful, well-known, and best-managed global companies in the world.


THE COHESION CASE

Coca-Cola Company, 2018

BY FRED R. DAVID

www.coca-cola.com, KO

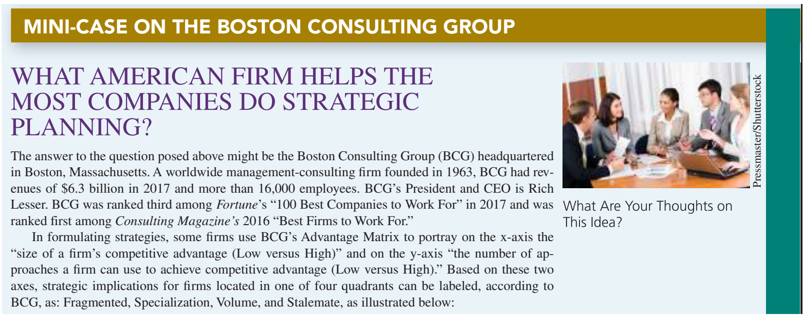
Headquartered in Atlanta, Georgia, Coca-Cola Company (Coke) is the world's largest producer and distributor of beverages, marketing over 500 nonalcoholic brands in more than 200 countries. Coke has 21 billion-dollar brands, 19 of which are available in lower- and no-sugar options. Four of the top five beverages sold globally are Coke products: 1) Coca-Cola, 2) Diet Coke, 3) Fanta, and 4) Sprite. Other Coke products include Dasani waters, Fanta, Gold Peak teas and coffees, Honest Tea, Powerade sports drinks, Simply juices, Glaceau Smartwater, Sprite, and Zico coconut water. However, company's revenues for 2017 declined 15 percent, so rumblings are spreading within the firm.

Mini-Cases

11 new mini-cases, one at the end of each chapter.

Complete with questions designed to apply chapter concepts, the new mini-cases focus on the following companies:

- Chapter 1: Tesla, Inc.
- Chapter 2: Ford Motor Company
- Chapter 3: Sam's Club
- Chapter 4: Procter & Gamble (P&G)
- Chapter 5: Facebook, Inc.
- Chapter 6: Boston Consulting Group
- Chapter 7: De Beers Group
- Chapter 8: Hasbro, Inc.
- Chapter 9: TJX Companies, Inc.
- Chapter 10: Chick-fil-A
- Chapter 11: Lynk & Company


MINI-CASE ON THE BOSTON CONSULTING GROUP

WHAT AMERICAN FIRM HELPS THE MOST COMPANIES DO STRATEGIC PLANNING?

The answer to the question posed above might be the Boston Consulting Group (BCG) headquartered in Boston, Massachusetts. A worldwide management-consulting firm founded in 1963, BCG had revenues of $6.3 billion in 2017 and more than 16,000 employees. BCG's President and CEO is Rich Lesser. BCG was ranked third among *Fortune*'s "100 Best Companies to Work For" in 2017 and was ranked first among *Consulting Magazine's* 2016 "Best Firms to Work For."

In formulating strategies, some firms use BCG's Advantage Matrix to portray on the x-axis the "size of a firm's competitive advantage (Low versus High)" and on the y-axis "the number of approaches a firm can use to achieve competitive advantage (Low versus High)." Based on these two axes, strategic implications for firms located in one of four quadrants can be labeled, according to BCG, as: Fragmented, Specialization, Volume, and Stalemate, as illustrated below:

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What Are Your Thoughts on This Idea?

Chapter Capsules—All NEW

Within each chapter, a new **EXEMPLARY STRATEGIST, GLOBAL CAPSULE,** and **ETHICS CAPSULE** are provided.

Strategist Capsules—one at the beginning of each chapter to showcase an individual that is employing strategic management exceptionally well.

Global Capsules—provided to showcase the strategic relevance of material to global operations, issues, and conditions.

Ethics Capsules—developed to accent the fact that "good ethics is good business" across all aspects of the strategic-management process.


EXEMPLARY STRATEGIST SHOWCASED

Anthony Wood, Founder and CEO of Roku, Inc.

ETHICS CAPSULE 10

TOMS Shoes, Inc.: Shoes Are Magic, Put Shoes on Every Child on the Planet

respective shoe or pair of sunglasses purchased. Another key tenet of TOMS' business model is its nonprofit foundation, Friends of TOMS, which organizes and leads several meaningful service activities, including the One Day Without Shoes initiative aimed at raising global awareness of health risks associated with not wearing shoes. Supporters of TOMS have the opportunity to volunteer for service trips to countries where the company's donations will be distributed to local communities in need. On their website, www.tomscampusprograms.com, TOMS provides students with information related to how they too can become involved with the

Yongsu Kwon/Shutterstock

GLOBAL CAPSULE 6

India's Economy Is Booming

For fiscal 2017–2018, India's gross domestic product (GDP) grew to 7.2 percent, one of the highest national growth rates on the planet. India has recently implemented many business-friendly reforms such as the Goods and Services Tax (GST) on July 1, 2017, that merged nearly all existing taxes into a single system of taxation. India's population of 1.324 billion (versus 295.5 million in the United States) is mostly a middle class willing to spend money in the most populated democratic country in the world. India's economy is

ruling on October 18, 2017, that "sexual intercourse with a girl below 18 years of age is rape regardless of whether she is married or not." This legal change is intended to prevent thousands of older men marrying 13- to 16-year-old girls that heretofore had commonly occurred in India. The number of female employees in Indian companies increased by 5 percent in 2017, compared to the previous year, moving the overall percentage representation of women in Indian companies to 30.55 percent.

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Should Your Firm Be Doing Business in India?

Chapter	Exemplary Strategist Capsules focus on the following people:	Global Capsules focus on the following topics:	Ethics Capsules address the following issues:
1	Legendary Coach of the Green Bay Packers—Vince Lombardi	Mobike: Global Bike Renting Takes off Like a Jet Plane	What Ethics Variable Is Most Important in Doing Business?
2	CEO and Founder of FedEx Corporation—Frederick Smith	LinkedIn: Clear Core Values, Vision, and Mission Lead to Global Prominence	Facebook: Changing Our Mission to Enhance Our Ethics and Integrity
3	CEO and Cofounder of Pinterest—Ben Silbermann	What Company Is Growing Fastest Globally?	Preserve Alaska Wildlife or Boost Alaska Economy?
4	CEO and Cofounder of Tesla and SpaceX—Elon Musk	Bitcoin: The New Global Currency	The Sagebrush Lizard versus the Big Oil Man
5	CEO of Apple, Inc.—Tim Cook	How Can a Firm Determine Where to Initiate New Business? Use GDP as a Guide	Are CEOs Less Ethical Today Than in the Past?
6	CEO of Hobby Lobby—David Green	India's Economy Is Booming	As We Strategize We Must Not Jeopardize Animal Welfare
7	Former CEO of PepsiCo—Indra Nooyi	Four Guidelines to Follow in Global Marketing	Do Firms Need a Policy against Workplace Phubbing?
8	CEO of JPMorgan Chase, Jamie Dimon	The Least (and Most) Corrupt Countries in the World for Doing Business	Projected Financial Statement Manipulation
9	CEO and Founder of Roku Inc.—Anthony Wood	What Country's New Strategy Is Called "Vision 2030"?	Achieving Exemplary Business Ethics through Exemplary Transparency
10	CEO (former) and Chairman of Microsoft—Bill Gates	India Is Turning Garbage into Cash	TOMS Shoes, Inc.: Shoes Are Magic, Put Shoes on Every Child on the Planet
11	CEO of Philip Morris International—Andre Calantzopoulos	China Aims for Superiority in Quantum Computing	Which Two U.S.-Based Airlines Are Worst on Customer Service?

Assurance-of-Learning Exercises —nearly all new and, for the first time ever, organized into four sets as follows that apply chapter concepts, tools, and techniques:

Set 1: Strategic Planning for Coca-Cola—25 exercises apply chapter material to the Coca-Cola Cohesion Case to prepare students for doing case analysis on for-profit companies.

Set 2: Strategic Planning for My University—12 exercises apply chapter material to your college or university to prepare students for doing case analysis on nonprofit organizations.

Set 3: Strategic Planning to Enhance My Employability—14 exercises apply chapter material to individuals instead of companies to prepare students for making career choices.

Set 4: Individual versus Group Strategic Planning—11 exercises apply chapter material by comparing the effectiveness of individual versus group decisions; these are fun, in-class group exercises that yield "a winning individual and winning group" for each activity.

Detailed Chapter-by-Chapter Changes

Chapter 1: THE NATURE OF STRATEGIC MANAGEMENT—SWOT analysis is introduced; the integrative comprehensive strategic-management model is repositioned to the opening page of each chapter; the model is enhanced to accent the process of strategic planning being fluid rather than merely a sequence of silo activities.

Chapter 2: BUSINESS VISION AND MISSION—new material is provided on core value statements; new examples abound throughout.

Chapter 3: THE EXTERNAL ASSESSMENT—new material is provided on Porter's Five-Forces Model; more guidance is provided regarding how to assign weights and ratings in matrices; new examples abound throughout; the ratings for a Competitive Profile Matrix now match the EFE Matrix in form and meaning.

Chapter 4: THE INTERNAL ASSESSMENT—this chapter has been revamped and shortened; the marketing material is enhanced; new examples abound throughout; the ratings for an IFE Matrix now match the EFE Matrix ratings in form and meaning.

Chapter 5: STRATEGIES IN ACTION—new material includes Blue Ocean Strategy, Value Chain Analysis, Porter's Two Generic Strategies, and the need for firms to "BUILD, BORROW, or BUY."

Chapter 6: STRATEGY ANALYSIS AND CHOICE—the presentation of this chapter that includes SWOT, BCG, IE, SPACE, GRAND, and QSPM analyses is enhanced and shortened; two new pages reveal how to estimate costs of recommendations.

Chapter 7: IMPLEMENTING STRATEGIES: MANAGEMENT AND MARKETING ISSUES—the title of this chapter changed to reflect new marketing material; our new coauthor is a marketing professor at Baylor University; this chapter is fully updated and enhanced, especially with new target marketing, segmentation, and positioning analyses.

Chapter 8: IMPLEMENTING STRATEGIES: FINANCE AND ACCOUNTING ISSUES—the title of this chapter changed since marketing material moved; there is enhanced presentation of financial and accounting tools, such as EPS/EBIT analysis, Corporate Valuation, and Projected Financial Statements; a new running example for P&G is provided; numerous author comments are given regarding the strategic planning template at www.strategyclub.com.

Chapter 9: STRATEGY EVALUATION AND GOVERNANCE—the title of this chapter changed due to excellent new material on corporate governance being presented.

Chapter 10: BUSINESS ETHICS, ENVIRONMENTAL SUSTAINABILITY, AND CORPORATE SOCIAL RESPONSIBILITY—this chapter provides updated and new coverage of ethics, workplace romance, hiring away rival firms' employees, wildlife welfare, and sustainability. This text reveals why "good ethics is good business" and why this is a strategic issue. The sustainability discussion is improved to promote and encourage firms to conduct operations with respect for the environment, an important concern for consumers, companies, society, and AACSB.

Chapter 11: GLOBAL AND INTERNATIONAL ISSUES—this chapter is enhanced and shortened but provides new coverage of cultural and conceptual strategic-management differences across countries. Doing business globally has become a necessity in most industries.

Part 6: STRATEGIC MANAGEMENT CASE ANALYSIS—this section that follows all chapters has been totally rewritten to be more concise and revealing for students performing case analysis.

22 Author-Created Video Assignments in the MyLab

We have added 11 videos introducing the content of each chapter and 11 videos discussing a variety of important topics such as mission statement delivery, BCG matrix, corporate evaluation, etc. created by the author. Each video is associated with multiple-choice questions to help students assess their learning.

Solving Teaching and Learning Challenges

The primary challenge facing strategy professors is to keep students engaged while making sure business skills are learned. This text leads all others in being practical, skills-oriented, and unfolding in the same manner as the process of actually doing strategic planning unfolds. Students and professors alike appreciate this practical approach presented in a concise, conversational, and exciting manner—beginning with the integrative model of the strategic-management process that unifies all chapters. All of the 11 end-of-chapter Mini-Cases, 471 Review Questions, and 62 Assurance-of-Learning Exercises are designed specifically to apply chapter concepts.

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

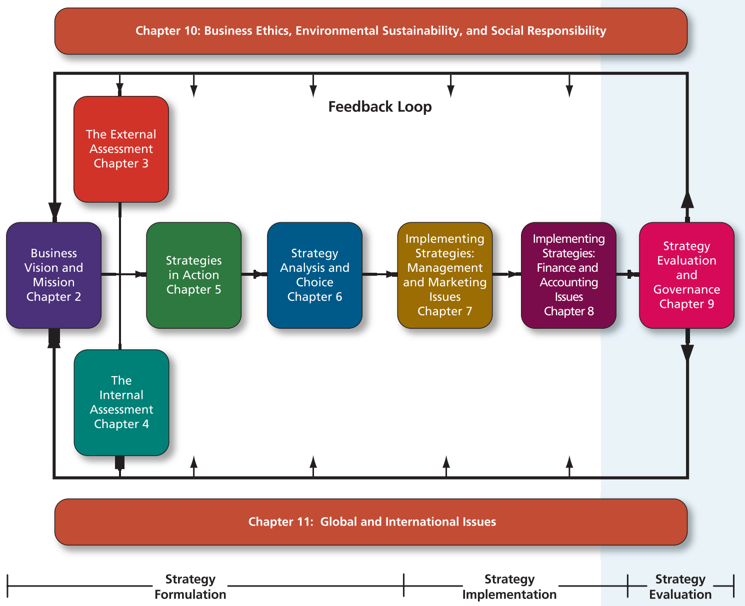


FIGURE 1-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

success. Working in teams gives students practical experience in 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 as well as timid, noncontributing group members. This experience is valuable because strategic-management students are near graduation and will 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.

The New Concepts-by-Cases Matrix

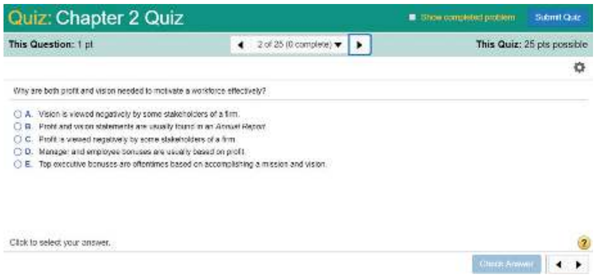
All 30 cases facilitate coverage of all strategy concepts, but as revealed by shaded cells, some cases especially exemplify particular key strategy concepts. The shaded cells reveal which concepts are tested with multiple-choice questions in the MyLab. The Concepts-by-Cases matrix enables professors to effectively utilize different cases to assure student learning of various chapter concepts. Note from the shaded boxes that two, three, or four cases are used to test each strategic-management concept. This new, innovative ancillary promises to elevate the case learning method to new heights in teaching strategic management.

The Case MyLab Testing Feature

The Concepts-by-Cases matrix facilitates student learning of 30 key strategic-management concepts applied to 30 cases. The Case MyLab Testing feature assures that the students can test their understanding of cases and the key strategic-management concepts, thus serving as a great mechanism for professors to achieve AACSB Assurance-of-Learning Objectives. This new testing feature simplifies grading for professors in both traditional and online class settings.

This MyLab assessment includes 25 multiple-choice questions for each case, comprising 10 *Basic* questions that simply test whether the student read the case before class, and 15 *Applied* questions that test the student's ability to apply various strategic-management concepts. The 15 *Applied* questions are presented in three sets of five that pertain to key concepts of particular importance for the respective 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 Domino's Pizza headquartered? Whereas a MyLab case *Applied* question may be: What are three aspects of the organizational chart given in the Domino's Pizza case that violate strategic-management guidelines?

The **Chapter Warm-up** assessment helps you hold your students accountable for **READING** and demonstrating their knowledge on key concepts in each chapter before coming to class.



Chapter Quizzes

Every chapter has quizzes written by the textbook authors so you can assess your students' understanding of chapter learning objectives.

The David Approach Is Unique

This textbook is globally considered to be the most practical, skills-oriented strategic management textbook on the market. All chapters unfold from a widely used integrative model of strategic planning, so students learn the "process of doing strategic planning," rather than focusing on seminal theories in strategy. The David approach is "learning by doing"—students develop skills that can enhance their own employability through numerous features, such as 62 new Assurance-of-Learning end-of-chapter exercises in this edition.

	Key Strategic Management Concepts	Strategy Model/Process	Vision/Mission Statements	Competitive Profile Matrix	Porter's Five Forces	EFE Matrix	Benchmarking	Value Chain Analysis	IFE Matrix	Strategy Types	Porter's Two Generic Strategies
		3	3	5	4	5	4	3	5	4	3
Case 1	Honda Motor Co., Ltd.				■						
Case 2	The Gap Inc.										
Case 3	Samsung Electronics Co., Ltd.		■			■		■			
Case 4	Lenovo Group Limited		■							■	
Case 5	Dick's Sporting Goods			■	■						
Case 6	11 Bit Studios S.A.										
Case 7	JPMorgan & Chase Co.	■									
Case 8	PPB Group Berhad	■									■
Case 9	Nestlé S.A.									■	■
Case 10	Domino's Pizza, Inc.				■		■				
Case 11	PetMed Express, Inc.	■									
Case 12	AstraZeneca plc										
Case 13	Shell plc								■		
Case 14	The Walt Disney Company										
Case 15	Adidas AG					■			■		
Case 16	Shoprite Holdings Ltd.			■							■
Case 17	Woolworths Group			■			■				
Case 18	Microsoft Corporation						■				
Case 19	Amazon.com									■	
Case 20	Nike, Inc.										
Case 21	Under Armour, Inc.										
Case 22	Polaris Industries, Inc.					■			■		
Case 23	PT Matahari Putra Prima Tbk.							■			
Case 24	Emirates Group								■		
Case 25	General Electric, Inc.				■			■			
Case 26	Barwa Group			■		■					
Case 27	Starbucks Corporation						■				
Case 28	PepsiCo, Inc.			■						■	
Case 29	National Audubon Society		■								
Case 30	MTN Group Limited					■			■		

First Mover Advantages	SWOT Matrix	SPACE Matrix	BCG & IE Matrices	Grand Strategy & QSPM	Organizational Structure	Organizational Culture	Market Segmentation & Product Position	EPS-EBIT Analysis	Projected Financial Statements	Company Valuation	Balanced Scorecard	Governance	Business Ethics	Environmental Sustainability
2	4	4	5	3	4	2	3	5	6	5	3	1	2	2

In addition, we offer more coverage on important topics, such as business ethics, social responsibility, and sustainability, than any other strategic-management textbook, including topics such as bribery, workplace romance, devising codes of ethics, taking a position (or not) on social issues, and preserving wildlife—topics that other textbooks do not mention, even though companies continually face strategic decisions in these areas.

> The Association to Advance Collegiate Schools of Business (AACSB) International increasingly advocates a more skills-oriented, practical approach in business books, which this text provides, rather than a theory-based approach.

We also offer more overage of global/international issues than any other strategic-management textbook, including topics such as how business culture, taxes, tariffs, political stability, and economic conditions vary across countries—all framed from a strategic-planning perspective.

Lastly, this textbook is trusted across five continents to provide students (and 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 advantages for any type of business. This text 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 globally.

Developing Employability Skills

Using this text, students learn how to actually do strategic planning—this is a huge employability skill because employers recognize the benefits of employees having an understanding of what a firm is trying to achieve and why. Nearly all students using this text also use the free strategic-planning template at the www.strategyclub.com author website; many students include this skill on their resume to showcase their experience using this Excel software commonly used by businesses for doing actual strategic planning.

Instructor Teaching Resources

The following supplements are available with this text:

Supplements available to instructors at www.pearsonglobaleditions.com	Features of the Supplement
Chapter Instructor's Resource Manual authored by Forest David	• Chapter-by-chapter summaries • Chapter Outlines with teaching tips • Answers to end-of-chapter Review Questions • Answers to the end-of-chapter Assurance-of-Learning Exercises • Answers to the end-of-chapter two Mini-Case Questions • Examples and activities not in the main book
Case Instructor's Manual authored by Forest David	• Case abstract followed by a complete strategic plan for the firm • Vision and mission statements • External and internal assessments with ratio analyses • Analyses that include SWOT, BCG, IE, SPACE, GRAND, QSPM • Recommendations and projected financial statements
Test Bank authored by Ramachandran Subramanian from Stetson University	Over 1,500 multiple-choice and true/false questions with these annotations: • Difficulty level (1 for straight recall, 2 for some analysis, 3 for complex analysis) • Type (multiple-choice, true/false, and essay questions) • Learning Objective (the concept the question supports) • AACSB learning standard (Written and Oral Communication; Ethical Understanding and Reasoning; Analytical Thinking; Information Technology; Interpersonal Relations and Teamwork; Diverse and Multicultural Work; Reflective Thinking; Application of Knowledge)

Supplements available to instructors at www.pearsonglobaleditions.com	Features of the Supplement
Computerized TestGen	TestGen allows instructors to: • Customize, save, and generate classroom tests • Edit, add, or delete questions from the Test Item files • Analyze test results • Organize a database of tests and student results.
PowerPoint Presentation authored by Ramachandran Subramanian from Stetson University	PowerPoints meet accessibility standards for students with disabilities. Features include, but are not limited to: • Keyboard and Screen Reader access • Alternative text for images • High color contrast between background and foreground colors • Image Library includes graphs, tables, and equations.

Acknowledgments

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 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. Thank you also Dr. Yajiang Wang at Hebei University for your emails to us regarding the weights versus ratings in an IFE Matrix.

Many special persons and reviewers contributed valuable material and suggestions for this edition. We would like to thank our colleagues and friends at Baylor University, 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 or marketing courses at all these universities. Scores of students and professors at these schools helped shape the development of this text.

We 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 **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 our attention to specific errors or deficiencies in coverage or exposition will especially be appreciated.

Thank you for using this text.

—Fred R. David

—Forest R. David

—Meredith E. David

Global Edition Acknowledgments

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Global Edition Reviewers

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About the Authors

Fred R. David, Forest R. David, and Meredith E. David are a father–son-daughter team that have published more than 50 articles in journals 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*. Six recent journal articles by the authors, listed below, are changing the way strategic-management courses are taught.

David, Meredith E. and Fred R. David, "Strategic Planning for Individuals: A Proposed Framework and Method," *SAM Advanced Management Journal*, (Winter 2018).

David, Fred R., Meredith E. David, and Forest R. David, "The Integration of Marketing Concepts in Strategic Management Courses: An Empirical Analysis," *SAM Advanced Management Journal*, (Winter 2017).

David, Fred R., Meredith E. David, and Forest R. David, "How Important Is Finance Coverage in Strategic Management? A Content Analysis of Textbooks," *International Journal of Business, Marketing, and Decision Sciences (IJBMDS*), 4, no. 1, (Winter 2016), pp. 64–78.

David, Fred R., Forest R. David, and Meredith E. David, "Benefits, Characteristics, Components, and Examples of Customer-Oriented Mission Statements," *International Journal of Business, Marketing, and Decision Sciences (IJBMDS)*, 9, no. 1, (Fall 2016), pp. 1–14.

David, Meredith E., Fred R. David, and Forest R. David, "The Quantitative Strategic Planning Matrix: A New Marketing Tool," *Journal of Strategic Marketing*, 3, (April 2016), pp. 1–11.

David, Meredith E. and Fred R. David, "Are Key Marketing Topics Adequately Covered in Strategic Management?" *Journal of Strategic Marketing*, 24, (March 2016), pp. 1–13.

Fred has been lead author of this textbook for three decades. This text is a global leader in the field of strategic management providing an applications, practitioner-approach to the discipline. About 500 colleges and universities currently use this textbook across about 20 countries. With a Ph.D. in Management from the University of South Carolina, Dr. David is currently the TranSouth Professor of Strategic Planning at Francis Marion University in Florence, South Carolina. He has published more than 100 academic journal articles and cases.

Fred R. David

Forest has been sole author of the *Case Instructor's Manual* for seven editions of this textbook. This *Manual* provides extensive teachers' notes (solutions) for all the cases. Forest has also been sole author of the *Chapter Instructor's Manual,* Case MyLab, and Chapter MyLab ancillaries, as well as the free Excel Student Template found on the author website (www.strategyclub.com). Forest has published more than 80 strategic management cases, articles, and papers. He has taught strategic-management courses at Mississippi State University and Francis Marion University, and management courses at Campbell University.

Forest R. David

Meredith holds a Ph.D. in Business Administration from the University of South Carolina and an MBA Degree from Wake Forest University. She is currently an Assistant Professor of Marketing at Baylor University in Waco, Texas. She has published more than 30 articles, cases, and papers on marketing and strategic management in such journals as *Journal of Consumer Behavior*, *Journal of Advertising*, *Journal of Strategic Marketing*, *European Journal of Marketing*, and *Journal of Business Research*. Meredith has traveled the world over as a professor and student. Meredith recently received the prestigious Young Researcher Award in the Hankamer School of Business at Baylor University, and taught strategic management at Jiao Tong University in Shanghai, China.

Meredith E. David

STRATEGIC MANAGEMENT
Concepts and Cases

A COMPETITIVE ADVANTAGE APPROACH

PART 1

1

OVERVIEW OF STRATEGIC MANAGEMENT

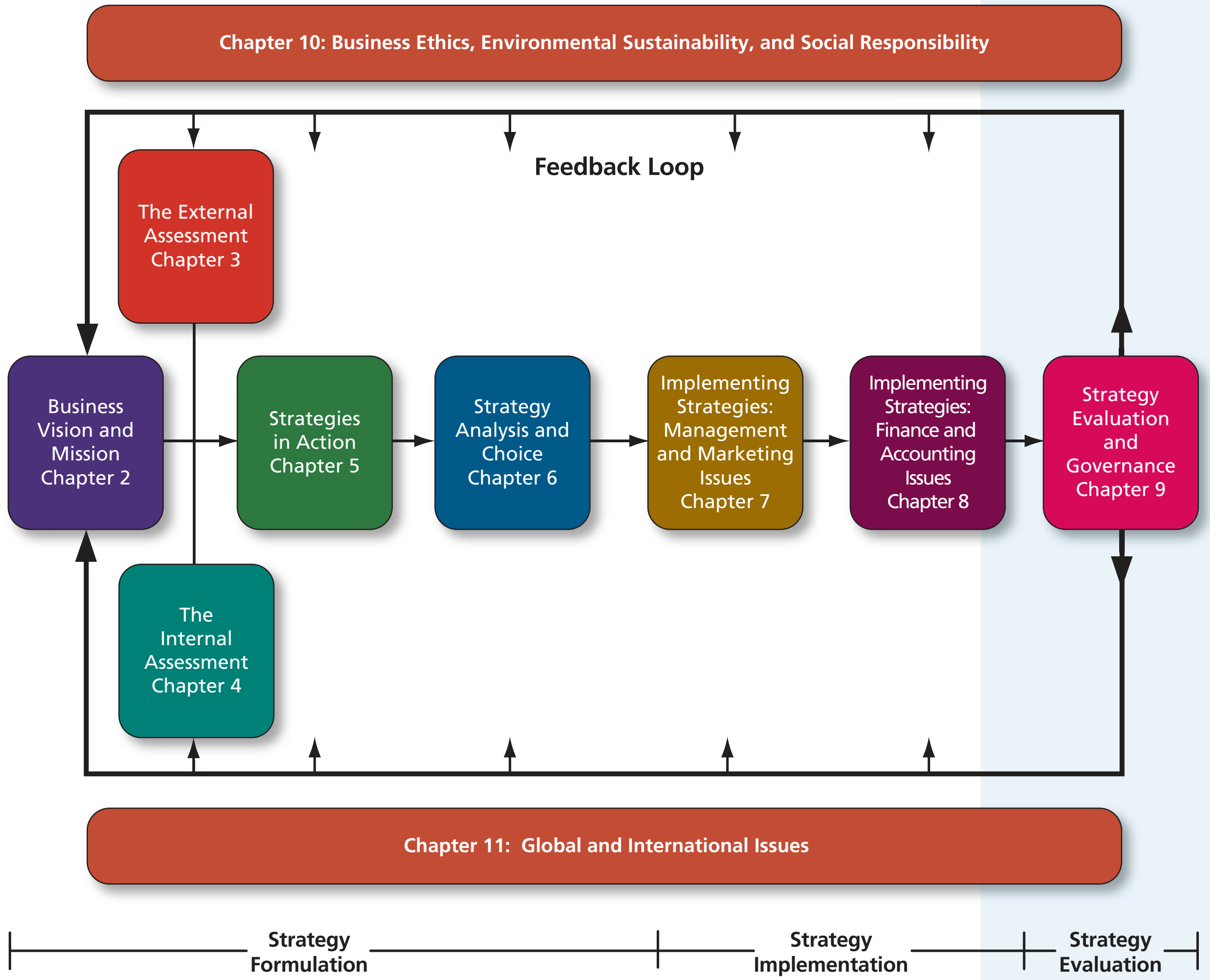

FIGURE 1-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

The Nature of Strategic Management

LEARNING OBJECTIVES

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

1-1. Describe the strategic-management process.

1-2. Discuss the three stages of activities for strategy formulation, implementation, and evaluation activities.

1-3. Explain the need for integrating analysis and intuition in strategic management.

1-4. Define and give examples of key terms in strategic management.

1-5. Describe the benefits of engaging in strategic management.

1-6. Explain why some firms do not engage in strategic planning.

1-7. Describe the pitfalls in doing strategic planning.

1-8. Discuss the connection between business and military strategies.

1-9. Explain how this course can enhance a student's employability.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1: Strategic Planning for Coca-Cola

EXERCISE 1A: Gather Strategy Information for Coca-Cola Company

EXERCISE 1B: Enter Coca-Cola Vitals into the Strategic Planning Template

SET 2: Strategic Planning for My University

EXERCISE 1C: Perform SWOT Analysis for My University

SET 3: Strategic Planning to Enhance My Employability

EXERCISE 1D: Perform SWOT Analysis on Myself

SET 4: Individual versus Group Strategic Planning

EXERCISE 1E: How Detrimental Are Various Pitfalls in Strategic Planning?

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Chapter 1 provides an overview of strategic management, introduces a practical, integrative model of the strategic-management process (illustrated in Figure 1-1), and defines basic activities and terms in strategic management. The primary focus of this textbook is on "learning by doing." From this text, students learn "how to do strategic planning." The integrative model reveals the *"layout of this text"* and the *"process of strategic planning"* so students can follow the journey in a meaningful way.

An exciting new feature of this edition at the beginning of each chapter is an exemplary strategist capsule to showcase a famous strategist for doing an exemplary job applying strategic-planning concepts, tools, and techniques. The first person featured for excellent strategic-management practices is Vince Lombardi, former head coach and General Manager of the Green Bay Packers professional football team. At the end of each chapter, a new, one-page, mini-case on a company is provided with respective questions that apply various concepts, tools, and techniques presented.

LO 1.1 What Is Strategic Management?

Strategic management is 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, accounting, production, and information systems to achieve organizational success. Strategic management can also be defined as the executive-level activity of distributing resources across products and regions to gain a sustainable competitive advantage over rivals.

Firms have liberty to compete many different ways in a variety of geographic areas, so decisions must be made regarding what markets to enter, what markets to avoid, which competitor's space to invade, and which to avoid. A firm's survival can hinge on these decisions being right; this textbook unveils the process needed for making effective strategic decisions. For example, Westinghouse Electric's recent strategy to build a new generation of nuclear power plants was ill formulated and thus resulted in bankruptcy and eventual acquisition (in 2018) by Canada's Brookfield Business Partners LP.

EXEMPLARY **STRATEGIST** SHOWCASED

Coach Vince Lombardi

CSU Archives/Everett Collection Inc/Alamy Stock Photo

The legendary football coach of the Green Bay Packers, Vince Lombardi (1913–1970) changed a losing culture into a winning culture. Founded in 1919 and headquartered in the small, frigid Wisconsin town of Green Bay, the Packers are the only nonprofit, community-owned major league professional sports team in the United States. The third-oldest franchise in the National Football League (NFL), the Packers were perennial losers until Vince Lombardi took over in 1959 as head coach and general manager. The very existence of the Packer franchise was in jeopardy when Lombardi arrived in Green Bay. Coming off a 1–10–1 season and 11 straight losing seasons, Lombardi led the Packers to 3 NFL championships in his first 7 seasons. The Pro Football Hall of Fame says: "Lombardi is arguably the greatest football coach of all time and is on the short list of history's greatest coach, regardless of sport." Because of his success as both a manager and strategist, Lombardi became a national symbol of single-minded determination to win. The following quotes from Vince Lombardi reveal his basic strategy for winning, which was based on building character, commitment, and setting an exemplary example:

1. Winning is not everything, but making the effort to win is.
2. The objective is to win—fairly, squarely, decently, by the rules, but to win.
3. The difference between a successful person and others is not a lack of strength and not a lack of knowledge, but rather a lack of will.
4. Winning is a habit. Watch your thoughts, they become your beliefs. Watch your beliefs, they become your words. Watch your words, they become your actions. Watch your actions, they become your habits. Watch your habits, they become your character.

Source: Based on Michael Mink, "Coach Vince Lombardi Set A Superb Standard," *Investors Business Daily*, (February 5, 2016): A3.

Formulating strategies such as deciding what to produce and where, when, and how to compete is what leads to a sustainable competitive advantage. Even the best strategies must be implemented well through operational- or tactical-level activities like hiring and motivating employees, cutting costs, benchmarking, outsourcing, securing financing, and keeping facilities warm (or cool). Implementation activities are vitally important and must be monitored by strategists, but effectively formulated strategies, more so than operational tactics, is generally what leads to sustained competitive advantages.

To gain a sustainable competitive advantage, firms need to provide unique products and services. Uniqueness matters. For example, Apple's computers, iPads, and iPhones all run on Apple's unique operating system; the only way to have an iPhone is to also be a user of Apple's operating system. To assure "effective uniqueness," firms must accept concessions in the strategy process to gain a sustainable competitive as exemplified in the Apple example. Another example is Rolex, and the company not offering cheaper lines of watches. Rolex has resisted increasing market share by offering new cheaper product lines to attract new customers. Instead, Rolex has maintained its unique reputation and market share as the top luxury watch brand in the world. Rolex, and all successful firms, thus make tradeoffs and tough decisions throughout the process of developing, producing, and selling products.

Chapter 2 discusses core values, vision, and mission—items that represent the starting point for developing and nurturing a firm's uniqueness. Everything in strategy flows from a particular firm's core values, vision, and mission, and all successful firms are different (unique) from rival firms in some key ways.

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. Two special features of this text are a Cohesion Case (on Coca-Cola) and end-of-chapter assurance-of-learning exercises, as described in Table 1-1.

Strategic Planning

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,

TABLE 1-1 A Cohesion Case and Assurance-of-Learning Exercises

A distinguishing, popular feature of this text is the Cohesion Case, named so because a written case on a company (Coca-Cola) appears at the end of this chapter, and then all other subsequent chapters feature end-of-chapter assurance-of-learning exercises to apply strategic-planning concepts, tools, and techniques to the Cohesion Case company. Coca-Cola is a well-known, well-managed global firm undergoing strategic change. By working through the Coca-Cola–related exercises, students become well prepared to develop an effective strategic plan for any company (case) assigned to them. Case analysis is a core part of almost every strategic-management course globally.

We are thrilled to provide new sets of end-of chapter assurance-of-learning exercises. All exercises have been carefully designed to "assure learning" by applying chapter concepts, tools, and techniques in a fun and meaningful way to best assure that competence is gained in particular employability skills discussed near the end of this chapter. The four sets of assurance-of-learning exercises that appear at the end of each chapter are as follows:

Set 1: Strategic Planning for Coca-Cola—Exercises that apply chapter material to the Coca-Cola Cohesion Case Company; these exercises ready students for doing case analysis as "knowledge application and analysis" and "information technology" skills are honed.

Set 2: Strategic Planning for My University—Exercises that apply chapter material to your college or university; these exercises ready students for doing case analysis in nonprofit organizations as "business ethics and social responsibility" and "data literacy" skills are honed.

Set 3: Strategic Planning to Enhance My Employability—Exercises that apply chapter material to individuals instead of companies; these exercises prepare students for making career choices and enable students to apply strategy tools, techniques, and concepts to enhance their own career.

Set 4: Individual versus Group Strategic Planning—Exercises that apply chapter material by comparing the effectiveness of individual versus group decisions; these are fun in-class group activities that yield "a winning individual and a winning group" for each exercise as critical-thinking and collaboration skills are honed.

implementation, and evaluation, with *strategic planning* referring only to strategy formulation. The purpose of strategic planning 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.

A strategic plan is, in essence, a company's game plan. Just as an athletic 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 Strategic-Management Model

The **strategic-management model** shown in Figure 1-1 is a widely accepted, comprehensive depiction of the strategic-management process.[1] The process conveyed 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 on the opening page of all subsequent chapters with appropriate area of the model shaded to show the particular focus of the chapter. This text is organized around the model because it reveals how organizations actually do strategic planning. There are three important questions to answer in preparing 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!

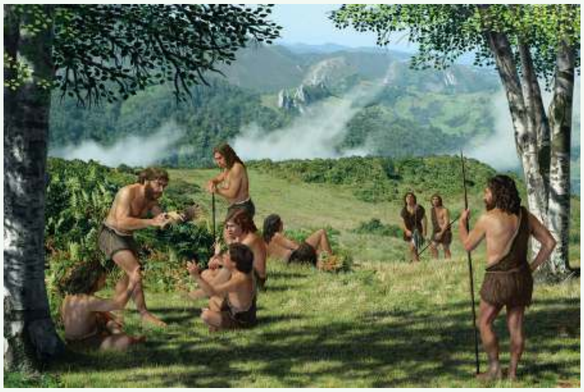
The strategic-management process is dynamic and continuous. A change in any one of the major components in the model can necessitate a change in any or all of the other components. For instance, various third-world countries coming online could represent a major opportunity and require a change in long-term objectives and strategies; a failure to accomplish annual objectives might require a change in policy; or a major competitor's change in strategy might require a change in the firm's mission. The activities represented in Figure 1-1 are not independent silos; they represent an interrelated process. Thus, activities for strategy formulation, implementation, and evaluation should be performed on a continual basis, not just at the end of the year or semi-annually. *The strategic-management process never really ends.*

In Figure 1-1, perhaps the most important "activity" is the feedback loop because strategy must be thought of as a "verb rather than a noun." The stages of strategic management (formulation, implementation, and evaluation) are so fluid as to be virtually indistinguishable when one starts and the other ends. Continuous feedback enables firms to readily adapt to changing conditions; when anyone is preparing an external or internal assessment or even implementing strategies, they should be mindful of the firm's vision and mission. The feedback loop reveals that a change in any strategic-planning activity can impact any or all other activities. For example, changes in a firm's mission can impact all other activities; *everything a firm does should be mission driven*.

Note in Figure 1-1 that business ethics, social responsibility, environmental sustainability, and international issues impact all activities in the model, as discussed in Chapters 10 and 11, respectively. Regarding business ethics, recent research revealed in the Ethics Capsule 1 concludes that "trustworthiness" is the most important variable in doing business.

ETHICS CAPSULE 1

What Ethics Variable Is Most Important in Doing Business?



MAURICIO ANTON/Science Photo Library/Getty Images

Who Is This Approaching?

Three professors from Harvard Business School, Amy Cuddy, Susan Fiske, and Peter Glick, recently revealed in a new book, *Presence*, that the most important variable in doing business with someone you do not know is trustworthiness. The authors say that within seconds of meeting someone, people determine first and foremost the extent that the person is trustworthy. They say that variable is far more important than competence, intelligence, looks, strength, height, and numerous other variables.

Professor Cuddy explains, "From an evolutionary perspective, it was more crucial to our survival that we know quickly whether a person(s) deserves our trust." In other words, for nearly a million years of man's evolution, when people first met other people, they assessed within seconds whether the new person(s) was trustworthy, meaning is this person going to steal from us or try to kill us. Trustworthiness, these authors report, was always assessed before competence (i.e., can this person start a fire or catch a fish). Cuddy says competence is evaluated today only after trust is established because physically and psychologically, man today is the result of various traits being promoted and others extinguished over the millennia, and trustworthiness is number one according to these researchers.

Curry, Fiske, and Glick go on to say that focusing too much today on displaying your strengths or that you are smart, whether in a job interview or in seeking to do business with someone, can backfire. Cuddy says, "A warm, trustworthy person who is also strong elicits admiration, but only after you've established trust does your strength become a gift, rather than a threat."

Based on Jenna Goudreau, A Harvard psychologist says people judge you based on 2 criteria when they first meet you, http://www.aol.com/article/2016/01/16/a-harvard-psychologist-says-people-judge-you-based-on-2-criteria/21298315/?cps=gravity_4816_5749740174701162847

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. To develop a strategic plan, 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 "basic approach" are objective and clear rather than subjective and vague. 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 organizational success.[2]

Stages of Strategic Management

LO 1.2

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 efficiently. Strategy implementation includes developing a strategy-supportive culture, creating an organizational structure, redirecting marketing efforts, preparing budgets, developing and using information systems, devising tactics, 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 constantly change. 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.[3]

LO 1.3 Integrating Analysis and Intuition

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. 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 General Motors (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."[4] 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."[5]

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 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.[6] 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."[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 through analysis in formulating strategies.

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.[8]

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 drop in oil prices caught so many firms by surprise. Firms, like organisms, must be "adept at adapting" or they will not survive.

To survive, all organizations must astutely identify and adapt to change, as the Chinese Mobike Company does as revealed in the Global Capsule 1 on page 38. The strategic-management process is aimed at allowing organizations to adapt effectively to change over the long run. Waterman 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.[9]

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?"; and "Are new technologies being developed that could put us out of business?"

Online commerce is forcing hundreds of brick-and-mortar retailers to change or liquidate. The fashion retailer Bebe Stores recently announced it is closing all its 168 stores and going online only. Yarden Research reports that 29.1 percent of retail sales of general merchandise, apparel and accessories, and furniture in America is now purchased online. Companies such as Macy's and Target are converting more and more of their retail store space to warehouse/distribution area rather than being open for customer shopping.

GLOBAL CAPSULE 1

Mobike: Global Bike Renting Takes off Like a Jet Plane

Natasha-Aleksandra/Shutterstock

Follow Me Biking

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, as well as idea sharing, 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, global distributors, and global entrepreneurs.

There are millions of start-up businesses rolling out services globally. For example, Mobike in Beijing, China, is a bicycle-sharing business with more than 100 million users who use the company's 6 million "connected" bikes. Members pay a fee for the privilege and retrieve a bike from one docking station and return it to another, but recently Mobike members simply download the company app, find a bike near them, scan a code to unlock it, and then drop the bike off wherever they like. GPS and wireless technology built into the bike enable Mobike to track the bike's whereabouts. No docking stations are needed. This type of small business likely would be viable in many cities all over the globe.

In the United States, the largest bike-share fleet resides in Dallas, Texas where 18,000 bikes flood Dallas streets and users are not required to use racks; racks are required in New York City. The rackless business model is the norm in China, but there, and in Dallas, bikes end up in trees, creeks, yards, and block sidewalks.

Source: Based on Clifton Leaf, "Ideas Know No Borders," *Fortune*, August 1, 2017, p. 10. Also, Ken Smith, "A Bike-Share Invasion From China," *Bloomberg Businessweek*, November 13, 2017, p. 22. Also, Eliot Brown, "It's the Wild West for Bike Sharing," March 27, 2018, p. B4.

LO 1.4 Key Terms in Strategic Management

Before we further discuss strategic management, we should define ten 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 any activity a firm does especially well compared with activities done by rival firms, or any resource a firm possesses that rival firms desire. For example, having fewer fixed assets than rival firms can provide major competitive advantages. Apple Inc. has virtually no manufacturing facilities of its own, whereas rival Sony owns 57 electronics factories. Apple relies almost entirely on contract manufacturers for production of its products.

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 simply to obtain competitive advantage. A firm must strive to achieve **sustained competitive advantage** by doing the following:

1. Continually adapting to changes in external trends and events and internal capabilities, competencies, and resources.
2. Effectively formulating, implementing, and evaluating strategies that capitalize on those factors.
3. Offering products that are unique and not easily duplicated by rivals.
4. Accepting tradeoffs by deciding what not to do; no firm can be everything to everybody.

Strategists

Strategists are the individuals most responsible for the success or failure of an organization. They have various job titles, such as *chief executive officer, chief strategy officer, president, owner, chair of the board, executive director, chancellor, dean,* and *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).

The chief strategy officer (CSO) position has become common in many organizations. Hundreds of companies have appointed a new chief strategy officer in the last couple of years, including Talon International, TeleTech, Fleet Complete, Ringler Associates, LRES, Amber Engine, Beaver-Visitec International, Momentum Worldwide, PGi, TIA, World Surf League, Bank of Hawaii, Snapdeal, Oramed, Saatva, Centrillion, Geisinger Health System, and Amplifi Commerce.

Strategists differ as much as organizations do, and these differences must be considered in the formulation, implementation, and evaluation of strategies. 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; some will not even consider various types of strategies because of their personal philosophies. The founder of Hershey, Milton Hershey, built the company so that he could afford to manage an orphanage. From corporate profits, Hershey today cares for about 850 boys and 950 girls in its boarding school for pre-K through grade 12.

Athletic coaches are also strategists. Football, basketball, baseball, soccer, and in fact many athletic contests are often won or lost based on a team's game plan. For example, a basketball coach may plan to fast break and play up-tempo, rather than play more half-court, if the players are smaller and faster, or if the team has more depth than the opposing team. Some inspirational, strategic-planning-related quotes from legendary National Football League (NFL) coaches are provided in Table 1-2.

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 as revealed through numerous examples in Chapter 2.

TABLE 1-2 Eight Famous, Strategic-Planning–Relevant Quotes from NFL Coaches

1. "Perfection is not attainable. But if we chase perfection, we can catch excellence."—*Vince Lombardi, Head Coach Green Bay Packers (1959–1967)*
2. "Leadership is a matter of having people look at you and gain confidence … If you're in control, they're in control."—*Tom Landry, Head Coach Dallas Cowboys (1960–1988)*
3. "If you want to win, do the ordinary things better than anyone else does them, day in and day out."—*Chuck Noll, Head Coach Pittsburgh Steelers (1969–1991)*
4. "Leaders are made, they are not born. They are made by hard effort, which is the price which all of us must pay to achieve any goal that is worthwhile."—*Vince Lombardi, Head Coach Green Bay Packers (1959–1967)*
5. "You fail all the time, but you aren't a failure until you start blaming someone else."—*Bum Phillips, Head Coach Houston Oilers (1975–1980), New Orleans Saints (1981–1985)*
6. "Success demands singleness of purpose."—*Vince Lombardi, Head Coach Green Bay Packers (1959–1967)*
7. "Stay focused. Your start does not determine how you're going to finish."—*Herm Edwards, Head Football Coach of the New York Jets (2001–2005), Kansas City Chiefs (2006–2008), and Arizona State University (2018 to present).*
8. "Nobody who ever gave his best regretted it."—*George S. Halas, Head Coach Chicago Bears (1933–1942, 1946–1955, 1958–1967)*

Source: A variety of sources.

A **mission statement** is an "enduring statement of purpose that distinguishes 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 and serves as a constant reminder to its employees of why the organization exists and what the founders envisioned when they put their fame and fortune (and names) 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*. Some general categories of opportunities and threats are listed in Table 1-3. Dollars, numbers, percentages, ratios, and quantification are essential so strategists can assess the magnitude of opportunities and threats and take appropriate actions. For example, in Table 1-3, rather than saying "Marketing is moving rapidly to the Internet," strategists need to conduct research and find, for example, that "spending on online advertisements globally is rising 18 percent annually and represents about 44 percent of total advertising spending in the USA." Strategies must be formulated and implemented based on specific factual information to the extent possible because so much is at stake in having a good game plan.

External trends and events are creating a different type of consumer and consequently a need for different types of products, services, and strategies. A competitor's strength could be a threat, or a rival firm's weakness could be an opportunity. 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 activities of management, marketing, finance/accounting, production, and information systems of a business. Identifying and

TABLE 1-3 Some General Categories of Opportunities and Threats

- Consumers's expectation for green operations and products is rising 8 percent annually in Western Europe.
- Internet marketing is growing 11 percent annually in the United States.
- Commodity food prices rose 6 percent the prior year.
- Oil and gas prices declined 18 percent in the last twelve months.
- Computer hacker problems are increasing 14 percent annually.
- Interest rates are 4 percent but rising in the United States.
- State and local governments's finances worsened 12 percent last year.
- The number of births declined 5 percent annually in many countries over the last three years.
- The gross domestic product (GDP) of Brazil fell from 6 percent to 5 percent in the last year.
- Competitor XYZ just introduced product ABC at a 10 percent lower price than our product.
- Social-media networking is growing 9 percent annually in China.

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 improve 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 instance, 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, "Sam Club's revenues grew 11 percent in the recent quarter," is far better than saying "Walmart's revenues grew 6 percent in the recent quarter." Being divisional enables strategies to be more effectively formulated and targeted. This is important because all firms must allocate resources across divisions (segments) of the firm (that is, by product, region, customer, or whatever the various units of the firm are), such as Walmart's Sam's Club compared with Walmart Supercenters, Walmart Mexico, or Walmart Europe.

Both internal and external factors should be stated as specifically as possible, using numbers, percentages, dollars, and ratios, as well as comparisons over time to rival firms. *Quantification 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 doing some research and incorporating 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 mission. Long term means more than one year. Objectives are essential for organizational success because they provide direction; aid in evaluation; foster 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 are needed both for the overall company and each division.

Headquartered in New York City, Foot Locker, Inc. recently posted the following long-term objectives on its corporate website (paraphrased):

1. Annual revenues: $7.5 billion
2. Annual revenues per square foot: $500
3. EBIT margin: 11 percent
4. Profit margin: 7 percent
5. Return on invested capital: 14 percent
6. Inventory turnover: 3+ times

In contrast, Macy's, Inc.'s *Annual Report* lists as objectives to "to grow sales profitably" and "to maximize total shareholder return." Avoid vagueness like this throughout a strategic-planning project!

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 venture. Strategies are potential actions that require top-management decisions and significant amounts of the firm's resources.

They affect an organization's long-term prosperity, typically for at least five years, and thus are future oriented. Strategies also have multifunctional and multidivisional consequences and require consideration of both the external and internal factors facing the firm.

Strategies currently being pursued by Amazon are described in Table 1-4.

TABLE 1-4 Amazon's Strategies

The world's largest bookseller, Amazon, is surprisingly embracing the brick-and-mortar bookstore retail format it's been killing for 20 years. Amazon's physical bookstore front fits with the company's increasing reliance on storefronts including AmazonBooks, Amazon Go, and AmazonFresh Pickup to build sales and meet customers where they are. AmazonBooks now has more than 10 physical stores. Another reason for Amazon's new strategy is that physical bookstores are experiencing something of a comeback. From 2010 to 2017, the number of independent bookstores increased by nearly 30 percent. These stores are capitalizing on a loyal customer base that appreciates the value of a real bookstore that hosts readings and events, offers conversation and discussion areas, and enables in-store browsing and discovery. Amazon also recently acquired the brick-and-mortar grocery store chain Whole Foods Market. Entire industries are being rocked or crushed by Amazon's competitive size, scale, diversity, automation, and prowess.

Source: Based on Jeremy Bowman, "3 Reasons Amazon Is Opening a Brick-and-Mortar Bookstore Chain," https://www.aol.com/article/finance/2017/06/07/3-reasons-amazon-is-opening-a-brick-and-mortar-bookstore-chain/22130842/

SWOT Analysis

Strengths-Weaknesses-Opportunities-Threats (SWOT) Analysis 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.[11] Matching key external and internal factors is a critically important activity in strategic planning. Note in Table 1-5 that the resultant strategies 1, 2, 3, and 4 are SO, WO, ST, and WT strategies, respectively. SWOT analysis is explained further in Chapter 6, but the matching of external with internal factors to generate strategies results in a SWOT Matrix as illustrated in Figure 1-2.

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 must also 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, and production accomplishments. A set of annual objectives is needed for each long-term objective. These

TABLE 1-5 Matching Key External and Internal Factors to Formulate Strategies

Key Internal Factor	Key External Factor	Resultant Strategy
S1: Demand for Dunkin Donuts up 6 percent annually (internal strength)	+ O1: Desire for healthy products up 8 percent annually (external opportunity)	= SO1: Dunkin Donuts eliminated all artificial dyes and colors in its donuts in 2018
W1: Insufficient production capacity by 1 million units annually (internal weakness)	+ O2: Exit of two major foreign competitors from the area (external opportunity)	= WO1: Purchase competitors' production facilities
S2: R&D has developed four new products in twelve months (internal strength)	+ T1: Sugary drink consumption is declining 5 percent annually (external threat)	= ST1: Spend $1 million to promote healthiness of four new products
W2: Poor employee morale (internal weakness)	+ T2: Healthcare costs rose 7 percent last year (external threat)	= WT1: Implement a new corporate wellness program

	S	W
O		
T		

	STRENGTHS (S)	WEAKNESSES (W)
	1. 2. 3. 4. 5. 6. 7. 8. 9. 10.	1. 2. 3. 4. 5. 6. 7. 8. 9. 10.
OPPORTUNITIES (O)	**SO STRATEGIES**	**WO STRATEGIES**
1. 2. 3. 4. 5. 6. 7. 8. 9. 10.	1. 2. ETC.	1. 2. ETC.
THREATS (T)	**ST STRATEGIES**	**WT STRATEGIES**
1. 2. 3. 4. 5. 6. 7. 8. 9. 10.	1. 2. ETC.	1. 2. ETC.

FIGURE 1-2

The Basic SWOT Matrix Format

objectives are especially important in strategy implementation, whereas long-term objectives are particularly important in strategy formulation. Annual objectives provide 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. Usually, policies are stated in terms of management, marketing, finance/accounting, production/operations, R&D, and MIS activities. They may be established at the corporate level and apply to an entire organization, at the divisional level and apply to a single division, or they may be established at the functional level and apply to particular operational activities or departments.

Like annual objectives, policies 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. For example, IBM recently instituted a new policy requiring employees to work from an IBM office rather than working remotely, reversing a 30-year policy. IBM had previously for decades boasted that more than 40 percent of its employees worked remotely, but the company's new policy is aimed at improving employee collaboration and accelerating the pace of work. The policy is also aimed at reversing IBM's two consecutive quarters of declining revenue. Several large companies are following the IBM lead, recalling at-home employees, including Yahoo, Bank of America, and Aetna Inc.

LO 1.5 Benefits of Engaging in 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 for decision making. In addition, the process, rather than the decision or document, is also a major benefit of engaging in strategic management. Through involvement in the process (i.e., dialogue and participation), managers and employees become committed to supporting the organization. *A key to successful strategic management is communication, and it may be the most important word in all of management.* Figure 1-3 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 therefore exceptionally important. A major aim of the process

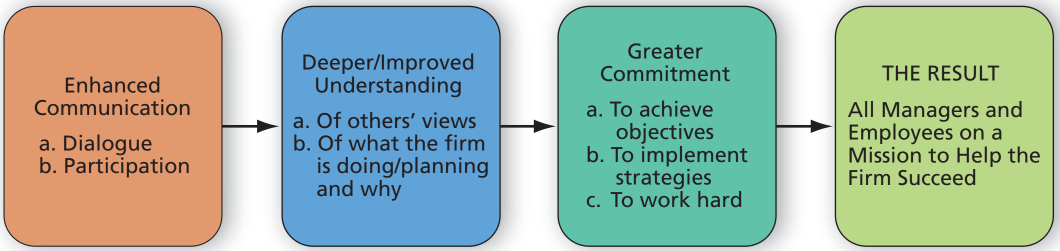


FIGURE 1-3
Benefits to a Firm that Does Strategic Planning

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. *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. A strategist must avoid developing a strategic plan alone and then present the plan to operating managers to execute. Through involvement in the process, line managers must become "owners" of the strategy. *Ownership of a strategic plan by the people who have to execute the plan is a key to success in any organization.*

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

Organizations that use strategic-management concepts are generally more successful, showing 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 management systems that use strategic-planning concepts, tools, and techniques 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 United States 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.

Nonfinancial Benefits

Besides helping firms avoid financial demise, strategic management offers other tangible benefits, such as enhanced awareness of external threats, 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 using strategic management are increased discipline, improved coordination, enhanced communication, increased forward thinking, improved decision making, increased synergy, and more effective allocation of time and resources.

LO 1.6 Why Some Firms Do No Strategic Planning

Some firms do not engage in formal strategic planning, and some firms do engage in strategic planning but receive little support from managers and employees. Ten reasons (excuses) often given for minimal 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. View planning as a waste of time because 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;
9. Overconfidence
10. Prior bad experience with strategic planning done sometime, somewhere

LO 1.7 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.

There are some pitfalls in doing strategic planning; avoid the following:

- 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
- Not communicating 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
- Not using plans as a standard for measuring performance
- Delegating planning to a "planner" rather than involving all managers
- Not involving key employees in all phases of planning
- Not creating a collaborative climate supportive of change
- Viewing planning as unnecessary or unimportant
- Viewing planning activities as silos comprised of independent parts
- Becoming so engrossed in current problems that insufficient or no planning is done
- Being so formal in planning that flexibility and creativity are stifled[12]

LO 1.8 Comparing Business and Military Strategies

A strong military heritage underlies the study of strategic management. Terms such as *objectives, mission, strengths*, and *weaknesses* were first 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."[13] The word *strategy* comes from the Greek *strategos*, which refers to a military general and combines *stratos* (the army) and *agos* (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.

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*. In a military setting there is generally one winner, but in business there are usually multiple winners. For example, several firms can win in the hamburger business; you do not have to confront McDonald's head on, instead offer a different mix of burgers, restaurant design, and customer service and still be successful. This example explains competition and avoiding conflict with a larger player such as McDonald's. In military situations, it is often impossible to avoid conflict with the larger army. 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 BCE, 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 thirty, 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 by a sheep." This quote reveals the overwhelming importance of an excellent strategic plan for any organization to succeed.

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.[14]

Sun Tzu's *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, the book 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. Similarities can be construed from Sun Tzu's writings to the practice of formulating and implementing strategies among businesses today. Table 1-6, on page 48, provides narrative excerpts from *The Art of War*; which of the principles listed do you believe are most applicable or analogous to companies as compared to armies?

TABLE 1-6 Excerpts from Sun Tzu's *The Art of War* Writings

- Strategic planning 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.
- Strategic planning 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. Attack the enemy where he is unprepared. Appear where you are not expected.
- A speedy victory is the main object in strategic planning. 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 strategic planning 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; those skilled in war bring the enemy to the field of battle rather than being brought there by him.
- Analyze the enemy's plans so that you will know his deficiencies as well as his strengths. Agitate him to ascertain the pattern of his movement. Lure him out to reveal his dispositions and position. Launch probing attacks to decipher strengths and weaknesses.
- Avoid strength. Strike weakness. Anyone 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 on battlefields. Brilliant strategists rarely go to battle; they achieve their objectives through tactical positioning well in advance of 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. Thus, commands from a distance should not interfere with spontaneous maneuvering at the point of attack.
- 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. Never allow your forces to be damaged by those who have nothing to lose.

Note: The word *strategic planning* is substituted for *war* or *warfare.*
Source: Based on *Sun Tzu's The Art of War* Writings, 1910, Lionel Giles.

LO 1.9 Developing Employability Skills

The how-to, skills-oriented, practical approach of this textbook's content and layout enables students to gain numerous career-enhancing (employability) skills that experts say are vital for success in the twenty-first-century workplace. "**Employability**" skills include actual tools, techniques, and concepts being used by businesses and learned by students using this text; the skills can be grouped into 6 broad categories and 14 specific categories, as shown in Table 1-7.

TABLE 1-7 Employability Skills to Be Gained by Students Using This Text

Broad Skills to Be Developed

1. Critical thinking: to define and solve problems and make decisions or form judgments about a particular situation or set of circumstances.
2. Collaboration: to work with colleagues on reports, presentations, and projects.
3. Knowledge application and analysis: to learn a concept and then apply that knowledge to other challenges.
4. Business ethics and social responsibility: to know in your heart that good ethics is good business.
5. Information technology: to enhance one's word-processing, spreadsheets, database, presentation, and software skills.
6. Data literacy: to access, assess, interpret, manipulate, summarize, and communicate data.

Specific Skills to Be Gained; Learn How to:

1. Develop a three-year strategic plan for any for-profit or nonprofit company or organization.
2. Write and evaluate vision and mission statements.
3. Conduct an external and internal strategic planning assessment.
4. Formulate strategies using SWOT analysis.
5. Develop and use a BCG and IE portfolio matrix analysis.
6. Develop and use a QSPM analysis.
7. Determine an appropriate set of recommendations with associated costs for any firm.
8. Develop and use perceptual maps to better position firms versus rival companies.
9. Determine the value of any firm using various corporate valuation methods.
10. Perform EPS-EBIT analysis to determine the extent that debt versus stock should be used to raise needed capital for the firm.
11. Develop and use value chain analysis, balance scorecards, and financial ratio analysis.
12. Evaluate corporate structures and develop effective organizational charts.
13. Develop and use projected financial statements to support any proposed strategic plan.
14. Use a popular corporate strategic planning Excel template.

Means Used to Develop Skills

This text has:

11 concise chapters organized around a practical, integrative strategic-planning model

61 end-of-chapter assurance-of-learning exercises organized in four effective, fun categories

355 end-of-chapter review questions

30 brand-new, student-friendly cases on companies in the news undergoing change

11 mini-cases with chapter relevant questions

1 Cohesion Case on Coca-Cola at the end of this chapter and many associated end-of-chapter exercises

1 popular Excel-based, Strategic Planning Template widely used by both companies and students doing strategic planning (see the author website at www.strategyclub.com)

750 chapter MyLab questions written by the authors

750 case MyLab questions written by the authors

IMPLICATIONS FOR STRATEGISTS

Figure 1-4 reveals that to gain and sustain competitive advantages, a firm must create and nurture a clear vision and mission, and then systematically formulate, implement, and evaluate strategies. Consistent business success rarely happens by chance; it most often results from careful planning followed by diligent, intelligent, hard work. If the process were easy, every business would be successful. Consistent success requires that strategists gather and assimilate relevant data, make tough trade-off decisions among various options that would benefit the firm, energize and reward employees, and continually adapt to change. To survive and prosper, a business must gain and sustain at least several major competitive advantages over rival firms. In the process, many attractive options will be discarded in favor of a few; strategic planning in a sense can be defined as "choosing what not to do."

The strategic-management process represents a systematic means for creating, maintaining, and strengthening a firm's competitive advantages. This text provides step-by-step guidance throughout the process to help strategists gain and sustain a firm's competitive advantages. As the eleven chapters unfold, more than one hundred key elements of the process, ranging from developing portfolio matrices to managing workplace romance, are examined to help strategists lead the firm in delivering prosperity to shareholders, customers, and employees. The 11 chapters provide a clear, planned, journey through the strategic-management process, with numerous highlights accented along the way, so strategists can perform essential analyses and anticipate and resolve potential problems in leading their firm to success. Use the free Excel template at www.strategyclub.com to keep your firm's strategic-planning process track.

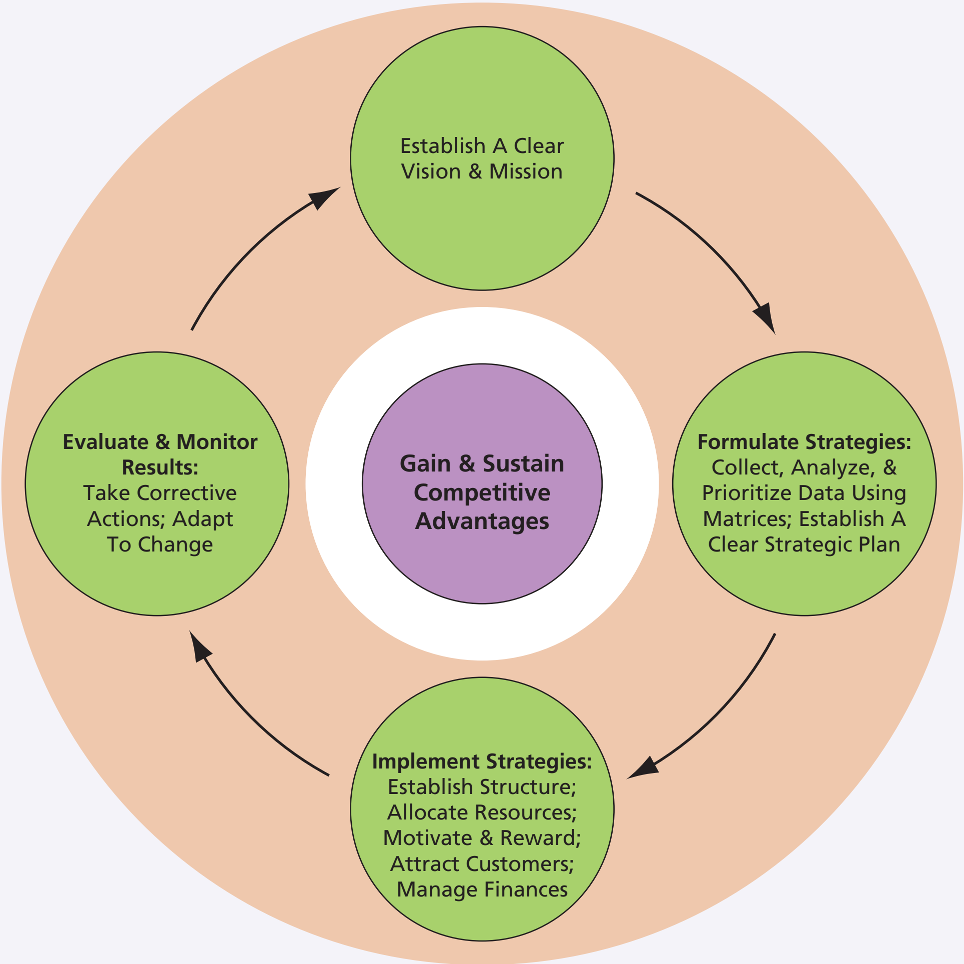


FIGURE 1-4
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR 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. Pave the way early and often in your presentation 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.

For all the reasons given in Table 1-8, use the free Excel strategic planning template at www.strategyclub.com to develop your three-year strategic plan for any assigned case company.

TABLE 1-8 Twelve Reasons Students (and Companies) Use the Strategic Planning Template at www.strategyclub.com

1. To save time in preparing a strategic-management case analysis; enables user to focus on the "thinking rather than the mechanics" of developing matrices and performing analyses.
2. To follow the correct process in formulating and implementing strategies.
3. To avoid mistakes in math calculations, plotting points, and drawing graphs.
4. To develop professional-looking charts, graphs, and matrices.
5. To develop existing and projected financial ratios.
6. To correctly place firms in BCG and IE portfolio matrices.
7. To examine many different scenarios for using debt versus stock to raise needed capital, using EPS-EBIT analysis.
8. To vary weights and ratings in matrices and to see the resultant impact on total weighted scores.
9. To more easily share information with team members and colleagues.
10. To more easily develop projected financial statements to reveal the expected impact of various strategies.
11. To develop skills with perceptual mapping or product positioning.
12. To gain experience using actual corporate strategic planning software; many business jobs require proficiency in Excel, which students gain in using the template.

Chapter Summary

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 text is devoted to providing you with the tools necessary to be a good strategist.

Key Terms and Concepts

annual objectives (p. 42)
competitive advantage (p. 38)
employability (p. 48)
empowerment (p. 45)
environmental scanning (p. 40)
external opportunities (p. 40)

external threats (p. 40)
internal strengths (p. 40)
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mission statement (p. 40)
policies (p. 44)
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strategy implementation (p. 36)
sustained competitive advantage (p. 38)
SWOT analysis (p. 42)
vision statement (p. 39)

Issues for Review and Discussion

1-1. Why do you believe SWOT analysis is so commonly used by businesses in doing strategic planning?
1-2. What variable does recent research reveal to be most important of all in doing business? Explain why this variable is so important.
1-3. For your college or university, identify a strategy that would exemplify the matching concept evidenced in SWOT analysis.
1-4. Diagram the comprehensive strategic-management model.
1-5. Develop a diagram to reveal the benefits to a firm for doing strategic planning. Include "improved understanding," "enhanced communication," "all managers and employees on a mission," and "greater commitment"—in the correct order.
1-6. How important do you believe "having an excellent game plan" is to winning a basketball or football game against your university's major rival? Discuss.
1-7. Are *strategic management* and *strategic planning* synonymous terms? Explain.
1-8. Why do many firms move too hastily from vision and mission development to devising alternative strategies?
1-9. Why are strategic-planning retreats often conducted away from the worksite? How often should firms have a retreat, and who should participate in them?
1-10. Distinguish between long-range planning and strategic planning.
1-11. How important do you think "being adept at adapting" is for business firms? Explain.
1-12. As cited in the chapter, famous businessman Edward Deming once said, "In God we trust. All others bring data." What did Deming mean in terms of developing a strategic plan?
1-13. What strategies do you believe can save newspaper companies from extinction?
1-14. Distinguish between the concepts of *vision* and *mission*.
1-15. Your university has fierce competitors. List three external opportunities and three external threats that face your university.
1-16. List three internal strengths and three internal weaknesses that characterize your university.
1-17. List reasons why objectives are essential for organizational success.
1-18. Why are policies especially important in strategy implementation?
1-19. What is a "retreat," and why do firms take the time and spend the money to have these?
1-20. Discuss the notion of strategic planning being more formal versus informal in an organization. On a 1- to 10-scale from formal to informal, what number best represents your view of the most effective approach? Why?
1-21. List what you believe are the five most important lessons for business that can be garnered from *The Art of War*.
1-22. What is the fundamental difference between business strategy and military strategies in terms of basic assumptions?
1-23. Explain why the strategic-management class is often called a "capstone course."
1-24. What aspect of strategy formulation do you think requires the most time? Why?
1-25. Why is strategy implementation often considered the most difficult stage in the strategic-management process?
1-26. Why is it so important to integrate intuition and analysis in strategic management?
1-27. Explain the importance of a vision and a mission statement.
1-28. Discuss relationships among objectives, strategies, and policies.
1-29. Why do you think some chief executive officers fail to use a strategic-management approach to decision making?

1-30. Discuss the importance of feedback in the strategic-management model.
1-31. How can strategists best ensure that strategies will be effectively implemented?
1-32. Give an example of a recent political development that changed the overall strategy of an organization.
1-33. Who are the major competitors of your college or university? What are their strengths and weaknesses? What are their strategies? How successful are these institutions compared to your college?
1-34. In your opinion, what is the single major benefit of using a strategic-management approach to decision making? Justify your answer.
1-35. Most students will never become a chief executive officer or even a top manager in a large company. So why is it important for all business majors to study strategic management?
1-36. Describe the content available at the Strategy Club website at www.strategyclub.com.
1-37. List four financial and four nonfinancial benefits of a firm engaging in strategic planning.
1-38. Why is it that a firm can normally sustain a competitive advantage for only a limited period of time?
1-39. Why it is not adequate simply to obtain competitive advantage?
1-40. How can a firm best achieve sustained competitive advantage?
1-41. In sequential order in the strategic-planning process, arrange the following appropriately: policies, objectives, vision, strategies, mission, strengths.
1-42. Label the following as an opportunity, a strategy, or a strength.

a. XYZ Inc. is hiring fifty more salespersons.
b. XYZ Inc. has fifty salespersons.
c. XYZ Inc.'s rival firm has only fifty salespersons.

1-43. Explain why internal strengths and weaknesses should be stated in divisional terms to the extent possible.
1-44. Explain why both internal and external factors should be stated in specific terms (that is, using numbers, percentages, money ratios, and comparisons over time) to the extent possible.
1-45. Identify the three activities that comprise strategy evaluation.
1-46. List six characteristics of annual objectives.
1-47. Would strategic-management concepts and techniques benefit foreign businesses as much as domestic firms? Justify your answer.
1-48. What do you believe are some potential pitfalls or risks in using a strategic-management approach to decision making?
1-49. What does recent research reveal to be the most important component or activity in the strategic-management process?

MINI-CASE ON TESLA, INC. (TSLA)

WHICH AMERICAN COMPANY DOES THE BEST JOB OF STRATEGIC PLANNING, AND HOW IS IT DONE?

Jim West/Alamy Stock Photo

A New Tesla Anybody?

The answer to the first part of the question posed may be Tesla Inc., the U.S. electric automobile manufacturer founded in 2003 and headquartered in Palo Alto, California. The answer to the second part of the question may be "by matching internal strengths/weaknesses with external opportunity/threats" using SWOT analysis. For the first time ever, in 2017, Tesla joined the *Fortune* 500 largest companies in the United States; the company's annual revenues exceed $7 billion.

An integral part of Tesla's excellent strategic plan is to capitalize on the 6.5 percent annual gross domestic product (GDP) growth in China, compared to the GDP growth of about 2 percent in the United States. Tesla's sales in China skyrocketed in recent years as CEO Elon Musk of Tesla capitalizes heavily on the firm's technological prowess (internal strength) matched with China's booming GDP (external opportunity) and China's strong preference for electric vehicles (external opportunity). In 2016, sales of electric and plug-in hybrid automobiles in China rose 50 percent to 507,000, more than triple the comparable figure in the United States. Electric vehicles are viewed in China as a way to help clear smoggy skies (an external opportunity), and that is a primary reason why China's government has exempted electric cars from rigid license plate restrictions in six large cities: Shanghai, Beijing, Shenzhen, Hangzhou, Guangzhou, and Tianjin; these six cities report the highest Tesla sales.

Tesla's strategic plan includes manufacturing cars in China by the end of 2018, because shipping cars from California to China is costly. Tariffs and taxes incurred to export cars to China increases the price of Tesla sedans and SUVs by 50 percent (external threat). The number of electric vehicle charging stations in China exceeds one thousand (external opportunity). Tesla mass produces its

Model X SUV because China's obsession with SUVs is a decade old and growing rapidly. Sales of SUVs in China now comprise nearly 40 percent of all passenger-vehicle sales in that country.

Turning to Australia, Tesla recently supplied the largest battery in the world to Jamestown, Australia. The battery is storing electricity from a new wind farm that supplies thirty thousand homes with power. The battery has a 100-megawatt capacity. Tesla's strategic plan is for the whole world to use its batteries in cars, trucks, homes, and businesses.

Questions

1. Identify several external opportunities and threats that face Tesla.
2. Identify several internal strengths and weaknesses that face Tesla.
3. Match several of your external and internal factors to formulate several strategies that Tesla is (or could) use going forward.
4. What is Tesla's competitive advantage in the automobile industry?

Source: Based on Scott Cendrowski, "Tesla Makes a U-Turn in China," *Fortune*, p. 128–136. June 15, 2017.

Web Resources

1. **The Author Website** The website for this textbook is widely used by both companies and students for actually doing strategic planning. The downloadable template at the website receives more than thirty thousand hits per year. www.strategyclub.com
2. **SWOT Analysis Narrative and Worksheet** This website explains SWOT analysis and provides a downloadable worksheet. https://www.mindtools.com/pages/article/newTMC_05.htm
3. **SWOT Analysis Images** This website provides more than one hundred jpeg images of SWOT matrices that can be used in a case project or strategic planning report. https://www.google.com/search?q=swot+analysis&tbm=isch&tbo=u&source=univ&sa=X&ved=0ahUKEwjokNTanonWAhUIPiYKHdfeAOQQsAQIeQ&biw=1295&bih=743
4. **Strategic-Management Models** This website provides more than one hundred jpeg images of strategic-planning models that can be used to guide a strategic planning undertaking https://www.google.com/search?q=strategic+management+models&client=safari&rls=en&tbm=isch&tbo=u&source=univ&sa=X&ved=0ahUKEwjh7ZfjoYnWAhVG7CYKHcNgBQcQsAQIgwE&biw=1295&bih=743
5. **Strategic-Management Organizations** Some popular strategy websites are as follows:
   Strategic Management Society (SMS)—https://strategicmanagement.net/—publishes the *Strategic Management Journal* and holds annual strategic management conferences
   Association for Strategic Planning—www.strategyassociation.org/—provides a Strategic Management Professional (SMP) certification program
   McKinsey & Company—www.mckinsey.com—perhaps the largest management-consulting firm in the world; the company does extensive strategic planning consulting

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THE COHESION CASE

Coca-Cola Company, 2018

BY FRED R. DAVID

www.coca-cola.com, KO

Headquartered in Atlanta, Georgia, Coca-Cola Company (Coke) is the world's largest producer and distributor of beverages, marketing over 500 nonalcoholic brands in more than 200 countries. Coke has 21 billion-dollar brands, 19 of which are available in lower- and no-sugar options. Four of the top five beverages sold globally are Coke products: 1) Coca-Cola, 2) Diet Coke, 3) Fanta, and 4) Sprite. Other Coke products include Dasani waters, Fanta, Gold Peak teas and coffees, Honest Tea, Powerade sports drinks, Simply juices, Glaceau Smartwater, Sprite, and Zico coconut water. However, company's revenues for 2017 declined 15 percent, so rumblings are spreading within the firm.

Coke brands sold mostly outside the United States include Ayataka green tea in Japan, I LOHAS water in Japan, Ice Dew water in China, FUZE TEA outside the United States, Minute Maid Pulpy in Asia Pacific, Georgia coffee in Japan, and Del Valle in Latin America. Five large independent bottling companies supply Coke with 39 percent of their bottling needs, led by Coca-Cola FEMSA that supplies central Mexico and countries in Latin and South America.

Coke revenues have declined every year for nearly a decade, usually accompanied by net income declines. Since 2005, sales of diet soda in general have dropped every year, a combined 34 percent. Although Diet Coke is the weakest link in the company's whole soda lineup, the brand is still the third best-selling carbonated drink in the United States.

Environmentalists are complaining, saying Coke produces 110 million plastic bottles annually that end up in landfills and oceans. To combat this complaint, the company launched in 2018 its "World Without Waste" initiative. Coke needs a good strategic plan because its customer base is eroding and its shareholders want sustained 5 percent annual growth in revenues and profits—and not declines—every year.

History

Founded in 1886, Coke's flagship product Coca-Cola was invented in 1886 by pharmacist John Pemberton in Columbus, Georgia. Coke has operated a franchised distribution system since 1889, whereby the company only produces syrup concentrate, which is then sold to various bottlers throughout the world, who hold exclusive territories.

Interestingly, the big, jolly man in the red suit with a white beard (Santa Claus), did not always look that way. In 1931, Coke paid illustrator Haddon Sundblom to create advertising images depicting a jolly, plump, red (like Coke cans) dressed, warm, friendly Santa Claus delivering toys to children. To create the new Santa ads, Sundblom used Clement Clark Moore's 1822 poem "A Visit from St. Nicholas" (commonly called "'Twas the Night Before Christmas").

Coke's new Santa advertisements debuted in 1931 in magazines such as *The Saturday Evening Post, National Geographic, The New Yorker*, and others. Before 1931, Santa was depicted as everything from a tall gaunt man to a spooky-looking elf. He was often shown wearing a bishop's robe and a Norse huntsman's animal skin. From 1931 to 1934, Coke ads featuring the new Santa Claus changed the whole world's view of Santa; these original images of Santa are valuable works of art even today.

In 2010, Coke became the first brand to exceed 1 billion euros in annual United Kingdom grocery sales. In January 2018, in the United States, Coke introduced its slimmer 12-ounce Diet Coke can, updating the logo and offering the 35-year-old drink four new flavors: mango, cherry, blood orange, and ginger lime. Diet Coke sales have declined as more people switch to other low-calorie drinks, such as flavored fizzy water. The company said the new flavors and look—with a different color vertical stripe for each flavor and red for plain—are aimed at appealing to millennials (people ages 18 to 34). Coke tested more than 30 flavors before settling on the four new ones.

Core Values, Vision, and Mission

Provided on the corporate website, Coke's *core values* center on seven words: leadership, collaboration, integrity, accountability, passion, diversity, and quality. Coke's *vision statement* has not changed in more than a decade; provided on the corporate website, it reads (paraphrased):

People: To be a workplace where people are inspired to be the best they can be.
Portfolio: To offer quality beverage brands that anticipate/satisfy consumer desires/needs.
Partners: To nurture customers and suppliers working together to provide value.
Planet: To be a responsible citizen helping build and support sustainable communities.
Profit: To maximize long-term return to shareowners given our overall responsibilities.
Productivity: To be an effective, lean, and fast-moving company.

Coke's *mission statement* too has not changed in more than a decade and is given on the corporate website; it reads (paraphrased): "To refresh the planet; to create moments of optimism and happiness; to provide value and make a difference."

Business Ethics and Diversity

The Coke website says the company "directs zero advertising targeted to children under age 12." Also, in regards to business ethics, the company places substantial nutrition information, including calories, on the front of most of their cans and packages. A wide range of packaging sizes are provided and over 100 reduced, low, or no-calorie beverages.

Coke annually publishes an elaborate Sustainability Report that details the company's water stewardship, women's economic empowerment, and philanthropic giving. In addition, the company's year 2020 sustainability goals include the firm giving back 1 percent of the company's operating income annually, and recovering 75 percent of the recyclable bottles and cans introduced into developed markets. The report is available on the corporate website.

Financial Position

Coke's fiscal year ends on December 31. As indicated in Exhibit 1, Coke posted revenues of $35.4 billion in 2017, compared to $41.8 billion in 2016, a 15 percent decline. Net income was $1.28 billion compared to $6.66 billion in 2016, an 81 percent decline. Declines in both of these numbers are alarming. Note all the negative numbers in Exhibit 1, even though for most companies 2017 was a very properous year.

Coke's balance sheets are provided in Exhibit 2. Note that Coke purchased $3.7 billion of its own stock in 2017. In 2017, Coke paid $5 billion out to shareholders in dividends even though the company's net income was only $1.28 billion. Thus, basically the company borrowed money to pay dividends; this event resulted in a negative retained earnings for the year 2017 and a large drop in retained earnings on the 2017 balance sheet, as shown in Exhibit 2. Note in Exhibit 2 that Coke's paid-in-capital increased a whopping 89 percent in 2017 revealing high use of equity as a source of capital.

EXHIBIT 1 Coke's Income Statements (in millions of dollars)

Income Statement	12/31/16	12/31/17		Percent Change
Revenues	$41,863	$35,410	⇩	−15.41%
Cost of Goods Sold	16,465	13,256	⇩	−19.49%
Gross Profit	25,398	22,154	⇩	−12.77%
Operating Expenses	16,772	14,653	⇩	−12.63%
EBIT	8,626	7,501	⇩	−13.04%
Interest Expense	490	759	⇧	54.90%
EBT	8,136	6,742	⇩	−17.13%
Tax	1,586	5,560	⇧	250.57%
Non-Recurring Events	(23)	66	⇧	NA
Net Income	6,527	1,248	⇩	−80.88%

Source: Based on information at www.coca-colacompany.com

EXHIBIT 2 **Coke's Balance Sheets (in millions of dollars)**

Balance Sheet	12/31/16	12/31/17		Percent Change
Assets				
Cash and Short Term Investments	$18,150	$15,358	⇩	−15%
Accounts Receivable	3,856	3,667	⇩	−5%
Inventory	2,675	2,655	⇩	−1%
Other Current Assets	9,329	14,865	⇧	59%
Total Current Assets	34,010	36,545	⇧	7%
Property Plant & Equipment	10,635	8,203	⇩	−23%
Goodwill	10,629	9,401	⇩	−12%
Intangibles	726	368	⇩	−49%
Other Long-Term Assets	31,270	33.379	⇧	7%
Total Assets	**87,270**	**87,896**	⇧	**1%**
Liabilities				
Accounts Payable	9,490	8,748	⇩	−8%
Other Current Liabilities	17,042	18,446	⇧	8%
Total Current Liabilities	26,532	27,194	⇧	2%
Long-Term Debt	29,684	31,182	⇧	5%
Other Long-Term Liabilities	7,834	10,543	⇧	35%
Total Liabilities	**64,050**	**68,919**	⇧	**8%**
Equity				
Common Stock	1,760	1,760	⇨	0%
Retained Earnings	65,502	60,430	⇩	−8%
Treasury Stock	(47,988)	(50,677)	⇧	6%
Paid in Capital & Other	3,946	7,464	⇧	89%
Total Equity	**23,220**	**18,977**	⇩	**−18%**
Total Liabilities and Equity	**87,270**	**87,896**	⇧	**1%**

Source: Based on information at www.coca-colacompany.com

Exhibit 3 reveals that Coke spends about $4 billion annually to advertise its beverages. Note also in Exhibit 3 that the company is intent on increasing its dividends paid every year even if it has to borrow money to make this payment. The company's long-term debt is creeping up every year.

Operating Segments

Regarding 2017 cases of beverages sold, the USA accounted for 19 percent of the company total; case volume outside the USA accounted for 81 percent of sales. Of the 19 percent of cases sold in the USA, 62 percent were sparkling soft drinks.

The four countries outside the United States that Coke sells most to are Mexico, China, Brazil, and Japan. These four countries accounted for 31 percent of Coke's outside-USA sales in 2017, and 71 percent of these sales were of sparkling soft drinks. Coke's revenues derived from the United States compared to the rest of the world through 2016 are given in Exhibit 4; the company did not provide this breakdown in 2017, perhaps because of significant declines. Note the decreases in 2016 on all three rows.

EXHIBIT 3 Coke Financial Data Across Key Variables (in millions of dollars)

	2017	2016	2015
Advertising expenditures	$3,958	$4,004	$3,976
Selling and distribution expenses	$3,257	$5,177	$6,025
Treasury stock purchased	$3,682	$3,681	$3,564
Number of shares repurchased	82	86	86
Average price per share of stock	44.09	$43.62	$41.33
Dividends paid	6,320	$6,043	$5,741
Long-term debt	$31,182	$29,684	$28,311

Source: Based on information at www.coca-colacompany.com

EXHIBIT 4 Coke's Revenues from the United States Compared to Outside the United States (in millions of dollars)

	2016	2015
United States	$19,899	$20,360
Outside United States	$21,964	$23,934
Total	**$41,863**	**$44,294**

Source: Based on information at www.coca-colacompany.com

Coke has five main operating segments: (1) Europe, Middle East, and Africa, (2) Latin America, (3) North America, (4) Asia Pacific, and (5) Bottling Investments. Revenues and operating profits by segment are provided in Exhibit 5 and Exhibit 6, respectively. Note that North America generates 29.9 percent of coke revenues and 34.4 percent of operating income. Note that only one segment, Latin America, showed an increase in operating income in 2017.

EXHIBIT 5 Coke's Revenues by Segment (in millions of dollars)

	2017	2016
1. Europe, Middle East, and Africa	$7,374	$7,278
2. Latin America	$4,029	$3,819
3. North America	$10,637	$10,210
4. Asia Pacific	$5,176	$5,294
5. Bottling Investments	$10,605	$19,885
6. Corporate	$138	$132
7. Eliminations	($2,549)	($4,755)
Total	**$35,410**	**$41,863**

Source: Based on information at www.coca-colacompany.com

EXHIBIT 6 Coke's Total Operating Income by Segment (in millions of dollars)

	2017	2016
1. Europe, Middle East, and Africa	$3,646	$3,676
2. Latin America	$2,214	$1,951
3. North America	$2,578	$2,582
4. Asia Pacific	$2,163	$2,224
5. Bottling Investments	($1,117)	($137)
6. Corporate	($1,983)	($1,670)
Total	**$7,501**	**$8,626**

Source: Based on information at www.coca-colacompany.com

Regarding number of cases of various product lines sold in 2017, Exhibit 7 reveals that only two of four categories increased: (1) Water, enhanced water, and sports drinks, up 1 percent, and (2) Tea and coffee, up 2 percent.

Organizational Structure

Coke's top executives and organizational structure are given in Exhibit 8. Note the segment top persons (#12, 13, 14, 15, 16) report to the COO (# 6).

Competitors

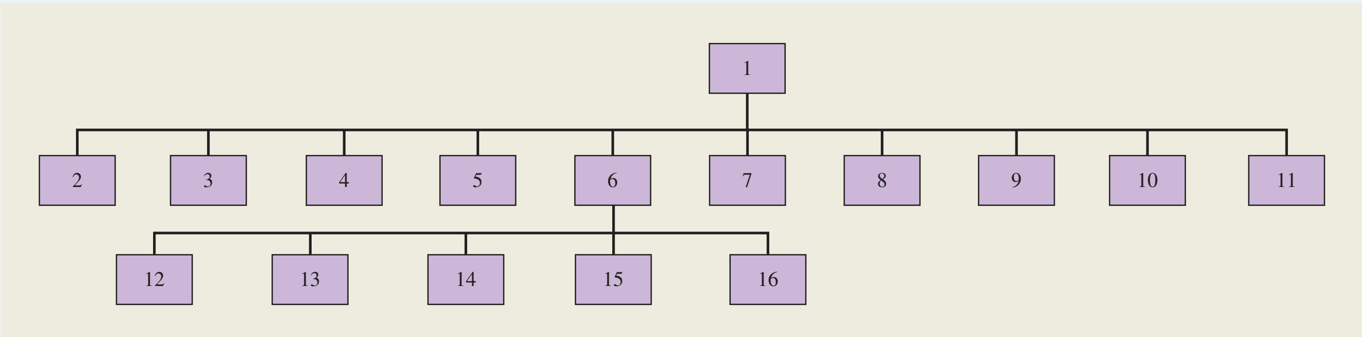
PepsiCo, Inc. and Dr Pepper Snapple are Coke's two primary competitors, but other rival firms include Nestlé SA, Groupe Danone, Suntory Beverage & Food Limited ("Suntory"), and Monster Beverage Corporation. Unlike Coke, PepsiCo derives most of its revenues and growth from its snack food business

EXHIBIT 7 Coke's Number of Cases Sold in 2017 Compared with 2016

Product Category	Percentage Change in 2017 from 2016
1. Sparkling soft drinks	–1
2. Juice, dairy, and plant-based beverages	00
3. Water, enhanced water, and sports drinks	+1
4. Tea and coffee	+2

Source: Based on company information.

EXHIBIT 8 Coke's Top Executive Officers and Organizational Chart



1. Muhtar Kent, CEO and Chairman of the Board of Directors
2. Marcos de Quinto, EVP and Chief Marketing Officer
3. Ceree Eberly, SVP and Chief People Officer
4. Bernhard Goepelt, SVP and General Counsel
5. Julie Hamilton, SVP and Chief Customer and Commercial Leadership Officer
6. James Quincey, President and COO
7. Brent Hastie, SVP, Strategy and Planning
8. Ed Hayes, SVP and Chief Technical Officer
9. Barry Simpson, SVP and CIO
10. Clyde C. Tuggle, SVP and Chief Public Affairs and Communications Officer
11. Kathy Waller, EVP and CFO
12. John Murphy, President of the Asia Pacific Group
13. Irial Finan, EVP and President, Bottling Investments Group
14. J. Alexander M. Douglas, Jr., EVP and President of Coca-Cola North America
15. Alfredo Rivera, President of the Latin America Group
16. Brian Smith, President of the Europe, Middle East, and Africa Group

Source: Based on information at www.coca-colacompany.com

rather than its beverages. 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 9 reveals the top 10 beverages sold in the United States. Note that Coke, inclusive of Coke Zero, Diet Coke, and other brands, lead among the top 10, but PepsiCo has four brands in the top 10. In the percentage-change column in Exhibit 9, notice that bottled water has the largest growth.

EXHIBIT 9 Coke and Rival Firms on Top Beverage Brands Sold (2016 and 2015)

Brand	Firms	Millions of Gallons 2015	Millions of Gallons 2016	Percentage Change	Share in Total 2015	Share in Total 2016
1. Coke (all types)	Coca-Cola	3,994	3,933	(1.5)	12.6	12.0
2. Pepsi (all types)	PepsiCo	1,946	1,859	(4.5)	6.1	5.6
3. Mountain Dew	PepsiCo	1,343	1,333	(0.7)	4.2	4.1
4. Dr Pepper (all types)	Dr Pepper Snapple	1,160	1,168	0.7	3.6	3.5
5. Nestlé Pure Life	Nestlé NAmerica	1,075	1,085	1.0	3.4	3.3
6. Gatorade	PepsiCo	1,042	1,082	3.8	3.3	3.3
7. Sprite	Coca-Cola	866	897	3.6	2.7	2.7
8. Poland Spring	Nestlé NAmerica	758	836	10.3	2.4	2.5
9. Dasani	Coca-Cola	707	743	5.0	2.2	2.3
10. Aquafina	PepsiCo	546	605	10.9	1.7	1.8
TOP 10		13,437	13,541	0.8	42.2	41.2
Others		18,387	19,364	5.3	57.8	58.8
Total		**31,824**	**32,904**	**3.4**	**100.0**	**100.0**

Source: Based on information developed by Beverage Marketing Corporation.

As indicated in Exhibit 10, Coke is 11 times larger than Dr Pepper Snapple and is 18 percent larger than PepsiCo based on market capitalization (stock price times number of shares outstanding). However, PepsiCo is much larger than Coke on numerous other variables as given.

EXHIBIT 10 A Comparison of Coke to Two Big Rivals

	COKE	DR PEPPER	PEPSICO
Market Capitalization	$ 197B	$ 17B	$ 167B
# of Employees	100,300	20,000	264,000
Revenue	$ 41.8B	$ 6.6B	$ 63.5B
Profit Margin	10.68%	11.73%	10.97%
EBITDA	$ 10.9B	$ 1.6B	$ 12.6B
Operating Margin	24.14%	20.73%	16.4%
Net Income	$ 6.5B	$ 770M	47.0B
ROA	6.23%	9.09%	8.56%
EPS	$ 0.95	$ 4.17	$ 4.84

PepsiCo, Inc. (PEP)

Headquartered in Purchase, New York, PepsiCo's beverage products include Pepsi, Gatorade, Mountain Dew, Diet Pepsi, Aquafina, Diet Mountain Dew, Tropicana Pure Premium, Mist Twist, and Mug brands; and ready-to-drink tea and coffee, and juices. PepsiCo's Frito-Lay segment offers Lays and Ruffles potato chips; Doritos, Tostitos, and Santitas tortilla chips; and Cheetos cheese-flavored snacks, branded dips, and Fritos corn chips. PepsiCo's Quaker Foods segment provides Quaker oatmeal, grits, rice cakes, granola, and oat squares; and Aunt Jemima mixes and syrups, Quaker Chewy granola bars, Captain Crunch cereal, Life cereal, and Rice-A-Roni side dishes.

PepsiCo obtains about 60 percent of its revenues from food and snacks, not beverages. PepsiCo and Coca-Cola are both investing in craft soda brands trying to reverse decreasing soda volume sales. After acquiring two craft soda brands from Monster Beverages, Coca-Cola recently relaunched Blue Sky and Hansen's. A few days later, PepsiCo launched the 1893 Original Cola and Ginger Cola lines, which are made with sparkling water, kola nut extract, and Fair Trade–certified sugar.

PepsiCo is having trouble with its Gatorade energy drink brand whose sales in the United States declined 0.5 percent to $5.9 billion in 2017. This was the brand's first decline in annual sales since 2012. Gatorade accounts for about 20 percent of PepsiCo's North American drink volume. The company released Gatorade Organic in August 2016 and made $20 million on that product through the end of 2017. The sports-drink market is becoming highly competitive; even up-start BodyArmour, a distant third in market share, is gaining rapidly on PepsiCo in sports drinks, such as Gatorade.

Dr Pepper Snapple Group, Inc. (DPS)

Headquartered in Plano, Texas, DPS manufactures nonalcoholic beverages in the United States, Canada, Mexico, and the Caribbean. It also markets ready-to-drink teas, juices, juice drinks, water, and mixers. The company offers brands such as: 7UP, A&W, Bai, Crush, Canada Dry, Schweppes, Sunkist soda, Squirt, Hawaiian Punch, and RC Cola. DPS manufactures and sells Mott's apple sauces. DPS's revenues increased slightly from $6.2 billion in 2014 to $6.3 billion in 2015, to $6.4 billion in 2016, to $6.7 in 2017. DPS's net income also has increased slightly every year, from $703 million in 2014 to $770 million in 2017. DPS recently acquired Bai Brands for about $1.7 billion. DPS currently has about 8.5 percent of the U.S. nonalcoholic beverage market, according to Euromonitor International.

DPS owns seven of the top 10 noncola soft drinks on the market. Third-quarter (Q3) 2017 results showed DPS's carbonated soft drinks decreasing 1 percent, whereas its noncarbonated beverages increased 6 percent. Q3 showed flat sales in the United States and Canada, but sales in Mexico and the Caribbean increased 2 percent. Also for Q3, the DPS brand named Clamato grew 7 percent and Mott's sauce sales grew 5 percent, but Snapple sales declined 5 percent.

The big news in the beverage industry is that Keurig Green Mountain, the maker of Keurig K-Cup coffee machines, acquired Dr Pepper Snapple in 2018. Keurig is privately owned by JAB Holdings, one of Europe's largest investment firms; JAB also owns Peeet's Coffee, Panera Bread, and Krispy Kreme doughnuts. JAB is a privately held fund that manages the money of the Reimann family, one of Germany's wealthiest families. This acquisition is aimed directly at both Coca-Cola and Starbucks Corp. This acquisition puts Keurig in the global soda business and strengthens its coffee business. Euromonitor reports that sales of ready-to-drink coffees increased more than 17 percent in 2017. JAB's partner in Keurig is Mondelez International that holds roughly 24 percent of the stock JAB, but that percentage dropped to about 14 percent when the Dr Pepper acquisition was finalized. Keurig's revenue for 2017 was about $4.1 billion and its market share in the coffee-pod industry has declined from 40 percent in 2013 to about 23 percent in 2017.

Groupe Danone

Headquartered in Paris, France, Groupe Danone is the number-one producer of yogurt in the world, the number-two bottled water and baby nutrition manufacturer, number-one in manufacturing 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. 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. Danone is present in more than 130 markets and generated sales of €21.9 billion in 2016, with more than half of that revenue coming from emerging countries. Fresh dairy products represent about 50 percent of Danone's total sales, early life nutrition 22 percent, water 21 percent, and medical nutrition 7 percent.

Monster Beverage Company (MNST)

Headquartered in Corona, California, Monster Beverage develops, markets, sells, and distributes energy-drink beverages, sodas, or concentrates for energy-drink beverages, under brand names such as Monster Energy, Monster Rehab, Monster Energy Extra Strength Nitrous Technology, Java Monster, Muscle Monster, Mega Monster Energy, Punch Monster, Juice Monster, Ubermonster, BU, Mutant Super Soda, Nalu, NOS, Burn, Mother, Ultra, Play and Power Play, Gladiator, Relentless, Samurai, BPM, and Full Throttle.

Coca-Cola owns 16.7 percent of the Monster Beverage, which it purchased in 2015 for approximately $2.15 billion. In addition to the equity stake, both companies' strategic partnerships related to business transfers and expanded global distribution. In October 2017, Coca-Cola transferred ownership of all of its worldwide energy businesses including NOS, Full Throttle, and nine smaller brands to Monster Beverage Company. At the same time, Monster transferred all of its nonenergy drink businesses to Coca-Cola, including Hansen's natural sodas, Peace Tea, Hubert's Lemonade, and Hansen's juice products. As shown in Exhibit 10, energy drinks comprise 4.8 percent of all nonalcoholic beverages sold.

Monster Beverage's sales for Q3 2017 that ended September 30, 2017, increased 11.5 percent to $2.6 billion from $2.3 billion versus the prior year. Net income for Q3 was $619.4 million, compared with $539.7 million the prior year. Net sales for Monster's Strategic Brands segment, which includes the various energy drink brands acquired from Coke, increased 6.2 percent to $76.6 million for that Q3, up from $72.1 million the prior year. Monster's sales to customers outside the United States increased 36.3 percent to $260.1 million in that Q3, up from $190.8 million in the prior year period. Net income for Q3 increased 14.1 percent to $218.7 million from $191.6 million in the prior year period.

The Nonalcoholic Beverage Industry

Exhibit 11 reveals the annual growth (or decline) in various categories of beverages. Notice declines in sales of carbonated soft drinks and fruit drinks but rapid growth in sales of flavored and enhanced water and ready-to-drink coffee.

Bottled Water

In 2016, bottled water surpassed carbonated soft drinks as the largest beverage category in the United States by volume. Per-capita consumption of bottled water reached more than 39 gallons annually, compared with around 38.5 gallons for carbonated soft drinks. Within the next decade, bottled water consumption per capita is expected to surpass 50 gallons. The U.S. bottled water market showed strong growth in terms of volume and revenues in the past 3 years. Bottled water sales are booming, up 7.3, 7.9, and 8.6 percent in 2014, 2015, and 2016, respectively. By comparison, carbonated soft drink volumes declined 2.1, 2.4, and 0.8 percent during those same years. According to BMC, in 2017, bottled water sales are projected to grow 8 to 9 percent, remaining the top nonalcoholic beverage for years to come, further confirmation of the shift in consumer preference toward healthier and lower-calorie options.

Sparkling Water

Sparkling water is projected to outpace even bottled water in the next decade as consumers search for tastier but healthier options. In fact, sparkling water sales surged more than 20 percent in 2017. Flavored sparkling water sales grew by more than 15 percent in 2017 to $2.4 billion. To better reach this flavored sparking water market, early in 2018 PepsiCo released its seltzer water brand called Bubly. Other beverages also growing in sales are flavored and enhanced water, ready-to-drink coffee, and energy drinks. Specifically, sales of flavored and enhanced water in the United States increased 12.3 percent in 2016, followed by ready-to-drink coffee up 11 percent, and energy drinks up 4.8 percent.

Given these positive trends, carbonated soft drinks still account for 83.5 percent of the beverages industry's market capitalization as of September 2017. In 2016, soda consumption in the United States fell 0.8 percent, continuing the downward trend. Consequently, in Q2 2017, Coke reported a 16 percent drop in net revenues to $9.7 billion. In that Q2, Coke reported increased volume for juice, dairy, and plant-based beverages (with 3% growth), tea and coffee (2%), as well as water, enhanced water, and sports drinks (1%). Coke is shifting its portfolio toward smaller-sized packages and healthier beverages. In August 2017, Coke replaced its Coke Zero products with the zero-sugar and

EXHIBIT 11 Annual Percentage Growth or Decline in Sales of Various Beverage Categories 2016 and 2015 in the United States

Flavored & Enhanced Water	+12.3
Ready-to-Drink Coffee	+11.0
Bottled Water	+8.6
Energy Drinks	+4.8
Sports Drinks	+3.9
Ready-to-Drink Tea	+3.1
Carbonated Soft Drinks	−0.8
Fruit Drinks	−1.4
Total	**+ 3.4**

Source: Based on information developed by Beverage Marketing Corporation (BMC).

zero-calorie brand Coke Zero Sugar. For PepsiCo, food and snacks volume increased 2 percent in the first half of 2017, whereas beverages declined 1 percent.

R&D

To reverse revenue declines, beverage firms boosted R&D spending at an average annual rate of nearly 20 percent over the past 5 years. R&D spending is likely to remain high in 2017 and 2018 as beverage companies strive to rejuvenate revenue growth. Developing flavored sparkling waters is an example.

Outside the United States

In 2016, international operations represented 62 percent of total nonbottling revenues at Coke and 42 percent at PepsiCo. Coke does business in countries using currencies other than the U.S. dollar, including the euro, the Japanese yen, the Brazilian real, and the Mexican peso. Coke uses 72 currencies in addition to the U.S. dollar. Unfavorable foreign currency exchange rates can have a significant effect on reported revenue growth for global beverage manufacturers, especially because the U.S. dollar's value relative to foreign currencies is on average at a 3-year low.

There are uncertainties going forward in our major international markets, including the United Kingdom's impending withdrawal from the European Union, commonly referred to as "Brexit," which is due to be finalized as of December 2020 and unstable political conditions, including civil unrest and governmental changes, in certain other international markets could undermine global consumer confidence and reduce consumers' purchasing power, thereby reducing demand for our products.

City, County, State, and Federal Taxes

Public health advocates are actively lobbying for tax referendums and legislation in more U.S. cities to tax soda. Companies such as Coke and PepsiCo Soda spent nearly $70 million from 2009 to 2016 lobbying against soda taxes and warning label measures in U.S. cities and states, as well as an average of about $15 million annually on federal lobbying, according to the consumer advocacy group Center for Science in the Public Interest (CSPI). For example, beverage companies spent about $9.4 million between January 2016 and June 2016 to oppose the Philadelphia City Council's soda tax proposal, according to CSPI's estimates. Philadelphia eventually imposed a soda tax in June 2016, the first major U.S. city (and the second city after Berkeley, California) to do so. In November 2016, three cities in California (San Francisco, Albany, and Oakland) passed their own soda tax laws, as did Cook County, Illinois (which includes Chicago) and Boulder, Colorado. In June 2017, Seattle implemented a tax of 1.75 cents per ounce on sugary drinks and soda. Chicago's soda tax began in the Fall 2017.

Taxes on sugary beverages came into effect in Mexico on January 1, 2014, in an effort to combat obesity in the country; higher product costs are likely to dampen demand, and tax revenue could help to fund costs related to preventive actions and medical treatment. Mexico is the country with the biggest obesity problem in the world, according to the Food and Agriculture Organization of the United Nations. This will be a game changer for beverage companies exporting to Mexico (such as Coke). In 2015, soda sales in Mexico plummeted 12 percent. Price-sensitive consumers are turning away from buying soda products.

Beverage Caloric Intake in the United States

The American Beverage Association reported in December 2017 that the average American drank 201.2 calories a day in 2016, up slightly from 2015. More than offsetting the decline in sales of soda and juice in cans or bottles, sales of soda from fountains in restaurants are increasing. And Americans are drinking more and more sweet tea at restaurants. In terms of liquid intake, the average beverage calories consumed in the United States per capita per day in 2016 was sodas (126.7), juice (42.5), teas (11.2), sports (10.6), and other (10.2) according to the Beverage Marketing Corporation. Consumption of diet and low-calorie soda continues to fall, but consumption of sports and energy drinks continues to rise at a faster rate.

Impulse Buying

PepsiCo is reinvesting some of the millions of dollars it is saving under the new tax laws in e-commerce, which today accounts for roughly $1 billion in the company's annual retail sales. PepsiCo is also investing savings in training for workers, cash returns for shareholders, and $100 million in employee bonuses. The rise of online shopping is bad news for Coca-Cola and PepsiCo because impulse buying makes up roughly 30 percent of overall beverage sales. Without customers grabbing a Diet Pepsi while checking out at Walmart or a two-liter bottle of Coke Zero at the grocery store, the beverage companies would be in big trouble. Sales of soft drinks by volume have dropped for 12 consecutive years in the United States, so companies like Coca-Cola and PepsiCo need impulse buying, which is being eroded by more online shopping. Coca-Cola is currently investigating click-and-collect grocery sales, bundled deals (such as meal kits), and new impulse "triggers" online.

The Future

Coke swung from net income of $550 million in Q4 2016 to a net loss of $2.75 billion in Q4 2017. This decline was mostly due to a one-time charge of $3.6 billion blamed on the new federal tax law, which forced Coke to pay taxes on certain past offshore earnings. However, Coke supports the tax changes because its effective tax rate is expected to decline to 21 percent in 2018.

The steady decline in consumption of carbonated beverages necessitates Coke formulating and implementing new strategies going forward. The company needs a full-blown, comprehensive strategic plan to determine specific actions needed under the following general categories of strategies:

1. Further global expansion to tap markets not yet saturated
2. Continued product development to introduce new healthy drinks
3. Acquisition of small rival firms to gain growth in revenues
4. Continued market penetration with extensive advertising and promotion to shift consumer perception away from unhealthiness to treating yourself with a soda
5. Continued shift to smaller cans and package sizes
6. Perhaps diversification into snacks and foods as PepsiCo has successfully done
7. Push aggressively into bottled water to capitalize on rapid growth in that sector
8. Develop natural sweeteners to replace artificial sweeteners
9. Increase lobbying to curtail city, county, and state sugar taxes

ASSURANCE-OF-LEARNING EXERCISES

Bob Pardue/Alamy Stock Photo

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 1A

Gather Strategy Information for Coca-Cola Company

Purpose

The primary purpose of this exercise is to show students how to obtain vital information for doing case analysis or preparing a strategic plan for any publicly held firm. The secondary purpose is to familiarize you with (1) strategy terms introduced in this chapter and (2) key sources of information for doing strategic planning. Generally in a strategic-management course, teams of students prepare a strategic plan (case analysis) for some assigned company, so this exercise can assist in learning how to get started in such a project.

Instructions

Step 1 Read the Coca-Cola Cohesion Case and list what you consider to be the firm's strengths, weaknesses, opportunities, and threats. Then, go to the corporate website at www.coca-colacompany.com, scroll down to the bottom of the website, and click on *Investors*. Click *Annual Reports* and then click *2017 Annual Report or Form 10K*. Download this pdf file to your desktop; peruse the information and add to your list of Coca-Cola's strengths, weaknesses, opportunities, and threats.

Step 2 Go to your college library website and download to your desktop Standard & Poor's *Industry Surveys* PDF file for the beverage industry. Use this information to add to your list of Coca-Cola's strengths, weaknesses, opportunities, and threats.

Step 3 Go to the www.finance.yahoo.com website. Enter the stock symbol KO. Note the wealth of information on Coca-Cola that may be obtained by clicking any item along the row below the company name. Use this data to refine your lists of key external and internal factors. Each factor listed for this exercise should include a percentage, number, dollar, 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. Avoid vagueness in strategic planning.

Step 4 Through class discussion, compare your lists of external and internal factors to those developed by other students and modify your lists as needed. Save this information for use in later exercises in the book.

Step 5 Whatever case company you work on this semester, update the information on your company by following the steps listed above.

EXERCISE 1B

Enter Coca-Cola Vitals into the Strategic Planning Template

Purpose

The purpose of this exercise is to give you practice using resources at the author website (www.strategyclub.com), especially the Excel strategic planning template. Thousands of students annually find the author website resources to be immensely useful in preparing and delivering a strategic management case analysis.

Instructions

Step 1 Go to the www.strategyclub.com website. Review the following resources:

- Excel student template
- Example sample case analysis PowerPoint
- Live author videos
- Live case analysis presentation on Barnes and Noble
- Chapter and case updates
- Guidelines for presenting a strategic plan or case analysis

Step 2 Download the free Excel strategic-planning template. Read carefully instructions given with the template.

Step 3 Using your Exercise 1A results, enter Coca-Cola's strengths, weaknesses, opportunities, and threats into the Excel template.

Step 4 Save this file for use in later exercises.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 1C

Perform SWOT Analysis for My University

Purpose

The purpose of this exercise is to apply SWOT analysis to a nonprofit organization—namely your college or university. SWOT analysis is the most widely used of all strategic planning tools and techniques because it is conceptually simple and lends itself readily to discussion among managers. SWOT analysis formulates strategies by matching an organization's internal strengths and weaknesses with external opportunities and threats to generate feasible strategies to be considered.

For a university, external factors could include declining numbers of high school graduates; population shifts; community relations; increased competitiveness among colleges and universities; rising numbers of adults returning to college; decreased support from local, state, and federal agencies; increasing numbers of foreign students attending U.S. colleges; and a rising number of Internet courses.

Internal factors of a college or university could be related to faculty, students, staff, alumni, athletic programs, physical plant, grounds and maintenance, student housing, administration, fundraising, academic programs, food services, parking, placement, clubs, fraternities, sororities, and public relations.

Instructions

Step 1 For your university, identify four External Opportunities, four External Threats, four Internal Strengths, and four Internal Weaknesses.

Step 2 Match your external with internal factors to develop or generate two SO Strategies, two WO Strategies, two ST Strategies, and two WT Strategies. For example, an SO Strategy to "Double the number of online course offerings in three years" could be developed or generated based on a strength "world renown faculty" coupled with an opportunity "rising interest in online courses."

Step 3 Discuss your key factors and strategies as a class.

Step 4 What new things did you learn about your university from the class discussion? How could this type of discussion benefit an organization? Save your answers and work for use in late exercises.

SET 3: STRATEGIC PLANNING TO ENHANCE MY EMPLOYABILITY

EXERCISE 1D

Perform SWOT Analysis on Myself

Purpose

This exercise can help you decide on the best career path for yourself. 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, some internal strengths and weaknesses, and reaches pivotal forks in the road. These and other similarities make it possible for individuals to use many corporate strategic-management concepts and tools such as SWOT analysis.

Instructions

Introduced in this chapter, SWOT analysis a popular strategic planning tool that can help individuals in career planning. Individuals can perform SWOT analysis by completing the following six steps:

1. Identify four external opportunities you face.
2. Identify four external threats you face.
3. Identify four of your personal strengths.
4. Identify four personal weaknesses.
5. Develop SO (strength-opportunity), WO (weakness-opportunity), ST (strength-threat), WT (weakness-threat) strategies—two strategies of each type, thus eight strategies total.
6. Select three strategies to implement.

An external opportunity could be, for example, that your university offers a graduate program that interests you, whereas an external threat could be that interest rates are rising precluding getting a loan. A weakness could be a low grade-point average, whereas a personal strength may be three years of work experience. Strategy is sometimes defined as "the match" a person (or firm) makes between its internal resources and skills and the opportunities and risks created by its external factors. When a person has major weaknesses, he or she should strive to overcome them and perhaps convert them into strengths. When a person faces major threats, they should seek to avoid or mitigate the effects of them to focus on opportunities. Even though SWOT analysis is explained considerably more in Chapter 6, give it a try here to help in planning your next career move.

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 1E

How Detrimental Are Various Pitfalls in Strategic Planning?

Purpose

Whenever a firm engages in strategic planning, there are certain potholes or pitfalls that need to be avoided. Being aware of potential pitfalls and being prepared to address them is essential to success. A list of thirteen pitfalls that commonly plague firms and undermine strategic-planning efforts follows. These can be ranked in terms of how potentially detrimental or severe they are in doing strategic planning. This exercise reveals the authors' ranking of the thirteen pitfalls in terms of how potentially detrimental or severe they are in doing strategic planning.

Pitfalls

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

The purpose of this exercise is to examine and discuss how potentially detrimental or severe the various pitfalls are in doing strategic planning. In addition, the purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Steps

1. Fill in Column 1 in Table 1-9 to reveal your individual ranking of how potentially detrimental to strategic planning the pitfalls are, where 1 = most detrimental to 13 = least detrimental. For example, if you feel Pitfall 1 is the fifth most detrimental, then enter a 5 in Table 1 in Column 1 beside Pitfall 1.
2. Fill in Column 2 in Table 1-9 to reveal your group's ranking of the thirteen pitfalls.
3. Fill in Column 3 in Table 1-9 to reveal the expert's ranking of the thirteen pitfalls. (To be provided by your professor, the expert rankings are based on the authors' experience and the end of the chapter.)
4. Fill in Column 4 in Table 1-9 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: For absolute difference, disregard negative numbers.)

TABLE 1-9 Pitfalls in Doing Strategic Planning: Comparing Individual versus Group Decision Making

Pitfalls to Avoid In Doing Strategic Planning	Column 1	Column 2	Column 3	Column 4	Column 5
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
9.					
10.					
11.					
12.					
13.					
SUM					

5. Fill in Column 5 in Table 1-9 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

PART 2

STRATEGY FORMULATION

2

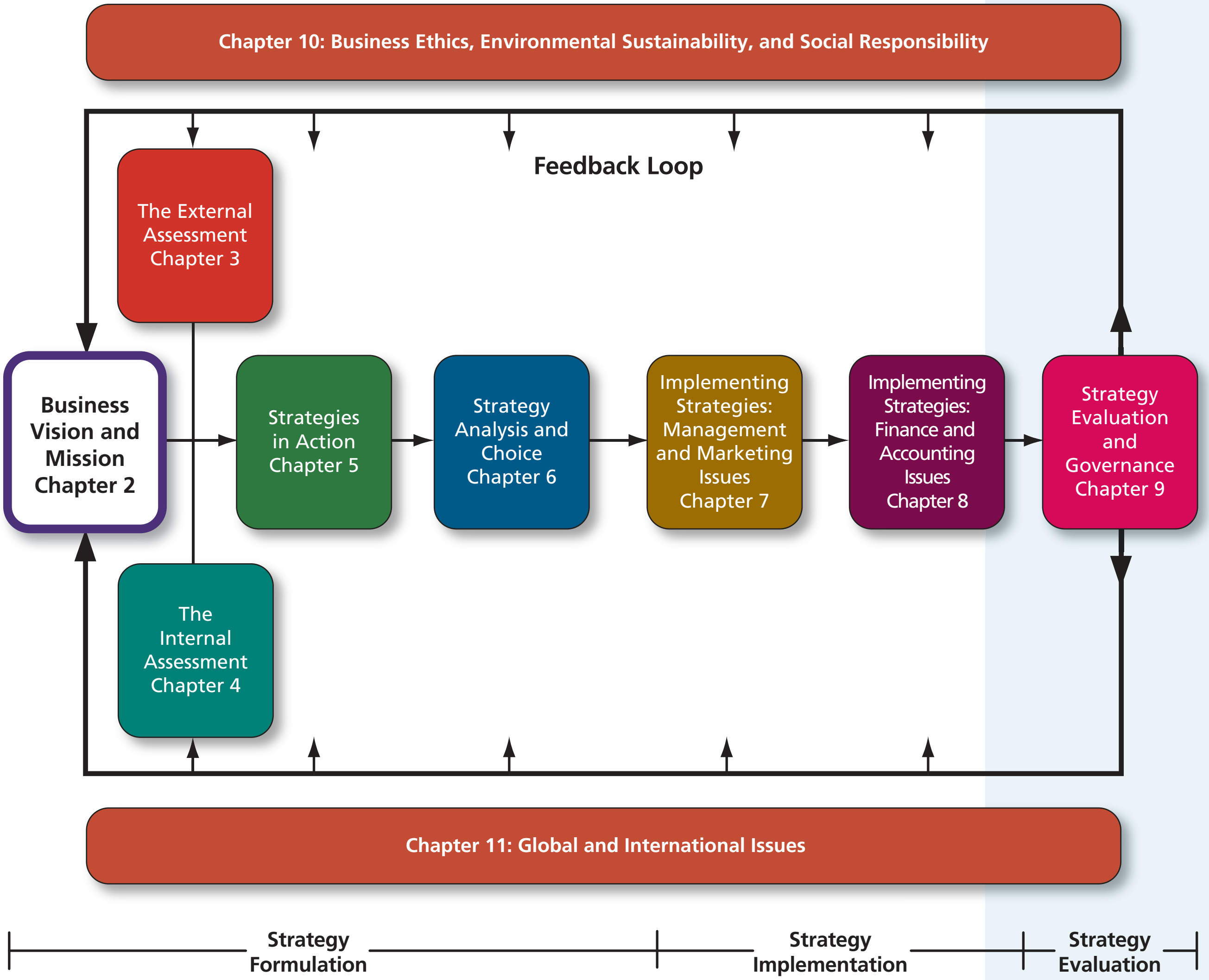


FIGURE 2-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

Business Vision and Mission

LEARNING OBJECTIVES

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

2-1. Explain the need for core values statements in strategic management.

2-2. Describe the nature and role of vision statements in strategic management.

2-3. Identify the characteristics of a vision statement.

2-4. Describe the nature and role of mission statements in strategic management.

2-5. Identify and discuss the characteristics of an effective mission statement.

2-6. Identify and discuss the components of mission statements.

2-7. Discuss the benefits for a firm of having clear vision and mission statements.

2-8. Evaluate and write mission statements for different organizations.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1:	Strategic Planning for Coca-Cola
EXERCISE 2A:	Develop an Improved Coca-Cola Vision Statement
EXERCISE 2B:	Develop an Improved Coca-Cola Mission Statement
EXERCISE 2C:	Compare Coca-Cola's Mission Statement to a Rival Firm's
SET 2:	Strategic Planning for My University
EXERCISE 2D:	Compare Your University's Vision and Mission Statement to Those of a Rival Institution
SET 3:	Strategic Planning for Myself
EXERCISE 2E:	Develop a Vision and Mission Statement for Yourself
SET 4:	Individual versus Group Strategic Planning
EXERCISE 2F:	What Is the Relative Importance of Each of the Nine Components of a Mission Statement?

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Chapter 2 focuses on the concepts and tools needed to evaluate and write core values, vision, and mission statements. As illustrated with shading in Figure 2-1, carefully prepared statements of vision and mission are widely recognized by both practitioners and academicians as the first step in strategic management. Actual vision and mission statements from large and small organizations and for-profit and nonprofit enterprises are presented and critiqued.

The exemplary strategist showcased is Frederick Smith, whose entrepreneurial vision four decades ago led to the creation of FedEx, a firm on a mission today to lead the package-delivery industry.

We can perhaps best understand core values, 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 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 his or her philosophy of the new enterprise will result in a favorable public image, and the business concept can be effectively communicated to and adopted by important constituencies. When the ideas and beliefs about a business at its inception are put into writing, the resulting documents mirror the same basic ideas that underlie core values, vision, and mission statements. As a business grows, owners or managers may revise the founding set of beliefs, but those original ideas usually are still reflected in core values, vision, and mission statements.

Core values, vision, and mission statements often can be found in the front of annual reports and commonly displayed throughout a firm's premises and distributed with company information sent to constituencies. These statements are part of numerous internal reports, such as loan requests, supplier agreements, labor relations contracts, business plans, and customer service agreements. However, too many companies and organizations today have no core values, vision, or mission statement, thus missing out on an incredible opportunity to motivate and energize customers, employees, and shareholders, and also jeopardizing their strategic-planning efforts.

LO 2.1 Core Values Statements: What Is Our Foundation?

Core values provide the needed ethical foundation for creating an excellent vision and mission. A **core values statement** specifies a firm's commitment to integrity, fairness, discipline, equal employment opportunity, teamwork, accountability, continuous improvement, or other such exemplary attributes. For example, LinkedIn's core values (paraphrased) are (1) customers first, (2) relationships matter, (3) be open and honest, (4) require excellence, (5) take intelligent risks, and (6) act like an

EXEMPLARY **STRATEGIST** SHOWCASED

Frederick W. Smith, Founder and CEO of FedEx Corporation

Sundry Photography/Shutterstock

Our Mission Is Fast Delivery

Headquartered in Memphis, Tennessee, and founded in 1973 by Frederick W. Smith, FedEx is one of the few *Fortune* 500 companies still led today by its founder. Forty-five years and counting as CEO of any company is quite exemplary, and his company's vision and mission have changed little in 45 years. Smith's vision to more quickly deliver time-sensitive mail enabled his company to bypass the U.S. Postal Service and thereby revolutionize the transportation industry. Back in 1973 and in the years that followed, Smith turned his vision of quick delivery into a reality and motivated thousands of workers to adopt the FedEx mission. FedEx was the first U.S. company ever to earn $1 billion in revenues within its first 10 years of business without merging or acquiring other firms. FedEx has grown into a $60 billion global transportation, business services, and logistics iconic U.S. firm.

Led by Smith, FedEx today includes FedEx Services, FedEx Ground, FedEx Freight, and FedEx Express, the latter of which has the world's largest all-cargo air fleet. Smith says the key to his success has been "having an effective strategy and everyone understanding what the strategy is." With a mission to offer flexible and innovative solutions for everyone from entrepreneurs to large corporations, FedEx's strategy is based on innovation and a clear purpose. Many postal services that we take for granted today, such as tracking mail and packages, were pioneered by an exemplary strategist, Frederick W. Smith.

Source: Based on the FedEx corporate website and a variety of other sources.

owner. Great firms possess core values that remain fixed and almost never change. The core values of any firm should transcend technological changes, fads, product life cycles, and globalization.

Because vision and mission statements do change over time, it is vital to know who you are before you can discuss what you want to become, what business are you in, or how will you get there. Generally, if core values are open for change in the future, they are not core values. Disney for example has a core value "to make people happy;" a technology firm may have a core value "to connect the world." Tyson Foods' core values statement that guides the firm's operations follows (paraphrased):

> We are engaged in the production of food, seeking to pursue truth and integrity, while creating value for our shareholders, customers, employees, and communities. We strive to be an honorable, faith-friendly company composed of diverse people. We feed the world with trusted food products while being excellent stewards of the animals, land, and environment entrusted to us.

The Global Capsule 2 reveals how LinkedIn's core values led to a vision and mission that catapulted the company to global prominence.

GLOBAL CAPSULE 2

LinkedIn: Clear Core Values, Vision, and Mission Lead to Global Prominence

The social-networking site, LinkedIn, has a network of more than 500 million registered users in two hundred countries. LinkedIn has grown globally as fast as almost any other firm. How? The answer is having a clear vision. LinkedIn's CEO Jeff Weiner is the key. Weiner has been voted the best CEO in the United States. Weiner's outstanding leadership style has earned him the trust and admiration of all LinkedIn employees. Weiner says "a manager is someone who tells others what to do, whereas a leader inspires others to do great things." When Weiner spoke at the Wisdom 2.0 conference in San Francisco, he identified and explained the three most important ingredients for being a great leader. **Weiner says the most important ingredient for a great leader is for that person to be clear about the organization's vision.** Fred Kofman is LinkedIn's VP of leadership and organizational development; Kofman says:

> *Most CEOs sit at the front of a boat and tell their employees where they need to row; Weiner grabs a surfboard and catches a huge wave, inspiring everyone behind him to do the same. The surfers are all riding the same wave, sharing the same vision, but are putting much more of their heart and personality into their work than the grunts in the rowboat.*

According to Weiner, the second-most important ingredient for a leader is to be brave. *Weiner says (paraphrased):*

Asif Islam/Shutterstock

Should You Join Our Network?

> *If you have true vision and you want to try something that has not been done before, there will be a lot of doubters, skeptics, people who feel threatened, and people who get in your way. Thus, you have to exude confidence to be able to overcome those challenges and for people to want to follow you. You have to be authentic and have true conviction or no one will get behind you.*

According to Weiner, the third-most important ingredient necessary to be a great leader is to be an effective communicator.

> *He explains that whenever a leader has these three ingredients, led by core values, vision, and mission, the job at hand becomes "a matter of what objective you're trying to achieve and then surrounding yourself with the best talent you can."*

Source: Based on http://jobs.aol.com/articles/2015/07/06/linkedin-ceo-jeff-weiner-leadership-qualities/?SiteID=cbaolcompromotion_july_14.Also, https://www.cnbc.com/2017/06/28/linkedin-ceo-jeff-weiner-heres-what-separates-leaders-from-managers.html and https://www.consciousculturegroup.com/linkedin-vision-values-insights/

Vision Statements: What Do We Want to Become?

LO 2.2

It is especially important for managers and executives in any firm to agree on the basic vision the organization 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. Examples of vision statements are provided in Table 2-1. The vision statement should be short, preferably one sentence, and as many managers as possible should have input into developing the statement. In the book of Proverbs in the Bible, Chapter 29, Verse 18, says, "Where there is no vision, the people perish."

TABLE 2-1 Six Exemplary Vision Statements (paraphrased)

- Dr Pepper Snapple: to be the best beverage business globally; our brands are synonymous with refreshment, fun, and flavor today and tomorrow.
- IBM: to be the world's most successful information technology company focused on helping customers apply technology to solve their problems now and in the future.
- Hilton Worldwide: to fill the Earth with the light and warmth of hospitality by delivering exceptional experiences—every hotel and guest for all time.
- Starbucks: to be the premier purveyor of the finest coffee in the world while maintaining uncompromising principles as we steadily grow.
- Kellogg: to enrich and delight the world through foods and brands that matter today and tomorrow.
- Harley-Davidson: to fulfill dreams through the experiences of motorcycling for all time.

For many corporations, profit rather than vision or mission is the primary motivator, but profit alone is not enough to motivate people. It is not uncommon that profit is perceived negatively by many stakeholders of a firm. For example, employees could 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. Reuben Mark, former CEO of Colgate, maintains that a clear vision increasingly must make sense internationally. Mark's thoughts on vision 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.[1]

When employees and managers together shape or fashion a vision statement of a firm, the resultant document 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, challenge, and belongingness. The motivation, dedication, and commitment associated with shared vision is an immense potential benefit for any firm or organization.

LO 2.3 Characteristics of a Vision Statement

A vision statement should reveal the type of business the firm conducts. For example, a vision that says, "to become the best retail firm in the United States," is too broad because that firm could be selling anything from apples (A) to zebras (Z). Although typically a single sentence, vision statements need to do more than identify the product or service a firm offers; vision statements should be written from a customer perspective. Ideally every organization wants its employees and customers to align their actions with the firm's vision. To fulfill this need, an excellent vision statement describes a desired future state. Being futuristic enables vision statements to be used to facilitate organizational change. The statement needs to be doable but challenging.

In summary, effective vision statements exhibit the following five characteristics; these five attributes can be used as guidelines for writing or evaluating vision statements. Any vision statement that scores a 5 out of 5 on these characteristics is exemplary. Let's call this vision assessment technique "The 5-out-of-5 Test."

1. Clear: reveals type of industry and what firm strives to become
2. Futuristic: reveals what the firm strives to become or accomplish within five years
3. Concise: one sentence in length
4. Unique: reveals the firm's competitive advantage
5. Inspiring: motivates the readers to support the firm

Vision Statement Analysis

There is no one best vision statement for a particular company in a given industry, but the 5-out-of-5 test can be used to both develop and evaluate vision statements. Six exemplary vision statements that meet the 5-out-of-5 test are provided in Table 2-1. Notice the Harley-Davidson statement meets the 5 criteria in just 11 words.

Four vision statements that do *not* meet the 5-out-of-5 test are given in Table 2-2.

TABLE 2-2 Four Nonexemplary Vision Statements (paraphrased)

1. Avon Products, Inc.: to be the firm that best understands and satisfies the product and service needs of women globally. *Author Comment:* Lacks Characteristics 1, 2, and 4.
2. Charles Schwab Corporation: to help investors help themselves. *Author Comment:* Lacks Characteristics 2, 4, and 5.
3. Instagram: to capture and share the world's moments. *Author Comment:* Lacks Characteristics 1, 2, 4, and 5.
4. Zappos.com: to deliver happiness to customers, employees, and vendors. *Author Comment:* Lacks Characteristics 1, 2, 4, and 5.

Key: Vision Statement Characteristics

1. Clear: reveals type of industry and what firm strives to become
2. Futuristic: reveals what the firm strives to become or accomplish in five years
3. Concise: one sentence in length
4. Unique: reveals the firm's competitive advantage
5. Inspiring: motivates the reader to support the firm

Mission Statements: What Is Our Business?

LO 2.4

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. Drucker believes that asking the question "What is our business?" is synonymous with asking "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 who it wants to serve. All organizations have a reason for being, even if strategists have not consciously transformed this reason into writing. Drucker has the following to say about mission statements (paraphrased):

> 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.[2]

Some strategists spend almost every moment of every day on administrative and tactical concerns; those who rush quickly to establish objectives and implement strategies often overlook the development of a vision and mission statement. This problem is so widespread that many corporations, organizations, and small businesses in the United States have not yet developed a formal vision or mission statement.

Some companies develop mission statements simply because owners or top management believe it is fashionable, rather than out of any real commitment. However, 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. For example, managers at Johnson & Johnson (J&J) meet regularly with employees to review, reword, and reaffirm the firm's mission. The entire J&J workforce recognizes the value that top management places on this exercise, and these employees respond accordingly.

LO 2.5 Characteristics of a Mission Statement

A mission statement is a declaration of attitude and outlook. It usually is broad in scope for at least two major reasons. First, a quality 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'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 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 **reconciliatory**. 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. Stakeholder expectations leveled 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' expectations on an organization cannot be pursued with equal emphasis. A quality mission statement reveals that the organization will strive to meet the varied expectations of stakeholders.

The statement of mission should be sufficiently broad to allow judgments about the most promising growth directions and those considered less promising. Numbers should not be included in a mission statement. George Steiner offers the following insight on the need for a mission statement to be broad in scope:

> 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; all in the firm need to be onboard with the firm's mission.[3]

An effective mission statement should not be too lengthy; the recommended length is less than one hundred 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, but never cast in stone, meaning that a statement may need to be changed at any time depending on changes anywhere in the integrative model of strategic management. This dynamic nature of both vision and mission statements is conveyed in Figure 2-1 through the feedback loop. An effective mission statement generates the impression that a firm is successful, has direction, and is worthy of time, support, and investment from all stakeholders.

A business mission reflects judgments about future growth directions and strategies that are based on forward-looking external and internal analyses. The statement should provide useful criteria for selecting among alternative strategies. A clear mission statement provides a basis for generating and screening strategic options. A mission statement should (1) define what the organization is, (2) be limited enough to exclude some ventures and broad enough to allow for creative growth, (3) distinguish a given organization from all others, (4) serve as a framework for evaluating both current and prospective activities, and (5) be stated in terms sufficiently clear to be widely understood throughout the organization.[4] The mission statement should reflect 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.

Table 2-3 summarizes 10 desired characteristics of an effective mission statement:

TABLE 2-3 **Characteristics of a Mission Statement**

1. Broad in scope; does not include monetary amounts, numbers, percentages, ratios, or objectives
2. Concise; fewer than one hundred words in length
3. Inspiring
4. Identifies the utility of a firm's products
5. Reveals that the firm is socially responsible
6. Reveals that the firm is environmentally responsible
7. Includes nine components: customers, products or services, markets, technology, concern for survival/growth/profits, philosophy, distinctive competence, concern for public image, concern for employees
8. Reconciliatory; resolves divergent views among stakeholders
9. Enduring but never cast in stone
10. Attracts customers; is written from a customer perspective

Quality mission statements identify the utility (value) of a firm's products to its customers. This is why Verizon'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 mission statement is to attract customers; all companies and organizations must continually attract customers.

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*.

Managers often perceive customer satisfaction as a valuable intangible asset to a firm; research suggests that customer satisfaction has a strong positive relationship with organizational performance.[5] When written from a customer perspective, mission statements can spur employees, salespersons, and managers to provide exemplary customer service, which arguably would enhance customer loyalty and translate into customers being "on a mission" to seek out, use, and promote the firm's products and services.

Components of a Mission Statement

LO 2.6

Most practitioners and academicians of strategic management agree there are nine **mission statement components** to be included in an exemplary statement. Because a mission statement is often the most visible and public part of the strategic-management process, it is important that it includes both the ten characteristics summarized previously, and the following nine components:

1. ***Customers***—Who are the firm's present and potential 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. ***Distinctive competence***—What is the firm's 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?[6]

To exemplify how mission statements should be written to include all nine components, a component-by-component example for a charter boat fishing company is provided in Table 2-4. Note the charter company's customers are "outdoor enthusiasts." "Customers" is an important component to include in a mission statement, so merely including the word *customer* is not sufficient or adequate because that word alone will not "attract customers." The statement needs to identify more precisely the target groups of customers. In fact, all nine components should be written from a customer perspective, as given in the Table 2-4 example. For example, regarding the "product/service" component, the charter fishing company provides "memories for a lifetime"—thus revealing the "utility" of the service offered and appealing to people who may not like to "just fish." Regarding the "distinctive competence" component, whereby the firm reveals the major competitive advantage its products/services provide, the statement says: "for customer enjoyment and safety, we provide the most experienced staff in the industry." A concise, inspiring, exemplary mission statement that could be derived from the component-by-component example shown in Table 2-4 follows.

> Our fleet of fast, clean deep sea fishing boats (products) offers outdoor enthusiasts (customers) an exciting fishing adventure off the coast of North Carolina (markets). Using the latest safety and fishing finding equipment (technology), as well as emission-friendly engines (public image), our friendly captain and first mate are the most experienced in the industry (distinctive competence). Ensuring that customers "catch rather than just fish," our staff of experienced captains and first mates (employees) follows the Golden Rule (philosophy) and creates lifelong memories for customers, all while charging the lowest possible prices and fostering repeat customers (survival, growth, profitability). (85 words)

TABLE 2-4 Mission Statement Components Written from a Customer Perspective

1. ***Customers:*** Our customers are outdoor enthusiasts seeking fishing excitement and adventure.
2. ***Products or services:*** We provide fast, clean boats, all the bait and tackle needed, and friendly first mates to create memories for a lifetime.
3. ***Markets:*** Our fleet of fast, clean vessels operate all along the North Carolina Coast.
4. ***Technology:*** Our vessels are equipped with the very latest safety and fish finding equipment to ensure that customers comfortably are "catching rather than just fishing."
5. ***Survival, growth, and profitability:*** Our prices are as low as possible to garner repeat customers and a reasonable return for our owners.
6. ***Philosophy:*** We assure customers the utmost courtesy and care as our motto on every vessel is to follow the Golden Rule.
7. ***Distinctive competence:*** For customer enjoyment and safety, we provide the most experienced staff in the industry.
8. ***Public image:*** Our vessels use emission-friendly engines; we strive to bring repeat tourists to all communities where we operate.
9. ***Employees:*** Our captains and first mates are "on a mission" to help customers have a great time.

Source: Based on Meredith E. David, Forest R. David, & Fred R. David, "Mission Statement Theory and Practice: A Content Analysis and New Direction," *International Journal of Business, Marketing, and Decision Sciences* 7, no. 1 (Summer 2014): 95–109.

Regarding the "survival, growth, and profitability" component, for publicly held firms, shareholders often expect at least a 4 percent annual growth in revenues because otherwise individuals could redirect their money to achieve this rate of growth (usually) in the stock market. Regarding the "philosophy" component, CEO Mark Zuckerberg of Facebook recently condensed his company's mission statement to focus only on the "philosophy" component, as revealed in Ethics Capsule 2. Note: The authors feel that component 7 (distinctive competence) is the most important among the nine, followed by "customers" and then "philosophy," but all nine components are important and need including.

ETHICS CAPSULE 2

Facebook: Changing Our Mission to Enhance Our Ethics and Integrity

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Facebook(ing) With Friends

It is 2018 and Facebook CEO Mark Zuckerberg is on a mission "to fix Facebook's ethical problems." Zuckerberg says his company "has made too many errors preventing misuse of our tools," and "my personal challenge for 2018 is to focus on fixing Facebook's ethical issues." More than 2 million people now log onto Facebook every month. The company allegedly allows objectionable content and fake news and increasingly is also criticized as being an invasion of personal privacy.

In June 2017, Facebook officially changed its mission from "making the world more open and connected," to "give people the power to build community and bring the world closer together." In announcing the new company mission, Zuckerberg, the fifth-richest person on the planet, said "giving people a voice and helping them connect is not sufficient to make the world a better place." With this change in mission, Facebook is taking down thousands of "revenge porn" photos and inappropriate videos and other content. The company is tripling its expenditures on security to screen bad people, even as more than 60 million new active users monthly join the site; Facebook is on course to have more than 3 billion users by the end of 2018. The world's largest social network site, Facebook is facing growing criticism from lawmakers for not monitoring shady content, bad users, misinformation, propaganda, and violent videos. The company's change in mission has led the firm to double the number of its employees and contractors who handle safety and security issues from ten to twenty thousand by the end of 2018. As part of the firm's new mission, Zuckerberg has publicly pledged to give a way 99 percent of his personal wealth. Zuckerberg stated at the 2017 Facebook Communities Summit: "we have to build a world where we care about a person in India, China, Nigeria, or Mexico as much as a person in America." Facebook's new mission focuses on building a global social network where friends take care of friends.

Source: Deepa Seetharaman, "Zuckerberg Vows to Work on Fixing Facebook," *Wall Street Journal*, (January 5, 2018): B1 & B2. Also, Deepa Seetharaman, "Facebook Vows to Sacrifice Growth for Secure Operations," *Wall Street Journal*, (November 2, 2017): B3. Also, Valentina Zarya, "Facebook's Secret Weapon," *Fortune*, (August 1, 2017): 26–28.

The Importance (Benefits) of Vision and Mission Statements

LO 2.7

A meta-analysis of 20 years of empirical research on mission statements concluded there is a positive relationship between mission statements and measures of financial performance.[7] 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 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.[8]

Another benefit of developing a comprehensive mission statement is that divergent views among managers can be uncovered 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 among faculty regarding the relative importance of teaching, research, and service often are expressed during the development of the mission statement. Negotiation, compromise, and eventual agreement on important issues are needed before people in any organization or company 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 J. C. Penney, respectively. W. T. Grant decided to adopt attributes of both Kmart and J. C. Penney; this compromise was a huge strategic mistake. In other words, top executives of W. T. Grant never resolved their vision or mission issue, which ultimately led to the firm's disappearance.[9]

Too often, strategists develop vision and mission statements only when the organization is in trouble. Of course, the documents are needed then. Developing and communicating these statements during troubled times indeed may have spectacular results and may even 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, as indicated, 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.[10]

In multidivisional organizations, strategists should ensure that divisional units perform strategic-management tasks (sometimes referred to as *business-level strategy*), including the development of a statement of vision and mission for their unique division. Each division should involve its own managers and employees in developing vision and mission statements that are consistent with and supportive of the corporate mission. The benefits of having a clear vision and mission are summarized in Table 2-5.

An organization that fails to develop an effective vision and 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. Vision and mission statements are effective vehicles for communicating with important

TABLE 2-5 10 Benefits of Having a Clear Vision and Mission

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.

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, and for external constituencies, reveal the firm's long-term commitment to responsible, ethical action in providing a needed product or service to customers.

The Process of Developing Vision and Mission Statements

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 vision and mission statements is first to select several articles (such as those listed as Current Readings at the end of this chapter) and ask all managers to read them as background information. Then, managers are asked to individually prepare vision and mission statements 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 vision and mission statements represents a great opportunity for strategists to obtain needed support from all managers in the firm.

Some organizations use discussion groups of managers to develop and modify existing statements. Other organizations hire an outside consultant or facilitator to manage the process and help draft the language. At times 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.

When an effective process is followed, developing a mission statement can create an "emotional bond" and "sense of mission" among employees and customers. 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. 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. Involving marketers and sales representatives in the development of the mission statement and writing statements from a customer perspective could enable firms to create an emotional bond with customers and enhance the likelihood that salespersons would be "on a mission" to provide excellent customer service.

Evaluating and Writing Mission Statements

LO 2.8

A mission statement should provide more than mere inclusion of a single word such as *products* or *employees* regarding a respective component. Why? Because the statement should motivate stakeholders to action, as well as be customer-oriented, informative, inspiring, and enduring.

Perhaps the best way to develop a skill for writing and evaluating mission statements is to study actual company missions. Thus, Table 2-6 provides a component-by-component critique of an actual mission statement from Hershey. The Hershey statement is too brief, being only 14 words total, is too vague, and is missing six of the nine components.

As additional guidance for practitioners (and students), mission statements are written from a customer perspective and proposed for four companies as presented in Table 2-7. The statements include the 10 characteristics and 9 components presented previously. The statements are written to enhance customer satisfaction, especially if communicated to customers by marketers, and backed by company commitment to and implementation of the mission message. The proposed statement for the footwear company Crocs, Inc., for example, talks about "dependable and lasting comfort all day," whereas the UPS proposed statement talks about "the most timely, dependable, and accurate delivery times in the world."

TABLE 2-6 Two Mission Statements Critiqued

Hershey's Actual Mission Statement (paraphrased) (12 words)

We bring sweet moments (2) of Hershey happiness (6) to the world (3) every day.

(Author Comment: Statement lacks six components: Customers (1), Technology (4), Survival/Growth/ Profits (5), Distinctive Competence (7), Public Image (8), and Employees (9).

A Proposed Mission Statement for Hershey (73 words)

We aim to serve consumers of all ages and lifestyles (1) by providing high-quality chocolate, candy, and snack products (2) globally (3). We intend to grow and expand our product offerings (5) using robotics and business analytics (4). We are dedicated to supporting all communities where we operate (8), especially to the boys and girls in the Milton Hershey School (6). Through our friendly and well-trained employees (9), we provide consumers the best chocolate anywhere and wrapped in Hershey Happiness (7).

Key: Mission Statement Components

1. Customers
2. Products or services
3. Markets
4. Technology
5. Concern for survival, growth, and profitability
6. Philosophy
7. Distinctive competence
8. Concern for public image
9. Concern for employees

Source: Based on information at the various corporate websites.

TABLE 2-7 Four Mission Statements Revised

The numbers in parentheses correspond to the nine mission statement components.

Rite Aid

We are on a mission to offer the best possible drugstore experience for people of all ages (1) around the United States (3). We have a state-of-the-art information system (4) that provides our pharmacists (9) with warnings of any possible drug interactions to help better ensure customer safety (8). We are determined to improve our customers' overall health through our wellness programs (5). We offer an extensive line of other beauty, food, drink, cosmetic, and vitamin products through our alliance with GNC (2). We believe in treating our customers like family (6) and strive to maintain our reputation as the most personable drugstore (7). *(88 words total)*

Best Buy

We are committed to providing individuals and businesses (1) the latest high-tech products (2) at the lowest prices of any retail store (7). Serving North America, China, and other markets (3), all Best Buy employees (9) are exceptionally knowledgeable about the products we offer. We believe good ethics is good business (6) and use business analytics (4) to better understand customer trends. We strive to make a profit for our shareholders (5) and be a good community citizen everywhere we operate (8). *(72 words)*

United Parcel Service (UPS)

We strive to be the most timely and dependable parcel and freight forwarding delivery service (2) in the world (3). By implementing the latest tracking technology (4), we are able to profitably grow (5) by offering individuals and businesses (1) dependable and accurate delivery times (7). We promote from within to improve morale among all employees (9). Our philosophy (6) is to responsibly balance the needs of our customers, employees, shareholders, and communities (8) in an exemplary manner. *(68 words)*

Crocs, Inc.

Crocs is committed to providing profound comfort, fun and innovation in all the shoe models (2) we produce. Through our Croslite technology (4) (7), we are able to provide men, women, and children (1) dependable and lasting comfort all day. We strive to expand our brand throughout the world (3) and are able to save on costs (5), while protecting the environment (8) with our package-less shoes. We adhere to the belief that good ethics is good business (6) in all that we do as we strive to take care of our employees and shareholders. (*85 words*)

Source: Reprinted with permission from Fred. R. David, "Mission Statement Theory and Practice: A Content Analysis and New Direction," *International Journal of Business, Marketing, and Decision Sciences* 7, no. 1 (Summer 2014): 95–109.

IMPLICATIONS FOR STRATEGISTS

Figure 2-2 reveals that establishing and nurturing an effective vision and mission is a vital first step in gaining and maintaining competitive advantages. Businesses succeed by attracting and keeping customers, and they do this by providing value for customers through unique experiences, products, and/or services. Firms nurture their uniqueness as evidenced in the "distinctive competence" component in mission statements. Marketers continually assess customers' changing needs and wants and make appropriate adjustments in the design and delivery of products and services to sustain competitive advantage. Developing and communicating a clear business vision and mission is essential because without effective vision and mission statements, a firm's short-term actions may be counterproductive to long-term interests. A clear vision and mission provides direction for all subsequent activities that endeavor to see customers, employees, and shareholders concurrently "on a mission" to see the firm succeed.

Vision and mission statements are not just words that look nice when framed or engraved; they provide a basis for strategy and action; they reveal the reason a business opens its doors every day, the reason salespersons sell, the reason customers buy, and the reason employees work. The statements ideally are the passion behind the company, the foundation for employee morale, and the basis for customer loyalty. Written from a customer perspective and included in both oral and written communication with customers, the statements could be used to attract and keep customers. Vision and mission statements do matter. Marketers pursue projects and managers make daily decisions mindful of the firm's basic vision, mission, and resources. Managers work hard every day to motivate employees. Executives are on a mission to present the firm favorably to many stakeholders. A clear vision and mission enables strategists to lead the way as a firm strives to gain, sustain, and grow its customer base and competitive advantages.

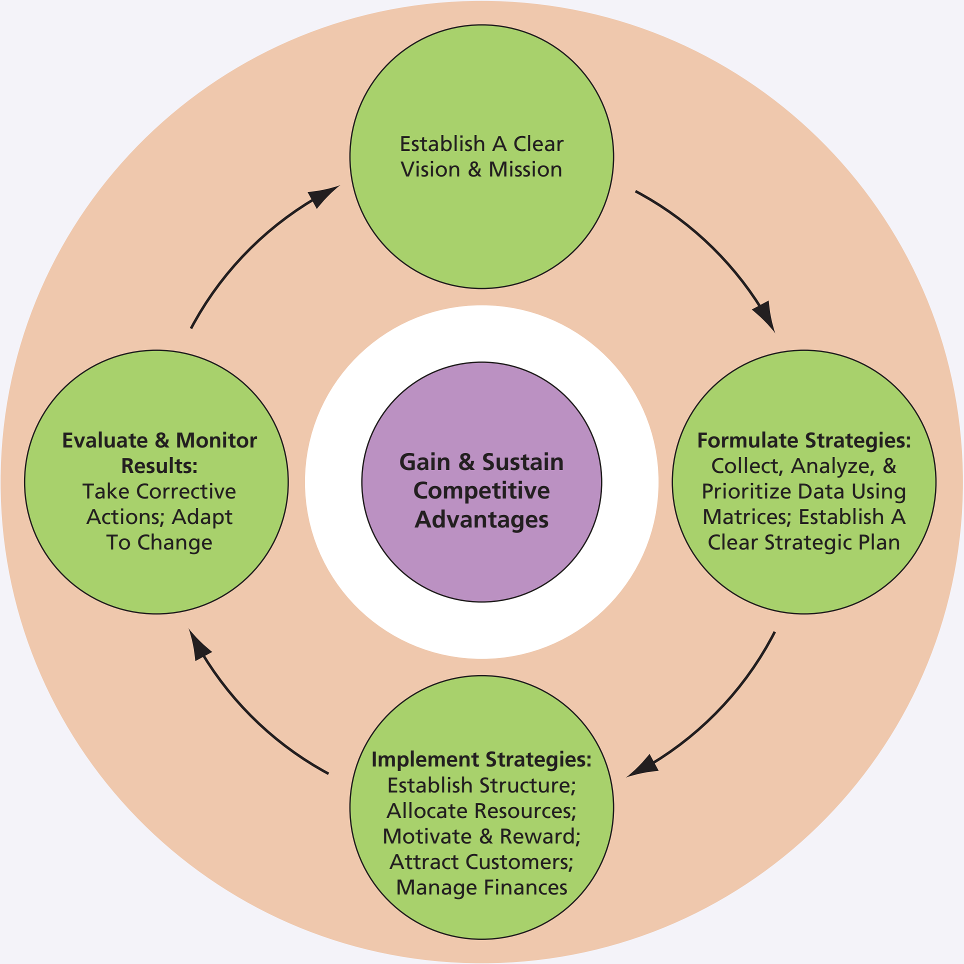

FIGURE 2-2
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

Because gaining and sustaining competitive advantage is the essence of strategic management, when presenting your vision and mission statements as part of a case analysis, be sure to address the "distinctive competence" component. Compare your recommended vision and mission statements 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. Your proposed mission statement should certainly include the 10 characteristics and 9 components, but in your discussion about the vision or mission, focus on competitive advantage. In other words, be prescriptive, forward-looking, and insightful—couching your vision or 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 9-component comparison of your proposed statement with rival firms' statements, although that would be nice to include in your analysis.

Chapter Summary

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' core values, 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 clear core values, vision, and mission. Drucker says that developing a clear business vision and mission is the "first responsibility of strategists."

A quality mission statement reveals an organization's customers; products or services; markets; technology; concern for survival, growth, and profitability; philosophy; distinctive competence; 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. As indicated next in the mini-case, even Under Armour's vision and mission statements can be improved.

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. Vision and mission statements should serve as guidance and be reviewed often when divergent views arise among managers on various strategies to implement. Organizations usually reexamine their vision and mission statements annually. Effective vision and mission statements stand the test of time.

Core values, 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. 78)
concern for public image (p. 78)
concern for survival, growth, and profitability (p. 78)
core values statement (p. 72)
creed statement (p. 75)
customers (p. 77)
distinctive competence (p. 78)
markets (p. 77)
mission statement (p. 75)
mission statement components (p. 77)
philosophy (p. 78)
products or services (p. 77)
reconciliatory (p. 76)
stakeholders (p. 76)
technology (p. 78)
vision statement (p. 73)

Issues for Review and Discussion

2-1. This chapter's exemplary strategist is CEO and founder of FedEx, Frederick W. Smith. How closely aligned do you think Smith's personal vision statement would be or should be with his corporate vision statement?

2-2. This chapter's ethics capsule is about Facebook changing its mission to become more ethical. How closely aligned do you think Facebook Chairman Mark Zuckerberg's personal mission statement would be or should be with his corporate mission statement?

2-3. Regarding the "survival, growth, and profitability component, for publicly held firms, shareholders oftentimes expect at least a 4 percent annual growth in revenues." Explain why is this statement true.

2-4. Explain the 5-out-of-5 test associated with vision statements.

2-5. At the website http://www.themarketingblender.com/vision-mission-statements/ it defines vision as "the dreaming piece" and defines mission as "the doing piece." How effective is this distinction?

2-6. Discuss the relative importance of vision and mission documents for managers compared with employees, customers, and shareholders.

2-7. Define *reconciliatory*, and give an example of how this "characteristic" can be met in a mission statement.

2-8. Which mission statement component most closely reveals the firm's competitive advantage? Give an example.

2-9. Critique the following vision statement by Stokes Eye Clinic: "Our vision is to take care of your vision."

2-10. For a university, students are the customer. Write a single sentence that could be included in your university's mission statement to reveal the institution's market components written from a customer perspective.

2-11. Some excellent nine-component mission statements consist of just two sentences. Write a two-sentence mission statement for a company of your choice.

2-12. How do you think an organization can best align company mission with employee mission?

2-13. What are some different names for "mission statement," and where will you likely find a firm's mission statement?

2-14. If your company does not have a vision or mission statement, describe a good process for developing these documents.

2-15. Explain how developing a mission statement can help resolve divergent views among managers in a firm.

2-16. Drucker says the most important time to seriously reexamine the firm's vision or mission is when the firm is successful. Why is this?

2-17. Explain why a mission statement should not include monetary amounts, numbers, percentages, ratios, goals, or objectives.

2-18. Discuss the meaning of the following statement: "Good mission statements identify the utility of a firm's products to its customers."

2-19. Distinguish between the "distinctive competence" and the "philosophy" components in a mission statement. Give an example of each for your university.

2-20. When someone or some company is "on a mission" to achieve something, many times the person or company cannot be stopped. List three things in prioritized order that you are on a mission to achieve in life.

2-21. Compare and contrast vision statements with mission statements in terms of composition and importance.

2-22. Do local service stations need to have written vision and mission statements? Why or why not?

2-23. Why do you think organizations that have a comprehensive mission tend to be high performers? Does having a comprehensive mission cause high performance?

2-24. What is your college or university's distinctive competence? How would you state that in a mission statement?

2-25. Explain the principal value of a vision and a mission statement.

2-26. Why is it important for a mission statement to be reconciliatory?

2-27. In your opinion, what are the three most important components that should be included when writing a mission statement? Why?

2-28. How would the mission statements of a for-profit and a nonprofit organization differ?

2-29. Write a vision and mission statement for an organization of your choice.

2-30. Who are the major stakeholders of the bank that you do business with locally? What are the major claims of those stakeholders?

2-31. List eight benefits of having a clear mission statement.

2-32. How often do you think a firm's vision and mission statement should be changed?

2-33. What four characteristics can be used to evaluate the quality of a vision statement?

2-34. Explain the importance of core values in establishing vision and mission statements.

2-35. According to the authors, what are the three most important mission statement components in rank order?

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 2A

Develop an Improved Coca-Cola Vision Statement

Purpose

Coca-Cola's vision statement is given on the Coca-Cola website at http://www.coca-colacompany.com/our-company/mission-vision-values. The purpose of this exercise is to evaluate Coca-Cola's vision statement and to develop a new and improved statement for the company.

Instructions

Step 1 Refer to the Cohesion Case (p. 57 on vision/mission). Go to the Coca-Cola website. Click on Our Company. Then click on Mission, Vision, and Values. Then find the company's vision statement and copy and paste this document to a word-processing file on your desktop.

Step 2 Write a new and improved vision statement for Coca-Cola following the guidelines presented in this chapter.

Step 3 Explain in a paragraph how or why your proposed vision statement is better than the existing document.

Step 4 E-mail your work to your professor for evaluation.

EXERCISE 2B

Develop an Improved Coca-Cola Mission Statement

Purpose

Coca-Cola's mission statement is given on the corporate website at http://www.coca-colacompany.com/our-company/mission-vision-values. The purpose of this exercise is to evaluate Coca-Cola's mission statement and to develop a new and improved statement for the company.

Instructions

Step 1 Refer to the Cohesion Case (p. 57 on vision/mission). Go to the Coca-Cola website. Click on Our Company. Then click on Mission, Vision, and Values. Find the company's mission statement and copy and paste this document to a word-processing file on your desktop.

Step 2 Write a new and improved vision statement for Coca-Cola following the guidelines presented in this chapter.

Step 3 Explain in a paragraph how or why your proposed vision statement is better than the existing document.

Step 4 E-mail your work to your professor for evaluation.

EXERCISE 2C

Compare Coca-Cola's Mission Statement to a Rival Firm's

Purpose

A mission statement is an integral part of strategic management because it provides direction for formulating, implementing, and evaluating strategies. This exercise will give you practice evaluating mission statements—a prerequisite skill for writing a good mission statement. Coca-Cola's mission statement is given on the Coca-Cola website at http://www.coca-colacompany.com/our-company/mission-vision-values.

Instructions

Step 1 In a word-processing document, prepare a 9×2 matrix. Place the nine mission statement components down the left column. Across the top of the file have two columns, one being Coca-Cola and the other being PepsiCo or Dr Pepper Snapple.

Step 2 Write *Included* or *Not Included* in each cell of your matrix to indicate whether you feel each particular mission statement includes the respective mission statement component written from a customer perspective. Justify your opinion.

Step 3 E-mail your work to your professor for assessment.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 2D

Compare Your University's Vision and Mission Statements to Those of a Rival Institution

Purpose

Most colleges and universities have vision and mission statements. The purpose of this exercise is to give you practice comparing the effectiveness of vision and mission statements. For your university (or school of business), compare your college or school with a rival institution.

Instructions

Step 1 Determine whether your institution has a vision or mission statement. Look online or in the front of your college handbook. Analyze your college's vision and mission statements in light of the concepts presented in this chapter.

Step 2 Compare the vision statement and the mission statement of your college or university to those of a leading rival institution.

Step 3 Write a one-page summary of your analysis of the statements as per the needed 10 characteristics and 9 components presented in this chapter.

SET 3: STRATEGIC PLANNING FOR MYSELF

EXERCISE 2E

Develop a Vision and Mission Statement for Yourself

Purpose

A personal vision and mission statement can be helpful to an individual in job-related decisions and career paths. This exercise will give you practice developing and writing vision and mission statements from a personal perspective. For most college students nearing graduation, it is nearly inevitable to be faced with employability decisions. Developing vision and mission statements compels an individual to think about the nature and scope of their skills and abilities and to assess the potential attractiveness of future job opportunities and activities. These statements broadly chart the future direction of a person's life and serve as a motivating force and constant reminder of why the individual continuously gets up in the morning and works hard.

Instructions

Step 1 Develop a professional vision statement for yourself. Your statement should answer the question "What and where do I want to be professionally and personally in 3 to 5 years?"

Step 2 Develop a professional mission statement for yourself. Your statement should answer the question "What do I want to accomplish professionally and personally in the next 1 to 3 years?"

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 2F

What Is the Relative Importance of Each of the Nine Components of a Mission Statement?

Purpose

Research reveals that a mission statement should include all nine components to be most effective. For some companies or organizations, some components may be more important to include than others. Based on their experience, this exercise reveals the authors' ranking of the relative importance of nine mission recommended components for inclusion in an exemplary statement.

The purpose of this exercise is to examine how well students understand the components of a mission statement. In addition, the purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Instructions

Rank the nine mission statement components as to their relative importance (1 = most important, 9 = least important). First, rank the components as an individual. Then, rank the components as part of a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision making in strategic planning.

Steps

1. Fill in Column 1 in Table 2-8 to reveal your individual ranking of the relative importance of the nine components (1 = most important, to 9 = least important, etc.). For example, if you feel the Customer component is the fifth-most important, then enter a 5 in Table 1 in Column 1 beside Customers.
2. Fill in Column 2 in Table 2-8 to reveal your group's ranking of the relative importance of the nine components (1 = most important, to 9 = least important, etc.).
3. Fill in Column 3 in Table 2-8 to reveal the expert's ranking of the nine components.

TABLE 2-8 Mission Statement Analysis: Comparing Individual versus Group Decision Making

Components	Column 1	Column 2	Column 3	Column 4	Column 5
1. Customers					
2. Products					
3. Markets					
4. Technology					
5. Survival/Growth					
6. Philosophy					
7. Distinctive Competence					
8. Public Image					
9. Employee					
Sums					

4. Fill in Column 4 in Table 2-8 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 2-8 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

MINI-CASE ON FORD MOTOR COMPANY (F)

EVALUATE FORD'S VISION FOR THE FUTURE AND MISSION FOR THE PRESENT

Probst/Alamy Stock Photo

Headquartered in Dearborn, Michigan, Ford is the second-largest U.S. automobile maker, behind General Motors, and the fifth-largest automobile maker globally. Ford is considering changing its vision and mission because of electric vehicles gaining such rapid prominence worldwide. The company foresees a day soon across the United States where you pull up at any gas station and either gas up or plug in to get charged up. Ford is behind nearly all automakers in electric product offerings and is losing ground. This gas up or plug in scenario already exists in some parts of the world. Ford's survival going forward may hinge on an assessment of the company's vision and mission statements.

Current Vision Statement

People working together as a lean, global enterprise to make lives better through automotive and mobility leadership.

Proposed Vision Statement

To be the global automotive industry leader through innovations in automotive transportation and service to customers, employees, and the environment.

Key: Vision Statement Characteristics

1. Clear: reveals type of industry
2. Futuristic: reveals what the firm strives to become
3. Concise: one sentence in length
4. Unique: reveals the firm's competitive advantage
5. Inspiring: motivates the readers to support the firm

Proposed Mission Statement

Ford Motor Company strives to become the global automotive industry (3) leader delivering quality innovations to transportation (2) that meet the needs of our customers (1). We are dedicated to adapting the latest technology (4, 7), including electric batteries, to facilitate change and social connectivity through transportation (6). Our highly-trained professionals (9) support our efforts for continued growth and profitability (5) while keeping our promise of environmental responsibility and sustainability in our communities (6, 8).

Key: Mission Statement Components

1. Customers
2. Product or services
3. Markets
4. Technology
5. Survival, growth, and profitability
6. Philosophy
7. Distinctive Competence
8. Public image
9. Employees

Questions

1. In what three ways is Ford's proposed vision statement better than the firm's actual vision statement? Does the current or proposed statement meet the 5-out-of-5 test? If not, prepare a new statement.
2. Evaluate the extent that the proposed mission statement for Ford meets the 10 characteristics and includes the 9 components presented in the chapter.

Source: Based on information at http://corporate.ford.com/company.html?gnav=footer-aboutford, coupled with a variety of other sources.

Web Resources

1. **Example vision statements**
   This website provides more than 50 example vision statements.
   http://www.themarketingblender.com/vision-mission-statements/
2. **Example vision statements**
   This website provides about one hundred example vision statements.
   https://www.executestrategy.net/wp-content/uploads/2016/06/100-of-the-worlds-best-vision-statements.pdf
3. **Example mission statements**
   This website provides more than one hundred example mission statements from *Fortune* 500 companies.
   https://www.missionstatements.com/fortune_500_mission_statements.html
4. **Example mission statements**
   This website provides 51 example mission statements from some of the world's leading companies.
   http://www.alessiobresciani.com/foresight-strategy/51-mission-statement-examples-from-the-worlds-best-companies/

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7. Sebastian Desmidt, Anita Prinzie, and Adelien Decramer, A. "Looking for the Value of Mission Statements: A Meta-Analysis of 20 Years of Research," *Management Decision* 49, no. 3 (2011): 468.
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9. "How W. T. Grant Lost $175 Million Last Year," *Business Week* (February 25, 1975): 75. Drucker, *Management*, 88.
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3

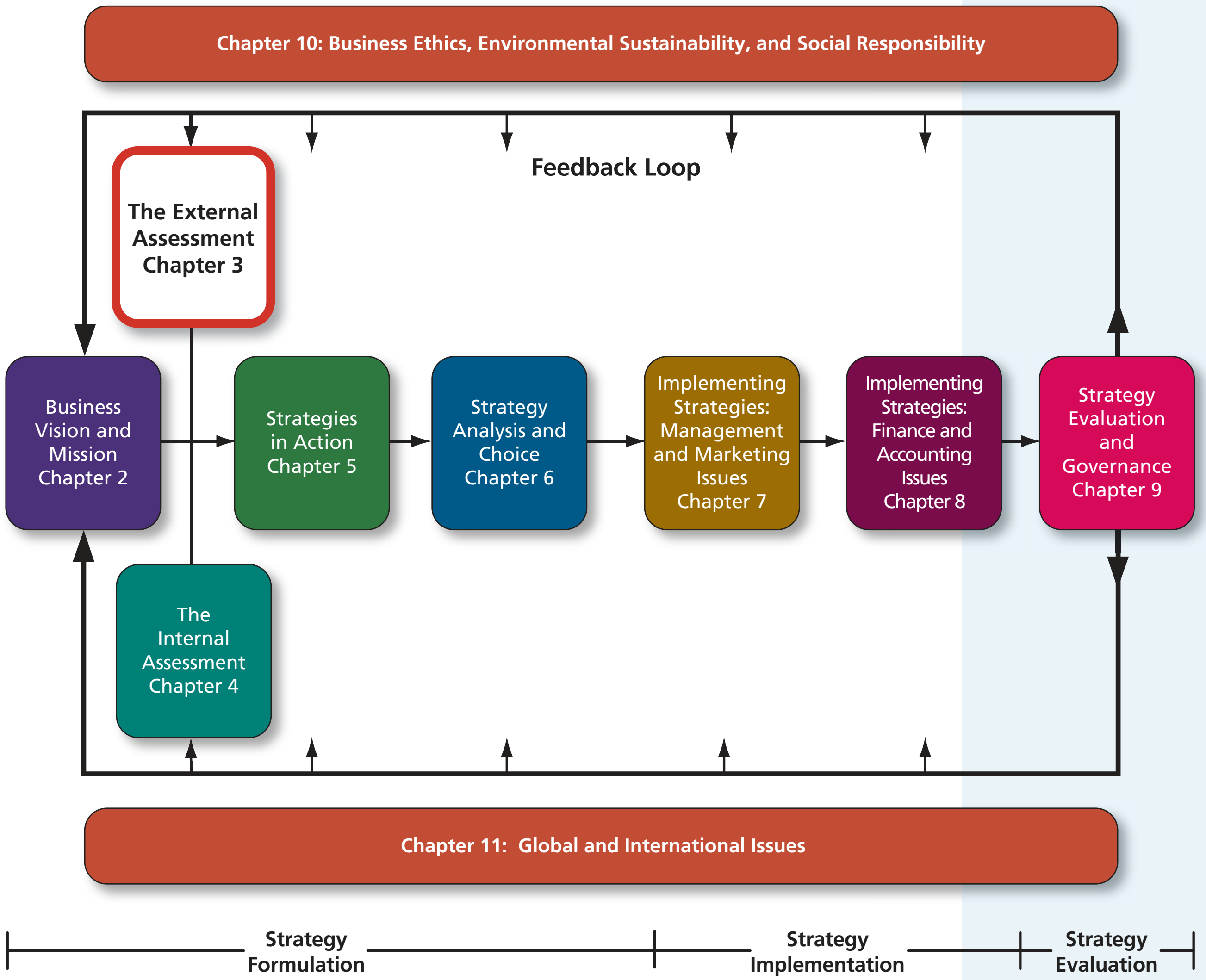

FIGURE 3-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, “How Companies Define Their Mission,” *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, “Balance Scorecard of David’s Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia,” *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

The External Assessment

LEARNING OBJECTIVES

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

3-1. Describe the nature and purpose of an external assessment in formulating strategies.

3-2. Identify and discuss 10 external forces that impact organizations.

3-3. Explain Porter's Five-Forces Model and its relevance in formulating strategies.

3-4. Describe key sources of information for identifying opportunities and threats.

3-5. Discuss forecasting tools and techniques.

3-6. Explain how to develop and use an External Factor Evaluation (EFE) Matrix.

3-7. Explain how to develop and use a Competitive Profile Matrix (CPM).

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1: Strategic Planning for Coca-Cola

EXERCISE 3A: Develop an EFE Matrix for Coca-Cola

EXERCISE 3B: Develop a Competitive Profile Matrix for Coca-Cola

SET 2: Strategic Planning for My University

EXERCISE 3C: Develop an EFE Matrix for Your College or University

EXERCISE 3D: Develop a Competitive Profile Matrix for Your College or University

SET 3: Strategic Planning to Enhance My Employability

EXERCISE 3E: How Competitive Is Your State among All States for Finding a Job?

EXERCISE 3F: Compare and Contrast CareerBuilder, Glassdoor, Monster Jobs, and ZipRecruiter

EXERCISE 3G: A Template Competency Test

SET 4: Individual versus Group Strategic Planning

EXERCISE 3H: What External Forces Are Most Important in Strategic Planning?

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Companies and organizations continually deal with external uncertainties and must quickly adapt to change to survive, as indicated in the following story:

> 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!"

As illustrated in Figure 3-1, this chapter focuses on the concepts and tools needed to manage external uncertainties by conducting an **external audit** (sometimes called **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, an aging society, and a social-media revolution. An external audit reveals key opportunities and threats confronting an organization; an external audit guides managers in formulating strategies that take advantage of the opportunities and avoid or reduce the impact of threats.

This chapter presents a practical framework for gathering, assimilating, analyzing, and prioritizing external information that provides a foundation for formulating strategies effectively. Specifically, the first two-thirds of this chapter address external opportunity/threat areas in terms of what, where, how, and why to obtain this information; the latter one-third of this chapter explains how to develop and use an External Factor Evaluation (EFE) Matrix and Competitive Profile Matrix (CPM) to assimilate all the opportunity/threat factors/information.

The exemplary strategist showcased in this chapter is Ben Silbermann, CEO and cofounder of Pinterest, the popular social-media company. Silbermann is outstanding at recognizing external opportunities and threats and formulating effective strategies accordingly.

EXEMPLARY **STRATEGIST** SHOWCASED

Pixellover RM 2/Alamy Stock Photo

Ben Silbermann, CEO and Cofounder of Pinterest

It is 2018 and Pinterest has grown to a valuation of more than $13 billion and a customer base of about 200 million users who have "pinned" more than 110 billion ideas on Pinterest boards. Led by CEO and strategist Ben Silbermann, Pinterest is one of the fastest-growing companies in the world. The Pinterest website (www.pinterest.com) is free to use and available in nearly 30 foreign languages. Headquartered in San Francisco, Pinterest has about 900 employees. Hundreds of companies advertise on Pinterest with display ads and "pin" their products and services on boards. The Pinterest website is a visual discovery, collection, and storage tool used by customers in the United States (60 percent) and abroad (40 percent). Thousands of businesses and marketers use Pinterest to access data collected on Pinterest customers, who interestingly are about 80 percent women, typically age 35 to 44. Silbermann has turned Pinterest into a global gold mine of data for advertisers and retailers. He says Pinterest is "only beginning to understand" how social media impacts consumers' lives, and he is blazing a new trail with an innovative, entrepreneurial company. Pinterest takes no commission or cut on transactions it processes and has no plans to go public to raise capital. A key advantage of staying private is to keep the ins and outs of business including the finance and marketing operations of the company, secret from rival companies, who may want to imitate and replicate Pinterest strategies and offerings.

Source: Erin Griffith, "Ben Silbermann," *Fortune*, (September 1–17, 2017): 69. Also, http://fortune.com/2015/07/13/pinterest-ceo-ben-silbermann/

The External Assessment Phase of Strategy Formulation

LO 3.1

The purpose of an external audit is to develop a finite list of both opportunities that could benefit a firm and threats that should be avoided or mitigated. 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 capitalize on external opportunities or that minimize the impact of potential threats. Figure 3-1 illustrates with white shading how the external audit fits into the strategic-management process.

Key External Forces

There are 10 **external forces** that can be divided into 5 broad categories: (1) economic forces; (2) social, cultural, demographic, and environment (SCDE) 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 3-2. External trends and events, such as increasing security concerns surrounding big data, changing consumer demand surrounding authenticity and personalization, and people in developing countries learning about online services, significantly affect products, services, markets, and organizations worldwide.

The Actionable-Quantitative-Comparative-Divisional (AQCD) Test

When identifying and prioritizing key external factors in strategic planning, make sure the factors selected meet the following four criteria to the extent possible:

1. Actionable (i.e., meaningful and helpful in ultimately deciding what actions or strategies a firm should consider pursuing);
2. Quantitative (i.e., include percentages, ratios, dollars, and numbers to the extent possible);
3. Comparative (i.e., reveals changes over time), and
4. Divisional (relates to the firm's products and/or regions (rather than consolidated) so inferences can be drawn regarding what products and regions are doing well or not).

Factors that meet the four criteria described above pass what can be called the "Actionable-Quantitative-Comparative-Divisional (AQCD) Test," which is a measure of the quality of an external factor. In addition to passing the AQCD Test, make sure that external factors are indeed external (not internal), and make sure that external factors, particularly opportunities, are stated as external trends, events, or facts, rather than being stated as strategies the firm could pursue. Also, make sure the external

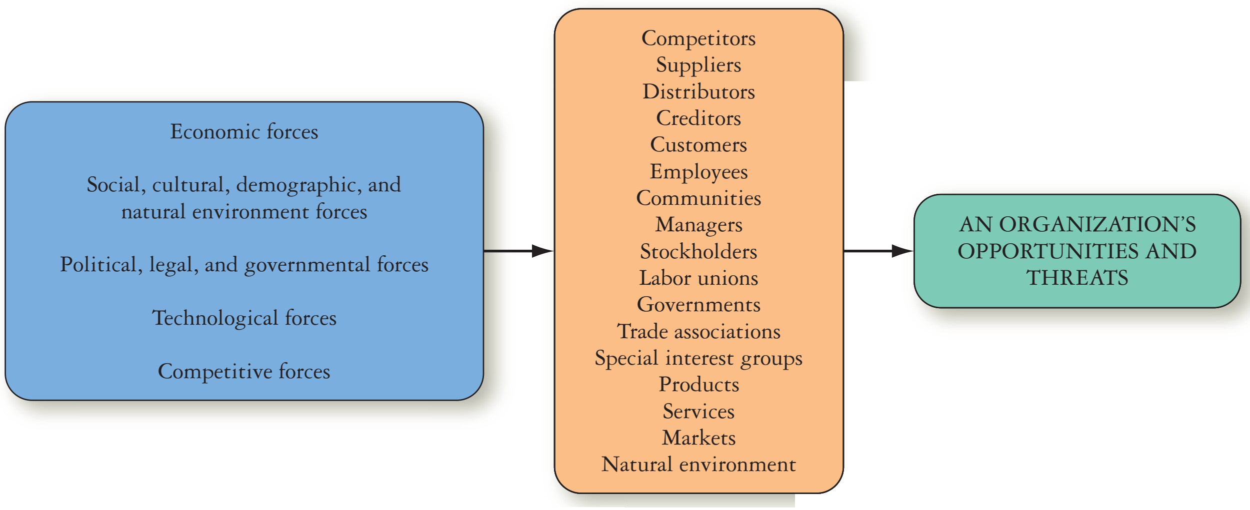

FIGURE 3-2

Relationships Between Key External Forces and an Organization

factors relate closely to the firm achieving its mission (opportunities) or hindering its mission (threats). Factors selected for inclusion in an external assessment should be mission-driven.

Regarding the AQCD criteria, strive to include all high quality factors in an external assessment for a firm. A high quality factor will meet three or four of the AQCD criteria; a low quality factor will meet two or fewer of the AQCD criteria. When performing an external assessment, engage in an engineering hunt for facts to make sure as many factors as possible pass the AQCD Test. It is important to state external factors to the extent possible in actionable, quantitative, comparative, and divisional terms.

High quality and low quality external factors for Walmart are given below to further exemplify this important concept:

	ASK YOURSELF IS THE FACTOR			
	Actionable	Quantitative	Comparative	Divisional
A High Quality External Factor				
Online retail grocery shopping grew from 12% to 16% in 2018.	yes	yes	yes	yes
A Low Quality External Factor				
Consumers' average disposable income increased greatly in 2018.	no	no	no	no

Changes in external forces translate into changes in demand for both industrial and consumer goods and services. External forces affect the types of products developed, the nature of market segmentation and positioning strategies, the range of services offered, and the choice of businesses to acquire or sell. External forces have a direct impact on both suppliers and distributors. Identifying and evaluating external opportunities and threats enables organizations to revise their vision and mission if needed, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives.

LO 3.2 10 External Forces that Impact Organizations

Economic Forces

Economic factors have a direct impact on the potential attractiveness of various strategies. An example of an economic variable is "value of the dollar," which can have a significant effect on financial results of companies with global operations. Domestic firms with significant overseas sales, such as McDonald's, are hurt by a strong dollar. If the dollar appreciates 10 percent relative to the local currency of a particular country in which a U.S. company has $100 million in revenues, that company's revenues would decrease by $10 million as they are translated into U.S. dollars. For foreign firms with relatively large U.S. sales, however, a strong dollar provides a boost. A strong dollar enables U.S. firms to purchase raw materials more cheaply from other countries. However, in early 2018, the value of the dollar was near a 3-year low versus foreign currencies.

Favorable economic conditions recently bode well for many firms because economic growth typically reduces unemployment, boosts consumer confidence, and increases disposable income. The World Economic Outlook report, published by the International Monetary Fund, predicts a broad-based global acceleration in the world economy; small, but wide-spanning growth (around 3.6 percent) is expected among most major economies in 2018–2021.[1]

A few categories of economic variables that often yield AQCD opportunities and threats for organizations are provided in Table 3-1. In doing strategic planning or case analysis, economic factors must be stated in AQCD terms to the extent possible to be useful in strategic planning.

TABLE 3-1 Example Economic Categories To Be Monitored

Shift to a service economy	Demand shifts for different goods and services
Availability of credit	Income differences by region and consumer groups
Level of disposable income	Price fluctuations
Propensity of people to spend	Foreign countries' economic conditions
Interest rates	Monetary and fiscal policies
Inflation rates	Stock market trends
Gross domestic product (GDP) trends	Tax rate variation by country and state
Consumption patterns	European Economic Community (EEC) policies
Unemployment trends	Organization of Petroleum Exporting Countries (OPEC) policies
Value of the dollar in world markets	
Import/export factors	

Social, Cultural, Demographic, and Environment (SCDE) Forces

SCDE forces impact strategic decisions 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 SCDE variables. These forces are shaping the way people live, work, produce, and consume. New trends are creating a shift in consumer demands and, consequently, a need for different products, new services, and updated strategies. For example, consumers in the United States now desire automobiles with greater space and utility, in lieu of sedans. In response to this external trend, Ford Motor recently invested $7 billion in higher-margin trucks and SUVs and announced plans to reintroduce the Ranger Trust and the Bronco SUV in North America.[2]

In the U.S. food industry, demand for processed packaged foods is declining because consumers are showing increased preferences for freshly prepared food options. Packaged food companies such as Kellogg are trying to quickly adapt to mitigate this external threat; Kellogg recently hired a new CEO, Steven Cahillane, who comes with extensive experience leading the health and wellness company, Nature's Bounty.

Consumer tastes and trends constantly change; people wander through stores less, opting increasingly to use their mobile phones and computers to research prices and cherry-pick promotions. Brick-and-mortar retail department stores consequently are struggling as consumers increasingly turn to online retailers and smaller specialty stores. These external trends have prompted many retail chains to slow or cease store openings.[3]

The United States (and the world) is also becoming older. Individuals age 65 and older in the United States, as a percentage of the population, will rise to 19 percent by 2030. The trend toward an older society is good news for restaurants, hotels, airlines, cruise lines, tours, travel services, pharmaceutical firms, automakers, and funeral homes. Older people are especially interested in health care, financial services, travel, crime prevention, and leisure. The aging population affects the strategic orientation of nearly all organizations.

Example categories of SCDE variables that often yield AQCD opportunities and threats for organizations are given in Table 3-2. In performing strategic planning and case analysis, relevant SCDE factors must be stated in AQCD terms to the extent possible to be useful in strategic planning.

Political, Governmental, and Legal Forces

Politics, governments, and legislators can and often do impact strategic decisions. Federal, state, local, and foreign governments are major regulators, deregulators, subsidizers, employers, and customers of organizations. Political, governmental, and legal factors, therefore, can represent major opportunities or threats for both small and large organizations. For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit. State and local income taxes and property taxes, for example,

TABLE 3-2 Key SCDE Variables

Population changes by race, age, and geographic area	Attitudes toward retirement
Regional changes in tastes and preferences	Energy conservation
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 places of worship
Per-capita income	Number of religious members
Social-media pervasiveness	Social responsibility issues

impact where companies locate facilities and where people desire to live. Nine U.S. states, for example, have zero state income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming, New Hampshire, and Tennessee.

Governmental legislation can significantly impact where businesses sell their products. For example, rapidly developing shifts in legislation surrounding the legality of marijuana are opening new markets for investors. Nearly a decade ago, Colorado passed the world's first legislation that would treat marijuana like alcohol, taxing and regulating its sales. U.S. consumers spent $6.7 billion on legal marijuana in 2016; this number is expected to reach $208 billion in 2021.

Example categories of political, governmental, and legal variables that often yield AQCD opportunities and threats to organizations are provided in Table 3-3. Political, governmental, and legal factors must be stated in AQCD terms to the extent possible to be useful in strategic planning. Local, state, and federal laws, as well as 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. As indicated in Ethics Capsule 3, new pending federal legislation regarding Alaska oil drilling could create business opportunities and threats and present ethical dilemma issues.

ETHICS CAPSULE 3

Preserve Alaska Wildlife or Boost Alaska Economy?

Tony Campbell/Shutterstock

Where Are We Going Mom?

Alaska is home to the largest wildlife refuge in the United States, the Arctic National Wildlife Refuge, which spans more than 19 million acres. The refuge serves an important role in the migration of wildlife including birds, caribou, and polar bears, and it is also believed to hold significant oil reserves. In December 2017, Congress voted to authorize drilling in Alaska's Arctic National Wildlife Refuge to boost the nation's energy independence and help the Alaskan economy. However, from an ethical perspective, the arctic program director for the Wilderness Society, Lois Epstein, states that, "Opening the Arctic refuge coastal plain to oil leasing, exploration, and production unacceptably threatens the Arctic refuge's globally significant wilderness and wildlife values." In performing an external strategic-management analysis, tradeoffs such as this abound and judgments must be made; decisions regarding tradeoffs are evidenced in the choice of factors, weights, and ratings assigned in an EFE Matrix presented in this chapter. Do you think the benefits from the potential drilling in the Refuge would offset the potential harm to Arctic wildlife? Government and environmental officials are weighing in on the issue as Congress discusses proposed legislation. What assurances would have to be made, if any, for you to approve of your company drilling in the Refuge?

Source: Based on Jim Carlton, "Interior Official Urges Arctic Drilling," *Wall Street Journal*, (November 3, 2017): A3.

TABLE 3-3 Example Political, Governmental, and Legal Categories To Be Monitored

Natural environmental regulations	United States versus other country relationships
Protectionist actions by countries	Political conditions in countries
Changes in patent laws	Global price of oil changes
Equal employment opportunity laws	Local, state, and federal laws
Level of defense expenditures	Import–export regulations
Unionization trends	Tariffs, particularly on steel and aluminum
Antitrust legislation	Local, state, and national elections

Technological Forces

A variety of new technologies such as the Internet of Things, three-dimensional (3D) printing, predictive analytics, quantum computing, robotics, and artificial intelligence are fueling innovation in many industries and impacting strategic-planning decisions. Businesses are using mobile technologies and applications to better determine customer trends and are employing advanced analytics to make enhanced strategy decisions. The vast increase in the amount of data coming from mobile devices and social-media sites is astonishing. A primary reason that Cisco Systems recently entered the data analytics business is that sales of hardware, software, and services connected to the Internet of Things is expected to increase to $7.1 billion by 2020 from approximately $2.0 billion in 2015. A recent report by Cognizant Technology Solutions Corp., an IT services and consulting firm, predicts that more than 20 new job categories are soon to emerge from technological advances.

Online retail is crushing traditional retail. Credit Suisse reports that more U.S. brick-and-mortar retail stores closed in 2017 than in the 2008 economic recession. U.S. online retail sales increased a whopping 24 percent in 2017, as consumers prefer having boxes delivered to their door. This technological trend is so pervasive that Walmart Stores, Inc. in 2018 changed their name to Walmart, Inc.—removing the word *stores*. In fact, in terms of online selling of groceries, Walmart is the leader in China, even though there are more than four hundred Walmart stores in China.

Advances in technology impact the manufacturing labor market. Ben Pring, Director of Cogniant's Center for the Future of Work estimates that nearly 19 million jobs in the United States will become obsolete or be replaced by automation in the next 15 years.[4] In a dramatic shift from employing people with low wages outside of the United States, Adidas is shifting to produce footwear in developed countries using fully robotic plants called "speed-factories." Adidas's speed-factories are now located across the world, including in Germany, the United States, France, China, and Japan. This shift from cheap manpower to complete automation is a technological revolution occurring in the footwear industry. Before new speed-factories, Adidas owned no factories, instead using more than one thousand suppliers that employ millions of people to assemble shoes at low-wage facilities globally. Adidas' new strategy aims to eventually surpass its major rival Nike.

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. In performing an external assessment, technology-related factors must be stated in AQCD terms to the extent possible to be useful in strategic planning. Technological advancements impact firms in countless ways, such as the following:

1. They can dramatically affect organizations' products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position.
2. They 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.
3. They 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.
4. They can create new competitive advantages that are more powerful than existing advantages.

A **chief information officer (CIO)** and **chief technology officer (CTO)** are common positions in firms today, reflecting 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 on demand. The CIO is primarily a manager, managing the firm's relationship with stakeholders; the CTO is primarily a technician, focusing on technical issues such as data acquisition, data processing, decision-support systems, and software and hardware acquisition.

Monitoring online reviews for businesses, large or small, has become a burdensome but essential task, especially given social-media channels, such as Twitter, that empowers opinionated customers. Benign neglect of a company's online reputation can quickly hurt sales, especially given the new normal behavior of customers consulting their smartphones for even the smallest of purchases.

Competitive Forces

Arguably the most important part of an external audit is identifying rival firms and determining their strengths, weaknesses, capabilities, objectives, and strategies. George Salk stated, "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." As indicated in Global Capsule 3, Netflix is faster than its rival firms but staying ahead requires constant monitoring of what those firms are doing and why. Go to www.owler.com for information about competitors.

Competition in virtually all industries is intense—and sometimes cutthroat. Within the smartphone and personal tech industry, for example, GoPro Inc. is struggling to maintain market share. To differentiate its offerings from the latest smartphone camera technologies offered by Apple and Samsung, GoPro developed a new product called Fusion that features a 360-degree spherical camera with a unique Over-Capture capability, enabling users to capture pictures from every angle simultaneously.

Addressing questions about competitors, such as those presented in Table 3-4, is essential in performing an external audit. **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). Quality competitive intelligence in business, as in the military, is one of the keys to success. 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:

- Reverse-engineer rival firms' products.
- Use surveys and interviews of customers, suppliers, and distributors of rival firms.
- Analyze rival firm's *Form 10-K*.
- Conduct fly-over and drive-by visits to rival firm operations.
- Search online databases and websites such as www.owler.com.
- Contact government agencies for public information about rival firms.

TABLE 3-4 Key Questions about Competitors

1. What are the strengths and weaknesses of our major competitors?
2. What products and services do we offer that are unique in the industry?
3. What are the objectives and strategies of our major competitors?
4. How will our major competitors most likely respond to current economic, SCDE, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are our major competitors to our new strategies, products, and services?
6. How vulnerable is our firm to successful counterattack by our major competitors?
7. How does our firm compare to rivals in mastering the social-media conversation in this industry?
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 are supplier and distributor relationships changing in this industry?

GLOBAL CAPSULE 3

What Company Is Growing Fastest Globally?

The answer to the question posed may be Netflix, a firm that pursues global expansion with a vengeance. Netflix added 4.45 million new international subscribers in the third quarter (Q3) of 2017 alone, with Q3 revenue increasing 30 percent. Netflix is taking advantage of the opportunity associated with the population of the world approaching 7.5 billion; the United States has slightly more than 320 million people. That leaves billions of people outside the United States 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 8.6 billion in 2030, 9.8 billion in 2050, and 11.2 billion in 2100.

Netflix is also mitigating an external threat in that some content owners such as Walt Disney Company are planning to offer their own movie- and video-streaming services instead of working with Netflix. Apple also expects to spend more than $1 billion in 2018 to produce its own original content. To combat this threat, Netflix is spending over $8 billion on content annually, substantially more than its rivals Hulu, Amazon.com, and HBO. Netflix is focused on signing creative talent and acquiring its own production and intellectual property. For example, the company recently made it first acquisition, taking onboard the comic-book publisher Millarworld. In addition to continued global expansion, Netflix's long-term strategy is to continue international expansion, rely less on licensing programs from content suppliers, and focus increasingly on acquiring original content.

Wavebreak Media Ltd/123RF

Enjoying a Netflix Movie

Source: Based on Austen Hufford, "Netflix Subscriber Growth Surges," *Wall Street Journal*, (October 17, 2017): B2.

- Monitor relevant trade publications, magazines, and newspapers.
- Purchase social-media data about customers of all firms in the industry.
- Hire top executives from rival firms.

Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants can make the difference between having superior or just average intelligence and overall competitiveness. All members of an organization—from the CEO to custodians—are valuable intelligence agents for the firm. Special characteristics of a successful CI program include flexibility, usefulness, timeliness, and cross-functional cooperation. CI is not corporate espionage. Unethical tactics such as bribery, wiretapping, and computer hacking should never be used to obtain information. Due to cybersecurity threats, CI must assure however that persons in a firm cannot access data and information unrelated to their job description because hackers exploit this avenue in firms.

In performing an external assessment, competitor-related factors must be stated in AQCD terms to the extent possible to be useful in strategic planning.

Porter's Five-Forces Model

LO 3.3

Harvard Business School Professor, Michael Porter, suggests that firms should strive to compete in attractive industries, avoid weak or faltering industries, and gain a full understanding of key external factors within that attractive industry. Given that competitive positioning within an industry is a key determinant of competitive advantage, Porter established the Five-Forces Model.

One of the major contributions of Porter's work is he shifted focus away from viewing competition directed toward a few rival firms to a broader analysis that includes forces from current competitors, new competitors, substitute products, suppliers, and buyers. Competitive advantage can be created in each area of the five forces by offering value to the consumer that exceeds cost. Rather than focusing solely on a top competitor, it is important that firms examine how suppliers and others listed in the five forces are trying to siphon off as much value as possible in all business transactions.

Porter's Model is also used to determine which industries to enter because generally the stronger the five forces are, the less profitable the industry. Porter is an advocate of external variables rather than internal ones being a larger driver of competitive advantage, similar to a rising or falling tide; it is difficult to overcome a rising tide no matter your internal capabilities. Porter's Model also prompts managers to focus on the medium- and longer-term factors that determine

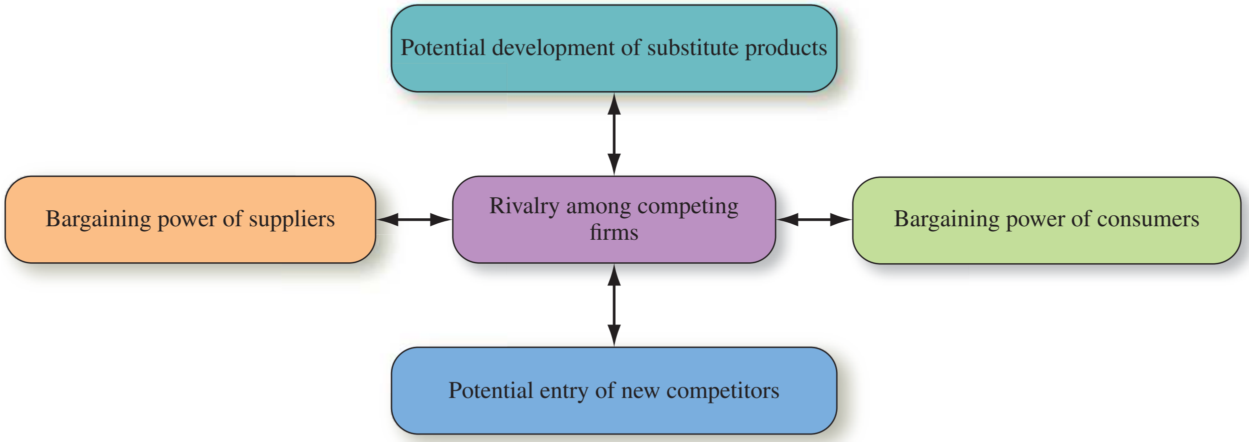

FIGURE 3-3
The Five-Forces Model of Competition

competitiveness, rather than short-term factors such as stock market movements, who won the election, or even something as trivial as inclement weather, which is often an excuse proposed by pundits on TV to explain slow Christmas sales. It is not that short-term factors are not important or have no impact, but they simply do not affect competition to the degree that long-term factors do, as revealed in the Five-Forces Model.

As illustrated in Figure 3-3, the **Porter's Five-Forces Model** offers guidance to strategists in formulating strategies to keep rival firms at bay. 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

Rivalry among Competing Firms

Rivalry among competing firms is usually the most powerful of the five competitive forces and the most traditional factor analyzed by managers. It is also the only factor most affected by changes in the other four factors. Strategies pursued by one firm can be successful only to the extent that they provide competitive advantage over the strategies pursued by rival firms. Intense rivalry among competitors in an industry can decrease overall industry profits because firms often lower prices or spend extra on advertising to maintain market share, often transferring profits directly to consumers and other players in the Five-Forces Model. Rivalry among competing firms increases for numerous reasons as given in Table 3-5, including an increase in the number of competitors and a shift towards competitors becoming more equal in size and capability.

As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive. 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—especially when a firm senses weakness from another. Although avoiding high-rivalry industries would be ideal, that is often easier said than done. At times it may be best to look for an industry with more favorable five forces and reduced rivalry, but firms can also compete within a similar or sub-industry by offering products targeting different customer groups with differentiated products. Offering differentiation helps all firms in the industry by moving away from competing on cost, where unique customers can be better served while maintaining profits for firms.

TABLE 3-5 Conditions that Cause High Rivalry among Competing Firms

1. When the number of competing firms is high
2. When competing firms are of similar size
3. When competing firms have similar capabilities
4. When demand for the industry's products is changing rapidly
5. When price cuts are common 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 competing firms
10. When products are perishable or have short product life cycles

Potential Entry of New Competitors

Whenever new firms can easily enter a particular industry, existing firms are likely to face threats of reduced market share. In such industries, a firm's strategies should deter new firms from entering the market to avoid further saturation of the market. Example barriers to entry can include economies of scale, specialized know-how, strong brand reputation, established customer loyalty, high capital requirements, absolute cost advantages, highly efficient supply chains, specialized distribution channels, access to key raw materials, and possession of patents. The automotive oil-change industry, for example, has relatively low barriers to entry; whereas the smartphone industry has much higher barriers to entry.

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take swift actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials. Even the threat of new entrants can increase rivalry and thus reduce profitability.

Potential Development of Substitute Products

In many industries, firms are in close competition with producers of substitute products in other industries. Examples are beer, wine, and liquor; public transportation and car, bike, and taxi/Uber; natural gas, electricity, and solar power; glass bottles, paperboard containers, and aluminum cans. A high threat of substitutes exists when consumer needs can easily be filled by one or more substitute products outside of the firm's industry. Competitive pressures arising from substitute products increase as the relative price of substitute products decline and as consumers' costs of switching decrease.

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. Substitute products can also come from places not normally expected. For example, a diamond producer may not consider a honeymoon package as a substitute for a less expensive ring. The bottom line with this "force" is that strategists must manage the potential threat of substitute products.

Bargaining Power of Suppliers

The bargaining power of suppliers refers to the ability of suppliers to raise the price of any inputs into the industry. This "force" affects the intensity of competitiveness in an industry, especially when there are few substitutes available for the product offered by suppliers, when the cost of switching to an alternative product offered by a different supplier is high, when the industry is not a key source of the supplier's revenues, or when there are few suppliers.

In some cases, firms pursue a backward-integration strategy to compete with suppliers. This strategy is especially effective when suppliers are unreliable, too costly, not capable of meeting a firm's needs on a consistent basis, or simply have too much bargaining power and are able to charge absorbent prices. Boeing and Airbus, the two largest jetliner manufacturers, are beginning to make a portion of the parts that go into planes because both firms determined too high of a proportion industry profitability was going to suppliers. A key lesson for suppliers is that if your customer has the means to backward-integrate, it may be best to renegotiate prices.

Overall, firms are in a better position when numerous suppliers exist. 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. In more and more industries, sellers are forging strategic partnerships with select suppliers in an effort to (1) reduce inventory and logistics costs, (2) accelerate the availability of next-generation components, (3) reduce defect rates, and (4) squeeze out important cost savings for both themselves and their suppliers.[5]

Bargaining Power of Consumers

Bargaining power of buyers refers to the ability of buyers to drive down prices for products offered by companies in a given industry. This force is strong when firms operate in industries that contain a limited number of buyers or that are made up of buyers that have multiple choices of where to buy from; this force is also strong when buyers purchase in volume or have low switching costs. Consumers (buyers) gain 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[6]

The impact of this "force" on industry competitiveness is higher when the products being purchased are standard or undifferentiated, enabling consumers to negotiate selling price, warranty coverage, and accessory packages to a greater extent. Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial. New car buyers, for example, often compare prices of their desired car across several dealerships, often negotiating lower prices and additional services from dealerships in exchange for their business.

As a result of Porter's Five Forces, the intensity of competition among firms varies widely across industries. Table 3-6 reveals the average operating profit for firms in different industries. Note substantial variation among industries, with the lowest being for bookstores. The collective impact of competitive forces is so brutal in some industries that the market is

TABLE 3-6 Competitiveness Across a Few Industries (2018 data)

Industry	Operating Profit (%)
Banking	30.8
Hotels	18.4
Pharmaceutical	8.7
Oil and Gas Extraction	7.5
Fragrances/Cosmetics	7.1
Telecommunications	6.1
Food Manufacturing	5.4
Machinery/Construction	4.9
Paper Manufacturing	4.9
Bookstores	2.9

clearly "unattractive" from a profit-making standpoint. Strategists must continually monitor the five forces to identify new opportunities and threats facing the firm, and alter strategies accordingly.

Eliminating competition is a possibility and common strategy employed by firms in an industry with high rivalry. Firms use mergers and acquisitions and purchase suppliers or buyers (distributors) all as a means to eliminate rivalry, but there are problems associated with this level of thinking. Acquiring the competition often is associated with paying a premium and dealing with different organizational cultures; although there may be no competitors currently, new competitors may enter with different products and ultimately better serve many current customers. Purchasing suppliers or distributors takes a firm away from the business they do best, possibly allowing competitors to better develop and improve their products without being bogged down with supply chain issues they know little about.

Several pitfalls firms should avoid when using the Five Forces Analysis, include (1) placing equal weight on all five forces instead of identifying the most pressing forces for their industry, (2) defining the industry too broad or too narrow, and (3) using the five forces to pin labels such as attractive or unattractive on an industry rather than using the model to more efficiently formulate strategies. When using Porter's Five Forces Model as an external assessment tool in doing strategic planning, strive to identify AQCD opportunities and threats most important for success in a given industry, and most relevant to the firm's vision and mission.

Key Sources of Information for an External Audit

LO 3.4

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 six outstanding ones that the authors use routinely in performing an external audit are:

1. http://finance.yahoo.com
2. www.hoovers.com
3. www.morningstar.com
4. www,mergentonline.com
5. http://globaledge.msu.edu/industries/
6. Corporate website of companies

The fifth website listed is operated by Michigan State University and provides industry profiles that are an excellent source for information, news, events, and statistical data for any industry. Most college libraries subscribe to excellent online business databases that can then be used free by students to gather information to perform a strategic-management case analysis. Simply ask your reference librarian. Some outstanding library database sources of external audit information are described in Table 3-7; the authors use all of these sources, especially S&P Net Advantage's *Industry Surveys* and IBISWorld, to obtain AQCD external factors for inclusion in an external assessment. Note also in Table 3-7 the PrivCo source is helpful for obtaining information about privately held firms; use www.owler.com for information about rival firms.

Forecasting and Making Assumptions

LO 3.5

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.

TABLE 3-7 Excellent Online Sources to Obtain EFE Matrix Factor Information

- **IBISWorld**—Provides online USA Industry Reports (NAICS), U.S. Industry iExpert Summaries, and U.S. Business Environment Profiles. A global version of IBIS is also available.
- **Lexis-Nexis Academic**—Provides online access to newspaper articles (including *New York Times* and *Washington Post*) and business information (including SEC filings).
- **Lexis-Nexis Company Dossier**—Provides online access to extensive, current data on 13 million companies. It collects and compiles information into excellent documents.
- **Mergent Online**—Provides online access to Mergent's Manuals, which include trend, descriptive, and statistical information on hundreds of public companies and industries. Unconsolidated company income statements and balance sheets are provided.
- **PrivCo**—Provides information on privately held companies, including private financials and revenues; private M&A deals and deal multiples, private firm valuations, VC funding, private equity deal history. (Go to www.owler.com for information about competitors.)
- **Regional Business News**—Provides comprehensive full-text coverage for regional business publications; incorporates coverage of more than 80 regional business publications covering all metropolitan and rural areas within the United States.
- **Standard & Poor's NetAdvantage**—Provides online access to Standard & Poor's (S&P) *Industry Surveys*, stock reports, corporation records, *The Outlook*, mutual fund reports, and more. Locate the "Company" tab at the top of the page or the "Simple Search" option located on the right side of the page. Use the "Company Profile" option.
- **Value Line Investment Survey**—Provides excellent online information and advice on approximately 1,700 stocks, more than 90 industries, the stock market, and the economy. Company income statements and balance sheets are provided.
- **U.S. Securities and Exchange Commission**—Provides the *Form 10K* for publicly held companies in the United States. Use the search box at the top of the page or look under the "Filings" tab along the top of the page.
- **Company Annual Reports On-Line (CAROL)**—Provides direct links to publicly held companies' financial statements in both Europe and the United States.

Source: Based on information at www.fmarion.edu/library.

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 use it to make educated assumptions (forecasts) that better guide our current decisions and foster 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 firms' assumptions.

No forecast is perfect; some 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.

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 managers have little if any control, but which may exert a significant impact on performance or the ability to achieve desired results."[7] 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.*

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. Firms that compile the best information generally make the most accurate assumptions, which can lead to major competitive advantages.

The External Factor Evaluation Matrix

LO 3.6

An **External Factor Evaluation (EFE) Matrix** allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. The EFE Matrix provides an empirical assessment of how well a firm is handling external factors overall, including the firm's effectiveness at capitalizing on opportunities and minimizing threats.

Steps to Develop an EFE Matrix

An EFE Matrix can be developed in five steps:

Step 1: Develop a Full and Narrow List of Key External Factors

Conduct research about the focal company using the resources listed in Table 3.7. Compile and organize information into two data sets, opportunities and threats, developing a full list of perhaps 50 to 100 opportunity and threat factors relevant to the 10 external areas described previously. Include factors most important to your firm's industry, vision, mission, and strategies, considering the five forces just discussed. Then, narrow your data sets down to 20 key external factors that include specifically 10 opportunities and 10 threats. (Note: We use 10 and 10 because organizations commonly use this breakdown and the template at www.strategyclub.com uses 10 and 10). List opportunities first and then threats. Also, do not include strategies as opportunities, so for example, "to build two new manufacturing plants in Europe" is a strategy, not an opportunity; there may be an underlying opportunity that could make that strategy reasonable, such as "eight European countries have repealed restrictions on the sale of generic drugs."

Firms determine the most important 20 factors among a full list usually by rating the factors according to importance (1 = least important to 10 = most important) and consolidating the rating data or by ranking the factors (1 = most important to 50 = least important) and consolidating the ranking data. Both methods will yield the 20 most important factors to include. The important point here is that companies (and students) never should include just the first 20 factors that come to mind. For example, someone recently included as a threat in his EFE Matrix that "a hurricane can come." Ninety-nine percent of the time that factor should not be included in the matrix; instead, conduct research to identify external factors that relate to the firm's vision, mission, strategies, and competitive advantages.

When determining particular factors to include in an EFE Matrix, and when assigning weights and ratings (Step 2) focus on a narrow industry perspective. For example, for Spirit Airlines, the industry is discount airlines, rather than all airlines, and for Lamborghini, the industry is high-end sports cars, not simply automobiles. This narrow industry perspective is important to facilitate external factors being stated in terms that meet the AQCD Test discussed earlier.

In developing a list of key external factors, be mindful of the AQCD Test because vagueness in stating factors must be avoided; vagueness gives analysts no guidance in assigning weights or ratings in developing an EFE Matrix. Recall that Edward Deming said, "In God we trust. Everyone else bring data." Include "actionable" factors as defined previously in this chapter.

Step 2: Assign Weights to Key External Factors

In developing an EFE Matrix, assign a weight that ranges from 0.01 (not important) to 1.0 (all-important) for each factor. The weight assigned to a given factor indicates the relative importance of the factor for being successful in the firm's industry relative to other factors included in the EFE. For example, a factor receiving a weight of 0.06 is 200 percent more important than a factor receiving a weight of 0.02 for success in the industry. Regardless of whether a key factor for a particular firm is an opportunity or threat, factors considered to have the greatest affect on organizational performance of all firms in a specific industry should be assigned the highest weights. The sum of all weights must equal 1.0. Do not try to even weights out to total 0.50 for opportunities and 0.50 for threats. In fact, if rivalry is high in a given industry, as discussed in the Porter's Five Forces section, then the sum of weights assigned to threats could be higher than the sum for opportunities. Weights are industry-based, not company-based. List opportunities from highest weight to lowest weight; do the same for threats.

Step 3: Assign Ratings to Key External Factors

In developing an EFE Matrix, assign a rating between 1 and 4 to each key external factor to indicate how effectively (or ineffectively) the firm's strategies are responding to the opportunity or threat, where 4 = the response is superior, 3 = the response is above average, 2 = the response is average, and 1 = the response is poor. Both opportunities and threats can receive a rating of 1, 2, 3, or 4 at any time. Ratings are based on the effectiveness of a firm's strategies in capitalizing on opportunities or avoiding/mitigating threats. Ratings are company-based, not industry-based.

Assignment of numerical values down the rating column in an EFE Matrix should be with consideration that companies carve out niches in industries that enable them to gain and sustain competitive advantages through effective strategies. These niches are most often based on capitalizing on some opportunities more effectively than rivals. This is not to say that threats are not important, they are; some threats can wipe a firm out. However, if a firm faces many opportunities, this is likely the result of effective strategies positioning the firm well, so higher ratings are often warranted for opportunities; higher ratings increase the total weighted score in an EFE Matrix.

As an example, the luxury car maker Ferrari could receive a high rating on a price competitiveness external factor, even though their sports cars are expensive because price competitiveness is not a deciding factor (low weight) for customers in the luxury sports car industry. Thus, in assigning ratings, as with weights, consider a subset of the industry in make effective judgments.

Step 4: Obtain Weighted Scores

Along each row in an EFE Matrix, multiply the factor's weight by its rating to determine a weighted score for each factor.

Step 5: Obtain Total Weighted Score

Sum the weighted scores to determine the total weighted score for the organization. Regardless of how many factors are included in an EFE 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 at responding to external factors, implying that new strategies are likely needed and perhaps a new direction, new vision or mission. Total weighted scores well above 2.5 indicate a strong external position, whereby a continuation of current strategies may be prudent, being ever mindful that there is always room for improvement. A total weighted score of 3.5 for example 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 weighted score of 1.5 indicates that the firm's strategies are not capitalizing on opportunities or avoiding external threats. Making "small" decisions regarding weights and ratings in matrices is essential for making effective big strategy decisions later in the strategic-planning process; for example, a billion dollars may be at stake in choosing a particular strategy over another to implement, and the EFE Matrix with its factors, weights, and ratings is helpful in making that type of choice.

An Example EFE Matrix

An example EFE Matrix is provided in Table 3-8 for a local 10-theater cinema complex. Observe in the table that the most important factor to being successful in this industry is "Trend toward healthy eating eroding concession sales," as indicated by the 0.12 weight. Also note that the local cinema is doing excellent (received a rating of 4) in regard to its handling of two external 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.

Overall, the total weighted score of 2.58 is above the average (midpoint) of 2.5, so this cinema business is doing slightly above average taking advantage of the external opportunities and minimizing external 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, the business needs to capitalize more on the "Two new neighborhoods developing within 3 miles" opportunity and work to avoid the "movies rented from … Time Warner" threat.

An actual EFE Matrix for one of the largest U.S. grocery retailers, Kroger, is given in Table 3-9 on page 110. As shown, the most important external factor facing Kroger, as indicated by a weight of 0.10, deals with Amazon acquiring Whole Foods Market. Kroger's key factors are listed in order from the most important (highest weight) to the least important. Notice how the factors largely meet the AQCD test. Recall that mathematically, 0.04 is 33 percent more important than 0.03, and a rating of 3 is 50 percent higher than a rating of 2. Small judgments regarding assignment of weights and ratings in matrices are vital for making effective larger decisions related to deployment of resources and money across regions and products.

Overall, the total weighted score of 3.03 is above the average (midpoint) of 2.5, indicating that Kroger is doing pretty well at taking advantage of the external opportunities and minimizing the threats facing the firm. There is definitely room for improvement, though, because the highest total weighted score would be 4.0. The rating of 1 for "The National Retail Federation estimates an 8–12% U.S. e-commerce growth in the next year," for example, suggests that Kroger should better capitalize on this opportunity, perhaps by expanding its online offerings.

TABLE 3-8 EFE Matrix for a Local 10-Theater Cinema Complex

Key External Factors	Weight	Rating	Weighted Score
Opportunities			
1. Two new neighborhoods developing within 3 miles	0.09	1	0.09
2. TDB University is expanding 6% annually	0.08	4	0.32
3. Major competitor across town recently closed	0.08	3	0.24
4. Demand for going to cinemas growing 10%	0.07	2	0.14
5. Disposable income among citizens up 5% in prior year	0.06	3	0.18
6. Rowan County is growing 8% annually in population	0.05	3	0.15
7. Unemployment rate in county declined to 3.1%	0.03	2	0.06
Threats			
1. Trend toward healthy eating eroding concession sales	0.12	4	0.48
2. County and city property taxes increasing 25%	0.08	2	0.16
3. Movies rented at local Redboxes up 12%	0.08	2	0.16
4. Demand for online movies growing 10%	0.06	2	0.12
5. Commercial property adjacent to cinemas for sale	0.06	3	0.18
6. Movies rented last quarter from Time Warner up 15%	0.06	1	0.06
7. Local religious groups object to R-rated movies	0.04	3	0.12
8. TDB University installing an on-campus movie theater	0.04	3	0.12
Total	**1.00**		**2.58**

TABLE 3-9 An Actual EFE Matrix for Kroger Co.

Opportunities	Weight	Rating	Weighted Score
1. Organic & natural food sales in the United States totaled $47 billion, an increase of nearly $3.7 billion from the previous year.	0.09	4	0.36
2. Online grocery spending is forecasted to grow from 4.3% of the total U.S. food and beverage sales to 20% by 2025.	0.07	3	0.21
3. Sales growth in the grocery industry is 3.8% annually.	0.07	4	0.28
4. Organic food sales increased 8.8% to $55 billion.	0.05	2	0.1
5. Convenience store lunch and dinner services contribute 21.7% of in-store sales.	0.05	2	0.1
6. The National Retail Federation estimates an 8% to 12% U.S. e-commerce growth in 2019.	0.05	1	0.05
7. Global food retail sales are about $4 trillion annually, led by supermarkets/ hypermarkets.	0.04	2	0.08
8. GDP of United States increased from 2.2% to 3.1%.	0.04	2	0.08
9. The Private Label Manufacturer's Association notes that private label products are 25% to 50% cheaper than national brands, appealing to customers who value affordability.	0.03	1	0.03
10. Studies show that 51.2% of Internet users make online purchases using mobile apps.	0.01	3	0.03
Threats	**Weight**	**Rating**	**Weighted Score**
1. Amazon spent $13.7 billion to acquire 460 brick-and-mortar Whole Foods Market stores.	0.10	2	0.2
2. Target is investing $7 billion to update and downsize its stores and develop new exclusive brands between 2018 and 2020.	0.08	1	0.08
3. Walmart's fiscal 2017 revenue was $485.8 billion, up $9.4 billion, or 0.78%. Kroger's total revenue is $115.3 billion.	0.07	3	0.21
4. Fast-food revenue exceeds $600 billion annually; it is rising 15% annually.	0.05	2	0.1
5. E-commerce sales as percentage of total retail sales is nearly 10%, and rising 3% annually.	0.05	1	0.05
6. Walmart groceries cost about 4% less than Kroger's.	0.04	2	0.8
7. Walmart.com now offers more than 67 million products, a 30% increase this year.	0.03	1	0.03
8. Walmart created its own "designer" cantaloupe that "tastes as sweet in winter as it does in summer," and a more flavorful tomato is in the works.	0.03	2	0.06
9. Publix Supermarket is growing 12% a year.	0.03	4	0.12
10. Aldi's U.S. grocery market is growing 15% a year.	0.02	3	0.06
Total	**1.00**		**3.03**

LO 3.7 The Competitive Profile Matrix

The **Competitive Profile Matrix (CPM)** reveals how a focal firm compares to major competitors across a range of key factors. This comparative analysis provides important strategic information regarding a firm's competitive advantages or disadvantages in a given industry. In determining what factors to include in a CPM, tailor the factors to the particular industry. For example, in the airline industry, such factors as on-time arrival, leg room in planes, and routes served are far better factors to include than merely including "quality of service" or "financial condition" as factors.

Similar to an EFE, a CPM uses weights and total weighted scores, which quantify the importance of a given factor to the industry, as well as total weighted scores, which quantify how well a given firm is doing relative to the other two firms evaluated in the CPM. The key difference between a CPM and EFE is that a CPM compares firms and an EFE Matrix analyzes how a firm internally is responding to key external issues. Critical success factors include points of competitive advantage within an industry, as well as other factors that are crucial for a firm to succeed within a given industry; *critical success factors* in a CPM can include both internal and external issues. List critical success factors from highest weight to lowest weight in a CPM.

Weights in a CPM are industry-based and sum to 1.0. Ratings in a CPM are assigned to quantify how well a firm and its key competitors are performing on each critical success factor; ratings reveal the degree of effectiveness of the firm's strategies. Assign a rating between 1 and 4 to each key 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 company-based; weights are industry-based.

A sample CPM is provided in Table 3-10. 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, including a weight column yields a more robust analysis because it enables the analyst to capture perceived or actual levels of importance. Note in Table 3-10 that Company 1's strategies are responding in a superior fashion to "product quality," as indicated by a rating of 4, whereas Company 2's strategies are superior regarding "advertising." Overall, Company 1's strategies are responding best, as indicated by the total weighted score of 3.15 and Company 3 is responding worst. Never duplicate ratings in a row in a CPM; go ahead and make judgments or decisions as to appropriate ratings based on your research and knowledge of the focal firm and rival companies. (Note: The point of this example is to illustrate the mechanics of developing a CPM rather than having industry-specific factors.)

Other than the critical success factors listed in the sample 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. In generating the list of critical success factors, strive to include factors that differentiate firms within the industry (i.e., factors that determine competitive advantages).

Just because one firm receives a 3.20 overall total weighted score 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 performing better on the variables included in the CPM. Regarding weights in a CPM or EFE Matrix, be mindful that 0.08 is mathematically 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.

TABLE 3-10 **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
Global Expansion	0.20	4	0.80	1	0.20	2	0.40
Financial Position	0.15	4	0.60	2	0.30	3	0.45
Management	0.10	4	0.40	3	0.20	1	0.10
Product Quality	0.10	4	0.40	3	0.30	2	0.20
Customer Loyalty	0.10	4	0.40	3	0.30	2	0.20
Price Competitiveness	0.10	3	0.30	2	0.20	1	0.10
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 = response is poor, 2 = response is average, 3 = response is above average, 4 = response is superior. As indicated by the total weighted score of 2.20, Company 3 is performing worst. Only 8 critical success factors are included for simplicity; in actuality, however, this is too few. The template asks that 12 factors be included and to tailor factors to a given industry.

TABLE 3-11 An Actual CPM for Kroger Company

		Kroger Company		Walmart Inc.		Amazom.com Inc.	
Critical Success Factors	Weight	Rating	Score	Rating	Score	Rating	Score
Price Competitiveness	0.17	3	0.51	4	0.68	2	0.34
Product Quality	0.13	2	0.26	3	0.39	1	0.13
Multiple Formats	0.10	4	0.40	3	0.30	1	0.10
Market Penetration	0.09	4	0.36	3	0.27	2	0.18
Customer Loyalty	0.08	2	0.16	4	0.32	3	0.24
Name Recognition	0.08	1	0.08	4	0.32	3	0.24
Store Locations	0.07	2	0.14	4	0.28	1	0.07
Customer Service	0.07	2	0.14	3	0.21	4	0.28
Market Share	0.06	2	0.12	4	0.24	1	0.06
Financial Profit	0.05	2	0.10	4	0.20	3	0.15
Distribution System	0.05	2	0.10	3	0.15	4	0.20
Advertising	0.05	1	0.05	4	0.20	2	0.10
Total	**1.00**		**2.42**		**3.56**		**2.09**

An actual CPM is provided in Table 3-11, again for Kroger Company. Note that the two rival firms, Walmart and Amazon, receive higher ratings than Kroger on several critical success factors, including distribution system, advertising, and customer service, for example. Also note the factors are listed beginning with the most important (highest weight). Note there is no duplication of ratings across a row and that Kroger is responding worse than Walmart and Amazon on "name recognition" and "advertising."

IMPLICATIONS FOR STRATEGISTS

Figure 3-4 reveals that to gain and sustain competitive advantages, strategists must collect, analyze, and prioritize information regarding the firm's competitors, as well as identify and consider relevant social, demographic, economic, and technology trends and events impacting the firm and its industry. It is not uncommon for there to be substantial discussing, perhaps even some cussing, in deliberating what external factors should be included in an EFE Matrix, because factors included ultimately impact the firm's strategies and direction. An engineering hunt for external facts is essential because resultant strategies can be expensive and sometimes irreversible. Survival of the firm can hinge on an effective, thorough external assessment being performed.

This chapter reveals that actionable, quantitative, comparative, divisional (AQCD) information is a key ingredient for making strategic decisions. The EFE Matrix and Competitive Profile Matrix presented in this chapter are excellent strategic-planning tools for assimilating and prioritizing information to enhance decision-making.

The Process of Performing an External Audit

In performing an external audit, involve as many managers and employees as possible because involvement leads to understanding and commitment; individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firm's industry, competitors, markets, and strategies. An effective way to gather competitive intelligence and information across the 10 forces discussed in this chapter is to ask various managers to monitor particular sources of information, such as key magazines, trade journals, newspapers, and online sources. These persons can submit periodic scanning reports to the person(s) who coordinate the external audit. This approach provides a continuous stream of timely strategic information and involves many individuals in the external-audit process. Suppliers, distributors, salespersons, customers, and competitors represent other sources of vital information.

After external-audit information is gathered, it should be assimilated into an EFE Matrix and CPM as described herein. To accomplish this task, some firms conduct a meeting or series of meetings to collectively determine the most important opportunities and threats facing the firm. A prioritized list of these factors can be obtained by requesting all managers to individually rank the factors identified, from 1 (for the most important opportunity/threat) to 20 (for the least important opportunity/threat). Then, by summing the rankings, a prioritized list of factors is revealed. Prioritization is absolutely essential in strategic planning because no organization can do everything that would benefit the firm; tough choices among good options have to be made; in both an EFE Matrix and CPM factors are listed from most important (highest weight) to least important. Even a full list of more than 50 factors can be distilled to the 20 most important in the manner described.

FIGURE 3-4
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

In developing and presenting the external assessment for your firm, be mindful that gaining and sustaining competitive advantage is the overriding purpose of developing the EFE Matrix and CPM. During this "external" section of your written or oral project, emphasize how and why particular factors can yield competitive advantage for the firm. In 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 recommendations, can subdue rival firms or at least profitably compete with them. Showcase during this part 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 doing case analysis. To obtain the most recent information about your case company, read the firm's most recent quarterly report; the narrative that accompanies quarterly reports is excellent.

It is necessary for students in developing an EFE Matrix to include specific (AQCD) factors related to direct competitors, trends in the economy, legal or tax issues, consumer attitudes, consumer demographics, and other similar facts, trends, and events. In addition, there are factors associated with Porter's Five Forces that may need including. For example, you may want to include factors such as the following:

1. China recently established four free-trade zones allowing foreign companies to establish operations in the country without having a Chinese partner; this may be an external threat because rival firms can enter the market more easily, such as in the automobile industry.
2. Potential substitute products may be a threat. For example, consumption of bottled water rising 8 percent annually is a threat for Dr Pepper Snapple.
3. Suppliers in any industry can potentially siphon away profits as easily as a direct competitor; suppliers raising prices by 10 percent may be an external threat.

Chapter Summary

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 provided a framework for collecting and evaluating economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. The AQCD Test was explained to assure that opportunities and threast as stated in an EFE Matrix are actionable, qualitative, comparative, and divisional to the extent possible.

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 EFE Matrix, CPM, and Porter's Five-Forces Model can help strategists evaluate their 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 responses (p. 95)
chief information officer (CIO) (p. 100)
chief technology officer (CTO) (p. 100)
competitive intelligence (CI) (p. 100)
Competitive Profile Matrix (CPM) (p. 110)
external audit (p. 94)
External Factor Evaluation (EFE) Matrix (p. 107)
external forces (p. 95)
industry analysis (p. 94)
information technology (IT) (p. 100)
just-in-time (p. 104)
Porter's Five-Forces Model (p. 102)

Issues for Review and Discussion

3-1. Explain why it is important to develop both a full and narrow list of key external factors in developing an EFE Matrix.

3-2. Explain the significance of an EFE Matrix total weighted score of 3.67 versus a 1.59.

3-3. What does a CPM total weighted score of 1.88 imply for a company?

3-4. In an EFE Matrix, should the weights for opportunities be designed to roughly equal the weights for threats? Why?

3-5. List the 10 external forces discussed in this chapter. When and why would some forces be more important than others?

3-6. How have external factors resulted in a major overhaul to the traditional retail industry as we once knew it?

3-7. Provide a synopsis of IBISWorld, Mergent Online, and PrivCo.

3-8. Compare and contrast the EFE Matrix with a CPM in terms of value provided for a strategist in performing an external assessment.

3-9. Mathematically, how much more important is a rating of 4 compared to a rating of 3? Why is this concept important in developing strategic-planning matrices?

3-10. Describe how political elections can be an important external factor for companies to consider. Select an industry and reveal some key political factors impacting firms.

3-11. List some legal or ethical ways to gather competitive intelligence. List some illegal or unethical ways.

3-12. As the value of the dollar rises, U.S. firms doing business abroad see their profits fall, so some firms raise prices of their products to offset the decrease in profits. What are some risks of raising prices?

3-13. Does McDonald's Corp. benefit from a low or high value of the dollar? Explain why.

3-14. Explain how Facebook, Twitter, and Instagram can represent a major threat or opportunity for a company.

3-15. If your CPM has three firms and they all end up with the same total weighted score, would the analysis still be useful? Why?

3-16. What external factors impact the ability of state to attract business? Visit the website: https://www.cnbc.com/2017/06/12/heres-how-your-state-can-become-a-cnbc-top-state-for-business.html and summarize how the selection criteria used to determine the best states for business compares to the information presented in this chapter.

3-17. Governments sometimes use "protectionism" to cope with economic problems, imposing tariffs and subsidies on foreign goods as well as placing restrictions and incentives on their own firms to keep jobs at home. What are the strategic implications of protectionism for international commerce?

3-18. Rank order the relative importance of Porter's five forces in the business of operating a college or university.

3-19. Let's say you work for McDonald's and you applied Porter's Five-Forces Model to study the fast-food industry. Rank the five forces as to relative importance for strategic planning at McDonald's.

3-20. Explain why it is appropriate for ratings in an EFE Matrix to be 1, 2, 3, or 4 for any opportunity or threat.

3-21. Why is inclusion of about 20 factors recommended in the EFE Matrix rather than about 10 factors or about 40 factors?

3-22. In developing an EFE Matrix, explain why is it advantageous to arrange your opportunities according to the highest weight, and your threats likewise?

3-23. In developing an EFE Matrix, would it be best to have 10 opportunities and 10 threats or would 17 opportunities (or threats) be fine with 3 of the other to achieve a total of 20 factors as desired?

3-24. Could or should critical success factors in a CPM include external factors? Explain.

3-25. Explain how to conduct an external strategic-management audit in a business versus as a student performing case analysis.

3-26. Identify a recent economic, social, political, or technological trend that significantly affects the local Pizza Hut.

3-27. Discuss the following statement: Major opportunities and threats usually result from an interaction among key environmental trends rather than from a single external event or factor.

3-28. Use Porter's Five-Forces Model to evaluate competitiveness within the U.S. banking industry.

3-29. How does the external audit affect other components of the strategic-management process?

3-30. Construct an EFE Matrix for an organization of your choice.

3-31. Let's say your boss develops an EFE Matrix that includes 62 factors. How would you suggest reducing the number of factors to 20?

3-32. Discuss the ethics of gathering competitive intelligence.

3-33. Discuss the ethics of cooperating with rival firms.

3-34. Do you agree with Porter's view that competitive positioning within an industry is a key determinant of competitive advantage(s)?

3-35. Define, compare, and contrast the weights versus ratings in an EFE Matrix.

3-36. What is the different between factors listed in an EFE Matrix versus critical success factors listed in a CPM? In which matrix is it particularly important to include specific, actionable factors? Why?

3-37. List the 10 external forces that give rise to opportunities and threats.

3-38. Why do annual reports often state external risk information in really vague terms; why should strategists avoid including such vagueness in developing an EFE Matrix?

3-39. Explain the AQCD Test for determining the quality of an external factor. Why should the AQCD Test be met to the extent possible in performing an external assessment?

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 3A

Develop an EFE Matrix for Coca-Cola

Purpose

This exercise will give you practice in developing an EFE Matrix. An EFE Matrix summarizes the results of an external audit. This is an important strategic-planning tool widely used by strategists.

Instructions

Step 1 Join with two other students in class, and jointly prepare an EFE Matrix for Coca-Cola. Refer to the Cohesion Case (p. 56) and to Exercise 1A (p. 65), if necessary, to identify external opportunities and threats. Make sure the factors you include are actionable, quantitative, comparative, and specific. Use the online sources listed in Table 3-7. 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 team's score.

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 3B

Develop a Competitive Profile Matrix for Coca-Cola

Purpose

Monitoring competitors' performance and strategies is a key aspect of an external audit. This exercise is designed to give you practice in evaluating the competitive position of organizations in a given industry and assimilating that information in a CPM.

Instructions

Step 1 Turn back to the Cohesion Case and review the section on competitors (p. 56). Also view online resources that compare Coca-Cola with Pepsi. Use the sources listed in Table 3-7.

Step 2 Prepare a CPM that includes Coca-Cola, Pepsi, and Dr Pepper.

Step 3 Turn in your CPM for a classwork grade.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 3C

Develop an EFE Matrix for Your College or University

Purpose

Most colleges and universities do strategic planning. Institutions are consciously and systematically identifying and evaluating external opportunities and threats facing higher education in your state, the nation, and the world.

Instructions

Step 1 Join with two other individuals in class and jointly prepare an EFE Matrix for your institution.

Step 2 Go to the board and record your total weighted score in a column that includes the scores of all three-person teams participating. Put your initials after your score to identify it as your team's score.

Step 3 Which team viewed your college's strategies most positively? Which team viewed your college's strategies most negatively? Discuss the nature of the differences.

EXERCISE 3D

Develop a Competitive Profile Matrix for Your College or University

Purpose

Your college or university competes with all other educational institutions in the world, especially those in your own state. State funds, students, faculty, staff, endowments, gifts, and federal funds are areas of competitiveness. Other areas include athletic programs, dorm life, academic reputation, location, and career services. The purpose of this exercise is to give you practice in thinking competitively about the business of education in your state.

Instructions

Step 1 Identify two colleges or universities in your state that compete directly with your institution for students. Interview several persons, perhaps classmates, who are aware of particular strengths and weaknesses of those universities. Record information about the two competing universities.

Step 2 Prepare a CPM that includes your institution and the two competing institutions. Include the following 10 factors in your analysis:

1. Tuition costs
2. Quality of faculty
3. Academic reputation
4. Average class size
5. Campus landscaping

6. Athletic programs
7. Quality of students
8. Graduate programs
9. Location of campus
10. Campus culture

Step 3 Submit your CPM to your instructor for evaluation.

SET 3: STRATEGIC PLANNING TO ENHANCE MY EMPLOYABILITY

EXERCISE 3E

How Competitive Is Your State among All States for Finding a Job?

Purpose

Just like companies, states compete against each other across numerous variables. For more than a decade, CNBC has been conducting annual research to determine where each U.S. state ranks (out of the 50 states) in terms of their quality of life, job prospects, business attractiveness, and education, among many other things. Each year, data is collected on more than 60 measures of competitiveness and all 50 states are scored on each measure, ranging from economic policies and taxes, to the cost of food, to the quality of their workforces.

The purpose of this exercise is to determine how your state ranks in terms of its job outlook and prospects. This information can enhance your job search as you near completion of a business administration degree.

Instructions

Step 1 Go to the following website https://www.cnbc.com/2017/07/11/top-states-to-find-a-job-in-america-in-2017.html and take a while to explore the types of reports offered, as well as the source of data collected and used to create such reports.

Step 2 Review where your state ranks on the list of top states for business, top states to get an education, and top states to find a job. Determine the three best competitive aspects of your state.

Step 3 Are there similarities between your state's ranking on each of these three reports? Do you think job outlooks, education, and business attractiveness are inherently related? Develop a report explaining your answer. Use information from the reports to support your arguments. What actions could your state take to improve its competitiveness overall?

EXERCISE 3F

Compare and Contrast CareerBuilder, Glassdoor, Monster Jobs, and ZipRecruiter

Purpose

Job hunting websites compete against each other for your business. Both job seekers and companies with job openings use job hunting websites, especially CareerBuider, Glassdoor, Monster Jobs, and ZipRecruiter. The purpose of this exercise is to familiarize you with the operation, strengths, and weaknesses of these four websites.

Instructions

Step 1 Review the four named websites taking note of what you especially like and dislike.

Step 2 Prepare a CPM for CareerBuilder. Include the three rival websites in your analysis.

EXERCISE 3G

A Template Competency Test

Purpose

The free Excel strategic planning template at www.strategyclub.com is widely used for strategic planning by students and small businesses; this exercise aims to enhance your familiarity with the template. Developing competence with the template will enable you to place this skill appropriately on your resume, in addition to facilitating your development of a comprehensive strategic plan for an assigned case company.

Instructions

Answer the following six questions about the template. Discuss your answers with classmates to determine any issues or concerns.

Questions

1. How many factors does the template include in an EFE Matrix; in a CPM?
2. What happens using the template if you enter an inappropriate rating or weight such as a weakness rating of 4 or a weight of 1.2?
3. In using the template, why are changes to a matrix done on Part I or Part II rather than on a matrix itself?
4. Why is it best to transform a firm's income statement and balance sheet into the template financial statement format early in developing a strategic plan for a case company?
5. What are key differences between Part I and Part II in the template?
6. Does the template address vision and/or mission statements?

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 3H

What External Forces Are Most Important in Strategic Planning?

Purpose

A prioritized list of external factors is needed for effective strategic planning. Oftentimes the process entails all managers individually ranking the factors identified, from 1 (most important) to 20 (least important). Prioritization is absolutely essential in strategic planning because no organization can do everything that would benefit the firm; tough choices among good choices have to be made.

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. For some companies or organizations at various times, some forces may be more important to include than others. This exercise reveals the authors' ranking of the relative importance of five external forces for inclusion in an external assessment.

The purpose of this exercise is to examine more closely the external areas of a business. In addition, the purpose of this exercise is to examine whether individual decision-making is better than group decision-making. Academic research suggests that groups make better decisions than individuals about eighty percent of the time.

Instructions

Rank the five external forces as to their relative importance (1 = most important, 5 = least important). First, rank the forces as an individual. Then, rank the forces as part a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision-making in strategic planning.

Steps

1. Fill in Column 1 in Table 3-12 to reveal your individual ranking of the relative importance of the five forces (1 = most important, 2 = next most important, etc.). For example, if you feel Economic factors are the 4th most important external force, then enter a 4 in Table 3-12 in Column 1 beside Economic.
2. Fill in Column 2 in Table 3-12 to reveal your group's ranking of the relative importance of the five forces (1 = most important, 2 = next most important, etc.).
3. Fill in Column 3 in Table 3-12 to reveal the expert's ranking of the five forces.

4. Fill in Column 4 in Table 3-12 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregard negative numbers)
5. Fill in Column 5 in Table 3-12 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision-making is superior to individual decision-making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

TABLE 3-12 External Force Analysis: Comparing Individual versus Group Decision-Making

External Forces	Column 1	Column 2	Column 3	Column 4	Column 5
1. Economic					
2. Social/Cultural/ Demographic/ Environment					
3. Political/ Governmental/Legal					
4. Technological					
5. Competitive					
Sums					

MINI-CASE ON SAM'S CLUB

SAM'S CLUB IS BOOMING IN CHINA

Kevin Foy/Shutterstock

Sam's Club in the United States has struggled to attract affluent shoppers. However, in China, Sam's Club targets high-income consumers, and specifically affluent mothers with young children. Sam's Club does a great job at positioning itself for the wealthy Chinese target market. Advertised as a trusted place with imported goods and high-quality foods, Sam's Club stores are located in China's most affluent cities. Its success thus far in China can be attributed largely to its effective market segmentation, targeting, and positioning.

Many large firms have trouble doing business in China despite the country's high GDP, rising levels of disposable income, shift to becoming a high-tech nation, and growing middle class. But Walmart's Sam's Clubs are booming in China. Three of the top five Sam's Clubs by sales are located in China. Rather than positioning itself as a place for bulk items and closeouts, Sam's Clubs in China are positioned as a place for high-quality products and foods. For example, eggs are guaranteed to be less than 12 days old and all have a serial number that customers can enter into their smartphone and see the production date and origin.

Sam's in China benefits from not having to "do battle" with Costco Wholesale; Costco does no business in China. Sam's has roughly 2 million members in China, many whom are affluent moms age 35 to 40, a primary target group. The number of Sam's stores in China is expected to increase from 20 at the start of 2018 to 40 by 2020. Sam's in China recently provided "two-kid seat" carts in all stores to take advantage of China recently relaxing its "one-child policy."

Another feature of Sam's stores in China is extra large parking lots; nearly all customers drive to Sam's and ample parking is greatly appreciated in a country where crowded and expensive parking is the norm otherwise. Sam's strategies in China are an excellent example of how a firm must adapt it policies, procedures, features, and actions when it enters a foreign land to capitalize on external opportunities and threats in that country. What works in one country quite likely needs changing in another; pushing the same business model globally has spelled doom for many firms that enter China, and then soon withdraw.

Questions

1. Consider the following two-dimensional matrix with weights on the *y*-axis and ratings on the *x*-axis, as given in Figure 3-5. What are example opportunities and threats that could possibly characterize Sam's Club in China in the four corners of the matrix? Develop a hypothetical opportunity and threat for Sams's that could be positioned in each of the four corners of the matrix. Give a supporting rationale for each factor. Which corner of the matrix do you think characterizes factors most commonly in an EFE Matrix? Why? Which corner of the matrix do you think characterizes factors least commonly in an EFE Matrix? Why? What could you say about the middle of the matrix in terms of factors commonly included in an EFE Matrix?

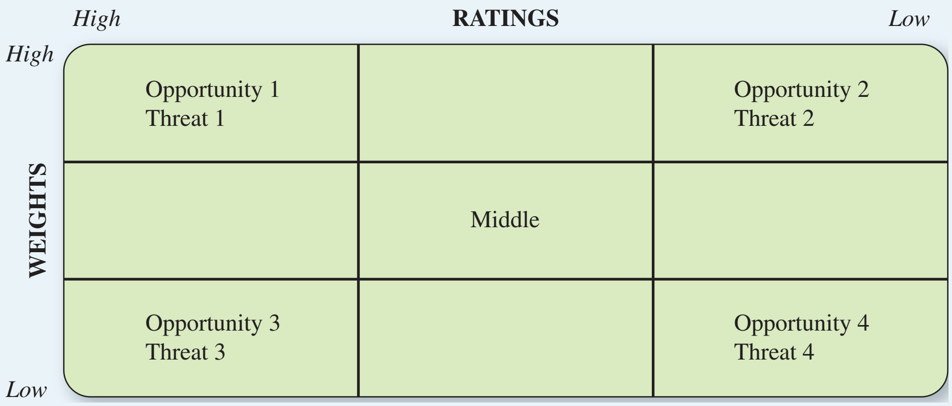

FIGURE 3-5

A Weights-by-Ratings Matrix to Exemplify EFE Matrix Logic

Note: A purpose of this mini-case is to give students practice thinking about when, in developing an EFE Matrix, could a particular factor receive the following weights and ratings:

1. a low weight and high rating
2. a high weight and high rating
3. a low weight and low rating
4. a high weight and low rating

Source; Based on Wayne Ma, "In China, Sam's Goes Up Market and Scores," *Wall Street Journal*, (December 8, 2017): B1.

Web Resources

1. http://finance.yahoo.com
2. www.hoovers.com
3. www.morningstar.com
4. www,mergentonline.com
5. http://globaledge.msu.edu/industries/
6. See Table 3-7 for Excellent Library Databases

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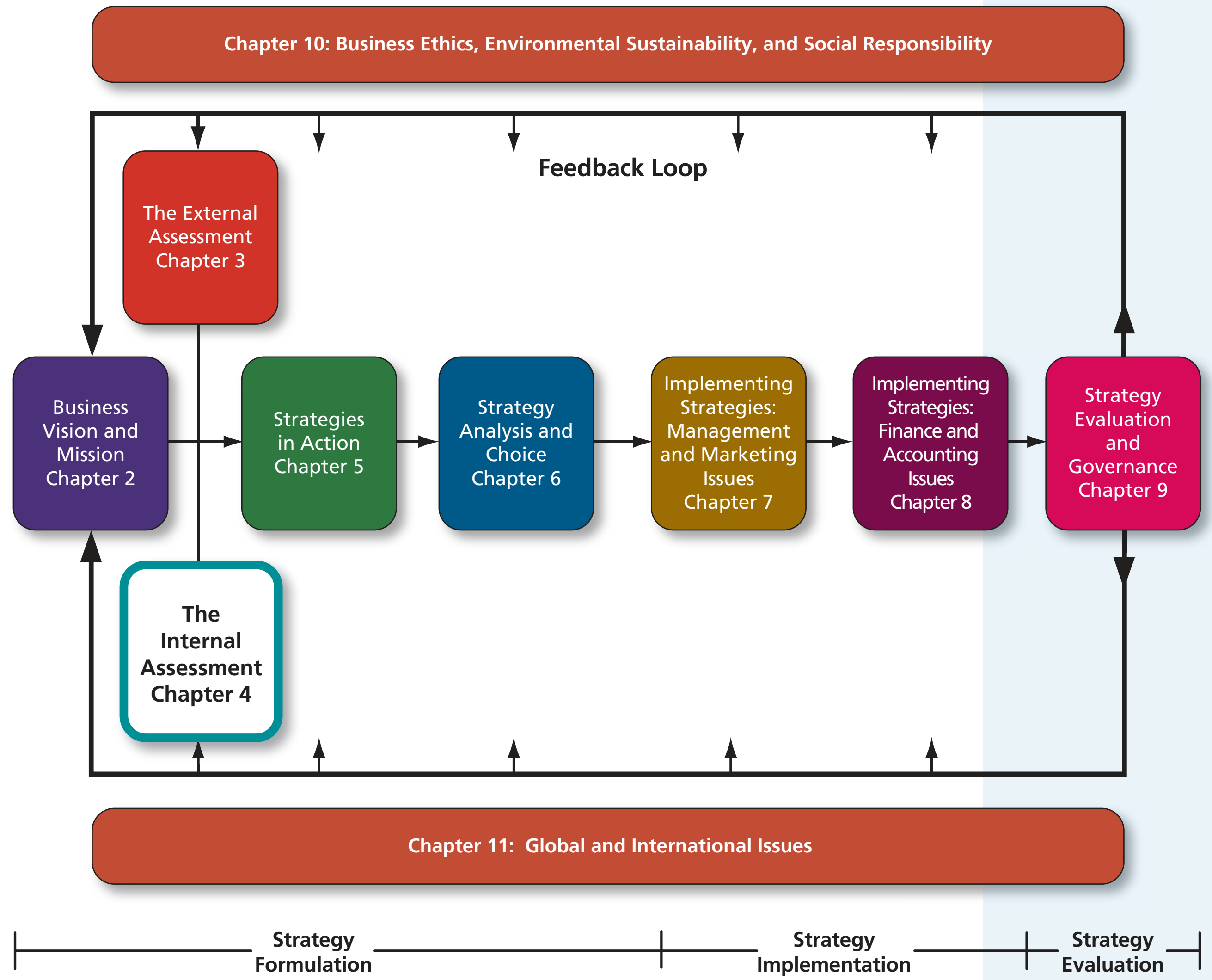

FIGURE 4-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

The Internal Assessment

LEARNING OBJECTIVES

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

4-1. Describe the nature and role of an internal assessment in formulating strategies.

4-2. Discuss the nature and role of management in formulating strategies.

4-3. Discuss the nature and role of marketing in formulating strategies.

4-4. Discuss the nature and role of finance and accounting in formulating strategies.

4-5. Discuss management information systems (MIS) in terms of formulating strategies.

4-6. Explain how to develop and use an Internal Factor Evaluation (IFE) Matrix.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1: Strategic Planning for Coca-Cola

EXERCISE 4A: Perform a Financial Ratio Analysis for Coca-Cola

EXERCISE 4B: Develop an IFE Matrix for Coca-Cola

SET 2: Strategic Planning for My University

EXERCISE 4C: Construct an IFE Matrix for Your College or University

SET 3: Strategic Planning for Myself

EXERCISE 4D: Construct an IFE Matrix for Yourself

SET 4: Individual versus Group Strategic Planning

EXERCISE 4E: What Internal Functional Areas Are Most Important to Examine in Strategic Planning?

MyLab Management

Improve Your Grade!

If your instructor is using MyLab Management, visit **www.pearson.com/mylab/management** for videos, simulations, and writing exercises.

This chapter focuses on identifying and evaluating a firm's strengths and weaknesses in the functional areas of business, including management, marketing, finance, accounting, and management information systems (MIS). Careful evaluation of a business' functional areas is necessary to determine the firm's core competencies and understand whether the firm's current strategy is effectively working to provide a sustainable competitive advantage. One excellent way to evaluate the effectiveness of a firm's strategy is to study the firm's financial performance relative to competitors and industry averages. Financial information alone, however, cannot provide a complete assessment of the effectiveness of a firm's strategy, and strategists as well as students of strategy must dig deep into management, marketing, finance, accounting, and MIS issues simultaneously to fully understand why a firm's strategy is effective or not.

The first two-thirds of this chapter address potential strengths and weaknesses in the functional areas cited in terms of what, where, how, and why to obtain this information; the latter one-third of this chapter explains how to assimilate and use this information through development and evaluation of an Internal Factor Evaluation (IFE) Matrix.

Showcased as an exemplary strategist, Elon Musk does an excellent job using his company's internal strengths to capitalize on external opportunities. Elon Musk has founded four different billion-dollar companies, PayPal, SolarX, Solar City, and Tesla. Once called a "technologist," Musk is revolutionizing the power and transportation industries and changing the world as we know it today.

LO 4.1 The Internal Assessment Phase of Strategy Formulation

All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. 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 4-1 with white shading.

EXEMPLARY **STRATEGIST** SHOWCASED

Elon Musk, CEO and Cofounder of Tesla, Inc. and Space Exploration Technologies Corporation (SpaceX)

NASA

On the way to Mars?

For more than a decade, Elon Musk has been a U.S. exemplary strategist on a mission to develop his rocket-ship company SpaceX and send humans on a 7-month, 34-million-mile journey to Mars. Headquartered in Los Angeles County, Musk's SpaceX already ferries supplies to and from the International Space Station. While pioneering private space exploration and preparing to colonize planets, Musk has also catapulted Tesla to be the world's leader in batteries that supply energy for cars, trucks, homes, businesses, and rockets.

SpaceX and Tesla aren't the only companies started by Musk; he also started two other billion-dollar companies, PayPal and Solar City. Named the "Architect of the Future," Musk was recently featured as a *Rolling Stones Magazine* cover story, highlighting his "world-changing plans to inhabit outer space, revolutionize high-speed transportation, and reinvent cars." As explained in Musk's own words, his ambition stems in part by his unfettered optimism for the future of human existence:

> Fundamentally, the future is vastly more exciting and interesting if we are a space-faring civilization and multi-planetary species than if we are not.

Musk told his more than 17 million Twitter followers in late 2017 that Tesla in 2020 would manufacture an F-150–type pickup truck except all electric, following the company's 2019 release of an all-electric commercial semitrailer truck.

Source: Based on Brian Deagon, "The New Space Race," *Investor's Business Daily*, September 11, 2017, B1 & B6. Also based on: http://www.rollingstone.com/culture/features/elon-musk-inventors-plans-for-outer-space-cars-finding-love-w511747 and https://www.cnbc.com/2017/11/21/how-tesla-and-elon-musk-became-household-names.html

Some researchers emphasize the importance of the internal-audit part of the strategic-management process by comparing it to the external audit in importance. Robert Grant, for example, 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.[1]

Resource-Based View

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. Proponents of RBV theory contend that a firm's performance is primarily determined by internal resources that enable the firm to exploit opportunities and neutralize threats. A firm's resources can be tangible, such as labor, capital, land, plant, and equipment, or intangible, such as culture, knowledge, brand equity, reputation, and intellectual property. Because tangible resources can more easily be bought and sold, intangible resources are often more important for gaining and sustaining competitive advantages.

A resource can be considered valuable to the extent that it is (1) rare, (2) hard to imitate, or (3) 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 (not held by many firms in the industry), hard to imitate (hard to copy or achieve), and not easily substitutable (invulnerable to threat of substitution from different products), the stronger a firm's competitive advantage will be and the longer the advantage will last. Valuable resources comprise strengths that a firm can capitalize on to prosper in a given industry.

The basic premise of RBV theory 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.

As indicated in the Ethics Capsule 4, exploiting a firm's unique resources and capabilities can present ethical dilemmas.

Key Internal Forces

An internal strategic-management assessment includes analysis of how strong or weak a firm is in each functional area of business, including management, marketing, finance, accounting, and MIS. Uniqueness or distinctive competences a firm has or lacks in each area provides the foundation for identifying strength and weakness factors. Strengths that cannot be easily matched or imitated by competitors are called **distinctive competencies**. It is of paramount importance in strategic planning to capitalize on and nurture strengths because competitive advantages generally arise more from strengths, uniqueness, and distinctive competencies than from weaknesses. Improving on weaknesses, however, is a vital task for all organizations and generally helps to improve efficiencies, weaknesses are unlikely to develop into sustainable competitive advantages, thus stressing the importance of nurturing strengths.

It is impossible in a strategic-management text to review in depth all the material presented in prior business courses; there are many subareas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing. However, strategic planning must include a detailed assessment of how the firm is doing in all internal areas. Thus, an overview of each of the functional business areas from a strategy perspective is provided here. Regardless of the type or size of firm, effective strategic planning hinges on identification and prioritization of internal strengths and weaknesses because a firm must

ETHICS CAPSULE 4

The Sagebrush Lizard versus the Big Oil Man

Petr Podrouzek/123RF

I need help from people.

The state of Texas leads the United States in crude oil production. West Texas, in particular, is home to the largest oil deposit ever discovered in the continental United States. With an estimated 20 billion barrels of oil, valued at more than $900 billion, West Texas has become a mecca for oil and gas companies. Warm weather, a sophisticated labor and equipment industry, and favorable geological formations all contribute to efficient drilling productions in West Texas. Numerous reservoirs can be drilled simultaneously through a process called *fracking*, in which a high-pressure mixture of water, sand, and chemicals is forcefully injected into the rock, causing gas to be released. Texas oil drilling helps oil and gas companies, boosts the Texas and U.S. economies, adds jobs, increases exports, reduces imports, and lowers gas prices for everybody. These touted benefits make the oil drilling seem like a good, ethical practice, but there is a dark side.

What many don't know is that the unique sand used in fracking in West Texas is also home to the dunes sagebrush lizard, a 3-inch long, tan-colored animal that lives only in a small portion of a few counties in West Texas and Southeastern New Mexico. The pretty, picky little lizard may soon be added to the federal endangered species list; more than half of the lizard's habitat has been taken over by miners and drillers, such as big Ben Brigham. Brigham has made hundreds of millions of dollars as a Texas oilman and claims to be working with biologists to recreate the sagebrush lizard's habitat and relocate the lizards to a new area that resembles the lizard's home ecosystem. From an internal analysis perspective, do you think Brigham's established oil-drilling operations and current production procedures that yield the benefits described offset the possibility of the sagebrush lizard becoming extinct? Investors, environmentalists, and policy makers are meeting in hopes of finding an appropriate solution.

Source: Based on Christopher M. Matthews, "It's Lizard vs. Oil Magnate In the Latest Fracking Fight," *Wall Street Journal*, (October 14, 2017): A1, A10.

continually capitalize on its strengths and improve on its weaknesses to gain and sustain competitive advantage.

LO 4.2 Management

There are four basic activities that comprise management: planning, organizing, motivating, and controlling. An overview of these activities is provided in Table 4-1 because an organization should continually capitalize on its strengths and improve on its weaknesses in these four areas.

TABLE 4-1 The Basic Functions of Management

Function	Description	Stage of Strategic-Management Process When Most Important
Planning	Planning consists of all managerial activities related to preparing for the future, such as establishing objectives, devising strategies, and developing policies.	Strategy Formulation
Organizing	Organizing includes all managerial activities that result in a structure of task and authority relationships, such as organizational design, job specialization, job descriptions, span of control, job design, and job analysis.	Strategy Implementation
Motivating	Motivating involves efforts directed toward shaping human behavior, such as leadership, communication, teamwork, job enrichment, and human resource management (HRM).	Strategy Implementation
Controlling	Controlling refers to all managerial activities that compare actual results with planned results, such as quality control, financial control, inventory control, expense control, analysis of variances, rewards, and sanctions.	Strategy Evaluation

Planning

Planning is the essential bridge between the present and the future; planning increases the likelihood of achieving desired results. Even though planning is considered the foundation of management, it is the task that managers most commonly neglect. Planning enables a firm to:

1. Take into account relevant factors and focus on the critical ones
2. Ensure that the firm is prepared for all reasonable eventualities and can make timely changes and adapt as needed
3. Gather the resources needed and carry out tasks in the most efficient way possible
4. Conserve its own resources and avoid wasting natural resources
5. Assess whether the effort, costs, and implications associated with achieving desired objectives are warranted
6. Be proactive, anticipate, and influence the future

Planning is more than simply projecting past and present trends into the future (long-range planning). Planning also includes revising a firm's vision and mission, forecasting future events and trends, establishing objectives, and choosing strategies to pursue. Successful organizations strive to guide their own futures rather than merely react to external forces and events as they occur. Historically, organisms and organizations that adapt well to changing conditions survive and prosper; others become extinct.

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.

Strengths and weaknesses with respect to planning could relate to: (1) quality of a firm's vision or mission and how well the firm's strategies support the vision or mission, (2) divisions' relative contribution to the firm's performance, and (3) resource allocation across regions and products.

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.

The organizing function of management can be viewed as consisting of three sequential activities: breaking down tasks into jobs, combining jobs to form departments, and delegating authority. 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.[2]

Organizing includes developing an appropriate structure, span of control, and chain of command. Structure dictates how resources are allocated and how objectives are established in a firm. Changes in strategy often require changes in structure because positions may be created, deleted, or merged. The most common types of structure are discussed in Chapter 7. Strengths and weaknesses with respect to organizing could relate to (1) how well the firm's current structure matches the various divisions and strategy of the firm, (2) the degree to which a clear chain of command is displayed through executive titles, and (3) the extent of overlap among related jobs and job descriptions.

Motivating

Motivating is the process of influencing people to accomplish specific objectives. Motivation helps explain why some people work hard and others do not. Strategies have little chance of succeeding if employees are not motivated to implement them once they are formulated. The motivating function of management includes such activities as developing leaders, managing groups, communicating effectively, and managing organizational change.

When managers and employees of a firm strive to achieve high levels of productivity, this indicates that the firm's strategists are excellent leaders—persons that establish rapport with subordinates, empathize with their needs and concerns, set a good example, and are trustworthy and fair. An excellent leader communicates a vision of the firm's future and inspires people to work hard to achieve that vision. Stressing the importance of leadership, Sun Tzu stated, "Weak leadership can wreck the soundest strategy." According to Peter Drucker:

> 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.[3]

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.

Human resource management (HRM) 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. The complexity and importance of HRM has increased to such a degree that all but the smallest organizations generally have a full-time human resource manager. As employees and managers come and go, HRM must manage this process effectively to maintain employee morale and minimize workplace stress. Table 4-2 reveals several of many ways that effective HRM can help create and maintain a competitive advantage for organizations. The type of HRM information listed in Table 4-2 could be the source of a firm's strengths or weaknesses with respect to the overall motivation of managers and employees.

Controlling

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 (the focal topic of Chapter 9). 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

TABLE 4-2 Six Ways Human Resource Management Can Provide a Competitive Advantage

1. Analyze turnover rates to determine where problems may lie.
2. Measure and monitor employee engagement and morale scores.
3. Track employee data to identify high and low performers.
4. Determine going market rates for talent and align compensation with company goals.
5. Design employee development and training pathways that take into account the strategic and long-term needs of the organization.
6. Provide guidance on legal issues related to all personnel matters.

Source: Based on information from http://hrdailyadvisor.blr.com/2017/08/21/using-hr-competitive-advantage/

TABLE 4-3 The Basic Decisions Areas Within Production/Operations

Decision Areas	Example Decisions
1. Process	Robotics, facility layout, process flow analysis, line balancing, process control, and transportation analysis.
2. Capacity	Forecasting, facilities planning, aggregate planning, scheduling, capacity planning, queuing analysis, and capacity utilization.
3. Inventory	Level of raw materials, work-in-process, finished goods, what to order, when to order, how much to order, and materials handling.
4. Workforce	Managing the skilled, unskilled, clerical, and managerial employees by caring for job design, work measurement, job enrichment, work standards, and motivation techniques.
5. Quality	Quality control, sampling, testing, quality assurance, and cost control.

Source: Based on a variety of sources.

The **production/operations** portion of a business consists of all those activities that transform inputs (raw materials, labor, capital, machines, and facilities) into finished goods and services. The extent to which a manufacturing plant's output reaches its full potential output is called **capacity utilization**, a key strategic variable. The higher the capacity utilization, the better; otherwise, equipment may sit idle. For example, if a manufacturing firm's plants are averaging 60 percent capacity utilization, that would represent a severe weakness of the firm.

As indicated in Table 4-3, Roger Schroeder suggests that production/operations comprises five decision areas: process, capacity, inventory, workforce, and quality. Production/operations activities often represent the largest part of an organization's human and capital assets. In many industries, the major costs of producing a product are incurred within operations, so production/operations can have great value as a competitive weapon in a company's overall strategy. Strengths and weaknesses in the five areas of production can mean the success or failure of an enterprise.

Increasingly in production settings, a new breed of robots called **collaborative machines** are working alongside people. Priced as low as $20,000 and becoming widely used even in small businesses, robots do not take lunch breaks or sick days or require health insurance, and they can work nonstop all night tirelessly if needed. Collaborative machines are more flexible, often doing one task one day and a different task the next day. At Panek Precision Inc., a Northbrook, Illinois-based machine shop, Mr. Panek states, "Having robots has allowed us to move our existing workers into more useful tasks, such as monitoring more-advanced machines that require human tending." Workers are generally quite receptive to collaborative machines, even giving them names, such as "Fred" at Stuller Inc., a jewelry factory in Lafayette, Louisiana, and "Baxter" at K'NEX Brands, a toy maker in Hatfield, Pennsylvania.[4] Strengths and weaknesses with respect to controlling could relate to (1) inventory turnover levels versus competitors, (2) how well or poorly the firm's operations are performing across various geographical regions, and (3) how cost efficient the firm is in acquiring needed supplies.

Integrating Strategy and Culture

The functions of management can be performed best when a firm's strategy and culture are integrated. Every business entity has a unique organizational culture that impacts strategic-planning activities. **Organizational culture** is "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."[5] 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 any firm.

The strategic-management process takes place largely within a particular organization's culture. A culture ideally supports the collective commitment of its people to a common purpose. It must foster competence and enthusiasm among managers and employees. 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.

To achieve and maintain competitive advantage, firms must continually learn, adapt, and evolve. Adapting to change can be difficult, particularly when change includes forging new alliances, partnerships, or mergers between different companies, each of which likely has its own unique culture and unique identity. Table 4-4 provides some example (possible) aspects of an organization's culture and possible considerations for identifying strengths and weaknesses within the firm.

When one firm acquires another firm, integrating the two cultures effectively can be vital for success. For example, in Table 4-4, one firm may score mostly 1s (low) and the other firm may score mostly 5s (high), which would present a challenging strategic problem. Regardless of a firm's industry, geography, or company history, it is imperative that firms effectively integrate corporate strategy and culture, even as they continuously adapt and evolve overtime.

An organization's culture should infuse individuals with enthusiasm for implementing strategies. Internal strengths and weaknesses associated with a firm's culture sometimes are overlooked because of the interfunctional nature of this phenomenon. This is a key reason why strategists need to view and understand their firm as a sociocultural system. Success is often determined by links 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 Audit Checklist of Questions

The following checklist of questions can help determine specific strengths and weaknesses in the management 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?

TABLE 4-4 15 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-mindedness	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

8. Are employee turnover and absenteeism low?
9. Are organizational reward and control mechanisms effective?

Marketing

LO 4.3

Marketing can be described as the process of defining, anticipating, and fulfilling consumers' needs and wants. Marketing is about satisfying current and potential customers' needs. Excellent marketing can provide firms with a competitive advantage. Table 4-5 lists companies that lead their respective industries in customer satisfaction according to the American Customer Satisfaction Index (ACSI) that surveys around 180,000 U.S. customers each year.

Marketing consists of five basic activities: (1) marketing research and target market analysis, (2) product planning, (3) pricing products, (4) promoting products, and (5) placing or distributing products. Understanding these activities helps strategists identify and evaluate marketing strengths and weaknesses—a vital strategy-formulation activity.

Marketing Research and Target Market Analysis

Marketing research is the systematic gathering, recording, and analyzing of data to identify and define opportunities and problems related to the marketing of goods and services. Marketing research is often used to help firms evaluate and formulate strategies. Marketing researchers employ numerous scales, instruments, procedures, concepts, and techniques to gather information; their research can uncover critical strengths and weaknesses. Organizations that possess excellent marketing research skills have a competitive advantage. According to the former president of PepsiCo:

> 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.[6]

An important use of marketing research involves **target market analysis**—the examination and evaluation of consumer needs and wants. Marketing research involves methods such as administering customer surveys, analyzing consumer information, evaluating market positioning strategies, developing customer profiles, and determining optimal market segmentation strategies, all of which contribute to effective customer analysis.

TABLE 4-5 Companies that Lead Their Industries in Customer Satisfaction According to the 2017 American Customer Satisfaction Index

Company	Industry
JetBlue	Airline
Lexus (Toyota)	Automobiles
Dillard's	Department Stores
Cracker Barrel	Full-Service Restaurants
LG	Household Appliances
Vanguard	Internet Investment Services
Amazon	Internet Retail
Google	Internet Search Engines and Information
Chick-fil-A	Limited-Service Restaurants
Clorox	Cleaning Products
Apple	Personal Computers
AAA	Property and Casualty Insurance
Trader Joe's	Supermarkets

Source: Based on information from http://www.theacsi.org/acsi-benchmarks/benchmarks-by-industry

Successful organizations continually monitor present and potential customers' buying patterns and engage in extensive marketing research to understand the needs and wants of different segments of customers. Firms tailor their product offerings to fit the needs of their target market(s). Many companies have recently shifted their target markets to focus on younger consumers, and particularly millennials because these individuals now make up the largest group of U.S. consumers. For example, Home Depot, P&G, Williams-Sonoma Inc., Sherwin-Williams Co., and Scotts Miracle-Gro Company are now targeting millennials by offering online lessons aimed at teaching basic skills such as how to mow a lawn, use a tape measure, hammer a nail, and care for plants.

With a clearly defined target market, marketers can best use their strategic toolbox to ensure that their firm's offering delivers value to target customers. A clear understanding of a firm's target market(s) serves as the foundation on which the marketing mix is designed. Commonly referred to as the "four Ps of marketing," the marketing mix includes product, price, promotion, and place, as indicated in Table 4-6. Marketers design a marketing mix to fit the unique needs of each target market. Table 4-6 reveals key areas to consider when searching for and identifying possible strengths and weaknesses related to the marketing functional area of a firm.

Product Planning

Products can be physical goods, services, ideas, or anything a company offers to satisfy individual or business customer needs through the exchange process. Product planning includes devising warranties; packaging; determining product options, features, brand style, and quality; deleting old products; and providing customer service. Product planning is particularly important when a company is pursuing product development or diversification. In such cases, companies often must decide whether to extend an existing product line or create an entirely new product line. In implementing a product development strategy, the Campbell Soup Company, for example, may consider extending its line of soups by developing a new soup, or entering a new category of products by perhaps offering a marinade.

One important part of product planning involves **test marketing**, which allows an organization to examine alternative marketing plans, learn about potential problems with the product, uncover ways to better market the product, or 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 industrial goods companies. The technique can enable an organization to avoid substantial losses by revealing weak products and ineffective marketing approaches before large-scale production begins.

Another important part of product planning 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. High-tech firms, such as Microsoft, spend a much larger proportion of their revenues on R&D. A key decision for many firms is whether to be a "first mover" or a "fast follower" (i.e., spend heavily on R&D to be the first to develop radically new products, or spend less on R&D by imitating, duplicating, or improving on products after rival firms develop them).

TABLE 4-6 The Marketing Mix Component Variables

Product	Place	Promotion	Price
Quality	Distribution channels	Advertising	Level
Features and options	Distribution coverage	Personal selling	Discounts
Style and brands	Outlet location	Sales promotion	Allowances
Packaging	Sales territories	Publicity	Payment terms
Product line	Inventory levels		
Warranty and services	Transportation carriers		

Source: Based on a variety of sources.

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 of every few thousand drugs created in the laboratory ends up on pharmacists' shelves.

Strengths and weaknesses with respect to products could relate to (1) the value of a firm's brands relative to competitors' brands, (2) the firm's product assortment or cannibalism among the firm's existing products, or (3) features of the firm's products relative to those of similar products found in the marketplace.

Pricing

Pricing refers to deciding the amount an individual must exchange to receive a firm's product offering. Pricing objectives often include setting prices at levels which maximize profit, sales, or market share or setting prices to weaken the competition's marketing efforts, to enhance customer satisfaction, or to enhance the image and prestige of a product. Pricing strategies are often based on costs, demand, the competition, or on customers' needs. Sometimes "free is a good price," as evidenced by what Google and Facebook charge basic customers.

Widespread Internet use and advances in technology have enabled firms to quickly adjust prices to meet changes in the marketplace. In dynamic pricing strategies, the same product may be sold to different customers for different prices, or even to the same customer for different prices. Intense price competition, coupled with Internet price-comparative shopping, has reduced profit margins to bare minimum levels for many companies. Target and Best Buy are among the many companies that now offer 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 rivals' websites. Issues related to pricing can represent key strengths or weaknesses for firms.

Firms must be aware of government constraints on pricing, including regulations regarding price fixing, price discrimination, predatory pricing, 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 (retailers and wholesalers) if competition is lessened. Pricing products in digital currencies, as discussed in Global Capsule 4, is increasingly a necessary consideration. Strengths and weaknesses with respect to pricing could relate to whether the focal firm price matches or not and why, or how the firm's prices (including currencies in which the products can be paid) compare to similar products sold by competitors.

Promotion

Successful strategy implementation generally rests on the ability of an organization to sell some good or service. **Promotion** includes many marketing activities, such as advertising, sales promotion, public relations, personal selling, and direct marketing. Common promotional tools designed to inform consumers about products include TV advertising, magazine ads, billboards, websites, and public relations, among others. Discounts, coupons, and samples are often used to encourage purchase. Promotional tools such as personal selling, buzz building, and social media are often used to build relationships with customers. The effectiveness of various promotional tools for consumer and industrial products varies. Personal selling is especially important for industrial goods companies, whereas advertising and social-media marketing are more important for consumer goods companies. Determining organizational strengths and weaknesses in the promotional function of marketing is an important part of performing an internal strategic-management audit.

Promotion in general and advertising in particular can be expensive, a primary reason marketing is a major business function to be studied carefully. Without marketing, even the best products have little chance of being successful. Worldwide advertising expenditures are increasing around 5 percent annually and are expected to reach $700 billion in 2021. Digital

GLOBAL CAPSULE 4

Bitcoin: The New Global Currency

Using cryptography, a new worldwide digital payment system has emerged in which money can be exchanged without the involvement of a central authority or bank. Cryptocurrencies, also referred to as *digital currencies* or *altcoins*, are becoming popular among investors, businesses, and consumers around the world. Much like cash for the Internet, but with no physical backing, digital currencies are increasingly prevalent as a means of value exchange between individuals and businesses.

Travis Wolfe/123RF

Is this money?

With a total market value of more than $600 billion, the digital currency market is made up of several players including Bitcoin, Ethereum, Ripple, and Litecoin. Bitcoin is the most well-known and widely used digital currency, making up over half of the cryptocurrency market value. Simply put, Bitcoin is a mobile app that provides individuals with a personal Bitcoin wallet that can be used to exchange Bitcoin with other users. Bitcoin is increasingly being used; Bloomberg, Dish, Fidelity, Expedia, Overstock.com, Reddit, Reeds Jeweler, United Way, and USAA are among a growing number of businesses accepting Bitcoin. Key advantages of Bitcoin include a simple payment process that can easily and quickly be done 24 hours a day and across international borders, all while protecting one's identity, protecting against fraud, and avoiding typical transaction fees imposed by banks or other intermediaries.

Companies are increasingly being faced with difficult decisions regarding Bitcoin. Should firms accept Bitcoin as a method of payment? Should products be priced in Bitcoin? If so, should firms price their products in both the local currency and Bitcoin? Executives are currently addressing these and other such questions.

Source: Based on https://bitcoin.org/en/how-it-works and Paul Vigna, "Rival Digital Currencies Nip at Bitcoin," *Wall Street Journal*, (December 20, 2017): B16.

advertising, especially on mobile devices, is fueling the increased ad spending because global Internet advertising recently surpassed television advertising and is expected to reach nearly $280 billion in 2020.[7] Many successful brands are now using digital platforms and social media to build relationships and establish emotional bonds with consumers. As social networks, virtual worlds, product review sites, and location-based social apps become increasingly popular among consumers, marketers spend heavily on social-media marketing. In performing a strategic-planning analysis, in addition to comparing rival firms' websites, it is important to compare rival firms' handling of social-media issues.

Strengths and weaknesses with respect to promotion could relate to a firm's (1) website and social media engagement (or lack thereof), (2) association with key celebrities or spokespersons, or (3) advertising and brand slogans or images.

Channels of Distribution

Channels of distribution is a term that refers to the various intermediaries that take a product from a producer to an end customer. These intermediaries bear a variety of names such as wholesalers, retailers, brokers, facilitators, agents, vendors—or simply distributors. In this regard marketers often make decisions related to warehousing, distribution channels, distribution coverage, retail site locations, sales territories, inventory location, transportation carriers, wholesaling, and retailing.

Marketers must determine how widely available their product should be for consumers to find and purchase. Some firms offer their products through as many wholesalers and retailers that will sell them while other firms offer products only through several select outlets or authorized outlets.

Some of the most complex and challenging decisions facing a firm concern product distribution. Successful organizations identify and evaluate alternative ways to reach their ultimate market. Many companies today are increasingly making their products available for purchase online, directly through their website, but this practice can upset retailers. Efficient supply chain and distribution systems are essential for any firm to gain and sustain a competitive advantage.

Strengths and weaknesses with respect to promotion could relate to the effectiveness of brick-and-mortar versus online sales or the average return on investment (ROI) of various purchase locations.

Marketing Audit Checklist of Questions

The following types of questions about marketing must be examined in performing an internal assessment

1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Are present channels of distribution reliable and cost effective?
4. Is the firm conducting and using market research effectively?
5. Are product quality and customer service good?
6. Are the firm's products and services priced appropriately?
7. Does the firm have an effective promotional strategy?
8. Is the firm's Internet presence excellent as compared to rivals?

Finance and Accounting

LO 4.4

Financial condition is often considered the single-best measure of a firm's competitive position and overall attractiveness to investors. Table 4-7 lists top companies for financial strength according to the Drucker Institute, which assesses financial performance based on return on assets, return on equity, return on invested capital, market share and profits, as well as investors' return on their shares. Note that Accenture PLC heads the list. Determining an organization's financial strengths and weaknesses is essential in 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 impact existing strategies and influence strategy-implementation plans.

Finance and Accounting

According to James Van Horne, finance and accounting activities can be categorized into three decision areas: the investment decision, the financing decision, and the dividend decision.[8] 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. After 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.

TABLE 4-7 A Sampling of Top Companies for Financial Strength

Company	Number of Employees	2017 Revenues (in billions)
Accenture PLC	425,000	$34.8
Altria Group, Inc.	8,300	$25.7
Apple Inc.	123,000	$215.6
Berkshire Hathaway, Inc.	45,500	$223.6
Home Depot, Inc.	406,000	$94.5
Mastercard, Inc.	11,900	$10.7
P&G Company	95,000	$65.0
Starbucks Corporation	254,000	$21.3
United Parcel Service, Inc.	434,000	$60.9
Verizon Communications, Inc.	160,900	$125.9
Walmart, Inc.	2,300,000	$482.1

Source: Based on Ezequiel Minaya, "Consumer-Goods Firms Shine in Financial Category," *Wall Street Journal*, (December 6, 2017): R2.

Dividend decisions concern issues such as the dollar amount per share to pay quarterly 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. Sometimes to appease shareholders, dividends are paid out (1) even when the firm has incurred a negative annual net income, (2) even when the firm has to obtain outside sources of capital to pay for the dividends, and (3) even when the funds were needed as reinvestment in the business. Reasons for this practice are as follows:

1. Paying cash dividends is customary for some firms. Failure to do so could be thought of as a stigma. A dividend change is 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.

Financial Ratios

Financial ratio analysis is the most widely used method for determining an organization's strengths and weaknesses in the investment, financing, and dividend areas. Because the functional areas of business are so closely related, financial ratios can actually signal strengths or weaknesses anywhere up and down a firm's value chain from suppliers through production to distribution.

Financial ratios are computed from an organization's income statement and balance sheet. Computing financial ratios is like taking a photograph: 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. Financial ratio trend analysis, illustrated in Figure 4-2, is a useful technique that incorporates both the time and industry average dimensions of financial ratios. Note that the dotted lines reveal projected ratios.

Financial ratios are equally applicable in for-profit and nonprofit organizations, but the ratios vary considerably across types of industries. Even though nonprofit organizations would not have return-on-investment or earnings-per-share ratios, they would routinely monitor many other special ratios. For example, a religious organization would monitor the ratio of dollar contributions to the 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. Nonprofit organizations because strive to be financially sound just as for-profit firms do. Nonprofit organizations need strategic planning just as much as for-profit firms.

Financial ratio 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. Examine whether each ratio has been historically increasing, decreasing, or nearly constant. Analysts often calculate the percentage change in a ratio from one year to the next to assess historical financial performance on that dimension. Large percentage changes can be especially relevant, but be mindful that if base numbers are small then large percentage changes can ensue more easily.
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 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 strengths and weaknesses.
3. ***How does each ratio compare with key competitors?*** Often 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.

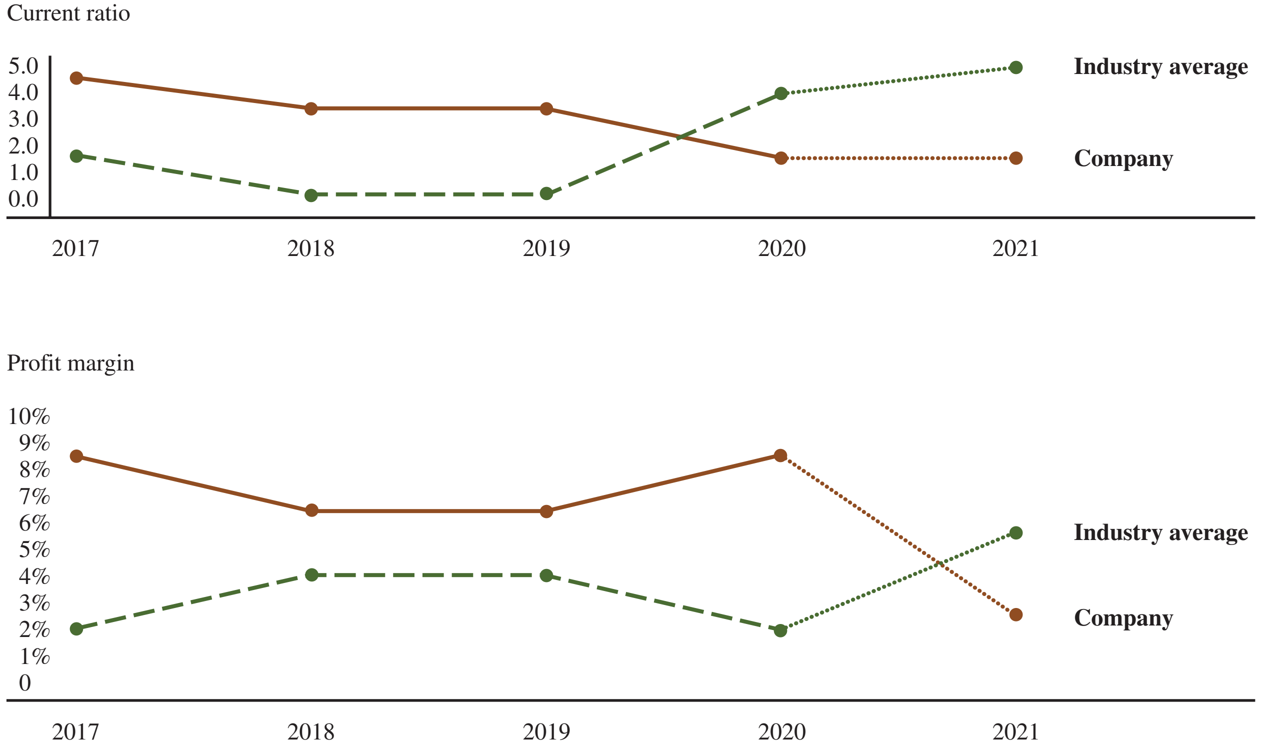

FIGURE 4-2
Financial Ratio Trend Analysis

Excellent free online and subscription (fee-based) resources for obtaining financial information about firms and industries are provided in Table 4-8. Some sources listed provide financial ratios. The free Excel template at www.strategyclub.com calculates ratios once students enter in relevant data.

Financial ratio analysis is not without some limitations. For example, 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., because 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 because the factor does not specify which current assets or current liabilities were most significant in contributing to the change. In contrast, a factor such as "the firm's fragrance division revenues increased 18 percent in Africa in 2018" would be considerably more actionable because more insight is provided as to actions needed to address the issue. Recall from the prior chapter the importance of factors being stated in actionable terms. The AQCD (actionable-quantitative-comparative-divisional) Test discussed in the prior chapter for performing an external assessment is equally important in performing an internal assessment.

Table 4-9 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

TABLE 4-8 Excellent Websites to Obtain Strategic Information (Including Financial Ratios) on Companies and Industries

1. **Online Free Resources.**
   - **a.** *Form 10K or Annual Report*
   - **b.** http://finance.yahoo.com
   - **c.** www.hoovers.com
   - **d.** http://globaledge.msu.edu/industries/
   - **e.** www.morningstar.com
2. **Online Subscription Resources (Likely Subscribed to by Your University Library)**
   - **a.** Mergent Online: www.mergentonline.com
     At this website, financial statements seem to be more complete than at other sites. You can also search for companies with the same SIC or NAICS code and then create a comparison financial ratio report. A number of different ratios can be used as comparison criteria to create a tailored report that can then be exported into a Microsoft Excel format. Alternatively, use the Competitors Tab in Mergent to build a list of companies and compare their ratios. Your college library likely subscribes to this service.
   - **b.** Factiva: http://new.dowjones.com/products/factiva/
     At this website, first use the Companies & Markets tab to search for a company. Next, click "Reports" and choose the "Ratio Comparison Report" to get a company's ratios compared to industry averages. Your college library likely subscribes to this service.
   - **c.** S&P NetAdvantage: http://www.standardandpoors.com/products-services/industry_surveys/en/us
     This website provides company and industry ratios and information in two sections of the database: (1) the Compustat Excel Analytics section of a particular company's information page and (2) the S&P Industry Surveys.
   - **d.** Onesource: www.avention.com/OneSource
     This is a widely used source for financial ratio information. Search for a particular company and then click on the link for "Ratio Comparisons" on the left side of the company information page. The data in Onesource will compare your company against the industry, against the sector, and against the stock market as a whole.
   - **e.** Yahoo Industry Center: http://biz.yahoo.com/ic/
     This is an excellent free resource that allows a user to browse industries by performance rankings, including return on equity, price-earnings ratio, market cap, price change, profit margin, price-to-book value, long-term debt, and more.
3. **Hardcopy Reference Books for Financial Ratios in Most Libraries**
   - **a.** Robert Morris Associate's *Annual Statement Studies:* An excellent source of financial ratio information.
   - **b.** Dun & Bradstreet's *Industry Norms & Key Business Ratios:* An excellent source of financial ratio information.

Source: Based on a variety of sources.

meaningful to a company that takes only cash receipts. As indicated in Table 4-9, key financial ratios can be classified into the following five types: liquidity (how is the firm's cash position), leverage (how is the firm's debt position), activity (how efficient is the firm's operations), profitability (how is the firm performing), and growth (is the firm meeting shareholders' expectations).

Finance and Accounting Audit Checklist

Strengths and weaknesses in finance and accounting commonly arise from answering the following types of questions:

1. Where is the firm financially strong and weak as indicated by financial ratio analysis?
2. Can the firm raise needed short-term capital?
3. Should 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 excellent 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?

TABLE 4-9 A Summary of Key Financial Ratios

Ratio	How Calculated	What It Measures
I. 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
II. Leverage Ratios		
Debt-to-Total-Assets Ratio	$\frac{\text{Total debt}}{\text{Total Assets}}$	The percentage of total funds provided by creditors
Debt-to-Equity Ratio	$\frac{\text{Total debt}}{\text{Total stockholders' equity}}$	The percentage of total funds provided by creditors versus by owners
Long-Term Debt-to-Equity Ratio	$\frac{\text{Long-term debt}}{\text{Total stockholders' equity}}$	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
III. Activity Ratios		
Inventory Turnover	COGS/Inventory	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	Sales/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)
IV. Profitability Ratios		
Gross Profit Margin	Gross Profit/Sales	The total margin available to cover operating expenses and yield a profit
Operating Profit Margin	$\frac{\text{Earning before interest and taxes EBIT}}{\text{Sales}}$	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)	$\frac{\text{Net Income}}{\text{Total stockholders' equity}}$	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
V. 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

Financial analysis provides an excellent tool for identifying many strengths and weaknesses of the firm but the numbers themselves generally do not reveal the source of issues, which could stem for example from marketing and promotional effectiveness, HRM and employee productivity, accounting errors, and so on. Therefore, carefully study your firm's *Form 10K* or *Annual Report* and other company documents including quarterly reports to uncover strengths and weaknesses associated within the functional areas. Finance and accounting strengths and weaknesses could relate to issues such as the firm's use of debt versus equity to raise capital, the firms dividend policy, or the firm's acquisition versus organic growth practices.

LO 4.5 Management Information Systems

Information ties all business functions together and provides the basis for all managerial decisions. Information can represent a major source of competitive advantage or disadvantage and a major source of a firm's internal strength and weakness factors. A **management information system (MIS)** collects, codes, stores, synthesizes, and presents information in such a manner that it aids in operational and strategic decision making. The heart of an information system is a database containing the kinds of records and data important to managers. If a business fails to manage information well, this is an internal weakness that needs fixing.

Business Analytics

Business analytics is a business 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, which is 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 every day.

Strategists use business analytics to 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. 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-card purchases, tax returns, insurance claims, mobile phone calls, online ad clicks, and more. Business analytics can also reveal where competitors are weak so that marketing activities can be directly targeted to take advantage of resultant opportunities.

Business analytics 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 and analysis of thousands, millions, or even billions of prior data points can reveal patterns of behavior for optimizing the deployment of resources and can dramatically enhance decision making at all organizational levels and all stages of strategic management. Business analytics can identify and analyze patterns, but perhaps more importantly, they can reveal the likelihood of an event, and that information can be worth millions of dollars to companies, organizations, and governments.

In 2018, global data analytics software is expected to reach $21.7 billion, a 64 percent increase from 2012.[9] Leading firms providing the software include IBM, SAP, Oracle, Microsoft, Qlik Technologies, Tibco Software, and Tableau Software. CEOs are increasingly worried about cybersecurity issues. The number of U.S. data breaches reached a record of 791 in the first 6 months of 2017, up 29 percent from the same period the prior year.[10] Fearing potential data breaches, CEOs are emphasizing to individuals throughout the company the importance of data security and are prioritizing cybersecurity efforts.

In terms of cyberthreats, a recent *Wall Street Journal* article revealed what companies should be most concerned about and what they can do to mitigate the threat.[11] The biggest threat currently facing firms is that too many people in too many organizations have too much access to too much information not needed to do their particular job, whether it is access to sales data, patent information, or even material about the next new product being developed. Technical controls must be put in place in organizations to prevent employees from having broad access to company information and data because hackers from various countries and companies and lone wolves are increasingly gaining access to corporate files through employees and managers who unknowingly allow the access to seemingly honest "constituencies." Cyberthreats are more a people threat than a technology threat.

The Internal Factor Evaluation (IFE) Matrix

LO 4.6

The internal topics discussed so far in this chapter provide a foundation for identifying strengths and weaknesses of a firm as they relate to a firm's current strategies, paying careful attention to strengths and weaknesses that are unique and lead to or hinder sustaining a competitive advantage. An internal assessment reveals key strengths and weaknesses confronting an organization; this is vital information for managers in formulating strategies that capitalize on strengths and mitigate/overcome/improve upon weaknesses.

The Actionable-Quantitative-Comparative-Divisional (AQCD) Test

When identifying and prioritizing key internal factors in strategic planning, make sure the factors selected meet the following four criteria to the extent possible:

1. Actionable (i.e., meaningful and helpful in ultimately deciding what actions or strategies a firm should consider pursuing);
2. Quantitative (i.e., include percentages, ratios, dollars, and numbers to the extent possible);
3. Comparative (i.e., reveals changes over time), and
4. Divisional (relates to the firm's products and/or regions (rather than consolidated) so inferences can be drawn regarding what products and regions are doing well or not).

As mentioned in the prior chapter, factors that meet the four criteria pass what can be called the "Actionable-Quantitative-Comparative-Divisional (AQCD) Test," that is a measure of the quality of an internal factor. In addition to passing the AQCD Test, make sure that internal factors are indeed internal (not external). Also, make sure the internal factors relate closely to the firm achieving its mission (strengths) or hindering its mission (weaknesses). Factors selected for inclusion in an internal assessment should be mission-driven.

Regarding the AQCD criteria, strive to include all high quality factors in an internal assessment for a firm. A high quality factor will meet three or four of the AQCD criteria; a low quality factor will meet two or fewer of the AQCD criteria. Engage in an engineering hunt for facts to make sure as many factors as possible pass the AQCD Test. It is important to state internal factors to the extent possible in actionable, quantitative, comparative, and divisional terms. Vagueness in stating factors must be avoided because vagueness gives little guidance in assigning weights or ratings in developing an IFE Matrix.

High quality and low quality internal factors (hypothetical) for Exxon Mobil Corporation are given below to further exemplify this important concept:

	ASK YOURSELF IS THE FACTOR			
	Actionable	Quantitative	Comparative	Divisional
A High Quality Internal Factor				
Exxon's natural gas segment sales grew 14% in 2018.	yes	yes	yes	yes
A Low Quality Internal Factor				
Exxon's price earnings ratio in 2018 was 14.4.	no	yes	no	no

Steps in Developing an IFE Matrix

An internal strategic-management audit includes development of an **Internal Factor Evaluation (IFE) Matrix**. This strategy-formulation tool weights and rates major strengths and weaknesses in the functional areas of a business, providing a total weighted score indicating the overall strength of a firm's internal position. The IFE Matrix is an evaluation of the effectiveness of the firm's current strategies, not taking into account opportunities and threats. The purpose of the IFE Matrix and the internal assessment as a whole is to determine how effective the firm's current strategies are based on the firm's strengths and weaknesses.

Strategists analyze the firm's response to key strengths and weaknesses (the ratings in step 3) in relation to the importance of these factors within the industry it operates (the weights in step 2). The resulting total weighted score (step 5) indicates the internal effectiveness of the current strategy. The IFE Matrix total weighted score is suggestive of whether a continuation of strategy is needed (scores above 2.5) or a change in strategy is warranted (scores below 2.5). Used in conjunction with the EFE Matrix and CPM discussed in Chapter 3, the IFE Matrix provides the input needed to perform strategy-matching analyses described in Chapter 6.

An IFE Matrix can be developed in five steps:

Step 1: Develop a Full and Narrow List of Key Internal Factors

Conduct research about the focal company using the resources listed in Table 4.8. Compile and organize information into two data sets, strengths and weaknesses, developing a full list of perhaps 50 to 100 strength and weakness factors. Be sure to include factors from management, marketing, finance, accounting, and MIS that are of strategic importance. Then, narrow your data sets down to 20 key internal factors that include specifically 10 strengths and 10 weaknesses. (Note: We use 10 and 10 because organizations commonly use this breakdown and the template at www.strategyclub.com uses 10 and 10). List strengths first and then weaknesses.

Firms determine the most important 20 factors among a full list usually by rating the factors according to importance (1 = least important to 10 = most important) and consolidating the rating data or by ranking the factors (1 = most important to 50 = least important) and consolidating the ranking data. Both methods will yield the 20 most important factors to include. The important point here is that companies (and students) never should include just the first 20 factors that come to mind. For example, a student recently included as a weakness in her IFE Matrix for a college that "there are feral cats on campus"; 99 percent of the time that factor should not be included in the matrix. Instead, conduct research to identify internal factors that relate to the university's vision, mission, strategies, and competitive advantages.

When determining particular factors to include in an IFE Matrix and when assigning weights and ratings, focus on a narrow industry perspective. Within the narrow industry, consider the vision and mission of the firm, and the firm's current strategies (i.e., when selecting factors and assigning weights and ratings). For example, for McDonald's, the industry is fast-food restaurants, rather than restaurants in general, and for Porsche, the industry is luxury sports cars, not simply automobiles. This narrow industry perspective is important, as indicated in Table 4-10.

Step 2: Assign Weights to Key Internal Factors

In developing an IFE Matrix, assign a weight that ranges from 0.01 (not important) to 1.0 (all-important) for each factor. The weight assigned to a given factor indicates the relative importance of the factor for being successful in the firm's industry relative to other factors included in the IFE. For example, a factor receiving a weight of 0.04 is 100 percent more important than a factor receiving a weight of 0.02 for success in the industry. Regardless of whether a key factor for a particular firm is a strength or weakness, factors considered to have the greatest effect on organizational performance of all firms in a specific industry should be assigned the highest weights. The sum of all weights must equal 1.0. Do not try to even weights out to total 0.50 for strengths and 0.50 for weaknesses. Weights are industry-based, not company-based. List strengths from highest weight to lowest weight; do the same for weaknesses.

Step 3: Assign Ratings to Key Internal Factors

In developing an IFE Matrix, assign a rating between 1 and 4 to each key internal factor to indicate how effectively (or ineffectively) the firm's strategies are responding to the strength

TABLE 4-10 Guidelines for Developing an IFE Matrix

1. **Use the Narrow (Not Broad) Industry the Firm Competes In**

   Example: Burger King competes in the fast-food industry (as opposed to the more general restaurant industry). Therefore, for Burger King, if including a weakness regarding the lack of healthy options on their menu, this factor should likely receive a low weight because healthy menu options are not as vital to the fast-food industry, whose customer base mostly desire quick service, good taste, and filling food. Similarly, Burger King's weakness related to low-quality meats should not receive a high weight either because quality meats are not that important in the fast-food industry; customers simply are not willing to pay for them. Similarly, Burger King's strength of providing low-priced coffee would receive a high weight if the analyst views coffee as being especially important in the fast-food industry for success. If however the analysts views coffee not to be especially important in the fast-food industry for success, then this strength of Burger King should receive a relatively low weight.

2. **State Factors So They Pass the Actionable-Quantitative-Comparative-Divisional (AQCD) Test**

   Example: A firm's revenues may have decreased 15 percent from one year to the next, but stated in this manner, this "weakness" is not actionable because it does not reveal the reason, or reasons, why revenues declined; the reason(s) could range from competition driving down prices to raw materials being unavailable for one product or division of the firm. Nonactionable factors could lead managers astray if they make false assumptions regarding what to do about the factor. Therefore, state the "revenue decline factor" perhaps as follows: Revenues in the chocolate segment of the firm declined 21 percent in the most recent quarter because of factory recall problems. Now the factor passes the AQCD Test in providing insightful, relevant, useful, information for formulating strategies.

or weakness, where 4 = the response is superior, 3 = the response is above average, 2 = the response is average, and 1 = the response is poor. Even though both strengths and weaknesses can receive a rating of 1, 2, 3, or 4 at any time, generally there should be a compelling reason to assign a rating of 3 or 4 to a weakness; it is more common for a firm to be responding in a superior fashion to strengths because competitive advantages are built on strengths; strategies that result in strengths are generally excellent. Responding well to a weakness may not lead to competitive advantage, whereas turning a strength into a distinctive competency could yield a competitive advantage. Ratings are based on the effectiveness of a firm's strategies in capitalizing on strengths or improving weaknesses. Ratings are company-based, not industry-based.

Assignment of numerical values down the rating column in an IFE Matrix should be with consideration that companies carve out niches in industries that enable them to gain and sustain competitive advantages through effective strategies. These niches are most often based on some unique strength(s) that yield prosperity amid rivals that are so strong in various areas the focal firm will rarely, if ever, want to attack those areas. This is not to say weaknesses are not important because they are, and firms need to continually strive to improve weaknesses, but strengths versus rivals are of paramount importance. If a firm possesses many highly-weighted strengths, this is likely the result of effective strategies, so higher ratings in general are warranted for strengths; higher ratings increase the total weighted score in an IFE Matrix.

Step 4: Obtain Weighted Scores

Along each row in an IFE Matrix, multiply the factor's weight by its rating to determine a weighted score for each factor.

Step 5: Obtain Total Weighted Score

Sum the weighted scores 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, implying that new strategies are likely needed and perhaps a new direction, new vision, or mission. Total weighted scores well above 2.5 indicate a strong internal position, whereby a continuation of current strategies may be prudent. (Note: The IE Matrix presented in Chapter 6 focuses on matching of EFE and IFE total weighted scores in formulating strategies.)

An Example IFE Matrix

An example IFE Matrix is provided in Table 4-11 for a retail computer store. The table reveals that the two most important factors to be successful in the retail computer store business (as indicated by the highest weighted factors) are Strength #1: "Revenues from repair/service in the store," and Weakness #1: Location of store negatively impacted by new Highway 34. Note that among the strengths, the store's strategies are not responding well (rating is 2) to two factors: "Average customer purchase increased from $97 to $128" and "Debt-to-total assets ratio declines to 34%," as indicated by the assigned 2 ratings. Regarding the store's weaknesses, note that the owner's strategies are responding "superior" to two factors: (1) "Location of store negatively impacted by new Highway 34," as indicated by the rating of 4 (because plans are underway to perhaps relocate the store), and (2) "Bathroom needs refurbishing," as indicated by the rating of 4 (because the bathroom is in the process of being remodeled). Note that the store's IFE Matrix overall contains numerous dollars, numbers, percentages, and ratios, rather than vague statements; this is excellent. This store receives a 2.73 total weighted score, which on a 1- to 4-scale, indicates some success but there is room for improvement in store operations, strategies, policies, and procedures.

Coupled with the EFE Matrix, 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 and paint. 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.

In multidivisional firms, each autonomous division or strategic business unit should construct their own IFE Matrix (and their own EFE 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. Financial ratios are generally the result of many 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.

TABLE 4-11 Sample Internal Factor Evaluation Matrix for a Retail Computer Store

Key Internal Factors	Weight	Rating	Weighted Score
Strengths			
1. Revenues from repair/service in the store up 16%.	0.15	3	0.45
2. Employee morale is excellent.	0.10	3	0.30
3. Average customer purchase increased from $97 to $128.	0.07	2	0.14
4. In-store promotions resulted in 20% increase in sales.	0.05	3	0.15
5. In-store technical support personnel have MIS college degrees.	0.05	4	0.20
6. Inventory turnover increased from 5.8 to 6.7.	0.05	3	0.15
7. Debt-to-total assets ratio declines to 34%.	0.03	2	0.06
8. Newspaper advertising expenditures increased 10%.	0.02	3	0.06
9. Revenues per employee up 19%.	0.02	3	0.06
Weaknesses			
1. Location of store negatively impacted by new Highway 34.	0.15	4	0.60
2. Revenues from software segment of store down 12%.	0.10	2	0.20
3. Often customers wait 15 minutes to check out.	0.05	1	0.05
4. Store has no website.	0.05	2	0.10
5. Revenues from service segment down 8%.	0.04	1	0.04
6. Supplier on-time delivery increased to 2.4 days.	0.03	1	0.03
7. Carpet and paint in store somewhat in disrepair.	0.02	3	0.06
8. Bathroom in store needs refurbishing.	0.02	4	0.08
Total	**1.00**		**2.73**

IMPLICATIONS FOR STRATEGISTS

Figure 4-3 illustrates that to gain and sustain competitive advantages, a firm must formulate strategies that capitalize on internal strengths and continually improve on its internal weaknesses. Firms must nurture and build on competitive advantages embedded largely within the list of strengths included in an IFE Matrix. Coupled with the vision or mission and external audit, the internal audit must be performed methodically and carefully because survival of the firm could hinge on the strategic plan that ensues from these assessments. Do not let assignment of weights and ratings become based on mere guessing, emotion, and opinion; use the sources of information mentioned in this chapter and others to extract actionable, quantitative, comparative, divisional, factors for inclusion in matrices. Use the AQCD Test as a guide for developing effective, useful strength and weakness factors.

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 throughout the firm need to be involved in determining a firm's strengths and weaknesses. The internal audit requires gathering, assimilating, and prioritizing information about the firm's management, marketing, finance, accounting, production, and MIS operations to reveal the firm's most important strengths and most severe weaknesses.

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. Thus, performing an internal audit is an excellent vehicle or forum for improving the process of communication in an organization.

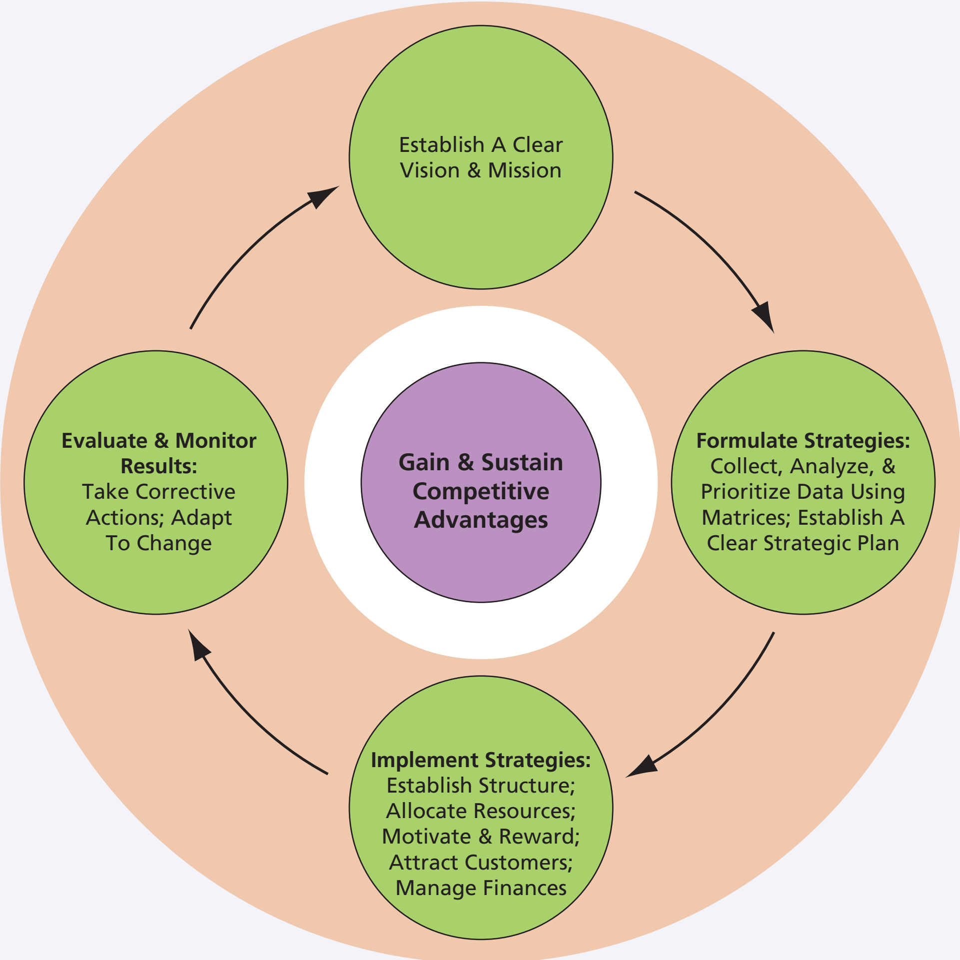

FIGURE 4-3
How to Gain and Sustain Competitive Advantages

William King believes 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 firm. According to King,

> 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 that such a list will inevitably have as it is used in the formulation, implementation, and evaluation of strategies.[12]

Strategic planning is most successful when 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. Financial ratio analysis, for example, exemplifies the complexity of relationships among the functional areas of business. A declining return on investment or profit margin ratio could, for example, be the result of ineffective marketing, poor management policies, R&D errors, or a weak MIS.

Strategists should follow the guidelines presented in this chapter and throughout this book to help assure that their firm is heading in the right direction for the right reasons, and rewarding the right people for doing the right things, in the right places.

IMPLICATIONS FOR STUDENTS

To obtain the most recent management, marketing, and financial information about your case company, read the firm's most recent quarterly report; the narrative that accompanies quarterly reports is excellent for revealing what a company is doing and the most recent financial results. Use these reports to obtain comparative information for developing an IFE Matrix.

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 both be leveraged to 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 firm's resources, capabilities, structure, and strategies, with your recommended improvements, can lead the firm to prosperity.

Although the numbers must provide the basis for your analysis and must be accurate and reasonable, do not bore a live audience or class with overreliance on numbers. In contrast, 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.

Chapter Summary

Management, marketing, finance and accounting, and MIS represent the core operations of most businesses and the sources of competitive advantages. 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, it is essential that strategists identify and evaluate internal strengths and weaknesses to effectively formulate and choose among alternative strategies. The IFE Matrix, coupled with the CPM, the EFE 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.

Understanding both external and internal factors and relationships among them (see SWOT analysis in Chapter 6) is the key to effective strategy formulation. 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. Adherence to the AQCD Test regarding internal (and external) factors statements will enable excellent "matching matrices" to be constructed (in Chapter 6).

Key Terms and Concepts

activity ratios (p. 139)
business analytics (p. 140)
capacity utilization (p. 129)
capital budgeting (p. 135)
channel of distribution (p. 134)
collaborative machines (p. 129)
controlling (p. 128)
Customer Analysis (p. 131)
data mining (p. 140)
distinctive competencies (p. 125)
Distribution (p. 134)
dividend decisions (p. 136)
empirical indicators (p. 125)
financial ratio analysis (p. 136)
financing decision (p. 135)
growth ratios (p. 139)
human resource management (HRM) (p. 128)
internal audit (p. 145)
Internal Factor Evaluation (IFE) Matrix (p. 142)
investment decision (p. 135)
leverage ratios (p. 139)
liquidity ratios (p. 139)
management (p. 126)
management information system (MIS) (p. 140)
marketing (p. 131)
marketing research (p. 131)
motivating (p. 127)
organizational culture (p. 129)
organizing (p. 127)
planning (p. 127)
production/operations (p. 129)
profitability ratios (p. 139)
promotion (p. 133)
research and development (p. 132)
resource-based view (RBV) (p. 125)
synergy (p. 127)
target market analysis (p. 131)
test marketing (p. 132)

Issues for Review and Discussion

4-1. Explain why strengths are more important than weaknesses in strategic planning.
4-2. What is bitcoin? Explain how to use bitcoin.
4-3. Do strengths always receive higher weights than weaknesses? Explain why.
4-4. Do strengths always receive higher ratings than weaknesses? Explain why.
4-5. Should assignment of weights down an IFE Matrix weight column be contingent on "intensity of industry rivalry"? Discuss.
4-6. Explain why it is so important to focus on a firm's narrow industry rather than its broader industry in developing an IFE Matrix?
4-7. Explain the concept of factors being "actionable."
4-8. Explain why companies develop a list of 50 to 100 internal factors before distilling the list to 20 to include in an IFE Matrix?
4-9. Describe two ways how a firm can determine from a list of 50 to 100 internal factors the 20 most important factors to include in an IFE Matrix.
4-10. Discuss strategic implications of a firm receiving a total weighted IFE Matrix score of 1.5 versus 3.5.
4-11. If IFE Matrix strength factor 4 receives a rating of 4 what does that signify for the analyst? If weakness factor 4 receives a rating of 4 what does that signify?
4-12. The primary means for gaining and sustaining competitive advantages for most companies are shifting downstream. Explain and discuss this statement.
4-13. In analyzing big data, there is a shift from focusing largely on aggregates or averages to also focusing on outliers because outliers oftentimes reveal (predict) critical innovations, trends, disruptions, and revolutions on the horizon. Explain and discuss this statement.
4-14. What are some limitations of financial ratio analysis?
4-15. Does RBV theory determine diversification targets? Explain and discuss.
4-16. True or False: Personal selling is typically more useful for industrial-goods companies, whereas advertising is typically more effective for consumer-goods companies. Explain.
4-17. What are "collaborative machines"?
4-18. Identify some excellent online resources for finding financial ratio information.

4-19. How might elements of the marketing mix, particularly "price" and "place" vary for common household goods versus luxury products?

4-20. Is a capacity utilization rate of 50 percent good? Why?

4-21. Explain why *communication* may be the most important word in management. What do you think is the most important word in marketing? In finance? In accounting?

4-22. Discuss how the nature of marketing has changed in the last few years.

4-23. Explain why it is best not to have more than 30 percent of the factors in an IFE Matrix be financial ratios.

4-24. List three firms you are familiar with and give a distinctive competence for each firm.

4-25. Give some key reasons why it is essential to prioritize strengths and weaknesses.

4-26. Why may it be easier in performing an internal assessment to develop a list of 80 strengths and weaknesses than to decide on the top 20 to use in formulating strategies?

4-27. Think of an organization with which you are familiar. List three resources of that entity that are empirical indicators.

4-28. Think of an organization with which you are familiar. Rate that entity's organizational culture on the 15 example dimensions listed in Table 4-4.

4-29. If you and a partner were going to visit a foreign country where you have never been before, how much planning would you do ahead of time? What benefit would you expect that planning to provide?

4-30. Even though planning is considered the foundation of management, why do you think it is commonly the task that managers neglect most?

4-31. Are you more organized than the person sitting beside you in class? If not, what problems could that present in terms of your performance and rank in the class? How analogous is this situation to rival companies?

4-32. List the three ways that financial ratios should be compared or used. Which of the three comparisons do you feel is most important? Why?

4-33. In an IFE Matrix, would it be advantageous to list your strengths, and then your weaknesses, in order of decreasing "weight"? Why?

4-34. In an IFE Matrix, a critic may say there is no significant difference between a "weight" of 0.08 and 0.06. How would you respond? What is the mathematical difference?

4-35. Why do many firms consistently pay out dividends?

4-36. What is marketing promotion? Name several example forms of promotion commonly used by marketers.

4-37. Explain why prioritizing the relative importance of strengths and weaknesses in an IFE Matrix is an important strategic-management activity.

4-38. How can delegation of authority contribute to effective strategic management?

4-39. Explain how you would motivate managers and employees to implement a major new strategy.

4-40. Why do you think production and operations managers often are not directly involved in strategy-formulation activities? Why can this be a major organizational weakness?

4-41. Give two examples of human resource management (HRM) strengths and two examples of HRM weaknesses of an organization with which you are familiar.

4-42. Define, compare, and contrast weights versus ratings in an EFE Matrix versus an IFE Matrix.

4-43. If a firm has zero debt in its capital structure, is that always an organizational strength? Why or why not?

4-44. After conducting an internal audit, a firm discovers a total of 100 strengths and 100 weaknesses. What procedures then could be used to determine the most important of these? Why is it important to reduce the total number of key factors?

4-45. Why is it important for companies to conduct marketing research? What type of information might they discover from marketing research?

4-46. What are 10 activities that comprise human resource management?

4-47. Explain the difference between *data* and *information* in terms of each being useful to strategists.

4-48. What are the most important characteristics of an effective management information system?

4-49. Do you agree or disagree with the resource-based view theorists that internal resources are more important for a firm than external factors in achieving and sustaining competitive advantage? Explain your and their position.

4-50. What makes a resource valuable to a company?

4-51. List five financial ratios that may be used by your university to monitor operations.

4-52. What is the most severe cyberthreat facing companies today, and how can firms best mitigate against this threat?

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 4A

Perform a Financial Ratio Analysis for Coca-Cola

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 analyses provide vital input information for developing an IFE Matrix.

Instructions

Step 1 Using the resources listed in Table 4-8, find as many Coca-Cola financial ratios as possible. Record your sources. Report your research to your classmates and your professor.

EXERCISE 4B

Construct an IFE Matrix for Coca-Cola

Purpose

This exercise will give you experience in 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 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 team IFE Matrix for Coca-Cola. Use information from Exercise 1B on page 66.

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 Coca-Cola to capitalize on its major strengths? What strategies would allow Coca-Cola to improve on its major weaknesses?

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 4C

Construct an IFE Matrix for Your College or University

Purpose

This exercise gives you the opportunity to evaluate your university's major strengths and weaknesses. As will become clearer in the next chapter, an organization's strategies are largely based on striving to take advantage of strengths and improving on weaknesses.

Instructions

Step 1 Join with two other individuals to form a three-person team. Develop a team IFE Matrix for your university.

Step 2 What was your team's total weighted score?

Step 3 Compare your team's IFE Matrix to other teams' IFE matrices. Discuss any major differences.

Step 4 What strategies do you think would allow your university to capitalize on its major strengths? What strategies would allow your university to improve on its major weaknesses?

SET 3: STRATEGIC PLANNING FOR MYSELF

EXERCISE 4D

Construct an IFE Matrix for Yourself

Purpose

This exercise gives you the opportunity to evaluate your own personal strengths and weaknesses. As will become clearer in the next chapter, an organization's strategies are largely based on striving to take advantage of strengths and improving on weaknesses. Similarly, in planning for your career, you should formulate and implement personal strategies based on capitalizing on your strengths and improving on your weaknesses.

Instructions

Step 1 Develop an IFE Matrix for yourself. As you assign weights, consider the relative importance of each factor for success in your desired career.

Step 2 What was your team's total weighted score? Compare your total weighted score to the average score of 2.5.

Step 3 What strategies might enable you to capitalize on your major strengths? What strategies might help you improve on your major weaknesses?

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 4E

What Internal Functional Areas Are Most Important to Examine in Strategic Planning?

Purpose

A prioritized list of internal factors is needed for effective strategic planning. Often, the process entails all managers individually ranking the factors identified, from 1 (most important) to 20 (least important). Prioritization is absolutely essential in strategic planning because no organization can do everything that would benefit the firm; tough choices among good choices have to be made.

Internal functional areas that yield strengths/weaknesses can be divided into five broad categories or areas: (1) management, (2) marketing, (3) finance, (4) accounting, and (5) MIS. For some companies or organizations at various times, some areas are more important than others. This exercise reveals the authors' ranking of the relative importance of six functional areas for inclusion in a strategic planning internal assessment.

The purpose of this exercise is to examine more closely the functional areas of business. In addition, the purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Instructions

Rank five internal areas as to their relative importance (1 = most important, 5 = least important) in doing strategic planning. First, rank the areas as an individual. Then, rank the areas as a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision making in strategic planning.

Steps

1. Fill in Column 1 in Table 4-12 to reveal your individual ranking of the relative importance of the six areas (1 = most important, 2 = next most important, etc.). For example, if you feel management is the third-most important functional area in doing strategic planning, then enter a 3 in Table 4-12 in Column 1 beside Management.
2. Fill in Column 2 in Table 4-12 to reveal your group's ranking of the relative importance of the five areas (1 = most important, 2 = next most important, etc.).
3. Fill in Column 3 in Table 4-12 to reveal the expert's ranking of the relative importance of the five functional areas.

TABLE 4-12 Internal Functional Area Analysis: Comparing Individual versus Group Decision Making

Internal Functional Areas	Column 1	Column 2	Column 3	Column 4	Column 5
1. Management					
2. Marketing					
3. Finance					
4. Accounting					
5. MIS					
Sums					

4. Fill in Column 4 in Table 4-12 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 4-12 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

MINI-CASE ON PROCTER & GAMBLE (P&G) COMPANY

Midosemsem/123RF

WHAT COMPANY IS BEST MANAGED IN THE UNITED STATES?

The answer could be P&G. Ratings by the Drucker Institute on overall corporate effectiveness show that P&G is certainly among the most effectively managed firms in the United States. P&G CEO, David Taylor, explains that, "Every day P&G people work to serve consumers with superior brands and reward shareholders with balanced, sustainable long-term growth and value creation. This recognition is further validation that we are on the right track."

The Drucker Institute analyzes performance of companies across the functional areas of business, including more than 35 metrics, such as market-share data, patents, and employee ratings. Information is collected and analyzed to determine how well companies are doing according to Drucker's core principles: customer satisfaction, financial strength, employee development, innovation, and corporate social responsibility. P&G received exceptionally high scores on innovation, social responsibility, and financial strength.

P&G competes in the consumer-products industry. The company's finance chief, Jon Moeller, explains that P&G wants to focus on product categories that are used daily, such as toothpaste and soap, so of late has narrowed its product mix, disposing of underperforming brands and cutting back from more than 100 brands to around 65. Simultaneously, P&G has cut over 20,000 jobs and trimmed nearly \$10 billion in costs. P&G puts its cash to good use and is considered a "dividend king" by some experts. P&G Chief Information Officer, Javier Polit, explained that "What was previously cost-prohibitive is now cost-effective with the use of the cloud. We're about to forecast now in ways we couldn't before. We've seen improvements in regard to the quantity of raw materials we buy, and the costs associated with ship and restock."

As stated by CEO David Taylor, "it is a combination of a few key capabilities that determine whether any company will be successful, especially "superior products that delight customers," "exemplary technology," and what underpins it all is "acquiring the best people."

Questions

1. Consider the following two-dimensional matrix with weights on the *y*-axis and ratings on the *x*-axis as given in Figure 4-4. What are example strengths and weaknesses that could possibly characterize P&G in the four corners of the matrix? Develop a hypothetical strength and weakness for P&G that could be positioned in each of the four corners of the matrix. Give a supporting rationale for each factor. Which corner of the matrix do you think characterizes factors most commonly in an IFE Matrix? Why? Which corner of the matrix do you think characterizes factors least commonly in an IFE Matrix? Why? What could you say about the middle of the matrix in terms of factors commonly included in an IFE Matrix?

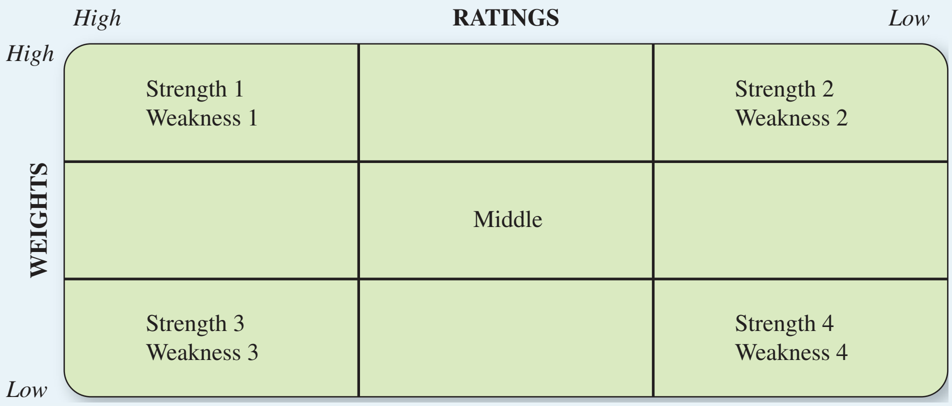

FIGURE 4-4

A Weights-by-Ratings Matrix to Exemplify IFE Matrix Logic

Note: A purpose of this mini-case is to give students practice thinking about when, in developing an IFE Matrix, could a particular factor receive the following weights and ratings:

1. a low weight and high rating
2. a high weight and high rating
3. a low weight and low rating
4. a high weight and low rating

Source: Company documents and a variety of sources including Sara Castellanos, "Tech Innovation Isn't Just for Tech Firms," *Wall Street Journal,* (December 6, 2017): R6, and Vanessa Fuhrmans and Yoree Koh, "The Most Effectively Managed U.S. Companies and How They Got That Way," *Wall Street Journal*, (December 6, 2017): R1–R2.

Web Resources

1. See Table 4-8 on page 138.

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12. Reprinted by permission of the publisher from "Integrating Strength–Weakness Analysis into Strategic Planning," by William King, *Journal of Business Research* 2, no. 4: 481. Copyright 1983 by Elsevier Science Publishing Co., Inc.

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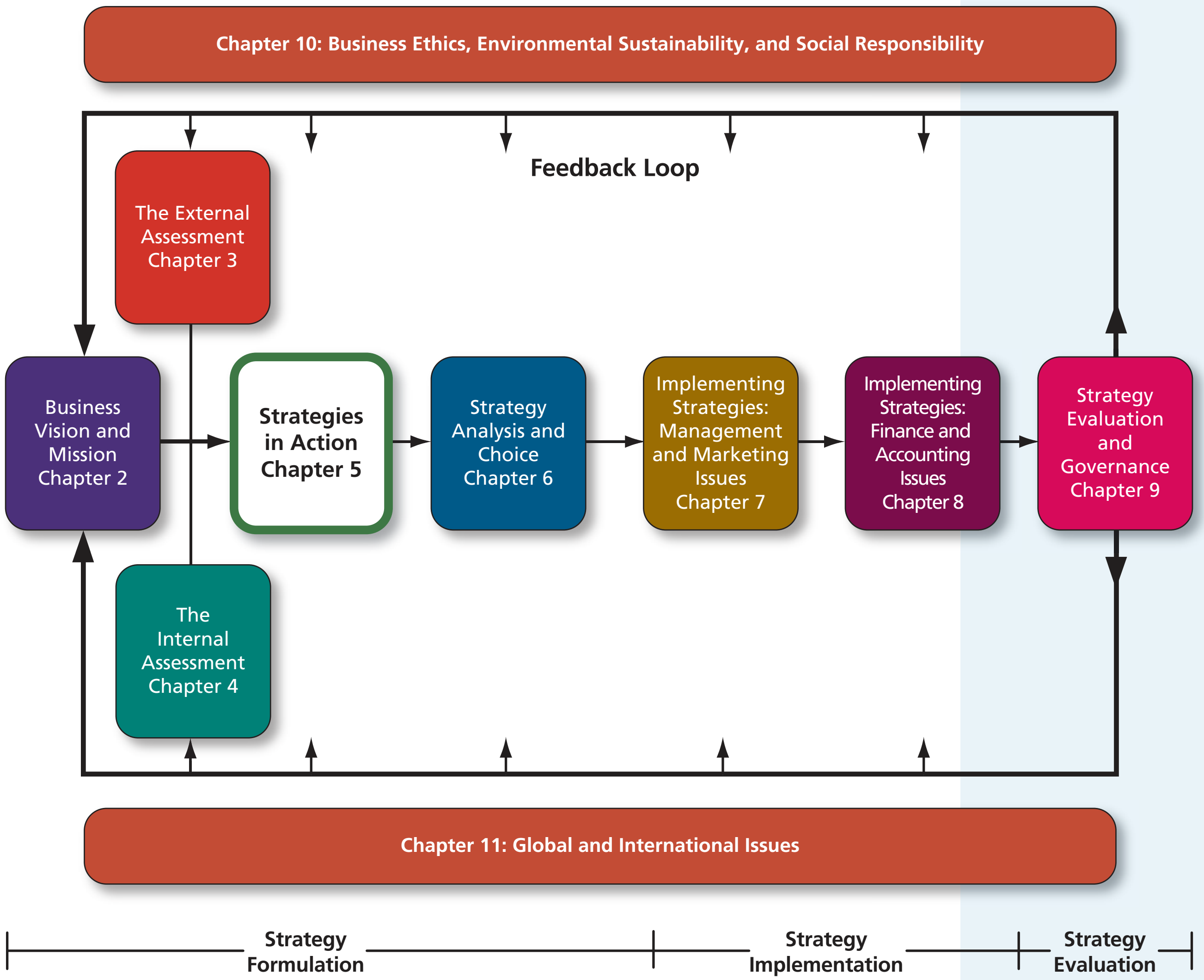

FIGURE 5-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

Strategies in Action

LEARNING OBJECTIVES

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

5-1. Identify and discuss 5 characteristics and 10 benefits of clear objectives.

5-2. Define and give an example of 11 types of strategies.

5-3. Identify and discuss the three types of "Integration Strategies."

5-4. Give specific guidelines when market penetration, market development, and product development are especially effective strategies.

5-5. Explain when diversification is an effective business strategy.

5-6. List guidelines for when retrenchment, divestiture, and liquidation are especially effective strategies.

5-7. Explain value chain analysis and benchmarking in strategic management.

5-8. Identify and discuss Porter's two generic strategies: cost leadership and differentiation.

5-9. Compare and contrast when companies should "build, borrow, or buy" as key means for achieving strategies.

5-10. Discuss first-mover advantages and disadvantages.

5-11. Explain how strategic planning differs in for-profit, not-for-profit, and small firms.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1:	Strategic Planning for Coca-Cola
EXERCISE 5A:	Develop Hypothetical Coca-Cola Company Strategies
EXERCISE 5B:	Should Coca-Cola Build, Borrow, or Buy in 2020–2021?
SET 2:	Strategic Planning for My University
EXERCISE 5C:	Develop Alternative Strategies for Your University
SET 3:	Strategic Planning for Myself
EXERCISE 5D:	The Key to Personal Strategic Planning: Simultaneously Build and Borrow
SET 4:	Individual versus Group Strategic Planning
EXERCISE 5E:	What Is the Best Mix of Strategies for Coca-Cola Company?

MyLab Management

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Hundreds of companies today have embraced strategic planning in their quest for higher revenues and profits. Kent Nelson, former chair and CEO of UPS, explains why his company 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] As illustrated in Figure 5-1, long-term objectives are needed before strategies can be generated, evaluated, and selected.

This chapter brings strategic management to life with many contemporary examples. Different types of strategies are defined and exemplified, including Michael Porter's generic strategies: cost leadership and differentiation. Guidelines are presented for determining when each strategy is most appropriate to pursue. The integral importance of value chain analysis and benchmarking in strategic planning is revealed. An overview of strategic management in nonprofit organizations, governmental agencies, and small firms is provided. As showcased next, Tim Cook is arguably the best strategist on the planet; he has led Apple to be the most admired company in the world. Read to see why Cook and Apple are "insanely great."

LO 5.1 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 2 to 5 years. Without long-term objectives, an organization would drift aimlessly toward some unknown end or become too focused on short-term fads and stray away from the firm's mission.

It is hard to imagine an organization or an 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 rarely occurs by accident; rather, it is the result of hard work directed toward achieving certain objectives.

Characteristics and Benefits of Objectives

Objectives should be quantitative, understandable, challenging, compatible (consistent vertically and horizontally in a chain of command), and obtainable. Each objective should also be associated with a timeline. Objectives are commonly stated in terms such as *growth in assets, growth*

EXEMPLARY **STRATEGIST** SHOWCASED

Tim Cook, CEO of Apple, Inc.

Ildogesto/Shutterstock

The editor of *Businessweek*, Megan Murphy, recently asked the CEO of Apple, Tim Cook, what he thought his legacy at Apple would be. Tim responded: "To be honest I don't think about it; I think about doing stuff." Cook went on to explain how and why Apple's founder, Steve Jobs, rather than himself, should be the person revered forever as Apple's supreme strategist extraordinaire. Cook told Megan that Apple in the past, present, and future is all about its founder Jobs. Tim explained that Job's "DNA" or "ethos" is and always will be Apple's "Constitution" or guiding set of principles. According to Cook, Jobs's ethos ingrained into Apple forever include the following items (paraphrased):

1. Pay acute attention to detail.
2. Keep it simple and genuinely care.
3. Focus on the user and user experience.
4. Focus on building the best.
5. Follow the motto "good isn't good enough"; every product and process must be, as Jobs's often said, "insanely great."
6. Apple should own the proprietary technology it uses to control its own quality of product and user experience.
7. Walk away and be honest with yourself when you do something wrong.
8. Never get married to your position or pride.
9. Invest for the long-term rather than striving to be the first to market with a product.

Source: Based on Megan Murphy, "Tim Cook," *Bloomberg Businessweek*, June 19, 2017, pp. 52–56.

in sales, profitability, market share, degree and nature of diversification, degree and nature of vertical integration, earnings per share, and *social responsibility*. (Note: Do not emulate many *Annual Reports* that print really vague objectives for the firm, such as Macy's *Annual Report* that states as objectives "to grow sales profitably" and "to improve return on invested capital." Such statements are useless in strategic planning.

Clearly established objectives offer many benefits. They provide direction, allow synergy, assist 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.

Table 5-1 and Table 5-2 summarize the desired characteristics and benefits, respectively, of having clear objectives.

TABLE 5-1 Five Characteristics of Objectives

1. Quantitative: measurable
2. Understandable: clear
3. Challenging: achievable
4. Compatible: consistent vertically and horizontally in a chain of command
5. Obtainable: realistic

TABLE 5-2 10 Benefits of Having Clear Objectives

1. Provide direction by revealing expectations.
2. Allow synergy.
3. Assist 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.

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 all other objectives relating to the financial position of the firm, whereas **strategic objectives** focus on goals for obtaining a competitive advantage, including factors such as a larger market share, quicker on-time delivery than rivals, lower costs than rivals, higher product quality than rivals, wider geographic coverage than rivals, achieving technological leadership, and consistently getting new or improved products to market ahead of rivals.

Often there is a trade-off between financial and strategic objectives such that crucial decisions have to be made. For example, a firm can do certain activities 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. Amazon, for example, operated for decades without concern for profits, instead concentrating on gaining market share. There are other trade-offs between financial and strategic objectives, related to riskiness of actions, concern for business ethics, the need to preserve the natural environment, and social responsibility issues. Both financial and strategic objectives should include annual and long-term performance targets.

Ultimately, the best way to sustain competitive advantage is to relentlessly pursue strategic objectives that strengthen a firm's business position over rivals.

Avoid Managing by Crisis, Hope, Extrapolation, and Mystery (CHEM)

Derek Bok, former President of Harvard University, once said, "If you think education is expensive, try ignorance." The idea behind this saying also applies to establishing objectives because strategists should avoid managing by CHEM.

- ***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 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, letting events dictate the *what* and *when* of management decisions.
- ***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.
- ***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 Mystery***—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).[2]

LO 5.2 Types of Strategies

Defined and exemplified in Table 5-3, 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, 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. Note for a particular company the strategy is very specific; be specific to the extent possible in all aspects of strategic planning.

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; priorities must be established. Difficult decisions must be made. Organizations, like individuals, have limited resources. Both organizations and individuals must choose among alternative strategies and avoid excessive indebtedness.

TABLE 5-3 Alternative Strategies Defined and Recent Examples Given

Strategy	Definition	Example
Forward Integration	Gaining ownership or increased control over distributors or retailers	Nike opening 100 outlet stores and selling 30% more products on its website
Backward Integration	Seeking ownership or increased control over suppliers	Boeing building 80% of its wing flap motors in-house
Horizontal Integration	Seeking ownership or increased control over competitors	Nestlé purchasing Sweet Earth Foods
Market Penetration	Seeking increased market share for present products in present markets through greater marketing	Cristiano Ronaldo and LeBron James sign lifetime endorsement deal with Nike
Market Development	Introducing present products into new geographic area	Publix building 20 new supermarkets in North and South Carolina
Product Development	Seeking increased sales by improving present products or developing new ones	Ford shifting one-third of its scheduled R&D budget on gas/diesel engines to electric engines

Related Diversification	Adding new but related products	Walmart acquired Jet.com for $3.3 billion
Unrelated Diversification	Adding new, unrelated products	CVS pharmacy acquiring Aetna insurance
Retrenchment	Regrouping through cost and asset reduction to reverse declining sales and profit	Eli Lilly laying off 3,500 employees
Divestiture	Selling a division or part of an organization	Toshiba aims to sell its memory-chip unit to Bain Capital
Liquidation	Selling all of a company's assets, in parts, for their tangible worth	Ringling Bros. and Barnum & Bailey Circus liquidated (last performance was on May 21, 2017)

Strategic planning thus 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." Strategy is all about "what to do" and "what not to do."

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 an educated wager based on predictions and hypotheses that are continually tested and refined by knowledge, research, experience, and learning. Survival of the firm often hinges on an excellent strategic plan.[3]

Organizations cannot excel in multiple different strategic pursuits 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. Organizations struggling to survive may simultaneously employ a combination of several defensive strategies, such as divestiture 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 5-2. However, in small firms, there are three levels of strategies: company, functional, and operational.

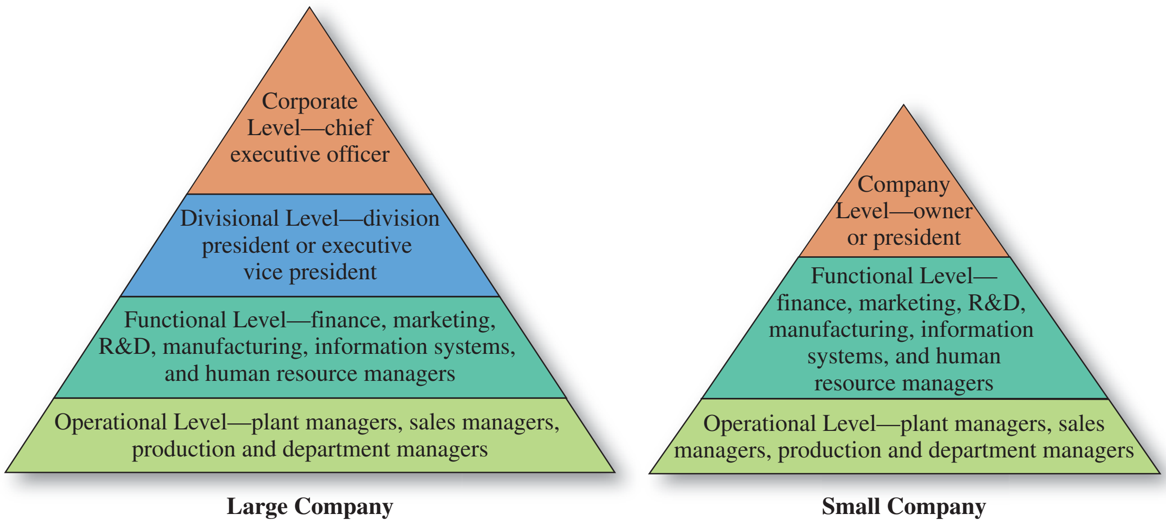

FIGURE 5-2
Levels of Strategies with Persons Most Responsible

The persons primarily responsible for having effective strategies at the various levels include the CEO at the corporate level; the president of segments at the divisional level; the chief finance officer (CFO), chief information officer (CIO), human resource manager (HRM), chief marketing officer (CMO), other executives at the functional level, and the plant manager, regional sales manager, and so on at the operational level. 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.

Long-term objectives are needed at the corporate, divisional, functional, and operational levels of an organization. They are an important measure of managerial performance. Bonuses or merit pay for managers today should 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 5-4. A particular organization could tailor these guidelines to meet their own needs, but incentives should be attached to both long-term and annual objectives.

TABLE 5-4 Varying Performance Measures By Organizational Level

Organizational-Level	Basis for Annual Bonus or Merit Pay
Corporate: overall firm	75% based on long-term objectives
	25% based on annual objectives
Divisional	such as by product or region 50% based on long-term objectives
	50% based on annual objectives
Functional	such as marketing and finance 25% based on long-term objectives
	75% based on annual objectives
Operational	such as manufacturing plants or stores 25% based on long-term objectives
	75% based on annual objectives

LO 5.3 Integration Strategies

Forward integration and backward integration are sometimes collectively referred to as **vertical integration**. Vertical integration strategies allow a firm to gain control over distributors and suppliers, whereas **horizontal integration** refers to gaining ownership or control over competitors. Vertical and horizontal actions by firms are broadly referred to as **integration strategies**.

Historically, vertical integration strategies have been difficult to implement because of the firm operating in businesses out of its core competency, and because large fixed costs are generally associated with such strategies. For example, if Coke wished to vertically integrate, it could acquire sugar farms to gain control over its suppliers and open its own brick-and-mortar stores to gain control of distributors. Both would be excessively costly and divert Coke from what it does best: producing beverage products. Although the risk of depending on suppliers and distributors may be high, owning these businesses is often associated with even greater risks. Viable options to vertical integration are joint ventures and strategic alliances discussed later in the chapter. Opportunity costs associated with the resources used for vertical integration usually could be more effectively deployed to other endeavors.

Forward Integration

Forward integration involves gaining ownership or increased control over distributors or retailers as a means of moving closer to the end customer and cutting out the middleman. Increasing numbers of manufacturers (suppliers) are pursuing forward integration to market the products they produce. For example, Nike sells millions of shoes and shirts in a variety of retail stores ranging from Foot Locker to J. C. Penney, but the company is rapidly boosting its direct-to-consumer business, bypassing, and in some cases infuriating, retail stores. Nike's forward-integration strategy has hundreds of retail stores upset; sales on the Nike.com website recently rose 50 percent. By 2020, Nike projects that its direct sales to consumers will exceed $16 billion annually and account for one-third of the company's revenue. At the three largest publicly traded U.S. athletic retailers, Finish Line, Foot Locker, and Dick's Sporting Goods, the percentage of their merchandise that comes from Nike is 73, 73, and 19 percent, respectively, so these firms must adapt or face disaster.

Forward integration is an increasingly popular strategy among U.S.-based restaurants. Scores of mainstream restaurant chains now use or are developing online-ordering apps that often entail delivery of food to customers. For example, Panera Bread has installed online-ordering and delivery in about 50 percent of its restaurants. Panera employs more than 10,000 of its own delivery drivers. Similarly, Dunkin' Brands is now delivering doughnuts and coffee in Dallas, Atlanta, Chicago, Los Angeles, and numerous other cities. Chipotle Mexican Grill has instituted a second food assembly line in its restaurants to accommodate delivery and online orders. Taco Bell now takes online orders and delivers in more than 50 markets through nearly 1,000 Taco Bell restaurants. Online ordering and delivery of restaurant food in general is expected to soon surpass pizzas.

An effective means of implementing forward integration is **franchising**. Approximately 2,000 companies in about 50 different industries in the United States 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 exceed $1 trillion annually. There are about 800,000 franchise businesses in the U.S. Subway is today in turmoil as the 100 percent franchised firm has mostly franchisees that disagree with top executives on the overall vision and mission of the firm. Year 2017 was the fourth consecutive year of declining sales at Subway. Top executives want to continue adding stores to the over 25,000 in the U.S., but franchisees cannot take further cannibalization caused by new Subways opening nearby. Instead, franchisees want more control over their supplier choices, more advertising from corporate, more flexibility on what promotions to participate in, more R&D to enhance a menu that has not changed much in a decade, and permission to add drive-through services.

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

1. An organization's present distributors are especially expensive, unreliable, or incapable of meeting the firm's distribution needs.
2. The availability of quality distributors is so limited a rival could potentially sign an exclusive contract, thus locking down a competitive advantage.
3. 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.
4. An organization has both the capital and human resources needed to manage the new business of distributing its own products.
5. 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.
6. 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

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. Starbucks recently purchased its first coffee farm—a 600-acre property in Costa Rica. This backward integration strategy was used primarily to develop new coffee varieties and to test methods to combat a fungal disease known as *coffee rust* that plagues the industry. Manufacturers, as well as retailers, purchase needed materials from suppliers.

Consolidation in the aircraft parts industry has resulted in increased prices of these parts, which has prompted Boeing and Airbus to begin producing many aircraft parts internally. Boeing is constructing a plant in England that will produce motors that aid in the movement of wing flaps. Airbus CEO Fabrice Bregier commented on how the firm continually reviews "make-or-buy" decisions on most of its components used in aircraft construction.

Some industries, such as automotive and aluminum producers, are reducing their historical pursuit of backward integration; this practice is called **de-integration**. Instead of owning their suppliers, companies negotiate with 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. This 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, many 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," said Mark Shimelonis, formerly of Xerox.

Four major U.S. hospital systems recently launched a nonprofit company to produce generic drugs in order to offset skyrocketing prices of drugs. The four firms are Intermountain Healthcare, Ascension, SSM Health, and Trinity Health; these four organizations own hundreds of hospitals.

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

1. An organization's present suppliers are especially expensive, unreliable, or incapable of meeting the firm's needs for parts, components, assemblies, or raw materials.
2. The number of suppliers is small and the number of competitors is large.
3. 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.
4. An organization has both capital and human resources to manage the new business of supplying its own raw materials.
5. The advantages of stable prices of raw materials are of upmost importance.
6. Present suppliers have high-profit margins, which suggest that the business of supplying products or services in a given industry is a worthwhile venture.
7. Whenever various resources may be needed quickly.

Horizontal Integration

Horizontal integration is a strategy aimed at gaining control over a firm's competitors; this is arguably the most common growth strategy. Thousands of mergers, acquisitions, and takeovers among competitors are consummated annually and most aim for increased economies of scale, enhanced transfer of resources and competencies, reduced competition, and fewer price wars. 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]

Walgreens Boot Alliance recently purchased two thousand Rite Aid stores; the remaining two thousand Rite Aid stores are being acquired by Albertsons Companies LLC. Horizontal integration is often met with legal antitrust challenges as the one displayed with Walgreens and Rite Aid, which took the Federal Trade Commission 18 months before giving final approval of the deal.

The largest merger of homebuilders in 10 years occurred in 2018 when Lennar Corp. acquired CalAtlantic Group to create a combined company with revenues more than \$17 billion annually. The next largest homebuilders in the United States in rank order are D. R. Horton, PulteGroup, NVR, Toll Brothers, and KB Home.

Britain's Cineworld Group PLC in 2018 acquired its U.S. counterpart Regal Entertainment Group for $3.6 billion, creating the world's second-largest movie cinema operator. The combined company now has more than 9,000 movie screens. The largest firm in the industry is AMC Entertainment Holdings that is part of China's Dalian Wanda Group. Cinemark Holdings is the third-largest cinema chain in the United States.

The following six guidelines indicate when horizontal integration may be an especially effective strategy:[7]

1. 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.
2. An organization competes in a growing industry.
3. Increased economies of scale provide major competitive advantages.
4. An organization has both the capital and human talent needed to successfully manage an expanded organization.
5. When competitors are faltering and can be acquired at a discount.
6. When a firm desires to enter a new geographic market quickly.

Intensive Strategies

LO 5.4

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. Intensive strategies are normally good options because they involve a firm sticking to what it does best with the only variation being (1) redoubling your effort (market penetration), (2) taking what it does best on the "road" (market development), or (3) improving on what it does best (product development). In contrast, forward and backward integration and diversification strategies take firms away from their core products, services, or competencies.

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 promotions, or increasing publicity efforts. For example, Verizon is spending millions of dollars on a new advertising theme named "Humanability" that tells stories about how Verizon's technology products are easing traffic flow, keeping fish fresh in transit, and supporting advancements in virtual surgery and health care; this new theme replaces Verizon's "Can You Hear Me Now?" theme.

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

1. Current markets are not saturated with a particular product or service.
2. The usage rate of present customers could be increased significantly.
3. The market shares of major competitors have been declining, whereas total industry sales have been increasing.
4. The correlation between dollar sales and dollar marketing expenditures historically has been high.
5. Increased economies of scale provide major competitive advantages.

Market Development

Market development involves introducing present products or services into new geographic areas. Tesla will soon manufacture (and sell) cars in China based on the Chinese government's plans to relax restrictions on automakers needing a local partner. For thousands of firms, market development means adding facilities and operations globally. The Global Capsule 5 reveals a key variable used to determine where we should concentrate new business.

GLOBAL CAPSULE 5

How Can a Firm Determine Where to Initiate New Business? Use Gross Domestic Product (GDP) as a Guide.

Madrugada Verde/ Shutterstock

Thousands of companies and organizations desire to grow globally, but they are not sure where among the two-hundred-plus countries in the world. A key barometer for examining how to determine where to begin or expand company operations is gross domestic product (GDP) of various countries. GDP is a quantitative measure of a nation's total economic output, growth, or activity over a specified period of time. According to a recent issue of *Bloomberg Businessweek*, the 2018 GDP will be a bit less than 2017 for most countries, and the magical 4 percent number is expected only in India and China for the sample countries.

Country	GDP Percent 2017	GDP Percent 2018
United States	2.1	2.5
United Kingdom	1.5	1.4
Mexico	2.3	2.3
Japan	1.5	0.9
Germany	2.1	1.6
Canada	3.0	1.9
China	6.8	6.4
India	7.1	7.0

Caveat: GPD is important, but consumption habits are more important. Does the foreign market value your product? If not, who cares about GDP? Market development allows for good risk/reward compared to other strategy types if consumption habits are similar in the targeted markets because the firm continues to focus on its core competency rather than entering businesses it knows less about. Also, brand recognition can likely transfer to a new market more easily when consumption habits are similar.

Source: Based on Peter Coy, "The World Economy Should Grow Nicely Again in 2018. (Unless Someone Does Something Dumb.)" *Bloomberg Businessweek* (November 6, 2017 to January 8, 2018):17.

Millions of small businesses annually add a second, third, or fourth store, office, or restaurant in new locations; that is market development. Dollar General is adding 1,000 new stores every 12 months across the United States, primarily in poor, rural communities. There are presently more than 14,000 one-story plain yellow-and-black Dollar Generals in the United States, more than Starbucks' two-tailed green mermaid stores.

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

1. New channels of distribution are available that are reliable, inexpensive, and of good quality.
2. An organization is successful at what it does.
3. New untapped or unsaturated markets exist.
4. An organization has the needed capital and human resources to manage expanded operations.
5. An organization has excess production capacity.
6. An organization's basic industry is rapidly becoming global in scope.
7. Consumption habits of the firm's products are similar in other geographic areas.

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 (R&D) expenditures. For example, Ford recently announced that up to one-third of its R&D budget scheduled for research on combustible engines would be shifted to battery and electric car research. Ford also shifted $7 billion in investment away from smaller cars into trucks and SUVs.

Kellogg recently purchased RXBAR in a move to shift its product mix away from traditional sugary breakfast foods such as Frosted Flakes and Pop-Tarts, which have experienced declining sales in recent years as customers turn to more healthy options. RXBARs get their sweeteners solely from dates rather than added sugar. In a similar product development move, Campbell Soup recently acquired Pacific Foods, a firm that specializes in organic soups.

Automobile companies use product development extensively. Some old truck brands are making a comeback as Americans buy more pickups and SUVs. For example, the following brands are being reintroduced in the respective years given: Jeep Scrambler (2019), Jeep Wagoneer (2019), Chevy Blazer (2019), Ford Bronco (2020), Ford Ranger (2019), and Land Rover Defender (2019). The bulk of profits earned at Ford, GM, and Fiat Chrysler today come from pickups and SUVs.

Product development overall is an excellent option because a firm does not stray far from what it does best. The following five guidelines indicate when product development may be an especially effective strategy to pursue:[10]

1. 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.
2. An organization competes in an industry that is characterized by rapid technological developments.
3. Major competitors offer better-quality products at comparable prices.
4. An organization competes in a high-growth industry.
5. An organization has especially strong research and development capabilities.

Diversification Strategies

LO 5.5

The two general types of **diversification strategies** are **related diversification** and **unrelated diversification**. Businesses are said to be *related* when their value chains possess competitively valuable cross-business strategic fits; businesses are said to be *unrelated* when their value chains are so dissimilar that few competitively valuable cross-business relationships exist.[11] Most companies favor related diversification strategies to capitalize on synergies such as follows:

- Transferring competitively valuable expertise, technological know-how, or other capabilities from one business to another
- Combining 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 still on the retreat. Michael Porter, of the Harvard Business School, commented, "Management found it couldn't manage the beast." Businesses are still selling, closing, or spinning off less profitable or "different" divisions to focus on their core businesses. For example, ITT recently divided itself into three separate, specialized companies. At one time, ITT 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." Rapidly appearing new technologies, new products, and fast-shifting buyer preferences make diversification difficult. Another highly diversified company, General Electric, is selling off many of its diversified parts.

Diversification must do more than simply spread business risks across different industries; after all, 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 that the strategy adds more to shareholder value than what shareholders could accomplish acting individually. Any industry chosen for diversification must be attractive enough to yield consistently high returns on investment and offer potential synergies across the operating divisions that are greater than those entities could achieve alone. Many strategists contend that firms should "stick to the knitting" and not stray too far from the firms' basic areas of competence.

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, Berkshire Hathaway, Allied Signal, Emerson Electric, GE, Viacom, Amazon, Google, Disney, and Samsung.

Conglomerates prove that focus and diversity are not always mutually exclusive. In an unattractive industry, diversification makes sense, such as for Philip Morris, because cigarette consumption is declining, product liability suits are a risk, and some investors reject tobacco stocks on principle.

Related Diversification

In a related diversification move, Walt Disney recently acquired 21st Century Fox's film and TV studios in a deal worth over $52 million. The deal included Fox-owned cable networks, including FX and National Geographic, and Fox's stakes in international networks like Star TV, Sky, and Hulu.

Five guidelines reveal when related diversification may be an effective strategy to follow:[13]

1. An organization competes in a no-growth or a slow-growth industry.
2. Adding new, but related, products would significantly enhance the sale of current products.
3. New, but related, products could be offered at highly competitive prices.
4. New, but related, products have seasonal sales levels that counterbalance an organization's existing peaks and valleys.
5. An organization has a strong management team.

Unrelated Diversification

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 strategic fit 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.

In an unrelated diversification move, Amazon.com is planning to enter the $412 billion pharmacy business. Today, 9 out of 10 patients pick up their prescriptions at a retail pharmacy, but Amazon is betting that home delivery of pharmaceuticals are soon to be the rule rather than the exception. Partly because of this external threat, CVS recently acquired the huge insurance firm, Aetna, Inc., in an unrelated diversification move targeted to offset their reliance on the drugstore industry, which as a whole has been experiencing faltering revenues and profits.

Five guidelines reveal when unrelated diversification may be an especially effective strategy follow:[14]

1. Existing markets for an organization's present products are saturated.
2. An organization competes in a highly competitive or a no-growth industry, as indicated by low industry profit margins and returns.
3. An organization's present channels of distribution can be used to market new products to current customers.
4. New products have countercyclical sales patterns compared to an organization's present products.
5. An organization has the capital and managerial talent needed to compete successfully in a new industry.

LO 5.6 Defensive Strategies

In addition to integrative, intensive, and diversification strategies, organizations also could pursue defensive strategies such as retrenchment, divestiture, or liquidation. Retrenchment is a broad term that can include divestiture and liquidation.

Retrenchment

Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a **turnaround 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 involve 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.

Eli Lilly is cutting 8 percent of its global workforce mostly centered on the production and marketing of existing drugs that are nearing patent expiration because competition from lower-priced generics is forecasted to be fierce. Eli Lilly is deploying much of the salary savings into R&D of new drugs.

The world's largest seller of generic drugs, Teva Pharmaceutical Industries is laying off 25 percent of its workforce, or about 14,000 employees around the world, and closing factories and research centers, and suspending its dividend to cut costs. Headquartered in Tel Aviv, Israel, Teva expects its retrenchment strategy to save $3 billion in costs in 2018–2019.

The action-camera company, GoPro Inc. in 2018 laid off one-fifth of its workforce and exited the drone market as part of the firm's retrenchment strategy. As smartphone cameras and videos have improved, GoPro's camera business has suffered.

In some cases, declaring **bankruptcy** can be an effective retrenchment strategy. Bankruptcy can allow a firm to avoid major debt obligations and to void union contracts. **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. Several hundred thousand companies declare Chapter 7 bankruptcy annually with most of the firms being small.

Chapter 11 bankruptcy allows organizations to retrench, reorganize, and come back after filing a petition for protection. About 40 large U.S. retail companies declared bankruptcy in both 2017 and 2018, up from 18 in 2016. Firms declaring bankruptcy in 2017 included RadioShack, Payless Shoes, The Limited, HHGregg, Rue 21, Gander Mountain, and Toys R Us. Other retail companies closing stores rapidly and possibly heading for bankruptcy include Gymboree, Bebe, Crocs, Gamestop, Sears/Kmart, J. C. Penney, Michael Kors, Staples, Macy's, and Chico's. A key problem for retail firms is shoppers' discount addiction spurred by Amazon's prowess and also smartphone-shopping tools and apps prompting never-ending price-cutting, price matching, and price wars. The dramatic shift to online purchasing has also severely curtailed the need for brick-and-mortar stores of all kinds.

Three guidelines reveal when retrenchment may be an especially effective strategy to pursue follow:[15]

1. An organization is plagued by inefficiency, low profitability, poor employee morale, and pressure from stockholders to improve performance.
2. 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).
3. 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**. It is often 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 refocus on their core businesses and become less diversified.

Volkswagen AG recently divested upward of 20 percent of the company's assets that are not part of the firm's core business including the potential sale of Ducati, the motorcycle brand. Commonwealth Bank of Australia recently divested all of its life insurance businesses in Australia and New Zealand totaling more than $3 billion, partly in response to pressure from regulators in the countries. Nestlé SA recently divested its U.S. chocolate segment to the Italian firm Ferrero International SA for $2.8 billion, making the family-owned Ferrero company the third-largest chocolate seller in the United States.

A form of divestiture occurs when a corporation splits into two or more parts. Most often, divested segments become separate, publicly traded companies. Many large conglomerate firms are employing this strategy. Sometimes this strategy is a prelude to the firm selling the separated part(s) to a rival firm. Corporations annually split off about $2 trillion worth of subsidiaries. Part of the reason for splitting diversified firms is that the homogenous parts are generally much more attractive to potential buyers. Most times, the acquiring firms desire to promote homogeneity to complement their own operations, rather than heterogeneity, and are willing to pay for homogeneity. For example, Nacco Industries is divesting its Hamilton Beach Brands appliances and a kitchen-accessory store chain in an effort to refocus on its core coal and mining businesses. Nacco's revenues are about $900 million annually with Hamilton Beach bringing in about $605 million and Kitchen Collection about $144 million. Similarly, Britain's GKN PLC in 2018 split into two companies, separating its aerospace and automotive businesses. Based in Redditch, England, GKN is one of Britain's oldest companies (250 years) and today has about 58,000 employees.

Another example is the German company Daimler AG in 2018 consolidating its five business divisions into three separately registered, wholly-owned subsidiary companies. Analysts expect the Daimler restructuring is a prelude for Daimler divesting (spinning off) the three segments into separate publicly listed companies: (1) Mercedes-Benz cars and vans, (2) Daimler trucks and buses, and (3) Daimler Financial Services. Pfizer Inc. and Honeywell International Inc. recently divested several of their major business units, spinning them off into separate publicly listed companies.

Here are some guidelines for when divestiture may be an especially effective strategy to pursue:[16]

1. An organization has pursued a retrenchment strategy and failed to accomplish needed improvements.
2. A division is responsible for an organization's overall poor performance.
3. A division is a misfit with the rest of an organization; this can result from radically different markets, customers, managers, employees, values, or needs.
4. A large amount of cash is needed quickly and cannot be obtained reasonably from other sources.
5. 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 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. Several hundred thousand companies declare Chapter 7 bankruptcy annually with most of the firms being small.

The legendary, world famous, Ringling Bros. and Barnum & Bailey circus liquidated in 2017 after 146 years in business because of "declining tickets sales and high operating costs." The final circus performances were in Providence, Rhode Island, on May 7 and Uniondale, New York, on May 21, 2017. In May 2016, the circus had previously retired its elephant act, years after a suit by activists. The animal rights group PETA says "we herald the end of what has been the saddest show on earth for wild animals, and ask all other animal circuses to follow suit, as this is a sign of changing times." PETA President Ingrid Newkirk says "our protests have awoken the world to the plight of animals in captivity." The Ringling Bros. and Barnum & Bailey circus went by the slogan: "The greatest show on earth," a catchphrase so famous it was employed for the title of the 1952 Cecil B. DeMille best picture Oscar-winning film starring Charlton Heston and Betty Hutton. For more than 100 years, schools would close in towns and cities when Ringling Bros. and Barnum & Bailey came to town; those days are long gone.

The American iconic toy store chain Toys "R" Us Inc. in 2018 liquidated, selling or closing all its 885 U.S. stores deleting about 33,000 jobs. The company is likely to liquidate also in France, Spain, Poland, and Australia. The company hopes to sell its operation in Canada, Central Europe, and Asia.

Two guidelines reveal when liquidation may be an especially effective strategy to pursue:[17]

1. An organization has pursued both a retrenchment strategy and a divestiture strategy, and neither has been successful.
2. The stockholders of a firm can minimize their losses by selling the organization's assets.

Value Chain Analysis and Benchmarking

LO 5.7

Whenever a customer buys a product it is because that consumer feels the "value" to be derived from that product in terms of price paid versus benefits received is worthwhile. However, the ultimate price paid by a consumer for a product is determined from scores of activities that went into producing that product, from raw materials to suppliers, to production processes, to distributors, etc. This collection of activities that leads to the ultimate price of a product is commonly referred to as a firm's **value chain**.[18] Firm's seek competitive advantages anywhere they can up and down their value chain, to ultimately provide some product at some price and some level of quality that consumers will perceive to be of sufficient value to warrant the purchase. The value chain concept, as illustrated in Figure 5-3, is important in strategic management.

Value chain analysis (VCA) can be defined as the process whereby a firm determines the value (price minus cost) of each and all activities that went into producing and marketing a product, from purchasing raw materials to manufacturing, distributing, and marketing those products. VCA is an excellent way to identify both external opportunities/threats and internal strengths/weaknesses of a firm. Companies strive to gain competitive advantages wherever possible up and down their value chain, because such "value activities" are not easily duplicated or imitable by rival firms. In contrast, just lowering the price of an end product or hiring a celebrity to promote an end product is easily imitable; such actions do not represent a sustainable competitive advantage. In other words, at every step along a firm's value chain, the firm strives to create value (price

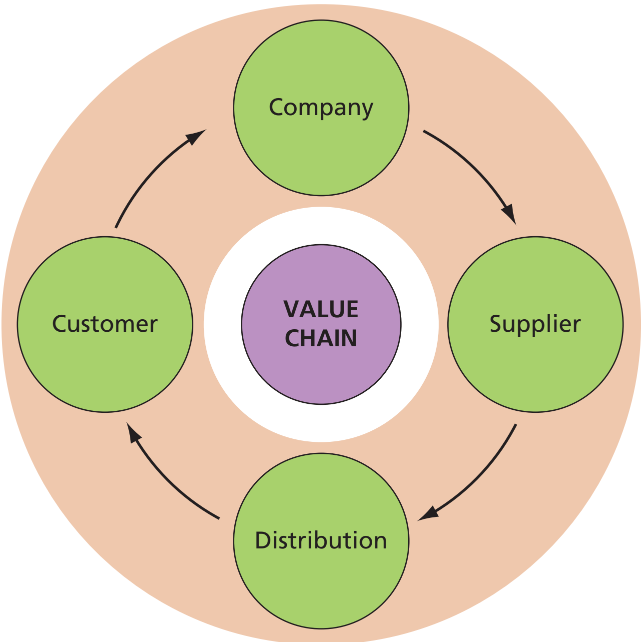

FIGURE 5-3
A Value Chain Illustrated

minus cost) that can ultimately be transferred to the end user (customers), so customers will buy the product at some price to obtain the perceived value.

Substantial judgment may be required in performing a VCA because different items along the value chain may impact other items positively or negatively, at times creating 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.

The initial step in implementing VCA is to divide a firm's operations into specific activities or business processes. Then the analyst attempts to attach a cost of each discrete activity versus the price to be paid; the costs could be in terms of both time and money. Finally, the analyst converts the "value data" into information by looking for competitive oppotunities/threats and/or strengths/weaknesses that may yield competitive advantage or disadvantage. Conducting a VCA is supportive of the research-based view'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. VCA enables a firm to examine and monitor the extent that its prices and costs are competitive throughout the value chain; those value segments lead cumulatively to the customers' perceived value received by paying some price for some end product.

A value chain is illustrated in Figure 5-4. 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 sustainable 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, mining of metals, licensing, software, hardware, and laptops. A motel would include food, housekeeping, check-in and check-out operations, website, reservations system where they order supplies and so on.

All firms should use VCA to develop and nurture a core competence and convert this competence into a distinctive competence. A **core competence** is any element of a firm's value chain that performs especially well (yields high value). When a core competence evolves into a major competitive advantage, then it is called a *distinctive competence.* Figure 5-5 illustrates this process.

More and more companies are using VCA to gain and sustain competitive advantage by becoming 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. In contrast, computer companies 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.

To gain and sustain competitive advantage, a firm must create value for a product or service that exceeds the value offered by rivals.[19] This is commonly done in one of two ways: (1) operating at the lowest cost, or (2) commanding a premium price. A few firms try to do both simultaneously. The bottom line, however, is that a business needs to be better than rivals on many points along its value chain because these points likely cannot be easily copied, thus they are sustainable. Rival firms ask, "How do they do it?" The answer for many successful firms is "through effective value chain analysis."

VCA focuses on the quality differences in activities among rival firms. Not all firms in a given industry will place equal weights on various value chain items. For example, Rolex and Timex both produce watches, yet each value chain will differ substantially on key areas. Rolex creates value for the customer through prestige and elegance, whereas Timex creates value through price and utility. Each firm creates value so long

- Supplier Costs
  - Raw materials
  - Fuel
  - Energy
  - Transportation
  - Truck drivers
  - Truck maintenance
  - Component parts
  - Inspection
  - Storing
  - Warehouse
- Production Costs
  - Inventory system
  - Receiving
  - Plant layout
  - Maintenance
  - Plant location
  - Computer
  - R&D
  - Cost accounting
- Distribution Costs
  - Loading
  - Shipping
  - Budgeting
  - Personnel
  - Internet
  - Trucking
  - Railroads
  - Fuel
  - Maintenance
- Sales and Marketing Costs
  - Salespersons
  - Website
  - Internet
  - Publicity
  - Promotion
  - Advertising
  - Transportation
  - Food and lodging
- Customer Service Costs
  - Postage
  - Phone
  - Internet
  - Warranty
- Management Costs
  - Human resources
  - Administration
  - Employee benefits
  - Labor relations
  - Managers
  - Employees
  - Finance and legal

FIGURE 5-4

An Example Value Chain for a Typical Manufacturing Company

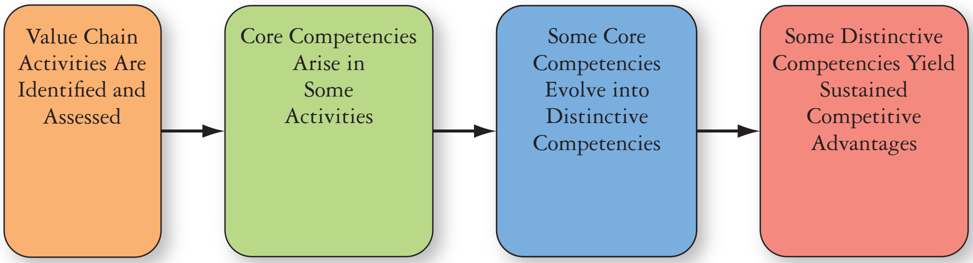

FIGURE 5-5
Transforming Value Chain Activities into Sustained Competitive Advantages

as consumers feel they are getting value for the price paid for the product or service and each firm can have its own competitive advantage in the watch industry. Even though the weights on various value chain items can differ within the same industry, firms should strive to understand not only their own value chain operations, but also those of the industry, competitors, suppliers, and distributors.

VCA is a tool used to examine each step along the path of creating value from upstream operations such as suppliers all the way to downstream operations of delivering the product to customers. One of the main benefits of VCA is that each activity from start to finish has a value element that can be improved upon. Pay careful attention to areas along the value chain that are likely to lead to higher quality or lower cost. Also, be mindful it is generally more advantageous to choose a path of being different than a rival on select value chain activities than simply trying to compete with them on every item. The jewelry firms Tiffany and Blue Nile are great examples of firms that have chosen to be different in the way they create value for customers.

Benchmarking

Benchmarking is another analytical tool used to determine whether a firm's value chain is competitive compared to those of rivals and thus conducive to winning in the marketplace. **Benchmarking** entails examination of value chain activities across an industry to determine "best practices" among competing firms; firms engage in benchmarking for the purpose of duplicating or improving on those best practices. Similar to VCA, benchmarking is an analytical tool used to identify key external opportunities/threats and internal strengths/weaknesses. 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.

A challenging part of benchmarking can be gaining access to other firms' VCAs 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.

Although benchmarking is useful, strategists should be mindful of their firm's unique position and how their firm differs from rivals when selecting which factors along a value chain to benchmark. Never benchmark variable after variable without discretion. For example, Five Guys who specialize in burgers made to order with quality ingredients should not benchmark McDonald's "service time" component, just as McDonald's should not benchmark Five Guys "quality" component. Five Guys benchmarking and attempting to compete with McDonald's on service time would be dysfunctional to Five Guys unique strategy and position of offering higher quality burgers; erroneous benchmarking could lead a firm away from what made the firm successful. This is not to say "improving on service time" is not important; it is just that Five Guys should not sacrifice "made to order burgers" for "premade burgers" simply to benchmark McDonald's service-time component. Recall that uniqueness is important in strategic management, so use benchmarking wisely.

LO 5.8 Michael Porter's Two Generic Strategies

According to Michael Porter, strategies allow organizations to gain competitive advantage from two different bases: cost leadership and differentiation. Porter calls these bases **generic strategies** because generally firms should be mindful it is often best to develop product lines that compete on cost or compete on unique value; it is difficult to compete on both simultaneously. **Cost leadership** emphasizes producing standardized products or services at a low per-unit cost for consumers who are price sensitive. **Differentiation** is a strategy aimed at producing products and services considered unique to the industry and directed at consumers who are relatively price insensitive. Unlike with cost leadership where a firm examines how to reduce costs all along its value chain, with differentiation the firm looks to maximize value all along its value chain.

Cost Leadership

As indicated in Table 5-5, there are two types of cost leadership strategies. Type 1 is a broad *low-cost* strategy that offers products or services to a wide range of customers at one of the lowest prices available on the market. Type 2 is a narrow or focused *low-cost* strategy that offers products or services to a small range of customers at one of the lowest prices on the market. A cost leadership 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.

Walmart could serve as an example firm pursuing a Type 1 cost leadership strategy because the company serves a broad range of market segments with varied socioeconomic backgrounds. Dollar General would serve as an example of Type 2 focusing mostly on rural areas, limited product lines, less décor devoted to the stores, and less service. Both Type 1 and Type 2 strategies target a large market. This is an important distinction of any cost leadership market; in order to achieve economies of scale, there must be large market potential. Both Walmart and Dollar General met the large market potential criteria, even though Dollar General has a significantly more focused target customer base. Amazon is potentially another example of Type 1 cost leadership; Jiffy Lube, Little Caesars Pizza, and Spirit Airlines are all examples of successful Type 2 cost-leadership strategies, as well as examples of firms "saying no and accepting trade-offs" as a part of their cost leadership strategy.

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 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. In other words, firms try to gain competitive advantages all along their value chain, so the firm can ultimately provide some product at some price low enough to yield compelling value to customers.

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. A key way to first ensure the firm is maintaining its cost-leadership competitive advantage is to routinely examine every level of its value chain relative to rival firms for areas of possible cost savings. A successful cost-leadership

TABLE 5-5 The Four Types of Generic Strategies

	Generic Strategies	
	Cost Leadership	Differentiation
Market Segments		
Broad	Type 1	Type 3
Narrow	Type 2	Type 4

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; technological breakthroughs in the industry may make the strategy ineffective; or buyer interest may swing to other differentiating features besides price; simply cutting retail prices will not yield a cost leadership position since such actions are easily copied and will erode margins.

Differentiation

There are two levels of a successful differentiation strategy, Type 3 having a wide target market and Type 4 having a narrow target market, as revealed in Table 5-5. Under differentiation strategies, firms are not as reliant on economies of scale, so targeting a small group of customers can be advantageous if they are willing to pay a premium for the products or services offered. A differentiation strategy should be pursued only after a careful study of buyers' needs and preferences has determined the feasibility of incorporating one or more differentiating features into a unique product that showcases 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 differentiating features, such as superior service, spare parts availability, engineering design, product performance, useful life, gas mileage, or ease of use.

Examples of firms employing Type 3-wide differentiation strategies would include Monster Beverage, Apple, and BMW; these firms employ a strategy that adds perceived value over Coca-Cola, an LG smartphone, or a Ford Escort at significantly higher prices than their counterparts. All three also target a wider audience than brands like Louis Vuitton, Rolex, or Maserati which operate under a Type 4 strategy. A firm does not have to offer extremely expensive products to use a Type 4 strategy, but generally this is the case because creating value at every step of the value chain is expensive and with limited buyers reducing economies of scale prices tend to be expensive.

Generally, environments favorable to differentiation are those where buyers have many different tastes or application needs. For example, the quality and type of food desired by consumers varies greatly, leading to many different types of restaurants. When technology is changing rapidly, firms can release new products and often have customers "trained" to purchase the latest and greatest. Apple enjoys being differentiated through its own IOS software. All the other leading phone manufacturers use Android, Windows, or some other operating system created by different firms. Whenever customers view products as commodities, there is a need for differentiation; even "commodities" such as milk or eggs can often be differentiated through marketing, attractive packaging, and other tactics leading to prices often twice as high as competitors.

Differentiation does not guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible. Products protected by barriers which prevent 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 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 will easily defeat a differentiation strategy. Another risk of pursuing a differentiation strategy is that competitors may quickly develop ways to copy the differentiating features. Thus, firms must find durable sources of uniqueness that cannot be imitated quickly or inexpensively 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 strategy based on many different competitive aspects. 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 difficult or expensive for rivals to duplicate. Competitors are continually trying to imitate, duplicate, and outperform rivals along any differentiation variable that yields competitive advantage. Firms must be careful when employing a differentiation strategy because buyers will not pay a higher price unless their perceived value of the differentiated offering exceeds its price.[20]

LO 5.9 Means for Achieving Strategies

Companies are under continual pressure from stockholders to maintain top line (revenues) and bottom line (net income) growth (usually 4+ percent) and pay higher dividends. To accomplish this end, firms are often faced with a BUILD, BORROW, or BUY decision. Building is growing internally (organically), borrowing is growing externally using means such as partnerships, joint ventures, and alliances; finally, buying includes mergers and acquisitions. Let's look at build, borrow, or buy options a bit closer.

BUILD from Within to Grow

When firms build from within, sometimes called **organic growth**, as a means for achieving strategies, strategists must consider how well current internal resources match the capabilities needed to grow (4+ percent). Building from within can include new training programs, hiring new employees, building (instead of buying rival's) stores, or developing a "blue ocean strategy." A **blue ocean strategy** aims to target a new market where competition is not yet present, thus creating a "blue ocean" as opposed to a red ocean where many firms are competing often on price, and the gains of one firm are often at the expense of another. Blue ocean strategy is similar to being a first mover seeking market space not yet occupied by rivals.

Kim and Mauborgne's research on blue oceans revealed that existing line extensions account for 86 percent of new products created; only 14 percent of new ventures are targeted at new markets or industries.[21] Blue ocean thinking in developing news markets and products can provide benefits far greater than competing in traditional markets. Apple's development of the PC and smartphone were blue ocean examples where customers did not even know they desired the products before they were brought to market by Apple. However, the blue ocean environment did not last long for Apple on either product because competitors entered quickly, forcing Apple to operate under what Porter would classify as a differentiation strategy.

Netflix, Southwest, eBay, and Amazon, like Apple, were all derived partly from blue ocean thinking. These examples are of blue oceans where there was no defined industry or market for the products previously, but according to Kim and Mauborgne, blue oceans can arise from already established industries as well. It is likely blue oceans within current industries will not be as sustainable and may even erode a firm's mission, moving it away from its core competencies. Extra care should be taken when considering blue ocean thinking while operating within an already established industry. However, a firm does not have to have a blue ocean to build.

BORROW from Others to Grow

Firms tend to "borrow" capabilities through joint ventures or strategic alliances when the (1) firm does not believe it can develop the necessary resources internally, or (2) the costs and risks of merging are too high. **Joint venture** occurs when two or more companies form a temporary partnership or consortium for the purpose of capitalizing on some opportunity and have shared equity ownership in the new entity. Joint ventures are being used increasingly because they allow companies to improve communications and networking, to globalize operations, and to minimize risk. They are formed when a given opportunity is too complex, uneconomical, or risky for a single firm to pursue alone, or when an endeavor requires a broader range of competencies and know-how than any one firm possesses. Joint ventures are less common than alliances but more common than mergers or acquisitions.

Qualcomm formed a joint venture with China's Guizhou province to produce server chips in China. The new company is owned 55 percent by the Chinese province and 45 percent by Qualcomm. Coca-Cola and Nestlé recently agreed to dissolve their tea joint venture named Beverage Partners Worldwide. 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?'"[22] Four common reasons joint ventures struggle are:

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.[23]

Six guidelines for when a joint venture may be an especially effective means for pursuing strategies are:[24]

1. A privately owned firm forms a joint venture with a publicly owned organization. The advantages to being privately held, such as closed ownership, and the advantages of being publicly held, such as access to stock issuances as a source of capital, can sometimes be synergistically combined in a joint venture.
2. A domestic firm forms a joint venture with a foreign company. A joint venture can provide a domestic firm with the opportunity for obtaining local management in a foreign country, thereby reducing risks such as expropriation and harassment by host country officials.
3. The distinct competencies of two or more firms complement each other especially well.
4. A particular project is potentially profitable but requires overwhelming resources and risks.
5. Two or more smaller firms have trouble competing with a large firm.
6. There is a need to quickly introduce a new technology.

Cooperation among competitors is a popular borrow strategy. Microsoft and business-software vendor SAP SE recently formed an alliance to challenge Amazon.com's dominance in the $23 billion annual market for web-based, on-demand computing resources. As part of the deal, SAP is now using Microsoft's Azure cloud-computing services. The Microsoft-SAP deal follows a similar deal whereby Microsoft and Adobe Systems agreed to cross promote each other's products.

Cooperation among competitors is becoming more common. For collaboration 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.[25] 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. 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. Increasing numbers of domestic firms are joining forces with competitive foreign firms to reap mutual benefits. Kathryn Harrigan at Columbia University contends, "Within a decade, most companies will be members of teams that compete against each other."

Often, U.S. companies enter alliances primarily to reduce costs and risks of entering new businesses or markets. 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. Companies in the United States often form alliances with firms in Asia to gain an understanding of their manufacturing excellence, but manufacturing competence 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. Therefore, U.S. firms need to be careful not to give away more intelligence than they receive in cooperative agreements with rival Asian firms.

BUY Others to Grow

Merger and acquisition refers to firms buying others to grow. 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. If a merger or acquisition is not desired by both parties, it is called a **hostile takeover**, as opposed to a **friendly merger**. Most mergers are friendly, but the number of hostile takeovers is on the rise. A hostile takeover is not unethical as long as it is conducted in a civil and legal manner. Sometimes shareholders are skeptical, though, given that current research reveals CEOs to be less ethical today, as indicated in Ethics Capsule 5.

Not all mergers are effective and successful. For example, soon after Halliburton acquired Baker Hughes, Halliburton's stock price declined 11 percent. So, a merger between two firms can yield great benefits, but the price and reasoning must be right. More than 10,000 mergers transpire annually in the United States, with same-industry combinations predominating. A general market consolidation is occurring in most industries.

Six reasons why many mergers and acquisitions fail are provided in Table 5-6. Table 5-7 presents the potential benefits of merging with or acquiring another firm.

A **leveraged buyout (LBO)** occurs when a firm'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 include instances when a particular division(s) lacks fit with an overall corporate strategy, as well as when selling a division could raise needed cash. An LBO converts a public firm into a private company.

Another popular way for firms to grow occurs whenever a private-equity (PE) firm acquires and takes private some target firm. For example, Ruby Tuesday was taken private in late 2017 when the private-equity firm NRD Capital Management bought the casual-dining restaurant

ETHICS CAPSULE 5

Are CEOs Less Ethical Today Than in the Past?

Wavebreakmedia/ Shutterstock

The New Policy Is Legal, But Is It Ethical?

A recent article suggests that the answer to the question posed is YES. CEO dismissals for ethical misconduct rose in North America and Western Europe from 4.6 percent in 2007–2011 to 7.8 percent in 2012–2016, a 68 percent increase. According to the 2017 Edelman Trust Barometer, only 37 percent of people consider CEOs credible/ethical today, an all-time low for the survey, and down from 59 percent the prior year. Confidence and trust in large corporations, and CEOs in particular, has declined for decades. Ethical misconduct was a key reason for passage of the Dodd-Frank Act of 2010 that imposed new regulations and standards on top executives and board members, including further measures to detect, discourage, and punish corporate wrongdoing. Also to combat wrongdoing, according to the Spencer Stuart Board Index, 85 percent of all board members of S&P 500 companies are independent (not employees of the firm), and 27 percent of these boards have an independent chairperson, up from 9 percent in 2005. Thus, the days of an all-powerful CEO presiding over a board composed of friends and insiders are essentially gone. The share of incoming CEOs who also serve as chair of the board has steadily declined at the world's 2,500 largest companies from 48 percent in 2002 to less than 10 percent today.

Source: Based on Per-Ola Karlsson, DeAnne Aguirre, and Kristin Rivera, "Are CEOs Less Ethical Than in the Past?" *Strategy & Leadership* (Summer 2017): 57–65.

TABLE 5-6 Six Reasons Why Many Mergers and Acquisitions Fail

1. Integration difficulties up and down the two value chains
2. Taking on too much new debt the target firm owes or to buy the target
3. Inability to achieve synergy
4. Too much diversification
5. Difficult to integrate different organizational cultures
6. Reduced employee morale due to layoffs and relocations

TABLE 5-7 Twelve Potential Benefits of Merging With or Acquiring Another Firm

1. To provide improved capacity utilization
2. To make better use of the existing sales force
3. To reduce managerial staff
4. To gain economies of scale
5. To smooth out seasonal trends in sales
6. To gain access to new suppliers, distributors, customers, products, and creditors
7. To gain new technology
8. To gain market share
9. To enter global markets
10. To gain pricing power
11. To reduce tax obligations
12. To eliminate competitors

chain for a 21 percent premium amount of about $146 million. At the time, there were 599 Ruby Tuesday restaurants in 41 states and 14 foreign countries.

The intent of virtually all PE acquisitions is to buy firms at a low price and sell them later at a high price, which is arguably just good business. Buffalo Wild Wings (BWW) recently received a $2.3-billion takeover bid from the PE firm Roark Capital Group. Roark's offer of $151 per share was a premium of at least 28 percent over BWW's stock price at the time. Roark eventually bought BWW for $157 per share, representing a premium of 7.2 percent (low because BWW stock price had increased).

PE firms are rapidly acquiring opioid-addiction clinics and treatment centers, such as Kohlberg & Co.'s recent $180 million acquisition of the Meadows in Wickenburg, Arizona. U.S. drug- and alcohol-addiction clinics generate over $10 billion in revenue annually through more than 3,000 facilities that are quickly growing.

First-Mover Advantages

LO 5.10

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 5-8, 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 (1) build a firm's image and reputation with buyers; (2) produce cost advantages over rivals in terms of new technologies, new components, new distribution channels; (3) create strongly loyal customers; and (4) make imitation or duplication by a rival difficult or unlikely.

TABLE 5-8 Six 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.
6. Gain patent protection early.

One of the keys in deciding to be a first mover is how quickly will a new technology, product, or service catch-on with a target market. Quicker adoption by the bulk of the customer base enhances the incentive to be a first mover. Quick adoption may especially be likely in industries such as pharmaceuticals where patent protection can virtually lock out anyone other than the first mover.

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 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, especially when initial costs are high. If technology is advancing rapidly, slow movers can often leapfrog a first-mover's products with improved second-generation products, so being a late mover has potential advantages.

In some industries, being a fast follower may be the better strategy, such as in the electric car business where most customers have not quickly adopted the new technology, due to high switching costs, lack of infrastructure of charging stations, and uneasiness. Apple was a first mover in the PC market, but initially struggled as the market was not ready to adopt PCs widespread. However, in iPods and iPhones, Apple was a first mover and continues to enjoy many benefits of entering the market first and profiting from high-switching costs that customers would incur by switching from Apple's unique operating system.

LO 5.11 Strategic Management in Nonprofit and Small Firms

Nonprofit organizations are similar to for-profit companies in virtually evey respect except for two major differences: (1) Nonprofits do not pay taxes, and (2) nonprofits do not have shareholders to provide capital. 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 as much as for-profit firms, and perhaps even more. Both nonprofit and for-profit organizations have competitors that want to put them out of business.

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, zoos, cities, and churches. 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. Nonprofits and governmental organizations owe it to their constituencies to garner and use monies wisely; that requires excellent strategy formulation, implementation, and evaluation.

Educational Institutions

Accrediting bodies that audit colleges and universities (such as SACS and AACSB) require continuous strategic planning. The Institute of International Education reported in late 2017 that the number of international new students attending U.S. universities declined by 7 percent in the fall of 2017, the largest drop in a few years. Some MBA programs across the United States are closing because of falling enrollments, including at the University of Iowa, Wake Forest University, Virginia Tech, Simmons College, and possibly even at the University of Wisconsin.

College enrollments in general are declining. State and federal support/monies given to institutions of higher learning in the United States is dropping more than 5 percent annually. All these factors make strategic planning essential for institutions of higher learning.

Population shifts nationally from the Northeast and Midwest to the Southeast and West are another threat. To cope with severe external threats, educational institutions are more frequently using strategic-management concepts, tools, and techniques. 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." Because MBA programs are struggling, universities are selling MBA courses piecemeal and offering various types of business certifications comprised of one to three online courses. For example, Wharton offers a professional certificate in digital marketing comprised of several $600 courses, as compared to their 900 MBA students who pay about $250,000 for their degrees.[26] Harvard Business School charges up to $1,500 for online 8-week classes like "Becoming a Better Manager."

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 degrees are 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. Reduced state and federal funding for higher education has resulted in more aggressive fundraising by colleges and universities.

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 organization's mission 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. However, 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 core value, vision, mission, objectives, strategies, and policies. In addition, government agencies are using a strategic-management approach to develop and substantiate formal requests for additional funding.

Small Firms

"Becoming your own boss" is a dream for millions of people and a reality for millions more. 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. However, the percentage of people younger than age 30 who own private businesses has reached a 24-year low in the United States, to about 3.6 percent, down from 10.6 percent in 1989. The stereotype that 20-somethings are entrepreneurial risk-takers is simply false, as millions of young adults struggle in underpaid jobs to maintain their own household, rather than living with their parents. Reasons for the decline vary, but reduced bank lending for small business startups, more indebtedness among young people, and increasing numbers of competitors because of the Internet, all contribute to a more risk-averse, younger-than-30 age group.

The strategic-management process is just as vital for small companies as it is for large firms. 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. However, a lack of strategic-management knowledge is a serious obstacle for many small business owners, as is a lack of sufficient capital to exploit external opportunities and a day-to-day cognitive frame of reference. Research indicates that strategic management in small firms is more informal than in large firms, but small firms that engage in strategic management generally outperform those that do not.

IMPLICATIONS FOR STRATEGISTS

Figure 5-6 reveals that to gain and sustain competitive advantages, firms must collect, analyze, and prioritize large amounts of information to make excellent decisions. A "strategic plan" is very much akin to an athletic team's "game plan" in the sense that both a strategic plan and a game plan are developed after carefully studying rival firms (teams); success of the firm (or team) depends greatly on that plan being a better plan than the rival's plan. Any strategist, much like any coach, puts his or her firm in great jeopardy of failure if the opposing strategist (coach) has a better strategic plan.

Value chain analysis and benchmarking are required to create, identify, nurture, and exploit sustained competitive advantages that can lead to success. Parity (and commoditization) is becoming commonplace in both business and athletics; as parity increases, the intrinsic value of the overarching strategic plan, or game plan, increases exponentially. For example, in college football, great parity exists among teams such as Auburn, Alabama, Ohio State, Florida State, Kansas State, Oregon, Arizona State, Michigan State, and Michigan, so the game plan can make the difference between winning and losing.

Most of the strategies described in this chapter would separately yield substantial benefits for firms, but no firm has sufficient resources to pursue more than a few basic strategies. Thus, strategists must select from a number of excellent alternatives, eliminate other excellent options, and consider risks, tradeoffs, costs, and other key factors. Any strategist, or coach, that gets "outstrategized" by his or her opposing strategist (or coach) puts his or her firm (or team) at a major disadvantage. Being outcoached can doom even a superior team (or firm). Therefore, in Chapter 6 we examine six additional analytical tools being widely used by strategists to help develop a winning strategic plan.

FIGURE 5-6
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

Numerous alternative strategies and means to achieve those strategies, as described in this chapter, could benefit any firm, but your strategic-management case analysis should result in specific recommendations whereby you decide what actions will best provide the firm with competitive advantages. Ultimately you will be transforming some of the general strategies and actions defined in this chapter into specific recommendations with projected costs. Because your recommendations with costs comprise the most important pages or slides in your case project, Chapter 6 will go into further detail on this topic. However, in giving an oral written presentation or paper, introduce bits of your recommendations early to "pave the way" for costs shown later on your recommendations page. 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 strategies and means to achieve those actions 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. You may ask: "What is the difference between recommendations and strategies?" The answer is: "Recommendations are strategies *generated and selected for implementation*."

Chapter Summary

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 importantly, 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.

This chapter reveals that firms can "grow" internally (organically) or by acquiring or cooperating with other firms. Guidelines are given in this chapter for when firms have been most successful historically pursuing which strategies by what means. Companies and industries change, but the material presented in this chapter should be relevant and useful for decades to come as companies strive to gain and sustain competitive advantage. In a nutshell, this chapter emphasizes that companies need to continuously manage and improve their value chain activities ranging from raw material securement to end product marketing to be successful.

Key Terms and Concepts

acquisition (p. 176)
backward integration (p. 161)
bankruptcy (p. 167)
benchmarking (p. 171)
blue ocean strategy (p. 174)
combination strategy (p. 158)
core competence (p. 170)
cost leadership (p. 172)
de-integration (p. 162)
differentiation (p. 172)
diversification strategies (p. 165)
divestiture (p. 167)
financial objectives (p. 157)
first-mover advantages (p. 177)
forward integration (p. 160)
franchising (p. 161)
friendly merger (p. 176)
generic strategies (p. 172)
horizontal integration (p. 160)
hostile takeover (p. 176)
integration strategies (p. 160)
intensive strategies (p. 163)
joint venture (p. 174)
leveraged buyout (LBO) (p. 176)
liquidation (p. 168)
long-term objectives (p. 156)
market development (p. 163)
market penetration (p. 163)
merger (p. 176)
organic growth (p. 174)
product development (p. 164)
related diversification (p. 165)
retrenchment (p. 166)
strategic objectives (p. 157)
turnaround strategy (p. 166)
unrelated diversification (p. 165)
value chain (p. 169)
value chain analysis (VCA) (p. 169)
vertical integration (p. 160)

Issues for Review and Discussion

5-1. Define and discuss vertical integration.

5-2. Identify the advantages and disadvantages of vertical integration.

5-3. Define and give an example of a “blue ocean strategy.”

5-4. Identify and discuss three common ways to build capabilities internally.

5-5. What are the advantages of being a first mover in a particular industry?

5-6. What are the two key differences between for-profit and not-for-profit organizations, besides one type seeks to make a profit and the other does not.

5-7. Define and discuss whether it is best for a small firm to BUILD, BORROW, or BUY to grow.

5-8. Give reasons why so many companies are divesting (spinning off) key segments or divisions of the firm.

5-9. When is a leveraged buyout an appropriate strategy to pursue?

5-10. Give actual examples of how Amazon is forward integrating and diversifying at the same time.

5-11. Explain the following statement: *Unlike with cost leadership where a firm examines how to reduce costs along its value chain, with differentiation one looks to maximize value along each level of the value chain.*

5-12. Define and explain benchmarking.

5-13. The number and dollar value of *hostile takeovers* are on the rise. Give two reasons for this trend.

5-14. How are for-profit firms different from nonprofit firms in terms of business? What are the implications for strategic planning?

5-15. If the CEO of a beverage company such as Dr Pepper Snapple asked you whether backward or forward integration would be better for the firm, how would you respond?

5-16. In order of importance, list the characteristics of objectives.

5-17. In order of importance, list the benefits of objectives.

5-18. Called de-integration, there appears to be a growing trend for firms to become less forward integrated. Discuss why.

5-19. Called de-integration, there appears to be a growing trend for firms to become less backward integrated. Discuss why.

5-20. What conditions, externally and internally, would be desired or necessary for a firm to diversify?

5-21. There is a growing trend of increased collaboration among competitors. List the benefits and drawbacks of this practice.

5-22. List major benefits of forming a joint venture to achieve desired objectives.

5-23. List major benefits of acquiring another firm to achieve desired objectives.
5-24. List reasons why many mergers or acquisitions historically have failed.
5-25. Can you think of any reasons why not-for-profit firms would benefit less from doing strategic planning than for-profit companies?
5-26. Discuss how important it is for a college football or basketball team to have a good game plan for the big rival game this coming weekend. How much time and effort do you feel the coaching staff puts into developing that game plan? Why is such time and effort essential?
5-27. How does strategy formulation differ for a small versus a large organization? How does it differ for a for-profit versus a nonprofit organization?
5-28. Give hypothetical examples of market penetration, market development, and product development.
5-29. Give hypothetical examples of forward integration, backward integration, and horizontal integration.
5-30. Give hypothetical examples of related and unrelated diversification.
5-31. Give hypothetical examples of joint venture, retrenchment, divestiture, and liquidation.
5-32. Are hostile takeovers unethical? Why or why not?
5-33. What are the major advantages and disadvantages of diversification?
5-34. What are the major advantages and disadvantages of an integrative strategy?
5-35. How does strategic management differ in for-profit and nonprofit organizations?
5-36. Why is it not advisable to pursue too many strategies at once?
5-37. Compare and contrast financial objectives with strategic objectives. Which type is more important in your opinion? Why?
5-38. How do the levels of strategy differ in a large firm versus a small firm?
5-39. List 11 types of strategies. Give a hypothetical example of each strategy listed.
5-40. Define and explain first-mover advantages.
5-41. Give some advantages and disadvantages of cooperative versus competitive strategies.
5-42. What are the two major differences between for-profit and not-for-profit organizations?
5-43. Give some guidelines when forward integration is an excellent strategy to pursue.
5-44. Give some guidelines when backward integration is an excellent strategy to pursue.
5-45. Give some guidelines when horizontal integration is an excellent strategy to pursue.
5-46. Give some guidelines when market penetration is an excellent strategy to pursue.
5-47. Give some guidelines when market development is an excellent strategy to pursue.
5-48. Give some guidelines when product development is an excellent strategy to pursue.
5-49. Give some guidelines when divestiture is an excellent strategy to pursue.
5-50. Give some guidelines when retrenchment is an excellent strategy to pursue.
5-51. Give some guidelines when liquidation is an excellent strategy to pursue.
5-52. Give some guidelines when unrelated diversification is an excellent strategy to pursue.
5-53. Give some guidelines when related diversification is an excellent strategy to pursue.
5-54. What is the difference between recommendations and strategies?
5-55. Why do *Annual Reports* often state objectives in really vague terms, such as to "hire good people" or to "stay ahead of trends"; why should strategists avoid including such vagueness in preparing a strategic plan?

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 5A

Develop Hypothetical Coca-Cola Company Strategies

Purpose

Chapter 5 identifies, defines, and exemplifies 11 key types of strategies available to firms. This exercise will give you practice formulating possible strategies within each broad category.

Instructions

Step 1 Review the Cohesion Case and your answers to the prior end-of-chapter assurance-of-learning exercises.

Step 2 For the 11 strategies given in Table 5-3, identify a feasible alternative strategy that could reasonably benefit the Coca-Cola Company.

EXERCISE 5B

Should Coca-Cola Build, Borrow, or Buy in 2020–2021?

Purpose

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 best among all feasible alternatives. This exercise gives you experience conducting research to determine what a firm is doing in 2018–2019 and should do in 2020–2021.

Instructions

Step 1 Go to the Coca-Cola corporate website and click on Press Center. Read through the most recent ten press releases.

Step 2 Determine two strategies that Coca-Cola *is* actually pursuing. Give some pros and cons of those two strategies in light of the guidelines presented in this chapter.

Step 3 Determine two strategies that Coca-Cola is *not* pursuing. Give some pros and cons of those two strategies in light of the guidelines presented in this chapter.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 5C

Develop Alternative Strategies for Your University

Purpose

It is important for representatives from all areas of a college or university to identify and discuss alternative strategies that could benefit faculty, students, alumni, staff, and other constituencies. As you complete this exercise, notice the learning and understanding that occurs as people express differences of opinion. Recall that *the process of planning is more important than the document.*

Instructions

Step 1 Recall or locate the external opportunity and threat and internal strength and weakness factors that you identified as part of Exercise 1A (p. 65). If you did not do that exercise, discuss now as a class important external and internal factors facing your college or university.

Step 2 Identify and put on the screen 10 alternative strategies that you feel could benefit your college or university. Your proposed actions should allow the institution to capitalize on particular strengths, improve on certain weaknesses, avoid external threats, or take advantage of particular external opportunities. Number the strategies as they are written on the screen from 1 to 10. State each strategy in specific terms, such as "Build two new dormitories," rather than in vague terms, such as "Do market penetration."

Step 3 On a separate sheet of paper, number from 1 to 10. Everyone in class individually should rate the strategies identified, using a 1 to 3 scale, where 1 = *I do not support implementation*, 2 = *I am neutral about implementation*, and 3 = *I strongly support implementation.* In rating the strategies, recognize that no institution has sufficient funds to do everything desired or potentially beneficial.

Step 4 Your professor will now pick up the rating sheets and have a student add up the scores for each strategy. That is, sum the ratings for each strategy, so that a prioritized list of recommended strategies is obtained. The higher the sum, the more attractive the strategy. This prioritized list reflects the collective wisdom of your class. Strategies with the highest score are deemed best.

Step 5 Discuss how this process could enable organizations to achieve understanding and commitment from individuals.

SET 3: STRATEGIC PLANNING FOR MYSELF

EXERCISE 5D

The Key to Personal Strategic Planning: Simultaneously Build and Borrow

Purpose

As a means to achieve various strategies, companies usually choose between "build, borrow, and buy" to grow. However, individuals must build and borrow. This exercise gives you insight on how to build and borrow to launch a successful career.

Instructions

Step 1 List four ways you can BUILD (i.e., grow internally) to advance your career opportunities.

Step 2 List four ways you can BORROW (i.e., grow using others) to advance your career opportunities.

Step 3 Compare and contrast your lists with those of other students. Collectively decide on the four best BUILD and four best BORROW means to achieve your objectives.

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 5E

What Is the Best Mix of Strategies for Coca-Cola Company?

Purpose

Strategic-management classes are usually composed of team of students who perform case analysis. The purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time. No company has sufficient resources to implement all strategies that would benefit the firm. Thus, tough choices have to be made. Ranking strategies as to their relative attractiveness (1 = most attractive, 2 = next most attractive, etc.) is a commonly used procedure to help determine which actions to actually fund. Often, a group of managers will jointly rank strategies and compare their ranking to other groups. This ranking process may be used to determine the relative attractiveness of feasible alternative strategies.

The purpose of this exercise is to examine how well students understand the advantages and disadvantages of a firm pursuing the strategic options described in Chapter 5. This is a fun exercise that also gives you experience selecting among feasible alternative strategies for a company.

Situation

Coca-Cola is doing really well, but wants to do better. Coca-Cola is trying to decide what strategies would be best for the company going forward. Seven strategies discussed in Chapter 5 are being seriously considered, as listed.

Strategies

Production operations

1. Forward integration: Build 100 Coca-Cola stores.
2. Backward integration: Purchase a 10,000-acre sugarcane farm to gain better control over supplies needed for Coca-Cola retail stores globally.
3. Horizontal integration: Acquire four beverage brands from Dr Pepper Snapple.
4. Market development: Build a manufacturing plant in Africa to better serve that continent.
5. Market penetration: Launch an advertising, promotion, and publicity campaign globally to shift public perception of Coca-Cola from unhealthy to healthy.
6. Product development: Develop, produce, and launch a full line of organic juices.
7. Unrelated diversification: Acquire a construction company to handle building new stores and manufacturing plants and distribution centers globally.

Task

Rank the seven strategies listed in terms of their relative attractiveness for Coca-Cola, where 1 = the most attractive strategy to pursue, 2 = the next most attractive strategy, etc. to 7 = the least attractive strategy to pursue. Rank the strategies first as an individual, and then as part a group. Then, listen to the EXPERT ranking and rationale. In this manner, this exercise enables you to determine what individual(s) and what group(s) in class make the best strategic decisions (i.e., that come closest to the expert ranking).

Steps

1. Fill in Column 1 in Table 5-9 to reveal your individual ranking of the relative attractiveness of the proposed strategies. For example, if you feel backward integration is the seventh-best option, then in Table 5-9, enter a 7 in Column 1 beside Backward Integration.
2. Fill in Column 2 in Table 5-9 to reveal your group's ranking of the relative attractiveness of the proposed strategies. For example, if your group feels backward integration is the third-best option, then enter 3 into Column 2 beside backward integration.
3. Fill in Column 3 in Table 5-9 to reveal the expert's ranking of the relative attractiveness of the proposed strategies.
4. Fill in Column 4 in Table 5-9 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 5-9 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. If you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

TABLE 5-9 Strategic Planning for Coca-Cola: Individual versus Group Decision Making

	Column Number				
The Strategies	(1) My Rank	(2) Group Rank	(3) EXPERT Rank	(4) Absolute Value 1-3	(5) Absolute Value 2-3
1. Backward integration					
Purchase sugarcane farm					
2. Forward integration					
Build 100 stores					
3. Horizontal integration					
Acquire four Dr Pepper brands					
4. Market development					
Build manufacturing plant in Africa					
5. Market penetration					
Launch marketing campaign					
6. Product development					
Launch a full line of organic candy juices					
7. Unrelated diversification					
Acquire a construction company					

MINI-CASE ON FACEBOOK (FB)

SHOULD FACEBOOK ACQUIRE, COOPERATE, OR JUST STAY FIERCE RIVALS WITH LINKEDIN?

This chapter discussed rival firms merging, cooperating, or staying rivals. Headquartered in Menlo Park, California, Facebook is by far the largest online social-networking company in the world. Headquartered in Mountain View, California, LinkedIn is the largest online professional network designed to help members find jobs, connect with other professionals, and locate business opportunities. The two companies are becoming more and more rivals as their business model becomes more and more similar. Both websites are free for members to join and both earn money through advertising spots. LinkedIn also earns revenue through its job-listing service. Companies post job openings on LinkedIn and search for candidates on LinkedIn—particularly advantageous for students nearing graduation. Facebook wants some of this action. Members of LinkedIn tend to be white collar and highly educated; 45 percent of LinkedIn visitors earn more than $75,000 per year. Facebook has nearly 3 billion members across the whole economic spectrum of income.

As evidence of the two firms gravitating toward each other in products and services, LinkedIn recently rolled out its video uploading feature, trying to become more like Facebook. Facebook is testing new professional (rather than social) features trying to take market share from LinkedIn. Both companies' primary strategy is product development. Both Facebook and LinkedIn continually develop new and improved, visible and invisible, business analytics models to gather and assimilate data, and then sell the data. LinkedIn has developed a big-data framework dubbed Gobblin that helps the social network collect tons of data from a variety of sources so that it can be analyzed in its Hadoop-based data warehouses. The company also houses a variety of internal data (information pertaining to member profiles, user actions such as comments and clicking, and so on) in databases such as Espresso and event-logging systems such as Kafka. Also, LinkedIn takes in data from outside sources—for instance, Salesforce and Twitter. Facebook is testing a mentorship feature to help Facebook members identify and spend time with professionals based on common interests. Facebook is also testing a LinkedIn-like resume feature. Many people prefer to keep their social activities (Facebook) separate from their professional activities (LinkedIn), but as these two firms become more and more similar, separation becomes cloudier.

Questions

1. Should Facebook develop features to allow people to efficiently hunt for jobs on their website, including posting their professional vita?
2. Should Facebook develop features to allow businesses to hunt for employees on their website, including posting job descriptions and job vacancies?
3. Should LinkedIn develop features to allow people to post personal pictures and videos on their website?
4. Should LinkedIn and Facebook merge? What are the pros and cons of merger for the two firms?
5. Should LinkedIn and Facebook cooperate rather than merge? Identify and describe three ways the two rival firms could cooperate in mutually beneficial ways.

Source: Company documents and a variety of sources.

Web Resources

1. The author website provides continuous updates to this chapter from both an academic journal and newspaper/magazine perspective.
   www.strategyclub.com

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6

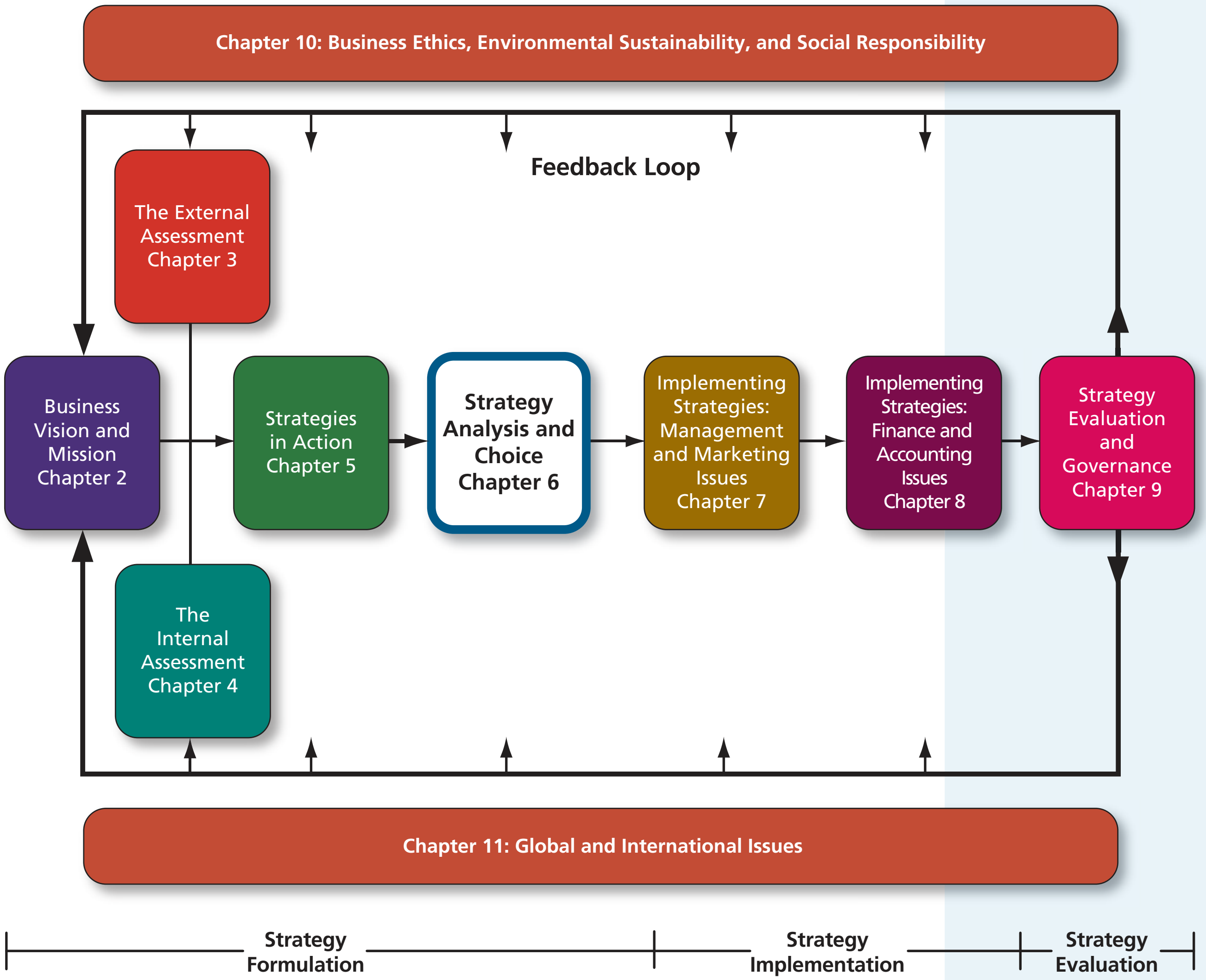

FIGURE 6-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4, (October 2010): 20.

Strategy Analysis and Choice

LEARNING OBJECTIVES

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

6-1. Describe the strategy analysis and choice process.

6-2. Diagram and explain the three-stage strategy-formulation analytical framework.

6-3. Construct and apply the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix.

6-4. Construct and apply the Strategic Position and Action Evaluation (SPACE) Matrix.

6-5. Construct and apply the Boston Consulting Group (BCG) Matrix.

6-6. Construct and apply the Internal-External (IE) Matrix.

6-7. Construct and apply the Grand Strategy Matrix.

6-8. Construct and apply the Quantitative Strategic Planning Matrix (QSPM).

6-9. Explain how to estimate costs associated with recommendations.

6-10. Discuss the role of organizational culture in strategic analysis and choice.

6-11. Identify and discuss important political considerations in strategy analysis and choice.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1:	Strategic Planning for Coca-Cola
EXERCISE 6A:	Perform a SWOT Analysis for Coca-Cola
EXERCISE 6B:	Develop a SPACE Matrix for Coca-Cola
EXERCISE 6C:	Develop a BCG Matrix for Coca-Cola
EXERCISE 6D:	Develop a QSPM for Coca-Cola
SET 2:	Strategic Planning for My University
EXERCISE 6E:	Develop a BCG Matrix for My University
SET 3:	Strategic Planning to Enhance My Employability
EXERCISE 6F:	Perform QSPM Analysis on Myself
EXERCISE 6G:	A Template Competency Test
SET 4:	Individual versus Group Strategic Planning
EXERCISE 6H:	How Severe Are Various Subjective Threats in Strategic Planning?

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Strategy analysis and choice largely involve making subjective decisions based on objective information. Prior chapters in this text focused on obtaining the objective information needed in this chapter to formulate strategies and decide upon particular strategies to implement. This chapter introduces important concepts that enable strategists to generate feasible alternatives, evaluate those alternatives, and choose a specific course of action. Behavioral aspects of strategy formulation are also covered in this chapter, including politics, culture, ethics, and social responsibility considerations. Modern tools for formulating strategies are described. Material in this chapter, as well as in prior chapters, largely follows the flow of the Excel strategic-planning template at www.strategyclub.com that is available for students to use freely, if desired.

The CEO of Hobby Lobby, David Green, is an exemplary strategist performing strategic planning "right by the book."

LO 6.1 Strategy Analysis and Choice

As indicated by Figure 6-1 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 an effective way to avoid an organizational crisis. Rudin's Law states, "When a crisis forces choosing among alternatives, most people choose the worst possible one."

Unless underlying EFE, CPM, and IFE matrices produced really low total weighted scores, alternative strategies will likely represent incremental steps that move the firm from its present position to a desired future position. Alternative strategies should 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.

EXEMPLARY **STRATEGIST** SHOWCASED

David Green, CEO of Hobby Lobby

ArchiVIZ/Shutterstock

The largest arts-and-crafts home décor company in the world, Hobby Lobby is a privately held, U.S. firm with $4.3 billion in annual sales from 750 stores. CEO David Green heads up Hobby Lobby and says "the secret to being a great manager is to manage by the book." The book Mr. Green refers to is the Bible, as evidenced by his company being closed on Sundays to allow employees to be with their families and attend a house of worship. All Hobby Lobby employees earn more than twice the federal minimum wage; the company offers generous employee benefits; and all stores close at 8 pm. Mr. Green says "The Bible has everything one needs to know about good leadership." Hobby Lobby employees are trained to always be positive; there is very little employee turnover, even though turnover among other retail company's hourly employees is about 65 percent. Hobby Lobby has zero long-term debt since Mr. Green says: "The Bible warns against becoming a slave to debt." About one-half of Hobby Lobby's pretax earnings are donated to charities as Mr. Green reveals in his new book "Giving It All Away … And Getting It Back Again."

Mr. Green's leadership guides include to: "always put integrity at the core of your business; never compromise principles to make more money; and make sure you never stop thinking about the customer's perspective." CEO Green is an American icon and an "exemplary strategist."

Source: Based on Scott Smith, "Why Retail's David Green Manages By 'The Book,' *Investor's Business Daily* (May 22, 2017): A4.

The Process of Generating and Selecting Strategies

Strategists never consider all feasible strategies that could benefit the firm because there is 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, examined, prioritized, and selected. The advantages, disadvantages, trade-offs, costs, and benefits of these strategies should be determined.

Identifying and evaluating 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. 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 vision and mission statements, 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. At a bare minimum, SWOT analysis should be performed by participants as described in this chapter. Additionally, BCG, IE, SPACE, GRAND, and QSPM analyses are always immensely helpful in strategic planning.

The Strategy-Formulation Analytical Framework

LO 6.2

Important strategy-formulation techniques can be integrated into a three-stage decision-making framework, as shown in Figure 6-2. The tools presented in this framework are applicable to all sizes and types of organizations and can help strategists identify, evaluate, and select strategies. The tools enable firms to break down complex data and ultimately establish an effective strategic plan. The tools shown anchor the analytical strategic-planning process advocated by the authors and this text.

All nine techniques included in the **strategy-formulation analytical 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 analytical 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,

STAGE 1: THE INPUT STAGE

External Factor Evaluation (EFE) Matrix	Competitive Profile Matrix (CPM)	Internal Factor Evaluation (IFE) Matrix

STAGE 2: THE MATCHING STAGE

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

STAGE 3: THE DECISION STAGE

Quantitative Strategic Planning Matrix (QSPM)

FIGURE 6-2
The Strategy-Formulation Analytical Framework

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 wisely to facilitate, rather than to diminish, communication. Without objective information and analysis, however, personal biases, politics, prejudices, emotions, personalities, and halo error (the tendency to put too much weight on a single factor) often play too dominant of a role in the strategy-formulation process, undermining effectiveness. Thus, an analytical approach is essential for achieving maximum effectiveness in strategic planning.

Stage 1: The Input Stage

Stage 1 of the strategy-formulation analytical framework consists of the External Factor Evaluation (EFE) Matrix, the Internal Factor Evaluation (IFE) Matrix, and the Competitive Profile Matrix (CPM). Called the **input stage**, Stage 1 summarizes the basic input information needed to formulate strategies. Procedures for developing an EFE, CPM, and IFE Matrix were presented in Chapters 3 and 4, respectively. Information derived from those analytical tools provides basic input information for the matching and decision stage matrices described 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, prioritize, evaluate, and select among alternative strategies. Good intuitive judgment is always needed in determining appropriate weights and ratings, but keep in mind that a rating of 3, for example, is mathematically 50 percent larger than a rating of 2, so small differences matter.

Stage 2: The Matching Stage

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.

Strategy is sometimes defined as the match an organization makes between its internal resources and skills and the external opportunities and risks facing the firm.[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 key factors is essential for effectively generating feasible alternative strategies. In most situations, external and internal relationships are complex, and matching requires multiple alignments for each strategy generated. Successful matching of key external and internal factors depends on those underlying key factors being *actionable, quantitative, comparative, and divisional* (AQCD) to the extent possible. (Recall that the basic concept of matching was introduced in Chapter 1).

Stage 3: The Decision Stage

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. It reveals the relative attractiveness of alternative strategies and thus provides an objective basis for selecting specific strategies. The QSPM is a more robust way to determine the relative attractiveness of strategies than the summed ranking method described previously.

Alternative strategies proposed by SWOT, BCG, IE, SPACE, and GRAND analyses 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 stated in specific terms and understood, the strategies should be individually rated in order of attractiveness by each participant, with 1 = *should not be implemented*, 2 = *possibly should be implemented*, 3 = *probably should be implemented*, and 4 = *definitely should be implemented*. Then, collect the participants' rating sheets and sum the ratings given for each strategy to end up with a useful ranking of the strategies. Strategies with the highest sums are deemed the most attractive, so this process results in a prioritized list of best strategies that reflects the collective wisdom of the group. Rather than, or in conjunction with, this ranking method, the QSPM, described later in this chapter, offers a more robust procedure to determine the relative attractiveness of alternative strategies.

The SWOT Matrix

LO 6.3

Recall that SWOT analysis was introduced in Chapter 1 (p. 42). There are four sets of strategies developed in SWOT analysis: SO, WO, ST, and WT. **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 more effectively position themselves into situations in which they can apply SO strategies.

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, for an auto parts manufacturer, the rising demand for electric cars (external opportunity), coupled with the firm having limited batteries to offer (internal weakness), suggests that the firm should consider developing and producing a new line of batteries.

ST strategies use a firm's strengths to avoid or reduce the impact of external threats. An example ST strategy could be when a firm uses its excellent legal department (a strength) to collect millions of dollars in damages from rival firms that infringe on its patents. Rival firms that copy ideas, innovations, and patented products are a threat to many industries. When an organization faces major threats, it will seek to avoid them while concentrating on opportunities. For example, when an organization has both the capital and human resources needed to distribute its own products (internal strengths) and distributors are unreliable, costly, or incapable of meeting the firm's needs (external threats), forward integration (gaining control of distributors) can be an attractive ST strategy.

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 to liquidate. For example, some restaurant chains do business with suppliers that treat livestock inhumanely (internal weakness) and face growing customer awareness of the need to preserve wildlife and treat animals with respect (external threat)—resulting in a WT strategy to cease using certain suppliers. As another example, 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.

Whatever strategies are ultimately chosen for implementation, ethics issues are a consideration. For example, as indicated in Ethics Capsule 6 on the next page, consumers are more sensitive to how animals are treated than ever before.

An example SWOT Matrix is illustrated in Figure 6-3, on the next page. As shown, there are nine cells: 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*. (*Author comment:* The strategic-planning template at www.strategyclub.com simply leaves a space to type in SO, WO, ST, and WT strategies. The process of constructing a SWOT Matrix can be summarized in eight steps, as follows:

1. List the firm's key internal strengths.
2. List the firm's key internal weaknesses.
3. List the firm's key external opportunities.
4. List the firm's key external threats.
5. Match internal strengths with external opportunities to develop specific SO strategies.
6. Match internal weaknesses with external opportunities to develop specific WO strategies.
7. Match internal strengths with external threats to develop specific ST strategies.
8. Match internal weaknesses with external threats to develop specific WT strategies.

ETHICS CAPSULE 6

As We Strategize We Must Not Jeopardize Animal Welfare

Travel Stock/Shutterstock

Are We Safe Here Mom?

Consumers are increasingly resentful of companies that harm wildlife or treat animals inhumanely. According to the World Wildlife Fund's Living Planet Report, the world's animal species are dying, and humans are a big reason why. The Report reveals that global populations of wild mammals, fish, birds, amphibians, and reptiles declined 58 percent on average in the last 45 years. Specifically, land animals declined by 38 percent, marine species incurred a 36 percent drop, and the number of freshwater species decreased by 81 percent. Using 1970 as a baseline, an estimated 66 percent of the world's wild animal population will be extinct by 2020. This fact has prompted experts to call this time in history "the Anthropocene," because these declining numbers for species are uncharted territory. Species like eastern and western gorillas are nearly extinct and poaching has decimated both elephant and northern white rhino populations. Even vulture populations are headed towards extinction as are certain species of bees. Other causes of the mass extinction of wildlife include urban development, over-hunting, pollution, disease, and climate change—all of which are tied to humans. In many respects, the earth is becoming inhospitable to animals and humans. SWOT factors and strategies oftentimes address this business ethics issue.

Source: http://www.aol.com/article/news/2016/10/27/were-on-track-to-lose-a-huge-chunk-of-the-worlds-animal-popula/21593252/

	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 1 mile away 3. Vehicle traffic passing store up 12 percent 4. Vendors average 6 new products a year 5. Older adults' 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 4 new in-store promotions monthly (S4, O3) 2. Add 2 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 1 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 2 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 2 new cashiers (W8, T1, T4) 2. Install new carpet, paint, and bath (W3, W4, T1)

FIGURE 6-3

A SWOT Matrix for a Retail Computer Store

Some important aspects of a SWOT Matrix are evidenced in Figure 6-3. For example, note that both the internal and external factors and the SO, ST, WO, and WT strategies are stated in specific terms. This is important! For example, regarding the second SO strategy (SO2), if the analyst simply said, "Add new repair and service persons," the reader may conclude that 20 new repair and service persons are needed, when only 2 are needed. So, in stating strategies, be as quantitative and divisional as possible. Furthermore, remember to consult the vision and mission statements of the firm; and keep in mind what the firm considers its competitive advantages or core competencies based on its value chain analysis. Take care to develop SO, WO, ST, and WT strategies based on these considerations as well as the factors receiving the highest weights from your EFE and IFE Matrices.

Regarding specificity, for each SWOT strategy included in the matrix, ask yourself this question: "Is the strategy stated specifically enough to estimate the cost (or savings) if it is selected for implementation?" If the answer is NO, then the strategy is too vague as stated. Thus, whenever words such as "expand, increase, decrease, more, or reduce" are used in a SWOT Matrix, clarify with a percent or number exactly what you are proposing. There is no need to give estimated costs in a SWOT Matrix, but the information must be specific enough to generate these numbers if the particular strategy is selected for implementation. Vagueness is disastrous in strategic planning, especially in a SWOT Matrix.

As shown in Figure 6-3, it is important to include the "S1, O2" notation after each strategy in a SWOT Matrix. This notation reveals the rationale for each alternative strategy in terms of 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 a new store" because a new Highway 34 will make the current location less desirable. The "S4, T5" type of notation, given after each strategy in a SWOT Matrix, accents that "*strategies do not come out of the blue yonder*."

The purpose of SWOT analysis and each Stage 2 matching tool is to generate a list of feasible, specific alternative strategies, not to select or determine which strategies are best. Not all of the strategies developed in the SWOT Matrix will be selected for implementation. No firm has sufficient capital or resources to implement every strategy formulated. As a rule of thumb, include at least four strategies in each SO, ST, WO and WT quadrant to encompass all aspects of the business; usually a SWOT matrix, thus, will include 16 strategies total.

Although the SWOT Matrix is widely used in strategic planning, the analysis does include limitations.[3] First, SWOT analysis does not reveal how to achieve a competitive advantage, so it must not be an end in itself. The analysis should be the starting point for a discussion on how proposed strategies could be implemented as well as cost–benefit, uniqueness, and tradeoff considerations that ultimately could lead to competitive advantage. Second, SWOT is a static assessment (or snapshot) in time. As circumstances, capabilities, threats, and strategies change, the dynamics of a competitive environment may not be revealed in a single matrix. Third, there are interrelationships among the key internal and external factors that SWOT does not reveal, but that may be important in devising strategies. Fourth, there are no weights or ratings in a SWOT analysis. Finally, the relative attractiveness of alternative strategies is not provided.

The Strategic Position and Action Evaluation (SPACE) Matrix

LO 6.4

The **Strategic Position and Action Evaluation (SPACE) Matrix** is another Stage 2 matching tool that uses two axes and four quadrants to reveal whether aggressive, conservative, defensive, or competitive strategies are most appropriate for a given organization. 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]**). To perform SPACE analysis, simply rate a company on each of the four dimensions (axes) named above and revealed in Figure 6-4.[4]

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

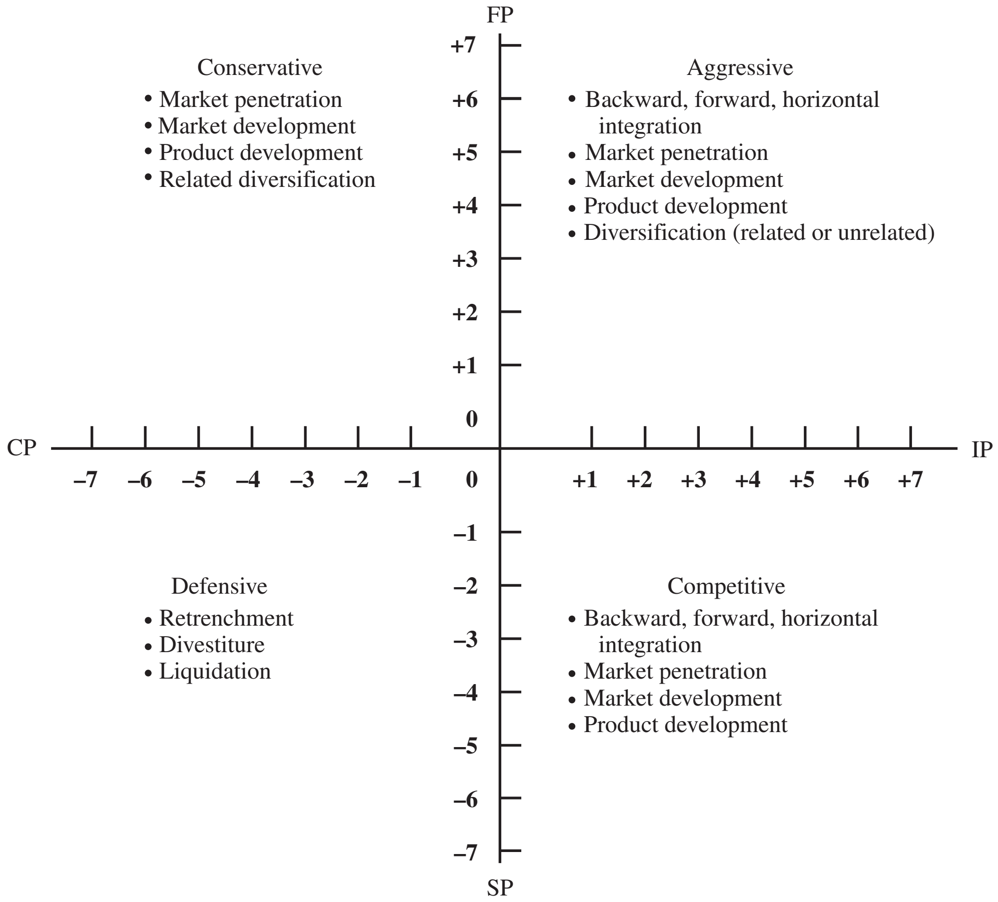


FIGURE 6-4

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.

commonly included in a SPACE analysis are given in Table 6-1. For example, return on investment, leverage, liquidity, working capital, and cash flow are commonly considered to be determining factors of an organization's financial position (FP).

Steps in Performing SPACE Analysis

The process of developing a SPACE Matrix can be summarized in six steps.

Step 1 Select a set of variables to define financial position (FP), competitive position (CP), stability position (SP), and industry position (IP).

1. Let's first elaborate on the difference between the SP and IP axes. The term SP refers to the volatility of profits and revenues for firms in a given industry based on the factors considered in the SPACE. Thus, SP volatility (stability) is based on the expected impact of changes in profits by volatility in core external factors such as technology, economy, demographic, seasonality, and so on. The higher the frequency and magnitude of profitability changes in a given industry, the more unstable the SP becomes. An industry can be stable or unstable on SP, yet high or low on IP. The robotics industry, for instance, would be unstable (−7) on the SP axis due to constant developments and upgrades, yet high growth on the IP axis (+7), whereas the canned food industry would be stable (−1) on the SP axis, yet low growth on the IP axis (+1).

TABLE 6-1 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	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, & K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., 1982); 155–156.

Regarding the FP axis, simply rate the firm on numerous financial variables where +7 is really strong and +1 is really weak. Similarly, on the CP axis, simply rate the firm as per its relative position on numerous variables versus rival firms, where −7 is really weak and −1 is really strong.

Step 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 comparisons to competitors. For example, a +7 on any FP or IP factor is outstanding, whereas a +1 is terrible. On the IP and SP axes, make comparisons to other industries. On the SP axis, know that a −7 on any factor denotes a highly unstable industry condition (unattractive), whereas −1 denotes a highly stable industry condition (attractive).

Step 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.

Step 4 Plot the average scores for FP, IP, SP, and CP on the appropriate axes in the SPACE Matrix.

Step 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 (x, y) coordinate.

Step 6 Draw a **directional vector** from the origin of the SPACE Matrix (0,0) through the new (x, y) coordinate. That vector, being located in a particular quadrant, reveals particular strategies the firm should consider. *Author comment: The template plots the new (x, y) coordinate, rather than drawing a vector; the template also lets you estimate (x, y) coordinates for rival firms without averaging SP, CP, IP, and FP values.*

SPACE Matrix Quadrants

Some example strategy profiles that can emerge from SPACE analysis are shown in Figure 6-5. The directional vector associated with each profile suggests the type of strategies to pursue: aggressive, conservative, defensive, or competitive. Specifically, when a firm's directional vector

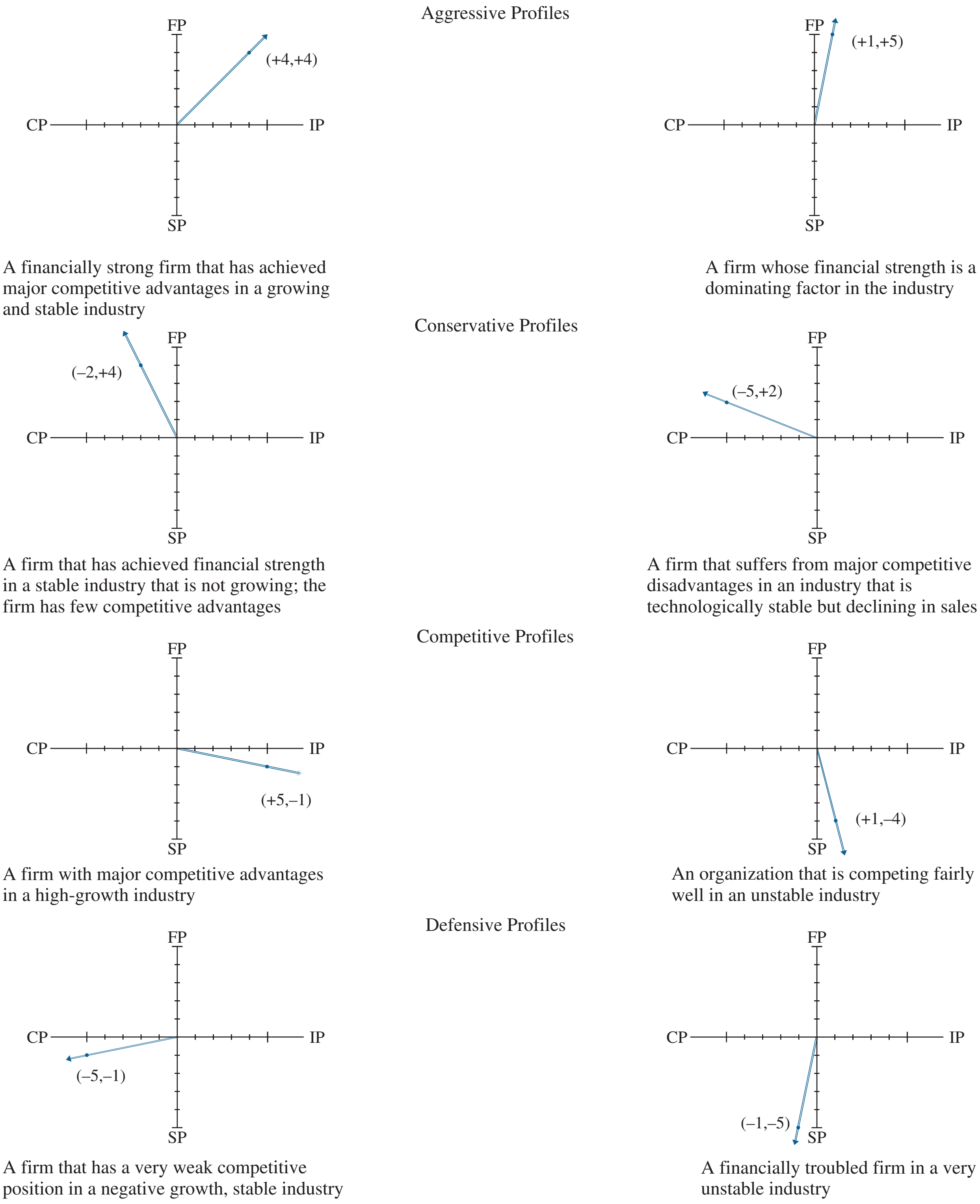


FIGURE 6-5

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.

is located in the **Aggressive Quadrant** (upper right) of the SPACE Matrix, an organization is in an excellent position to use its internal strengths to (1) take advantage of external opportunities, (2) overcome internal weaknesses, and (3) avoid external threats. Therefore, as indicated in Figure 6-4, market penetration, market development, product development, backward integration, forward integration, horizontal integration, or diversification, can be feasible, depending on the specific circumstances that face the firm.

When performing SPACE analysis for a particular firm, be specific in terms of recommended strategies. For example, instead of saying market penetration is a recommended strategy when a vector is located in the Aggressive Quadrant, say "adding 34 new stores in India is the proposed strategy." This is an important point for students doing case analyses because whenever a particular company is known, then the terms learned in Chapter 5 on page 182, such as market development, must be quantified to enable specific recommendations to be proposed. The term "market development" could refer to adding a manufacturing plant in Thailand or Mexico or Kenya. Thus, be *specific* to the extent possible regarding implications of all the matrices presented in this chapter. Vagueness is disastrous in strategic management. Avoid terms such as *expand, increase, decrease,* and *grow*, unless accompanying numbers are provided.

The SPACE directional vector may appear in the **Conservative Quadrant** (upper left), which implies staying close to the firm's basic competencies and not taking excessive risks. As indicated in Figure 6-4, conservative strategies most often include market penetration, market development, product development, and related diversification. The SPACE directional vector may be located in the **Defensive Quadrant** (lower left), which suggests the firm should focus on improving internal weaknesses and avoiding external threats. Defensive strategies include retrenchment, divestiture, liquidation, and related diversification. Finally, the SPACE directional vector may be located in the **Competitive Quadrant** (lower right), indicating competitive strategies. Competitive strategies include backward, forward, and horizontal integration; market penetration; market development; and product development—as indicated in Figure 6-4.

Like the SWOT Matrix, the SPACE Matrix should be tailored to the particular organization being studied and based on factual information to the extent possible. Include specific factors; for example, Delta Airlines may include "volatility of oil prices" as a factor under SP with a rating of −6. To the degree factors are unique to a particular firm and industry, the more effective the SPACE results will be in suggesting possible generic strategies to implement.

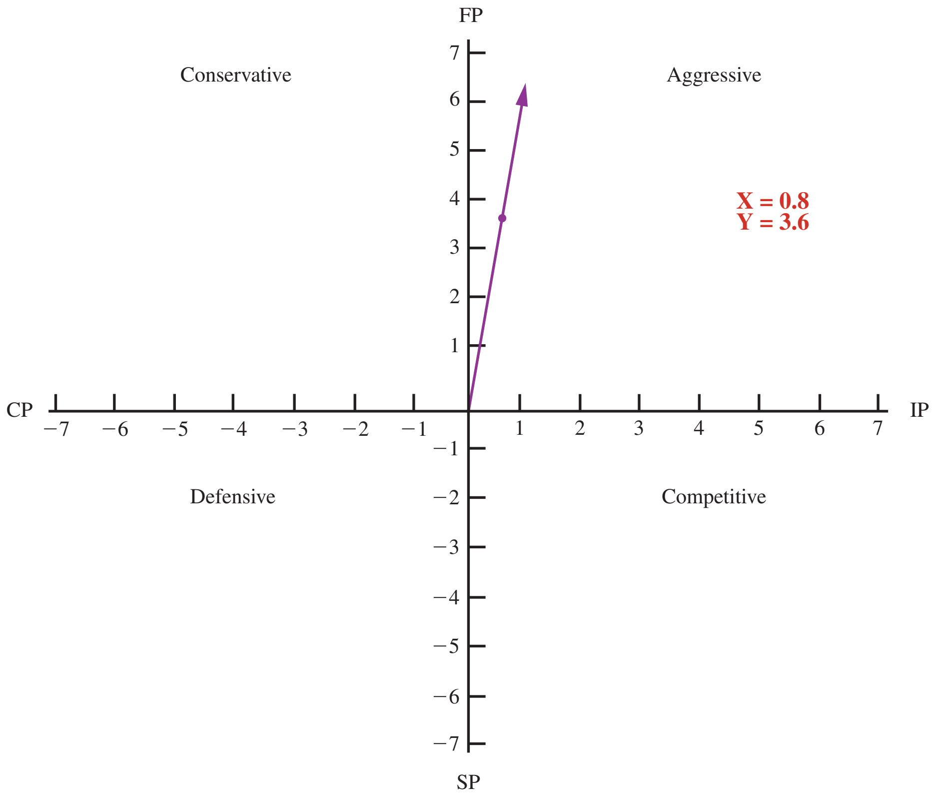
SPACE analysis is an excellent tool for transferring complex information into a manageable list of strategies to consider for implementation. SPACE analysis can be helpful in deciding how aggressive or defensive a firm should be—so it's important to always include SPACE analysis in doing strategic planning.

A SPACE Matrix analysis has some limitations as follows:

1. It is a snapshot in time.
2. There are more than four dimensions that firms could/should be rated on.
3. The directional vector could fall directly on an axis, or could even go nowhere if the coordinate is (0,0). Whenever this happens, analysts usually add a few more evaluative criteria that comprise the FP (and any other) axis to make the vector shift into a particular quadrant.
4. Implications of the exact angle of the vector within a quadrant are unclear.
5. The relative attractiveness of alternative strategies generated is unclear.

The SPACE Matrix has been used to help identify Facebook's overall strategic position as provided in Figure 6-6. As noted in Figure 6-6, Facebook falls in the Aggressive Quadrant. Note the factors used to construct the SPACE Matrix are specific to Facebook and the social media industry. An implication of the Facebook SPACE analysis is that the company should more aggressively add professional networking services, similar to rival firm LinkedIn, or perhaps even acquire LinkedIn.

SPACE Matrix



Internal Analysis:		*External Analysis:*	
Financial Position (FP)		**Stability Position (SP)**	
Debt Ratio	7	Competitive Pressure	−4
Liquidity	7	Price Comparison	−2
Current Ratio	7	Product Demand	−2
EPS	7	Diversity of Social Media Interest Served	−3
ROA	4	Number of Inactive Accounts	−3
Financial Position (FP) Average	**6.4**	**Stability Position (SP) Average**	**−2.8**

Internal Analysis:		*External Analysis:*	
Competitive Position (CP)		**Industry Position (IP)**	
Cash Flow	−2	Growth Potential	6
Social Networking Market Share	−1	Cyber Security Concerns	2
Professional Networking Market Share	−6	Ease of Entry into Market	2
Product Variety	−5	Profit Potential	5
Use of Technology	−2	Alternative Products	5
Competitive Position (CP) Average	**−3.2**	**Industry Position (IP) Average**	**4.0**

FIGURE 6-6

A SPACE Matrix for Facebook

LO 6.5

The Boston Consulting Group (BCG) Matrix

BCG is a private management consulting firm that specializes in strategic planning. Based in Boston, Massachusetts and employing 6,200 consultants worldwide, BCG has approximately 90 offices in 45 countries, and annually ranks in the top five of *Fortune*'s list of the "100 Best Companies to Work For."

Autonomous divisions (also called *segments* 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 must often be developed for each business. The **BCG Matrix** is designed specifically to enhance a multidivisional firm's efforts to formulate strategies. Allocating resources across divisions is arguably the most important strategic decision facing multidivisional firms. Multidivisional firms range in size from small, three-restaurant, mom-and-pop firms, to huge conglomerates such as Walt Disney Company, to universities that have various schools or colleges—and they all need to use **portfolio analysis**—a tool that compares divisions of a firm to determine how best to allocate resources among those divisions.

In a *Form 10K* or *Annual Report*, and sometimes in quarterly reports, most companies disclose revenues and sometimes operating profits by segment. BCG portfolio analysis can be performed based on whatever information is provided, such as the location of all the firm's stores or branches. In the BCG matrices in this chapter, the size of circles correspond to segment revenues (or number of stores), and pie slices within circles correspond to segment operating profits. Let regions be the basis for BCG circles if needed. Reasons to disclose by-segment financial information in a *Form 10K* more than offset the reasons not to disclose, as indicated in Table 6-2.

TABLE 6-2 Reasons to (or Not to) Disclose Financial Information by Segment (by Division)

Reasons to Disclose	Reasons Not to Disclose
1. Stakeholders will better understand the firm, which leads to greater support. 2. Managers and employees will better understand the firm, which leads to greater commitment. 3. Disclosure enhances communication process both within the firm and with outsiders.	1. To avoid rival firms obtaining free competitive information. 2. To avoid performance failures being exposed. 3. To avoid rivalry among segments becoming too intense. 4. To avoid lucrative markets being revealed to rival firms.

The BCG Matrix graphically portrays differences among divisions based on two dimensions: (1) relative market share position on the *x*-axis, and (2) industry growth rate on the *y*-axis. The BCG Matrix allows a multidivisional organization to manage its portfolio of businesses by examining these two dimensions for each division relative to other divisions in the organization. **Relative market share position (RMSP)** is defined as the ratio of a division's own market share (or revenues or number of stores) in a particular industry to the market share (or revenues or number of stores) held by the largest rival firm (leader) in that industry. In the U.S. candy industry, for example, Russell Stover's relative market share position is Russell Stover's market share divided by Hershey's market share, or 1.6/25.9 = 0.062; similarly, Mars' relative market share position is 25.2/25.9 = 0.973, as indicated in Table 6-3.

TABLE 6-3 Market Share Data for the U.S. Candy Industry

Company	Market Share (percent)	BCG: Relative Market Share Position
Hershey	25.9	25.9/25.9 = 1.000
Mars	25.2	25.2/25.9 = 0.973
Ferrara	05.8	05.8/25.9 = 0.232
Mondelez	05.6	05.6/25.9 = 0.216
Nestlé	02.9	02.9/25.9 = 0.039
Lindt & Sprungli	02.0	02.0/25.9 = 0.077
Perfetti Van Melle	02.0	02.0/25.9 = 0.077
Russell Stover	01.6	01.6/25.9 = 0.062

Source: Based on Brian Blackstone and Annie Gasparro, "Nestle to Sell U.S. Candy Business," *Wall Street Journal* (June 16, 2017): A1 and A4.

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 (IGR)** in sales, measured in percentage terms—that is, the average annual increase in revenue for all firms in an industry. The growth rate percentages on the *y*-axis could range from –20 to +20 (or −10 to +10) 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 for the IGR value. Also, various sources, such as the *S&P Industry Surveys* and www.finance.yahoo.com would provide this value.

Based on each division's respective (*x, y*) coordinate, each segment can be properly positioned in a BCG Matrix. Divisions located in Quadrant I (upper right) of the BCG Matrix are called "Question Marks," those located in Quadrant II (upper left) are called "Stars," those located in Quadrant III (lower left) are called "Cash Cows," and those divisions located in Quadrant IV (lower right) are called "Dogs." The four BCG quadrants are described below:

- *Question Marks*—Divisions in Quadrant I (upper right) 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 strategy (market penetration, market development, or product development) or to sell them. An example question mark could be Snap's portfolio of virtual reality technology devices; virtual reality is a high-growth industry, but Snap has a low relative market share.
- *Stars*—Divisions in Quadrant II (upper left) represent the organizations' best long-run opportunities for growth and profitability, and are therefore called **stars**. 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 6-7. A star example could be Facebook's portfolio of virtual reality devices; Facebook is one of the leaders in the industry in revenues in these devices.
- *Cash Cows*—Divisions in Quadrant III (lower left) have a high relative market share position but compete in a low-growth industry; they are 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 an attractive strategy for strong cash cows. However, as a cash cow division becomes weak, retrenchment or divestiture can become more appropriate. A cash cow example is Hewlett-Packard (HP) with its desktop computers; HP is a market leader in terms of revenues, but desktop computers are a low-growth industry.
- *Dogs*—Divisions in Quadrant IV (lower right) 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 basic BCG Matrix appears in Figure 6-7. 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.

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.

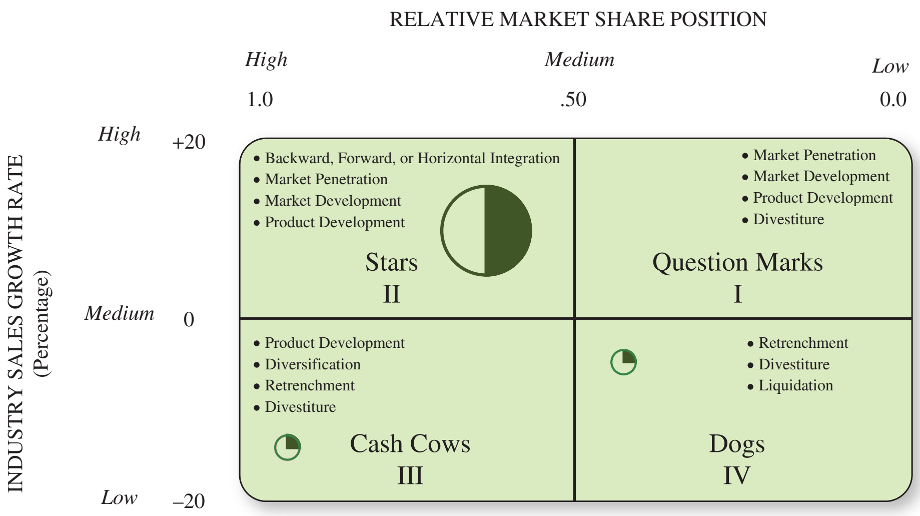
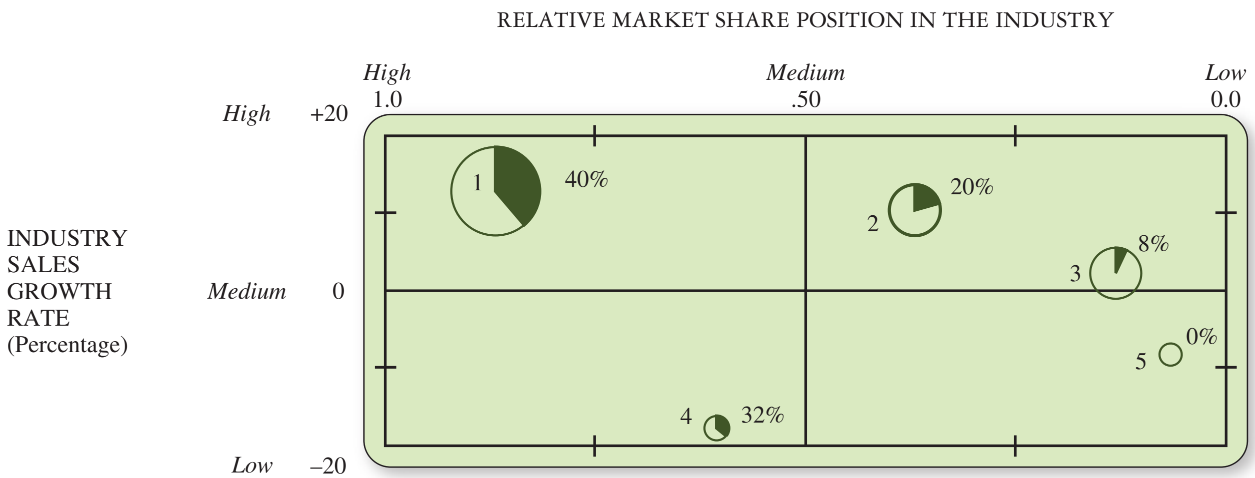


FIGURE 6-7
The BCG Matrix

Source: Based on the BCG Portfolio Matrix from the Product Portfolio Matrix, © 1970, The Boston Consulting Group.

An example of a BCG Matrix is provided in Figure 6-8, which illustrates an organization composed of five divisions with annual sales ranging from $5,000 to $60,000. Division 1 has 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.

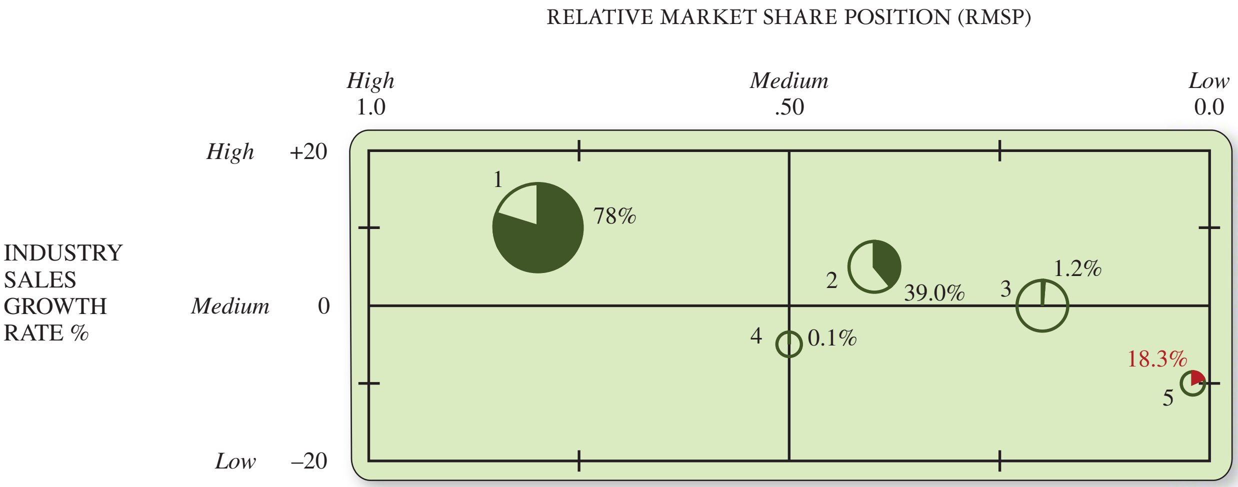


Division	*Revenues*	*Percent Revenues*	*Profits*	*Percent Profits*	*Relative Market Share*	*Industry Growth Rate (%)*
1	$60,000	37	$10,000	40	.80	+15
2	40,000	24	5,000	20	.40	+10
3	40,000	24	2,000	8	.10	+1
4	20,000	12	8,000	32	.60	–20
5	5,000	3	–500	0	.05	–10
Total	**$165,000**	**100**	**$24,500**	**100**	—	—

FIGURE 6-8
An Example BCG Matrix

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 if 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 the size of the market and competitive advantages, are important in making strategic decisions about various divisions.

Another example BCG Matrix is provided in Figure 6-9. As you can see, Division 5 had an operating loss of $188 million as indicated by its red shading. The remaining pie slices add up to over 100 percent profits to account for negative net income associated with Division 5 (This is a different way to portray divisional losses in a BCG matrix analysis).



Division	*$ Sales (millions)*	*% Sales*	*$ Profits (millions)*	*% Profits*	*RMSP*	*IG Rate %*
1	$5,139	51.5	$799	78.0	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)	0.02	–10
Total	**$9,979**	**100.0**	**$1,027**	**100.0**		

FIGURE 6-9
An Example BCG Matrix

LO 6.6

The Internal-External (IE) Matrix

The **Internal-External (IE) Matrix** positions an organization's various divisions (segments) in a nine-cell display, as illustrated in Figure 6-10. The IE Matrix is similar to the BCG Matrix in that both tools involve plotting a firm's divisions in a schematic diagram; this is why both tools are forms of portfolio analysis. In both the BCG and IE Matrices, the size of each circle represents the percentage of revenues or number of stores each division contributes, and pie slices reveal the percentage of operating profits contributed by each division. But there are four important differences between the BCG Matrix and the IE Matrix, as follows:

1. The *x*- and *y*-axes are different.
2. The IE Matrix requires more information about the divisions than does the BCG Matrix.
3. The strategic implications of each matrix are different.
4. The IE Matrix has nine quadrants versus four in a BCG Matrix.

For the above 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

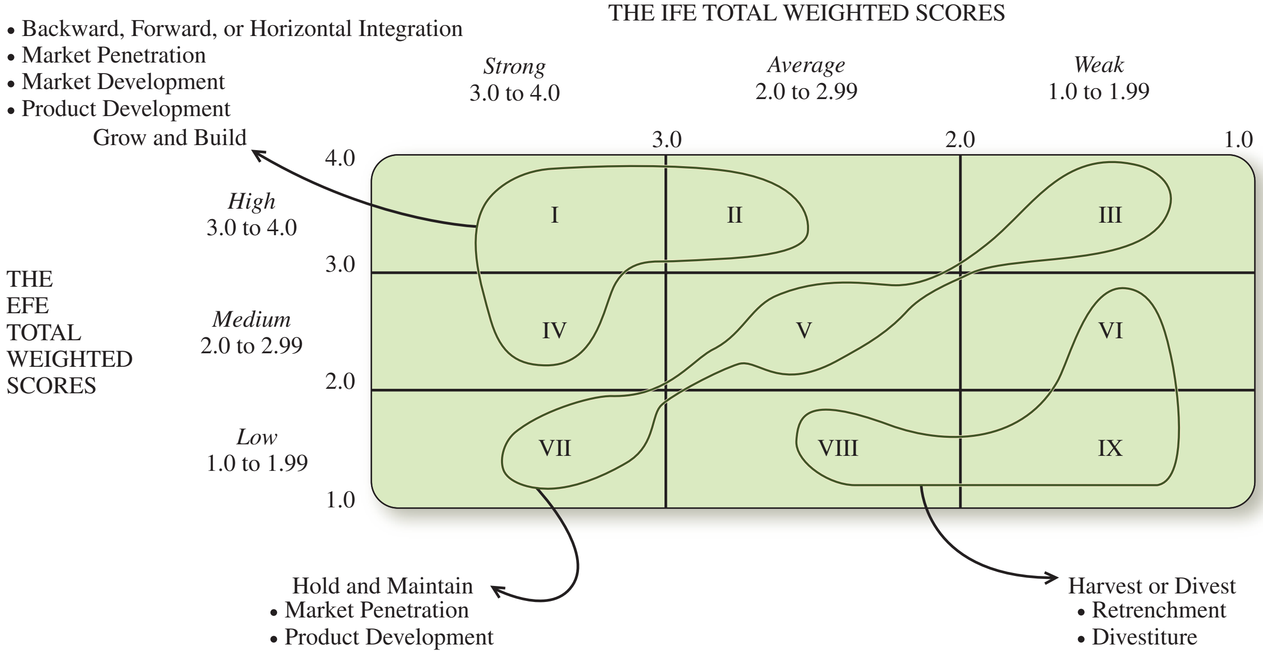


FIGURE 6-10

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.

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 can be quite effective in an oral presentation, enabling students (or strategists) to pave the way for (justify or give some rationale for) their recommendations across divisions of the firm. Also, commonly a BCG Matrix will be developed by region and an IE Matrix by product, or vice versa.

The IE Matrix is based on two key dimensions: (1) the IFE total weighted scores on the *x*-axis and (2) 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, but usually in performing case analysis, strategic-management students simply estimate divisional IFE and EFE scores, rather than prepare those underlying matrices for every division. Regardless, it is the total weighted scores derived from the divisions that 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 weak; a score of 2.0 to 2.99 is average; and a score of 3.0 to 4.0 is strong. Circles, representing divisions, are positioned in an IE Matrix based on their (*x, y*) coordinate.

Despite having nine cells (or quadrants), the IE Matrix has three major regions that have different strategy implications, as follows:

- *Region 1*—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. This is the best region for divisions, given their high IFE and EFE scores. Successful organizations are able to achieve a portfolio of businesses positioned in Region 1.
- *Region 2*—The prescription for divisions that fall into cells III, V, or VII can be described as *hold and maintain* strategies; market penetration and product development are two commonly employed strategies for these types of divisions.
- *Region 3*—The prescription for divisions that fall into cells VI, VIII, or IX can be described as *harvest or divest*.

An example four-division IE Matrix is given in Figure 6-11. As indicated by the positioning of the four circles, *grow and build* strategies are appropriate for Divisions 1, 2, and 3. But 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.

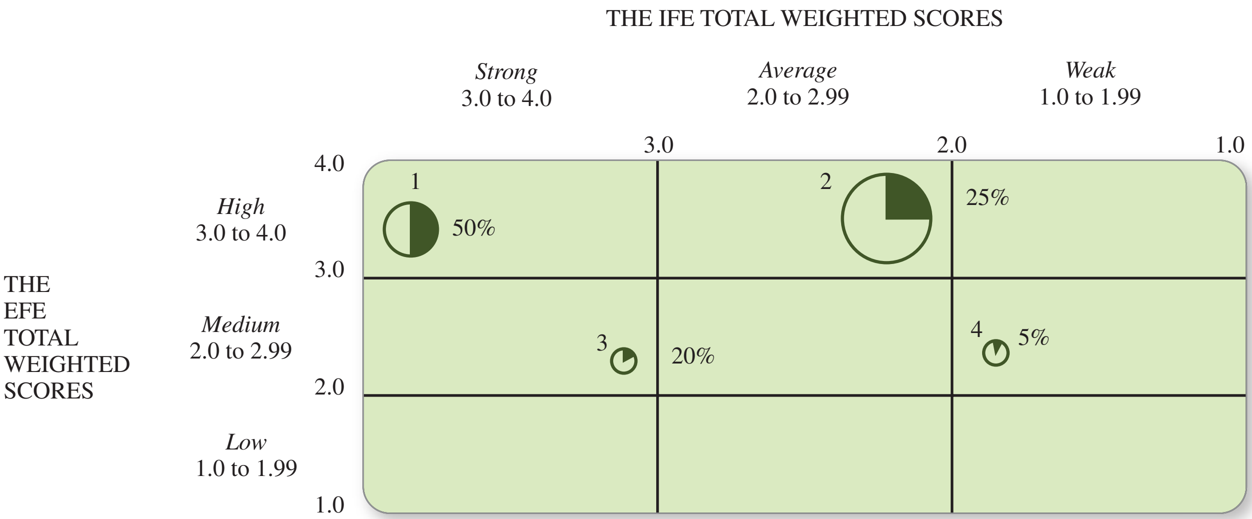
An example five-division IE Matrix is given in Figure 6-12. Note that Division 1 has the largest revenues (as indicated by the largest circle) and the largest profits (as indicated by the largest pie slice) in the matrix. It is common for organizations to develop both geographic and product-based IE Matrices to more effectively formulate strategies and allocate resources among divisions. This latter idea minimizes the limitation of these matrices being a "snapshot in time."

Important Note: Whenever a particular company is known, such as in doing case analysis or in the real world, be more specific with proposed strategies rather than using generic terms in regards to resultant IE Matrix strategies. Couch your strategies in quantitative and divisional terms to the extent possible. (This is true also with strategies derived from the BCG, SPACE, GRAND, and even SWOT analyses; specificity is golden—avoid vagueness)

LO 6.7

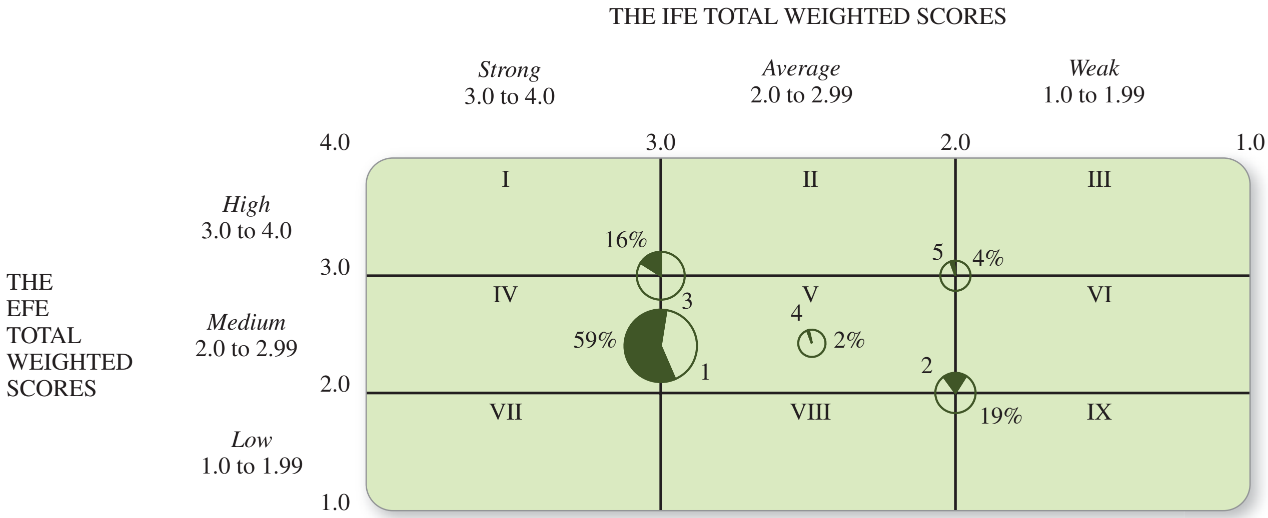
The Grand Strategy Matrix

In addition to the SWOT Matrix, SPACE Matrix, BCG Matrix, and IE Matrix, the **Grand Strategy Matrix** is 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 6-13, the Grand Strategy Matrix is based on two evaluative dimensions: (1) competitive position on the *x*-axis and (2) market (industry) growth on the *y*-axis. 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 Grand Strategy Matrix.



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 6-11
An Example IE Matrix



Grow and Build Division	$ Revenue	Percent Revenue	Profits	Percent Profits	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 6-12
The IE Matrix

FIGURE 6-13
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.

Firms located in Quadrant I of the Grand Strategy Matrix are in an excellent strategic position. For these companies, 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, yet all firms seek continual improvement. Thus, when a Quadrant I organization has excessive resources, then backward, forward, or horizontal integration may be considered. When a Quadrant I firm is too heavily committed to a single product, then 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; 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 organizations 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 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 businesses 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.

Even with the Grand Strategy Matrix, be certain that you always, whenever possible, state your alternative strategies in specific terms to the extent possible. For example, avoid using terms such as divestiture. Rather, specify the exact division to be sold. Also, be sure to use the free Excel student template at www.strategyclub.com that facilitates construction of all strategic planning matrices.

If using the strategic planning template at www.strategyclub.com to perform GRAND analysis, you may use the 1 to 9 scale offered on the template, where 1 = the weakest competitive position and also the slowest industry growth rate, and 9 = the strongest competitive position and the fastest industry growth rate. Also, the template enables up to six points (coordinates) to be plotted in a Grand Strategy Matrix, analogous to various divisions of a firm, or rival firms, or even years to depict expected results of proposed recommendations. You may be creative in this regard.

LO 6.8

The Decision Stage: The QSPM

Other than ranking strategies to achieve the prioritized list, as mentioned on page 194 near the start of this chapter, there is only one analytical technique in the literature designed to determine the relative attractiveness of feasible alternative plans or actions. The **Quantitative Strategic Planning Matrix (QSPM)**, which comprises Stage 3 of the strategy-formulation analytical framework, objectively indicates which alternative strategies are best.[5] 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 the assignment of ratings (called attractiveness scores), but making "small" rating decisions enables strategists to make effective "big" decisions, such as which country to spend a billion dollars in to sell a product.

TABLE 6-4 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				

The basic format of the QSPM is illustrated in Table 6-4. 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, perhaps including two or more SWOT strategies, so you could designate your QSPM strategies using SWOT notation such as SO4 versus WT3. Make sure your strategies are stated in specific terms, such as “Open 275 new stores in Indonesia” rather than “Expand globally” or “Open new stores in Africa.” Specificity is vital because ultimately a dollar value must be established for each recommended strategy; it would be impossible to establish a dollar value for “expand globally.” If you cannot reasonably assign a dollar value to a QSPM (or SWOT) strategy, then the strategy is too vague. Vagueness is disastrous in strategic planning because no one knows what you really are suggesting/saying, and a $1 billion investment may be on the line.

Conceptually, the QSPM determines the relative attractiveness of various strategies based on the extent that key external and internal factors are capitalized on or improved. The relative attractiveness of each strategy is computed by determining the cumulative impact of each external and internal factor. Any number of strategies can be included in the QSPM.

A QSPM for a retail computer store is provided in Table 6-5. 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 score, (2) total attractiveness score, 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. (The Excel template at www.strategyclub.com can facilitate this process.)

TABLE 6-5 A QSPM for a Retail Computer Store

		STRATEGIC ALTERNATIVES			
		1 Buy New Land and Build New, Larger Store		2 Fully Renovate Existing Store	
Key Factors	*Weight*	*AS*	*TAS*	*AS*	*TAS*
Opportunities					
1. Population of a city growing 10%	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%	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%	0.05	—		—	
6. Small business growth in an area up 10%	0.05	—		—	
7. Desire for websites up 18% by realtors	0.04	—		—	
8. Desire for websites up 12% by small firms	0.03	—		—	
Threats					
1. Best Buy opening new store nearby in one year	0.15	4	0.60	3	0.45
2. New bypass for Highway 34 in one year will divert traffic	0.12	4	0.48	1	0.12
3. Local university offers computer repair	0.08	—		—	
4. New mall being built nearby	0.08	2	0.16	4	0.32
5. Gas prices up 14%	0.04	—		—	
6. Vendors raising prices 8%	0.03	—		—	
Total	**1.00**				
Strengths					
1. Revenues from repair/service segment of a store up 16%	0.15	4	0.60	3	0.45
2. Employee morale is excellent	0.10	—		—	
3. Average customer purchase increased from \$97 to \$128	0.07	2	0.14	4	0.28
4. Inventory turnover increased from 5.8 to 6.7	0.05	—		—	
5. In-store promotions resulted in 20% increase in sales	0.05	—		—	
6. In-store technical support personnel have MIS college degrees	0.05	—		—	
7. Store's debt-to-total-assets ratio declined to 34%	0.03	4	0.12	2	0.06
8. Newspaper advertising expenditures increased 10%	0.02	—		—	
9. Revenues per employee up 19%	0.02	—		—	
Weaknesses					
1. Location of store negatively impacted by new Highway 34	0.15	4	0.60	1	0.15
2. Revenues from software segment of a store down 12%	0.10	—		—	
3. Often customers have to wait to check out	0.05	2	0.10	4	0.20
4. Store has no website	0.05	—		—	
5. Revenues from businesses down 8%	0.04	3	0.12	4	0.16
6. Supplier on-time delivery increased to 2.4 days	0.03	—		—	
7. Carpet and paint in store somewhat in disrepair	0.02	1	0.02	4	0.08
8. Bathroom in store needs refurbishing	0.02	1	0.02	4	0.08
Total	**1.00**		**3.64**		**3.27**

Step 2 ***Assign weights to each key external and internal factor.*** These weights are identical to those in the EFE Matrix and IFE Matrix. The weights are presented in a straight column just to the right of the external and internal 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, perhaps selecting two or more of your SO, WO, ST, and/or WT strategies.

Step 4 ***Determine the Attractiveness Scores (AS)***, defined as numerical values that indicate the relative attractiveness of each strategy considering a single external or internal factor. **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 the respective key factor has no effect on the specific choice being made, then do not assign AS to the strategies in that set. Use a dash (or 0 if using the template) 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 (or 0)—then all others must receive a dash (or 0) 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).

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 6-5, 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 the STAS's 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 scores should be recorded for both strategies. Never rate one strategy and not the other. Note also in Table 6-5 that there are no consecutive 1s, 2s, 3s, or 4s across any row in a QSPM; never assign the same AS score across a row. Always prepare a QSPM working row by row. Also, if you have more than four strategies 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 the first row of Table 6-5 that the "Population of city growing 10 percent" opportunity could be capitalized on best by Strategy 1, "Buy New Land and Build New, Larger Store," so an AS score of 4 was assigned to Strategy 1. Attractiveness Scores, therefore, are not mere guesses; they should be rational, defensible, and reasonable. Mathematically, the AS score of 4 in row 1 suggests Strategy 1 is 100 percent more attractive than Strategy 2, whose AS score was 2 (since $4 - 2 = 2$ and 2 divided by $2 = 100$ percent).

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. It draws attention to important relationships that affect strategic decisions. Although developing a QSPM requires Attractiveness Scores (AS) decisions, those small decisions enhance 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, and even can be used by individuals in making career choices.[6]

The QSPM has two limitations. First, it always requires informed judgments regarding AS scores, but quantification is helpful throughout the strategic-planning process to minimize halo error and various biases. Attractiveness Scores are not mere guesses. Be reminded that a 4 is 33 percent more important than a 3; making informed small decisions is important for making effective big decisions, such as deciding among various strategies to implement. Second, a limitation of the QSPM is that its factors and strategy choices are based on underlying input and matching matrices/analysis.

LO 6.9

How to Estimate Costs Associated with Recommendations

The SWOT, BCG, IE, SPACE, and GRAND matrices are used in strategic planning to generate feasible alternative strategies that could benefit the firm. The term **recommendation** is used to refer to "any alternative strategy that is selected for implementation." Due to monetary and/or nonmonetary constraints, no firm can implement all alternative strategies proposed in the matching matrices, so firms utilize the QSPM and expert judgment to select particular strategies. Perhaps the

GLOBAL CAPSULE 6

India's Economy Is Booming

For fiscal 2017–2018, India's gross domestic product (GDP) grew to 7.2 percent, one of the highest national growth rates on the planet. India has recently implemented many business-friendly reforms such as the Goods and Services Tax (GST) on July 1, 2017, that merged nearly all existing taxes into a single system of taxation. India's population of 1.324 billion (versus 295.5 million in the United States) is mostly a middle class willing to spend money in the most populated democratic country in the world. India's economy is flourishing, unemployment is at 4.02 percent (August 2017), and more than 51 million small and medium size businesses are doing well—almost twice the number of small companies in the United States. Scores of companies are building manufacturing plants in India. FedEx has more than 6,000 employees, 1,000 vehicles, and 22 daily incoming flights in India. Some women in India experience significant challenges to achieving financial security. India is making progress to achieve gender equality and protect women from sexual violence such as the India Supreme Court ruling on October 18, 2017, that "sexual intercourse with a girl below 18 years of age is rape regardless of whether she is married or not." This legal change is intended to prevent thousands of older men marrying 13- to 16-year-old girls that heretofore had commonly occurred in India. The number of female employees in Indian companies increased by 5 percent in 2017, compared to the previous year, moving the overall percentage representation of women in Indian companies to 30.55 percent.

Hywards/Shutterstock

Should Your Firm Be Doing Business in India?

Source: Based on Philip Cheng, "Opportunities Abound in India's Booming Economy," *Fortune* (October 1, 2017): 30. Also, https://www.nytimes.com/2017/10/11/world/asita/india-child-marriage-rape.html?rref=collection%2Ftimestopic%2FIndia&action=click&contentCollection=world&region=stream&module=stream_unit&version=latest&contentPlacement=4&pgtype=collection Also, http://www.hindustantimes.com/business-news/women-representation-in-india-inc-up-5-this-year-study/story-6hx60yoKBAfCNorGWKzuiI.html most important page in a student's strategic planning case project is his/her **Recommendations Page**—a page where recommendations are listed along with an estimated dollar amount for the expected cost (or savings) of each recommendation over the next three years. The dollar amounts should all be added to reveal a total amount of new capital needed over the three years.

As indicated in Global Capsule 6, India is a country where many companies are building a new manufacturing plant due to that country's flourishing economy. So, how much does it cost to build a manufacturing plant? Guidance is given in Table 6.6 for determining the estimated cost (or savings) of various recommendations. Table 6.6 gives six example actions that could be recommendations for a firm, along with a rationale and author comment for how dollar values can be estimated on a recommendations page. As indicated, a cost per square foot approach may be used to estimate the total cost of building manufacturing plants, retail stores, distribution centers, or warehouses. Another way to estimate various costs is to find costs incurred for similar expenditures by other firms. Also, look in the firm's *Form 10K* because costs are often given for previous expenditures, and these dollar values can give guidance for estimating costs associated with new recommendations. Avoid wild cost guesses; ask "experts" in the field if needed.

TABLE 6-6 Recommendations and Associated Costs with Rationale

Recommendation with Total Cost Rationale
1. Build one new manufacturing plant. \$40M = \$400 per sq. ft. : 100K sq. ft. = \$40M *Author Comment* – Depending on the size of the plant, cost of the land, and complexity of the plant, the dollar amount could be higher or lower. Oftentimes a *Form 10K* will reveal the actual cost of a similar plant recently built. Another way to estimate this cost is to divide the firm's total property, plant, and equipment on their balance sheet by the number of manufacturing plants to get an average for one and use this as a basis for the cost of building a new plant. A good rule of thumb is to spread the cost of building a new manufacturing plant over two years.
2. Open 200 new retail stores. \$300M = 200 stores × 10K sq. ft. per store × \$150 per sq. ft = \$300M. *Author Comment* – Depending on the average store size and cost of land, the dollar amount could be higher or lower. Another way to estimate this cost is to divide the firm's total property, plant, and equipment on their balance sheet by the number of existing stores to get an average for one store and use this as a basis for opening 200 new stores. Be mindful that many firms use a franchise instead of a company-owned business model, whereby most costs are borne by the franchisee; also, many firms lease instead of own retail space. If the 200 new stores are to come online over 3 years, spread the total cost over 3 years.
3. Hire 100 new salespersons. \$7.5M = 100 × \$75K annual pay = \$7.5M *Author Comment* – The cost could be higher or lower depending on the average salary plus commission and amenities to be paid to salespersons in a given industry.
4. Divest our fragrance division. \$59.4M fragrance segment comprises 27% of firm's revenues; total corporate value of firm is \$640M. So 27% × \$640M = \$59.4M (revenue). *Author Comment* – Besides going into debt, issuing stock, or using net income, a way to raise needed funds is to divest of a segment. Divestiture may be needed if the segment is performing poorly, or if the firm desires to become less diversified, or if the firm needs to realign its portfolio of businesses with its new or existing mission statement.
5. Increase R&D expenditures. \$66.2M current R&D annual expenditures10% annually. (\$200M) × 10% increase annually = \$20M + \$22M + \$24.2M = \$66.2M *Author Comment* – As a percent of revenue, R&D expenditures can range from zero for low-tech firms to upwards of 20% of revenue for hi-tech firms.
6. Acquire the jewelry segment. \$225M jewelry segment comprises 15% of XYZ company. Rival firm's revenues; total value of rival firm is \$1.5B. So 15% of \$1.5B = \$225M estimate. *Author Comment* – Firms need to show 5+ percent annual growth in revenues to keep shareholders pleased. An acquisition is widely used to achieve this need, especially if internal (organic) growth is not sufficient.

LO 6.10 Cultural Aspects of Strategy Analysis and Choice

As defined in Chapter 4, organizational culture includes the set of shared values, beliefs, attitudes, customs, norms, rites, rituals, 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. For these reasons, it is beneficial to view strategy analysis and choice 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 an organization's culture, 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 difficult to implement.

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. Organizational culture can be the primary reason for 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.[7]

LO 6.11 The Politics of Strategy Analysis and 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 strategic 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 the development of improved strategy-formation analytical 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 strategists and found that these persons 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.[8] Successful strategists keep a low political profile on unacceptable proposals and strive 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 do a lot of chatting and informal questioning to stay abreast of how things were progressing and to know when to intervene. Successful strategists lead strategy but do not dictate it. They give few orders, announce few decisions, depend heavily on informal questioning, and seek to probe and clarify until a consensus emerged.

Successful strategists generously and visibly reward key thrusts that succeeded. They assign 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 stay 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.

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 than imposing a particular method; therefore, 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.

IMPLICATIONS FOR STRATEGISTS

This chapter has revealed six new matrices widely used by strategists to gain and sustain a firm's competitive advantages, the core purpose of strategic planning, as illustrated in Figure 6-14. Five of the six are matching tools, SWOT, SPACE, BCG, IE, and GRAND, coupled with the single decision-making tool, QSPM. Whereas some consulting firms and some textbooks advocate using only one or two matrices in strategic planning, our experience is that all six tools introduced in this chapter are uniquely valuable. Coupled with the EFE Matrix, the CPM, and the IFE Matrix from earlier chapters, the nine tools together give strategists the appropriate means for leading a firm down the narrow path to success. Rarely is the path to success wide or easy, due to parity, commoditization, imitation, duplication, substitute products, global competitors, and the willingness and ability of consumers to switch allegiances and loyalties. Employees expect strategists to formulate a superior "game plan," so their hard work implementing the strategic plan will yield job security, good compensation, and ultimately happiness for employees.

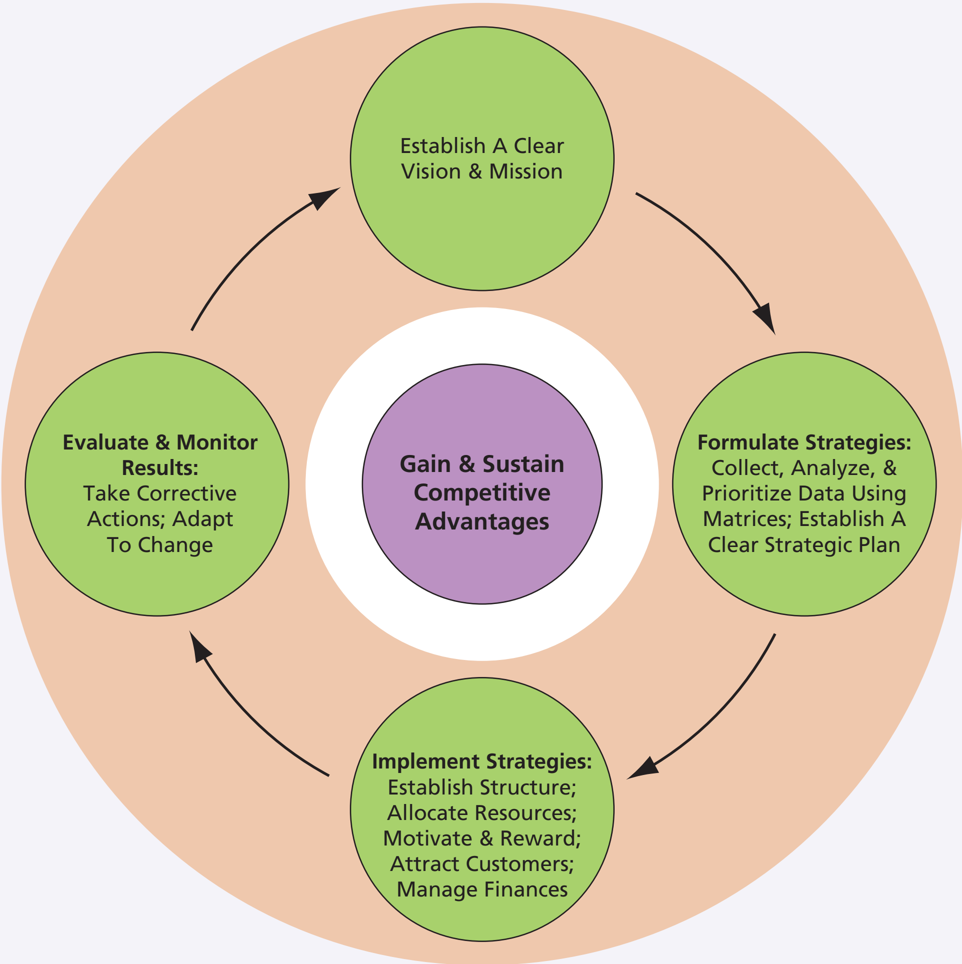


FIGURE 6-14
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

In preparing the strategy-formulation matrices, avoid "wild guesses," but become comfortable with "excellent estimates," as needed, based on research, to move forward with appropriate matrices. Sometimes students are so accustomed (due to their accounting and finance classes especially) to being counted wrong if their answer is off at the third decimal place, it takes a while in a strategic-management class to realize that businesses make "excellent estimates based on research" all the time, because no business is sure what tomorrow will bring. So, if you can make reasonable estimates, move forward with particular matrices. For example, with the BCG Matrix, if segment information is not provided, enter only a single circle in the matrix to represent the overall firm, rather than two or more circles for the divisions. But be mindful that multiple circles could be included based on the number of stores, or the number of customers, rather than traditional dollar revenue information; so do not rush to the conclusion that portfolio information is not available. Also, prepare all matrices based on the point in time of your analysis rather than a desired future point in time—but seriously consider performing a before and after analysis whereby you show for example the existing BCG placement of segments versus your expected future placement.

To generate and decide on alternative strategies that will best gain and sustain competitive advantages, your SWOT, SPACE, BCG, IE, Grand, and QSPM need to be developed accurately. However, 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. Silence from an audience is not good because silence means your audience either fell asleep or was disinterested, unconvinced, or unimpressed. Use the free Excel student template at www.strategyclub.com as needed.

3. Often, an effective way to gain commitment and achieve desired results is to shift from short-term to long-term issues and concerns.
4. Middle-level managers must be genuinely involved in and supportive of strategic decisions, because successful implementation will hinge on their support.[9]

Chapter Summary

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, for 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 someplace it does not want to be. Every organization needs to consciously establish and communicate clear objectives and strategies. Any organization, whether military, product-oriented, service-oriented, governmental, or even athletic, must develop and execute effective strategies to win. An excellent offense without an excellent defense, or vice versa, usually leads to defeat. Developing strategies that use strengths to capitalize on opportunities could be considered offensive, whereas strategies designed to improve on weaknesses while avoiding threats could be termed defensive. Every organization has numerous external opportunities and threats and internal strengths and weaknesses that can be aligned to formulate feasible alternative strategies.

Modern strategy-formulation tools and concepts described in this chapter are 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. 201)
Attractiveness Scores (AS) (p. 213)
Boston Consulting Group (BCG) Matrix (p. 203)
business portfolio (p. 202)
cash cows (p. 204)
champions (p. 216)
competitive position (CP) (p. 197)
Competitive Quadrant (p. 201)
Conservative Quadrant (p. 201)
decision stage (p. 194)
Defensive Quadrant (p. 201)
directional vector (p. 199)
dogs (p. 204)
financial position (FP) (p. 197)
Grand Strategy Matrix (p. 208)
halo error (p. 224)
industry growth rate (p. 204)
industry position (IP) (p. 197)
input stage (p. 194)
Internal-External (IE) Matrix (p. 206)
matching (p. 194)
matching stage (p. 194)
portfolio analysis (p. 203)
Quantitative Strategic Planning Matrix (QSPM) (p. 210)
question marks (p. 204)
recommendation (p. 214)
Recommendations Page (p. 215)
relative market share position (RMSP) (p. 203)
SO strategies (p. 195)
stability position (SP) (p. 197)
stars (p. 204)
Strategic Position and Action Evaluation (SPACE) Matrix (p. 197)
strategy-formulation analytical framework (p. 193)
Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix (p. 194)
ST strategies (p. 195)
Sum Total Attractiveness Scores (STAS) (p. 213)
Total Attractiveness Scores (TAS) (p. 213)
WO strategies (p. 195)
WT strategies (p. 195)

Issues for Review and Discussion

6-1. Explain the difference between strategies and recommendations.
6-2. Explain how to estimate costs associated with recommendations.
6-3. Why is it essential for a SWOT strategy to be stated specifically enough to estimate the cost (or savings)?
6-4. Why is it important to treat all animals, even cattle, pigs, and chickens, with care and respect?
6-5. A *Wall Street Journal* article (July 12, 2014, p. B3) said Apple's smartphone market share in China is 6.0 percent, behind the two leaders Samsung (17.8%) and Lenovo (11.4%). With regard to a BCG Matrix, what are the three firms' relative market share position?
6-6. List five limitations of a SPACE Matrix.
6-7. List the pros and cons of a firm disclosing by-segment corporate information in a *Form 10K*.
6-8. What are some key differences between the BCG and the IE portfolio matrices?
6-9. In developing a QSPM, if 10 strategies are being compared simultaneously, what would be a good scale for the AS scores? Why?
6-10. In developing a BCG Matrix or an IE Matrix, what would be a good surrogate for revenues for Target Corp., Burger King, Bank of America, and Spirit Airlines?
6-11. In developing a SPACE Matrix, what would you expect the SP average to be for Apple, Heinz, Verizon, Amazon, and Kroger? Diagram and explain.
6-12. Rather than developing a QSPM, what is an alternative procedure for prioritizing the relative attractiveness of alternative strategies?
6-13. Overlay a BCG Matrix with a Grand Strategy Matrix and discuss similarities in terms of format and implications. Diagram and explain.
6-14. Define halo error. How can halo error inhibit selecting the best strategies to pursue?
6-15. List six drawbacks of using only subjective information in formulating strategies.
6-16. For a firm that you know well, give an example of SO strategy showing how an internal strength can be matched with an external opportunity to formulate a strategy.
6-17. For a firm that you know well, give an example WT strategy, showing how an internal weakness can be matched with an external threat to formulate a strategy.
6-18. List three limitations of the SWOT Matrix and analysis.
6-19. For the following three firms using the given factors, calculate a reasonable stability position (SP) coordinate to go on their SPACE Matrix axis, given what you know about the nature of those industries.

Factors	Winnebago	Apple	U.S. Postal Service
Barriers to entry into market			
Seasonal nature of business			
Technological changes SP Score			

6-20. Would the angle or degrees of the vector in a SPACE Matrix be important in generating alternative strategies? Diagram and explain.

6-21. On the competitive position (CP) axis of a SPACE Matrix, what level of capacity utilization would be necessary for you to give the firm a negative 1? Negative 7? Why? Diagram and explain.

6-22. If a firm has weak financial position and competes in an unstable industry, in which quadrant will the SPACE vector lie? Diagram and explain.

6-23. Describe a situation where the SPACE analysis would have no vector. In other words, describe a situation where the SPACE analysis coordinate would be (0,0). What should an analyst do in this situation?

6-24. Develop a BCG Matrix for your university. Because your college does not generate profits, what would be a good surrogate for the pie slice values? How many circles do you have and how large are they? Explain.

6-25. In a BCG Matrix, would the question mark quadrant or the cash cow quadrant be more desirable? Diagram and explain.

6-26. Would a BCG Matrix and analysis be worth performing if you do not know the profits of each segment? Why?

6-27. What major limitations of the BCG Matrix does the IE Matrix overcome? Diagram and explain.

6-28. In an IE Matrix, do you believe it is more advantageous for a division to be located in quadrant II or IV? Why? Diagram and explain.

6-29. Develop a 2 • 2 • 2 • 2 • 2 QSPM for an organization of your choice (i.e., two strengths, two weaknesses, two opportunities, two threats, and two strategies). Follow all the QSPM guidelines presented in the chapter.

6-30. How would application of the strategy-formulation analytical framework differ from a small to a large organization?

6-31. What types of strategies would you recommend for an organization that achieves total weighted scores of 3.6 on the IFE Matrix and 1.2 on the EFE Matrix? Diagram and explain.

6-32. Given the following information, develop a SPACE Matrix for the XYZ Corporation: FP = +2; SP = – 6; CP = −2; IP = +4. Diagram and explain.

6-33. Given the information in the following table, develop a BCG Matrix and an IE Matrix:

Divisions	1	2	3
Profits	$10	$15	$25
Sales	$100	$50	$100
Relative Market Share	0.2	0.5	0.8
Industry Growth Rate	+.20	+.10	−.10
IFE Total Weighted Scores	1.6	3.1	2.2
EFE Total Weighted Scores	2.5	1.8	3.3

6-34. How would you develop a portfolio matrix for your school of business?

6-35. Explain how to estimate the cost of building one new manufacturing plant for a company.

6-36. Discuss the limitations of various strategy-formulation analytical techniques.

6-37. Explain why cultural factors should be an important consideration in analyzing and choosing among alternative strategies.

6-38. How would for-profit and nonprofit organizations differ in their applications of the strategy-formulation analytical framework?

6-39. Develop a SPACE Matrix for a company that is financially weak and is a weak competitor. The industry for this company is pretty stable, but the industry's projected growth in revenues and profits is not good. Label all axes and quadrants.

6-40. List four limitations of a BCG Matrix. Diagram and explain.

6-41. Make up an example to show clearly and completely that you can develop an IE Matrix for a three-division company, where each division has $10, $20, and $40 in revenues and $2, $4, and $1 in profits. State other assumptions needed. Label axes and quadrants.

6-42. What procedures could be necessary if the SPACE vector falls right on the axis between the competitive and defensive quadrants? Diagram and explain.

6-43. In a BCG Matrix or the Grand Strategy Matrix, what would you consider to be a rapid market (or industry) growth rate?

6-44. Why is it important to work row by row instead of column by column in preparing a QSPM?

6-45. Why should one avoid putting double 4s in a row in preparing a QSPM?

6-46. Envision a QSPM with no weight column. Would that still be a useful analysis? Why or why not? What do you lose by deleting the weight column?

6-47. Prepare a BCG Matrix for a two-division firm with sales of $5 and $8 versus profits of $3 and $1, respectively. State assumptions for the RMSP and IGR axes to enable you to construct the diagram.

6-48. Consider developing a before and after BCG or IE Matrix to reveal the expected results of your proposed strategies. What limitation of the analysis would this procedure overcome somewhat?

6-49. If a firm has the leading market share in its industry, where on the BCG Matrix would the circle lie? Diagram and explain.

6-50. If a firm competes in an unstable industry, such as telecommunications, where on the SP axis of the SPACE Matrix would you plot the appropriate point? Diagram and explain.

6-51. Why do you think the SWOT Matrix is the most widely used of all strategy matrices?

6-52. What are two limitations of the QSPM discussed in the chapter?

6-53. The number of people in millions that visited various finance-focused information websites in September 2017 are as follows: Yahoo! Finance

(59.7), Business Insider (53.4), CNBC (49.2), Forbes Digital (48.6), Bloomberg (36.6), CNN Money (36.2), Dow Jones (34.7), Reuters sites (24.7), and Fortune.com sites (19.2). What would the RMSP values be for the nine firms if you were going to develop a BCG Matrix?

6-54. AT&T and Time Warner are perhaps merging. The following data table gives the 9-month 2017 revenue and operating income by segment for both AT&T and its rival Time Warner. This type of information for firms can enable construction of circles (based on revenues) and pie slices (based on profits) in portfolio matrices. Develop a BCG Matrix based on the information given.

Company	Revenue in billions	Operating income in billions
AT&T Segments		
1. Business Solutions	$51.0	$13.3
2. Entertainment	38.0	4.6
3. Consumer Mobility	23.2	7.1
4. International	6.1	–0.3
Time Warner Segments		
1. Turner	9.0	3.5
2. HBO	4.7	1.7
3. Warner Bros.	9.8	1.3

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 6A

Perform a SWOT Analysis for Coca-Cola

Purpose

The SWOT Matrix is the most widely used of all strategic planning tools and techniques because it is conceptually simple and lends itself readily to discussion among executives and managers. The SWOT Matrix is effective in formulating strategies because it clearly matches a firm's internal strengths and weaknesses with the firm's external opportunities and threats to generate feasible strategies that should be considered. This exercise gives you practice in performing SWOT analysis for a large corporation.

Instructions

Step 1 Join with two other students in class. Together, develop a SWOT Matrix for Coca-Cola. Follow guidelines provided in the chapter, including notation (for example, S4, T3) at the end of each strategy. Include two strategies in each of the four (SO, ST, WT, WO) quadrants. Be specific regarding your strategies, avoiding generic terms such as *forward integration.* Use the Cohesion Case, your answers to Assurance-of-Learning Exercise 1B on page 66, and the company's most recent quarterly report as given at the corporate website.

Step 2 Turn in your team-developed SWOT Matrix to your professor for a classwork grade. Note: Feel free to list factors and strategies vertically on a page rather than necessarily fitting everything into a nine-cell array.

EXERCISE 6B

Develop a SPACE Matrix for Coca-Cola

Purpose

The SPACE Matrix is one of five matching strategic management tools widely used to formulate feasible strategies. Used in conjunction with the SWOT, BCG, IE, and GRAND, the SPACE can be helpful in devising a strategic plan because hard choices normally must be made between attractive strategic options. This exercise gives you practice in developing a SPACE Matrix.

Instructions

Step 1 Review Coca-Cola's business as described in the Cohesion Case as well as the company's most recent *Form 10K* and quarterly report.

Step 2 Review industry and competitive information pertaining to Coca-Cola.

Step 3 Develop a SPACE Matrix for Coca-Cola. What strategies do you recommend for Coca-Cola given your SPACE analysis? Avoid generic, vague terms such as *market development.*

EXERCISE 6C

Develop a BCG Matrix for Coca-Cola

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 that need to be divested. This exercise can give you practice in 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, Industry Growth Rate. Down the far left of your page, list Coca-Cola's divisions/segments as given on pages 58–59. Now turn back to the Cohesion Case and find information to fill in all the cells in your data table from page 59.

Step 2 Based on Coca-Cola's year-end 2017 segment data given in the Cohesion Case, complete a BCG Matrix for the company.

Step 3 Compare your BCG Matrix to other students' matrices. Discuss any major differences.

EXERCISE 6D

Develop a QSPM for Coca-Cola

Purpose

This exercise can give you practice in developing a 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 Coca-Cola.

Step 2 Compare your team's QSPM to those of other teams.

Step 3 Discuss any major differences.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 6E

Develop a BCG Matrix for My University

Purpose

Developing a BCG Matrix for many nonprofit organizations, including colleges and universities, is a useful exercise. Of course, there are no profits for each division or department—and in some cases no revenues. However, be creative in performing a BCG Matrix. For example, the pie slice in the circles can represent the number of majors receiving jobs on graduation, or the number of faculty teaching in that area, or some other variable that you believe is important to consider. The size of the circles can represent the number of students majoring in particular departments or areas.

Instructions

Step 1 Develop a BCG Matrix for your university. Include all academic schools, departments, or colleges.

Step 2 Diagram your BCG Matrix on paper.

Step 3 Discuss differences among the BCG Matrices developed in class.

SET 3: STRATEGIC PLANNING TO ENHANCE MY EMPLOYABILITY

EXERCISE 6F

Perform QSPM Analysis on Myself

Purpose

QSPM analysis is designed to determine the relative attractiveness of feasible alternative actions. Although primarily used in a business setting, QSPM analysis can enable individuals to objectively determine which alternative strategies are best to pursue. The purpose of this exercise is to showcase how individuals can use QSPM analysis to make career choices.

Instructions

Step 1 Follow the steps provided in Chapter 6 for developing a QSPM analysis, but do so for yourself rather than a company. Use the external and internal factor information about yourself that you earlier developed in Exercise 1D (p. 67) to get started.

Step 2 Across the top row of your QSPM, consider two strategies as follows:
1) Go to graduate school or 2) Go to work full-time.

Step 3 To keep this example simple, do not include a weight column, as some firms also prefer; simply add the AS scores to obtain your recommended best strategy, rather than multiplying across rows and summing TAS scores.

Step 4 Share with the class what strategy, More School or More Work, yields the highest TAS score in your personal analysis.

EXERCISE 6G

A Template Competency Test

Purpose

The free Excel strategic planning template at www.strategyclub.com is widely used for strategic planning by students and small businesses; this exercise aims to enhance your familiarity with the template. Developing competence with the template will enable you to place this skill appropriately on your resume, in addition to facilitating your development of a comprehensive strategic plan for an assigned case company.

Instructions

Answer the following Chapter 6 related questions about the template. Discuss your answers with classmates to determine any issues or concerns.

1. In performing SPACE analysis, does the template allow you to show your firm and rival firms? If yes, would a legend be nice to create to organize information? Why?
2. In performing BCG analysis, how does the template address firms competing in markets with over or under 20% IGR?
3. Using the template, what is a good way to show a before and after (your recommendations) BCG?
4. In performing IE portfolio analysis using the template, are your EFE and IFE Matrix total weighted scores automatically plotted after you finish those matrices? For divisions, does the template call for all “divisional” EFE and IFE matrices?
5. Why is it best to label divisions 1, 2, 3 etc. on BCG and IE matrices and thereby create a legend, rather than let division names plot in the matrix?
6. In performing GRAND analysis, how many firms/divisions/scenarios does the template allow to be considered/placed in the matrix? Why is this a nice feature? What are some scenarios you could examine?
7. Why is there no need to reenter weights when performing QSPM analysis using the template?

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 6H

How Severe Are Various Subjective Threats in Strategic Planning?

Purpose

As discussed in Chapter 6, without objective information and analysis, six subjective threats (personal biases, politics, prejudices, emotions, personalities, and halo error) oftentimes play a dominant role in the strategy-formulation process, undermining effectiveness. Halo error is the tendency to put too much weight on a single factor.

The purpose of this exercise is to examine more closely various threats of relying too heavily on subjectivity in formulating strategies. A secondary purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Instructions

Rank the six subjective threats as to their relative severity (1 = most severe, 9 = least important). First, rank the threats as an individual. Next, rank the threats as part of a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision making in strategic planning.

The Steps

1. Fill in Column 1 in Table 6-7 to reveal your individual ranking of the relative severity of the six subjective threats (1= most severe to 6 = least severe). For example, if you think Personal Biases is the third-most severe threat, then enter a 3 in Table 6-7 in Column 1 beside Personal Biases.
2. Fill in Column 2 in Table 6-7 to reveal your group's ranking of the relative severity of the six threats (1 = most severe to 6 = least severe).
3. Fill in Column 3 in Table 6-7 to reveal the expert's ranking of the six threats. To be provided by your professor, the expert rankings are based on the authors' experience, rather than on findings from empirical research.
4. Fill in Column 4 in Table 6-7 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 6-7 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

TABLE 6-7 Assessing Severity of Being Too Subjective in Making Strategic Decisions: Comparing Individual versus Group Decision Making

Threats of Being Too Subjective	Column 1	Column 2	Column 3	Column 4	Column 5
1. Personal Biases					
2. Politics					
3. Prejudices					
4. Emotions					
5. Personalities					
6. Halo error					
Sums					

MINI-CASE ON THE BOSTON CONSULTING GROUP

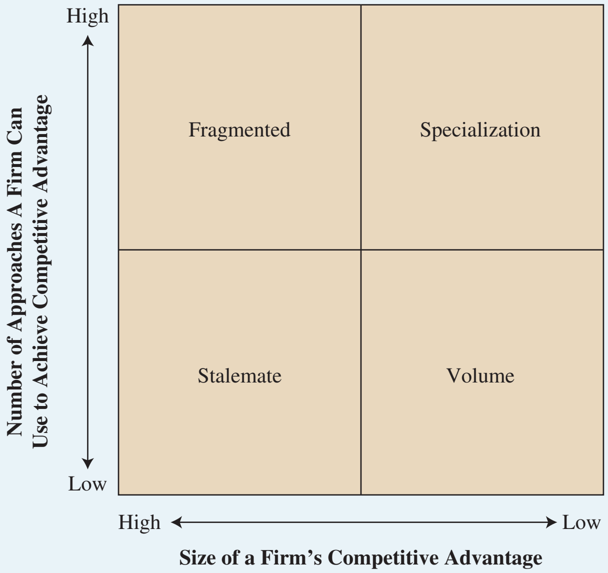
WHAT AMERICAN FIRM HELPS THE MOST COMPANIES DO STRATEGIC PLANNING?


Pressmaster/Shutterstock

What Are Your Thoughts on This Idea?

The answer to the question posed above might be the Boston Consulting Group (BCG) headquartered in Boston, Massachusetts. A worldwide management-consulting firm founded in 1963, BCG had revenues of $6.3 billion in 2017 and more than 16,000 employees. BCG's President and CEO is Rich Lesser. BCG was ranked third among *Fortune*'s "100 Best Companies to Work For" in 2017 and was ranked first among *Consulting Magazine's* 2016 "Best Firms to Work For."

In formulating strategies, some firms use BCG's Advantage Matrix to portray on the x-axis the "size of a firm's competitive advantage (Low versus High)" and on the y-axis "the number of approaches a firm can use to achieve competitive advantage (Low versus High)." Based on these two axes, strategic implications for firms located in one of four quadrants can be labeled, according to BCG, as: Fragmented, Specialization, Volume, and Stalemate, as illustrated below:



Do some online research to answer the following questions about BCG's Advantage Matrix.

Questions

1. In a sentence or two for each quadrant, how would you describe implications for a firm based on their position in the Advantage Matrix? Do you like the four words proposed for "quadrant implications?" Can you think of a better word or words?
2. What do you think are the primary benefits of using the Advantage Matrix?
3. What are the primary limitations of using the Advantage Matrix in your view?
4. How could the Advantage Matrix be improved?

Source: Based on information at http://www.differentiateyourbusiness.co.uk/competitive-advantage-matrix

Web Resources

1. **BCG Matrix Images** This website provides more than 100 jpeg images of BCG matrices that can be used in a case project or strategic planning report.
https://www.google.com/search?source=hp&q=bcg+matrix+images&oq=bcg+matrix+im&gs_l=psy-ab.1.0.0l2j0i22i30k1l2.94589.100985.0.103449.15.13.0.0.0.0.109.1230.9j4.13.0.foo%2Ccfro%3D1%2Cnso-ehuqi%3D1%2Cnso-ehuui%3D1%2Cewh%3D0%2Cnso-mplt%3D2%2Cnso-enksa%3D0%2Cnso-enfk%3D1%2Cnso-usnt%3D1%2Cnso-qnt-npqp%3D0-1633%2Cnso-qnt-npdq%3D0-5608%2Cnso-qnt-npt%3D0-1229%2Cnso-qnt-ndc%3D2051%2Ccspa-dspm-nm-mnp%3D0-06145%2Ccspa-dspm-nm-mxp%3D0-153625%2Cnso-unt-npqp%3D0-1506%2Cnso-unt-npdq%3D0-4694%2Cnso-unt-npt%3D0-061%2Cnso-unt-ndc%3D300%2Ccspa-uipm-nm-mnp%3D0-007625%2Ccspa-uipm-nm-mxp%3D0-053375...0...1.1.64.psy-ab..2.13.1229.0..35i39k1j0i131k1j0i20k1.pk-zD4sqIjQ
2. **The QSPM Matrix** This website provides numerous PDF files that discuss and exemplify the QSPM Matrix in further detail.
https://scholar.google.com/scholar?q=quantitative+strategic+planning+matrix&hl=en&as_sdt=0&as_vis=1&oi=scholart&sa=X&ved=0ahUKEwihptaiwonWAhWK5yYKHYYMBZ4QgQMINDAA
3. **Strategic Planning Template** This website offers the best strategic planning template available for developing a three-year strategic plan, and it is free. All six new matrices introduced in Chapter 6 (SWOT, SPACE, BCG, IE, GRAND, QSPM) are included in the template.
http://www.strategyclub.com

Current Readings

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PART 3

STRATEGY IMPLEMENTATION

7

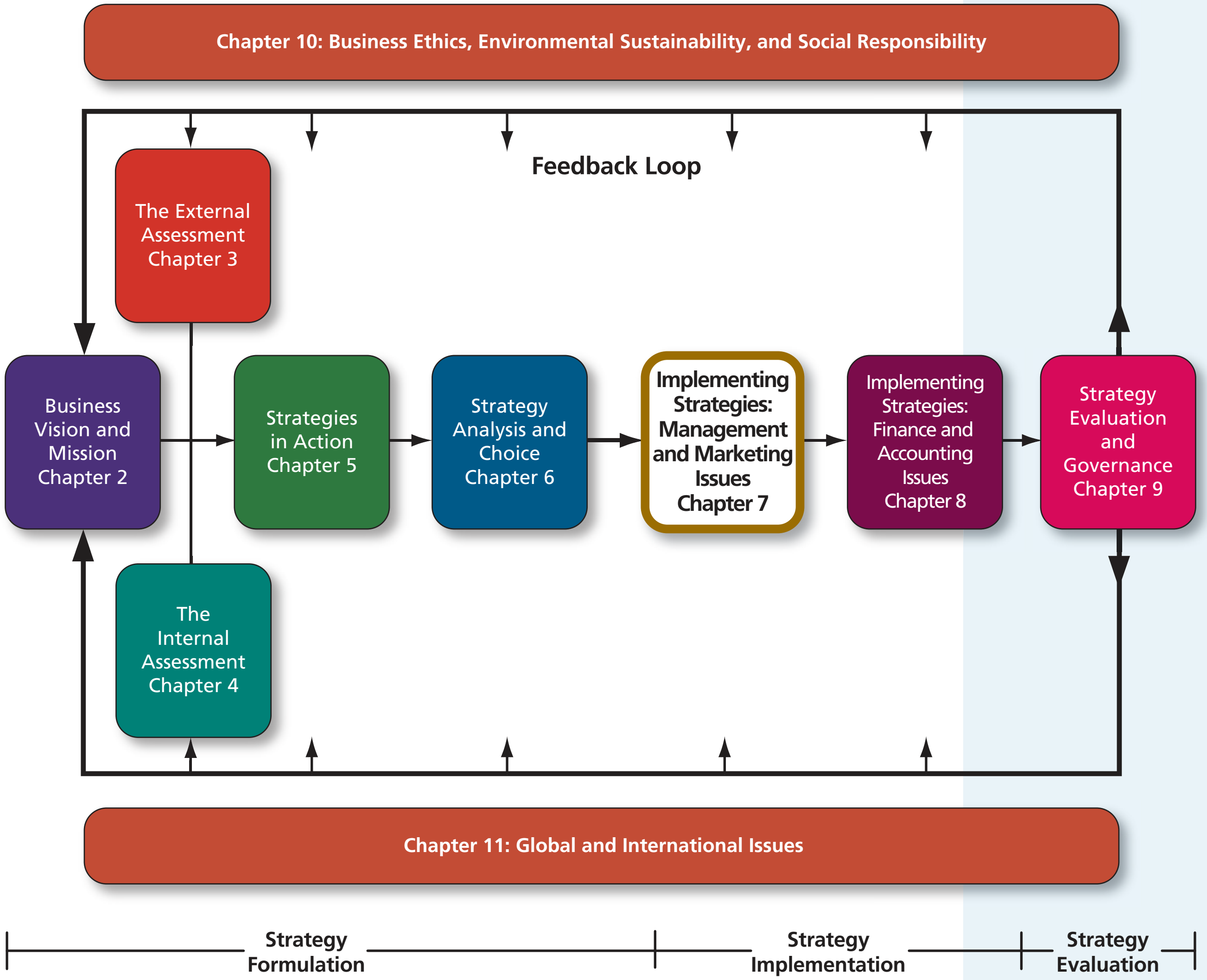

FIGURE 7-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

Implementing Strategies: Management and Marketing Issues

LEARNING OBJECTIVES

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

7-1. Describe the transition from formulating to implementing strategies.

7-2. Discuss reasons why annual objectives are essential for effective strategy implementation.

7-3. Identify and discuss the nature and role of policies in strategy implementation.

7-4. Explain the roles of resource allocation and managing conflict in strategy implementation.

7-5. Discuss the need to match a firm's structure with its strategy.

7-6. Identify, diagram, and discuss different types of organizational structure.

7-7. Identify and discuss 15 do's and don'ts in constructing organizational charts.

7-8. Discuss four strategic production/operations issues vital for strategy implementation.

7-9. Discuss seven strategic human resource issues vital for strategy implementation.

7-10. Describe key strategic marketing issues vital for implementing strategies.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1: Strategic Planning for Coca-Cola
EXERCISE 7A: Compare and Contrast Coca-Cola's Marketing Expenses versus Rival Firms
EXERCISE 7B: Diagram an Existing and Proposed Organizational Chart for Coca-Cola

SET 2: Strategic Planning for My University
EXERCISE 7C: Develop a Perceptual Map for My University

SET 3: Strategic Planning to Enhance My Employability
EXERCISE 7D: Marketing Yourself to Best Achieve Your Career Objectives

SET 4: Individual versus Group Strategic Planning
EXERCISE 7E: What Are the Most Important Benefits of Having a Diverse Workforce?

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The strategic-management process does not end with deciding what strategy or strategies to pursue. There must be a translation of strategic thought into action. This translation is significantly easier when 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 commented, "The best game plan in the world never blocked or tackled anybody."

> 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, all the while 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 a perfect plan that never gets off the paper it is written.[1]

Implementing strategy affects an organization from top to bottom, including all the functional and divisional areas of a business. This chapter focuses on management and marketing issues most critical for successful strategy-implementation, whereas Chapter 8 focuses on analogous finance and accounting issues. Showcased as an exemplary strategist, former CEO of PepsiCo, Indra Nooyi, is one of the most successful persons ever to lead the management and marketing strategy-implementation efforts of a major corporation.

EXEMPLARY **STRATEGIST** SHOWCASED

Indra Nooyi, Former CEO of PepsiCo

Nenov Brothers Images/Shutterstock

The former CEO of PepsiCo, Indra Nooyi, was voted *Fortune*'s second-most powerful woman in business in the U.S. in 2017. Former CEO Nooyi has appeared 18 out of the last 20 years on *Fortune*'s list of the 50 most-admired businesswomen in the U.S. Nooyi has catapulted PepsiCo to currently have 22 brands that each bring in more than $1 billion in annual sales; three new PepsiCo brands (Naked Juice, $923M; Pure Leaf, $873M; and Sabra, $618M) are poised to soon join the company's over $1 billion brand list. In a recent interview, Nooyi answered a few strategy implementation questions (condensed and paraphrased):

1. **Question**: You supported Hillary Clinton for President of the United States, but when Donald Trump was elected, you joined Trump's Business Advisory Council and became a Trump supporter. What do you think about political issues in terms of strategy implementation?
   Answer: Before a presidential election, you can support any candidate you like, but the day after the election, support whoever is elected. Mr. Trump is my president and our president and his CEO Business Advisory Council was a great idea.
2. **Question**: What advice would you give women (and men) entering the workforce today?
   Answer: Strive to get increasingly better at multitasking. Be very well organized and manage your time efficiently. Every day write down (make a list of) 50 items you need to accomplish; check the items off as you complete them; carry forward to the next day's list any item that still needs work; continually develop your business skills by prioritizing tasks that need to be done. I personally do all these things daily in leading PepsiCo's management and marketing efforts to implement strategies successfully.

Source: Based on Beth Kowitt, "The Queen of Pop," *Fortune*, October 1, 2017, 70–74.

Transitioning from Formulating to Implementing Strategies

LO 7.1

The strategy-implementation stage of the strategic-management process is illustrated with white shading in Figure 7-1 on the first page of this chapter. 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 implementation is fundamentally different from strategy formulation.

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 both strategy-formulation and strategy-implementation activities. Strategy formulation and implementation can be contrasted in the ways illustrated in Figure 7-2.

Strategy-formulation concepts and tools do not differ greatly for small, large, for-profit, or nonprofit organizations. However, in contrast, 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 across manufacturing, service, and governmental organizations.

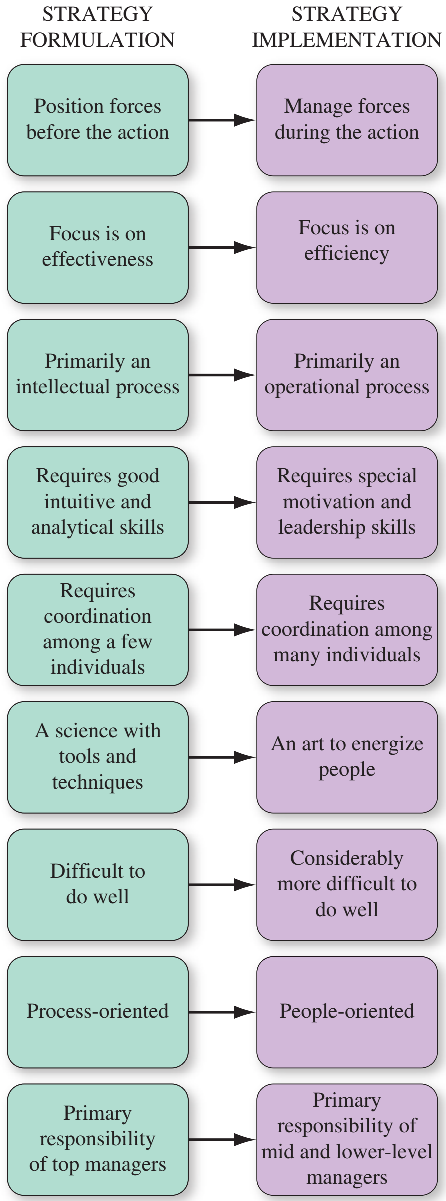


FIGURE 7-2

Contrasting Strategy Formulation with Strategy Implementation

The Need for Clear Annual Objectives

LO 7.2

Annual objectives are desired milestones an organization should achieve to ensure successful strategy implementation. Annual objectives are essential for strategy implementation for five primary reasons:

1. They represent the basis for allocating resources.
2. They are a primary mechanism for evaluating managers.
3. They enable effective monitoring of progress toward achieving long-term objectives.
4. They establish organizational, divisional, and departmental priorities.
5. They are essential for keeping a strategic plan on track.

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. Active participation in establishing annual objectives is needed for the preceding reasons listed. 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 are often stated in terms of profitability, growth, and market share

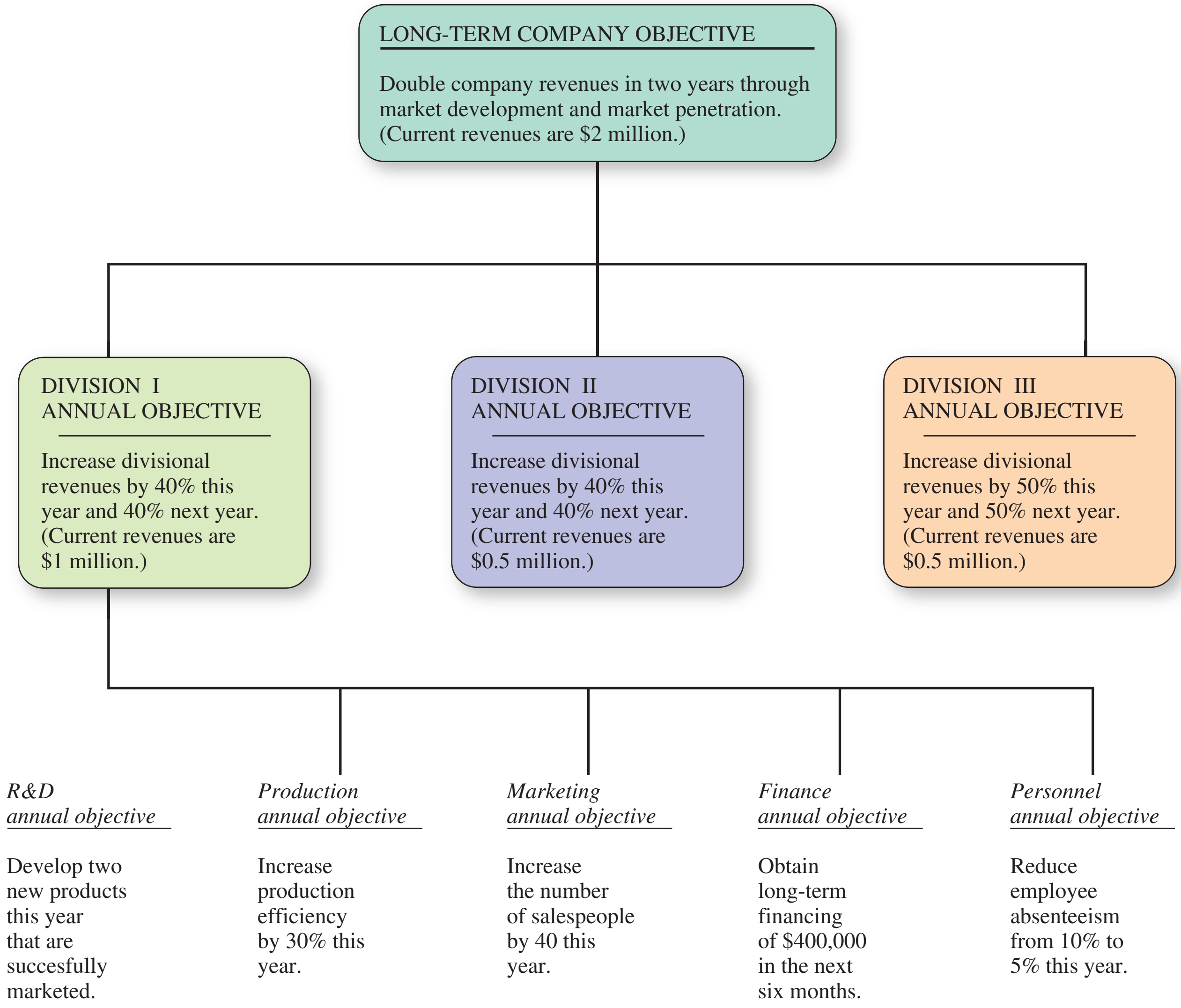


FIGURE 7-3
The Stamus Company's Hierarchy of Aims

by business segment, geographic area, customer group, and product. Figure 7-3 illustrates how the Stamus Company could establish annual objectives based on long-term objectives. Table 7-1 reveals associated revenue figures that correspond to the objectives outlined in Figure 7-3. Note that, according to plan, the Stamus Company will slightly exceed its long-term objective of doubling company revenues between 2020 and 2022. Figure 7-3 also reflects how a hierarchy of annual objectives can be established based on an organization's structure.

TABLE 7-1 The Stamus Company's Revenue Expectations (in millions, $)

	2020	2021	2022
Division I Revenues	1.00	1.40	1.96
Division II Revenues	0.50	0.70	0.98
Division III Revenues	0.50	0.75	1.12
Total Company Revenues	**2.00**	**2.85**	**4.06**

Objectives should be consistent across both horizontal (functional/departmental/staff) and vertical (top to lower managers) levels in a chain of command. **Horizontal consistency of objectives**, such as pertaining to a CFO, CMO, CIO, CSO, or HRM laterally across a chart, is as important as **vertical consistency of objectives**, such as pertaining to a Chairperson, CEO, division president, or plant manager downward in a chart.

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. These elements are often called the *characteristics of objectives*. 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. For example, an annual objective could be "increase sales of brand ABC to 1,000 units yielding $20,000 in revenue annually."

Annual objectives should be supported by clearly stated policies. 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. Wells Fargo had a probem with this a few years ago in regards to employees opening new customer accounts.

Based on management activities such as establishing clear annual objectives, *Fortune* annually ranks companies as the most admired in the world; its recent ranking is revealed in Table 7-2. Note that the top 10 firms are U.S. companies, but three outside-U.S.-headquartered companies made the top 35: BMW (#14), Singapore Airlines (#33), and Toyota Motor (#34).

TABLE 7-2 The Most Admired Companies in the World

Rank	Company	Author Comment
1	Apple	The most valuable brand on the planet
2	Amazon.com	Delivers 80% of the e-books read globally
3	Starbucks	Offers tea, beer, wine, lunch, and dinner
4	Berkshire Hathaway	Very highly diversified; owns many companies
5	Walt Disney	Produces great movies; owns ESPN and ABC Sports
6	Alphabet	Owns Google, the best search engine anywhere
7	General Electric	Highly diversified; competes in many industries
8	Southwest Airlines	Has reported 40 straight years of profitability
9	Facebook	The most popular social-media website globally
9	Microsoft (A TIE at #9)	The most popular computing software firm
10	FedEx	Delivers the goods as people shop and ship more

Source: Based on information at http://fortune.com/worlds-most-admired-companies/list/

Establish Policies

LO 7.3

Policies refer to specific guidelines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals. 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. Policies are essential instruments for strategy implementation, for at least six reasons:

1. Policies set boundaries, constraints, and limits on the kinds of administrative actions that can be taken to reward and sanction behavior.
2. Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully.

3. Policies provide a basis for management control and allow coordination across organizational units.
4. Policies reduce the amount of time managers spend making decisions. Policies also clarify what work is to be done and by whom.
5. Policies promote delegation of decision making to appropriate managerial levels where various problems usually arise.
6. Policies clarify what can and cannot be done in pursuit of an organization's objectives.

As an example policy, more and more companies, including IBM, Aetna, Bank of America, Best Buy, and Reddit, are abandoning the idea of allowing employees to work from home. Businesses are finding there is need for more collaboration at the work site, closer contact with customers, and more control of the workday. Research reveals that the percentage of U.S. workers who performed all or some of their work at home fell to less than 20 percent in 2017, down from 24 percent the prior year.[3] Commuting to work, teamwork, and working in cubicles at company-owned office spaces is on the rise, while staying at a home office to work remotely is becoming less common.

Many organizations have a policy manual that serves to guide and direct behavior. Policies can apply to all divisions and departments, such as: "We are an equal opportunity employer," or to a single department, such as: "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 7-3. Some example issues that may require a management policy are provided in Table 7-4. As discussed in Ethics Capsule 7, there is an increasing need for firms to establish policies regarding employees' use of personal smartphones at work, as distractions caused by such behavior can undermine employee morale.

TABLE 7-3 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."
2. "All stores must support company advertising by contributing 5 percent of their total monthly revenues for this purpose."

Divisional Objective

Increase the division's revenues from \$10 million in 2020 to \$15 million in 2021.

Supporting Policies

1. "Beginning in January 2021, 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."
2. "Beginning in January 2021, this division will return to its employees 5 percent of its gross revenues in the form of a Christmas bonus."

Production Department Objective

Increase production from 20,000 units in 2020 to 30,000 units in 2021.

Supporting Policies

1. "Beginning in January 2021, employees will have the option of working up to 20 hours of overtime per week."
2. "Beginning in January 2021, perfect attendance awards in the amount of \$100 will be given to all employees who do not miss a workday in a given year."

TABLE 7-4 Some Issues That May Require a Management Policy

- To offer extensive or limited management development workshops and seminars
- 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 allow heavy, light, or no overtime work
- To establish a high- or low-safety stock of inventory

ETHICS CAPSULE 7

Do Firms Need a Policy against Workplace Phubbing?

Edhar Yuralaits/123RF

Why Did That Guy Even Come to Our Meeting?

Recent research examined the impact of boss "phubbing" (short for phone snubbing) and found that boss phubbing negatively impacts employee job performance. Specifically, cell phone use by supervisors, while in the presence of their subordinates, impacts the extent to which their subordinates trust them, which in turn lowers the subordinates' job satisfaction and performance. With nearly 7 billion mobile connections worldwide, it is imperative that managers recognize the extent to which they and their employees use their cell phones in ways that may unintentionally snub other employees or even customers.

Companies should consider setting formal "cell-phone policies," which outline clear rules for cell phone use and access, as well as consequences for violating those rules. Setting specific boundaries and guidelines for cell phone use at work will ensure that managers and employees have a consistent understanding of when and where cell phones are permitted in the workplace. But, what should those policies look like and how restrictive should they be? Phubbing is a harmful behavior, and regardless of whether the phubbing occurs when eating with others or in a meeting with others, it undermines any corporate culture based on respect for others.

Source: James A. Roberts and Meredith E. David (2017), "Put Down Your Phone and Listen to Me: How Boss Phubbing Undermines the Psychological Conditions Necessary for Employee Engagement," *Computers in Human Behavior*, 75 (October), 206–217.

Allocate Resources and Manage Conflict

LO 7.4

Allocate Resources

All organizations have at least four types of resources (or assets) that can be used to achieve desired objectives: (1) financial resources, (2) physical resources, (3) human resources, and (4) technological resources. **Resource allocation** can be defined as distributing an organization's "assets" across products, regions, and segments according to priorities established by annual objectives. Allocating resources is a vital strategy-implementation activity. Strategic management itself is sometimes referred to as a *resource-allocation process*. In fact, *allocating resources across business segments (divisions) is arguably the most important strategic decision facing large companies annually.*

In organizations that do no strategic planning, resource allocation is often based on political or personal factors and bias, rather than on clear analysis and thought. Strategists should be wary of a number of factors that commonly prohibit effective resource allocation, including 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. Effective resource allocation does not guarantee successful strategy implementation because programs, personnel, controls, and commitment must breathe life into the resources provided.

TABLE 7-5 Some Management Trade-Off Decisions Required in Strategy Implementation

1. To emphasize short-term profits or long-term growth
2. To emphasize profit margin or market share
3. To emphasize market development or market penetration
4. To lay off or furlough
5. To seek growth or stability
6. To be more socially responsible or more profitable
7. To outsource jobs or pay more to keep jobs at home
8. To acquire externally or to build internally
9. To use leverage or equity to raise funds
10. To use part-time or full-time employees

Manage Conflict

Honest differences of opinion, turf protection, and competition for limited resources can inevitably lead 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, perceptions, schedules, pressures, obligations, and personalities. Misunderstandings between line managers (such as production supervisors) and staff managers (such as human resource specialists) can 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. Conflict must be managed for strategy implementation to be successful. Managing conflict is a strategic issue in most, if not all, organizations.

Establishing objectives can lead to conflict because managers and strategists must make tradeoffs, 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. Tradeoffs are necessary because no firm has sufficient resources to pursue all strategies that would benefit the firm. Table 7-5 reveals some important management trade-off decisions required in strategy implementation. Strategic planning necessitates making effective trade-off decisions.

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 range from ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals, to compromising, to exchanging members of conflicting parties so that each can gain an appreciation of the other's point of view, or even holding a meeting at which conflicting parties present their views and work through their differences.

LO 7.5 Match Structure with Strategy

Disney restructured in 2018 to add a direct-to-consumer segment and an international division. With the restructuring, Disney combined its consumer products and theme parks divisions. 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.

Changes in strategy often require changes in structure 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 are 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.

When a firm changes its strategy, the existing organizational structure may become ineffective. As indicated in Table 7-6, 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 7-6 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 requires massive structural changes, it may 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 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. These types of structure are discussed in the next section.

Types of Organizational Structure

LO 7.6

Structure matters! There are seven basic types of organizational structure: (1) functional, (2) divisional-by-region, (3) divisional-by-product, (4) divisional-by-customer, (5) divisional-by-process, (6) strategic business unit (SBU), and (7) matrix. Companies, like people and armies, strive to be better organized or structured than rivals because better organization can yield tremendous competitive advantages. There are countless examples throughout history of incidents, battles, and companies where superior organization overcame massive odds against the entity.

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 marketing or finance. For example, a university may structure its activities by major functions that include academic affairs, student services, alumni relations, athletics, maintenance, and accounting.

Under a functional structure, divisions or segments of the firm are not delegated authority, responsibility, and accountability for revenues or profits; rather, key decisions are made centrally. For example, a small business composed of three restaurants in three adjacent towns is functionally structured if all hiring, firing, promotion, and advertising decisions are made centrally, but this same small business is divisionally structured if those decisions are delegated to each restaurant manager. 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. For these reasons, most large companies have abandoned the functional structure in favor of decentralization and improved accountability. Table 7-7 summarizes the advantages and disadvantages of a functional organizational structure.

TABLE 7-7 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

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]

The Divisional Structure

The **divisional (decentralized) structure** is the second-most common type. Divisions are sometimes referred to as *segments, profit centers*, or *business units*. As a small organization grows, it has more difficulty managing different products 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: (1) by geographic area, (2) by product, (3) by customer, or (4) by process.

With a divisional structure, functional activities are performed both centrally and in each separate division.

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 becomes more effective than a by-customer or by-geographic type of divisional structure. In 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 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 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 7-8 gives the advantages and disadvantages of a divisional organizational structure.

TABLE 7-8 Advantages and Disadvantages of a Divisional Organizational Structure

Advantages	Disadvantages
1. Clear accountability	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

A *divisional-by-region* type of structure 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.

The *divisional-by-product (or service)* type of structure is most effective for implementing strategies when specific products need special emphasis. Also, this type of structure is widely used when an organization offers only a few products or when an organization's products or services differ substantially. The divisional-by-product 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.

A *divisional-by-customer* type of structure can be the most effective way to implement strategies when a few major customers are of paramount importance and many different services are provided to these customers. 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: (1) passengers and (2) freight or cargo services. Utility companies often use (1) commercial, (2) residential, and (3) industrial as their divisions by customer.

A *divisional-by-process* type of structure 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.

The Strategic Business Unit 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 CEO could have difficulty even remembering the first names of divisional presidents. In multidivisional organizations, a **strategic business unit (SBU) structure** can greatly facilitate strategy-implementation efforts.

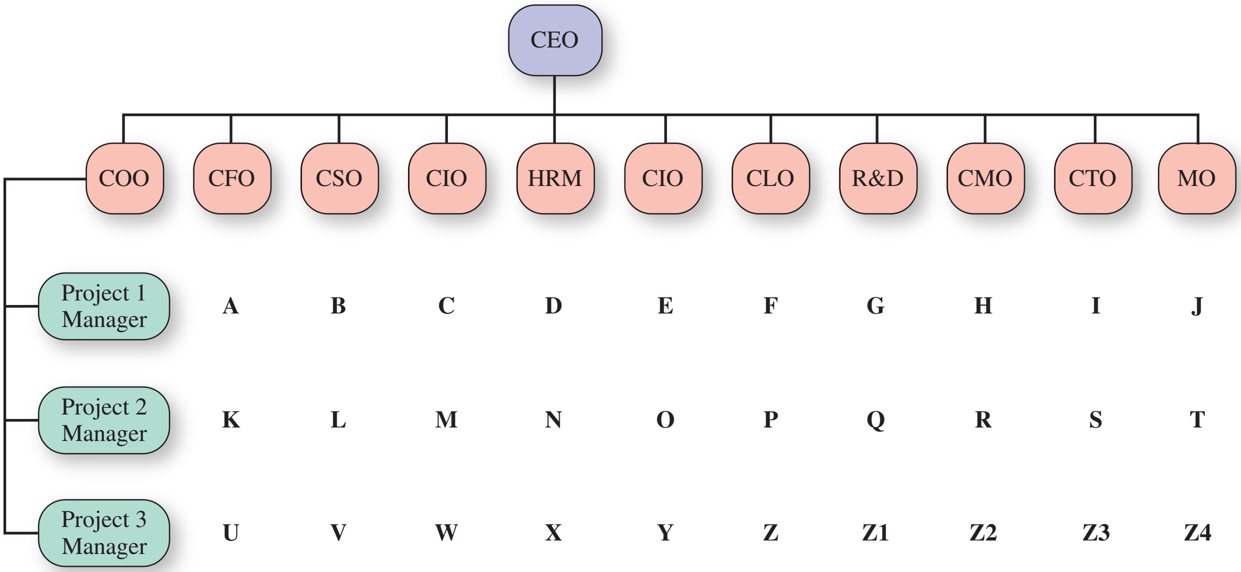
An SBU structure simply groups similar divisions together into “units” and delegates authority and responsibility for each unit to a senior executive who reports directly to the CEO. This change in structure can facilitate strategy implementation by improving coordination between similar divisions and 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.

A disadvantage of an SBU structure is that it requires an additional layer of management, which increases salary expenses. However, this limitations does 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. Halliburton operates from an SBU structure with the divisions based on process, as described at www.halliburton.com (click on About Us, then click Corporate Profile, then scroll down to see the SBUs listed). Microsoft recently changed its organizational structure to become three by-product strategic business units: (1) Windows and Devices Group (WDG), (2) Cloud and Enterprise (C+E), and (3) Applications and Services Group (ASG).

The Matrix Structure

A **matrix structure** is an organizational design in which vertical and horizontal flows of authority and communication (hence the term *matrix*) are created whereby functions are horizontally arrayed and divisions, products, or projects are vertically arrayed. In contrast, functional and divisional structures depend primarily on a vertical chain of command and authority. 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.

The matrix structure is often used in the construction and health care industries. For example, in the construction industry, a matrix structure would work well for Bechtel Corporation and Fluor Corporation, since every construction project has a head project person, and if the project is large, such as when Fluor worked on the 800-mile Trans-Alaska Pipeline System, each project also has a head HR person, who reports both to the head project person and the corporate head HR person.



Note: Titles spelled out as follows.

Chief Executive Officer (CEO)
Chief Operating Officer (COO)
Chief Finance Officer (CFO)
Chief Strategy Officer (CSO)
Chief Information Officer (CIO)
Human Resources Manager (HRM)
Competitive Intelligence Officer (CIO)
Chief Legal Officer (CLO)
Research & Development Officer (R&D)
Chief Marketing Officer (CMO)
Chief Technology Officer (CTO)
Maintenance Officer (MO)

FIGURE 7-4
A Typical Matrix Structure with Typical Executive Titles in a Large Firm

As indicated in Table 7-9, some advantages of a matrix structure are that project objectives are clear, there are many channels of communication, workers can see the visible results of their work, shutting down a project can be accomplished relatively easily, and 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

TABLE 7-9 Advantages and Disadvantages of a Matrix Structure

Advantages	Disadvantages
1. Clear project objectives	1. Requires excellent vertical and horizontal flows of communication
2. Employees clearly see results of their work	2. Costly because creates more manager positions
3. Easy to shut down a project	3. Violates unity of command principle
4. Facilitates uses of special equipment, personnel, and facilities	4. Creates dual lines of budget authority
5. Shared functional resources instead of duplicated resources, 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

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, inclusive of typical executive titles, is illustrated in Figure 7-4. 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.

LO 7.7 Do's and Don'ts in Developing Organizational Charts

Students analyzing strategic-management cases (and actual corporate executives) often revise and improve a firm's organizational structure. This section provides basic guidelines and several dos and don'ts in regards to developing organizational charts, especially for midsize to large firms. First of all, reserve the title *CEO* for the top executive of the firm. Do not 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*, *vice-president*, *manager*, or *officer*, such as "Chief Information Officer," or "VP of Human Resources." Furthermore, 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 and CEO of a company. Of note, *chairperson* or *chair* is much better than *chairman* for the top board person's title. Corporate America is splitting the chair of the board and the CEO positions in publicly held companies. This 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. Many more European and Asian companies split the two positions. For example, 80 percent of British companies split the positions, and virtually all German and Dutch companies split the positions. For the first time ever, the South Korean firm Samsung Electronics separated the role and title of its Chair of the Board from its CEO in 2018.

Directly below the CEO, it is best to have a chief operating officer (COO) with any division presidents reporting directly to the COO. On the same level as the COO and also reporting to the CEO are functional business executives, such as a chief financial officer (CFO), VP of human resources, a chief strategy officer (CSO), a chief information officer (CIO), a chief marketing officer (CMO), a VP of R&D, a VP of legal affairs, an investment relations officer, maintenance officer, and so on. Note in Figure 7-6 that these positions are labeled and placed appropriately in a matrix structure, which, as shown, generally include project managers rather than division presidents reporting to a COO.

The COO position is increasingly being deleted in U.S. companies. Twitter recently divided the duties of its COO among all managers. McDonald's, Tiffany & Co., and Yahoo recently deleted their COO position. In fact, the percentage of large companies in the United States with COOs has declined almost every year for a decade, to about 35 percent today. Healthcare and industrial companies are least likely to have a COO today. An accounting firm, PricewaterhouseCoopers, suggests there are four reasons why companies are phasing out the COO position to: (1) flatten their structure, (2) eliminate a layer of management, (3) reduce costs, and (4) expand the CEO's authority and responsibility. Digital communications and even social media today enable a CEO often to perform COO duties. Many companies now delegate the traditional duties of a COO to the CEO or to other positions, such as the CFO or chief brand officer. Deleting the COO position does increase the span of control of the CEO, spreading the latter thinly, which is not a good idea for many companies.

In developing an organizational chart, avoid having a particular person reporting to more than one person in the chain of command (except in a matrix structure). This would violate the unity-of-command principle of management that "every employee should have just one boss." Also, do not have any functional positions such as CFO, CIO, CSO, and human resource officer report to the COO. All these positions report directly to the CEO.

In contrast to the COO position, the number of chief accounting officers (CAO) among U.S. companies is increasing. CAOs now do much more than just manage the company's books and prepare financial statements. They stand up and debate strategic issues related to how best to balance the balance sheet, when and how to recognize revenue, and know how to report results using both U.S. and foreign standards (GAAP vs. IFRS). CAOs are more commonly signing the company's financial filings, making them personally liable for any mistakes or improprieties—along with the CFO and CEO.

Garu Kabureck, former CAO at Xerox Corp. says: "I think what happened over the last 15 years in the USA is that the accounting function started to separate from the controller function." In a firm, a controller is typically more focused on budgeting and planning, whereas the CAO is responsible for the ins and outs of global bookkeeping. The CAO also interacts closely with the board's audit committee, as well as with outside firms auditing the company.

A relatively new, but increasingly popular, top management position, is the Chief Design Officer (CDO). Johnson & Johnson (J&J), for example, hired a CDO, Ernesto Quinteros, to be a liaison between the CMO and R&D officer. The CDO position has equal status with the CMO position at J&J, PepsiCo, and Phillips Electronics NV because "a product that is wonderfully designed sells itself, and has a huge benefit on the marketing side," said J&J's Sandi Peterson, who created the CDO position at J&J.

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. Important guidelines to follow in devising organizational charts for companies are provided in Table 7-10.

TABLE 7-10 15 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. Include a COO if divisions are large or geographically dispersed.
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 a SBU type structure for large firms with more than 10 divisions.
15. Make sure executive titles match product names as best possible in division-by-product and SBU-designated firms.

How to Depict an Organizational Chart

For whatever reason, companies rarely provide a diagram of their organizational chart, neither in their *Form 10K* or on their corporate website. Therefore, students often wrestle with actually drawing an existing chart and devising a new and improved organizational chart. Nearly all companies provide, however, a list of their top executives and associated titles. This "title" information can be used to develop existing and proposed charts. Follow three simple steps to develop organizational charts:

Step 1. List executive positions by title and number. Numbering positions enables numbers, rather than boxes or circles, to be used in a structure diagram to reveal reporting relationships; it is just easier to use numbers.

Step 2. Using numbers to denote positions, devise your chart to show reporting relationships, consistent with guidelines presented in this chapter.

Step 3. Draw lines connecting numbers to reveal reporting relationships. Be mindful that a line connecting one number to another means that person reports to the other; so do not connect, for example, a CFO to a CMO.

Figure 7-5 and Figure 7-6 give an existing and improved organizational chart for ABC Company, respectively. ABC Company's example charts demonstrate how to apply the three steps given. In devising any organizational chart, do not be concerned with the names of executives because people come and go in a firm; positions stay relatively constant. Also, do not be overly concerned with the existing chart reporting relationships because those are usually unknown to all but corporate insiders; your new and improved chart is of paramount importance. Also, do not include the 20 or so lower and mid-level managers in a chart; similarly, do not include the board of director members in a chart. It's not that lower and mid-level managers and board members are not important because they are. It is just that reporting relationships among the top executives in a firm reveals the (1) type of structure and (2) chain of command. The firm must get those two aspects correct to effectively implement any strategy.

EXECUTIVES' TITLES

1. Chairman of the Board
2. CEO and President
3. VP of HRM
4. VP of Finance
5. VP of Technology
6. VP of Marketing
7. VP of Design and R&D
8. Manager of USA
9. Manager of Europe
10. Manager of Asia

THE "EXISTING" CHART

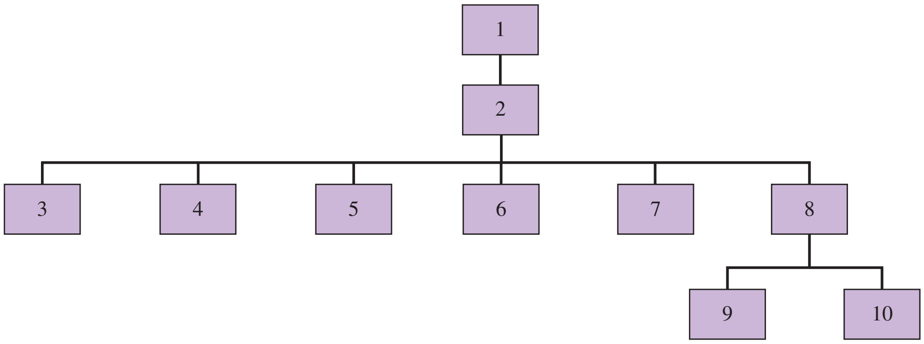


FIGURE 7-5
ABC Company's Existing (Not Good) Organizational Chart

EXECUTIVES' TITLES

1. Chairperson of the Board
2. CEO
3. Chief HRM Officer
4. CFO
5. CTO
6. CMO
7. Chief Design Officer
8. President of USA
9. President of Europe
10. President of Asia
11. COO

THE PROPOSED CHART

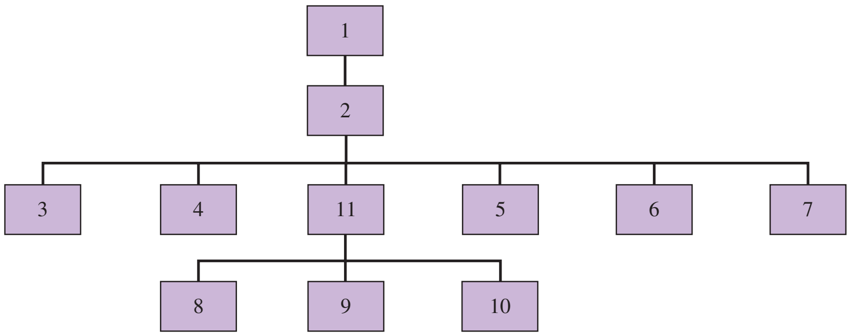
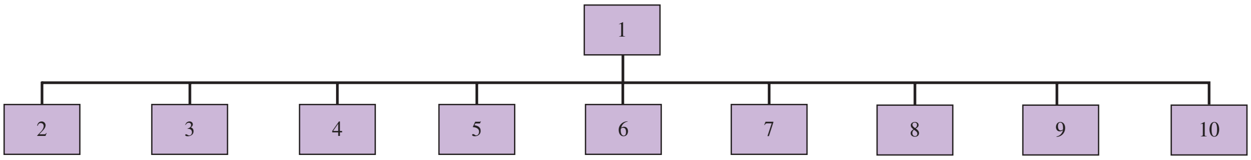
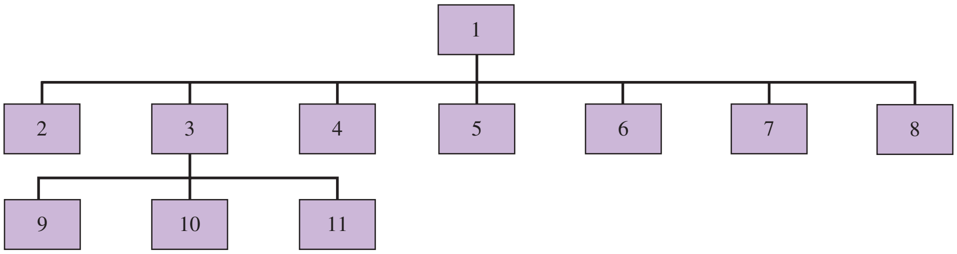


FIGURE 7-6
ABC Company's Improved (Excellent) Organizational Chart



1. Michael Happe, President and CEO
2. Ashis Bhattacharya, VP, Strategic Planning and Development
3. Donald Clark, President, Grand Design RV; VP, Winnebago Industries
4. Jeff Kubacki, VP, Information Technology, Chief Information Officer
5. Chris West, VP of Operations
6. Bret Woodson, VP, Administration
7. Bryan Hughes, VP, CFO
8. Scott Folkers, VP, General Counsel and Secretary
9. Scott Degnan, VP, General Manager, Towables Business
10. Brian Hazelton, VP, General Manager, Motor Home Business

FIGURE 7-7
Winnebago's Actual (Not Good) Organizational Chart



1. Michael Happe, CEO
2. Ashis Bhattacharya, VP, Strategic Planning and Development
3. Donald Clark, COO
4. Jeff Kubacki, VP, Information Technology, Chief Information Officer
5. Chris West, VP of Operations
6. Bret Woodson, VP, Administration
7. Bryan Hughes, VP, CFO
8. Scott Folkers, VP, General Counsel and Secretary
9. Scott Degnan, President of Towables
10. Brian Hazelton, President of Motor Homes
11. Jane Doe, President of Ancillary Products

FIGURE 7-8
Winnebago's Improved (Excellent) Organizational Chart

Figure 7-7 and Figure 7-8 give Winnebago Industries, Inc.'s actual and improved organizational chart respectively, further illustrating how to apply the three steps. Headquartered in Forest City, Iowa, Winnebago manufactures and sells recreation vehicles (RVs), including motor homes, travel trailers, and fifth wheel trailers under the Winnebago brand name; component parts for other manufacturers; motorhome shells for law enforcement command centers, mobile medical clinics, and mobile office space; and commercial vehicles as bare shells to third parties. Winnebago sells products primarily through independent dealers in the United States and Canada.

Strategic Production/Operations Issues

LO 7.8

Production/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. Thus, a major part of the strategy-implementation process takes place at the production site. Strategic 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 determine the success or failure of strategy-implementation efforts.

Three production/operations issues, (1) restructuring/reengineering, (2) managing resistance to change, and (3) deciding where/how to produce goods, are especially important for successful strategy implementation and are therefore discussed next.

Restructuring and Reengineering

Restructuring and reengineering are forms of retrenchment discussed in Chapter 5. **Restructuring**, sometimes called downsizing, 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 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 associated with pending and actual employee layoffs. In 2018, General Electric restructured, reducing its six commercial business units down to three.

Job security in European companies is slowly moving toward a U.S. business model, 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. European firms still prefer to downsize by attrition and retirement, rather than by blanket layoffs because of culture, laws, and unions.

In contrast to restructuring, reengineering is concerned more with employee and customer well-being than shareholder well-being. **Reengineering** 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.

Manage 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 can impose major changes on individuals and processes. Reorienting an organization to get people to think and act strategically is not an easy task. Strategy implementation can pose a threat to many managers and employees. 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.

Resistance to change may be 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 by managers and employees as an opportunity for the firm to compete more effectively, rather than being seen as a threat to everyone's livelihood.

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. Strategy implementation is basically a process of managing change.

Decide Where and How to Produce Goods

In China, about 700,000 assembly workers at manufacturing contractors such as Foxconn put together Apple products. It would be virtually impossible to bring those jobs to the United States for at least three reasons. First, 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. Second, 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 unbearably 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 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.

Examples of adjustments in production systems that could be required to implement various strategies are provided in Table 7-11 for both for-profit and nonprofit organizations. The largest bicycle company in the United States, 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 themselves. The Dayton, Ohio, company closed its plants in Ohio, Missouri, and Mississippi.

TABLE 7-11 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.

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, currency and tax considerations, language and legal issues, and the availability of trainable employees. Some of these factors explain why many manufacturing operations in China are moving back to Mexico, to Vietnam, or even back to the United States. President Donald Trump has pledged to create such a pro-business environment that companies will reshore (relocate) their manufacturing facilities to the Untied States.

Strategic Human Resource Issues

LO 7.9

Any organization is only as good as its people! Thus, human resource issues can make or break successful strategy implementation. Thus, seven human resource issues are discussed further in this section, as follows: (1) linking performance and pay to strategy, (2) balancing work life with home life, (3) developing a diverse workforce, (4) using caution in hiring a rival's employees, (5) creating a strategy-supportive culture, (6) using caution in monitoring employees' social media, and (7) developing a corporate well-being program.

Link Performance and Pay to Strategy

An organization's compensation system needs to be aligned with strategic outcomes. Decisions on salary increases, promotions, merit pay, and bonuses need to support the long-term and annual objectives of the firm. A dual bonus system based on both annual and long-term objectives can be helpful in linking performance and pay to strategies. 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.

Bank of America's 2018 compensation plan includes a bonus system that allows brokers in its wealth-management team to earn up to an additional 2 percent in pay if certain growth targets are achieved. Merrill Lynch brokers receive a similar bonus but, if Merrill brokers fail to meet minimum growth targets, their pay is reduced 2 percent. Bank of America has no such pay penalty provision.

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. Bank of America, 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 Bank of America 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."

A combination of reward strategy incentives, such as salary raises, stock options, employees 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. A firm, for example, could give its employees a 10-year option to buy up to 1000 shares of company stock at a set price lower than the current market price.

For the first time ever in 2018, U.S. publicly-held companies were required to divulge their median employee pay in addition to CEO pay, as well as the ratio between the two figures. For example, Whirlpool Corporation revealed that its median worker earns $19,906 a year, while the CEO made $7.08 million, or 356 times as much. At another firm, Intuitive Surgical, the median employee was paid just over $157,000, while the CEO got $5.1 million, or 32 times the employee amount. Marathon Petroleum's median worker made $21,034 versus its CEO making $19.7 million, or 935 times the employee amount.

Balance Work Life and Home Life

Work and family strategies now represent a competitive advantage for those firms that offer such benefits as elder-care assistance, flexible scheduling, job sharing, adoption benefits, 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. Globally, it is widely acknowledged that the best countries for working women are Iceland, Norway, Sweden, Finland, and Denmark, all of which rate above the United States. According to the World Economic Forum's Global Gender Gap Index Report, the United States, in fact, ranked forty-fifth overall.

Working Mother magazine annually publishes its listing of "The 100 Best Companies for Working Mothers" (www.workingmother.com). Three especially important variables used in the ranking are availability of flextime, advancement opportunities, and equitable distribution of benefits. 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 2017 are provided in Table 7-12. *Working Mother* also conducts extensive research to determine the best U.S. firms for women of color.

TABLE 7-12 Top 10 Companies for Working Women

Company	# Employees	% Women	Headquarters
1. Bank of America	175,400	55	Charlotte, North Carolina
2. Deloitte	53,500	43	New York, New York
3. McKinsey & Company	7,110	44	New York, New York
4. Ernst & Young LLP	41,600	45	New York, New York
5. Unilever	10,150	44	London, England
6. IBM	380,000	31	Armonk, New York
7. Prudential Financial	20,314	49	Newark, New Jersey
8. PwC	36,500	45	New York, New York
9. Johnson & Johnson	39,370	45	New Brunswick, New Jersey
10. Zoetis	3,960	41	Florham Park, New Jersey

Source: Based on information at the *Working Mother* website, January 1, 2018.

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; supplying 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 or paid family leave for fathers as a benefit, most men still take short, informal leaves and do so 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.

Promote Diversity

The term **glass ceiling** refers to the invisible barrier in many firms that bars women and people of color from top-level management positions. Michele Buck became Hershey Company's CEO in 2017, becoming the twenty-eighth female to head a *Fortune* 500 business, up from 21 in 2013. Thus, progress in this regard is slow, even in the United States.

An organization can perhaps be most effective when its workforce mirrors the diversity of its customers. Six benefits of having a diverse workforce are as follows:

1. Women and minorities have different insights, opinions, and perspectives that should be considered.
2. A diverse workforce portrays a firm committed to nondiscrimination.
3. A workforce that mirrors a customer base can help attract customers, build customer loyalty, and design or offer products and services that meet customer needs and wants.
4. A diverse workforce helps protect the firm against discrimination lawsuits.
5. Women and minorities represent a huge additional pool of qualified applicants.
6. A diverse workforce strengthens a firm's social responsibility and ethical position.

A January 2018 article in *Fortune* (p. 44) revealed several companies that have a really high percentage of people of color on its payroll: Hyatt Hotels (65%), Marriott International (65%), Publix Super Markets (42%), Capital One Financial (49%), and Kimpton Hotels and Restaurants (60%).

Use Caution in Hiring a Rival's Employees

An article titled "Dos and Don'ts of Poaching Workers" in *Investor's Business Daily* gives guidelines to consider before hiring a rival firm's employees.[5] The practice of hiring employees from rival firms has a long tradition, but increasingly in our lawsuit-happy environment, firms must consider whether that person(s) had access to the "secret sauce formula, customer list, programming algorithm, or any proprietary or confidential information" of the rival firm. If the person has that information and joins your firm, lawsuits could follow that hiring, especially if the person was under contract at the rival firm or had signed a "noncompete agreement." The article says that to help safeguard the firm from this potential problem, a "well-written employee handbook" addressing the issue is necessary. The article talks about Hewlett-Packard (HP) recently hiring an IBM general manager, and IBM suing HP over the hiring; IBM lost in that case, but this type of legal action is becoming more commonplace.

According to Wayne Perrett, human resource manager for ComAp in Roscoe, Illinois, "A company does not want to become known as one that 'steals' employees from competitors; that is bad for ethics and bad for business." It is not illegal to interview and hire employees from rival firms, and it has been done for centuries, but increasingly this is becoming a strategic issue to be managed, to avoid litigation.

Create a Strategy-Supportive Culture

All organizations have a unique **culture**. For example, at Facebook, Inc., employees are given unusual freedom to choose and change assignments. Even low-level employees are encouraged to question and criticize managers. Facebook employees are rated on a normal distribution curve (Bell curve), which creates a hectic, intense work environment where past accomplishments mean little compared to what you have done lately for the firm. Managers are not revered at Facebook as bosses; rather, they are regarded as helpers.

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. 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 7-13, numerous techniques are available to alter an organization's culture, including recruitment, training, transfer, promotion, restructure of an organization's design, role modeling, positive reinforcement, and mentoring.

In the personal and religious side of life, the impact of loss and change is easy to see.[6] 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."[7] 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 years ago. Some people find comfort

TABLE 7-13 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 or mission
11. Redesigning physical spaces or facades
12. Altering reward system
13. Altering organizational policies, procedures, and practices

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.[8]

Wells Fargo recently reinforced a business culture to sell more and more products to existing bank customers, termed *cross-selling*—a market penetration strategy. This business culture spiraled out of control; federal investigators found that Wells Fargo had opened as many as two million deposit and credit-card accounts without customers requesting or knowing of the actions. The cross-selling problem was systemic across all the company's 6,000 branches and all its products. A spokeswoman at Wells Fargo responded to the fiasco saying: "We are committed to fixing this issue, to strengthening our culture throughout the company and taking the necessary actions to begin restoring our customer's trust." Steven Schrodt worked at Wells Fargo and reported that employees at his branch had a daily goal to open two new checking accounts and make eight other product sales; Steven left the company because the sales pressure was too stressful. The Wells Fargo culture problem cost the firm billions in lost revenue, lawsuits, and penalties.

Use Caution in Monitoring Employees' Social Media

Many companies monitor employees' and prospective employees' social-media activities, and have the legal right to do so, but there are many pros and cons of this activity. Proponents of companies monitoring employees' social-media activities emphasize that (1) a company's reputation in the marketplace can easily be damaged by disgruntled employees venting on social-media sites and (2) social-media records can be subpoenaed, like e-mail, and used as evidence against the company. Proponents say companies have a responsibility to know the nature of employees' communication through social media as related to clients, patients, suppliers, distributors, coworkers, managers, technology, patents, procedures, policies, and much more. To ignore social-media communication by employees, proponents say, is irresponsible and too risky for the firm. Some companies use social media to research and screen job candidates, sometimes finding provocative or inappropriate photos and information related to potential employees' bias, stereotypes, prejudices, drinking, and drug use. Companies however should never use social media to discriminate based on age, race, ethnic background, religion, sexuality, or disability.

Arguments against the practice of companies monitoring employees' social-media activities say it is an invasion of privacy and too often becomes "a fishing expedition" sifting through tons of personal information irrelevant to a company or its business. Positions on political issues, gun rights, or immigration are example topics where company researchers may "not like" individuals with different belief systems than their own. In a recent study, 77 percent of employers said they conduct Internet searches of prospective employees, and 35 percent have rejected job applicants because of information they found.[9] Rejecting potential employees because of private behavior unrelated to work is unfair. In addition, whenever a company discovers through social media that an employee or potential employee is of a certain background or has a particular disability, and then denies a promotion or hires someone else; that "social media discovery information" could be the basis of a discrimination suit against the firm. For some jobs, such as law enforcement, due diligence may require firms to monitor social-media activities to help assure their entire workforce is not involved in drugs, child pornography, gangs, and so on.

On balance, companies should monitor employee and potential employee's social-media activities whenever they have a reason to believe the person is engaged in illegal or unethical conduct, but to systematically investigate every employee and job candidate's social-media activities is arguably counterproductive. The bottom line is that companies have the *legal right* to monitor employees' conduct, but have the *legal duty* to do so only if there is sufficient reason for concern.

Develop a Corporate Well-Being Program

Corporate wellness has become a major strategic issue in companies. If you owned a company and paid the health insurance of employees, would you desire to have a healthy workforce? Your likely answer is *yes* because health insurance premiums are more costly for an unhealthy workforce. Healthy employees are more productive and less absent from work.

The notion of corporate wellness is rapidly shifting from health assessment, weight loss, and biometric screenings to also include financial well-being, social networks, work-life balance, and overall well-being. The focus now is thus on lifestyle management rather than just cholesterol management; this shift includes such things as sit-stand desks in the workspace and access to the outdoors while at work. The term *corporate wellness* has largely been replaced with *corporate well-being*, and these newly designed programs are being used in recruitment and retention; the programs are being intertwined with company goals and objectives. LuAnn Heinen says "the happiness of your customers is a direct reflection of how happy and engaged your employees are." Michael Sokol says "your corporate wellbeing program should be multi-year, with clear expectations and should include the entire healthcare continuum"; a recent study concludes that wellness programs pay off because healthy employees are more productive employees.[10]

LO 7.10

Strategic Marketing Issues

Countless marketing considerations affect the success or failure of strategy implementation efforts, such as the following:

1. How to make advertisements more interactive to be more effective
2. How to take advantage of social-media conversations 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 supplier or business customer
6. To be a price leader or a price follower
7. To offer a complete or limited warranty
8. To extend an existing product line or create a new line of products

Market segmentation, target marketing, and product positioning are marketing's most important contributions to strategic management. Strategies such as market development, product development, market penetration, and diversification require increased sales through new markets or products. To implement strategies successfully, effective segmentation, targeting, and positioning are required and discussed next.

Segment and Target Markets Effectively

As illustrated in Figure 7-9, companies engage in market segmentation first, then target marketing, and then position products among industry offerings. Because consumers vary in their needs and wants, blanket marketing is rarely an effective strategy, partly due to the high cost of reaching everybody. Thus, firms engage in **market segmentation**, dividing a market into distinct subsets of customers that differ from one another in product needs and buying habits. The segments are created based on unique demographic, geographic, psychographic, or behavioral characteristics of consumers. Successful strategy implementation requires effective (and efficient) marketing.

Market segmentation requires strategists to determine the characteristics and needs of consumers, to analyze consumer similarities and differences, and to develop consumer group profiles. After segmenting markets, companies select particular segment(s) to target. Individual market segments differ in consumer needs and buying habits so firms carefully select segment(s) to target. Firms such as Marriott, InterContinental, and Wyndham have multiple brand hotels so they can market varied offerings tailored to particular target segments.

As indicated in the mini-case at the end of this chapter, the world-renowned diamond engagement ring company De Beers recently repositioned itself to target younger consumers. This segmentation, targeting, and positioning was essential to the implementation of a new strategy

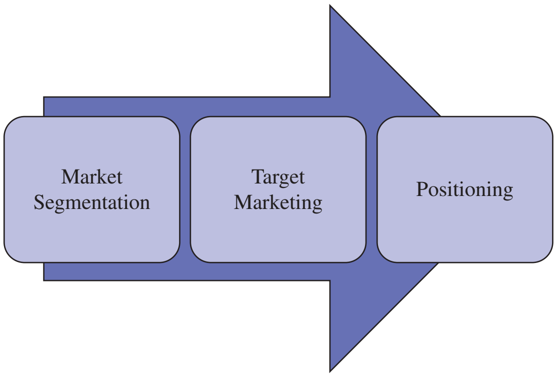


FIGURE 7-9

Segment, Target, and Position: The Key to Marketing Strategy

Source: Based on a variety of sources.

aimed at attracting the market segment of millennials (people ages 18 to 34), which recently surpassed the number of baby boomers in the United States. Market segmentation and targeting decisions directly affect the **marketing mix variables**: product, place, promotion, and price (discussed in Chapter 4, p. 132).

Product Positioning

After markets have been segmented and one or more segments have been selected as the target market(s), firms engage in positioning. **Positioning** entails designing a marketing mix that offers unique value to target customers. The product offering, its price, the way it is promoted or advertised, and the channels through which it is sold all complement one another and are designed to attract a particular target market. As illustrated in Figure 7-10, product, price, promotion, and place aspects of any offering collectively yield value to a target market, resulting in consumer demand being high (or low) versus rival offerings.

Through marketing, Procter & Gamble (P&G) has effectively implemented product-development and market-penetration strategies. Consider the following P&G laundry detergent brands, for example: Era "effectively removes stains"; Cheer provides "exceptional color-protection"; and Ivory "safely cleans baby clothing." These detergents target unique segments and are positioned as such.

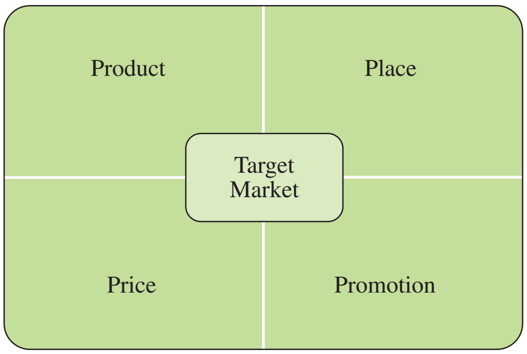


FIGURE 7-10

Positioning Products to Meet Target Market Needs

Source: Based on a variety of sources.

Changing brand names is a tactic marketers use to reposition a company's offerings. Walmart recently implemented strategies aimed at growing its online market and increasing online sales, so the company changed its official name from Wal-Mart Stores Inc. to Walmart, Inc.

Because 95 percent of the world's population (potential customers) lives outside the U.S., it is becoming increasingly common for companies to offer their goods and services abroad. Marketers often are charged with leading the way on global expansion, but there are many guidelines to follow in global marketing, such as tailoring a firm's website and social-media platforms to fit the specific target markets. Global Capsule 7 reveals four important guidelines for global marketing.

Perceptual Mapping

Firms continuously monitor the image of their brands as perceived by consumers. A product-positioning tool widely used in marketing is **perceptual mapping**, or developing schematic representations to reflect how a firm's goods or services compare to competitors' in the mind of consumers. Perceptual mapping is widely used for deciding how to better meet the needs and wants of particular consumer groups. The technique can be summarized in five steps:

1. Select key criteria that effectively differentiate products in the industry. Specifically, consider the key characteristics of your brand offerings that provide unique value to your target customers.
2. Diagram a two-dimensional product-positioning map with specified criteria on each axis.
3. Plot major competitors' brands in the resultant four-quadrant matrix.
4. Assess whether your brand's location in the matrix is ideal, especially relative to competitors. That is, consider whether your brand's position, as perceived by consumers, offers unique value.
5. Reposition your brand's offering as needed to shift consumers' perceptions of the brand to a location that provides a competitive advantage over rival brands.

GLOBAL CAPSULE 7

Four Guidelines to Follow in Global Marketing

Four key guidelines to follow in rolling out any product or service abroad are:

1. Use a country-by-country rather than a continent or regional approach; countries vary greatly across many variables such as culture, technology, currency, economy, and laws. Customers are unique at the country and local level. Therefore, conduct market research, develop perceptual maps, and establish objectives at the country level based on local norms, rival firms, and challenges customers face. Gather your own primary data because third-party data sources do not know your firm, brand, or customer. Draw extensively on input from your local teams (salespersons, suppliers, and distributors).

IndianSummer/Shutterstock

There Are Potential Customers Almost Everywhere

2. In countries such as Japan where relationships have a high cultural value, use local resellers or channel partners, rather than direct sales models.
3. Carefully study pricing issues. Alter prices as needed. Make certain that purchases can be easily made and payments received; some countries are predominantly cash based and some do not accept PayPal, etc.
4. Make certain the company website and associated software for webinars, chat sessions, and so on are 100 percent compatible with each country's language, norms, and technology.

Source: Based on https://hbr.org/2015/09/the-most-common-mistakes-companies-make-with-global-marketing.

An effective product-positioning strategy uniquely distinguishes a company from the competition. Companies commonly develop several perceptual maps to better understand competitive advantages and disadvantages versus rival companies, rival products, or in-house products. Figure 7-11 shows a perceptual map of major U.S. auto insurance companies. Consider for example that Allstate is implementing a market-penetration strategy with objectives aimed at increasing revenue; the perceptual map in Figure 7-11 may help guide Allstate managers by suggesting that the firm needs to either focus on improving customer service or lowering prices. For incumbent firms planning to enter the auto-insurance business as part of a diversification or product-development strategy, the perceptual map in Figure 7-11 could foster the implementation of such strategies.

Figure 7-11 indicates that several firms already offer average range prices and customer service, but a firm could perhaps differentiate itself by offering enhanced customer service for moderately or slightly higher prices (while remaining below State Farm). Perceptual maps also reveal unclaimed space that may contain a target market. Marketers draw a line of best fit through the plots and look for places along the line that are uncontested. Also, items well above or well below the line may be over- or underserving customers and costing the firm money. Allstate for example may look decent at first glance, but they would have to significantly lower price or raise customer service to remain competitive. GEICO is possibly overserving customers on customer service; sure customers will accept this, but they probably would accept less and not run away based on still being above the "line of best fit."

A perceptual map for Marriott is shown in Figure 7-12, illustrating how several of the firm's hotel brands compare to or are differentiated from one another in terms of price and customer satisfaction. When implementing strategies, Marriott may use a perceptual map such as the one shown in Figure 7-12 to understand which of its individual brands are doing best, to identify potential problems with underperforming brands, or to visualize potential markets that could best serve as a focus for a new brand of Marriott hotels. For example, the addition of another mid-range hotel brand may cannibalize sales of existing Marriott brands, but the addition of an economy-brand of hotels may be fruitful for Marriott to consider as a means of implementing a growth strategy.

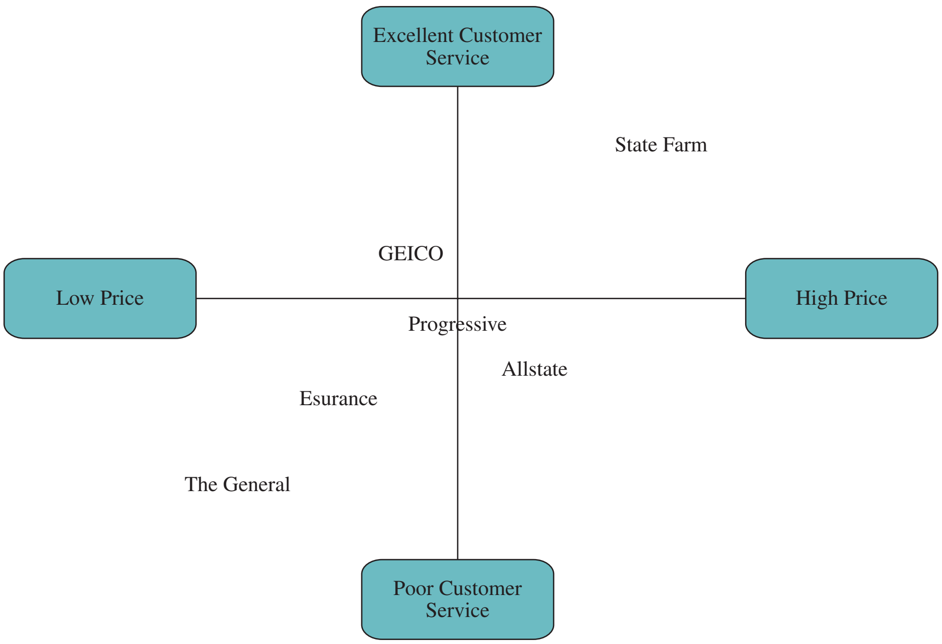


FIGURE 7-11
A Perceptual Map for Auto-Insurance Providers

Source: Based on a variety of sources.

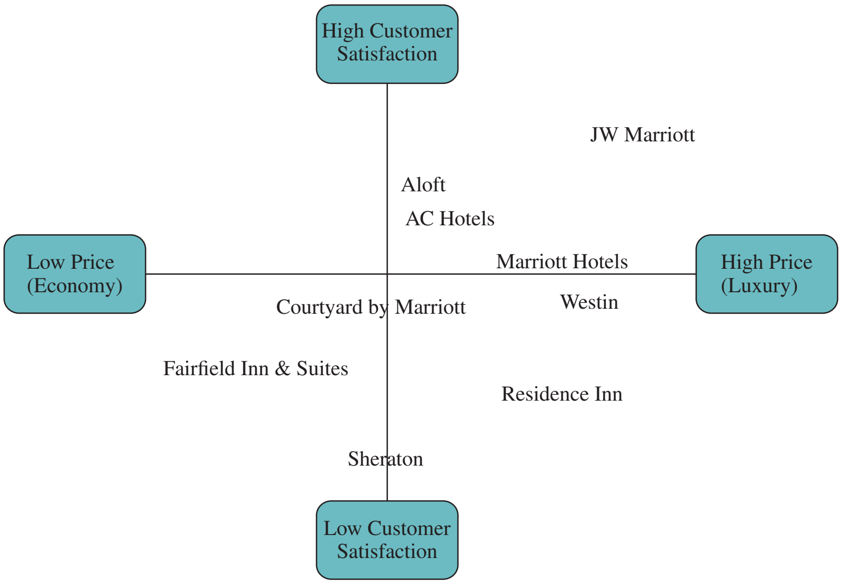


FIGURE 7-12
A Perceptual Map for Marriott's Brands of Hotels

Source: Based on a variety of sources.

Engage Customers in Social Media

Social-media marketing has become an important strategic issue and an effective way to understand consumers' perceptions of brands. Marketing has evolved to be more about building a two-way relationship with consumers than just informing consumers about a product or service. Marketers increasingly strive to get customers involved in the company website and social-media pages and solicit suggestions in terms of product development, customer service, and ideas. Companies want customers to interact with the firm on such social-media networks as Facebook, Google Plus, Twitter, LinkedIn, Instagram, Pinterest, and Foursquare. To manage this process, many larger companies have hired social-media managers to be the face or voice of the company on social and digital media sites. These managers respond to comments and problems, track negative or misleading statements, manage the online discussion about a firm, and gather valuable information about opinions and desires—all of which can be vital for monitoring strategy implementation progress and making appropriate changes.

The online community of customers increasingly mirrors the offline community; online engagement can be a much quicker, cheaper, and effective source for gathering market research data than traditional focus groups and surveys. Successful strategy implementation requires a firm to know what people are saying about it and its products. Social-media posts, blog discussions, tweets, e-mails, and conversations with family and friends represent valuable content for brand management. The best firms today embrace consumers' opinions, desires, and feelings, and learn from, and leverage consumer-generated content to improve the effectiveness of their marketing mix.

Firms benefit immensely by providing incentives to customers to share their thoughts, opinions, and experiences on the company website. Firms should encourage customers to network among themselves on topics of their choosing on the company website. The company website must not be just about the company; it must be all about the customer, too. Offering points, discounts, or coupons on the website for customers who provide ideas, suggestions, or feedback can be helpful. Driving traffic to the company website and then keeping customers at the website for as long as possible with daily new material, updates, excitement, and offers is effective marketing.

Customers trust other customers' opinions more than a company's marketing pitch, and the more they talk freely, the more the firm can learn how to improve its overall marketing mix. Marketers should 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 7-14 provides some key principles of marketing communications.

TABLE 7-14 Key Principles of Marketing Communications

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 conversation; 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.

Millennials spend more time weekly on the Internet than watching television, listening to the radio, and watching movies combined. Thus, social-media ads are often a better means of reaching younger customers than traditional yellow pages, television, magazine, radio, or newspaper ads. However, about 35 percent of all traffic on the Internet is reportedly fake, being the result of bogus computers programmed to visit websites to take advantage of marketers who typically pay for ads whenever a user visits a webpage, regardless if the user is an actual person. Criminals can erect websites and deliver phony traffic and collect payments from advertisers through middlemen, often in third-world countries. Although the exponential increase in social-media engagement has created huge opportunities for marketers, it also has produced severe threats; any kind of negative publicity travels fast online. Seemingly minor ethical and questionable actions can catapult into huge public relations problems for companies as a result of the monumental online social and business communications.

IMPLICATIONS FOR STRATEGISTS

Figure 7-13 reveals that to gain and sustain competitive advantages, firms must be exceptionally well organized and must allocate resources appropriately across products, services, and regions. Employees must know clearly what rewards and benefits they will receive if the firm does well; this knowledge will help motivate the workforce to work hard. As indicated in this chapter, other management policies and procedures also are needed to facilitate superior strategic implementation, including creating an inclusive organization, linking compensation to firm performance, encouraging corporate well-being, and nurturing an organizational culture that treats all people with respect. If strategists do an exceptional job with the management and marketing issues related to strategy implementation, the firm is well on its way to success.

Perceptual mapping and market segmentation especially are vitally important tools for strategists to make sure that monies devoted to advertising, promotion, publicity, and selling are wisely used. Marketing expenditures can be unnecessarily exorbitant if not based on clear product positioning analyses and target marketing.

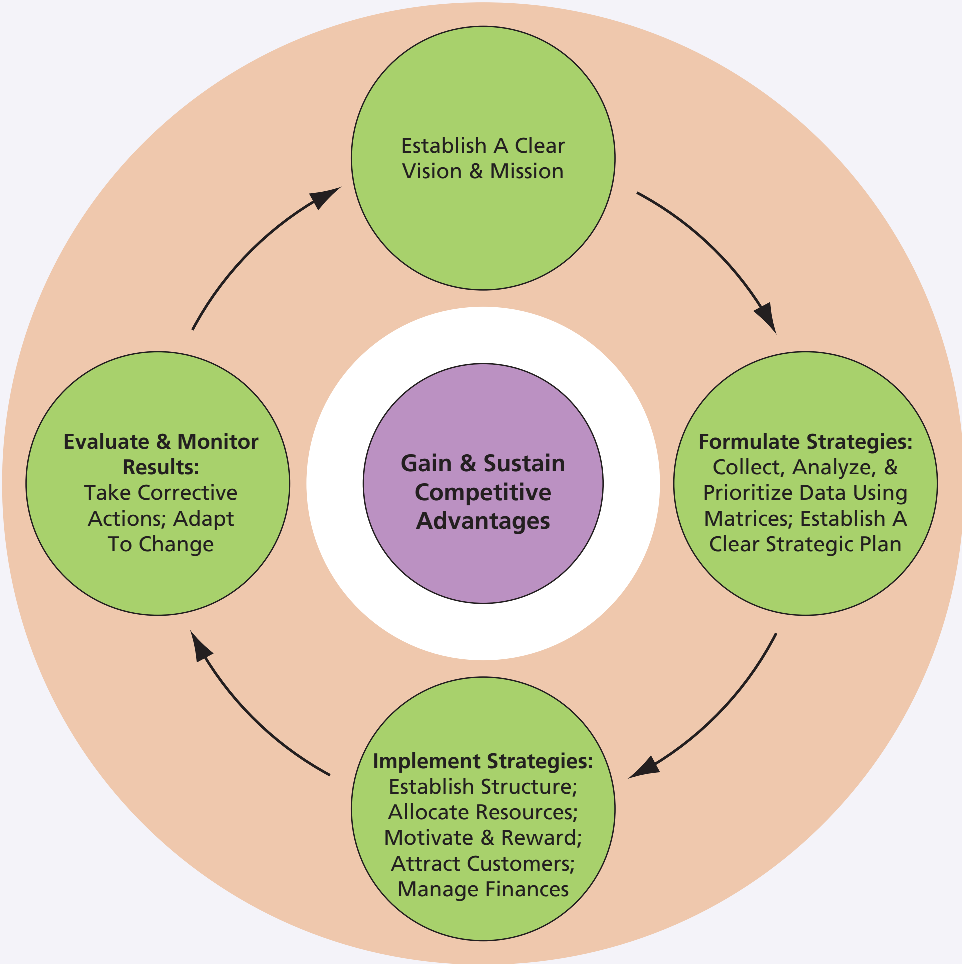


FIGURE 7-13
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

An integral part of managing a firm is continually and systematically seeking to gain and sustain competitive advantage through effective planning, organizing, motivating, and controlling. Rival firms engage in these same activities, so emphasize in your strategic-management case analysis how your firm can best implement your recommendations. 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 it 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.

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 company presently has no divisions, determine whether it 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).

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 currently divisionally structured.

Capitalize on your expertise in marketing in regards to proposing how best to segment, target, and position your firm's products to facilitate effective strategy implementation. Use the template at the author website to develop several perceptual maps to lay the foundation for spending resources to best position a firm's products to gain and sustain competitive advantages. To develop your perceptual maps, find data tables using a Google search that compare your firm and its products to rival firms, and give the reference(s) as a source, not to each map.

Chapter Summary

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. Similarly, depending on the size and type of firm, marketing issues, practices, and policies may vary, but effective segmentation, target marketing, and then positioning is required for organizational success.

Key Terms and Concepts

accounting functions (p. 243)
annual objectives (p. 231)
Bonus system (p. 248)
conflict (p. 236)
culture (p. 250)
divisional (decentralized) structure (p. 238)
functional structure (p. 237)
glass ceiling (p. 249)
horizontal consistency of objectives (p. 233)
market segmentation (p. 252)
marketing mix variables (p. 253)
matrix structure (p. 240)
perceptual mapping (p. 254)
policies (p. 233)
positioning (p. 253)
product positioning (p. 254)
reengineering (p. 246)
resistance to change (p. 246)
resource allocation (p. 235)
restructuring (p. 246)
strategic business unit (SBU) structure (p. 240)
vertical consistency of objectives (p. 233)

Issues for Review and Discussion

7-1. What are the benefits and drawbacks of many firms' new policy of prohibiting employees to work from home? On balance, do you believe the benefits offset the drawbacks?

7-2. In terms of organizational culture, explain why Wells Fargo's cross-selling practice led to massive losses for the firm.

7-3. From a human-resource-management perspective, explain the difference between corporate wellness and corporate well-being?

7-4. As indicated in the chapter, workplace well-being is gaining steam. Explain the term and give three examples.

7-5. Array correctly in sequential order market positioning, segmenting, and targeting.

7-6. Identify and discuss three reasons why market segmentation is so important in strategy implementation.

7-7. What is the "marketing mix," and why is it so important in strategy implementation?

7-8. Advertisements are getting more and more lengthy, annoying, and intrusive on both television and social-media platforms. On television, for example, sometimes eight ads will play on a commercial break. How lengthy of a commercial break will you tolerate before switching the channel to some other program, 1 minute, 3 minutes, 5 minutes, or 10 minutes? Despite the rising cost of placing an ad, could the annoyance factor offset the potential benefits of an ad? How can firms best counter this growing problem in strategy implementation?

7-9. What policy do you recommend for companies regarding employees spending time on their personal Facebook and other social-media accounts? Could your policy be enforced? How? Why?

7-10. List five important benefits of a company or organization having a diverse workforce.

7-11. Have you noticed differences in gender representation among the leadership in your institution? How would you account for this? Discuss.

7-12. Discuss the "Do's and Don'ts of Poaching Workers" from rival firms.

7-13. Discuss recent trends and facts regarding corporate well-being programs in the United States.

7-14. Should companies monitor employees' social media? Why or why not? If yes, how?

7-15. List four reasons why companies are phasing out the COO position.

7-16. Discuss three ways for linking performance and pay to strategies.

7-17. List the different types of organizational structure. Diagram what you think is the most complex of these structures and label your chart clearly.

7-18. List the advantages and disadvantages of a functional versus a divisional organizational structure.

7-19. Why is perceptual mapping an important marketing tool in strategy implementation?

7-20. In the beverage soda industry, what two variables would be helpful to include in a perceptual map? Why?

7-21. List seven guidelines to follow in developing an organizational chart.

7-22. Women comprise less than 20 percent of boards of directors. Why is this a problem globally for many companies and countries?

7-23. Some head football coaches get paid millions, presumably because there is so much money involved in college football, the need to win is paramount. However, head coaches are often fired when a season goes badly, with huge payouts to the coach by contract. How could a head coach's compensation package be better structured to encourage winning, and at the same time not be so potentially costly to a university?

7-24. *Businessweek* says firms should "base executive compensation on actual company performance, rather than on the company's stock price." For example, Target Corp. bases executive pay on same-store sales growth rather than stock price. Discuss.

7-25. Explain why firms need a policy against workplace phubbing.

7-26. The chapter says strategy formulation focuses on effectiveness, whereas strategy implementation focuses on efficiency. Which is more important, effectiveness or efficiency? Give an example of each concept.

7-27. In stating objectives, why should terms such as *increase, minimize, maximize, as soon as possible, adequate*, and *decrease* be avoided?

7-28. Among the three marketing activities (product positioning, target marketing, market segmentation), which activity comes first, second, and third?

7-29. Explain why Alfred Chandler's strategy–structure relationship commonly exists among firms.

7-30. If you owned and opened three restaurants after you graduated, would you operate from a functional or divisional structure? Why?

7-31. Explain how to choose between a divisional-by-product and a divisional-by-region organizational structure.

7-32. Think of a company that would operate best, in your opinion, by a division-by-services organizational structure. Explain your reasoning.

7-33. Identify and discuss pros and cons of keeping the COO position in a corporate design.

7-34. In order of importance, in your opinion, list six advantages of a matrix organizational structure.

7-35. Why should division head persons have the title *president* rather than *vice president*?

7-36. In order of importance, in your opinion, list six techniques or activities widely used to alter an organization's culture.

7-37. Allocating resources can be a political and an ad hoc activity in firms that do not use strategic management. Why is this true? Does adopting strategic management ensure easy resource allocation? Why?

7-38. Describe the relationship between annual objectives and policies.

7-39. Identify and discuss three policies that apply to your present strategic-management class.

7-40. Explain the following statement: Horizontal consistency of goals is as important as vertical consistency.

7-41. To conflict problems, how would you resolve a disagreement between a human resource manager and a sales manager over the firing of a particular salesperson? Why?

7-42. Describe the organizational culture of your college or university.

7-43. Explain why organizational structure is so important in strategy implementation.

7-44. In your opinion, how many separate divisions could an organization reasonably have without using an SBU-type organizational structure? Why?

7-45. Do you believe expenditures for child care or fitness facilities are warranted from a cost/benefit perspective? Why or why not?

7-46. Explain why successful strategy implementation often hinges on whether the strategy-formulation process empowers managers and employees.

7-47. Identify and discuss four primary reasons why annual objectives are so essential for effective strategy implementation.

7-48. Identify and discuss eight characteristics of objectives.

7-49. Why is it essential for organizations to segment markets and target particular groups of consumers?

7-50. Why did Walmart, Inc. change their corporate name in 2018?

7-51. Develop a perceptual map for five colleges and universities in your state. Explain the potential value of your map for the president of your institution.

7-52. Under the marketing mix factor of price, what are four considerations or decisions many firms face?

7-53. Under the marketing mix factor of promotion, list four subsets or decision areas.

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 7A

Compare and Contrast Coca-Cola's Marketing Expenses versus Rival Firms

Purpose

Marketing is expensive. For example, a 30-second ad spot during the annual NFL Super Bowl costs about $5 million. Yet, firms must do marketing otherwise even the best products in the world can go unnoticed. But firms can go broke doing marketing. These are reasons why marketing is a key business function and an important issue in strategy implementation. This exercise can give you experience comparing and contrasting Coca-Cola's marketing expenditures versus two major rivals: PepsiCo and Dr Pepper Snapple. Analysis in this regard can provide guidance on whether to increase or decrease Coca-Cola's marketing expenditures.

Instructions

Step 1 Go online to Coca-Cola, PepsiCo, and Dr Pepper Snapple websites at the respective Investor Relations page and download the three *Form 10Ks* for the respective firms.

Step 2 Look in the Table of Contents to each *Form 10K* to find the pages that reveal the three firms' marketing or advertising expenditures.

Step 3 Prepare a comparative data table to consolidate this information.

Step 4 Prepare a report to suggest implications for Coca-Cola in terms of marketing or advertising expenditures going forward as needed to implement strategies.

EXERCISE 7B

Diagram an Existing and Proposed Organizational Chart for Coca-Cola

Purpose

Organizational structure matters because being well organized is vital for success in all aspects of business (and personal) endeavors. This exercise gives you experience developing an existing organizational chart for a company, and based on the chapter guidelines, proposing a new and improved design for a firm. Rarely do companies publicly provide an organizational chart, but nearly all publicly held firms provide a list of their top executives in the annual *Form 10K*, as does Coca-Cola. Based on that document, Coca-Cola's top management team is as follows:

1. Muhtar Kent, Chairman of the Board of Directors and Chief Executive Officer
2. Alexander M. Douglas, Jr., EVP and President of Coca-Cola North America
3. Irial Finan, EVP and President, Bottling Investments Group
4. John Murphy, President of the Asia Pacific Group
5. James Quincey, President and Chief Operating Officer

6. Alfredo Rivera, President of the Latin America Group
7. Brian Smith, President of the Europe, Middle East and Africa Group
8. Clyde C. Tuggle, SVP and Chief Public Affairs and Communications Officer
9. Kathy N. Waller, EVP and Chief Financial Officer
10. Marcos de Quinto, EVP and Chief Marketing Officer
11. Ceree Eberly, SVP and Chief People Officer
12. Bernhard Goepelt, SVP, General Counsel and Chief Legal Counsel
13. Julie Hamilton, SVP and Chief Customer and Commercial Leadership Officer
14. Brent Hastie, SVP, Strategy and Planning
15. Ed Hays, PhD, SVP and Chief Technical Officer
16. Barry Simpson, SVP and Chief Information Officer of the Company

Instructions

Step 1 Develop an existing organizational chart for Coca-Cola. As described in the chapter, use numbers in your chart rather than drawing boxes or circles. Always number executive positions as shown, so you can then use just numbers in your actual chart rather than drawing boxes or circles to reveal reporting relationships.

Step 2 Develop a new and improved organizational chart for Coca-Cola. You may want to change up the list given, adding and deleting positions as you deem necessary as well as changing certain titles to assure adherence to the chapter guidelines and dos and don'ts in devising organizational charts.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 7C

Develop a Perceptual Map for My University

Purpose

The purpose of this exercise is to give you practice developing product-positioning maps. Nonprofit organizations, such as universities, increasingly use product-positioning maps to determine effective ways to implement strategies.

Instructions

Step 1 Join with two other people in class to form a group of three.

Step 2 Jointly prepare a product-positioning map that includes your institution and four other colleges or universities in your state.

Step 3 Compare your map to other teams' maps. Discuss differences.

Step 4 How can your college or university best take advantage of the information revealed in the diagrams developed?

SET 3: STRATEGIC PLANNING TO ENHANCE MY EMPLOYABILITY

EXERCISE 7D

Marketing Yourself to Best Achieve Your Career Objectives

Purpose

As indicated in this chapter, establishing annual objectives and marketing products or services is vital for successful strategy implementation in companies, but these two activities are equally important for an individual in career planning. This exercise offers guidelines for you to better market yourself to meet your career objectives. In particular, 10 guidelines are provided for enhancing your resume.

1. Meticulously make certain there are no typos, not even a comma missing.
2. Include no personal pronouns, such as my or I, and no abbreviations, such as Rd. or St, anywhere in your resume.

3. Looks matter, so use 12-point font throughout; manage white space margins well; double space after headings; use bullets to showcase points; never repeat wording in bullets
4. Include your highest GPA four ways: (1) in your major, (2) in the business school, (3) overall at the university, or (4) your last 60 hours, if that highest score is 2.75 or higher.
5. Begin with an Objective saying something like "To gain an entry level position in accounting with a large manufacturing firm." Tailor this wording to the prospective firm of interest.
6. List Education before Work Experience unless you have substantial work experience.
7. Make sure you list your degree, your major, and when you expect your degree.
8. Do not list courses completed but do list skills gained in courses, such as when using this textbook say: "Learned how to use a popular, Excel-based strategic planning template" or "Gained experience developing strategic plans for a wide variety of firms."
9. Make sure you use business terms in describing your work experience, saying something like "Learned the value of hard work, dependability, and reliability," or "Gained experience with customer service, pricing, and inventory control," focusing on skills learned rather than duties performed.
10. Unless constrained otherwise, include three reference persons with their titles and contact information; reveal their professional association with you; place horizontal or vertical depending on spacing; do not have only references on second page.

Instructions

Step 1 Use the guidelines listed to polish up your resume.
Step 2 E-mail your resume to your professor and ask for his or her feedback.

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 7E

What Are the Most Important Benefits of Having a Diverse Workforce?

Purpose

Sometimes students, and even managers and executives, do not realize or appreciate why it is important to have a diverse workforce and management team. As discussed in this chapter, there are six major benefits of having a diverse workforce, as follows:

1. Women and minorities have different insights, opinions, and perspectives that should be considered.
2. A diverse workforce portrays a firm committed to nondiscrimination.
3. A workforce that mirrors a customer base can help attract customers, build customer loyalty, and design or offer products and services that meet customer needs and wants.
4. A diverse workforce helps protect the firm against discrimination lawsuits.
5. Women and minorities represent a huge additional pool of qualified applicants.
6. A diverse workforce strengthens a firm's social responsibility and ethical position.

The purpose of this exercise is to examine more closely the benefits of having a diverse workforce and management team. In addition, the purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Instructions

Rank the six benefits of having a diverse workforce and management team as to their relative importance (1 = most important, 9 = least important). First, rank the six benefits as an individual. Then, rank the six benefits as part a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision making in strategic planning.

The Steps

1. Fill in Column 1 in Table 7-15 to reveal your individual ranking of the relative importance of the six benefits (1 = most important to 6 = least important). For example, if you think Benefit #1 (Women and minorities have different insights, opinions, and perspectives) is the second-most important benefit, then enter a 2 in Table 7-15 in Column 1 beside Benefit 1.
2. Fill in Column 2 in Table 7-15 to reveal your group's ranking of the relative importance of the six benefits (1 = most important to 6 = least important).
3. Fill in Column 3 in Table 7-15 to reveal the expert's ranking of the six benefits.
4. Fill in Column 4 in Table 7-15 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 7-15 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER

TABLE 7-15 Assessing the Benefits of a Diverse Workforce: Comparing Individual versus Group Decision Making

Individual versus Group Decision-Making

Benefits of Diversity	Column 1	Column 2	Column 3	Column 4	Column 5
1. Women and minorities have different insights, opinions, and perspectives that should be considered.					
2. A diverse workforce portrays a firm committed to nondiscrimination.					
3. A workforce that mirrors a customer base can help attract customers, build customer loyalty, and design or offer products and services that meet customer needs and wants.					
4. A diverse workforce helps protect the firm against discrimination lawsuits.					
5. Women and minorities represent a huge additional pool of qualified applicants.					
6. A diverse workforce strengthens a firm's social responsibility and ethical position.					
Sums					

MINI-CASE 7 ON DE BEERS GROUP OF COMPANIES

Ed Rooney/Alamy Stock Photo

Which Diamond Do You Like Best?

DE BEERS SHIFTS ITS MARKET SEGMENTATION STRATEGY

Headquartered in Johannesburg, South Africa, De Beers Group is the 130-year-old company that specializes in diamond exploration, mining, retail, and trading. De Beers is partly if not mostly responsible for diamond rings being globally associated with engagement to marry. The company's motto is "A Diamond is Forever." De Beers is shifting its market segmentation strategy to focus on millennial consumers in response to generational shifts. Recognizing that millennials (76 million, ages 18–34) now outnumber baby boomers (75 million, ages 51–69) in the United States, De Beers wants to make sure diamonds appeal to this younger consumer segment. In the interview summarized here (condensed and paraphrased), De Beers' CFO Nimesh Patel, explains that marketing diamonds to millennials will be critical to the future of De Beers. (Marketers refer to consumers ages 35 to 50 as Generation X; they will outnumber Boomers by the year 2028).

Q: What is your focus as CFO of De Beers since the firm has excellent finances?

A: Mining contributes 75 percent of our business, but it is the rest of the business that helps us drive consumer demand and maintain the value of the mining business. It is helpful for consumers to understand diamonds in order to maintain their affinity with the product.

Q: Why have you increased marketing spending and stepped up diamond advertising?

A: Our marketing spurs consumer demand through our downstream (retail store) business, Forevermark and De Beers Diamonds Jewelers, and through our sale of rough diamonds to the mid-stream industry. "Desirability" is what drives sales of luxury goods, and with increased competition from other luxury-good categories (such as designer handbags and shoes), we use advertising to drive desirability for diamonds. De Beers has 30 retail stores across Asia, the U.S., Europe, and the Middle East.

Q: How are you communicating the heritage of the De Beers brand to millennials?

A: We know that millennials have fewer real connections with people (despite more online/virtual connections), and these connections are more difficult to sustain. A diamond symbolizes a lasting, valuable relationship between two people; similarly, a diamond is rare, timeless, and valuable.

Q: Millennials value experiences and goods with an interesting and authentic story; how are you addressing this?

A: We know that buying diamonds is an experience. We talk to customers about where diamonds are from, how they are formed, and all the good that diamond mining has done to boost local economies in Namibia and Botswana, educating young girls, investing in clean water, and even helping preserve the white rhino.

Q: What trends are you seeing in regards to women purchasing diamond jewelry for themselves?

A: De Beers Diamond Jeweler has tailored its offerings to the strong, independent, often career woman; this is a growing consumer segment. Aside from diamond engagement rings, other diamond jewelry including rings, necklaces, and bracelets are actually often self-purchased. Many self-purchases come from unmarried women that comprise 43 percent of all women in the U.S.

Q: How are you approaching e-commerce?

A: Digital platforms are a useful way to educate consumers on diamonds. With the significant value tied to diamond jewelry, the experience of buying is important. People remember how, when, where, and why they purchased a diamond, so we try hard to make the process great.

Questions

1. How do you think De Beers could most effectively and efficiently advertise to millennials?
2. How do you think De Beers could most effectively and efficiently advertise to baby boomers?
3. How do you think De Beers could most effectively and efficiently advertise to unmarried women? How would this market segmentation strategy differ for targeting unmarried men?

Source: Based on Tatyana Shumsky, "The Tricky Task of Selling Diamonds to Millennials," *Wall Street Journal* (October 30, 2017): B7. Note: In 1947, De Beers introduced its iconic slogan "A Diamond is Forever" that conveys the eternal promise of a diamond. See http://www.debeers.com/the-world-of-de-beers/about-de-beers/story

Web Resources

1. **Organizational Chart Images** This website provides more than 100 free organizational chart images used by various organizations.
https://www.google.com/search?q=organizational+chart+template&tbm=isch&tbo=u&source=univ&sa=X&ved=0ahUKEwjG1rfNoaHYAhXjc98KHWX7AKoQsAQIeA&biw=1295&bih=720
2. **Positioning Map Images** This website provides more than 100 free perceptual maps used by various organizations.
https://www.google.com/search?q=positioning+map+images&tbm=isch&tbo=u&source=univ&sa=X&ved=0ahUKEwiQvveooqHYAhWwlOAKHdDJAl8QsAQIKA&biw=1295&bih=743

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8

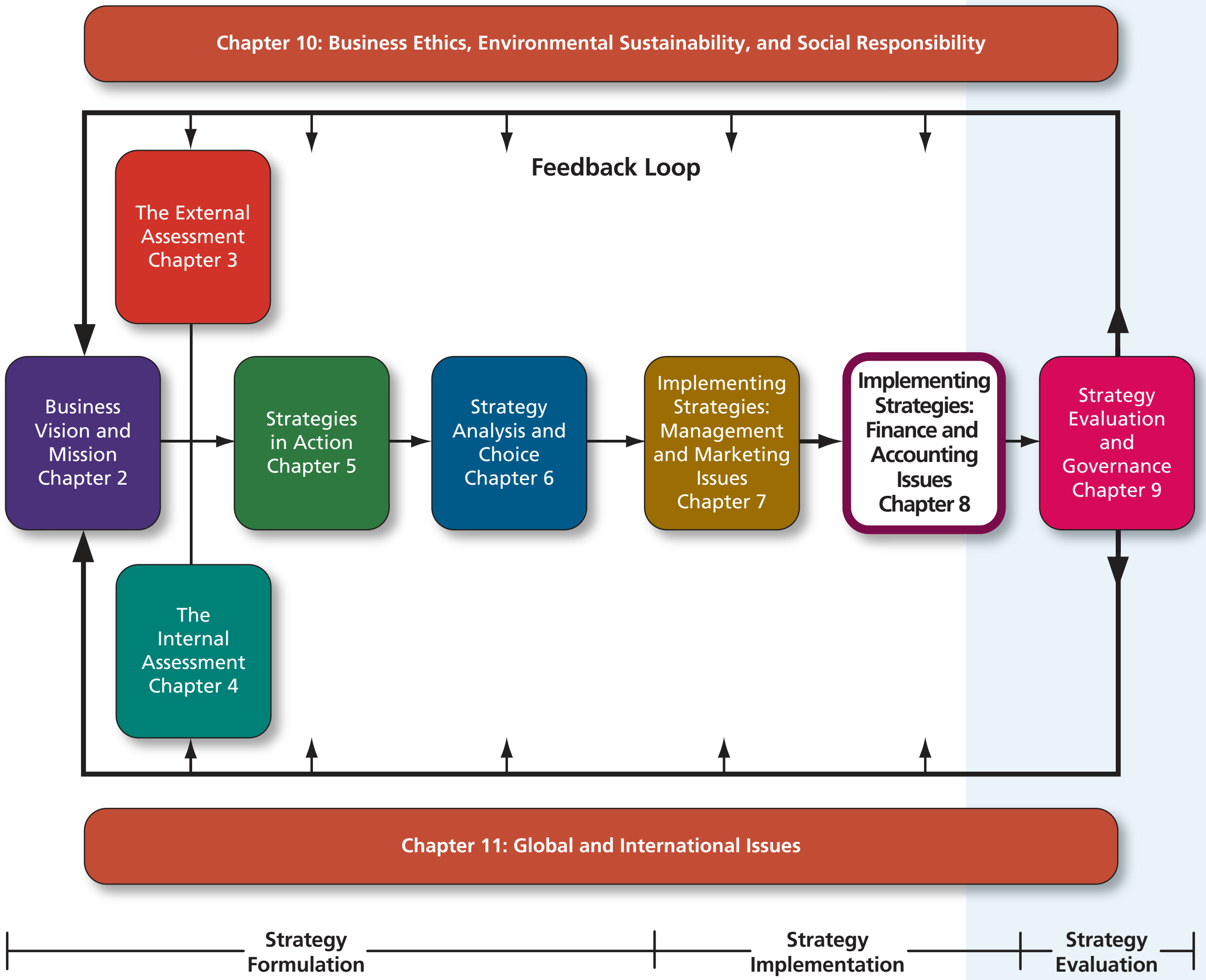

FIGURE 8-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

Implementing Strategies: Finance and Accounting Issues

LEARNING OBJECTIVES

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

8-1. Determine an appropriate capital structure for the firm by performing EPS/EBIT analysis to compare the relative attractiveness of debt versus stock as a source of capital to implement strategies.

8-2. Develop projected financial statements to reveal the impact of recommendations with associated costs.

8-3. Determine the cash value of the firm, or a division of the firm, using four corporate evaluation methods.

8-4. Discuss financial ratios, initial public offerings (IPOs), and issuing bonds as strategic decisions.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1:	Strategic Planning for Coca-Cola
EXERCISE 8A:	Perform an EPS/EBIT Analysis for Coca-Cola
EXERCISE 8B:	Prepare Projected Financial Statements for Coca-Cola
EXERCISE 8C:	Determine the Cash Value of Coca-Cola
EXERCISE 8D:	Prepare Projected Financial Ratios for Coca-Cola
SET 2:	Strategic Planning for My University
EXERCISE 8E:	Determine the Cash Value of My University
SET 3:	Strategic Planning to Enhance My Employability
EXERCISE 8F:	Developing Personal Financial Statements
EXERCISE 8G:	A Template Competency Test
SET 4:	Individual versus Group Strategic Planning
EXERCISE 8H:	How Severe Are the Seven Limitations to EPS/EBIT Analysis?

MyLab Management

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Strategies can be implemented successfully only when an organization manages its finances effectively, as illustrated in Figure 8-1. This chapter examines important finance and accounting topics associated with implementing strategies. An actual working example for Procter & Gamble (P&G) is provided to illustrate and explain key finance and accounting topics. A proposed set of P&G recommendations with associated costs is presented, followed by an EPS/EBIT analysis to determine the most appropriate means for raising capital, projected financial statements to show the expected impact of those recommendations, and projected financial ratios. Corporate valuation is discussed, too, because firms sometimes acquire other firms or may be the target of an acquisition.

Strategy implementation generally impacts the lives of everyone in an organization; thus, all employees need to buy in and support the firm's efforts to succeed in the face of numerous rival firms counterattacking. When employees understand the thinking that goes into strategy formulation and understand their roles, they will be more inclined to accept the work required for strategy implementation.

A football quarterback can call the best play possible in the huddle, but that does not translate into the play going for a touchdown. The team may even lose yardage, illustrating the importance of everyone working together to ensure the play is properly executed (implemented) well. Headquartered in New York City, JPMorgan Chase is implementing strategies especially well, led by its exemplary strategist, Jamie Dimon. Dimon is an advocate of involving multiple people in the decision-making process.

EXEMPLARY **STRATEGIST** SHOWCASED

Jamie Dimon, CEO JPMorgan Chase


Create jobs 51/Shutterstock

Dimon Manages Dollars Really Well.

Jamie Dimon is widely considered one of the world's preeminent CEOs. His company, JPMorgan Chase, reported record profits in 6 of the last 7 years dating from 2010 to 2016 despite operating during a period of heightened regulatory and legally challenging environments. Previously CEO of Bank One, Dimon is routinely heard discussing issues facing the financial industry, but two key strategic issues he consistently mentions are applicable to firms in all industries: (1) the importance of involving others in decision making and (2) the importance of economies of scale.

On the importance of people learning to work together, Dimon claims that successful strategic planning has more to do with heart than mind. This means recognize people, admit you do not have all the answers, value others' expertise and experiences, provide people a platform to contribute, applaud people for their contributions, and basically let people know you care. Dimon says to avoid finger-pointing and scapegoating and focus on improved relations and collaboration. He contends that most business decisions lead to better outcomes after detailed analyses are performed and multiple people from various departments (finance, management information system (MIS), accounting, marketing, and others) are involved in the decision-making process.

Dimon is also an advocate for economies of scale, arguing that growth for the sake of growth is a misguided strategy. He suggests firms should be careful not to venture into areas outside their corporate strategy and instead deploy resources into areas that will build economies of scale because this is often more advantageous to customers, shareholders, and ultimately for the entire economy. Dimon even has joked before that without economies of scale, we might still be living in tents and hunting for our own food—revealing just how important he considers striving for economies of scale for all business across various industries.

JPMorgan Chase is one of *Fortune*'s most admired companies, led by Dimon, and one of this book's most admired strategists, especially in the finance and accounting world of business.

Source: Based on a variety of sources.

A sampling of issues that may require finance and accounting policies, decisions, analyses, and actions in implementing strategies include the following:

1. To raise capital with short- or long-term debt, a bond issuance, divestiture, or a preferred or common stock issuance
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 or not
6. To establish a certain percentage discount on accounts within a specified period of time
7. To determine the amount of cash to be kept on hand
8. To purchase additional treasury stock or not
9. To determine whether to accept a merger offer
10. To determine how much to ask (or pay) for a division of the firm to be divested

Five especially important finance and accounting activities central to strategy implementation are listed and discussed sequentially in this chapter:

1. Determine capital structure: acquire needed capital to implement strategies; perform EPS/EBIT analysis.
2. Develop projected financial statements: show expected impact of recommendations.
3. Perform corporate valuation: in the event an offer is received or a rival firm is to be acquired.
4. Analyze financial ratios.
5. Manage initial public offerings (IPOs), cash levels, and corporate bonds

Capital Structure

LO 8.1

After developing a set of recommendations with associated costs (as explained in the prior chapter), a firm must determine the most profitable means for raising needed capital. Occasionally cash on hand can finance small projects, but much of the cash on a firm's balance sheet may not be readily accessible without incurring taxes depending on what country the cash resides. Another way to raise the capital for new projects is to divest existing businesses. Jack Welsh, the former CEO of General Electric, was famous for divesting any business that was not first or second in its industry. P&G recently divested more than one hundred underperforming brands to cut costs, raise capital, and shift focus from underperforming brands into the firm's core competencies. Annual net income is also available for implementing strategies, but usually all debt, all stock, or some combination of debt and stock is necessary to implement a set of recommendations. The proportion of debt to equity on a balance sheet is often referred to as a firm's **capital structure**; performing an EPS/EBIT analysis is a common way to determine the appropriate capital structure needed.

Before explaining EPS/EBIT analysis, let's be clear on some accounting terms as follows:

1. EPS is *earnings per share*, which is net income divided by number of shares outstanding.
2. EBIT is *earnings before interest and taxes*, or as it is sometimes called, *operating income*.
3. *Shares outstanding* is similar to *shares issued* except shares issued also includes shares of stock that a firm has repurchased (**treasury stock**). The denominator of EPS is shares outstanding; this number is reduced when a firm repurchases a portion of its own stock, thus increasing the overall EPS value. Most large firms have treasury stock, but some do not, such as Starbucks Corporation.
4. *Shares authorized* are the number of shares a firm has approval to issue in total, normally considerably more than the number of shares outstanding.
5. EBT is *earnings before tax*; EAT is *earnings after tax*. Another term for earnings is profits or net income.

Successful strategy implementation often requires additional capital beyond net income from operations or the sale of assets. Two primary sources of capital are debt and equity. Determining an appropriate mix of debt and equity in a firm's capital structure is an important strategy-implementation decision. **EPS/EBIT analysis** is a widely used technique for determining whether debt, stock, or a combination of the two 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 EPS under various expectations for EBIT, given specific recommendations (strategies to be implemented).

Theoretically, an enterprise should carry enough debt in its capital structure to boost its return on investment in projects earning more than the cost of the debt. In low-earning periods, excessive debt in the capital structure of an organization can endanger stockholders' returns and jeopardize company survival. Fixed debt obligations must be met, regardless of circumstances, to avoid default. Avoiding debt obligations however does not automatically make financing through equity a more attractive means for raising capital. When the cost of capital (interest rates) is low, 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 include dilution of ownership, increased takeover risk, effect on stock price, the need to pay dividends on the additional shares if the firm pays dividends, and lower EPS.

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, in contrast to maximizing profits in the short run. If profit maximization is the primary objective of the firm, then in performing an EPS/EBIT analysis, you may focus more on the EAT rather than EPS.

EPS/EBIT Analysis: Steps to Complete

There are four steps to complete in performing EPS/EBIT analysis:

Step 1: Gather the Input Data Needed; Determine the Following Numbers:

a. The dollar amount in capital the firm needs to raise = the total associated costs of recommendations
b. Number of shares outstanding; usually given on a firm's balance sheet
c. Interest rate (%) that funds can be borrowed (use 3 to 5 percent)
d. Tax rate (%) the firm is paying (calculated from a firm's income statement; i.e., taxes or provision for taxes divided by EBT. (Note: in 2018 the US corporate tax rate changed to 21 percent).
e. The dollar amount of EBIT range; use the most recent year EBIT number plus or minus the impact of recommendations to determine a range; select a low, medium, and high dollar amount of EBIT to simulate pessimistic, realistic, and optimistic values for the year ahead.

Step 2: Set Up a Computation Table as Follows

	All Stock Financing			All-Debt Financing			50-50 Stock-Debt Financing		
	Pessimistic	Realistic	Optimistic	Pessimistic	Realistic	Optimistic	Pessimistic	Realistic	Optimistic
$ EBIT									
$ Interest									
$ EBT									
$ Taxes									
$ EAT									
# Shares Issued									
$ EPS									

Step 3: Insert Numbers in the Table Following These Row-by-Row Steps/Guidelines

a. For the $ EBIT row, select a pessimistic (low), realistic (medium), and optimistic (high) $ amount for EBIT based on the previous year EBIT plus what you expect your recommendations to yield; use large ranges to get variation; place these three $ EBIT numbers across the EBIT row under each capital structure scenario; thus place the three numbers three times across that first row.

b. For the $ Interest row, in the three All-Stock columns, place zeros because no new interest will be paid if the firm elects to use the All-Stock approach. In the interest row for the All-Debt columns, multiply the $ capital needed times the interest rate and place the resultant amount in the three All-Debt columns. Similarly, in the 50-50 Combo columns, multiply the $ capital needed (50% of total) times the interest rate and place the resultant amount in the 50-50 Combo columns. (Note: Change the percentage if using a different combination such as 70-30 stock-debt).
c. For the $ EBT row, subtract row 2 from row 1, in each respective column.
d. For the $ Taxes row, multiply row 3 by the tax percentage, in each respective column.
e. For the $ EAT row, subtract row 4 from row 3, in each respective column.
f. For the # Shares Issued row, in the three All-Stock columns, divide the $ capital needed by the stock price and add that number to the existing number of shares outstanding and place the resultant number in the All-Stock columns. In the three All-Debt columns, simply place the existing number of shares outstanding number because no new shares are being added. In the three 50-50 Combo columns, multiply the $ capital needed by 50 percent; then divide this number by the stock price and add the resultant number to the existing number of shares outstanding to determine the number in the 50-50 Combo columns. (Note: Change the percentage if using a different mix of stock versus debt.)
g. For the $ EPS row, divide row 5 by row 6, in each respective column. Take notice of which EPS values are highest along the row for each capital structure scenario. The highest EPS values reveal the best financing decision. If the EPS values are the same or nearly the same across the bottom row for the same level of EBIT, then the amount of funds raised may be too low to reveal significant differences based on the current interest rates or stock price, or the EBIT range may be too narrow. If you are recommending strategies that require high capital requirements, there should be differences in EPS values between All-Debt and All-Stock for the same level of EBIT.

Step 4: Graph Your EPS/EBIT Analysis
Simply place the top row ($ EBIT) on the *x*-axis and place the bottom row ($ EPS) on the *y*-axis. Then, plot three resultant lines for All-Stock, All-Debt, and 50-50 Stock-Debt Combo, respectively. The highest line in the graph reveals the highest EPS that maximizes shareholder value; select this highest EPS financing option unless you have a compelling reason(s) to overturn this decision as per limitations of this analysis discussed in Table 8-3.

EPS/EBIT Analysis: An Example

Perhaps the best way to explain EPS/EBIT analysis is by working through an example for P&G, examining the All-Stock, All-Debt, and 60-40 Stock-Debt Combo financing alternatives. Following Steps 1 to 3, the needed input data and computations are given in Tables 8-1 and 8-2, respectively.

TABLE 8-1 P&G Input Data Needed for EPS/EBIT Analysis

P&G Input Data	The Number
$ Amount of Capital Needed	$5,000 million
EBIT Range	$10,000 to $18,000 million
Interest Rate	5%
Tax Rate	23%
Stock Price	$94.17
# Shares Outstanding	2,550 million

TABLE 8-2 P&G Computations in Performing EPS/EBIT Analysis (in millions, except the EPS row)

	Common Stock Financing			Debt Financing		
	Pessimistic	Realistic	Optimistic	Pessimistic	Realistic	Optimistic
EBIT	$10,000	$15,000	$18,000	$10,000	$15,000	$18,000
Interest	0	0	0	250	250	250
EBT	10,000	15,000	18,000	9,750	14,750	17,750
Taxes	2,300	3,450	4,140	2,243	3,393	4,083
EAT	7,700	11,550	13,860	7,508	11,358	13,668
#Shares	2,603	2,603	2,603	2,550	2,550	2,550
EPS	$2.96	$4.44	$5.32	$2.94	$4.45	$5.36

	Stock	60%	Debt	40%
		Pessimistic	Realistic	Optimistic
EBIT		$10,000	$15,000	$18,000
Interest		100	100	100
EBT		9,900	14,900	17,900
Taxes		2,277	3,427	4,117
EAT		7,623	11,473	13,783
#Shares		2,582	2,582	2,582
EPS		$2.95	$4.44	$5.34

Note when EBIT is forecasted as pessimistic, then equity financing is more attractive than debt financing, as indicated by the EPS value of $2.96 compared to the debt financing EPS value of $2.94. However, as the economy or projected EBIT improves, All-Debt financing will maximize P&G's EPS, as revealed by a $5.36 EPS for All Debt versus a $5.32 EPS for All-Stock financing. Our conclusion is that P&G should use stock to raise capital under the pessimistic forecast, but if the economy is forecasted to be realistic or optimistic, then debt is the most attractive financing alternative.

Following Step 4, a graph of the P&G EPS/EBIT analysis is given in Figure 8-2. The intersection points near the $15,000 level of EBIT are break-even points where one method of financing becomes more attractive than another. Note at the $10,000 level of EBIT, All-Stock yields the highest EPS, and at the $18,000 level, All-Debt financing yields the highest EPS. So, the analyst is faced with a decision regarding what to recommend based on his or her confidence levels for the EBIT ranges and the limitations discussed in Table 8-3.

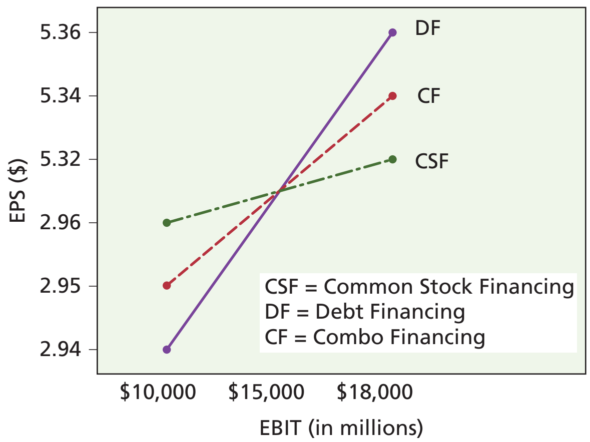

FIGURE 8-2
P&G's EPS/EBIT Chart

TABLE 8-3 Limitations/Considerations Associated with EPS/EBIT Analysis

1. ***Flexibility.*** As a firm's capital structure changes, so does its flexibility for considering future capital needs. Using all debt or all stock to raise capital today may impose fixed obligations, restrictive covenants, or other constraints tomorrow that could reduce or enhance a firm's ability to raise additional capital.
2. ***Dilution of Ownership.*** 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. If dilution of ownership is a concern, then debt could be more attractive than stock, even if EPS values are higher with stock.
3. ***Timing.*** If interest rates are expected to rise, then debt may be more attractive than stock (assuming a fixed rate is locked in), even if EPS values are higher with stock. In times of high stock prices, stock may more attractive than debt.
4. ***Leveraged Situation.*** If the firm is currently too highly leveraged versus industry average ratios, then financing through stock may be more attractive than debt, even if EPS values are higher for debt.
5. ***Continuity.*** The analysis assumes stock price, tax rate, and interest rates stay constant across pessimistic, realistic, and optimistic conditions.
6. ***EBIT Ranges.*** The EBIT values are estimated based on the prior year, plus the impact of strategies to be implemented.
7. ***Dividends.*** If EPS values are highest for all stock, and if the firm pays dividends, then more funds will leave the firm as per dividends if all-stock financing is selected.

Be mindful that large companies may have millions of shares outstanding, so even small differences in EPS across different financing options, such as in this example, can equate to large sums of money gained by using that highest EPS value alternative. For example, P&G has 2,550 million shares outstanding, so the $0.04 difference you see in EPS at the $18,000 level translates into 2,550 × 0.04 = $102 million in potential monies that P&G would have if the firm uses debt financing (DF) over common stock financing (CSF) at the $18,000 level of EBIT.

Any number of combination stock/debt (S/D) scenarios, such as 70/30 S/D or 30/70 S/D, may be examined in an EPS/EBIT analysis to determine expected EPS values. The free Excel template at www.strategyclub.com enables easy calculation of various financing options.

EPS/EBIT Analysis: Limitations

All analytical tools have limitations, including EPS/EBIT analysis. But unless you have a compelling reason to overturn the highest last row EPS values dictating the best financing option, then indeed those highest values along the bottom row should dictate the financing decision because EPS is an excellent measure of organizational performance, and thus is an excellent variable to examine in deciding which financing option to use. EPS/EBIT analysis itself does not alert the analyst of potential limitations discussed in Table 8-3.

Projected Financial Statements

LO 8.2

Projected financial statements are income statements and balance sheets developed for future years to forecast the potential impacts of various recommendations proposed for implementation. Recall from Chapter 6 that all recommendations carry with them an estimated cost value. Most financial institutions require 3 years of projected financial statements whenever a business seeks capital. On financial statements, different companies use different terms for various items. For example, *revenues* or *sales* can refer to the same item; *net income, earnings*, or *profits* can refer to the same item; *capital surplus* or *paid-in-capital* can refer to the same item. A term sometimes used for *retained earnings* is *accumulated equity* or (if losses) *accumulated deficit.*

The Free Excel Strategic Planning Template at www.strategyclub.com

Many practitioners and students of strategic planning use the template to develop existing and projected financial statements to reveal the expected impact of proposed recommendations for the firm. Do not expect the template to do the thinking for you in terms of projecting each row on both the income statements and balance sheets. The template does the calculating for you but you must supply the thinking regarding the amount to alter each row given the expected impact of your recommendations. For anyone using the template to develop actual and projected financial statements, Table 8-4 provides author comments.

TABLE 8-4 Template Considerations in Developing Financial Statements

Almost every row of the template's projected financial statements is to be forecasted by the user to reveal the expected impact of his or her recommendations for the firm. However, a few rows in the template's projected statements are automatically calculated (rather than forecasted) as discussed below.

1. Make Conversion. Convert (enter) your firm's most recent *Form 10K* actual income statements and balance sheets into the template-formatted statements. Doing this will greatly facilitate development of projected financial statements and ratios. In making this conversion, use the *nonrecurring events* row to house extraneous items on the income statements; on the balance sheets, use the *other current or long-term assets*, the *other current or long-term liabilities* rows.
2. Income Statements. Use the nonrecurring events row to adjust for divesting a division or any other extraneous events in order for your firm's *Form 10K* revenues, cost of goods sold, operating expenses, and net income to match perfectly with the template statement. If having an issue with EBIT perfectly matching the *Form 10K*, simply subtract EBIT from Gross Profit on the *Form 10K* and enter this number for Operating Expenses. This procedure will ensure your template EBIT matches the EBIT from your firm's *Form 10K* because sometimes the Operating Expenses line is difficult to transfer over perfectly; it is okay if your template Operating Expenses do not perfectly match the *Form 10K* as long as EBIT does. Net income is automatically calculated from your other income statement forecasts, so the net income row is not forecasted.
3. Retained Earnings (RE) Row. The RE row on the template projected balance sheets is automatically calculated because the RE row is determined by carrying over the net income less dividends annually from the income statement to the RE row near the bottom of the balance sheet.
4. Balance Sheets. Work row-by-row from the bottom to the top making changes as needed to reflect the impact of your recommendations on each row. Leave forecasted items and rows the same as the prior year if you expect no change in that row given your recommendations. The template has a note to the right of each row to aid in how to enter the numbers. Get the total liabilities plus stockholders' equity number, then transfer that number to the total assets row, and then move further upward towards the cash row forecasting each item/row given your recommendations.
5. Cash. The template uses the balance sheet cash row as a plug figure to make the projected balance sheet balance, so this row is automatically calculated. Often the cash figure will be abnormally high after forecasting all other rows; in this situation make appropriate adjustments in the liability or equity sections, usually using the long-term-debt or paid-in-capital rows, to offset the amount you increase or decrease the cash row to keep liquidity in line with industry averages. Making adjustments, even to other items on the balance sheet, is good practice and routinely done by all accountants, so do not feel you are cheating the system until you get the numbers reasonable. Projected statements are a good-faith estimate, and a high cash figure only indicates other estimates need to be reconsidered. Also, check for typos or miscalculations on both the projected income statement and balance sheet. For example, it is possible you are over- or underestimating the 1) revenue impacts of your recommendations or 2) the amount of capital you need to implement your recommendations. Also, experiment with adjusting the historical percentages on both asset and liability items such as accounts payable or accounts receivable; it is possible the historical number needs to be increased on asset line items or decreased on liability items if the firm is operating more efficiently, and the result will bring cash down. Also, double check plant property and equipment because a high cash figure may indicate you are underestimating how much these assets will cost. Once you make one change, revaluate the cash figure on the new projected balance sheet and continue until you find the cash number reasonable. Accountants do this all the time, striving for excellent, reasonable, truthful projected statements. Ethics Capsule 8 and Global Capsule 8 address the truthfulness or reasonableness aspect of projected financial statements.
6. Financial Ratios. The template will automatically calculate actual and forecasted financial ratios once income statement and balance sheet data are entered. When compared to prior years and industry averages, financial ratios provide valuable insights for implementing strategies. (Financial ratios were discussed in Chapter 4.)

ETHICS CAPSULE 8

Projected Financial Statement Manipulation

Casper1774 Studio/Shutterstock

How Realistic Are These Numbers?

Investors, shareholders, and others need to know that top executives can legally manipulate financial statements to inflate or deflate expected results, and they often do. Firms may inflate or present an overly rosy picture of projected financial statements to garner support from a wide range of constituencies for a variety of reasons. But you may wonder why would executives present a deflated or unfavorable picture of the future? Reasons to deflate include (1) to discourage potential acquirers or (2) to load bad financial information into a particular accounting period so that periods beyond will look better. In the famous book *Financial Shenanigans* (2002) by Dr. Howard Schilit, five ways are discussed in which top executives manipulate financial statements, as follows:

1. Record revenue prematurely.
2. Record fictitious revenue.
3. Increase net income with one-time gains.
4. Shift current expenses to an earlier or later period.
5. Failure to record certain liabilities.

The Securities and Exchange Commission (SEC) has taken steps to curtail projected financial statement manipulation, but this remains an ethical issue in corporate America (and globally).

Source: https://www.investopedia.com/articles/fundamental-analysis/financial-statement-manipulation.asp, Also, http://www.understand-accounting.net/TheReliabilityandAccuracyoffinancialstatements.html

GLOBAL CAPSULE 8

The Least (and Most) Corrupt Countries in the World for Doing Business

Ruslan Olinchuk/123RF

New Zealand Is a Winner

As a part of its Global Coalition Against Corruption, Transparency International publishes annual corruption-perception indices that rank countries according to their relative corruption levels. The 2016 corruption-perception scores averaged 43, and more than two-thirds of the 176 included countries fell below the midpoint of 50 (0 = very corrupt; unethical; 100 = very clean; ethical). Highly ranked countries avoid the most obvious forms of corruption that negatively impact the daily lives of its citizens; whereas, lower-ranked countries are plagued by corruption because laws are frequently ignored and citizens often face bribery, extortion, or other corrupt experiences. Table 8-5 shows the rankings of the top 20 (least corrupt) countries, as well as the bottom 10 (most corrupt) countries.

TABLE 8-5 Corruption-Perception Indices (2016)

2016 Rank	Country	2016 Score
1	Denmark	90
1	New Zealand	90
3	Finland	89
4	Sweden	88
5	Switzerland	86
6	Norway	85
7	Singapore	84
8	Netherlands	83
9	Canada	82
10	Germany	81
10	Luxembourg	81
10	United Kingdom	81
13	Australia	79
14	Iceland	78
15	Belgium	77
15	Hong Kong	77
17	Austria	75
18	United States	74
19	Ireland	73
20	Japan	72
166	Venezuela	17
168	Guinea-Bissau	16
169	Afghanistan	15
170	Libya	14
170	Sudan	14
170	Yemen	14
173	Syria	13
174	Korea (North)	12
175	South Sudan	11
176	Somalia	10

Source: Based on information at https://www.transparency.org/news/feature/corruption_perceptions_index_2016

Steps to Develop Projected Financial Statements

Whether you use the free, Excel strategic-planning template, projected financial statement analysis can be explained in seven steps:

Step 1. Prepare the projected income statement before the balance sheet. Start by forecasting sales (revenues) as accurately as possible to reveal the expected impact of recommendations being implemented. In forecasting revenues, do not blindly push historical revenue growth percentages into the future without considering ventures the firm undertook in prior years to achieve those results. What a firm did previously to achieve those past sales increases may or may not be appropriate for the future, depending on whether your recommendations take similar or analogous actions (e.g., such as opening a similar number of stores). If dealing with a manufacturing firm, also be mindful that if the firm is operating at 100 percent capacity running three 8-hour shifts per day, then probably new manufacturing facilities (land, plant, and equipment) will be needed to increase sales further.

Step 2. Use the percentage-of-sales method to project cost of goods sold (COGS) and the Operating Expenses in the income statement. For example, if COGS is 50 percent of sales in the prior year (as it is in Table 8-5), then use a similar percentage to calculate COGS 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.

Step 3. Calculate the projected net income (NI).

Step 4. Subtract from the NI any dividends to be paid. The remaining NI is retained earnings (RE). Bring the RE amount over to the balance sheet by adding it to the prior year's RE amount on the balance sheet. In other words, every year, a firm adds its RE (which is NI – Dividends for that particular year) 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; it is a cumulative number of dollars reinvested into the company over many years; it is *not* cash in the bank; it can be a low or even negative number if the firm has been incurring losses or paying dividends that exceed NI. In fact, the most common ways 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 NI for the year but paid out dividends in excess of the net income. Be mindful that RE is the key link between a projected income statement and projected balance sheet, so be careful to make this calculation correctly.

Step 5. Project the balance sheet items working from the bottom to the top; begin with the RE row; if using the template, the RE number is calculated automatically based on the amount of dividends paid; then forecast the remaining equity items, followed by forecasting the long-term liabilities, current liabilities, long-term assets, and current assets (in that order), working from the bottom to the top.

Step 6. Use cash as the plug figure—that is, project every line item on the projected balance except cash (and RE); use the cash account to make the assets equal to the sum of the liabilities and shareholders' equity. Then make appropriate adjustments. For example, if the cash needed to balance the statements is too small (or too large), considering making appropriate changes to borrow more (or less) money than planned and reevaluate line items such as inventory, accounts receivable, plant property and equipment and/or other asset lines. For example, if cash is too high, (1) consider paying off some long-term debt; (2) reevaluate the projected percentage increase of various liabilities because it is possible the firm may be operating more efficiently or have greater economies of scale, or (3) increase your treasury stock. Rarely is the cash account number perfect on the first pass-through, so adjustments are needed and made.

Step 7. List commentary or notes below the projected statements to clarify for the reader why significant changes were made on particular items or rows in one year versus the next. Notes are essential for a reader to understand the changes made on certain rows. The template does not prepare notes because notes reflect your thinking regarding the impact of your recommendations and your associated costs.

Nonprofit Organizations

The steps outlined for preparing projected financial statements apply equally to nonprofit organizations; prepare the projected income statements first then the projected balance sheets. Since nonprofits never pay dividends, simply add the nonprofit's net income (usually called Net Assets) to their balance sheet retained earnings row (usually called Net Assets). If the cash account is too high or too low, just make adjustments as needed to the nonprofit's assets or liabilities sections of the balance sheets, since there is no equity section (except for Net Assets). So, the projected financial statement steps/process (and template steps/process) is equally applicable for both for-profit firms and nonprofit organizations. Of course, taxes paid by nonprofits is zero, and there is zero paid-in-capital, treasury stock, and common stock.

P&G's Actual Financial Statements

To further explain projected financial statement analysis, let's work through an actual example for P&G. P&G's actual income statement and balance sheets for 2016 and 2017 are given in Table 8- 6 and Table 8-7, respectively. Notice that P&G's actual *Form 10K* statements are converted or condensed into the "template format." (Note: About 95% percent of all strategic-management students using this textbook, as well as thousands of corporate practitioners, use this template for doing strategic planning and developing projected financial statements; if you use it put on your resume that you "gained experience using strategic-planning software.")

Notice in Tables 8-6 and 8-7 that P&G's actual *Form 10K* revenues declined in 2017 and their current ratio (current assets divided by current liabilities) was less than 1.0. Thus, let's propose that P&G go forward with the following four recommendations with associated costs and comments; then we follow the impact of the costs on the firm's projected financial statements:

1. Five new plants will be built in each of the three forecasted years (2018, 2019, 2020) at $250 million each ($1,250 million per year attributed to plant, property, and equipment) with adjustments to long-term debt and paid in capital, as described in # 4 below.
2. Raise an additional $1,250 million to finance research and development (R&D) and new advertising. The total amount of capital being raised is $5 billion.

TABLE 8-6 P&G's Actual Income Statements for 2016–2017 (in millions)

Income Statement	6/30/16	6/30/17		Percent Change
Revenues	$65,299	$65,058		−0.37%
Cost of Goods Sold	32,909	32,535		−1.14%
Gross Profit	32,390	32,523		0.41%
Operating Expenses	18,442	18,801		1.95%
EBIT	13,948	13,722		−1.62%
Interest Expense	579	465		−19.69%
EBT	13,369	13,257		−0.84%
Tax	3,342	3,063		−8.35%
Non-Recurring Events	481	5,132		966.94%
Net Income	10,508	15,326		45.85%

TABLE 8-7 P&G's Actual Balance Sheets for Fiscal 2016 and 2017 (in millions)

Balance Sheet	6/30/16	6/30/17		Percent Change
Assets				
Cash and Equivalents	$7,102	$5,569	⇩	−22%
Accounts Receivable	5,880	4,594	⇩	−22%
Inventory	4,716	4,624	⇩	−2%
Other Current Assets	16,084	11,707	⇩	−27%
Total Current Assets	33,782	26,494	⇩	−22%
Property Plant & Equipment	19,385	19,893	⇧	3%
Goodwill	44,350	44,699	⇧	1%
Intangibles	24,527	24,187	⇩	−1%
Other Long-Term Assets	5,092	5,133	⇧	1%
Total Assets	**127,136**	**120,406**	⇩	**−5%**
Liabilities				
Accounts Payable	16,774	16,656	⇩	−1%
Other Current Liabilities	13,996	13,554	⇩	−3%
Total Current Liabilities	30,770	30,210	⇩	−2%
Long-Term Debt	18,945	18,038	⇩	−5%
Other Long-Term Liabilities	19,438	16,380	⇩	−16%
Total Liabilities	69,153	64,628	⇩	−7%
Equity				
Common Stock	4,009	4,009	⇨	0%
Retained Earnings	87,953	96,124	⇧	9%
Treasury Stock	(82,176)	(93,715)	⇧	14%
Paid in Capital & Other	48,197	49,360	⇧	2%
Total Equity	57,983	55,778	⇩	−4%
Total Liabilities and Equity	**$127,136**	**$120,406**	⇩	−5%

3. Increase dividends by 1 percent in each of the 3 forecasted years (these funds are derived from net income so no need to raise additional capital for them).
4. Forty percent of the capital needed will be financed through debt ($2,000 million) in projected year 2018 and 60 percent ($3,000) through equity in projected year 2019. Note $2,000 + $3,000 = $5,000, which is the total cost of recommendations not considering dividends.

Note on P&G's actual income statements in Table 8-6 the large increase in nonrecurring events in 2017; this change was because of the company divesting various businesses to streamline the firm and better align its activities with its mission. Divestitures explain much of the large increase in P&G net income for fiscal 2017 and the large increase in retained earnings on the balance sheet. Without further similar divestitures moving forward, net income will decline the following year, whereas revenues actually increase. This example illustrates the importance of studying the *Annual Report* to determine what likely caused the changes in the current financial statements; then carefully consider how your recommendations will impact the projected statements. Simply pushing forward historical numbers on every line item is a common mistake in projected financial statement development.

Note on P&G's actual balance sheets in Table 8-7 the $11.5 billion increase in treasury stock from 2016 to 2017, indicating substantial stock buybacks by P&G. Lately, many companies have been aggressively buying their own stock, reflecting optimism about their future. However, some analysts argue that stock buybacks eat cash that a firm could better use to grow the firm. Stock buybacks do however reduce a firm's number of shares outstanding, thus increasing EPS; so firms reap this "intangible benefit" with stock buybacks. Sometimes firms will even increase their Treasury Stock near the end of the quarter, or near the end of the year, to "artificially" inflate their EPS to meet/beat EPS projections to perhaps avoid a stock price decline. This may be why Home Depot, in 2017–2018, bought back \$15 billion of its stock, Honeywell bought \$8 billion of its shares, Bank of America bought back \$17 billion in stock, Mastercard repurchased \$4 billion of its common shares, and T-Mobile began a \$1.5 billion buyback.

Note on P&G's actual balance sheets in Table 8-7 that more than 50 percent of total assets are in the form of **goodwill** and intangibles; some financial experts suggest these items to be simply "smoke" because they are not physical assets that can easily be transferred into cash. P&G's history of acquiring firms for over book value (market capitalization value) is the reason for the firm's large goodwill values.

P&G's Projected Financial Statements

Table 8-8 and Table 8-9 reveal P&G's projected income statements and balance sheets, respectively, given the four recommendations with associated costs listed previously and the annual retained earnings carried forward to the projected balance sheet. Note, on the projected income statement in Table 8-8 both projected revenues and net income are increasing, but projected net income is down significantly from the prior year, largely because (as mentioned) there are no major divestitures (recorded as nonrecurring events on the income statement) in any projected years.

TABLE 8-8 P&G's Projected Income Statements for 2018, 2019, and 2020 (in millions)

Projected Income Statement	6/30/18	6/30/19	6/30/20
Revenues	\$66,359	\$68,350	\$72,451
Cost of Goods Sold	33,180	34,175	36,225
Gross Profit	33,180	34,175	36,225
Operating Expenses	20,571	21,188	22,460
EBIT	12,608	12,986	13,766
Interest Expense	565	562	559
EBT	12,043	12,424	13,207
Tax	2,770	2,858	3,302
Non-Recurring Events	0	0	0
Net Income	\$9,273	\$9,567	\$9,905

TABLE 8-9 P&G's Projected Balanced Sheets for 2018, 2019, and 2020 (in millions)

Projected Balance Sheet	12/31/15	12/31/17	12/31/18
Assets			
Cash and Equivalents	\$3,015	\$7,409	\$9,552
Accounts Receivable	4,645	4,784	5,072
Inventory	4,645	4,784	5,072
Other Current Assets	11,945	12,303	13,041
Total Current Assets	24,250	29,281	32,736

(continued)

TABLE 8-9 (Continued)

Projected Balance Sheet	12/31/15	12/31/17	12/31/18
Property Plant & Equipment	21,143	22,393	23,643
Goodwill	44,699	44,699	44,699
Intangibles	24,187	24,187	24,187
Other Long-Term Assets	5,309	5,468	5,796
Total Assets	**119,588**	**126,028**	**131,061**
Liabilities			
Accounts Payable	15,926	16,404	17,388
Other Current Liabilities	11,281	11,619	12,317
Total Current Liabilities	27,207	28,023	29,705
Long-Term Debt	20,038	20,038	20,038
Other Long-Term Liabilities	14,599	15,037	15,939
Total Liabilities	61,844	63,098	65,682
Equity			
Common Stock	4,009	4,009	4,009
Retained Earnings	98,089	100,275	102,725
Treasury Stock	(93,715)	(93,715)	(93,715)
Paid in Capital & Other	49,360	52,360	52,360
Total Equity	57,743	62,929	65,379
Total Liabilities and Equity	**119,588**	**126,028**	**131,061**

Note on the projected balance sheets in Table 8-9, the increase in long-term debt from fiscal 2017 to fiscal projected 2018 indicating the proportion (40 percent) of debt financing based on the recommendations along with the increase in paid-in-capital from fiscal projected 2018 to fiscal projected 2019 representing the proportion (60 percent) of common stock financing per our recommendations. Table 8-10 provides author comments regarding the projected income statement and balance sheet changes to reveal rationales for various changes in the statements.

TABLE 8-10 Author Comments Regarding P&G's Financial Statements (in millions of USD)

Projected Income Statement	Comments	Fiscal 2018	Fiscal 2019	Fiscal 2020
Revenues	Revenues were flat from fiscal 2016 to fiscal 2017 partly due to significant divestitures and other nonrecurring events totaling more than $5 billion offsetting gains in revenues.	2% increase based on current operations and new revenues generated from increased advertising.	3% increase based on current operations and new revenues generated from increased advertising.	6% increase based on current operations and new revenues generated from increased advertising and from new plants providing new products to sell.
Cost of Goods Sold	Historically 50% of revenues	50%	50%	50%
Operating Expenses	Historically 29% of revenues adjusted to 31% to account for increased R&D expenditures and increased advertising	31%	31%	31%
Interest Expense	Financing $2,000 million by debt in fiscal 2018 at 5%. Slight interest deduction in fiscal 2019 and 2020 as debts are paid, but interest expense is much higher than in 2017 when P&G did not service this new debt.	$2,000 × 0.05 = $100	−$3	−$3

Projected Income Statement	Comments	Fiscal 2018	Fiscal 2019	Fiscal 2020
Tax	Tax rate remains constant at 23% until fiscal 2020 when increased revenues eventually move PG into higher tax brackets in some markets; some countries have higher tax rates than the 21% U.S. corporate rate.	23%	23%	25%
Nonrecurring Events	No selling of properties or any other major one year changes such as divestures	0	0	0

Projected Balance Sheet	Comments	Fiscal 2018	Fiscal 2019	Fiscal 2020
Cash	Cash is the plug figure used to balance the projected balance sheets and is calculated automatically with the template. No entry or estimations for cash are required whether using the template or performing by hand. Simply enter the number for Cash that creates balance where Total Assets = Total Liabilities + Owners Equity.			
Accounts Receivable	Historically 7% of revenue	7%	7%	7%
Inventory	Historically 7% of revenue	7%	7%	7%
Other Current Assets	Historically 18% of revenue	18%	18%	18%
Property Plant & Equipment	Adding five new plants per year at $250 million each. Note P&G will not see substantial revenue from the new plants until the plants are completed in fiscal 2020.	$1,250	$1,250	$1,250
Goodwill	No new acquisitions	0	0	0
Intangibles	No new patents	0	0	0
Other Long-Term Assets	Historically 8% of revenue	8%	8%	8%
Liabilities				
Accounts Payable	Historically 26% of revenue; forecasting firm operates more efficiently after restructuring over fiscal 2016 and 2017.	24%	24%	24%
Other Current Liabilities	Historically 21% of revenue; expecting firm to operate more efficiently after restructuring over fiscal 2016 and 2017.	17%	17%	17%
Long-Term Debt	Adjust fiscal 2018 to account for debt financing. No debt financing in either fiscal 2019 or 2020.	$2,000	0	0
Other Long-Term Liabilities	Historically 25% of revenue; expecting firm to operate more efficiently after restructuring over fiscal 2016 and 2017.	22%	22%	22%
Equity				
Common Stock	Function of par value when the stock was issued × shares outstanding. Keep at 0.	0	0	0
Treasury Stock	No stock buybacks recommended by firm.	0	0	0
Paid in Capital and Other	Financed $3,000 million through equity in fiscal year 2019	0	$3,000	0
Additional Retained Earnings	Net Income Current Year (or latest projected year) − current dividends to be paid = new *additional* retained earnings	$1,965	$2,186	$2,450
Total Dividends to Pay	Increase dividends by 1% each year	$7,308	$7,381	$7,455

P&G's Retained Earnings Data Table

As indicated in the prior pages, the key link between a projected income statement and balance sheet is the annual transfer of a firm's net income less dividends = retained earnings (RE) to the firm's balance sheet. In light of the importance of this transaction, a P&G RE data table given in Table 8-11 on page 284 shows specifically how this annual transfer of money is made.

TABLE 8-11 P&G's Retained Earnings Data Table (in millions)

Dividend Information			Balance Sheet Information		
	1	2	3	4	5
	Net Income	− Dividends Paid	= RE	+ Prior Year BSheet RE	= Current Year BSheet RE
2018	$ 9,273	$ 7,308	$ 1,965	$ 96,124	$ 98,089
2019	$ 9,567	$ 7,381	$ 2,186	$ 98,089	$ 100,275
2020	$ 9,905	$ 7,455	$ 2,450	$ 100,275	$ 102,725

LO 8.3

Corporate Valuation

Evaluating the worth of a business is central to strategy implementation because firms acquire other firms, divisions of other firms, or even divest part of their own firm. Thus, thousands of transactions occur each year in which businesses are bought or sold for some dollar amount in the United States and around the world. In fact, about $1.5 trillion in mergers are consummated in the United States annually. For example, CVS Healthcare is trying to buy Aetna Inc. and Walt Disney is trying to buy a segment of 21st Century Fox. In all such cases, it is necessary to establish the financial worth or cash value of a business to successfully implement strategies.

Corporate valuation is not an exact science; value is sometimes in the eye of the beholder. Companies desire to sell high and buy low, and negotiation normally takes place in both situations. The valuation of a firm's worth is based on financial facts, but common sense and good judgment enter into the process because 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 valuable patents—that may not be fully reflected in a firm's financial statements. Also, different valuation methods will yield different totals for a firm's worth. Evaluating the worth of a business truly requires both qualitative and quantitative skills.

With the recent merger and acquisition boom, S&P 500 firms experienced a 70 percent increase in goodwill from $1.7 trillion in 2007 to more than $3 trillion in 2017. For example, with the acquisition of SAB Miller, Anheuser-Busch InBev recently increased its goodwill to $141 billion, up from $65 billion just 18 months prior, currently accounting for over 50 percent of total assets. Sometimes it is OK to pay more for a company than its book value (market capitalization = number of shares outstanding × stock price) if the firm has technology or patents you need or economies of scale you desire, possibly to gain a better hold on distribution or even to reduce competitive pricing pressure, as in the Anheuser example. However, buying a company is like buying a house in that paying a "premium" (defined as the amount of money paid for an acquisition over the market capitalization amount) is usually not financially prudent.

In addition to preparing to buy or sell a business, corporate valuation analysis is often performed when dealing with the following finance and accounting issues: bank loans, tax calculations, retirement packages, death of a principal, partnership agreements, and IRS audits. Practically, it is just good business to know what your firm is worth. This knowledge protects the interests of all parties involved. To estimate the value of a division or segment of a firm, some analysts calculate the total corporate value and multiply that number by the percentage of revenues the division contributes to the firm.

Corporate Valuation Methods

There are numerous methods to determine the worth of a company, but four methods are most often used, as described:

METHOD 1 **The Net Worth Method** = Shareholders' Equity (SE) − (Goodwill + Intangibles)
Other terms for SE are Owners' Equity, Total Equity, or Net Worth, but this line item near the bottom of a balance sheet represents the sum of common stock, additional paid-in capital, retained earnings, treasury stock, and other equity items. After calculating total SE, subtract goodwill and intangibles if these items appear as assets on the firm's balance sheet. Whereas intangibles include copyrights, patents, and trademarks, **goodwill** arises when a firm acquires

TABLE 8-12 Company Worth Analysis for P&G (in millions)

The Input Data	
Shareholders' Equity	\$55,778
Net Income	\$15,326
Stock Price	\$94.17
EPS	\$6.01019
Number of Shares Outstanding	2,550
Goodwill	\$44,699
Intangibles	\$24,187
The Four Valuation Methods	
Stockholders' Equity − (Goodwill + Intangibles)	(\$13,108)
Net Income × 5	\$76,630
(Share Price/EPS) × Net Income	\$240,134
Number of Shares Outstanding × Share Price	\$240,134
Method Average	**\$135,947**

another firm and pays more than the book value for that firm. Note in Table 8-12 that P&G's goodwill + intangibles exceeds the firm's SE, resulting in a negative valuation. As a result, Method 1 is not likely a good indicator of P&G's market value; however it should raise concern for shareholders, managers, and potential firms looking to acquire P&G that most of the firm's assets are intangible in nature.

METHOD 2 **The Net Income Method** = Net Income × Five

The second approach for measuring the monetary value of a company 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 5-year average profit level could also be used. When using this approach, remember that firms may suppress earnings in their financial statements to minimize taxes. Note in Table 8-12 that Method 2 results in a low corporate valuation. If you were acquiring a business, this might be a good first offer, but likely Method 2 does not produce a value you would want to begin with if you are selling your business. If a firm's net income is negative, theoretically Method 2 would imply that the firm would pay you to acquire them. Of course, when you acquire another firm, you obtain all of the firm's debt and liabilities, so theoretically this would be possible. In general, this method is more feasible for small business evaluation.

METHOD 3 **Price-Earnings Ratio Method** = (Stock Price ÷ EPS) × NI

To use the **price-earnings ratio method**, divide the market price of the firm's common stock by the annual EPS and multiply this number by the firm's average net income for the past 5 years. Notice in Table 8-12 this method yields an answer the same as Method 4. Algebraically, this method is identical to Method 4, if earnings and number of shares figures are taken at the same point in time. In Table 8-12, P&G's actual fiscal year-end 2017 net income was used as opposed to a 5-year average.

METHOD 4 **Outstanding Shares Method** = Number of Shares Outstanding × Stock Price

To use the **outstanding shares method**, simply multiply the number of shares outstanding by the market price per share. If the purchase price is higher than this amount, the additional dollars are called a **premium**. The outstanding shares method may also 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. If you pay less for a firm than the market cap number, the difference is called a **discount**.

The owner of *Better Home & Gardens*, Meredith Corp., recently paid a 46 percent premium dollar amount of \$1.85 billion to acquire Time Inc. Meredith is based in Des Moines, Iowa. Time Inc. owns *Fortune, People*, and *Sports Illustrated*.

TABLE 8-13 The Top 20 College Football Programs in Terms of Monetary Value (in millions of $)

Rank	University	Value ($)
1	Ohio State	1,511
2	Texas	1,243
3	Oklahoma	1,002
4	Alabama, SEC	930
5	LSU, SEC	911
6	Michigan	893
7	Notre Dame	857
8	Georgia, SEC	822
9	Tennessee, SEC	756
10	Auburn, SEC	724
11	Florida, SEC	682
12	Penn State	550
13	Texas A&M, SEC	523
14	Nebraska	508
15	South Carolina, SEC	484
16	Iowa	484
17	Arkansas, SEC	456
18	Wisconsin	439
19	Washington	434
20	Florida State	385

Source: Based on information from the *Wall Street Journal*, September 23, 2017, and www.sportingnews.com, and other sources.

A corporate valuation analysis by researcher Ryan Brewer was recently reported by several media outlets to reveal the monetary value of the top 20 college football programs. A summary of the resultant numbers is provided in Table 8-13; the numbers may have been derived by discounting future revenue streams back to the present to obtain a present value; this is another corporate valuation method sometimes used. Note in Table 8-13 that the Southeastern Conference (SEC) leads all conferences with 9 of the top 20 most valuable teams.

LO 8.4

Manage Financial Ratios, IPOs, and Bonds

Financial Ratio Analyses

Introduced in Chapter 4, financial ratios are an important tool used to access a firm's financial situation at one point in time. Financial ratios are examined based on (1) how they change over time, (2) how they compare to industry norms, and (3) how they compare with key competitors. Financial ratios based on actual financial statements reveal strengths and weaknesses of the firm; ratios based on projected financial statements reveal potential problems and successes likely to occur if a particular set of recommendations is implemented. For example, if a current ratio skyrockets or plummets versus industry averages, then cash (and other short-term assets) must be managed.

Continuing with our P&G example, Tables 8-14 and 8-15, respectively, reveal the company's actual (historical) and projected financial ratios, both calculated using the template. Comparing the actual to the projected leverage and activity ratios do not indicate any serious abnormalities or changes, suggesting the four recommendations to be implemented indeed are feasible and doable. Note a significant drop in P&G's return on equity (ROE) and return on assets (ROA) ratios from 2017 in the projected years because P&G's divestitures ceased in 2017–2020. It is important to note, the projected ratios for P&G in Table 8-15 were not derived on the first attempt at creating

TABLE 8-14 P&G's Actual Financial Ratios

	Historical Ratios	
	6/30/16	6/30/17
Current Ratio	1.10	0.88
Quick Ratio	0.94	0.72
Total Debt-to-Total-Assets Ratio	0.54	0.54
Total Debt-to-Equity Ratio	1.19	1.16
Times-Interest-Earned Ratio	24	30
Inventor/Turnover	6.98	7.04
Fixed Assets Turnover	3.37	3.27
Total Assets Turnover	0.51	0.54
Accounts Receivable Turnover	11	14
Average Collection Period	32.87	25.77
Gross Profit Margin %	50%	50%
Operating Profit Margin %	21%	21%
ROA %	8%	13%
ROE %	18%	27%

Note: These are actual P&G financial ratios computed by the template based on actual P&G financial statements

TABLE 8-15 P&G's Projected Financial Ratios

	Projected Ratios		
	6/30/18	6/30/19	6/30/20
Current Ratio	0.89	1.04	1.10
Quick Ratio	0.71	0.86	0.91
Debt-to-Total-Assets Ratio	0.52	0.50	0.50
Debt-to-Equity Ratio	1.07	1.00	1.00
Times-Interest-Earned Ratio	22	23	25
Inventory Turnover	6.71	6.46	6.40
Fixed Assets Turnover	3.14	3.05	3.06
Total Assets Turnover	0.55	0.54	0.55
Accounts Receivable Turnover	14	14	14
Average Collection Period	25.55	25.55	25.55
Gross Profit Margin %	50%	50%	50%
Operating Profit Margin %	19%	19%	19%
ROA %	8%	8%	8%
ROE %	16%	15%	15%

Note: These are projected P&G financial ratios computed by the template based on P&G projected financial statements

projected income statements and projected balance sheets. They are the result of several different interactions and adjustments to the projected statements before the projected ratios were reasonable. Take care to make adjustments as needed to your respective projected statements as well to produce both feasible projected statements and the resulting projecting ratios.

Go Public with an IPO?

Hundreds of companies annually hold **initial public offerings (IPOs)** to move from being private to being public. "Going public" means selling off a percentage of a company to others to raise capital; this action 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 less than $1 million; $1 in $20 will go to cover these costs for issuances more than $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. The new equity capital derived from going public can enable firms to develop new products, build plants, remodel stores, enter foreign countries, and market products and services more aggressively. Blue Apron, a meal-kit home-delivery firm, recently cut its IPO price from $17 to $10 after Amazon acquired Whole Foods Market.

The year 2017 witnessed about 1,600 IPOs globally, more than any year in a decade, according to Dealogic data. There were 950 IPOs the prior year.

Issue Bonds to Raise Capital?

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. On a balance sheet, bonds are included in the long-term debt row. Especially when a company's balance sheet is strong and its credit rating excellent, issuing bonds can be an effective way to raise needed capital. Corporate bond prices are less sensitive to daily or quarterly firm operations compared to stock prices. For example, an expected equity price forecasted to finance potential recommended strategies may be significantly higher or lower than forecasted, but bond prices and rates will be more in line with the forecast based on unforeseen events such as CEO succession, new competitor emerging, bad earnings surprise, and other factors. Smaller firms or firms with negative earnings will also likely have higher rates associated with their bonds, possibly resulting in issuing bonds (debt) to be a more expensive alternative than equity. Bonds are also used because sometimes banks do not want to lend money for long periods of time to fund business operations.

The year 2017 was the seventh straight year that a record dollar value of bonds was sold in the United States, totaling more than $1.5 trillion. A large recent transaction was Anheuser-Busch InBev's $46 billion bond issuance to purchase SAB Miller. Firms issue bonds to (1) finance acquisitions, (2) buy back their own stock (called *treasury stock*), (3) refinance old debt, and (4) raise cash to finance strategic initiatives. With the Federal Reserve in the United States slowly raising rates, bond issuances may level off.

The practice of firms issuing bonds to buy back their own stock and to pay cash dividends to shareholders has become a concern in terms of being financially prudent. A strategic decision facing corporations therefore, is whether to issue bonds to raise capital to pacify shareholders with cash dividends and purchase company stock, or to issue bonds to finance strategies carefully formulated to yield greater revenues and profits.

IMPLICATIONS FOR STRATEGISTS

Figure 8-3 reveals that to gain and sustain competitive advantages, firms must manage their finances more efficiently than rival firms, by using tools like EPS/EBIT analysis, projected financial statement analysis, and corporate valuation analysis, as described herein. As you know, it is difficult to make a dollar of profit; every dollar saved is like a dollar earned. Dollars matter and successful strategy implementation is dependent on superior "dollar management." The concepts, tools, and techniques presented in this chapter can make the difference between success and failure in implementing strategies in many companies and organizations.

Many firms are giving employees bonuses, such as Erie Insurance Group, as a result of the new 2018 corporate tax of 21 percent. Companies are paying more in dividends too. From January 1 to March 1 2018, not a single S&P 500 company cut their dividend payout amounts, the first time this has happened since 2011. And the average increase in dividends over that time period was 14 percent, the largest increase since 2014. Companies are basically sharing their huge corporate tax cuts with shareholders, some sharing more than others. Cisco Systems in 2018 repatriated (brought back to the U.S.) $67 billion in cash held overseas. Cisco plans to use $44 billion of that cash to pay shareholder dividends and repurchase shares of its own stock. Apple reports that it is bringing most of its $252.3 billion in foreign cash back to the U.S. and adding 20,000 new jobs in the U.S. In contrast, Microsoft, Alphabet Inc., and Amazon.com plan to keep their overseas cash overseas.

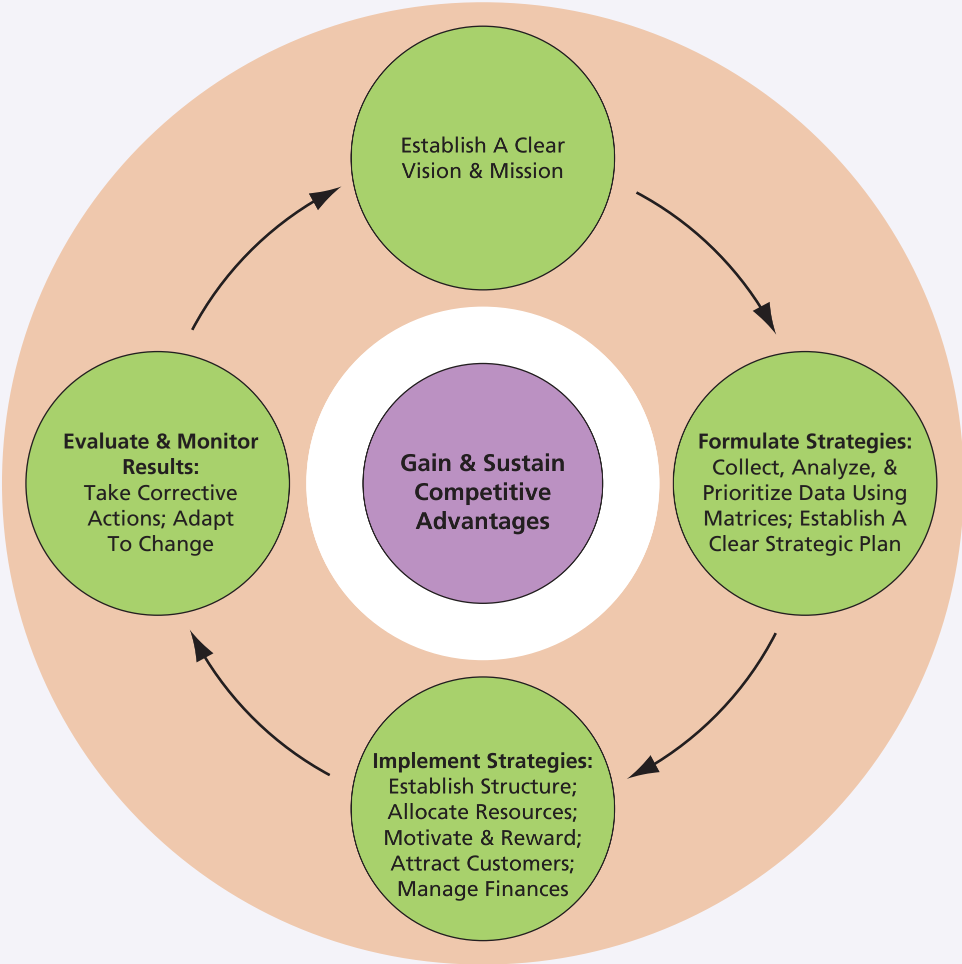

FIGURE 8-3
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

A personal note from the authors to students; we are exceptionally proud of you for mastering this chapter. At student international case competitions, we have witnessed numerous teams of students win case competitions largely because they are able to demonstrate that their recommendations are financially feasible and reasonable and will lead to excellent financial returns for the firm. We know this chapter is a bit tough but hopefully you find it to be concise, accurate, and easy to follow. Mastering the skills conveyed in this chapter will provide you a competitive advantage over other students and provide you a financial knowledge base to use in your business career and personal lives.

Whenever the opportunity arises in your oral or written project, reveal how your firm can gain and sustain competitive advantage using the finance and accounting concepts and analyses presented in this chapter. 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 analysis, projected financial statement analysis, or corporate valuation 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 as needed, so fellow students (and your professor) will be assured the analyses are correct and reasonable. Too often, when students rush at the end of an oral presentation, it means their financial statements are nonexistent or incorrectly developed—so avoid that issue. Use the free Excel strategic planning template at www.strategyclub.com and consider putting on your resume that you have "Gained experience using strategic-planning software."

Chapter Summary

Finance and accounting managers must devise effective strategy-implementation approaches at low cost and minimum risk to the firm. The nature and role of finance and accounting activities, coupled with the management and marketing activities described in the prior chapter, largely determine organizational success. An excellent capital structure can be a competitive advantage; EPS/EBIT analysis is needed to make capital structure decisions. Projected financial statements are vital for anticipating the impact of various recommendations. Corporate valuation methods are used all the time to acquire, merge, divest, and manage a firm's finances. Together these finance concepts, tools, and techniques can help assure effective and efficient strategy implementation.

Key Terms and Concepts

book value (p. 285)
capital structure (p. 271)
discount (p. 285)
EPS/EBIT analysis (p. 272)
goodwill (p. 281)
initial public offering (IPO) (p. 287)
market capitalization (p. 285)
market value (p. 285)
outstanding shares method (p. 285)
premium (p. 285)
price-earnings ratio method (p. 285)
projected financial statement (p. 275)
treasury stock (p. 271)

Issues for Review and Discussion

8-1. True or False? Acquisition premiums the last few years have averaged 25 to 40 percent, but sometimes exceed 100 percent; prior research suggests that high premiums generally have negative impacts on acquisition performance. Explain.

8-2. Explain why increasing treasury stock will increase EPS in any corporation.

8-3. Some analysts say that huge New York Stock Exchange IPOs from companies such as Alibaba, headquartered in China, should be illegal in the United States because under communist governments there are not sufficient safeguards in place for financial transactions. Do you agree or disagree? Why?

8-4. True or False? In the United States, no federal laws prevent businesses from using GPS devices to monitor employees, nor does federal law require businesses to disclose to employees whether they are using such techniques. What are the implications for employees and companies?

8-5. To raise capital, what are the pros and cons of selling bonds compared to issuing stock or borrowing money from a bank?

8-6. Many companies are aggressively buying their own stock. What are situations when this practice is recommended or especially beneficial? What are the pros and cons of increasing treasury stock on the balance sheet?

8-7. Hewlett-Packard has more goodwill ($) than the book value ($) of the firm. Explain what this means, how it could occur, and what can be done about this situation.

8-8. Give a hypothetical example where Company A buys Company B for a 15 percent premium.

8-9. Give a hypothetical example where Company A buys Company B for a 15 percent discount.

8-10. What is treasury stock? When should a company purchase treasury stock?

8-11. What is an IPO? When is an IPO good for a company? Why did Dropbox in 2018 use an IPO? Was that a wise strategic move? Why?

8-12. Generally speaking, how large should a firm be to justify having an IPO? Explain the IPO process.

8-13. How could or 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?

8-14. In performing an EPS/EBIT analysis, where do the first-row (EBIT) numbers come from?

8-15. In performing an EPS/EBIT analysis, where does the tax rate percentage come from?

8-16. 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?

8-17. 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?

8-18. Explain four methods often used to calculate the total worth of a business.

8-19. Explain how and why top executives can and do, on occasion, legally manipulate financial statements to inflate or deflate expected results.

8-20. Explain why EPS/EBIT analysis is a central strategy-implementation technique.

8-21. Identify and discuss the limitations of EPS/EBIT analysis.

8-22. True or False? Retained earnings on the balance sheet are not monies available to finance strategy implementation. Explain.

8-23. Explain why projected financial statement analysis is considered both a strategy-formulation and a strategy-implementation tool.

8-24. Complete the following EPS/EBIT analysis for a company whose stock price is $20, interest rate on funds is 5 percent, tax rate is 20 percent, number of shares outstanding is 500 million, and EBIT range is $100 million to $300 million. The firm needs to raise $200 million in capital. Use the following table to complete the work.

	100% Common Stock	100% Debt Financing	20% Debt–80% Stock Financing
EBIT			
Interest			
EBT			
Taxes			
EAT			
#Shares			
EPS			

8-25. Under what conditions would retained earnings on the balance sheet decrease from one year to the next?

8-26. In your own words, list all the steps in developing projected financial statements.

8-27. Based on the financial statements provided for Coca-Cola (p. 292), how much dividends in dollars did Coca-Cola pay in 2016? In 2017?

8-28. Why should you be careful not to use historical percentages blindly in developing projected financial statements?

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 8A

Perform an EPS/EBIT Analysis for Coca-Cola

Purpose

An EPS/EBIT analysis is one of the most widely used techniques for determining the extent that debt or stock should be used to finance strategies to be implemented. This exercise can give you practice performing EPS/EBIT analysis.

Instructions

Amount Coca-Cola needs: $5,000 million to build four new manufacturing plants outside the United States

Interest rate: 5%
Tax rate: 21%
Stock price: $45.54 as of January 2, 2018
Number of shares outstanding: 4,255 million
EBIT: Pessimistic: $7,000 million, Realistic: $9,000 million, Optimistic: $11,000 million

Steps

1. Prepare an EPS/EBIT analysis for Coca-Cola. Determine whether the company should use all debt, all stock, or a 50-50 combination of debt and stock to finance this market-development strategy.
2. Develop an EPS/EBIT chart after completing the EPS/EBIT table.
3. Next, give a three-sentence recommendation for Coca-Cola's CFO.

EXERCISE 8B

Prepare Projected Financial Statements for Coca-Cola

Purpose

This exercise is designed to give you experience preparing projected financial statements. This analysis is a strategic finance and accounting issue 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 projected income statement and balance sheet for Coca-Cola. Use the template if possible. Assume that Coca-Cola needs to raise $1 billion to increase its market share, 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.

Step 2 Bring your projected statements to class and discuss any problems or questions you encountered.

Step 3 Compare your projected statements to the statements of other students. What major differences exist between your analysis and the work of other students?

EXERCISE 8C

Determine the Cash Value of Coca-Cola

Purpose

It is simply good business to continually know the cash value (corporate valuation) of your company. This exercise gives you practice in determining the total worth of a company using several methods. To perform this analysis, use Coca-Cola's financial statements as given in the Cohesion Case.

Instructions

Step 1 Calculate the financial worth of Coca-Cola based on four approaches: (1) the net worth method, (2) the net income method, (3) the price-earnings ratio method, and (4) the outstanding shares method.

Step 2 Get an average of the four methods. In a dollar amount, how much is Coca-Cola worth?

Step 3 Compare your analyses and conclusions with those of other students.

EXERCISE 8D

Prepare Projected Financial Ratios for Coca-Cola

Purpose

Financial ratios are vastly more than just an exercise for students to perform. If any firm's financial ratios get out of line with industry average or decline over time, investors can withdraw support literally overnight. Projected financial ratios are an excellent means for anticipating financial results so as to avoid overnight calamities. The template will generate projected financial ratios after you convert your firm's financial statements to the template format and then develop projected financial statements based on recommended strategies.

Step 1 Review the results of your EXERCISE 8B

Step 2 Compute Coca-Cola's projected current ratio, debt-to-equity ratio, and return-on-investment ratio. How do your projected ratios compare to prior year ratios? Why is it important to make this comparison?

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 8E

Determine the Cash Value of My University

Purpose

It is simply good business to continually know the cash value (corporate valuation) of any organization, including colleges and universities. The four largest private universities in the United States by on-campus number of undergraduate students (in parentheses) are as follows: Brigham Young University (30,500), New York University (28,500), University of Southern California (19,000), and Northeastern University (17,500). This exercise gives you practice in determining the total worth of an organization using two methods.

Instructions

Step 1 Locate your university's most recent income statement and balance sheet.

Step 2 Calculate the financial worth of your university based on two approaches: (1) the net worth method and (2) the net income method.

Step 3 Get an average of the two methods. In a dollar amount, how much is your university worth?

Step 4 Compare your analyses and conclusions with those of other students.

SET 3: STRATEGIC PLANNING TO ENHANCE MY EMPLOYABILITY

EXERCISE 8F

Developing Personal Financial Statements

Purpose

Banks require individuals to develop personal financial statements whenever a mortgage or loan is requested. Managing your personal finances is important before and after you begin working full-time. This exercise gives you a heads up on the process of developing an income statement and balance sheet for yourself.

Instructions

Step 1 Develop an income statement and balance sheet for yourself using the free Excel template at www.strategyclub.com. Follow the steps outlined in this chapter.

Step 2 Determine your net worth = your total assets minus your total liabilities.

Step 3 Explain why managing personal finances is important to enhance your employability.

EXERCISE 8G

A Template Competency Test

Purpose

The free Excel strategic planning template at www.strategyclub.com is widely used for strategic planning by students and small businesses; this exercise aims to enhance your familiarity with the template. Developing competence with the template will enable you to place this skill appropriately on your resume, in addition to facilitating your development of a comprehensive strategic plan for an assigned case company.

Instructions

Answer the following questions about the template. Discuss your answers with classmates to determine any issues or concerns.

1. Why is it important to take the time to enter your financial statements into the template format rather than simply copying and pasting financial statements off line with respect to the template?
2. Does this chapter focus on Part I or Part II of the template?
3. If the EPS ranges for equity and debt for a given level of EBIT are identical, what change in the analysis would likely provide the most variance: (1) Adjusting the amount of capital needed by 25%, (2) increasing the interest rate by 1% (100 basis points), or (3) increasing the tax rate by 5% (500 basis points)? Why?

4. Which of the following methods will never maximize EPS? (1) 100% equity financing, (2) 100% debt financing, or (3) combination financing? Why?
5. Explain how analyzing projected financial ratios generated by the template can be helpful in making adjustments to your projected financial statement estimates?
6. Do you physically have to calculate any number on the projected statements when using the template?
7. The template assures your projected balance sheets are in balance every time by using what line item to achieve the balancing?
8. If you notice your current ratio went from a historical 1.0 to a projected 5.0, what are some steps you should consider taking?
9. When entering treasury stock on the template, why do you enter a negative number?
10. If you desire to quit paying dividends in projected years, what entry is needed for the template to make this calculation?
11. If current plant property and equipment were $500 million and you wish to increase plant property and equipment by $50 million in the first fiscal year, what number would you enter into Part II of the template by plant property equipment under the first projected fiscal year?
12. If you sold $100 million of common stock, what line item on the projected balance sheet on Part II of the template would you make this entry?
13. Just to the right of each line item on PART II of the projected income statement and projected balance sheet, the template provides what type of hint?
14. Why should a student enter into the template their existing and projected financial data, from oldest year to most recent year, even though the template will allow students to enter in dates in any sequence desired and even though many published statements may enter the data in reverse order?

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 8H

How Severe Are the Seven Limitations to EPS/EBIT Analysis?

Purpose

As discussed in this chapter, EPS/EBIT analysis is the most widely used financial tool used to determine whether debt or equity is better to raise needed capital. However, all analytical tools have some limitations. Chapter 8 identifies and discusses seven limitations of EPS/EBIT analysis, as follows:

1. Flexibility
2. Control
3. Timing
4. Extent leveraged
5. Continuity
6. EBIT ranges
7. Dividends

The purpose of this exercise is to examine more closely the limitations of EPS/EBIT analysis in terms of their relative severity. In addition, the purpose is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Instructions

Rank the seven limitations of EPS/EBIT analysis as to their severity, where 1 = most severe to 7 = least severe. Use Table 8-16. First, rank the limitations as an individual. Then, rank the limitations as part of a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision making in strategic planning.

Steps

1. Fill in Column 1 in Table 8-16 to reveal your individual ranking of the severity of the seven limitations (1 = most severe to 7 = least severe). For example, if you think Limitation #1 (Flexibility) is the fourth-most severe limitation, then enter a 4 in Table 8-15 in Column 1 beside Flexibility.
2. Fill in Column 2 in Table 8-16 to reveal your group's ranking of the severity of the seven limitations (1 = most severe to 7 = least severe).
3. Fill in Column 3 in Table 8-16 to reveal the expert's ranking of the seven limitations.
4. Fill in Column 4 in Table 8-16 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 8-16 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

TABLE 8-16 Assessing EPS/EBIT Limitations: Comparing Individual versus Group Decision Making

Limitations	Column 1	Column 2	Column 3	Column 4	Column 5
1. Flexibility					
2. Control					
3. Timing					
4. Extent leveraged					
5. Continuity					
6. EBIT ranges					
7. Dividends					
Sums					

MINI-CASE ON HASBRO, INC.

Let's Build a House

NERF WANTS TO TAKE OVER BARBIE DOLL: THE CASE OF HASBRO, INC.

Based in Pawtucket, Rhode Island, the largest U.S. toymaker, Hasbro Inc., is engaged in a hostile takeover attempt of the second largest toymaker, Mattel Inc., based in El Segundo, California. Mattel is the maker of Barbie dolls, American Girl dolls, and Fisher-Price and Hot Wheels toys. But Mattel has been losing money and its market value has dropped to less than $5 billion, whereas Hasbro is valued at about $11 billion. Hasbro has brands such as Nerf, Transformers, and My Little Pony.

Hasbro's stock has gained 18 percent on the year to $92, whereas Mattel's stock has declined 47 percent on the year to $14. Hasbro owns no toy factories, but Mattel does own its factories. Hasbro has forged close ties to Hollywood by producing movies and creating toys tied to movies, even having toys now tied to Disney's *Star Wars* and Princess characters. A problem for toy makers is that Toys "R" Us has closed all stores and Lego AS just cut 8 percent of its global staff. A few years ago Mattel was trying to buy Hasbro but the firm's fortunes have changed place.

Even if Hasbro and Mattel merge, the combined company would control about 35 percent of the U.S. market and 22 percent of global toy sales. In some categories however, such as model vehicles, which includes Mattel's Hot Wheels, the combined firm would control 62 percent of the U.S. market. Mattel recently suspended its dividend payments to shareholders to stay financially solvent; credit rating firms are downgrading Mattel even as the firm tries to secure more debt financing.

Questions

1. How much is Hasbro worth today compared to the $11 billion figure in late 2017?
2. How much is Mattel worth today compared to the $5 billion figure in late 2017?
3. What would be the advantages and disadvantages of these two firms combining?
4. Assess the extent that antitrust regulators would approve a combination of the industry's two biggest players.

Source: Based on Dana Mattioli, "Hasbro Sets Its Sights on Mattel," *Wall Street Journal*, November 11–12, 2017, p. A1–A2. Also, Paul Ziobro, "For Toy Makers, a New Game," *Wall Street Journal*, November 15, 2017, B7.

Web Resources

1. **Accounting Tools1** gives excellent narrative about retained earnings and other accounting tools and techniques https://www.accountingtools.com/articles/what-is-the-retained-earnings-formula.html
2. **Accounting Tools2** gives excellent narrative about projected financial statements and other accounting tools and techniques http://www.understand-accounting.net/TheReliabilityandAccuracyoffinancialstatements.html

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PART 4

STRATEGY EVALUATION AND GOVERNANCE

9

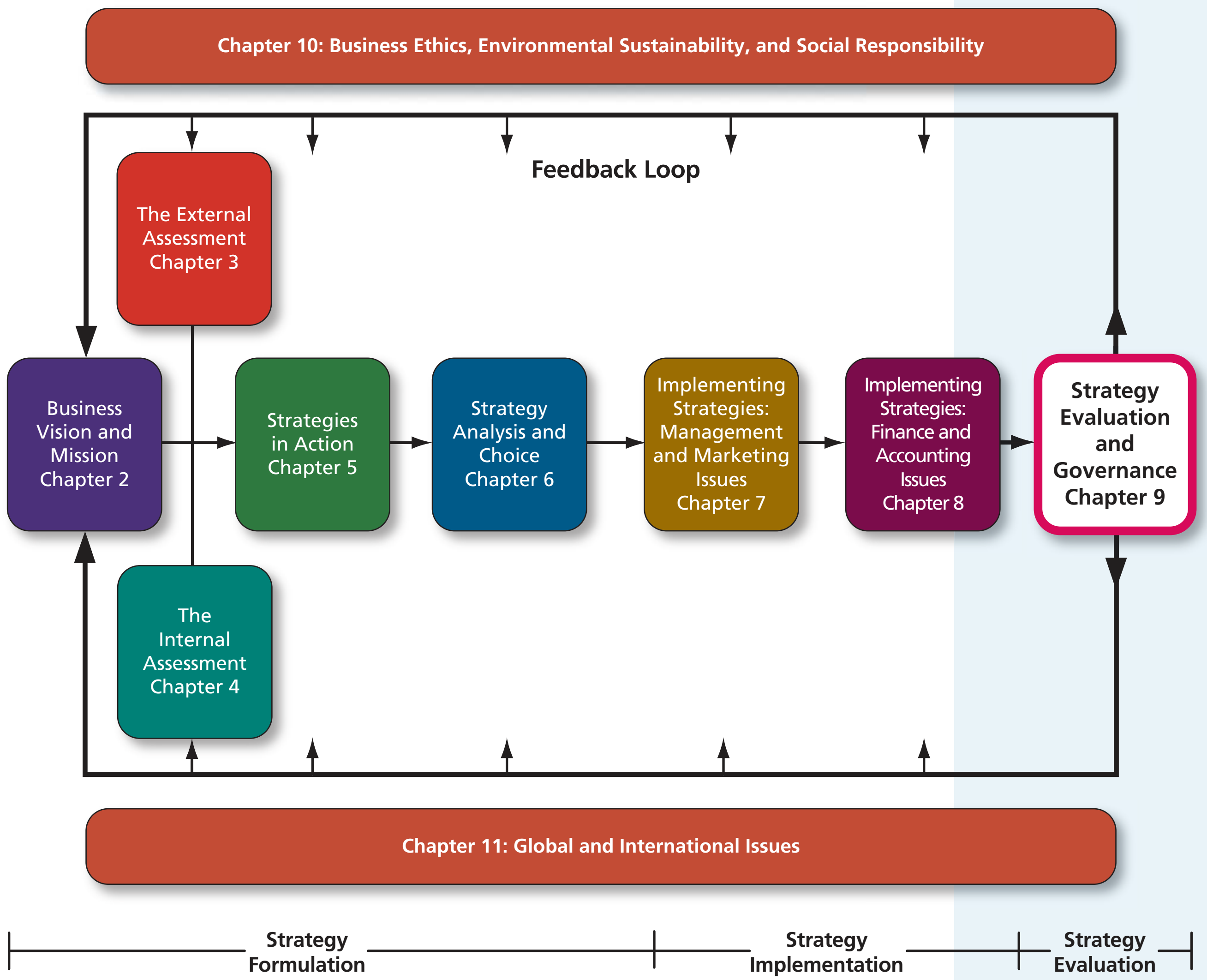

FIGURE 9-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4 (October 2010): 20.

Strategy Evaluation and Governance

LEARNING OBJECTIVES

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

9-1. Discuss the strategy-evaluation process.

9-2. Discuss three activities that comprise strategy evaluation.

9-3. Describe and develop a Balanced Scorecard.

9-4. Discuss the role of a board of directors (governance) in strategic planning.

9-5. Identify and discuss four challenges in strategic management.

9-6. Identify and describe 17 guidelines for effective strategic management.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1: Strategic Planning for Coca-Cola
EXERCISE 9A: Develop a Balanced Scorecard for Coca-Cola

SET 2: Strategic Planning for My University
EXERCISE 9B: Prepare a Strategy Evaluation Report for My University

SET 3: Strategic Planning to Enhance My Employability
EXERCISE 9C: A Balanced Scorecard to Evaluate My Professional versus Personal Objectives

SET 4: Individual versus Group Strategic Planning
EXERCISE 9D: How Important Are Various Guidelines for Effective Strategic Management?

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The best formulated and implemented strategies become obsolete as a firm's external and internal environments change. It is essential, therefore, that strategists systematically evaluate the execution of strategies, as illustrated and highlighted in Figure 9-1. This chapter presents a framework that can guide managers' efforts to evaluate strategies, to make sure they are working, and to make timely changes.

Boards of directors evaluate strategies as part of their job description, so governance issues are discussed in this chapter. Guidelines are presented in this chapter for actually doing strategic planning because board members are more and more involved in the process with top management. Special challenges impacting strategic-planning activities also are discussed.

The exemplary strategist showcased in this chapter is Anthony Wood, founder and CEO of Roku, the fast-growing video streaming and television manufacturing and marketing company.

LO 9.1 The Strategy-Evaluation Process

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. Therefore, most strategists agree 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. The strategy-evaluation process includes three basic activities:

1. Examine the underlying bases of a firm's strategy.
2. Compare expected results with actual results.
3. Take corrective actions to ensure that performance conforms to plans.

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-level managers contriving numbers they think will be

EXEMPLARY **STRATEGIST** SHOWCASED

Anthony Wood, Founder and CEO of Roku, Inc.

Andriy Popov/123RF

Anthony Wood, who started Roku in 2002, might be the next Steve Jobs or Mark Zuckerberg, seriously. Roku is the television streaming company that provides media players, televisions, and accessories. Headquartered in Los Gatos, California, Roku manufactures and sells televisions with its own special operating system. About 20 percent of all televisions sold in the United States are powered by the Roku operating system, but Roku's market share is growing nearly 30+ percent annually. Unlike many of its biggest rivals, Roku relies solely on deals with outside content producers; Roku does not make its own original programming, in contrast with Amazon's Fire TV, Google's YouTube and Chromecast, and Apple TV. This competitive advantage means Roku can stay neutral when it comes to carrying streaming apps and the content it markets to users. Roku devices are the cheapest, at Walmart for as low as $29.95, and arguably the best.

The name Roku comes from the Japanese word meaning "six" because Roku was the sixth company that Wood started. Prior to Roku, Wood invented the digital video recorder (DVR) and founded ReplayTV, where he served as President and CEO before the company's acquisition, and subsequent sale to DirecTV. Before ReplayTV, Wood was founder and CEO of iband, Inc., an Internet software company. Even earlier in his career, Wood was founder and CEO of SunRize Industries, a leading supplier of hardware and software tools for nonlinear audio recording and editing. Wood completed his bachelor's degree in electrical engineering at Texas A&M University, where he started his first company his junior year in college.

Wood's primary aim during his early years was to make money, and lots of it. Wood says he did not grow up rich, and his dad grew up pretty poor. Wood says he saw various guys start businesses and get rich, so he was determined to do the same. Wood says money was his motivation, but he goes on to say: "Money is not an honorable motivation, but it does work." Wood is an exemplary strategist, and an entrepreneur extraordinaire.

Source: Based on a variety of sources.

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! Yet too little or no evaluation can create even worse problems. Strategy evaluation is essential to ensure that stated objectives are being achieved. Strategists need to create an organizational culture where strategy evaluation is viewed as an opportunity to make the firm better, so the firm can compete better, and so everyone in the firm can share in the firm's increased profitability. This chapter reveals how to evaluate strategies.

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. Bad strategies may not affect short-term operating results until it is too late to make needed changes, and excellent strategies may take several years instead of months to produce great results.

Strategy evaluation is important because firms 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 (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 organizations. A firm should never be lulled into complacency with success. Countless firms have thrived 1 year only to struggle for survival the following year. According to Peter Drucker, "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."

It is impossible to demonstrate conclusively that a particular strategy is optimal or even to guarantee that it will work. But any 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 so long as the key external and internal factors that underlie it remain stable. This is why entrenched firms can be difficult to unseat, even if their raw skill levels are only average.[1]

Strategy evaluation is becoming increasingly difficult because domestic and world economies are today more interrelated, product life cycles are shorter, technological advancements are faster, change occurs rapidly, competitors abound globally, planning cycles are shorter, and social media and smartphones have changed everything. A fundamental problem facing managers today is how to effectively manage a workforce that increasingly demands fairness, openness, transparency, flexibility, and involvement. Managers need empowered employees acting responsibly. Otherwise the costs to companies in terms of damaged reputations, fines, missed opportunities, and diversion of management's attention can be enormous; bad news can spread like wildfire over social media. Too much pressure to achieve specific goals can lead to dysfunctional behavior, as Wells Fargo found out a few years ago putting so much pressure on their bankers opening new accounts.

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! Monitoring and managing change is vital. 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.[2]

Managers and employees of a firm should be kept up to date regarding progress being made toward achieving a firm's objectives. If assumptions, expectations, or results deviate significantly from forecasts, then strategy evaluation is needed. Evaluating strategies is like formulating and implementing strategies in the sense that 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.

As indicated in the Global Capsule 9, even countries engage in the three strategy-evaluation activities revealed and discussed in this chapter.

GLOBAL CAPSULE 9

What Country's New Strategy Is Called "Vision 2030"?

The answer to the question is Saudi Arabia. After reviewing the nation's standing in the world and measuring its performance across many variables, Saudi Arabia is taking corrective actions under its new strategy called "Vision 2030." Led by Crown Prince Mohammed bin Salman, Saudi Arabia is engaged in massive progressive reforms, anchored by change to anti-corruption actions. A review of the country's finances in late 2017 revealed that $100+ billion had been misappropriated through systematic corruption and embezzlement over several decades; so 208+ individuals in the country, including 17 princes, were recently arrested and their personal bank accounts closed.

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Saudi Arabia is moving to diversify its economy beyond oil by relaxing restrictions against women and spurring tourism and trade. Women can now drive cars and attend sporting events. Automobile companies are eyeing about 150,000 new Saudi women driving each year and many of them wanting their own vehicle. For example, Ford recently hosted driving lessons in Saudi Arabia to show women how to drive. The country is creating a transparent business environment for investors, a thriving economy, a vibrant society, and a responsible nation. Saudi Arabia has launched a $500 billion independent economic zone that includes itself, Jordan, and Egypt. The Crown Prince wants Aramco, the oil company owned by the Saudi government, to be listed on the New York Stock Exchange. The Crown Price is moving Saudi Arabia toward being "open to the world and all religions." However, women in Saudi Arabia are still legally required to have a male guardian's permission to travel abroad or marry. In stadiums and most public places, Saudi women and men cannot comingle in public; women are restricted to "family sections" and separate stadium entrances from men. (In Iran, women are still banned from attending sporting events).

Saudi Arabia in 2018 began allowing movie theaters to be constructed, lifting a decades-old ban on Hollywood-style entertainment. Content within movies is censored, and it is not clear whether men and women can comingle at the new theaters; gender segregation is widely practiced everywhere in the country, but this is changing under Vision 2030. But still many restaurants and cafes in Saudi Arabia are open only to men, and all women must wear floor-length gowns known as abayas outside their home.

Source: Based on Majid Al Qasabi, "Riyadh Is Delivering on Vision 2030." *Wall Street Journal*, November 13, 2017, A17.

LO 9.2

Three Strategy-Evaluation Activities

Table 9-1 summarizes three 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.

TABLE 9-1 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

Reviewing Bases of Strategy

Relationships among strategy-evaluation activities are illustrated in Figure 9-2. As shown, **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, accounting, production, and information systems (MIS) strengths and weaknesses. A **revised EFE Matrix** should indicate how effective 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. It is not a question of *whether* underlying key external and internal 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?

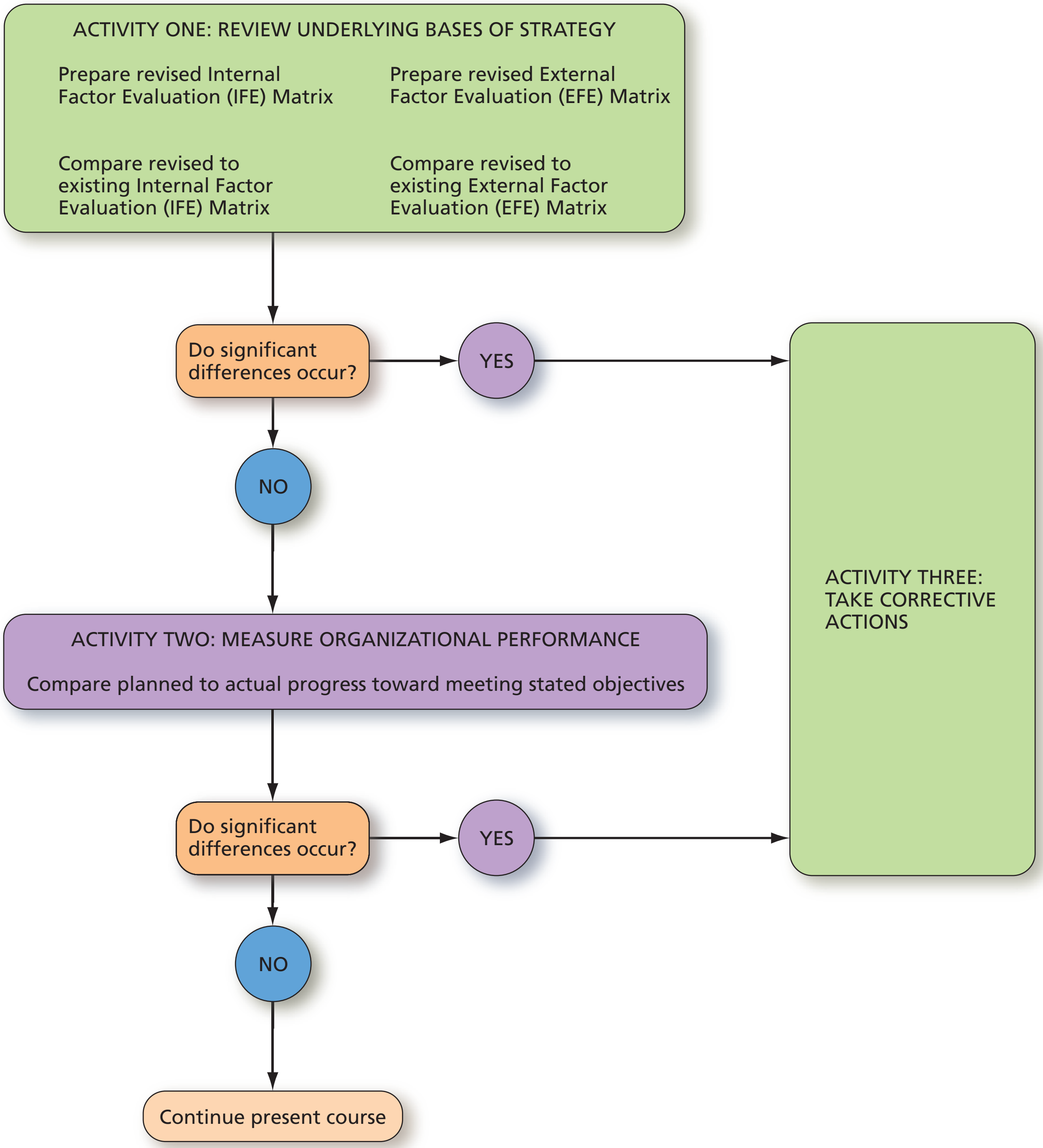

FIGURE 9-2

A Strategy-Evaluation Framework

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).

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 a 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 financial ratios to make three critical comparisons:

1. Compare the firm's performance over different time periods.
2. Compare the firm's performance to competitors.
3. Compare the firm's performance to industry averages.

Many variables can and should be included in measuring organizational performance. As indicated in Table 9-2, typically a favorable or unfavorable variance is recorded monthly, quarterly, and annually, and resultant actions needed are then determined.

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 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, accounting, or MIS factors can also cause financial problems. The need for a "balanced" quantitative/qualitative approach in evaluating strategies gives rise in a moment to discussion of the balanced scorecard.

TABLE 9-2 A Sample Framework for Assessing 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				

Several additional key questions that reveal the need for qualitative 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 9-3, 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, allocating resources differently, 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.

If either the actions or results of employees, departments, or divisions do not comply with preconceived or planned achievements, then corrective actions are needed. For example, the U.S. iconic company General Electric (GE) is taking massive corrective actions (all 12 items listed in Table 9-3) in 2018 to reverse severe declines in both revenues and profits over the last few years. GE is cutting $1 billion annually in expenses through the end of 2018.

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.[3] The most

TABLE 9-3 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 reshore) business functions.

successful organizations today continuously adapt to changes in the competitive environment. It is not sufficient today to simply react to change. Managers must anticipate change and be the creator of change.

Strategy evaluation can lead to strategy-formulation or strategy-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.[4]

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.[5]

The Balanced Scorecard

LO 9.3

Do a Google search using the keywords *balanced scorecard images* and you will see more than a hundred currently used balanced scorecards. Note the wide variation in format evidenced through the images. Developed in the early 1990s 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. The technique is based on the need of firms to "balance" financial measures that are often used exclusively in strategy evaluation with nonfinancial measures such as product quality, business ethics, environmental sustainability, employee morale, pollution abatement, community involvement, and customer service. The rationale behind balanced scorecard is that financial measures report what has already happened, whereas nonfinancial metrics have a tendency to better predict what will happen in the future. 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 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 4 years. The overall aim of a balanced scorecard is to "balance" shareholder objectives with customer and operational objectives. 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.

A sample balanced scorecard is provided in Table 9-4. 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

TABLE 9-4 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.			

(6) Financial. 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 with external concerns. The balanced scorecard could 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. Companies strive to achieve both quantitative and qualitative objectives all along their value chain, from end-users to raw materials, as discussed in Chapter 5.

LO 9.4 Boards of Directors: Governance Issues

A **board of directors** is a group of individuals at the top of an organization with 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 held accountable for the entire performance of an organization. Boards of directors are increasingly sued by shareholders for mismanaging their interests. New accounting rules in the United States and

TABLE 9-5 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. Evaluate corporate strategies.
   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.
   h. Guarantee the firm's financial statements are feasible and accurate.

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 9-5.

Shareholders are increasingly wary of boards of directors. Most 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, 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 often merely reactive. These are all reasons why the chair of the board of directors should not also serve as the firm's CEO. In North America, the number of new incoming CEOs that also serve as Chair of the Board has declined to about 10 percent today from about 50 percent 15 years ago.

Until recently, individuals serving on boards of directors did most of their work sitting around polished mahogany 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 fully informed every 2 months to discuss the biggest issues facing the firm. New board involvement policies are aimed at curtailing lawsuits against board members.

Research reveals that companies with fewer board members outperform larger boards, largely because having fewer directors facilitates deeper debates, more nimble decision making, and greater accountability.[6] Also, among companies with a market capitalization of at least $10 billion, smaller boards produced substantially higher shareholder returns. Specifically, 9-person boards perform much better, for example, than 14- to 15-member boards. Thus, many companies are reducing their number of board members. As part of a major restructuring, GE recently reduced the size of its board from 18 to 12. This change brings GE more in line with the national average of 10.9 board members per U.S. firm with a market capitalization of at least $10 billion.

Another benefit of fewer board members is that CEOs are more often reprimanded (or dismissed) if needed. Dr. David Yermack, a finance professor at New York University's business school, reports that smaller boards are generally more decisive, more cohesive, more hands-on, and have more informal meetings and fewer committees. Netflix is another example of a company with a small board, only 7 members, who debate extensively before approving important management moves. Netflix is doing great. In contrast, Eli Lilly & Co. has 14 board members who find it "too big to encourage the kinds of discussions you want, because drilling down on different issues simply takes too long; members feel constrained even asking a second or third question." Bank of America has 15 directors—too many to be efficient. In addition, the chair of the board should rarely, if ever, be the same person as the CEO, as discussed. In summary, companies should seek to reduce their board of directors to fewer than 10 persons, whenever possible—and strategy students should examine this issue in their assigned case companies.

Today, boards of directors are composed mostly of outsiders who are becoming more involved in organizations' strategic management. The trend in the United States is toward much greater board member accountability with smaller boards, now averaging 11 members rather than 18 as they did a few years ago. An executive recruitment firm, Spencer Stuart, reported in late 2017 that women and minorities account for half of the 397 newest independent board of directors' members at S&P 500 companies—the first time this has ever occurred; women made up 36 percent of new directors appointed. Spencer Stuart also reports that more than half of S&P companies now have split the roles of chairman and CEO.

BusinessWeek provides 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 serve on the board's audit, compensation, or nominating committee.
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).[7]

Jeff Sonnerfeld, associate dean of the Yale School of Management, comments, "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. Legal suits are becoming more common against directors for fraud, omissions, inaccurate disclosures, lack of due diligence, and culpable ignorance about a firm's operations.

LO 9.5 Challenges in Strategic Management

Four particular challenges 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, (3) contingency planning, and (4) auditing.

The Art or Science Issue

This book 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.[8] Mintzberg and his followers reject strategies that result from objective analysis, preferring instead subjective imagination. In contrast, "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 (including this text's authors) insist on more formality. Mintzberg refers to strategic planning as an "emergent" process, whereas strategy scientists use the term *deliberate* process.[9]

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. The CEO of Williams-Sonoma, Laura Alber, recently stated, "I've found that the very best solutions arise from a willingness to blend art with science, ideas with data, and instinct with analysis." 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 3, 4, and 6 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 mini-case near the end of this chapter examines this issue for TJX Companies, a secretive company. The Chinese warrior Sun Tzu and military leaders today strive to keep strategies secret, because war is based on deception. But for business organizations, secrecy may not be best. Keeping strategies secret from employees and stakeholders at large could severely inhibit employee and stakeholder communication, understanding, and commitment, as well as forgo valuable input that these persons could have regarding formulation or implementation of those strategies. As indicated in the Ethics Capsule 9, CEO Bipul Sinha considers transparency to be the key to his company's success.

Strategists 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 more openness or secrecy in regard to strategies being formulated and implemented?

There are excellent reasons to keep the strategy process and strategies themselves visible and open rather than hidden and secret. There are also excellent 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 in many respects.

ETHICS CAPSULE 9

Achieving Exemplary Business Ethics through Exemplary Transparency


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We Are All in This Together

Based in Palo Alto, California, Rubrik is a data management company whose CEO, Bipul Sinha, has established a culture of complete openness as a means of achieving superior business ethics. Sinha believes extreme honesty helps create a strong corporate culture that spurs entrepreneurism, innovativeness, motivation, commitment, and integrity. Even the company's board of director meetings are completely open to all 600 of the company's employees, and most employees either attend in person or teleconference to listen, view, and ask questions. The only aspect of company operations off limits or secret within the firm is confidential client information. In contrast to Rubrik's transparency, GE's board of directors did not know until *Wall Street Journal* reported it in 2017 that their former CEO Jeff Immelt had an extra jet follow his corporate jet on many of his overseas trips during his 16-year tenure as CEO. Immelt resigned days after the disclosure.

An increasing number of companies and organizations are in fact providing employees with regular updates on how the firm is doing financially and what, where, when, and why. Even among private (not public) companies, 43 percent of all private firms today share financial information with all employees, up from 24 percent in 2012. That is nearly a 100 percent increase. Greater communication yields greater understanding that leads to greater commitment that results in higher performance.

Source: Based on: John Simons, "A Startup Where Board Meetings Are Open to All," *Wall Street Journal*, October 30, 2017, R11. Also, Thomas Gryta, Joann Lublin, and Mark Maremont, "GE Board in Dark on CEO's Use of Extra Jet," *Wall Street Journal*, October 30, 2017, B1.

Four reasons to be primarily 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.

Four 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.[10] This balancing act is difficult but essential for survival of the firm.

Promote Workplace Democracy

Employees at more and more companies are voting on more and more issues. For example, employees at InContext Solutions recently voted on whether to play music in office common areas. Employees at Whole Foods Market and at MediaMath Inc. vote quite often on issues.

Research suggests that giving employees a voice or vote on even small issues such as holiday parties helps to spark loyalty to the company. InContext employees recently voted on whether to have cubicles or open tables and even on which brews to keep in the company keg. MediaMath employees recently voted on which new headquarters location they prefer to relocate.

Whole Foods employees vote on whether to keep new employees beyond a trial period of up to 90 days. Menlo Innovations employees vote on job applicants after observing how candidates work during a trial period. 1Sale.com employees recently voted to do away with free lunches in favor of lower health-insurance premiums. Social Tables Inc. employees recently voted on the company's core values, as well as the company's conference-room themes and the company theme song played at corporate events. The strategic decision at hand for many companies increasingly is the extent to allow or encourage employee voting on numerous large and small issues that affect workplace productivity and morale.

A 2017 *Wall Street Journal* article titled "Pay is Less Secretive in Millennial Workforce" reveals that in this day and age of sharing social contacts, pictures, and videos, millennials are issuing in a new corporate culture of democracy and openness (rather than secrecy), even with compensation systems. Research reveals that roughly one-third of U.S. workers ages 18 to 36 say they are comfortable discussing pay with their coworkers, unlike baby boomers, ages 53 to 71, who are four times more likely to want to keep pay secret. More than half of all millennials talk about pay with their friends whether pay is secret or not.

Contingency Planning

A basic premise of excellent strategic management is that firms strive to be proactive, planning ways to deal with unfavorable and favorable events before they occur. Too many organizations prepare contingency plans just for unfavorable events; this is a mistake because both minimizing threats and capitalizing on opportunities can improve a firm's competitive position.

Regardless of how carefully strategies are formulated, implemented, and evaluated, unforeseen events, such as strikes, boycotts, natural disasters, arrival of foreign competitors, and government actions, can make a strategy obsolete. To minimize the impact of potential threats, organizations should develop contingency plans as part of their strategy-evaluation process. **Contingency plans** can be defined as alternative plans that can be put into effect if certain key events do not occur as expected. Only high-priority areas require the insurance of contingency plans. Strategists cannot and should not try to cover all bases by planning for all possible contingencies. But in any case, contingency plans should be as simple as possible.

Some contingency plans commonly established by firms include the following:

1. If a major competitor withdraws from particular markets as intelligence reports indicate, what actions should our firm take?
2. If our sales objectives are not reached, what actions should our firm take to avoid profit losses?
3. If demand for our new product exceeds plans, what actions should our firm take to meet the higher demand?
4. If certain disasters occur—such as loss of computer capabilities; a hostile takeover attempt; loss of patent protection; or destruction of manufacturing facilities because of earthquakes, tornadoes, or hurricanes—what actions should our firm take?
5. If a new technological advancement makes our new product obsolete sooner than expected, what actions should our firm take?

Too many organizations discard alternative strategies not selected for implementation although the work devoted to analyzing these options would render valuable information. Alternative strategies not selected for implementation can serve as contingency plans in case the strategy or strategies selected do not work. 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. Sometimes, 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 report that contingency planning gives users, such as DuPont, Dow Chemical, Consolidated Foods, and Emerson Electric, three major benefits, as follows:

1. It enables quick responses to change.
2. It prevents panic in crisis situations.
3. It makes managers more adaptable by encouraging them to appreciate just how variable the future can be.

In addition, Linneman and Chandran suggest that effective contingency planning involves a five-step process, as follows:

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 for 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 statements 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)** is approaching in the United States, 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." The GAAP standards are comprised of 25,000 pages, whereas the IFRS comprises only 5,000 pages, so in that sense IFRS is less cumbersome.

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, believing 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 United States. Some firms also would pay higher taxes because last in, first out (LIFO) inventory methods are not allowed under IFRS. The International Accounting Standards Board (IASB) has publicly expressed "regret" over the slowness in the United States of 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 United States 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 United States is likely to 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), which derives more than 60 percent of its revenues from abroad and is already training its entire staff to use IFRS.

LO 9.6 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; 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.[13]

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 firm's strategies to the satisfaction of the strategists. This degree of discipline will promote understanding and learning.

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 need information on a daily or even continuous basis. For example, when a firm has diversified by acquiring another firm, evaluative information may be needed frequently. In contrast, in a research-and-development (R&D) department, daily or even weekly evaluative information could be unnecessary. 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 processes 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 restrictive. Complex strategy-evaluation systems often confuse people and accomplish little. The test of an effective evaluation system is its usefulness, not its complexity.

Large organizations require a more elaborate and detailed strategy-evaluation system because it is more difficult to coordinate efforts among different divisions and functional areas. Managers in small companies often communicate daily with each other and their employees and do not need extensive evaluative reporting systems. Familiarity with local environments usually makes gathering and evaluating information much easier for small organizations than for large businesses. But the key to an effective strategy-evaluation system may be the ability to convince participants that failure to accomplish certain objectives within a prescribed time is not necessarily a reflection of their performance.

There is no one ideal strategy-evaluation system. The unique aspects of an organization, including its size, management style, purpose, problems, and strengths, can determine a strategy-evaluation and control system's final design. Robert Waterman offered the following observation about successful organizations' strategy-evaluation and control systems:

> Successful companies treat facts as friends and controls as liberating. Morgan Guaranty and Wells Fargo not only survive but thrive in the troubled waters of bank deregulation, because their strategy evaluation and control systems are sound, their risk is contained, and they know themselves and the competitive situation so well. Successful companies have a voracious hunger for facts. They see information where others see only data. Successful companies maintain tight, accurate financial controls. Their people don't regard controls as an imposition of autocracy but as the benign checks and balances that allow them to be creative and free.[14]

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, then, 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. 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 tradeoffs such as long-range versus short-range considerations or maximizing profits versus increasing shareholders' wealth. There are ethics issues, too. Strategy tradeoffs 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 9-6 summarizes important guidelines for the strategic-planning process to be effective.

TABLE 9-6 17 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, non-routine, economical, and provide timely information.
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 and provide a true picture of what is happening.
8. It should welcome open-mindedness 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 and should not dominate decisions.
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.

IMPLICATIONS FOR STRATEGISTS

Figure 9-3 reveals on the far left that strategists must systematically, continuously, and carefully evaluate and monitor results by product, region, territory, segment, store, department, and even by individual, so that timely corrective actions can be taken to keep the firm on track. Quarterly, weekly, and even daily, companies have to adapt to changes that occur externally and internally, because even the best strategic plan needs periodic adjusting as rival firms adjust and launch new initiatives and products in new areas. As described in this chapter, the balanced scorecard is widely used by strategists to help manage the strategy-evaluation process.

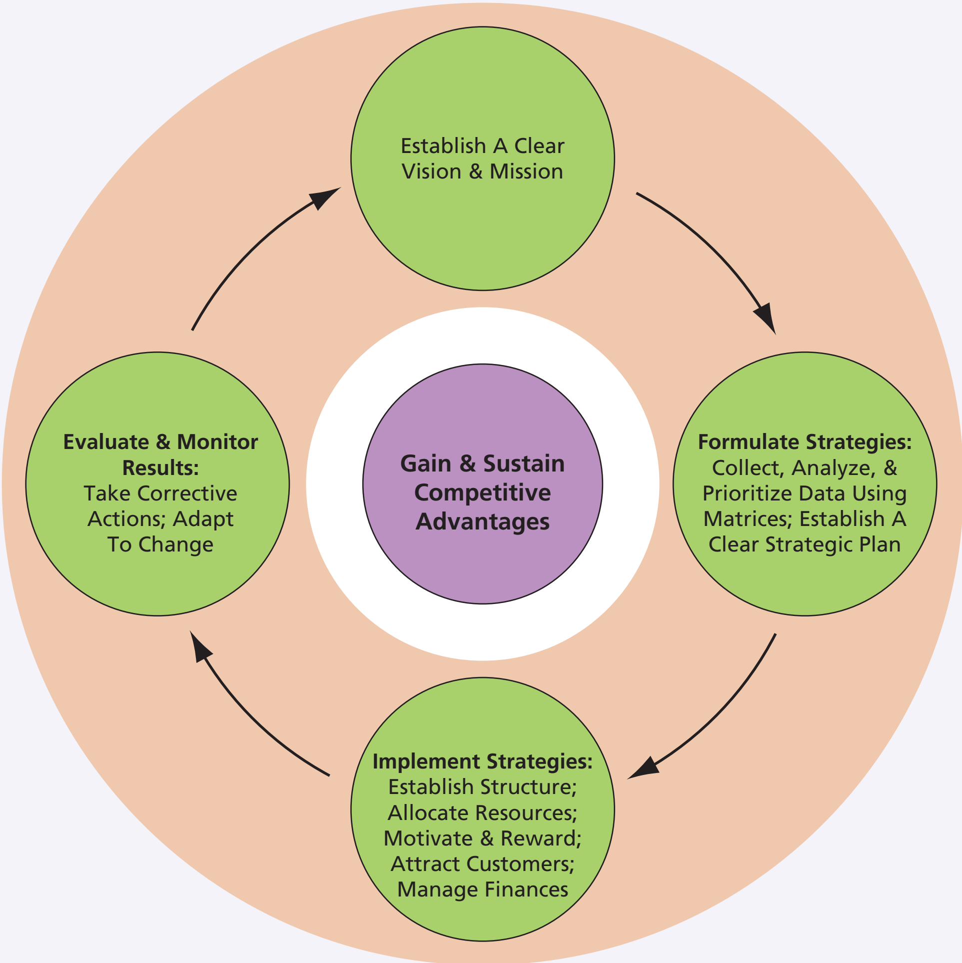

FIGURE 9-3
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

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 advantages versus rival firms.

Chapter Summary

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 or improve 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. 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.

Key Terms and Concepts

auditing (p. 314)
balanced scorecard (p. 307)
board of directors (p. 308)
contingency plans (p. 313)
future shock (p. 306)
generally accepted accounting principles (GAAP) (p. 314)
generally accepted auditing standards (GAAS) (p. 314)
governance (p. 308)
international financial reporting standards (IFRS) (p. 314)
measuring organizational performance (p. 304)
reviewing the underlying bases of an organization's strategy (p. 303)
revised EFE Matrix (p. 303)
revised IFE Matrix (p. 303)
taking corrective actions (p. 306)

Issues for Review and Discussion

9-1. Do a Google search using the terms *balanced scorecard images*. Review the many different formats of the balanced scorecard currently being used by organizations. Decide on three formats that you believe are particularly effective.

9-2. Do a Google search using the terms *balanced scorecard adopters*. Review the many different organizations currently using the balanced scorecard as part of their strategic planning. Select three different companies or organizations. Compare and contrast their use of the balanced scorecard technique.

9-3. Give several hypothetical situations whereby a company should establish contingency plans.

9-4. Explain why companies continually evaluate their strategies, rather than waiting for the end of the quarter or fiscal year to engage in the three core strategy evaluation activities discussed in this chapter.

9-5. Which of the three core strategy-evaluation activities do you think is most critical to be performed well? Why?

9-6. If a firm has two regions and two products, develop a sample framework for measuring organizational performance.

9-7. Compare strategy formulation with strategy implementation in terms of each being an art or a science.

9-8. What is Saudi Arabia doing after evaluating strategies for that country?

9-9. How does an organization know if it is pursuing "optimal" strategies?

9-10. Discuss the nature and implications of the upcoming accounting switch from GAAP to IFRS in the United States.

9-11. Ask an accounting professor at your college or university the following question and report back to the class: "To what extent would my learning the IFRS standards on my own give me competitive advantage in the job market?"

9-12. Evaluating strategies on a continuous rather than a periodic basis is desired. Discuss the pros and cons of this statement.

9-13. Why has strategy evaluation become so important in business today?

9-14. What types of quantitative and qualitative criteria should be used to evaluate a company's strategy?

9-15. As owner of a local, independent barbecue restaurant, explain how you would evaluate the firm's strategy.

9-16. Under what conditions are corrective actions not required in the strategy-evaluation process?

9-17. Identify types of organizations that may need to evaluate strategy more frequently than others. Justify your choices.

9-18. As executive director of the local Chamber of Commerce, in what way and how frequently would you evaluate the organization's strategies?

9-19. Identify some key financial ratios that would be important in evaluating a bank's strategy.

9-20. Strategy evaluation allows an organization to take a proactive stance toward shaping its own future. Discuss the meaning of this statement.

9-21. Diagram and discuss the balanced scorecard.

9-22. Develop a balanced scorecard for a local movie cinema complex.

9-23. Do you believe strategic management is more an art or a science? Explain.

9-24. Regarding the strategic-planning process, give four "should be" guidelines and four "should not be" guidelines.

9-25. Researchers say contingency planning is a five-step process. Identify and discuss the five steps.

9-26. Identify and discuss five characteristics of effective strategy evaluation.

9-27. Identify and discuss four reasons to be open (visible) in regard to the strategic-planning process and outcomes.

9-28. Identify and discuss four reasons to be closed (secret) in regard to the strategic-planning process and outcomes.

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 9A

Develop a Balanced Scorecard for Coca-Cola

Purpose

Balanced scorecards are widely used by companies to "balance" their financial with nonfinancial objectives. Do a Google search using the phrase "Coca-Cola balanced scorecard" or "balanced scorecard images" or "balanced scorecard examples" to see examples.

Instructions

Step 1 Prepare a new and improved balanced scorecard for Coca-Cola.
Step 2 Explain why your recommended balanced scorecard is best for Coca-Cola.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 9B

Prepare a Strategy Evaluation Report for My University

Purpose

Virtually all institutions of higher learning monitor financial and other operating ratios such as those listed here, and take appropriate correction actions as needed to address unfavorable variances. Be mindful that all companies and organizations, even colleges, develop unique sets of ratios to measure performance.

Ratios Monitored by Colleges and Universities	Actual Value	Expected Value	Variance
1. Tuition monies ($) received per student (#)			
2. Number of students (#) per faculty (#)			
3. Number of faculty (#) per grant monies ($) received			
4. Contributions ($) per contributor (#)			
5. Number of male students (#) per total of students (#)			
6. Number of female students (#) per total of students (#)			
7. Number of minority students (#) per total of students (#)			
8. Number of international students (#) per total of students (#)			
9. Increase/decrease (%) in number of students (#)			
10. Increase/decrease (%) in number of out-of-state students (#)			
11. Increase/decrease (%) in number of international students (#)			
12. Increase/decrease (%) in number of minority students (%)			
13. Long-term debt ($) to total assets ($)			
14. Current assets ($) to current liabilities ($)			
15. Number of business students (#) per total students (#)			
16. Number of out-of-state students (#) per total students (#)			
17. Growth/decline (%) in number of MBA students (#)			
18. Growth/decline (%) in number of BBA students (#)			
19. Number of accounting majors (#) per number of BBA students (#)			
20. Number of management majors (#) per number of BBA students (#)			
21. Number of finance majors (#) per number of BBA students (#)			
22. Number of marketing majors (#) per number of BBA students (#)			

23. Instructions

Step 1 Review your college's website and annual report to obtain as much comparative information as possible to fill in the table. Review your college's most recent Southern Association of Colleges and Schools (SACS) Accreditation Report.

Step 2 Speak with the School of Business Dean's Office personnel to gather additional information to complete the above table.

Step 3 Based on the information gathered, prepare a strategy evaluation report for your college or university.

SET 3: STRATEGIC PLANNING TO ENHANCE MY EMPLOYABILITY

EXERCISE 9C

A Balanced Scorecard to Evaluate My Professional versus Personal Objectives

Purpose

A balanced scorecard can be used by individuals to help balance their professional and personal objectives and lives. Some variables commonly included are given in Table 9-7:

TABLE 9-7 A Balanced Scorecard for Individual Assessment

Area of Objectives	Expected Target	Actual Target	Variance	Action Needed
Professional				
A. Current Employer				
1. Pay				
2. Benefits				
3. Potential for Growth				
B. Potential Future Employer				
1. Pay				
2. Benefits				
3. Potential for Growth				
Personal				
A. Social				
1. Marital status				
2. Friend status				
3. Online activity				
4. Offline activity				
B. Health				
1. Body weight				
2. Nutrition intake				
3. Exercise quotient				
4. Stress level				

Instructions

Step 1 In Table 9-7, reveal your professional and personal objectives, and your progress to date on achieving those objectives.

Step 2 In Table 9-7, in the variance column, indicate Very Favorable (VF), Favorable (F), Unfavorable (U), Very Unfavorable (VU) to reveal your status on each item measured.

Step 3 In Table 9-7, reveal corrective actions that you plan going forward on each item measured.

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 9D

How Important Are Various Guidelines for Effective Strategic Management?

Purpose

This chapter discusses numerous guidelines that should be followed in formulating, implementing, and evaluating strategies. Ten guidelines associated with the strategic-planning process are as follows:

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 vary assignments, team memberships, meeting formats, and even the planning calendar.
5. It should challenge the assumptions underlying the current corporate strategy and welcome bad news.
6. It should welcome open-mindedness and a spirit of inquiry and learning.
7. It should not become ritualistic, stilted, orchestrated, or rigid.
8. It should not be a formal system for control.

9. It should not be controlled by "technicians."
10. Do not pursue too many strategies at once.

The purpose of this exercise is to examine more closely guidelines for the strategic-planning process to be most effective. In addition, the purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Instructions

Rank the 10 guidelines as to their relative importance for the strategic-planning process to be effective, where 1 = most important to 10 = least important. First, rank the guidelines as an individual. Then, rank the guidelines as part a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision making in strategic planning.

Steps

1. Fill in Column 1 in Table 9-8 to reveal your individual ranking of the relative importance of the 10 guidelines (1 = most important, 2 = next most important, to 10 = least important). For example, if you think Guideline #1 (People Process) is the eighth-most important guideline, then enter an 8 in Table 9-8 in Column 1 beside Guideline 1.
2. Fill in Column 2 in Table 9-8 to reveal your group's ranking of the relative importance of the 10 guidelines (1 = most important, 2 = next most important, to 10 = least important).
3. Fill in Column 3 in Table 9-8 to reveal the expert's ranking of the 10 guidelines.
4. Fill in Column 4 in Table 9-8 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 9-8 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

TABLE 9-8 Strategic-Planning Guidelines Analysis: Comparing Individual versus Group Decision Making

Strategic-Planning Guidelines	Column 1	Column 2	Column 3	Column 4	Column 5
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
9.					
10.					
Sums					

MINI-CASE ON TJX COMPANIES, INC. (TJX)

SECRET STRATEGIC PLANNING WORKS GREAT FOR TJX

Gordon Bell/Shutterstock

I Save Money by Shopping TJ Maxx

Headquartered in Framingham, Massachusetts, TJX Companies is a discount apparel and home fashions retailer in the United States and abroad. The company owns T.J. Maxx, Marmaxx, Home Goods, TJX Canada, TJX Europe, and Sierra Trading Post—operating in total more than 4,000 stores in 9 countries: United States, Canada, United Kingdom, Ireland, Germany, Poland, Austria, the Netherlands, and Australia. TJX's annual sales and profits are increasing nicely. Operations today include 1,219 TJ Maxx, 1,057 Marshalls, 660 HomeGoods, 26 Sierra Trading Post, and 3 HomeSense stores, as well as tjmaxx.com and sierratradingpost.com in the United States; 265 Winners, 117 HomeSense, and 72 Marshalls stores in Canada; 540 TJ Maxx and 55 HomeSense stores, as well as tjmaxx.com, in Europe; and 38 TJ Maxx stores in Australia.

In January 2018, TJX received an unsolicited offer from TRC Capital Corp. to purchase up to 2,000,000 shares of TJX's common stock at a price of $70.95 per share in cash. The offering price is 4.34 percent below the $74.17 per share closing price of TJX's common stock on December 15, 2017. TJX's top management asked all TJX shareholders to reject the offer.

Regarding its corporate strategic planning and evaluating process, TJX is one of the most secretive of all publicly held retailers. As discussed in this chapter, there are numerous advantages and disadvantages of being secretive rather than open in revealing corporate strategy. TJX's CEO, Carol Meyrowitz, as well as her top executives, rarely give interviews and never discuss corporate strategy. TJX does not talk about its corporate strategy in part because rival firms are eager to learn this information to duplicate, imitate, undermine, and replicate. However, *Fortune* reports that "excellent inventory control" is a secret to the strategic success of TJX, including the following practices:

1. Turn inventory over quickly. According to Morningstar, TJX turns over inventory every 55 days, versus 85 days for its peer group. TJX is structured to buy quickly and sell merchandise. Often, merchandise is sold before TJX has paid its vendors. Quick inventory turnover keeps new merchandise on the floor so customers rarely see the same items on repeat visits. TJX trains employees to "buy when you see it; otherwise it will be gone."
2. Provide "value, trendy merchandise," not "cheap, leftover merchandise."
3. Promote the "treasure hunt" experience rather than catering to lower-income customers. Even high-income customers love the treasure hunt experience in TJX stores.
4. Train buyers extensively and then give buyers autonomy to negotiate millions of dollars of purchases from suppliers. Purchase inventory year-round, continuously rather than seasonally, and purchase as close to the time of need as possible to negotiate a better price and be assured of the latest fashion trend. Negotiate low prices for purchases even if it means often purchasing "all available items in a category."

Questions

1. What are the advantages and disadvantages of keeping the strategic-planning process secret versus placing the firm's strategic plan on the corporate website and discussing strategies and planning publicly?
2. What are three types of industries where secrecy is warranted and three industries where secrecy is not warranted, or does type of industry even matter?
3. Many colleges and universities have their strategic plan posted on their website. What are the advantages and disadvantages of this practice?
4. Rank order the four "secret" practices listed in terms of how important you think the items are to TJX's overall success. Rank the four items from 1 = most important to 4 = least important.

Source: Based on a variety of sources and on information at http://fortune.com/2014/07/24/t-j-maxx-the-best-retail-store/?icid=maing-grid7%7Chtmlws-main-bb%7Cdl30%7Csec1_lnk3%26pLid%3D508272

Web Resources

1. ***Balanced scorecard images*** 100 balanced scorecard images are provided at this website https://www.google.com/search?source=hp&ei=A8wJWty6LIbqjwSXlocI&q=balanced+scorecard+images&oq=balanced+scorecard+images&gs_l=psyab.1.0.0j0i22i30k1.1719.9368.0.11358.29.25.1.0.0.0.355.3755.0j18j3j1.22.0....0...1.1.64.psy-ab..6.23.3762.0..35i39k1j0i131k1j0i20i264k1.0.Iip5WN7tEk4
2. ***Balanced scorecard examples*** 17 balanced scorecard examples and templates are provided at this website https://bscdesigner.com/real-bsc-examples.htm

Current Readings

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PART 5

KEY STRATEGIC-MANAGEMENT TOPICS

10

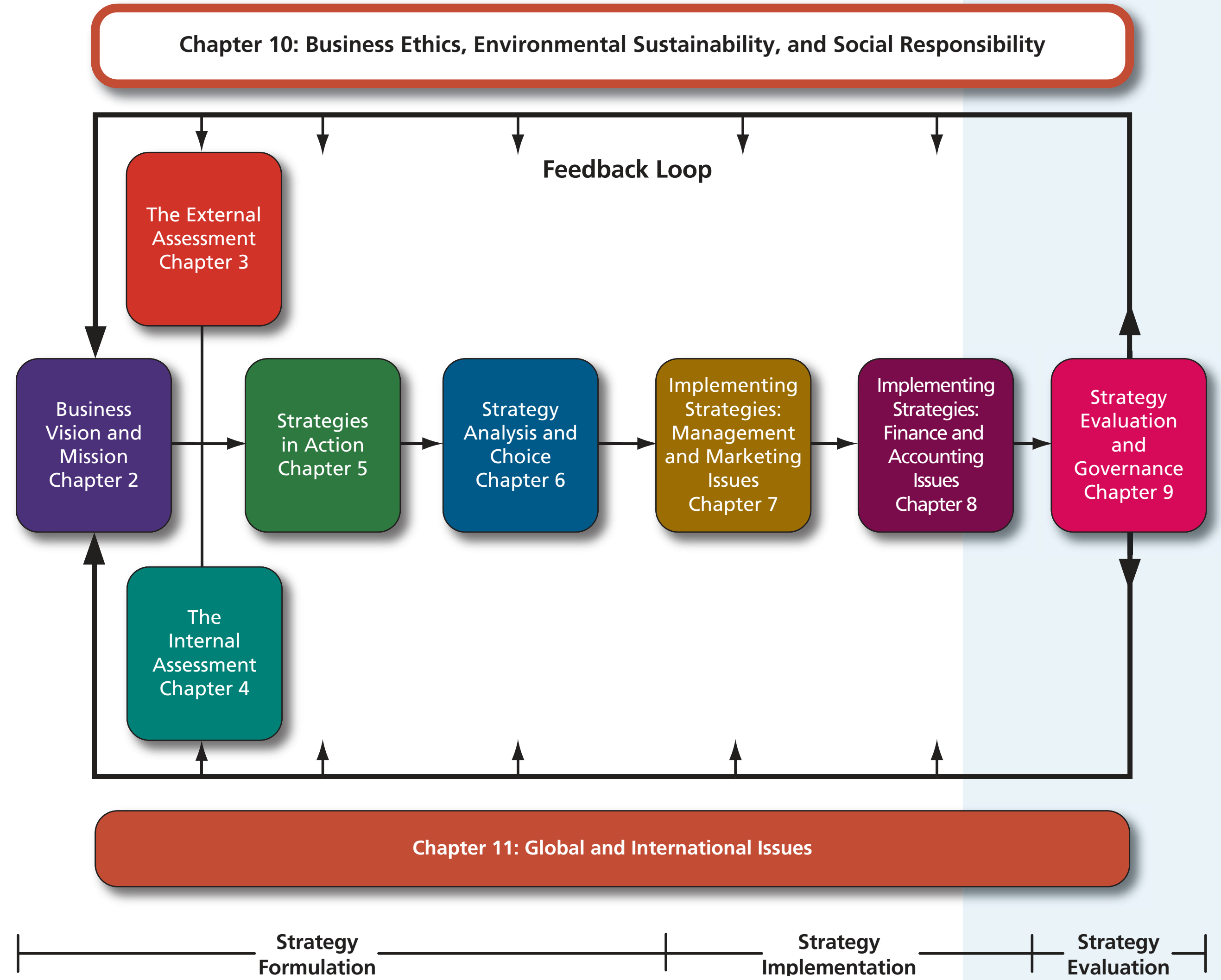

FIGURE 10-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4, (October 2010): 20.

Business Ethics, Environmental Sustainability, and Corporate Social Responsibility

LEARNING OBJECTIVES

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

10-1. Explain why good ethics is good business in strategic management.

10-2. Explain why whistle-blowing, bribery, and workplace romance are strategic issues.

10-3. Discuss why environmental sustainability is a key issue in strategic planning.

10-4. Discuss why corporate social responsibility (CSR) is a key issue in strategic planning.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1: Strategic Planning for Coca-Cola
EXERCISE 10A: Does Coca-Cola or PepsiCo Win on Sustainability?

SET 2: Strategic Planning for My University
EXERCISE 10B: How Does My University Compare to Others on the Use of Green Power?

SET 3: Strategic Planning for Myself
EXERCISE 10C: What Is My Business Ethics Quotient?

SET 4: Individual versus Group Strategic Planning
EXERCISE 10D: How Potentially Severe Are the Various Reasons Why Workplace Romance Should Be Discouraged?

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Organizational performance entails more than simply profits. "People" and "planet," collectively with "profits," are commonly referred to as the three "Ps" that largely explain organizational performance. Increasingly, companies are following a **triple-bottom-line** approach, in which success depends on (1) the financial bottom line, (2) the social bottom line, and (3) the natural environment bottom line. Following a triple-bottom-line philosophy, organizations make conscious and strategic efforts to provide both financial profits to shareholders and contributions to communities in which the firm operates, all while minimizing damage to the environment.

Business ethics are "principles of conduct within organizations that guide decision making and behavior." Good business ethics is a prerequisite for good strategic management; good ethics is good business! Ethics is about integrity, honesty, and fairness. **Social responsibility** refers to actions an organization takes beyond what is legally required to protect or enhance the well-being of all living things, including employees. Socially responsible actions would include providing daycare for employees' children or paying for college tuition for employees. **Sustainability** refers to the extent that an organization's operations and actions protect, mend, and preserve rather than harm or destroy the environment. Switching your firm's primary energy source to solar power is an example.

Business ethics, social responsibility, and environmental sustainability issues are interrelated and impact all areas of the strategic-management process, as illustrated in Figure 10-1. The cofounder and former CEO of Microsoft Corporation, Bill Gates, is the businessperson showcased below as an exemplary strategist. Mr. and Mrs. Gates have donated more money to charity (called philanthropy) than perhaps any couple ever to live.

All strategy formulation, implementation, and evaluation decisions have ethical ramifications. Strategists such as CEOs and business owners are the persons primarily responsible for ensuring that high ethical principles are espoused and practiced within an organization. Literally hundreds of business actions are unethical, including:

1. Misleading advertising or labeling
2. Causing environmental harm
3. Producing unsafe products or services
4. Padding expense accounts
5. Insider trading
6. Dumping banned or flawed products in foreign markets
7. Discriminating against women and minorities
8. Overpricing or price gouging
9. Sexual harassment, bullying, and favortism
10. Using company resources for personal gain

EXEMPLARY **STRATEGIST** SHOWCASED

Bill Gates, Former CEO and Chairman of Microsoft Corporation

As one of the world's richest and most successful businessmen, Bill Gates is also one of the world's most ethical and philanthropic businesspersons. In 2000, Mr. Gates stepped down as CEO of Microsoft and shifted much of his attention to establishing and operating the Bill and Melinda Gates Foundation. Bill and his wife, Melinda, started the foundation with an initial contribution of $28 billion and have since grown the foundation into the world's largest private charitable foundation. The foundation works to support education, assist low-income communities, and improve global health. With a net worth of nearly $90 billion, Gates has topped *Forbes*' list of the world's billionaires for 18 of the past 23 years. For more than a decade, Mr. Gates has shifted billions of dollars of his personal money to those most in need throughout the world. As stated by Bill Gates: "Money has no utility to me beyond a certain point. Its utility is entirely in building an organization and getting the resources out to the poorest in the world." Working with Rotary International, the Bill and Melinda Gates Foundation strive to eradicate polio globally. Bill Gates was recently named by *Time Magazine* as one of the most influential people of the twentieth century.

Source: Based on https://www.forbes.com/profile/bill-gates/https://www.biography.com/people/bill-gates-9307520

11. Laundering money or engaging in bribery
12. Treating animals inhumanely
13. Overusing personal smartphone while at work
14. Polluting with inappropriate waste disposal
15. Engaging in a conflict of interest
16. Failing to protect employee and customer privacy
17. Giving inappropriate gifts
18. Failing to properly secure company records
19. Engaging in Internet fraud or theft
20. Hacking into company computers
21. Phubbing (phone snubbing, such as being on your phone when meeting with others)

Why "Good Ethics Is Good Business"

LO 10.1

A rising tide of consciousness regarding the importance of business ethics is sweeping the United States and the rest of the world. Moral breaches of ethical conduct by both public and private organizations are reported hourly on Internet websites, newspapers, magazines, social media, news media, emails, and texts—quickly spreading fact and rumor pertaining to the inside dealings of firms. For example, in late 2017, the rate of self-reported foodborne illnesses was reported to be at least nine times higher for Chipotle than all other restaurant chains, according to Patrick Quade, the founder of IWasPoisoned.com.

Increasingly, executives' and managers' personal and professional decisions are placing them in the crosshairs of angry shareholders, disgruntled employees, and even their own board of directors—making the once imperious CEO far more vulnerable to personal, public, and corporate missteps. One reason CEO salaries are high is that they must take the moral risks of the firm. Strategists are responsible for developing, communicating, and enforcing a code of business ethics for their organizations. An integral part of the responsibility of all managers is to provide ethical leadership by constant example and demonstration. Managers hold positions that enable them to influence and educate many people; managers are responsible for developing and implementing ethical decision making. Gellerman offers 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."[1]

Does It Pay to Be Ethical?

The Institute of Business Ethics (IBE) recently conducted 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 the right thing to do in principle, it pays off in financial returns." Table 10-1, on the following page, provides some results of the IBE study.

Research at DePaul University by Frigo and Litman suggests that it pays to be ethical. These researchers studied the financial performance of more than 15,000 public companies using 30 years of financial data and found that high-performing companies generally exhibit high business ethics.[2] Similarly, results of a 7-year study by Fred Kiel, author of "*Return on Character*," which followed 8,000 employees and 84 top executives of *Fortune* 500 companies, indicated that character-driven leaders deliver 5 times greater profitability results and 26 percent higher workforce engagement than self-focused leaders. Being unethical is a recipe for headaches, inefficiency, and waste.

TABLE 10-1 Seven Principles of Admirable Business Ethics

1. Be trustworthy; no individual or business wants to engage in business with an organization it does not trust.
2. Be open-minded, continually asking for "ethics-related feedback" from all internal and external stakeholders.
3. Honor all commitments and obligations.
4. Avoid misrepresenting, exaggerating, or misleading with print materials, actions, or words.
5. Visibly be a responsible community citizen.
6. Use your accounting practices to identify and eliminate questionable activities.
7. Follow the Golden Rule: "Do unto others as you would have them do unto you."

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

Bad ethics can derail even the best strategic plans. Drucker explained the following in terms of ethical leadership:

> 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 states, "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.[3]

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. No society anywhere in the world can compete long-term 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. Recent examples of bad corporate cultures are Uber Technologies and Wells Fargo & Company where lawsuits specifically zeroed in on the firms' culture.

How to Establish an Ethics Culture

A key ingredient for establishing an ethics culture is to develop a clear **code of business ethics**, however, simply having a code of ethics is not sufficient to ensure ethical business behavior. Managers must take care in considering the specific details of the content of the code, how it will be implemented, and how adherence to it will be monitored. Otherwise, a code of ethics may not even be read, understood, or believed by employees, and the code itself may well be viewed as a public relations gimmick, a set of platitudes, or window dressing. Once implemented, the code of ethics should be reinforced by showing employees examples of punishment for violating the code. The website www.ethicsweb.ca/codes provides guidelines on how to write an effective code of ethics.

Companies should take active steps to ensure that the code is read, understood, believed, and remembered. Firms should consider implementing the following four practices recommended by Donald Palmer to minimize and deter ethical wrongdoings.[4]

1. Punish wrongdoing swiftly and severely when detected.
2. Hire employees who possess high ethical standards.
3. Develop socialization programs to reinforce desired cultural values.
4. Encourage subordinates to challenge questionable orders from superiors.

Companies are increasingly formalizing cultural oversight within the organization. For example, board members at Whirlpool closely monitor the firm's culture through annual employee surveys, executive performance evaluations, and analysis of whistleblower activities. Citigroup and CACI International as well as many other firms have established formal committees designed to monitor corporate culture. To help create an ethics culture, Citicorp developed an interactive 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?"

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 ethical culture can create strategic advantage. According to Max Killan, "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." Several key ethical issues are discussed in greater detail in this chapter.

Being unethical is not abnormal or rare. Donald Palmer reports that misconduct is a normal phenomenon, that wrongdoing is as prevalent as "rightdoing," and that misconduct is most often done by people who are primarily good, ethical, and socially responsible.[5] Palmer reports that individuals engage in unethical activities because of a plethora of structure, processes, and mechanisms inherent in the functioning of organizations—and, importantly, all of us are candidates to be unethical in the right circumstances in any organization. Implications of this new research abound for managers.

Whistle-Blowing, Bribery, and Workplace Romance

LO 10.2

As social media and technology have become commonplace globally, three business ethics topics—whistle-blowing, bribery, and workplace romance—have become important strategic issues facing companies. Missteps in any of these three areas can severely harm an organization.

Whistle-Blowing

Whistle-blowing refers to employees reporting any unethical violations they discover or see in the firm. Employees should practice whistle-blowing, and organizations should have policies that encourage whistle-blowing. Three individuals once received $170 million for helping investigators obtain a record $16.65 billion penalty against Bank of America for inflating the value of mortgage properties and selling defective loans to investors. The whistle-blower payouts are among the highest ever in financial institution cases. Thousands of firms warn managers and employees that failing to report an ethical violation by others could bring discharge.

The Securities and Exchange Commission's (SEC) whistle-blowing policies virtually mandate that anyone seeing unethical activity must report such behavior. The website www.whistleblower.org describes dozens of recent whistleblower cases and rewards to individuals. Whistleblowers in the United States are protected under both the Sarbanes–Oxley and Dodd–Frank legislation.

Whistle-blowers in the corporate world receive up to 25 percent of the proceeds of legal proceedings against firms for wrongdoing. Such payouts are becoming more and more common. The SEC recently paid $30 million to a non-U.S. citizen whistle-blower who reported an ongoing fraud matter. Sean McKessy, the SEC's whistle-blower top executive, commented about the case, "Whistleblowers from all over the world should feel similarly incentivized to come forward with credible information about potential violations of the U.S. securities laws." Worldwide, local public opinion surveys indicate that Taiwan, Indonesia, Myanmar, and Portugal are the countries in which residents feel that it is the most socially acceptable to report witnessed corruption; unfortunately, however, it still remains socially unacceptable in some countries, such as Armenia, Lithuania, Hungary, and Croatia, to report corruption that one witnesses.[6]

An accountant who recently tipped off the IRS that his employer was skimping on taxes 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 U.S. 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, discussing the codes of ethics, and detailing procedures for reporting unethical behavior. Firms can align ethical and strategic decision making by incorporating ethical considerations into strategic planning, integrating ethical decision making into the performance-appraisal process, encouraging whistle-blowing, and monitoring departmental and corporate performance regarding ethical issues.

Avoid Bribery

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 money, goods, actions, property, preferment, privilege, object of value, advantage, or merely a promise or undertaking to induce the action, vote, or influence of a person in an official or public capacity.

Bribery is a crime in most countries, including the United States. Even in sports, bribery is unlawful. Late in 2017, six basketball coaches at Division I universities and a top Adidas executive were among 10 people charged with crimes including bribery and fraud as part of a wide-ranging federal investigation into corruption in college basketball. Coaches at Auburn, Oklahoma State, Arizona, Louisville, Miami, and Southern California were accused of accepting bribes in exchange for offering to steer players to preferred financial advisers, business managers, and agents. In this case, three Adidas executives were accused of arranging illicit payments for high school stars and their families to secure athlete commitments to Adidas-sponsored schools. These coaches were implicated in brokering deals between the Adidas executive and top basketball recruits.

Countries with the lowest bribery rates include Japan, Hong Kong, South Korea, Mauritius, Botswana, and Cyprus; countries with the highest bribery rates include India, Liberia, and Vietnam.[7] Anti-bribery and extortion initiatives are advocated by many global 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. Tipping is even now considered bribery in some countries. Taking business associates to lavish dinners and giving them expensive holiday gifts and even outright cash may have been expected in some countries, such as South Korea and China, but there is now increased enforcement of bribery laws virtually everywhere.

Countries with the lowest corruption rates include Denmark, New Zealand, Finland, Sweden, Switzerland, Norway, Singapore, Netherlands, Canada, Germany, and the U.K. In contrast, the most corrupt country is Somalia. Information such as this impacts company strategic decisions regarding where in the world to do business.

Workplace Romance

Workplace romance is an intimate relationship between two 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. The former head of Amazon Studios, Roy Price, recently resigned after a year-long old accusation of sexual harassment of a coworker became public.

The entertainment and media industries were recently rocked by sexual harassment allegations against public figures Harvey Weinstein, Kevin Spacey, Louis C. K., Mark Halperin, Charlie Rose, Matt Lauer, and Garrison Keillor. These and other revelations prompted the *Wall Street Journal* to publish a full two-page article titled "Is Office Romance Still Allowed?" The article reveals the following statistics about Americans at work:

- 33 percent of millennials view their workplace as a dating pool;
- 20 percent met their spouse or partner at work;
- 48 percent of women have personally experienced sexual harassment;
- 79 percent of women and 63 percent of men disagree that harassment reports are exagerrated.

Workplace romance between two consenting employees simply happens, so the question is generally not whether to allow the practice, or even how to prevent it, but rather how best to manage it. A recent survey by CareerBuilder found that nearly 40 percent of workers have dated a coworker, and approximately 30 percent of those relationships resulted in marriage.[8] An organization 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, workplace romance could 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.
7. Conflicts of interest can arise, especially when the well-being of the partner trumps the 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 and policies that address workplace romance, for at least six reasons:

1. Guidelines can enable the firm to better defend 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, as well as recent court cases.
6. Lack of any guidelines sends a lackadaisical message throughout the firm.

A *Wall Street Journal* article recaps U.S. standards regarding supervisor and subordinate romantic rlationships at work.[10] The report reveals that only 5 percent of all firms sampled have no restrictions on such relationships; 80 percent of firms have policies that prohibit relationships between a supervisor and a subordinate; 4 percent of firms strictly prohibit all such relationships; 39 percent have policies that require individuals to inform their supervisors whenever a romantic relationship begins with a coworker; and 24 percent of firms require 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 and workplace romance 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." Former World Bank president Paul Wolfowitz was forced to resign as a result of a relationship he had with a bank staff member.

In general, company guidelines or policies in general should discourage workplace romance because "the downside risks generally exceed the upside benefits" for the firm. Workplace romance guidelines should specify certain situations in which affairs are especially discouraged, such as between a supervisor and subordinate, and should also detail the types of relationships allowed, such as between peer-level employees in different departments who also have different career paths. Importantly, the workplace romance policy guidelines should apply to all employees at all levels of the firm and should clearly state the actions management will take if employees violate any terms of the policy.

As a result of increasing sexual misconduct allegations across companies and organizations, more and more firms are requiring their employees to complete sexual harassment training. The large advertising firm Interpublic Group of Companies is having all of its 20,000 U.S. employees complete sexual harassment training even though the firm has had no legal problems. Dell, Rockwell Automation, 21st Century Fox, ESPN, and Facebook are other firms initiating sexual harassment training for employees. Most universities require all faculty to complete training regarding how to handle situations where a student mentions experiencing some forms of sexual harassment by another student, faculty, or staff member. U.S. laws require that faculty report any instance, claim, or even suggestion of sexual harassment from a student to university administrators.

LO 10.3

Environmental Sustainability

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 global warming, depletion of rain forests, destruction of animal habitats, protecting endangered species, and waste management. Firms are increasingly developing green product lines that are biodegradable or made from recycled products. Managing the health of the planet requires an understanding of how international trade, competitiveness, and global resources are connected. Managing environmental affairs, for example, 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 firms in India have a problem with this issue, as mentioned in Global Capsule 10.

Businesses must not exploit and decimate the natural environment. Mark Starik at George Washington University believes, "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, the word **environment** is defined as surroundings in which an organization operates, including air, water, land, natural resources, flora, fauna, humans, and their interrelation. Many firms are gaining competitive advantage by being good stewards of the natural environment. Green products sell well.

Employees, consumers, governments, and societies are often 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 at an all-time high.

GLOBAL CAPSULE 10

India Is Turning Garbage into Cash

The Indian city of Mysuru (formerly Mysore) is leading the way for all of India to turn its garbage into compost and energy. India generates about 62 million tons of solid waster every year and that amount is expected to increase fivefold by 2051, so the country is revamping how it handles garbage. Currently only about 28 percent of India's garbage is treated and processed out of the 82 percent that is actually collected. The other 18 percent that is not collected at all ends up in drains, waterways, landfills, and/or is consumed by animals. But in Mysuru, 50 percent of garbage is turned into compost and another 25 percent is recycled. India's Modi administration currently has 56 waste-to-energy power plants under construction and has installed incentives and requirements for all municipalities in India to handle their garbage more effectively and efficiently. Other cities in India leading the way on turning garbage into cash are Suryapet, Warangal, Kolar, and Vengurla.

Muan simte/123RF

Source: Based on Bibhudatta Pradhan, "Can India Turn Garbage Into Cash?" *Bloomberg Businessweek*, January 15, 2018, p. 33.

Sustainability Reports and the Environmental Protection Agency (EPA)

A **sustainability report** reveals how 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. For example, Coca-Cola's annual sustainability reports are provided online at http://www.coca-colacompany.com/stories/sustainability-reports.

No business wants the reputation of being a polluter. For the first time ever in the United States, cars, trucks, planes, and trains have displaced power plants as the biggest polluters. This trend is accelerating, as the nation's electrical grid gets cleaner faster than the transportation means.

A bad sustainability record will hurt any firm in any 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. It is simply good business for any organization to provide a sustainability report annually to the public. The Global Reporting Initiative provides a set of detailed reporting guidelines specifying what information should go into sustainability reports (https://www.globalreporting.org/information/sustainability-reporting/Pages/default.aspx).

The proxy advisory firm Institutional Shareholder Services reports that an increasing number of shareholder groups are pushing firms to provide sustainability information annually. 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 or model to follow in preparing their own report.

Around the world, political and corporate leaders now realize that the "green business" topic is not going away and in fact is gaining ground rapidly. 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 formally 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. 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 social performance (facts and figures) must back up its rhetoric and be consistent with sustainability standards.

Many companies are moving the corporate environmental group to report directly to the CEO. 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 the following:

1. Developing or acquiring green businesses
2. Divesting or altering environment-damaging businesses
3. Becoming a low-cost producer through waste minimization and energy conservation
4. Pursuing a differentiation strategy through green product features
5. Including an environmental or sustainability representative on their board of directors
6. Conducting regular environmental audits
7. Implementing bonuses for favorable environmental or conservation-related results
8. Becoming involved in environmental issues and programs
9. Incorporating environmental values in mission statements
10. Establishing environmentally oriented objectives
11. Acquiring "green" skills
12. Providing environmental training programs for company employees and managers.

Through its Green Power Partnership, the EPA works with organizations to increase the use of green power as a percentage of total electricity use. Table 10-2 and Table 10-3, on the following pages, reveal the top 15 "green" retailers and universities, respectively, based on kilowatts (KWh) of green power used annually. (Note: Green power is renewable, such as wind, solar, and water, as opposed to fossil fuels, such as oil, gas, and coal that are not renewable). Note below that Kohl's and the University of Tennessee at Knoxville are the total KWh green-power usage leaders for retail companies and higher education institutions, respectively. Many commercial and residential builders now offer solar panels as standard equipment on homes and offices.

TABLE 10-2 The Top 15 Green Power-Use Retailers (2017)

Retail Partner Name	Annual Green-Power Usage (KWh)	Green Power of Total Electricity Use (%)	Green-Power Resources
1. Kohl's Department Stores	1,429,423,791	115	Solar, Wind
2. Starbucks (company-owned cafe retail stores)	975,575,000	105	Wind
3. IKEA	776,143,808	310	Biogas, Solar, Wind
4. Wal-Mart Stores, Inc.	747,587,534	4	Solar, Wind
5. Ahold USA	358,867,165	19	Solar
6. Best Buy	282,103,000	31	Various
7. H&M	276,291,000	100	Various
8. REI	87,146,830	117	Solar, Wind
9. H-E-B Grocery Company	85,104,333	5	Solar, Wind
10. The Estee Lauder Companies Inc./ Operations and Selected Retail Brands	60,685,392	88	Solar, Wind
11. Sundance Square	30,334,826	46	Wind
12. The North Face	21,778,186	115	Solar, Wind
13. Giant Eagle, Inc.	20,000,000	3	Wind
14. Panera Bread/ Maryland Locations	15,212,943	100	Wind
15. Staples	15,064,852	3	Biogas, Solar, Wind

Source: Based on information at https://www.epa.gov/greenpower/green-power-partnership-top-30-retail

Solar panels have become quite cost effective and they "exhume good ethics rather than bad fumes." Kohl's has converted nearly all of its 80 California stores to solar power.

International Standardization Organization (ISO) Certification

Based in Geneva, Switzerland, the International Organization for Standardization (ISO) is a network of national standards institutes of 162 countries, with one member per country. The ISO is the world's largest developer of sustainability standards. ISO has published nearly 22,000 international standards covering almost every industry, from healthcare to agriculture to food safety to technology. ISO standards reveal "required" specifications for products, services, and systems to ensure quality, safety, and efficiency; ISO standards facilitate international trade and commerce.

Widely accepted all over the world, ISO standards are voluntary because the organization itself does not regulate or legislate. Governmental agencies in various countries, such as the U.S. EPA, 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. Businesses and municipalities should consider becoming ISO certified to help attract business.

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. These standards have been adopted by thousands of firms and municipalities worldwide to certify to their constituencies that they are conducting business in an environmentally friendly manner; these standards offer a universal technical benchmark for environmental compliance that more and more firms are requiring not only of themselves but also of their suppliers and distributors. Included in the ISO 14000 series are the **ISO 14001** standards in fields

TABLE 10-3 The Top 15 Green-Power Use Colleges and Universities (2017)

Partner Name	Annual Green Power Usage (KWh)	Green Power of Total Electricity Use (%)	Green-Power Resources	Athletic Conference
1. University of Tennessee, Knoxville	250,070,000	94	Solar, Wind	Southeastern Conference
2. University at Buffalo, the State University of New York	211,977,208	97	Solar, Wind	Mid-American Conference
3. University of Pennsylvania	200,000,000	52	Wind	Ivy League
4. Georgetown University	159,640,000	129	Wind	Big East Conference
5. Stanford University	154,190,253	53	Solar	Pac-12 Conference
6. University of Oklahoma	128,895,000	69	Wind	Big 12 Conference
7. Carnegie Mellon University	128,593,388	100	Solar, Wind	University Athletic Association
8. University of California	128,084,650	11	Biogas, Biomass, Solar, Wind	Numerous
9. Northwestern University	122,014,800	50	Solar, Wind	Big Ten Conference
10. The Ohio State University	107,499,814	17	Wind	Big Ten Conference
11. University of North Texas	107,250,000	100	Solar, Wind	Conference USA
12. Oklahoma State University	101,559,806	71	Wind	Big 12 Conference
13. University of Missouri	97,892,973	37	Biomass, Solar, Wind	Southeastern Conference
14. University of Maryland	96,927,825	34	Biogas, Small-hydro, Solar, Wind	Big Ten Conference
15. Drexel University	96,509,000	100	Solar, Wind	Colonial Athletic Association

Source: Based on information at https://www.epa.gov/greenpower/green-power-partnership-top-30-college-university

such as environmental auditing, environmental performance evaluation, pollution prevention, environmental labeling, and life-cycle assessment. According to the ISO 14001 standard, a community or organization is required to put in place and implement a series of practices and procedures that, when taken together, result in an **environmental management system (EMS)**. 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.

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.

Table 10-4 reveals the impact that bad environmental policies have on songbirds and coral reefs, two of nature's many ecosystems.

TABLE 10-4 Songbirds and Coral Reefs Need Help

Songbirds

Being a good steward of the natural environment can help save our songbirds. Bluebirds are one of 76 songbird species in the United States 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; other scientists 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 be 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.[11] Many companies now make it a point to keep/maintain "green" areas on their properties.

Coral Reefs

Being a good steward of the natural environment can help save our coral reefs. Oceans cover more than 71 percent of the Earth. Although coral reefs occupy only 1 percent of the world's marine system, they are home to more than a quarter of marine species, including unique fish, turtles and algae, all of which depend on the reef for survival. The destructive effect of commercial fishing on ocean habitats coupled with increasing pollution runoff into oceans, as well as global warming, 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. 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 United States is only about 50 square miles, compared to some 93 million acres of national wildlife refuges and national parks on the nation's land.[12]

LO 10.4

Corporate Social Responsibility (CSR)

Social responsibility refers to a firm's obligation to care for its employees, customers, communities, and society in which it operates. For example, the food seasoning firm McCormick & Company states that its corporate social responsibility (CSR) goals for 2025 include working to "improve the health and well-being of all people, building resilience in communities around the world and positively impacting the environment." 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 firm's costs of the future, because if this is not achieved, no other social responsibility can be met. Indeed, no social need can be met if the firm fails. Many economists suggest that firms should not engage much, if any, in philanthropy because simply making a profit is difficult, and shareholders expect a high return on their investment. However, substantial research reveals a u-shaped relationship between CSR and corporate financial performance, whereby firms with the greatest CSR are generally also the firms with the highest financial performance; firms with the lowest CSR tend to have higher performance than those with moderate social responsibility.

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, if a firm avoids cutting jobs to protect employees' livelihood, and that decision forces the firm to liquidate, then all the employees lose their jobs. Walmart selectively engages in social responsibility efforts that directly complement its business initiatives. For example, between 2017 and 2021, Walmart will reportedly contribute more than $20 million to disaster relief and prevention efforts. As evidenced in the Ethics Capsule 10, an exemplary company regarding social responsibility is TOMS Shoes; the example reveals there are hundreds of different ways a company can be socially responsible.

ETHICS CAPSULE 10

TOMS Shoes, Inc.: Shoes Are Magic, Put Shoes on Every Child on the Planet

Yongju Kwon/Shutterstock

Headquartered in Santa Monica, California, TOMS Shoes exhibits high social responsibility, excellent business ethics, and a daily commitment to fair-labor practices and environmentally sustainable design and manufacturing. Founded by Blake Mycoskie, TOMS emphasizes philanthropy as an integral part of its business model—as evidenced with its "One for One" program through which the company donates a pair of shoes or provides vision care with every respective shoe or pair of sunglasses purchased. Another key tenet of TOMS' business model is its nonprofit foundation, Friends of TOMS, which organizes and leads several meaningful service activities, including the One Day Without Shoes initiative aimed at raising global awareness of health risks associated with not wearing shoes. Supporters of TOMS have the opportunity to volunteer for service trips to countries where the company's donations will be distributed to local communities in need. On their website, www.tomscampusprograms.com, TOMS provides students with information related to how they too can become involved with the company's philanthropic efforts. TOMS Shoes showcases how good ethics, sustainability, and social responsibility is good business; the company not only has excellent financial performance but is doing noticeably well in all three areas of the triple-bottom line performance (profits, people, and planet).

Source: Based on http://www.toms.com/about-toms#companyInfo and https://www.privco.com/private-company/toms-shoes#.

Food Suppliers and Livestock Welfare

CSR extends to the 9-plus billion land animals raised in the United States annually for food; many of these animals live their short lives in inhumane factory-like structures. Animal welfare concerns are on the rise among consumers; retailers are beginning to respond to such concerns by increasingly demanding that food suppliers provide humane treatment of animals. A recent study by market research firm Packaged Facts revealed that more than half of U.S. consumers are significantly more concerned with livestock welfare than they have been in past years. The report explained how animal welfare and the humane treatment of animals raised for food will soon become a new standard shaped by next-generation consumer expectations.

A large-scale survey by the American Society for the Prevention of Cruelty to Animals (ASPCA) found that U.S. consumers (67 percent to be exact) are demanding meat, eggs, and dairy products that have higher welfare standards, even if it means paying more for the products. ASPCA believes that "animals are entitled to kind and respectful treatment at the hands of humans and must be protected under the law." Recent video footage at Florida-based Larson Dairy showed workers kicking cows and striking them with metal rods; the Okeechobee County Sheriff's Office launched an investigation and Publix Supermarkets stopped taking milk deliveries from Larson.

Policies aimed at improving livestock welfare are increasingly being developed and approved by lawmakers around the world. In addition to newly emerging, more stringent regulations surrounding livestock welfare, substantive scientific research studies are beginning to reveal significant financial benefits of enhanced animal welfare guidelines. For example, heat stress and rough handling often lower the quality, safety, and value of livestock by bruising the meat, reducing growth, and even inhibiting reproduction. As a result, large food companies such as Whole Foods, Bon Appetit, Sodexo, and Aramark have implemented more animal-friendly policies.

Pete Stanton and Gerry LaFlamme, founder of the largest free-range egg producer in the United States, Pete & Gerry's Organic Eggs, offered suggestions for companies seeking to grow sustainable humane practices:

> Build your brands and company on a mission that you fully believe in, your employees believe in, and most importantly, your customers can believe in. The mission of the business may not be the reason people buy your product, but it should be the reason they can believe in who you are and in your brand. For your employees, a strong mission is critical; anyone can work at a job, but not everyone is fortunate enough to work on something that is meaningful, that offers them a sense of pride and accomplishment. The mission of your business should be the engine and the fuel that keeps you moving ahead, even during difficult times.[13]

Wildlife Welfare

CSR also extends to wildlife. Consumers globally are becoming increasingly intolerant of any business or nation that directly or indirectly destroys wildlife, especially endangered wildlife, such as tigers, elephants, whales, songbirds, and coral reefs. Affected businesses range from retailers that sell ivory chess pieces to restaurants that sell whale meat. Many New Zealanders, supported by Australians, are outraged about Japan's large-scale whaling operations in the Antarctic. In a recent annual Antarctic hunt, Japanese whaling fleets caught and killed nearly 500 whales as part of a "research project on the ecological system in the Antarctic Sea and Northwest Pacific." Ironically, Japan is a member of the International Whaling Commission that has banned commercial whaling in a 50-million-square-mile-area around Antarctica known as the Southern Ocean Whale Sanctuary. Only a few countries—such as Norway, Iceland, and Japan—favor and engage in commercial whaling. Norway has been criticized globally in recent years for continuously launching whale-hunting expeditions and killing more than 700 minke whales each year, many of them pregnant females. Countries, municipalities, and companies run the risk of being boycotted and exposed for direct or indirect wildlife endangering practices.

Nearly 100 million sharks are killed each year solely to cut off (and sell) their fins.[14] Although "shark-finning" was outlawed in U.S. waters in 2000, the law does not ban fin imports or serving the fins in food, resulting in about 65 metric tons of fins being imported in the United States annually. Only eight U.S. states have laws banning the sale of shark fins in food: Hawaii, Oregon, Washington, Illinois, California, Maryland, New York, and Delaware. The problem is much worse in some countries, especially China, which is the world's largest consumer of shark fins. Most of the shark fins are used to make the delicacy, shark fin soup, which can sell for nearly $100 per bowl. A pair of shark fins can sell for as much as $700 per kilogram in Asia. More than 30 percent of the world's shark species now face extinction, according to the International Union for Conservation of Nature because sharks are being killed almost 30 percent faster than they can reproduce.

A spokesperson for the Foundation for National Parks and Wildlife in Australia says koala populations are down from 100,000 a few years ago to just 40,000 now. Forest fires, stress-induced diseases, and business development have crushed koala bear populations. When the marsupial bears leave their trees to relocate, they are often killed by predators and vehicles. Experts say the bears will be extinct by 2040 unless something is done now.

What Firms Are the Best CSR Stewards?

Corporate Responsibility Magazine annually conducts and publishes research on the 100 Best Corporate Citizens. Companies are ranked in seven categories, including (1) environment, (2) climate change, (3) employee relations, (4) human rights, (5) corporate governance, (6) financial performance, and (7) philanthropy and community support. The top 10 Best Corporate Citizens for 2017 were as follows:

1. Hasbro
2. Intel
3. Microsoft
4. Altria Group
5. Campbell's Soup Company
6. Cisco Systems
7. Accenture
8. Hormel Foods
9. Lockheed Martin
10. Ecolab

Source: Based on information at https://www.forbes.com/sites/karstenstrauss/2017/05/11/americas-100-best-corporate-citizens-in-2017/#1c309d752b68

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 favor among its stakeholders for its actions. Firms are becoming more proactive by doing more than the bare minimum to develop and implement strategies that preserve the environment and help local communities.

Forbes' list of best global companies in regard to consumers' perceptions of social responsibility are listed in Table 10-5. With a top-to-bottom approach to CSR, the number one ranked firm, Danish toy company The Lego Group, embraces socially-responsible opportunities through its Build the Change and Sustainable Materials Center initiatives, as well as through its partnership with the World Wildlife Fund.

TABLE 10-5 10 Companies with the Best CSR Reputation as Rated by Consumers

1. The Lego Group
2. Microsoft
3. Google
4. Walt Disney Company
5. BMW Group
6. Intel
7. Robert Bosch
8. Cisco Systems
9. Rolls-Royce Aerospace
10. Colgate-Palmolive

Source: Based on information at https://www.forbes.com/sites/karstenstrauss/2017/09/13/the-10-companies-with-the-best-csr-reputations-in-2017/#3bf7894b546b

IMPLICATIONS FOR STRATEGISTS

Figure 10-2 reveals that the entire strategic-management process is designed to gain and sustain competitive advantages, but all can be lost with ethical violations, ranging from bribery to sexual harassment to selling whale meat. Consider this: Trees die from the top; strategists are at the top of the firm, meaning that ethical problems at the top of a firm spell dire consequences for lower levels. Strategists must set an exemplary example personally and professionally to establish and continually reinforce an organizational culture for "doing the right thing." Social responsibility and environmental sustainability policies, practices, and procedures must reinforce a "triple-bottom-line" approach that emphasizes "good ethics is good business" and "good ethics is the foundation for everything we do and say."

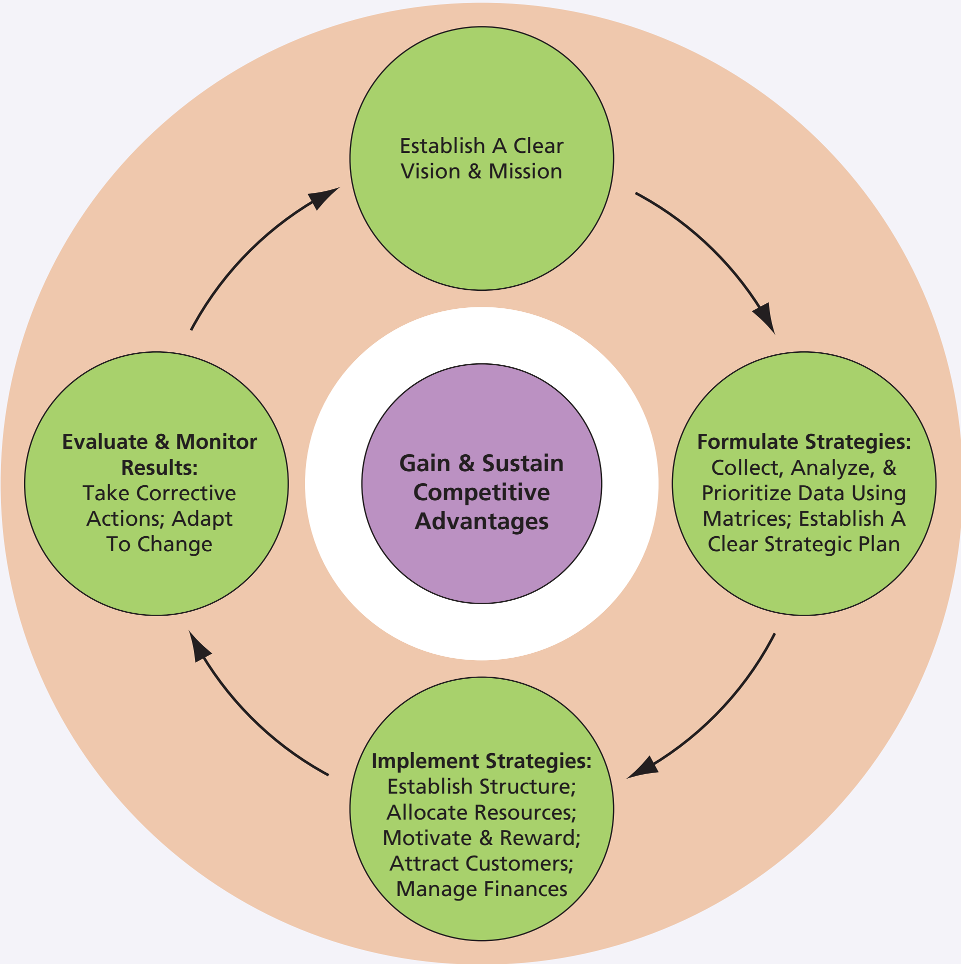

FIGURE 10-2
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

No company or individual wants to do business with someone who is unethical or insensitive to natural environment concerns. To survive, companies must be environmentally proactive; it is expected, and in many respects, is the law. On a daily basis, firms are being compared to rival firms on sustainability and ethics behavior, and constantly using social media. 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 financially-sound suggestions for the firm to be a good corporate citizen and promote that for competitive advantage. Although the first responsibility of any business is to stay in business, so the triple-bottom-line approach can be an effective means for framing your entire project.

Chapter Summary

In a final analysis, ethical standards come out of history and heritage. Our predecessors left us with an ethical foundation on which to build. 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 ethical 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, developing 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. 332)
bribery (p. 332)
business ethics (p. 328)
code of business ethics (p. 330)
environment (p. 334)
environmental management system (EMS) (p. 337)
ISO 14000 (p. 336)
ISO 14001 (p. 336)
sexual harassment (p. 332)
social responsibility (p. 328)
sustainability (p. 328)
sustainability report (p. 335)
triple-bottom-line (p. 328)
whistle-blowing (p. 331)
workplace romance (p. 332)

Issues for Review and Discussion

10-1. Explain the triple-bottom-line approach to managing any business or organization.

10-2. How does TOMS Shoes uniquely meet its social responsibility obligations?

10-3. As a part of its Global Coalition Against Corruption, Transparency International publishes annual corruption perception indices that rank countries according to their relative corruption levels. Name 3 countries in the top 20 (least corrupt). Name three countries in the bottom 20 (most corrupt).

10-4. What do whales, sharks, songbirds, and coral reefs have in common? What are the implications for companies?

10-5. Does it pay to be socially responsible? In general, economists say *no* and philanthropists say *yes*. What do you say? Why? What are the implications for companies?

10-6. Summarize Donald Palmer's research regarding "Who Is Prone to Be Unethical in a Business?" What are the implications for companies?

10-7. Chick-fil-A is closed on Sundays. Is that wise management or irresponsible activism? Discuss.

10-8. List five reasons why workplace romance can be detrimental to workplace morale and productivity.

10-9. List five benefits of having workplace romance guidelines in a workplace.

10-10. Discuss the ethics of workplace romance.

10-11. Explain why concern for wildlife is a strategic issue for firms.

10-12. Explain why whistle-blower payouts by the federal government to informants are becoming more and more common.

10-13. AOL has 100 lobbyists on its payroll and spends about $20 million on lobbying in Washington, DC, annually. Is this ethical?

10-14. 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?

10-15. What do you feel is the relationship between personal ethics and business ethics? Are they or should they be the same?

10-16. How can firms best ensure that their code of business ethics is read, understood, believed, remembered, and acted on, rather than ignored?

10-17. Why is it important *not* to view the concept of whistle-blowing as "tattle-telling" or "ratting" on another employee?

10-18. List six desired results of "ethics training programs" in terms of recommended business ethics policies and procedures in the firm.

10-19. 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.

10-20. 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?

10-21. What is the International Standardization Organization (ISO)? What is the purpose of the ISO 14001 standards, and what types of entities can receive these certifications?

10-22. How are policies and procedures changing regarding growing animals for slaughter for supermarkets?

10-23. Is it a conflict of interest for companies to encourage employee whistle-blowing because the firm could be fined heavily or incur worse penalties? Explain.

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 10A

Does Coca-Cola or PepsiCo Win on Sustainability?

Purpose

Sustainability reports are increasingly becoming expected or even required by business organizations. This exercise will give you practice in comparing and evaluating sustainability reports.

Instructions

Step 1 Go to the Coca-Cola corporate website and click on Sustainability and review the company's most recent Sustainability Report. Determine the six best aspects of the Coca-Cola report.

Step 2 Go to the PepsiCo corporate website and click on Sustainability and review the company's most recent Sustainability Report. Determine the six best aspects of the PepsiCo report.

Step 3 Develop a report comparing and contrasting the two companies' Sustainability Report with regard to business ethics, social responsibility, and environmental sustainability. In your opinion, does Coca-Cola receive a grade of A on their business ethics, social responsibility, and sustainability efforts? Grade each company on the three dimensions, and give each an overall grade. Justify your grades.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 10B

How Does My University Compare to Others on the Use of Green Power?

Purpose

Green energy sources include wind, geothermal, hydro, and solar energy. Wind and hydro sources generate energy through the movement of air and water, whereas geothermal and solar sources generate energy through heat. All, however, provide renewable, reliable energy and protect the environment. In contrast, fossil-fuel energy sources, such as oil, gas, and coal, are not renewable and pollute the environment. The purpose of this exercise is to determine where your university would rank among all universities on its reliance of green energy.

Instructions

Step 1 The following website reveals colleges and universities rated according to the extent that they use green energy sources to operate.
https://www.epa.gov/greenpower/green-power-partnership-top-30-college-university
Even if your university is not listed in the current report by the EPA, conduct research to determine where your institution would rank.

Step 2 Develop an action plan to move your university towards greater reliance on green energy.

SET 3: STRATEGIC PLANNING FOR MYSELF

EXERCISE 10C

What Is My Business Ethics Quotient?

Purpose

This chapter reveals that being unethical is not abnormal or rare. Misconduct is a normal phenomenon and wrongdoing is as prevalent as “rightdoing,” Misconduct is most often done by people who are primarily good, ethical, and socially responsible. Palmer reports that individuals engage in unethical activities because of a plethora of structure, processes, and mechanisms inherent in the functioning of organizations, and, importantly, all of us are candidates to be unethical under the right circumstances in any organization. Implications of this new research abound for managers.

The purpose of this exercise is to determine your business ethics quotient. We can use the word quotient to refer to the extent that your behavior and attitude are good or bad compared to your fellow business students. In this exercise, your business ethics quotient can range from very bad (total score of 16) to very good (total score of 80). (Donald Palmer, “The New Perspective on Organizational Wrongdoing,” *California Managment Review*, 56, no. 1 (2013): 5–23).

Instructions

Step 1 Rate your personal behavior and attitude on the following dimensions on a 1- to 5-scale where 1 is really bad, 2 is bad, 3 is OK, 4 is good, and 5 is really good. Beside each word given, rate yourself compared to your fellow business students.

1. Trustworthy
2. Reliable
3. Dependable
4. Caring
5. Humble
6. Considerate
7. Compassionate
8. Forgiving
9. Loving
10. Courteous
11. Respectful
12. Reverent
13. Supportive
14. Encouraging
15. Helpful
16. Giving

Step 2 Sum your ratings to determine your total business ethics quotient score. Are you pleased with your score? Do you need to improve your score? How can you improve your score? Would a business thinking of hiring you be pleased with your score?

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 10D

How Potentially Severe Are the Various Reasons Why Workplace Romance Should Be Discouraged?

Purpose

This chapter discusses workplace romance as being potentially 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 person or a third party.
7. Conflicts of interest can arise, especially when wellbeing of the partner trumps wellbeing of the firm.

The purpose of this exercise is to examine more closely the reasons why workplace romance can cause problems. In addition, the purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Instructions

Rank the seven reasons why workplace romance can cause problems as to their relative importance (potential severity), where 1 = most important, to 7 = least important). Use Table 10-6. First, rank the reasons as an individual. Then, rank the seven reasons as part of a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision making in strategic planning.

Steps

1. Fill in Column 1 in Table 10-6 to reveal your individual ranking of the relative importance of the seven reasons (1= most important, 2 = next most important, etc.) in terms of how potentially damaging each reason can be. For example, if you think Reason #1 (Favoritism) is the eighth-most important (potentially severe) reason, then enter an 8 in Table 1 in Column 1 beside Favoritism.
2. Fill in Column 2 in Table 10-6 to reveal your group's ranking of the relative importance of the seven reasons (1= most important, 2 = next most important, etc.) in terms of how potentially damaging each reason can be.
3. Fill in Column 3 in Table 10-6 to reveal the expert's ranking of the seven reasons in terms of how potentially damaging each reason can be.
4. Fill in Column 4 in Table 10-6 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 10-6 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

TABLE 10-6 Workplace Romance Analysis: Comparing Individual versus Group Decision Making

Reasons Why Workplace Romance Is Not Recommended	Column 1	Column 2	Column 3	Column 4	Column 5
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 male or a third party.					
7. Conflicts of interest can arise, especially when wellbeing of the partner trumps wellbeing of the firm.					
Sums					

MINI-CASE ON CHICK-FIL-A

WHAT COMPANY HAS THE MOST ETHICAL BUSINESS CULTURE?


Jurgenfr/Shutterstock

The answer: Chick-fil-A. Headquartered in Atlanta, Georgia, Chick-fil-A is a privately-held company that prides itself on demonstrating high business ethics, anchored by being closed once a week to spend time with family and friends. Despite being closed one-seventh of the time, Chick-fil-A has surpassed Kentucky Fried Chicken (KFC) as the largest chicken quick-service restaurant (QSR) in the United States by revenue. This is shocking because there are only about 2,200 Chick-fil-A's in the nation, compared to KFC's 4,500. Total annual revenues for Chick-fil-A are about $5 billion.

Each Chick-fil-A restaurant averages more than $4.4 million in annual sales, more than three times KFC's average at $1 million. In fact, Chick-fil-A's average sales per restaurant is highest of all restaurants in the United States, with the number two chain being Whataburger, which generates $2.7 million per restaurant, a mere 61 percent of Chick-Fil-A. In terms of direct chicken restaurant rival firms, Chick-fil-A dominates in annual per-restaurant sales, toppling direct competitors Zaxby's ($2.3 million), El Pollo Loco ($1.9 million), Bojangles' ($1.8 million), Popeyes ($1.4 million), Boston Market ($1.4 million), and Wingstop ($1.1 million).

About 65 percent of Check-fil-A's business is through its drive-thru where employees stand outside the restaurant taking orders on tablets. Research shows that Chick-fil-A employees say "thank you" 97 percent of the time; customers report that employees have a pleasant demeanor and smile in 9 out of 10 visits. The company's employee retention rate is exceptionally high. Chick-fil-A has the second-highest rate of accuracy at the drive-thru of all restaurants, getting orders right 95 percent of the time, second only to Carl's Jr.'s accuracy rate of 97 percent, in a recent study.

The only aspect of business where Chick-fil-A does not rank highly is in speed of service. The average wait time at Chick-fil-A's drive thru is 4 minutes and 16 seconds, which is about 31 seconds longer than the average drive-thru wait time. But all in all, Chick-fil-A is an exemplary triple-bottom-line company.

Questions

1. Describe the business culture at Chick-fil-A.
2. To what extent does Chick-fil-A's culture account for Chick-fil-A's performance?
3. How would you grade Chick-fil-A's triple-bottom-line? Why?
4. Should Chick-fil-A change its policy and be open on Sundays since all its major rivals are open on Sunday? Why or why not?

Source: Based on http://dailycaller.com/2017/08/02/chick-fil-a-generates-most-revenue-per-restaurant-in-us/Also, http://www.businessinsider.com/why-chick-fil-a-is-so-successful-2016-10

Web Resources

1. **Forbes** reveals the top-rated companies for corporate social responsibility.
https://www.forbes.com/sites/karstenstrauss/2017/09/13/the-10-companies-with-the-best-csr-reputations-in-2017/#3bf7894b546b
2. **EPA** reveals the top-rated universities that operate using green power such as solar and wind.
https://www.epa.gov/greenpower/green-power-partnership-top-30-college-university
3. **EPA** reveals the top-rated retail companies that operate using green power such as solar and wind.
https://www.epa.gov/greenpower/green-power-partnership-top-30-retail
4. **Transparency International** Reveals the least corrupt and most corrupt countries on the plant.
https://www.transparency.org/news/feature/corruption_perceptions_index_2016
5. **Global Reporting Initiative** gives guidelines for what to include in a Sustainability Report.
https://www.globalreporting.org/information/sustainability-reporting/Pages/default.aspx
6. **U.S. Fish and Wildlife Service's Endangered Species Program** provides excellent tips on how you can help save wildlife and plants in your everyday life.
https://www.fws.gov/endangered/esa-library/pdf/what_you_can.pdf

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1. Saul Gellerman, "Why 'Good' Managers Make Bad Ethical Choices," *Harvard Business Review* 64, no. 4 (July–August 1986): 88.
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11

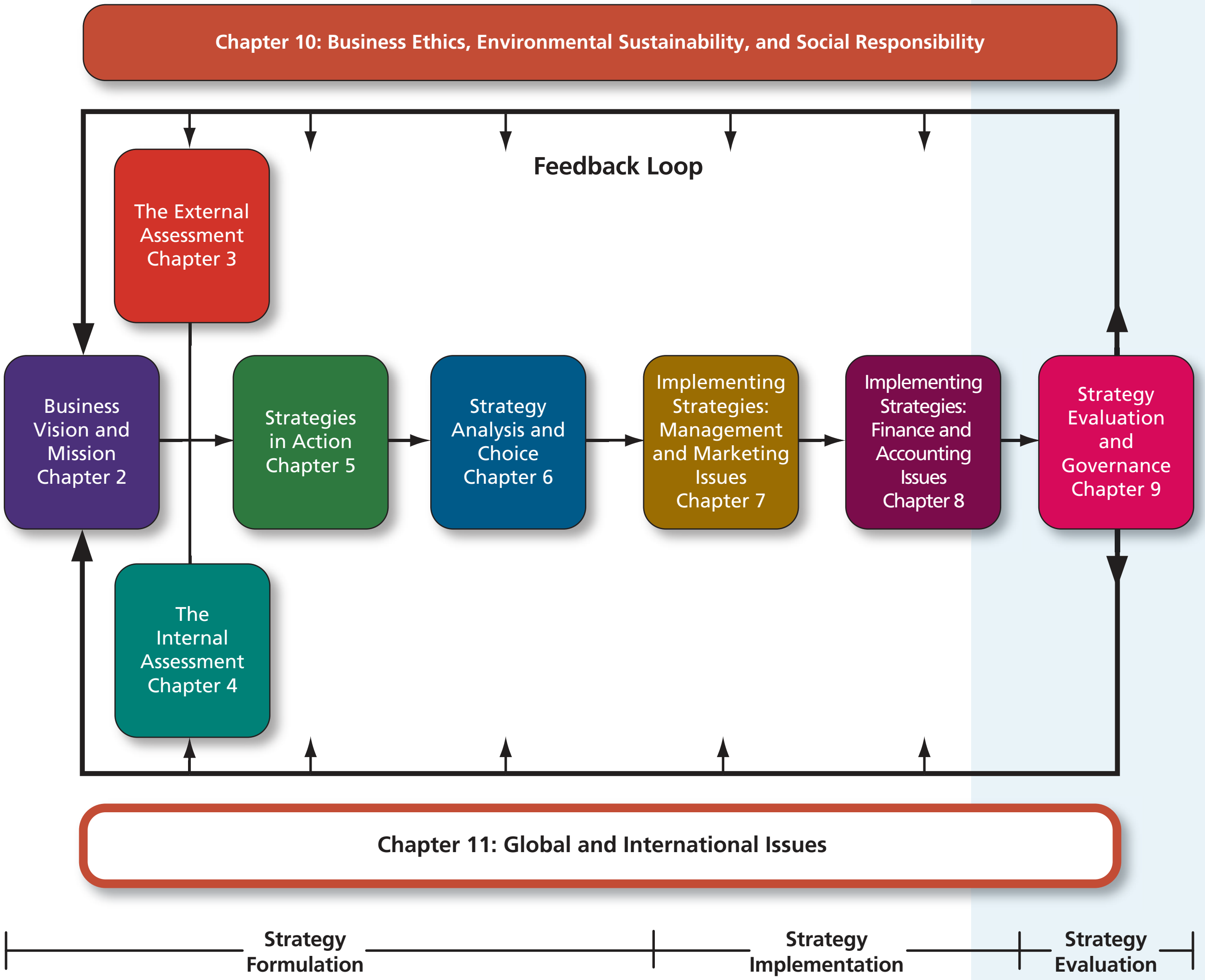

FIGURE 11-1

The Comprehensive, Integrative Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 1 (February 1989): 91. See also Anik Ratnaningsih, Nadjadji Anwar, Patdono Suwignjo, and Putu Artama Wiguna, "Balance Scorecard of David's Strategic Modeling at Industrial Business for National Construction Contractor of Indonesia," *Journal of Mathematics and Technology*, no. 4, (October 2010): 20.

Global and International Issues

LEARNING OBJECTIVES

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

11-1. Discuss the nature of doing business globally, including labor union issues and tax rates.

11-2. Explain the advantages and disadvantages of doing business globally.

11-3. Discuss the global challenge facing firms, including outsourcing and reshoring.

11-4. Compare and contrast American business culture versus foreign business cultures; explain why this is a strategic issue.

11-5. Discuss business culture, with emphasis on Mexico, Japan, China, and India.

11-6. Discuss business climate, with emphasis on Africa, China, Indonesia, India, and Mexico.

ASSURANCE-OF-LEARNING EXERCISES

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

SET 1: Strategic Planning for Coca-Cola

EXERCISE 11A: Business Culture Variation across Countries: A Report for Coca-Cola Company

EXERCISE 11B: Coca-Cola Wants to Further Penetrate Africa. Can You Help Them?

SET 2: Strategic Planning for My University

EXERCISE 11C: Does My University Recruit in Foreign Countries?

SET 3: Strategic Planning to Enhance My Employability

EXERCISE 11D: How Well-Traveled Are You Compared to Your Colleagues?

SET 4: Individual versus Group Strategic Planning

EXERCISE 11E: How Important Are Various Potential Advantages to Initiating, Continuing, or Expanding a Firm's International Operations?

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Global considerations impact virtually all strategic decisions, as illustrated with white shading in Figure 11-1. The boundaries of countries can no longer define the limits of our imaginations. To see and appreciate the world from the perspective of others has become a matter of survival for many businesses. To survive and grow, more and more companies are monitoring and capitalizing on changes in competitors, markets, prices, suppliers, distributors, governments, creditors, shareholders, and customers worldwide.

The price and quality of a firm's products must be competitive on a worldwide basis, not just on a local basis. Shareholders expect substantial revenue growth; doing business globally is an excellent way to achieve this end. More and more countries are 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 on a global scale. As indicated in the exemplary strategist capsule, CEO Andre Calantzopoulos is leading his company to succeed globally.

LO 11.1 The Nature of Doing Business Globally

Exports of goods and services from the United States account for only 13 percent of U.S. gross domestic product (GDP), so the nation is still largely a domestic, continental economy. In contrast, as a percentage of GDP, exports comprise 46 percent of the German economy, 20 percent of the Chinese economy, and 172 percent of the Singapore economy. Singapore's number is so high because it imports oil and other products and then reexports them globally. A point here is that, with exports making up just 13 percent of the country's GDP, the United States has substantial room for improvement in doing business.

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 across diverse cultures worldwide. Consequently, companies may find it difficult to survive by relying solely on domestic markets.

Globalization is a process of doing business worldwide, such that 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

EXEMPLARY **STRATEGIST**

Andre Calantzopoulos, CEO of Philip Morris International

Stockfotocz/123RF

There Is an Alternative!

Andre Calantzopoulos, CEO of Philip Morris, is actively shifting consumers worldwide to a smokeless tobacco product, that heats but does not burn tobacco. The product is much less harmful than regular cigarettes and electric (e) cigarettes. Calantzopoulos has pledged $1 billion to create a foundation to encourage every smoker to switch to the company's smoke-free alternative. Calantzopoulos's new smokeless strategic plan at Philip Morris is based on the premise that most smokers have two unmet needs: (1) they want something not personally harmful, and (2) they want something that does not bother others. The company plans to spend billions on R&D to develop new smokeless cigarette-like products and market those products globally. A smokeless tobacco starter kit costs a bit more than $100, but is selling really well. Philip Morris' revenues and profits are growing nicely with Calantzopoulos leading the way, even as rival traditional tobacco companies falter. Some analysts say Calantzopoulos could save millions of lives and trillions of dollars (in health-care costs) if his strategic plan continues to be successful. Let's all wish this exemplary strategist the best of luck.

Source: Based on Saabira Chaudhuri, "Behind Philip Morris International's Smokeless Bet," *Wall Street Journal* (October 30, 2017): R3 and R10.

cost. This may mean locating production in countries with lower 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 rather than considering just a home country. A global strategy integrates actions against competitors into a worldwide plan. Today, many global buyers and sellers have mastered capabilities for instant transmission of money and information across continents.

In any industry that is global, it can be a risky posture to remain a domestic competitor, because more aggressive rival firms may use global growth to capture economies of scale and learning. The domestic firm could then face an attack on domestic markets using different (and possibly superior) technology, product design, manufacturing, marketing approaches, and economies of scale. As a point of global reference, the five largest companies in nine different countries are listed in Table 11-1, (as determined from "equally weighted measures of revenue, profits, assets, and market value").

TABLE 11-1 The Five Largest Companies in Nine Countries (2018)

United Kingdom	**India**	**Japan**
1. HSBC Holdings	1. Reliance Industries	1. Toyota Motor
2. Prudential	2. State Bank of India	2. Mitsubishi UFJ Financial
3. Lloyds Banking Group	3. Oil and Natural Gas	3. Nippon TeleG & TeleP
4. Barclays	4. HDFC Bank	4. Softbank
5. Rio Tinto	5. Indian Oil	5. Japan Post Holdings
Australia	**Mexico**	**China**
1. Commonwealth Bank	1. America Movil	1. Ind. & Com. Bank of China
2. Westpac Banking	2. FEMSA	2. China Construction Bank
3. ANZ	3. GFNorte	3. Agricultural Bank of China
4. National Australia Bank	4. Grupo Mexico	4. Bank of China
5. BHP Billiton	5. Cemex	5. Ping An Insurance Group
USA	**Canada**	**Indonesia**
1. Berkshire Hathaway	1. Royal Bank of Canada	1. Bank Rakyat Indonesia
2. JPMorgan Chase	2. TD Bank Group	2. Bank Mandiri
3. Wells Fargo	3. Bank of Nova Scotia	3. Bank Central Asia
4. Bank of America	4. Bank of Montreal	4. Telkom Indonesia
5. Apple	5. Manulife	5. Bank Negara Indonesia

Source: Based on information at forbes.com/global2000/list/

Multinational Firms

Organizations that conduct business operations across national borders are called **international (or multinational) firms**. The strategic-management process is conceptually the same for multinational firms as for purely domestic firms; however, the process is more complex as a result of more variables and relationships. The external opportunities and threats that face multinational firms 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. Millions of small businesses do business everyday outside their home country by interacting with customers though websites, smartphones, and social media.

More time and effort are required to identify and evaluate external trends and events in multinational firms. 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. Multinational firms 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 global firms 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).

The decision to expand operations into foreign markets—that is, to globalize—is one of the most important strategic decisions made by companies. Variables that influence how, when, where, and why to internationalize have attracted much attention in scholarly journals. Recent research reveals that countries are attractive not only because of their own institutions but also as a function of their serving as a platform for entry into other regions.[1] Therefore, multinational firms make globalization decisions with special consideration in mind for how a particular region or country will facilitate the firm's further globalization into other regions and countries. Also important is the need to align any strategy with a firm's vision and mission and an assessment of the potential to gain and sustain competitive advantages.

U.S.-based multinational firms have historically kept cash earned offshore in foreign subsidiaries and banks to avoid high U.S. corporate taxes. However, this changed in 2018 with the new federal corporate tax overhaul. The new U.S. federal tax law that went into effect in 2018 imposed a one-time 15.5 percent tax on foreign earnings held offshore in cash accounts, whether the firm brings the cash back to the United States or not. The law is designed to encourage companies to bring cash back to the United States. Numerous companies, such as Apple Inc., have billions of dollars in cash offshore, and many, perhaps most, of those firms are indeed bringing that cash back into the United States. So, what are those firms doing with the cash? About 70 percent of the cash repatriated by companies is going towards stock buybacks and paying dividends, with the remaining amount going to investments in company infrastructure and employees. For example, Apple in recent years bought back 5 percent of its stock, but in the beginning of 2018, that percentage rose to 7 percent annually. The huge transfer of cash from outside company coffers to inside U.S. investments from 2018 to 2022 is expected to spur the U.S. economy, boost the stock market, and lead to increased employee wages and benefits.

Labor Unions

The existence or prevalence of labor unions can be an important factor in many strategic decisions, such as where to locate stores or factories because companies often like to avoid unions. The presence of unions raises wage rates for companies. Union membership varies widely across Europe, ranging from 74 percent of employees in Finland, 70 percent in Sweden, 67 percent in Denmark, and 8 percent in Lithuania and France. In general, the popularity of unions across Europe is declining and has been for a decade. The major exception to this trend is Italy where union membership is slowly growing.

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 United States. The European average is held down by relatively low levels of membership in some of the larger EU states: Germany with 18 percent, France with 8 percent, Spain with 19 percent, and Poland with 12 percent.

Tax Rates

Tax rates in countries can represent an important strategic consideration regarding where to build manufacturing facilities or retail stores or even where to acquire other firms. High corporate tax rates deter investment in new factories and also provide strong incentives for corporations to avoid and evade taxes. Corporate tax rates vary considerably across countries and companies.

Across 190 countries on the planet, the average corporate income tax rate is about 22 percent. The average corporate tax rate across Europe is 18 percent. The average corporate rate globally has been falling annually since 1980 when the average was 38 percent. Hungary reduced their corporate tax rate from 19 to 9 percent in 2017. The United States cut its top statutory corporate tax in 2018 to 21 percent, the lowest rate among the Group of Seven (G7) nations, which include Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

As indicated in Table 11-2, the top national statutory corporate tax rates in 2018 among sample countries ranged from 0 percent in Bermuda to 55 percent in the United Arab Emirates (UAE). Signet Jewelers Ltd., owner of Kay's Jewelers, Zale Corporation, and Jared the Galleria of Jewelry, is headquartered in Bermuda for one key strategic reason: zero corporate taxes.

TABLE 11-2 Corporate Tax Rates for Various Countries in 2018 (from High to Low)

Country	Corporate Tax Rate
United Arab Emirates	55
Argentina	35
France	33.33
India	34
Germany	30
Mexico	30
Canada	26.5
Italy	24
China	25
USA	21
Finland	20
Turkey	20
Poland	19
Singapore	17
Romania	16
Ireland	12
Bulgaria	10
Bermuda	00
Caymen Islands	00
Anguilla	00
Turks and Caicos Islands	00

Source: Based on https://taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/. Also https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html

Advantages and Disadvantages of Doing Business Globally

LO 11.2

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. Multinational 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 better 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.
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.

LO 11.3 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 United States, but this is quickly changing. Thomson Reuters annually compiles a list of the world's most innovative companies, using metrics that include patent activity, R&D investment, success rate, globalization, and influence. In terms of total annual expenditures on R&D in 2017, Amazon, Alphabet, and Intel in the United States led the world with $16.1, $13.9, and $12.7 billion spent, respectively, but Samsung in South Korea ($12.7B), Volkswagen in Germany ($12.1B), Roche Holding AG in Switzerland ($11.4B), Novartis AG in Switzerland ($9.6B), and Toyota Motor in Japan ($9.3B) were other firms in the top 11. Other outside U.S. firms that spend more than $5 billion annually in R&D include Daimler AG (Germany), Honda Motor (Japan), AstraZeneca PLC (Britain), Siemens (Germany), and Sanofi (France).

The U.S. economy is becoming much less American and more global. A globalzed 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 associated with changing market conditions. China has more than one billion residents, including a dramatically growing middle class that is eager to buy goods and services.

Many countries are quite protectionist, and this position can impact companies' strategic plans. **Protectionism** refers to countries imposing tariffs, taxes, and regulations on firms outside the country to favor their own companies and people. The U.S. and China in early 2018 are imposing various tariffs on each other's products imported. 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 outside the U.S. 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 of virtually all companies expect sustained (more than 5 percent) growth in revenues from firms; that level of growth for many firms can only be achieved by capitalizing on demand outside the United States. 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 United States, 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 and Ford compete with Toyota and Hyundai. General Electric and Westinghouse Electric 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.

Different industries become global for different reasons. The need to amortize massive 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.

Outsourcing and Reshoring

Outsourcing involves companies hiring other companies to take over various parts of their functional operations, such as human resources, information systems, payroll, accounting, customer service, and even marketing. The outsourcing business is booming. According to an analysis by S&P Global Market Intelligence, 5 of the top 20 global employers in 2017 were outsourcing firms that essentially lease workers to clients, led by Compass Group PLC and Accenture PLC; the annual value on outsourcing contracts grew to more than $40 billion in 2017 from $12.5 billion in 2000, according to research and advisory firm Information Services Group Inc. Outsourcing made up 46 percent of Accenture's revenues in 2017.

For more than a decade, U.S. and European companies have been outsourcing their manufacturing, tech support, and back-office work, but most insisted on keeping R&D activities in-house. However, an ever-growing number of firms today are outsourcing their product design to Asian developers. China and India have become important suppliers of intellectual property. The details of what work to outsource, to whom, where, and for how much can challenge even the

TABLE 11-3 Potential Benefits of Outsourcing

1. *Cost savings:* Access lower wages in foreign countries.
2. *Focus on core business:* Focus resources on developing the core business rather than being distracted by other functions.
3. *Cost restructuring:* Outsourcing changes the balance of fixed costs to variable costs by moving the firm more to variable costs.
4. *Improve quality:* Improve quality by contracting out various business functions to specialists.
5. *Knowledge:* Gain access to intellectual property and wider experience and knowledge.
6. *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.
7. *Access to talent:* Gain access to a larger talent pool and a sustainable source of skills, especially science and engineering.
8. *Catalyst for change:* Use an outsourcing agreement as a catalyst for major change that cannot be achieved alone.
9. *Reduce time to market:* Accelerate development or production of a product through additional capability brought by the supplier.
10. *Risk management:* Manage risk by partnering with an outside firm.
11. *Tax benefit:* Capitalize on tax incentives to locate manufacturing plants to avoid high taxes in various countries.

biggest, most sophisticated companies. India is a booming place for outsourcing. China requires many firms to share their technological knowledge as a condition of doing business in that country; this is a growing problem for U.S. firms and America in general.

Table 11-3 reveals potential benefits that firms strive to achieve through outsourcing. Notice from the first benefit that outsourcing is often used to access lower wages in foreign countries.

Reshoring refers to U.S. companies moving a portion of their manufacturing back to the United States. The Donald Trump administration is spurring and rewarding reshoring. Many U.S. companies plan to *reshore* in 2018–2020 to take advantage of new U.S. tax laws, to get products to market faster and respond rapidly to customer orders, to save from reduced transportation and warehousing, and to improve quality and protection of intellectual property. “Made in the USA” is making a comeback. For example, the Italian firm Fiat Chrysler Automobiles N.V. in 2018 moved production of its large Ram Heavy Duty trucks from Saltillo, Mexico to Warren, Michigan. The move created 2,500 new jobs in Warren.

The strength of the dollar, however, has led some U.S. firms to look outside the United States to produce goods. The high value of the dollar makes U.S. goods more expensive overseas and makes imports to the United States cheaper. Overall however, benefits of reshoring are as follows:

1. U.S. laws protect female and minority employees
2. Reliable energy at low cost
3. Excellent security to protect designs from overseas copycats
4. Enable closer tabs on quality control and supply chains
5. Excellent economy with consumers purchasing more
6. Less shipment costs with consumers nearby
7. Excellent human rights, education, legal, and political systems that promote freedom and opportunity for citizens
8. Capitalize on the new 21 percent corporate tax rate

LO 11.4 U.S. versus Foreign Business Culture

To be successful 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. For multinational firms, knowledge of business culture variation across countries can be essential for gaining and sustaining competitive advantage. An excellent website to visit on this topic is www.worldbusinessculture.com, where you may select any country in the world and check out how business culture varies in that country versus other lands. 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.

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 11-4 lists other cultural differences or pitfalls that U.S. managers may benefit from considering.

TABLE 11-4 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 because 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.

Managers from the United States place greater emphasis on short-term results than do foreign managers. In marketing, for example, Japanese managers strive to achieve "everlasting customers," whereas many Americans strive to make a one-time sale. Marketing managers in Japan see making a sale 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 summarized some important cultural differences between U.S. and foreign managers.[2] 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 and punctuality as vital. Many foreigners place more worth on family and 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 3 feet from each other when carrying on business conversations, but Arabs and

Africans stand about 1 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 regardless of their own nationality and cultural norms.
5. 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.
6. 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.
7. 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 some countries, but not in the United States. 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.
8. 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. The United States provides legal protection against sexual harassment and discrimination based on race, sexual orientation, religion, and so on, but not all countries offer the same legal protections. 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. Also, 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 managers from any country working in another is the fact that it is almost impossible to change the attitude of an international workforce. "The system drives you; you cannot fight the system or culture," says Bill Parker, president of Phillips Petroleum in Norway. For example, in the Middle East, be careful of alcohol and pork, because many Muslims do not eat pork or drink alcohol. In India, cows are revered, so no leather gifts.

Communication Differences across Countries

Communication may be the most important word in strategic management. Americans increasingly interact with managers in other countries, so it is important to understand communication differences across countries. Americans sometimes come across as intrusive, manipulative, and garrulous; this impression may reduce their effectiveness in communication. Asian managers view extended periods of silence as important for organizing and evaluating one's thoughts, whereas U.S. managers have a low tolerance for silence. Sitting through a conference without talking is unproductive in the United States, but may be viewed as positive in Japan as one's silence helps preserve unity. Managers from the United States 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.

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

Like many Asian and African cultures, the Japanese are nonconfrontational. 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 nonprofitable 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 Culture across Countries[3]

LO 11.5

Managers, marketers, salespersons, and virtually all businesspersons can be more effective in doing business with persons and companies in other countries if they have an understanding and appreciation of business culture variation across countries. One aspect of business culture common across countries is appreciation for excellent customer service. Airlines fly people from nation to nation all over the world. Ethics Capsule 11 examines customer service ratings of airlines and asks the question "does bad customer service equate to bad business ethics?"

For a flavor of how cultures vary across continents, let's examine four countries: Mexico, Japan, China, and India.

Mexico

Mexico is an authoritarian society in terms of schools, churches, businesses, and families. In general, employers seek workers who are agreeable, respectful, and obedient, rather than innovative, creative, and independent. When visitors walk into a Mexican business, they are met with a 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 than in the U.S.

Mexican employers are more likely to provide weekly food baskets, free meals, free bus service, and free day care. 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. U.S. business embodies individualism, achievement, competition,

ETHICS CAPSULE 11

Which Two U.S.-Based Airlines Are Worst on Customer Service?

Best images/Shutterstock

On the Way to Another Country

A recent *Wall Street Journal* article ranked eight airlines from best to worst for providing customer service. The best is Delta, followed by Alaska, Southwest, United, Frontier, American, Spirit, and finally JetBlue providing the worst customer service. The rankings are based on seven customer-service variables: (1) on-time arrivals, (2) canceled flights, (3) extreme delays, (4) 2-hour-tarmac delays, (5) mishandled baggage, (6) involuntary bumping, and (7) complaints. JetBlue (and Spirit) ranked seventh or eighth in 5 out of 7 variables. In contrast, Delta ranked first or second in 5 out of 7 variables. Spirit had more customer complaints than any of the eight carriers examined. Does bad customer service equate to bad business ethics? This is a debatable question, but bad customer service is bad business and usually leads to bad profitability.

Source: Based on Scott McCartney, "Which Airlines Soared in 2017?" *Wall Street Journal* (January 11, 2018): A9.

curiosity, pragmatism, informality, spontaneity, and doing more than expected on the job, whereas Mexican businesses stress collectivism, continuity, cooperation, belongingness, formality, and doing exactly what is told. 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. Do not get irritated at the lack of punctuality in Mexico.

Japan

Japan's workforce population ages 15 to 64 is declining about 500,000 each year, so the country is facing its tightest labor market in 40 years. This shift toward an older population has forced Japan to increasingly open its doors to immigrant workers, which has increased demand for housing and international goods. The world's third-largest economy, Japan is undergoing an economic turnaround where business confidence is approaching its highest point in decades.

Because of its dwindling workforce and aging population, Japan is increasingly promoting women into managerial positions. Prime Minister Shinzo Abe of Japan has proclaimed a goal to fill 30 percent of leadership positions in Japan with women by 2020. Abe recently filled five open positions in his own cabinet with women. A key reason that Japanese women have historically not advanced to managerial positions is the business culture of notorious long work hours.

The Japanese people place great importance on group loyalty and consensus—a concept called *Wa*. 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.

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, so 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 in Japan is to bow. The deeper you bow, the more respect you show, but at least bow the head slightly in greetings.

In Japan, 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.

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.

China

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, often laughing at themselves if they have a comfortable relationship with the other person. 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.

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 U. S. 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 may be boisterous. Never ask the Chinese to turn off their mobile phones because this causes you both to lose face.

India

India's rate of female participation in the labor force is about 35 percent, which is quite low, especially considering that women make up about 42 percent of college graduates in India. Even 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.[4] Hewlett adds, "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.

Be mindful that neither Hindus nor Sikhs eat beef, and many are vegetarians. 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 is 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 him or her. This is a nice, expected gesture in most countries around the world.

Business Climate across Countries

LO 11.6

Among 20,000 companies listed on stock exchanges around the world, FactSet reported in December 2017 that companies' EPS on average was $9.69 for 2017—up 19 percent over the prior year and the highest level ever recorded—evidence of a booming economy globally.[5] Similarly, the Citigroup Global Economic Surprise Index that measures the extent that companies are beating or missing analysts' expectations, reports more "beating" than in a decade prior—for both emerging and developing markets. The International Monetary Fund reported that international trade growth grew 4 percent in 2017, up from 2.4 percent in the prior year. EPS for China's Tencent Holdings Ltd. grew 55 percent in 2017; South Korea's Samsung Electronics' EPS grew 95 percent. Analysts project continued corporate prosperity in 2018–2020 barring any global conflicts or extraneous occurrences.

The World Bank and the International Finance Corporation annually rank 189 countries in terms of their respective ease of doing business (http://www.doingbusiness.org/rankings). The index ranks nations from 1 (best) to 189 (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) resolve insolvency, and (10) get electricity.

Table 11-5 reveals the 2018 “Ease of Doing Business” rankings for the top 10 nations in six regions of the world. Note, for example, that Norway is rated the sixth-best country on the planet for doing business and the United States is ranked eighth. This information can be helpful for strategists (and students) deciding where to locate new operations and where to focus new efforts.

TABLE 11-5 The Top 10 Nations That Are Easiest to Do Business with Across Continents

Overall Best	East Asia Pacific	East Europe/ Central Asia	Latin America/ Caribbean	Middle East /North Africa	Sub-Saharan Africa	South Asia
1. New Zealand	Singapore	Macedonia	Mexico	United Arab Emirates	Mauritius	Bhutan
2. Singapore	Hong Kong	Latvia	Columbia	Bahrain	Rwanda	Nepal
3. Denmark	Taiwan	Georgia	Peru	Oman	Botswana	Sri Lanka
4. Hong Kong	Malaysia	Lithuania	Puerto Rico	Morocco	South Africa	India
5. South Korea	Thailand	Kazakhstan	Costa Rica	Malta	Kenya	Maldives
6. Norway	Mongolia	Romania	Jamaica	Tunisia	Seychelles	Pakistan
7. United Kingdom	Brunei Darussal	Belarus	St. Lucia	Qatar	Zambia	Bangladesh
8. United States	China	Armenia	Guatemala	Saudi Arabia	Lesotho	Afghanistan
9. Sweden	Vietnam	Bulgaria	Uruguay	Kuwait	Nambia	---
10. Macedonia	Vanuatu	Russia	El Salvador	Jordan	Ghana	---

Source: Based on information at http://www.doingbusiness.org/rankings, retrieved on January 1, 2018.

In 2018, the U.S. economy is the strongest that it has been in more than a decade. Unemployment is at record lows (below 4 percent), inflation is low, gas prices are low, interest rates are rising, the stock market is booming, and optimism is exceptionally high. The 19 countries in Europe that use the euro reported late in 2017 that their economy is improving more than it has in 17 years. The European Commission’s economic sentiment indicator rose to 114.0 in October 2017, its highest level in 8 years. For a flavor of how business climate varies globally, let’s examine several regions, because more and more companies are locating employees and facilities globally.

The African Continent

About 30 African countries are considered democracies. Currencies in Africa are stabilizing and many countries are fundraising to build modern highways, ports, and power grids. Many non-African companies are launching operations in Africa because of the rapidly growing middle class and an average GDP growth of 5 percent for the continent through 2020. Morocco has the highest Internet penetration among all countries in Africa, with more than 50 percent. On average however, fewer than 20 percent of Africans have access to the Internet. McKinsey predicts that by 2025, 50 percent of Africans will be online, so the continent is rapidly joining the world business community.

Many multinational firms are now gaining first-mover advantages by engaging Africa at all levels. Today, more than 40 percent of Africans live in the cities—a proportion close to China and India. The general global image of Africa is rapidly changing to that of 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.

China

As the world's most populous country, China's economic output annually exceeds the United States. Hundreds of companies are scurrying to set up business in China. All 31 Chinese provinces and regions recently boosted their minimum wage for the third consecutive year. Demand for workers in China now outstrips supply, 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. China ranks about 90th out of 190 countries in terms of doing business. That ranking is relatively low for a variety of reasons, ranging from human-rights issues to substantial disregard for copyright, patent, and trademark rules of law.

China's new cybersecurity law requires that foreign technology firms store their data inside China and allow the government to keep tabs on how firms use the technology. Chinese law also requires foreign companies that want to enter various industries such as energy and telecom to do so through joint ventures. Often these ventures lead to China gaining the technology of the United States and other countries. China is encouraging companies from all over the world to set up R&D operations there; Apple, Amazon, Microsoft, and Google have done so, including Google's new Artificial Intelligence Center. As indicated in the Global Capsule 11, China is on a mission to gain technological superiority among all nations in the next decade, through quantum computing, artificial intelligence, robotics, and cybersecurity.

China accounts for nearly one-third of the global market for cars, so the country is in a good position to lead the market of electric cars. China accounted for nearly half of the world's sales of electric cars in 2016, with sales reaching over 351,000. Ford recently set a goal, that by 2025, 70 percent of its Chinese cars will be electric.

Indonesia

A democratic Pacific archipelago comprised of thousands of islands, Indonesia's currency is the rupiah and its economy is one of the fastest growing in Asia, behind China and the Philippines. Indonesia's GDP growth is 5 percent in 2017 and growing. Exports are surging in Indonesia. Indonesia has a large population and densely populated regions; Indonesia also has the world's second-highest level of biodiversity, with vast areas of wilderness and abundant natural resources.

In 2018–2019, Indonesia has made remarkable progress across a broad range of economic and social dimensions. Health, education, standards of living, and other social outcomes have never been better in Indonesia. The government of Indonesia is closer than ever to the people. As a member of the G20, Indonesia is actively engaged in world affairs, and economic integration with regional Association of Southeast Asian Nations (ASEAN) partners is moving ahead. The economic forecast for Indonesia is very bright—its population is young, the domestic market is large, it has a rich endowment of natural resources, public debt is low, and its political system is broad based and stable.

India

The World Bank's annual report "*Doing Business 2017: Equal Opportunity for All*" reported that India moved up only one spot to 130 from 131 the prior year in terms of its ranking among all countries as per ease of doing business. Among the BRICS nations, Brazil (123), Russia (40), India (130), China (78), and South Africa (74), India was ranked lowest; however, has made substantial progress in some areas such as electricity connections but has slipped in other areas such as payment of taxes and enforcing contracts.

Online activity has accelerated in India partly because of the exceptionally low $5 per month unlimited access to high-speed Internet on a smartphone. In 2017, India replaced the United States as the country that downloaded more apps from Google's Play Store than any other on the planet. Google has a booming business in India, yet the company is not allowed to do any business in China.

GLOBAL CAPSULE 11

China Aims for Superiority in Quantum Computing

What Costs $91.6 Billion?

Quantum computing, or quantum mechanics, is a concept in physics whereby atoms can exist in two states at once, called *superposition*; because everything is made of atoms, entire objects can exist in multiple dimensions, allowing for the possibility of parallel universes. Nearly all current computers and technology today operate using bits that have a value of 1 or 0, but quantum bits, or qubits, can be 1 and 0 at the same time. Qubits are infinitely more powerful than bits, so quantum computers can tackle unthinkably complex problems. Google, IBM, Intel, D-Wave Systems, and Microsoft are example companies spending millions on quantum computing. Google already has a 22-qubit chip and is developing a 49-qubit chip. The National Security Agency (NSA) has issued an order that all U.S. national-security employees and vendors must begin overhauling their encryption to guard against the threat posed by quantum computers. Code-breaking quantum computers could hack into every computer system on the planet, gaining control of any company's files and any country's national security. The reason this is doable is because all encryptions today that protect all computer systems rely on complex math problems that a conventional computer cannot solve, but a quantum computer can solve with ease. The U.S. government spends only $200 million a year on quantum research of all kinds, spread over a variety of agencies such as NSA and Department of Energy, and this is woefully inadequate.

China's strategic plan is to develop and use quantum computers to gain world dominance and superiority in information technology, financial systems, power grids, and military weapons. China is spending billions on this effort and is building the world's largest quantum research facility aimed at developing a computer that can potentially hack into, extract information from, and otherwise disable any and all computers anywhere. Called their National Laboratory for Quantum Information Science, China's newest quantum facility is located in Hefei, Anhui province. Pan Jianwei leads China's quantum efforts aimed primarily at military applications. Pan says: "Our plan is that by 2020, we will achieve quantum supremacy with calculation power one million times all existing computers around the world combined." China's new quantum computer facility should be completed in 2020 at a cost of $91.6 billion. China recently launched a quantum satellite and conducted advanced experiments such as quantum entanglement and teleportation in space. All companies and countries globally must recognize and prepare for the quantum leap coming soon in information technology.

Source: Based on Hartmut Neven, "The Future of Everything – Quantum Leap," *Wall Street Journal* (November/December 2017): 62–67. Also, http://www.scmp.com/news/china/society/article/2110563/china-building-worlds-biggest-quantum-research-facility. Also, Arthur Herman, "The Computer That Could Rule the World," *Wall Street Journal* (October 28–29, 2017): A13.

Mexico

South Korea's Kia Motors just built a $1 billion assembly near Monterrey, Mexico, joining Mazda Motors, Honda Motors, Audi AG, BMW AG, Renault SA, Nissan Motors, and Daimler AG that have automobile assembly operations to Mexico. Mexico is the fourth-largest exporter and seventh-largest producer of automobiles in the world. Mexico's auto industry now employs one of every six Mexican factory workers and comprises one-third of all exports from Mexico. Mexico is also the world's largest exporter of flat screen televisions. Mexico's exports and production of vehicles were up 12 and 9.4 percent, respectively for the first 11 months of 2017 compared to the prior year. In 2020, Ford's new electric vehicle manufacturing plant in Cuautitlan, Mexico, will be completed.

Foreign direct investment (FDI) in Mexico has surged to exceed $30 billion annually, led by automobile manufacturers such as Volkswagen AG building new factories, and auto-parts suppliers such as Delphi Automotive PLC following. Home Depot has more than 150 stores in Mexico.

Mexico is especially attractive for manufacturing products that are bulky or costly to transport, such as automobiles. However, a key variable hurting Mexico is drug-related violence. Mexico's homicide rate exceeds 15 people per 100,000, compared with a per-capita rate of about 5.0 in the United States and 1.1 in China. If Mexico can improve its security situation as it intends, then hundreds of additional firms may consider returning to Mexico from China (and India).

Income remains highly concentrated in Mexico because many families live in poverty, insecurity is high, childcare facilities are weak, and discrimination is a problem for disabled and disadvantaged. As a percentage of GDP, Mexico's oil-related activities have declined from 13 to 7 from 2007 to 2017, so the country is far less dependent today on oil and gas.

IMPLICATIONS FOR STRATEGISTS

Figure 11-2 reveals that doing business globally is increasingly a prerequisite for success even for the smallest of firms. About 95 percent of consumers globally live outside the United States; firms can grow and gain economies of scale by serving these consumers. Whatever product a company has to offer, it would likely be well received in many nations. It may be strategically best for your firm to outsource operations, procure resources, and use a labor force away from home to gain and sustain competitive advantages at home.

More and more countries around the world are welcoming foreign investment and capital. As a result, labor markets have steadily become more international. 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.

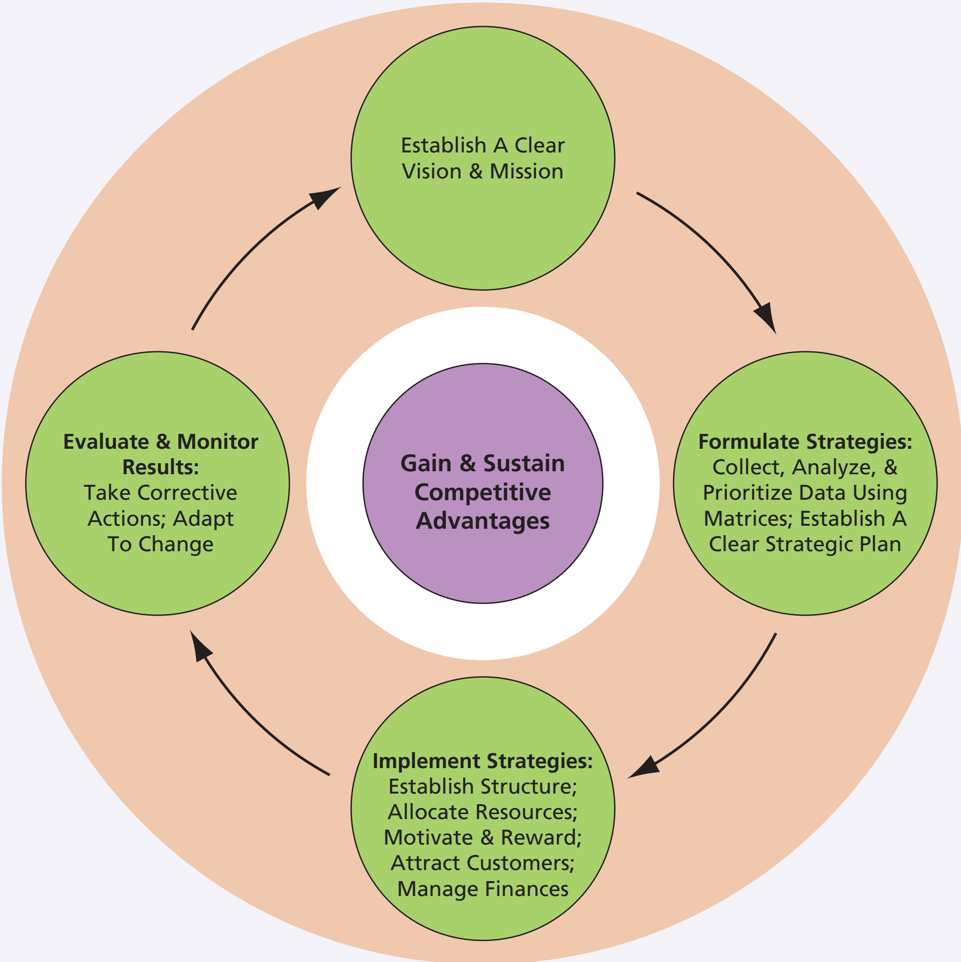

FIGURE 11-2
How to Gain and Sustain Competitive Advantages

IMPLICATIONS FOR STUDENTS

Even the smallest businesses today regularly serve customers globally and gain competitive advantages and economies of scale by doing so. Many iconic U.S. businesses, such as Tupperware, obtain more than 80 percent of their revenue from outside the United States. 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. Continually compare and contrast what you are recommending compared with what the company is actually doing or planning to do.

Chapter Summary

The population of the world has surpassed 7 billion. Businesses more than ever before are now searching for new opportunities beyond their national boundaries. There has never been a more internationalized and economically competitive society than today's. Some U.S. industries, such as textiles, steel, and consumer electronics, are in disarray as a result of the international challenges of globalization.

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 United States, 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. Business culture and climate across countries are particularly important topics in strategic planning. 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. 360)
global strategy (p. 353)
globalization (p. 352)
guanxi (p. 359)
international firms (p. 353)
inhwa (p. 359)
multinational firms (p. 353)
nemaswashio (p. 360)
outsourcing (p. 357)
protectionism (p. 357)
reshoring (p. 358)
Wa (p. 359)

Issues for Review and Discussion

11-1. Why are companies such as Apple Inc. bringing cash back to the United States that prior to 2018 was kept in offshore banks? What impact is that having on the U.S. economy?

11-2. Discuss the climate for doing business in India. What are the implications for companies?

11-3. How would you describe the business climate globally in 2017–2018? What are the implications for companies?

11-4. In what manner are firms investing or using "offshore cash" being brought back into the United States?

11-5. List four benefits and four drawbacks of reshoring.

11-6. Describe the economic outlook for Indonesia.

11-7. What country in Africa has the highest Internet penetration among all countries?

11-8. What areas of business does China seek superiority in within a decade?

11-9. What does the concept "daughterly guilt" mean with regard to the business culture in India?

11-10. Give specifics regarding the nature and role of "Union Membership across Europe." What are the strategic implications of these facts and figures?

11-11. Give specifics regarding income tax rates and practices across countries and associated strategic implications.

11-12. Exports from the United States comprise about 13 percent of GDP, compared to about 45 percent of Germany's GDP. What are the implications of this for U.S. firms doing business globally?

11-13. A company is planning to begin operations in Switzerland. That company's EFE Matrix includes 20 factors. How much weight (1.0 to 0.01) would you place on the corporate tax rate factor? Discuss.

11-14. Explain how awareness of business culture across countries can enhance strategy implementation.

11-15. Describe the business culture in China.
11-16. Describe the business culture in India.
11-17. Describe the business culture in Mexico.
11-18. Describe the business culture in Japan.
11-19. Do some research on New Zealand to determine whether you agree that the country merits its number 1 or 2 ranking globally in attractiveness for doing business.
11-20. About 53 percent of people in Belgium are members of a labor union. Compare the labor union situation across European countries and comment on the positive or negative impact this factor has on attracting business investment into those countries.
11-21. Explain why consumption patterns are becoming similar worldwide. What are the strategic implications of this trend?
11-22. What are the major differences between domestic and multinational operations that affect strategic management?
11-23. Why is globalization of industries a common factor today?
11-24. Compare the United States with foreign cultures in terms of doing business.
11-25. List six reasons that strategic management is more complex in a multinational firm.
11-26. Do you feel that protectionism is good or bad for the world economy? Why?
11-27. Why are some industries more "global" than others? Discuss.
11-28. *Wa, guanxi*, and *inhwa* are important management terms in Japan, China, and South Korea, respectively. What would be analogous terms to describe U.S. management practices?
11-29. Why do many Europeans find the notion of "team spirit" in a work environment difficult to grasp?
11-30. In China, *feng shui* is important in business, whereas in Japan, *nemaswashio* is important. What are analogous U.S. terms and practices?
11-31. Compare tax rates in the United States with other countries. What impact could these differences have on "keeping jobs at home"?

ASSURANCE-OF-LEARNING EXERCISES

SET 1: STRATEGIC PLANNING FOR COCA-COLA

EXERCISE 11A

Business Culture Variation across Countries: A Report for Coca-Cola Company

Purpose

Various websites give excellent detail that compare business culture across countries. One excellent website is http://www.kwintessential.co.uk/resources/country-profiles.html, where you can click on more than 100 countries and obtain a synopsis of a country's business culture. After clicking on a country at that website, you may scroll down to reach the section titled "Business Etiquette and Protocol."

This exercise will expand your knowledge about how business culture varies across countries. Being knowledgeable of various countries' business culture can make you a more effective manager and communicator with people and organizations globally. This knowledge is especially helpful for firms that desire to grow globally. There are about 190 different countries with different business cultures, creating many options. Business culture is an important variable in global expansion decisions.

Instructions

Step 1 Go to http://www.kwintessential.co.uk/resources/country-profiles.html. Click on three countries located on different continents. Scroll down to the "Business Etiquette and Protocol" section of each country.

Step 2 Come to class prepared to give an oral presentation that compares the business culture in the three countries you selected. Frame your presentation as if you are giving advice to top managers at Coca-Cola regarding expansion into those three countries.

EXERCISE 11B

Coca-Cola Wants to Further Penetrate Africa. Can You Help Them?

Purpose

More and more companies every day decide to launch operations in Africa. Coca-Cola sees millions of potential customers in Africa. Research is necessary to determine the best strategy for being the first mover in many African countries.

Instructions

Step 1 View a map of Africa.

Step 2 Compare demographic data across eight African countries.

Step 3 Gather competitive information regarding the presence of PepsiCo in Africa.

Step 4 Develop a prioritized list of eight African countries in which you would recommend Coca-Cola build distribution warehouses. Country 1 is your best, and country 2 is your next best. List in prioritized order two cities in each of your eight African countries where you believe Coca-Cola should focus distribution and retail efforts. Justify your choices.

SET 2: STRATEGIC PLANNING FOR MY UNIVERSITY

EXERCISE 11C

Does My University Recruit in Foreign Countries?

Purpose

A competitive climate exists 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 a 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 recruit U.S. students.

Instructions

Step 1 Select a foreign country. Conduct research to determine the number and nature of colleges and universities in that country. What programs are institutions in those countries recognized for offering? What percentage of undergraduate and graduate students attending those institutions are U.S. citizens? Do these institutions actively recruit U.S. students? Are any of the schools of business at the various universities AACSB International accredited?

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

SET 3: STRATEGIC PLANNING TO ENHANCE MY EMPLOYABILITY

EXERCISE 11D

How Well-Traveled Are You Compared to Your Colleagues?

Purpose

How well-traveled are students, including yourself, at your university? To what extent do students consider their travels to be helpful in becoming an effective businessperson? Generally speaking, the more one has traveled, especially outside one's country, the more tolerant, understanding, and appreciative one is for diversity. Many students even state on their résumé the extent to which they have traveled.

Instructions

Step 1 Administer the following survey to at least 30 business students, including your classmates in the strategic-management course.

Step 2 Administer the following survey to yourself.

Step 3 Analyze the results with special emphasis comparing yourself to your colleagues. Give a 15-minute presentation to your class regarding your findings and implications.

The Survey

1. How many states in the United States have you visited?
2. How many states in the United States have you lived in for at least 3 months?
3. How many countries outside the United States have you visited?
4. List the countries outside the United States that you have visited.
5. How many countries outside the United States have you lived in for at least 3 months?
6. List the countries outside the United States that you have lived in for at least 3 months.
7. To what extent do you feel that traveling across the United States can make a person a more effective businessperson? Use a 1- to 10-scale, where 1 is "Does Not Make a Difference" and 10 is "Makes a Tremendous Difference."
8. To what extent do you feel that visiting countries outside the United States can make a person a more effective businessperson? Use a 1- to- 10-scale, where 1 is "Does Not Make a Difference" and 10 is "Makes a Tremendous Difference."
9. To what extent do you feel that living in another country can make a person a more effective businessperson? Use a 1-to-10 scale, where 1 is "Does Not Make a Difference" and 10 is "Makes a Tremendous Difference."
10. What three important ways do you feel that traveling or living outside the United States would be helpful to a person in being a more effective businessperson?

SET 4: INDIVIDUAL VERSUS GROUP STRATEGIC PLANNING

EXERCISE 11E

How Important Are Various Potential Advantages to Initiating, Continuing, or Expanding a Firm's International Operations?

Purpose

Chapter 11 discusses potential advantages (and disadvantages) to initiating, continuing, or expanding international operations. Some important advantages 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 global operations 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 purpose of this exercise is to examine more closely eight potential advantages for a firm to initiate, continue, or expand international operations. In addition, the purpose of this exercise is to examine whether individual decision making is better than group decision making. Academic research suggests that groups make better decisions than individuals about 80 percent of the time.

Instructions

Rank the eight potential advantages for a firm to initiate, continue, or expand international operations, as to their relative importance, where 1 = most important, to 8 = least important. First, rank the advantages as an individual. Then, rank the advantages as part of a group of three. Thus, determine what person(s) and what group(s) here today can come closest to the expert ranking. This exercise enables examination of the relative effectiveness of individual versus group decision making in strategic planning.

Steps

1. Fill in Column 1 in Table 11-6 to reveal your individual ranking of the relative importance of the eight advantages (1 = most important, 2 = next most important, etc.). For example, if you think Advantage 1 (New Customers) is the second-most important advantage, then place a 2 in Table 1 in Column 1 by the first advantage listed (new customers).
2. Fill in Column 2 in Table 11-6 to reveal your group's ranking of the relative importance of the eight advantages (1 = most important, 2 = next most important, etc.).
3. Fill in Column 3 in Table 11-6 to reveal the expert's ranking of the eight advantages for a firm to initiate, continue, or expand international operations.
4. Fill in Column 4 in Table 11-6 to reveal the absolute difference between Column 1 and Column 3 to reveal how well you performed as an individual in this exercise. (Note: Absolute difference disregards negative numbers.)
5. Fill in Column 5 in Table 11-6 to reveal the absolute difference between Column 2 and Column 3 to reveal how well your group performed in this exercise.
6. Sum Column 4. Sum Column 5.
7. Compare the Column 4 sum with the Column 5 sum. If your Column 4 sum is less than your Column 5 sum, then you performed better as an individual than as a group. Normally, group decision making is superior to individual decision making, so if you did better than your group, you did excellent.
8. The Individual Winner(s): The individual(s) with the lowest Column 4 sum is the WINNER.
9. The Group Winners(s): The group(s) with the lowest Column 5 score is the WINNER.

TABLE 11-6 How Important Are Various Potential Advantages to Initiating, Continuing, or Expanding a Firm's International Operations? Comparing Individual versus Group Decision Making

Advantages of Doing Business Globally	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5
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.					
Sums					

MINI-CASE ON LYNK & COMPANY

YOU MAY DRIVE A LYNK SOON

Maksim Toome/123RF

In November 2017, a new Chinese firm, Lynk & Company, offered cars for the first time, 3,000 vehicles were sold online in 2 minutes. Lynk's parent is Zhejiang Geely Holding Group headquartered in Hangzhou, China. The Lynk 01 is a gasoline-powered SUV that offers free wireless connectivity, voice-operated music streaming, and car-sharing services. After China, Lynk plans to market their vehicles across Europe and the United States. An all-electric version of the Lynk is coming soon. Geely automobile sales in China rose 63 percent in 2017 as "made in China" vehicles start to dominate the countryside there. Another large China automaker is SAIC Motor who sells the popular Roewe RX5. China's top-selling SUV is a brand named Wey, manufactured by Great Wall Motors Company in China. Another Chinese firm, Zotye Auto, is building and selling electric cars in their country.

With U.S., German, and Korean firms doubling down on trying to manufacture and sell automobiles in China, coupled with the national firms mentioned above tripling down on building home market share, China has become the most-contested region in the world for marketing vehicles. In China, Volvo just launched its Polestar premium electric car while Tesla is both producing and selling electric cars there already. Although car sales in China grew only 1.4 percent in 2017, the slowest pace in 15 years, sales of electric cars in China in 2017 grew 72 percent to 578,000.

The automobile market in China is analogous in many respects to any region that offers a fast growth rate for certain products in any industry, in that numerous rival firms join the fray trying to be a first mover to the extent possible, rather than a late follower. All firms cannot win and a big shakeout is inevitable in China, but Lynk plans to gain economies of scale soon by rolling out its brand across the planet.

Questions

1. How important are economies of scale in the automobile industry for being successful in a country such as China?
2. What are the competitive advantages and disadvantages of entering a market or country where rivalry among firms (as Porter describes in Chapter 3) is so intense compared to targeting areas that offer less growth and less rivalry?

3. If you put on the *x*-axis rivalry of firms (low, medium, high) and on the *y*-axis potential growth in revenues (low, medium, high), draw a line for China and another line for the United States to reveal your thinking regarding the automobile industry tradeoffs that firms make in deciding where and why to focus money and resources. What do your lines represent or mean strategically?

Source: Based on Trefor Moss, "Chinese Cars Close In on Rivals," *Wall Street Journal* (November 29, 2017): B5, also company documents and a variety of sources.

Web Resources

1. **The World Bank's Annual "Doing Business" Report** An excellent annual report that compares the ease of doing business across 11 areas such as dealing with construction permits, getting electricity, and discussing credit. http://www.doingbusiness.org/reports/global-reports/doing-business-2017
2. **Forbes' Annual "Global 2000" Ranking of the World's Largest Public Companies** An excellent annual report that reveals the largest companies by country and associated demographic information. The 2017 report included 565 U.S. companies followed by China and Hong Kong where 263 of the global 2000 list were headquartered. The 2017 list included companies from 58 countries, down from 62 countries the prior year, with Cyprus, Kazakhstan Romania, and Malta companies exiting the list. https://www.forbes.com/forbes/welcome/?toURL=https://www.forbes.com/sites/corinnejurney/2017/05/24/the-worlds-largest-public-companies-2017/&refURL=https://www.google.com/&referrer=https://www.google.com/
3. **The Tax Foundation's Annual "Corporate Income Tax Rates Around the World"** An excellent annual report that reveals changes in corporate tax rates among countries around the world https://taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/

Current Readings

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Endnotes

1. Based on Jean-Luc Arregle, Tuyah Miller, Michael Hitt, and Paul Beamish, "Do Regions Matter?" An Integrated Institutional and Semi-Globalization Perspective on the Internationalization of MNEs," *Strategic Management Journal* 34 (2013): 910–934.
2. Rose Knotts, "Cross-Cultural Management: Transformations and Adaptations," *Business Horizons* (January–February 1989): 29–33.
3. Some of the narrative in this section is based on information at http://kwintessential.co.uk/resources/country-profiles.html and http://www.kwintessential.co.uk/resources/global-etiquette/
4. Mehul Srivastava, "Keeping Women on the Job in India," *Bloomberg Businessweek,* March 7–13, 2011, 11–12.
5. Mike Bird, "Record Earnings Mark Global Recovery," *Wall Street Journal*," December 6, 2017, B16.

PART 6

STRATEGIC-MANAGEMENT CASE ANALYSIS

How to Prepare and Present a Case Analysis

LEARNING OBJECTIVES

After studying Part 6, you should be able to do the following:

1. Discuss guidelines for preparing to discuss a case in class.
2. Discuss guidelines for developing a written comprehensive case analysis.
3. Discuss guidelines for giving an effective oral case analysis presentation.
4. Discuss special tips for doing a case analysis.

ASSURANCE-OF-LEARNING EXERCISE

Strategic Planning to Enhance My Employability: How Important Are Various Reasons to Use the Free Excel Strategic Planning Template at www.strategyclub.com?

The purpose of this section is to help you analyze strategic-management cases. Numerous guidelines and suggestions are presented as are steps to follow. Be sure to use the author website (www.strategyclub.com), which provides sample case analyses, sample presentations, author videos, case and chapter updates, and especially the free Excel strategic planning template.

A *strategic-management case* describes an organization's external and internal conditions and raises issues concerning the firm's vision, mission, strategies, objectives, and policies. Most of the information in a 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. For example, a marketing case would focus on how some company does marketing. But a strategic-management case focuses on how a firm can generate a sustainable competitive advantage so it considers all the functional areas of business as well as external contingencies.

A case puts you at the scene of the action by describing a firm's situation at some point in time and asking you to recommend an effective path or plan forward. Strategic-management cases are written to give you practice applying strategic-management concepts. The case method for studying strategic management is *learning by doing*, meaning you will usually be asked to prepare a three-year strategic plan for a firm, just as if you were among top management of the firm or a consultant tasked with this work.

Guidelines for Preparing to Discuss a Case in Class

The *case method* of teaching can involve a classroom situation where 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?
- How is your firm unique to the competition? What products and services are different? Where along the value chain does your firm have uniqueness and a competitive advantage—and how will your proposed recommendations enhance the firm's competitiveness?
- Are revised vision and mission statements needed given your strategic plan for the firm?

Your professor may ask the whole class 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 as well as internal strengths and weaknesses, perform appropriate analyses, and come to class prepared to offer and defend some specific recommendations. Be excited about strategic management because in practice, the firm's survival, and thus many people's jobs, may depend on your decisions. Guidelines for participating in a case analysis class discussion are as follows:

Be Practical

There is no such thing as a complete case, and no case ever provides all the information needed for conducting analyses and making 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 cases, do what strategists do every day, make reasonable assumptions about unknowns, perform appropriate analyses, and make decisions. *Be practical.* For example, in performing a projected financial analysis, make reasonable assumptions 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.

Be Thorough

There is no single best solution or one right answer to a strategic-management case, so it is important to give ample justification for your recommendations. In the business world, strategists often 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. Therefore, in your project, be thorough in justifying your thought process and recommendations, from the beginning to the end of your written or oral presentation.

Be Realistic

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 your recommendation. Determine whether debt, stock, or a combination of debt and stock could be used to obtain the capital. Make sure your suggestions 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.

Be Specific

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. Vagueness in stating factors and performing analyses is disastrous in strategic-management case analysis. For example, in an internal audit, say, "The firm's current ratio fell from 2.2 in 2018 to 1.3 in 2019, and this is considered to be a major weakness," instead of "The firm's financial condition is bad." Recall that external and internal factors need to be "*actionable, quantitative, comparative, and divisional (AQCD)*" to the extent possible. Rather than concluding from a 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 2020." Use ratios, percentages, numbers, and dollar estimates. Businesspeople dislike generalities and hate vagueness.

Be Original

Do not necessarily recommend the course of action that the firm plans to undertake. 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. Support your position with charts, graphs, ratios, analyses, and the like. *Be original.* Compare and contrast what you recommend versus what the company plans to do or is doing.

Listen and Contribute

Strategy decisions are commonly made by a group of individuals rather than by a single person. Your professor will likely divide the class into three- or four-person teams and ask you to prepare written or oral case analyses. Members of a 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. Be open-minded to others' views.

Developing and Delivering a Written Case Analysis

Rather than have students analyze multiple cases during a semester, you may be asked to prepare a comprehensive written case analysis similar to the sample case analysis project provided at the author website at www.strategyclub.com. Or your professor could ask you or your team 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; (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.

In preparing a comprehensive case analysis, you could follow the table of contents (TOC) given in Table 1; sequence your analyses according to the TOC given. The TOC sequence matches the strategic-management process, stages, and chapters in this text. In your written project (strategic plan) file, provide a narrative after each analysis or matrix to reveal specific implications of that particular tool or technique for the focal firm. Avoid vagueness anywhere in project file. See the author comments in Table 1 for additional information regarding how to effectively develop and deliver a written comprehensive case analysis on a company.

TABLE 1 A Sample Table of Contents (with author comments)

1. Introduction: Give a one-page overview of the firm.
2. Vision Statement: Present the firm's vision statement versus your proposed statement.
3. Mission Statement: Present the firm's mission statement versus your proposed statement.
4. EFE Matrix: Include 10 external opportunities and ten external threats.
5. CPM: Include the firm and two rival firms compared across 10 to 20 key variables (the template allows inclusion of 12 factors).
6. Most Recent Income Statement and Balance Sheets: Provide here to enable ratio analysis to come next (Note: Convert actual *Form10K* statements to the template-formatted statements to enable financial ratio analyses and development of projected financial statements later in project).
7. Financial Ratio Analysis: Show template-calculated and/or Internet-derived ratios and comment on key ones; do not give definitions of the ratios and do not highlight all the ratios.
8. IFE Matrix: Include 10 strengths and 10 weaknesses.
9. SWOT Analysis: Include four SO, WO, ST, WT strategies (16 total) and make sure the strategies are specific so you can reasonably estimate a cost (dollar value) for any strategy that makes it to recommendations page.
10. BCG: Prepare two BCG matrices, one by geographic area and the other by product, if possible; focus more on the implications than the numbers or mechanics of the matrix; strategies must be specific; avoid vague terms such as *market penetration*.
11. IE Matrix: Prepare two IE matrices, one by geographic area and the other by product, if possible; focus more on the implications than the numbers. For example, state how a division located in the hold and maintain quadrant will move to the grow and build quadrant after your strategies are implemented. This approach is more effective than simply stating the division is located in the row and build quadrant. Slowly introduce your recommendations during your written project or oral presentation – to facilitate the audience following your thought process throughout. If you attempt to "save" your recommendations to the end as a surprise, you risk losing the audience.
12. SPACE Matrix: Prepare a detailed analysis for the focal firm; also show plots for two rival firms; focus more on the implications than the numbers. For example, describe how your firm will move within the SPACE graph/matrix after your recommendations are implemented. Comment specifically on a few axis variables and how your actions will improve them and thus the position of the firm in the SPACE. As with any matrix, do not teach the mechanics of the matrix during your presentation.
13. Grand Strategy Matrix: Include the focal firm and two rival firms in your matrix.
14. QSPM: Select the two most attractive SWOT strategies to include along the top row of your QSPM.

15. Perceptual Maps: Include two maps, be creative as per the dimensions; frame your discussion in terms of competitive advantage of focal firm versus rivals as per your proposed strategic plan. Discuss market space that is not yet used by rivals and the benefits or drawbacks of serving this market space. Comment on how rival firms are repositioning versus how you plan the focal firm to reposition given your recommendations.
16. Organizational Structure: Include (1) the existing chart developed based on executive titles, and (2) your proposed chart based on the guidelines provided in Chapter 7.
17. Corporate Valuations: Include (1) focal firm, (2) rival firm, and (3) potential firm to be acquired.
18. Recommendations: Include at least 10 with costs for each given and summed; divide your strategies (1) existing strategies to be continued and (2) new strategies to be started.
19. EPS/EBIT Analysis: Include (1) all stock, (2) all debt, and (3) some combination of stock and debt.
20. Projected Financial Statements: Provide 3 years to show expected impact of your recommendations.
21. Projected Financial Ratios: Show template-calculated ratios and comment on key ones.
22. Retained Earnings Table: Make sure far right column of table matches the retained earnings row on your projected balance sheets (see Chapter 8).
23. Executive Summary: Give a one-page overview of your strategic plan for the firm.

Making an Oral Presentation

Your professor may ask you to 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. Present a united front when presenting as a team. Always say “we did” and “we recommend,” rather than, “I did the financial ratios” or “I recommend boosting advertising by 30 percent.” A light or humorous introduction can be effective at the beginning of a presentation.

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 talking too fast. Individuals commonly speak too fast when they are 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, take your 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. Maintain a straight posture, with one foot slightly in front of the other. Above all, 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, too. 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. No presentation should ever be dull!

Speaking from Slides

Be sure *not* to read to your audience; reading puts people to sleep, and to be quite honest, reading to an audience is demeaning. Know your project well enough to present your project from a dozen or so PowerPoint slides. Generally, there should be no more than four to six lines of text on each slide. Use clear headings and subheadings. Do not use many handouts or your audience may concentrate on them instead of you during the presentation. Do not read from notecards.

Answering Questions

It is best to field questions at the end of your presentation, rather than during the presentation itself. Do not abruptly exit the stage or delete your last PowerPoint slide when you finish speaking; genuinely seek to answer questions. Encourage questions, and take your time to respond to each one. Answering questions can be persuasive because it involves you with the audience. 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 calculation mistake, reflects self-confidence, maturity, poise, and command of the particular company and its industry.

Presenting a Case Analysis Orally

Your professor may allow between 10 and 30 minutes for your case presentation. Be sure in an oral presentation to manage time, knowing that your recommendations and associated costs are the most important part. Your project file should be a .docx, but if giving a presentation also, develop a dozen or more PowerPoint slides to anchor your presentation.

On the strategyclub.com website, a breakdown is given for a 10- and a 15-minute oral case presentation. Once at the www.strategyclub.com website, simply click on Student Resources and then download the files needed. Whatever amount of time is allowed, use time effectively, so practice before actual delivery.

Tips for Success in Case Analysis

Strategic-management students who have used this text over 16 editions offer you the following 22 tips for success in doing case analysis. The tips are provided in Table 2.

TABLE 2 Tips for Being Successful in Developing and Presenting a Strategic-Management Case Analysis

1. Use the www.strategyclub.com website resources. The free Excel student template is especially useful as are the sample PowerPoint case analyses.
2. In preparing your external assessment, use the online databases subscribed to by your college library as identified in Chapters 3 and 4.
3. 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, such as wear clothes of the focal firm or show a compelling 30-second video.
4. Seek the help of professors in other specialty areas when necessary, and mention them by name in your presentation.
5. A goal of case analysis is to improve your ability to think clearly in uncertain situations; do not get frustrated that there is no single best answer.

6. Develop confidence in using quantitative tools for analysis. Being a business major, never shy away from quantitative analyses. Exude self-confidence when speaking.
7. Strive for excellence in writing. Avoid typos and sloppiness. Neatness is important.
8. Pay attention to detail. Be meticulous. Employers want careful, meticulous employees.
9. Do not merely recite ratios or present figures. Rather, develop ideas and conclusions concerning the possible trends. Use figures to support what your team is recommending.
10. 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 parts.
11. Throughout your case analysis, emphasize how your proposed strategic plan will enable the firm to gain and sustain competitive advantage.
12. When working as a team, do most of the work individually. Use team meetings mostly to assimilate work. This approach is most efficient.
13. 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. Ask the audience to point out any mistakes seen or any work that is unclear.
14. Capitalize on the strengths of each member of the group; volunteer your services in your areas of strength.
15. Think of your case analysis as if it were really doing this for a company. For example, do not invest much time describing what the firm has been doing; spend considerable time describing what needs to be done. After all, this is what the firm would have paid you to do, they likely already know what they are doing.
16. Develop a case-presentation style that is direct, assertive, enthusiastic, and convincing; be concise, precise, fluent, and accurate.
17. Enjoy strategic management and your project while you can; it may be several years before you are playing CEO again.
18. Let someone else read and critique your project file and your presentation several times a few days before you deliver a written project or present a project orally.
19. Include this project on your resume and include that you "gained experience using business strategic planning software."
20. Apply for a full-time job at the case company for which you prepared a comprehensive strategic plan.
21. For every slide you show in an oral presentation, point out how the information supports your recommendations for the firm.
22. Make certain that your key external and internal factors are actionable, quantitative, comparative, and divisional (AQCD) to the extent possible.

ASSURANCE-OF-LEARNING EXERCISE

STRATEGIC PLANNING TO ENHANCE MY EMPLOYABILITY: HOW IMPORTANT ARE VARIOUS REASONS TO USE THE FREE EXCEL STRATEGIC PLANNING TEMPLATE AT WWW.STRATEGYCLUB.COM?

Purpose

There are numerous reasons how the free Excel strategic-planning template is used globally in doing strategic planning. This exercise aims to enhance your familiarity with the template, so you ultimately will be comfortable using and referring to this skill in your career progression in business.

Instructions

Rank order the following 12 reasons according to why students (and companies) like using the template at www.strategyclub.com. Let 1 = the most important reason, 2 = next most important reason, all the way to 12 = the least important reason. Compare your answers to fellow students and to your professor's expected/expert answer.

____ 1. To save time in preparing a strategic-management case analysis; to focus on the "thinking rather than the mechanics" of developing matrices and performing analyses.
____ 2. To follow the correct process in formulating and implementing strategies.
____ 3. To avoid mistakes in math calculations, plotting points, and drawing graphs.
____ 4. To develop professional-looking charts, graphs, and matrices.
____ 5. To develop existing and projected financial ratios.
____ 6. To correctly place firms in BCG and IE portfolio matrices.
____ 7. To examine different scenarios for using debt versus stock to raise needed capital, using EPS/EBIT analysis.
____ 8. To vary weights and ratings in matrices and to see the resultant impact on total weighted scores.
____ 9. To more easily share information with team members, colleagues, or a professor.
____ 10. To more easily develop projected financial statements to reveal the expected impact of various strategies.
____ 11. To develop skills with perceptual mapping or product positioning.
____ 12. To gain experience using corporate strategic-planning software; many business jobs require proficiency in Excel, which students obtain using the template. After obtaining proficiency, you may include two competencies on your resume: (1) Excel and (2) using strategic planning software.

Honda Motor Co., Ltd.—2022

global.honda

Headquartered in Tokyo, Japan, Honda Motor Co., Ltd. is a multinational manufacturer of automobiles, motorcycles, marine engines, personal watercraft, lawn mowers, generators, power tools, and even aircraft engines. Honda is organized into four major divisions: Motorcycle Business, Automotive Business, Financial Services Business, and Life Creations and Other Businesses. Within the Life Creation and Other Businesses division lies Engine Manufacturing and Powersports Manufacturing. Honda currently employs over 200,000 associates worldwide and is a respected top competitor globally. Major rival companies include Toyota, Suzuki, Ford Motor Company, General Motors, Volkswagen, BMW, Harley-Davidson, and Polaris Industries.

Honda has assembly plants globally, including in Argentina, Belgium, Brazil, Canada, China, India, Indonesia, Japan, Pakistan, Malaysia, Mexico, New Zealand, Peru, Philippines, Taiwan, Thailand, Turkey, the United Kingdom, the United States, and Vietnam. Honda Canada is headquartered in Markham, Ontario, and in Alliston, Ontario. In India, Honda has the joint ventures Honda Siel Cars and Hero Honda Motorcycles. In China, Honda owns Guangzhou Honda and Dongfeng Honda. In Malaysia and Pakistan, Honda owns Boon Siew Honda and Honda Atlas, respectively. The American Honda Motor Company is based in Torrance, California.

Honda receives the majority of its annual sales from automobiles, a market the firm entered in 1963, but the firm is also the world leader in producing motorcycles. Well-known Honda vehicles include its lightweight, fuel-efficient passenger cars such as the popular Civic and Accord models and its luxury car, Acura. Honda is a major Japanese exporter to the United States and to other parts of the world. In total, Honda serves 25 million customers the world over.

In 2021, Honda recommitted to producing clean vehicles and machines and stated that decarbonization is an important "mission" of the company and that they aimed to achieve carbon neutrality by 2050. Honda says that its new electric vehicle, introduced into Europe and Japan in 2020, is only the first step of this process, and the company has worked for years to use renewable energy and recycle as often as possible.

In addition to environmental friendliness, Honda is also striving for zero traffic fatalities with Honda products by 2050. The firm is counting on their Honda SENSING technology and features, which qualify as Level 3 automated-driving equipment.

Though focused on transportation and power tools, Honda can be said to have a related diversification strategy. However, sales have decreased in all business categories, based on figures at the end of Honda's fiscal year, which at the time of writing is March 21, 2021. The firm needs a strong strategic plan moving forward, especially centered around what products to continue selling and which geographic and demographic markets to focus resources on.

History

Honda Motor Company's founder, Honda Soichiro, worked in the 1930s as a mechanic at the Art Shokai garage, fine-tuning cars that he would later enter in race competitions. He later founded Tōkai Seiki (Eastern Sea Precision Machine Company) to make piston rings for Toyota in support of the war effort. After attending engineering school (but not graduating), he visited factories around Japan to better understand Toyota's quality control processes, known as "Five Ways."

To address the demand for efficient small internal combustion engines, he founded the Honda Technical Research Institute in 1946, which was incorporated as Honda Motor Company only two years later. It started producing motorcycles in 1949, and by 1953, the C-100, a small-engine motorcycle, was available for purchase. It quickly gained popularity and made Honda the world's largest motorcycle company by 1959. In another innovation, Honda introduced its dual-clutch transmission in motorcycles in 2010.

In 1959, Honda established the American Honda Motor Company, a U.S. subsidiary, which began producing motorcycles in the United States in 1979 and automobiles in 1982.

Honda has remained the world's largest motorcycle manufacturer since 1959, and today it has a production level of over 400 million units annually. Honda is also the world's largest manufacturer of internal combustion engines measured by volume, producing more than 14 million units each year. Honda is the second-largest Japanese automobile manufacturer, behind Toyota, and was the first Japanese automobile manufacturer to release a dedicated luxury brand, Acura, in 1986. In 1987, it became America's best-selling import luxury vehicle with its Integra and Legend product lines.

Vision/Mission

Honda has two fundamental beliefs: "Respect for the Individual," and "The Three Joys," which are the joy of buying, the joy of selling, and the joy of creating. "Respect for the Individual" represents a philosophy of nurturing and promoting admirable characteristics throughout the company by respecting individual differences and trusting one an other as equal partners. "The Three Joys" are based on "Respect for the Individual" as the company strives to "create joy together" at all Honda worksites, with the ultimate goal of creating joy among its customers as the driving force.

Honda's vision for 2030 is to help its customers worldwide to grow their "life's potential." By doing so, Honda fulfills its mission statement, which affirms its commitment to customer satisfaction through high-quality products at reasonable prices, all through a global perspective. The mission statement can be viewed in the "Philosophy" section of the company website: honda-rd.asia.

Honda is known globally for excellent quality products at a competitive price point. The company's commitment to affordable quality is the distinct competitive advantage it uses to remain among the top competitors in the industry.

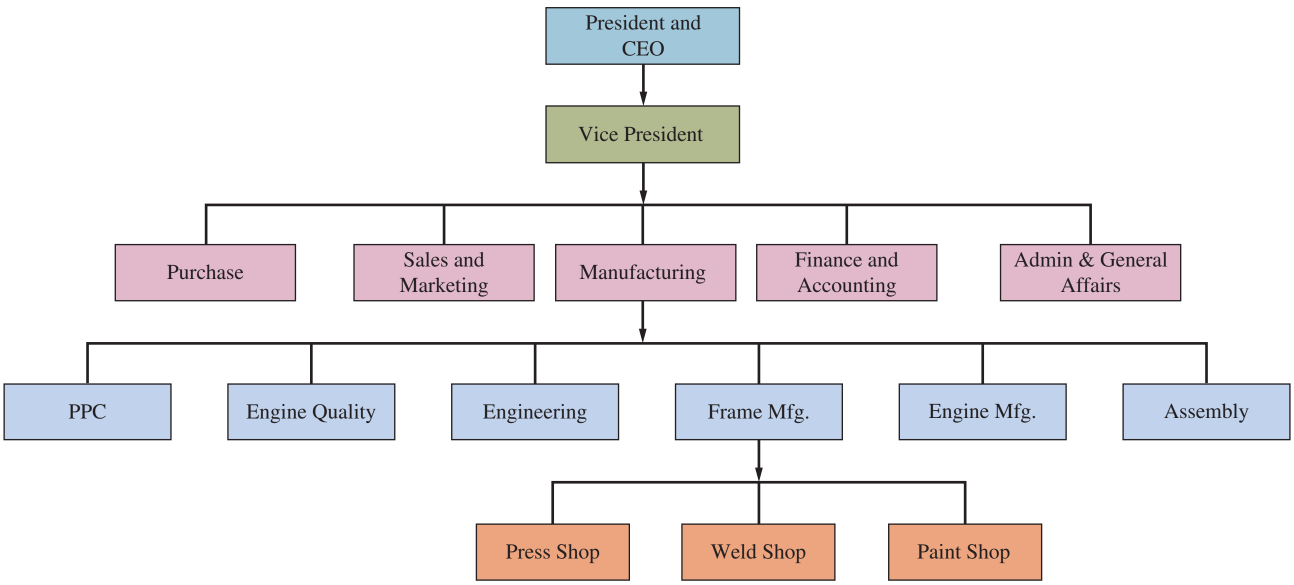
Internal Issues

Organizational Structure

Honda has 81 Japanese subsidiaries and 267 overseas subsidiaries. Pages 33 and 34 in the company's 2021 *Annual Report* lay out each of Honda's principal subsidiaries, the country of incorporation, function and percentage ownership, and voting interest held by Honda.

Given in Exhibit 1 is the current organizational chart for Honda Motor Company. Note that Honda's current CEO is also President of the company. The current organizational chart does not exhibit presidents of either regions or product categories, so the actual type of structure is unclear.

EXHIBIT 1 Honda's Organizational Chart



Source: Based on information in Honda's fiscal 2021 *Annual Report*.

Production/Operations

With several hundred factories around the world, Honda produces many of the major components of its products to ensure quality control. These components include engines, frames, and transmissions. Smaller components such as shock absorbers, electrical equipment, and tires are outsourced. Other raw materials including paint, steel plates, steel tubes, plastic, and zinc are also purchased from outside suppliers. Among these raw materials, the most important is steel plates, accounting for approximately 36 percent of Honda's total purchases of raw materials.

Financial Data and Statements

Honda's revenue for the fiscal year ending March 31, 2021, decreased by ¥1.76 trillion, or 12 percent, to ¥13.17 trillion from the prior fiscal year. The company's operating profit increased by ¥26.5 billion, or 4.2 percent, to ¥660.2 billion from the previous fiscal year. However, the company's profit before income taxes rose by ¥124.1 billion, or 15.7 percent, to ¥914.0 billion compared to the previous fiscal year. Profit for the year increased from the previous fiscal year by ¥185.5 billion, or 36 percent, to ¥695.4 billion.

Exhibits 2 and 3 provide Honda's most recent income statements and balance sheets.

EXHIBIT 2 Honda Income Statements (in millions of JPY)

Income Statement	3/31/20	3/31/21		Percent Change
Revenues	14,931,009	13,170,519	↓	–12%
Cost of Goods Sold	11,851,659	10,439,689	↓	–12%
Gross Profit	3,079,350	2,730,830	↓	–11%
Operating Expenses	2,445,713	2,070,622	↓	–15%
EBIT	633,637	660,208	↑	4%
Interest Expense	(156,281)	(253,845)	↑	62%
EBT	789,918	914,053	↑	16%
Tax	279,986	218,609	↓	–22%
Non-Recurring Events	—	—	NA	NA
Net Income	509,932	695,444	↑	36%

Source: Based on information in Honda's fiscal 2021 *Annual Report*.

EXHIBIT 3 Honda Balance Sheets (in millions of JPY)

Balance Sheet	3/31/20	3/31/21		Percent Change
Assets				
Cash and Short-Term Investments	2,672,353	2,758,020	↑	3%
Accounts Receivable	2,512,267	2,596,468	↑	3%
Inventory	1,560,568	1,545,600	↓	–1%
Other Current Assets	555,822	679,003	↑	22%
Total Current Assets	7,301,010	7,579,091	↑	4%
Property Plant & Equipment	3,051,704	3,021,514	↓	–1%
Goodwill	—	—	NA	NA
Intangibles	760,434	818,763	↑	8%
Other Long-Term Assets	9,348,317	10,501,662	↑	12%
Total Assets	20,461,465	21,921,030	↑	7%

(*continued*)

Balance Sheet	3/31/20	3/31/21		Percent Change
Liabilities				
Accounts Payable	958,469	1,088,061	↑	14%
Other Current Liabilities	4,831,619	4,627,396	↓	–4%
Total Current Liabilities	5,790,088	5,715,457	↓	–1%
Long-Term Debt	4,221,229	4,715,361	↑	12%
Other Long-Term Liabilities	2,164,125	2,117,373	↓	–2%
Total Liabilities	12,175,442	12,548,191	↑	3%
Equity				
Common Stock	86,067	86,067	↓	0%
Retained Earnings	7,973,637	8,142,948	↑	2%
Treasury Stock	(177,827)	(273,940)	↑	54%
Paid in Capital & Other	404,146	1,417,764	↑	251%
Total Equity	8,286,023	9,372,839	↑	13%
Total Liabilities and Equity	**20,461,465**	**21,921,030**	↑	**7%**

Source: Based on information in Honda's fiscal 2021 *Annual Report*.

By-Product Segment Information

The Motorcycle Division

Honda's unit sales of motorcycles, all-terrain vehicles (ATVs), and side-by-sides (SxS) in fiscal 2021 totaled 10.264 million units, down 17.4 percent from the previous fiscal year. About 88 percent of Honda's motorcycle units on a group basis were sold in Asia. Honda produces a wide range of motorcycles, with engine displacements ranging from the 50cc class to the 1800cc class in 1-, 2-, 4-, or 6-cylinder configurations. Honda also has electric vehicles in its lineup as well as motorcycle racing, sports, business, and commuter models.

Honda's motorcycle revenues decreased from the previous fiscal year by ¥272.0 billion in fiscal 2021, or 13.2 percent, to ¥1.787 trillion. Most other major lines on the income statement for motorcycles also decreased in fiscal 2021, including research and development (R&D) expenses, which decreased 16.5 percent, and operating profit, which decreased 21.4 percent from the previous fiscal year.

From a by-region perspective, Honda's motorcycle sales in Japan for fiscal 2021 was 370,000 units, an increase of 4 percent from the previous fiscal year. However, Honda's unit sales in North America only increased 0.6 percent in fiscal 2021 from the previous fiscal year to 332,000 units. Honda's unit motorcycle sales in Europe decreased 2.1 percent in fiscal 2021 from the previous fiscal year to 234,000 units, mainly due to decreases in sales units of the CB500 model series. Honda's motorcycle sales decreased by over 18 percent in fiscal 2021, attributed predominantly to a decrease in sales in India of the Activa model and the Air Blade model in Vietnam. These numbers do not include sales by P.T. Astra Honda Motor in Indonesia, which reported that unit sales for fiscal 2021 decreased a whopping 45 percent from the previous fiscal year to 2.69 million units, mainly due to decreases in sales units of the BeAT and Vario model series. In Honda's Other Regions (including South America, the Middle East, Africa, Oceania, and other markets), unit sales in fiscal 2021 decreased 20.9 percent from the previous fiscal year to 1.03 million units, due mainly to decreases in sales units of the CG160 and Biz model series in Brazil.

In 2010, Honda engineers introduced the dual-clutch transmission, which gives riders the sensation of a manual drive along with the convenience of an automatic drive without the clutch. More recently, Honda engineers have integrated smartphone apps in new motorcycles. Riders can now enjoy navigation, text, music, and even phone calls in a safe, hands-free journey that does not take the focus off the road. Honda considers this technology especially important for the Indian and Thai markets, where people use motorcycles more than in other regions and also, at least according to Honda, talk to their family more on the phone than people living in other countries do.

Honda engineers also are increasingly designing braking systems based on the type of riding the motorcycle is designed for. Traditionally, bikes came with single-type antilock brakes (ABS), which had a tendency to cause falls off the bike. Now bikes are designed with dual-type ABS, super sport-type ABS (used for breaking while cornering in circuit riding), and even off-road ABS systems.

The Automobile Division

Honda began automobile operations in 1963 and quickly grew into a dominant player in the world automobile market. In 1982, Honda became the first Japanese automaker to produce vehicles in the United States with the popular Honda Accord, leading to the establishment of the Acura Brand in 1986.

Honda's unit sales of automobiles in fiscal 2021 totaled 2.6 million units, down 21.1 percent from the previous fiscal year and down in all regions. About 49 percent of Honda's automobile units (including sales under the Acura brand) were sold in Asia, followed by 33 percent in North America and 13 percent in Japan. Honda's vehicles use gasoline engines of 3-, 4-, or 6-cylinder configurations; diesel engines; gasoline-electric hybrid systems; and gasoline-electric plug-in hybrid systems, as well as alternative fuel-powered vehicles such as battery electric vehicles, fuel cell vehicles, and flexible fuel vehicles. Honda's principal automobile products include the Accord, City, Civic, Crider, Fit/Jazz, Breeze, CR-V, Freed, Odyssey, Pilot, Vezel/HR-V, XR-V, and N-Box.

Honda's automobile division sales revenue for fiscal 2021 decreased by ¥1.39 trillion, or 14 percent, to ¥8.56 trillion from the previous fiscal year. Selling, general and administrative expenses, and research and development expenses also decreased in this division. The company's automobile operating profit decreased from the previous fiscal year by ¥63 billion, or 41.1 percent, during fiscal 2021 to ¥90.2 billion. In Japan and the United States, which are the two main sales markets for Honda automobiles, the contribution margin of light truck unit sales was about 25 percent higher than Honda's passenger cars category.

Honda experienced sharp declines in many popular automobile sales in fiscal 2021 across many of its most profitable regions. In Japan, for example, unit automobile sales decreased nearly 12 percent, attributed mostly to reduced sales of the N-box model series. In North America, sales were down 19 percent due to sharp declines in sales of both the Accord and Civic. Many of the sales reductions were from manufacturing fewer automobiles. In Europe, Honda's automobile sales were down 24 percent over the same period, Asia sales were down 31 percent, and China sales were down 34 percent.

Honda management talks often about their strategy to become near-zero emissions by 2050 and to reduce traffic deaths to zero by 2050. To help move the firm toward the former commitment, Honda has increased its R&D of hydrogen stations instead of relying on outside firms to develop this technology. Honda hopes its R&D in this area will soon produce vehicles that will run on hydrogen, often called fuel cell vehicles (FCVs). To fulfill their commitment to safer roads, Honda's global safety concept of "Safety for Everyone" is designed to make the roads safer not just for operators of vehicles and motorcycles but also for pedestrians. When fully developed, the technology can detect pedestrians, reduce blind spots, aid drivers in staying in the lane, notify drivers if they are not focusing on the road, and support drivers in many other ways.

The Financial Services Segment

Financial services provided by Honda include retail lending, leasing to customers, and wholesale financing to dealers. Honda offers a variety of financial services to customers and dealers in many countries to provide sales support for products.

Honda's sales revenue from its Financial Services division decreased by ¥92.6 billion, or 3.6 percent, to ¥2.49 trillion in fiscal 2021, due mainly to lower revenues from leased vehicles. This decline enabled operating profits to increase in fiscal 2021 by ¥137.2 billion, or 62.5 percent, to ¥356.9 billion.

The Life Creation and Other Division

In 2019, Honda changed the name of its Power Product segment to Life Creation and Other in order to signify the company's intent for this segment to create new value for "mobility" and "daily lives," which includes improving existing power products and starting new businesses for the future, including energy products. In this division, Honda manufactures power products such as general-purpose engines, generators, water pumps, lawn mowers, riding mowers, robotic mowers, brush cutters, tillers, snow blowers, outboard marine engines, walking assist devices, and portable battery inverter power sources. Energy products are to consist of portable and swappable batteries rechargeable with renewable energy, but this also includes energy management services for electric vehicle owners to charge their car with renewables.

Regarding the "Other" businesses, Honda began deliveries of the HondaJet aircraft in December 2015. For fiscal 2021, about 47 percent of Honda's power products units were sold in North America, followed by 25 percent in Asia, and 17 percent in Europe. Sales in power products were down 1.4 percent in 2021, mostly from decreased sales in North America; sales in Europe and Asia, on the other hand, increased slightly.

Exhibit 4 provides a breakdown of Honda's revenues by product category. Note the significant decreases across all segment categories.

EXHIBIT 4 Honda Revenues by Product (in billions of JPY; for fiscal years ended March 31, 2021)

	2019	2020	2021
Motorcycle	2,100.1	2,059.3	1,787.2
Automobile	11,072.1	9,959.0	8,567.2
Financial Services	2,365.3	2,586.9	2,494.2
Life Creation and Other	350.9	325.6	321.7
Total	15,888.6	14,931.0	13,170.5

Source: Based on Honda's 2021 *Annual Report*, p. 9.

By-Region Segment Information

Japan

Honda's unit sales of all products in Japan in 2021 increased 7.7 percent from the previous fiscal year to about 336,000 units, mainly due to the increases in sales of generators and original equipment manufacturer (OEM) engines, which are engines installed on products sold under a third party. In Japan, Honda's sales revenue from domestic and export sales decreased in 2021 by ¥555 billion, or 12.6 percent, from the previous fiscal year to ¥3.86 trillion, due mainly to decreased sales revenue in the Automobile business.

North America

Honda's unit sales of all products in North America, where the United States is the principal market, were down 8.1 percent in 2021 from the previous fiscal year to 2.6 million units, mainly due to the decrease in sales of OEM engines, which offset the increase, mainly in the sales of generators. In North America, Honda's sales revenue in 2021 decreased from the previous fiscal year by ¥1,075.9 billion, or 12.6 percent, to ¥7,480.8 billion, due mainly to decreased sales revenue in the Automobile business. Operating profit increased from the previous fiscal year by ¥150.5 billion, or 49.3 percent, to ¥455.8 billion.

Europe

Honda's unit sales of all products in Europe increased 9.9 percent in 2021 from the previous fiscal year to about 929,000 units, mainly due to increased sales of lawnmowers and OEM engines, which offset the decrease in sales of generators. In Europe, Honda's sales revenue in 2021 decreased from the previous fiscal year by ¥90.7 billion, or 11.7 percent, to ¥681.8 billion, due mainly to decreased sales revenue in the Automobile business. Operating profit increased by ¥12.4 billion, or 83.1 percent, to ¥27.4 billion from the previous fiscal year.

Asia

Honda's unit sales of all products in Asia increased 2.2 percent in fiscal 2021 from the previous year to 1.4 million units. This was also mainly due to the increased sales of OEM engines, which offset the decrease in sales of generators. In Asia, Honda's sales revenue decreased by ¥400.9 billion in fiscal 2021, or 10.4 percent, to ¥3,458.7 billion, while operating profit decreased by ¥67.6 billion, or 21.2 percent, to ¥251.8 billion.

Other Regions

Honda's unit sales in their Other Regions segment (including South America, the Middle East, Africa, Oceania, and other markets) increased 4.7 percent in 2021 from the previous year to about 336,000 units, mainly due to increases in sales of OEM engines. In the Other Regions business, revenues decreased by ¥259.1 billion, or 37.4 percent, to ¥434.4 billion in 2021. Exhibit 5 provides a breakdown of Honda's by-region revenues. Note the decreases across all regions in all years, indicating a need for the company to develop a clear strategic plan moving forward.

EXHIBIT 5 Honda Revenues by Region (in billions of JPY; for Fiscal Years Ended March 31, 2021)

	2019	2020	2021
Japan	2,042.8	1,985.9	1,849.2
North America	8,519.0	8,164.3	7,080.8
Europe	660.9	568.7	511.7
Asia	3,793.7	3,449.8	3,250.1
Other Regions	872.0	762.0	478.4
Total	15,888.6	14,931.0	13,170.5

Source: Based on Honda's 2021 *Annual Report*, p. 9.

Exhibit 6 provides a breakdown of Honda's segment revenue as a percent of the company's total revenue. Note increases in the Financial Services segment and decreases in the Automobiles segment.

EXHIBIT 6 Honda's Segment Revenue as a % of Total Revenue

	2019	2020	2021
Automobile	70	67	65
Motorcycle	13	14	14
Financial Services	15	17	19
Life Creation and Other	2	2	2

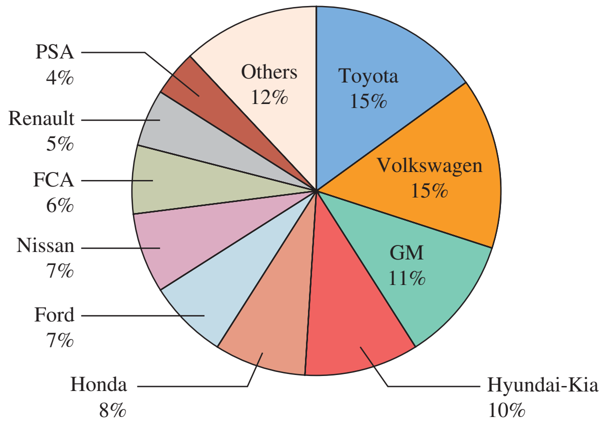
Source: Based on information in Honda's fiscal 2021 *Annual Report*.

Competitor Information

Companies globally that manufacture motorcycles, mopeds, and motor scooters include Jiangmen Dachangjiang Group, Lifan Industry (Group), Loncin Motor, and Zongshen Industrial Group (all based in China); BMW (Germany); Hero MotoCorp (India); Honda, Kawasaki, Suzuki, and Yamaha (Japan); and Harley-Davidson and Polaris (USA). In the motorcycle industry, personal income and interest rates drive demand. The profitability of firms largely depends on the volumes and sales of high-margin accessories and add-ons. Large firms enjoy economies of scale in purchasing and in maintaining dealer networks. Small producers compete by offering highly customized products.

Companies globally that manufacture automobiles include Volkswagen (Germany), Toyota (Japan), Renault (France), Mitsubishi (Japan), General Motors (USA), Hyundai-Kia (South Korea), FCA (Italy), Ford Motors (USA), Groups PSA (France), Daimier AG (Germany), Changan (China), Geely (China), BAIC (China) BMW (Germany), SAIC (China), Nissan (Japan), and Mazda (Japan). The largest automobile manufacturers in the world in 2020 were Toyota, Volkswagen, General Motors, Hyundai-Kia, Honda, Ford, Nissan, FCA, Renault, and PSA, with a market share ranging from 15 percent to 4 percent as shown in Exhibit 7.

EXHIBIT 7 Global Percentage of 2020 Vehicles Sold by Units



Source: Based on information from a variety of sources.

Toyota Motor Corporation

Headquartered in Toyota City, Japan, and employing about 370,000, Toyota is the largest automobile manufacturing company in the world, recently surpassing Volkswagen. In April 2021, Toyota purchased Lyft's self-driving technology for $550 million and merged that operation with its own newly created Woven Planet automation division. Toyota designs and manufactures a diverse product line-up that ranges from subcompacts to luxury and sports vehicles to SUVs, trucks, minivans, and buses. Popular models include the Prius, Camry, Corolla, Land Cruiser, and Lexus lines, as well as the Tundra truck. Toyota's subsidiaries also manufacture vehicles; for example, Daihatsu Motor produces mini-vehicles and Hino Motors produces trucks and buses. Toyota's domestic sales account for about 45 percent of the company's revenue.

Volkswagen AG

Headquartered in Wolfsburg, Niedersachsen, Germany, Volkswagen (VW) produces nearly 11 million vehicles each year, alternating with Toyota for the position of the world's largest auto manufacturer. VW produces cars, motorbikes, and commercial vehicles of all sizes under more than 10 popular brand names including VW, Audi, SKODA, SEAT, Porsche, Lamborghini, and Scania. VW has over 120 factories in more than 30 countries (two-thirds of these are European) and has customers in virtually all world markets. VW offers leasing, financing, and fleet solutions for customers and is aggressively positioning for the growth in demand for electric vehicles.

Ford Motor Company

Headquartered in Dearborn, Michigan, Ford manufactures cars, trucks, and SUVs under the Ford and Lincoln brands. About 65 percent of Ford's total sales comes from the United States. Ford is making significant investments in vehicle technology and mobility services. The company's F-150 is the bestselling truck in the world.

Harley-Davidson

Headquartered in Milwaukee, Wisconsin, Harley-Davidson (HD) is the largest U.S. motorcycle manufacturer and sells its bikes globally through a network of about 1,380 dealers. HD offers all kinds of bikes, including cruiser and touring models, standard and sport bikes, and dual models that can be used on- and off-road. HD trademarks include Softail, H-D Street, Sportster, and Livewire. HD sells "attitude" with its clothing brand-name products, which include a line of riding gear and apparel (MotorClothes). Harley-Davidson Financial Services (HDFS) offers financing to dealers and consumers in the United States and Canada. About 70 percent of HD's revenue are derived from the United States.

General Motors Corporation

Headquartered in Detroit, Michigan, General Motors Corporation (GM) makes and sells cars and trucks worldwide under well-known brands such as Buick, Cadillac, Chevrolet, and GMC. General Motors Financial Co. provides financing services. GM is developing electric vehicles and autonomous vehicles and has established a ride-sharing service dubbed Maven. The United States accounts for about 80 percent of GM's sales.

External Factors

Automakers globally face a rapidly changing external environment due, variously, to digitalization, connectivity, evolving powertrain technologies, tougher regulations, and shifts in consumer attitudes. These challenges are threats but also present opportunities. In pursuit of sales growth, global automakers are investing heavily in emerging markets by setting up local subsidiaries or joint ventures. Domestic manufacturers in emerging markets commonly reap tax benefits or other policies that give them an advantage over foreign competitors. Manufacturers in emerging markets are increasingly exporting their products to world markets. The global auto market declined nearly 14 percent in 2020 but is expected to rebound 13 percent in 2021. In 2020, 4 percent of new global auto sales were electric vehicles (EVs), but only 2 percent of new sales in the United States were electric vehicles. However, EVs are certainly the future, as demonstrated by Tesla's sales of 500,000 EVs in 2020 and forecasts of 20 million EV units to be sold by 2030.

Honda continues to face difficulties globally due to the spread of COVID-19 and the impact of a semiconductor supply shortage. In the United States, the government's economic stimulus measures were minimally effective. In Europe, economic activity remains restrained, while in Asia the economies have slowed in India, Thailand, Japan, and Indonesia. China, however, has experienced a moderate economic recovery mainly due to government stimulus measures.

A multitude of economic factors have affected Honda. In addition to COVID-19 concerns and economic distress, populations are aging, urbanization is accelerating, climate change is worsening, and industry structures are changing due to progress in technologies such as the use of electric-powered motors, autonomous driving, and IoT, all on a global scale.

Within the motorcycle business, competition with emerging manufacturers is intensifying. Data suggests that highway motorcycles account for 54 percent of the U.S. motorcycle market share, followed by off-highway motorcycles at 19 percent share. Dual motorcycles accounted for 9 percent of revenue in 2020, with scooters at 4 percent. Bicycles and parts filled the balance of Honda's 2020 revenue.

Honda has set a CO_2 reduction target rate that far exceeds the governmental targets for emerging markets. The company aims to become an environmental leader in motorcycles, not only through the use of electric-powered motors, but also through improved fuel efficiency and the use of biofuels.

With regard to electrification in the Automobile business, Honda plans to achieve carbon neutrality in accordance with the needs of each country it operates in. The company is striving to effectively respond to electrification, driver-assistive technologies, connected technologies, and other technological innovations. Honda needs to develop products and services equipped with such next-generation technologies across all its product-based and region-based segments. For example, Honda likely needs to further expand its lineup of EVs and FCVs based on electric-powered motor technology. Honda is currently developing its own all-solid-state batteries.

Vehicle sales across all regions have been flat since 2015. Global sales of vehicles were 90 million in 2015, increasing only to 95 million by 2018 before falling back to 90 million in 2019 and falling again to 78 million in Covid-impacted 2020. The United States and Europe each account for about 22 percent of the global market share; China, 32 percent; Japan, 6 percent; and South America, 4 percent; with other regions making up the balance. Annual growth in the United States is forecasted to be 1 percent from 2021 through 2024, with a 2 percent growth forecasted in the United States on SUV and light trucks. Trucks in the United States tend to sell for a premium and hold their value, making new trucks an attractive product for auto manufacturers.

Conclusion

With the automotive industry spiraling rapidly toward new innovations and electric vehicles, Honda should perhaps accelerate its electric automotive product development efforts. Due to the increases in minimum wage expected soon around the world, Honda may need to invest more in automotive assembly automation. This is important because the Automotive Division generates the most profits for Honda, and profits will be severely decreased by the mandatory wage increases. Automation also creates the potential for more production output due to less downtime required for automated processes.

Honda's Life and Creation Division is experiencing higher demand than Honda's current production capabilities, so capacity needs to increase. The powersports industry has become highly competitive, so additional expenditures in R&D are also likely needed for this division.

The second largest income-producing division for Honda is the Motorcycle Division. As most of the revenue for this division is generated in the Asia-Pacific region, Honda should perhaps increase motorcycle exports over the next 5 years to benefit from rising global demand for motorcycles. More exports would necessitate increased motorcycle production capabilities.

Honda needs additional marketing to get the message out globally to inform potential customers of its upcoming hi-tech electronic products. A comprehensive strategic plan is needed at Honda to guide its decision making in the future.

The Gap Inc.—2018

www.gapinc.com, GPS

The Gap Inc. (Gap) is a popular retailer providing clothing, accessories, and personal-care products for men, women, children, and babies under Gap, Old Navy, Banana Republic, Intermix, Weddington Way, Piperlime, and Athleta brands. Stores are located in the United States, Canada, China, the U.K., France, Ireland, Italy, Taiwan, Mexico, and Japan. Franchise agreements expand operations into Asia, Australia, Europe, Latin America, Africa, and the Middle East. Gap employs about 135,000 full and part-time people at 3,200 company-owned store locations that are almost all under a lease agreement. Customers can shop online at gap.com, oldnavy.com, bananarepublic .com, and athleta.com. Other Gap-owned retail outlets include GapBody, GapKids, and BabyGap. Weddington Way does not have a material impact on Gap's financial statements.

Gap 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.

As indicated in the following numbers, the company needs a clear strategic plan going forward. Fiscal year 2017 company's sales were up 3 percent compared with a decline of 2 percent the prior year. Sales by brand for fiscal year 2017 were as follows:

- **Old Navy Global:** up 6 percent versus down 1 percent the prior year
- **Gap Global:** down 1 percent versus down 3 percent the prior year
- **Banana Republic Global:** down 2 percent versus down 7 percent the prior year

History

In 1969, Doris and Don Fisher entered the clothing retail business with the vision of creating a unique shopping experience that offered a wide selection of styles. The idea behind the first Gap store, founded in San Francisco, was to provide fresh, casual, American style clothes. 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 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 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 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.

In 2005, Gap revamped its online stores by offering more convenience and interactive shopping. The following year, Gap added PiperLime to its online brands. In 2008, the company acquired Athleta Inc., a women's sports and active apparel company based in Petaluma, California, for $148 million. Gap opened its first stores in Serbia and Ukraine in 2011, broadening the clothing chain's reach into Eastern Europe. Gap stores opened early 2018 in Belgrade and Kiev. Stephen Sunnucks, Gap's international president, said in a statement that Ukraine is the fastest-growing retail market in Eastern Europe, while Serbia has many young customers who enjoy shopping.

Vision/Mission

Gap provides extensive literature and discussion on their corporate website regarding its efforts to enhance sustainability and take care of employees. Gap does not, however, report a written vision or mission statement. However, from reviewing current and past *Annual Reports,* a possible mission could look something like the following:

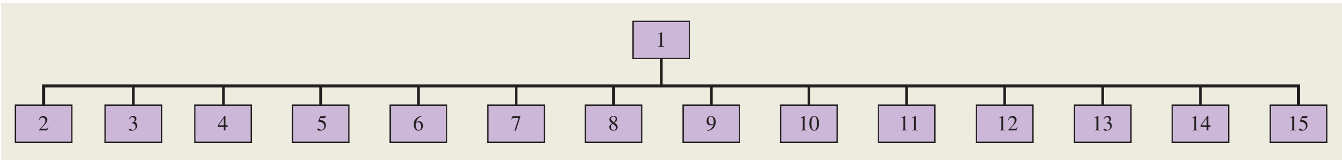
Gap strives to be a leader in the specialty family clothing industry offering excellent value to consumers by providing quality products at a fair price throughout North America, Asia, and Europe. Gap strives to minimize its environmental impact on raw materials with special consideration for both Gap employees and persons employed all along its supply chain. Gap is committed to producing lasting and positive relationships in all communities it impacts.

Internal Issues

Organizational Structure

Gap's organizational structure is provided in Exhibit 1. Of the 15 people listed, 6 are women. It appears the firm operates under a divisional-by-product structure, but there are duplicate titles of President and CEO for numerous positions, and there is no COO. Apparently every top executive reports to Art Peck.

EXHIBIT 1 Gap Inc.'s Top Executives and Organizational Chart



1. Art Peck, President and CEO
2. Brent Hyder, EVP, Global Talent and Sustainability
3. Julie Gruber, EVP, Global General Counsel, Corporate Secretary and Chief Compliance Officer
4. Paul Chapman, EVP and Chief Information Officer
5. Sebastian Digrande, EVP Strategy and Chief Customer Officer
6. Michael Yee, EVP Global Supply Chain: Sourcing and Production
7. Shawn Curran, EVP Global Supply Chain and Operations
8. Christophe Roussel, EVP Global Sourcing and Product Operations
9. Teri List-Stoll, EVP and Chief Financial Officer
10. Jeff Kirwan, President and CEO Gap
11. Sonia Syngal, President and CEO Old Navy
12. Nancy Green, President and CEO Athleta
13. Mark Breitbrad, President and CEO Banana Republic
14. Abinta Malik, EVP and General Manager, Greater China
15. Jyothi Rao, President and General Manager, Intermix

Source: Based on company documents.

Sustainability

Gap's sustainability strategy is aligned with the United Nations Global Sustainable Development Agenda that focuses on human rights, and the Paris Agreement that focuses on climate, and other sustainability programs. Gap is committed to ensuring its 135,000 employees and millions of people within its supply chain are paid fairly and work in safe conditions, as outlined in the company's five focus areas on core sustainability. Also included among the five key areas are water stewardship, product sustainability, and operational eco-efficiency. All areas are geared toward taking care of employees, and ensuring a small environmental footprint on all Gap products produced.

Segment Data

Gap primarily operates under Gap, Old Navy, Banana Republic, Athleta, and Intermix brands focusing primarily on clothing in all business segments. The company controls store layouts, marketing, brand development, and virtually all other vital factors for its full line of stores. Gap specializes in offering trendy but casual American style clothing focusing on denim, T-shirts, button-downs, khakis, and other casual styles of clothing and focusing on providing an affordable product though moderate price points. GapKids, GapBody, GapFit, babyGap, GapMaternity are common marketing names utilized by Gap. Customers can shop Gap at retail stores, outlet and factory stores, and on Gap's website. Gap stores account for 41 percent of all The Gap Inc. stores.

The company provides revenues by both geographic region and by store brand on their *Annual Report*. Exhibit 2 reveals the number of store locations by geographic region and store brand. Note there are nearly 25 percent more Old Navy stores in North America than Gap stores, but only 2 percent of international stores are Old Navy with 88 percent of international stores being Gap. Also, around 12.5 percent of all company stores are franchised owned, primarily all

EXHIBIT 2 Gap Inc. Store Demographics (2017 data)

Store	Region	Number of Locations
Gap	North America	844
Old Navy	North America	1,043
Banana Republic	North America	601
Athleta	North America	132
Intermix	North America	43
Total North America Stores		**2,663**
Gap	Asia	311
Old Navy	Asia	13
Banana Republic	Asia	48
Total Asia Stores		**372**
Gap	Europe	164
Banana Republic	Europe	1
Total Europe Stores		**165**
Total Company Stores	**Worldwide**	**3,200**
Total Franchise Stores	**Worldwide**	**459**
Total Stores Overall		**3,659**

Source: Based on company website information.

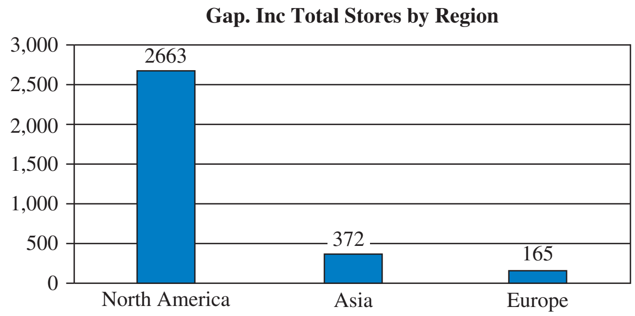
outside of North America. Exhibit 3 reveals that over 83 percent of all Gap stores are located in North America. Exhibit 4 reveals that Gap, Old Navy, and Banana Republic account for 94 percent of all Gap Inc. stores worldwide.

Gap plans to open additional Old Navy stores in Mexico and China in the coming years, but closed all 53 Old Navy Stores in Japan in 2016. The company kept its presence in Japan with its 200 Gap and Banana Republic stores in that market. In total, the company closed 67 stores worldwide in 2016, revealing how important branding is among different nations; a one-size-fits-all approach does not apply; for example all but 13 of the 1,056 Old Navy stores are located in North America.

Athleta focuses on premium fitness and performance apparel focused on women and girls. The business focus is on yoga, sports, and everyday activities. The Gap Inc. acquired Intermix in 2012.

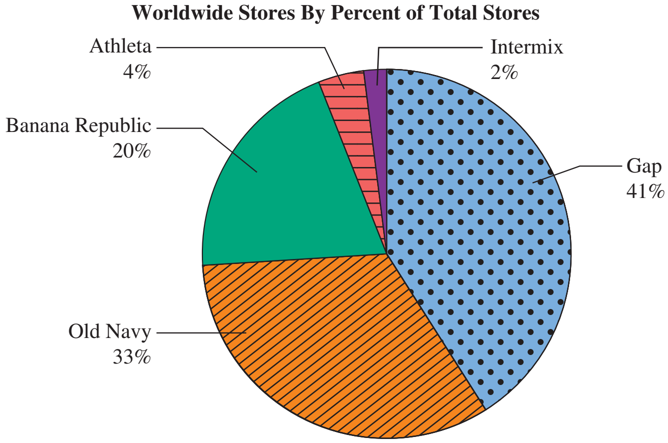
Exhibit 5 and Exhibit 6 reveal the company's revenues and number of locations across regions and store type, respectively. Fiscal 2017 ended February 3, 2018. The U.S. region includes Puerto Rico and Guam. Fiscal 2017 results showed a substantial drop in company revenues in the United States, Canada, Europe, and Asia and across all brands, except slight increases in revenues from "Other Regions" and "Other Brands."

EXHIBIT 3 The Gap Inc.'s Total Stores by Region in 2017



Source: Based on company website information.

EXHIBIT 4 **The Gap Inc. Worldwide Stores Percent Data for 2017**



Source: Based on company website information.

EXHIBIT 5 **Gap Inc.'s Revenues by Store Type and Region in Fiscal 2017 (in millions $)**

Year End February 3, 2018	Gap	Old Navy	Banana Republic	Other	Total
U.S. & Canada	$3,463	$7,117	$2,242	$919	$13,741
Asia	1,117	50	96	0	1,263
Europe	626	0	15	0	641
Other Regions	112	71	27	0	210
Total	$5,318	$7,238	$2,380	$919	$15,855

Source: Based on company documents.

EXHIBIT 6 **Gap Inc.'s Number of Store Locations on 11-1-17 versus 2-1-18**

Division	# of Stores on 11-1-17	# of Stores on 2-1-18
Gap North America	835	810
Gap Asia	309	313
Gap Europe	157	155
Old Navy North America	1,057	1,066
Old Navy Asia	13	14
Banana Republic North America	596	576
Banana Republic Asia	48	45
Athleta North America	140	148
Intermix North America	38	38
Company-operated stores total	3,193	3,165
Franchised stores total	446	429
Grand total	3,636	3,594

Source: Based on company documents.

Current Strategies

Cost cutting and efficiencies along the value chain are planned to improve the company's short-term bottom line, but these initiatives going forward cannot assure a sustainable competitive advantage. The company must be diligent in deciding where to sell what. A strategic issue facing the company moving forward is whether the company should continue to add store locations in the United States, and if so, under which brand names? Historically, the family clothing business is bimodal in nature, with bargain stores such as TJX Companies and Ross Stores doing well during recessions and normal economic cycles and higher-end stores performing better during more prosperous economic times. How well is the company's strategy aligned to take advantage of this bimodal situation? From the market bottom in 2002 to early 2018, the company's stock price rose about 220 percent compared to 760 and 2,100 percent for TJX and Ross, respectively. Should Gap consider divesting possibly Banana Republic and adding a store similar to Ross or TJX as a product-development strategy?

Production and Seasonality

Gap purchases its products from approximately 800 venders in over 40 countries, with the largest two venders both providing around 5 percent of purchases annually. The majority of purchases are from factories outside the United States with around 50 percent of purchases coming equally from Vietnam and China. The company's sales peak around the Christmas holiday period.

Finance

The company's sales decreased about 2 percent in fiscal 2016 (year ending January 2017). The bulk of the decline was from reduced net sales at Gap and Banana Republic, with exchange rate losses only accounting for $20 million. However, more alarmingly, net income was down over 26 percent over the same time period due mostly to a substantial increase in operating expenses. In fiscal 2015, total net sales declined $638 million. The company pays a $0.92 dividend and plans to re-initiate its $1 billion share repurchase plan in fiscal 2017 (year ending January 2018). Interesting use of the term "re-initiate" by The Gap Inc. as the firm listed $0 for treasury stock on its balance sheets, but did record treasury stock in fiscal 2014. The firm has $1.25 billion in long-term debt at a surprisingly high fixed rate of 5.95 percent through April 2021. From purchasing Athleta and Intermix in recent years, Gap Inc. reports a nominal amount of goodwill on the balance sheet.

The Gap's income statements and balance sheets are provided in Exhibit 7 and Exhibit 8, respectively, for fiscal 2016 and 2017. For fiscal 2017 that ended February 3, 2018, The Gap Inc.'s revenues were $15.9 billion, up slightly from the prior year. The company ended fiscal 2017 with 3,594 store locations; among these were 3,165 company-operated as opposed to being franchised.

EXHIBIT 7 Gap Inc.'s Income Statements (in millions $)

Income Statement	1/28/17	2/3/18		Percent Change
Revenues	$15,516	$15,855	↑	2.18%
Cost of Goods Sold	9,876	9,789	↓	−0.88%
Gross Profit	5,640	6,066	↑	7.55%
Operating Expenses	4,441	4,568	↑	2.86%
EBIT	1,199	1,498	↑	24.94%
Interest Expense	75	74	↓	−1.33%
EBT	1,124	1,424	↑	26.69%
Tax	448	576	↑	28.57%
Non-Recurring Events	0	0	NA	NA
Net Income	676	848	↑	25.44%

Source: Based on company documents.

EXHIBIT 8 **Gap Inc.'s Balance Sheets (in millions of $)**

Balance Sheet	1/28/17	2/3/18		Percent Change
Assets				
Cash and Equivalents	$1,783	$1,783	⇨	0%
Accounts Receivable	0	0	NA	NA
Inventory	1,830	1,997	⇧	9%
Other Current Assets	702	788	⇧	12%
Total Current Assets	4,315	4,568	⇧	6%
Property Plant & Equipment	2,616	2,805	⇧	7%
Goodwill	0	0	NA	NA
Intangibles	0	0	NA	NA
Other Long-Term Assets	679	616	⇩	-9%
Total Assets	7,610	7,989	⇧	5%
Liabilities				
Accounts Payable	2,388	2,461	⇧	3%
Other Current Liabilities	65	0	⇩	−100%
Total Current Liabilities	2,453	2,461	⇧	0%
Long-Term Debt	1,248	1,249	⇧	0%
Other Long-Term Liabilities	1,005	1,135	⇧	13%
Total Liabilities	4,706	4,845	⇧	3%
Equity				
Common Stock	20	19	⇩	−5%
Retained Earnings	2,749	3,081	⇧	12%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	135	44	⇩	−67%
Total Equity	2,904	3,144	⇧	8%
Total Liabilities and Equity	**7,610**	**7,989**	⇧	5%

Source: Based on company documents.

Competitors

The family clothing business in the United States is highly fragmented, with over 20,000 businesses, ranging in size from a mom-and-pop to TJX, the largest based on total revenues. Profit margins are slim, valued at $100 billion in annual sales, with profits slightly above $3 billion and a growth rate of less than 2.5 percent. Top competitors in the industry include TJX Companies, Ross Stores, L Brands, Gap, Cato, Stein Mart, and many more, including Walmart, Target, Belk, Kenneth Cole, Abercrombie & Fitch, and J. C. Penney. Notable newcomers to the U.S. market include H&M, based in Sweden and popular throughout Europe specializing in inexpensive but quality clothing. Also, Zara, a fashionable clothing store with inexpensive prices based in Spain, now has stores in the United States.

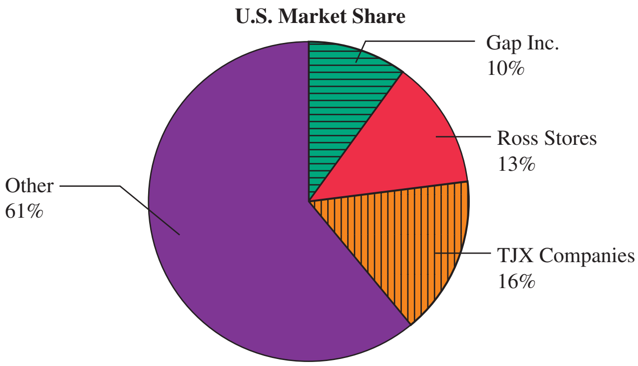
Exhibit 9 provides a financial comparison of some leading competitors in the family clothing industry. Exhibit 10 reveals the U.S. market share of family clothing stores—TJX, Ross, and The Gap Inc., account for the largest revenues.

EXHIBIT 9 A Financial Comparison of Gap Inc. with TJX and Ross (July 1, 2017 data)

	The Gap Inc.	TJX	Ross
$ Market Cap.	13.4B	48.3B	30.6B
# Employees	135K	235K	79K
$ Revenue	15.5B	33.2B	12.8B
% Gross Margin	36.3%	30.0%	28.7%
$ Net Income	676M	2,247M	1,118M
EPS Ratio	2.17	3.70	3.13
P/E Ratio	15.88	20.60	25.60

Source: Based on a variety of sources.

EXHIBIT 10 U.S. Market Share Information for Family Clothing Companies



Source: Based on a variety of sources.

The TJX Companies (TJX)

A treasure hunt in a department store? This is the experience that CEO Carol Meyrowitz of TJX wants customers to have when they come into any of the company's more than 3,200 stores in United States, Canada, and Europe. TJX is a huge retail conglomerate of off-price brands, including T.J. Maxx, Marshalls, and HomeGoods—with stores in all 50 states in the United States, 10 provinces of Canada, United Kingdom, Ireland, Germany, Poland, and in Europe. Approximately 75 percent of revenues are derived from the United States and approximately 25 percent of sales are derived from home goods. Headquartered in Framingham, Massachusetts, TJX's revenue increased to $33 billion in fiscal 2016 that ended January 28, 2017 up from $31 billion, while the company's net income remained at $2.3 billion. Interestingly, net income for TJX has been stable with no real growth in the last 4 years. In 3,812 stores, TJX has about 235,000 employees who often work "just a few doors down" from rival companies such as Ross Stores, Stein Mart, Gap, and Cato. TJX's largest customer group are women; the firm has a female CEO, the same as rival Gap Inc.

Ross Stores (ROST)

Based in Dublin, California, Ross Stores is a discount clothing and home fashions store offering products at prices generally 20 to 60 percent off typical retail department store prices. The firm's main slogan is Ross, Dress for Less. The company operates under two segments, 1) Ross, Dress for Less and 2) dd's Discounts, employs over 78,000, and reported revenues over $12.8 billion in fiscal year end January 2017. In total, Ross operates over 1,412 stores in 37 states with product offerings similar to TJX that include women's clothing, lingerie, maternity clothing, shoes, accessories, handbags, watches, jewelry, luggage, and more. Ross operates under a no-frills policy that extends to having no window displays, no mannequins or other fancy marketing and advertising displays. The primary age groups for the store are 25 to 54 year olds. The company increased its store count by 87 stores in the most recent fiscal year, amounting to a 6 percent increase, which is in line with the increases in the last several years.

Online

Consumers are increasingly shopping online for clothing through auctions and online-only stores. Traditional retailers have virtually all responded with their own online websites, yet often at the same high prices found in their stores. Brick and mortar stores still hold the distinct advantage of customers being able to hold, feel, and try on items before purchasing, as well as talk to knowledgeable salespeople at higher quality stores.

Twenty of the most popular online clothing stores that compete with Gap Inc. by offering inexpensive clothing, mainly for women, are listed as follows:

1. Boohoo—a UK-based company; dresses start at $6; free shipping on orders over $60
2. Cotton On—an Australian retailer; dresses start at $10; free shipping on orders over $55
3. One Loved Babe—an online boutique for women; dresses start at $20; free shipping
4. Yes Style—a Hong Kong-based store; dresses start at $3.95, free shipping on orders over $35
5. Amazon.com—Prime members get free shipping and returns
6. Missguided—a UK-based firm; dresses start at $6; shipping free is $5 on all orders
7. ASOS—very fast and reliable; dresses start at $12.50; free shipping on orders over $40
8. Adore Me—specializes in lingerie in straight and plus sizes; free shipping
9. Saved by the Dress—Miami-based; dresses start at $25; free shipping on orders over $60
10. Dog Dog—dresses start at $17.95; free shipping on all orders
11. Lulu's—dresses start at $14; free shipping on orders over $50
12. Dress Up—boutiques; dresses start at $16; free shipping on orders over $50
13. Thred Up—a resale store carrying all brands like new; free shipping on orders over $79
14. Blame Betty—offers vintage or retro clothing; dresses start at $27.60; shipping costs vary
15. 6pm—carries many brands such as Columbia, Under Armour, Prana; for men and women
16. Nordstrom Rack—dresses start at $6.08; free shipping on orders over $90
17. Charming Charlie—dresses start at $19; free shipping on orders over $50
18. Old Navy—dresses start at $12; free shipping on orders over $50
19. Hollister—mainly for teens; dresses start at $20; free shipping on orders over $50
20. TJ Maxx—dresses start at $7.99; free shipping on orders over $89

External Issues

The family clothing business is very competitive as consumers increasingly have many options and many mediums to buy products. Many customers have been trained to wait for sales resulting in lower inventory turnover times and reduced profit margins for retailers. Unlike many industries such as automobiles, electronics, or restaurants, the retail clothing business is highly seasonal in nature as styles, colors, and temperatures drastically affect stocking, allocating, and marketing various merchandise. Customer tastes can change quickly as well, with one year's hot color or style of cut being less desired the next year. In the United States alone, family clothing stores account for over $100 billion in revenue, but yield profits less than $5 billion and a stagnate growth rate of around 1 percent. It is simply a tough business. Women's clothing accounts for 52 percent of industry revenues; men and children account for 28 and 20 percent, respectively.

Reshoring

Over the last 50 years, production of apparel (textile industry) moved from the northern United States to the southern states, then to Mexico, and from there to places in Asia, such as China and Vietnam. However, there is a growing trend, according to the Boston Consulting Group, to produce products domestically. Increasing transportation cost, government incentives, being closer to the end consumer, increasing labor cost abroad, recent changes to tax laws, and just simply being able to have "Made in the USA" on your product, is driving some firms to start production again in the United States. Several apparel firms who are now producing some of their brands in the U.S. include Abercrombie & Fitch, J. Crew, and Ralph Lauren's Club Monaco brand. Even Nike, plagued by its operations in sweatshops in the past, is seriously considering reshoring select products.

Expenses

The family clothing store industry's profit margin is less than 5 percent with purchases accounting for 60 percent of all expenses, putting further pressure on finding cheap sources of clothing manufacturing. In 2017, over 80 percent of clothes sold in family clothing stores in the United States were imported from overseas. Also, contributing to the higher purchasing percentage is the price of cotton, which can vary wildly from year to year. Wages paid to store employees account for just over 10 percent of industry revenues and there are constant pressures to increase wages. Rent and utilities account for 6 percent and advertising and marketing only account for 2 percent of revenues.

Clothing Materials Sustainability

Many different materials are used to construct clothing. Cotton and linen are derived from plants, whereas wool, leather, and cashmere are derived from animals; today there are a slew of synthetic fibers such as polyester and spandex along with rayon, modal, and many others from wood. Cotton cultivation can leave a substantial economic footprint as pest and weed control measures, along with providing adequate water, are necessary to ensure growth. Two advantages to cotton are old clothing can be recycled and used again; Additionally, cotton is a renewable resource, or in other words, is able to be planted annually. Synthetic materials typically are nonrenewable—being derived from petroleum by products and have much longer biodegradable times than cotton. Cellulosic fibers from wood such as rayon and modal are often difficult to trace where the wood products were derived from, and at times, wood pulp is derived from endangered forests.

Future

In fiscal year 2018, The Gap Inc. plans to open about 25 additional company-operated stores, net of closures and repositions, with particular emphasis on opening new Athleta and Old Navy stores, with closing poorly performing Gap and Banana Republic stores. The company needs a clear strategic plan to best manage its thousands of brick-and-mortar stores in the face of rapidly increasing online preferences. The company hopes to maintain, or increase, its fiscal 2017 operating margin of 9.3 percent—compared with 7.7 percent the prior year. The company's products are available for purchase in more than 90 countries through company-owned, franchisee-owned, and e-commerce sites. Prepare an effective three year strategic plan for The Gap Inc.

Samsung Electronics Co., Ltd.—2022

www.samsung.com

Headquartered in Seoul, South Korea, Samsung Electronics Co., Ltd. (Samsung) was incorporated in 1969 and listed on the Korea Stock Exchange in 1975. Samsung is the largest South Korean multinational conglomerate corporation and among the top 10 largest companies in the world. Samsung and its subsidiaries are organized into four distinct business segments, groups, or divisions, as follows:

1. **Consumer Electronics (CE)** includes digital TVs, monitors, air conditioners, refrigerators, and medical equipment.
2. **Information Technology & Mobile Communications (IM**) produces mobile phones, communication systems, computers, network systems, smart computers, tablets, and wearables.
3. **Device Solutions (DS)** has two divisions: 1) Semiconductor (SC), which produces DRAM, NAND flash, and mobile applications, and 2) Display Panel (DP), which produces OLED panels for smartphones, LCD panels for TVs, semiconductor products ("Semiconductor") such as memory, foundry, and system LSI, and display products ("DP") such as LCD and OLED panels.
4. **Harman** includes connected car systems and speakers, audio and visual products, and enterprise automation solutions and services.

History

When it was founded in 1938 by Lee Byung-Chui in Ingyo-dong, Samsung was a trading company with 40 employees, but in the decades since then, the company diversified into food processing, textiles, insurance, securities, and retail. However, the company's big move was when Samsung entered the electronics business in the late 1960s by forming Samsung Electronics Devices, Samsung Electro-Mechanics, Samsung Corning, and Samsung Semiconductor & Telecommunications. Some of Samsung recent product launches include the following:

2019—5G smartphone, Galaxy S10 5G

2019—Exynos 980, 5G mobile processor

2020—AI-technology-based Grande AI washer/dryer

2020—World's first ultra-high-speed DRAM for AI and next-generation super computers

2020—Galaxy Z Flip, a foldable model with a new form factor

2020—Operation of Pyeongtaek Line 2, the world's largest semiconductor line

Vision/Mission

Vision Statement

In 2019, Samsung announced its "Semiconductor Vision 2030," a vision to invest KRW 133 trillion up to 2030 in their system semiconductor business and to employ 15,000 persons. No other vision statement could be located for Samsung either on their corporate website or in the company's *Annual Report.*

Mission Statement

Samsung's mission (adapted from content at the global corporate website) is to remain committed to following a global code of conduct by adhering to local laws and regulations and expecting the best from employees. Samsung values ethics and strives to build trust and to aid in responding to a dynamic environment. Samsung knows that trust helps build relationships with customers, employees, business partners, and communities. The company is committed to improving both its talent and products to make the world a better place to live.

Internal Issues

Organizational Structure

Samsung has its corporate headquarters and 29 consolidated subsidiaries in South Korea. Important Samsung locations include Suwon, Gumi, Gwangju, Giheung-gu, Hwaseong, and Pyeongtaek. Samsung has 212 overseas subsidiaries for product manufacturing, sales, and research and development (R&D), with locations in the United States, Europe/CIS, Middle East/ Africa and Asia. Among these operations, Samsung has 55 subsidiaries in North America, including SEA (New Jersey, responsible for the sales of set products including TVs and HHPs), SII (California, manufacturing TVs), SAS (Texas, manufacturing semiconductor products), and Harman (Connecticut, automotive components).

In Europe and the Far East, Samsung has 75 subsidiaries, including SEUK (United Kingdom), SEG (Germany), SEF (France), and SEI (Italy) for sales of set products; SEH (Hungary) and SESK (Slovakia) for manufacturing TVs; and SEPM (Poland) for manufacturing home appliances such as refrigerators. The company has 19 subsidiaries in the Middle East and Africa for product manufacturing and sales. Additionally, the company has 30 subsidiaries in Asia-Pacific (excluding China), including SAPL (Singapore), SEAU (Australia), SEPCO (Philippines), and SME (Malaysia), which are responsible for regional sales. Samsung also operates numerous production sites including SIEL (India) for HHPs and other products, SEV and SEVT (Vietnam) for HHPs, SEHC (Vietnam) for TVs, and SDV (Vietnam) for DPs. Samsung operates 33 subsidiaries in China, including SCIC (Beijing) and SEHK (Hong Kong) for the sales of set products in those regions, and SSS (Shanghai) and SSCX (Xian) for semiconductors and DP sales. Production sites include SSEC (Suzhou) for set products and SCS (Xian) for semiconductor production.

Samsung is organized utilizing a strategic business unit (SBU) design, the SBUs being the four divisions of the company. Under each division, there are many affiliates and subsidiaries. As indicated on pages 213–216 in Samsung's 2020 *Annual Report*, the top 5 executives of Samsung are as follows:

1.	Ki-nam Kim	CEO of DS Division
2.	Hyun-suk Kim	CEO of CE Division
3.	Dong-jin Koh	CEO of IM Division
4.	Jong-hee Han	Head of Visual Display (DP) Business
5.	Jae-wan Bahk	Chairman of the Board

Financial Data and Statements

Samsung's revenues increased 3 percent in 2020, with a net income increase of 21 percent, making the firm one of the best performers in the world during that year. The global work-from-home corporate environment created a need for digital products, and people had time for home improvements as well. Industrywide, demand for many of these products declined in early 2020, but a massive demand for work-from-home products such as PCs and tablets emerged by the latter half of 2020. Exhibits 1 and 2 provide the latest income and balance sheets for Samsung.

EXHIBIT 1 Samsung Income Statements (in millions of KRW)

Income Statement	12/31/19	12/31/20		Percent Change
Revenues	230,400,881	236,806,988	↑	3%
Cost of Goods Sold	147,239,549	144,488,296	↓	–2%
Gross Profit	83,161,332	92,318,692	↑	11%
Operating Expenses	55,392,823	56,324,816	↑	2%
EBIT	27,768,509	35,993,876	↑	30%
Interest Expense	(2,663,680)	(351,241)	NA	NA
EBT	30,432,189	36,345,117	↑	19%
Tax	8,693,324	9,937,285	↑	14%
Non-Recurring Events	0	0	NA	NA
Net Income	21,738,865	26,407,832	↑	21%

Source: Based on information in the 2020 Samsung *Annual Report,* p. 70.

EXHIBIT 2 Samsung Balance Sheets (in millions of KRW)

Balance Sheet	12/31/19	12/31/19		Percent Change
Assets				
Cash and Short-Term Investments	108,779,703	124,652,843	↑	15%
Accounts Receivable	39,310,463	34,965,058	↓	–11%
Inventory	26,766,464	32,043,145	↑	20%
Other Current Assets	6,528,630	6,554,533	↑	0%
Total Current Assets	181,385,260	198,215,579	↑	9%
Property Plant & Equipment	119,825,474	128,952,892	↑	8%
Goodwill	0	0	NA	NA
Intangibles	20,703,504	18,468,502	↓	–11%
Other Long-Term Assets	30,650,259	32,598,745	↑	–6%
Total Assets	352,564,497	378,235,718	↑	7%
Liabilities				
Accounts Payable	35,114,203	38,191,673	↑	9%
Other Current Liabilities	28,668,561	37,412,678	↑	31%
Total Current Liabilities	63,782,764	75,604,351	↑	19%
Long-Term Debt	5,356,728	4,630,763	↓	–14%
Other Long-Term Liabilities	20,544,584	22,052,588	↑	7%
Total Liabilities	89,684,076	102,287,702	↑	14%
Equity				
Common Stock	778,047	778,047	↓	0%
Retained Earnings	254,582,894	271,068,211	↑	6%
Treasury Stock	(4,968,829)	(8,687,155)	NA	NA
Paid in Capital & Other	12,488,309	12,788,913	↑	2%
Total Equity	262,880,421	275,948,016	↑	5%
Total Liabilities and Equity	**352,564,497**	**378,235,718**	↑	7%

Source: Based on information in the 2020 Samsung *Annual Report,* p. 67.

R&D Information

Samsung's R&D expenditures are large and growing; specifically, in millions of Korean won, these were KRW 18,662,029 in 2018, KRW 20,207,612 in 2019, and KRW 21,229,200 in 2020. As a percentage of total sales, these R&D expenditures were 7.7, 8.8, and 9.0 in 2018, 2019, and 2020, respectively. In 2020, Samsung invested KRW 21.2 trillion in R&D and registered 6,648 domestic patents and 8,520 U.S. patents. In its home country of South Korea, Samsung operates three levels of R&D organizations: 1) a business unit development team under each division that focuses on short-term product enhancements, 2) a research institute under each business unit that develops mid- to long-term technology with a 3- to 5-year outlook, and 3) the Samsung Advanced Institute of Technology, which develops core long-term technology. (Pages 54–63 in Samsung's 2020 *Annual Report* provide detailed information about current R&D projects by segment of the company.)

Outside South Korea, Samsung operates R&D organizations in the United States (SRA), China (SRC-Beijing, SRC-Nanjing, SRC-Guangzhou, SRC- Shenzhen, and SSCR), India (SRI-Bangalore and SRI-Delhi), Bangladesh (SRBD), Israel (SRIL and SIRC), Russia (SRR), and Japan (SRJ) to carry out research activities for product development and basic technological research. Additionally, Samsung has established AI centers in Cambridge (UK), Moscow (Russia), Toronto (Canada), Montreal (Canada), and New York (USA).

Human Resources

Exhibit 3 provides the gender distribution for Samsung's global workforce. Note that there are nearly three times more men than women working for Samsung, and that the DS segment has twice the employees as the CE segment with relatively the same revenue.

EXHIBIT 3 A Breakdown of Samsung's Workforce by Gender

Segment	Gender	
	Male	**Female**
CE	10,262	2,165
IM	19,762	7,144
DS	42,391	16,726
Others	8,159	2,271
Gender Total	80,575	28,306

Source: Based on information in Samsung's 2020 *Annual Report*, p. 215.

By-Segment Information

As defined and described earlier, Samsung has four divisions: CE, IM, DS, and Harman. In 2020, the CE Division's output of image devices was 48.2 million units produced at sites in Mexico, Vietnam, Brazil, and Hungary. The IM Division's calendar 2020 output of HHPs was 249.2 million units, with major production sites in Korea (Gumi), Vietnam, India, and Brazil. In 2020, the DS Division's memory output was 1.2 million units, produced at factories in Korea (Hwaseong and Pyeongtaek) and China. The DP Division's output of display panels in 2020 was 5.9 million units, produced in Korea (Cheonan and Asan) and China. Lastly, the Harman Division's digital cockpit output was 6.11 million units.

In 2020, Samsung's CE and IM capacity utilization rates were calculated as actual output relative to production capacity. The utilization rates were 93.6 percent for Image devices and 77.5 percent for HHPs. The DS Division operates memory and display panel production 24 hours a day, in 3 shifts. Cumulative operating days, including holidays, were 366 days in 2020. The DS capacity utilization rate was calculated as actual hours (operating days × number of production lines × 24 hours) relative to production capacity. In 2020, Harman's utilization rate was 65.3 percent, calculated as actual output relative to production capacity. Be mindful that companies desire and strive for capacity utilization rates of 90 percent or above. This is analogous to commercial airplanes and tractor trailer trucks; you want those items working and in motion, not idle on runways or in parking lots.

CE Segment

The CE division has nine regional headquarters and has been the global market leader in the production of televisions for more than 15 years. Samsung continually produces new and improved TVs in, for example, their 8K QLED and ultra-large product range. Samsung's global market share in the TV business has slowly increased from 29 percent in 2018, to 30.9 percent in 2019, to 31.9 percent in 2020. In 2020, Samsung introduced their 4K and 8K QLED TVs and new Lifestyle TVs such as The Premier and The Sero. In 2021, Samsung plans to enhance their product lineup by launching 80″–110″ Neo QLED TVs featuring significantly enhanced contrast and picture quality as well as MicroLED TVs for homes. Samsung first received global market share in this segment in 2026. The firm continues to strive for rapid growth through the strategy of offering differentiated design and focusing on the premium market.

CE continues to grow demand for new and improved products, such as its ultra-large QLED TVs featuring premium technology, Bespoke refrigerators tailored to experience-oriented lifestyles, extra-large dryers, module-type air purifiers, and garment care appliances. In the TV business, Samsung is developing innovative products such as 8K ultra-large TVs and Neo QLEDs, which are full of new technologies such as Lifestyle TVs—The Premier in 120″–130″, The Frame, The Serif, and The Sero—which as the name suggests are designed for different lifestyles. It also develops soundbars, outdoor signage, and gaming monitors.

In 2021, for QLED, Samsung planned to offer new models of enhanced Neo QLED TVs and to launch MICRO LED TVs with top features in the 80″–110″ range. In addition, Samsung plans to enhance its eco-friendly activities, including the use of eco packaging and solar-powered remote controls.

Another major revenue generator in the CE division is Samsung's digital appliance operations. One of the market leaders in intelligent appliances, Samsung appliances can even change colors to fit your mood and your style with Bespoke technology. Not only can appliances be controlled remotely with sophisticated AI technology, but Samsung appliances can also learn about users' washing styles and suggest customized recommendations for efficiency and effectiveness.

Samsung competes heavily in the healthcare segment, producing radiography, ultrasounds, and even mobile CT equipment for medical providers worldwide. Focusing on mobility in equipment, it seeks to enable virtually any suitable room in a hospital to be transformed into a suite capable of providing advanced images to healthcare professionals. An aging population in Europe and the United States bodes well for medical products as both these regions have quality healthcare and patients that have the means to afford such care. The CE segment lags significantly behind both the IM and DS segments in revenues, operating profits, and assets. The segment is also not as efficient in the "operating profits/sales" measure.

IM Segment

Samsung's global market share in their IM Division's key products has slowly decreased from 17.4 percent in 2018, to 17.5 percent in 2019, to 16.2 percent in 2020. However, the company plans to spur growth of the smartphone market and deliver exceptional user experiences soon by 1) offering innovative hardware features such as OLED technology, high-definition cameras, biometric sensors, and battery charger technologies; 2) improving the software capabilities of mobile payment service Samsung Pay and AI platform Bixby; and 3) investing in the cloud, IoT, healthcare, AR, and VR. At the same time, Samsung plans to lead in the global market shift to 5G.

In 2020, the smartphone portion of total phones sold was 76 percent, and the feature phone portion of the total was 24 percent, driven by demand in developing nations. As the smartphone market matures, the importance of applications such as UX, mobile payments, AI, and AR is rising alongside that of competitive hardware, which includes high-performance AMOLED displays, foldable form factors, multiple cameras, sensors, waterproof and dustproof designs, and biometric recognition.

In 2020, Samsung led the mobile technology trend by introducing the Galaxy Z Flip, which folds from the top, and the Galaxy Z Fold 2. In addition, Samsung now offers the A Series and offers new and innovative user experiences by leading the convergence of technologies such as 5G, AI, and IoT. Samsung plans to provide a more colorful and easy-to-use mobile experience for smartphone users through services such as Samsung Pay, Samsung Health, and SmartThings and via connections with premium tablets including the Galaxy Tab S, wearable devices such as smartwatches, Wi-Fi Bluetooth earphones, and other accessories.

The Samsung IM segment is likely what many consumers think of first when they hear the brand's name. As of 2021, Samsung has annual sales of over 400 million mobile phones across the globe. Notable products include the Galaxy, Knox, and Bixby, in addition to tablets and PCs and wearables. PCs are making a comeback as remote work is becoming more accepted and common around the world. Samsung also produces simpler smartphones and non-smart phones to better serve a global marketplace as mentioned previously. In fact, industrywide, non-smart phones are projected to continue to outpace smartphone sales through 2025.

To support both mobile devices and other smart devices, within the DS segment Samsung is aggressively producing chips and devices, including modems and other equipment that work with all products, but particularly well with Samsung products. While these products are not mainstream yet, Samsung is heavily investing in R&D to introduce these products in the United States, South Korea, and Japan. In 2019, Samsung secured a major 5G contract in the United States.

DS Segment

As stated earlier, Samsung's DS Division includes the company's Semiconductor (SC) and Display Panel (DP) businesses. Samsung's global market share in the SC business has slowly declined from 43.9 percent in 2018, to 43.7 percent in 2019, to 43.1 percent in 2020. Its global market share of smartphone panels within its DP business has declined overall, from 47.6 percent in 2018, to 43.6 percent in 2019, to 43.8 percent in 2020.

Samsung's SC business is divided into Memory (storage) and System LSI (logical processing). Samsung's memory SC business is further divided into RAM products and ROM products. RAM is called volatile memory, as the information is deleted when the power is turned off. It is used for temporary loading and storage of application programs. ROM is nonvolatile and holds memory even when power is removed; it is used in input/output systems, IC cards, and other components. For System LSI products, there are many categories for various applications, with central processing units (CPUs) for PCs, mobile devices, and servers forming the largest market. System LSI products have a wide range of applications, such as household electronics, networks, and games. Samsung manufactures image sensors as well as mobile APs for smartphones and tablets. As part of the company's SC operations, the Foundry Business makes customized semiconductors for other companies based on customer designs. In other words, companies consign the manufacturing of their products to fabrication plants, also called foundries or fabs. The number of fabless semiconductor companies is growing.

Samsung's mobile DP panel business's differentiated technology is a main factor behind the increased adoption of OLED panels, supported by its release of new products such as foldable devices, rollable devices, and automotive components. Samsung today is focusing on the large panel business and premium products such as high-definition, ultra-large QD TVs and is enhancing its competitiveness through continuous improvements in technology and productivity.

As the first to secure core technology in next-generation DRAM development and to achieve a breakthrough in advanced node processes, Samsung is the only player in the industry to mass-produce products based on extreme ultraviolet (EUV) lithography. Samsung is conducting full-fledged migration to 6th-generation V-NAND while actively addressing mobile and laptop SSD demand. Foundry demand is expected to remain strong in 2021–2023 due to competition between fabless customers and growing demand for data centers and PCs.

In 2021, amid accelerating penetration of 5G smartphones, Samsung plans to improve the basic features of OLED panels as smartphone makers increasingly favor power efficiency and ultra-thin design. Samsung plans to offer increased accessibility of foldable products.

Harman Segment

Acquired in 2017, Samsung's Harman division is a global leader in the market for connected car systems, audio and visual products, professional solutions, and connected services. Samsung's global market share of digital cockpits has increased from 18.8 percent in 2018, to 24.8 percent in 2019, to 27.5 percent in 2020.

Samsung's sales, operating profit, and total assets by segment are provided in Exhibit 4. Note the increases in total assets in every category for 2020 except Harman. In 2020, CE reported net sales of KRW 48.1 trillion (20.3 percent of total net sales) and IM reported net sales of KRW 99.58 trillion (42.1 percent). DS contributed about 43.5 percent of net sales: KRW 72.85 trillion (30.8 percent) by the semiconductor sub-division and KRW 30.58 trillion (12.9 percent) by the DP Business Unit. The Harman Division reported net sales of KRW 9.18 trillion (3.9 percent); this segment is the least efficient of all when dividing operating sales by revenues.

EXHIBIT 4 Samsung's Financials by Product (in 100 million KRW)

		2018	2019	2020
Segment				
	Sales	426,498	453,228	481,733
CE	Operating Profits	19,073	25,090	35,615
	Total Assets	492,302	680,244	602,487
IM	Sales	1,006,777	1,072,662	995,875
	Operating Profits	101,720	92,725	114,727
	Total Assets	1,243,340	1,432,804	1,682,692
DS				
SC	Sales	862,910	649,391	728,578
	Operating Profits	445,739	140,163	188,050
	Total Assets	1,515,782	1,791,177	1,863,977
DP	Sales	324,650	310,539	305,857
	Operating Profits	26,198	15,813	22,369
	Total Assets	641,543	642,264	661,929
	Total DS Sales	1,185,658	955,180	1,030,361
	Operating Profits DS	465,164	155,817	211,202
	Total DS Assets	2,425,593	2,451,438	2,741,270
Harman Sales		88,437	100,771	91,837
	Operating Profits	1,617	3,223	555
	Total Assets	150,599	156,091	147,020

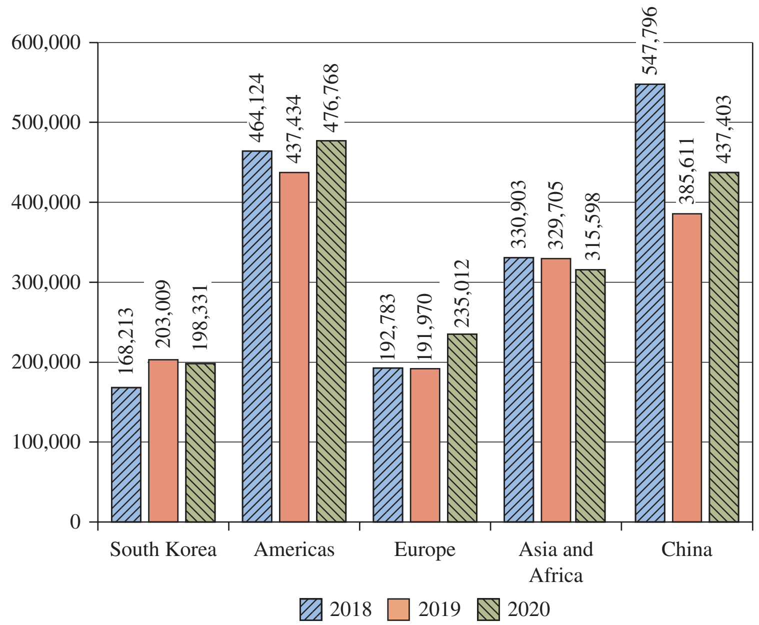
Source: Based on Samsung's 2020 *Annual Report*, p. 36.

The Harman division's revenue and operating profit in 2020 declined year-over-year as COVID-19 weakened demand from automotive companies and consumers. Revenue decreased by KRW 893.3 billion (8.9 percent) to KRW 9.2 trillion and profitability decreased by KRW 266.8 billion (82.8 percent) to KRW 55.5 billion. The Harman segment is working hard to enhance its mobile, IT, display, and AI as well as the variety of its brands and product groups. Samsung is spearheading technology innovations such as the world's first 5G telematics control unit (TCU). In the consumer audio market, Harman's portable Bluetooth speakers and earphones have achieved the highest market share for several years based on brand reputation, leading the consumer audio market.

Exhibit 4 provides a summary of Samsung's financial data by segment. Note decreasing sales in the IM, DS, and DP segments, implying need for a clear strategic plan going forward.

Exhibit 5 provides a summary of Samsung's sales by region. Note the reduction in sales from 2018 in China and in the Asia and Africa region. It is important to observe and consider just how strong a grip Samsung has on its home market of South Korea based on total sales and on the potential for expansion in the United States and Europe in particular. South Korea had a population in 2020 of about 51 million, compared to 330 million for the United States and 770 million for Europe. Despite Europe having 15 times the population as South Korea, sales in this region were only 19 percent greater in 2020 than Samsung's home country sales.

EXHIBIT 5 Samsung's Sales by Region (in 100 million KRW)



Source: Based on Samsung's 2020 *Annual Report*, p. 44.

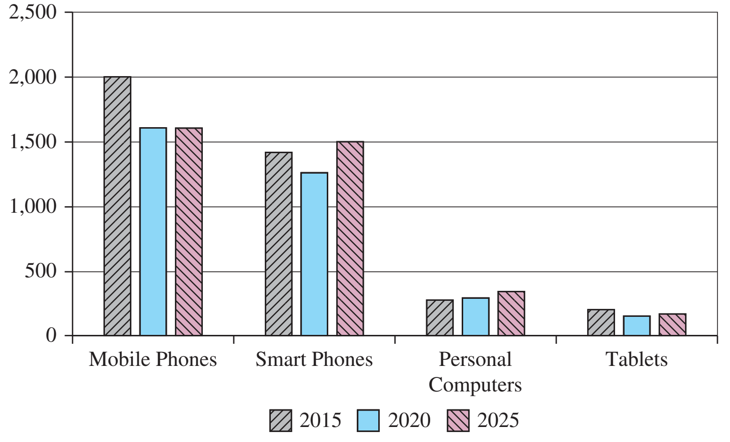
Competitors and External Issues

As a conglomerate, Samsung must contend with rivals that specialize in the various industries that Samsung competes in. For example, in smartphones, Samsung competes with Apple, which focuses almost entirely on PCs, phones, tablets, and wearables. In semiconductors, Samsung competes with the best, such as Intel, which specializes only in semiconductors. Is being diversified a good strategic strategy for Samsung?

Phones, PCs, Tablets, and Wearables

Samsung competes with many players in this industry, including household names such as Apple, Lenovo, and Dell. Exhibit 6 reveals trends from 2020 to 2025 and expected sales in units sold worldwide. Note the strong demand for mobile phones that are not classified as smartphones; this demand is expected to continue up to 2025, but some estimates suggest the profit margin is higher on smartphones than traditional phones. While many people own wearables, wearables are not included in Exhibit 6 because sales volume is significantly lower than the other four categories. PC sales are expected to increase due to more work at home and remote working arrangements as well as the release of new video-conferencing solutions.

EXHIBIT 6 Global Sales of Smart Devices (in millions of units sold)



Source: Based on information from S&P NetAdvantage and www.statista.com/statistics/671053/smart-devices-unit-sales-worldwide/.

Medical Equipment

A 4 percent annual growth in medical equipment is expected up to 2026, but prices are only expected to rise marginally in developed economies, yielding a similarly marginal increase in industry-wide profits. In addition, the pressure to maintain increased sales has resulted in downward pressure on per-unit cost, also cutting into profit margins. Cardiovascular, irradiation, recovery, and neuromodulation devices are the most common, accounting for 23, 21, and 10 percent of all devices in use. The industry is fragmented in the U.S. market, with Medtronic accounting for 28 percent of the market share and Abbot Laboratories and GE accounting for 10 percent each. The other estimated 1,000 businesses compete for the remaining 50 percent of the market share. Similar fragmentation is present in the global market.

Appliances

The appliance market has a profit margin of over 7 percent and over 150 businesses competing globally. Large firms in the industry are Whirlpool, Haier, and Electrolux, with over 60 percent of the market share in the U.S. market. However, annual growth worldwide is expected to be less than 3 percent up to 2026. Cooking appliances account for 28 percent of sales, refrigerators and freezers account for 25 percent, and laundry equipment accounts for about 21 percent. A successful marketing campaign on the benefits of owning a dryer could possibly increase laundry equipment's market share. All other appliances account for the remaining market share. Many firms have yet to catch up with the trend of home appliances having smart applications. Products that have smart capabilities also have higher profit margins, and industry players are hoping that they can convince customers to make the switch. The trend of energy-efficient appliances has come at the expense of quality, with many new customers frustrated at products that in many cases do not work well, which increases opportunities for R&D and firms to produce smart, energy-efficient appliances that do work as well as older models.

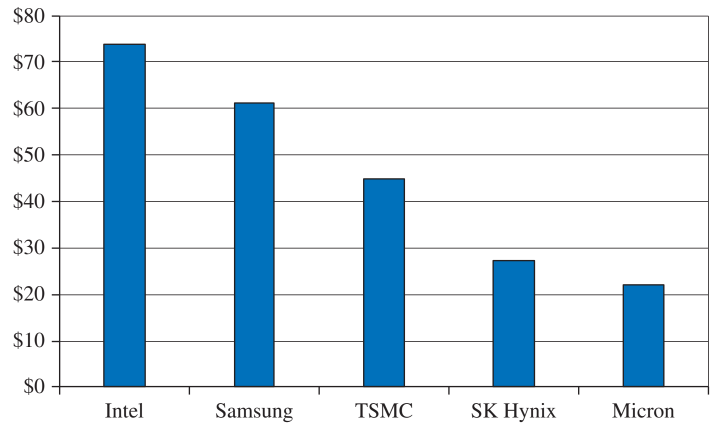
Audio Equipment

Samsung's Harman division has two segments: consumer audio and professional audio. Consumer audio (smart audio, headphones, connected audio solutions, etc.) has just a few major competitors, such as Amazon, Apple, Beats, Bose, and Ultimate Ears. Smartphone manufacturers dominate market share in Bluetooth headsets, and the market is expected to grow rapidly for the next decade. The professional audio industry (commercial audio, audio for large venues, lighting, and video and control solutions) is led by QSC and Yamaha. In the connected systems business within the automotive industry, competition is fierce among rival firms, which include Alpine, Aptiv, Continental, Mitsubishi, Panasonic, and Visteon. There are several major competitors in car audio systems, including Bose, Pioneer, and Panasonic.

Semiconductors

The semiconductor business is expected to report sales worth over $500 billion annually in 2022 and beyond, with 35 percent of sales in China and over $140 billion in sales to support mobile phones. Expected sales of cars with embedded systems are expected to grow over 20 percent in 2022. Semiconductor sales grew 14 percent alone during 2020. The largest semiconductor competitors as of early 2021 by market capitulation were Intel, Samsung, TSMC, SK Hynix, and Micron. SK Hynix is a large competitor for Samsung based in its home market of South Korea. Six of the top 10 semiconductor firms based on market cap are in the United States, with only one firm in the top 10, Infineon, located in Europe. Exhibit 7 reveals the top 5 semiconductor firms based on market capitalization.

EXHIBIT 7 Largest Semiconductor Firms in 2020 (Annual Sales in billions of USD)



Source: Based on information from S&P NetAdvantage and www.zippia.com/advice/largest-semiconductor-companies-world.

In 2020, the price of wafers for semiconductor disks declined about 2 percent, while prices of tempered glass windows increased about 1 percent. As per the Semiconductor (SC) part of DS, the demand for DRAM grew about 22 percent in 2020, led by server application products. In 2021, the market is expected to expand by another 15 percent thanks to the acceleration of digital transformation, mainly from contactless businesses. Smartphone and datacenter server demand is also expected to increase as the economy recovers. The SC business's 2020 revenue increased by KRW 7.9 trillion (12.2 percent) from the previous year to KRW 72.85 trillion due to strong server and mobile demand. Operating profit increased by KRW 4.78 trillion (34.2 percent) to KRW 18.80 trillion year-over-year.

Samsung is the only firm in the memory semiconductor industry using the EUV lithography process in the mass production of memory semiconductors, as mentioned above. In the foundry business, demand continues to be strong as smartphone manufacturers look to benefit from U.S. sanctions against Huawei.

Active-matrix technology is most commonly used in displays (that is, screens in electronic devices), including organic light-emitting diode (OLED) panels and thin film transistor liquid crystal display (TFT-LCD). OLED panels use organic materials, which offer sharp contrast and color, high color gamut, and fast response rates. A TFT-LCD panel is a liquid crystal-based display that features a thinner and lighter profile while offering high resolution. The market for smartphone OLED panels in 2021 is expected to be around 600 million units and is forecast to continue expanding with the growth of 5G smartphone demand.

Conclusion

Strategy Considerations

With Samsung producing many different products in its segments, it is important to consider when developing a strategic plan how the firm should allocate both its monetary and human capital resources across product lines and regions. Factors to consider should include expansion as well as divesture of certain segments to free up resources for more profitable segments. Can Samsung continue to compete with homogeneous firms that only focus on medical equipment or appliances? Even if Samsung could compete here, would the firm be more profitable if it expanded its smartphones and TV production and reduced R&D on appliances? Should Samsung continue to cater to both the high-end market and the lower-end markets on phones? Does producing lower-end phones lower the perceived brand quality of higher-end phones? Should Samsung continue to cater to both a commercial and a retail market?

A careful analysis of the competitors and available opportunities within segments is needed along with that of Samsung's strengths and weaknesses to plot a strategy for the company. Remember, your job is not to describe what Samsung is currently doing or what Samsung plans to do based on reading press releases or the company's *Annual Report*, but instead is to imagine that you have been hired by Samsung to develop and provide a 3-year strategic plan. Samsung's upper management, and in this case your classmates and professor, are looking for you (or paying you a high fee if actually hired by Samsung) to recommend what you feel is the best direction for the firm based on your strategic management research, knowledge, and expertise.

Consumers globally are becoming increasingly price-sensitive but also demanding perfection in the devices they buy. People are also willing to pay a premium for quality and brand awareness. These trends, coupled with increased competition from rival firms in many industries, call for a comprehensive Samsung strategic plan to be developed. Recall from the case that Samsung is a conglomerate doing business in multiple industries against firms that often specialize in the industry they compete in. Conglomerates were very popular in the 1960s but have increasingly become rare with a few exceptions, such as Samsung, Walt Disney, and 3M. Does Samsung need to "stick with the knitting" to be successful today, or in other words, should it be doing one thing really well, offering the best value to consumers, rather than striving to be an expert in everything?

Prepare a clear 3-year strategic plan for Samsung indicating the direction you think will be most advantageous for management. Consider a new mission statement if needed as well as new strategies that provide guidance regarding which divisions should be strengthened and which divisions, if any, should possibly be divested. Deciding how to allocate resources across segments is a difficult but major challenge—and the job of a strategist. Prepare projected financial statements, if at all possible, to show your expectations regarding the financial impact of your proposed strategies.

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2. Flynn, Jack, "10 Largest Semiconductor Companies in the World," Zippia, October 17, 2021, https://www.zippia.com/advice/largest-semiconductor-companies-world/.
3. "Smart Devices Unit Sales Worldwide 2013–2020," *Statista*, https://www.statista.com/statistics/671053/smart-devices-unit-sales-worldwide/.

Lenovo Group Limited—2022

www.lenovo.com

Lenovo Group Limited (Lenovo) (HKSE: 992) (ADR: LNVGY) is a Chinese multinational technology firm that has global headquarters in Beijing, China, operational headquarters in Morrisville, North Carolina, in the United States, and an operational center in Singapore. Lenovo is the world's largest personal computer (PC) manufacturer and is a major producer of laptops, tablet computers, smartphones, workstations, peripherals, printers, scanners, servers, supercomputers, IT management software, storage devices, modems, routers, wearables, and smart televisions.

Lenovo's brand name products include the Legion, ThinkPad, ThinkBook, IdeaPad, Yoga, IdeaCentre, ThinkCentre, ThinkStation, ThinkVision displays, ThinkServer, ThinkSystem, and numerous other items such as Motorola Razr smartphones. With operations in over 60 countries and revenue derived from about 180, Lenovo has research centers in Beijing, Chengdu, Yamato (Kanagawa Prefecture, Japan), Shanghai, Shenzhen, and Morrisville (North Carolina, USA). Lenovo has the leading market share (about 27 percent) of all PCs sold in the world. Lenovo's fiscal year (2021) at the time of writing ended March 31, 2021.

History

Lenovo was founded by Liu Chuanzhi along with a group of engineers in Beijing in 1984. Computers were not the company's original business; under the name Legend, it originally specialized in televisions. The business was incorporated in Hong Kong in 1988, but it gained the international spotlight when it acquired IBM's PC business in 2005 and then its Intel-based server business in 2014. Lenovo entered the smartphone market in 2012, and by 2014 it was the largest supplier of smartphones in mainland China. Lenovo acquired Motorola Mobility from Google in 2014 and in 2017 acquired Fujitsu's personal computer business.

For calendar 2020, Lenovo reported revenue of $60.7 billion, up 19.8 percent year-over-year, and net income of $1.2 billion, up 77 percent. The company's services, software, and solutions accounted for 8 percent of the total revenue and was growing twice as fast as the company's overall sales of hardware and software products.

Vision/Mission

A $60-billion-revenue Fortune Global 500 company, Lenovo's vision describes its goal as helping to create a diverse, honest, sustainable "digital society" through innovative, leading technology for customers globally, "powering" them through devices and infrastructure and "empowering" them through solutions, services, and software.

Internal Issues

Organizational Structure

A few acronyms to be aware of as you read this case are as follows:

IDG (Intelligent Devices Group)

ISG (Infrastructure Solutions Group)

SSG (Solutions and Services Group)

PCSD (Personal Computer and Smart Device)

DCG (Data Center Group)

MBG (Mobile Business Group)

HPC (High Performance Computing)

AI (Artificial Intelligence)

SDI (Software-Defined Infrastructure)

CSP (Cloud Service Provider)

LA (Latin America)

NA (North America).

For the 2021 fiscal year, MBG achieved its highest market shares ever in LA and NA, while DCG maintained is leading position globally in HPC and AI. In April 2021, Lenovo reorganized itself into three strategic business units (SBUs) to better deliver on the company's 3S Strategy (Smart IoT, Smart Infrastructure, Smart Solutions). Previously, there were only 2 groups (IDG and ISG). Specifically, the three SBU groups today are

1. IDG (Intelligent Devices Group), which produces various smart devices and IoT, and includes PCSD and MBG. The products include the ThinkPad X1 Laptop, ThinkPad P17 Workstation, ThinkStation 340, the Motorola Razr and Edge smartphones, modems, routers, and wearables.
2. ISG (Infrastructure Solutions Group, renamed from DCG, Data Center Group), which produces Smart Infrastructure.
3. SSG (Solutions and Services Group), which produces Smart Verticals & Services, designed to spur business across verticals, attached services, and managed services, including DaaS and Truscale.

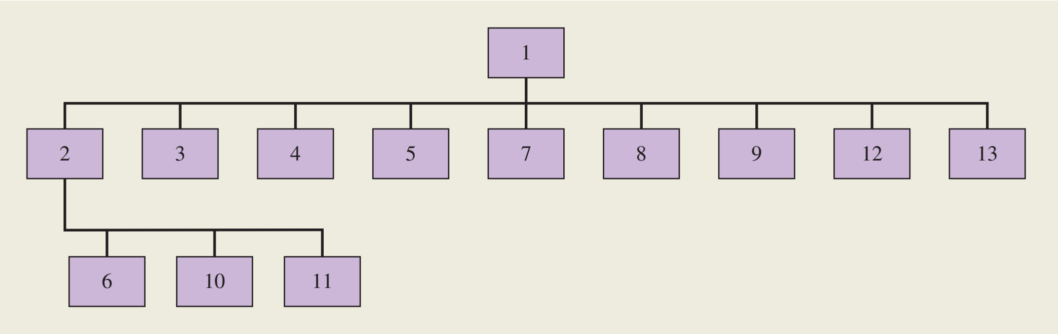
Lenovo's top executives are listed and arrayed in Exhibit 1.

Financial Data

On May 27, 2021, soon after reporting a fantastic full fiscal year and Q4 financial results, Lenovo's board of directors declared a dividend of 3.09 U.S. cents or 24 HK cents per share for the fiscal year ended March 31, 2021. Some of the fiscal 2021 full company results reported in May 2021 are as follows:

- Overall company revenue spiked to $60 billion, up more than $10 billion, or 20 percent from the prior year.

EXHIBIT 1 **Lenovo's Top Management Team**



The Executive	Executives' Titles
1. Yang Yuanqing	Chairman and CEO
2. Gianfranco Landci	COO
3. Gao Lan	Senior Vice President for HR
4. He Zhiqiana	Senior Vice President and President of Lenovo Capital & Incubator
5. Yong Rui	Senior Vice President and Chief Technology Officer
6. Kirk Skaugen	Executive Vice President and President of the Infrastructure Solutions Group
7. Liu Jun	Executive Vice President and President of the China Geography
8. Qiao Jian	Senior Vice President, Chief Strategy Officer, Chief Marketing Officer
9. Laura Quatela	Senior Vice President and Chief Legal Officer
10. Luca Rossi	Senior Vice President and President of the Intelligent Devices Group
11. Ken Wong	Senior Vice President and President of the Solutions & Services Group
12. Wong Wai Ming	Executive Vice President and Chief Financial Officer
13. Matthew Zielinski	Senior Vice President and President of the International Sales

Source: Based on Lenovo's 2021 *Annual Report*, pp. 12–13 and pp. 147–148.

- The company's IDG (PCSD and MBG) and DCG achieved revenue growth of 20 percent and 15 percent, respectively.
- The company's transformation to services is accelerating. Software and services revenue grew twice as fast as the company's total revenue, up almost 40 percent year-over-year to a record $4.9 billion; services now comprise 8 percent of Lenovo's total revenue.

For Lenovo's Q4 that ended March 31, 2021, the financial results included the following:

- It was the best Q4 ever for Lenovo's PC and Smart Devices (PCSD), which reported $12.4 billion in revenue, up 46 percent, and profitability at an all-time high at 6.7 percent.
- All regions reported over 15 percent growth in PCSD revenue; PC volume outgrew the market, further strengthening the company's global no. 1 ranking in PCs.
- Lenovo tablets shipments grew 157 percent, three times as fast as the market.
- Lenovo's Gaming, Thin & Light, Chromebooks, and Visuals revenues continue to outgrow the market and report double- and triple-digit growth rates.
- Revenues from the MBG jumped 86 percent year-over-year to $1.54 billion—with pre-tax income of $21 million—a record high since the Motorola acquisition.
- Smartphone volumes grew by over 100 percent in North America, Europe, and Asia Pacific.
- Smartphone market share in Latin America reached a record of nearly 21 percent.
- Revenues from the firm's DCG grew 32 percent to $1.6 billion.
- The firm's cloud service provider business grew 73 percent year-on-year.
- The firm's Server, Storage, Software Defined Infrastructure, Software, and HPC/AI reported record high Q4 revenue; traditional storage revenues increased a whopping 73 percent year-over-year.
- The firm's services and software revenue increased 44 percent year-on-year.
- The firm's Managed Services revenue (DaaS, TruScale) nearly doubled, and Solutions revenue grew 65 percent year-over-year.

Fiscal 2021 ended with Lenovo's cash and cash equivalents totaling $3.12 billion, broken down as follows: U.S. dollar (34.9 percent), Renminbi (25.7 percent), Japanese yen (11.3 percent), euro (5.5 percent), British pound (1.4 percent), and other currencies (21.2 percent). Lenovo has all of its cash held in bank deposits; it conservatively does not invest in liquid money market funds.

Lenovo's recent income statements and balance sheets are provided in Exhibit 2 and Exhibit 3 respectively. Note dramatic increases across the board, including long-term debt that increased $1.7 billion.

By-Segment Data

For fiscal 2021, Lenovo's IDG Group reported a 20 percent increase in revenue to $54 billion and a 35 percent increase in IDG profits to $3.1 billion. Within IDG, PCSD remained the largest PC supplier globally, and MBG set new records for sales in LA and NA. PCSD revenue increased

EXHIBIT 2 Lenovo's Income Statements (in thousands of USD)

Income Statement	3/31/20	3/31/21		Percent Change
Revenues	$50,716,349	$60,742,312	↑	20%
Cost of Goods Sold	42,359,045	50,974,425	↑	20%
Gross Profit	8,357,304	9,767,887	↑	17%
Operating Expenses	6,918,708	7,587,481	↑	10%
EBIT	1,438,596	2,180,406	↑	52%
Interest Expense	420,889	406,209	↓	–3%
EBT	1,017,707	1,774,197	↑	74%
Tax	213,204	461,198	↑	116%
Non-Recurring Events	0	0	NA	NA
Net Income	804,503	1,312,999	↑	63%

Source: Based on information in the 2021 Lenovo *Annual Report*, p. 174.

EXHIBIT 3 Lenovo's Balance Sheets (in thousands of USD)

Balance Sheet	3/31/20	3/31/21		Percent Change
Assets				
Cash and Short-Term Investments	$3,617,470	$3,127,770	↓	–14%
Accounts Receivable	9,833,780	13,454,265	↑	37%
Inventory	4,946,914	6,380,576	↑	29%
Other Current Assets	335,277	372,741	↑	11%
Total Current Assets	18,733,441	23,335,352	↑	25%
Property Plant & Equipment	1,398,440	1,573,875	↑	13%
Goodwill	0	0	NA	NA
Intangibles	7,984,582	8,405,005	↑	5%
Other Long-Term Assets	4,011,704	4,676,399	↑	17%
Total Assets	32,128,167	37,990,631	↑	18%
Liabilities				
Accounts Payable	18,712,783	25,195,302	↑	35%
Other Current Liabilities	4,545,338	2,176,335	↓	–52%
Total Current Liabilities	23,258,121	27,371,637	↑	18%
Long-Term Debt	1,564,619	3,299,582	↑	111%
Other Long-Term Liabilities	3,246,132	3,708,879	↑	14%
Total Liabilities	28,068,872	34,380,098	↑	22%
Equity				
Common Stock	0	0	NA	NA
Retained Earnings	3,197,542	3,559,036	↑	11%
Treasury Stock	993,670	0	↓	–100%
Paid in Capital & Other	(131,917)	51,497	↓	–139%
Total Equity	4,059,295	3,610,533	↓	–11%
Total Liabilities and Equity	**32,128,167**	**37,990,631**	↑	**18%**

Source: Based on information in the 2021 Lenovo *Annual Report*, pp. 176–177.

22 percent to $48 billion. Given a booming e-learning industry in 2020–2021, partly due to COVID-19, the IDG Group reported a 219 percent increase in its Chromebook revenue. The company's Smart IoT revenues grew 43 percent in fiscal 2020–2021, led by Smart Verticals such as Smart Health Care in North America, Smart Education, and Smart City in China.

For fiscal 2021, Lenovo's DCG Group (now called ISG) reported its highest-ever revenue of $6.3 billion, up 15 percent from the prior year and comprising 10 percent of total company revenues. Especially strong contributors to the DCG results were its CSP, ESMB, SDI, and HPC/AI businesses. Specifically within DCG, HPC/AI maintained its no. 1 position in the global Top 500 Supercomputer list.

At the end of fiscal 2021, SSG was formed to focus on Attached Services, Managed Services such as as-a-service offerings, and Project and Vertical Solutions. These products are tailored to financial services companies, large food retailers and distributors, sporting events, and other technology companies.

Exhibit 4 provides Lenovo's revenue percentage by SBU group. Note the increases in IDG-PCSD and IDG-OTHERS alongside decreases in IDG-MBG and DCG.

EXHIBIT 4 Lenovo's Revenue % Contribution by SBU Group, 2021 vs. 2020 (Revenues in millions of USD)

Group	2020	2021
TOTAL REVENUES	50,716	60,742
IDG-PCSD	79	80
IDG-MBG	10	09
IDG-OTHERS	00	01
DCG	11	10

Source: Based on Lenovo's 2021 *Annual Report*, p. 5.

Exhibit 5 provides data regarding Lenovo's percent revenue contribution by region. For fiscal 2021, Lenovo reported a 31 percent revenue increase from China and double-digit growth in North America across all three business groups.

EXHIBIT 5 Lenovo's Revenue % Contribution by Region, 2021 vs. 2020 (Revenues in millions of USD)

Group	2020	2021
TOTAL REVENUES	50,716	60,742
China	21	24
Asia/Pacific	22	19
EMEA	25	26
AG	32	31

Source: Based on Lenovo's 2021 *Annual Report*, p. 5.

Exhibit 6 provides actual dollar amounts of revenues by segment for the company. Note in Exhibit 4 that for 2021, IDG reported a revenue increase of 20 percent from the prior year to $54 billion, while profit grew 35 percent to $3.1 billion.

EXHIBIT 6 Lenovo's Revenues by Group (in thousands of USD)

Group	2020	2021
IDG	45,216,190	54,411,212
DCG	5,500,159	6,331,100
Total	50,716,349	60,742,312

Source: Based on Lenovo's 2021 *Annual Report*, p. 51.

External Issues

In Q1 of 2021, sales of PCs and tablets skyrocketed. Global shipments of traditional PCs, including desktops, notebooks, and workstations, grew 55.9 percent compared to Q1 2020, with 84.3 million units shipped. Tablets especially were in high demand, with a 55.4 percent growth and shipments totaling 39.9 million units; Chromebook shipments totaled 13.2 million units in Q1 of 2021. High demand was accompanied, however, by increases in average selling prices due to fast growth in videogaming and advanced touchscreens within the education segment. Some analysts predicted an increase in demand for tablets of 12 percent in 2021 after the 13.6 percent increase the prior year.

All three major segments in the PC market (consumer, education, and commercial) are low on inventory, especially the consumer segment. Thousands of customers are settling for desktops due to the unavailability of notebooks, including governments and corporate customers. It should be noted here that the rising popularity of Chromebooks is quickly eroding demand for tablets in markets such as the United States, Western Europe, and more recently, Japan. As lockdowns due to COVID-19 wane, however, it is expected that consumers will travel more and demand for all PC variants will level off instead of continuing their robust rise.

People are spending more time using devices, buying more devices, and upgrading their devices. There is pent-up demand following the pandemic. Even 6-year-old children today wear smart watches and use them to interact constantly with their parents and the world around them. There are numerous key technologies driving the device innovation agenda: people want to look better in video calls with computational photography technology, they want to hear better through microphones with AI-based active noise cancellation, and they want to see better with low blue light flicker-free screens to reduce eye strain. To meet these changing consumer desires, Lenovo is enhancing its ThinkBook Plus Gen 2, ThinkReality A3 smart glasses, Yoga AIO 7, and many other related products.

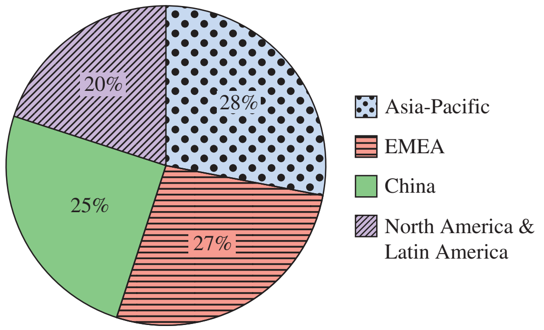
One of today's consumer trends is faster infrastructure upgrades and purchases of devices that offer not just hardware but also solutions anchored by AI. Hundreds of smart devices are being developed and purchased, ranging from smart medical devices and machine tools to smart home, car, and work systems. Data increasingly needs to be stored, organized, and analyzed for machine learning, and this requires more computing power, which requires high-speed networks like 5G and 6G and fiber-optic advancements to avoid "traffic jams" when too much data gets transmitted between client and cloud.

In the Lenovo 2021 *Annual Report* on pages 24–35, the company details numerous external risk factors that include issues related to COVID-19, cyberattacks, new competitors, existing competitors, economic factors, political and regulatory uncertainty, privacy concerns, employee diversity and welfare concerns, intellectual property risks, supply chain concerns, climate change, corruption issues, and pollution problems. Lenovo has received numerous awards for being a great place to work, as detailed on page 43–45 in their 2020–2021 *Annual Report*. The company has been recognized by Corporate Knights as one of the 100 most sustainable corporations in the world.

The demand for 5G advancements and for wearables is expected to increase 6 percent in 2021 and 5 percent in 2022. Upgrades to expect are a new 5G modem chip from Qualcomm, better battery life, and a faster A15 processor from Taiwan Semiconductor. The iPhone 13 is expected soon, and iPhone units sold are estimated to increase 25 percent in fiscal year 2021 over the prior year, followed by a 4 percent increase in 2022. Among all phones, smartphones now comprise about 82 percent, up from 80 percent in 2020. Some analysts project an 18- to 20-percent increase in PC shipments in 2021 as companies allow employees to work from home more and schools transition to more and more online courses.

Exhibit 7 provides a forecast of the global smartphone market share across countries. Note that China + Asia is over 50 percent. Restrictions imposed by the U.S. government on the Chinese firm Huawei have benefited Lenovo, Apple, and Samsung.

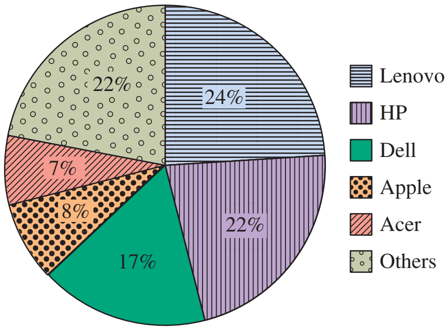
EXHIBIT 7 2024 Projected Global Smart Phone Market Share across Countries



Source: Based on information in S&P *Industry Surveys*, Technology Hardware, Storage, & Peripherals, April 2021.

Exhibit 8 provides a breakdown of the 2020 company leaders in the global PC market share. Note that Lenovo is the leader, followed by Hewlett-Packard.

EXHIBIT 8 The PC Global Market Share among Leading Firms in 2020



Source: Based on information in S&P *Industry Surveys*, "Technology Hardware, Storage, & Peripherals," April 2021.

Tablets

Tablet shipments globally increased 19.6 percent in Q4 of 2020 compared with the prior-year quarter and recorded double-digit unit growth for the whole year. Worldwide tablet shipments grew 13.6 percent, and this momentum is persisting, with growth of 12 percent in mid-2021. Demand for detachable tablets was especially strong, growing 33.6 percent in Q4 2020, compared to the prior-year quarter, for total shipments of 24.1 million units. By producer from highest to lowest, Apple, Samsung, Microsoft, Lenovo, and Huawei comprised the top 5 detachable tablet suppliers, with close to 96 percent market share.

Per region, the largest market for detachable tablets during Q4 2020 was the United States, followed by Asia Pacific (including Japan) and then Western Europe. In terms of segment growth, the consumer detachable market across the globe saw 17.4 million units being shipped for a growth rate of 30.3 percent compared with the prior-year quarter. On the other hand, commercial detachable shipments touched 6.7 million units, growing 43.1 compared with the prior-year quarter. In contrast, in Q4 2020, the slate tablet market grew 9.7 percent compared with the prior-year quarter, reaching 28.1 million units. Android slate tablets comprised 96 percent of total slate volume shipped, with the leading suppliers being Samsung, Lenovo, Amazon, Huawei, and TCL.

Competitors

Over 100 companies compete against Lenovo. A few of these rivals are listed and described below.

Apple, Inc.

Headquartered in Cupertino, California, Apple designs and produces a wide variety of consumer electronic devices, including smartphones (iPhones), tablets (iPads), PCs (Macs), and smartwatches (Apple Watches). The iPhone makes up the majority of Apple's total revenue, but the MacBookPro laptop competes directly with Lenovo's PCs. While Lenovo is trying to shift more to a services company, Apple already offers its customers a variety of services such as Apple Music, iCloud, Apple Care, Apple TV+, Apple Arcade, Apple Card, and Apple Pay. Unlike Lenovo products, Apple's products are distributed online as well as through company-owned stores and third-party retailers. Apple generates roughly 40 percent of its revenue from the Americas, with the remainder earned internationally.

Dell Technologies, Inc.

Headquartered in Round Rock, Texas, and competing with Lenovo, Dell Technologies is a leading global provider of servers and storage products as well as PCs, peripherals, and virtualization software. Dell operates under 2 divisions: 1) Dell Client Solutions Group (about 50 percent of revenues), which produces desktop PCs, notebooks, tablets, and peripherals such as monitors, printers, and projectors under the Dell brand name, and 2) Dell EMC Infrastructure Solutions Group (about 42 percent revenues), which produces servers, storage, and networking products.

Other Competitors

Headquartered in Palo Alto, California, **Hewlett-Packard** designs, produces, and distributes a wide variety of computer hardware, software, peripherals, printers, and more for global markets.

Headquartered in New Taipei City, Taiwan, **Acer** ranks among the world's top 5 branded PC suppliers. This multinational computer technology and electronics corporation manufactures desktop and laptop PCs, personal digital assistants (PDAs), servers, storage devices, displays, smartphones, peripherals, and hardware.

Headquartered in Tokyo, Japan, **Toshiba** is a Japanese multinational company that manufactures and supplies all kinds of electrical products, including laptops, notebooks, computer desktops, and other computer-related products and services.

Headquartered in Tokyo, Japan, **Fujitsu** is a Japanese multinational computer hardware and IT services company. Fujitsu is a leading provider of IT products and services including hardware, software, networking, and business solutions.

Headquartered in Tokyo, Japan, **NEC Corporation** is a Japanese multinational IT company that provides information technology (IT) and network solutions. NEC is one of the world's leading providers of Internet, broadband network, and enterprise business solutions.

Conclusion

In July 2021, Lenovo introduced the next generation of its entry-level desktop workstations, the ThinkStation P350 Tower, Small Form Factor (SFF), and Tiny. These products are equipped with cutting-edge storage technologies and enhanced professional graphics support. They are Lenovo's most powerful entry-level offerings, delivering a complete package of size options.

In June 2021, Lenovo introduced a series of smarter devices including the Lenovo Yoga Tab 13, the new Lenovo Yoga Tab 11, the powerful Lenovo Tab P11 Plus Android™ tablet, and the Lenovo Smart Clock 2. Lenovo realizes that consumers are increasingly using their tablets for streaming, gaming, learning, and more screen time, as the lines separating our relaxation time from hours spent working or learning start to blur.

Lenovo is also acutely interested in the rapidly growing hearables (smart headphones) and wearables (smartwatch) market. There is a growing shift in the wearables industry from a focus on fitness to offering broader healthcare solutions, such as the new Apple Watch Series 6, which provides a sensor to measure one's blood oxygen level. It should be noted here that China is well ahead of the United States in terms of 5G broadband availability and is a favorable competitive landscape for Lenovo given that Huawei has been penalized by the U.S. government.

Lenovo definitely needs to maintain and likely grow its leadership position in the worldwide PC industry. Demand across the globe remains strong and in some cases was at record levels in 2020. PC demand is accelerating globally as students need reliable systems to be productive and corporate upgrades abound. Lenovo's 72.7 million PC shipments in 2020 led all rival firms with a 24 percent market share, followed by HP in second place with 67.6 million PC shipments for a market share of 22.4 percent (23.5 percent in 2019). Dell sold 50.3 million devices in 2020 for third place with a 16.6 percent market share, while Apple followed in fourth, shipping 23.1 million PCs for a 7.6 percent share, and finally, Acer had a 6.9 percent market share, having shipped about 21 million devices.

Lenovo expects to capitalize on the fact that smart home technology increasingly enables nearly everything in our homes—from our alarm systems, to air-conditioners, to thermostats, to lights, to garage doors—to be connected to the Internet and be remotely controlled with our phones or smart speakers. The largest impetus to smart homes will be greater access to high-speed Internet, with the roll-out of 5G as well as the emergence of smarter assistants like Amazon Alexa and Google Assistant.

Lenovo strives to stay ahead of competitors on all fronts, even as rival firms introduce advanced products and services that compete with all Lenovo offerings on a daily basis. A comprehensive strategic plan is needed for Lenovo to maintain its dominance in some areas and its desired dominance in other product and service industries.

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1. "Annual Interim Reports," Lenovo, https://investor.lenovo.com/en/publications/reports.php.
2. S&P, *Industry Surveys*, Technology Hardware, Storage, & Peripherals, April 2021.

Dick's Sporting Goods—2018

www.dickssportinggoods.com (DKS)

Headquartered in Pittsburgh, Pennsylvania, Dick's Sporting Goods (Dick's) is a large chain of brick-and-mortar retail stores that offers a wide selection of sporting equipment, footwear, apparel, and accessories such as tennis rackets, weights, outdoor cooking equipment, bicycles, sports clothing and much more. By some accounts, Dick's is the largest sporting goods store in the United States based on 2017 revenues, larger than Bass Pro Shops, Academy Sports, and Big 5 Sporting Goods. Dick's also operates Golf Galaxy, Field & Stream, and Dick's Team Sports HQ. Dick's Team Sports HQ is targeted at youth sports and provides league management services free of charge including scorekeeping, scheduling, and custom uniform designs.

Competition is intense in the retail business, especially in the brick-and-mortar sporting goods retail business. In 2017, for example, Gander Mountain filed for bankruptcy and closed most of their stores. Dick's is counting on its 1) updated website, 2) store-in-a-store concept, 3) talented sales people, 4) in-store demonstrations, and 5) a wide range of products at different price points. However, brick-and-mortar retailers are struggling so Dick's faces a precarious future and needs a clear strategic plan.

In May 2018, Dick's Sporting Goods hired three lobbyists to push Congress for gun control measures, irritating many of its gun enthusiasts customers. Specifically, Dick's hired two Democrats and one Republican from the Washington-based public affairs firm Glover Park Group, with the only specific lobbying issue listed for their work is "lobbying related to gun control."

History

In 1948, an 18-year-old named Richard "Dick" Stack was working for an army surplus store in Binghamton, New York, and was assigned to research and develop several tactics for adding fishing and camping product lines to the business. Upon presenting his research and suggestions, the owner rudely called Dick a "dumb kid," rejecting his work and ideas.

Distraught, but convinced he was right about the fishing market in Binghamton, Dick consulted with his grandmother. She asked: "Dick, how much would it would cost you to build the store yourself." Dick responded, "It will cost me $300." His grandmother then went to the cookie jar where she kept her life savings and gave Dick $300 and told him "Do it yourself." Dick used that money to rent a storefront and purchase inventory for a new bait-and-tackle shop in Binghamton.

Dick was determined to succeed despite the first few years of mediocre sales. By the 1960s however, Dick had two stores and formally named the company Dick's Sporting Goods. Dick Stack served as CEO of his company until his retirement in 1984, passing the torch to his son Edward (Ed) who is currently the Chairman and CEO of Dick's Sporting Goods. However, when Ed took the reigns from his father, there were still only two Dick's stores in operation. Young and energetic and having worked his way up the chain since 1977, Ed quickly put the business on an expansion route, opening multiple stores in the early 1990s, and ultimately moving the headquarters to Pittsburgh in 1994.

Dick's Sporting Goods went public on the New York Stock Exchange on October 15, 2002 under the ticker symbol DKS. As of February 3, 2018, the company operates 716 Dick's Sporting Goods stores in the United States.

Vision/Mission

Dick's has the following mission statement on the corporate website (paraphrased):

We strive to be the #1 sports and fitness specialty omnichannel retailer that serves and inspires athletes and outdoor enthusiasts to achieve their personal best. Basically Dick's is on a mission to exceed the expectations of athletes and outdoorsmen around the world by providing quality name brand products, an excellent selection, fair prices, and a knowledgeable and helpful staff of employees.

Dick's does not have a formal vision statement, but the company strives to serve customers in a manner that they will recognize Dick's as the number-one sports and fitness retailer that serves a wide array of athletes and outdoor enthusiasts.

Code of Business Ethics

Dick's Sporting Goods provides separate codes of conduct for associates, vendors, and directors. As CEO Ed Stack mentions in a letter to teammates, he is on a mission to ensure Dick's plays the game fairly while continuing to offer shareholders value, rewarding loyal customers, and treating associates fairly. Mr. Stack suggests all associates, vendors, and directors read their respective codes and the codes of the others as an athlete would read a playbook or game plan for an athletic event. All team members are expected to prevent unfair play and report any occurrences to their HR representative or anonymously on Dick's Ethics Hotline. Dick's ensures protection for whistle blowers promising there will be no retaliation on your employment.

Internal Issues

Organizational Structure

Dick Stack's (founder) son, Ed Stack has served as chairman and CEO of Dick's Sporting Goods since 1984, having started with the company full-time in 1977. Based on the executive titles illustrated in Exhibit 1, it appears that Dick's operates from a divisional-by-product type structure composed of three segments: softlines, hardlines, and team sports. Hardlines are basically anything except footwear and apparel. However, since an official organizational chart is not made public, likely only insiders know exactly who reports to who in the company.

Current Strategies

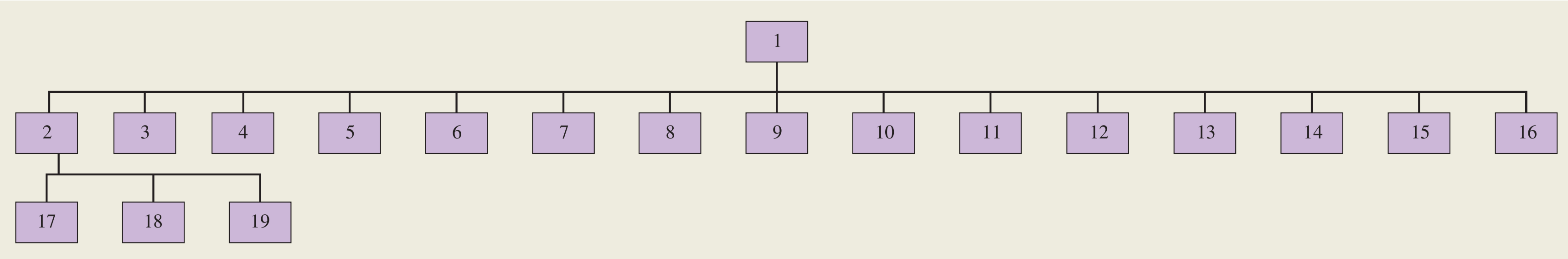
Dick's operates in a highly competitive market where customers can purchase from traditional retailers or simply purchase from online merchants including Amazon and eBay where virtually anybody can be a merchant and barriers to entry are slim. However, Dick's has done well with net income up over 12 percent in the year ending February 2018. The company offers a wide selection of brands ranging in prices (according to Dick's) from good to excellent, providing customers of all income levels and athletic skill levels attractive products. Dick's is committed to hiring expert personal in the various departments of the store. For example, if someone is in the market for a bicycle, Dick's has bicycle mechanics on staff who often have the same level of knowledge one would find in a bicycle specialty shop.

If someone wants to hit golf balls, they can go to Dick's golf hitting bay and work with coaches to help select the right clubs. If they want instead to shoot a bow or test out new running shoes, they can simply shoot a few arrows in the archery lane or hop on a treadmill in the store, all supported by knowledgeable employees. This level of service is one way Dick's competes with online merchants as customers are not as likely to "showroom" (browse the store then go buy online for a cheaper source) if they received such personal and dedicated attention. It is also a great way to build customer loyalty and attract people into the store.

In 2017, Dick's transitioned from outsourcing its e-commerce platforms to performing these tasks in-house in what Dicks hopes will provide increased control and allow the firm to target and interact with customers more effectively. Dick's is aggressively adding Field & Stream stores inside existing Dick's Sporting Goods stores in hopes of cross selling fishing gear with other sporting goods products. In addition, Dick's offers Golf Galaxy stores inside select Dick's stores. Dick's markets itself as offering multiple specialty shops inside each store; footwear, team sports, outdoor lodge, fitness and others are all considered specialty stores by some measures. Adding similar store-in-a-store concepts is a viable strategy many firms are starting to employ in hopes of increasing foot traffic.

Dick's offers many popular brands including Asics, Adidas, Nike, Columbia, Callaway Golf, TaylorMade, Under Armour, and Yeti. Offering famous brands aids in attracting customers into Dick's stores. Dick's also offers several private label brands which tend to have higher profit margins than brand names. Several private label brands include: Field & Stream, Fitness Gear, Lady Hagen, CALIA of women's athletic apparel, Top-Flite, Quest, and others. Private label brands

EXHIBIT 1 **Dick's Top Executives and Organizational Chart**



1. Ed Stack, CEO, Chairman of the Board
2. Lauren Hobart, President Dick's Sporting Goods
3. Lee Belitsky, EVP—CFO
4. Paul Gaffney, EVP—Chief Technology Officer
5. Holly Tyson, SVP—Chief Human Resources Officer
6. Nina Barjesteh, SVP—Product Development
7. Dave Barnes, SVP—Real Estate
8. Donald Germano, SVP—Operations
9. George Giacobble, SVP—Supply Chain
10. Navdeep Gupta, SVP—Finance and Chief Accounting Officer
11. John Hayes III, SVP—General Counsel and Secretary
12. Scott Hudler, SVP—Chief Marketing Officer
13. Joseph Oliver, SVP—Organizational Productivity
14. Daniel Ostrowski, SVP—Store Environment
15. Kurt Schnieders, SVP—IT and CIO
16. Will Swisher, SVP—Merchandise Planning and Allocation
17. Liz Haesler, SVP—GMM – Softlines
18. Wendy Fritz, SVP—GMM – Hardlines
19. Ed Plummer, SVP—Dick's Team Sports HQ

Source: Based on the company's 2017 *Annual Report,* other company documents, and a variety of other sources.

account for about 10 percent of company wide sales, but Dick's is planning to aggressively expand private brands, in particular its CALIA line. Dick's also has agreements from several brand name firms to be an excusive provider, including Slazenger, Umbro, Reebok, and others.

Dick's is somewhat dependent on Nike and Under Armour for its products as the two account for 20 and 12 percent, respectively, of Dick's sales. No other firm accounts for more than 10 percent out of the remaining 1,400 vendors.

Finance

The income statements in Exhibit 2 reveal that Dick's had a successful year ending in February 3, 2018, with sales up over 8 percent and net income up 12.5 percent. Unlike many firms, Dick's does not appear to have received a substantial tax break in the latest calendar year stemming from the new corporate tax laws in the United States. Being 100 percent U.S.-based, the new tax laws should benefit Dick's significantly as all their revenue is from the United States.

The balance sheets in Exhibit 3 reveal that Dick's remains in the mist of a stock buy back program that is expected to last until at least 2020. The firm's stock price declined over 50 percent from late 2016 to late 2017 so purchasing stock at low prices and betting on yourself may be a positive move for Dick's if the firm is able to regain its equity price footing. Signs are positive based on the company's revenue and net income increases, but most brick-and-mortar retailers are having difficulty competing with Amazon and other online competitors.

EXHIBIT 2 Dick's Income Statements (in thousands USD)

Income Statement	12/28/17	2/3/18		Percent Change
Revenues	$7,921,981	$8,590,472		8.44%
Cost of Goods Sold	5,556,198	6,101,412		9.81%
Gross Profit	2,365,783	2,489,060		5.21%
Operating Expenses	1,915,929	2,011,486		4.99%
EBIT	449,854	477,574		6.16%
Interest Expense	(8,568)	(23,763)		−177.35%
EBT	458,422	501,337		9.36%
Tax	171,026	177,892		4.01%
Non-Recurring Events	0	0	NA	NA
Net Income	287,396	323,445		12.54%

Source: Based on Dick's Q4 2017 *Report* and other documents.

Segment Data

Exhibit 4 reveals Dick's revenues by product type. Hardlines comprise 45 percent of revenues. Hardlines include fishing rods, basketballs, cookware, bicycles, and any other products that is not considered apparel or footwear. Despite hardlines accounting for a larger portion of revenue, softlines (footwear and apparel) account for a combined 55 percent of revenue. This comes as little surprise if you recall that Nike and Under Armour account for 32 percent of Dick's sales and both predominantly supply Dick's with softgoods.

Locations Map

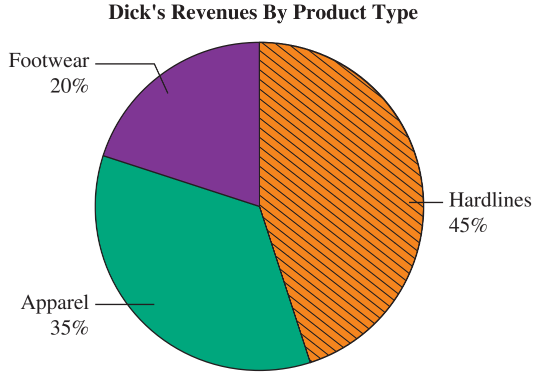
Exhibit 5 reveals Dick's store locations by region. Both Dick's Sporting Goods and Specialty Concept Stores are included in Exhibit 5. Specialty Concept Stores account for 15 percent of stores and include Golf Galaxy and Field & Stream with some free-standing and some combined with Dick's Sporting Goods stores. Dick's added a net of 55 stores in fiscal 2016. Dick's home market of the Northeast trails the Southeast in total number of stores by a wide margin.

EXHIBIT 3 **Dick's Balance Sheets (in thousands USD)**

Balance Sheet	12/28/17	2/3/18		Percent Change
Assets				
Cash and Short Term Investments	$164,777	$101,253	⇩	−39%
Accounts Receivable	75,199	60,107	⇩	−20%
Inventory	1,638,632	1,711,103	⇧	4%
Other Current Assets	117,070	133,622	⇧	14%
Total Current Assets	1,995,678	2,006,085	⇧	1%
Property Plant & Equipment	1,552,574	1,677,340	⇧	10%
Goodwill	245,059	250,476	⇧	2%
Intangibles	140,835	136,587	⇩	−3%
Other Long-Term Assets	154,150	133,451	⇩	−13%
Total Assets	**4,058,296**	**4,203,939**	⇧	**4%**
Liabilities				
Accounts Payable	755,537	845,075	⇧	12%
Other Current Liabilities	641,878	581,939	⇩	−9%
Total Current Liabilities	1,397,415	1,425,014	⇧	2%
Long-Term Debt	4,679	60,084	⇧	1184%
Other Long-Term Liabilities	726,713	777,340	⇧	7%
Total Liabilities	2,128,807	2,262,438	⇧	6%
Equity				
Common Stock	1,003	1,131	⇧	13%
Retained Earnings	1,956,066	2,205,651	⇧	13%
Treasury Stock	(1,158,378)	(1,442,880)	⇧	25%
Paid in Capital & Other	1,130,798	1,177,599	⇧	4%
Total Equity	1,929,489	1,941,501	⇧	1%
Total Liabilities and Equity	**4,058,296**	**4,203,939**	⇧	4%

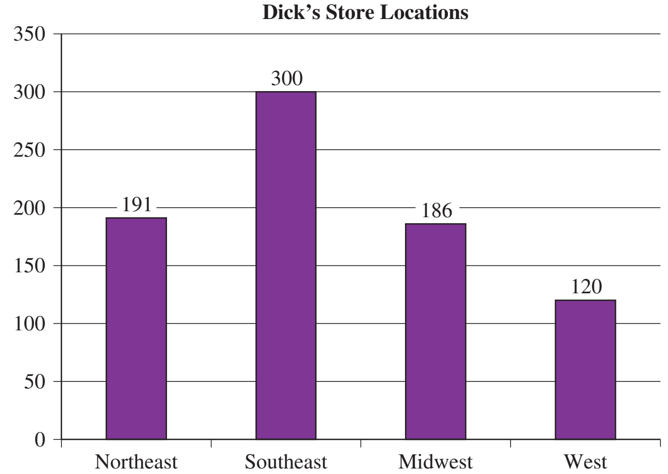
Source: Based on Dick's Q4 2017 *Report* and other documents.

EXHIBIT 4 **Product Segments**



Source: Based on Dick's Q4 2017 *Report* and other documents.

EXHIBIT 5 Dicks Store Locations by Region



Source: Based on Dick's Q4 2017 *Report* and other documents.

Competitors

In the world of sports retailing, Dick's Sporting Goods, Academy Sports + Outdoors, Bass Pro Shops, Big 5 Sporting Goods, and Hibbett Sports, are five of the more recognizable names. Dick's is leader of the group in terms of market capitalization $3.6 billion and sales about $8.6 billion annually, while Academy Sports + Outdoors, Bass Pro Shops, Big 5 Sporting Group, and Hibbett rank second, third, fourth, and fifth respectively in sales. Bass Pro Shops and Academy Sports are privately held firms. Exhibit 6 provides information on Dick's vs two competitors.

Exhibit 7 reveals that Dick's is the largest specialty sporting goods company in the U.S. with an impressive market share of 17 percent in 2017. Dick's market share includes sales from Golf Galaxy and Field & Stream. Academy Sports + Outdoors is similar to Dick's but includes significantly more fishing and hunting aspects. Bass Pro Shops is also mostly fishing and hunting in nature.

Academy Sports + Outdoors

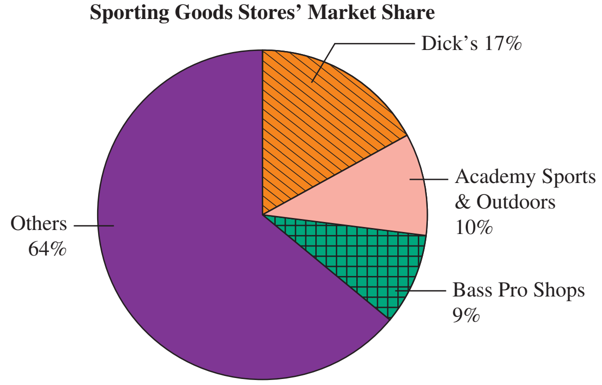
Headquartered in Katy, Texas, Academy Sports + Outdoors is a privately held company owned by KKR & Company. Founded in 1938, Academy is a sports, outdoor, and lifestyle retailer with a broad assortment of high-quality hunting, fishing, and camping equipment and gear along with sports and leisure products, footwear, apparel, and much more. Academy operates more than 200 stores throughout Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, Missouri, Oklahoma, South Carolina, Tennessee, and Texas. Academy revenues have been flat for the last 3 years but are up 60 percent from 2012 to 2017.

EXHIBIT 6 Dick's Versus Two Rivals on Seven Variables

	Dick's	Big 5	Hibbett Sports
$ Market Cap.	3,653M	145M	436M
# Employees	27,500	9,000	4,000
$ Revenue	8,590M	1.01B	968M
% Gross Margin	29%	32%	NA
$ Operating Income	2.4B	323M	338M
$ EPS Ratio	3.01	0.05	1.7
$ P/E Ratio	3.07	3.5	−1.6

Source: Based on a variety of sources.

EXHIBIT 7 Dick's Estimated Market Share



Source: Based on a variety of sources.

Bass Pro Shops (BPS Direct, LLC)

Headquartered in Springfield, Missouri, BPS Direct, LLC is a privately held brick-and-mortar retailer of hunting, fishing, camping, and related outdoor merchandise. BPS Direct owns Cabela's, White River Marine Group, and Tracker Marine Group. Founded in 1972, Bass Pro Shops recently opened up its new Angler's Inn in Springfield, Missouri. BPS Direct is similar to Dick's except BPS offers a full line of boats and boat motors.

Big 5 Sporting Goods (BGFV)

Headquartered in El Segundo, California, and founded in 1955, Big 5 Sporting Goods operates about 425 stores in the western United States only. The company has an e-commerce platform at the www.big5sportinggoods.com website. Big 5's product mix is almost exactly like Dick's, including athletic shoes, apparel and accessories, a range of outdoor and athletic equipment for team sports, fitness, camping, hunting, tennis, golf, winter and summer recreation, and roller sports.

Like Dick's, Big 5 stores carry products from brand name manufacturers, such as Adidas, Coleman, Columbia, Everlast, New Balance, Nike, Rawlings, Skechers, Spalding, Under Armour, and Wilson. Additionally, Big 5 offers private label items including shoes, apparel, camping equipment, fishing supplies, and winter sports equipment. Big 5 sells private label merchandise under its own trademarks (Golden Bear, Harsh, Pacifica, and Rugged Exposure) and offers licensed trademarks brands (Beach Feet, Bearpaw, Body Glove, Morrow, and The Realm).

Hibbett Sports, Inc. (HIBB)

Headquarterd in Birmingham, Alabama, Hibbett Sports is engaged in operating athletic specialty stores in small- and mid-sized markets primarily in the South, Southwest, Mid-Atlantic, and the Midwest U.S. Founded in 1945 and very similar to Dick's except considerably smaller, Hibbett provides sportswear apparel, footwear, equipment, and accessories. Hibbett's Sports Additions stores provides fashion-based merchandise assortment of athletic footwear, caps, and apparel. The Hibbett Team Sales, Inc. is a supplier of customized athletic apparel, equipment, and footwear primarily to school athletic programs. As of Fall 2018, Hibbett operates about 1,000 stores consisting of about 990 Hibbett Sports stores and 10 smaller-format Sports Additions athletic shoe stores in 35 states.

Industry Analysis

Sporting goods stores have out performed many other retail stores in recent years as there is a growing number of health conscious people. Participation in sports and exercise activities has slowly risen over the last 5 years and is expected to rise about 2 percent annually through 2023. A key group for the industry is children and young adults under 21 years of age. This group has experienced robust demand, likely creating a strong market of customers well into the future.

In fact, about 50 percent of the market is customers 45 and under in age. However, even older people are significantly more active than their predecessors in years past.

Consolidation through acquisitions or bankruptcies within the industry has helped firms, like Dick's, by eliminating competition. A reduction in the number of wholesalers who used to supply firms like Dick's with many of their products are fewer in number, now allowing all firms in the industry to cut out this middleman and do business directly with the manufacturers. Overall, the industry is valued at over $50 billion annually.

The United States has a whopping 40,000 sporting goods businesses, including Dick's and Bass Pro Shops, but also thousands of mom-and-pop bait and tackle stores located on small creeks, rivers, lakes, and coastal areas across the United States. The Internet is also a major player now, as many people purchase sporting goods and fishing equipment directly from China on eBay and other websites, often at bottom line prices.

The main drivers of revenue in the industry are not footwear or athletic apparel but rather sporting equipment such as exercise stuff, golf, team sport items such as football and baseball gear, hunting, fishing, and camping gear. In total, about 64 percent of industry revenues are derived from sporting equipment, while 17 percent is derived from athletic apparel. and 12 percent from athletic footwear. The remaining revenues are derived from various items including furniture and other items not directly used in sports or physical activity.

Omnichannel Strategy

Dick's mission statement mentions its omnichannel strategy discussed. The term is simply a fancy way of stating the company sells its products through its website and through brick-and-mortar stores and has exposure to social media. Omnichannel strategies require that firms ensure they have excellent inventory tracking systems in place, ensure products are well described online rather than simply having a picture, use advanced data analytics to predict customer habits and desires, and finally ensure an efficient supply chain.

Online sporting goods sales are increasing rapidly, up 15 percent in 2017 by some accounts to over $400 billion in the U.S. alone. A recent study reported that 33 percent of men and 25 percent of women indicated they are considering purchasing their sporting goods and apparel exclusively online. In total, online purchases of sporting related goods is expected to increase 7 percent per year through 2021. Customers are increasingly using the internet to research products as well, not always purchasing online.

Dick's partly relies on customers researching products on their website then coming into their stores to talk to sales staff and hopefully purchase the item. Firms like Amazon, who are still predominantly online, have the distinct advantage over firms with brick-and-mortar locations in being able to operate at higher margins and charge lower prices. Retail stores such as Dick's, though, have the buffer in that many of their products customers want to try on before they buy including shoes, apparel, baseball gloves, bats, golf clubs, and even test out exercise equipment and bicycles, so maintaining an omnichannel strategy is vital for such retailers.

Shift to Markets Outside the United States

Although Dick's is located 100 percent within the United States, many retailers are pushing their products and markets overseas as a growing middle class is developing in many emerging markets. Amazon for example earns over one-third of its revenues from outside the United States, and even legacy firms such as Staples, earn about 20 percent of its revenues from outside the U.S. However, despite robust sales from overseas markets, profit margins are generally significantly higher in the United States, and many firms struggle to turn a profit in their overseas operations.

Inventory Management Strategies

As discussed, is the need to operate under an omnichannel strategy, inventory management is a key element to being successful in retail. Why do people enter a Dick's Sporting Goods store, a Bass Pro Shops, or an antique shop? Why not simply buy online? The answer is rather simple—people simply enjoy seeing, holding, sitting in, and playing with the inventory. Some analysts even consider displaying the appropriate inventory at the right time is the Holy Grail for any retail business—more important than buildings, equipment, and even location. Being able to lure customers into the store to see new, exciting inventory first-hand is becoming increasingly important to compete with the Amazons and eBays of the world, where customers simply purchase with the click of a button or a tap on their smart phone screen.

To ensure the proper inventory is available, many firms are adopting so called quick response (QR) systems that order a replacement item as soon as one is purchased. Stores like Dick's must be cognizant, however, of the risk of simply becoming a showroom for inventory with customers leaving to purchase the very products they played with online at a cheaper price. Having the correct inventory may be the most important factor for attracting customers into your store, but how do you increase the odds for a sale? See the next section.

Store-in-a-Store and Employees' Strategies

A way to increase the odds of customers actually making a purchase while in the store is through having a highly trained staff. Staffing the store with knowledgeable personnel is a key element to closing a sale. Dick's, for example, has extremely knowledgeable employees working throughout the store. Similarly, ULTA, formally known as ULTA Beauty, also has knowledgeable personnel selling its products and even has a beauty parlor store-in-a-store concept which forces customers coming to have their hair done to walk through the store. Bass Pro Shops employees, in fishing, hunting, or hiking sections, for example, can talk educationally about the products. In essence, some retail stores are not even selling inventory, rather selling information—as opposed to Walmart who simply competes on bottom of the line price. There are not many Walmarts in the country where you can receive detailed fishing tips and information from the personnel working sporting goods or what type wax is best for your vehicle from the people working in the automobile section. Walmart is not in the information business; they compete on cost.

Customer Loyalty Strategies

Much of the above discussion is around building customer loyalty, but a few additional considerations are included in this section. Unlike a giant department store that sells everything under the sun, specialty retailers have a narrower range of customers. In many ways, they operate under what Porter would call a focused strategy. As a result, specialty retailers must keep their core customers happy and returning because this core group is predominantly the only customers the firm has, as opposed to Walmart, who has many customers buying anything from food to socks—the penalty on faltering on one product category is not as severe. Tactics used to foster customer loyalty include increased marketing, reward cards, private label credit cards, and creating your own private label brands, which often are sold at higher margins for the firm and cheaper prices for the customer. Another advantage of private label brands is customers are not able to compare prices as easily because the store is the only source for that particular product. Dick's peer and foe, Bass Pro Shops, has done a phenomenal job with its Johnny Morris (the firm's founder) brand of fishing rods and reels and other items using Morris' namesake. The only place to purchase is at Bass Pro shops, not Amazon, not ebay, only Bass Pro. To the degree a firm can market effectively and hire the proper personnel to endorse store branded items combined with possibly offering double rewards when purchasing store branded items, significant brand loyalty can be built.

Future

The United States has an extremely high rate of diabetes and hypertension, and by some estimates, the highest rate of obesity among developed countries—34 percent of men and 37 percent of women classified as obese. The U.S. government has introduced several programs aimed at increasing physical activity of its citizens and even promoted them through key figures, including former first lady Michelle Obama. Nike, and other firms, are also encouraging and marketing in a manner to get people more active.

With a growing health-minded segment of the population, increased pressure is being placed on others to conform, which should bode well for Dick's Sporting Goods. However, smartphones and laptop video games and the like have overall curtailed the prevalence of outdoor activities. Too many young people are hooked on online games and social media communications—to the detriment of firms like Dick's that want to get you out in the field, in the woods, on the court, or on the water.

Dick's needs a clear strategic plan going forward to obtain and nurture a loyal customer base.

11 Bit Studios S.A.—2022

www.11bitstudios.com

Headquartered in Warsaw, Poland, 11 Bit Studios (11 Bit) is a large video game development and publishing company with sales derived globally. Founded in 2010, 11 Bit has made a name for itself developing such games as *Anomaly: Warzone Earth* (2011), *This War of Mine* (2014), *Moonlighter* (2018), and *Frostpunk* (2018). The company has also released *Children of Morta* (2019). 11 Bit's Chinese partner, NetEase, is working on the mobile version of *Frostpunk*, while its board game version is being produced by Glass Cannon Unplugged. 11 Bit is a successful, growing company with space for more than 300 employees at its headquarters in Warsaw; as of year-end 2021, the company has about 200 employees.

For 2020, 11 Bit reported revenue of PLN 87.1 million, up 22.3 percent from the prior year, while the company's operating profit was PLN 40.79 million, up 57.6 percent from 2019. The firm's net profit for 2020 was PLN 37.36 million, up 57.5 percent from the prior year. The company's available cash at year-end 2020 was PLN 96.13 million, up 16.9 percent and the highest level ever. Thus, this company is doing really well financially. However, the pandemic has impacted the gaming industry in interesting ways. Lockdowns have increased game sales, but development has taken a major hit: studios were forced to adapt to varied seating arrangements, and many new releases had to be delayed, inflating production costs on both counts. Thus, a revenue spike in 2020 doesn't necessarily mean stellar performance.

History

Founded in December 2009, 11 Bit's stock was listed on the Warsaw Stock Exchange in December 2015. This company handles every stage of the video game creation process, from idea conception and software creation to production and marketing globally. Gaming titles are usually sold through a third-party platform like Steam or Epic Games Store on the PC and through official stores on the consoles.

In 2010, 11 Bit released *Anomaly*, which quickly became one of the world's most popular "tower offense" games. The company's *This War of Mine* (*TWoM*) was released in 2014 (PC version) and within weeks occupied top positions on the bestseller lists of Steam and other digital distribution platforms. *TWoM* was soon adapted to new hardware platforms and new language versions, and it remained a key contributor to 11 Bit's financial performance in 2014–2017. *TWoM* was replaced as 11 Bit's main revenue source by *Frostpunk*, which debuted (PC version) in April 2018. Within 3 days of its release, customers purchased over 250,000 copies of *Frostpunk*, which more than covered its production costs.

In 2017, 11 Bit's publishing division released two games: *Beat Cop* and *Tower 57*; *Moonlighter* followed in 2018. These 3 products increased the percentage of revenues contributed by the publishing division from 12 percent to 18 percent. In 2019, this percentage increased to 40 percent following release of another third-party developed title, *Children of Morta*, whose PC and console versions were released in Fall 2019. In 2020, the percentage of 11 Bit's total revenue derived from the sale of third-party developed games (the publishing segment) was 29 percent.

For Q1 of 2021, 11 Bit again reported excellent financial results, including more than PLN 14.83 million in revenue, PLN 6.38 million in EBITDA, PLN 3.56 million in net profit, and nearly PLN 107.8 million in liquid assets. These numbers exceeded even the company's expectations.

Vision/Mission

Note that 11 Bit isn't even the most prominent publisher in Poland (that honor probably goes to CD Projekt). Companies such as Valve, Ubisoft, etc. are much larger players in this industry globally. This should be kept in mind when thinking about the vision and mission statements.

11 Bit does not have a formal vision statement on its website or in its *Annual Report*, but the company's mission statement is stated to be two words: "Meaningful Entertainment."

A possible vision statement for 11 Bit could read something like this: to become the most renowned video game producer and marketer in Europe.

By-Segment Information

11 Bit operates under two segments or divisions: 1) Game Development, which entails developing, producing, marketing, distributing, and enhancing video games internally, and 2) Publishing, which entails acquiring, marketing, and distributing video games developed by third-party companies.

Game Development

11 Bit has established three internal development teams consisting of about 70 persons each. The company's internal operations include all aspects of the creative process (concept, design, art, programming, quality assurance, cross-platform development, and customer support). Video games included in 11 Bit's Game Development segment include *This War of Mine* (*TWoM*), *Frostpunk*, and *Project 8*. From its debut in Fall 2014 to the end of 2020, *This War of Mine* game generated total revenue of more than PLN 110 million for 11 Bit.

Frostpunk is a video game that tells the story of the struggle for survival of a community stranded in a freezing world. Revenue from *Frostpunk* in 2020 totaled more than PLN 130 million. In 2021, *Frostpunk* was made available for mobile devices running iOS and Android and had a F2P (free-2-play) model. For 11 Bit to build *Frostpunk* into a cross-platform global brand was a big step. *Frostpunk* for mobile devices was developed by China-based NetEase, a gaming industry giant with a very strong position in the mobile games sector.

At the time of writing, *Project 8* is the code name for 11 Bit's newest, still secret video game. A team of more than fifty 11 Bit employees are working on *Project 8*, compared to the team of 65 persons that produced *Frostpunk*. Analysts expect that *Project 8* will be released simultaneously for the PC and for consoles. 11 Bit recently changed *Project 8*'s game engine from the proprietary (internal) solution on which the company's earlier games had run to the Unreal Engine.

Publishing

11 Bit's revenue from sales of video games in its Publishing segment in 2020 accounted for 29 percent of total revenue, down from 40 percent the prior year. Prominent video games included in 11 Bit's Game Development segment include *Beat Cop, Tower 57, Moonlighter, Children of Morta, Vitriol, Foxhole, Botin*, and *Ava.*

Developed by Spanish studio Digital Sun but published by 11 Bit, *Moonlighter* was released in mid-2018 for the PC, Xbox One, Nintendo Switch, and PS4. Through 2020, 11 Bit derived revenue of over PLN 44 million from *Moonlighter* with the Nintendo Switch as the primary sales platform. This game is available from the world's leading digital gaming platforms, including Steam. A version for Apple smartphones was launched in November 2020. Preparations are under way to release *Moonlighter* for Android devices. By the end of December 2020, 11 Bit's revenue from *Moonlighter* and its add-ons for all hardware platforms was more than PLN 44 million.

Produced by the American studio Dead Mage, *Children of Morta* was released in Fall 2019 for the PC, Xbox One, PS4, and Nintendo Switch. *Children of Morta* is an action-RPG and ranked among top ten of the Steam's bestsellers. In August 2020, 11 Bit released downloadable content (DLC) named *Children of Morta: Paws and Claws*, which introduced animal characters in the game. All proceeds from the sale of the DLC are being donated by 11 Bit to The Humane Society International Foundation. As of year-end 2020, 11 Bit derived total revenue from *Children of Morta* of PLN 24 million.

At year-end 2020, 11 Bit has four titles being developed under its Publishing division. The first is codenamed Vitriol and under development by Fool's Theory Studio, based in Bielsko-Biała. The second and third are codenamed Foxhole and Botin and are being produced by Digital Sun. The fourth is a game codenamed Ava, under development by Spanish development studio Chibig. 11 Bit's total investment in these four games as of year-end 2020 is about PLN 20 million, compared to a total investment in *Moonlighter* and *Children of Morta* of about PLN 5 million.

By-Region Segments

Like most game publishers, 11 Bit competes globally, not just in its home country of Poland. In 2020, foreign sales (outside Poland) accounted for 97.6 percent of the 11 Bit's total revenue, down slightly from 97.9 percent the prior year. 11 Bit does business in six geographical areas, as indicated in Exhibit 1. Note that the lion's share of the company's revenues are generated from the United States, followed by Japan, and then the European Union. Note the decreasing 11 Bit revenues in 2020 from the European Union, China, and the "Other" category.

EXHIBIT 1 11 Bit's Revenues by Region (in millions of PLN)

	2019	2020
Poland	1.49	2.06
EU	6.39	5.12
USA	51.27	66.98
Japan	10.31	12.08
China	00.83	00.22
Other (Canada, Korea, Brazil, & Australia)	00.93	00.63
Total	71.22	87.09

Source: Based on information on p. 40 in the 11 Bit 2020 *Annual Report*.

Internal Issues

Objectives

11 Bit's objectives, dispersed across the company's 2020 *Annual Report*, include the following:

1. Employ about 200 employees by the end of 2021
2. Increase production budgets on its own IP and third-party IP titles
3. Release one premiere game per year for its own IP titles
4. Publish 3–4 third-party IP titles each year
5. Release increasingly complex and higher-priced games. (Note: The development and production costs of a single video game may exceed PLN 5.5 million.)
6. Grow much faster than the entire video games market and steadily increase its market share.

Marketing

For marketing, 11 Bit relies almost exclusively on third-party companies to sell its products. This is standard for most independent game companies; it's a select few firms that can sell by themselves.

The firm's revenue from sales of video games was PLN 87 million in 2020, with PLN 86 million coming from sales of the company's products through Valve Corporation's Steam, Nintendo Co. Ltd, Microsoft Corporation, Google, Apple, Sony, and Humble Bundle—the world's leading electronic distribution platforms. In 2020, the company's largest distributors were Value Corporation, Humble Bundle., Nintendo Co Ltd., Google LLC, GOG Sp. z.o.o, and Sony Interactive Entertainment America LLC. Receivables from those firms ranged from 3.66 million PLN from Valve to 0.577 million PLN from Sony.

Organizational Structure

Przemysław Marszał is currently the CEO of 11 Bit and Grzegorz Miechowski is the COO of the company. However, beyond these two persons, the company's website and its 2020 *Annual Report* offer no information about who reports to who or who is responsible for what. Some analysts would suggest that 11 Bit is sufficiently large to function with a divisional-by-region type of structure, with divisional head persons carrying the title President. In other words, this firm likely needs to be less centralized in its overall design and chain-of-command.

The board of directors consists of Przemyslaw Marszaf, President of the Management Board; Grzegorz Miechowski, Member of the Management Board; and Michaf Drozdowski, Member of the Management Board.

Supervisory Board

- Wojciech Ozimek, Chairman of the Supervisory Board
- Jacek Czykiel, Deputy Chairman of the Supervisory Board
- Radosław Marter, Member of the Supervisory Board
- Marcin Kuciapski, Member of the Supervisory Board
- Piotr Wierzbicki, Member of the Supervisory Board

Financial Data

For fiscal 2020, 11 Bit reported sales of PLN 87.1 million for 2020, up 22.3 percent over the prior year. The company's 2020 operating profit reached PLN 40.79 million, up 57.6 percent from the prior year, with net profit at PLN 37.36 million, up 57.5 percent. 11 Bit's 2019 and 2020 income statements and balance sheets are provided in Exhibit 2 and Exhibit 3, respectively.

EXHIBIT 2 **11 Bit Studios' Income Statements (in PLN)**

	12/31/19	12/31/20
Revenue	71,221,248	87,101,774
Cost of Goods Sold	438,947	353,338
Gross Profit	70,782,301	86,748,436
Operating Expenses	38,470,037	35,710,455
EBIT	32,312,264	51,037,981
Interest Expense	5,265,487	
EBT	27,046,777	40,651,821
Tax	247,777	304,981
Non-Recurring Events	3,072,086	2,983,709
Net Income	23,726,914	37,363,131

Source: Based on information in the 2020 11 Bit *Annual Report,* p. 16.

EXHIBIT 3 **11 Bit Studios' Balance Sheets (in PLN)**

	12/31/19	12/31/20
Assets		
Cash and Short-Term Investments	14,882,519	24,134,648
Accounts Receivable	17,750,932	11,601,506
Inventory	0	11,830
Other Current Assets	73,219,811	90,193,641
Total Current Assets	105,853,262	115,941,625
Property Plant & Equipment	20,380,205	26,889,502
Goodwill	0	0
Intangibles	24,870,505	37,859,517
Other Long-Term Assets	5,564,416	5,648,578
Total Assets	156,668,388	186,339,222

	12/31/19	12/31/20
Liabilities		
Accounts Payable	11,429,892	9,791,955
Other Current Liabilities	13,236,010	1,429,741
Total Current Liabilities	24,665,902	11,221,696
Long-Term Debt	10,429,732	9,499,650
Other Long-Term Liabilities	833,455	969,752
Total Liabilities	35,928,089	21,691,098
Equity		
Common Stock	228,720	236,055
Retained Earnings	17,454,092	33,106,943
Treasury Stock	4,870,274	12,407.633
Paid in Capital & Other	97,187,213	118,897,493
Total Equity	119,740,299	164,648,124
Total Liabilities and Equity	155,668,388	186,339,222

Source: Based on information in 11 Bit's 2020 *Annual Report,* pp. 17–18.

External Issues

Consumers globally are spending more and more time in front of their computers, smartphones, consoles, PCs, laptops, and tablets. Thus, the outlook for the video game industry in the coming years is outstanding, with the mobile games segment growing fastest of all.

Regional Information

For more than a decade, video games have been the fastest-growing segment of the entertainment industry. In fact, the value of the video gaming market already exceeds that of the film and music markets combined. Newzoo, a Dutch provider of games analytics, reports that the global video games market in 2019 was valued at $152.1 billion, an increase of 9.6 percent compared with the prior year. Newzoo's 2020 growth forecasts were for the gaming market to increase by another 9.3 percent to $159.3 billion (an all-time record).

Exhibit 4 provides information related to regional growth in the global video games market. Note that the Middle East & Africa market grew 30.2 percent in 2020 to $6.2 billion.

EXHIBIT 4 Growth in the Global Games Revenue by Region

Region	Global Revenue (in $ billions)	Global Growth (% in 2020)
Middle East & Africa	06.2	30.2
Europe	32.9	19.9
Latin America	6.8	25.2
North America	44.7	21.4
Asia-Pacific	84.3	17.5
Total	174.9	19.6

Source: Based on information in 11 Bit's 2020 *Annual Report*, p. 86.

Newzoo revised its projections upwards for growth in the video games industry, saying in 2020 that the value of the global gaming market would rise by 19.6 percent compared to the prior year, to $174.9 billion. The firm also reports that in geographical terms, Asia, especially China, is the world's largest gaming market. Newzoo reports that in 2020 customers in Asia spent

$84.3 billion on computer games, a 17 percent increase over 2019. However, in 2020, the Asian market accounted for about 48 percent of the global gaming market, down 1 percent from the prior year.

Some analysts report that rates of growth in the European and American gaming markets in 2020 were markedly higher than in Asia. Newzoo too reported that Americans spent $44.7 billion on video games in 2020, up 21.4 percent from the prior year and comprising 26 percent of global spending on this type of entertainment. Moreover, according to Newzoo, European spending on video games reached $32.9 billion in 2020, up 19.9 percent, and comprising a 19 percent share of the global gaming market.

Latin America loves video games even more than Asia, as spending there increased 25.2 percent in 2020 to $6.8 billion, comprising 4 percent of the global market. Based on spending, in 2020, Africa and the Middle East comprised 3 percent of the global gaming market, or $6.2 billion, up 30 percent year-over-year.

Although the market for video games in 11 Bit's home country of Poland represents an almost negligible share of the global gaming market at about 0.4 percent, a report titled "Condition of the Polish Gaming Industry 2020" states that in 2020 the value of the Polish gaming market was PLN 2.43 billion, compared with PLN 2.23 billion the prior year. This report estimates that the video games market in Poland will be worth PLN 2.54 billion in 2021 and grow to PLN 2.69 billion in 2022, and then to PLN 3 billion by 2024.

Device Information

Video games can be played on different kinds of devices, and producers of video games spend considerable resources tailoring products to play on multiple devices. Exhibit 5 provides information related to growth in the global games market by type of device. Note that smartphone games generated both the largest revenue and the fastest percentage growth.

EXHIBIT 5 Growth in the Global Games Revenue by Region

Region	Global Revenue (in $ billions)	Global Growth (% in 2020)
Mobile Devices (Total)	86.3	25.6
Tablet Games	11.4	07.3
Smartphone Games	74.9	29.0
PCs	37.4	06.2
Browser PC Games	03.2	–8.7
Boxed/Downloaded PC Games	34.2	07.9
Console Games	51.2	21.0

Source: Based on information in the company's 2020 *Annual Report*, p. 88.

Newzoo reported that in 2020 smartphone owners spent $86.3 billion on video games, up a whopping 25.6 percent from the prior year, comprising 49 percent of the device-playing video game market. Video games dedicated for play on smartphones are often sold at low prices or even offered in the F2P (free-to-play) model.

Behind smartphones in revenue are video games for consoles, at $51.2 billion in 2020, up 21 percent from the prior year, and comprising 29 percent of the global gaming market. However, Newzoo reports that projections for video game spending on PCs in 2020 grew only 6.2 percent and comprised just $37.4 billion. The PC share in the global video gaming market in 2020 declined 22 percent, partly due to a further decline in the share of web browser games (titles available via social media, for example). The PC segment of the video game market now comprises only 2 percent of the global gaming market.

Video games for handheld devices will play an increasing role in the future due to a rapid rise in the number of such devices globally. This growth will come at the expense of the PC and web browser games segments. Console games are set to retain their market position, although sales of the new generation Sony and Microsoft consoles are picking up rather slowly. The market share of games dedicated to tablet computers is expected to remain unchanged from its current level of a few percent.

Major Industry Players

The industry includes both big-budget developers and publishers of so-called AAA games and smaller firms that specialize in low-budget "indie" games. The former includes studios like Rockstar Games, Bioware, Blizzard, and Bethesda; the latter includes Chucklefish, Digital Devolver, and Annapurna Interactive. 11 Bit Studios arguably sits closer to the indie end of the spectrum, but this section will discuss the most prominent names in the video game industry to present a broad view of the gaming landscape.

Headquartered in Kyoto, Japan, Nintendo was arguably the first video game development company—its first product was introduced in 1979. Nintendo is the world's largest video game company by revenue, with a net value of over $150 billion. Some of Nintendo's notable video franchises are *Mario, Pokémon*, and *The Legend of Zelda.*

Headquartered in Bellevue, Washington, and with a key subsidiary in Luxembourg, Value Corporation has total equity of over $5 billion, though most of this is from Steam, its online games marketplace. Some of the company's most popular games include the *Portal, Team Fortress*, and *Half-Life* series.

Headquartered in New York City and owned by Take-Two Interactive, Rockstar Games was founded in 1998 by Sam House, Dan Houser, Terry Donovan, Jamie King, and Gary Foreman. Its many popular video games series include *Grand Theft Auto* and *Red Dead Redemption.*

Headquartered in Redwood City, California, Electronic Arts (EA) is a video game development and publishing company with annual revenue over $8 billion. Some of its popular video games are the *Battlefield* and *FIFA* series as well as several games in the *Star Wars* franchise.

Headquartered in Santa Monica, California, Activision Blizzard is a NASDAQ-listed holding company that owns and operates subsidiaries that have developed bestselling videogames such as the *Call of Duty* series, *World of Warcraft, Overwatch*, and the *Tony Hawks* series.

Headquartered in Minato, Tokyo, Japan, Sony Computer Entertainment is a wholly owned subsidiary of the Sony Corporation. Sony produces the PlayStation series of gaming consoles, one of the biggest gaming platforms around the world. This video game company has several subsidiaries in Asia, Europe, and North America.

Headquartered in Montreuil, France, Ubisoft is a video game developer and publisher that has subsidiaries in 26 countries throughout the world and trades on Euronex as UBI. Some of its popular video games include the *Assassin's Creed, Far Cry*, and *Tom Clancy* series.

Sega Games Co. Ltd. is headquartered in Tokyo, Japan, and is a wholly owned subsidiary of the larger Sega Holdings. Sega Games has several offices around the world. Some of the best-selling games from this company are the *Sonic the Hedgehog, Yakuza, Persona*, and *Total War* series.

Headquartered in Edmonton, Canada, BioWare is wholly owned by Electronic Arts. BioWare has developed popular video games including the *Mass Effect* series, the *Dragon Age* series, and *Star Wars: The Old Republic.*

Headquartered in Santa Monica, California, Naughty Dog Inc. is a wholly owned subsidiary of Sony Computer Entertainment. Some popular Naughty Dog games include *Crash Bandicoot, Jak and Daxter, The Last of Us*, and *Uncharted.*

Headquartered in Shinjuku, Toyo, Japan, Square Enix Holdings Co. Ltd. is listed on the Tokyo stock market and produces such popular video games as *Final Fantasy, Tomb Raider, Chrono Trigger*, and *Kingdom Hearts*.

Headquartered in Chuo-Ku Osaka, Japan, Capcom Company Ltd. is a public listed company that develops and publishes video games such as *Monster Hunter, Resident Evil, Street Fighter*, and *Mega Man.*

Headquartered in Bellevue, Washington, Bungie Inc. has developed such popular video games such as *Marathon, Destiny,* and the *Halo* series. Bungie was acquired by Microsoft in 2000, but it has since split from it, with the software giant retaining the *Halo* franchise.

Headquartered in Redmond, Washington, Microsoft's presence in the gaming world is driven by its Xbox game consoles and gaming service. The company has acquired numerous video game developers and is now a major force to reckon with in the industry.

Headquartered in Shinagawa, Tokyo, Bandai Namco Entertainment is a wholly owned subsidiary of Bandai Namco Holdings, with operations all over the world. Some of the company's popular video games are *Little Nightmares, Soulcalibur, Ace Combat,* and *Dark Souls*.

Headquartered in Stockholm, Sweden, Mojang was founded in 2009 by game programmer Markus Persson. The company, primarily known for breakout hit *Minecraft*, was acquired by Microsoft in 2014.

Headquartered in Cary, North Carolina, Epic Games is a private company that has subsidiaries in China, South Korea, the United Kingdom, and Japan. The company is best known as the developer of the *Unreal, Gears of War*, and *Fortnite* franchises and of the widely used Unreal game engine.

Headquartered in Tokyo, Japan, Game Freak is a privately owned company that is famed for developing the *Pokémon* series.

Headquartered in Burbank, California, Insomniac Games Inc. has been named the best place to work in America by Society for Human Resource Management and one of the best video developers by IGN. Popular games from this company include *Spyro the Dragon, Ratchet and Crank*, and *Resistance*.

Headquartered in Woodland Hills, Los Angeles, Infinity Ward is a subsidiary of Activision. Popular video games by Infinity include the *Call of Duty* series.

Headquartered in both New York City, USA, and Windsor, UK, Take-Two Interactive Software is a holding company with development studios in Toronto, Canada, and in North America. Games published by its brands include *Grand Theft Auto, Civilization, NBA 2K,* and *Red Dead Redemption.*

Headquartered in Paris, France, Gameloft is a video game development company that specializes in the mobile games market. Its products include *Hero of Sparta, Castle of Magic,* and mobile versions of several *Assassin's Creed* games.

Headquartered in Rockville, Maryland, ZeniMax Media Inc. publishes popular video games such as the *Doom, The Elder Scrolls, Fallout,* and *Dishonored* series. It is now owned by Microsoft.

Headquartered in Seoul, South Korea, NCSOFT has subsidiaries in several parts of the world and has developed massively multiplayer online role-playing games such as *Lineage* and *Guild Wars*.

Headquartered in Irvine, California, Blizzard Entertainment has been a subsidiary of Activision Blizzard since 2008. The company has popular video games such as *Diablo, Starcraft, World of Warcraft*, and *Overwatch.*

EXHIBIT 6 A Sampling of Companies that Produce Video Games

Company	Home Country	Popular Games
Zynga	USA	*Farm Ville, Zynga Poker, ChefVille*
Nexon Co. Ltd	Japan	*Nexus: Kingdom of the Winds, Shattered Galaxy, MapleStory*
Konami Holdings	Japan	*Scramble, Super Cobra, Frogger, Dance Dance Revolution*
Bethesda Game Studios	USA	*Oblivion, Skyrim, Fallout 3, Fallout 4, Fallout 76*
Double Fine Productions	USA	*Broken Age, Psychonauts, Brutal Legend*
IC Company	Russia	*Cliffs of Dover, Theatre of War, Hard Truck 2*
Intelligent Systems	Japan	*Fire Emblem, Paper Mario*

Conclusion

11 Bit's forthcoming Project 8 game is based on the Unreal Engine, not a self-developed one. In fact, on February 23, 2021, 11 Bit announced that the company is discontinuing further work on its own engine, which means that new productions of 11 Bit games will be based solely on third-party solutions.

In addition to Project 8, 11 Bit is engaged in prototype work on a game with the code name *Dolly Project* (formerly Project 9) and a game code-named *Eleanor Project* (formerly *Project 10*). The company's strategy for the next few years is to have three in-house development teams that are comparable in size (about 60–70 people each). Given an average production cycle of about 3–4 years for each game, with three teams, 11 Bit desires to release one proprietary title a year.

11 Bit is regularly updating and improving its existing games and developing DLCs to spur revenues. In June 2020, 11 Bit announced Chinese NetEase would create a new version of *Frostpunk* for mobile devices, so the game will soon be offered with the F2P model.

11 Bit anticipates that its publishing division will become an increasingly important contributor to company revenues and profits. In 2021 and beyond, revenue delivered by the publishing division from third-party developed titles will mainly include revenue from *Moonlighter* and *Children of Morta*, as DLCs and new platform versions are under development, such as for iOS and Android mobile devices.

11 Bit's previous strategy for the publishing segment had assumed that a single project would not consume more than PLN 2 million, but that cap has since increased to PLN 5 million. Now, 11 Bit wants to launch third-party developed games every quarter. At year-end 2020, 11 Bit had four publishing agreements with third-party development teams.

11 Bit needs a clear strategic plan to guide its top management decisions in the coming months and years. Recall from the case that the company desires to strengthen its affiliations with third-party video game developers. If your strategic analysis supports this strategy, where and how should the company do this? Note also that the company's organizational structure is not clear, despite the fast pace with which the firm continues to grow. Would a divisional structure by product, region, customer, or device be effective, and why? Develop projected financial statements for 11 Bit to reveal the expected impact of your recommendations on the company's finances.

Reference

1. 11 Bit Studio, *Annual Report of 11 Bit Studios S.A. for 2020*, ir.11bitstudios.com/wp-content/uploads/2021/05/Annual-Report-of-11-bit-studios-for-2020.pdf.

JPMorgan & Chase Co.—2018

www.jpmorgan.com, JPM

Headquartered in New York City, JPMorgan Chase (JPM) is one of the oldest financial institutions in the world. JPM is the world's sixth largest bank by total assets of over $2.6 trillion, and the second most valuable bank based in market capitalization. JPM offers services in investment banking, financial services for consumers and small businesses, commercial banking, financial transaction processing, and asset management. JPM has over 240,000 employees, with operations in 60 countries worldwide. Based on total assets, JPM ranks first in banking industry market share with about 14 percent, and second in total domestic deposits of about $1.8 billion. JPM's revenues have increased every year to almost $100 billion in 2017. 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 hedge funds in the United States.

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, 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/income by the two brands.

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 JPMorgan & Co. Arguably the most influential financial institution of its era, JPM 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, JPM 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.

In 2004, JPM merged with Chicago-based Bank One Corp., bringing on board current chairman and CEO Jamie Dimon as president and COO, and designating him as former 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 JPM 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 over 1,200 financial institutions over its life. 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.

Vision/Mission

JPM's actual vision statement (paraphrased) is as follows: "We strive to be the best financial services company on the planet."

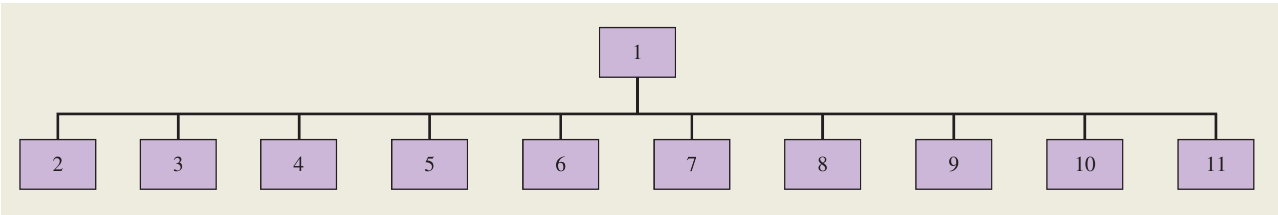
JPM's actual mission statement (paraphrased) is as follows: "We strive to be the worldwide leader in financial services offering a complete platform of products. Our clients include individuals, companies, institutional investors, hedge funds, governments, and municipalities in more than 100 countries."

Internal Issues

Organizational Structure

In January 2018, JPM appointed Daniel Pinto, CEO of its Corporate & Investment Bank, and Gordon Smith, CEO of Consumer & Community Banking, co-presidents and co-chief operating officers of the company, continuing to report to Jamie Dimon, Chairman and CEO. Perhaps those appointments are part of a broader shift within JPM to a strategic business unit (SBU type organizational structure whereby numerous by-product or by-region executives report to Pinto and Smith).

EXHIBIT 1 **JPM's Top Executives and Organizational Chart**



1. Jamie Dimon, Chairman of the Board and CEO
2. Mary Callahan, Erdoes Asset and Wealth Management CEO
3. Douglas Petno, Commercial Banking CEO
4. Daniel Pinto, Corporate and Investment Bank CEO
5. Gordon Smith, Consumer and Community Banking CEO
6. Ashley Bacon, Chief Risk Officer
7. Lori Beer, Chief Information Officer
8. Stacey Friedman, General Counsel
9. Marianne Lake, CFO
10. Robin Leopold, Head of Human Resources
11. Peter Scher, Head of Corporate Responsibility

Source: Based on company documents.

Current Strategies

JPM is utilizing a growth strategy and aggressively buying back stock. In 2017, JPM repurchased about $14 billion in treasury stock. JPM is heavily investing in technology, spending nearly $10 billion on technology in 2016 with $3 billion dedicated solely toward new initiatives, such as opening new accounts from a mobile phone, mobile investment advice, and improved ability to buy and sell stocks online. JPM invested about $20 billion from the new tax law passed in 2017, using much of this money to open 400 new branches across the United States. In February 2018, JPM increased wages for retail banking employees (tellers and similar jobs) from an average of $14.25 to $16.50 per hour—a 16 percent increase. The company also expanded home lending to low- to moderate-income customers from $7.7 billion to $50 billion. JPM plans to increase its philanthropic donations by 40 percent to $1.75 billion through 2022.

Finance

JPM's recent income statements and balance sheets are provided in Exhibit 2 and Exhibit 3 respectively. Note the 4.14 percent increase in revenues in 2017, but the slight decline in net income. Also notice in Exhibit 3 that JPM did not sell additional shares of stock in 2017 to raise capital, nor did the company increase its long-term debt—so all financing basically came from internally generated net income.

Segment Data

JPM operates under four main business segments: Consumer & Community Banking, Corporate & Investment Banking, Commercial Banking, and Asset & Wealth Management. According to Exhibit 4, Consumer & Community Banking reports the largest revenues based on year-end 2017 data with Corporate & Investment Banking generating the largest profits. Commercial Banking has the largest profit margin at 40 percent.

Consumer & Community Banking

As the largest division of JPM, Consumer & Community Banking revenues grew from $45 billion in 2016 to just over $46 billion in 2017, but net income dropped $300 million to $9.4 billion. The division has relationships with almost half the households in the United States, with 70 percent

EXHIBIT 2 **JPM's Income Statements (in millions USD)**

Income Statement	12/31/16	12/31/17		Percent Change
Revenues	$95,668	$99,624	↑	4.14%
Cost of Goods Sold	0	0	NA	NA
Gross Profit	95,668	99,624	↑	4.14%
Operating Expenses	61,132	63,724	↑	4.24%
Interest Expense	0	0	NA	NA
EBIT	34,536	35,900	↑	3.95%
EBT	34,536	35,900	↑	3.95%
Tax	9,803	11,459	↑	16.89%
Non-Recurring Events	0	0	NA	NA
Net Income	24,733	24,441	↓	0.01%

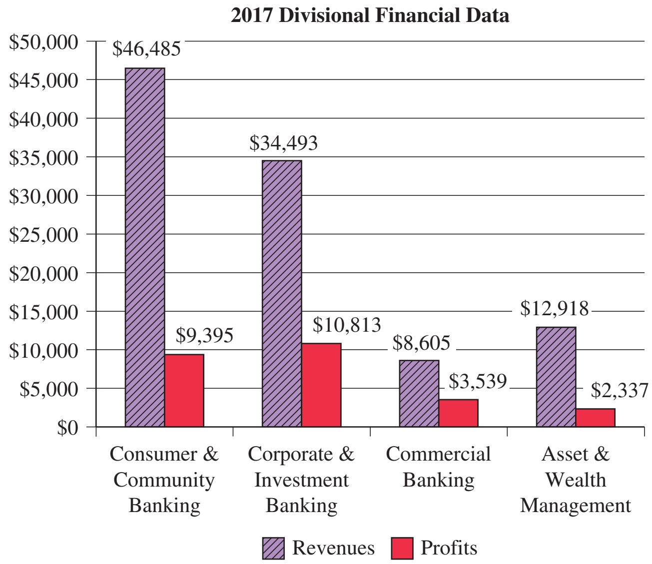
Source: Based on company documents.

EXHIBIT 3 **JPM's Balance Sheets (in millions USD)**

Balance Sheet	12/31/16	12/31/17		Percent Change
Assets				
Cash and Short-Term Investments	$880,989	$917,093	↑	4%
Accounts Receivable	52,330	67,729	↑	29%
Inventory	0	0	NA	NA
Other Current Assets	0	0	NA	NA
Total Current Assets	933,319	984,822	↑	6%
Property Plant & Equipment	14,131	14,159	↑	0%
Goodwill	47,288	47,288	→	0%
Intangibles	6,958	7,164	↑	3%
Other Long-Term Assets	1,489,276	1,480,167	↓	−1%
Total Assets	**2,490,972**	**2,533,600**	↑	**2%**
Liabilities				
Accounts Payable	190,543	189,383	↓	−1%
Other Current Liabilities	1,575,288	1,654,720	↑	5%
Total Current Liabilities	1,765,831	1,844,103	↑	4%
Long-Term Debt	295,245	284,080	↓	−4%
Other Long-Term Liabilities	175,706	149,724	↓	−15%
Total Liabilities	2,236,782	2,277,907	↑	2%
Equity				
Common Stock	4,105	4,105	→	0%
Retained Earnings	162,440	177,676	↑	9%
Treasury Stock	(28,854)	(42,595)	↑	48%
Paid in Capital & Other	116,499	116,507	↑	0%
Total Equity	254,190	255,693	↑	1%
Total Liabilities and Equity	**2,490,972**	**2,533,600**	↑	**2%**

Source: Based on company documents.

EXHIBIT 4 JPM's Segment Data (in millions USD)



Source: Based on the company's 2017 Q4 *Report* and other data.

of these households using the bank as their primary bank. About 80 percent of Chase households with a mortgage initiated the mortgage from another bank, although this number may reduce in the future as rates are now rising; there is less of a need for buying out existing mortgages with likely lower rates. The division has claims to have the top-rated mobile banking app, ATM network, and most visited banking portal in the United States. The division had 26 million active mobile customers in 2016, with these customers spending 90 percent more than customers who do not engage in digital banking; mobile customers increased 16 percent in 2016 as the firm looks to attract more to mobile options. The division also plans to significantly expand its over 5,000 branches by nearly 10 percent in the coming years. Services provided by the division include: traditional banking, business banking, mortgages, credit cards, auto loans, and merchant processing services for businesses accepting credit cards. The credit card business at Chase increased new accounts by 20 percent in 2016, but sales volume only increased 10 percent. This was possibly due to the new Chase Freedom Unlimited card and the Amazon Prime card. Chase's new Sapphire Reserve credit card exceeded the annual target of customers in only 2 weeks, but the average customer has a FICO score above 785 with deposit including stock investments in excess of $800,000. Auto loans and mortgages were up 16 and 14 percent, respectively, in 2016, with foreclosures down 36 percent.

Corporate & Investment Bank

The Corporate & Investment Bank is the second largest division at JPM with 2017 revenues in excess of $34 billion. The division reported record profits of $10.8 billion in 2016, up 34 percent from 2015. They did not increase profits in 2017, but maintained profits at $10.8 billion and saw revenue drop $700 million. The relatively flat increases in revenues and profits for the division is partly explained by the flat year of mergers and acquisitions in 2016, which JPM suggests was even lower than 2015. The bank still completed more merger and acquistion (M&A) deals in 2016 than any other U.S. bank and was number-two in global deals created. The division predicts emerging markets will account for over 70 percent of worldwide GDP growth up from 40 percent currently. In addition to specializing in M&As, the division is also the leader of debt capital for U.S. nonprofits, governments, states, universities, and municipalities—extending $90 billion to these clients in 2016. The division led over 340 equity underwriting deals for IPOs in 2016, making it the only global bank to gain market share during this difficult time period.

Commercial Banking

Commercial Banking enjoyed record revenue in 2017 of $8.6 billion, up from $7.5 billion in 2016, accompanied by a record net income of $3.5 billion, up 29 percent from 2016. The division invested more than ever before in 2016 in technology, data, and other key capabilities with plans to devote increased capital to wholesale payment platforms, data, and technology moving forward. The Commercial Banking division has a partnership with the Corporate & Investment Bank division at JPM, working on various issues together. In 2016, the firms worked to launch new digital platforms designed to aid small- to medium-sized companies. The division plans to focus on market penetration by opening offices in eight new markets. The division focuses on business banking for small- to medium-sized firms, and offers many of the same services as the Consumer & Community Banking division, rather targeted at businesses.

Asset & Wealth Management

This division enjoyed $900 million in revenue growth in 2017 accounting for a 7.5 percent gain and profits of $2.3 billion. With direct relationships with 60 percent of the largest pension funds, wealth funds, and central banks in the world and 50 percent of the wealthiest individuals, the division is well positioned to serve large customers. However, the Asset & Wealth Management division also provides advice to over 1 million U.S. families through Chase Wealth Management, balancing out the division with a wide range of customers in various economic positions. The division grew its office spending by 14 percent and retained over 95 percent of its top talent.

Competitors

JPM has over 5,000 competitors, ranging from hundreds of small local banks to multinational peers such as Bank of America and Wells Fargo, that are compared to JPM in Exhibit 5. There is a notable difference in net incomes and the resulting EPS ratios. JPM has a higher market cap, more revenue, net income, and a significantly larger EPS than both its top rivals.

Bank of America Corporation (BAC)

Bank of America serves individuals, businesses, institutional investors and large corporations and governments worldwide on a variety of financial needs. The company traces its roots back to 1904 and is headquartered in Charlotte, North Carolina. With over 209 thousand employees, Bank of America reported 2017 revenues in excess of $87 billion. The company operates in over 35 countries and all 50 U.S. states with a footprint that includes 80 percent of the U.S. population. Bank of America has over 16,000 ATMs and 34 million accounts with 25 million mobile users and 5,500 branches.

The company serves over 3 million small business owners and is considered the global leader in investment banking and trading. By some metrics, Bank of America is the second largest bank in the United States. The organization is made up of Bank of America, Merrill Lynch, US Trust, and Bank of America Merrill Lynch and offers eight lines of businesses. These include retail, preferred and small business, Merrill Lynch Wealth Management, and US Trust for individual consumers. For companies, they offer businesses in business banking, global commercial banking, and global corporate and investment banking. For institutional investors, global markets are provided. Investment management, brokerage, banking, trust, and retirement products are many of the services that are provided to their customers.

Wells Fargo & Company (WFC)

Founded in 1852, Wells Fargo today has assets that total over $1.9 trillion. The company offers banking, insurance, investments, mortgage, and consumer and commercial financial services. They provide their 70 million customers with over 8,400 locations, 13,000 ATMs, online and mobile support. Wells Fargo has 286,000 employees in 42 countries around the world. They rank third in total deposits, third in total assets, fifth as the biggest public company in the world, and

EXHIBIT 5 Comparing JPM with Two Rival Companies

	JPM	Bank of America	Wells Fargo
$ Market Cap.	398B	331B	322B
# Employees	253K	209K	263K
$ Revenue	99.6B	87.4B	94.1B
$ Net Income	24.4B	18.2B	21.9B
$ EPS Ratio	6.31	1.56	4.10
$ P/E Ratio	18.39	20.63	16.08

Source: Based on a variety of sources.

twenth-fifth as the biggest company by revenue in the United States. They have numerous innovated rewards and have been selected as number-one in overall mobile performance, functionality, ease of use, quality and availability, and best app and mobile web experience. Wells Fargo has been the number-one largest workplace employee giving campaign in the United States for 8 consecutive years. They are also considered the number-one retail mortgage lender.

One of the largest acquisitions in banking history in 2008 was the Wells Fargo acquisition of Wachovia, giving this California-based bank an increased presence on the east coast, much like Bank of America's acquisition of NationsBank.

External Issues

Industry Overview

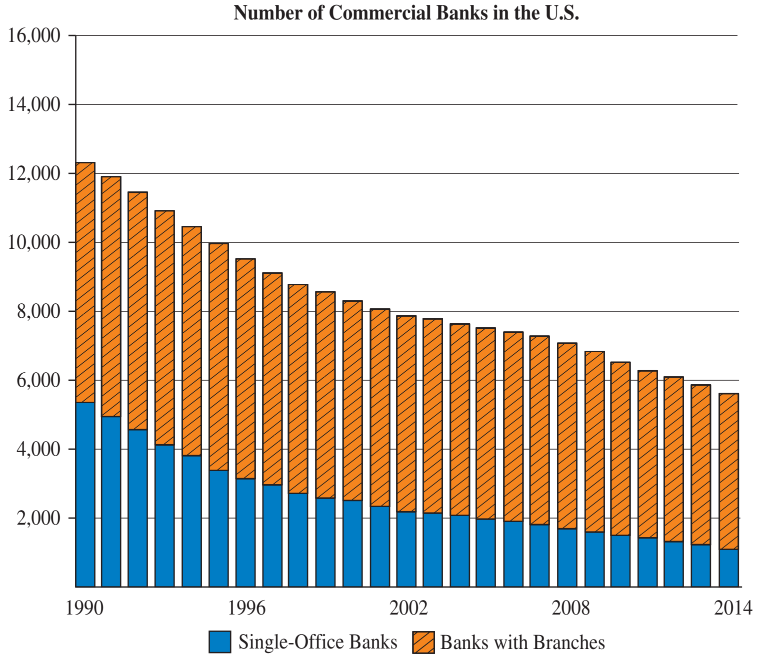
The banking industry in the last decade has experienced a decline in the number of branch locations that each banking organization owns. As indicated in Exhibit 6, the number of commercial banks with branches in the United States was over 14,000 from 1975 to 1985. This number fell to less than 6,000 in 2014 and has since fallen to just over 5,000 in 2017. Single office banks declined from 10,000 down to less than 2,000 from 1966 to 2014. The decline has been brought upon because of rapid technological advancements. The ease of doing mobile deposits and transfers without having to go to a branch has persuaded customers to demand more online banking offerings. Many banks now offer more convenient hours to service their customers.

The increase in mobile and online banking has brought upon other issues such as cybercrime. Cyber criminals today can more easily steal one's identity and money from a financial institution. This has created bigger challenges for banks to come up with better ways of protecting the customers' money.

Banking Industry Services Breakdown

The banking industry is categorized into several distinct areas which mirror the four divisions JPM operates under. Top industries within the U.S. banking industry include: Commercial Banking, Credit Card Issuing, Investment Banking, Securities Brokering, and Financial Planning. The commercial banking industry includes over 5,000 competitors in the U.S alone. Annual revenues total over $575 billion with profits of over $120 billion. Growth has been slow at around 1 percent but with the widening of the yield curve, growth is expected to increase to over 2 percent through 2023. The industry offers real estate loans, deposit services, commercial

EXHIBIT 6 Number of Commercial Banks in the U.S.



Source: Based on a variety of sources.

loans, credit card loans, and other products. Of the $575 billion in industry revenues, deposits account for approximately $200 billion and real estate loans account for just over $100 billion of revenues. Deposits include traditional bank accounts and retirement accounts.

Banks make money on various fees and lending money to others at higher rates than they are paying the depositor. Income from customer deposits and fees on "everything" are the lifeblood of the overall banking industry. This industry most closely aligns with JPM's Consumer & Community Banking Division.

JPM is active in the credit card business, issuing new cards in 2016 including the Chase Sapphire Reserve and Chase Freedom cards. The credit card business has grown around 1.5 percent recently with annual growth nearing 3 percent through 2013, as forecasted. Only 7 percent of profits in this industry are derived from fees charged to the cardholder including: annual fees, late payment fees, non-usage fees, and other fees. With increased competition, charging annual fees may become a revenue stream of the past moving forward. Far and away the largest segment of income for credit card firms is interest income, accounting for around 60 percent of all income. The remaining balance of 33 percent is mostly derived from fees charged to merchants when customers use their card. There is increased competition among credit card issuers to attract new customers with cards that return increased points or bonuses for spending, which in turn have higher fees on the merchant that are in excess of the points provided to the buyer. For now, this strategy has worked well for banks, but large merchants such as Walmart and other major players have tremendous bargaining power, and can even create their own cards and possibly even become a "bank" themselves if credit card fees become too high. For example, in 2018, Starbucks and Chase released a new Starbucks Visa Card. But for now, firms like JPM continue to offer cards with attractive rewards as a means to attract customers and increase their revenues from fees charged to merchants.

The investment banking and securities business in the United States is a $130 billion industry with profits of $38 billion and growth through 2023 expected around 2.8 percent. Underwriting services on both debt and equity account for 35 percent of industry revenues. The large investment banks often serve as middlemen for firms looking to raise capital through both mediums. Advising fees for direction on mergers, divestitures, restructurings, and other such activities account for 22 percent of revenues, along with trading related services also accounting for 22 percent of industry revenues. Trading services include fixed income services, futures exchanges, stock trading, and other activities generally for large volume clients. JPM has a few different competitors in this industry along with Bank of America, Morgan Stanley, Citigroup, and Goldman Sachs; all are large competitors with market shares between 9 and 11 percent. JPM is the market leader with a 12 percent market share with Bank of America having a 10 percent market share.

Securities brokering and financial planning are other key industries in the banking industry accounting for over $200 billion in 2016 revenues. The key competitors are Bank of America and Wells Fargo.

Increased Consolidation

Between 2015 and the middle of 2017, 23 bank mergers in the United States were announced accounting for $300 billion in assets, with 10 of these deals announced in the first half of 2017. Banks are not simply buying smaller local banks, but increasingly are looking to purchase online banks. JPM lost a bidding war with Vantiv to acquire Worldpay for $10 billion. Much of the acquisition activity is expected to be among mid to smaller banks moving forward, as the top four banks in the United States are near the FDIC deposit limits. This however, will not seriously impact the four largest banks from acquiring other financial players who offer services not directly tied to deposits.

Regulations

Following the 2007 to 2009 financial crisis, in 2010, then president Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act 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 where 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-sized 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.

There is increased hope today within the banking industry that President Trump will increasingly deregulate the industry in hopes of accelerating growth. As of early 2018, no major deregulation changes have been enacted, however, Treasury Secretary Mnuchin and Federal Reserve Chair Janet Yellen support adjustments to many of the current regulations placed on banks. Key regulators of banks include the Federal Reserve System (Fed), Federal Deposit Insurance Corp. (FDIC), Office of the Comptroller of the Currency (OCC), Consumer Financial Protection Bureau (CFPB), and state regulatory agencies.

Annual Stress Test

Large banks in the United States are subject to an annual stress test performed by the Federal Reserve System to ensure banks are able to better handle adverse market conditions, such as the ones experienced during the recession in 2009. The shakedown includes probing dividend payments, lending activities, and stock repurchases. In 2016, all 34 banks under the stress test protocol passed the test, hopefully ensuring they are able to lend and operate even during a global recession. A side benefit from the recent passing of all 34 banks, the Fed has allowed banks to increase their dividends and repurchase shares.

Future

As Wells Fargo stumbles, JPM is capitalizing on their rival's weakness. For Q1 2018, JPM reported net revenue of $28.52 billion, up from $25.754 billion in Q1 2017; JPM's Q1 2018 net income was $8.712 billion, up from $6.448 billion in Q1 2017. Also for Q1 2018, JPM reported that their client investment assets of $276 billion were up 13 percent from the prior quarter, while the company's credit card sales volume increased 12 percent and credit card merchant processing volume increased 15 percent.

A recent *Wall Street Journal* article (February 28, 2018, p. B14) revealed that JPM plans to open 400 new bank branches over the coming 5 years, while entering 15 to 20 new markets (cities). For all of 2017, JPM increased its commercial and industrial loan balances by 8 percent, compared to 1 percent growth for all commercial banks. Marianne Lake, JPM's CFO, says the company will keep buying back its own stock, even though the stock price increased 31 percent in 2017, compared to a 20 percent increase for all Nasdaq banks.

Both JPM and Bank of America believe that to bring in disgruntled Wells Fargo customers the companies needs new branch offices. JPM already has branches in 23 states, but lacks branches in some key areas such as Philadelphia, Boston, and Washington, D.C. Similarly, Bank of America is opening more than 500 branches between 2018 and 2021, led by substantial growth in Cincinnati, Cleveland, and Columbus, Ohio. Both JPM and BOA are also closing branches in some areas, so the net effect of new brick-and-mortar branches will likely stay even for each company over the next few years.

JPM needs a clear strategic plan to maintain, and hopefully improve, its excellent financial performance as reported in 2017.

PPB Group Berhad—2022

www.ppbgroup.com

Headquartered in Kuala Lumpur, Malaysia, PPB Group Berhad (PPB) is a conglomerate with a wide range of businesses that includes food production, agriculture, waste management, and movie cinemas. FFM owns and operates the largest flour milling business in Malaysia and has a total milling capacity of 2,550 megatons daily. Flour and animal feed–milling is PPB's largest revenue generating segment and includes FFM Berhad, an 80-percent-owned subsidiary of PPB. FFM is also a large animal-feed supplier in Malaysia and operates mills in Vietnam, Thailand, and China.

Another subsidiary of PPB is Golden Screen Cinemas (GSC), the largest cinema chain in Malaysia and a distributor of Chinese, English, and various foreign-language films to cinemas and television channels in the region. Another subsidiary still, Chemquest, provides water treatment and waste-management solutions for cities and communities in Malaysia. PPB is also in the property management and investment business through its subsidiary Hartabina, which owns and manages the Cheras Leisure Mall and Ceras Plaza in Cheras and the New World Park in Penang. Through Hartabina, PPB is also involved in developing Puteri Harbour and Iskandar Malaysia. PPB also owns about 20 percent of Wilmar International, a Singapore-based company that is the largest palm-oil trader in the world.

Having diversified operations throughout Southeast Asia, PPB needs a clear strategic plan for the best allocation of its available resources across its numerous endeavors, products, and regions.

History

PPB was founded in 1968 in the northern Malaysian state of Perlis as Perlis Plantations Berhad (hence the derivation of its current name) by Robert Kuok, who wanted to cultivate and mill sugarcane. A closer precursor to PPB was the rice wholesaler business Robert Kuok and his brother Phillip opened in Malaysia in 1948, after which they soon began acquiring sugar plantations. The two brothers then founded Federal Flour Mills (FFM). By the end of the 1960s, the Kuok brothers controlled an estimated 10 percent of the world's sugar supply, earning them the nickname "the Sugar Kings." In 1972, PPB went public and initiated substantial business in Singapore. PPB divested its sugar business in 2009. Today, PPB is highly diversified, but its main business is to supply flour to downstream food-producers primarily through FFM. The Kuok family in Malaysia retains control of the company with a 50.8 percent shareholding.

Vision and Mission

PPB's vision and mission statements are overly broad and leave the reader with little knowledge of the firm's business. The firm may be better off with a clear focus from both the vision and mission to guide its business operations. The vision and mission statements can be viewed in the annual report available at the company's website, in the "Financial Performance" section: www.ppbgroup.com.

Vision Statement

The PPB vision statement, given on the corporate website, describes its goal as becoming a market leader in its core businesses by delivering quality products and services.

Mission Statement

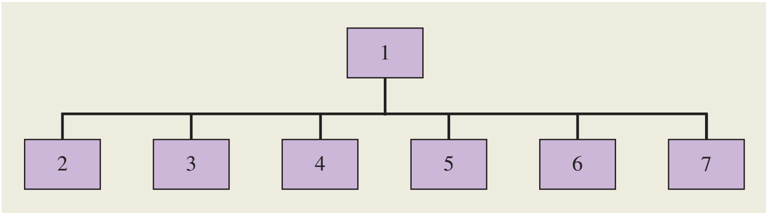
The PPB mission statement, given on the corporate website, lists three objectives, which are to be achieved with social and environmental responsibility: reinforcement of its leadership position in Malaysia, regional expansion, and investment in activities that facilitate these goals.

Internal Issues

Organizational Structure

PPB appears to function with a centralized organizational design as their 2020 *Annual Report* does not list presidents of segments as being top executives. The top executives of PPB are listed and arrayed in Exhibit 1:

EXHIBIT 1 **PPB's Top Executives**



1. Lim Soon Huat, Managing Director of PPB Group
2. Jeremy Good Kin Wai, Director and General Manager of FFM
3. Low Eng Hooi, CEO of PPB Properties
4. Yap Choi Foong, CFO of PPB Group
5. Ir Leong Yew Weng, Managing Director of Chemquest Sdn Bhd
6. Koh Mei Lee, CEO of Golden Screen Cinemas, and Head of Corporate Affairs, PPB Group
7. Amanda Oh Sok Tuan, Chief Human Resources Officer, PPB Group

Source: Based on information in PPB's 2020 *Annual Report,* pp. 67–70.

Some analysts would content that PPB should revise its organizational structure to become more decentralized, thereby delegating more effective accountability and responsibility for each segment to a president of those operations. An alternative design would be divisional-by-region, but this would likely necessitate too much varied competencies across too many products. However, a structure based on strategic business units (SBUs) could serve the company well moving forward.

Finance

Exhibit 2 reveals the income statements for PPB (RM stands for ringgit Malaysia; ringgit is the Malaysian currency). Note a large drop in revenues—blamed mostly on the closure of many theater businesses during 2020—but a large increase in net income during 2020. It is interesting to note that the revenues provided align closely with the business segments of Grains & Agribusiness, Consumer Products, Film Exhibition & Distribution, and Environmental Engineering & Utilities and Property. However, the corresponding net income derived from these segments does not match the reported net income on the income statements. According to the *Annual Report*, PPB has many subsidiaries located in China that focus on Grains & Agribusiness, and it is possible that the net income from these businesses is reflected in the line item non-recurring events. However, in the case of PPB, these events can be expected to recur provided the terms of the subsidiaries remain. These businesses are hinted at in the "Other Business" discussion in the Segments section.

Exhibit 3 reveals the firm's balance sheets. Of particular interest is the current ratio of nearly 3.2 and cash totaling more than plant property and equipment. The firm also has relatively low long-term debt, low goodwill, and even low inventory levels. All can be viewed as attractive depending on aspirations of the firm and the strategic path it is undertaking.

Segments

Grains & Agribusiness: Flour Milling

PPB's Grains and Agribusiness segment operates through FFM Berhad, which is an 80-percent subsidiary of PPB with four principles businesses: 1) Flour Milling, 2) Animal Feed Milling, 3) Livestock Farming, and 4) Organic Fertilizers. In total, this segment experienced a revenue

EXHIBIT 2 PPB's Income Statements (in thousands of RM)

Income Statement	12/31/19	12/31/20		Percent Change
Revenues	$4,683,776	$4,190,690	↓	–11%
Cost of Goods Sold	4,053,680	3,760,894	↓	–7%
Gross Profit	630,096	429,796	↓	–32%
Operating Expenses	359,308	326,886	↓	–9%
EBIT	270,788	102,910	↓	–62%
Interest Expense	33,814	28,683	↓	–15%
EBT	236,974	74,227	↓	–69%
Tax	72,366	57,511	↓	–21%
Non-Recurring Events	1,034,654	1,346,706	↑	30%
Net Income	1,199,262	1,363,422	↑	14%

Source: Based on PPB's 2020 *Annual Report*, pp. 90–91.

EXHIBIT 3 PPB's Balance Sheets (in thousands of RM)

Balance Sheet	12/31/19	12/31/20		Percent Change
Assets				
Cash and Short Term Investments	$1,500,909	$1,420,341	↓	–5%
Accounts Receivable	752,164	768,361	↑	2%
Inventory	802,513	658,626	↓	–18%
Other Current Assets	95,338	147,034	↑	54%
Total Current Assets	3,150,924	2,994,362	↓	–5%
Property Plant & Equipment	1,337,417	1,320,984	↓	–1%
Goodwill	73,704	71,201	↓	–3%
Intangibles	9,202	7,704	↓	–16%
Other Long-Term Assets	19,008,510	20,489,407	↑	8%
Total Assets	23,579,757	24,883,658	↑	6%
Liabilities				
Accounts Payable	647,363	367,732	↓	–43%
Other Current Liabilities	438,000	565,954	↑	29%
Total Current Liabilities	1,085,363	933,686	↓	–14%
Long-Term Debt	232,072	264,768	↑	14%
Other Long-Term Liabilities	131,531	138,759	↑	5%
Total Liabilities	1,448,966	1,337,213	↓	–8%
Equity				
Common Stock	1,429,314	1,429,314	↓	0%
Retained Earnings	17,180,017	18,012,433	↑	5%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	3,521,460	4,104,698	↑	17%
Total Equity	22,130,791	23,546,445	↑	6%
Total Liabilities and Equity	**23,579,757**	**24,883,658**	↑	**6%**

Source: Based on PPB's 2020 *Annual Report*, pp. 92–93.

reduction of less than 1 percent in fiscal 2020, but profits were up 28 percent due to lower raw material cost and a higher share of profits from associates. The segment generated 76 percent of fiscal 2020 revenues and 19 percent of profits. For the purposes of this case and to avoid confusion, PPB will be used throughout, as they are the parent company and the majority owners of FFM Berhad.

The flour-milling business has a Malaysian capacity of over 2,800 metric tons daily, operating through 5 flour mills strategically located in Malaysia, making it Malaysia's largest flour miller. It also has 2 flour mills in Vietnam, 1 in Thailand (with a capacity of 670 metric tons per day) through a 43 percent stake in Kerry Flour Mills Ltd., and 1 in Indonesia. In addition, PPB controls a 20 percent stake in 9 associates in China, with a combined capacity of 17,550 metric tons a day, resulting in a controlling stake in China overall (as opposed to all flour mills in the country) that exceeds the firm's production output in its home market of Malaysia. However, it appears data from China may not be included in the financials of this segment on the *Annual Report.*

The mills generate many products from the wheat flour, including bread, noodles, biscuits, and cakes. In addition, several of the flour products are considered specialties, such as whole meal or semolina, while other flour products are marketed as improvers or premixes for bread and cakes. By late 2021, PPB expected to double its capacity in the production of flour in Vietnam.

Grains & Agribusiness: Animal Feed

In 1981, PPB entered the animal feed business with a modest capacity of 10,000 metric tons of feed annually, but today this business has a capacity of over 2,200 metric tons per day across 5 mills in Malaysia, making the firm a major provider of feed in the country. The different types of feed are marketed under the brand names Friendship and Five Rings and available in three distinct forms: mash, crumble, and pellet. Products are tailored to meet the individual diets of the intended animals, which include broilers, poultry, duck, ruminants, quail, and rabbit. PPB is currently saving costs by including lower-cost feed ingredients in its products.

Grains & Agribusiness: Livestock Farming

In 1993, PPB forward integrated into broiler day-old chicks and eggs. Under the brand name "Swarney Select," PPB is able to produce over 3 million day-old chicks every month in 2 farms located in Malaysia. The farms are both closed-housing facilities, which limits the spread of diseases commonly associated with raising poultry. The firm's chicken farms have the capacity to produce 20 million eggs a month and are marketed under the brand names Seri Murni, Seri Murni Fresh Eggs, and Seri Murni Premium Eggs. Over 2020, this segment explored new markets and sales channels, including new ways to brand existing products. Historically, Malaysia has one of the highest poultry and egg consumption populations in the world per capita. However, this business is a difficult one in Malaysia because of overproduction, cheaper imported frozen chicken, and governmental price controls on chicken during holiday seasons. With the rise in government regulations and as independent farmers join cooperatives, the pressure on raising poultry continues to rise.

Grains & Agribusiness: Organic Fertilizers

Composted chicken manure is a byproduct of raising and growing chickens, enabling PPB to also produce organic fertilizer. Bags are sold under the brand name Organic in 25-kilo quantities, which suggests untapped potential for smaller-volume customers.

Film Exhibition and Distribution

The Film Exhibition and Distribution (FE&D) segment of PPB includes the following activities:

1. Film Exhibition: Golden Screen Cinemas (GSC) has 339 screens at 33 locations in Malaysia, plus 18 locations and 108 screens in Vietnam.
2. Film Distribution: GSC Movies Sdn Bhd distributes films and TV shows in Malaysia, Brunei, Vietnam, Myanmar, and Cambodia.

GSC's 33 theaters and 339 screens in Malaysia make it the leading movie provider in the country. A 40-percent stake in Vietnam-based Galaxy Studio extends PPB's movie theater business to this key regional market. Financial results associated with this division were likely harmed by COVID-19 more than any other segment of PPB as box office revenue dropped by 85 percent in Malaysia (and 71 percent in the global film industry). Golden Screen Cinemas has started selling merchandise on Keepsake, an in-house platform for e-commerce, and is even delivering snacks and movie treats to customers unable to visit the theaters in person. For the long-term, GSC is optimistic the industry will continue to grow and be profitable. Reducing its dependence on Hollywood, the firm is forward integrating to co-produce its own movies, made in Malaysia. The new Happy Food Company concept being rolled out across its theaters provides customers with new and exciting food and beverages to enjoy while watching the movies. In 2020, MBO, formerly the third largest cinema in Malaysia, was purchased by GSC, adding 26 cinemas to the GSC line if they choose to keep all of MBO's properties in operation.

Environmental Engineering and Utilities

Through its subsidiaries, PPB is a leading firm in water and sewage management in Malaysia. For the long term, PPB is attempting to focus increasingly on cutting costs in the utilities segment through operational efficiency tactics, improvements in technologies, and working more closely with project management teams.

The Environmental Engineering and Utilities (EE&U) segment of PPB is led by the Chemquest Group, in which PPB has a 55-percent equity interest. This segment includes 1) water engineering, 2) solid waste management, 3) sewage treatment, and 4) flood mitigation.

Consumer Products Segment

Many consumers in Southeast Asia will recognize brands owned by the Consumer Products Segment of PPB. Currently, the products sold include bakery items, edible oils, and chilled and frozen foods, which reach over 42,000 retail locations in Malaysia, served through 13 warehouses. Massimo, one of the more notable PPB brands, specializes in bakery items. During 2020, PPB acquired BRF Foods GmbH, a processed-food manufacturer. PPB is currently seeking to increase brand awareness and effect a slow shift toward providing more packaged and canned products, particularly flour and frozen food, as demand for them is projected to grow. Two notable products introduced in 2020 are the Massimo Primo Sandwich Bun and Massimo Favorito Lemon Krunch Cream Roll.

Property Segment

PPB's vision within the Property Segment is to continue to provide customers with trusted property options that will improve local communities. Many of the properties in development are high-rise buildings such as the Cheras Leisure Mall, The Whiteways Arcade, and the most recent property, the Megah Rise, a condominium with 228 apartments and retail space. Currently, managers of this division are increasing its online shopping options, and the long-term plan is to acquire further land to develop both commercial and residential properties, with a focus on high-rise style buildings to save space. This segment is focused entirely on Malaysia.

Investments and Other Operations

This segment of PPB includes diverse operations under the following headings:

1. Investment Holding & Trading: Chemquest Sdn Bld and Malayan Adhesives and Chemicals Sdn Bld
2. Investment Holding: Masuma Trading Company, Hexarich Sdn Bdh, Orion Fund Pte Ltd., and Orion Fund II Pte Ltd.
3. IT Services: Eat (M) Sdn Bhd, Enterprise Advanced System Intelligence Pte Ltd., and Easi Ticketing Sdn Bhd
4. Integrated Agribusiness: Wilmar International Limited

Exhibit 4 shows PPB's revenues and profits by segment. Note that data is not provided for investment and other operations, and a large percentage of the firm's income could be derived from the Investments and Other Operations segment. The two largest and most significant segments are Grains & Agribusiness and Film Exhibition & Distribution.

Exhibit 5 reveals that Malaysia accounts for 68 percent of PPB's 2020 revenues, but revenues were down over most regions in 2020. The Vietnam region enjoyed an increase of 12 percent in revenues, which also correlates to this region being the fastest-growing country in the region by some measures.

EXHIBIT 4 PPB's By-Segment Revenues and Profits in 2020 (in millions of RM)

Segment	Revenue	%	Change	%	Profit	%	Change %
Grains & Agribusiness	3,300.0	76	Down	1	271.7	19.0	Up 28
Consumer Products	628.3	15	Up	1	31.5	02.0	Up 4,900
Film Exhibition & Distribution	114.3	03	Down	80	135.6	09.0	Down 100
Environmental Engineering & Utilities	189.5	04	Down	3	14.4	01.0	Up 28
Property	67.0	01	Up	4	3.9	00.3	Down 72

Source: Based on information in PPB's 2020 *Annual Report*, pp. 2–10 and 15.

EXHIBIT 5 PPB's By-Region Revenues and Profits in 2020 vs. 2019 (in thousands of RM)

Region	Revenue 2019	Revenue 2020	% Change
Malaysia	3,216,785	2,806,432	Down 12.8
Indonesia	745,712	651,867	Down 12.6
Vietnam	488,916	545,477	Up 11.6
Other ASEAN countries	176,829	126,806	Down 28.3
Other Asian countries	13,032	18,950	Up 45
Others	42,502	41,158	Down 3.1
Total	4,683,776	4,190,690	Down 10.5

Source: Based on information in PPB's 2020 *Annual Report*, p. 164.

Strategy

PPB is a leading Grain & Agriculture business in Southeast Asia as well as a leading business in cinemas. Unfortunately, the firm's Environmental Engineering & Utilities and Property segments do not generate significant revenue. PPB's second largest revenue generating segment is its Consumer Products. Recall that the firm did not have a clear vision or mission statement and may be conducting business in areas it should avoid. PPB has aggressively acquired other cinema retailers and is actively adding capacity in milling and grains. According to the *Annual Report*, the firm plans to expand its property business with malls and condos.

External Issues

Southeast Asia Region Snapshot

The Association of Southeast Asian Nations (ASEAN) was established in 1967 to promote economic growth and stability in the region. ASEAN has 10 member states, but 6 countries account for most of the growth and vitality of the organization: Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. The growing macroeconomic climate in most Southeast Asian countries is spurring a change in eating habits as there are more and more middle-income and upper-middle-income consumers who seek more Western foods like pasta and baked goods rather than a traditional diet dominated by rice.

ASEAN Countries

Singapore is a republic of 5.7 million people and one of the world's busiest transportation hubs for container ports. Singapore's international airport has over 5,000 weekly flights, and this country is often ranked as the best in the world for ease of doing business. The people of Singapore are a mix of Chinese, Malay, Indian, and Eurasian; they are generally highly educated and excellent businesspersons. Singapore's GDP is forecast to grow annually by 2.3 percent through 2024.

With a population of about 270 million, Indonesia is composed of 17,000 islands, including Java, Sumatra, Kalimantan, Sulawesi, Papua, Bali Lombok, and Komodo. Indonesia offers an excellent business environment and a stable political system. About 60 percent of the country's population and economic activity are on the island of Java. The capital of Indonesia is Jakarta, but there is an ongoing debate in the country about moving the capital from an overcrowded Jakarta to Borneo, in the eastern part of the country. President Joko Widodo says the new capital of Borneo will be very modern and green, and the move is likely to come to fruition in the year 2024. Indonesia's GDP growth is forecast to reach 5.1 percent by 2024, as a steady decline in the unemployment rate is fueling consumption of products and services. The expansion of special economic zones (SEZs) is also benefiting the economy and all Indonesians.

Indonesia is spending Rp 466 trillion (about $33 billion) to move all government offices, the military, police, and parliament to Borneo. However, Jakarta will remain the country's financial and commercial centerpiece. Indonesia has about 30 flour-milling companies with a production capacity of about 15 million tons of flour.

The Philippines offers potential businesses and tourists a population of about 110 million and a rapidly growing consumer market. Filipino employees are known worldwide for their proficiency in English and their professionalism, work ethic, persistence, determination, and technical skills. The Philippines's capital is Manila, but the most populated city is Quezon City, and the largest island is Luzon, followed by Mindanao. GDP growth in the Philippines is estimated to be 6.2 percent up to 2024 as the country's labor market conditions are spurring consumption.

With Bangkok as its capital, Thailand is an economically and politically stable country with about 70 million residents. Tourism accounts for about 20 percent of Thailand's GDP, which is estimated to be 3.2 percent up to 2024 as the country continually encourages capital formation and investment.

With a population of about 100 million people, Vietnam has transformed in the last 10 years from one of the poorest nations in the world to a rapidly growing place to do business. Unlike many countries in the region, Vietnam allows 100 percent foreign ownership of businesses in most sectors. Vietnam is rapidly building highways and seaports and offers relatively low tax rates and other incentives for firms to initiate or expand operations in the country. Vietnam's GDP is forecast be about 6.5 up to 2024 due to a robust investment climate and its excellent foreign investment strategies.

Malaysia

Malaysia is arguably the most technologically advanced country in Southeast Asia. Malaysia has the fourth largest economy in the region and the 36th largest economy in the world. Its main industries include electronics, semiconductors, microchips, rubber, oleochemicals, automotives, optical devices, pharmaceuticals, and medical equipment. With a population of about 32 million people, the country's GDP per capita is about $12,000. Malaysian companies export globally, but especially to China, Singapore, Japan, Bangladesh, Hong Kong, Thailand, India, and the United States. Malaysia's GDP growth is forecast to reach 4.4 percent annually by 2024 as the country continually improves its digital infrastructure.

The Malaysian economy contracted 5.6 percent in 2020, primarily due to constrictions on the movement of people because of COVID-19, and the company's cinema business was especially hard hit. The country's ease-of-doing-business rank globally was 12th (out of 190 countries) in 2020. Malaysia also has excellent natural resources and is the world's 11th largest producer of manganese, the 11th largest producer of tin, the 12th largest producer of bauxite, the 19th largest producer of lime, and the 2nd largest producer of palm oil behind Indonesia. Malaysia has proven oil reserves of about 5 billion barrels. Malaysia has an outstanding highway system and rail network and more than 40 paved airports; it also has excellent access to the sea thanks to its location on the Strait of Malacca, one of the busiest shipping lanes in the world. Malaysia's Port Klang and Port of Tanjung Pelepas are the 2nd and 3rd busiest ports in Southeast Asia behind Singapore.

Malaysia offers potential businesses and visitors a well-educated and highly diverse workforce. The country has an excellent digital infrastructure and is a major regional hub for financial, information and communications technology, and logistic sectors. Malaysia is a major tourist destination as well.

Animal Feed

The growth of populations and income levels in Southeast Asia presents a large opportunity for firms engaging in all types of businesses, including agricultural businesses. According to the United States Department of Agriculture (USDA), the region encompassing Indonesia, Malaysia, the Philippines, Thailand, and Vietnam are currently importing soybean meal faster than any region in the world. In fact, according to the USDA, this region as well as Brunei, Cambodia, Laos, Myanmar, and Singapore will import more soybean meal than European Union by 2022, making it the number one importer of soybean meal in the world. Soybean meal is a key component in animal feed, but the region lacks factories that can crush the soybean into animal feed, which is both a major opportunity and a threat. As such, soybean meal accounts for a larger percentage of imports than whole soybeans. The foremost supplier of soybean to Southeast Asia is the United States, with Brazil coming in second. Cheaper soybean has enabled many companies to produce healthier livestock meals for animals. Malaysia, for example, is a country that has no soybean production of its own and must import all soybeans for use. Other nations produce soybeans only marginally. Similar patterns are present with corn as well, with the region being heavily reliant on imports.

Other grains—such as corn—are also rapidly increasing. Indonesia, Vietnam, and Malaysia import more corn than any country other in this region. However, before competitors jump at the opportunity, governments are implementing restrictions on imports. For example, the Philippines has a tariff quota on corn imports, and Indonesia flat out limits the amount of corn that can be imported.

Overall growth is strong in the region. The three wealthiest nations, in order, are Singapore, Brunei, and Malaysia, followed by Thailand, Indonesia, Philippines, and Vietnam. GPD in Singapore is around $12,000, which is double that of Thailand. Most GDP numbers in the region are increasing approximately 3.5 percent, but Vietnam is growing at a faster rate of around 4.5 percent. Consumers in Indonesia, Malaysia, and Thailand tend to prefer chicken over pork (pork is *haram* in Muslim-majority Malaysia), while many of the other nations listed above prefer pork over chicken, especially Vietnam (and China). However, seafood is still the most popular meat in the region.

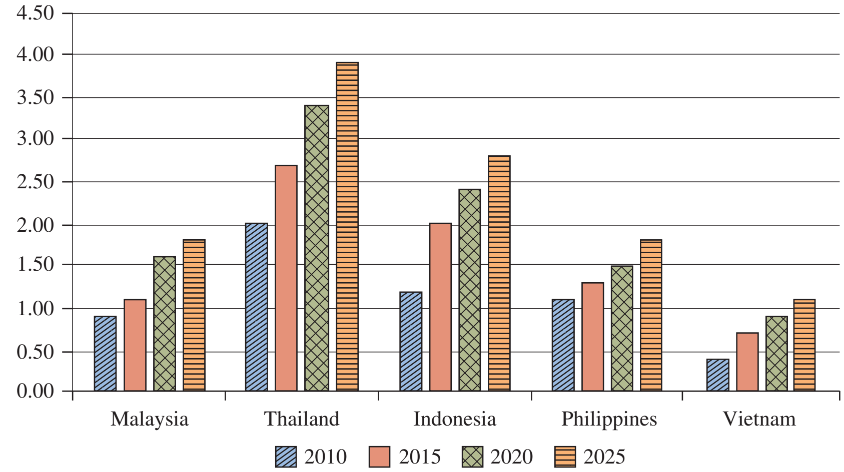
Animal Feed Consolidation

Feed mills globally grew rapidly from 2010 to 2015, from 25,000 to over 32,000, but between 2015 and 2020, they declined by over 12 percent. Feed mills in Asia (including China) peaked at over 5,700 in 2015 and as of 2020 stands around 2,600. Feed demand has perhaps declined the most in China over this period as feed and animal disease reduced the numbers of smaller mills. However, many of the older mills in Southeast Asia did not close, easing productivity in this region. Nevertheless, feed demand declined by perhaps 6 percent in Malaysia, the Philippines, Thailand, and Vietnam in 2020.

Southeast Asia Meat Production

Exhibit 6 reveals poultry production in five key markets in Southeast Asia. Thailand and Indonesia are significantly larger markets than Malaysia on poultry production, but Malaysia has a larger GDP than both nations. A problem for some firms in this region is that competitors based

EXHIBIT 6 Poultry Production in Southeast Asia

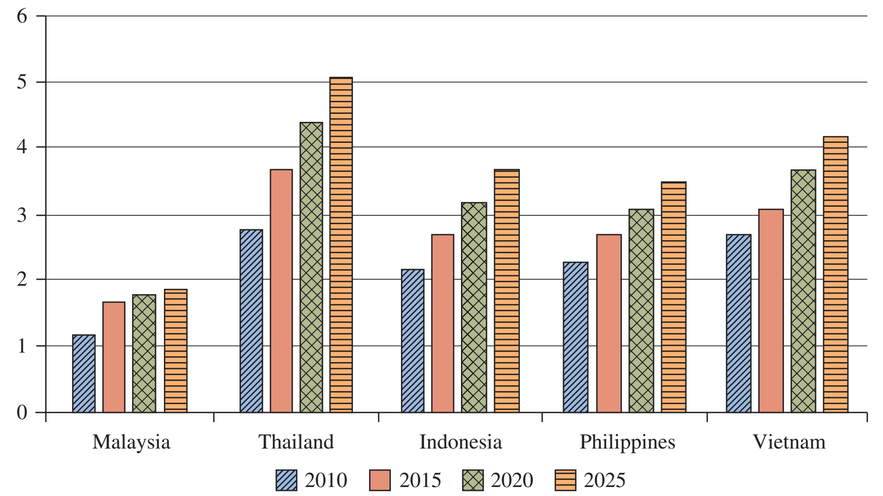


Source: Based on the United States Department of Agriculture Economic Research Service, March 2019.

in nations with lower GPD, such as Thailand, can grow livestock cheaper and even export to richer nations such as Malaysia, where consumers can purchase at lower prices than the domestic chicken. Thailand, for example, is a significant player in the poultry export business (only behind Brazil, the United States, and the European Union), exporting around 0.40 metric tons of poultry in 2010. This rose to 1 metric ton in 2020 and is expected to rise further to 1.4 metric tons by 2028, according to research by the USDA.

Exhibit 7 reveals pork production in the region. It is interesting to note that even in nations such as Malaysia, where chicken is more popular (and not *haram*), pork production actually exceeds chicken production. This is because of large markets for pork exports like China.

EXHIBIT 7 Pork Production in Southeast Asia



Source: Based on United States Department of Agriculture Economic Research Service, March 2019.

Competitors

Cinemas in Malaysia

Rivals of PPB's Golden Screen Cinemas—the largest cinema in Malaysia—include TGV Cinemas and Lotus Five Star. TGV Cinemas, sometimes referred to as TGV Pictures, is the second largest movie theater in Malaysia, with 35 multiplexes and 282 screens. Of the 35 screens, 33 are on Peninsular Malaysia and the remaining 2 are located in Sarawak. The firm has plans to open 4 additional cinemas. TGV is a robust rival offering plush seating and even large seating for families. Children's playrooms are also provided in some locations. Lotus Five Star is a relatively small cinema owned by an Indian firm, operating a total of 13 cinemas in Malaysia.

Animal Feeds and Agribusiness in Malaysia

Although headquartered in Mumbai, India, Godrej Agrovet is a huge animal feed and agribusiness in the Southeast Asia region. Similar to PPB Group, Godrej Agrovet is a market leader in poultry processing, animal feed, and palm-oil production. The company has new automated manufacturing plants for animal feed and could easily expand its operations from India into Malaysia.

Bakeries in Malaysia and Beyond

Headquartered in Singapore but also servicing Malaysia and the Philippines, Gardenia Foods operates bakeries throughout the region. In Malaysia, the company is named Gardenia Bakeries (KL) Sdn Bhd (GBKL) and has bread, snacks, cakes, toasts, and pocket sandwich manufacturing facilities.

The world's largest flour-milling production facility is owned and operated by P.T. Bogasari Flour Mills in Jakarta, Indonesia. This particular manufacturing plant was expanded further in 2020–2021, reflecting the accelerating importance of flour-based products in all of Southeast Asia.

This single plant produces more than 4 million tons of flour annually. An industry insider recently said that the demand for flour-based products will continue to grow about 5 percent annually throughout Southeast Asia. Having about 2,500 workers, Bogasari controls 50 percent market share of the Indonesian flour milling business, down from a high of 70 percent a decade earlier.

Conclusion

Strategy Considerations

Any time a business of any size or type is diversified in its product offerings, effective allocation of available capital and human resources across products and regions is of paramount importance and necessitates excellent strategic planning. PPB is a huge, diversified conglomerate in need of a clear strategic plan to guide decision-making. Should PPB strive to capitalize move effectively on rapidly developing countries in Southeast Asia such as Vietnam? Could PPB's traditional cinema operations survive a renewed pandemic or should the company shift focus to its other businesses or even new business areas? With regard to flour and animal-feed milling and bread production, the demand for such products will increase as the population and tourism levels of various countries increase.

Recall from the case that the firm's mission and vision are likely too general, and consideration should be taken on how both should be altered. Factors to include are how PPB should allocate its resources among segments and whether any segments should be sold off. As there are few mills in the region that can crush soybean, resulting in most soybean being imported as crushed products, should PPB enter the crushed soybean milling business? Should the firm move more operations to Vietnam since labor is cheaper? What is the solution for cheaper chicken from Vietnam underpricing PPB's chicken in Malaysia?

Develop for Lim Soon Huat, Managing Director of PPB Group, a strategic plan that you believe will lead the company to prosperity. Recall from the case that consumption patterns in Southeast Asia in general are moving further away from rice to more flour-based products and this bodes well for PPB if the company can capitalize on such external opportunities. A comprehensive strength-weakness-opportunity-threat (SWOT) analysis and portfolio analysis is needed to facilitate PPB's decision-making moving forward. Be sure to include in your analysis what you feel the firm should be doing, not what they are currently doing or what you think they will be doing after studying the latest news releases (unless, of course, you agree with these strategies). PPB is in desperate need of a clear strategic plan as they service a rapidly growing regional market with multiple product lines that differ significantly.

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Nestlé S.A.—2022

www.nestle.com

Nestlé is headquartered in Vevey, Switzerland, has over 273,000 employees, serves 186 countries, and is the largest food producing company that sells finished, ready-for-consumption food products. In 2020, Nestlé had four times the revenue of Kraft Heinz Company, the second largest food-producing firm in the world. Notable product categories that Nestlé offers include baby food, pet foods, ice cream, chocolate, coffee, frozen goods, water, and weight management products. Top Nestlé brands include Carnation, Coffee Mate, Nescafé, Perrier, DiGiorno, Stouffers, Lean Cuisine, Nesquik, Milo, Haagen-Dazs, Purina pet foods, Butterfinger, Baby Ruth, and Nestlé Toll House, with hundreds more besides. For example, Nestlé has over 70 bottled water brands alone and over 100 chocolate and confectionary brands. Currently, Nestlé is focusing on its premium water business, divesting its U.S. ice cream business to Forneri, and divesting its low-priced water business in the United States.

In fiscal 2020, Nestlé launched over 1,200 new products, and 33 million children benefited from Nestlé's Healthier Kids program. Nestlé is increasingly focusing on organic products, with less emphasis on meat and dairy products as discussed throughout the case. In fact, in 2019, 2.8 billion vegetables portions were added to the company's food and beverages segment, and since 2010, 235 million coffee saplings have been distributed. Nestlé also reports that its emission of greenhouse gases has been reduced by 37 percent since 2010, 50 percent of its electricity is derived from renewable sources, and 368 factories have achieved zero waste. Nestlé continues to promote healthy food and a clean environment while charging affordable prices for its customers.

History

Many people instantly associate Nestlé first with chocolate, but Nestlé's roots are embedded in milk products, in particular baby formula. Nestlé got started in 1866, when the Anglo-Swiss Condensed Milk Company first opened a milk factory in Cham, Switzerland. Nestlé was founded one year later when a German pharmacist, Henri Nestlé, saved a neighbor's child in Vevey, Switzerland, from starvation through a combination of cow's milk, wheat flour, and sugar. Fittingly, Nestlé's logo always has been that of a mother bird feeding her new hatchlings.

More recently, Nestlé diversified into the pet food business in 2001 with its acquisition of Ralston Purina. Nestlé purchased the American baby food giant Gerber in 2007 along with Wyeth Nutrition from Pfizer Nutrition a few years later to strengthen its baby nutrition business. In 2014, Nestlé expanded its Nestlé Skin Health S.A. business to capitalize on the growing trends of global skin care.

In 2014, Nestlé's then CEO Paul Bulcke diversified the company into skin health, having spent $5 billion on acquisitions in 2014 to acquire L'Oreal SA's stake in a joint venture, plus rights to drugs from Valeant Pharmaceuticals International. Nestlé has since divested these businesses.

Food companies like Nestlé reported a slump in frozen-food sales in 2016 because of a move toward "fresh" or "natural" food. Though frozen vegetables are often as wholesome as their fresh counterparts, frozen meals and snacks are widely considered to be full of sodium and other preservatives. In 2016, Nestlé revamped its frozen-food brands Lean Cuisine and Stouffer's.

Vision and Mission

Based on Nestlé's *Annual Report*, the following will serve as plausible vision and mission statements.

Vision Statement

We strive to produce the healthiest and tastiest food with the aim to improve life for everyone on earth, now and for future generations.

Mission Statement

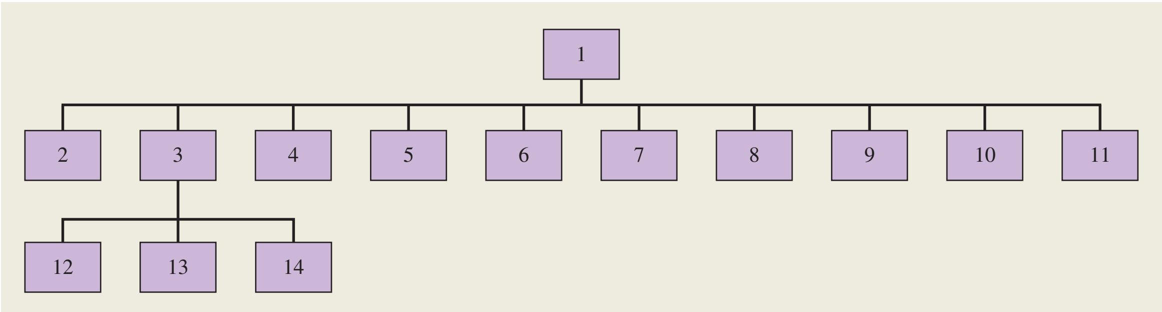
Our philosophy at Nestlé is to hire the most talented scientists and most devoted employees as we strive to provide the most nutritious foods, drinks, and pet foods to our customers. Quality, healthy, affordable foods should be available to everyone around the world. We are committed to controlling costs and conducting business in an ethical way that has a neutral impact on the environment.

Internal Issues

Organizational Structure

Nestlé's organizational structure is based on strategic business units (SBUs) as illustrated at the company website (www.nestle.com/aboutus/management). Exhibit 1 provides a list of Nestlé's top executives along with their titles. Paul Bulcke once served as CEO but is now Chairman of the board. Note that the three SBUs are by region and headed by Marco Settembri, Laurent Freixe, and Chris Johnson.

EXHIBIT 1 Nestlé's Top Executive Team



1. Paul Bulcke, Chairman of the Board
2. Mark Schneider, CEO
3. Magdi Batato, Operations
4. Bernard Meunier, Strategic Business Units, Marketing and Sales
5. Francois-Zavier Roger, Chief Financial Officer
6. Stefan Palzer, Chief Technology Officer
7. Beatrice Guillaume-Grabisch, Head of Group, Human Resources & Business Services
8. Leanne Geale, General Counsel
9. Greg Behar, Nestlé Health Science
10. Sanjay Bahadur, Head of Group Strategy and Business Development
11. David Rennie, Deputy Executive Vice President and Head of Nestlé Coffee Brands
12. Marco Settembri, Executive Vice President, and CEO, Zone Europe, Middle East, North Africa
13. Laurent Freixe, Executive Vice President, and CEO, Zone Americas
14. Chris Johnson, Executive Vice President, and CEO, Zone Asia, Oceania, and sub-Africa

Source: Based on information in Nestlé's 2020 *Annual Report*.

Finance

Nestlé's income statements are provided in Exhibit 2. Note that Nestlé had a difficult year in 2020, with sales down nearly 9 percent. In contrast, rival Hershey reported a sales increase of 2 percent in revenues, General Mills reported a 3 percent increase, and Kraft had a nearly 5 percent increase. Nestlé attributes the decline to COVID-19, an 8 percent appreciation of the Swiss Franc to most currencies, and divestures that added a 4.5 percent decline in sales. A plus for Nestlé is that operating expenses decreased 11 percent, resulting in net income only dropping 4 percent compared to the 9 percent drop in revenues.

Exhibit 3 shows Nestlé's 2019 and 2020 fiscal balance sheets. Note the large portion of goodwill and intangible assets. Nestlé has been active in 2021 acquiring new firms, so bear in mind the new goodwill amount on the 2021 statements and beyond. Is Nestlé overpaying for their acquisitions?

EXHIBIT 2 Nestlé's Income Statements (in millions CHF)

Income Statement	12/31/19	12/31/20	Percent Change
Revenues	92,865	84,681	–9%
Cost of Goods Sold	46,647	42,971	–8%
Gross Profit	46,218	41,710	–10%
Operating Expenses	30,140	26,914	–11%
EBIT	16,078	14,796	–8%
Interest Expense	1,016	874	–14%
EBT	15,062	13,922	–8%
Tax	3,159	3,365	7%
Non-Recurring Events	1,001	1,815	81%
Net Income	12,904	12,372	–4%

Source: Based on Nestlé's 2020 *Annual Report*, p. 68.

EXHIBIT 3 Nestlé's Balance Sheets (in millions CHF)

Balance Sheet	12/31/19	12/31/20	Percent Change
Assets			
Cash and Short-Term Investments	10,263	8,609	–16%
Accounts Receivable	11,766	10,746	–9%
Inventory	9,343	10,101	8%
Other Current Assets	4,291	4,612	7%
Total Current Assets	35,663	34,068	–4%
Property Plant & Equipment	28,762	25,840	–10%
Goodwill	28,896	27,620	–4%
Intangibles	17,824	20,148	13%
Other Long-Term Assets	16,795	16,352	–3%
Total Assets	127,940	124,028	–3%
Liabilities			
Accounts Payable	18,803	18,515	–2%
Other Current Liabilities	22,812	21,207	–7%
Total Current Liabilities	41,615	39,722	–5%
Long-Term Debt	23,132	27,928	21%
Other Long-Term Liabilities	10,331	9,864	–5%
Total Liabilities	75,078	77,514	3%
Equity			
Common Stock	298	288	–3%
Retained Earnings	83,060	76,812	–8%
Treasury Stock	(9,752)	(6,643)	–32%
Paid in Capital & Other	(20,744)	(23,943)	15%
Total Equity	52,862	46,514	–12%
Total Liabilities and Equity	**127,940**	**124,028**	–3%

Source: Based on Nestlé's 2020 *Annual Report*, p. 70.

Segments

Nestlé reports segment data both by seven different product classifications and by three different geographic regions. By product, Nestlé reports that its Powdered and Liquid Beverages segment contributed CHF 22.2 billion in 2020, followed by PetCare with CHF 14 billion. The remaining product lines with their 2020 revenues are shown in Exhibit 4.

Powdered and Liquid Beverages

Nestlé's most profitable segment in terms of 2020 revenues, Powdered and Liquid Beverages, accounts for over CHF 22 billion in sales and represents 26 percent of total sales and a margin of 22.5 percent. Top coffee brands included in this segment are Nescafé, Nespresso, and Starbucks. Another top coffee brand in this segment is Dolce Gusto, which is commonly delivered in pods similar to Keurig coffee. Nestlé claims their Dolce Gusto's New Orleans is the first cold brew coffee of its type. Nestlé has a partnership arrangement with the coffee giant Starbucks whereby Nestlé provides expertise with producing quality instant coffee while Starbucks lends its quality coffee and brand name, creating delicious Starbucks instant coffee in the same manner as Nescafe coffee. Milo, the most popular malt coffee drink in the world is also a Nestlé product. Recently, the Milo brand has extended its product line by including Milo Plant, which uses soy and oats to replace milk as an increasing number of people globally are consuming less meat and dairy products.

PetCare

Nestlé states that as people have better lives when their lives are shared with pets, it is the firm's aspiration to ensure these pets receive the healthiest cost-effective food available. This segment reported sales of CHF 14 billion, with a margin of 22 percent, representing nearly 17 percent of Nestlé sales. Employing over 500 scientists, veterinarians, and other experts in pet care, Purina provides affordable nutrition to pets that enables significantly healthier lives. Purina ONE, Pro Plan, Friskies, and Tidy Cats are all brands owned by Nestlé.

Nestlé is constantly marketing their pet food products heavily to keep pet owners buying. For example, in their *Annual Report*, Nestlé claims to be "disrupting the cat treat segment"; however, reading more about exactly what this disruption entails reveals that Nestlé is simply making cat treats similar to their candy bars, where the treats can be broken into smaller pieces easily, allowing the cat to enjoy the treats for a longer time. Another marketing-oriented message is "providing nature-inspired meals," where natural ingredients such as tuna are used with tomatoes and rice, without artificial colors or flavorings. One key omission from Nestlé's discussion of pet products is the true extent of how much healthier these products are. The developments in the PetCare segment read as a rebranding (or marketing tactics) rather than meaningful changes in nutrition.

Nutrition and Health Science

One of the largest brands within this segment is Gerber, but NAN, Illume, and Cerelac are other blockbuster brands owned by Nestlé. This segment accounts for over CHF 12 billion in sales and represents over 14 percent of corporate sales. Nestlé's NAN supplements are designed as a replacement or supplement for a mother's breast milk. Baby formula Belsol was produced in coordination with Alibaba's innovation center, and Nestlé's *Annual Report* claims that the product is tailored for Chinese babies. BrainXpert is a drink product that, according to Nestlé, is "clinically proven" to increase brain functioning in people with cognitive difficulties, which research says affects about 20 percent of all people over 65 around the world. Other products in this segment focus on food allergies and supporting healthy mitochondria. A common theme across all Nestlé divisions is a push toward marketing heavily and producing products that can be marketed as plant-based.

Prepared Dished and Cooking Aids

Besides the baby food, chocolate, and coffee the brand is widely associated with, Nestlé also owns top brands such as Maggi, Stouffer's, Lean Cuisine, Magic Sarap, Totole cooking sauces, and even DiGiorno. Unlike coffee, where consumption habits around the world are strikingly similar, many of the food items offered here are regional in nature.

Nestlé's Prepared Dished and Cooking Aids segment contributes CHF 11.5 billion in sales and accounts for just under 14 percent of total sales. Like other divisions, Nestlé is marketing heavily plant-based options by offering more veggie pizzas, but new products like veggie burgers and the firm's Sensational Vuna (a plant-based alternative to tuna) require significant R&D and tactical and strategic adjustments—these are much more than simply marketing ploys. In 2021, Nestlé plans to launch a new plant-based Awesome Burger.

Milk Products and Ice Cream

The milk-product segment reported 11 billion in CHF sales, accounting for 13 percent of corporate sales in 2020. Keep in mind from the introduction that Nestlé recently divested its U.S. ice cream business. This segment is an ironic development for Nestlé, as the firm is aggressively marketing less dairy, less meat, and more plant-based products in their other segments while still operating a billion-dollar business within the milk product segment. However, in accordance with the other segments, Nestlé also promotes plant-based alternatives, with notable brands such as Nesfit, Nido, Coffee-mate, nesQino, Carnation, Moca, and La Lechera.

Many of the brands in this segment are regional, targeting a specific group of customers. The regions include the United States, Europe, Japan, and China—these are not small markets by any means. Against a growing number of people worldwide who are lactose intolerant and a more health-minded public, brands owned by Nestlé such as Ninho, Nesfit Sabor Natural, and Carnation all launched plant-based products in 2020. Carnation, a thick, fatty, and sweet condensed milk product, is now offering a plant-based option that—importantly—tastes good.

Confectionery

Nestlé's confectionery segment may be what many people worldwide picture first when they think of the company, yet this segment reported sales of CHF 7 billion in 2020, representing only 8 percent of total sales for Nestlé. Many of the products in this segment are regional and even local brands. One of the reasons is that Nestlé has purchased many successful product lines from local regions and incorporated them in their portfolio; this acquisition strategy continues today. Nestlé is also committed in this segment to providing food options based on plants, with a line of protein bars offering 10 grams of protein derived from plants, mostly from nuts and peas. Of course, within this segment is chocolate, a product perhaps loved more around the world than coffee. However, to keep chocolate exciting, Nestlé often offers chocolate in new formats, including gift boxes and seasonal items designed for religious and national holidays.

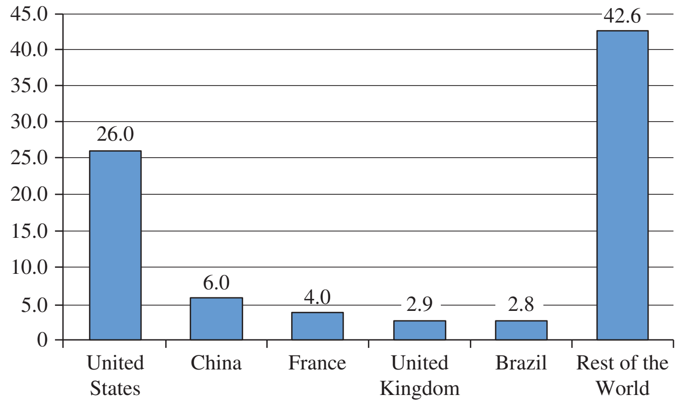
Water

The final segment Nestlé divides its portfolio of products into is water. Consumers may argue about whether S.Pellegrino or Perrier is better, but both are Nestlé products, along with many other local sparkling water brands. This segment has pledged to be carbon neutral by 2025, with S.Pellegrino and Acqua Panna pledging to be carbon neutral by 2022. Of course, this carbon neutrality likely does not include shipping the product to stores, as providing water through a pipeline is still much more economically friendly, both in terms of transporting and packaging. Nestlé is aware of these facts and committed to a waste-free future through recyclable or reusable packaging, and it currently uses recycled plastic in most of its water bottles. Maintaining the plant-based theme, Buxton is a new plant-infused water that blends spring water, plant polyphenols, and minerals with fruit flavors. This segment reported 6.4 billion in CHF sales in 2020 and accounted for 7.6 percent of companywide sales.

By-Region Data

Exhibit 4 reveals the top 5 2020 revenue-generating nations for Nestlé in billions of CHF. Note how large Nestlé's presence is in the United States and how much growth likely remains possible in other regions. For example, the United States generates over four times the revenues as the next largest nation, China. Nestlé's home nation of Switzerland ranks sixteenth in the world, with 2020 Nestlé revenues of CHF 1.1 billion. Global powers Germany and Japan rank eighth and tenth respectively, with CHF 2.4 billion and CHF 1.6 billion in sales, respectively. Remember that Germany, Japan, and Switzerland are included in the "Rest of the World" numbers below. Nestlé reported 45 percent of its revenues were derived from North, Central, and South America; 29 percent derived from North Africa, Middle East, Europe, and Russia; and 26 percent from sub-Saharan Africa, Asia, and Oceania.

EXHIBIT 4 Nestlé's Sales (in billions of CHF)



Source: Based on Nestlé's 2020 *Annual Report,* p. 49.

Exhibit 5 reveals that only pet-care products reported an increase in revenues in fiscal year 2020. This is concerning for Nestlé because key rival firms had an increase in overall revenues in the same year against Nestlé's justifications of COVID-19, the Swiss Franc, and divestures. Recall from the introduction that Nestlé sold its U.S. ice cream business, so this divestiture does explain a large portion of the drop in ice cream revenue. Note that revenues for the milk and ice cream segment dropped over 17 percent from 2019 to 2020 but operating profits jumped 56 percent in 2020, so it appears on the surface that the divesture of the U.S. ice cream business was a strong strategic move for Nestlé. Note as well the high profit margin for water; the firm may not generate significant income from this division relative to others and sales and operating profits may have decreased in 2020, yet the segment is an extremely cost-effective business to operate.

EXHIBIT 5 Nestlé's 2020 Revenue and Trading Operating Profit Breakdown

	2019	2020	Percent Change
Powdered and Liquid Beverages			
Coffee/Coffee Systems	9,144	8,616	–6%
Other	14,077	13,640	–3%
Total Sales	23,221	22,256	–4%
Trading Operating Profits	4,701	4,824	3%
PetCare			
Total Sales	13,622	14,001	3%
Trading Operating Profits	2,741	3,089	13%
Nutrition and Health Science			
Total Sales	14,990	12,160	–19%
Trading Operating Profits	3,092	2,490	–19%
Prepared Dishes and Cooking Aids			
Frozen and Chilled	6,092	5,694	–7%
Culinary and Other	6,096	5,829	–4%
Total Sales	12,188	11,523	–5%
Trading Operating Profits	1,857	2,147	16%
Milk Products and Ice Cream			
Milk Products	10,433	10,087	–3%
Ice Cream	2,835	920	–68%
Total Sales	13,268	11,007	–17%
Trading Operating Profits	1,678	2,615	56%

(*continued*)

	2019	2020	Percent Change
Confectionery			
Chocolate	5,930	5,265	–11%
Sugar Confectionery	722	585	–19%
Snacking and Biscuits	1,236	1,125	–9%
Total Sales	7,888	6,975	–12%
Trading Operating Profits	1,857	2,147	16%
Water			
Total Sales	914	639	–30%
Trading Operating Profits	748	522	–30%

Source: Based on Nestlé's 2020 *Annual Report,* p. 54.

Strategy

Nestlé is in the process of transforming its image from a food company to a health and wellness company. While the company has no plans to stop selling the chocolate, coffee, ice cream and other food products that the firm is world-famous for, it is actively engaged in offering healthier food options to customers. Nestlé has the largest R&D budget of any food company; the firm aims to offer healthier and tastier options right from infant formula all the way to products designed for seniors. Nestlé recently reduced the amount of salt, sugar, and saturated fats in many of its products as a means of improving nutrition while enhancing other flavors so as not to compromise the taste of their products. Pay careful attention to the added flavors section later in the case.

Nestlé has a large portfolio of products globally and is active in shifting its resources around through acquisitions and divesting product lines. In 2020, Nestlé sold its 60 percent ownership in Herta to Casa Tarradellas. In food, Nestlé purchased the Yinlu peanut milk and canned rice porridge business in 2020. With respect to growth, Nestlé is strongly focused on increasing its global growth in water due to its extremely high profit margin. However, in 2021, Nestlé sold its Nestlé Waters North America brands, which included Poland Spring, Deer Park, and Ice Mountain. Most of these waters came with low margins, unlike the expensive mineral and sparkling waters more commonly sold in Europe. The deal did not include mega brands such as S.Pellegrino Perrier and Acqua Panna. In fact, only a month after Nestlé sold the North American water business, it acquired Essential, a U.S.-based water that sells at a premium and likely has a high profit margin.

Nestlé is increasingly focusing on the lucrative water market outside the United States as well. Nestlé is also expanding the Health Science division through the acquisitions of Zenpep, Vital Proteins, Aimmune Therapeutics and others. The Aimmune acquisition allowed Nestlé to control the only "double approved" rug (U.S. Food and Drug Administration and the European Commission) for the treatment of peanut allergies. In the Spring of 2021, Nestlé acquired Nuun, a U.S.-based firm producing a tablet and powder to mix with water, similar to Gatorade. In Spring 2021, Nestlé also acquired The Bountiful Company, which manufactures dietary supplements such as Nature's Bounty, Solgar, Osteo Bi-Flex, and Puritan's Pride. The recent history of divestures and acquisitions suggests that Nestlé is shifting resources away from low-margin to higher-margin product lines.

To aid with the transition to plant-based protein, in 2020 Nestlé opened a new R&D Accelerator in Konolfingen, Switzerland, that will enable startups, students, and other partners to work together using Nestlé's resources to test projects for up to 6 months. R&D is not limited to plant-based proteins; at Nestlé, 1.6 billion Swiss Francs are invested in R&D annually, with 23 R&D locations worldwide and 4,000 employees devoted solely to this. In fact, 31 percent of all sales in 2020 derived from products innovated or renovated over the previous 3 years.

External Issues

Within the food and beverage business, Nestlé competes with global chocolate giants Hershey and Mars, French-based Danone, European-focused Nomad Foods, U.S.-based Kraft, and many more. In pet foods, Nestlé competes with—perhaps surprisingly—Mars, which is the world leader in pet food in addition to a chocolate company. Del Monte, Procter & Gamble, Kraft, and General Mills are also in the pet food business.

Frozen-Food Industry

The global frozen-food industry is rapidly growing and becoming much more sophisticated, as customers around the globe have more disposable income and are growing more health-conscious. In 2019, the global frozen-food market was valued at $290 billion and is projected to increase by nearly 40 percent to $406 billion by 2027. The large increase should provide excellent opportunities for firms, also raising the threat of many new entrants into the business, all looking for a piece of the action. Representing about 30 percent of all frozen-food purchases globally are ready-to-eat frozen meals that contain everything in one package. By contrast, in the United States, 45 percent of all frozen foods are considered ready-to-eat entrées.

Globally, the next two largest categories of frozen foods are frozen vegetables followed by frozen pizza. While the outlook for frozen entrees is expected to continue to grow, the strategist should be mindful that the relative market share of frozen entrees may fall due to the increased demand globally for frozen pizza. For all the talk of healthy eating around the world, taste and convenience still play a significant role in eating habits. Europe is currently the largest market for frozen foods, but China and India are growing at the fastest pace. Large global players in the industry include ConAgra, Schwan's Lamb Weston, and Nestlé. Profit margins in this industry tend to be less than 5 percent, significantly less than in drinks.

Plant Protein Growth in the United States

Plant proteins are growing rapidly in popularity around the world and by some estimates, plant-based protein will consist of one third of the protein market by 2054. Most of the data is currently from the U.S., but the plant-based trend is expected to grow globally as well. Growth in traditional foods hovers around 2 percent but if the prediction of 33 percent of all protein being derived from plants by 2054 holds, it would represent monumental growth for players in the plant-based protein industry. But consumers are after the protein, not simply plants, as 25 percent of Americans feel increased protein is beneficial and up to 50 percent of Americans check the ingredient list for the source of proteins.

In 2019, plant-based meat sales rose over 20 percent, and according to S&P's Industry Surveys, plant-based meat sales outpaced animal meat sales in 2020 partly due to several meat plants closing down in 2020 from the pandemic. While the research presented above is for Americans, there is strong evidence that plant-based proteins are extremely popular in other regions around the world. In fact, over 45 percent of Americans believe plant-based proteins are healthier than animal-based and 30 percent of Americans enjoy meat-free days in their diet. However, only 6 percent of Americans are categorized as "true" vegetarian (vegan).

Flavor Enhancers

There is a growing awareness of sugar's harmful effects on people, in particular of high-fructose corn syrup. Hershey, for example, is replacing high-fructose corn syrup in some of its products with sugar, in a move away from a sweetener that is widely seen as increasing weight gain and causing diabetes (the American Medical Association has stated that there is not enough evidence that it is worse than other sweeteners). A study of perceptions of sweeteners commissioned by the Corn Refiners Association found that about two-thirds of consumers believe that moderation is a more important factor than which sweetener is used. This was borne out when Hunt's ketchup switched from corn syrup to more sugar and then back to corn syrup when there was no change in the sales. The U.S. Food and Drug Administration (FDA) has denied requests by some companies to have their sweetening agent renamed "corn sugar" on nutrition labels. In addition, in July 2015, the FDA proposed that food companies be forced to add the percentage of daily allotment of sugar on all nutrition labels, similar to the percentage of daily allotment of salt, fat, and other ingredients listed. As of 2021, labels in the United States still only refer to the amount of sugars in grams, not percentages of daily allowance. However, any added sugar can have dramatic effects on the body and have been linked to diabetes, tooth decay, heart problems, weight gain, and many other health problems.

In response to the harmful effects of sugar, there is growing global demand for artificial sweeteners as a means to reduce calories, maintain blood sugar levels, and just have an overall healthier choice. However, research has not been conclusive, and some studies reveal artificial sweeteners are not dissimilar to raw sugar once ingested. Europe has banned several artificial sweetener products such as stevia and aspartame, but other nations such as Japan and the United States have been using the same sweeteners for decades. Nevertheless, there is a growing public awareness regarding both raw and artificial sugars.

Another common flavor enhancer found in food is salt. Table salt has been linked to water retention, high blood pressure, stomach cancer, osteoporosis, and killing of beneficial bacterial in the body. Many medical researchers recommend limiting salt consumption to 6 grams per day; for comparison, the World Health Organization suggests the average person consumes between 9 and 12 grams of salt daily. Many food companies are attempting to reduce the amount of sodium in their products as global awareness of the harmful effects of a high-salt diet increases.

Cocoa Prices

Consumers in emerging markets worldwide are able to afford increasingly higher-quality chocolates that require better and higher percentages of cocoa. Unlike other crops, such as corn or soybeans, cocoa is more difficult to produce, and cocoa prices are expected to rise 2.2 percent globally. Demand is also expected to increase globally, and a minimum price was recently introduced to cocoa producers, but cocoa production is highly labor intensive, and even with the minimum wage paid, a major threat facing the industry is producers switching to produce less labor-intensive crops.

Potential Taxes and Health-Minded Public

Growing awareness among consumers has led many different governments (local, regional, and national) to increase taxes on or flat out ban unhealthy items. Taxes on products like tobacco are viewed by governments as a way not only to curb citizens' consumption but also as an additional source of revenues. In 2014, New York City banned most sugary drinks in 16 oz (500 ml) and larger quantities from being served. Former NBA star Yao Ming is campaigning in his home country of China to promote healthier eating and exercise habits.

Increasing obesity is a major problem among the world's population. A study in the *Journal of the American Medical Association* reported people who get 17 to 21 percent of their calories from added sugar had over four times the chance of dying from cardiovascular disease than someone limiting their added sugar intake to 8 percent of total calorie intake. Scientific tests suggest that sugar is basically a food for cancer cells, and people who drink two soft drinks a week are 87 percent more likely to develop pancreatic cancer. For comparison, a Nestlé Butterfinger and Baby Ruth contains 29 and 33 grams of sugar, respectively, and a can of cola contains about 39 grams of sugar. Sugar is also believed to be damaging to your skin, looks, and overall mood.

Competitors

Kraft Heinz

Headquartered in Pittsburgh, Pennsylvania, in the United States, Kraft Heinz is a global food company with many brands popular around the world, including the iconic Heinz Ketchup. The firm reports offering 4,392 products as of 2021, including deli meats, sauces, drinks, cheeses, desserts, snacks, soups, and coffee. Some of the more famous brands owned by the company include Maxwell House Coffee, Miracle Whip, A.1., Jell-O, and Oscar Mayer. The firm even has partnerships with firms like Hershey to provide chocolate for select Kraft Heinz products. With its frozen foods, drinks, sweets, and snacks, Kraft Heinz competes directly with Nestlé in many markets worldwide. Against products such as Oscar Mayer and Lunchables deli meats, Nestlé does not currently offer a close rival list of matching products. In fact, Nestlé is attempting to position itself as a healthier nutrition company while rival Kraft Heinz tends to be more traditional in its product offerings. In 2010, Kraft sold the DiGiorno pizza brand to Nestlé.

In 2021, Kraft Heinz indicated its plans to increase marketing by 30 percent to help Kraft become the industry leader. The firm indicates it also will become more environmentally friendly and increase its healthy living marketing and products. The firm is in the process of restructuring from 55 individual categories of products to six broad platforms: taste elevation, easy meals made better, real food snacking, fast fresh meals, easy indulgent desserts, and flavorful hydration. Based on this new focus, it appears Kraft is furthering its alignment and competition with

Nestlé. In 2021, the firm announced that it planned to acquire Assan Foods, a sauce business based in Istanbul, Turkey. Kraft also announced in 2021 that it is selling its nuts business, including Planters, to Hormel Foods, and the firm plans to blend its famous cheese with ice cream to produce macaroni-and-cheese flavored ice cream. Kraft Heinz reported revenues of $26.2 billion in fiscal 2020, up from $25 billion in 2019.

General Mills

Headquartered in Minneapolis, Minnesota, in the United States, General Mills (GM) markets and manufactures food products worldwide. The firm operates in five segments: North America Retail, Convenience Stores, Europe & Australia, Asia & Latin America, and Pet. The firm's revenues increased from $17.6 billion to $18.1 billion from 2019 to 2020. Some of the firm's most popular brands include cereals (Cheerios), ice cream (Haagen-Dazs), and yogurt (Yoplait). In fact, the firm is expanding its cereal business, which may come as a surprise to some, as cereals are high-carb and high in sugar, and global trends are moving away from such items. However, as mentioned above, taste and convenience are key, and GM considers cereals an important component of the market of those who have less time to cook. Top GM brands include Cheerios, Cinnamon Toast Crunch, Lucky Charms, Chex, Total, and Wheaties. Top products considered meals include Helper, Old El Paso, Wanchai Ferry, V.Pearl, and Green Giant. The firm competes in the highly competitive frozen pizza business with brands Annie's and Totino's. In 2021, GM acquired Tyson Food's pet treat business for $1.2 billion in cash; this acquisition came on the heels of GM entering the pet food business in 2018 with the $8 billion acquisition of Blue Buffalo, a premium brand of pet food. Blue Buffalo sales grew at 10 percent over 2020 partly due to an increase in new pets worldwide; in the United States, 12.6 million households purchased or adopted a new pet in 2020. GM competes on many of Nestlé's exact product lines.

Hershey

Headquartered in Hershey, Pennsylvania, in the United States, Hershey is the largest chocolate producer in North America and a confectionary leader worldwide, with over 80 brands, annual revenues over $8 billion in 2020, about 15,000 employees, and operations in about 80 countries. Hershey offers chocolates as well as other candies, mints, and chewing gum. Notable products include Hershey Kisses, Mr. Goodbar, Twizzlers, Jolly Ranchers, Ice Breakers, and Reese's, which Hershey is currently expanding globally with strategic emphasis on markets in China and Mexico. Hershey is focused almost entirely on chocolate, candy, and gum, making it a significant competitor for Nestlé in this industry.

Danone

Danone is a global company based in Paris, France, and reported $24.6 billion in 2020, down from $25.3 billion in 2019. The firm has three main business categories: Essential Dairy and Plant-Based, Waters, and Specialized Nutrition. Top global brands in the first segment include Danone Yogurt, Activia, Oikos, Delight, Danonino, and Silk. Top water brands owned by Danone include Aqua, Bonafont, evian, Volvic, and Hayat, and the nutrition business focuses mostly on baby foods. In 2020, Danone sold Vega, a Canadian and U.S.-based plant-based food brand to a private equity firm in the United States. This is an interesting development as Nestlé is focusing heavily on plant-based products, and Danone has perhaps chosen to leave this playing field and focus on its more traditional product lines.

Plant-based Competitors

Firms like Beyond Meat and Impossible Foods are early players in the trend toward meatless products. Beyond Meat, for example, has popular plant-based burgers that many say taste like and have the same texture as real meat. While there is a huge trend toward plant-based products as concerns about animal welfare and healthier eating increase, the most important factor in getting customers to switch to plant-based products remains taste, which also includes the texture of the product. Despite what many cite as the reason for the switch, health is the second most important reason, followed by animal welfare in third.

Global firms such as Kellogg, Hormel, and Tyson Foods are entering the plant-based market as well. Tyson, a large meat-producing company, initiated a new brand named Raised & Rooted, which offers burgers with a blend of meat and plant-based options. Tyson also offers

100 percent plant-based chicken nuggets. Hormel Foods, another firm specializing in meats, introduced a new product line called Happy Little Plants, and Kellogg is offering MorningStar Farms's Incogmeato.

Research reveals that people who consume a mostly plant-based diet rarely purchase meat, but nearly 49 out of the 50 consumers who purchase plant-based meat also purchase animal meat. The global meat market is over $1 trillion, leaving firms competing in this industry to jockey for position, hoping many of the meat-consuming consumers will also buy plant-based meat products. It is important to remember that taste is the number one driver, and some items, such as a thick-cut beef steak, likely will not be replicated closely enough.

Conclusion

Strategy Considerations

From studying the case, you should be aware that Nestlé often divests and acquires new businesses in addition to spending heavily on its own R&D to bring new products to market. It also sells off less desirable product lines to competitors. Based on your research, what actions would you recommend to CEO Bulcke for the next 3 years? Which businesses or product lines, if any, should be divested? Are there any companies out there that Nestlé should acquire? Should Nestlé continue to invest heavily in R&D, or would it be more cost-effective to sit back, watch new firms emerge and risk their own capital, and then simply cherry pick and buy the successful firms through acquisitions?

Recall that Nestlé receives four times the revenue from the United States than from any other country. What country or countries would you suggest that the CEO aggressively penetrate further? Would it be more profitable for shareholders if Nestlé simply started promoting successful existing products more heavily in these regions instead of developing new products or acquiring new firms? Recall that when a firm acquires a firm for over book value, the extra amount is recorded as goodwill on the balance sheet. This is intangible fluff or smoke, generally not considered an attractive asset by accountants, yet sometimes, as is the case with Nestlé, the decision is made to accept the goodwill impairment and acquire the desired firm or desired product lines.

As you study and prepare a strategic planning case analysis, be sure to recommend what you think the future direction of Nestlé should be, not what they are currently doing, and not what you think they will be doing based on the latest news (unless of course, you agree with these strategies based on your analysis). Imagine that you have been hired by Nestlé to provide a series of recommendations for their future direction; this type of analysis and recommendations is in fact exactly what Nestlé would be paying a consulting firm to deliver for a high fee.

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Domino's Pizza, Inc.—2018

www.dominos.com, DPZ

Headquartered in Ann Arbor, Michigan, Domino's delivers more than 1 million pizzas a day worldwide to over 85 different countries, with over half of sales coming from outside the United States. To many people's surprise, Domino's ranks among the top 10 companies with online transactions, right up there with Amazon and Apple; over 60 percent of Domino's sales in the United States are through digital channels. The firm is the second-largest pizza restaurant chain in the world with over 14,400 locations and is the number-one pizza delivery company in the United States.

Domino's is 97 percent franchised with royalties accounting for a large portion of its revenue. Selling food, equipment, and supplies primarily to stores in the United States and Canada accounts for a large portion of revenue as well. Domino's has over 260,000 full- and part-time employees worldwide that generated sales of over $11 billion in 2017. Over 90 percent of all Domino's franchisees (owners) started their careers working in some capacity in a Domino's.

Domino's Q1 2018 financials released 4-26-18 were fantastic. Domestic same store sales grew 8.3 percent versus Q1 2017. The company's international division reported that same store sales increased 5.0 percent during Q1 2018, marking the 97th consecutive quarter of positive international same store sales growth for Domino's, and the 28th consecutive quarter of positive domestic same store sales growth. The company's global net store growth for Q1 2018 was up 110 stores, comprised of 79 net new international stores and 31 net new domestic stores. Given these excellent results, Domino's repurchased 448,008 shares of its common stock during Q1 2018 for approximately $101.1 million. On April 24, 2018, the Board of Directors declared a 55-cent per share quarterly dividend for shareholders. Domino's revenues increased $161.2 million, or 25.8 percent in Q1 2018, while net income increased $26.4 million, or 42.2 percent. The company is obviously doing well but literally millions of rival firms are taking aim at Domino's in local villages, towns, and cities globally.

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 named Domi-Nick's in Ypsilanti, Michigan. After trading his brother James a Volkswagen Beetle in 1961 for his half of the business, 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 United States. By 1998, there were over 6,000 Domino's with 1,500 located outside the United States. Tom Monaghan retired in 1998 by selling 93 percent of the company, worth $1 billion, to Bain Capital Inc. In the 6 years following the sale, Domino's enjoyed great success under Bain Capital and in 2004, Domino's became a publicly traded company. The initial stock price was $16 per share and placed a value on the company at over $2 billion (double the price Bain paid).

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, the same year that Domino's was ranked number-one in *Forbes Magazine's* "Top 20 Franchises for the Money" list.

Vision/Mission

Domino's vision (paraphrased) is "to be the best place on the planet to prepare, deliver, and consume pizza." The company's mission statement (paraphrased) is to "have fun preparing, delivering, and consuming pizza." In addition to these statements, Domino's describes itself in terms of its employees, united by the common goal of becoming the global leader in pizza delivery.

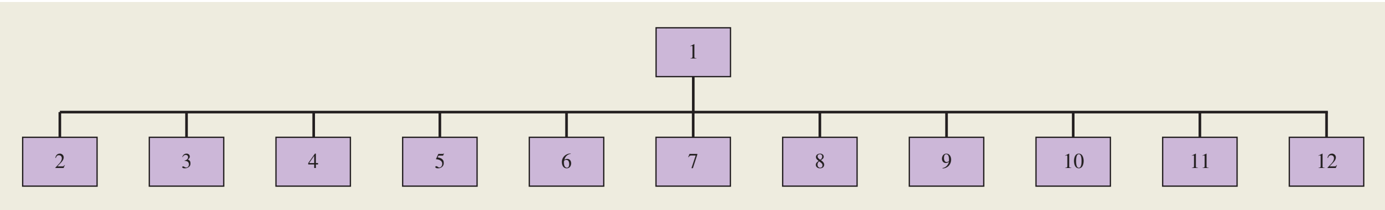
The company's motto in a few words are opportunity, hard work, inspired solutions, winning together, embracing community, and uncommon honesty. The reason for these special words is that nearly all Domino's franchise owners started their careers with the firm as delivery drivers or in other in-store positions. Thousands of other Domino's employees, including supervisors, trainers, quality auditors, international business consultants, marketers, and executives, also began their careers in the stores. Domino's core beliefs are to promote internal growth and provide opportunities for anyone willing to work hard.

Internal Issues

Organizational Structure

Since there is no COO or CAO by title depicted among Domino's top executives, the firm appears to operate from a very flat divisional-by-region type design. Since the firm's structure is portrayed neither in the firm's *Form 10K* nor on the company website, perhaps only insiders know exactly who reports to who, but apparently every top executive reports to CEO Brandon.

EXHIBIT 1 Domino's Top Executives and Organizational Chart



1. David Brandon, Chairman
2. J. Patrick Doyle, President and CEO
3. Troy Ellis, EVP Supply Chain
4. Judy Werthauser, EVP Chief People Officer
5. Stanley Gage, EVP Team USA
6. Scott Hinshaw, EVP Franchise Operations and Development
7. Jeffrey Lawrence, EVP and CFO
8. Timothy McIntyre, EVP Communications, Legislative Affairs, and Investor Relations
9. Kevin Morris, EVP General Counsel
10. J. Kevin Vasconi, EVP Chief Information Officer
11. Russell Weiner, President Domino's USA
12. Richard Allison, President Domino's International

Source: Based on information at the company website.

Current Strategies

Perhaps Domino's most profitable strategy is their vertically integrated supply chain where they have backward control, to some extent, over many of their supplies such as dough, veggies, equipment, and uniforms, and direct forward control over about 400 retail stores that are company-owned. One area where Domino's could possibly extend their backward integration strategy would be to purchase trucks to deliver their products. Currently Domino's leases these vehicles.

Unlike Yum! Brands and other competitors who have diversified into other foods and restaurants, Domino's has maintained their strategy of staying focused on the Domino's Pizza Brand. The company still offers little to nothing in terms of healthy food options on the menu other than three salad options, but offers chicken wings, sandwiches, pasta, and desserts. While this approach enables Domino's to focus almost 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 CEO desires to extend further the company's domestic and global presence. With over 14,400 stores and more than half of those international-based, Domino's enjoys large economies of scale and brand name recognition enabling the firm to spread costs effectively. With economies growing in many underdeveloped markets, Domino's senior management estimates the company is only serving about 50 percent of the international market they should be serving, thus suggesting the firm's plans to add an additional 5,000 internationally based stores in the coming years. Further expansion globally would increase risks as marketing research costs will be high, and trademark and patent protection laws are not as sophisticated in developing countries.

Domino's derives most of its income from U.S. and Canadian markets through royalties and supply-chain operations—including selling equipment, food, and supplies that franchisees must purchase from Domino's. In international markets, Domino's uses the "master franchisees" model, where the corporation attempts to attract an investor to take on multiple Domino's and gives them franchisee rights in that region. Here the master franchisee profits by sub-franchising, selling ingredients and equipment, and running their own stores.

Domino's attributes much of its success to an incentive-based system for franchisees where they actively share in profits through increasing demand for new stores and through purchasing supplies from the Domino's Supply Chain. Domino's individual franchisee stores and the over 400 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 utilize a dine-in business model which is much more costly. Competitive advantages such as these make Domino's an attractive franchisee option in the quick-service restaurant (QSR) market as overhead and investment is generally cheaper than competing firms.

Sustainability and Ethics

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 their actions and commitment to sustainability. Domino's combines several reports into one calling it a Corporate Stewardship Report. The firm has long prided itself on taking care of its employees as 90 percent of all current owners started out working in a Domino's. In recent years, Domino's has improved its menu with an almost total revamp since 2008.

Today, MSG and artificial food colorings have been eliminated from all Domino's products in the United States except for where they occur naturally, like in cheese and some meats. Vegetables are distributed from a supply chain facility in Georgia to many U.S.-based locations. Having a central supply-chain location improves food safety issues as opposed to letting each individual store cut and prep its own veggies and meats. To better serve customers in a nutrition-minded society, Domino's adds their "Cal-O-Meter" online—as customers build a pizza they can watch the calorie clock tick up, or tick down if they are willing to forgo an extra tasty option—such as double meat or cheese. Allergen information is also available online.

Domino's uses 100 percent sustainable palm oil product for some of their items such as pan pizza dough, but palm oil is not used in the majority of Domino's offerings. To ensure the oil used is from sustainable sources, Domino's, in 2015, traced 100 percent of oil obtained from its supplier to environmentally friendly means. Like its palm oil supplier, Domino's cardboard suppliers hold certifications with several forestry councils to ensure responsible processing of trees; most pizza boxes at Domino's are 40 to 70 percent recycled.

Domino's is also a good citizen in the communities in which it operates. For over 50 years, the firm has aggressively supported schools, youth sports teams, and first responders. The company often provides free pizzas to first responders in times of crisis and donating free food to various programs for kids. In 2016 alone, the firm donated over $8 million to communities, raised over $7 million for St. Jude Children's research hospital, and donated over 14,000 pizzas as a small sampling of their philanthropic giving back to the community.

Advertising/Sales Force

Up until 2008, Domino's domestic stores contributed 4 percent of all retail sales to support national and local advertising campaigns. However, starting in 2009, domestic stores voted to increase their advertising revenue contribution rate to 5 percent and eventually to 5.5 percent in 2011, and now 6 percent heading into 2018. 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.

Finance

Domino's income statements and balance sheets are provided in Exhibit 2 and Exhibit 3, respectively. Note the 12.75 percent increase in revenues in 2017 and the 29.45 percent increase in net income. Note also the 22 percent increase in property, plant, and equipment in 2017.

EXHIBIT 2 Domino's Income Statement (in thousands USD)

Income Statement	1/1/17	12/31/17		Percent Change
Revenues	$2,472,628	$2,787,979	↑	12.75%
Cost of Goods Sold	1,704,937	1,921,988	↑	12.73%
Gross Profit	767,691	865,991	↑	12.80%
Operating Expenses	313,649	344,759	↑	9.92%
EBIT	454,042	521,232	↑	14.80%
Interest Expense	109,384	121,079	↑	10.69%
EBT	344,658	400,153	↑	16.10%
Tax	129,980	122,248	↓	–5.95%
Non-Recurring Events	0	0	NA	NA
Net Income	214,678	277,905	↑	29.45%

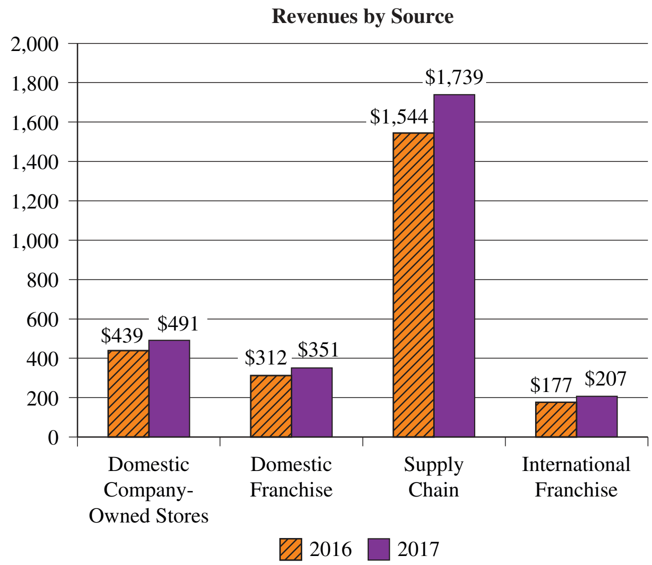
Source: Based on company documents.

EXHIBIT 3 Domino's Balance Sheets (in thousands US)

Balance Sheet	1/1/17	12/31/17		Percent Change
Assets				
Cash and Short Term Investments	$169,311	$227,530	↑	34%
Accounts Receivable	150,369	173,677	↑	16%
Inventory	40,181	39,961	↓	–1%
Other Current Assets	136,012	138,621	↑	2%
Total Current Assets	495,873	579,789	↑	17%
Property Plant & Equipment	138,534	169,586	↑	22%
Goodwill	16,058	15,423	↓	–4%
Intangibles	0	0	NA	NA
Other Long-Term Assets	65,830	71,955	↑	9%
Total Assets	**716,295**	**836,753**	↑	**17%**
Liabilities				
Accounts Payable	111,510	106,894	↓	–4%
Other Current Liabilities	292,188	291,391	↓	0%
Total Current Liabilities	403,698	398,285	↓	–1%
Long-Term Debt	2,148,990	3,121,490	↑	45%
Other Long-Term Liabilities	46,750	52,362	↑	12%
Total Liabilities	2,599,438	3,572,137	↑	37%
Equity				
Common Stock	481	429	↓	–11%
Retained Earnings	(1,881,520)	(2,739,437)	↓	–46%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	(2,104)	3,624	↑	NA
Total Equity	(1,883,143)	(2,735,384)	↓	–45%
Total Liabilities and Equity	**716,295**	**836,753**	↑	17%

Source: Based on company documents.

EXHIBIT 4 Domino's Revenues by Source (in millions)



Source: Based on company information.

Segment Data

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 4 that the largest revenue-generating segment is the Domestic Supply Chain with over 60 percent of all revenue. Note also the large revenue numbers for the relatively few company-owned stores due to each Domino's Domestic Franchisee owning his/her own store(s) and reporting their revenues on their own personal financial statements rather than Domino's. Domino's derives revenue from only the royalties and advertising fees they receive from franchisees. The financial data for the International Supply Chain Centers are included in the International Division, not under the Domestic Supply Chain Division.

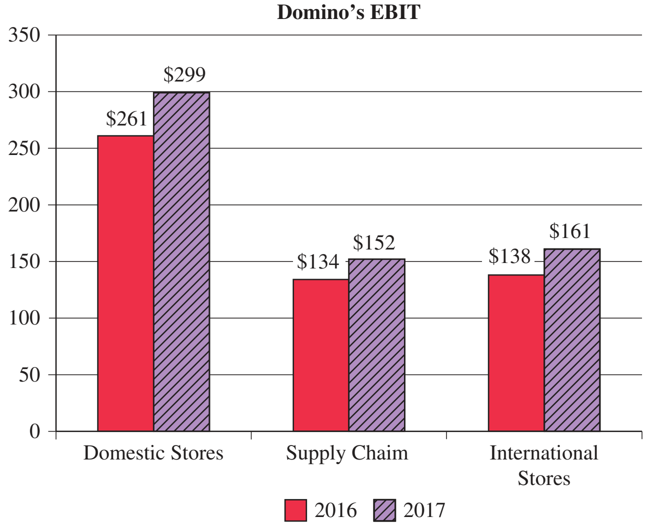
Also note in Exhibit 4 revenue increases across all divisions in 2017 compared to 2016. Exhibit 4 reveals that even though half of the stores are internationally based, almost all revenues are derived from domestic operations. The numbers are not as abnormal as they first appear though. Take for example the revenue breakdown between Domestic Franchise and International Franchise in Exhibit 4—based on both having the same number of stores, the International Franchise reports 37 percent of revenues between the two divisions, a bit off from an even 50–50, but with the master franchiser system, there is another middleman, so to speak.

Exhibit 5 depicts Domino's revenues by region. Note domestic is largest, followed by supply chain.

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 18 regional dough manufacturing and supply-chain centers and leases a fleet of over 400 trucks to aid in delivering products to stores twice a week. Domino's franchisees are, however, not required to purchase supplies from Domino's, but interestingly, over 99 percent do purchase all their 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 their products from Domino's. In addition to the 18 dough manufacturing supply chains and a few other supply chains for other

EXHIBIT 5 Domino's EBIT by Division (in millions)



Source: Based on company information.

products in the United States, the company owns another five dough manufacturing supply chains in Canada.

Domestic Stores

The company's Domestic Stores division includes a network of over 5,195 stores operated by franchisees and 392 company-owned stores in the United States. Domino's desires to have all of their stores owned and operated by franchisees, but if certain stores are under-performing, Domino's often will purchase these stores in hopes of turning them around and refranchising them at a later date. Domino's also uses company-owned stores as test sites for new products, promotions, new potential store layout improvements, and for prospective new franchisees.

Although the typical franchisee of Domino's operates 4 stores, the 14 largest franchisees operate over 50 stores, including the largest domestic franchisee that operates 187 stores. Currently, Domino's has 789 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 one 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.

Franchise agreements require the franchisee to operate a store in a location for 10 years with the ability to renew for another 10 years with franchise renewal rates around 99 percent. Franchisees pay 5.5 percent royalty fee on sales and another 6 percent on national advertising and marketing.

International Division

Domino's has operations in over 85 countries with 9,269 internationally based locations. Exhibit 6 provides a breakdown of stores in the top 11 markets; the top 10 international markets account for over 64 percent of all Domino's international stores. Note that India has the most Domino's of all countries, followed by the UK. Just 5 years earlier, India was only third in total stores outside the United States behind both the UK and Mexico. 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). Domino's aggressively attracts a master franchiser in international markets to sub-franchise out to other individuals.

EXHIBIT 6 **Domino's Store Locations at Year-End 2017**

Country	Number of Stores
USA	5,491
India	1,123
UK	1,002
Mexico	679
Australia	658
Japan	497
Turkey	491
Canada	452
South Korea	442
France	354
Netherlands	230

Source: Based on the company's 2017 *Annual Report* and other information.

Competitors

Pizza delivery and carry-out competition in both the United States and internationally is extremely intense, with Pizza Hut (owned by Yum! Brands) being the largest competitor in the industry. Yum! Brands' revenues are over 128 percent greater than Domino's. Papa John's and Little Caesars are also fierce rivals in the industry. In addition to the three main rivals of Pizza Hut, Papa Johns, and Little Caesars, Domino's faces intense competition from thousands of local mom-and-pop pizza stores, frozen pizzas from the grocery store, as well as hundreds of non-pizza fast food options.

Exhibit 7 provides a quick comparative analysis of Domino's with two rival firms. Note that Yum! Brands is three times the size of Domino's, but Domino's is nearly five times the size of Papa John's from a market capitalization perspective.

Internationally, Pizza Hut and Domino's are the main companies in the industry, but most countries also have thousands of mom-and-pop pizza and Italian restaurants. 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 RAVE Restaurant Group, owner of Pizza Inn, based in The Colony, Texas. RAVE owns and franchises out more than 300 Pizza Inn and Five Pie Pizza stores in the United States and Internationally.

Pizza Hut

A division of Yum! Brands, Pizza Hut is based in Plano, Texas, and operates over 16,000 restaurants in the United States and internationally in over 100 countries as of the beginning of 2018, up from 12,800 restaurants just 5 years earlier. In contrast to Domino's, almost all Pizza Huts

EXHIBIT 7 **Financial Comparison of Domino's with Two Rival Firms**

	Domino's	Yum! Brands	Papa John's International
$ Market Cap.	9.5B	26.6B	2.0B
# Employees	14,100	60,000	20,700
$ Revenue	2,788M	6,366M	1,713M
% Gross Margin	31	45	21
$ Net Income	278M	1,619M	103M
$ EPS Ratio	5.25	3.77	2.90
$ P/E Ratio	42.35	21.27	19.89

Source: Based on a variety of sources.

are dine-in restaurants. Pizza Huts serve their Pan Pizza, as well as their Thin n' Crispy, Stuffed Crust, Hand-Tossed, and Sicilian. Other menu items include pasta, salads, and sandwiches. Pizza Huts offer dine-in service at their famous red-roofed restaurants, as well as carryout and delivery service. About 15 percent of all Pizza Huts are company-operated while the remaining stores are franchised. The world's largest fast food company, Yum! Brands also owns and operates Kentucky Fried Chicken (KFC) and Taco Bell. The firm lost its CEO in 2018 to Chipotle Mexican Grill.

Papa John's International, Inc. (PZZA)

Headquartered in Louisville, Kentucky, and founded in 1985, Papa John's operates 5,097 pizza restaurants, with 4,456 of these being franchisee-owned and 743 being company-owned stores. Total restaurants have increased over 30 percent from year-end 2012 through 2017. Papa John's has restaurants in all 50 U.S. states and 44 foreign markets. The company currently has 16,500 full-time employees and markets their pizza under the slogan "Better ingredients, better pizza." The company reported revenue of over $1.7 billion for year-end 2017 with net income of $102 million. Papa John's carries $85 million in Goodwill on their balance sheet.

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. The company announced in 2018 that it was reducing its formal partnership with the NFL over founder and Chairman John Schnatter's comments on players' rights to stand or not stand at games during the playing of the U.S. National Anthem.

RAVE Restaurant Group

RAVE owns Pizza Inn and Pie Five Pizza. The latter two are a relatively small chain of franchised quick-service pizza restaurants, with more than 300 locations in the United States and the Middle East. Pizza Inns offer pizzas, pastas, and sandwiches, along with salads and desserts. Most locations offer buffet-style and table service, while 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. The firm has struggled in recent years with flat revenues from fiscal 2015 through 2017, hovering around only $55 million. Net losses of $1.2 million in 2015 have swollen to over $12 million in 2017.

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 by 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 third largest pizza chain in the United States, along with Papa Johns. Little Caesars operates in 30 foreign countries and has over 5,460 locations that are both franchised and company-owned.

Little Caesars is building a new $150 million, nine-story, 234,000 square foot, world headquarters expansion, more than doubling the size of its current campus in Detroit, to accommodate the company's rapid global growth and hiring. Little Caesars claims to be the largest carryout-only pizza chain in the world with a presence in all 50 states and 20 international markets. The company recently opened franchises in Dominican Republic, Costa Rica, and Panama with additional expansion taking place worldwide. Little Caesars attracts and continues to look for highly capable franchisee candidates for new market opportunities domestically and throughout the world.

External Issues

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, much like the tobacco industry (in respect to labeling their products). It appears the war is close to being lost for the restaurant industry. Domino's itemizes nutrition information on their website. 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 they can print the nutrition label on the Big Mac as there is uniformity in ingredients and the label is understood to be for the base item.

To complicate matters for the QSR industry as a whole, many lawmakers want to force nutrition information to be included on the menu at the point of sale, and there is still a debate in the United States regarding whether each state could/should enact their own nutrition guidelines or if there will be a national mandate/standard. Further spearheading the government's position, there have been several recent lawsuits where plaintiffs sought monetary damages in respect to advertising to children and obesity in children derived from eating fast food. As the United States (and world) population becomes more health conscious and more litigious, it seems evitable that detailed nutrition and possibly even warning labels similar to those in the tobacco industry will appear on some products and menus. In addition, lawsuits and governments are also encouraging the elimination of trans fats (and other harmful products) that are still present in the cheese on a Domino's pizza, and many other pizzas.

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 their pizzas as having gluten-free crust. These are attempts 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 their 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.

Demographic Issues

Some analysts say there are too many restaurants in the United States to be supported by the population. Currently, there are around 1 million fast food service locations in the United States, or 1 for about every 330 people. With people looking for cheaper and healthier options, it is difficult to determine just how many restaurants are too many. As businesses increasingly use business analytics to better determine potential restaurant locations, it will be interesting to see if the net total number of restaurants in the United States increases or declines in the coming years. Domino's for example plans to continue to add restaurants, but they target mainly college campuses, shopping malls, and other high-traffic areas of their core customer base, while eliminating stores in unproductive areas, and also are expanding internationally heavily.

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, etc. 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 Quick Service Restaurant (QSR) business is a bimodal population distribution with a large population of bargain-minded customers seeking deals on less expensive, 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 as 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 capitalized on this very well recently with the introduction of their Artisan pizzas, and new recipes (or higher-quality products) for their crust, sauce, and cheeses. In addition, Domino's offers many pick-up specials. While pick-up may be an inconvenience over delivery, many customers in today's climate are willing to tolerate a degree of inconvenience if they can get a better deal.

Similar to Domino's, many restaurant owners in the fast food industry have experienced stronger growth in their international markets than in domestic markets. This trend is expected to continue, especially in China and other developing nations, as many American fast food options are still novel, even in Europe.

Global Issues

The fast food restaurant industry has been rapidly expanding overseas for the last 20 years and is expected to continue to do so in the foreseeable future. Domino's, for example, has over half of their store locations overseas and Yum! Brands generated over 60 percent of their revenue from overseas markets.

Expanding into global markets presents problems such as exchange rate fluctuations, diet of local consumers, securing permits, possible anti-American association with U.S. brands, collecting royalties from foreign operations, supply and distribution issues, currency valuation issues, and even language barriers are all potential threats of operating overseas. In addition, securing fresh food products in a timely manner may be difficult, as most franchises based in the United States have backward integrated supply chains providing better control over supplies.

Expanding across countries also increases the risk of not being able to protect intellectual property as well as desired. Trademark protection and registration, patents, dilution, and unfair competition are all risks associated with developing markets that are not as problematic in more developed markets. In the United States, most fast food restaurants are aimed at lower income people who wish for a quick and easy drive-though meal. However, in contrast, in many developing markets, while still offering virtually the same menu as in the United States, the fast food industry is geared more to the middle class and a sit down dine-in experience, much like a Buffalo Wild Wings, Moe's Southwest Grill, or TGI Fridays would be in the United States. In general, the overall décor and ambience in international fast food establishments tends to be a bit nicer than the United States counterparts.

Future

In February 2018, Domino's launched its oven-baked sandwiches, but only in Australia. Domino's CEO of Australia and New Zealand operations says the fillings were chosen to include "on-trend" ingredients such as avocado and kale-slaw. There are four flavors to choose from and each sandwich costs $5.95.

Almost as soon as Papa John's ended its sponsorship agreement with the NFL over differing beliefs, Pizza Hut was named as the official pizza sponsor of the NFL. The Pizza Hut sponsorship began with the 2018 NFL Draft. Papa John's is focusing on each of the 22 NFL teams separately now, rather than marketing to the league as a whole.

With up to a million or more restaurants selling pizza every day across the world, Domino's needs a clear strategic plan moving forward. The company is doing well now, but doing well today is not a guarantee to do well tomorrow, so diligence is required and needed.

PetMed Express, Inc.—2018

www.1800petmeds.com, PETS

Headquartered in Delray Beach, Florida, PetMed Express is a licensed online pharmacy that fills prescriptions written by veterinarians. The company has over 9 million satisfied customers and dispenses drugs only in the United States. The company competes with local veterinarians, many of whom make money selling drugs for pets. PetMed carries all the medications sold in veterinarian offices. The company says it employs the largest number of veterinary pharmacists in the world. The company has a history of legal problems with veterinaries across the country undercutting their prices and other related concerns. PetMed does not disclose where it obtains its pet drugs and this fact irritates many veterinarians.

PetMed Express is America's largest pet pharmacy, delivering prescription and non-prescription pet medications and other health products for small animals at competitive prices direct to consumers through its 1-800-PetMeds toll-free number and on the Internet through its corporate website. The company's fiscal 2017 year ended March 31, 2017. For the company's Q3 2018 that ended December 3, 2017, new order sales increased 15.5 percent, new income increased 88 percent, and revenues increased 13.7 percent—so PetMed is doing well. In January 2018, the company's board of directors increased the firm's dividend by 25 percent from $0.20 to $0.25 per share paid on February 16, 2018.

PetMed markets prescription and non-prescription pet medications, as well as health products and supplies for small animals to retail customers. A sampling of the company's products include flea and tick control products, bone and joint care products, vitamins, treats, nutritional supplements, hygiene products, and supplies; and prescription medications, including heartworm preventatives, flea and tick preventatives, arthritis, thyroid, diabetes, pain medications, antibiotics, and other specialty medications, as well as generic substitutes. PetMed also sells food, beds, crates, stairs, strollers, and other pet supplies through its website, direct mail, and its toll-free number. It markets its products through Internet; telephone contact center; and direct mail/print through 1-800-PetMeds catalogs, brochures, and postcards under various brands.

History

PetMed was founded in 1996 by Marc Puleo. The company got off to a rocky start. In 1999, the company settled charges with the Florida Pharmacy Board for selling drugs that did not have prescriptions, false advertising, poor record keeping, and not labeling drugs correctly. As part of the settlement, the company paid a fine but also agreed to send its pharmacists for further education, agreed to random inspections, and agreed to provide regular reports to the board.

In 2002, PetMed was fined by the Environmental Protection Agency (EPA) for selling drugs marked with metric doses—the drugs that were made by Novartis for sale in Europe and Australia. PetMed is exclusively a U.S. firm and the doses and labeling were not FDA-approved—Novartis sued PetMed for damages. In 2002, PetMed was charged by the Florida Pharmacy Board for contracting with veterinarians to write prescriptions for animals they had never examined, and for selling animals drugs that had not been approved by the FDA. In the same year, the company settled similar charges in Ohio. Also in 2002, the pharmacy board in Texas filed a lawsuit charging PetMed Express with dispensing veterinary drugs without prescriptions. The case was settled in 2006.

Even as late as August 2017, PetMed has legal problems as the Rosen Law Firm filed a class action lawsuit against the company alleging that PetMed was marketing dangerous and addictive animal drugs to humans. As a result of this action, Google may halt PetMed's advertising and business operations with that firm.

Vision/Mission

PetMed Express appears to not have a vision or mission statement provided at the corporate website or in the company's *Annual Report*.

Internal Issues

Customers and Advertising

PetMed says 2.3 million customers purchased from the company in fiscal 2016 and 2017, and that about 50 percent of those customers reside in California, New York, Pennsylvania, North Carolina, Virginia, and Georgia. The company dispenses drugs across the United States. The company obtained 514,000 new customers during fiscal 2017, compared to 489,000 new customers from the prior year.

As a percent of revenue, the company's advertising expenses were 7.1 and 9.3 percent, respectively, for fiscal 2017 and 2016. In fiscal 2017, the company eliminated all television advertising.

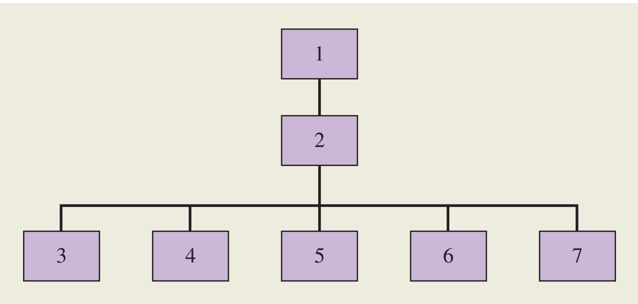
Employees

PetMed has about 190 full-time employees, including 105 in marketing, 43 in pharmacy, 3 in information technology, 3 in administrative positions, and 5 top managers.

Organizational Structure

Based on the titles of their corporate executives, it appears that PetMed operates from a functional organizational structure with no divisions. The company is quite light on top executives and no one appears to head up potential segments, such as prescription versus non-prescription, online versus traditional, or pharmaceutical versus other.

EXHIBIT 1 PetMed's Top Executives and Organizational Chart



1. Robert Schweitzer, Director, Chairman of the Board
2. Menderes Akdag, Director, CEO and President
3. Frank Formica, Director and Legal Consultant
4. Ronald Korn Director, President of Ronald Korn Consulting
5. Gian Fulgoni, Director, CEO and Co-Founder of comScore, Inc.
6. Bruce Rosenbloom, CFO and Treasurer
7. Allison Berges, Corporate Secretary and General Counsel

Source: Based on company documents.

Segment Information

PetMed does not provide much segment information beyond what is summarized in Exhibit 2. Note in Exhibit 2 that Reorder Sales comprise about 83 percent of all sales, and ironically Internet sales also comprise about 83 percent of all sales.

Finance

PetMed's fiscal year ends March 31. For the company's Q3 2018 quarter that ended December 31, 2017, net sales were $60.1 million, compared to $52.9 million for the prior year same quarter, an increase of 13.7 percent. Net sales for the 9 months ended December 31, 2017, and were $206.5 million, compared to $186.1 million for the 9 months previous, an increase of 10.9 percent. The increase in sales for the company's Q3 2018 quarter

EXHIBIT 2 PetMed's By-Segment Sales Information (in thousands USD)

Segment	2017	%	2016	%	% Variance
Reorders	206,299	82.8	195,569	83.3	+5.5
New Orders	42,877	17.2	39,115	16.7	+9.6
Total	249,176	100	234,684	100	+6.2
Internet	205,643	82.5	190,781	81.3	+8.8
Phone	43,533	17.5	43,903	18.7	−0.8
Total	249,176	100	234,684	100	+6.2

Source: Based on the company's 2017 *Annual Report*.

were up due to increased new order sales, which increased 15.5 percent, and reorder sales, which increased 13.4 percent. Net income for the Q3 2018 quarter was $9.1 million, compared to net income of $4.8 million the previous year same quarter, an 88 percent increase. Net income for the 9 months ended December 31, 2017 was $27.1 million, compared to net income of $16.3 million, for the 9 months the prior fiscal year, a 66 income increase to net income. Average order size increased to $86 for the Q3 2018 quarter, compared to $81 for the same quarter in the prior year. Also for the company's Q3 2018 quarter, online sales increased 15.0 percent to $50.4 million from $43.8 million for the same period the prior year, and were approximately 84 percent of all sales, compared to 83 percent for the same quarter the prior year. The company's Q3 2018 was the fourth consecutive quarter of increasing both new order and reorder sales.

In January 2018, the company's board of directors declared and increased the quarterly dividend by 25 percent from $0.20 to $0.25 per share on the firm's common stock. The dividend was paid on February 16, 2018.

PetMed Express beat profit estimates again in its Q4 2018 that ended 3-31-18. For Q4 2018, the company reported net income of $10.2 million, up from $7.5 million in the year-earlier period. Sales rose to $67.3 million from $63.0 million. Also for that Q4, the company's margins rose to 37 percent from 35.1 percent, boosted by a product mix shift to higher margin items. Additionally, for Q4 2018, PetMed's average order value was $89 compared to $86 for the same quarter the prior year.

PetMed's income statements and balance sheets are provided in Exhibit 3 and Exhibit 4, respectively.

EXHIBIT 3 PetMed's Income Statements (in thousands USD)

Income Statement	3/31/16	3/31/17		Percent Change
Revenues	$234,684	$249,176	↑	6.18%
Cost of Goods Sold	158,388	169,862	↑	7.24%
Gross Profit	76,296	79,314	↑	3.96%
Operating Expenses	43,908	41,831	↓	−4.73%
EBIT	32,388	37,483	↑	15.73%
Interest Expense	(190)	(141)	↓	−25.79%
EBT	32,578	37,624	↑	15.49%
Tax	12,000	14,105	↑	17.54%
Non-Recurring Events	(11)	300	↑	NA
Net Income	20,567	23,819	↑	15.81%

Source: Based on company documents.

EXHIBIT 4 **PetMed's Balance Sheets (in thousands USD)**

Balance Sheet	3/31/16	3/31/17		Percent Change
Assets				
Cash and Short-Term Investments	$37,639	$58,730	↑	56%
Accounts Receivable	1,724	1,808	↑	5%
Inventory	25,586	20,228	↓	−21%
Other Current Assets	2,678	1,019	↓	−62%
Total Current Assets	67,627	81,785	↑	21%
Property Plant & Equipment	20,929	30,164	↑	44%
Goodwill	0	0	NA	NA
Intangibles	860	860	→	0%
Other Long-Term Assets	863	0	↓	−100%
Total Assets	**90,279**	**112,809**	↑	**25%**
Liabilities				
Accounts Payable	5,004	15,221	↑	204%
Other Current Liabilities	2,080	3,134	↑	51%
Total Current Liabilities	7,084	18,355	↑	159%
Long-Term Debt	0	0	NA	NA
Other Long-Term Liabilities	0	1,088	NA	NA
Total Liabilities	7,084	19,443	↑	174%
Equity				
Common Stock	20	21	↑	5%
Retained Earnings	78,295	86,530	↑	11%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	4,880	6,815	↑	40%
Total Equity	83,195	93,366	↑	12%
Total Liabilities and Equity	**90,279**	**112,809**	↑	25%

Source: Based on company documents.

Competitors

Eight companies in particular generate sales in the billions for animal pharmaceuticals: Zoetis, Merck Animal Health, Merial, Elanco Animal Health, Bayer Animal Health, Boehringer Ingelheim Animal Health, Novartis Animal Health, and Virbac. However, arguably two of PetMed's major rivals are Kroger and Walmart. Both firms fill animal prescriptions.

Headquartered in Parsippany-Troy Hills, New Jersey, Zoetis develops vaccines, parasiticides, anti-infectives, medicinal feed additives and drugs for pain, sedation, and cancers for pets and farm animals. The company has annual sales of $5 billion. The company name has its root in "zo", familiar in words such as zoo and zoology and derived from zoetic, meaning "pertaining to life." About 60 percent of Zoetis sales come from farm animal products and 40 percent from companion animal products, mainly medicines and vaccines.

Headquartered in Kenilworth, New Jersey, Merck Animal Health manufactures vaccines, anti-infective and anti-parasitic drugs, fertility management drugs, and other specialty pharmaceutical products for companion animals and livestock.

Owned by Eli Lilly and headquartered in Indianapolis, Indiana, Elanco Animal Health develops and markets products to treat animal health and increase protein production. Products include flea protection for dogs and cats, drugs to combat parasites in poultry, and vaccines and feed additives for livestock and poultry.

Headquartered in Ingelheim am Rhein, Germany, Boehringer Ingelheim Animal Health markets biologicals, vaccines, pharmaceuticals, and other care products for use in pets and livestock. Boehringer owns Merial that develops and markets veterinary products including anesthetics, antiparasitics, antimicrobials, and gastrointestinal, respiratory, and cardiovascular medicines. It also produces vaccines for livestock, poultry, and pets.

Headquartered in Leverkusen, Germany, Bayer HealthCare Animal Health manufactures antimicrobials, parasiticides, sedatives, pain killers, and nutritional supplements and feed additives for dogs, cats, and horses. Products for food animals include anti-infectives, vaccines, parasiticides, sedatives, and pain killers.

Headquartered in Basel, Switzerland, Novartis Animal Health develops and markets health product for companion animals, livestock, and the aquaculture market. Popular products include treatments for dermatitis, flea protection, pain and heartworm prevention in pets, and antibiotics and antiparasitics in farm animals. Novartis also developed some of the first vaccines for combating viral and parasitic infections in fish. Novartis was acquired by Eli Lilly in 2015 for $5.4 billion.

Headquartered in Carros, France, Virbac Group manufactures antibiotics, vaccines, antiparasitics, dermatological, and dental products for the treatment and care of pets and food animals.

Although the companies mentioned above are competitors to PetMed, including Kroger and Walmart, two other companies are major pet pharmacy rivals. They are PetIQ and Heska Corporation, even though as of right now neither sell drugs direct to consumers; they only sell to vets or businesses, but that could change anytime.

PetIQ, Inc. (PETQ; www.petiq.com)

Founded in 2010 and headquartered in Eagle, Idaho, PetIQ manufactures and distributes pet medications, including veterinarian-grade prescription and over-the-counter products. The company develops, manufactures, and sells pet medications, and health and wellness products for dogs and cats in the United States, Canada, and Europe. PetIQ is quite similar to PetMed Express in offering pet prescription medications, including products for arthritis, thyroid, and diabetes and pain treatments, as well as heartworm preventatives, antibiotics, and other specialty medications; over-the-counter medications and supplies, such as flea and tick control products in various forms comprising spot-on treatments, chewables, and collars; and health and wellness products consisting of specialty treats and other pet products, which include dental treats and nutritional supplements. Various PetIQ trade names include PetAction, Advecta, PetLock, Heart Shield, TruProfen, Betsy Farms, Minties, Vera, Delightibles, vetGuard, Mimi's Market, PAWS IQ, VET + CHOICE, VET WORKS, TEX RANCH, and VetIQ brands.

PetIQ markets over-the-counter and prescription pet medications and pet wellness products through wholesale distributors and retail stores in mass, club, grocery, pharmacy, and online. In January 2018, PetIQ acquired Community Veterinary Clinics, LLC d/b/a VIP Petcare ("VIP"), a leading operator and provider of nationwide veterinary clinics and veterinarian services within major U.S. retailers. VIP is now a wholly-owned subsidiary of PetIQ. VIP has its national footprint in the veterinarian services and products industry. As evidenced by this acquisition, PetIQ is rapidly growing, executing upon its mission (paraphrased) "to enhance pet lives by educating pet parents on the basics of veterinary care and veterinary-recommended pet products and services."

VIP Petcare has a nationwide network of community clinics and wellness centers that deliver high value pet preventive and wellness veterinary services to all pet owners.

Heska Corporation (HSKA; www.heska.com)

Headquartered in Loveland, Colorado, Heska sells veterinary diagnostic and other specialty veterinary products, including allergy testing, blood testing instruments, diagnostic tests, digital imaging equipment, and supplements. The company develops, manufactures, and markets advanced veterinary diagnostic and specialty products for the dog and cat healthcare markets in the United States, Canada, Europe, and internationally.

Heska operates through two segments: 1) Core Companion Animal Health, and 2) Other Vaccines, Pharmaceuticals and Products. The Core Companion Animal Health segment offers such products as the Element DC and DRI-CHEM 7000 veterinary chemistry analyzers for blood chemistry and electrolyte analysis, as well as the HT5 and HEMATRUE veterinary hematology analyzers to measure white and red blood cell count, platelet count, and hemoglobin levels in animals. Other popular products include the Element POC blood gas and electrolyte analyzers and the Element i immunodiagnostic analyzers, as well as mobile digital radiography products, point-of-care heartworm diagnostic test products for dogs and cats, TRI-HEART Plus Chewable Tablets for the preventive treatment of heartworm infection in dogs, and treatment and control of ascarid and hookworm infections.

Heska's Other Vaccines, Pharmaceuticals and Products segment offers bovine vaccines, biological, and pharmaceutical products for other animal-health companies, and various turnkey services comprising research, licensing, production, labeling, and packaging. This segment also sells its products to veterinarians through a field organization, a telephone sales force, and independent third-party distributors, as well as trade shows, print advertising, and other distribution relationships.

Exhibit 5 provides a financial comparison of PetMed with PetIQ and Heska Corp. Notice that PetMed is the largest of the three firms and has the highest profit margin.

EXHIBIT 5 A Financial Comparison of PetMed with PetIQ and Heska Corp.

	PetMed	PetIQ, Inc.	Heska Corp.
$ Market Cap.	873M	475M	445M
% Profit Margin	13	–1.39	10.67
$ Revenue	270M	260M	135M
$ Net Income	35M	–3.6M	14.5M
# Shares Outstanding	20.5M	13.2M	7.2M
$ EPS Ratio	1.70	–0.28	1.91

Source: Based on a variety of sources.

External Issues

As the year 2018 begins, worldwide sales of animal vaccines, medicines, and medical devices exceeds $8 billion annually with an additional $14 billion in sales of vaccines and medicines for livestock. An industry trade group named Animal Health Institute reports that the global market for animal medicines is about one-fortieth of that spent on human medicines. The trade group estimated that today "24 billion chickens, more than 1 billion cattle and sheep, 750 million pigs and goats, 500 million dogs and 400 million cats" worldwide benefit from innovations in animal health.

Animal health drugs dispensed in the United States require approval from the Food and Drug Administration (FDA). According to the Animal Health Institute, the development of a new animal drug can take up to 10 years and cost up to $100 million prior to approval. A new vaccine takes 3 to 5 years to develop and averages around $80 million in costs. Animal health product manufacturers support the FDA approval process through user fees authorized by the Animal Drug User Fees Act (ADUF) and the Animal Generic Drug User Fee Act.

The American Pet Products Manufacturers Association says pet spending in the United States increased 10.7 percent to $66.9 billion in 2016. Among that total, pet supplies and medications comprised 22 percent, or $14.7 billion. PetMed Express says the pet medication market they target is worth about $4.3 billion in annual sales. According to the company's 2017 *Form 10K*, the dog and cat population in the United States is about 184 million, with about 68 percent of all households having a pet.

There are numerous facts and figures related to pet ownership worldwide, but simply focusing on the United States as PetMed does. Exhibit 6 provides some relevant information for performing an external strategic management assessment.

EXHIBIT 6 Relevant U.S. Facts and Figures for PetMed Express External Audit

- 55 percent of American households have pets
- Dog ownership is growing faster than any other pet category
- Aging boomers are more likely than previous generation to own pets
- Aging boomers prefer large dogs for security reasons
- Dog ownership has increased 29 percent in the past decade
- Multiple-dog ownership households is growing fastest of all categories
- Millennials are today more likely than previous generation to own pets
- Non-Hispanic whites are overrepresented in the population of dog owners
- Half of dog owners live in the 25 largest American cities
- Owners of multiple dogs are more likely to splurge on their pets
- 59 million Americans own cats
- There is little growth in the cat pet population over the past decade
- Women are responsible for most of the cat pet ownership
- Cat ownership among seniors increased 43 percent in the last decade
- Cat ownership among Hispanics is growing rapidly
- 24 percent of owners have overweight cats
- Owners of multiple cats are more likely to by pet products at discount stores
- Birds, fish, and other non-cat-or-dog pets live in 15 million U.S. households
- 23 percent of pet owners have a pet other than a dog or cat
- Population of pets other than dogs and cats reaches 86 million in the United States
- Boomers are less interested in pets other than cats or dogs
- Latinos most likely to own pet birds
- High income households usually are who owns non-dog-or-cat pets
- Children are a major factor in ownership of non dog-or-cat pets

Source: Based on information at https://globenewswire.com/news-release/2017/07/17/1047437/0/en/United-States-Pet-Population-and-Ownership-Trends-Report-2017-Focus-on-Dogs-Cats-and-Other-Pets.html

Future

In the first two months of 2018, shares of PedMed stock declined 10 percent, even though the company's earnings per share (EPS) were $.44 for Q3 of fiscal 2018, up 83.3 percent from the year-ago quarter's $.24. That year-over-year rise in earnings was accompanied by company sales in Q3 2018 rising 13.7 percent year-over-year to $60.1 million. Also, for Q3 2018, PedMed's reorder sales increased 13.4 percent to $50.9 million, while new order sales rose 15.5 percent to $9.2 million. The company's average order value was $86 in Q3, compared with $81 in the year-ago quarter. There is seasonality in the company's business because of the proportion of flea, tick, and heartworm medications in the product mix. Spring and summer are considered peak seasons while fall and winter represent off-seasons. Also, during Q3 2018, PetMed acquired 106,000 new customers, up from 99,000 a year ago. Roughly, 84 percent of all orders was generated from its website (versus 83% in the prior-year quarter). Finally, for Q3, the company's advertising expenses rose 30.2 percent to $4.1 million. Given the excellent Q3 results, PetMed announced a 25 percent increase in quarterly dividend to $.25 cents per share that was paid to shareholders in March 2018.

PetMed is performing quite well, but this success gives incentive for manufacturers of pet medications to forward integrate into PetMed's business, potentially crushing PetMed. The company needs a clear strategic plan going forward.

AstraZeneca plc—2022

www.astrazeneca.com

Headquartered in Cambridge, England, AstraZeneca plc is a huge pharmaceutical firm that focuses on oncology, cardiovascular disease, renal and metabolism disorders, respiratory disorders, immunology, and several other areas. It employs 76,100 persons, up from 70,000 and 64,000 in 2019 and 2018, respectively. In 2021, the company had 171 projects in its pipeline, with 12 considered as in the late stage.

Global populations are shifting toward older age groups, spurring a greater need for advanced medical care. People in developing regions have more disposable income and are increasingly able to pay for advanced medical care. In fact, 34 percent of AstraZeneca's sales in 2020 were derived from emerging markets. COVID-19 is still fresh in everyone's minds. With today's technology and advanced data analytics, drugs can be tailored for specific customers. Such trends are increasing competition among pharmaceutical firms.

History

AstraZeneca traces its origins to the 1890s, when a group of pharmacists in Sweden proposed that pharmaceuticals be produced on an industrial scale as opposed to pharmacists (often called chemists) producing drugs locally. In 1913, Astra AB was formally incorporated and quickly became a leading pharmaceutical firm in Sweden. AstraZeneca was founded in 1999 when the Swedish firm Astra AB merged with the British Zeneca Group.

AstraZeneca reported goodwill of over $11 billion in 2020, indicating a history of paying more than book value for acquisitions. (Note that whenever a firm pays more than the stock price times the number of shares outstanding for a rival firm, then the overpaid amount is referred to as goodwill and is recorded on the acquiring firm's balance sheet.) Sometimes a company will pay more than book value to obtain certain patents, trademarks, or technologies. AstraZeneca acquired Cambridge Antibody Technology in 2006, Medimmune in 2007, Spirogen in 2013, Definiens in 2014, and Alexion Pharmaceuticals in 2020.

AstraZeneca has a strong history of employing women, as evidenced by over 50 percent of the company's workforce being female. The firm also has a strong history with sustainability-related issues; it is a member of several sustainability indices, including the Dow Jones Sustainability Index, FTSE4Good, and the Access to Medicine Index. AstraZeneca produced a successful vaccine for COVID-19 in late 2020.

Vision/Mission

AstraZeneca does not have a stated vision or mission statement. However, paraphrased from narrative on the corporate website and the company's 2020 *Annual Report*, the following could function as AstraZeneca's vision and mission statements.

Vision Statement

We are committed to becoming the global leader in providing life-changing medicines through science and the entrepreneurial spirit of our employees.

Mission Statement

At AstraZeneca, we serve people around the world to provide health solutions that increase the quality of life of all we serve. Focused on producing ethical drugs and financial growth, we are committed to using the latest technology and hiring the most talented scientists and business professionals. Our core areas of service are oncology, cardiovascular, renal and metabolism, and respiratory diseases. With respect to oncology, we are determined to find a cure for every cancer known to man. By focusing on sustainability and environmental protection, we are also committed to operating in a manner that balances business growth with preserving the natural environment.

Internal Issues

Organizational Structure

AstraZeneca is proud to have a workforce that is 50.5 percent female. However, the company's senior executive team has only 4 women out of 12 team members, and the board of directors has 5 female members out of 14 members.

The firm's structure features one major team referred to as the Senior Executive Team (SET) and two governance bodies that make key decisions related to the business portfolios and pipeline. One team is called the Early Stage Portfolio Committee (ESPC), and the other is called the Late Stage Portfolio Committee. Members of the SET are provided below. It is difficult to figure out exactly how the firm is structured, but considering consumption habits of drugs are likely similar across geographic regions, a new organizational structure with presidents of the four key segments should perhaps be considered.

AstraZeneca's top executives are listed below:

1. Pascal Soriot, CEO
2. Marc Dunoyer, CFO
3. Katarina Ageborg, Executive Vice President, Sustainability and Chief Compliance Officer
4. Jose Baselga, Executive Vice President, Oncology R&D
5. Pam Cheng, Executive Vice President, Operations & Information Technology
6. Ruud Dobber, Executive Vice President, BioPharmaceuticals Business Unit
7. David Fredrickson, Executive Vice President, Oncology Business Unit
8. Menelas Pangalos, Executive Vice President, Biopharmaceuticals R&D
9. Jeff Pott, General Counsel and Chief Human Resources Officer
10. Iskra Reic, Executive Vice President, Europe and Canada
11. Leon Wang, Executive Vice President, International and China President
12. Fiona Cicconi, Executive Vice President, Human Resources

Financial Data and Statements

As indicated in Exhibit 1, AstraZeneca reported revenue growth of 9 percent in fiscal 2020 but a 156 percent net income growth due in large part to controlling the cost of goods sold expenses and a slight reduction in operating expenses. In Exhibit 2, note the large amount of goodwill on the balance sheet from purchasing rival firms in excess of book value and the large intangibles number. Intangibles are common for firms such as AstraZeneca as they indicate patents. In December 2020, AstraZeneca agreed to acquire Alexion Pharmaceuticals for $39 billion in part because of the firm's desire to report revenues of $40 billion by 2023. Note the goodwill on the 2021 balance sheet once the acquisition is finalized; just how much will AstraZeneca overpay for Alexion? Don't be misled by large increases in revenues or net income in fiscal 2021, as they will largely be derived from this merger.

EXHIBIT 1 AstraZeneca's Income Statements (in millions of USD)

Income Statement	12/31/19	12/31/20		Percent Change
Revenues	$24,384	$26,617	⇧	9%
Cost of Goods Sold	4,921	5,299	⇧	8%
Gross Profit	19,463	21,318	⇧	10%
Operating Expenses	16,539	16,156	⇩	–2%
EBIT	2,924	5,162	⇧	77%
Interest Expense	1,376	1,246	⇩	–9%
EBT	1,548	3,916	⇧	153%
Tax	321	772	⇧	140%
Non-Recurring Events	0	0	NA	NA
Net Income	1,227	3,144	⇧	156%

Source: Based on information in the 2020 AstraZeneca *Annual Report,* p. 176.

EXHIBIT 2 AstraZeneca's Balance Sheets (in millions of USD)

Balance Sheet	12/31/19	12/31/20		Percent Change
Assets				
Cash and Short Term Investments	$5,369	$7,832	↑	46%
Accounts Receivable	5,761	7,022	↑	22%
Inventory	3,193	4,024	↑	26%
Other Current Assets	1,240	666	↓	–46%
Total Current Assets	15,563	19,544	↑	26%
Property Plan & Equipment	7,688	8,251	↑	7%
Goodwill	11,668	11,845	↑	2%
Intangibles	20,833	20,947	↑	1%
Other Long-Term Assets	5,625	6,142	↑	9%
Total Assets	61,377	66,729	↑	9%
Liabilities				
Accounts Payable	13,987	15,785	↑	13%
Other Current Liabilities	4,130	4,522	↑	9%
Total Current Liabilities	18,117	20,307	↑	12%
Long-Term Debt	16,217	17,994	↑	11%
Other Long-Term Liabilities	12,447	12,790	↑	3%
Total Liabilities	46,781	51,091	↑	9%
Equity				
Common Stock	328	328	↓	0%
Retained Earnings	2,812	5,299	↑	88%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	11,456	10,011	↓	–13%
Total Equity	14,596	15,638	↑	7%
Total Liabilities and Equity	**61,377**	**66,729**	↑	9%

Source: Based on information in the 2020 AstraZeneca *Annual Report,* p. 177.

R&D Information

Research and development (R&D) activities and expenditures are the backbone of virtually all pharmaceutical firms. R&D is a major expense at AstraZeneca. The company markets itself as focusing on quality rather than quantity with its R&D through its 5R Framework strategy. Over the period from 2015 to 2020, the 5R Framework aided the firm in advancing the former proportion of pipeline molecules by four times. The basis of the 5R Framework is 1) selecting the right targets that have a significant correlation with the disease under concern, 2) assuring new drugs more effectively target the correct tissues, 3) ensuring that safety is high before beginning clinical trials, 4) ensuring the right markets are chosen based on the value propositions of the right-size target markets, and 5) ensuring that drugs are tailored more closely to individual patients.

Typically, the average success rate for small molecule (virus) research is 6 percent, but through the 5R Framework, AstraZeneca has been able to advance its Phase III clinical trials from 4 to 19 percent, well above the 6 percent average. For example, implementing just Step 5 above enabled the launch of 9 companion diagnostics tests over a 5-year period ending in 2016, compared to only 1 companion diagnostics test launched between 2005 and 2010. Notable areas of these diagnostics included lung cancer, ovarian cancer, and bladder cancer. For the patient, a diagnostic test is much more cost effective, time saving, and less invasive than a traditional biopsy. The test is often possible with just a simple prick of the finger.

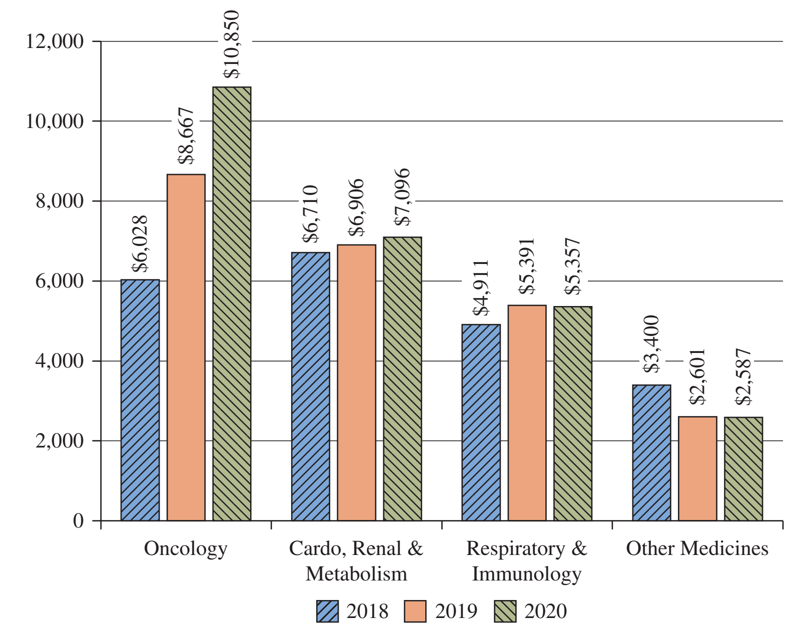
To further benefit from R&D investments, AstraZeneca routinely partners with leading universities and research laboratories, enabling AstraZeneca scientists to work with the world's best researchers and scientists in joint partnerships. This open innovation initiative benefits not only AstraZeneca but also the world at large. The firm spent $6 billion on R&D in both 2019 and 2020.

The general phases of R&D projects is 5 to 15 years, with a 6-step sequence: 1) identify medicines that will have a positive impact; 2) initiate preclinical studies; 3) conduct Phase I trials, which includes trials with health volunteers to determine dosage and side effects; 4) Phase II trials, which expand on Phase I trials, and where the sample size of volunteers are increased and further data is collected for regulatory approvals; 5) Phase III trials, where larger sample sizes are used and a branding strategy for the drug is determined; and 6) regulatory submission and pricing. These R&D phases are followed by a launch phase that could last another 5 to 15 years.

By-Segment Information

AstraZeneca conducts business in four key segments: 1) Oncology, 2) Cardiovascular, Renal & Metabolism, 3) Respiratory & Immunology, and 4) Other Medicines. Exhibit 3 shows that Oncology is the largest division, with 42 percent of sales in 2020, and the fastest-growing division, with sales up a remarkable 80 percent since 2018. The weakest division is Other Medicines, representing only 10 percent of total revenue, and with sales down 24 percent since 2018.

EXHIBIT 3 AstraZeneca's Sales by Segment (in millions of USD)



Source: Based on AstraZeneca's 2020 *Annual Report*, p. 2.

Oncology

Exhibit 3 shows that oncology, the branch of medicine that specializes in cancer, is the most profitable and fastest-growing segment at AstraZeneca. The firm claims their mission is to discover and provide a cure for every type of cancer known to man. This segment has grown 80 percent since 2018 and represents 42 percent of all sales. Globally, cancer is the second leading cause of deaths. Lung cancer has the highest mortality rate, taking a life every 18 seconds, and is followed by colorectal, stomach, liver, and breast cancer. The two most common types of cancer worldwide are lung and breast cancer. Prostate and ovarian are other common cancers for which AstraZeneca specializes in finding cures and medical treatment.

The market for oncology is over $140 billion annually, and AstraZeneca enjoys $10.8 billion of this market (less than 8 percent), leaving substantial room for growth. Tagrisso, AstraZeneca's drug for lung cancer, has been approved in the United States and in 85 other countries. Sales of this drug were up 36 percent in 2020, with revenues of $4.3 billion. Lynparza is a drug that can treat ovarian, breast, pancreatic, and prostate cancers, and it accounted for $2.2 billion in sales, up 24 percent from 2019. This drug is approved in 78 countries for ovarian cancer but only in 55 countries for pancreatic cancer. This discrepancy calls to attention the heavy regulation in this industry, as many of the same countries that approve drugs for some cancers do not approve the same drug for other cancers.

Imfinzi, which is used to treat both lung and bladder cancer, experienced an increase in sales of 39 percent to $2 billion in 2020; it is approved in 67 countries. While AstraZeneca has many other drugs, these three drugs account for 79 percent of 2020 revenues for the oncology division. New regulation, patent expiration, and piracy of any one of these three drugs are all serious threats for AstraZeneca moving forward. The firm has numerous other products in the pipeline waiting approval, but careful strategic planning is needed because of expiring patents on the same drugs that treat these common types of cancers. Recall from earlier that AstraZeneca only controls 7.7 percent of the oncology market.

Cardiovascular, Renal, & Metabolism

The mission of this business segment is to protect people from cardiovascular, renal, and metabolism (CVRM) diseases. The CVRM market is estimated to be over $204 billion worldwide, with AstraZeneca controlling $7 billion of it, or 3.4 percent. Globally, diabetes represents $100 billion of the $204 billion world market in CVRM, with high blood pressure and blood cholesterol accounting for $35 and $17 billion, respectively. In total, 463 million people worldwide live with diabetes, and 18 million people die from heart failure and cardiovascular disease annually. About 700 million people live with chronic kidney disease. Similar to oncology, a few drugs comprise most of the revenue for AstraZeneca in this division.

Farxigal is approved in 100 countries and is used to treat both Type 1 and Type 2 diabetes. The reported revenue for the drug was nearly $2 billion in 2020, up 27 percent from 2019. Brilinta, which treats coronary artery disease and stroke, is approved in 110 countries and reported revenues of $1.5 billion in 2020, but it was up only 1 percent from 2019. The third and fourth most profitable drugs in this segment for AstraZeneca both had revenues around $500 million but were down 11 and 18 percent in 2020. With flat sales over 3 years in an important division, AstraZeneca needs a clear strategic plan to determine what direction this division should take, as the data indicates that unless something changes, the entire division's growth predominately hinges on just Farxigal.

Respiratory & Immunology

The annual worldwide market value for this segment is projected to be $72 billion, with asthma accounting for $22 billion and chronic obstructive pulmonary disease (COPD) accounting for $17 billion. AstraZeneca accounted for $5.3 billion of this $72 billion industry, which forecasters quickly see growing into a $100 billion industry. Globally, 339 million people suffer from asthma, and 60 percent of the cases are considered uncontrolled. COPD is the third leading cause of death in the world, with over 384 million people suffering annually. AstraZeneca has three leading asthma drugs that represent about $4.6 billion of the firm's $5.3 billion in sales. Overall, this segment reported a 1 percent decline in revenue in fiscal 2020. The firm has several drugs in Phase III of the pipeline to hopefully help asthma patients.

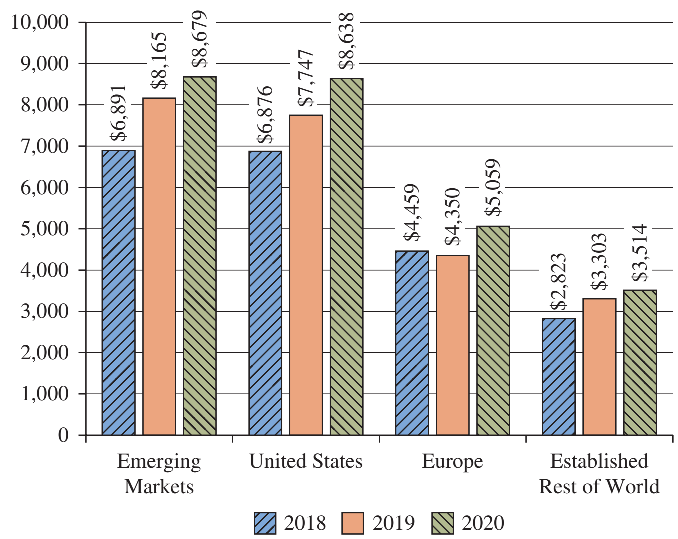
Other Medicines

The drugs AstraZeneca includes in this segment cover the areas of infection, neuroscience, and gastroenterology. COVID-19 drugs are included here—AstraZeneca had one of the more popular coronavirus drugs in the world along with rivals Moderna and Pfizer. This segment accounts for $2.5 billion in annual sales for AstraZeneca, and the products treat such aliments as influenza, schizophrenia, bipolar disease, osteoarthritic pain, and opioid-induced constipation. The drug Nexium, a proton pump inhibitor to treat acid-related diseases, represented nearly 50 percent of all sales in this segment. The firm divested rights in Europe to Grunenthal in October 2018 but still enjoys strong sales in other regions of the world. In the 2020 *Annual Report*, AstraZeneca derived only $2 million from COVID-19 vaccines, but this data only covered a limited period of the drug's availability to the public.

Regions Served

Exhibit 4 shows that emerging markets accounted for the same revenue generation as the United States in 2020. Europe, with more than double the U.S. population, accounts for significantly less revenue, due in part to firms not being able to charge higher prices in this region. Infrastructure problems, governmental incentives, differences in drug approvals, and the preponderance of persons across countries capable of paying for various drugs explain the variation in AstraZeneca's sales across regions.

EXHIBIT 4 AstraZeneca's Sales by Region (in millions of USD)



Source: Based on AstraZeneca's 2020 *Annual Report*, p. 3.

Competitors

The highly competitive pharmaceutical industry is led by Johnson & Johnson, with a market cap at the time of writing of $430 billion, followed by Roche, Pfizer, Merck, and Novartis, with market caps of $288 billion, $214 billion, $195 billion, and $195 billion, respectively. AstraZeneca checks in at ninth with a market cap of $132 billion. Most of the top pharmaceutical firms are based in the United States, but Roche and Novartis are based in Switzerland. Interestingly, Moderna, another notable drug company with a popular COVID-19 vaccine, is not in the top 10 largest firms based on market cap. There are several key players in the generic market, including Viatris, Teva Pharmaceuticals, and Sun Pharmaceutical, with India being the largest nation providing generic drugs globally.

Bristol Myers Squibb

Although only the seventh largest firm in the global pharmaceuticals industry, Bristol Myers Squibb (BMS) controls the second and third most popular oncology drugs in the industry. Recall that oncology is the top revenue-generating segment for AstraZeneca and the top overall revenue-generating segment in the industry. The firm specializes in oncology and cardiovascular diseases, HIV, and other diseases. BMS traces its roots to 1887, and in 1989 it was the second largest pharmaceutical company in the world, but it lost market share after divesting holdings and making poor strategic decisions. BMS has had an aggressive acquisition history recently, with large acquisitions in 2015, 2017, and 2019, and it recently announced plans to acquire Celgene for $74 billion. Celgene is a leading biopharmaceutical manufacturer in oncology, so this could place significant pressure on AstraZeneca.

Johnson & Johnson

The largest company by market capitalization in the pharmaceutical industry, Johnson & Johnson (J&J) is a household name around the world partly because the firm is so diversified, and many of the products are over-the-counter items such as baby powder, skin lotions, and skin oils. With respect to pharmaceuticals, J&J's focus includes immunology, infectious diseases, vaccines, nervous system disorders, and oncology. J&J also has one of the more popular COVID-19 vaccines; however, batches of the vaccine had to be recalled.

Pfizer

Pfizer is likely the big winner in the COVID-19 vaccine lottery as it is arguably the most popular one worldwide. Other key drugs of the firm include Lipitor, Norvasc, and Zoloft. Most of Pfizer's manufacturing facilities are located in the United States as the country is the largest market, but the firm is expanding internationally as patent protection laws are increasingly enforced. Pfizer's main businesses include biologics, small molecule medicines, and vaccines. Due to this profile, Pfizer and AstraZeneca do not compete as directly as some other firms do in the very competitive cancer research arena.

External Issues

Regions

The United States is the world's largest pharmaceutical market by a wide margin, partly because pharmaceutical firms can charge higher prices. Healthcare customers in the United States tend to be more fragmented and private, and there is less regulation on pricing as there is no centralized national health system like many other countries. As a result, U.S. consumers tend to pay the bill for citizens from other nations. For instance, in 2020, the U.S. government accelerated development of treatments and vaccines for COVID-19, likely saving millions of lives, and perhaps paving the way for quicker to-the-market products from pharmaceutical firms. However, there are signs the U.S. windfall for big pharma may be waning as both Democrats and Republicans are lobbying for affordable drug prices.

In 2021, the U.S. pharmaceutical market was estimated at over $500 billion. The top 6 pharmaceutical spending nations in Europe account for $174 billion, with Germany and France being the largest spenders at $52 and $35 billion, respectively. China spent $95 billion and Japan spent $81 billion on pharmaceuticals in 2020. China's spending is expected to grow to $165 billion by 2023.

Trends

The global demand for healthcare is accelerating, with an aging population in established markets and a growing income level in developing nations. By 2050, the number of people over the age of 60 will be 2 billion, and 80 percent of these citizens will be living in developing regions. Research suggests that as the percentage of older people is growing quicker than the younger percentage of the population, the reports of non-communicable diseases (NCDs) will increase. Disabilities caused by NCDs will become a large burden for global disease control and treatment but presents a large opportunity for pharmaceutical firms. NCDs kill over 41 million people annually and are responsible for 34 percent of the disease burden in 2019, compared to only 21 percent in 1990. Smoking, poor diet, and lack of exercise have been blamed for many NCD deaths and health problems.

Historically, R&D investments have focused on treatment options. This has been extremely profitable for the industry, but with increasing competition, there is a shift industrywide now to R&D that focuses more on prevention and even early intervention and detection. AstraZeneca's research in developing many new diagnostic tests serve as examples here. It was a long-held belief that focusing on treatment was far more profitable than prevention and early detection, but some analysts now contend that pharmaceutical firms should focus more on developing cures rather than treatments.

In 2020, the United States had $514 billion in global pharmaceutical sales, or 48 percent of the world's total. Europe totaled $211 billion in sales, and emerging markets totaled $228 billion. The entire world saw around $1.07 trillion in pharmaceutical sales in 2020. Note that AstraZeneca received 34 percent of its 2020 sales from emerging markets compared to the industry average of 21 percent.

Regulatory Environment

Regulations offer a major threat for many players in the industry as the public expects safe and effective drugs. As a result, governments around the world highly regulate their production and distribution. This prolonged approval process increases the cost of drugs and the time it takes for the drugs to reach desperate patients. Patents are used to protect firms, but piracy is increasing globally, and there is often a worry that drugs, once approved, may be stripped of patent protection if they benefit society. One notable example is the question of COVID-19 vaccine patent protection rights. Fortunately, for the coronavirus and other diseases, government regulators have started the process of accelerating patient access to drugs that have transformative prospects.

With the exit of the United Kingdom from the European Union and the relocation of the European Medicines Agency from London to Amsterdam, there may be increased disruption of the regulatory process, and this could impact AstraZeneca directly. China continues to change requirements on its drug development, and the EU Health Strategy in November 2020 sought to redefine regulation of the pharmaceutical industry in the European Union. It is the hope of firms like AstraZeneca that the new EU policy will expediate and reduce the cost of bringing drugs to market.

Pricing of Medicines

There is significant downward pressure on what is a fair price for pharmaceutical products—good for consumers but bad for pharmaceutical companies. Highly regulated governments, insurance companies, and other players are keeping costs down in many regions of the world. Drug prices in China dropped 50 percent for 119 medicines in March 2021, and in Europe, governments extend stringent price control measures on medicines. President Joe Biden has supported proposals that significantly reduce the price of drugs in the United States, which was traditionally viewed as a market where drug makers could generate the bulk of their sales—this market accounted for 48 percent of global pharmaceutical sales in 2020.

Generic Drugs

Even when prices remain high and patents are honored, both are finite, and protection does expire. Generic drugs benefit from not having large R&D and market development expenses and are available at substantially lower prices. For example, in 2020, in the United States alone, over 85 percent of prescriptions dispensed were for generic drugs. The generic drug market presents a significant threat for firms that have enormous R&D expenses like AstraZeneca. In addition, governments are offering incentives (or legal bribes, if you care to think of incentives this way) to pharmacists to fill prescriptions with generics.

Brexit

A year after the United Kingdom exited the European Union ("Brexit"), the UK government and the European Union were able to come to terms on a trade agreement, but many issues remain. Free trade and free movement of workers will play an important role; at present, 11 percent of the workforce of AstraZeneca is based in the United Kingdom and 12 percent in Europe.

Oncology Remains on Top

As discussed earlier in the case, AstraZeneca's leading segment is oncology, and oncology is, in fact, the largest segment across the industry in terms of revenue as well in spending on drug research (it is thus a major driver of spending growth). New technology in this area includes drugs working with the body's immune system to fight off cancer as opposed to older technology where the drugs directly targeted the cancer cells themselves. Three of the leading drugs with this approach are owned by Merck and BMS. While BMS is eighth in terms of market cap, this firm has the second and third most popular drugs in the field of oncology, making BMS a serious competitor for AstraZeneca. For reference, AstraZeneca's Tagrisso is the seventh most popular oncology drug.

Conclusion

Strategy Considerations

AstraZeneca is a global player in the pharmaceutical industry and needs a clear strategic plan moving forward. Note that the firm has four distinct divisions with one, the cancer research division, leading sales by a wide margin. What should AstraZeneca do with the other divisions? How should the firm shift its resources around? Your job as a student is to assume you have been hired by AstraZeneca to produce a three-year strategic plan, so be careful not to report what the firm has been doing or what you think they are going to do based on the latest news releases, unless this matches your own detailed strategic analysis. Instead, report what your analysis suggests the company should do based on your strategic management knowledge and research. In fact, this is exactly what AstraZeneca would pay you to do if you were really hired to develop a three-year strategic plan. Other considerations to take into account are the organizational structure. Would you suggest a change? Does the mission or vision of the firm need to be reworked? Do you agree with the latest mergers and management's desire to push revenues past $40 billion annually? Is growth in this direction the most effective and efficient option, or is there a better alternative to grow? What drug lines would you consider selling to rival firms? Be mindful that shareholders expect at least a 5-percent top-line and bottom-line growth annually.

The pharmaceutical industry has a bright future, with an aging population in the United States, Europe, and Japan and emerging markets that have more disposable income. What products and regions are best served? In AstraZeneca's *Annual Report,* the CEO often mentions that AstraZeneca is out to win. Help CEO Soriot by developing a detailed three-year strategic plan.

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2. S&P Net Advantage, Industry Surveys, Pharmaceutical Report.

Shell plc—2022

www.shell.com

Headquartered in Haagse Hout, The Hague, Netherlands, Shell is the largest company in Europe. A British–Dutch oil and gas company that is highly vertically integrated with extensive operations in over 100 countries, Shell employs experts in the exploration, production, refining and marketing of oil and natural gas as well as the manufacturing and marketing of chemicals globally. The company uses advanced technologies to extract and process oil and gas and is also involved in wind, solar, advanced biofuels, and hydrogen.

At the end of 2020, Shell had 87,000 employees working in over 70 countries, operated 13 refineries, and produced about 3.5 million barrels of oil and 70 million tons of liquefied natural gas (LNG) per day. Shell globally explores for crude oil and natural gas and extracts these products from major fields; it also extracts bitumen from oil sands, cools natural gas to produce LNC, and builds and operates refineries and chemical plants that produce lubricants, petrochemicals, diesel, and aviation fuel. Additionally, Shell invests in wind and solar to reduce global carbon dioxide emissions.

History

The Shell Transport and Trading Company was founded by Marcus Samuel in 1890, and the Royal Dutch Petroleum Company was founded by Jean Kessler, Henri Deterding, and Hugo Loudon in 1897. The two rival companies merged in April 1907, primarily for the purpose of competing more effectively with the U.S.-based Standard Oil. In 1912, the merged company, Royal Dutch Shell, purchased the Rothschilds' Russian oil assets.

Shell was battered by the COVID-19 pandemic, with the company in February 2021 reporting a loss of $21.7 billion for the year 2020 despite a reduction in operating expenses by $4.5 billion (12 percent). To give you a feel for what Shell does globally today, some of its projects that are currently operating or under construction are described below.

Appomattox is Shell's largest floating deep-water oil and gas operation/platform in the Gulf of Mexico.

LNG Canada is a huge natural gas project under construction off the west coast of British Columbia, Canada, but 10 years away from completion. Shell owns 40 percent of this project, followed by PETRONAS (25 percent), PetroChina (15 percent), Mitsubishi Corporation (15 percent), and KOGAS (5 percent). This location offers a relatively short shipping distance to northern Asia, one of the fastest-growing gas markets in the world, avoiding the Panama Canal.

Pennsylvania Petrochemicals Complex is a 100-percent Shell-owned petrochemicals plant under construction 30 miles northwest of Pittsburgh to process ethane from shale gas. About 70 percent of North American polyethylene customers are within a 700-mile radius of Pittsburgh, thus offering Shell a competitive advantage over rivals.

Vito is Shell's 11th deep-water project in the Gulf of Mexico, scheduled to begin producing about 100,000 barrels of oil per day in 2021. Shell owns 63 percent of the operation and Statoil USA E&P Inc. owns 37 percent.

Bonga North West is a Shell operation producing 40,000 barrels of oil per day in the Gulf of Guinea off the coast of Nigeria in an average water depth of 3,300 feet.

Cardamom is a 100-percent Shell-owned oil and gas operation located in the Gulf of Mexico currently producing about 50,000 barrels of oil per day in 2,600-feet-deep water.

Gumusut-Kakap is Shell's first deep-water project in Malaysia, producing about 148,000 barrels of oil per day from the Gumusut-Kakap field in 3,900-feet-deep water.

Kaikias is an 80-percent Shell-owned deep-water oil and gas project in the Gulf of Mexico. MOEX North America LLC owns 20 percent of the project.

Malampaya Phases 2 & 3 is a 45 percent Shell-owned natural gas-to-power project located off the northwest coast of the Philippines that provides 20 percent of that country's electricity. Chevron owns 45 percent of the operation, and the Philippine National Oil Corporation-Exploration Corporation (government) owns 10 percent.

Malikai is a 35-percent Shell-owned floating oil production facility located off Sabah, Malaysia, that produces about 60,000 barrels of oil per day. ConocoPhilips owns 35 percent and Petronas Carigali owns 30 percent of this floating platform, which produces and pipes oil about 30 miles to the shallow-water Kebabangan platform for processing.

Nanhai Petrochemicals Complex is located in Guangdong Province, China, and is 50 percent owned by both Shell and the China National Offshore Oil Company (CNOOC) Petrochemicals Investment Company Limited. This operation supplies the Chinese market with about 3 million tons of ethylene and propylene derivative products, used in a wide range of industrial and consumer products, including household appliances, cars, furniture, and computers.

Ormen Lange is a 17.8-percent Shell-owned deep-water oil and gas operation located in the Norwegian Sea 75 miles northwest of Kristiansund, Norway. It meets 20 percent of the United Kingdom's gas needs via one of the world's longest subsea pipelines. Petoro owns 36.5 percent of this operation, followed by Statoil at 25.4 percent. The facility produces about 100,000 gallons of oil per day.

Parque Das Conchas is a 50-percent Shell-owned ultra-deep oil and gas operation located at Campos Basin, Brazil, that currently produces natural gas. The other owners are ONGC, at 27 percent, and Qatar Petroleum International, at 23 percent.

Vision/Mission

On their corporate website, Shell states their "purpose" as offering more and cleaner energy solutions that raise standards of living globally in order to drive demand for energy, including oil and gas, for years to come. It also notes the need to tackle climate change and transition to a low-carbon energy consumption planet. Also mentioned is a focus on safety and having a "Goal Zero" philosophy, meaning zero harm to its people or the environment.

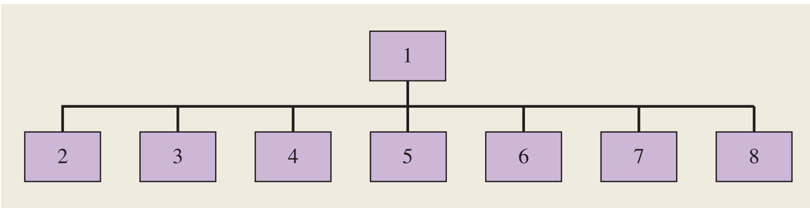
Internal Issues

Organizational Structure

Shell appears to have an organizational structure based on strategic business units (SBUs). There are four: 1) Downstream, 2) Upstream, 3) Projects & Technology, and 4) Integrated Gas/Renewables/Energy. There appears to be no chief operating officer (COO). The Chair of Shell's board of directors is Sir Andrew Mackenzie, but the company's CEO, Ben van Beurden, serves as a board member, as does the company's CFO, Jessica Uhl. There are more women than men on Shell's board of directors.

Exhibit 1 provides a list of the top Shell executives that comprise the company's executive committee, as well as the company's likely chain of command.

EXHIBIT 1 **A List of Shell's Top Executives and a Flow Chart**



1. Ben van Beurden, CEO
2. Jessica Uhl, CFO
3. Harry Brekelmans, Projects & Technology Director
4. Donny Ching, Legal Director
5. Ronan Cassidy, Chief HRM Director
6. Wael Sawan, Upstream Director
7. Huibert Vigeveno, Downstream Director
8. Maarten Wetselaaar, Integrated Gas, Renewables, and Energy Solutions Director

Source: Based on information at www.shell.com.

Financial Data and Statements

Exhibits 2 and 3 below show the financial statements for Shell. Note that the firm had a disastrous year in 2020 as COVID-19 stopped or curtailed travel for both leisure and work. Note that on the balance sheets cash increased significantly as plant property and equipment were sold off as mentioned later under the segment data. Accounts receivable dropped 23 percent, lowering total assets by 6 percent on the year.

EXHIBIT 2 **Shell's Income Statements (in millions of USD)**

Income Statement	12/31/19	12/31/20		Percent Change
Revenues	352,106	183,195	↓	–48%
Cost of Goods Sold	279,421	141,094	↓	–50%
Gross Profit	72,685	42,101	↓	–42%
Operating Expenses	42,510	64,979	↑	53%
EBIT	30,175	(22,878)	↓	–176%
Interest Expense	4,690	4,089	↓	–13%
EBT	25,485	(26,967)	↓	–206%
Tax	9,053	(5,433)	↓	–160%
Non-Recurring Events	(2,659)	(1,978)	↓	–26%
Net Income	13,773	(23,512)	↓	–271%

Source: Based on information in Shell's 2020 *Financial Supplement Excel File.*

EXHIBIT 3 **Shell's Balance Sheets (in millions of USD)**

Balance Sheet	12/31/19	12/31/20		Percent Change
Assets				
Cash and Short-Term Investments	18,055	31,830	↑	76%
Accounts Receivable	43,414	33,625	↓	–23%
Inventory	24,071	19,457	↓	–19%
Other Current Assets	7,149	5,783	↓	–19%
Total Current Assets	92,689	90,695	↓	–2%
Property Plant & Equipment	238,349	210,847	↓	–12%
Goodwill	–	–	NA	NA
Intangibles	23,486	22,451	↓	–4%
Other Long-Term Assets	49,812	55,275	↑	11%
Total Assets	404,336	379,268	↓	–6
Liabilities				
Accounts Payable	49,208	41,677	↓	–15%
Other Current Liabilities	30,416	32,274	↑	6%
Total Current Liabilities	79,624	73,951	↓	–7%
Long-Term Debt	83,702	93,419	↑	12%
Other Long-Term Liabilities	50,547	53,361	↑	6%
Total Liabilities	213,873	220,731	↑	3%

(*continued*)

Balance Sheet	12/31/19	12/31/20		Percent Change
Equity				
Common Stock	657	651	⇩	–1%
Retained Earnings	172,431	142,616	⇩	–17%
Treasury Stock	(1,063)	(709)	⇩	–33%
Paid in Capital & Other	18,438	15,979	⇩	–13%
Total Equity	190,463	158,537	⇩	–17%
Total Liabilities and Equity	**404,336**	**379,268**	⇩	–6%

Source: Based on information contained in Shell's 2020 *Financial Supplement Excel File*.

Strategy

Being reliant on oil and gas is starting to become a threat for a firm, for electric vehicles are becoming increasingly popular, overall fuel efficiency is increasing, and new measures are being created by governments to reduce emissions. Shell is attempting to shift its resources to becoming a net-zero-emissions firm with a deadline of 2050. In 2021, Shell introduced its Powering Progress initiative to accelerate the transition to a net-zero-emissions business. Shell plans to achieve this target by reducing emissions generated from the products it sells to customers, capturing residual emissions, or countering them with offsets.

Shell is in the process of shifting its business more toward biofuels, hydrogen-charging for electric automobiles, and solar and wind technology. However, this is a slow process for Shell as the firm has a stated goal of increasing biofuels and hydrogen in transportation from 3 percent to 10 percent by 2030. By then, Shell also aims to provide renewable electricity to 50 million households and offer 2.5 million electric charging ports for automobiles

Shells' other aspirations or targets include $100 million spent on nature areas such as forest and wetlands as well as plans to invest up to $3 billion annually in the renewables and energy solutions businesses. Shell has tied a portion of pay to 16,500 staff (Shell has not disclosed what portion this amounts to) to reducing the firm's carbon footprint by 6 to 8 percent between 2016 and 2023.

By-Segment Information

Shell is organized into four basic segments: 1) Integrated Gas, 2) Renewables & Energy Solutions, 3) Upstream, 4) Downstream, and 5) Projects & Technology. However, the firm reports segment data by 1) Integrated Gas, 2) Upstream, 3) Oil Products, and 4) Chemicals and Corporate. Integrated Gas, Upstream, Oil Products, and Chemicals are all within the Projects and Technology segment. Corporate does not sell anything; it is only reported separate for bookkeeping purposes.

Integrated Gas, Renewables, & Energy Solutions

This segment manages the firm's extensive liquefied natural gas (LNG) operations, including exploration, extraction, conversion of natural gas into fuels, and all upstream and downstream activities associated with LNG. This segment includes the old New Energies business and the new Renewables and Energy Solutions business. In 2020, this segment was able to develop the first phase of Arrow Energy's Surat Gas Project, which is located in Australia. Total gas output is expected at 90 billion cubic feet per year by 2030. In the same year, a new LGN processing unit in Nigeria was established by Shell and the Blauwwind consortium, and it now generates power.

Integrated Gas, Renewables, & Energy Solutions is the second-largest revenue generating segment and, at over 20 percent, has the best profit margin of all divisions. Most of the revenue derived from this segment is from LNG, not the renewables section, but Shell actually combines renewables with LNG for reporting purposes. Shell is building Renewables and Energy Solutions through both organic (internal) growth and acquisitions (external).

By 2020, Shell was investing about $900 million annually in renewables and had a few notable accomplishments. In the United Kingdom, 900,000 homes were being supplied with natural gas and smart-home technology and 80,000 homes in Germany with Shell Energy Retail GmbH. Shell has contributed to 60,000 solar panel home installations globally and is partly responsible for 60,000 thousand electric vehicle (EV) charging ports at private homes across the Netherlands, Germany, France, and the United Kingdom, with another 8,000 for businesses and private drives in the United States, Canada, and Singapore. Finally, Shell has many onshore and offshore wind farms across the world, but most of the wind farms are located in the United States.

Upstream

This segment manages raw material exploration for and extraction of crude oil, natural gas, and natural gas liquid. Getting oil (and other products) from oil rigs, deep-water drilling, oil sands, and other means is considered Upstream. This segment generates the least revenue for Shell but was quite profitable until 2020, when this segment lost more than all other segments combined.

Shell has over 40 years' experience extracting oil from deep beneath the ocean, with projects in the United States, Brazil, Nigeria, and Malaysia. At Shell's Stones Project in the Gulf of Mexico, oil is drilled in water 3,000 meters deep and another 6,000 meters through bedrock for a production of 50,000 barrels of oil a day. In terms of total distance from the surface, Shell owns and operates the world's deepest oil drilling operation utilizing a floating production, storage, and offloading (FPSO) vessel. Today, Shell has 12 such FPSOs in use worldwide. In Malaysia, Shell's Gumusut-Kakap platform operates in 1,200-meter-deep water, with peak production in the area of 148,000 barrels per day, but this region is notorious for tropical storms, making safety an issue at times.

Regarding Shell's value chain, the upstream products are backward integrated. There are many businesses and profit points along the value chain that strive to secure a slice of the profit pie. The actual price of oil fluctuates quite a lot; it can double or halve in a matter of months, whereas the price at the gas station will not move as quickly. Competing in this industry can be volatile, showcased by the great profit margins in 2019 followed by absolute disaster in 2020. Shell has sold a 60-percent interest in the Vaca Muerta Basin in Argentina and divested many businesses in Brazil, Canada, Nigeria, the United States, and Egypt. Shell is in fact rethinking competing in the upstream market—but one should be careful when analyzing the 2021 profits and revenues from this segment based on extensive divestiture activity in 2020.

Oil Products

This segment generates more revenue than all other segments combined but experienced a huge drop in 2020 revenues compared to the other segments. The COVID-19 pandemic impacted much of these results, but the broader lesson is that products sold in this segment are much more prone to fluctuations from any number of events. Note that while earnings can be quite good, profit margins are less impressive than in other businesses, meaning there is much less room for mismanagement from the corporate office and less wiggle room from external events.

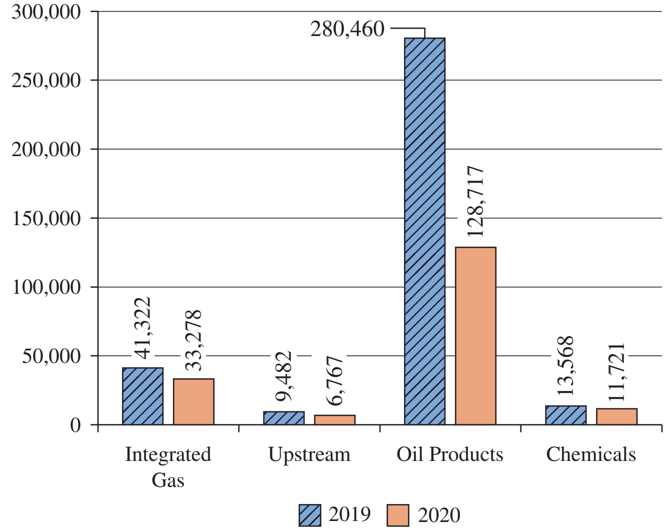
This business is part of Shell's integrated value chain, where the company refines products and moves them to customers as needed. Products sold in this segment include gasoline, diesel, heating oil, aviation fuel, marine fuel, lubricants, bitumen, and sulfur. This segment can be thought of as "middle stream," with upstream being finding the products and drilling for them. This segment refines the products; downstream sells the products to the end customer. Shell has 13 refineries worldwide that can process 2.2 million barrels of crude oil daily, with refining capabilities in Europe & Africa, the Americas, and Asia totaling 46, 33, and 21 percent, respectively. The fact is, despite all the talk about clean energy, Shell is still overwhelmingly dependent on traditional aspects of finding, drilling, and refining oil.

Chemicals

Shell's chemical business did well in 2020—it was the only segment to turn a profit. Note, however, that the segment only generates marginal revenue and limited profits. The industries served by the chemical business includes automobiles, packaging, and other machinery industries. The chemicals produced include ethylene, propylene, solvents, detergent alcohols, and ethylene glycol. Shell operates chemical plants worldwide and supplied 1,000 industrial customers with over 15 million tons of petrochemicals in 2020. At the time of writing, Shell had plans to integrate a portion of its chemical business with its refining business, so be careful comparing numbers between 2020 and future years within chemicals.

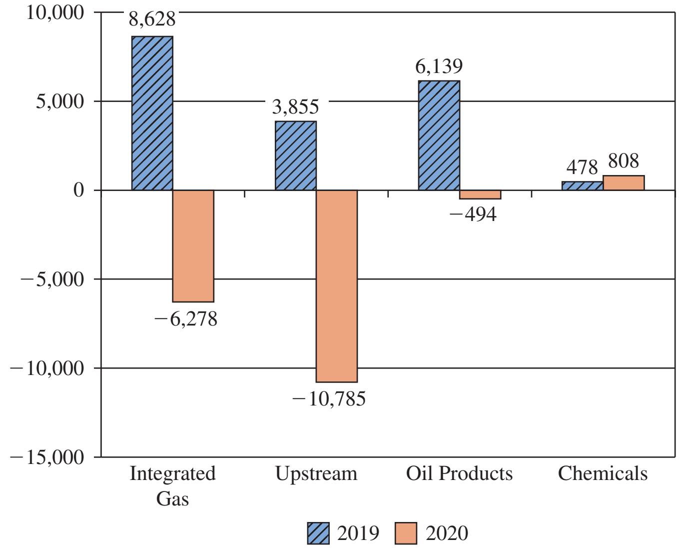
Exhibits 4 and 5 summarize Shell's revenues and profits by segment as discussed above.

EXHIBIT 4 Shell's Revenues by Product (in millions of USD)



Source: Based on information from Shell's corporate website.

EXHIBIT 5 Total Segment Earnings/Losses (in millions of USD)



Source: Based on Shell's 2020 *Annual Report,* p. 26.

External Issues

Deep-Water Drilling

Many oil companies feel that, despite cleaner energy alternatives becoming more common, popular, and in demand by the public, as the world's population increases, so does the need for oil. Under the oceans, in water ranging from hundreds to thousands of meters, are vast amounts of oil and gas, most of which have never been found. Some estimates suggest there are 270 billion barrels of oil in deep water left to be found. In 1978 the deepest offshore drilling location was in less than 400 meters, but today the deepest drilling can be done in water over 3,000 meters deep.

There are many risks associated with drilling, such as oil spills, which have profound environmental effects and are dangerous work for employees. In 2010, the Deepwater Horizon rig, situated in water 1,500 meters deep but drilling through an additional 11,000 meters of ocean floor to reach the oil, became the largest oil spill in American history. In this accident, 11 people were killed and 720 million liters of oil were spilled into the Gulf of Mexico over 3 months.

As of 2021, the technology exists to drill 20,000 meters past the ocean floor. Equipment must be able to tolerate 180°C in some locations, where the earth's mantle is close to the oil. Deep-water drilling is becoming increasingly popular. Many firms, including Shell, drill in the Gulf of Mexico. During the first decade of this century, only 15 percent of the U.S. oil production in the Gulf of Mexico was derived from ultra-deep drilling; by 2017, this number had increased to 52 percent, thanks in part to technology allowing deeper drilling. In 2020, a new record for the Gulf of Mexico was set with 2 million barrels of oil produced in a single day. It has been accepted in the industry that massive amounts of free cash can be generated from a bountiful deep-water well.

However, the new technology has not advanced as fast as the dangers and margins of error of engaging in such risky activities; in fact, research reveals that in deep-water drilling, for every additional 30 meters drilled, serious accidents grow by a staggering 8 percent.

Other hot spots for deep-water drilling are off the coasts of Malaysia, Brazil, and Nigeria. Keep in mind that there is a lot of ocean drilling done in places like the North Sea that may not be considered "deep water" as the term is generally used for drilling in water in excess of 300 meters, and ultra-deep water is drilling in water in excess of 1,500 meters.

Macroeconomic Risks

There is a significant and growing trend toward electric cars, and a lot of social stigma is attached to high-polluting vehicles in much of the world. The supply and demand factors of oil procurement and distribution are also a major risk in this industry, and wild swings in oil and gas prices are fairly common. In 2020 alone, oil prices ranged from $13 per barrel to $50 per barrel, down over 30 percent average from 2019. By the middle of 2021, oil prices ranged from $45 to $75 a barrel. Oil and gas firms cannot set their own prices either, as organizations such as Brent, West Texas Intermediate, Henry Hub, UK National Balancing Point, Japan Customs, and OPEC all influence the price of oil. Political instability in much of the world where gas is located presents risks, and poor weather conditions on offshore drilling can significantly impact revenues.

Petroleum Refining

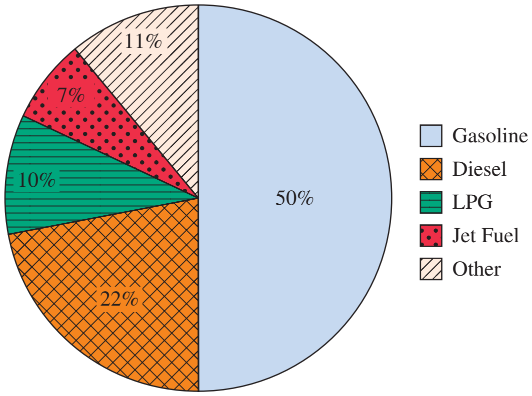
The global market for petroleum refining is huge, with top players including Marathon Petroleum, Valero Energy, ExxonMobil, Chevron, BP, Phillips, and Shell. One advantage to competing in this industry is that the barriers to entry are quite high for several reasons, which include extremely high competition, high volatility, lower profit margins, and the high capital investments needed. Nevertheless, revenue growth is to remain high up to 2026, so before oil firms shut traditional operations down, there is still a significant amount of money to be made in this business. Increased regulations, however, will likely reduce margins.

A common trend in the oil and gas industry is to upgrade existing facilities rather than build new ones. A threat for refiners in the United States is West Texas Intermediate prices, which are expected to increase to match Brent's in the coming years, adding further downward pressure on profits for refineries. Exhibit 6 reveals that about half of all oil refined is produced as gasoline and 22 percent is converted to diesel fuel, indicating the vast majority of the market is based on the transportation business, and the transportation industry is committed long-term to combustible engines.

Many People Live without Electricity

About 1 billion people worldwide currently live without electricity, creating an enormous humanitarian situation and an opportunity for energy providers. The current global population of over 7 billion people is expected to grow to 9 billion in the next two decades. The middle class will expand by more than 5 billion by 2030, with Asia accounting for 90 percent of the world's new entrants into this demographic.

EXHIBIT 6 Breakdown of a Refined Barrel of Oil



Source: Based on information derived from IBISWorld, and Exxon's 2020 *Annual Report.*

Competitors

There are not as many rival firms in the oil and gas industry as in many other industries, but the firms that are competing tend to be extremely large. Shell, Exxon, BP, Chevron, ConocoPhillips, Eni, Total, and other behemoths dominate the business. Many of these firms compete up and down the value chain, from exploration and drilling (upstream) all the way to owning their own gas stations and selling to the public (downstream). Deciding where and how to compete along this value chain is of extreme importance. Deciding where to drill is also paramount. With so many firms competing on the same dimensions and selling the same commodity, management and research become key components to success as margins are low and it is difficult to distinguish a liter of gas produced by Shell from one by Exxon; customers often simply want the cheapest they can get.

In addition to large traditional energy players, many smaller firms who specialize in wind power, solar power, and electric battery production are competing in the green space. A few notable solar firms include Solar Edge Technologies and SolarPower Corp. Plug Power, QuantumScape, and even Tesla are producing battery technology for cars. There are too many of these firms to list and most are small, but many firms could certainly develop into serious rivals.

Exxon

Headquartered in Texas, in the United States, Exxon is a large oil and gas corporation that reported revenues of $279 billion, $255 billion, and $178 billion in 2018, 2019, and 2020, respectively; the firm also made $21 billion and $14 billion in 2018 and 2019, respectively, and lost $22 billion in 2020. Exxon operates in the same businesses as Shell: upstream, downstream, and chemical.

Exxon's upstream business produces 4 million oil-equivalent barrels of oil and natural gas daily and operates in 40 countries. The upstream business has stakes in deep-water drilling, unconventional, LNG, heavy oil, and conventional. The firm's Mobil 1 leads the world in synthetic motor oil sales and is the single best-selling U.S. retail motor oil.

ExxonMobil is one of the largest petrochemical companies in the world, providing materials for use in products such as plastic bottles, synthetic rubber, solvents, and countless other goods; it sells 5 million barrels a day of petroleum products in total. The company is the largest global manufacturer of paraxylene and benzene. Exxon is also a large producer of ethylene and propylene; like many of the chemicals Exxon produces, these are considered feedstock, meaning they are the basic ingredients used to help produce many products we use today in different fuels, fibers, packaging film, automotive parts, etc.

Exxon is the world leader in capturing CO_2. It has captured more than 120 million tons to date, which amounts to 40 percent of all the anthropogenic CO_2 ever captured in the world. Exxon states that it is committed to transforming itself as green energy becomes increasingly sought after, affordable, reliable, and powerful.

Eni

Headquartered in Italy, Eni SpA is a large oil and gas company that operates in many businesses including 1) Refining & Marketing, which focuses on refining and marketing of petroleum products; 2) Trading, which covers group services in commodity trading, shipping, and derivatives; 3) Petrochemicals, which includes the production and sale of petrochemical products; 4) Engineering & Construction, which includes services for the oil and gas industry; 5) Exploration & Production, which focuses on exploration for, development of, and production of oil and natural gas; 6) Gas & Power, which covers the supply, regasification, transport, storage, distribution and marketing of natural gas, power generation, and electricity sales; and 7) Power and Renewables. Eni sells oil and gas in over 80 countries and operates numerous subsidiaries. The firm reported revenues of €44 billion in 2020, down from €70 billion in 2019.

Conclusion

Traditional oil and gas is slowly being phased out and replaced with wind, solar, and battery power. The automobile industry is on the forefront of this change, and many homes are powered by solar panels as well. The days of drilling for oil and using oil to power everything are eventually going to go the way of coal-powered steamboats of the 1800s. People still want the power—just not from antiquated technology. In the meantime though, oil still generates billions of dollars in revenues and profits and can serve to help firms in the industry shift their capacity to cleaner energy alternatives. There are gigantic fixed assets in this industry that firms like Shell must cope with while trying to produce a profit even as industrywide profit margins decline.

When developing a strategic plan for Shell, be sure to consider where along the value chain Shell should do business—upstream, in the middle, or downstream? How much capital should Shell devote to renewable energy and renewable energy technologies? What is the most effective way to acquire these capabilities? Should Shell spend more on R&D—that is, grow organically—or should Shell purchase firms like the ones mentioned previously that are already in these industries—that is, should Shell grow externally?

CEO Beurden has a lot to consider as he moves resources around and charts the future for Shell. When developing the 3-year strategic plan, be mindful not to simply report exactly what Shell is currently doing or what you think they are going to do from reading the news releases (unless you agree with this path based on your analysis). Rather, focus on what direction you would recommend Shell pursue, as if the company had hired your team as consultants to chart the future path over the next 3 years. Your task is to design a strategic plan for Shell that will win tomorrow, but remember that winning today is a prerequisite for that.

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The Walt Disney Company—2018

www.disney.com, DIS

Headquartered in Burbank, California, The Walt Disney Company (Disney) is a diversified entertainment company operating worldwide in four segments that include: Media Networks, Parks and Resorts, Studio Entertainment, and Consumer Products & Interactive Media (CP&IP). The word Disney for many people means Mickey Mouse-related products, but the entire umbrella of Disney also includes ESPN, ABC, Marvel, Pixar, cruise boats, and many other products and services. Disney reported revenues and net income in 2017 of $55 billion and $9 billion, but both numbers were down slightly from 2016.

For Disney's Q2 2018 that ended 3-31-18, the company reported a 9 percent increase in revenues, compared to the prior year period, to $14.5 billion, and a 23 percent increase in net income to $2.9 billion. These excellent results were led by the company's strong performance from its (1) Parks and Resorts and (2) Studio Entertainment segments. Within the Studio Entertainment segment, excellent movies such as *Black Panther* and *Avengers: Infinity War* helped lead the way. Within the Parks and Resorts segment, the company reported nice growth at Disneyland Paris and Hong Kong Disneyland Resort, and Walt Disney World Resort—but decreases in attendance and revenues at Shanghai Disney Resort.

Mickey and Minnie Mouse need a comprehensive 3-year strategic plan to guide their allocation of resources across Disney divisions in 2018–2020.

History

Mr. Walt Disney and his brother Roy arrived in California in the summer of 1923 to sell his 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. Also in 1955, the new Disneyland Park in Anaheim, California, opened.

Disney created a series of releases from the 1950s through the 1970s, including *The Shaggy Dog, Zorro, Mary Poppins*, and *The Love Bug*. Mr. Walt Disney died in 1966. In 1969, the 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 the 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 for the first time led Hollywood studios in box-office gross.

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. Shanghai Disney Resort opened in 2015, the same year Disney released *Star Wars Episode VII* in 2015.

Vision/Mission

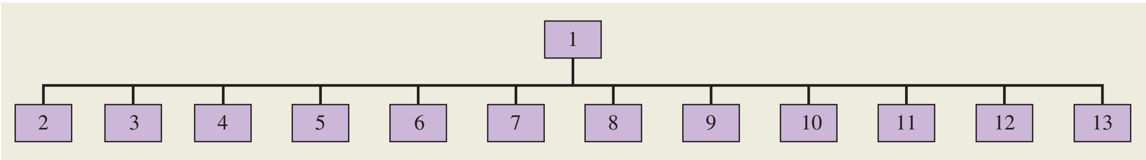
Disney's vision (paraphrased) is "to make people feel great." The mission of Disney (paraphrased) is "to be one of the leading producers and providers of creative, innovative, and profitable entertainment and information globally.

Internal Issues

Organizational Structure

Disney seemingly operates from a strategic business unit (SBU) type structure with the units aligning with the four executives with the title Chairman. Perhaps division heads report to these Chairman persons, such as the head theme park person for each park reporting to Bob Chapek. Although actual reporting relationships are not made public, an extended SBU type organizational structure would likely work well for the firm, but it would require changes in the Exhibit 1 depiction.

EXHIBIT 1 Disney's Top Executives and Organizational Chart



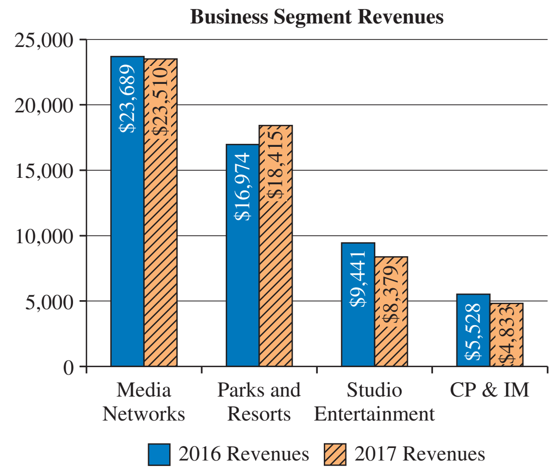
1. Robert Iger, Chairman and CEO
2. Alan Braverman, EVP, General Counsel, and Secretary
3. Ronald Iden, SVP, Global Security
4. Kevin Mayer, EVP and Chief Strategy Officer
5. Christine McCarthy, EVP and CFO
6. Zenia Mucha, EVP and Chief Communications Officer
7. Jayne Parker, EVP and Chief HR Officer
8. Brent Woodford, EVP, Controllership, Financial Planning, and Tax
9. Andy Bird, Chairman, Walt Disney International
10. Bob Chapek, Chairman, Walt Disney Parks and Resorts
11. Alan Horn, Chairman, The Walt Disney Studios
12. James Pitaro, Chairman, Disney Consumer Products and Interactive Media
13. Ben Sherwood, Co-Chair, Disney Media Networks, and President, Disney ABC Television Group

Source: Based on company documents.

Segment Data

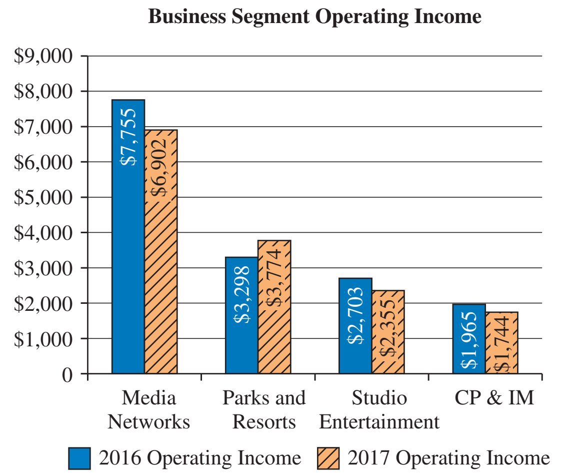
As given in Exhibit 2 and Exhibit 3, Disney provides segment revenue and operating income for each of their four SBUs: 1) Media Networks, 2) Parks and Resorts, 3) Studio Entertainment, and 4) Consumer Products and Interactive Media. Note that only the Parks and Resorts segment

EXHIBIT 2 Disney's Business Segment Revenues (in millions USD)



Source: Based on Disney's 2017 *Annual Report.*

EXHIBIT 3 Disney's Business Segment Operating Income (in millions)



Source: Based on Disney's 2017 *Annual Report.*

experienced a rise in revenues and net income. Note also that two segments comprise most of Disney's revenues: 1) Media Networks and 2) Parks and Resorts.

Specifically for Q2 2018, Disney reported that its revenues increased 3, 13, 21, and 2 percent, respectively for its four segments: 1) Media Networks, 2) Parks and Resorts, 3) Studio Entertainment, and 4) Consumer Products & Interactive Media. However for Q2, two of those four segments reported declines in operating income, Media Networks (−6 percent) and Consumer Products & Interactive Media (−4 percent). Regarding the Media Networks segment, for Q2 2018, the Cable Networks business grew revenues 5 percent to $4.2 billion but reported a decline in operating income of 4 percent to $1.7 billion. The other business within Media Networks is Broadcasting which for Q2 2018 reported steady revenues and operating income of $1.9 billion and $343 million, respectively.

Media Networks

Media Networks is the largest Disney SBU in both revenues and operating income, accounting for $23 billion or 43 percent of all revenues in 2017. This percent has been fairly constant since 2012. Within Media Networks, Disney owns and operates the ABC Television Network that reaches nearly 100 percent of all U.S. households. This segment also includes ABC-owned Television Stations Group, ABC Studios, Disney Channels Worldwide, ABC Family, A&E, History, Lifeline, Disney ABC Domestic Television, Disney Media Distribution, Hyperion, Radio Disney network and many more. The ABC Television Network operates more than 244 affiliated stations across the United States. Disney Channels Worldwide consists of 94 kids and family entertainment channels available in 162 countries and 34 languages. ABC Family is a mixture of series 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 non-branded content to all platforms. Hyperion publishes fiction and non-fiction titles for adults. Radio Disney is available in more than 40 U.S. markets, and on satellite radio, mobile apps, and the web.

Disney owns 80 percent of ESPN with the other 20 percent owned by Hearst Corporation. The ESPN network operates eight sports channels, with most operating 24 hours a day, reaching 61 nations in English, Spanish, Portuguese, and French. ESPN owns 30 percent stake in CTV Specialty Television located in Canada; Disney owns a 20 percent stake in Seven TV in Russia.

Revenue growth in the Media Networks segment for 2017 was slightly negative as production costs increased primarily because college sports, as well as NFL, MLB, NBA, The Masters, U.S. Open Tennis, and Wimbledon, were able to negotiate more lucrative contracts over the last few years. In particular, the NBA's new TV contract in fiscal 2017 lowered Disney's revenue. The Disney segment's operating income in 2017 was down 11 percent. Approximately 54 percent of the segment's revenues are generated from charging fees to cable, satellite and communication providers (affiliate fees) and 35 percent of revenues generated from advertising with the balance being derived from other sources. There are simply fewer television viewers today, and fewer viewers generally mean less bargaining power for Disney to negotiate prices with advertisers and cable providers.

Disney is forward integrated by owning eight TV stations in the United States, including the top 4 markets in New York, Los Angeles, Chicago, and Philadelphia and two more in the top eight. In a somewhat interesting deal, Hulu LLC, a live streaming service, is each owned 30 percent jointly by Disney and rivals 21st Century Fox, and Comcast Corporation with Time Warner owning the remaining 10 percent stake in Hulu.

Parks and Resorts

When most people think of Disney, Parks and Resorts probably is the first thing that comes to mind. Parks and Resorts derive revenue from park ticket prices, food, hotels, cruise vacations, and merchandise. In 2017, 80 percent of the division's revenues were derived from domestic operations with 20 percent derived from international sales. U.S. Parks and Resorts revenues only increased 4 percent in 2017 while international revenues increased 32 percent. In fact, the growth internationally was so robust in 2016, the U.S. Parks and Resorts accounted for 84 percent of segment revenues. In total, U.S. revenues for this division increased less than $600 million while International revenues increased nearly $900 million in 2017.

The international growth of this segment is mostly explained through 27 percent higher volumes but also through 4 percent higher spending per customer on average. Disney has done an excellent job attracting additional "park" customers but has room to improve on getting them to spend more once in the park or on the cruise. Exhibits 2 and 3 reveal that Disney domestic revenues from its Parks and Resorts division increased overall 8.5 percent in 2017 to $18.4 billion, up from $16.9 billion in 2016 and $12.9 billion in 2012. Operating income increased $550 million or 14.4 percent from 2016 to 2017. This is the only Disney division to increase either revenues or operating income in 2017, and it successfully increased both.

Disney's Parks and Resorts segment includes 11 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, 10) Aluani, a Disney Resort and Spa in Hawaii, and 11) Disney Shanghai. Disney does not fully own its international parks. For example, Disney controls 77 percent of the Euro Disney in Paris, only earns royalties from Tokyo Disneyland, and owns 43 percent of Disney in Hong Kong.

Disney's four cruise ships operate under this segment. The ships are named as follows: Disney Magic, Disney Wonder, Disney Dream, and Disney Fantasy. The latter two ships are Disney's largest and are the same size, both 130,000-ton-vessels, offering 1,250 staterooms and 14 decks.

Studio Entertainment

Within this segment, 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 Disney Theatrical Productions. Disney has licensed the rights to produce and distribute features films such as *Spider-Man, The Fantastic Four,* and *X-Men* to third-party studios. Disney also produces Star Wars. 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 the following: Marvel, Touchstone, Pixar, Disneynature, Disney Studios Motion Pictures, and more Disney branded services. Disney's Studio Entertainment revenues for 2017 decreased 11 percent to $8.4 billion and operating income decreased 13 percent. This SBU is divided into three areas: theatrical distribution, home entertainment, and TV/SVOD (Subscription Video on Demand) distribution. There was no change in TV/SVOD revenues in 2017 and it is the largest revenue generating division of this segment, representing 44 percent of the SBU's revenues. The largest drop in SBU revenue within this segment came from theatrical distribution, dropping 21 percent with home entertainment dropping 15 percent in 2017.

Consumer Products & Interactive Media

Historically Disney separated these two SBUs but now combines them in their *Annual Report.* 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 1) character merchandise and publications licensing, 2) books and magazines, and 3) 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/distributor of children's film-related products based on retail sales. Disney's Interactive Media segment creates and delivers games and media for smartphones and tablets. Revenues for the SBU dropped 13 percent in 2017, but this SBU is the lowest generating SBU at Disney as revealed in Exhibit 3. The SBU's operating income as revealed in Exhibit 3, dropped 11 percent in 2017.

Finance

Disney has been struggling financially mostly with its media-related divisions. Overall company revenues were down slightly in 2017 and net income down 4 percent as revealed in Exhibit 4. Exhibit 5 reveals that approximately one third of Disney's assets are in the form of goodwill. Disney has accumulated tons of goodwill over the years through its purchases of media outlets and media content. Goodwill is not a good item to have on a balance sheet since it arrives there only when a firm pays "too much" for another firm.

Competitors

Disney competes directly with NBC, Universal Pictures, 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 Florida-based Sea World, Marineland, and Silver Springs. In China, a large, new state-run theme park has opened right beside the new (2015) Disney theme park in Shanghai, China, serving as a major competitor.

Exhibit 6 provides a financial comparison for Disney and several rival firms. Note that Comcast is larger than Disney.

Comcast Corporation (CMCSA)

The major competitor to Disney World in Orlando is Universal Studios Florida, owned by Comcast Corporation, headquartered in Philadelphia, Pennsylvania. Comcast is a media and technology company operating through five segments: Cable Communications, Cable Networks, Broadcast Television, Filmed Entertainment, and Theme Parks. The Cable Communications

EXHIBIT 4 Disney's Income Statements (in millions USD)

Income Statement	10/1/16	9/30/17		Percent Change
Revenues	$55,632	$55,137	⇩	–0.89%
Cost of Goods Sold	29,993	30,306	⇧	1.04%
Gross Profit	25,639	24,831	⇩	–3.15%
Operating Expenses	10,511	10,658	⇧	1.40%
EBIT	15,128	14,173	⇩	–6.31%
Interest Expense	260	385	⇧	48.08%
EBT	14,868	13,788	⇩	–7.26%
Tax	5,078	4,422	⇩	–12.92%
Non-Recurring Events	(399)	(386)	⇧	3.26%
Net Income	9,391	8,980	⇩	–4.38%

Source: Based on 2017 *Annual Report* and other company data.

EXHIBIT 5 **Disney's Balance Sheets (in millions USD)**

Balance Sheet	10/1/16	9/30/17		Percent Change
Assets				
Cash and Short Term Investments	$4,610	$4,017	⇩	–13%
Accounts Receivable	9,065	8,633	⇩	–5%
Inventory	1,390	1,373	⇩	–1%
Other Current Assets	1,901	1,866	⇩	–2%
Total Current Assets	16,966	15,889	⇩	–6%
Property Plant & Equipment	27,349	28,406	⇧	4%
Goodwill	27,810	31,426	⇧	13%
Intangibles	6,949	6,995	⇧	1%
Other Long-Term Assets	12,959	13,073	⇧	1%
Total Assets	**92,033**	**95,789**	⇧	**4%**
Liabilities				
Accounts Payable	9,130	8,855	⇩	–3%
Other Current Liabilities	7,712	10,740	⇧	39%
Total Current Liabilities	16,842	19,595	⇧	16%
Long-Term Debt	16,483	19,119	⇧	16%
Other Long-Term Liabilities	15,443	14,612	⇩	–5%
Total Liabilities	48,768	53,326	⇧	9%
Equity				
Common Stock	35,859	36,248	⇧	1%
Retained Earnings	66,088	72,606	⇧	10%
Treasury Stock	(54,703)	(64,011)	⇧	17%
Paid in Capital & Other	(3,979)	(2,380)	⇩	–40%
Total Equity	43,265	42,463	⇩	–2%
Total Liabilities and Equity	**92,033**	**95,789**	⇧	4%

Source: Based on Disney's 2017 *Annual Report* and company data.

EXHIBIT 6 **A Disney Competitor Comparison across Some Financials**

	Disney	Comcast	Viacom
$ Market Cap.	156.8B	180.9B	13.6B
# Employees	199,000	164,000	10,750
$ Revenue	55,137M	84,526M	13,263M
% Gross Margin	45%	70%	44%
$ Net Income	8,980M	22,714M	1,874M
$ EPS Ratio	7.01	4.75	5.01
$ P/E Ratio	14.85	8.20	7.79

Source: Based on a variety of sources.

segment offers video, high-speed Internet, and voice, as well as security and automation services under the XFINITY brand. This segment also provides Ethernet network services, and cellular backhaul services to mobile network operators. The cable networks segment operates national cable networks providing entertainment, news and information, and sports content; regional sports and news networks; international cable networks; and cable television studio production operations.

Comcast's Broadcast Television segment operates NBC and Telemundo. NBC broadcasts many sports including the Olympics, NFL, college football, major golf tournaments, and many others. The broadcasting arm of the NBC, including sports and other TV shows, did not have a meaningful change in revenues in 2017 from 2016; like Disney, the difficulty in doing business in this industry is widespread.

Comcast's Filmed Entertainment segment produces, acquires, markets, and distributes filmed entertainment under the Universal Pictures, Illumination, Focus Features, and DreamWorks Animation names. The company's theme parks segment operates Universal theme parks in Orlando, Florida, as well as in Hollywood, California, and Osaka, Japan. Universal parks center around rides and attractions based on Universal Studios films. A few notable themes at the parks include The Simpsons and Harry Potter. Revenues from Comcast-owned theme parks doubled between 2012 and 2017, increasing 8 percent between 2016 and 2017.

CBS Corporation (CBS)

Headquartered in New York City, CBS is a large media conglomerate operating through four segments: Entertainment, Cable Networks, Publishing, and Local Media. The Entertainment segment produces sports and entertainment programming; acquires and/or distributes programming, including series, specials, news, and public affairs; operates online content networks for information and entertainment; produces, acquires, and distributes theatrical motion pictures; and digital streaming services. CBS's Cable Networks segment offers subscription program services, such as original series, theatrical feature films, documentaries, boxing, and other sports-related programming and special events. This segment also operates CBS Sports Network, a 24-hour cable program service that provides college sports and related content; and Smithsonian Networks, which operates a channel featuring cultural, historical, scientific, and educational programs.

Another CBS segment, Publishing, publishes and distributes adult and children's consumer books. This segment also delivers content. The Local Media segment owns 30 broadcast television stations and operates local websites, including content from the company's television stations, and news and sports radio stations.

Time Warner, Inc. (TWX)

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. The firm employs 25,000 and reported nearly $30 billion in 2016 revenue.

Viacom Inc. (VIA)

Headquartered in New York City, Viacom is considered the market leader in television broadcasting owning top brands including: Nickelodeon, Nick Jr., BET, Comedy Central, MTV, Comedy Central, SPIKE, VH1, TV Land, CMT, Logo, Channel 5, Telefe, Colors, Paramount Channel, TeenNick, Nicktoons, Nick Music, MTV2, MTV Classic, MTV Live, BET Her, BET Gospel, and BET Hip Hop. Viacom shows reach over a half billion households in over 180 different countries in 40 languages. Viacom's strength lies in its programming mix to specifically target demographics of people that watch a lot of TV. All of the above are part of the company's Media Networks segment. Viacom also operates through its Filmed Entertainment segment that produces, finances, acquires, and distributes motion pictures, television programming, and other entertainment content under the Paramount Pictures, Paramount Players, Paramount Animation, Paramount Television, Nickelodeon Movies, and MTV Films brands. Viacom reported 2017 revenue of $13.2 billion with income of $1.9 billion.

Carnival Corporation (CCL)

Headquartered in Miami, Florida, Carnival is the world's number-one 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 ships compete with Disney's cruise ships. Another large cruise line company, Royal Caribbean, also competes with Disney ships. Carnival reported 2017 revenues of $17 billion with profits of $2.6 billion.

External Issues

Cloud Based Society and Cord Cutting

Gone are the days of VHS and DVDs as on-demand streaming is here to stay. Customers today demand instant access to many of their videos and shows on demand. There is also an increased cord cutting society where customers are increasingly unwilling to pay for massive cable packages where they may only watch a few channels. Netflix, Amazon, Roku, and Disney part-owned Hulu, all provide content often called "skinny" packages addressing the video programming the customer wants. Internet delivery as opposed to traditional pay-TV is expected to increase to 18 million households by 2021, up from 11 million in 2017.

International Markets' Love for American TV shows

While many Americans are enjoying and watching shows and movies developed in other nations, the same can be said of people living outside the United States watching and enjoying U.S.-based TV shows. As the U.S. market becomes increasingly saturated, firms are increasingly looking for new markets through market penetration strategies of taking existing products to new markets. Of the nearly $40 billion in 2016 box office sales worldwide, over 70 percent of the sales were generated outside of the United States and Canada, compared to 64 percent of total sales being international 10 years earlier. The trend is not just with movies though, U.S.-based TV shows including sitcoms, reality TV, and many others. All four major U.S. networks: ABC, CBS, FOX, and NBC, are enjoying exploding opportunities to license their products in foreign markets. High-speed Internet is growing in developing markets as well, providing increased content delivery as more programs move to being viewed in this medium. For example, high-speed Internet in Asia is around 46 percent participation, with the Middle East and Latin America around 60 percent each, and Europe at 79 percent. North America, by comparison, enjoys 88 percent high-speed Internet accessibility. One point for strategists to consider in the above data, for example, is in the Middle East—just how many years are the 40 percent nonusers from adopting high-speed Internet based on economic and demographic trends in the regions? Nevertheless, the potential for growth in all international markets remains extremely attractive for the large U.S. networks and, to date, it is estimated around two-thirds of all young people in developing countries are active Internet users.

Video and Media

The video and media business generates over $40 billion in U.S. revenue annually with growth around 2 percent. Disney is the largest player in the industry with a market share of around 18 percent, followed by NBCUniversial Media and Time Warner Inc. with market shares of 16 percent. 21st Century Fox and Sony Corporation have market shares of around 12 percent each. In total, there are nearly 10,000 businesses in this industry, but the top five discussed here account for nearly 80 percent of industry revenue. Over half of industry revenues are derived from the action and adventure genre with thriller themed programs accounting for 15 percent. Drama and comedy account for 12 and 8.2 percent of industry revenues, respectively, with the balance uncategorized. Growth rates in this industry are affected by movie theaters which have undergone consolidation in recent years with various movie theater firms trying new strategies of offering healthy foods, 3D screens, chair back seats, full service meals, and a variety of other options to attract customers. Disney is not forward integrated into this arena so it depends heavily on movie theaters being able to attract viewers. Higher ticket prices and large screens at home have held total attendance in check, which may eventually result in Disney's less bargaining power on prices they charge theater companies to show their video programs. Disney and other producers such as NBCUniversal could possibly form tighter alliances with Hulu, Roku, Netflix or similar content delivery providers to show movies upon release or even show them on their own networks. Currently, there remains a lag between when Disney allows new releases to be shown in mediums other than theaters.

Theme Parks

Theme parks represent one of Disney's most profitable SBUs, and as a whole, the theme park industry in the United States accounts for nearly $18 billion in sales. They have enjoyed robust annual growth of over 5 percent from the bottom of the recession to 2017. Annual growth is expected at around 2 percent through 2023. Admissions account for nearly 65 percent of revenues followed by food and beverage and merchandise at around 12 percent each. The balance of revenues are derived from multiple sources. Disney is the top player in the industry, representing a staggering 50 percent of industry revenues followed by Comcast Corporation's NBCUniversal Media, then SeaWorld and Six Flags at 18, 7 and 6 percent, respectively. The remaining 20 percent is derived from over 550 competitors in the industry, many of which are small parks, or a single large park in one city. The future, however, may be in international markets where Disney is already growing much more rapidly than they are domestically. Smaller parks likely will find it increasingly difficult to compete with the likes of Disney and Universal, as huge capital expenses are needed to create rides and as customers increasingly demand new and more modem attractions, especially if the firm is attempting to get the same customers accustomed to visit time after time. Advertising to potential international customers is another strategy many theme park operators are doing to attract new customers to their facilities.

Television Broadcasting

The television broadcasting business in the United States generates over $55 billion in annual revenue, with 900 businesses directly competing in the industry. Viacom is the industry leader, responsible for 17 percent of revenues followed by NBCUniversal Media, Disney, and Fox. Half of the industry revenues are derived from firms not included above, indicating a fragmented industry that could experience consolidation in the future. Dramas account for one-third of all industry revenue, followed by news programming at 25 percent. Sitcoms account for over 15 percent of industry revenues and have the advantage over dramas in that the viewer can tune in to a show anytime, without having to have followed previous episodes. On the decline is reality type shows accounting for 13 percent of revenues, while sports account for 10 percent. Growth in sports is expected to continue and this should be good news for Disney-owned ABC/ESPN, as well as rivals NBC, CBS, and Fox.

Future

Disney's Marvel Studios' *Black Panther* movie grossed $201.8 million over its first 3 days in February 2018, making it one of the top five domestic openings of all time. The film grossed $242 million over the Presidents' Day holiday weekend, making it the second highest 4-day domestic opening of all time. The movie's international single-day debut grossed $169 million. *Black Panther* was just the fifth film in industry history to break the $200 million mark in its debut, joining *Star Wars: The Force Awakens, Star Wars: The Last Jedi*, and Marvel's *The Avengers* as Disney's fourth release to do so. Walt Disney Studios now holds 8 of the top 10 all-time domestic debuts, five of them from Marvel Studios. Internationally, *Black Panther* opened with number-one debuts of all time in some countries. In the U.K. and Ireland, the film set a new February opening weekend record and surpassed the entire runs of *Captain*

America: The First Avenger, Thor, Ant-Man, and *Iron Man*. In Korea, *Black Panther* was the fifth biggest Western industry opening of all time and exceeded in a few days the entire runs of *Guardians of the Galaxy* and *Ant-Man*. Disney shareholders are hoping *Black Panther* is a sign of great things to come for the company, but external threats abound to derail the best-laid-plans-of-mice-and-men-and-Mickey.

Two of the largest and most powerful media conglomerates in the United States, 1) Disney and 2) Time Warner, together produce 50 of the 100 biggest box office hits of all time. Each company has numerous superheroes, such as Disney owning the Marvel brand and Time Warner owning DC Entertainment. Both companies also are embroiled in enormous merger actions. Specifically, Time Warner is considering an $85 million buyout bid from AT&T, while Disney wants to buy most of 21st Century Fox for $52 billion, but Disney is in a bidding war with Comcast. Disney needs a clear strategic plan to sucessfully combat both Time Warner and Comcast.

Adidas AG—2022

www.adidas.com

Headquartered in Herzogenaurach, Germany, adidas AG is a sports apparel and footwear manufacturer employing over 62,000 people. It is the parent company of the Adidas Group, which also includes the Reebok sportswear company. Besides sports footwear, adidas also produces accessories 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-biggest sportswear manufacturer in the world, with Nike being the largest.

Across 170 countries, adidas sells sports shoes, apparel, and equipment featuring the company's iconic three-stripe logo. Adidas focuses on American football, European football, basketball, running, and training gear and apparel, as well as lifestyle goods such as the SLVR and Y-3 fashion brands. Adidas has three segments: footwear, apparel, and accessories and gear.

History

At the age of 20, Adolf "Adi" Dassler was driven by the goal to produce the most durable and safest footwear for athletes in different sports. Dassler pursued this vision until his death in 1978. His first shoe back in 1920 was constructed of canvas due to the few materials available in the post-war period. By the 1930s, Dassler employed around 100 workers and was making 30 different styles of shoes for 11 different sports. 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 the rival company Puma, which is also headquartered in Herzogenaurach. Adi Dassler made the first post-war sports shoes in 1949 and formally registered 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 convinced many famous athletes to endorse his product, including Jessie Owens, Muhammad Ali, and 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 batting star Kevin Pietersen. The following year, adidas signed the English player Ian Bell and the Indian player Ravindra Jadeja. Adidas currently produces and sells cricket bats in the Incurza, Pellara, and Libro lines; it also manufactures the uniforms worn by both the England and the Australia cricket teams. Adidas announced in 2020 that it plans to divest Reebok and is looking for a buyer.

Vision/Mission

Vision Statement

On their corporate website, adidas presents the simple goal of being the world's leading sports brand. Though described as a "mission," this fits better as a vision statement.

Mission Statement

Adidas has not posted a mission statement on its corporate website, so we propose the following: At adidas we are committed to hiring a globally diverse workforce to design, promote, and sell top-of-the-line athletic footwear and apparel. We strive to use the latest e-commerce technology to provide better shopping experiences for our customers globally.

Internal Issues

Organizational Structure

The term "organizational structure" refers to how a firm's operations are grouped or arranged for battle against rival firms. Structure is vital for success. An organizational chart reveals the chain of command, showing who reports to whom, and who is responsible for what products, regions, and activities. Adidas does not provide an organizational chart or any indication of top executive reporting relationships on its corporate website or in its 2020 *Annual Report*. What is available is a mere list of management executives with titles, some of which are vague. However, adidas appears to operate utilizing a functional (centralized) organizational structure.

As companies such as adidas grow, acquire, and change, alteration of their structure is generally needed to maintain or obtain effectiveness. Among the basic types of structure—such as functional, divisional, and matrix—a strategic business unit (SBU) structure is based on grouping similar divisions together within groups. Some analysts contend that adidas should utilize an SBU structure when the number, size, and geographic dispersion of segments, divisions, or profit centers in an organization increases beyond about 10 (depending on the size and geographic dispersion of the segments).

Transitioning to an SBU-type structure can facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units. Exhibit 5 reveals adidas' current list of top managers and the firm's organizational structure. Note the lack of clear executive titles and the lack of divisional head-persons by region, country, or continent, or even by product, both points that suggest a need for adidas to reorganize consistent with current organizational structure concepts and practice.

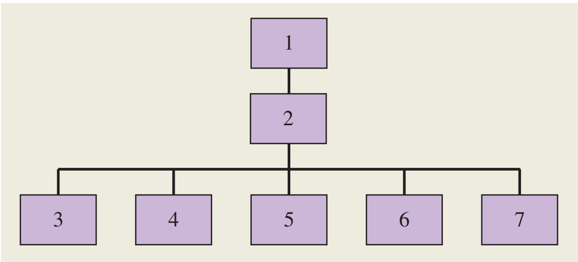
Adidas' top executives are listed and arrayed in Exhibit 1. Apparently adidas does not have a chief operating officer (COO), nor does the company have presidents of divisions-by-product or presidents of divisions-by-region. Some analysts contend that adidas should revamp its organizational structure and utilize a design based on strategic business units (SBUs), where the units are continents and under each unit top executive are the presidents of various countries, who would be responsible for all adidas operations, marketing, and sales in those respective countries.

Fifty-five percent of adidas's employees throughout the firm are women, and 35 percent of management positions are held by women. Adidas considers promoting women worldwide throughout the company as a prerequisite for promoting women to top management positions. Adidas is committed to maintaining a pipeline that is balanced between women and men moving forward. Note, however, that currently only one female is listed among the top 7 executives.

Financial Data and Statements

Adidas reported a 16 percent revenue decline in fiscal 2020 and a 78 percent net income decline. These numbers are extremely concerning for adidas, which blamed COVID-19 in their 2020 *Annual Report*. However, Nike, which reports in May each year (instead of January), reported

EXHIBIT 1 Adidas' Top Executives and Organizational Chart



1. Thomas Rabe, Chairman of the Board
2. Kasper Rorsted, CEO
3. Roland Auschel, Global Sales
4. Harm Ohlmeyer, CFO
5. Amanda Rajkumar, Global Human Resources
6. Brian Grevy, Global Brands
7. Martin Shankland, Global Operations

Source: Based on information in adidas' 2020 *Annual Report*.

only a 4 percent revenue drop in their fiscal 2020 and a 37 percent drop in net income. German rival Puma reported a 5 percent drop in fiscal 2020 revenues and 70 percent drop in net income over the same 12-month period as adidas.

EXHIBIT 2 Adidas' Income Statements (in millions of euros)

Income Statement	12/31/19	12/31/20	Percent Change
Revenues	23,640	19,844	–16%
Cost of Goods Sold	11,347	9,990	–12%
Gross Profit	12,293	9,854	–20%
Operating Expenses	9,633	9,103	–6%
EBIT	2,660	751	–72%
Interest Expense	102	175	72%
EBT	2,558	576	–77%
Tax	640	146	–77%
Non-Recurring Events	59	13	–78%
Net Income	1,977	443	–78%

Source: Based on information contained in adidas' 2020 *Financial Supplement,* p. 4.

Exhibit 3 reports the balance sheet numbers for adidas. Note that long-term debt increased by €500 million, or 56 percent, and cash increased by €1.5 billion, or 59 percent, while interest expense on the income statement increased 72 percent. With less revenue coming in and similar expenses going out, adidas no doubt had a rough fiscal 2020.

EXHIBIT 3 Adidas' Balance Sheets (in millions of euros)

Balance Sheet	12/31/19	12/31/20	Percent Change
Assets			
Cash and Short-Term Investments	2,512	3,994	59%
Accounts Receivable	2,625	1,952	–26%
Inventory	4,085	4,397	8%
Other Current Assets	1,712	1,811	6%
Total Current Assets	10,934	12,154	11%
Property Plant & Equipment	2,380	2,157	–9%
Goodwill	1,257	1,208	–4%
Intangibles	1,164	1,002	–14%
Other Long-Term Assets	4,945	4,532	–8%
Total Assets	20,680	21,053	2%
Liabilities			
Accounts Payable	2,703	2,390	–12%
Other Current Liabilities	6,051	6,437	6%
Total Current Liabilities	8,754	8,827	1%
Long-Term Debt	1,595	2,482	56%
Other Long-Term Liabilities	3,273	3,053	–7%
Total Liabilities	13,622	14,362	5%

Balance Sheet	12/31/19	12/31/20		Percent Change
Equity				
Common Stock	196	195	⇩	–1%
Retained Earnings	6,555	6,733	⇧	3%
Treasury Stock	–	–	NA	NA
Paid in Capital & Other	307	(237)	⇩	–177%
Total Equity	7,058	6,691	⇩	–5%
Total Liabilities and Equity	**20,680**	**21,053**	⇧	2%

Source: Based on information contained in adidas' 2020 *Financial Supplement,* pp. 2–3.

Strategy

Adidas implemented a strategy dubbed "Creating the New" for the 2015 to 2020 period, which focused on advancing the desirability of adidas' brand and proved successful. Adidas' new strategy from 2020 to 2025, called "Own the Game," is similar to the former strategy in that the intent is to once again increase brand credibility but also improve the customer experience and sustainability. Much of the strategy centers around adidas' commitment to a digital transformation. This digital transformation was accelerated during 2020 as lockdowns were put in place and as adidas' management cut costs, improved operational efficiency, and invested and improved its digital capabilities.

While adidas actively refers to the above marketing slogans as strategy, what product lines, where they are sold, and how they are sold better represent the actual strategy of the firm. The two main brands owned by Adidas Group are adidas and Reebok. The adidas brand accounted for 91 percent of sales in 2020 while Reebok accounted for only 7 percent. The Group is currently in the process of divesting Reebok. Within the adidas brand, the firm is focused on providing premium sportswear to its customers around the world. Adidas sponsors many professional teams around the world as well as many top college teams in the United States across virtually all sports. The brand provides footwear, apparel, and accessories and gear as product options.

Notable events sponsored by adidas include the FIFA Women's World Cup, the Rugby World Cup, the UEFA Champions League, and both the Boston and the Berlin marathons. A sampling of sports teams sponsored includes the national football teams of Argentina, Germany, and Spain; top football clubs Juventus, Real Madrid, and Flamengo Rio de Janerio; and the All Blacks in rugby. Top American universities include the University of Miami, Arizona State University, and Texas A&M University. Texas A&M, for example, is valued at $541 million, but there are 11 university sports teams in the United States that are valued higher, with the top brand being the University of Texas, which is valued at $1.1 billion and sponsored by Nike. Rivals Nike and Under Armour (UA) have contracts with many American college teams.

As of 2020, Real Madrid and Barcelona are the most valued football teams in the world, both with a value of $4.7 billion. Keep in mind, however, that the 15th most valuable football team, Everton, is valued at $658 million, and the 15th most valuable college team in the United States, Nebraska, is valued at $472 billion. There are over 100 top university teams competing in the top division in the United States, leaving a huge opportunity for adidas.

Top football athletes who are sponsored by adidas include Lionel Messi, Mohamed Salah, the retired David Beckham, and Wendie Renard. Top adidas-sponsored basketball players include Candace Parker, Donovan Mitchell, and James Harden; top American football players include Aaron Rodgers and Patrick Mahomes; baseball players include Aaron Judge and Carlos Correa; and tennis stars include Alexander Zverev, Angelique Kerber, and Dominic Thiem. Note that while Lionel Messi, Candace Parker, and Aaron Rodgers are three of the biggest names in their respective sports, many of the top superstar athletes in the world are not sponsored by adidas—this is one area where Nike has always excelled. In total, of the 19 top global endorsement deals in 2020, adidas sponsored 2 and Reebok sponsored 1 while Nike sponsored 9 and Under Armour sponsored 2.

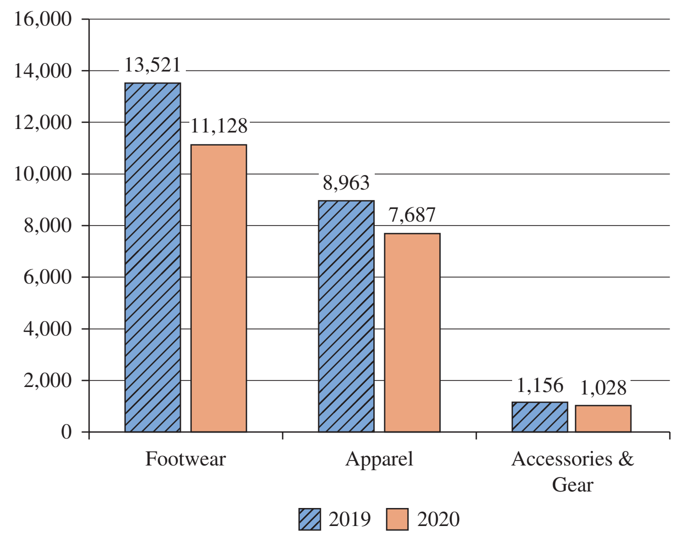
Sales by Channel

Adidas is in a process of improving its e-commerce presence as a means of increasing direct sales to consumers. E-commerce has many benefits, including the convenience of shopping from home, more impulse purchasing, and significantly less cost (as no retail stores are needed). In addition, selling directly to the consumer provides deep marketing analytic possibilities. In 2020, 41 percent of adidas's sales were derived from direct-to-the-consumer methods, with about 21 percent from e-commerce, and 20 percent from adidas' own retail stores, which total over 2,500 worldwide. Wholesale revenues account for 59 percent of sales. Wholesale has the benefit of adidas using other firms' fixed assets, advertising, and other expenses to sell its products. Be sure to note that e-commerce sales represented 33 percent of sales, or $7.9 billion, in 2019, while in 2020, adidas reported that 41 percent of direct-to-the-consumer sales netted $8.1 billion in sales. COVID-19 may can explain part of the online growth, but adidas appears committed to online sales.

By-Segment Information

Exhibit 4 shows adidas' 2020 revenues by product lines. Note that footwear accounted for about 56 percent of revenues in both 2019 and 2020, with accessories and gear accounting for about 5 percent. Adidas manufactures both men and women's shoes for most of the major sports as well as for leisure activities such as running and walking. In addition, the firm makes shoes designed for hiking and skateboarding, and even sandals. Adidas also produces apparel such as shorts, pants, t-shirts, jerseys, jackets, hoodies, socks, and underwear. Accessories include balls, gloves, hats, even phone cases. Adidas used to own TaylorMade and had a larger presence in golf and hockey, but the firm has since diverted its resources to other revenue streams.

EXHIBIT 4 Adidas 2020 Revenues by Product (in millions of euros)



Source: Based on adidas' 2020 *Annual Report*, p. 133.

Regions Served

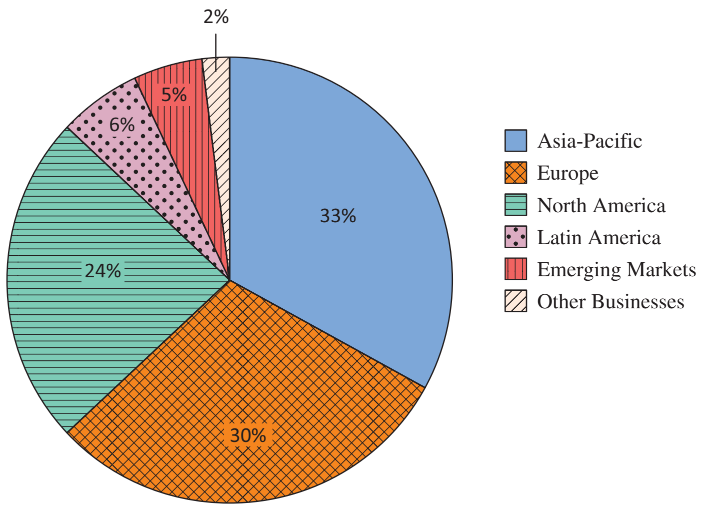
Exhibit 5 reveals that adidas has excellent geographic coverage, deriving substantial revenues from Asia, Europe, and North America. However, adidas trails Nike by quite a margin in the U.S. market.

External Issues

E-commerce Becoming the New Normal

During 2020, e-commerce sales nearly doubled globally, from 16 percent to 29 percent. McKinsey predicts 2021 and beyond will see huge booms for e-commerce, and 70 percent of executives are projecting growth of up to 20 percent annually in 2021 and 2022 in their digital outlets. China is predicted to be the leader in e-commerce gains, followed by Europe and the United States.

EXHIBIT 5 Adidas Percent of Net 2020 Sales by Region



Source: Based on adidas' 2020 *Annual Report*, p. 134.

Zara, for example, plans to close 1,200 stores from 2021 to early 2023 and reroute $3.2 billion to its digital transformation. Top adidas rival Nike has also pledged to accelerate its movement to a digital strategy. Consumers are valuing time and convenience more than ever, and good service firms that do not compete heavily in e-commerce are at a severe disadvantage. In fact, in 2020, 25 percent of all shoes sold in the United States were derived from online retailers, which is particularly interesting for a product that many people want to try on before purchase.

Athleisure Clothing & Athletic Footwear

In 2015, Athleisure, a term coined for athletic clothing worn in normal day-to-day activities, started to become popular across the world. Celebrity endorsements and a growing concern for global wellness has spurred demand for this segment, but many people who are not particularly active or overly concerned with wellness also find this type of clothing more comfortable. Among footwear categories, sport leisure products outperformed performance footwear sales in the United States in 2020. *Forbes* forecasted in 2019 that dressier fashion-type shoes would be replaced by higher sales of athleisure footwear in 2020.

The global athletic footwear business, which includes running, walking, hiking, and sports shoes, is estimated to be worth $72 billion in 2020 and expected to grow to over $100 billion by 2027, but some reports project $120 billion by 2027. Running shoes alone are expected to account for nearly $40 billion by 2027. In 2020, the U.S. market accounted for nearly 27 percent of the global market with over $19 billion, while China, the world's second largest economy, is expected to reach $19 billion by 2026 and grow nearly 8 percent through 2027. By contrast, Japan is expected to grow 2.7 percent and Germany to grow 3.4 percent over the same period.

Like athleisure clothing, athletic footwear is increasingly being used by people around the world for casual, day-to-day activities. Developments in new materials and technology have made this class of shoes extremely comfortable, but it has also increased the costs and complicated development of the shoes. This segment overall is expected to occupy 40 percent of the entire shoe industry revenue by 2025.

Brand Polygamists

There is a growing trend in the industry where customers are showing lower brand loyalty, leading industry analysts to label them "brand polygamists." Firms like adidas and Nike have spent significant capital and resources to promote their brands, and a decrease in loyalty would be a serious problem. This is particularly true for top firms like adidas and Nike, who have much more to lose. So what motivates customers if not the brand name? Today, many customers are basing their purchases on product features and price. In fact, in some cases a logo can even detract from a purchase. Companies like Nike have established the NikeiD program where shoppers can customize their own products. However, policies such as these are expensive, and the products sold have a smaller margin. Thanks to the trends of less brand loyalty and more e-commerce, startup firms can compete much more easily now. The global brands may have to start a period of acquisitions to eliminate the competition, as seen in many other industries.

Competitors

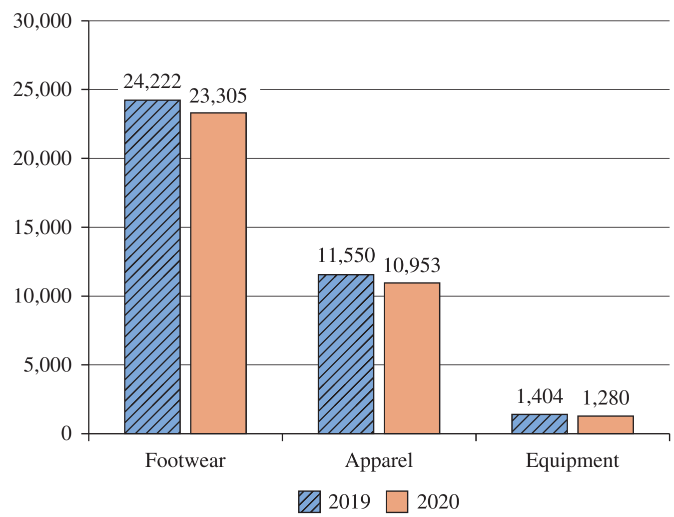
Nike

In January 2020, Nike hired John Donahoe as their new CEO to lead the largest sports apparel company in the world. Nike serves athletic clubs, universities, fitness-minded people, and many others. According to CEO Donahoe in his letter to the shareholders in 2020, Nike is the number one favorite brand in all 12 of the key cities identified by it as the most important for business. The majority of Nike's products are tailored to specific sports, from shoes to shorts, and of course equipment. Nike owns the Converse brand, Chuck Taylor, All Star, Star Chevron, and Jack Purcell. Converse's financials are, however, reported as a separate division but are still included in Nike's overall bottom line.

As mentioned above, Nike excels in hiring famous athletes to market their brands; Michael Jordan, LeBron James, and Cristiano Ronaldo have currently signed lifetime endorsement deals. In fact, in 2020, four of the five largest endorsement deals were controlled by Nike, and rival adidas had the fourth highest deal of the five in Lionel Messi.

Nike operates 338 stores in the United States and 758 stores in 45 countries. Nike's products are, of course, sold in retail stores the world over. Nike reported revenues of over $37 billion in 2020. Exhibit 6 below provides data on Nike's revenue over the same three product lines adidas offers. It is interesting to note that, if a $1.20 = €1.00 conversion were used, adidas would report $9.224 billion for their apparel business in 2020 and $1.234 billion for their accessories and gear business, both quite close to Nike's performance. Where Nike really crushes adidas is footwear. At Nike, 41 percent of companywide sales are derived from North America; 26 percent from Europe, Middle East, and Africa; 19 percent from China; and 14 percent from the rest of the world.

EXHIBIT 6 Nike Revenues by Segment (in millions of USD)



Source: Based on Nike's 2020 *Annual Report*, p. 31.

Puma

Puma is a German company that traces its roots to a quarrel between the two founding brothers of adidas over the direction of the company, which ended with one of them leaving adidas and starting Puma. Like other rivals, Puma is devoting much of their strategy to focusing on digital capabilities. Puma is a leader regarding women in management; 43 percent of management positions are held by women. Pages 25–90 of Puma's 2020 *Annual Report* are devoted to environmental sustainability, demonstrating in great detail what Puma is doing to present itself as a green corporate player. In 2020, Puma signed up football star Neymar da Silva Santos Júnior, basketball player LaMelo Ball, Dutch football club PSV Eindhoven, and Ukrainian club Shakhtar Donetsk. Puma also signed up English singer Dua Lipa as a women's ambassador and Canadian model Winnie Harlow. J-Cole, a Grammy-winning artist, was also signed on.

Signing celebrities who are not also sports stars is an interesting strategy for Puma. Puma is in the process of a brand transformation, yet its mission is to become the fastest-growing sports brand in the world. To help implement this strategy, the firm has six strategic focus points: creating brand heat, focus on the correct product ranges, comprehensive offers for women, improvement in distribution, increases in speed and efficiency, and strengthening of the firm's position in North America with its reentry into basketball.

A key new Puma distribution center in Indianapolis will allow U.S. customers to be served within 2 days, and a new warehouse in Geiselwind, Germany, opened in 2021 to help serve the European market. In 2020, Puma reported revenues from footwear, apparel, and accessories of €2.368 billion, €1.974 billion, and €893 million, respectively. While Puma is significantly smaller than the top players in the industry, its percent of revenue derived from apparel is much more than both Nike and adidas. Puma is also fairly balanced on the markets it serves, with 37 percent, 34 percent, and 20 percent of revenue in 2020 being derived from Europe, Middle East and Africa; the Americas; and Asia, respectively.

Under Armour

Headquartered in Baltimore, Maryland, Under Armour (UA) was founded in 1996 by a former University of Maryland football player who desired a t-shirt that would whisk away perspiration rather than get soggy. UA today is a top firm in the athletic clothing industry and is worn by some of the largest American college football and European football teams. The former include Auburn University and The University of South Carolina; the latter include Tottenham Hotspur, Aris F.C., and Deportivo Toluca F.C. UA employs superstar athletes such as American football mega stars Tom Brady and Cam Newton, baseball star Bryce Harper, and the possibly the most famous Olympic swimmer of all times, Michael Phelps.

Like the other firms disused in the case, UA produces footwear, apparel, and accessories. UA were once unique in offering three styles: compression, fitted, and loose, for various weather conditions. Rival firms have since adapted many UA features into their own clothing. However, UA has trademarked products, such as HEATGEAR, COLDGEAR, and UA HOVR. An interesting difference between UA and its rivals is its continuity since its founding, with the majority of sales still derived from apparel—64 percent of all 2020 sales were in this category. Footwear and accessories accounted for 21 and 9 percent of UA's 2020 revenues, respectively.

Conclusion

Strategy Considerations

Adidas competes in an extremely competitive industry and is in desperate need of an effective strategic plan. During fiscal 2020, adidas by some measures performed poorly compared to Nike, UA, and Puma, which may signal that other aspects of the company are weak, perhaps even the company's organizational structure, as indicated in the case. Top considerations when designing a proposed strategic plan for adidas will include how to allocate resources across the three divisions of footwear, apparel, and accessories. Recall from the case that adidas was once strong in golf but has since divested this business. Should adidas double down its efforts in a particular sport or cater to a wide range of sports? Additionally, should adidas spend more on hiring key sports stars to endorse their products?

What global markets should adidas shift resources to or invest more in? Nike is killing adidas in the U.S. market. Recall from the case that athletic wear is becoming increasingly popular attire even in day-to-day activities. German rival Puma has seized on this opportunity by hiring models and talented musicians to promote their brands. How should adidas balance its new e-commerce strategy with the traditional store strategy? Is it too early for adidas to move similarly significant resources to e-commerce? Should adidas acquire new startup firms as the case mentioned in passing? Is it wise for adidas to divest itself of Reebok as planned? What type of organizational structure would be best for adidas? As indicated in the case, structure matters tremendously for overall success and effectiveness.

The above ideas and suggestions are not all-inclusive or even all-important. The most important factors and considerations will be derived from reading the case and doing your own research. When preparing the 3-year plan for adidas, be sure to provide recommendations based on what direction you feel the company should pursue moving forward. Be careful not to report what adidas is currently doing or what you think they are going to do based on company literature, unless of course you agree with this stance based on a comprehensive analysis. The firm experienced a 78 percent drop in net income in 2020, and shareholders are worried. Know that in the business world, shareholders in general expect at least a 4 to 5 percent annual growth in the top line (revenues) and bottom line (net income), and adidas's failure here could lead to shareholder abandonment. Adidas needs to avoid disastrous years even during times of distress, as experienced in 2020. Excuses don't cut it in business.

Shoprite Holdings Ltd.—2022

www.shopriteholdings.co.za

Headquartered in Brackenfell, Western Cape, South Africa, Shoprite Holdings Ltd. (Shoprite) is Africa's largest retail supermarket, with 17 brands serving 14 countries through 2,387 corporate stores and 505 franchise outlets. Shoprite Holdings' brands include Shoprite, Usave (also spelled USave and U$save), Checkers, LiquorShop, House & Home, Medirite, and MoneyMarket. Shoprite employs over 140,000 across its total range and is the largest private sector employer in South Africa. Over 24 million people shop in Shoprite properties every day.

Shoprite differentiates itself based on high volume of sales and a variety of brands and formats. The company is committed to serving underserved markets, becoming more digital, and having a lean cost structure. Shoprite offers customers a place to not only buy food but also to purchase furniture, pay bills, pay for funereal services, buy medicine, and much more. Since the firm's humble founding in 1979, the firm has stuck to its initial vision and mission to provide quality products and a quality shopping experience. With its beginnings in South Africa but now expanding over much of the African continent, Shoprite serves all customer types, from low to high income, with different store concepts. The firm reported revenues in excess of ZAR 156 billion in 2020.

History

Shoprite was founded in 1979 when an 8-store Western Cape grocery chain, also named Shoprite, was purchased by PEP Stores. Right away, the upper management declared that the mission of the new grocery store was to cater to low- to middle-income shoppers and grow through acquisitions. Through much of the 1980s, Shoprite expanded slowly across South Africa before entering Namibia in 1990. In 1991, Shoprite purchased Checkers, and in 1997 the firm expanded by acquiring OK Furniture and House & Home.

In the early 2000s, Shoprite began operations in Zimbabwe and Egypt and opened the first Usave in 2001. In 2008, Shoprite was added to the Johannesburg Top 40 index of blue-chip stocks, and by 2009, it was South Africa's largest chain by market value. Over the last 10 years, Shoprite has expanded further across Africa, opening many new stores and adding many new product lines to existing stores, earning Shoprite the distinction of South Africa's largest retailer in 2019 and a ranking of 89th in Deloitte's Global Powers of Retailing 2021 report.

Vision/Mission

The following statements can be proposed for the company based on the content at the Shoprite corporate website.

Vision Statement

To improve the quality of life for all we serve.

Mission Statement

Shoprite's mission is to provide our customers across the African continent with the best value in grocery items, home improvement items, and all other products we sell to our customers, while maintaining an attractive return for our shareholders. We believe in doing things the right way, with care, integrity, and a commitment to excellence in all we do. We achieve this by putting our customers first and providing excellent service while maintaining integrity in all that we do.

Internal Issues

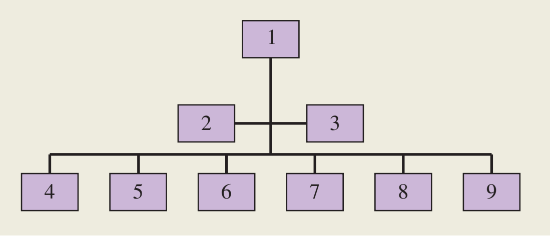
Organizational Structure

The term "organizational structure" refers to how a firm's operations are grouped or arranged for battle against rival firms. Structure is vital for success in any firm. An organizational chart reveals the chain of command, showing who reports to whom and who is responsible for what products, regions, and activities. Neither its corporate website nor its 2020 *Annual Report* provides an organizational chart or any indication of top executive reporting relationships. Based on a list of management executives with titles, some of which are vague, Shoprite appears to operate utilizing a functional (centralized) organizational structure, but this would be ineffective for such a large, geographically dispersed company.

As companies such as Shoprite grow, acquire, and change, alteration of their structure is generally needed to maintain or obtain effectiveness. Among the basic types of structure—such as functional, divisional, and matrix—a strategic business unit (SBU) structure is based on grouping similar divisions together within groups. Some analysts would contend that Shoprite should be utilizing an SBU structure because this type of design is especially useful when the number, size, and geographic dispersion of segments, divisions, or profit centers in a firm is roughly greater than 10 (depending on the size and geographic dispersion of the segments). Transitioning to an SBU-type structure could facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units.

Exhibit 1 reveals Shoprite's current list of top managers and the firm's organizational structure. Note the lack of clear executive titles and the lack of divisional head persons, both of which suggest a need for Shoprite to reorganize based on current organizational structure concepts and practices.

EXHIBIT 1 Shoprite's Top Management Team



1. Christo Wiese, Chairperson of the Board
2. Pieter Engelbrecht, CEO
3. Joseph Bronn, Deputy CEO
4. Anton de Bruyn, CFO
5. Ram Harisunkerk, Divisional Manager
6. Pieter du Preez, Company Secretary
7. Adele Lambrechts, Head, Investor Relations
8. Sizo Njova, Operations Manager
9. Neil Schreuder, Marketing Director, Checkers

Source: Based on information in the Shoprite 2020 *Annual Report* and other documents.

Financial Data and Statements

Note in Exhibit 2 that Shoprite experienced a 6 percent increase in revenues in 2020 but a 3 percent drop in net income. This is an ongoing problem for firms currently competing across Africa, as droughts, pandemics, unemployment, and other factors restrict what can be charged for goods and services, cutting into profit margins. It is worthy of note that net income/revenues for 2019 were approximately 2.4 percent, but for 2020 the number dropped to 2.2 percent. These numbers may not seem like much, but the math results in a drop in net profit margin of over 8 percent from 2019 to 2020—this is a negative trend that bears monitoring.

Exhibit 3 provides summarized balance sheets for 2019 and 2020 for Shoprite. Take note of the large increase in cash in fiscal 2020, which can possibly be partly explained by limited inventory in 2020 and by a reduction in plant, property, and equipment (PP&E), which may indicate a sale of some existing properties from 2019. In addition, note the zero goodwill on the balance sheet. Shoprite has a history of acquiring other grocery stores, so this is a positive sign that management has strong negotiation skills when purchasing rival firms.

EXHIBIT 2 Shoprite's Income Statements (in millions of ZAR)

Income Statement	12/31/19	12/31/20		Percent Change
Revenues	147,478	156,855	↑	6%
Cost of Goods Sold	113,028	119,323	↑	6%
Gross Profit	34,450	37,532	↑	9%
Operating Expenses	26,583	29,781	↑	12%
EBIT	7,867	7,751	↓	–1%
Interest Expense	2,327	2,505	↑	8%
EBT	5,540	5,246	↓	–5%
Tax	1,715	1,783	↑	4%
Non-Recurring Events	(345)	(87)	↓	–75%
Net Income	3,480	3,376	↓	–3%

Source: Based on Shoprite's 2020 *Financial Supplement,* p. 8.

EXHIBIT 3 Shoprite's Balance Sheets (in millions of ZAR)

Balance Sheet	12/31/19	12/31/20		Percent Change
Assets				
Cash and Short-Term Investments	3,583	10,019	↑	180%
Accounts Receivable	4,156	4,106	↓	–1%
Inventory	20,889	18,845	↓	–10%
Other Current Assets	6,081	6,967	↑	15%
Total Current Assets	34,709	39,937	↑	15%
Property Plant & Equipment	19,196	16,861	↓	–12%
Goodwill	–	–	NA	NA
Intangibles	3,077	2,955	↓	–4%
Other Long-Term Assets	21,580	21,465	↓	–1%
Total Assets	78,562	81,218	↑	3%
Liabilities				
Accounts Payable	19,325	20,157	↑	4%
Other Current Liabilities	10,431	12,416	↑	19%
Total Current Liabilities	29,756	32,573	↑	9%
Long-Term Debt	19,158	20,168	↑	5%
Other Long-Term Liabilities	9,340	9,228	↓	–1%
Total Liabilities	58,254	61,969	↑	6%
Equity				
Common Stock	7,516	7,515	↓	0%
Retained Earnings	13,291	12,396	↓	–7%
Treasury Stock	(605)	(806)	↑	33%
Paid in Capital & Other	106	144	↑	36%
Total Equity	20,308	19,249	↓	–5%
Total Liabilities and Equity	**78,562**	**81,218**	↑	3%

Source: Based on Shoprite's 2020 *Financial Supplement,* p. 9.

Strategy

Shoprite describes their strategy as growth focused on optimization of the firm's retail stores in existing markets. This choice is quite interesting, as firms have many strategic options, including expansion into new geographic areas, expansion of new products in the same areas, or simply attempting to gain a larger market share in current markets with current products. Shoprite hopes to execute its strategy by focusing more on existing markets and existing customers and by becoming more innovative. Shoprite suggests it will implement this strategy by focusing on three key areas: 1) a smarter Shoprite, 2) closing the gap in key segments, and 3) winning the long term. Reading more closely, though, Shoprite is clearly more aggressive than this would imply.

Shoprite plans to execute the "smarter Shoprite" prong by being customer-first, developing new channels, and improving its precision retailing. Reading the *Annual Report,* it is clear that being customer-first means that Shoprite intends to use data provided from customers to target them more effectively and profitably.

Shoprite is often voted first for lowest prices and Checkers first for best value. In 2020, Checkers established the Xtra Saving Rewards Programme, and over 5 million customers joined. Shoprite is focusing on "future fit channels," which refers to its goal of increasing omnichannel shopping options for customers, possibly allowing customers to order products from home for pick-up at the store. In 2019, online sales increased by 386 percent, and Sizty60 was launched in 2020 for home delivery with 87 stores participating by the end of the year. Precision retailing, similar to the customer-first concept, utilizes data analytics to improve business decisions; 57 products categories were successfully optimized soon after the start of this new program.

By closing the gap in key segments, Shoprite seeks to improve its private labels, increase its market share in premium food and fresh food, and provide stronger franchise offers. In 2019, 1,251 new private label products were offered, and an additional 828 new private labels were added in 2020. To grow in premium and fresh food, Shoprite relies on its Checkers FreshX concept stores as well as the addition of fresh products to existing store types. Over 220 fresh product pipelines were established in the first half of 2021. A less publicized fact is that Shoprite offers franchises and is currently improving its franchise offerings. In 2021, Shoprite had almost completed its full supply chain integration; this will likely improve delivery for franchise owners and allow increased profit for Shoprite corporate.

The third prong of Shoprite's reported strategy is winning the long term. It plans to do so by continuously evaluating this position in Africa, refocusing capital allocation, and determining sources of alternative revenue. As mentioned earlier, Shoprite has not announced plans to expand beyond Africa. In 2019, Shoprite ventured outside South Africa to open 14 stores in the continent, and in 2021 it started a program that will tailor business models to conditions in particular markets within Africa. Shoprite is currently shifting toward smaller stores located closer to their customers; it opened 23 such Usave stores in 2019 and a huge 105,000-square-meter distribution center in 2018 while building a different series of distribution centers in 2020. Part of this refocusing of capital allocation is likely to center around Shoprite's needs in terms of fully integrated supply chains.

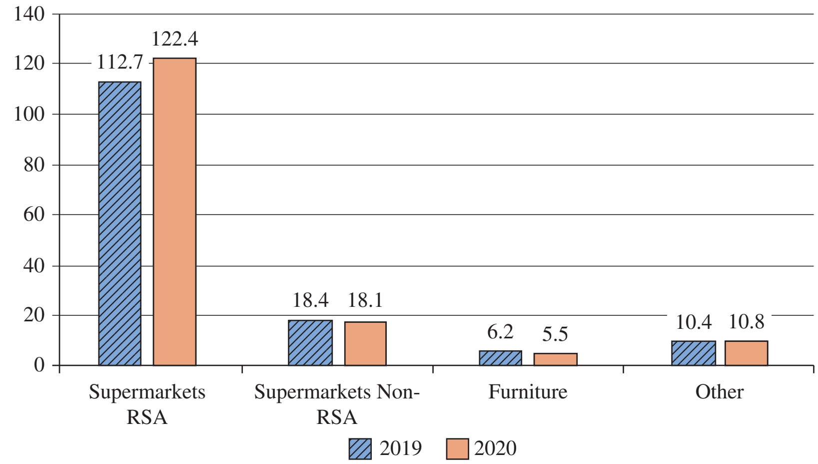
Shoprite plans to unlock alternative revenue streams through data analytics. In 2018, Shoprite started a program where customers could upload money onto a Shoprite wallet and use the funds in a Shoprite store. Its new K'nect stores allow customers to purchase cellular products and accessories. In 2020, Shoprite started a partnership that will provide customers a means of buying funeral coverage within Shoprite stores.

By-Segment Information

Exhibit 4 shows that approximately 78 percent of 2020 sales were derived from Shoprite markets in South Africa, which include LiquorShop and K'nect. While Shoprite serves 15 countries in Africa, the firm is predominantly based in South Africa. The firm says that it employs a cost-leadership strategy. Shoprite supermarkets hold 32 percent of the formal food retail market in South Africa.

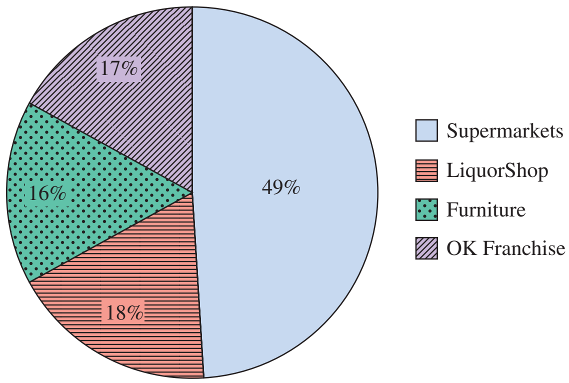
Exhibit 5 shows that nearly half of the 2,829 total stores owned by Shoprite are supermarkets; 683 of the total of 1,387 supermarkets are Shoprite branded, 425 are Usave, 233 are Checkers, and 37 are Checkers Hyper. Furniture stores accounted for a total of 442 stores and are split

EXHIBIT 4 Shoprite Sales by Segment (in billions of ZAR)



Source: Based on information in the Shoprite 2020 *Annual Report*, p. 27.

EXHIBIT 5 Shoprite's 2020 Stores



Source: Based on Shoprite's 2020 *Financial Supplement,* p. 11.

between OK Furniture, with 397, and House & Home, with 45. OK Franchise and LiquorShop accounted for 477 and 523, respectively.

Shoprite

Shoprite is the largest business of the Shoprite Group portfolio, both in number of stores (503 stores as of 2020) and in revenues. The supermarkets are full-service and offer one-stop shopping for many items, including basics such as food, drinks, and household goods as well as prescription medicine, funeral arrangements, bills payments, and even government payouts. The store's busiest times of the month are the middle and the end of the month, corresponding to most pay-checks and government social grant pay dates.

Checkers and Checkers Hyper

Focused on the more affluent customer, Checkers and Checkers Hyper accounts for 261 supermarkets. Shoprite senior management is making a commitment to this branch of the business as they feel the firm is underserving consumers looking for more upscale grocery items as well as customers with the disposable income to shop at such stores. FreshX stores are also considered premium stores tailored to a specific customer type, in particular the premium consumer segment that enjoys fresh markets. The main driver of FreshX is healthier options rather than simply being more upscale.

USave

Shoprite's small-grocery-store-with-limited-items concept is Usave, often spelled U$ave or even USave. Similar to Checkers and Checkers Hyper, the USave concept also serves underserved communities but generally caters to more rural or less-affluent communities. The USave brand is associated with convenience of location and cheaper prices. The concept has even expanded to include trucks, often referred to as eKasi truck stores, that are able to travel to regions of need during times of distress. Fourteen new USave stores, seven eKasi truck stores and six eKasi container stores opened in 2020.

Other Stores

Shoprite also operates OK franchise and its liquor and furniture stores. The OK concept allows entrepreneurs across Africa to open their own business with the backing of a trusted brand. In 2020, 17 such stores were opened, and there were plans to open 24 by the end of 2021. There are currently 500 LiquorShop stores in South Africa, generally found near a Shoprite or Checkers store. Shoprite plans to expand and grow the Liquor concept in the future. House & Home has 41 South African stores and serves middle- to upper-class customers while OK Furniture, with 314 stores in South Africa and 83 in the rest of Africa, serves mostly middle-income customers. Customers can purchase beds, appliances, furniture, and many other items at both store concepts.

External Issues

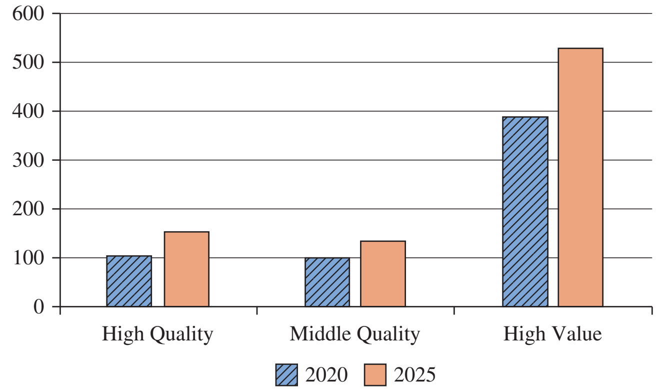
Regions Served

Exhibit 6 reveals the South African grocery market's expected growth up to 2025. Historically, growth in this segment has been 1–1.5 percent annually, but now, growth in the higher-end grocery business is expected to be 48 percent into 2025, which is just over 8 percent annually when taking compounding into account. Note that the middle-priced grocery options are a smaller market and are expected to grow less than the other two categories. Value-based grocery options are expected to grow 36 percent through 2025, or about 6.33 percent annually when adjusted for compounding. Keep in mind, though, that 62 percent of all growth will come from the value-based grocery concept in South Africa through 2025. Note as well that data on profit margins are limited, and it would be wise to research which stores—high-quality, middle-quality, or high-value—have the larger profit margins before deciding how to expand further.

Nature of Customers in the Regions

Customers in much of sub-Saharan Africa, including South Africa, tend to have limited incomes and budgets due to adverse weather conditions, pandemics, governmental challenges, high unemployment, and other reasons. These external issues place a tremendous strain on businesses operating in these regions; customers simply cannot afford to spend as much as is needed to operate for the businesses to be profitable. As a result, virtually all businesses serving such communities

EXHIBIT 6 South African Grocery Market Growth Expectations



Source: Based on Pick n Pay *Annual Report,* p. 12.

have become experts on operational efficiencies. Due to lack of fuel and lack of the means to buy fuel when it is available, there is a greater need to open smaller grocery shops near the customer; however, this places a higher financial burden on companies. Nevertheless, convenience is more important than ever, and many firms are seizing the opportunity to locate smaller stores close to the consumer. One interesting development that may run counter to the trend of having stores close to home is customers making less frequent trips to the grocery stores, opting instead to purchase many items less frequently and expecting stores to offer one-stop shopping and a wide range of products. Across the regions served by Shoprite, many customers are increasingly valuing online shopping even for grocery items.

Nature of Select Markets

The food and grocery market in South Africa was valued at about ZAR 900 billion in 2021, with a 60/40 ratio of formal-to-informal grocery market. The four largest grocery retailers in South Africa account for 50 percent of the market share. The informal market, accounting for 40 percent, are small mom-and-pop shops that could be purchased if desired. Alternatively, if a large firm like Shoprite or Pick n Pay simply placed a smaller grocery store concept in these locations, it would likely place tremendous pressure on the smaller stores.

Zambia is currently enduring a prolonged drought, which has placed tremendous pressure on this country, especially because the nation relies on hydroelectric power. The drought has lowered the prices of copper, one of Zambia's major products, which in turn has put tremendous pressure on the employment rate. Zambia's GDP is projected to grow less than 1 percent in 2021 compared to Zimbabwe's nearly 4 percent expected growth. However, Zimbabwe is currently experiencing a weak currency due to hyperinflation. Fuel shortages and a drought, with water and power shortages like Zambia's, make business difficult in Zimbabwe. In 2020, for example, 30 Zimbabwe dollars were equal to 1 USD; one year later 115 Zimbabwe dollars equaled 1 USD.

Demand for Healthy Food

There is growing demand globally for healthy food options. Generally, consumers consider foods healthy if they are gluten-free, natural, organic, and without "genetic modification," but lower fat and lower sugar is also considered healthy. However, most of all, consumers like food that is tasty and convenient. Many consumers in the markets served by Shoprite eat at home, so convenience plays a large factor in what is purchased, which includes salty and sweet snacks with a long shelf life. Nevertheless, companies such as Shoprite should be mindful of growing healthy eating trends and consider offering more high-protein, plant-based, dairy-free snacks. In fact, 31 percent of people in South Africa claim they always try to eat healthy and consider vegetables and fruits to be the healthiest options. Despite the growing trends globally of plant-based diets, over 35 percent of South Africans surveyed indicated they do not know what a plant-based diet refers to. The good news for residents in South Africa is that over 80 percent feel it is easier to find healthy food option now compared to 2015, but like many people around the world, about half of the population do not consider healthy food affordable.

South African Eating Habits

A study by Nielsen in 2021 revealed that 84 percent of South Africans eat meat nearly every day. Meat consumption is higher for consumers who live in urban areas. People in rural areas also eat meat but include a higher percentage (based on total calories) of grains and vegetables in their diets. In fact, 41 percent of the typical South African plate consist of starch; 26 percent, meat; 13 percent, vegetables; 8 percent, dairy; and 12 percent, miscellaneous food categories. However, for healthy living it is recommended that 12 percent be derived from meat, 33 percent from vegetables, and 32 percent from starch. Perhaps surprisingly, researchers at the University of Cambridge recommend that 15 percent of plate composition be derived from dairy.

The most popular meats in South Africa are poultry, red meat, seafood, and pork, consumed by 92, 83, 53, and 45 percent, respectively. Nearly 98 percent of the population eats some type of meat, but beans are the most commonly used meat replacement, eaten by 66 percent of the population. In starches, bread, rice, and potatoes are the most commonly eaten, at 93, 88, and 80 percent, respectively. Green beans and cauliflower are considered starch replacements and are eaten by over 30 percent of the population. However, about 50 percent of the population cannot afford such vegetables. Tomatoes, onions, cabbages, carrots, spinach, lettuce, peppers, and cucumbers are commonly consumed in South Africa, with tomatoes, onions, and cabbage consumed by over 80 percent of the population

Competitors

Massmart

Massmart is a South Africa–based retailer of consumer goods. Considered the leading retailer of general merchandise, it also sells liquor, home improvement goods, supplies, and basic food products. With 423 stores in sub-Saharian Africa across 13 countries, the firm trades on the Johannesburg Stock Exchange. Notable countries with Massmart stores include South Africa, Zambia, Namibia, Nigeria, and Ghana. The firm operates under a high-volume, low-expense model to best serve the majority of its customers.

Massmart is owned 53 percent by U.S. retail giant Walmart. The firm is broken into four divisions. Massdiscounters, focusing on general merchandise and discounted grocery foods, has the largest number of stores, with ZAR 20 billion of revenues in 2019. Masswarehouse, Massbuild, and Masscash are the other three divisions. The Masscash includes Cambridge Food and reported sales ZAR 30 billion in 2019.

Pick n Pay Group

The Pick n Pay Group is the second largest grocery store chain in South Africa behind Shoprite. The firm was founded in 1967 and has about 2,000 locations. The firm has locations in 8 countries in Africa plus a 49 percent stake in a Zimbabwean supermarket business. With 1,831 stores in South Africa, this market dominates the Pick n Pay portfolio. Zimbabwe is next, with 61 stores, followed by Namibia, with 36. In March 2021, the first Pick n Pay store opened in Nigeria, a market that rival Shoprite is looking to exit. A notable exception for Pick n Pay is Egypt, where the firm has no locations.

Like Shoprite, Pick n Pay stores are both franchise-owned and company-owned. The firm currently operates 830 company-owned and 761 franchise-owned stores. The firm prides itself on its three pillars to business success: "consumer sovereignty, doing good is good business, and maximizing business efficiency." The Pick n Pay Group has three store formats: Pick n Pay, Boxer, and TM Supermarkets. Pick n Pay stores sell clothing, liquor, and pharmaceutical products in addition to food. The Boxer concept stores sell liquor and offer Boxer Punch, which are smaller-footprint grocery stores, and Boxer Build, which are stores that offer home improvement products and food. In addition, Pick n Pay operates a large online grocery platform in sub-Saharan Africa.

Boxer is South Africa's fastest growing discount supermarket chain, focusing on the lower to middle class. Boxer is enjoying double-digit sales growth through its range of 3,000 products, which include fresh meat and produce offered at unbeatable prices. In 2020, 13 supermarkets and 5 liquor stores were converted to Boxer stores. The Pick n Pay Group estimates their market share in South Africa at 16 percent, and the management says the company is underrepresented in the value-based grocery store chains.

Conclusion

Strategy Considerations

Shoprite operates mostly in South Africa but has operations in many other African countries, including Egypt. The firm derives most of its revenues from the grocery business but has expanded its operations to include financial services, home improvement, funeral services, and much more. CEO Engelbrecht is in desperate need of a clear strategic plan moving forward. Currently, the trend in the grocery industry in Africa is to cut costs in every way possible, though margins are slim. Do you agree with this cost-cutting tactic? In addition, what would you recommend CEO Engelbrecht do with respect to new stores? Would it be more profitable to build smaller stores closer to the consumer with fewer options or build larger stores where the consumer can purchase everything they need, but which would require travel further from home? Recall that many in South Africa are dependent on checks from the government twice a month to purchase the products they need. Would this situation lend itself to larger stores in central locations?

What markets should Shoprite expand into? Do you agree with the divesture from the Nigeria market? Recall that rival Pick n Pay is looking to expand into this same market. When developing a strategic plan for Shoprite, be sure to provide solutions for what you feel is the best direction for the firm moving forward. These recommendations may not be what Shoprite is currently doing or what the latest news releases suggest Shoprite plans to do. The firm is in desperate need of a detailed strategic plan as it competes in a difficult region of the world for profitable business.

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Woolworths Group—2022

www.woolworthsgroup.com.au

Headquartered in Bella Vista, New South Wales, Australia, the Woolworths Group has 215,000 employees working in its network of 3,357 stores. The firm reported nearly AU$64 billion in fiscal 2020. The company is part of the highly competitive grocery business in Australia, with its top rival being Coles. Together, they dominate the market, with Woolworths enjoying 37 percent and Coles taking 28 percent of the market.

Woolworths is structured with several divisions, which include Australia Food, New Zealand Food, Online Foods, Drinks, and Hotels. In 2019, Woolworths divested a petroleum business. Australia and New Zealand are markets where customers are quite patriotic and tend to significantly favor products that are made in their own countries.

History

Five Australian entrepreneurs—Percy Christmas, Stanley Chatterton, Cecil Scott Waine, George Creed, and Ernest Williams—founded Woolworths on September 22, 1924. Woolworths opened its first store in December 1924, then named Woolworths Stupendous Bargain Basement and located in Sydney's Imperial Arcade. The company's first CEO, Percy Christmas, described the first store opening thus: "Every city needs a Woolworths: Sydney has it now. Every man, woman, and child needs a handy place where good things are cheap."

A second Woolworths store opened in 1927. The company solely used newspapers for advertising up until 1937, when it began radio advertising very effectively with leading radio personality Jack Davey. It was not until 1957 that the firm opened its first dedicated food store in Sydney's Dee Why.

In 1960, Woolworths became Australia's first nationwide retailer after acquiring Centralian Traders in Alice Springs. With this acquisition, the company finally achieved its mission of catering to every state and territory in Australia.

The company's chain of discount stores, named BIG W, opened in 1976 in Tamworth, New South Wales. By the end of 1978, the company was operating 13 BIG W discount stores across five states.

The 1980s were a decade of expansion, including the acquisition of Dick Smith and America Safeway; by 1985, Woolworths had acquired all 126 of Safeway's Australian stores.

In 2005, Woolworths acquired Foodland Australia Limited's (FAL's) entire New Zealand supermarket business as well as their 22 Action stores in Australia. In 2009, Woolworths formed a joint venture with U.S.-based home improvement retailer Lowe's and also acquired the Danks Group of hardware businesses in Australia. In 2011, Woolworths opened its first Masters Home Improvement stores.

Vision/Mission

A formal vision statement or mission statement could not be located on the Woolworths corporate website or in its 2020 *Annual Report*, but the following have been proposed as likely statements.

Vision Statement

We strive to dominate the grocery market with both small local stores and larger, more centralized stores in Australia and New Zealand.

Mission Statement

We are committed to providing customers with a varied shopping experience, from online, with the best applications available, to traditional in-store shopping, with new concepts regularly in all our stores. We additionally offer quality hotel rooms at a fair price. We are committed to serving people across Australia and New Zealand in both large and small stores with exceptionally friendly staff. We strive to be a good corporate citizen and to do business ethically.

Internal Issues

Organizational Structure

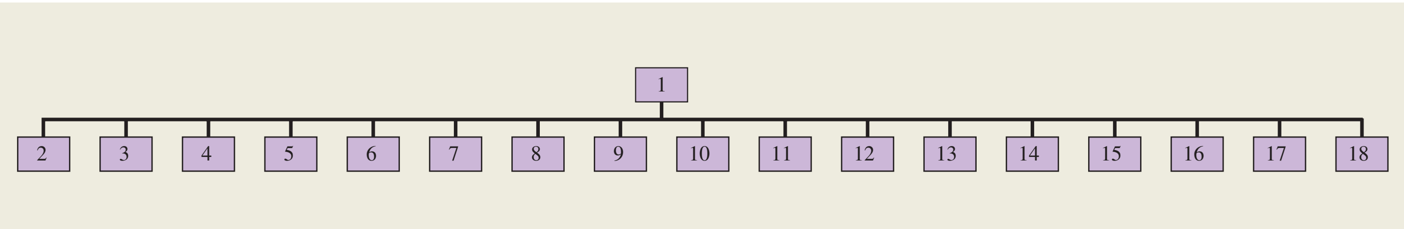
It appears that Woolworths is organized using a decentralized chain-of-command, but the divisional head person's responsibilities are not clearly defined. For example, there appears to be no head person for the BIG W or for Countdown or even for Insurance or Financial Services. Thus, there is substantial room for improvement in the overall design of the company's structure for reporting relationships, although the centralized (functional) head person titles and responsibilities are clear. Allocation of resources across divisions or segments is arguably the most important strategy decision that firms make annually, so it is vital for the division head-person's titles and responsibilities to be clear to all insiders and outsiders.

The term "organizational structure" refers to how a firm's operations are grouped or arranged for battle against rival firms. Structure is vital for success in any firm. An organizational chart reveals the chain of command, showing who reports to whom and who is responsible for what products, regions, and activities. Neither Woolworths' corporate website nor its 2020 *Annual Report* provides an organizational chart or any indication of top executive reporting relationships. In fact, beyond a mere list of management executives with titles, no one is sure whether this company tends to operate by-region or by-product in overall accountability and responsibility of top executives.

Especially because it is such a large firm, Woolworths' basic organizational structure needs both clarification and enhancement to improve effectiveness and efficiency. Among the basic types of structure—such as functional, divisional, and matrix—a strategic business unit (SBU) structure is based on grouping similar divisions together within groups. Some analysts contend that Woolworths should be utilizing an SBU structure because this type of design is especially useful when the number, size, and geographic dispersion of segments, divisions, or profit centers in a firm is roughly greater than 10 (depending on the size and geographic dispersion of the segments). Transitioning to an SBU-type structure could facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units.

Exhibit 1 provides a list of Woolworths' top executives and a flow chart of likely reporting relationships. As there is no chief operating officer, it appears that all top executives report

EXHIBIT 1 A List of Woolworths' Top Executives with a Flow Chart



1. Bradford Banducci, CEO
2. Amanda Bardwell, Managing Director, WooliesX (which includes Woolworths Digital, E-Commerce, Customer Loyalty, and Customer Services).
3. Christain Bennett, Group Head, Reputation, Government Relations, and Industry Affairs
4. Guy Brent, Managing Director, The Woolworths Food Company and Metro
5. Natalie Davis, Managing Director, Woolworths Supermarkets
6. Paul Graham, Chief Supply Chain Officer and Managing Director of Primary Connect
7. Stephen Harrison, Chief Financial Officer
8. Andrew Hicks, Chief Marketing Officer
9. Alex Hold, Chief Sustainability Officer
10. John Hunt, Chief Information Officer
11. Von Ingram, Chief Customer Transformation Officer
12. Caryn Katsikogianis, Chief People Officer
13. Rob McCartney, Format & Network Development Director
14. Pejman Okhovat, Managing Director, BIG W
15. Claire Peters, Managing Director, B2B and Everyday Needs
16. Bill Reid, Chief Legal Officer
17. Spencer Sonn, Managing Director, Woolworths New Zealand
18. David Walker, Chief Risk Officer

Source: Based on information provided at the Woolworths' corporate website,www.woolworthsgroup.com.au directly to the CEO. Many analysts suggest a need for Woolworths to reorganize based on current organizational structure concepts and practice. Transforming into an SBU-type structure based on products likely would be best for the company. Under this arrangement, regional presidents would likely be below all product-based unit managers.

Financial Data and Statements

Exhibit 2 shows recent income statements for Woolworth. Note that revenues increased 6 percent, but there was a 56 percent decrease in net income, due mostly to the AU$1.2 billion in non-recurring events in 2019, when Woolworths sold its petrol business; the AU$1.2 billion was after-tax profit from this sale. Note that interest expense increased as well, but this is a result of a new accounting policy in Australia described in detail in the discussion of the balance sheet. Since net income and earnings before tax include both the new accounting rule and the one-time sale of the petroleum business, the EBIT number may be the better number for accessing profitability in 2020. With a 12 percent increase, it appears that Woolworths overall had a good year in 2020.

EXHIBIT 2 Woolworths' Income Statements (in millions of AU$)

Income Statement	6/30/19	6/30/20		Percent Change
Revenues	59,984	63,675	⇧	6%
Cost of Goods Sold	42,542	45,105	⇧	6%
Gross Profit	17,442	18,570	⇧	6%
Operating Expenses	15,091	15,942	⇧	6%
EBIT	2,351	2,628	⇧	12%
Interest Expense	126	843	⇧	569%
EBT	2,225	1,785	⇩	–20%
Tax	667	576	⇩	–14%
Non-Recurring Events	1,200	–	⇩	–100%
Net Income	2,758	1,209	⇩	–56%

Source: Based on information contained in Woolworths' 2020 *Annual Report,* p. 76.

Exhibit 3 provides a 2-year balance sheet summary for Woolworths. On the statements provided by Woolworths in their *Annual Report*, the firm combines goodwill with intangibles, but when reading the notes to the balance sheet, the precise goodwill number can be found; keep this in mind when doing your research. Treasury stock is referred to as contributed equity on the balance sheet for Woolworths.

The major change to the balance sheet from 2019 to 2020 resulted from the passing of a new law by the Australia Accounting Standards Board (AASB) whereby firms must now place leases that are of significant financial weight on their balance sheet (this was not required previously). Note that Woolworths' long-term assets increased 804 percent and long-term debt increased by the same dollar amount to reflect this accounting change. While this change may not have any impact on your recommendations moving forward for Woolworths, it is important to understand what the numbers on the balance sheet represent.

Strategy

Woolworths is currently revamping their food offerings to provide customers with a more varied selection of healthy and fresh meals. In fiscal 2020, 131 new Fresh Made Easy products were offered to customers. In addition, 54 Woolworths stores provided an extra store section for ethnic foods, providing customers with increased variety in their selection process. A new app was offered in 2020 and was downloaded over a million times just a few months after launch.

EXHIBIT 3 **Woolworths' Balance Sheets (in millions of AU$)**

Balance Sheet	6/30/19	6/30/20		Percent Change
Assets				
Cash and Short Term Investments	1,066	2,068	⇧	94%
Accounts Receivable	682	740	⇧	9%
Inventory	4,280	4,434	⇧	4%
Other Current Assets	270	550	⇧	104%
Total Current Assets	6,298	7,792	⇧	24%
Property Plant & Equipment	8,252	8,742	⇧	6%
Goodwill	4,155	4,217	⇧	1%
Intangibles	3,638	3,500	⇩	–4%
Other Long-Term Assets	1,573	14,221	⇧	804%
Total Assets	23,916	38,472	⇧	61%
Liabilities				
Accounts Payable	6,676	7,508	⇧	12%
Other Current Liabilities	2,209	5,683	⇧	157%
Total Current Liabilities	8,885	13,191	⇧	48%
Long-Term Debt	–	13,168	NA	NA
Other Long-Term Liabilities	4,547	3,081	⇩	–32%
Total Liabilities	13,432	29,440	⇧	119%
Equity				
Common Stock	0	0	NA	NA
Retained Earnings	3,783	2,329	⇩	–38%
Treasury Stock	5,828	6,022	⇧	3%
Paid in Capital & Other	873	681	⇩	–22%
Total Equity	10,484	9,032	⇩	–14%
Total Liabilities and Equity	**23,916**	**38,472**	⇧	61%

Source: Based on information contained in Woolworths' 2020 *Annual Report,* p. 78.

The app allows customers to order food online and monitor order tracking; it also makes personalized offers to customers. Group online sales totaled AU$3.5 billion in 2020, up 42 percent from 2019. About 5.5 percent of total sales in 2020 were derived from online purchases.

It appears that the firm likes to renew the key drivers of growth every year. For 2021, the six key drivers of growth are: 1) keeping the business Covid-safe, 2) expanding food options to customers, 3) separating the Endeavor Group, 4) building adjacencies, 5) advancing e-commerce options, and 6) working more closely with all stakeholders. While these drivers are important, most are not strategic in nature, except possibly for the separation of the Endeavour Group, which trades on the Australian Stock Exchange as a separate firm from Woolworths as of July 2021. An additional strategy the firm is undertaking is building smaller stores closer to customers rather than having fewer mega-sized stores.

Woolworths' Segments

Woolworths performs operations within four business segments: 1) Australian Food, 2) New Zealand Food, 3) BIG W, and 4) Endeavour Group (Drinks and Hotels).

Australian Food

Within Woolworths' Australian Food segment is Woolworths Supermarkets, Metro Food Stores, and WooliesX. Sales for Australian Food were up 8.3 percent for 2020, making this segment the fastest growing and largest, with revenues in excess of AU$42 billion. Metro Food Stores contributed only AU$943 million in sales in 2020, but that number did increase 5 percent from the previous year. There was a trend during 2020 of customers shopping more locally at smaller stores. Additionally, the average basket price increased 5.8 percent, but the total number of transactions declined 1.8 percent. These numbers reflect customers making fewer trips to the grocery store but purchasing more while there. It can also be inferred from these numbers that customers were eating out less in 2020, enabling this segment's 8.3 percent revenue growth for the fiscal year.

Woolworths Supermarkets: The company owns and operates 995 supermarket stores as well as distribution centers and support offices across Australia. The company is proud of the fact that it obtains 96 percent of all its fresh fruit and vegetables and 100 percent of all its fresh meat from Australian farmers and growers, making the company "Australia's Fresh Food People."

WooliesX: This is the company's online operations, reorganized in 2020 into three platforms: Digital & Medical, eCom & Fulfilment, and Loyalty & FinTech. Digital & Medical include generating demand and cartology; eCom & Fulfilment include home delivery and pick-up. Loyalty & FinTech covers Everyday Rewards, gift cards, and insurance for cars, pets, homes, furniture, roadside assistance, landlords, renter contents, and travel, in addition to life insurance. Grocery shoppers get a 10 percent discount if the customer has an insurance policy. Additionally, the company has its own Visa credit cards and sells gift cards.

New Zealand Food

This segment of Woolworths consists of Countdown, a chain of 181 supermarkets located all across New Zealand, as well as 4 dry grocery distribution centers, 3 fresh produce distribution centers, 2 meat-processing plants, 1 seafood-processing plant, and support offices. Online sales in this segment grew 44.5 percent in 2020, anchored by a 74.8 percent increase in Q4. The company's New Zealand Food's franchise stores (FreshChoice and SuperValue) added online capability to 58 stores in 2020. In 2020, CountDown opened an 8,800-square-meter eStore in Penrose, an industrial suburb in Auckland where 200 employees complete online orders for customers at 10 of CountDown's busiest Auckland supermarkets.

Big W

BIG W is a chain of 183 stores located across Australia, Hong Kong, and Bangladesh. The stores offer a variety of products similar to a small Walmart, providing discounted prices on quality products. BIG W is doing great, with 2020 revenues up 11.2 percent over the prior year and Q4 of 2020 showing revenues up 30.5 percent. In the same quarter, BIG W's online sales were up 181 percent as people transition to online business both regionally and globally.

Endeavour Group—Endeavor Drinks

This segment of Woolworths includes EndeavourX, which is the company's investment in digital and online efforts to spur sales. Online sales in this segment grew 28.6 percent in 2020 while growth in door-to-door deliveries grew 161 percent. In this segment, during 2020, over 1,500 plexiglass screens and sanitation stations were installed at 1,500 Dan Murphy and BWS liquor stores. Among alcoholic beverages, Australian-made gin is the fastest growing category of spirits, but craft and premium beer remain popular among Australians. Among wines, premium and super-premium brands sold well at the Dan Murphy's liquor stores throughout 2020.

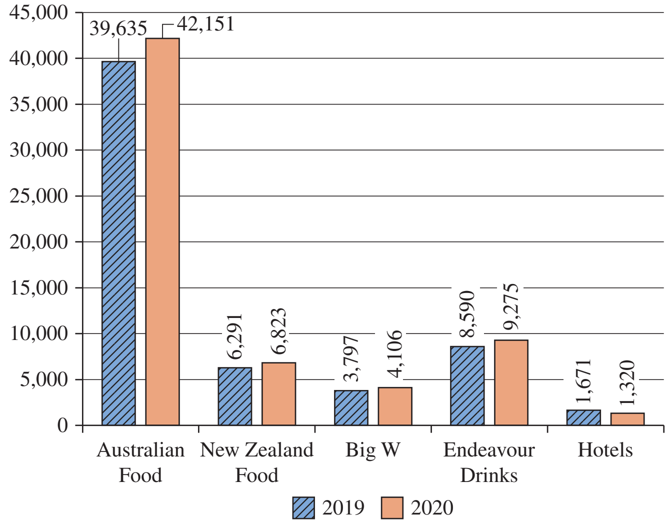
Endeavor Group—Hotels

Australian government–mandated closures of hotels in 2020 due to COVID-19 devasted this segment. In mid-2020, 80 Endeavor hotels and 5 managed clubs remained closed in Victoria.

Segment Performance

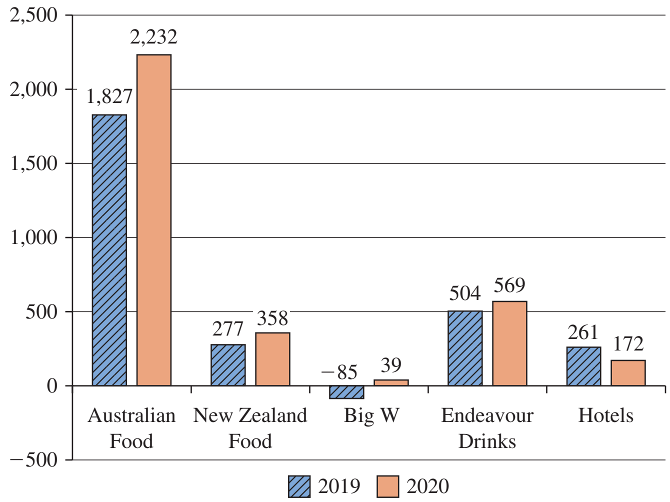
Exhibits 4 and 5 provide a segment-based breakdown of sales. Note that Australia Food is the main driver of the company and should probably be the main attention of your analysis. What should be done with the other segments is important, though. Recall that the firm plans to spin off the Endeavor Drink business, so bear this in mind when researching the case.

EXHIBIT 4 Woolworths' Revenues by Product (in millions of AU$)



Source: Based on Woolworths' 2020 *Annual Report*, p. 19.

EXHIBIT 5 Woolworths' EBIT by Product (millions of AU$)



Source: Based on Woolworths' 2020 *Annual Report*, p. 19.

External Issues

Australian Business Considerations

Australians take great pride in purchasing products that are labeled "Made in Australia" or "Grown in Australia," and as a result, imported products need attractive marketing of their unique attributes to compete with domestic products. Australians in general value quality over quantity, so portion sizes are not that important, which presents an excellent opportunity for grocery stores to promote their store brands: cut back on the portion size, market the unique healthy aspects of the product, and charge a similar price, resulting in a higher margin. There remains a large demand in Australia for organic and ethnic foods. One major opportunity or threat facing grocery stores is Australia is the country's free trade negotiations with the European Union and the United Kingdom. Once finalized, Australian customers can expect a significant upgrade in quality of food and options on food.

Private Label

Private label products are growing in popularity in Australia, with Aldi leading the way. Australians have traditionally not trusted private labels as much as their brand-name counterparts, but this is changing, and no-name brands are expected to grow significantly. These store brands tend to be of similar quality and have much higher margins, benefiting grocery stores. Generally, a store can make more on, for example, a store cola than on a Pepsi or Coke since the major brand has spent millions on advertising. Woolworths and Coles, for example, are including private label brands for up to 40 percent of their store offerings. One of the more common areas for private label brands is in prepared foods and meats. Interestingly, when most people think of store brands, they think of soda, chips, or similar items, but gourmet foods and expensive deli meats, once price-prohibitive, are now consumed much more often and have become extremely popular no-name brand options.

A Better Shopping Experience

The COVID-19 pandemic accelerated the online shopping experience, and most industry experts agree it is here to stay. Coles and Woolworths have reported that their online sales grew in excess of 30 percent in 2020. Supply-chain optimization, excellent mobile applications, and other online platforms are needed to maintain the online shopping demand. One interesting difference between Coles and Woolworths is that the former is much more centralized, with distribution centers that are heavily automated and a partnership with British online supermarket Ocado, while the latter mostly avoids having to depend on a partner like Ocado; instead of a few jumbo centralized centers, it utilizes many micro-fulfillment centers. Metcash also has entered the online sector of the grocery industry with IGA Shop Online, but the firm remains a significantly smaller player than Coles and Woolworths in the online arena.

Coles and Woolworths are improving the shopping experience by refurbishing their existing stores, increasing online options, and gravitating to more market-style formats. Both companies have learned that a market-style fresh-food section is extremely popular with customers. In addition, both companies are focusing on expanding through smaller stores in more locations rather than huge central location stores. With this new strategy, both Coles and Woolworths are competing with IGA's and Foodland's niche.

Healthier Eating

The global trend toward more healthy eating is true in Australia too. Traditional snacks such as cookies and candy are set to grow modestly, but sports nutrition, packaged foods and healthy on-the-go snacks are booming. Keep in mind that many products marketed as healthy may not be the healthiest choices. For example, sports nutrition bars, granola bars, and cereals may be loaded in sugar and processed ingredients. Nevertheless, the trends favor these products over traditional candy bars and cookies.

More and more customers are choosing to incorporate meat-free days in their diets. The plant-based diet is extremely popular in many parts of the world and is expanding into Australia as well. Demand for fish, seafood, and lean chicken is expected to grow more rapidly than other meat options. Products with natural sweeteners are also seeing a large growth rate as more customers avoid sugar-based and artificial sweeteners. People are also consuming less alcohol in Australia, creating a boom for zero- or low-alcohol beverages. Recall that store brands, as opposed to global brands, are increasing in popularity and generally have a higher margin, providing many creative options for new store brand product creations.

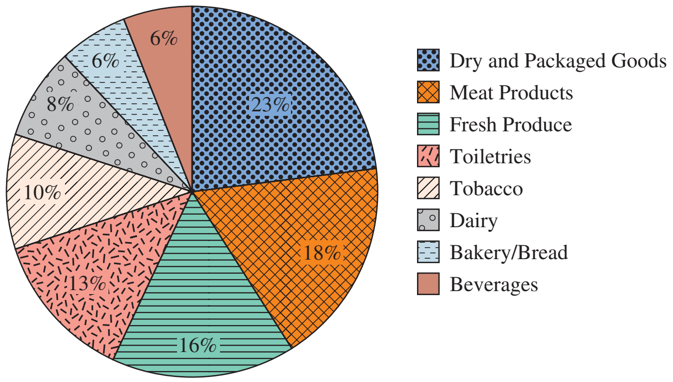
Australia Grocery Shopping Habits

The annual grocery market in Australia is over AU$120 billion, with the average home spending AU$160 weekly on groceries. Men reportedly spend about 10 percent more than women on average. Woolworths and Coles dominate the market, with a combined 65 percent market share. Woolworths is the largest grocery store in Australia, with 37 percent market share and nearly half of Australians shopping at the stores. Women tend to prefer Woolworths, with 10 percent more women shopping there than men, while men prefer Aldi or Metcash (also called IGA). Gen Z shoppers are Woolworths' most loyal customer by age, with 54 percent shopping at the stores.

About 75 percent of Australians shop for groceries at least once a week, and 80 percent of them are a member of a grocery store points program, the two largest of these being Coles' Flybuys and Woolworths' Everyday Rewards. Good news for grocery stores is that 62 percent of customers use their points to get cash back off groceries (7 percent reported they do not use their points for anything). Having an established reward system is likely important in Australia as a recent consumer sentiment survey listed the price of groceries as the third most stressful expense for Aussies, only trailing rents and mortgages and energy expenses for stress levels.

Exhibit 6 reveals the percent revenue breakdown of grocery stores in Australia. Note that Dry and Packaged Foods generate the most revenue, and Beverages generates the least. Keep in mind, though, that revenue and profit margins are not the same; note the high revenue that tobacco generated in the year 2021.

EXHIBIT 6 Product Percent of Revenue in Australia Grocery Market



Source: Based on our reading of various sources.

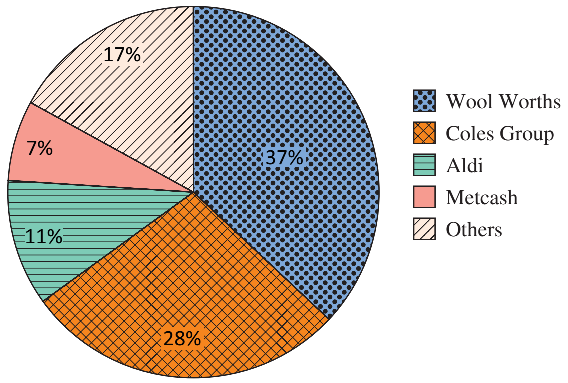
Competitors

Based on data from *Statista* in 2021, New South Wales, Victoria, and Queensland are home to 2,790, 2,672, and 1,602 grocery stores, respectively, or about 80 percent of all grocery stores in Australia. Although Coles is Woolworths' major rival, in South Australia and Queensland, Drakes is a large supermarket and another contender. Harris Farm Markets is a major regional player in New South Wales and Queensland. In addition to Metcash and Aldi, there are many smaller, local grocery store chains in Australia that compete by trying to provide exceptional customer service for local patrons.

While Aldi only represents 11 percent of the grocery store market in Australia, it is growing and offering strong competition, mainly through lower prices but also from the unique goods it offers. Aldi appears to have finished its expansion, considering it has reached the saturation point of new stores, and is now attempting to attract new customers to the same stores, keeping existing customers, and focusing on higher profit margin items.

Grocery store companies always risk placing too much downward pressure on prices. However, between 2019 and 2020, Coles increased prices 2.4 percent while Woolworths charged 1.4 percent more. Exhibit 7 provides a breakdown of the market share in Australia. The good news for grocery stores in Australia is that solid growth is expected through 2026, and no major competitors appear ready to enter the market with the possible exception of AmazonFresh. This came as a surprise as major German Grocer Kaufland was investing heavily in real estate in Australia before deciding to forgo its plans and exit the market in 2020. This unexpected development makes Costco the last major retailer to enter the market, which it did over a decade ago, in 2009. It is interesting that both Coles and Woolworths are today shifting from competing on price to competing by offering more products that have a higher profit margin. Moreover, firms are expanding their loyalty programs and promotions rather than providing discounts.

EXHIBIT 7 Percent of Market Share in Australia Grocery Market



Source: Based on information in *IBISWorld.*

Conclusion

Strategy Considerations

Woolworths competes in a challenging, low profit-margin business in both Australia and New Zealand. However, as the old adage goes, "everyone has to eat," and this fact protects grocery firms from major downturns in the economy. During rough times, grocery store firms can even experience an increase in revenues, as Woolworths did in 2020 despite divesting its petroleum business in 2019.

Profit margins are generally low in the grocery business and inventory turnover attention is especially important. To prosper in this business, it takes exceptional customer service, low prices, varied product offerings, excellent inventory management, and a well-developed strategic plan. Regarding the latter, Woolworths must be effective in allocating resources across its segments, particularly in determining how best to grow its BIG W and New Zealand Foods segments into stronger divisions.

CEO Banducci is shifting Woolworths' strategy to building more and smaller grocery stores in more local markets, competing more heavily with Aldi and the myriad other players in these markets. Perform a comprehensive strategic analysis to determine whether this is a good strategy. Would the future of Woolworths be brighter if it made plans to double its BIG W and New Zealand operations in 3 years? Be mindful that no firm can do everything that could benefit it; there is simply not sufficient capital. So tough choices must be made, and that is why strategic planning is so important.

What would you suggest to CEO Banducci with respect to promotions and rewards versus flat out promoting the traditional discounts to get people into the store? What mix of products would you recommend the CEO shift to? How aggressively should firms in the industry switch to store-brand products over brand-name products? Recall that Exhibit 6 provided data on the most popular grocery items in Australian grocery stores.

With respect to their Hotel and Endeavor Drinks businesses, should Woolworths divest these divisions and deploy those funds into other regions or products? As you can see, there are many strategic considerations for the company regarding how to allocate resources to best satisfy Woolworths' shareholders and other stakeholders.

After reading and studying this case and doing your own research regarding the latest trends in Australia and New Zealand, prepare a strategic plan for the CEO that includes your recommendations for the firm. Be sure not to simply report what the firm is doing or what you think they are going to do based on the news, unless of course you also feel this is the best option based on your analyses. Rather, imagine that CEO Banducci and the Woolworths board are paying you a large fee to develop an exemplary three-year strategic plan for the firm. What should be done with the WooliesX operations and the company's hardware stores and hotels? Can Woolworths remain this diversified and stay successful going forward?

You may need to develop a new vision and mission for Woolworths if your strategy recommendations are significantly different from what the firm is currently doing in terms of the products, services, or regions. A new and improved organizational structure is needed to more clearly identify the accountability and responsibility of top executives, especially in light of your recommendations for the future.

Microsoft Corporation—2018

www.microsoft.com, MSFT

Headquartered in Redmond, Washington, Microsoft is the world's largest software company developing products for customers in over 190 countries. The company's products include Windows Office, Windows 8 operating system for personal computers (PC)s, Windows, 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, LinkedIn, and offers the popular *Surface* tablet computer.

In May 2018, Microsoft announced its offering of AI for Accessibility, a new $25 million, five-year program aimed at harnessing the power of AI to amplify human capabilities for more than 1 billion people around the world with disabilities. This program aims to capitalize on smart devices proliferating in homes and businesses across the globe. Smart devices are today powering advanced ways to see, listen, reason, and predict, without constant connectivity to the cloud. That is the intelligent edge as Microsoft refers to the movement.

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 personal computer 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 personal computers and tablet computers. Then, in May 2012, introduced its own tablet computer, called 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 United States. Bill and Melinda Gates are today one of the richest couples on the planet, and one of the most giving couples in terms of philanthropy endeavors through the Bill and Melinda Gates Foundation.

In May 2018, DJI, the world's leader in civilian drones and aerial imaging technology, and Microsoft began a strategic partnership to bring advanced artificial intelligence (AI) and machine learning capabilities to DJI drones. The two companies want to help businesses harness the power of commercial drone technology and edge cloud computing. This partnership entails DJI releasing its software development kit (SDK) for Windows to extend the power of commercial drone technology. Additionally, DJI selected Microsoft Azure as its preferred cloud-computing partner, taking advantage of Azure's industry-leading AI and machine learning capabilities. The two firms desire to turn vast quantities of aerial imagery and video data into actionable insights for thousands of businesses across the globe.

Vision/Mission

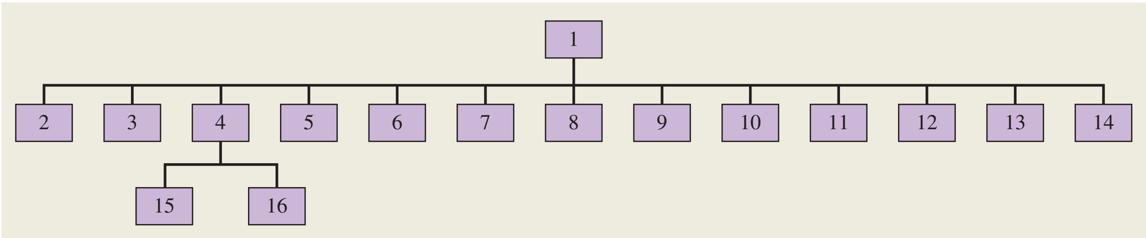
On its website, Microsoft describes what could be taken as its vision statement: to empower people and businesses globally to attain greater success. The company uses the terms vision and mission interchangeably. Yet, later in the *Form 10K* when discussing the company's cloud computing operations it says (paraphrased): "Our vision is to develop and provide best-in-class platforms and services for an intelligent cloud infused with artificial intelligence."

Internal Issues

Organizational Structure

Microsoft's website reveals that the company operates using a strategic business unit (SBU) type of organizational structure, with three SBUs and various divisions reporting to those Unit Head Persons. However, as indicated in Exhibit 1, the titles of Microsoft executives do not align well with those segments. Probably no one but Microsoft insiders know exactly who reports to who—but what is important for students is to devise a recommended reporting relationship, perhaps deleting some positions and creating others, to more clearly reveal for all insiders and outsiders the chain of command.

EXHIBIT 1 Microsoft's Top Executives and Organizational Chart



1. Satya Nadella, CEO
2. Scott Guthrie, EVP Microsoft Cloud and Enterprise Group
3. Terry Myerson, EVP Windows and Devices Group
4. Rajesh Jha, EVP Officer Product Group
5. Judson Althoff, EVP Worldwide Commercial Business
6. Chris Capossela, CMO, EVP Marketing and Consumer Business
7. Jean-Philippe Courtois, EVP and President Microsoft Global Sales Marketing
8. Kurt DelBene, Chief Digital Officer and EVP Corporate Strategy
9. Kathleen Hogan, EVP HR
10. Amy Hood, EVP and CFO
11. Peggy Johnson, EVP Business Development
12. Kevin Scott, Chief Technology Officer
13. Harry Shum, EVP Artificial Intelligence and Research Group
14. Brad Smith, President and Chief Legal Officer
15. Phil Spencer, EVP Gaming
16. Jeff Weiner, CEO of LinkedIn

Source: Based on company documents.

R&D

In 2017, Microsoft spent $13 billion on research and development, a 9 percent increase over the previous year. The company develops most of their products and services internally using various engineering scientists that focus on everything from artificial intelligence to cloud infrastructure.

Distribution and Licensing

Microsoft has more than 30 different distribution and licensing agreements with companies, organizations, municipalities, and individuals to sell their products and services. There are site license options available, individual licenses, group licenses, with various firms that include Dell, Fujitsu, Lenovo, Samsung, Toshiba, and Hewlett-Packard. Firms can purchase perpetual licenses or subscribe to licenses.

Employees

As fiscal 2018 began, Microsoft employed 124,000 persons full-time, 73,000 of which were located in the United States, and 51,000 outside the U.S. Among those persons, 39,000 were in manufacturing, distribution, and product support, 40,000 were in research and development, 34,000 were in sales or marketing, and 11,000 worked for LinkedIn.

Segments

Microsoft operates under three segments: 1) Productivity and Business Processes, 2) Intelligent Cloud, and 3) More Personal Computing. Microsoft has become the second largest (behind Amazon.com) company for businesses renting computing power and storage via cloud computing. For Q2 2018 that ended December 31, 2017, revenues at the company's two biggest cloud-computing businesses, Azure infrastructure services and Office 365 online-productivity, grew 98 and 41 percent, respectively, following up on the previous quarters 90 and 42 percent gains. Revenues in Q2 2018 for the company's Intelligent Cloud segment, which includes Azure, rose 15 percent to $7.8 billion, while revenues at the company's Productivity and Business Processes segment, which includes Office, gained 25 percent to $8.95 billion.

Productivity and Business Processes

This segment includes the following four divisions:

1. Office Commercial—includes Office 365 subscriptions and Office licensed on-premises, comprising Office, Exchange, SharePoint, Skype for Business, and Microsoft Teams, and related Client Access Licenses ("CALs").
2. Office Consumer—includes Office 365 subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
3. LinkedIn—includes Talent Solutions, Marketing Solutions, and Premium Subscriptions.
4. Dynamics Business Solutions—includes Dynamics ERP on-premises, Dynamics CRM on-premises, and Dynamics 365, a set of cloud-based applications across ERP and CRM.

Intelligent Cloud

This segment includes the following two divisions:

1. Server products and cloud services—includes Microsoft SQL Server, Windows Server, Visual Studio, System Center, and related CALs, and Azure.
2. Enterprise Services—includes Premier Support Services and Microsoft Consulting Services.

More Personal Computing

This segment includes the following three divisions:

1. Windows—includes Windows equipment, operating system, cloud services, patent licensing, Windows Internet of Things ("IoT"); and MSN display advertising.
2. Devices—includes Microsoft Surface, PC accessories, and other devices.
3. Gaming—includes Xbox hardware and Xbox software and services.

Exhibit 2 provides a revenue and profit breakdown of Microsoft's three segments for 2017, 2016, and 2015. Note that the company's "More Personal Computing" segment generates the most revenue and operating income, but also is the only segment reporting declining revenues for three years.

EXHIBIT 2 Microsoft's By-Segment Financial Results (in billions USD)

Revenue per Segment	2017	2016	2015
Productivity and Business Processes	30.4	26.5	26.4
Intelligent Cloud	27.4	25.0	23.7
More Personal Computing	38.8	40.4	43.4
Operating Income per Segment			
Productivity and Business Processes	11.9	12.4	13.3
Intelligent Cloud	9.1	9.3	9.8
More Personal Computing	8.3	6.2	5.1

Source: Based on company documents.

Finance

Microsoft is a very transparent company in that their website provides full segment revenue and operating profit information, and the firm's *Form 10K* is provided on the corporate website as a .docx file which is unusual. The company's recent income statements and balance sheets are provided in Exhibit 3 and Exhibit 4 respectively. The company's fiscal year ends June 30.

Microsoft's revenues for Q2 2018 increased 12 percent to $28.92 billion, but profits were negative $6.3 billion. The prior quarter reported an overall profit of positive $6.27 billion. Microsoft's CFO Amy Hood said in February 2018 that she has no plans yet to bring back to the United States the company's $142.8 billion in cash in overseas accounts.

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, while 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 Systems, 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 more than 5 years and game selection is one of the largest factors in deterring the success of a gaming console.

Microsoft's new Windows smartphone competes with market share leader Apple with their iPhone, and Google with their Android platform powering Samsung, among 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 5 provides a financial comparison of Microsoft's with three competitors. Note that Microsoft has the lowest EPS among the firms included, partly due to having by far the most shares of stock outstanding.

Apple Inc. (APPL)

Headquartered in Cupertino, California, Apple produces smartphones, watches, personal computers, digital music players, and other communication media to customers around the world. Some of their most popular products include the iPhone, iPad, MacBook Pro, and iPod. Apple

EXHIBIT 3 Microsoft's Income Statements (in millions USD)

Income Statement	6/30/16	6/30/17		Percent Change
Revenues	$85,320	$89,950	⇧	5.43%
Cost of Goods Sold	32,780	34,261	⇧	4.52%
Gross Profit	52,540	55,689	⇧	5.99%
Operating Expenses	32,789	32,540	⇩	−0.76%
EBIT	19,751	23,149	⇧	17.20%
Interest Expense	0	0	NA	NA
EBT	19,751	23,149	⇧	17.20%
Tax	2,953	1,945	⇩	−34.13%
Non-Recurring Events	0	0	NA	NA
Net Income	16,798	21,204	⇧	26.23%

Source: Based on company documents.

EXHIBIT 4 Microsoft's Balance Sheets (in millions)

Balance Sheet	6/30/16	6/30/17		Percent Change
Assets				
Cash and Short Term Investments	$113,240	$132,981	⇧	17%
Accounts Receivable	18,277	19,792	⇧	8%
Inventory	2,251	2,181	⇩	–3%
Other Current Assets	5,892	4,897	⇩	–17%
Total Current Assets	139,660	159,851	⇧	14%
Property Plant & Equipment	18,356	23,734	⇧	29%
Goodwill	17,872	35,122	⇧	97%
Intangibles	3,733	10,106	⇧	117%
Other Long-Term Assets	13,847	12,273	⇩	–11%
Total Assets	**193,468**	**241,086**	⇧	**25%**
Liabilities				
Accounts Payable	13,036	14,024	⇧	8%
Other Current Liabilities	46,321	50,503	⇧	9%
Total Current Liabilities	59,357	64,527	⇧	9%
Long-Term Debt	40,557	76,073	⇧	88%
Other Long-Term Liabilities	21,557	28,092	⇧	30%
Total Liabilities	121,471	168,692	⇧	39%
Equity				
Common Stock	68,178	69,315	⇧	2%
Retained Earnings	2,282	2,648	⇧	16%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	1,537	431	⇩	–72%
Total Equity	71,997	72,394	⇧	1%
Total Liabilities and Equity	**193,468**	**241,086**	⇧	25%

Source: Based on company documents.

EXHIBIT 5 A Financial Comparison of Microsoft to Rival Companies

	Microsoft	Apple	Alphabet	Oracle
# Employees	124,000	100,000	73,000	138,000
$ Revenue	95B	239B	111B	39B
$ Net Income	9.5B	50.5	12.7B	9.9B
% Profit Margin	10	21	11.4	25.5
$ EPS Ratio	1.23	9.7	18.2	2.33
$ Market Capitalization	703B	829B	754B	204B
# Shares Outstanding	7.7B	5.1B	349M	4.1B

Source: Based on company documents.

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, and Logic Studio. 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 United States, and 140 stores internationally.

Oracle Corporation (ORCL)

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 IT, strategy alignment, and ongoing product enhancements. Oracle's revenues and net income have been holding steady at about $38 billion and $9 billion, respectively.

External

Cloud Computing

Cloud computing, supplying computing services via the Internet without having to utilize hardware or platform support, continues to grow in its use and offerings. Many businesses employ the technology to save on costs as 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 upon 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.

Broadly speaking, there are hundreds of external opportunities and threats that impact Microsoft related to cybersecurity, intellectual property rights, anti-trust litigation, patent infringement, privacy issues regarding the collection and use of personal information, laws and regulation variation across countries, tax issues, rapid technological advancements across their diversified product line, artificial intelligence, quantum computing, robotics, and changes in levels of disposable income across countries. These issues are complicated by the fact that Microsoft has such different competitors across its three basic segments. For example, Facebook is a huge competitor to LinkedIn, whereas Amazon, Oracle, and Google are huge competitors in cloud computing. China in particular has firms gaining rapidly in the artificial intelligence, quantum computing, and robotics industries, so rival firms to Microsoft are not limited to American businesses.

Future

Microsoft's plans going forward are to continue making acquisitions and entering into joint ventures and strategic alliances. The company took on substantial goodwill and intangible "dollars" with its LinkedIn acquisition—and expects to record perhaps a $5 billion impairment charge in 2018 to draw down the high goodwill and intangible amounts shown on its balance sheets. Effort must be made to acquire firms at market capitialization value or less, not more.

In early 2018, Microsoft formed a partnership with Sunseap Group that marked Microsoft's first clean energy deal in Asia and will create the single-largest solar energy portfolio in Singapore to date. This 60 megawatt-peak (MWp) solar portfolio is to span hundreds of rooftops across the nation and is the first rooftop solar portfolio in the country focused on serving datacenter energy consumption. Sunseap is a leading solar provider in Singapore. Microsoft began operations in Singapore in 1990, and now has over 850 employees. Singapore is also home to Microsoft's datacenter services that deliver Microsoft Azure, Office 365 and numerous other cloud services for customers.

Also in early 2018, Xiaomi Corporation and Microsoft signed a Strategic Framework Memorandum of Understanding (MoU) to deepen the partnership between the two companies. Founded in 2010, Xiaomi is one of the world's most innovative technology companies offering smartphones, smart TVs, and a range of smart home products. Microsoft's cloud computing and artificial intelligence (AI) technologies will help strengthen Xiaomi's mobile, smart devices and services, and contribute to the acceleration of its international expansion. This partnership also allows Microsoft to reach more users around the world who are using Xiaomi products. Xiaomi and Microsoft's cooperation will focus on the following aspects:

1. **Cloud support:** The two firms will explore utilizing Microsoft Azure cloud platform to support Xiaomi's user data storage, bandwidth, computing and other cloud services in international markets.
2. **Laptop-type devices:** Xiaomi gains Microsoft support on joint marketing, channel support, and future product development for Xiaomi's laptop and laptop-type devices to penetrate international markets.
3. **Microsoft Cortana and Mi AI Speaker:** Both companies desire to integrate Cortana with Mi AI Speaker.
4. **AI services collaboration:** Xiaomi and Microsoft intend to explore multiple cooperative projects based on a broad range of Microsoft AI technologies, such as Computer Vision, Speech, Natural Language Processing, Text Input, Conversational AI, Knowledge Graph and Search, as well as related Microsoft AI products and services, such as Bing, Edge, Cortana, XiaoIce, SwiftKey, Translator, Pix, Cognitive Services, and Skype.

Microsoft is looking to form other partnerships similar to the ones with Sunseap Group and with Xiaomi to extend Microsoft desires to further penetrate world markets with its unique products and services. For example, in the summer 2018, Microsoft began working with Qualcomm Technologies to create a vision AI developer kit running Azure IoT Edge. This solution makes available the key hardware and software required to develop camera-based IoT solutions that can power advanced Azure services, such as machine learning, stream analytics, and cognitive services.

Microsoft needs a clear strategic plan going forward to manage and grow its worldwide footprint.

Amazon.com—2018

www.amazon.com, AMZN

Headquartered in Seattle, Washington, the year 2017 was phenomenal for Amazon that over the last twenty years has grown from being solely an online bookstore to a worldwide powerhouse, selling virtually everything today to everybody. Amazon is the largest online retailer in the world as measured by both revenue and market capitalization. The second largest online retailer is Alibaba Group located in China. Led by their CEO, Jeff Bezos, Amazon has expanded heavily into smart homes and through its Alexa platform, and even into machine learning. In 2017, the firm shipped over 5 billion items with Prime worldwide with more paid members joining Prime in 2017 than any previous year, both in North America and worldwide.

Amazon reported record revenues in 2017, up 31 percent—helped in part by Fire TV Stick and Echo Dot—that were the bestselling products across all of Amazon's products sold. Tens of millions of Echo devices alone were purchased, but a portion of the revenue increase can be explained through the acquisition of Whole Foods. Amazon hired 130,000 new employees in 2017, globally, and employs over 17,500 veterans and their spouses in the United States. In 2017, Amazon Prime Video reported over 18 million views from customers in 11 NFL games across over 200 countries on their smart TVs and other devices. Amazon also now holds the global TV rights to *The Lord of the Rings*. The company even launched two furniture brands in 2017.

Amazon reports in three segments: North America, International, and Amazon Web Services (AWS). Amazon, in early 2018, launched a new service called "Shipping with Amazon" aimed at competing with FedEx Corporation and United Parcel Services (UPS). But the Amazon's 40 planes and 300 warehouses pale in comparison, for example, to FedEx's 650 planes, 150,000 trucks, 400,000 employees, and 4,800 operating facilities globally to handle about 12 million shipments a day. UPS is even larger than FedEx and handles 20 million packages a day with service to more than 220 countries through a fleet of more than 500 planes and 100,000 vehicles. At least for now, neither FedEx or UPS is concerned that Amazon wants into the shipping business, but that could change.

History

Amazon opened for business in July 1995 as an online bookstore and has since grown into the largest e-commerce firm in the world. The name Amazon was chosen because the Amazon River region is "exotic and different" and the biggest river system in the world; founder Jeff Bezos planned to make his bookstore the biggest in the world. Amazon started an associate program where other websites could post on amazon.com; this led to allowing individuals to post items for sale. Online shopping became popular with the growth of the Internet in 1995 with the world's population percentage of using the Internet being 0.4 percent. That was a total of 16 million people using the Internet in 1995.

After a decade, the world's population percentage of using the Internet grew to 15.7 percent; which is a total of 1,018 million people. As of June 2017, the world's population of using the Internet was 51.7 percent; which is a total of 3,885 million people. The demand for online shopping also has grown substantially.

Amazon's number of worldwide customer accounts has grown from 1.5 million customer accounts in the 1990s to over 500 million in 2018. In 2005, Amazon created the Amazon Prime membership program where members were eligible for faster 2-day, or even 1-day, shipping on their orders. The program also allowed members to have access to the Amazon Instant Video where members could stream videos. About 60 percent of Amazon users in the U.S. are Amazon Prime subscribers.

In 2007, Amazon began offering its Kindle 3rd-generation-readers, paving the way for e-books. Today, you do not even need a kindle to read e-books as the free kindle app is sufficient. The firm's establishment of Prime offering free shipping and select audio and video to customers for free was a hit with consumers and now Amazon generates more revenues from Prime customers than from nonprime customers in the United States.

Amazon, in the last few years, is aggressively expanding its Amazon Web Services (AWS) business which focuses on machine learning, powering smart homes, and other data driven applications. Many people are familiar with Amazon's smart speakers, or Alexa, who is ready to help on many items.

In early 2017, Amazon acquired Whole Foods Market for $13.7 billion in at attempt to both move into the brick and mortar business, but possibly as a means of delivering groceries in the future. Whole Foods is a leader in organic foods in North America and has over 477 stores in North America and the United Kingdom.

Amazon is locating a second headquarters in a city with at least a million people; the city is to be revealed in mid-2018. The $5 billion second headquarters, starting with 500,000 square feet and eventually expanding to as much as 8 million square feet, may have as many as 50,000 employees. The company is also building a new downtown Seattle building, expected to be completed in 2020.

Organizational Culture

Amazon

From his first *Annual Report* in 1996, CEO Jeff Bezos indicated that Amazon puts customers first, and even today, in the 2017 *Annual Report*, Amazon describes itself as on a mission to be the "Earth's most customer-centric company." Amazon also has a culture that promotes new inventions, long-term thinking, and operational excellence (being efficient).

Bezos has routinely reminded his employees and executives it is still Day 1 at Amazon, in fact, the building Bezos works in is named Day 1 and when they changed buildings, he took the name with him for the new building. As it would happen, an employee in 2016 finally summoned the courage to ask Bezos what all other employees for the last 20 years were probably wondering, when does Day 2 start? In short, Bezos describes Day 2 as "irrelevance, and an excruciating painful decline followed by death." And for this reason, it is always Day 1 at Amazon. To remain in Day 1, Bezos suggests to experiment, accept failures as part of business, plant and protect seeds, and maybe most important, ramp it up when you see delighted customers.

In May 2018, for the third year in a row, customers voted Amazon #1 in corporate reputation in the Harris Poll, a poll that surveys more than 25,000 people and evaluates public perceptions classified into six dimensions of corporate reputation: Workplace Environment, Social Responsibility, Emotional Appeal, Financial Performance, Vision & Leadership, and Products & Services. At about the same time, a poll of 50,000 U.S. consumers ranked Amazon #1 in the American Customer Satisfaction Index for the Internet Retail category for the eighth year in a row. Additionally, a poll of 10,000 U.K. customers ranked Amazon.co.uk #1 in customer satisfaction for the fifth consecutive time as reported by the U.K. Customer Satisfaction Index. Amazon recently received other accolades too, such as LinkedIn recognizing Amazon as the #1 most desirable workplace in the U.S. based on data about where job seekers want to work and how long employees stay with companies across the country.

Whole Foods Market

At Whole Foods Market, all employees, managers, and executives know what everyone else's pay is at the company, including hourly wages earned, salaries, and bonuses. Headquartered in Austin, Texas, but now owned by Amazon, Whole Foods keeps its employees as informed as possible, even when it comes to pay. The open-compensation policy is designed to both encourage conversations about salary among staff members and to promote competition within the company. Whole Foods co-CEO, John Mackey, introduced the policy in 1986, just 6 years after he co-founded the company; the policy is part of the company's culture.

Whole Foods believes that when employees understand why some people are paid more than others, when workers understood what types of performance and achievement earned certain people more money, folks are more motivated and successful. John Mackey says: "I'm challenged on salaries all the time. How come you are paying this regional president this much, and I'm only making this much?' I have to say, 'because that person is more valuable. If you accomplish what this person has accomplished, I'll pay you that, too.'"

Whole Foods' policy is for all its managers to post their store's sales data each day and regional sales data each week. The company believes that a culture of shared information helps create a sense of a "shared fate" among employees. Mackey says: "If you're trying to create a high-trust organization, an organization where people are all-for-one and one-for-all, you can't have secrets." The bottom line for Whole Foods is that its workforce has high-level access to the company's financial data, and therefore a greater stake in the business, and this culture has resulted in outstanding customer service and a highly motivated workforce.

Internal Issues

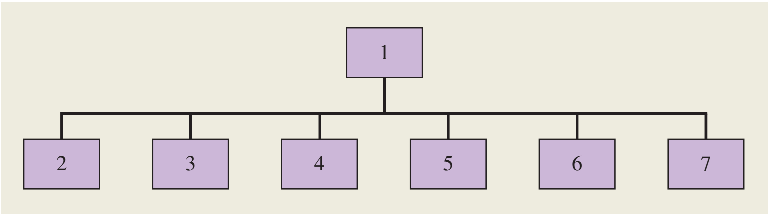
Vision/Mission

Amazon's vision statement (paraphrased) is to be the most customer-oriented company on the planet, where customers can find virtually anything they wish to purpose online. Amazon's mission statement (paraphrased) is to offer customers the lowest possible prices, coupled with the best selection and the upmost convenience. On its website, Amazon lists its guiding principles: customer-centric culture, innovation, operational excellence, and long-term strategy.

Organizational Structure

Jeff Bezos is President, CEO, and Chairman of the Board of Amazon. The company apparently has two divisions: Amazon Web Services and Worldwide Consumer, but it is not clear what these divisions entail. The company's top executives are listed in Exhibit 1 along with a possible organizational chart. Amazon does not make its organizational chart public so no one, except insiders, know who reports to whom.

EXHIBIT 1 Amazon's Top Executives and Organizational Chart



1. Jeffrey Bezos, President, Chairman of the Board, and CEO
2. Brian Olsavsky, Senior VP and CFO
3. Jeffrey Blackburn, Senior VP Business Development
4. Andrew Jassy, CEO Amazon Web Services
5. Shelley Reynolds, VP, Worldwide Controller and Principal Accounting Officer
6. Jeffrey Wilke, CEO Worldwide Consumer
7. David Zapolsky, Senior VP, General Counsel, and Secretary

Source: Based on the company's 2017 *Annual Report,* other company documents, and a variety of other sources.

Current Strategies

There are four key points used to develop Amazon's strategy: 1) have an obsession with your customers, 2) resist proxies, 3) embrace external trends, and 4) make rapid decisions. Bezos says being truly customer focused is a better approach than focusing on competitors, products, technology, or even your business model. Surprisingly, Bezos' take on why being customer focused is the most important is a bit of a negative reason. He contends that customers are often dissatisfied, and sometimes significantly dissatisfied, yet will still report being happy all while your business is prospering. What Bezos is getting at here is the same line of logic Apple's Steve Jobs mentioned countless times, customers don't know what they want, therefore by default become dissatisfied with your products when a better option becomes available.

Bezos mentions the Prime membership program as one example where customers never knew they would want or desire such a platform, yet now millions use and love Prime. Steve Jobs often mentioned virtually no customer knew they would want or need a personal computer, yet the Apple II was a huge hit in the early 1980s, and the development of the smartphone in 2006 was the same concept.

Avoiding proxies is another trait Bezos believes is important to remaining in Day 1. By proxy he means using one tool as a substitute for another (generally, the most important). He uses having a formal process as proxy instead of serving customers first. Really, since Bezos puts extreme emphasis on serving customers, any area that receives focus in lieu of customers can be considered a proxy. Areas to avoid with having a detailed process are letting the process become king and following it to a tee instead of routinely examining business outcomes. Bezos also cites beta testing and surveys as proxies but they, like having a formal process, should not be a replacement for heart, intuition, guts, and other variables, yet he still contends it is important to have a process.

Embracing external trends is also vitally important to avoiding Day 2. Currently, machine learning and data analytics are two huge external trends and Amazon is well positioned with its AWS Division.

Finally, being able to make rapid decisions is important to avoiding Day 2 according to Bezos. The difference in a Day 1 and Day 2 firm, is not based on good or poor decisions, but generally when the decisions are made. Day 2 firms make the decision too late, after it is clear to everyone, thus much of the money or opportunity is gone. Yet decisions should be two-way doors, there should be a way out if it becomes apparent a different decision should have been made. To act fast, make the decision with 70 percent information; waiting for 90 percent is what Day 2 firms do. Learn how to become good at correcting course because here it generally ends up far less costly to have a go with 70 percent knowledge and be wrong, than wait for 90 percent and miss the market.

Amazon is aggressively entering the AWS (Amazon Web Services) environment. The firm's Alexa program far exceeded 2017 projections and CEO Jeff Bezos expects the company to "double down" on expanding and funding Alexa. As of early 2018, customers are able to control with Alexa over 4,000 smart home devices produced by 1,200 different brands.

Amazon used an unrelated diversification strategy to launch Rivet and Stone & Beam, two new furniture brands with the former focusing on mid-century modern furniture for smaller rooms, and the later focusing on durable and stylish furniture for larger areas. Possibly a related diversification strategy was the purchase of Whole Foods in 2017.

In several market development moves, Amazon started a third-party marketplace in Australia offering customers timely delivery products, many from small businesses. Launching Prime in the Netherlands, Belgium, and Luxembourg, providing Prime members there with free one- or two-day delivery and other Prime benefits for the inexpensive introductory price of €3.99 or around $5.00. Amazon reported negative EBIT in both 2016 and 2017 with EBIT losses over doubling in 2017. The inexpensive Prime membership in overseas markets may explain part of the losses; in the United States for comparison, Prime for one month cost $12.99.

Students in the United States may subscribe to Prime for generally half the retail cost. Prime in Singapore, India, and other locations also come with inexpensive introductory rates. Amazon is actively expanding third-party marketplaces around the world, not just in Australia, but in Brazil, India, Europe, and many other places. Amazon Prime in both North America and

International markets allows customers to pay a monthly or yearly fee for free shipping. In the United States, the free shipping is promised with a two-day delivery window. In addition customers are provided Prime Music and Video as part of their subscription.

Prime members spend over $700 more than non-Prime members—possibly by getting customers to sign up as they feel they should order more to justify the $99 annual membership (U.S. price). Or potentially, customers that order more are the majority of the ones that sign up for Prime potentially reducing Prime's effectiveness somewhat. Amazon has angered some customers who are not Prime members though by taking 7 to 10 days to ship items ordered in the United States when free shipping is selected for orders over $50.

Amazon has moved from books to retail products, to music, to online data procession, to the grocery delivery business, and even to package delivery. It seems just 5 years ago, in the United States, about the only food you could have delivered in most locations outside of a large city was pizza. Amazon is changing this by offering grocery delivery. The Whole Foods Market price paid by Amazon was possibly too high, but as Bezos mentioned earlier, he prides himself on acting quickly, and thought waiting would be more expensive than simply paying the price. If Whole Foods studied Bezos tendencies, (which they probably did) they knew this tendency when entering any negotiating. The Whole Foods acquisition, Amazon moved away from strictly online into the brick and mortar business. However, with the firm's Echo, Dot, Plus, and other technologies used in the smart home, it will make ordering from home and having groceries delivered easier. It is just speculation at this point, what Amazon's true intentions are with the Whole Foods acquisition, but gravitating into grocery delivery is certainly a plausible long-term rationale from the merger.

Finance

Amazon reported excellent earnings in 2017, up 31 percent from 2016 with net income up 28 percent. It is important to note, however, in Exhibit 2, that EBIT actually decreased due to operating expenses, representing a larger percent of sales in 2017. The company was spared from a drop in net income due to a 46 percent drop in their tax rate. Also, the Whole Foods Market acquisitions can explain a portion of the revenue increases and likely explain a large portion of the additional goodwill in Exhibit 3. Note in Exhibit 3, the large increase in long-term debt. Amazon does not pay dividends either, but this is not a real surprise as the firm is ready to invest its capital in other ventures.

For Q1 2018 that ended 3-31-18, Amazon reported that its sales increased 43 percent to $51.0 billion, compared with $35.7 billion in Q1 2017. The company's operating income for Q1 increased 92 percent to $1.9 billion, while net income increased to $1.6 billion compared with net income of $724 million the previous year Q1.

EXHIBIT 2 Amazon's Income Statements (in millions USD)

Income Statement	12/31/16	12/31/17		Percent Change
Revenues	$135,987	$177,866	⇧	30.80%
Cost of Goods Sold	88,265	111,934	⇧	26.82%
Gross Profit	47,722	65,932	⇧	38.16%
Operating Expenses	43,536	61,826	⇧	42.01%
EBIT	4,186	4,106	⇩	−1.91%
Interest Expense	294	300	⇧	2.04%
EBT	3,892	3,806	⇩	−2.21%
Tax	1,425	769	⇩	−46.04%
Non-Recurring Events	(96)	(4)	⇧	95.83%
Net Income	2,371	3,033	⇧	27.92%

Source: Based on Amazon's 2017 *Q4 Report* and other company data.

EXHIBIT 3 **Amazon's Balance Sheets (in millions USD)**

Balance Sheet	12/31/16	12/31/17		Percent Change
Assets				
Cash and Short Term Investments	$25,981	$30,986	⇧	19%
Accounts Receivable	8,339	13,164	⇧	58%
Inventory	11,461	16,047	⇧	40%
Other Current Assets	0	0	NA	NA
Total Current Assets	45,781	60,197	⇧	31%
Property Plant & Equipment	29,114	48,866	⇧	68%
Goodwill	3,784	13,350	⇧	253%
Intangibles	0	0	NA	NA
Other Long-Term Assets	4,723	8,897	⇧	88%
Total Assets	**83,402**	**131,310**	⇧	**57%**
Liabilities				
Accounts Payable	25,309	34,616	⇧	37%
Other Current Liabilities	18,507	23,267	⇧	26%
Total Current Liabilities	43,816	57,883	⇧	32%
Long-Term Debt	7,694	24,743	⇧	222%
Other Long-Term Liabilities	12,607	20,975	⇧	66%
Total Liabilities	64,117	103,601	⇧	62%
Equity				
Common Stock	5	5	⇩	0%
Retained Earnings	4,916	8,636	⇧	76%
Treasury Stock	(1,837)	(1,837)	⇩	0%
Paid in Capital & Other	16,201	20,905	⇧	29%
Total Equity	19,285	27,709	⇧	44%
Total Liabilities and Equity	**83,402**	**131,310**	⇧	57%

Source: Based on Amazon's 2017 *Q4 Report* and company data.

Segment Data

Amazon Studios

In early 2018, Amazon Studios became partners with Oscar-winning filmmaker Kenneth Lonergan to direct and write both film and television projects. Lonergan and Amazon Studios worked together in 2017 on the famous Manchester by the Sea film, which won Lonergan an Academy Award for Best Original Screenplay and a nomination for Best Director. Manchester by the Sea is available now for streaming and download on Prime Video. Lonergan's upcoming projects include Howards End, a four-part limited series starring Hayley Atwell, and the play "Lobby Hero" starring Chris Evans, Michael Cera, Bel Powley & Brian Tyree Henry, that premiered on Broadway in 2018 at the Helen Hayes Theater as a Second Stage Production.

Amazon Studios produces series and films from top -ier and up-and-coming creators to customers in over 200 countries and territories. Original productions include Amy Sherman-Palladino's award-winning *The Marvelous Mrs. Maisel*. In film, Amazon Studios produces and acquires original movies for theatrical release and early window distribution exclusively for Amazon Prime members. At the 2017 Academy Awards, Amazon Studios became the first streaming service to win Oscars for Best Screenplay, Best Actor, and Best Foreign film. A notable recent release was *The Big Sick*.

Amazon's Prime Video is a premium on-demand entertainment service that offers customers immense choices of movies, films, and television. Amazon channels provide over 140 channel subscriptions that Prime members can add to their membership, including HBO, Showtime, STARZ, Cinemax, PBS KIDS, Acorn TV, and more.

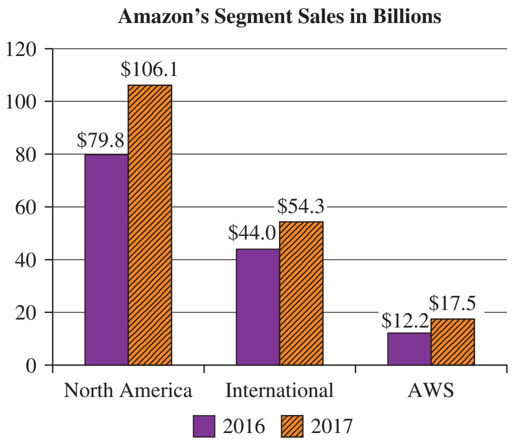
Amazon reports in three main segments: Amazon Web Services, North America, and International—but says very little about its North America and International segments.

Amazon Web Services (AWS)

AWS helps clients with their machine learning processes, removing much of the traditional heavy lifting or need for many experts to start up such programs. Amazon's EC2 P3 provides performance up to six fold better than existing GPU services available in the cloud as of the start of 2018.

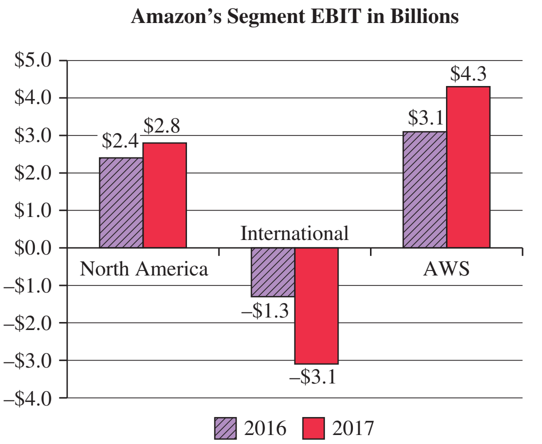
In 2017, Walt Disney named AWS its top choice out of all pubic cloud providers. Symantec, Expedia, Capital One, National Football League, Dow Jones, FICO, Bristol-Myers Squibb, and countless others all initiated either a new, or increased, presence with AWS. AWS is not limited to the U.S. market; France was recently provided service through AWS, and Bahrain, Hong Kong, Sweden, China, and a second GovCloud Region in the United States are all set to be active by 2019. As revealed in Exhibit 4 and Exhibit 5, AWS revenues grew over 43 percent in 2017, and EBIT grew 39 percent. Both exceeded growth in Amazon's traditional product offerings in both North America and International. Also, the profit margins from AWS are significantly higher than any other division, evidenced by significantly more operating income from this division in 2017 than other divisions, with also astronautically lower sales. Amazon is attempting to expand AWS across the globe. In fact, on Amazon's 2017 Q4 report, there was significant discussion on AWS and hardly any segment discussion on North America or International.

EXHIBIT 4 Amazon's Revenues by Segment



Source: Based on Amazon's 2017 *4Q* and other company information.

EXHIBIT 5 Amazon's EBIT by Segment



Source: Based on 2017 *4Q* and other company information.

Competition

Offering a large variety of products and services both in the United States and abroad puts Amazon in competition with all kinds and sizes of firms from all around the world. A sampling of competitors for Amazon include: similar online sites to purchase goods, traditional brick-and-mortar stores, firms that provide e-commence services, and firms that provide streaming content. However, some big-time rivals to Amazon include Walmart, Trader Joe's, Alibaba, Kroger, Target, Alphabet (owner of Google), and e-Bay.

One of Amazon's competitive advantages in the industry is fulfillment since the company places great importance on being able to deliver goods quickly to the consumers. In addition, price, selection, and convenience are important factors to Amazon's success. Exhibit 6 provides a snapshot comparison of Amazon with two rival firms. Note that Walmart has the highest revenue but Amazon has the largest market capitalization and cash reserves.

As per capita disposable income increased during recent years, many consumers have shifted to premium, organic, all natural brands, helping lift industry revenue. Overall, grocery industry revenue is expected to grow annually by .9 percent to $607.9 billion over the next 5 years. Consumers also shifted toward limited assortment and fresh format stores like Trader Joe's that provide a simpler layout and primarily sell less costly store brand products. As consumers become more health conscious, measured by the healthy eating index, they tend to purchase a greater variety of all-natural and organic products. The healthy eating index is expected to slightly increase from year to year.

Over the past 5 years, limited assortment grocery stores like Trader Joe's have experienced the most rapid growth in the grocery industry. Trader Joe's stores are often located in populous areas and are much more compact and efficient than traditional grocery stores. Rather than offering dozens of brands of the same product, these stores sell primarily private label products, which are both less expensive for consumers and more profitable for the industry operators. Trader Joe's, the leading supermarket in sales per square foot, sells more than 80 percent private-label goods, all of which are free of GMOs, artificial coloring, trans fat, and high fructose corn syrup. While private-label brands are traditionally perceived as inferior, stores like Trader Joe's have positioned their store brands as premium products without charging premium prices.

Low profit margins and a highly competitive market have discouraged many companies from entering the grocery business—but not Amazon. Over the 5 years leading up to 2017, the total number of industry enterprises remained flat at about 42,205 companies. In addition to low profit margins, the steady rise of online grocery services has further deterred new operators from entering the industry. E-commerce sales are expected to rise at an annualized rate of 7.8 percent, indicating a continued shift toward virtual shopping. Despite the flat, no growth statistics, Amazon still "overpaid" for Whole Foods Market.

Walmart, Inc. (WMT)

Walmart consists of Sam's Club, Walmart Supercenter, and the Neighborhood Market. Each week, over 260 million customers and members visit Walmart's 11,695 stores under 59 banners in 28 countries and e-commerce websites in 11 countries. Walmart's revenue was $485.9 billion

EXHIBIT 6 Amazon versus Two Rivals on Seven Variables

	Amazon	Walmart	Trader Joe's
$ Market Cap.	748B	26.6B	2.7B
# Employees	566,000	2.3M	16,600
$ Revenue	178B	500B	1,553M
% Profit Margin	1.7	1.97	39
$ Net Income	3B	9.9B	135M
$ EPS Ratio	6.15	3.77	3.69
$ Total cash	31B	6.76B	24.48M

Source: Based on a variety of sources.

for the fiscal year of 2017. Recently, the company implemented free 2-day shipping on more than two million items, with no membership required.

Walmart has about 17 percent of the market share in the food and beverage industry. In spring 2017, the number of individuals who bought most of their groceries in their household at Walmart Supercenters was 45.15 million and 9.31 from Neighborhood Markets from the United States alone. Walmart plans to increase their market share and revenues with the convenience and growth of grocery pickup.

When it comes to shipping, Amazon and Walmart are both trying to outdo each other. Walmart now offers free shipping to anyone ordering $35 in eligible items. Walmart is trying to win over consumers by offering free 2-day shipping without having to have a membership like Amazon. Amazon has Amazon Prime where consumers must pay $119 annually to get free 2-day shipping. However, Amazon's membership also includes having early access to some deals, unlimited photo storage, include Sunday delivery in many markets, and the company's video streaming and music services. Walmart is often called the king of brick-and-mortar retail and remains to this day the world's leader in revenues among retail stores. Walmart acquired jet.com in 2016 and is now offering same-day shipping to New York City. E-commerce revenues in 2017 were only $12 billion but Walmart looms as a potential 800-pound gorilla for Amazon in the online business, and certainly is a major threat and rival to Amazon with their thousands of free-standing mega stores offering groceries, electronics, toys, clothing, and everything in between.

Trader Joe's

Based in Monrovia, California, Trader Joe's is owned by a German private equity firm. Trader Joe's has about 500 stores in 45 states and Washington, D.C. All stores are compact and sell premium private-label foods that actually comprise 80 percent of all items sold in each store. This allows customers to choose between a select number of high-quality products rather than thousands of brand names. Millennials are the typical customer for Trader Joe's as they are health conscious and value driven. About 42 percent of millennial grocery shoppers find private label foods more innovative than branded products, and about 70 percent believe that the quality of these store-brand products has increased in recent years. Trader Joe's had 1.1 percent of the market share in 2016; the company is growing quickly from year-to-year. In spring 2017, the number of individuals in the United States who bought most of their groceries in their household at Trader Joe's was 4.27 million. You can shop at Trader Joe's through Amazon at the website: https://www.amazon.com/Trader-Joe-s/pages/3045489011

Alphabet Inc. (GOOG)

When it comes to the battle of online shoppers, Amazon and Google (owned by Alphabet) are competitors. Google is in the business of selling ads, whereas Amazon is in the business of delivering goods, but Google has introduced Google Express. Google Express is a delivery service designed to compete with Amazon Prime. However, roughly 33 percent of online shoppers start directly on Amazon, which is more than twice the number that start on Google. Therefore, every time someone bypasses Google, Google loses opportunities to show viewer ads. This also means that more consumers are seeing more advertisements on Amazon than Google.

Google also has their own streaming videos and music services that are competing with Amazon's streaming videos and music services. Google has Google Play, Google Chromecast, and their own Google Play Store. Whereas, Amazon has the Kindle Fire Tablet, Amazon's Fire TV, and their own app store. These two behemoth companies compete more and more with each other daily as both firms become more and more diversified with overlapping businesses and interests.

eBay Inc. (EBAY)

Headquartered in San Jose, California, eBay Inc. operates commerce platforms that connect buyers and sellers worldwide. Sellers can organize and offer their inventory for sale; and buyers can find and purchase it on eBay. ebay.com and the eBay mobile apps and stubhub.com, and the

StubHub mobile apps and online ticket platform connect fans with their favorite sporting events, shows, and artists. eBay's classifieds platforms include a collection of brands, such as mobile .de, Kijiji, Gumtree, Marktplaats, eBay Kleinanzeigen, and others that offer online classifieds to enable people to find almost anything they are looking for in their local communities. Using eBay websites, people find, buy, sell, and pay for items through various online, mobile, and offline channels that include retailers, distributors, liquidators, import and export companies, auctioneers, catalog and mail-order companies, classifieds, directories, search engines, commerce participants, shopping channels, and networks. eBay competes with Amazon because both companies are gigantic online retail establishments.

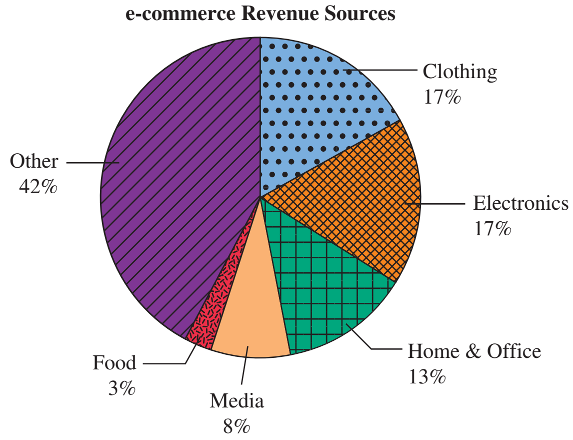
External Issues

A total of 16 million people used the Internet in 1995. As of June 2017, the world's population of using the Internet grew to 51.7 percent; which is a total of 3,885 million people. The demand for online shopping is skyrocketing, and Amazon is the world's largest online retailer. The e-commerce market in the United States is huge with revenues over $450 billion with growth expected through 2023 at 10 percent annually. There are over 135,000 businesses in the United States doing business through the Internet, ranging from a person selling custom made fishing lures to the king Amazon, which controls over 20 percent of the e-commerce market. Possibly surprisingly, the next largest player online is Walmart, yet they only control around 3 percent of the market. eBay controls less than 1 percent with Apple controlling approximately 2 percent.

The most common items Amazon sells are selected for inclusion in Exhibit 7,with the balance of items listed as "Other" making up 42 percent of the market. Of this 42 percent, about 7 percent are derived from both sporting goods and medications, another 10 percent from beauty products, and the balance from tools, jewelry, and many other items.

The Exhibit 7 categories are so broad, for example, clothing includes footwear and accessories. As of 2017, 17 percent of clothing industry revenues in the United States were from e-commerce. Electronics is also a broad category, including computer hardware, software, phones, and even appliances. Like clothing, 17 percent of industry revenues are derived from electronics. Media and Entertainment includes books, music, and video, once Amazon's top selling products. Today, industry-wide, media and entertainment only account for 8 percent of industry revenues.

EXHIBIT 7 e-Commerce's Primary Revenue Sources



Source: Based on a variety of sources.

While many now may think e-Commerce equals or exceeds brick-and-mortar sales, that is not the case yet. As of 2017, about 10 percent of retail revenues are attributed to online, and the number is only expected to grow to 15 percent by 2023, so despite public assumptions, the old-time brick-and-mortar is hanging around, but customers are increasingly gravitating to online options as it is more convenient and delivery times are improving.

Future

In February 2018, Amazon, Chase, and Whole Foods Market announced that the new Amazon Rewards Visa Card can now be used to earn even more rewards when shopping at Whole Foods Market on everything from animal welfare-rated meat to sustainably caught wild and responsibly farmed seafood. In particular, with the announcement, benefits to Prime members increased to 5 percent back on Whole Foods Market purchases when using the Amazon Prime Rewards Visa Card, and 5 percent back on all Amazon.com purchases, 2 percent back at restaurants, gas stations, and drugstores, and 1 percent back on all other purchases.

In May 2018, Amazon and Best Buy announced a multi-year, exclusive collaboration to bring the next generation of Fire TV Edition smart TVs to customers in the U.S. and Canada. The two companies are jointly launching more than ten 4K and HD Fire TV Edition models from Toshiba and Insignia brands, available for purchase in 2018 through Best Buy stores, BestBuy.com, and Amazon.com.

In Q1 2018, Amazon acquired Ring, a home security company. Ring's mission is to reduce crime in neighborhoods with affordable, effective home security products and services. Also during the Q1 2018, Amazon introduced FreeTime on Alexa, the first Alexa experience designed just for kids. These new offerings bring Alexa-specific features and premium content to Amazon's FreeTime and FreeTime Unlimited services, all available on Echo, Echo Dot, and Echo Plus devices. Amazon now offers Echo Dot Kids Edition, the simplest way to get started with FreeTime and FreeTime Unlimited on Alexa.

Amazon has become one of the most diversified companies in the world, selling almost everything to everybody. Managing diversified operations has increasingly been a bad strategy for companies. Led by General Electric, diversified companies between 2017 and 2020 were trying their best to become more homogeneous. How much longer can Amazon successfully buck this trend? Amazon's culture, philosophy, or strategy of being willing to enter almost any business, at any time, is risky, and lucrative when it works out, but potentially devastating long term.

A clear strategic plan for Amazon would be consistent with Bezos' guiding principle to engage in long-term thinking and planning—and would help safeguard against entering too many bad ventures.

Nike, Inc.—2018

www.nike.com, NKE

Headquartered in Beaverton, Oregon, Nike is a large sports apparel company providing apparel to athletic clubs, universities, fitness-minded people, and many others. Most products are designed for specific athletic activities, but many people wear the products for casual purposes. In addition to apparel and shoes, Nike sells sports bags, eyewear, watches, bats, gloves, and many other types of equipment. The firm also owns the Hurley and Converse brands. Nike has always been famous for hiring star athletes to market their brands; the company has three athletes, Michael Jordan, LeBron James, and Cristiano Ronaldo, signed to life-time endorsement deals. Jordan, from 1993 through 2016, was paid over $475 million from Nike even though Jordan retired from professional sports in 2003.

Nike has over 70,000 full-time employees, operates 384 U.S.-based stores and 758 international stores. Nike reported 2017 revenues and net income of about $34 billion and $4 billion, respectively, both figures increasing nicely from the prior year. However, for Nike's second quarter (Q2) of fiscal 2018, revenues for the Converse division of Nike were $408 million, down 4 percent, due to faltering sales in North America. Nike's net income for Q2 2018 decreased 9 percent to $767 million. For both Q1 and Q2 of fiscal 2018, the company's footwear sales declined 5 percent and the company's equipment sales dropped 8 percent in North America. Thus, rival companies are eating into Nike's financial performance in the United States. However, outside North America, Nike is doing really well, growing both revenues and net income in double digits.

For fiscal 2018, Nike's revenues rose 6 percent to $36.4 billion, up 4 percent. For fiscal 2018, NIKE Brand sales to wholesale customers increased 2 percent while NIKE Direct revenues grew 12 percent to $10.4 billion, due primarily to a 25 percent increase in digital commerce sales, the addition of new stores, and 4 percent growth in comparable store sales. For fiscal 2018, Nike's revenues for Converse were $1.9 billion, down 11 percent, as growth in Asia was more than offset by declines primarily in North America. For fiscal 2018, the company's net income decreased 54 percent to $1.9 billion.

Nike needs a clear strategic plan going forward, especially to revitalize its businesses in North America.

History

Bill Bowerman and Phil Knight founded Nike in 1964 as Blue Ribbon Sports and changed the name to Nike in 1971. The name comes from the Greek goddess of victory who was named Nike. Phil Knight was a University of Oregon track athlete and his coach was Bill Bowerman. Nike went public in 1981. Nike originally manufactured shoes in the United States but exited the U.S. manufacturing market in 1984. Nike's trademarks such as "Just Do It" and the Swoosh logo are well known worldwide. Phil Knights stepped down as chairman of Nike in 2016.

Over the years, Nike has acquired many companies, including Cole Haan in 1988, Bauer Hockey in 1994, Hurley International in 2002, Converse in 2003, Umbro in 2008—but then began divesting companies, including Bauer Hockey in 2008, Umbro in 2012, and Cole Haan in 2013.

Nike still today pays top athletes top dollar in many sports to use, promote, and advertise their technology, design, trademarks, logo, and products. Nike's first professional athlete endorser was Romanian tennis player Ilie Nastase, soon followed by track star Steve Prefontaine. Michael Jordan signed on with Nike in 1984, followed by numerous others such as Spike Lee and Mars Blackmon.

Vision/Mission

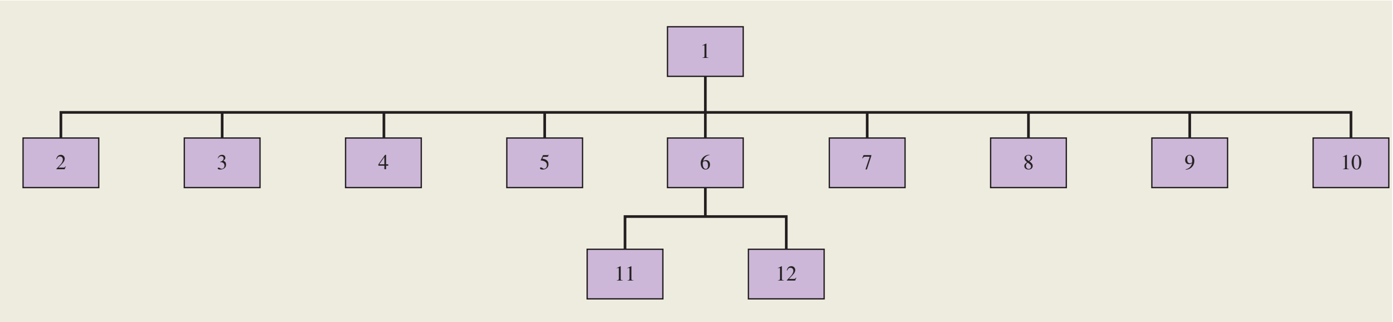
Nike does not appear to have a formal vision statement. Nike's mission (paraphrased) is "to inspire and facilitate every athlete in the world to achieve greatness."

Internal Issues

Organizational Structure

Nike does not make its organizational chart public but likely a division-by-product or division-by-region type structure would work well since the company reports revenues and operating profits both by product (footwear, apparel, and equipment) and by region (North America, Western Europe, China, and Japan). The company's top executives are listed in Exhibit 1 along with a possible organizational chart. However, the existing executive titles do not match well with either of these reportable segment scenarios.

EXHIBIT 1 Nike's Top Executives and Organizational Chart



1. Mark Parker, Chairman, President, and CEO of Nike, Inc.
2. Andy Campion, EVP, CFO
3. Hilary Krane, EVP, Chief Administrative Officer, and General Counsel
4. Monique Matheson, EVP Global HR
5. John Slusher, EVP Global Sports Marketing
6. Eric Sprunk, Chief Operating Officer
7. Ann Miller, VP and Corporate Secretary
8. Nitesh Sharan, VP Investor Relations and Treasurer
9. Chris Abston, VP Corporate Controller
10. Jim Scholefield, Chief Information Officer
11. Michael Spillane, President of Categories and Product
12. Trevor Edwards, President, Nike Brand

Source: Based on company documents.

Current Strategies

Nike has built an empire based on product development followed by heavy marketing. Nike offers products in most major sports played worldwide and hires professional athletes to market their products, even signing Michael Jordan, LeBron James, and Cristiano Ronaldo to lifetime endorsement contracts. Nike has paid Jordan over $475 million in endorsements and the deals with James and Ronaldo are valued as much as $1 billion. The $1 billion number may seem high, but estimates are Ronaldo's social media presence alone generated $475 million in value for Nike in 2016. Another study concluded that Ronaldo generates around $175 million for his sponsors annually, which is seven times what Stephen Curry, the second top-revenue generating athlete for sponsors. Based on data in 2016, of the 15 top athlete endorsement deals, Nike owns 11, with rival Adidas responsible for 3, and Li Nian accounting for one with their relationship with Dwayne Wade. Nike also has deals with many professional teams around the world to be the sole supplier of their uniforms.

Nike uses social media heavily, especially with the NikePlus membership, which is free. Nike offers two applications that include Nike Run Club and Nike Training Club used on mobile devices and Apple Watch, whereby users can track their progress through running or cross training programs. Nike has a partnership with Apple where the Nike logo appears on select Apple watches. Nike benefits by tracking tons of data on workouts from users across the world. In addition to using the apps for free, customers earn Nike Fuel points whereby they can purchase items at discounts on Nike's website and even purchase products not yet available to the public in stores.

Nike recently introduced the Air Tech Challenge, a strategy whereby the company offers tennis shoes with synthetic leather, stabilizers, and better heel cushioning, all in a lighter shoe. Two new running shoes developed by Nike are Free Flyknit and Free Hyperfeel. The firm also has a new pair of self-lacing shoes called the HyperAdapt 1.0.

Manufacturing

Nike produces 97 percent of its products through contractors in overseas markets, with Vietnam, China, and Indonesia accounting for 44, 29, and 21 percent, respectively. In total, 127 footwear factories in 15 different nations supply Nike, with no single factory responsible for more than 8 percent of total footwear sales. Nike is supplied by over 369 apparel factories in 37 different countries, with the largest supplier accounting for 13 percent of revenues. Like shoe production, virtually all Nike apparel is manufactured outside the United States with China, Vietnam, and Thailand as the three largest suppliers of apparel.

With the Trump administration's incentives to reshore manufacturing back to the United States, Nike has announced plans to build additional manufacturing plants in America. Presently, the company has 8 manufacturing facilities in the United States, accounting for about 8 percent of the company's total manufacturing output. Nike is very transparent about its manufacturing of footwear, apparel, and equipment. Simply click on the website http://manufacturingmap.nikeinc.com/# to see the company's manufacturing facilities worldwide by country.

Finance

Nike's fiscal year ends on June 30. Nike had an excellent fiscal 2017 with revenues up 6 percent and net income up nearly 13 percent as indicated in Exhibit 2. However, Nike received a tax benefit in 2017 or either reduced a tax burden from 2016, helping to partially explain the larger jump in net income than in revenues. Nike's overseas revenues and profits are increasing nicely, but its North American financial results revealed in the company's segment data are problematic.

Exhibit 3 reveals a strong balance sheet for Nike with relatively little goodwill or intangibles and a current ratio around 3.0. Despite increasing net income by $500 million in fiscal 2017 to $4.2 billion, notice on Exhibit 3 that Nike's retained earnings dropped 4 percent in 2017, explained partly through $1.1 billion in dividend payments, but also by an anomaly called "deferred compensation" revealed on the company's cash flow statement. It is very unusual for any company to have some amount of net income, pay less in dividends than that net income, and then have its retained earnings to decrease on the balance sheet.

Segment Data

Being very transparent, Nike reports revenues in several different categories. The two principle brands owned by Nike are Nike and Converse; Converse accounts for only 6 percent of revenues. Men account for about 57 percent of Nike revenues, followed by women with 26 percent, and kids account for 17 percent of revenues. Revenues from all three groups are growing

EXHIBIT 2 Nike's Income Statements (in millions USD)

Income Statement	5/31/16	5/31/17		Percent Change
Revenues	$32,376	$34,350	⇧	6.10%
Cost of Goods Sold	17,405	19,038	⇧	9.38%
Gross Profit	14,971	15,312	⇧	2.28%
Operating Expenses	10,469	10,563	⇧	0.90%
EBIT	4,502	4,749	⇧	5.49%
Interest Expense	19	59	⇧	210.53%
EBT	4,483	4,690	⇧	4.62%
Tax	863	646	⇩	−25.14%
Non-Recurring Events	140	196	⇧	40.00%
Net Income	3,760	4,240	⇧	12.77%

Source: Based on 2017 *Annual Report* and other company data.

EXHIBIT 3 Nike's Balance Sheets (in millions USD)

Balance Sheet	5/31/16	5/31/17		Percent Change
Assets				
Cash and Short Term Investments	$5,457	$6,179	↑	13%
Accounts Receivable	3,241	3,677	↑	13%
Inventory	4,838	5,055	↑	4%
Other Current Assets	1,489	1,150	↓	−23%
Total Current Assets	15,025	16,061	↑	7%
Property Plant & Equipment	3,520	3,989	↑	13%
Goodwill	131	139	↑	6%
Intangibles	281	283	↑	1%
Other Long-Term Assets	2,422	2,787	↑	15%
Total Assets	**21,379**	**23,259**	↑	**9%**
Liabilities				
Accounts Payable	2,191	2,048	↓	−7%
Other Current Liabilities	3,167	3,426	↑	8%
Total Current Liabilities	5,358	5,474	↑	2%
Long-Term Debt	1,993	3,471	↑	74%
Other Long-Term Liabilities	1,770	1,907	↑	8%
Total Liabilities	9,121	10,852	↑	19%
Equity				
Common Stock	3	3	→	0%
Retained Earnings	4,151	3,979	↓	−4%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	8,104	8,425	↑	4%
Total Equity	12,258	12,407	↑	1%
Total Liabilities and Equity	**21,379**	**23,259**	↑	9%

Source: Based on 2017 *Annual Report* and company data.

around 5 percent annually. Three of Nike's top-revenue generating brands including sportswear, running, and the Jordan brand account for 30, 19, and 11 percent of revenue, respectively. Sportswear enjoyed a 14 percent revenue gain in 2017 and the Jordan brand enjoyed a 13 percent increase in revenues from 2016, both coming off double-digit revenue growth the prior year as well. The lowest revenue generating brands include Nike Basketball and Women's Training, each representing 4 percent of revenues, followed by Action Sports and Golf, each representing 2 percent of revenues. The three lowest revenue-generating brands discussed above all experienced declining revenue in 2017, with golf's revenues falling 18 percent, and the other three brands mentioned revenues falling between 6 and 9 percent. Each of the four worse performing areas suffered revenue drops from 2015 to 2016 as well, with golf reporting another 18 percent revenue drop during this time period. Moving forward, it will be important for Nike to decide how to allocate resources across these product lines.

Nike is in the retail business, having forward integrated over the years. Nike operates 384 factory stores in the United States and 758 factory stores outside the U.S. Exhibit 4 reveals revenues and EBIT for Nike (not including Converse) in 2017. Canada accounted for 54 percent of all revenue in 2017. China generated the most EBIT per dollar of revenue received, followed by North America. Central & Eastern Europe, followed by Western Europe, generate significantly lower EBIT for every dollar of revenue, compared to other parts of the world. Both regions in Europe also suffered from a 16 percent drop in their respective EBIT contribution for 2017. Exhibit 4 reveals that Nike revenues in all markets in fiscal 2017 experienced a net positive revenue change in 2017 with Japan and China experiencing 17 and 12 percent revenue growths and North America only growing revenue by 3 percent.

EXHIBIT 4 Nike's Worldwide Revenues and EBIT (in millions USD)

Geographic Region	Revenues	EBIT
North America	$15,216	$3,875
Western Europe	$6,211	$1,203
China	$4,237	$1,507
Emerging Markets	$3,995	$816
Central & Eastern Europe	$1,487	$244
Japan	$1,014	$224
Totals	**$32,160**	**$7,869**

Source: Based on Nike's 2017 *Form 10K.*

Exhibit 5 reveals Nike's revenues by product type. Footwear is far and away the largest revenue-generating segment of Nike, representing 66 percent of 2017 sales. Both footwear and apparel sales were up 6 percent in 2017, but equipment sales were down 5 percent. Notable 2017 changes in revenue by region and product type are as follows: apparel sales up 15 percent in Western Europe; footwear and apparel sales each up 13 percent in China and 17 and 21 percent, respectively in Japan; footwear sales up 11 percent in emerging markets. The largest loser on a percentage basis was equipment sales in North America, that were down 10 percent in 2017 as this division across all nations continues to struggle for Nike.

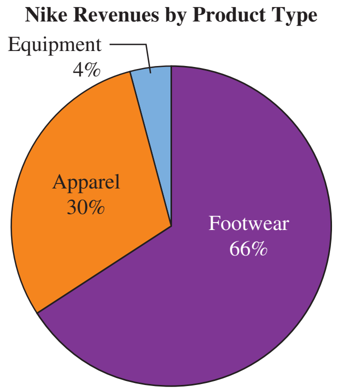
Exhibit 6 reveals Nike (not including Converse) revenues by customer type; wholesale customers account for 72 percent of 2017 revenues. Wholesale customers include Foot Locker, Dick Sporting Goods, and other merchants that purchase and sell Nike products, while direct-to-consumer includes Nike stores and online sales.

Competitors

Nike is the largest seller of athletic footwear, apparel, and equipment in the world, but there are aggressive rival firms, including Adidas, Under Armour, New Balance, and Puma, along with a few others in the production of athletic gear. In addition, as a forward integrated company, Nike competes with retail stores such as Foot Locker and other shoe retailers who ironically also sell Nike products. Nike represents nearly 50 percent of the whole athletic sportswear industry based on market capitalization on U.S. stock markets, followed by V.F. Corp at 14 percent. U.S. based Under Armour only represents 2.5 of the industry.

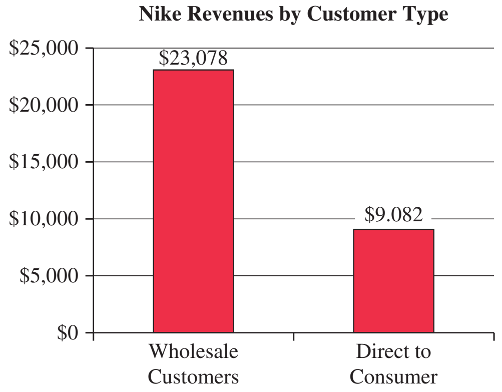
Exhibit 7 gives a quick glimpse at Nike compared to two rival firms. Note that Nike is far larger than Under Armour and Adidas combined.

EXHIBIT 5 Nike's Revenues by Product Type



Source: Based on Nike's 2017 *Form 10K.*

EXHIBIT 6 Nike's Revenues by Customer Type (in millions USD)



Source: Based on Nike's 2017 *Form 10K*.

Adidas (www.adidas-group.com)

Headquartered in Herzogenaurach, Germany, Adidas was founded in 1949 and operates over 2,800 stores. Adidas owns Reebok, TaylorMade, and CCM Hockey products. Adidas reported $54 billion USD in 2016 with net income of 1.3 billion. Adidas is the largest sportswear manufacturer in Europe and the second largest in the world, behind Nike. In 2015, professional basketball player James Harden left Nike for Adidas, reportedly signing a 13-year contract worth $200 million. Adidas's strategic plan is very similar to Nike's; both companies use product development followed by heavy marketing, signing teams and players across almost all sports to market and promote their products.

Foot Locker (FL)

Headquartered in New York City, Foot Locker's stock price soared between 2012 and 2017 increasing around 300 percent despite revenues only increasing 15 percent, and operating income declining 12 percent over the same time period. Founded in 1879, the company operates nearly 3,500 stores and employs 15,000 full time workers across the United States, Europe, Australia, New Zealand, and Canada. However 80 percent of company sales come from the U.S. Also, 70 percent of Foot Locker's inventory for sale is Nike merchandise.

Foot Locker uses the store-in-a-store concept used by many retailers where they have 217 House of Hoops shops offering premium basketball products. Foot Locker also offers Lady Foot Locker, Champs Sports, Footaction, Runners Point, Sidestep, and Kid's Foot Locker stores. Foot Locker sells Nike products along with other brands. With Nike's forward integration strategy of opening their own retail stores and selling online, they directly compete with Foot Locker and all other merchants that sell Nike products at the retail level. There are 62 franchised Foot Locker stores in the Middle East and South Korea, as well as 15 franchised Runners Point stores in Germany.

EXHIBIT 7 Nike's Competitor Comparison

	Nike	Under Armour	Adidas
$ Market Cap.	106.5B	5.7B	54.4B
# Employees	74,400	6,500	55,414
$ Revenue	34,350M	4,825M	24,113M
% Gross Margin	70%	46%	49%
$ Net Income	4,240M	257M	1,271M
$ EPS Ratio	2.31	0.32	4.25
$ P/E Ratio	28.34	38.34	32.06

Note: Numbers for Adidas were converted into USD assuming 1 Euro = $1.25.
Source: Based on information at a variety of sources.

Under Armour (UA)

Headquartered in Baltimore, Maryland, Under Armour (UA) was founded in 1996 by a former University of Maryland football player who desired a t-shirt that would whisk away perspiration rather than get soggy wet. The company has grown to be one of the most sought after brands among athletes around the world, being worn by some of the largest American college football and European soccer teams. Colleges such as the Maryland Terrapins, Auburn Tigers, South Carolina Gamecocks, and many more have contracts with UA to outfit their teams. English soccer team Tottenham Hotspur, Greek team Aris F.C. and Mexican club Deportivo Toluca F.C. all are outfitted by UA. Mega stars such as Tom Brady, Cam Newton, Bryce Harper, Michael Phelps, and many more, all sponsor and market UA products currently or at one time.

Under Armour was one of the pioneers to produce the compression and performance workout gear and in 2017 introduced bioceramic materials in their sleepwear line of clothing that is supposed to reduce inflammation. The firm reported revenues of $4.8 billion in 2016 up from 3.9 billion in 2015. However, the firm's stock price dropped 75 percent from the high in 2015 to the low in 2017. Under Armour is well known for its partnership with PGA golfer Jordan Spieth, who recently launched his own golf shoe, "Spieth One." The company is also widely known for its partnership with NBA star Stephen Curry, who is considered to be the "face of Under Armour's footwear line." Just like Nike and Adidas, Under Armour's strategy is to pursue product development and follow up with heavy marketing.

External Issues

Athletic Shoe Stores

The athletic shoe store industry in the United States generates over $15 billion in revenue, annually, with growth around 3 percent expected through 2022. The industry is fragmented with over 3,000 businesses, many small mom-and-pops, with the two top players, Foot Locker and Nike, accounting for 32 and 18 percent of sales, respectively. Unlike many retail outlets, the industry is healthy and growing since more and more consumers worldwide are becoming more health conscious. In addition, a growing trend referred to as athleisure grew over 40 percent between 2009 and 2016, where consumers are increasingly wearing athletic apparel in every day settings, including at work. Many work environments are calling workers back to the office and requiring increased levels of dress code, so it remains to be seen if the athleisure industry can continue to grow at such a rapid pace.

Online athletic shoe merchants are also growing, and, as athletic apparel becomes more popular, department stores that tend to offer business casual clothing are increasing their athletic shoe store spaces. In contrast to most clothing categories where women are the primary customers, men account for nearly 60 percent of athletic shoe sales, with women and children both around 20 percent. The industry enjoys a fairly even distribution of sales volumes from varying age groups, but customers under age 55 account for about 75 percent of sales.

The total footwear market in the United States is worth $65 billion, but the fastest growing segment of this industry is athletic footwear. China supplies over 70 percent of all shoes sold in the U.S.

Athletic and Sporting Goods

Athletic and sporting goods industry accounts for over $8 billion in U.S. revenue, annually, but experienced a negative growth rate around 3 percent between 2010 and 2017. Moving forward, the growth rate is expected to improve to upwards of 1 percent through 2022. The main driver of revenue is golf-related equipment, accounting for nearly 50 percent of industry revenues, followed by playground equipment, and fishing tackle and equipment around 7 percent each. Other types of sports equipment make up the remaining 36 percent. Football, soccer, basketball and other products attribute little to overall industry revenues, but this is not totally surprising considering just how equipment-intensive sports like golf and fishing can be. Apparel and shoes are not considered in the industry. Nike controls around 9 percent of the industry revenues in the U.S., with rival firm Calloway Golf owning 5 percent.

Technology

In 1996, Under Armour started offering compression apparel that helped to regulate body temperature and keep athletes warm in the cold and cool in the heat. Today, firms are becoming more advanced by adding computer technology to their products. Many firms are now experimenting with t-shirts made of conductive yards that can even transmit heart rate and other data directly to the user's doctor. A spinoff of Samsung, IOFIT is a sports-smart shoe where golfers have their swings and balance analyzed. In 2017, Chinese-based Xiaomi released a smart running shoe with a chip powered by Intel. Google and Levi have partnered to produce a smart jacket worn by cyclists. The athletic sportswear industry is getting more technical every day.

Inventory Turnover Problems

Inventory turnover ratios have been declining for the past 10 years in the athletic sportswear industry. In 2006, for example, the inventory turnover ratio for the industry was 4.0, but in 2017 the ratio has steadily dropped to 3.0. Nike is doing better than its peers on this ratio, reporting an inventory turnover ratio of 3.8 in 2017. Many analysts suggest the drop is simply from firms overestimating their inventory needs and by weaker customer traffic. Footwear accounts for less of the drop in inventory turnover than apparel. Retailers are inclined to have enough products to meet demand as hot ticket items attract people into stores. Thus, a question arises regarding whether having a high inventory turnover ratio is worth possibly running out of hot ticket items that firms certainly lose sales on, but also risk losing sales on impulse purchases by customers coming into the store. Having excess inventory, however, trains customers to wait for the clearance sales, ultimately hurting revenues and profits. Inventory management is a strategic issue facing all retain firms including Nike.

Brand Polygamist

Some experts in the apparel field are dubbing customers today as being "brand polygamist" referring to customer decrease in brand loyalty over the last decade. Customers are now purchasing increasingly based on price or extra product features rather than simply buying for the status of a logo or brand name. The trend has cut into gross margins and increased rivalry within the athletic sportswear industry. It also allows newer start up firms a larger chance as customers are increasingly willing to look at all options closer. Nike, for example, now has a NikeID program where they allow shoppers to design their own shoes, apparel, bags, and other items online in an attempt to attract more customers through personalization. However, schemes such as this are expensive, and firms like Nike are often not able to charge significantly more to offset the extra costs of say, producing 100,000 of the same blue shirts. Do not mistake the value of brands such as Nike, Adidas, Under Armour and others; they remain a powerful force in the industry, but simply having customers to purchase based on a logo alone is becoming extinct as customers become more Internet savvy.

Direct-to-Consumer Sales

There is increased momentum in the athletic sportswear industry for direct-to-consumer sales through factory shops, thus using the Internet to bypass traditional retailing merchants. An advantage to Internet sales other than cutting out a middleman is that firms can design customer products as Nike does with NikeID. In total, e-commerce sales as a whole, including all industries, grew 15 percent in 2016 versus the less than 3 percent growth for retail sales over the same time period.

Using the direct-to-consumer business model, firms are also able to collect accurate data on customer's habits who purchase versus don't purchase and tailor advertising and marketing strategies to customers based on their likelihood to purchase or not purchase. For example, profiles are developed for customers who are not likely to purchase without a coupon versus customers who will likely purchase either way; in addition, profiles may be developed to determine what length of time after a purchase do you need to offer an incentive to attract the customer to purchasing again. The information garnered from having a robust direct-to-consumer sales medium is arguably priceless.

Future

According to Global Industry Analysts, Inc., the global market for Sports and Fitness Clothing is projected to reach $231.7 billion by 2024. More and more people are living healthier life styles and participation in sports and fitness activities is growing. This is great news for Nike. The research reveals that sportswear is turning into a highly popular style statement and fashion trend. Additionally, the report points out that the Asia-Pacific region is expected to be the fastest growing region.

Market research firm Euromonitor International reports that sales of sportswear, which includes items such as yoga pants and activewear, is growing faster than any other apparel or footwear category. Specifically, both sports-inspired footwear and apparel is growing at about 10 percent and 6 percent annually. Regarding the growth of sportswear apparel and footwear across regions, emerging markets such as India and Thailand are growing fastest, but even core markets such as the United States are also producing significant sports-inspired growth.

A few new firms that Nike is monitoring in the sportswear industry include RYU Apparel, Inc. (TSX: RYU.V) that produces urban athletic apparel. Founded in 2005, RYU's financial results for the 6 months ended June 30, 2017 included revenues in the second quarter of 2017 of $641,231, 113 percent higher than revenue of $300,773 during the same period in 2016. RYU continues to show a balanced ratio of apparel sales between men and women at 46 percent and 54 percent, respectively. By reaching an underserved gap in the industry for men, and developing the Beautiful Tough brand positioning that's resonating with women, RYU currently derives 17 percent of revenue from e-commerce with a target of reaching 30 percent by the end of 2018.

Nike is also monitoring Lululemon Athletica, Inc. (NASDAQ: LULU), an athletic apparel company for yoga, running, and training. Lulu creates transformational experiences for people to live happy, healthy, fun lives. Seemingly new companies arise all across the globe each month, desiring a piece of Nike's market share, so Nike needs a clear strategic plan moving forward.

Under Armour, Inc.—2018

www.ua.com, UA

Headquartered in Baltimore, Maryland, Under Armour (UA) apparel is sold and worn worldwide by athletes at all levels, as well as by customers with active lifestyles. UA products are used in training, fitness, athletics, and outdoor activities. UA has three different product materials: HeatGear, ColdGear, and AllSeasonGear to be worn when the weather is hot, cold, or mild, respectively. UA apparel is designed to regulate body temperature and improve performance, regardless of weather conditions, to increase mobility and comfort.

UA is involved in Connected Fitness, offering digital fitness platform licenses and subscriptions, with MapMyFitness, MyFitnessPal, Endomondo, and UA Record applications. The majority of UA sales are generated through wholesale channels such as sporting goods chains like Dick's Sporting Goods (DKS), department store chains, and other retailers, but UA also sells through retail channels such as athletic departments, colleges, leagues, and teams. UA also sells products direct-to-consumers through factory stores globally.

Despite a booming stock market in 2017, UA stock was among the worst performers in the S&P 500 the past two years, falling 30 percent in 2016 and 50 percent more in 2017; the stock rebounded some in 2018. A huge problem for UA is that specialty sporting goods retailers such as Dick's Sporting Goods and Foot Locker that sell UA products are losing market share to Amazon and Walmart. Other UA distributors such as The Sports Authority, Gander Mountain, and Sports Chalet have all gone bankrupt in the past two years.

Especially in North America, UA is struggling to compete with Nike and Adidas that dominate the athletic footwear and apparel industries. In May 2018, UA reported that its revenue in North America dropped slightly from a year ago. However, outside of North America, UA is doing well. For example, in Q1 of 2018, UA's sales in Latin America increased 21 percent from the prior year period, accompanied by a 23 percent increase in the company's Europe, the Middle East and Africa segment, and a 35 percent increase in the company's Asia operations as compared to Q1 of 2017 a year earlier. But the company's strength outside the USA is not sufficient to overcome trouble in its domestic operations because UA's sales in North America account for nearly three-quarters of its revenue. UA's North America segment lost money in Q1 2018.

History

Under Armour (UA) was founded in 1996 by a former University of Maryland football player (CEO Kevin Plank) who desired a t-shirt that would wick away perspiration rather than get soggy wet. At age 23, Kevin Plank developed a new t-shirt in his grandmother's basement in Washington, D.C. after noticing that his compression shorts always stayed dry, but t-shirts had to be changed frequently as they became sweat-soaked. This observation led Plank to create a new compression t-shirt that wicked away sweat. After graduating, Plank provided this t-shirt to his former teammates who were playing in the NFL. After positive reviews, UA had t-shirt orders totaling $100,000 in 1997. UA's first big break came when *USA Today* pictured Oakland Raiders quarterback Jeff George wearing UA apparel. In late 1997, Georgia Tech asked for 10 shirts, ultimately leading to deals with Georgia Tech, Arizona State, and North Carolina State universities.

The company has grown to be one of the most sought-after brands among athletes around the world, being worn by some of the largest American college football and European soccer teams. Colleges such as the Maryland Terrapins, Auburn Tigers, South Carolina Gamecocks, and many more have contracts with UA to outfit their teams. English soccer team Tottenham Hotspur, Greek team Aris, F.C., and Mexican club Deportivo Toluca F.C. all are outfitted by UA. Megastars such as Tom Brady, Cam Newton, Bryce Harper, Michael Phelps, and many more, all sponsor and market UA products.

UA designs, develops, markets, and distributes apparel, footwear, and accessories for men, women, and children worldwide. The company offers apparel in three styles: compression, fitted, and loose, and is designed to be worn in hot, cold, or normal weather. Footwear products include cleats for most all sports, running and basketball shoes, and even hunting boots. Accessories include gloves for football, baseball, golf, socks, and team uniforms. UA's moisture-wicking fabrications are engineered in many different designs and styles for wear in nearly every climate to provide a performance alternative to traditional products. Its products are sold worldwide and worn by athletes at all levels, from youth to professional, on playing fields around the globe. UA's European headquarters are in Amsterdam's Olympic Stadium, with additional offices in Denver, Hong Kong, Toronto, and Guangzhou, China. With about 76,000 employees, UA distributes their products through specialty retailers, department stores, outlet stores, and institutional athletic departments.

In the 2000s, UA expanded rapidly after outfitting Warner Brothers with apparel for two films, and an advertisement placed in *ESPN Magazine* generated $750,000 in sales. In 2003, UA became the outfitter of the now defunct XFL football league and launched its first TV advertisement with the motto "Protect this House." In 2011, the company purchased 400,000 square feet of office space for $60.5 million. UA has new contracts with the NFL, NBA, and MLB to produce footwear, apparel, and accessories. Many European football teams such as Tottenham Hotspur and other rugby teams are outfitted with UA products. In 2012, UA's women's apparel became a major focus with strong sells reported in the company's Studio and ArmourBra products.

Vision/Mission

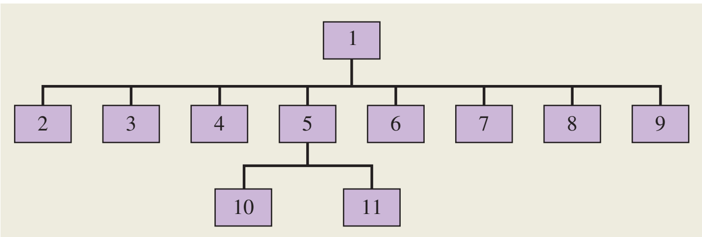
UA's vision (paraphrased) is "to empower athletes globally by providing innovative products." The company mission (paraphrased) is "to enhance athletes' performance through exemplary design and relentless pursuit of innovation." Regarding UA's vision, CEO Plank recently said (paraphrased): "Our long-term vision is for our women's business to one day be larger than our men's business, footwear to be larger than apparel, and our international business to be larger than our U.S. business." UA also has all employees to agree to "four wills (paraphrased):" I will act responsibly, I will think like an entrepreneur, I will be innovative, and I will be a great teammate. "The biggest, baddest brand in the world, bar none" is also how Kevin Plank likes to describe his vision (paraphrased) for what UA can ultimately become.

Internal Issues

Organizational Structure

UA reports its finances under four geographic segments: (1) North America, (2) Europe, the Middle East and Africa ("EMEA"), (3) Asia, and (4) Latin America. However, based on titles of executives, it appears UA operates from a divisional-by-region type structure with one person (Jason LaRose) handling North America and one person (Colin Browne) handling outside-North America. Exhibit 1 provides a possible depiction of UA's organizational structure.

EXHIBIT 1 Under Armour's Top Executives and Organizational Chart



1. Kevin Plank, Chairman of the Board and CEO
2. David Bergman, CFO
3. Kerry Chandler, Chief HR Officer
4. Paul Fipps, Chief Technology Officer
5. Patrik Frisk, President COO
6. Kip Fulks, Chief Product Officer
7. Michael Lee, Chief Digital Officer
8. Karl-Heinz Maurath, Chief Revenue Officer
9. John Stanton, SVP, General Counsel and Corporate Secretary
10. Colin Browne, President of Global Sourcing
11. Jason LaRose, President of North America

Source: Based on information at the company website.

UA's co-founder Kip Fulks announced in October 2017 he was taking a sabbatical. Also disturbing to investors is that UA's footwear chief, head of women's and kids' apparel, and its chief marketing officer also announced they were leaving after the company reported weak Q3 2017 results. UA is in some disarray and has hired Patrik Frisk, the former CEO of shoe retailer Aldo, as president and chief operating officer. Before that hire, Plank also served as president. Analysts have said the move is a sign that Under Armour realizes it needs some fresh blood to fix its many problems at home. On a positive note, UA's leading endorser, Steph Curry of the Golden State Warriors just led his NBA team to defeat the Cleveland Cavaliers to win the NBA championship. Note in Exhibit 1 above that all eleven top executives are male.

Current Strategies

Similar to Nike, UA's strategies largely focus on product development followed by heavy marketing. UA has contracts with many top professional leagues including the NBA and NFL. UA will become a Connected Fitness partner with major league baseball (MLB) starting in 2020. Connected Fitness offers digital fitness subscriptions to consumers through MapMyFitness platform and the UA Record platform. UA acquired both Endomondo and MyFitnessPal platforms which includes MapMyRun and MapMyRide. As of 2017, about 2 percent of revenues were derived from Connected Fitness, but the platform keeps data on customers, exposes customers to UA, and allows users to be rewarded with discounted UA gear for using the apps and staying fit.

Marketing

UA develops and markets products primarily for use in athletics, fitness, and other outdoor activities. UA attempts to drive demand through brand equity and increasing consumer awareness of their superior product. UA growth is largely dependent on sales from Dick's Sporting Goods (Dick's) and Foot Locker, with which it has developed store-within-a-store sales channels. However, UA has been making great strides selling its products directly to consumers, with 31 percent of revenue in the latest quarter coming from direct sales, up from 25 percent 6 years earlier. Wholesale sales to retail companies such as Dick's Sporting Goods account for 65 percent of sales, with 4 percent of sales being derived from Connected Fitness and Licensing in fiscal 2016.

Like Nike, UA pays big money to secure endorsements for their products from high performing athletes who have significant influence in the NFL, NBA, MLB, and even high school teams. Sports stars such as Cam Newton and Tom Brady endorse and wear UA products. Many fans become familiar with UA products seeing them worn by high performing athletes on a year-round basis. In addition to focusing on the large market leagues, UA also focuses on brand authenticity from a more grassroots level by hosting camps, clinics, and other activities for young athletes.

UA uses broadcast, print, and social media outlets to promote the firm's product. UA also also owns 162 outlet stores and 19 brand house stores in North America. Plank and his team are excellent marketers; company ads resonate with athletes and those who aspire to become athletes. UA's bold logo and brash and edgy marketing campaigns inspire movement and physical fitness, positioning the company well within the healthier lifestyle megatrend. Plank and his team relish their underdog image versus big rival firms; they love to operate within and promote an "us versus them" philosophy. This competitive fire has served UA well and has encapsulated many athletes and fans.

Seasonality

UA generates a large portion of its revenue during the third (Q3) and fourth (Q4) quarters of each year. In fact, Q3 and Q4 account for 35 percent more revenues than Q1 and Q2, and account for about 58 percent of yearly revenues. Q3 and Q4 correspond to football season and the holiday and winter seasons in much of the world. Fall and cooler weather gear also cost more.

Finance

UA reported a 3 percent increase in revenues in 2017, but notice in Exhibit 2 a large drop in net income from $256 million to negative $48 million, mostly attributed to higher operating

EXHIBIT 2 Under Armour's Income Statements (in thousands USD)

Income Statement	12/31/16	12/31/17		Percent Change
Revenues	$4,825,335	$4,976,553		3.13%
Cost of Goods Sold	2,584,724	2,737,830		5.92%
Gross Profit	2,240,611	2,238,723		−0.08%
Operating Expenses	1,823,140	2,210,880		21.27%
EBIT	417,471	27,843		−93.33%
Interest Expense	29,189	38,152		30.71%
EBT	388,282	(10,309)		−102.66%
Tax	131,303	37,951		−71.10%
Non-Recurring Events	0	0	NA	NA
Net Income	256,979	(48,260)		−118.78%

Source: Based on 2017 *4Q Report* and other company data.

expenses and cost of goods sold. About 50 percent of UA's cash and equivalents on the balance sheet are located outside the United States. UA's balance sheets are provided in Exhibit 3; note that property plant and equipment increased 10 percent in 2017.

A major concern that analysts have about UA is its fast-rising inventories which reached $1.148 billion in value by the end of Q1 2018. This problem is evidenced by UA's high

EXHIBIT 3 Under Armour's Balance Sheets (in thousands USD)

Balance Sheet	12/31/16	12/31/17		Percent Change
Assets				
Cash and Short-Term Investments	$250,470	$312,483		25%
Accounts Receivable	622,685	609,670		−2%
Inventory	917,491	1,158,548		26%
Other Current Assets	174,507	256,978		47%
Total Current Assets	1,965,153	2,337,679		19%
Property Plant & Equipment	804,211	885,774		10%
Goodwill	563,591	555,674		−1%
Intangibles	64,310	46,995		−27%
Other Long-Term Assets	247,066	180,245		−27%
Total Assets	**3,644,331**	**4,006,367**		**10%**
Liabilities				
Accounts Payable	409,679	561,108		37%
Other Current Liabilities	276,137	499,267		81%
Total Current Liabilities	685,816	1,060,375		55%
Long-Term Debt	790,388	765,046		−3%
Other Long-Term Liabilities	137,227	162,304		18%
Total Liabilities	1,613,431	1,987,725		23%
Equity				
Common Stock	145	146		1%
Retained Earnings	1,259,414	1,184,441		−6%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	771,341	834,055		8%
Total Equity	2,030,900	2,018,642		−1%
Total Liabilities and Equity	**3,644,331**	**4,006,367**		10%

Source: Based on 2017 *4Q Report* and company data.

days-inventory-outstanding ("DIO") that stands at 159 days. Historically, Under Armour's quarterly DIO only exceeded 150 days in Q2 of the calendar year as the company builds stocks in preparation for the holiday season. Given that it is not going to be any different this year, we should be expecting the DIO to climb above 170 days (and potentially above 180 days) in Q2, something that has not happened since the 2008–2009 recessionary period.

Segment Data

By-Product

Exhibit 4 provides a breakdown of UA's revenues by product. Note that apparel continues to be the strongest product offered based on net revenues, but accessories such as bags, hats, and gloves experienced higher percent increases over the most recent fiscal year. License revenues decreased due partly to fewer orders of hats and bags. About 66 percent of company revenues are derived from apparel in 2017, down from 80 percent in 2010, as other product lines are growing at a quicker pace.

UA apparel is specifically engineered to replace traditional non-performance fabrics and replace them with the most cutting-edge products available. UA's three products are marketed under Heatgear, designed for hot weather, Coldgear, designed for cold temperatures, and AllSeasonGear, designed for between the extremes. In addition to the three temperature ratings, all products also come in three fit types: compression (tight fit), fitted (athletic fit), and loose (relaxed). All UA appeal products are designed to wick water away from the wearer to keep them as dry and comfortable as possible in any temperature or type of activity.

Designed to cushion and manage moisture, UA makes footwear for virtually all sports, including running and even hunting boots. Although there was only a 2.7 percent increase in footwear sales in 2017, there was a nearly 50 percent increase in footwear sales in 2016. Other UA revenues are derived from licensing and Connected Fitness but only accounted for 4 percent of sales in 2017.

Geographic Region

Exhibits 5 reveals UA's recent revenues derived from North American versus International markets. UA reports revenues in four distinct geographic regions: (1) North America, (2) Europe, the Middle East and Africa ("EMEA"), (3) Asia, and (4) Latin America. Each geographic segment operates in the same manner, to design, develop, market, and distribute UA products. As of fiscal 2017, 22 percent of revenues are derived from international markets. UA breaks down revenues by the four geographic regions and by Connected Fitness.

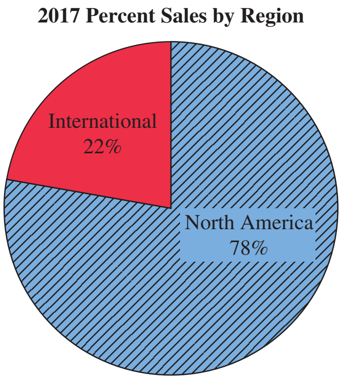
Exhibit 6 reveals the revenue breakdowns from each of the 3 international regions and Connected Fitness. UA acknowledges that the trend in performance products is becoming increasingly global. UA's North American segment accounted for 76 percent of fiscal 2017 sales, down from 91 percent in 2014, indicating how rapidly the firm is expanding into markets outside of North America. UA also owns 151 outlet stores and 18 brand house stores located in 34 different states. The company's largest customer is Dicks's Sporting Goods accounting for around 10 percent of revenues. In addition to selling to the public, UA earns income from the sale of uniforms and practice gear to high school, college, and professional teams. Exhibit 6 on the next page reveals a 95 percent reduction in operating income for UA in 2017. The firm attributes a

EXHIBIT 4 Under Armour's Revenues by Product (in thousands USD)

	2017	2016	2015
Apparel	$3,287,121	$3,229,142	$2,801,062
Footwear	$1,037,840	$1,010,693	$677,744
Accessories	$445,838	$406,614	$346,885
Other	$205,754	$178,886	$137,622
Total	$4,976,553	$4,825,335	$3,963,313

Source: Based on the company's 2017 *4Q Report* and other data.

EXHIBIT 5 **Under Armour's Revenues by Geographic Region**



Source: Based on a variety of sources.

EXHIBIT 6 **Under Armour Revenues and Operating Income in North America (in millions $)**

	Revenues		Operating Income	
	2016	2017	2016	2017
North America	$4,005	$3,802	$408	$20

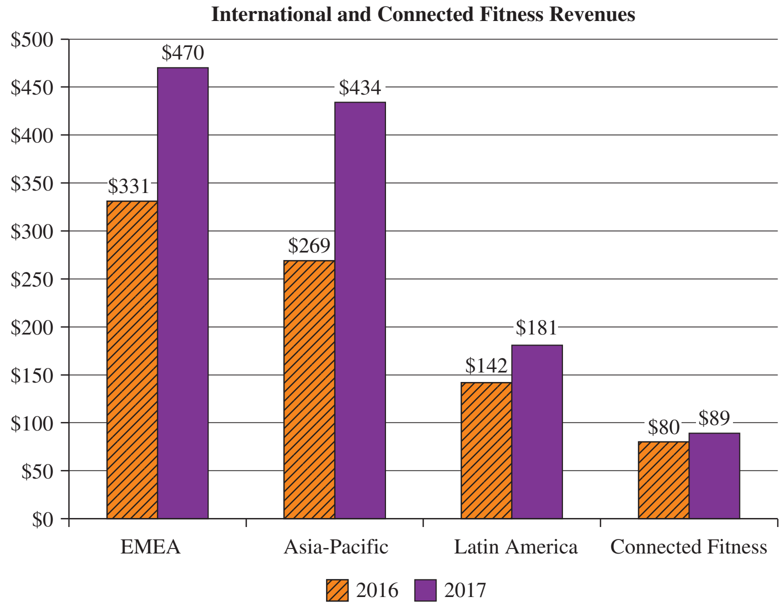
Source: Based on the company's 2017 *Form 10K*.

$63 million restructuring, lower margins, and decrease in sales as the reasons; however, sales in North America were only down 5 percent over the same time period.

Exhibit 7 provides the UA revenues and operating income for international segments and Connected Fitness. Contrary to the domestic revenues, all revenue streams increased with Asia-Pacific leading the way with a 61 percent revenue increase in 2017.

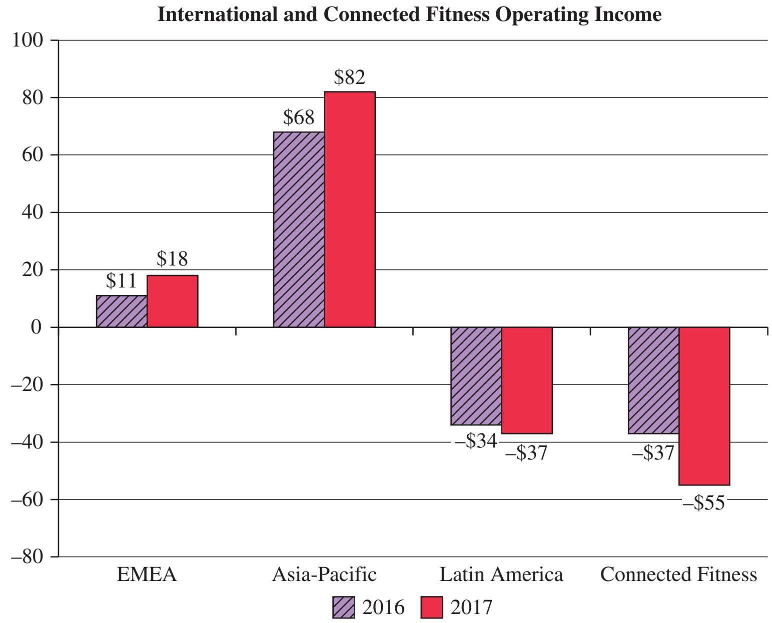
Exhibit 8 reveals poor operating income in Latin America and Connected Fitness, with operating income reporting larger losses in 2017. EMEA reported the largest percentage gain at 64 percent, while Asia-Pacific reported the largest total dollar gain at $14 million.

EXHIBIT 7 **Under Armour's Revenues Derived from Its International and Connected Fitness Segments (in millions $)**



Source: Based on the company's 2017 *Form 10K*.

EXHIBIT 8 Under Armour's Operating Income Derived from Its International and Connected Fitness Segments (in millions USD)



Source: Based on the company's 2017 *Form 10K*.

For Q1 2018 that ended 3-31-18, UA's revenue increased 6 percent to $1.2 billion, but the company's net income loss widened to $30.2 million, or 7 cents a share, compared with $2.3 million, or a penny per share, during the same period one year ago. UA's Q1 2018 sales in North America fell 0.4 percent, while those in international markets climbed 27 percent. Outside North America sales now represent 24 percent of UA's total sales. On a positive note, UA's men's training category helped drive apparel sales up 7 percent during Q1 2018, accompanied by footwear and accessories sales increasing 1 percent and 3 percent, respectively. UA's strongest international segment in Q1 2018 was Asia-Pacific, where sales increased 35 percent.

Competitors

UA faces competition from Adidas, Nike, New Balance, Reebok, and Puma along with a few others in the production of athletic gear. In addition, being forward integrated, UA competes with retail stores such as Foot Locker, Dick' Sporting Goods, Bass Pro Shops, and many other firms. Competitors such as Nike and Adidas have copied NA's designs and technology. The fabrics UA uses are not unique to them, and they do not control any patents on fabrics or processes. This has always been a huge problem for UA. Thus, it is all about branding for UA.

UA's branding strategy has not been perfect because UA's stock declined as much as 75 percent from 2015 to 2017, while over the same period the S&P 500 increased nearly 50 percent and Nike increased around 10 percent. Nike and Adidas have much larger resources to draw upon, thus competing long term may be difficult for UA. Competing for floor space at large retailers is also becoming more difficult since many stores now have their own store brands, in addition to private label brands, all competing for floor space.

Exhibit 9 provides some comparative information for UA, and rival firms. Note that Nike and Adidas are 7 and 5 times larger revenue than UA, respectively, and in teams of market capitalization, both rivals are larger than UA.

Nike, Inc. (NKE)

Headquartered in Beaverton, Oregon, Nike has over 70,000 full-time employees, operates 384 U.S.-based stores and 758 international stores. Nike reported 2017 revenues and net income of about $34 billion and $4 billion, respectively, both figures increasing nicely from the prior year.

EXHIBIT 9 Competitor Comparison

	Under Armour	Adidas	Nike
$ Market Cap.	5.7B	54.4B	106.5B
# Employees	15,200	55,414	74,400
$ Revenue	4,825M	24,113M	34,350M
% Gross Margin	46%	49%	70%
$ Net Income	257M	1,271M	4,240M
$ EPS Ratio	0.32	4.25	2.31
$ P/E Ratio	38.34	32.06	28.34

Numbers for Adidas were converted into USD assuming 1 Euro = 1.25USD
Source: Based on a variety of sources.

However, for Nike's second quarter (Q2) of fiscal 2018, revenues for the Converse division of Nike were $408 million, down 4 percent, due to faltering sales in North America. Nike's net income for Q2 2018 decreased 9 percent to $767 million. For both Q1 and Q2 of fiscal 2018, the company's footwear sales declined 5 percent and the company's equipment sales dropped 8 percent in North America. Thus, rival companies are eating into Nike's financial performance in the United States. However, outside North America, Nike is doing really well, growing both revenues and net income in double digits.

Nike has recently doubled down on designing shoes on an individual basis by building its new Nike By You Studio in New York City. The studio utilizes augmented reality and projection systems to custom-design shoes that are then produced and available within an hour for the customer. The company has a team of 1,000 designers to oversee development and production of customer Nike shoes, incorporating such designs as Nike's Pro Hijab for Muslim athletes.

Nike is in the retail business, having forward integrated over the years. Nike operates 384 factory stores in the United States and 758 factory stores outside the United States. Exhibit 10 reveals revenues and EBIT for Nike (not including Converse) in 2017. Canada accounted for 54 percent of all revenue in 2017. China generated the most EBIT per dollar of revenue received, followed by North America. Central & Eastern Europe, followed by Western Europe, generate significantly lower EBIT for every dollar of revenue, compared to other parts of the world. Both regions in Europe also suffered from a 16 percent drop in their respective EBIT contribution for 2017. Exhibit 10 reveals that Nike revenues in all markets in fiscal 2017 experienced a net positive revenue change in 2017 with Japan and China experiencing 17 and 12 percent revenue growths and North America only growing revenue by 3 percent.

Adidas AG - (www.adidas-group.com)

Headquartered in Herzogenaurach, Germany, Adidas was founded in 1949 and operates over 2,800 stores. Adidas owns Reebok, TaylorMade, and CCM Hockey products. Adidas reported $54 billion USD in 2016 with net income of 1.3 billion. Adidas is the largest sportswear

EXHIBIT 10 Nike's Worldwide Revenues and EBIT (in millions USD)

Geographic Region	Revenues	EBIT
North America	$15,216	$3,875
Western Europe	$6,211	$1,203
China	$4,237	$1,507
Emerging Markets	$3,995	$816
Central & Eastern Europe	$1,487	$244
Japan	$1,014	$224
Totals	**$32,160**	**$7,869**

Source: Based on Nike's 2017 *Form 10K.*

manufacturer in Europe and the second largest in the world, behind Nike. In 2015, professional basketball player James Harden left Nike for Adidas, reportedly signing a 13-year contract worth $200 million. Adidas's strategic plan is very similar to Nike's; both companies use product development followed by heavy marketing, signing teams and players across almost all sports to market and promote their products.

Foot Locker, Inc. (FL)

Like many players in the industry, Foot Locker's stock rose hugely between 2012 and 2017 increasing around 300 percent despite revenues only increasing 15 percent and operating income declining 12 percent over the same time period. The company operates nearly 3,500 stores and employs 15,000 full time workers across the United States, Europe, Australia, New Zealand, and Canada; however, 80 percent of sales derive from the United States. Foot Locker has bought into the store-in-a-store concept used by many retailers where they have 217 House of Hoops shops offering premium basketball products. Foot Locker also offers Lady Foot Locker and Kids Foot Locker stores. Foot Locker sells UA and Nike products along with other brands. UA competes with Foot Locker and all other merchants that sell UA products at the retail level.

External Issues

Athletic Shoe Stores

The athletic shoe store industry in the United States generates over $15 billion in revenue annually with growth around 3 percent expected through 2022. The industry is fragmented with over 3,000 businesses, many small mom and pops with the two top players Foot Locker and Nike accounting for 32 and 18 percent of sales, respectively. Unlike many retail outlets, the industry is healthy as a growing number of consumers in the United States are world wild are becoming increasingly health conscious. In addition, a growing trend referred to as athleisure grew over 40 percent between 2009 and 2016 where consumers are increasingly wearing athletic apparel in every day settings including at work. Many work environments are calling workers back to the office and requiring increased levels of dress code, so it remains to be seen if the athleisure industry can continue to grow at such a rapid pace. Online merchants are also growing, and as athletic apparel becomes more popular, department stores that tend to offer business casual clothing are increasing their athletic shoe store spaces. Unlike most all clothing categories where women are the primary customers, men account for nearly 60 percent of athletic shoe sales with women and children both around 20 percent. The industry enjoys a fairly even distribution of sales volumes from varying age groups but customers under 55 account for 75 percent of sales. Nike holds nearly 50 percent of the athletic-footwear industry based on market capitalization, followed by V.F. Corp at 14 percent. UA has only 2.5 percent of the athletic-footwear industry.

Technology

Many athletic apparel firms are now experimenting with t-shirts made of conductive yards that can even transmit heart rate and other data directly to the user's doctor. A spinoff of Samsung, IOFIT is a sports-smart shoe where golfers have their swings and balance analyzed. Chinese based Xiaomi released in 2017 a smart running shoe with a chip powered by Intel. Google and Levi have partnered to produce a smart jacket worn by cyclists.

Brand Polygamist

Some experts in the apparel field are dubbing customers today as brand polygamists in reference to customers' decrease in brand loyalty over the last decade. A decrease in brand loyalty is a serious problem for most firms in the industry as customers are now purchasing increasingly on price or extra product features rather than simply buying for the status of a logo or brand name. The trend has cut into gross margins and increased rivalry within the industry. It also allows newer start-up firms a larger chance as customers are increasingly willing to look at all options closer. UA has purchased several apps for phones and smart watches and developed their own to attract customers to the UA product lines. Nike for example now has a NikeID program where they allow shoppers to design their own shoes, apparel, bags and other items online in an attempt to attract more customers through personalization. However, schemes such as this are expensive and firms like Nike are often not able to charge significantly more to offset the extra cost of say, producing 100,000 of the same blue shirts. Do not mistake the value of brands such as Nike, Adidas, UA, and others; they remain a powerful force in the industry but simply having customers to purchase based on a logo alone may be extinct.

Direct-to-Consumer Sales

There is increased momentum in the athletic sportswear industry for direct-to-consumer sales through factory shops, thus using the Internet to bypass traditional retailing merchants. An advantage to Internet sales other than cutting out a middleman is that firms can design customer products as Nike does with NikeID. In total, e-commerce sales as a whole, including all industries, grew 15 percent in 2016 versus the less than 3 percent growth for retail sales over the same time period.

Using the direct-to-consumer business model, firms are also able to collect accurate data on customers' habits who purchase and don't purchase and tailor advertising and marketing strategies to customers based on their likelihood to purchase or not purchase. For example, profiles are developed for customers who are not likely to purchase without a coupon versus customers who will likely purchase either way; in addition, profiles may be developed to determine what length of time after a purchase do you need to offer an incentive to attract the customer to purchasing again. The information garnered from having a robust direct-to-consumer sales medium is arguably priceless.

Future

According to Global Industry Analysts, Inc., the global market for Sports and Fitness Clothing is projected to reach $231.7 billion by 2024. More and more people are living healthier lifestyles and participation in sports and fitness activities is growing. This is great news for UA. The research reveals that sportswear is turning into a highly popular style statement and fashion trend. Additionally, the report points out that the Asia-Pacific region is expected to be fastest growing region.

Market research firm Euromonitor International reports that sales of sportswear, which includes items such as yoga pants and activewear, is growing faster than any other apparel or footwear category. Specifically, both sports-inspired footwear and apparel are growing at about 10 percent and 6 percent annually. Regarding the growth of sportswear apparel and footwear across regions, emerging markets such as India and Thailand are growing fastest, but even core markets such as the United States are also producing significant sports-inspired growth.

A few new firms that UA is monitoring in the sportswear industry include RYU Apparel, Inc. (TSX: RYU.V), that produces urban athletic apparel. Founded in 2005, RYU's financial results for the 6 months ended June 30, 2017, included revenues in the second quarter of 2017 of $641,231, 113 percent higher than revenue of $300,773 during the same period in 2016. RYU continues to show a balanced ratio of apparel sales between men and women at 46 percent and 54 percent, respectively. By reaching an underserved gap in the industry for men, and developing the Beautiful Tough brand positioning that's resonating with women, RYU currently derives 17 percent of revenue from e-commerce with a target of reaching 30 percent by the end of 2018.

Some analysts contend that UA has lost its identity in the athletic sportswear space by collaborating with rapper A$AP Rocky to become more of a brand for everyday wear rather than a performance line made famous for its compression tees. UA's apparel for women definitely lags niche competitors such as Lululemon, Fabletics, and Gap Inc.'s Athleta which are seen as more fashionable.

UA is monitoring Lululemon Athletica, Inc. (NASDAQ: LULU), an athletic apparel company for yoga, running, and training. Lulu creates transformational experiences for people to live happy, healthy, fun lives. Seemingly new companies arise all across the globe each month desiring a piece of UA's market share, so UA needs a clear strategic plan moving forward.

Polaris Industries, Inc.—2018

www.polaris.com, PII

Headquartered in Medina, Minnesota, Polaris operates mainly through four segments: Off-Road Vehicles (ORV), Snowmobiles, Motorcycles, and Global Adjacent Markets. Polaris is best known for their snowmobiles, yet that segment only represents 7 percent of total company sales. Polaris produces power-sports vehicles, including motorcycles, snowmobiles, and All-Terrain Vehicles (ATV). On May 21, 2018, Polaris announced that for the first time ever the company was named to the Fortune 500, coming in at a ranking of 496. The Fortune 500 for 64 years has been offered the premier ranking of U.S. companies by total revenues for their respective fiscal years.

Polaris has a defense (military) segment. In November 2016, the U.S. Marine Corps signed a $2.5 million contract with Polaris to deliver 144 MRZR-D ATVs. Called the Utility Task Vehicle (UTV), the vehicle is designed to be diesel-powered and can run on JP-8 fuel. The Marines bought the unarmored ATVs because they can fit inside an MV-22 Osprey aircraft, enabling them to be deployed from long distances, to provide logistics support to ground combat units, assisting them to travel and transport supplies quicker and easier than previously on foot. The vehicles can carry four troops and have a small cargo bed capable of carrying 1,500 lb (680 kg) of payload.

In 2017, Polaris issued nearly a dozen recalls on a number of products, and later that year recalled over 400,000 of its machines. However, in October 2017, Polaris reported that sales were up by 25 percent for the quarter, setting a record of $1.48 billion, and almost tripling net income at $81.9 million. Most companies would experience difficulty recovering from such catastrophic setbacks, yet Polaris charges ahead doing better than ever as the year 2017 ends at a record level.

History

Founded in 1954 in Roseau, Minnesota, Polaris' legacy actually started back in 1945 with forerunners Edgar Hetteen, his brother Alan, and their close friend David Johnson who together wanted a vehicle to ride on the snow. The three decided to start a never before heard of type of business—making snowmobiles. Edgar Hetteen would eventually be described in the Snowmobile Hall of Fame in St. Germain, Wisconsin, as the father of the snowmobile. Edgar dropped out of school after the eighth grade in 1934. The three guys founded a business and named it Hetteen Hoist & Derrick. The three guys desired to create a vehicle that could travel through snow to make hunting locations more accessible. No similar product existed at that time anywhere in the world.

Producing a version of the snowmobile in 1955, the company earned a monopoly in the industry by demonstrating its toughness, reliability, and durability. However, in 1960, Edgar became disgruntled with his brother and their close friend, so Edgar quit working for Polaris and started his own snowmobile company that today is named Arctic Cat—a large, fierce rival to Polaris.

Polaris throughout the 1960s produced snowmobiles amidst growing competition worldwide. In 1964, it released the Comet, in 1965 the Mustang, and in 1985 it released the Trailboss, and later the Polaris Rocky Mountain King (RMK). Polaris opened a manufacturing plant in Monterrey, Mexico, in 2010 to go with its sister facility in Osceola, Wisconsin, that still operates today. In January 2015, Polaris purchased the entire electric motorcycle business from Brammo, based in Ashland, Oregon. Production of electric motorcycles began at Polaris' factory in Spirit Lake, Iowa, during the second half of 2015. Polaris also manufactured Victory and Indian motorcycles at the Spirit Lake factory.

In 2016, Polaris opened a new 600,000-square-foot facility in Huntsville, Alabama, that employs about 1,700 workers. In January 2017, Polaris' Chairman and CEO Scott Wine announced they would be shutting down Victory Motorcycles. However, the company will continue to honor warranties and produce parts for Victory Motorcycles for the next 10 years.

Polaris snowmobiles hold the most number of wins in the "World's Longest Toughest Snowmobile Race," the Iron Dog—a 2,000-mile race across Alaska. Polaris is currently expanding into the clothing and accessory industry.

On May 10, 2018, Polaris announced formation of *Club Slingshot,* a national owners group that is designed to embrace and recognize the loyal Slingshot owners across the country. Slingshot is Polaris' open air, three-wheeled roadster that delivers "The Ultimate Joyride," for its more than 25,000 new and used Slingshot owners who will receive a complimentary one-year membership, which includes special offers, access to events and rides, as well as a first-edition Slingshot owners magazine. The Slingshot vehicle was initially offered in late 2014. New Slingshot vehicles are powered by 2.4L engines that provide 173 horsepower and 166 ft-lbs of torque. Prices range from $19,999 to $30,999.

Vision/Mission

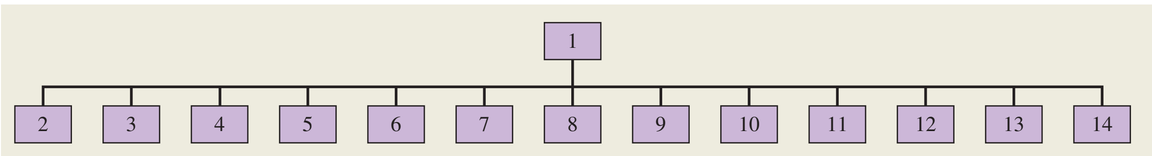
Polaris' vision focuses on excellence and innovation in its products and services, with the overarching goal of generating excitement and enthusiasm among its customers around the globe. The vision can be viewed on the company's website: https://www.polaris.com/. Polaris does not appear to have a formal mission statement but does have some guiding principles that are a few words: "best people, best team, safety and ethics always, and customer loyalty."

Internal Issues

Organizational Structure

Based on executives' titles, Polaris appears to operate from a divisional-by-product type organizational design, but with no COO or CAO. This is a large organization for every top executive to report to the CEO. Note in Exhibit 1 there is only one female among the top executives, Stacy Bogart, the firm's General Counsel.

EXHIBIT 1 Polaris Industries' Top Executives and Organizational Chart



1. Scott Wine, Chairman and CEO
2. Kenneth Pucel, EVP Operations, Engineering, and Lean
3. Michael Speetzen, EVP Finance and Chief Financial Officer
4. Stacy Bogart, Senior VP, General Counsel, and Compliance Officer and Secretary
5. James Williams, Senior VP and Chief HR Officer
6. Bob Mack, Senior VP Corporate Development and Strategy, President Global Adjacent Markets
7. Matthew Emmerich, VP, Chief Information Officer
8. Stephen Kemp, VP, Chief Technical Officer
9. Craig Scanlon, Chief Retail and Marketing Officer of ORV
10. Christopher Wolf, President Snowmobiles
11. Michael Dougherty, President International
12. Stephen Eastman, President Parts, Garments, and Accessories
13. Steven Menneto, President Motorcycles
14. Chris Musso, President Off-Road Vehicles

Source: Based on the company's 2017 *Annual Report* and other documents.

Strategy

Polaris aims to become an $8 billion global enterprise by 2020. The company actively engages in strategic planning. Polaris has a history of successfully acquiring and divesting businesses to continue on a path of strategic improvement. Yet to their credit, Polaris reports minimal goodwill on their balance sheet. Some recent notable divestures include exiting the jet-ski market in 2004 after a 12-year stint. Polaris ceased production of its Breeze line of on-road vehicles in 2011, and acquired GEM and Goupil to fill this void. Since 2014, Polaris has been striving to achieve the following strategic objectives (paraphrased):

5–8 percent annual organic growth
>$2 billion from acquisitions & new markets
>33 percent of Polaris revenue coming from outside the United States
>10 percent net income margin

Polaris purchased Taylor-Dunn Manufacturing Company in 2016. Based in Anaheim, California, Taylor-Dunn produces industrial vehicles serving a broad range of commercial, manufacturing, warehouse, and ground-support customers. Also in 2016, Polaris entered into an arrangement with Transamerican Auto Parts (TAP), "a privately held, vertically integrated manufacturer, distributor, retailer and installer of off-road Jeep and truck accessories." Polaris paid $668 million for TAP and used debt to secure the deal.

In 2011, Polaris purchased the Indian Motorcycle Company. Polaris is committed to rebranding the product line, and 2017 seems to be a breakout year. For example, the 2017 Slingshot, Victory, and Indian motorcycles offered an inventory of 24 models. The lower end of the price range will be $9,000 and the higher will be $30,000. Polaris will phase out the Victory line to continue to develop the Indian engine, the primary reason consumers purchase the motorcycle.

Polaris purchased the electric energy company Brammo, Inc., in April 2015. Brammo designs electric vehicles and the two companies have been working together since 2011.

Marketing

In 2016, Polaris spent $342.2 million on advertising, promotion, and publicity, up from $316.7 million in 2015 and $314.5 million in 2014. Polaris has a network of about 1,800 independent dealers in North America, 11 subsidiaries, and 45 distributors in 125 countries outside of North America. The company's brands include RZR and Ranger ATVs, Indian and Victory motorcycles, and Polaris Rush snowmobiles. Snowmobiles are sold to dealers in the United States and Canada; many dealers also carry Polaris ORVs. A little more than half of all Polaris dealers in North America sell snowmobiles.

Finance

Polaris' financial statements are provided in Exhibits 2 and 3. Note the 20.19 percent increase in revenues in 2017. Note also the 24 percent decline in long-term debt in 2017.

Segment Data

Polaris is quite transparent in reporting its revenues and gross profit by product and region. Exhibit 4 and Exhibit 5 reveal the company's by-product and by-region financial results,

EXHIBIT 2 Polaris' Recent Income Statements (000 omitted)

Income Statement	12/31/16	12/31/17		Percent Change
Revenues	$4,516,629	$5,428,477	↑	20.19%
Cost of Goods Sold	3,411,006	4,103,826	↑	20.31%
Gross Profit	1,105,623	1,324,651	↑	19.81%
Operating Expenses	755,345	964,994	↑	27.76%
EBIT	350,278	359,657	↑	2.68%
Interest Expense	37,027	40,866	↑	10.37%
EBT	313,251	318,791	↑	1.77%
Tax	100,303	146,299	↑	45.86%
Non-Recurring Events	0	0	NA	NA
Net Income	212,948	172,492	↓	−19.00%

Source: Based on the company's 2017 *Annual Report* and other documents.

EXHIBIT 3 Polaris' Recent Balance Sheets (000 omitted)

Balance Sheet	12/31/16	12/31/17		Percent Change
Assets				
Cash and Short-Term Investments	$127,325	$138,345		9%
Accounts Receivable	174,832	200,144		14%
Inventory	746,534	783,961		5%
Other Current Assets	142,298	131,054		−8%
Total Current Assets	1,190,989	1,253,504		5%
Property Plant & Equipment	727,596	747,189		3%
Goodwill	792,979	780,586		−2%
Intangibles	0	0	NA	NA
Other Long-Term Assets	388,033	308,314		−21%
Total Assets	**3,099,597**	**3,089,593**		**0%**
Liabilities				
Accounts Payable	273,742	317,377		16%
Other Current Liabilities	686,009	812,934		19%
Total Current Liabilities	959,751	1,130,311		18%
Long-Term Debt	1,120,525	846,915		−24%
Other Long-Term Liabilities	152,281	180,708		19%
Total Liabilities	2,232,557	2,157,934		−3%
Equity				
Common Stock	631	631		0%
Retained Earnings	300,084	242,763		−19%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	566,325	688,265		22%
Total Equity	867,040	931,659		7%
Total Liabilities and Equity	**3,099,597**	**3,089,593**		0%

Source: Based on the company's 2017 *Annual Report* and other documents.

EXHIBIT 4 Polaris' Sales and Gross Profit by Product (000 omitted)

	2016		2017	
	Sales	Gross Profit	Sales	Gross Profit
ORV/Snowmobiles	$3,283,900	$907,600	$3,570,800	$1,054,600
Motorcycles	$699,200	$87,500	$576,000	$16,700
Global Adjacent Markets	$341,900	$95,100	$396,800	$94,900
After Market	$191,600	$46,300	$884,900	$225,500

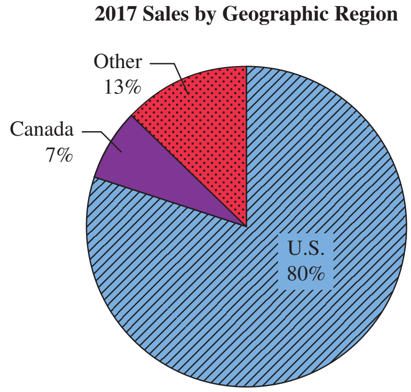
Source: Based on the company's 2017 *Annual Report* and other documents.

respectively. Note in Exhibit 4 that Polaris is still primarily a snowmobile company, and note in Exhibit 5 that Polaris still primarily does business in the United States.

Information Systems

Polaris is expanding its RIDE Command, an onboard rider information system, across its Indian Motorcycle segment, as well as Polaris GENERAL and RZR product lines. The Ride Command connects Polaris customers to other riders and friends to plan an event and otherwise coordinate the entirety of the Polaris experience. Polaris likely generates access to a wide swath of user-data, preferences, and access to additional marketing opportunities for a strong core of Polaris users.

EXHIBIT 5 Polaris' Sales by Region as a Percent



Source: Based on the company's 2017 *Annual Report* and other documents.

This in turn can be used to more effectively target customers, identify customer trends, and cultivate and maintain a loyal base of Polaris users.

Research and Development

Polaris employs 850 personnel in the research and development (R&D) arm of the corporation. The company's R&D function is divided into two segments: (1) improving existing products and (2) designing new offerings. Polaris places a premium on improving engine functionality, striving to reduce noise levels, increase fuel efficiency, and generate more power. The company also owns Swissauto Powersports LTD, an engineering firm focusing on engine efficiency and innovative vehicles. In 2016, Polaris spent $185.1 million on R&D, that followed up $166.4 million and $148.5 million the prior two years, respectively.

Production Activities

Polaris assembles its products in 18 facilities in Minnesota, Iowa, Wisconsin, Mexico, and elsewhere in the world. To save costs and improve component part quality, many of the firm's product lines are vertically integrated. Plastic injection molding, welding, clutch assembly, and painting are all produced in-house. Items such as fuel tank, tires, seats, and instruments are purchased from third-party vendors.

Polaris has an effective inventory management process called the Maximum Velocity Program (MVP) where ORV orders can be placed at 2-week intervals for high volume dealers. Smaller dealers can utilize a similar process. The new process helps to keep costs down and keep inventories at manageable levels. While ORV orders can be placed at any time, snowmobile orders must be placed in the spring and secured by a deposit. Victory motorcycle orders are currently under MVP testing.

Operations

While Polaris maintains its corporate headquarters in Medina, Minnesota, it sustains a nationwide presence with facilities in Wyoming, Minnesota; Roseau, Minnesota; Osceola, Wisconsin; Spirit Lake, Iowa; Milford, Iowa; Huntsville, Alabama; Vermillion, South Dakota; Spearfish, South Dakota; and Wilmington, Ohio. Internationally, Polaris has a manufacturing and distribution presence in a number of offices including, but not limited to, Winnipeg, Canada; Melbourne, Australia; Auckland, New Zealand; Coleshill, England; Askim, Norway; Ostersund, Sweden; Frankfurt, Germany; and an office near Barcelona, Spain. Exhibit 4 details those locations. Polaris has about 1,800 dealers in North America and 1,700 dealers overseas through 80 distributors. The company has about 400 dealers for its Victory and Indian motorcycles, and 200 dealers in North America.

Competitors

Polaris' primary competitors for off-road vehicle (ORV) sales are Bombardier Recreational Products, Inc., and Yamaha. Arctic Cat is the primary snowmobile competitor. The top four major players in the ORV market are estimated to hold a combined market share of 57.7 percent. Concentration levels are much higher in the snowmobile segment, especially with major manufacturers Polaris and Arctic Cat commanding the segment.

Honda and Polaris are the two major manufacturers of ATVs in the United States. Polaris itself accounts for 27.6 percent of total industry revenue. IBISWorld estimates that the level of industry concentration will gradually increase during the next 5 years. The supply chain of this market comprises raw material suppliers, component manufacturers, ATV manufacturers, distributors, and buyers. The market for ORVs is highly consolidated with the presence of global as well as regional players. Major ORV manufacturers other than Polaris are Honda Motor Co., Ltd., Yamaha Motor Co., Ltd., BRP Inc., Arctic Cat Inc., Deere & Company (John Deere), Kubota Corporation, and Kawasaki Motors Corp.

Bombardier Recreational Products, Inc. (BRP)

Based in Valcourt, Canada, BRP designs, develops, manufactures, distributes, and markets power sports vehicles and propulsion systems. The company manufactures and sells all-terrain vehicles (ATVs), side-by-side vehicles (SSVs) and roadsters, as well as seasonal products consisting of Lynx snowmobiles and personal watercrafts (PWCs). Bombardier also produces propulsion products consisting of engines for outboard and jet boats, karts, motorcycles, and recreational aircraft. Bombardier's diversified portfolio of brands and products includes Can-Am ATVs, SSVs and roadsters, Ski-Doo and Lynx snowmobiles, Sea-Doo PWCs, and propulsion systems consisting of Evinrude outboard boat engines and Rotax engines for jet boats, karts, motorcycles, and recreational aircraft. In addition, Bombardier operates a parts, accessories, and clothing (PAC) business. BRP products are sold through a network of dealers, distributors, and to original equipment manufacturers.

Arctic Cat, Inc. (ACAT)

On January 25, 2017, it was announced that Arctic Cat will be acquired by Textron in a $247 million cash transaction. However, Arctic Cat is a North American manufacturer of snowmobiles and all-terrain vehicles as well as snowmobile suits and accessories. Founded by Polaris founder, Edgar Hetteen, Arctic Cat was formed in 1960 and was originally based in Thief River Falls, Minnesota. In 2016, the headquarters was relocated to a more prominent location in downtown Minneapolis. Also in 2016, most of the ATV/UTV engineering was moved to St. Cloud, Minnesota, in the same facility that produces the Arctic Cat engines. Arctic Cat continues the majority of their manufacturing, along with snowmobile engineering, in Thief River Falls, Minnesota.

Harley-Davidson, Inc. (HOG)

Headquartered in Milwaukee, Wisconsin, Harley-Davidson (Harley) is an iconic brand worldwide and provides a unique customer experience few companies can match. Its ticker symbol HOG and its Harley Owners Group (H.O.G.) both stem from the nickname for the famous Harley motorcycle. Harley is America's largest motorcycle producer with 2017 revenue of $5.6 billion, down from $5.9 billion the prior year.. The company's net income declined in 2017 to $521 million from $692 million the prior year. Harley has sales in about 97 countries and services over 1,400 independently owned dealers.

Honda Motor Company Ltd. (HMC)

Headquartered in Tokyo, Japan, Honda sells motorcycles, but also cars, outboard motors, generators, and other various power equipment products. For Honda's last fiscal year ended on March 2017, revenues in the company's motorcycle segment decreased 4.95 percent to ¥1,716.1 billion ($15.77 billion). For that fiscal year, Honda's motorcycle unit sales rose 6.3 percent to 11 thousand motorcycles. Operating profit of the motorcycle segment decreased 6.1 percent to ¥170.5 billion ($1,567 million).

Suzuki Motor Company (SZKMY)

Headquartered in Hamamatsu, Japan, Suzuki manufactures, and markets motorcycles, automobiles, outboard motors, wheelchairs, and all-terrain vehicles. Suzuki has over 57,000 employees. Worldwide production decreased by 7.4 percent on 2016 compared to 2015, to 1,370,000 units.

Improving their operating loss from ¥10.2 billion ($93.7 million) in 2015 to an operating loss of ¥0.9 billion ($8.2 million) in 2016.

External Issues

The global off-road vehicles (ORVs) market is projected to reach $11.1 billion in 2022. A booming global economy and increasing disposable income is spurring recreational and touring activities, an advancement in the ORV technology, and increasing usage of ORVs in the agriculture and military operations are the major factors proliferating the demand for ORVs globally. The United States is the largest ORV market due to its large stretches of natural terrain, unpaved roads, and large ranches and farms across the country.

The global ORVs market is segmented based on vehicle type as ATV and SSV. SSV is likely to witness higher growth through 2020 due to a significant shift from ATVs to SSVs. SSV offers advantages over ATVs, such as better riding experience, rollover protection bars, and improved mobility. These factors significantly reduce the number of accidents and injuries as compared to ATVs.

Based on region, North America is expected to remain the largest market for ORVs over the next 5 years. The United States accounted for more than 50 percent of the global ORV sales in 2016. Asia-Pacific is relatively a small market but is likely to report the highest growth through 2020, driven by an increasing demand for powersports in China, Australia, and India.

Future

Polaris' Indian Motorcycle line is gaining market share against Harley-Davidson, and the company reported that retail sales were up 16 percent in Q3 of 2017. Polaris is eliminating the Victory brand in order to focus on Indian and could create a brand to rival Harley-Davidson in the long term.

Polaris sales for Q4 of 2017 increased 18 percent to $1,431 million, up 17 percent, with the majority being from organic growth. Q4 2017 sales of $1,431 million were up 18 percent from $1,218 million for Q4 of 2016. The company's Q4 2017 net income was $31 million, down from net income of $63 million the prior year quarter. Motorcycle segment sales totaled $103 million, a decrease of 2 percent compared to $104 million reported in Q4 of 2016. Gross profit from Motorcycle segment for Q4 of 2017 was $5 million compared to $1 million in Q4 of 2016.

On May 17, 2018, Polaris announced that the U.S. Army was purchasing 20 of its MRZR X vehicles for soldier trials. The MRZR X is a robotic vehicle to be used by infantry brigade combat teams for the next year of trials as part of the Army's Squad Multipurpose Equipment Transport (SMET) program. The vehicle can be manned or non-manned so it helps the Army transition from manned to unmanned vehicles. The new robotic vehicle complements the worldwide commonality with the MRZRs already in service in the United States and more than 30 allied nations. The new vehicle has the capability for remote control, teleoperation, follow-me, leader-follower, and full autonomy. Thus the new vehicle can be used as an autonomous resupply vehicle, warfighter-driven squad carrier, logistics support vehicle, rescue mission enabler, and high-speed casualty evacuation capability. Polaris initially had teamed up in 2017 with Applied Research Associates Inc. (ARA), and Neya Systems LLC.

Polaris has updated its strategic plan and aims to generate annual sales growth of greater than 5 percent compounded annually, and net income growth of greater than 15 percent through 2022. The company could use a fresh look at its strategic plan since analysts agree that competitiveness in the industry is growing.

PT Matahari Putra Prima Tbk.—2022

hypermart.co.id

Headquartered in Tangerang, Indonesia, PT Matahari Putra Prima Tbk. (Matahari) is a large Indonesian chain of retail stores with a product range that includes food, clothes, chairs, dog beds, cosmetics, tableware, and household appliances. The word "matahari" in Indonesian means "the sun"; many of the company's products are handmade outdoors, in the sun, by local artisans in small villages throughout Indonesia and Southeast Asia. The company's customers are primarily retail stores (online, catalog, and brick-and-mortar) and interior design firms. Matahari owns and operates Hypermart, Primo, Foodmart, Hyfresh, Boston Health & Beauty, FMX, and Smart Club across 200 locations in Jakarta and around Indonesia.

History

Founded in 1986, Matahari has become a trusted retailer in Indonesia. The firm became public in 1992 on the Jakarta and Surabaya Stock Exchanges and began supermarket operations in 1995. Boston Health & Beauty was launched in 1995 and Hypermart in 2004. In 2012, the firm divested its non-core businesses. Matahari remodeled many of its locations in 2015 and continued building new stores. In 2018, it reduced its exposure in the business-to-business (B2B) market and increased its focus on selling and providing services directly to consumers through its Hypermart and Foodmart locations before launching Hyfresh in 2019, further concentrating its efforts on the consumer.

The COVID-19 pandemic severely hurt Matahari and other supermarket retailers, as social distancing and general travel restrictions in Indonesia were stringent. In response to the pandemic and the change in consumer behavior buying patterns, Matahari has been trying to become more of an online company, but so far that transition has been a challenge. The company is at a critical juncture in its history and needs a clear strategic plan to weather the continual storms it faces.

Vision/Mission

There is no posted vision or mission statement for the company at the corporate website or in the firm's most recent *Annual Report*. A plausible vision statement for Matahari could read something like this: To become the premier, multi-format, go-to shopping destination throughout Indonesia.

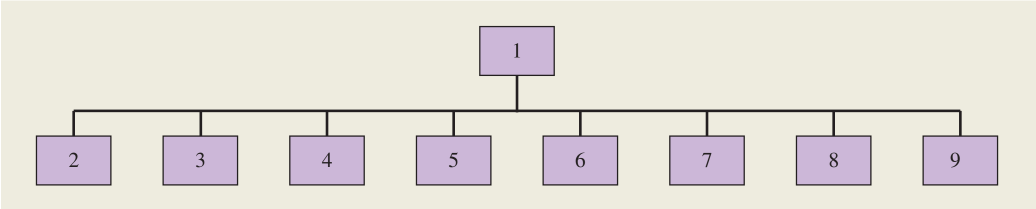
Internal Issues

Organizational Structure

Unlike most corporations, Matahari provides an organizational chart in its 2020 *Annual Report* to reveal its top executive reporting relationships. As shown in Exhibit 1, Matahari has no COO within its executive ranks; nor does it have presidents of divisions. The company does, however, have a Director of Large Stores Format and a Director of Small Stores Format, implying a decentralized design with two profit centers based on customer size. CFOs across the world are taking on more and more of the responsibility traditionally held by a COO, and perhaps that is also true of Matahari. If so, then Herry Senjaya, CFO of Matahari, is a busy person.

Being well organized is vitally important for success in any company, and there are guidelines for when various types of structure should be utilized. You can find many of these guidelines in Chapter 7, "Implementing Strategies: Management and Marketing Issues." Based on the guidelines and various organizational structure journal articles listed in the References section of this case, it is clear that extensive improvements are needed in Matahari's organizational design. Probably the most effective type of structure for Matahari would be a divisional-by-product-type design, where the products are the various types of stores the company operates, such as Hypermart, Primo, Foodmart, Hyfresh, Boston Health & Beauty, FMX, and SmartClub. There should probably be a president or similar head responsible for

EXHIBIT 1 **Matahari's Top Management Team**



1. Elliot Dickson, CEO
2. Herry Senjaya, CFO
3. Kyutae Park, Director, Merchandising & Marketing
4. Anto Suwartono, Director, Large Stores Format
5. Wirawan Winarto, Director, Small Stores Format
6. Iwan Goenadi, Director, Information Technology
7. Danny Kojongian, Director, Corporate Secretary & Public Affairs
8. Lydiawati Kurniawan, Vice President, Human Capital
9. Purwanto, Head of Internal Audit

Source: Based on information in Matahari's 2020 *Annual Report*.

each of these operations. Vagueness is disastrous both in strategic planning and in organizational design, and at present there is too much vagueness in Matahari's structure. In addition, this company seems sufficiently large to warrant having a COO for all those new presidents to report to, rather than everyone in the company reporting to the CEO.

Financial Data and Statements

As indicated in Matahari's recent income statements provided in Exhibit 2, the company had a rough 2020, with the COVID-19 pandemic discouraging consumers and companies worldwide. Note that revenues were down 22 percent and the company's net income was again negative, albeit a bit less so than the prior year. Matahari's business apparently suffered in 2020 directly as pandemic lockdowns prevented people from getting out of their homes and going shopping. Trends such as this are quite worrisome for Matahari's shareholders, who expect to see at least a 5 percent top-line (revenues) and for the bottom line (net income) to increase annually.

As shown in Matahari's recent balance sheets provided in Exhibit 3, the company's property, plant, and equipment declined 15 percent in 2020, while long-term debt increased 396 percent. Basically, the company is apparently using debt to meet its payroll and pay expenses as profits have been nonexistent. Matahari needs a clear strategic plan moving forward.

EXHIBIT 2 **Matahari's Income Statements (in millions of Rupiah)**

Income Statement	12/31/19	12/31/20		Percent Change
Revenues	8,654,646	6,746,594		–22%
Cost of Goods Sold	7,074,249	5,439,936		–23%
Gross Profit	1,580,397	1,306,658		–17%
Operating Expenses	1,776,502	1,446,926		–19%
EBIT	(196,105)	(140,268)		28%
Interest Expense	118,496	267,419		126%
EBT	(314,601)	(407,687)		–30%
Tax	238,073	(2,380)		–101%
Non-Recurring Events	–	–	NA	NA
Net Income	(552,674)	(405,307)		27%

Source: Based on information in Matahari's 2020 *Financial Supplement,* p. 1.

EXHIBIT 3 Matahari's Balance Sheets (in millions of Rupiah)

Balance Sheet	12/31/19	12/31/20		Percent Change
Assets				
Cash and Short Term Investments	304,295	299,805	↓	–1%
Accounts Receivable	220,079	193,210	↓	–12%
Inventory	1,191,567	964,503	↓	–19%
Other Current Assets	188,106	77,748	↓	–59%
Total Current Assets	1,904,047	1,535,266	↓	–19%
Property Plant & Equipment	926,287	789,871	↓	–15%
Goodwill	–	–	NA	NA
Intangibles	4,132	2,315	↓	–44%
Other Long-Term Assets	986,343	2,183,059	↑	121%
Total Assets	3,820,809	4,510,511	↑	18%
Liabilities				
Accounts Payable	1,022,948	836,691	↓	–18%
Other Current Liabilities	1,595,442	1,926,408	↑	21%
Total Current Liabilities	2,618,390	2,763,099	↑	6%
Long-Term Debt	250,000	1,240,153	↑	396%
Other Long-Term Liabilities	421,738	322,525	↓	–24%
Total Liabilities	3,290,128	4,325,777	↑	31%
Equity				
Common Stock	376,457	376,457	↓	0%
Retained Earnings	(1,313,905)	(1,659,855)	↓	–26%
Treasury Stock	–	–	NA	NA
Paid in Capital & Other	1,468,129	1,468,132	↑	0%
Total Equity	530,681	184,734	↓	–65%
Total Liabilities and Equity	**3,820,809**	**4,510,511**	↑	18%

Source: Based on information in Matahari's 2020 *Financial Supplement,* pp. 2–3.

Strategy

Matahari has vaguely disclosed that the company has two distinct strategies, the first focusing on consumer retailing and providing quality fresh products and the second on expanding its omnichannel online business and improving digital payments. The first strategy seems to imply an increased focus on fresh fruit and vegetables, but a closer reading of what the company calls "fresh" is much more broad; it also includes more emphasis on consumer goods and many other types of groceries. In fact, the term "fresh" mostly likely means any product that has a shelf life of perhaps less than a year.

Regarding the second strategy, Matahari is increasingly shifting toward an omnichannel presence by forming partnerships with firms to become more virtual. In 2021, the firm expanded its partnership with Tokopedia, a technology company with the leading marketplace in Indonesia; Matahari opened 95 virtual stores on Tokopedia's platform, which boasts more than 100 million active monthly users who purchase food and household products. While Matahari is by some estimates the fifth largest grocery store chain in the country, the company claims this agreement with Tokopeida makes them the largest online grocery platform in Indonesia. This agreement follows on the heels of the merger of Tokopeida and GoJek, another firm that Matahari works closely with, which launched 31 stores in 2021 before quickly expanding to 76 virtual stores.

In 2020, Matahari reported that 5 percent of its total sales were derived from online sources, compared to just 0.1 percent in 2019. Online sales were expected to amount to 10 percent of Matahari's total sales in 2021—a rapid increase.

While the firm calls the two above items strategies, they are perhaps best considered tactics. The true strategy of Matahari would center more around how to allocate resources around the large format Hypermart or the smaller format stores such as Foodmart and Primo. Both of what the firm calls strategies above can be applied to large or smaller format stores. But it is vital to get the large- versus small-store balance correct because having fresher products on the shelf may not matter much if you are operating the incorrect size-store balance or have stores in the wrong locations.

By-Segment Information

Broadly speaking, Matahari has three segments, 1) Large Stores, 2) Small Stores, and 3) Wholesale, as indicated in Exhibit 4. More specifically, however, the company has seven segments or store chains, as discussed below.

EXHIBIT 4 Matahari's Segments by Type Facility

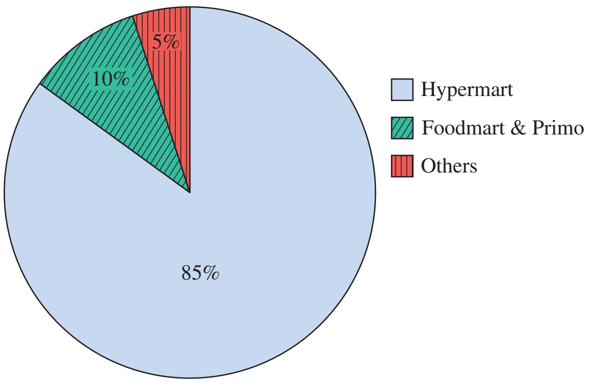
Large Format	Hypermarket
Small Format	Primo Supermarket
	Foodmart Supermarket
	Hyfresh Supermarket
	Boston Health & Beauty (Boston HBC)
	FMX
Wholesale	SmartClub Trader Wholesale

Source: Based on information at Matahari's corporate website.

Hypermart

As shown in Exhibit 5, Hypermart accounted for 85 percent of Matahari's total revenue in 2020. Matahari is in the process of transforming Hypermarts into smaller, more efficient stores and increasing store numbers. In addition, much attention is being given to improving the shopping experience by modernizing existing stores to international standards and consistency. The company's Hypermart stores cater to everyone but target middle-income families, offering products such as groceries, fresh food, electronics, and soft-line products. Hypermart products are tracked closely to determine profit margins and best practices for distribution networks and centers to supply stores. Improved tracking has enabled Matahari to offer products with higher margins, focus more on high-demand products, and drop low-demand products. Hypermarts are shifting focus increasingly to individual consumers rather than B2B.

EXHIBIT 5 Matahari's By-Segment Contribution to Total Revenues



Source: Based on Matahari's 2020 *Annual Report,* p. 46. (Based on contribution to total sales)

Foodmart

Foodmart, Matahari's second largest brand, produces about 10 percent of its total revenues. Focusing on convenience and providing a modem atmosphere, the brand supplies a wide range of both local and international products. Customers also can purchase ready-to-eat meals to enjoy at home. Foodmart tends to focus on higher-quality products, especially fresh foods. Foodmart Primo is more upscale, focusing on affluent customers, and offers many international products, a greater variety, and a range of ready-to-eat take away meals. Matahari operates 25 such Foodmart Primo stores across Indonesia.

Hyfresh

The most recent new type of store owned and operated by Matahari is Hyfresh, which was launched in 2019. Hyfresh's stores are smaller and focus on middle-class communities where customers need to shop every day due to smaller living spaces at home or inadequate means of keeping food fresh. Fresh groceries and attractive prices are part of Hyfresh's strategy. There are 9 Hyfresh stores as of 2020.

Boston HBC

Standing for Boston Health and Beauty, Boston HBC offers Indonesian customers a health and beauty concept, as the name suggests. Select stores offer health consultations and even a pharmacy. The brand struggled in 2020, opening no new stores and closing 7 stores permanently, for a total of 62 stores in operation. The closure of 10 percent of the stores in 2020 is concerning; it might be explained away by the pandemic, but 9 stores were closed in 2019, before the outbreak. Extra care should be taken when analyzing this concept's fit going forward.

FMX

FMX is the convenience store arm of Matahari. These stores are located near malls, apartments, railway stations, and other high-traffic public places in local communities. FMX is different from other convenience stores in Indonesia in offering more modern layouts, huge ready-to-eat food and drink sections, and assortments of grocery items focusing on snacks. Customers can even pay their bills at FMX stores. Matahari is optimistic over FMX's growth potential and plans to continue store expansion. However, in 2020, the company closed 2 FMX locations permanently and now operates 14 such stores.

Supporting Function

To service its range of stores, Matahari operates 3 distribution centers. Just over 50 percent of all sales are derived from merchandise flowing through these centers. Far and away the largest center is in Balaraja, with a capacity of 43,000 pallets, followed by the center in Porong, with a capacity of 30,000 pallets. The smallest distribution location is in Cibitung, with a capacity of 4,200 pallets. Radio frequency scanning, voice picking technology, and single-pick technology allow for paperless fast operations and enhance data collection applications.

Segment-based Performance Data

As indicated in Exhibit 6, Matahari's Hypermarts generate almost all of the company's revenues, but moving forward, other segments may be expanded substantially even as the firm downsizes the average square footage of each Hypermart to the extent possible.

External Issues

Demographics of Indonesia

It may come as a surprise to many non-Indonesians that the country is the fourth most populous nation in the world, with over 270 million people, behind China, India, and the United States. Nearly 60 percent of the population of Indonesia resides on the island of Java. The country is spread across hundreds of islands. The largest city, Jakarta, has nearly 10 million residents, followed by Surabaya, with nearly 3 million people. The country's GDP per capita is $3,907 as of 2021. Agricultural imports reached nearly $20 billion in 2020. The Indonesian government has set agricultural self-sufficiency as its goal.

EXHIBIT 6 Numbers of Matahari's Outlets and Their 2020 Performance

				2020	2020
	2018	2019	2020	Stores	Sales
Opened/	in				
Closed	Rp billion				
Hypermart	117	102	100	0/2	5,698
Foodmart Supermarket	19	17	16	0/1	344
Primo Supermarket	5	9	9	0/0	345
Hyfresh Supermarket	0	8	9	2/1	135
Boston Health & Beauty	74	69	62	0/7	45
FMX	12	16	14	0/2	46
SmartClub	1	1	2	0/0	134
Total	219	222	211	2/13	6,747

Source: Based on Matahari's 2020 *Annual Report,* p. 3 and pp. 36 and 46.

About 57 percent of Indonesians live in urban areas, with the main cities being Jakarta, Surabaya, Medan, and Bandung. The literacy rate in Indonesia is high at 95.7 percent, and the size of households is also pretty high—41 percent are comprised of 4–5 persons. The average monthly salary in Indonesia is Rp 12,100,000 ($862); women on average earn 23 percent less than men in Indonesia. There are several hundred ethic groups in the country, but the most common are Javanese (42 percent), Sundanese (15 percent), and Malay, Madurese, and Batak (3 percent each). Although Indonesia is a Muslim majority country, alcohol consumption is allowed nationwide except in the province of Aceh. Nevertheless, there are numerous constraints on advertising alcoholic beverages.

E-commerce in Indonesia

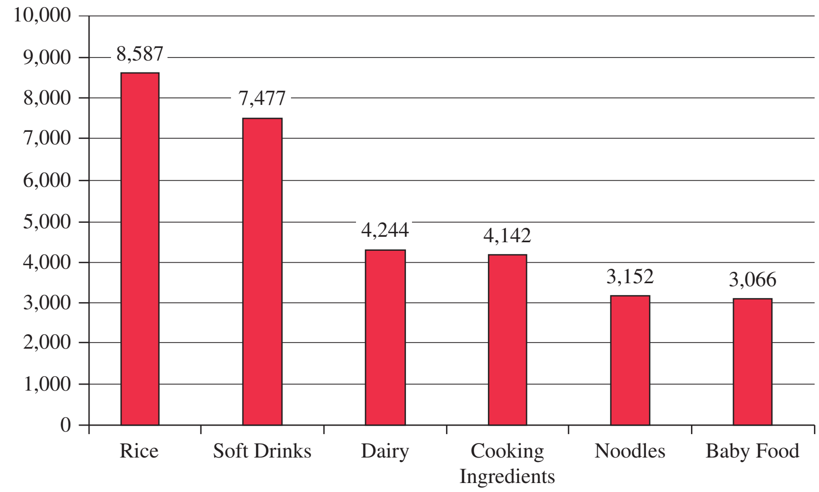
Indonesians are rapidly embracing e-commerce, and the country's e-commerce market is expected to grow from $32 billion in 2020 to $83 billion by 2025 (it was $21 billion in 2019). According to Statista, fashion is the largest category of goods being purchased online in Indonesia. Analysts report that about 50 percent of Indonesian consumers conduct Google searches and read customer reviews before making their purchase. The top four social media platforms utilized by Indonesian internet users are, in order of popularity, YouTube, WhatsApp, Instagram, and Facebook. The top four e-commerce sites in Indonesia in rank order are Tokopedia, Shopee, Bukalapak, and Lazada; Tokopedia and Shopee are nearly on par with each other and together garner about 80 percent of all views and purchases.

Non-urban areas of Indonesia do not have access to regular banking services such as credit cards or bank transfers, so cash on delivery is commonly used. Any business that services such areas—like Matahari—should consider having a logistics partner to help facilitate the cash-on-delivery method of payment. However, the Indonesian government promises to soon have a standard single-code QR system (QRIS) as part of their Indonesia Payment Systems Blueprint 2025. Go-Jek recently launched digital payment options such as GoPay and PayLater. Similarly, Shopee offers Shopee Pay. OVO is another popular eWallet payment option. There are even some "buy-now-pay-later" options in Indonesia, such as PayLater, which is the third most popular fintech in Indonesia (about 58 percent of the Indonesian population are aware of its offering). At end of Q1 2020, Matahari launched Chat & Shop by WhatsApp, which is supported by the Park & Pickup and BELLA (Single National WhatsApp Number) features.

Annual Food Sales in Indonesia

Exhibit 7 reveals the dollar amount of various types of food purchased by consumers in Indonesia in 2020. Notice that rice is number one, but surprisingly soft drinks are number two, followed by dairy products. Matahari is continually monitoring its own sales of different foods to determine the most effective mix to provide on the shelves of its various stores.

EXHIBIT 7 Food Sales in Indonesia in 2020 by Type of Food (in millions of USD)



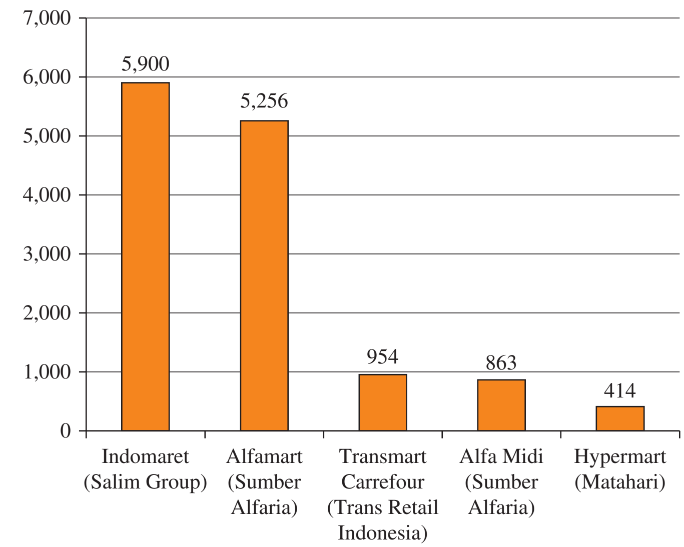
Source: Based on information at Euromonitor, 2020.

Competitors

The top 5 food retailers in Indonesia are shown in Exhibit 8. Note that Matahari's largest chain of stores, Hypermart, comes in a distant fifth based on sales; it is sixth based on store numbers. In 2020, there were over 4.4 million traditional stores in Indonesia, which equates to about one for every 60 people. Convenience stores totaled just over 36,000, followed by supermarkets at 1,457. Forecourt and hypermarkets totaled 730 and 337, respectively. By comparison, there is one supermarket for every 185,000 people in Indonesia, revealing just how prevalent traditional stores are.

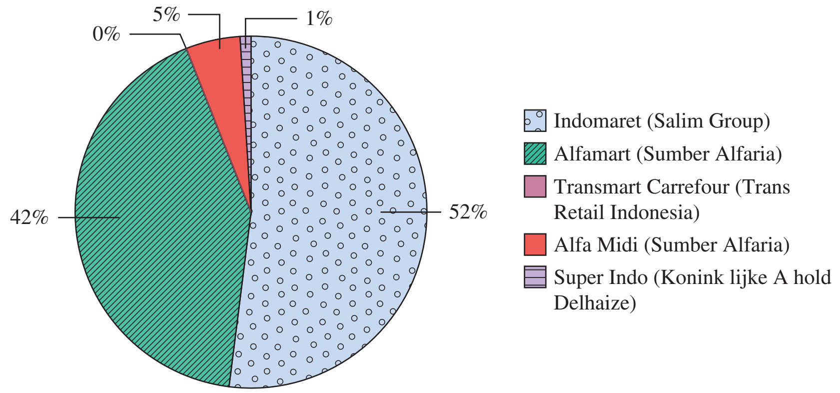
Regarding the competitive landscape in which Matahari functions, Exhibit 9 reveals the top 5 food retailers in Indonesia by percentage of outlets. Notice that Salim Group's Indomaret dominates the food retailer industry in the country, followed by Alfamart. These two rival firms hold a whopping 94 percent of the outlets in the country (among the top five). Matahari (which placed

EXHIBIT 8 The Top 5 Food Retailers in Indonesia by Sales (millions of USD in 2020)



Source: Based on information at Euromonitor, 2020.

EXHIBIT 9 The Top 5 Food Retailers in Indonesia by Percent of Outlets



Source: Based on information at Euromonitor, 2020.

sixth and is not pictured in the exhibit) must be continually mindful of what these two firms are doing—and where and how they are doing it—to maintain a competitive advantage in a very low-margin industry and be consistently profitable.

Conclusion

Strategy Considerations

Through 2021, the COVID-19 pandemic continued to wreak havoc on hypermarket and supermarket chains in Indonesia, especially those located in malls or shopping centers, which seem to suffer the most from low to no customer traffic. For example, grocery retailer Hero Group (operator of the Hero and Giant stores) saw 2020 sales decline by 33 percent to $418 million compared to 2019, and in mid-2021 it was forced to close all Giant stores (approximately 75 hypermarket and supermarket stores across Indonesia).

Amid the hardship, some retail businesses in Indonesia are nevertheless growing. For example, convenience stores have benefited from having smaller locations closer to residential areas. Retailers such as Supra Boga Lestari (operator of Ranch Market, Farmers Market, the Gourmet and Day 2 Day) have launched their own online shopping apps to provide instant delivery to customers. This strategy enabled Supra Boga Lestari to report a sales revenue increase of 26 percent year-over-year in 2020 due to store expansion and increased efficiencies. Indonesia's second largest convenience store, Alfamart, reported a 2 percent increase in revenues in 2020, reaching sales of $3.5 billion.

There is hope, therefore, for Matahari to turn its faltering revenues and profits around, likely through more transitioning to online and to smaller store formats. But the company has seven segments, as described in the case, and allocating resources effectively across them is now more important than ever. Prepare a comprehensive strategic plan that includes a portfolio analysis, SWOT analysis, and QSPM analysis for the CEO of Matahari. Include in your plan a new and improved organizational chart for the company based on sound management principles. Recall that the majority of people purchase their food items from roadside stands or small shops. Should Matahari focus increasingly on smaller shops or are the large shops the way to go? Should the firm divest all operations from serving businesses and focus entirely on the consumer? What should the firm do with respect to its one large wholesale property? Being the fifth largest grocery in the country, Matahari is still small enough to really offer a distinctive service. Perhaps the firm should only focus on middle- to upper-income customers? The possibilities for Matahari are many and the firm is in desperate need of a strong strategic plan. Develop a set of recommendations for CEO Dickson that you feel will lead Matahari to success, based on a thorough external and internal analysis of the competitive climate in Indonesia. With some rival firms closing and divesting stores and properties, there is opportunity for Matahari to capitalize on turmoil in the industry. Based on your analyses, what is your recommended course of action for the company to pursue over the 2021–2025 period?

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Emirates Group—2022

theemiratesgroup.com

The name "Emirates Group" includes two entities: 1) the well-known Emirates Airline and 2) the aviation services company Dubai National Air Transport Association (stylized as dnata). Headquartered in Garhoud, Dubai, near the Dubai International Airport, Emirates Airline (or simply Emirates) is the state-owned global airline of Dubai. The largest airline in the Middle East, Emirates provides passenger and freight services to about 100 countries, while dnata provides ground handling, cargo, catering, and travel services in 35 countries. (Note that Emirates Airlines and dnata do not form a group according to International Financial Reporting Standards [IFRS], so much of the Emirates Group's *Annual Report* presents separate data for the two entities, but the name "Emirates Group" refers to the two entities combined.)

More than 20 brands of the Emirates Group are described on its corporate website, including everything from catering to food services, to travel agencies, to ground handling and cargo services—this is a diversified, backward- and forward-integrated, well-managed, fast-growing enterprise. Today, Emirates serves 155 airports in 81 countries from its hub in Dubai. However, the COVID-19 pandemic hit the Emirates Group hard in 2020–2021, and corporate revenue dropped 65.8 percent to AED 35.586 billion, while the number of employees dropped 30.8 percent to 75,145. All flights to and from the UAE were suspended from March 25, 2020, to May 25, 2020. All UAE-based Emirates Group employees in 2020 took a six-month salary cut, and the Government of Dubai injected AED 11.3 billion into the Emirates Group in 2020 to keep the company solvent.

Emirates's response to the ban on air travel during the COVID-19 shutdown included modifying 19 Boeing 777-300ER passenger aircraft by removing seats in the cabin to make room for more cargo and then adding these to their 777-freighter fleet. Revenues from carrying cargo comprised 60 percent of the Group's revenues in 2020; nevertheless, dnata incurred its first loss ever (AED 1.8 billion) in fiscal 2020. But even during the pandemic, dnata secured new contracts, such as ground handling in Australia for Qantas Airlines and a 5-year ground handling contract for services at Canada's Vancouver International Airport. By March 31, 2021, the pandemic was under greater control—though by no means disappeared—and Emirates was flying again to 120 destinations.

History

The founder of the Emirates Group was Sheikh Ahmed bin Saeed Al Maktoum, who started the company under the name dnata in 1959. The name "Emirates" was conceived in March 1985 with backing from Dubai's royal family; its first flight was from Dubai to Karachi, Pakistan, in October 1985. The airline grew rapidly and by 2005 had a workforce of 25,000, making it Dubai's largest employer. Emirates's passenger numbers reached 23 million in 2009. At the end of March 2020, Emirates employed 59,519 persons, including 21,789 cabin crew, 4,313 flight deck crew, 3,316 in engineering, 12,627 listed as "other," 5,376 employees at overseas stations, and 12,098 at subsidiary companies.

In 2020–2021, for the seventh consecutive year, Emirates won the Best Airline award at the Business Traveler Middle East Awards, and won in the categories Best First Class, Airline with the Best Cabin Crew, and Best Airport Lounge. In December 2020, Emirates won the Airline of the Year award at the annual Aviation Business Awards Conference. Emirates is one of the world's fastest-growing airlines, but the pandemic still plagues all airlines.

Vision/Mission

If the Emirates Group has a written vision or mission statement, it is not available on either the corporate website or the 2020 *Annual Report*. A likely vision and mission could read something like this:

Vision

To provide passenger and cargo air flight services wherever people live and work, today and tomorrow.

Mission

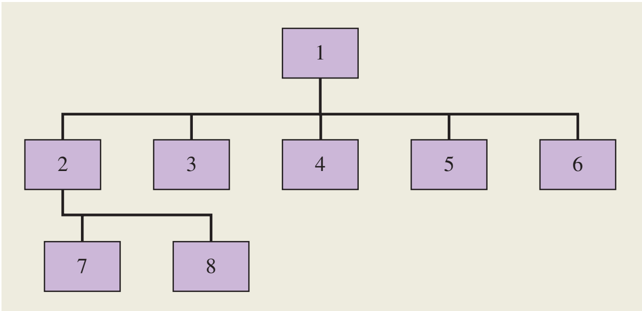
We strive to offer the best award-winning passenger and cargo jet services and on-the-ground airport services around the world and to set an excellent example of integrity and humility for all. We strive to hire the best employees and utilize the latest technology to ensure customer and community safety and happiness as we endeavor to meet and exceed the expectations of our shareholders and the silent needs of the natural environment.

Internal Issues

Organizational Structure

As stated on page 2 in Emirates' 2020–2021 *Annual Report*, the Vice President and Prime Minister of the UAE and the Ruler of Dubai is his Highness Sheikh Mohammed bin Rashid Al Maktoum. Exhibit 1 provides a list of the Group's top executives and their titles and a flow chart of their reporting relationships. There are no women among the Emirates Group top's management team.

EXHIBIT 1 Emirates Group Top Executives and a Company Structural Flow Chart



1. H.H. Sheikh Ahmed bin Saeed Al Maktoum, Chairman and CEO of Emirates Airline & Group
2. Adel Ahmad Al Redha, Chief Operating Officer
3. Adnan Kazim, Chief Commercial Officer for Emirates Airline
4. Abdulaziz Al Ali, Executive Vice President and Human Resources Officer for Emirates Group
5. Ali Mubarak Al Soori, Executive Vice President & Head of Facilities & Project Mgt. & Non-Aircraft P&L
6. Nigel Hopkins, Executive Vice President & Head of Service Departments at Emirates Group
7. Sir Tim Clark, President of Emirates Airline
8. Steve Allen, Executive Vice President of dnata

Source: Based on information in the Emirates Group's 2020–2021 *Annual Report*, pp. 16 and 17.

Strategy

In 2020–2021, Emirates retired 9 Boeing 777 aircraft and 5 A380 aircraft while adding 3 new A380 aircraft. The company is committed to maintaining a young fleet of aircraft.

The Emirates Group is very active in three key areas of environmental sustainability: 1) emissions reduction, 2) responsible consumption, and 3) wildlife and habitat conservation. The company's 2020–2021 *Annual Report* (pages 58–64) details many activities the company engages in to assure its excellence in these areas.

Emirates Group Segments

Emirates Airline

Emirates Airline is subdivided into several revenue generating parts:

1. Emirates Skyward
2. Emirates Holidays
3. Emirates SkyCargo
4. Emirates Flight Catering
5. Emirates Aviation University

6. Emirates Flight Training Academy
7. Emirates Partners Portal
8. Emirates Group Security

However, as indicated in Exhibit 2, Emirates has 7 reporting segments (the two Others are treated as one; the second Other category in the Exhibit was included to reconcile data provided on pages 7 and 72). Exhibit 3 provides the financial highlights of Emirates' 2020–2021 fiscal year. Note the crushing declines due almost exclusively to COVID-19 bans on and restrictions on travel.

EXHIBIT 2 A Financial Summary of Emirates' Operations in Recent Years

	2019–2020	2020–2021	% Change
Revenue (AED m)	91,972	30,927	(66.4)
Passenger	75,587	11,012	(85.4)
Cargo	11,207	17,106	52.6
Excess baggage	478	218	(54.4)
Sale of goods	2,745	1,334	(51.4)
Hotel operations	584	296	(49.3)
Other	394	264	(33.0)
Non-transport	3,723	1,894	(49.1)
Other	977	697	
Operating Profit (AED m)	6,408	(15,021)	(334.4)
Profit Margin	1.1	(65.6)	(66.7) pts
# Passengers Carried	56,162	6,553	(88.3)
Tons of Cargo Carried	2,389	1,873	(21.6)
# of Aircraft	270	259	(11) nos
# of Employees	60,033	40,801	(32.0)

Source: Based on the Emirates Group's *Annual Report 2020–2021,* pp. 7 and 72.

EXHIBIT 3 A Financial Summary of dnata's Operations in Recent Years

	2019–2020	2020–2021	% Change
Revenue (AED m)	14,760	5,541	(62.5)
International Airports	3,940	2,263	(42.6)
UAE Airports	3,171	1,671	(47.3)
Inflight catering	3,313	1,046	(68.4)
Travel services	3,537	130	(96.3)
Other services	799	431	(11.8)
Operating Profit (AED m)	507	(1,857)	(466.3)
Profit Margin	4.2	(32.9)	(37.1) pts
Tons of Cargo Handled	2,929	2,686	(8.3)
# Meals Uplifted	93,492	16,939	(81.9)
# of Employees	48,503	34,344	(29.2)

Source: Based on the Emirates Group's *Annual Report 2020–2021,* pp. 7 and 83.

dnata

This services provider is subdivided into several revenue contributing parts:

1. *Airport Operations*: Due to strong cargo business, this segment reported only an 8 percent decline in tons of cargo handled in fiscal 2020–2021, to 2.7 million tons.
2. *Catering*: This segment reported a decline of 82 percent of meals uplifted, down to 16.9 million, due to the ban on and restrictions on air travel.

3. *Travel*: Revenue in 2020–2021 also dropped 96 percent to AED 130 million due to pandemic restrictions.
4. *Airport Handling SpA*: Dnata's subsidiary in Italy now offers full ground and cargo services at Milan Malpensa Airport (MXP).

In terms of actual segment reporting, however, dnata has five segments as revealed in Exhibit 3, which provides financial highlights of dnata's 2020–2021 fiscal year. Note the drastic declines due almost exclusively from COVID-19 bans on and restrictions on travel.

Emirates Group Consolidated Financials

As indicated earlier in the case, IFRS do not allow the Emirates Group to combine Emirates Airlines and dnata financials into the firm's consolidated financial statements. The consolidated statements provided in Exhibits 4 and 5 are thus for the Emirates Group, excluding the dnata operations. Note the drastic declines along almost all rows of the statements.

EXHIBIT 4 Emirates Group Consolidated Income Statements (in millions of AED)

Income Statement	3/31/20	3/31/21		Percent Change
Revenues	$91,972	$30,230		–67%
Cost of Goods Sold	0	0	NA	NA
Gross Profit	91,972	30,230		–67%
Operating Expenses	85,564	45,251		–47%
EBIT	6,408	(15,021)		–334%
Interest Expense	5,154	5,279		2%
EBT	1,254	(20,300)		–1719%
Tax	66	10		–85%
Non-Recurring Events	(132)	31		–123%
Net Income	1,056	(20,279)		–2020%

Source: Based on the Emirates Group's *Annual Report 2020–2021*, p. 92.

EXHIBIT 5 Emirates Group Consolidated Balance Sheets (in millions of AED)

Balance Sheet	3/31/20	3/31/21		Percent Change
Assets				
Cash and Short-Term Investments	$8,232	$4,945		–40%
Accounts Receivable	4,783	4,763		0%
Inventory	2,670	2,322		–13%
Other Current Assets	12,020	10,861		–10%
Total Current Assets	27,705	22,891		–17%
Property Plant & Equipment	86,084	79,258		–8%
Goodwill	0	0	NA	NA
Intangibles	4,373	5,266		20%
Other Long-Term Assets	53,900	44,362		–18%
Total Assets	172,062	151,777		–12%
Liabilities				
Accounts Payable	12,880	10,199		–21%
Other Current Liabilities	36,012	25,506		–29%
Total Current Liabilities	48,892	35,705		–27%
Long-Term Debt	90,728	89,637		–1%
Other Long-Term Liabilities	8,855	6,288		–29%
Total Liabilities	148,475	131,630		–11%

(*continued*)

Balance Sheet	3/31/20	3/31/21		Percent Change
Equity				
Common Stock	0	0	NA	NA
Retained Earnings	27,878	7,593		–73%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	(4,291)	12,554		–393%
Total Equity	23,587	20,147		–15%
Total Liabilities and Equity	**172,062**	**151,777**		–12%

Source: Emirates Group's 2020–2021 *Annual Report*, p. 93.

Competitors

Emirates Airlines competes with dozens of airlines globally, but 5 seem to be the company's major rivals: 1) Singapore Airlines, 2) Etihad Airways, 3) Air China, 4) Qantas Airways, and 5) Malaysia Airlines Berhad.

Emirates Airline's Competitors

Singapore Airlines is based out of the Singapore Changi Airport and has been ranked as the world's best airline at least four times by UK-based *Skytrax* and more than 20 times by *Travel & Leisure* magazine. As of August 2021, Singapore Airlines operates a fleet of 154 Airbus and Boeing passenger aircraft and 7 Boeing 747-400 cargo aircraft.

Etihad Airways is headquartered near Abu Dhabi International Airport in the UAE and is the second-largest airline in the country after Emirates. Etihad operates about 100 Airbus and Boeing aircraft and flies to about 120 passenger and cargo destinations in the Middle East, Africa, Europe, Asia, Australia, and North America.

Founded in 1988 and headquartered in Beijing, Air China is one of China's big three airlines. As of March 2021, Air China operates 459 Airbus and Boeing aircraft, with another 110 planes on order. The company flies passengers and cargo virtually everywhere on the globe.

Headquartered in the Sydney suburb of Mascot, New South Wales, Qantas Airways is the largest airline company in Australia. Qantas owns Jetstar, a low-cost airline based in Australia. In March 2021, Qantas reported a half-year revenue loss of AU$1.08 billion, a 75-percent decline from the prior year, and passenger counts dropped 83 percent. All airlines need COVID-19 to go away, and in August 2021 Australia was basically under lockdown due to the lingering pandemic.

Malaysia Airlines is the flag carrier and largest airline company in Malaysia; it is also a member of the OneWorld Airline Alliance. With its headquarters at Kuala Lumpur International Airport, as of January 2021, Malaysia Airlines flies to 59 destinations in Asia, New Zealand, and Australia.

Dnata's Competitors

The International Air Transport Association (IATA) reports that airlines outsource more than 50 percent of the ground handling that takes place at airports globally. Ground handling includes everything a plane may need between the time it arrives at a terminal gate and the time it departs on its next flight. Speed, efficiency, and accuracy are important in ground handling services to minimize turnaround time, as faster turnarounds yield higher profits.

Dnata competes with dozens of firms globally in providing airport and aviation services, such as Egypt Air Ground Services, HAVAS Ground Handling Company, Bahrain Airport Services, Qatar Aviation Services, New Star Aviation Services, Airmach Aviation, MDFS Philippines, SATS Ltd., and SAL Ground Services. Two of dnata's rivals are 1) Angkasa Pura and 2) Shenzhen Airlines.

Angkasa Pura, comprised of Angkasa Pura I and II, are government entities of the Indonesian Ministry of State Owned Enterprises. Pura I is headquartered in Kamayoran, Jakarta, while Pura II is at the Soekarno–Hatta International Airport in Tangerang, Banten. Much like dnata, Pura I provides ground handling services at about 20 airports in central and eastern Indonesia, while Pura II does the same at about 20 airports in western Indonesia. Angkasa Pura could easily expand to become a more serious rival for dnata.

Shenzhen Airlines is headquartered at Shenzhen Bao'an International airport in Shenzhen, Guangdong, China. A large airline and a member of the Star Alliance, Shenzhen Airlines has about 200 Airbus and Boeing jets currently in service flying throughout Asia, Africa, Middle East, Australia, and Europe. However, it also handles airport and aviation services at numerous locations.

External Issues

All airlines and airport ground handling service companies sorely need the COVID-19 pandemic to terminate because any interruption to passenger travel for any reason seriously reduces both revenues and profits. To make money, airlines need to keep their planes flying and ground handlers need planes to land and depart. Anything that keeps billion-dollar assets such as passenger planes from operating severely erodes profitability. Two-thirds of the world's passenger planes in 2020 lay unused on runways or in hangars, and upwards of 18 airlines filed for bankruptcy during that time. The airline industry posted a loss of about $320 billion in passenger revenue in 2020.

How Do Airlines Make Money?

Airlines receive the bulk of their revenue from tickets but also generate income from fees, food, credit card usage, frequent-flyer programs, movement of cargo, and—at times—government bailouts. Emirates uses all these means to make money.

On average, business travelers account for about 12 percent of global airline-ticketed passengers but 60 to 75 percent of revenues, as business-class tickets can cost upwards of 10 times the price as coach. Corporations are often willing to pay for business-class flights as well-rested and less-stressed employees are worth the additional cost of business-class travel. Although the advent of Zoom and other means of video conferencing is curtailing business travel significantly, video conferencing is nothing new, and business travel has been in demand for the last 20 years.

Affluent travelers are a significant source of income for airlines as they often purchase business-class seating, and Zoom is no replacement for a fancy vacation. To take advantage of business and high-end vacation travelers, airlines are catering more and more to business-class customers. Even traditionally low-cost firms such as Texas-based Southwest Airlines and European carrier RyanAir are competing more aggressively for these customers.

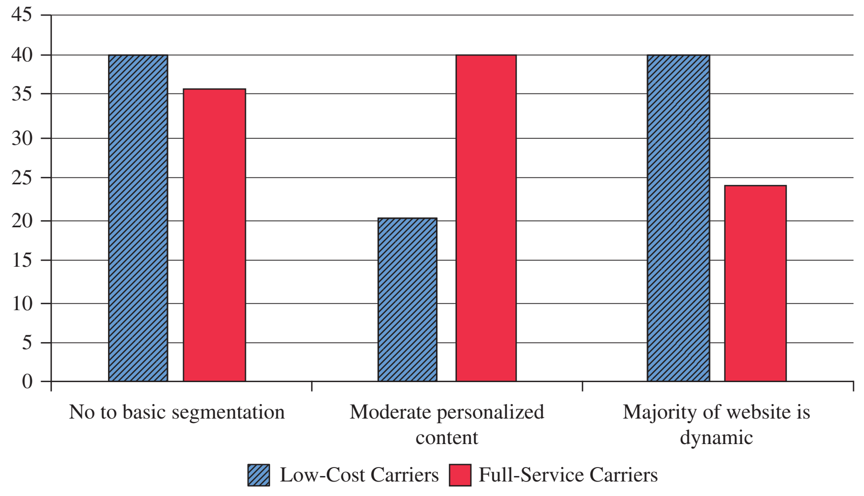
Airlines benefit immensely from their frequent flier programs and also from credit cards linked to these programs. High-income customers tend to purchase more flights with these cards. Moreover, the use of these cards in day-to-day purchases provides significant data for marketing and strategy. These frequent flier miles programs can be worth more than the very airlines that own them; they are so profitable that airlines are able to offer more attractive pricing on tickets as well as more and better routes. Many of the rewards earned by customers are not redeemed, further profiting the airlines.

Personalized Websites

Customers today demand increased flexibility and options in the products and services they buy, and this is also true of how they purchase airline tickets. This shift in buying behavior has challenged airlines to produce increasingly modern websites that are even more user-friendly and personalized. Exhibit 6 reveals, perhaps surprisingly, that with respect to home pages that are dynamic and effective in nature, low-cost carriers are performing significantly better than full-service carriers. Offering customers customizable features, nudging tactics, personalized widgets, etc. create a meaningful experience and help increase brand loyalty.

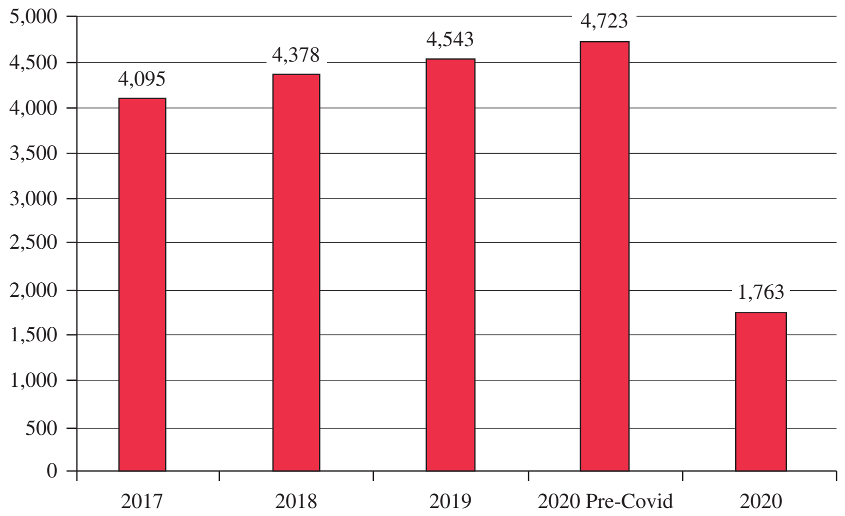
Exhibit 7 reveals that airline travel in terms of passengers is increasing around 3.5 percent annually and is expected to continue at this rate once travel restrictions normalize. The Asia-Pacific region leads the world, with 33 percent of all global travel originating or concluding in this region. However, one of the main drivers of growth in air travel is the doubling of low-cost carriers' market share from 2005 to 2020. The global middle class is also rapidly growing, especially in China, and many countries and cities are actively engaged in airport infrastructure investment.

EXHIBIT 6 Low-Cost vs. Full-Service Airlines; Nature of Their Corporate Website (in percentage)



Source: Based on information from a variety of sources, including McKinsey's *Global Airline Survey,* July 2020.

EXHIBIT 7 Scheduled Ticketed Passengers in Global Airlines Industry (in millions)



Source: Based on information from a variety of sources, including *Statistica*.

Conclusion

As the pandemic wanes, consumer demand for both business and leisure air travel is expected to return and grow upwards of 5 percent annually even as video conferencing and online meetings become the new normal. The Emirates Group has achieved a global reputation for excellence and seems poised to take advantage of the new normal. But Emirates faces many challenges, threats, and competitors.

But there are opportunities for the Emirates Group too. For example, as mentioned in the case, the pandemic bankrupted numerous airline companies, and these could be acquired by Emirates at a good price. Similarly, there are also many airport ground handling service companies that could be acquired by dnata. Can you identify the best candidates on both fronts for CEO Sheikh Al Maktoum to consider bringing into the fold?

There are many viable strategic options that could benefit the company moving forward. Strategic planning is about making tough choices, as no firm can do everything that will benefit the enterprise; there simply are not enough funds or people, especially in lean times with the effects of the pandemic still lingering.

The Emirates Group needs a comprehensive strategic plan developed to most effectively allocate scarce resources. Can you conduct the research and perform the analyses necessary to provide this strategic report to the CEO and top management of the company? Make sure that your report includes a recommended new vision and mission statement for the company as no such content is currently available.

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General Electric, Inc.—2018

www.GE.com, GE

Headquartered in Boston, Massachusetts, General Electric (GE) ranked thirteenth among the *Fortune* 500 largest companies by gross revenue. In the 2017 letter to shareholders, GE CEO John Flannery promised to "own up" to the current state at GE with employees and shareholders. 2017 was a difficult year for GE financially, losing over $5 billion with CEO Flannery calling 2017 "a very tough year." Most people associate GE with some appliance in their homes or a light bulb, and GE does make these devices, but the firm also is heavy into building jet engines, high-tech medical devices, and wind turbines. Every two seconds around the world a plane takes off powered by a GE jet engine, and GE's MRI's (Magnetic Resonance Imaging) cat scans and other medical devices help doctors save over 3,000 lives daily.

GE employs 313,000 people that live and work in over 180 countries. The company is still highly diversified. For example, in March 2018, GE's Marine Solutions division was chosen by ASMAR Shipyards in Talcahuano, Chile, to provide an integrated marine propulsion system for the Chilean Navy's new Antarctic icebreaking Polar Class vessel. The new vessel will anchor the Chilean navy's Antarctic expedition for search and rescue missions, scientific research, logistic support, and resupplying bases in the Chilean Antarctic Territory. The 350-foot long vessel will have GE's full marine propulsion system, including diesel-electric propulsion, GE's International Maritime Organization's (IMO) Tier 3-compliant diesel engine, a complete propulsion shaft line and propeller, a tunnel thruster, SeaStream Dynamic Positioning (DP), and vessel automation system. With the GE installed power of 14.5 megawatts, the vessel will be capable of breaking 1 meter of ice at 3 knots.

On May 23, 2018, GE's corporate value declined about $10 billion in market capitalization that single day, in what amounted to the worst GE trading day percentage-wise loss since the height of the financial crisis in early 2009. That day GE's stock price dropped 7.4 percent as CEO John Flannery spoke at an annual Electrical Products Group conference in Florida. GE is in financial trouble as it divests assets and faces a dilemma of whether to use those funds to shore up the firm's balance sheet or distribute those funds to shareholders. The iconic American company needs a good strategic plan going forward.

History

In 1890, Thomas Edison brought his various businesses together under the name Edison General Electric Company. Upon a merger with then rival, Thomson-Houston Company, General Electric (GE) was formed. GE was incorporated in 1892 and in 1896 became one of the original 12 companies listed on the newly formed Dow Jones Industrial Average. GE remains today the only original company listed on the Dow Index. GE has been buying and selling companies for over a century, becoming one of the most diversified companies on the planet. However, this diversification eventually led to its demise and today GE is divesting, trying to become more homogeneous. Under the leadership of Chairman and CEO Jack Welch from 1981 to 2001, GE became the classic, revered diversified company that many other firms tried to emulate. When Welch retired from GE in 2001, he received the largest severance payment ever— $417 million. Welch had joined GE in 1960 as a chemical engineer. From 1973 to 1979, Welch was head of GE's strategic planning division. Welch became GE's youngest CEO in 1981.

In February 2017, GE announced intentions to close its gender gap by hiring 20,000 women in technical roles by the year 2020. GE is also seeking to have a 50:50 male to female representation in all entry-level technical programs. In October 2017, GE announced they would be closing research and development centers in Shanghai, Munich, and Rio de Janeiro. The company spends about $5 billion on R&D annually.

On May 9, 2018, GE Renewable Energy announced its first wind energy project in Chile with Arroyo Energy Compañía de Energías Renovables Limitada whereby GE will supply six 3.6 MW wind turbines with 137-meter rotors and 110-meters tower. The machines will be installed at Chile's El Maitén and El Nogal wind sites in the south of the country, representing a total of 21,8 MW. Chile already has 1.7 GW of wind power capacity installed and 4.9 GW of renewable energy capacity overall. The Chilean government's "Energía 2050" plan calls for about 60 percent of the country's energy demands to be met with renewable energy sources by 2035, and 70 percent by 2050.

GE's new $200 million new corporate headquarters will be named "GE Innovation Point." Completion of the project is scheduled for mid-2019.

Vision/Mission

Although GE does not use the terms vision and mission, the corporate website implies that the firm's vision is to become the world's premier digital industrial company. The corporate website also implies that GE's mission is "to be a focused industrial leader of unmatched scale and diversity, committed to shareholder value, with high-value businesses in critical industries, positioned to lead in a new digital era."

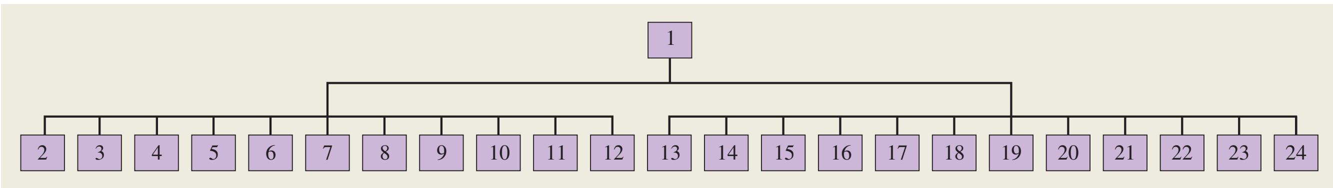
GE is a customer-oriented company. Instead of solely focusing on the number of gas turbines, wind turbines, jet engines, or CT scanners produced and sold, the firm's ultimate purpose is couched as follows (paraphrased): We work to help children in distant villages get access to electricity for the first time; we work to help travelers who get home safely; we work to help patients receive better diagnoses and treatments in the moments that matter most; we understand customer needs and deliver outcomes for them—when we all view business this way, we end up in a good place for our customers, employees, and owners.

Internal Issues

Organizational Structure

CEO John Flannery was appointed CEO of GE in August 2017 and Chairman in October 2017. He has a 30-year career at GE, most notably on turning around GE's Healthcare segment that generates about $20 billion in revenues annually. CFO Jamie Miller is new since November 2017 along with four other new CEOs of divisions. Mr. Flannery is moving quickly in putting new people in high positions within the firm. In addition, GE's 23-member board is being reduced in 2018. As illustrated in Exhibit 1, GE's organizational structure is basically divisional, with numerous CEO's, but with all 24 top executives reporting to CEO Flannery.

EXHIBIT 1 GE Top Executives and Organizational Chart



1. John Flannery, Chairman and CEO of GE
2. Jay Ireland, President and CEO of GE Africa
3. Sue Siegel, Chief Information Officer at GE, and CEO of GE Ventures
4. David Joyce, Vice Chair of GE and President and CEO of GE Aviation
5. Russell Stokes, SVP of GE, and President and CEO of GE Power
6. Jérôme Pécresse, President and CEO of GE Renewable Energy
7. Rafael Santana, President and CEO of GE Transportation
8. Paul McElhinney, SVP of GE, and President and CEO of Power Services
9. Kieran Murphy, President and CEO of GE Healthcare
10. Duncan Berry, CEO of LM Wind Power
11. Lorenzo Simonelli, SVP of GE, and President and CEO of Baker Hughes
12. William Ruh, SVP & Chief Digital Officer, CEO of GE Digital
13. Victor Abate, SVP and Chief Technology Officer
14. Alex Dimitrief, SVP and General Counsel
15. Matthew Cribbons, VP, Investor Communications
16. Jan Hauser, VP, Controller, and Chief Accounting Officer
17. Daniel Janki, SVP, GE Treasurer and Global Operations
18. Raghu Krishnamoorthy, SVP and Chief HR Officer
19. Deirdre Latour, VP, Senior Advisor and Chief Communications Officer
20. Puneet Mahajan, VP, Financial Planning and Analysis
21. Jamie Miller, SVP and CFO
22. Jamey Mock, VP, Audit Staff
23. Alec Burger, VP and President, GE Capital
24. William Ruh, SVP & Chief Digital Officer, and CEO or GE Digital

Source: Based on the company's 2017 *Annual Report,* other company documents, and a variety of other sources. GE's most recent list of corporate executives are given at https://www.ge.com/about-us/leadership/executives.

Current Strategies

GE's 2017 *Annual Report* describes the firm's overall strategy as focusing upon four key areas: 1) Outcomes for customers, 2) GE's businesses, 3) Cash flow, and 4) Creating a culture of accountability. When discussing creating outcomes for customers, GE is not simply referring to the total number of jet engines or CAT scanners it manufactures, rather how the firm's actions impact the lives of customers in addressing their needs. For example, GE also considers outcomes to be: providing cleaner energy, better diagnoses of diseases, or simply being there for customers when nobody else is. One of GE's largest customers, American Airlines, through their CEO Robert Isom routinely thanks GE and says "American Airlines depends on a strong GE." Using data analytics, GE produces a turboprop engine that has 10 percent more power than rival products with 20 percent fuel efficiency. This is just one example of many in how GE is working to improve the lives of its customers while providing measurable outcomes other than simply raw number of products produced to gauge its success.

GE's CEO announced in the 2017 *Annual Report* that the firm is moving forward to focus on three key business segments: aviation, healthcare, and renewable energy, which account for the bulk of the firm's revenues and profits aside from the power division, which is currently struggling; GE appears to be moving away from devoting resources to power generation. Earnings were down 45 percent for power in 2017, and it appears GE is currently entering a retrenchment strategy with this division, as their CEO says "resetting and refocusing." This objective will mainly be executed through cost-cutting and counting on improved developments in sub-Saharan Africa. To date, there are 600 million people living in sub-Saharan Africa without electricity.

GE is heavily focused on cash management, which is another way GE is saying it wishes to cut costs and become more efficient. In 2017, GE cut costs of $1.7 billion and has a target to cut an additional $2 billion in 2018. GE's cost-cutting measures currently include reducing dividends, laying off employees, reducing overhead, reducing inventory, and attempting to cut costs on all products. In addition, senior executive bonuses are being tied more closely to performance.

Buying and Selling Divisions

Consistent with the company's long history of buying and selling businesses, in 2015, GE Capital divested its transportation-finance unit to Canada's Bank of Montreal. In 2016, Haier Group acquired GE's appliance division for $5.4 billion. In 2017, GE received final approval to combine its GE Oil and Gas segment with Baker Hughes to create a separate publicly traded company controlled by GE.

GE acquired several firms in 2017 including ServiceMax and LM Wind Power. In total, the two acquisitions cost GE $2.6 billion, but should improve GE's cloud technology and wind turbine production. LM Wind Power was one of the largest wind turbine blade producers in the world. GE divested its water business for $3.1 billion and has an agreement to sell its Industrial Solutions business for $2.6 billion to ABB Group based in Zurich, Switzerland. Both the Water business and Industrial Solutions business were contained within GE Power. GE expects to sell its non-U.S. lighting business by mid-2018, subject to completing the paperwork and passing legal compliance with various local and national governments.

Finance

The year 2017 was a difficult year for GE financially, with revenues down 1 percent, but net income down significantly due to increased cost of goods sold and operating expenses. The firm was forced to cut its quarterly dividend substantially from $0.24 per share to $0.12 cents per share and lay off thousands of workers, but still paid $12.1 billion in dividends and stock buybacks. The firm did benefit greatly from tax reform with over a $3 billion tax credit. CEO Flannery has indicated over $20 billion of industrial assets will be divested moving forward, including substantially reducing the size of its poorest performing division, GE Capital, which alone lost over $6 billion in 2017.

GE's recent income statements and balance sheets are provided in Exhibit 2 and Exhibit 3, respectively. Note the declines in both revenues and net income. Note also the $13 billion increase in Goodwill on the 2017 balance sheet, indicating that the company is still paying arguably too much for its acquisitions.

EXHIBIT 2 GE's Income Statements (in millions USD)

Income Statement	12/31/16	12/31/17		Percent Change
Revenues	$123,693	$122,092	↓	–1.29%
Cost of Goods Sold	90,280	104,102	↑	15.31%
Gross Profit	33,413	17,990	↓	–46.16%
Operating Expenses	19,358	21,912	↑	13.19%
EBIT	14,055	(3,922)	↓	–127.90%
Interest Expense	5,025	4,869	↓	–3.10%
EBT	9,030	(8,791)	↓	–197.35%
Tax	(464)	(3,043)	↑	555.82%
Non-Recurring Events	0	(38)	NA	NA
Net Income	9,494	(5,786)	↓	–160.94%

Source: Based on 2017 *Annual Report* and other company data.

EXHIBIT 3 GE's Balance Sheets (in millions USD)

Balance Sheet	12/31/16	12/31/17		Percent Change
Assets				
Cash and Short-Term Investments	$92,442	$81,996	↓	–11%
Accounts Receivable	42,263	41,075	↓	–3%
Inventory	22,354	21,923	↓	–2%
Other Current Assets	0	0	NA	NA
Total Current Assets	157,059	144,994	↓	–8%
Property Plant & Equipment	52,263	58,117	↑	11%
Goodwill	70,438	83,968	↑	19%
Intangibles	16,436	20,273	↑	23%
Other Long-Term Assets	68,987	70,593	↑	2%
Total Assets	**365,183**	**377,945**	↑	**3%**
Liabilities				
Accounts Payable	14,435	76,297	↑	429%
Other Current Liabilities	67,145	44,713	↓	–33%
Total Current Liabilities	81,580	121,010	↑	48%
Long-Term Debt	105,080	108,575	↑	3%
Other Long-Term Liabilities	98,008	80,699	↓	–18%
Total Liabilities	284,668	310,284	↑	9%
Equity				
Common Stock	702	702	→	0%
Retained Earnings	139,532	125,682	↓	–10%
Treasury Stock	(83,038)	(84,902)	↓	–2%
Paid in Capital & Other	23,319	26,179	↑	12%
Total Equity	80,515	67,661	↓	–16%
Total Liabilities and Equity	**365,183**	**377,945**	↑	3%

Source: Based on 2017 *Annual Report* and company data.

GE Segments

GE operates in eight divisions with Aviation and Healthcare being the leaders in profits, and Power being the leader in total revenues. Managing segments effectively and efficiently always has been and remains the key for GE to prosper; the firm is trying to get back on course in this regard. CEO Flannery has indicated GE will scale back its Capital Division and Expand Aviation and Healthcare along with Renewable Energy which is viewed as the future.

GE Power

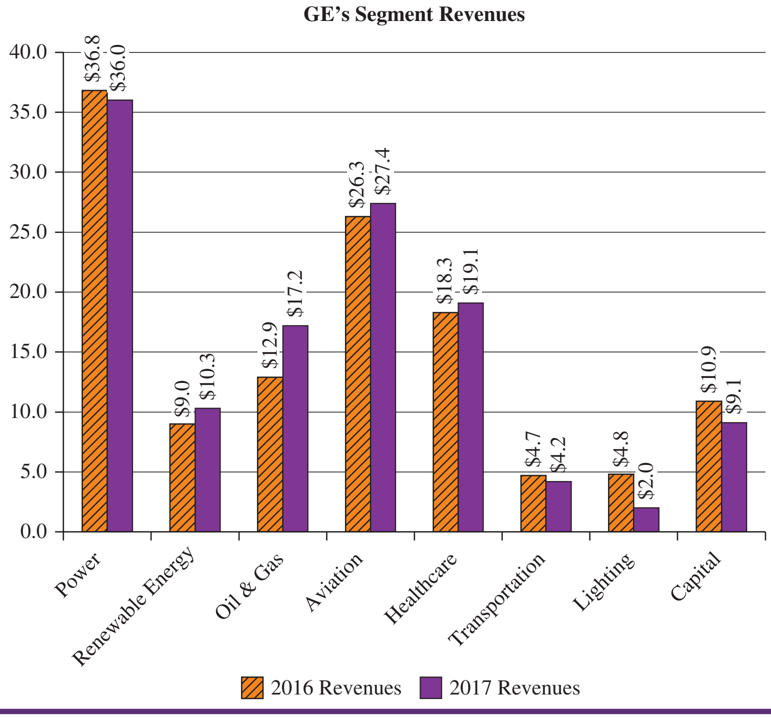
GE Power has a mission to provide affordable, reliable and sustainable energy to customers around the world. Major products GE produces within this division include: gas & steam turbines, generators, high voltage equipment, engines, and digital solutions. As revealed in Exhibits 4 and 5, revenues from the Power segment in 2017 declined slightly, but profits declined significantly in 2017. GE maintains a 50 percent market share in the heavy-duty turbine market; however this same market is plagued by overcapacity and declining prices and is a declining industry overall. With lower profit margins down 7 percent in 2017 alone, orders down 13 percent, and GE being such a substantial player in the turbine market, resources devoted to this division may be diverted to faster-growing areas such as renewable energy.

GE Power is further plagued by lower upgrade demand (customers are simply happy with their current products), supply chain over capacity, and difficulty in customers obtaining financing. The outlook for this industry looks bleak moving forward with a possible tactic of focusing on operational efficiencies and slowly moving capital resources to other divisions. The Power Division at GE can be in some cases considered a Cash Cow on a BCG Matrix as GE is clearly the market leader, but industry-wide revenues/profits are not attractive. GE's Power revenues from the United States totaled $11.3 billion with revenues from international operations totaling 24.7 billion, led by the Middle East and Africa region at $8.0 billion in revenue. In total, worldwide, about half of the division's revenue was derived from equipment and half from services.

GE Renewable Energy

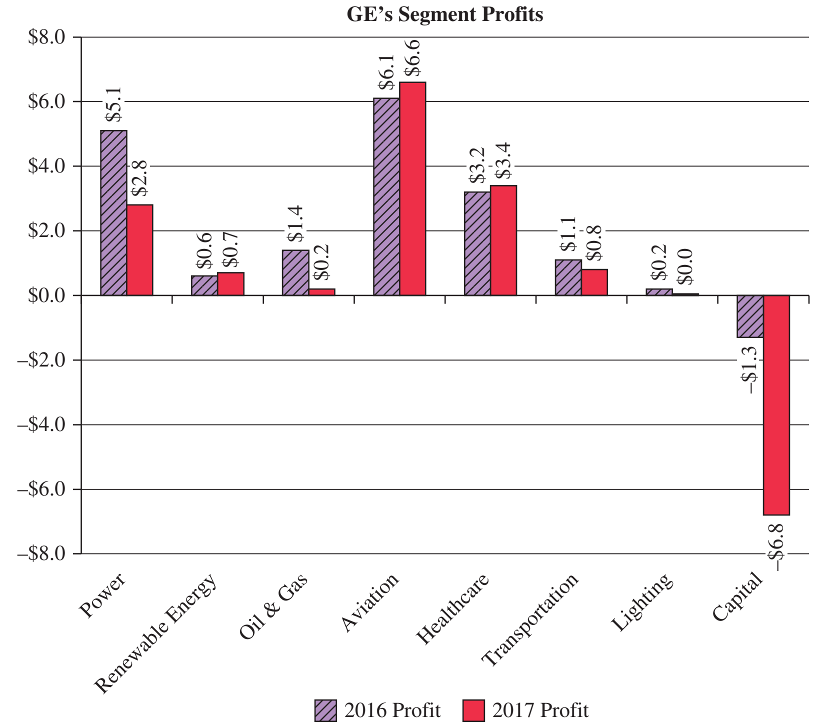
GE Renewable Energy provides the same mission as its Power Division except with focus on renewable energy sources. Key products are wind turbines and hydropower solutions. Profit margins are up 7 percent in 2017 with a backlog increase of 15 percent indicating GE is not effectively meeting demand. Increased competition resulting in lower prices and improvements in quality may keep pressure on profit margins in this industry moving forward. Revenues from the United States totaled $4.8 billion with revenues from international operations totaling $5.4

EXHIBIT 4 GE's Segment Revenues (in billions USD)



Source: Based on the GE 2017 *Annual Report* and other company information.

EXHIBIT 5 GE's Segment Profits (in billions USD)



Source: Based on 2017 *Annual Report* and other company information.

billion, led by the Americas region with $2.0 billion in revenue. Equipment accounted for 79 percent of the division's revenues with services accounting for the balance. Onshore wind accounted for 86 percent of the division's revenues; offshore wind only accounted for 3 percent. Hydropower accounted for the remaining 11 percent of divisional revenues.

GE Oil and Gas

GE Oil and Gas appears to be a relic of the past. GE does not engage in drilling like a large oil company, instead, GE provides the digital solutions and equipment that help oil firms find and extract oil and gas products. Key products include: turbo-machinery, equipment, and digital solutions. The division's stated mission is to provide these products across the oil and gas value chain. Interestingly, GE used the term value chain here, as it is probable GE is operating on the least profitable area of the value chain in this industry, an area with very poor profit margins. The division's profit margins declined 1.3 percent in 2017, but studying Exhibits 4 and 5, it is clear to see substantial revenue with minuscule profits. Orders were up 56 percent in 2017 for the division, so GE as a whole is actually increasing its commitment to the poorest performing division from a profit margin perspective other than GE Capital.

GE revenues from the U.S. Oil and Gas segment totaled $4.4 billion with revenues from international operations totaling $12.8 billion led by the Middle East and Africa region at $4.8 billion in revenue. In total, worldwide, about 40 percent of the division's revenue was derived from equipment and half from services.

GE Aviation

If constructing a BCG Matrix, GE Aviation likely lands in the Quadrant labeled Stars, certainly if the BCG focused on the narrow industry GE operates within in both segments. GE's Aviation Division in 2017 enjoyed a profit margin increase of 24 percent with orders and a backlog up 12 and 10 percent, respectively. The division is on a mission to design and manufacture advanced engines and systems for its customers. The bulk of profits in this division are derived from both commercial and military engines, but the division also produces aviation systems and other machinery needed to support flight. The demand for aircraft engines is expected to be robust in the future as millions of people in China and India, and other emerging markets are increasingly able to afford air travel. Revenues from the United States totaled $10.8 billion with revenues from international operations totaling $16.6 billion led by the Europe region with $6.2 billion in revenue. Equipment accounted for 36 percent of the division's revenues with services accounting for the balance. Commercial engines and services accounted for 73 percent of the division's revenues with military and systems only accounting for 14 and 13 percent.

GE Healthcare

GE Healthcare is a booming business as evidenced by Exhibits 4 and 5. Profit margins were up 18 percent in 2017 with orders and backlogs up 6 and 8 percent, respectively. The division is on a mission to create precision healthcare through delivering outcomes. Interesting use of the word "outcomes" in the division's mission as CEO Flannery suggested the firm will start measuring itself on outcomes rather than simply how many products were produced or what the quarterly or yearly income was for a division. Recall that CEO Flannery became CEO of GE after heading up the Healthcare Division. Growth in emerging markets is huge for this division and in markets such as the United States and Europe; populations are aging everywhere. Revenues from the United States totaled $8.6 billion with revenues from international operations totaling $10.6 billion led by the Asia region with $4.9 billion in revenue. Equipment accounted for 62 percent of the division's revenues with services accounting for the balance.

GE Transportation and Lighting

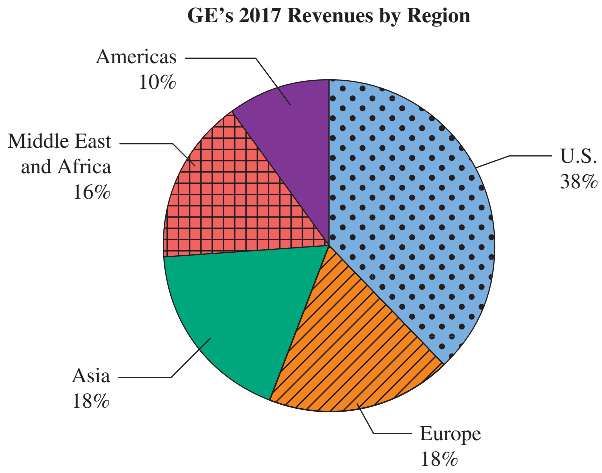
GE Transportation and Lighting only account for about 5 percent of 2017 revenues. GE transportation supplies the railroad, mining, and marine industry with engines, equipment, locomotives, and digital solutions. GE Lighting focuses on LED technology and creating smart lighting situations for homes and businesses. Both transportation and lighting saw profit margins, revenues, and profits all decline in 2017, however, neither business is a major player in GE's overall portfolio of products. Currently, the majority of GE's non-U.S. lighting business is expected to be sold in 2018, which accounted for $500 million in sales in 2017 compared to $1.5 billion for U.S. lighting operations. GE Transportation revenues for the United States were $2.4 billion to $1.8 billion for non-U.S.

GE Capital

GE Capital helps to finance customers' orders, provides product support, and invests in markets with longer-term hopes of turning a profit. Currently, GE is drastically reducing its exposure to this division, which lost $6.8 billion in 2017. About $4.4 billion in revenues were derived from the United States and $4.7 billion derived from outside the United States in 2017.

Exhibit 6 reveals the bulk of GE's 2017 revenues are derived from outside the United States. One interesting fact not revealed in Exhibit 6 is revenues in every region increased in

EXHIBIT 6 GE's Revenues by Region as a Percent of GE Total Revenues



Source: Based on 2017 *Annual Report* and other company information.

2017 except for the U.S. division, where revenues declined enough to create an overall decline of 1 percent companywide. GE did not provide detailed breakdowns on product data in various regions, but from a close examination of Exhibit 4, it is difficult to attribute any one division's sales in the United States as the principal culprit. Further suggesting that across all product lines, U.S.-based revenues simply lagged international derived revenues.

Competitors

Caterpillar, Siemens, and United Technologies are the largest GE rivals corresponding to the three main GE divisions (power turbines, diagnostic devices, and jet engines, respectively). However, Emerson Electric Company (EMS) and Haier Group Corporation (headquartered in Qingdao, China) are also competitors.

Siemens AG

Headquartered in Berlin and Munich, Siemens is very similar to GE. Siemens is the largest industrial manufacturing company in Europe, but the company has branch offices around the world. Siemens' principal segments are 1) Industry, Energy, Healthcare and 2) Infrastructure and Cities. Siemens is a major producer of medical diagnostics equipment; its medical healthcare division generates about 12 percent of the company's total sales and is its second-most profitable unit after the industrial automation division. Siemens and its subsidiaries employ about 372,000 people worldwide and reported global revenue of around €83 billion in 2017.

Siemens produces gas and steam turbines; generators; compressors; on- and offshore wind turbines; high-voltage transmission products; power transformers; high-voltage switching products and systems; alternating and direct current transmission systems; medium-voltage components and systems; and power automation products. The company also produces all kinds of lighting products such as incandescent, halogen, compact fluorescent, fluorescent, high-intensity discharge and Xenon lamps; opto-electronic semiconductor light sources such as light emitting diodes (LEDs), organic LEDs, high power laser diodes, LED systems and LED luminaires; electronic equipment including electronic ballasts; lighting control and management systems; and related precision components.

Siemens produces all kinds of medical products such as clinical information technology systems; hearing instruments; in-vitro diagnostics equipment; imaging equipment including angiography, computed tomography, fluoroscopy, magnetic resonance, mammography, molecular imaging ultrasound, and x-ray equipment; and radiation oncology and particle therapy equipment. The company also produces transportation and logistics-related products such as equipment and systems for rail transportation including rail vehicles for mass transit, regional and long-distance transportation, locomotives, equipment and systems for rail electrification, central control systems, and automated train controls.

Emerson Electric Company (EMS)

Headquartered in St. Louis, Missouri, Emerson Electric is a technology and engineering company that produces parts and products for the industrial, commercial, and residential markets worldwide. The company's Automation Solutions segment most closely competes with GE. Emerson offers software; measurement and analytical instrumentation; valves, actuators, and regulators; industry services and solutions; process control systems and solutions; and digital plant solutions. Emerson serves oil and gas, refining, chemicals, power generation, pharmaceuticals, food and beverages, automotive, pulp and paper, metal and mining, and municipal water supplies markets.

Caterpillar, Inc. (CAT)

Headquartered in Deerfield, Illinois, Caterpillar manufactures and sells diesel and natural gas engines, industrial gas turbines, and diesel-electric locomotives for construction, resource, and energy and transportation industries. Many of these items compete with GE products. Caterpillar's Energy & Transportation segment produces and markets reciprocating engine powered generator sets; reciprocating engines; integrated systems used in the electric power generation industry; turbines, centrifugal gas compressors, and related services; integrated systems and solutions for the marine and oil and gas industries; remanufactured reciprocating engines and components; and diesel-electric locomotives and components. Many of these items also compete directly with GE.

Haier Group Corporation

In 2016, GE sold its appliances business to Haier Group Corporation of China for $5.4 billion in cash. The GE divestiture included the stake of 48.4 percent that GE Appliances owned in Mabe, a Mexican appliances company. Qingdao Hai'er, a Chinese appliances company, had revenues of about $33 billion prior to acquiring GE Appliance. GE, however, even through 2018, continues to use the GE Appliances brand, and the unit's headquarters remains in Louisville, Kentucky. Since the divestiture, Haier and GE have engaged in joint collaboration on many fronts, including healthcare and advanced manufacturing. In addition, since the acquisition, GE products have been distributed through Qingdao Hai'er in China. At the time of the acquisition, GE Appliances had revenue of about $6 billion and employed about 12,000 people.

United Technologies Corporation (UTX)

Headquartered in Farmington, Connecticut, United Technologies owns Pratt & Whitney (P&W) that competes directly with GE. P&W manufactures aircraft engines for commercial, military, business jet, and general aviation markets, and provides aftermarket maintenance, repair, and overhaul, as well as fleet management services—just like GE. In addition to P&W, United Technologies has an Aerospace Systems segment that provides electric power generation, power management, and distribution systems, as well as numerous air data and aircraft sensing systems, engine control, intelligence, surveillance, and reconnaissance systems.

Exhibit 7 provides a comparison of GE, Emerson Electric, and Caterpillar in 2018. Note that GE is substantially larger than Caterpillar and Emerson, but GE is unprofitable whereas the rival firms are doing quite well.

External Issues

Medical Devices

The medical devices industry had revenues in 2017 of $340 billion, with growth around 5 percent. One key advantage to doing business in this field is the aging population around the world and an increasing birthrate in the developing world. GE produces an array of irradiation devices, or diagnostic imaging devices, including CAT scanner, X-rays, beta-rays, and more. GE is the largest player in the irradiation device market with around 20 percent market share in the United States, followed by Siemens AG and Phillips Healthcare with 10 and 7 percent market shares. Globally, Siemens has 20 percent more revenues than GE in diagnostic imaging sales and GE has 15 percent higher sales than Phillips. Globally, GE ranks eighth based on revenues in all devices under the medical devices umbrella, in which the industry is estimated to have sales over $340 billion. Estimating sales is difficult though

EXHIBIT 7 A Comparison of United Technologies, GE, Caterpillar, and Emerson Electric

	Caterpillar	GE	Emerson	United Technologies
$ Market Capitalization	90B	130B	45B	102B
# of Employees	98K	313K	77K	204K
$ Revenue	45B	121B	15.9B	60B
% Profit Margin	1.7	–4.8	10.9	7.6
$ EBITDA	8.5B	5.13B	3.4B	12.1
% Operating Margin	6.5	–1.8	17.4	13.2
$ Net Income	745M	–5.9B	1.7B	4.6B
% ROA	4.6	–0.37	9.30	5.3
$ EPS	1.26	–0.72	2.48	5.7

Source: Based on a variety of sources.

because estimates may include hospital beds made by Stryker in some estimates, but other estimates may categorize hospital beds as something different than medical devices, which are generally thought of as MRI's CAT scans, X-rays, and other devices discussed earlier. Of the various categories of medical devices in the industry, diagnostic imaging or irradiation devices are third in global sales behind both vitro diagnostics and cardiology. Growth rates are forecasted around 3.3 percent for diagnostic imaging devices but growth near 6 percent are forecasted for the two former areas of medical devices. GE is not a major player in either of these areas.

While the U.S. market is the world's largest and most profitable on virtually everything medical, China, India, Latin America, and the Middle East are increasingly providing opportunities. Asia, in particular, has almost an epidemic, according to some medical experts, with an increasing number of smokers and an increased desire for fast food—accounting for 60 percent of cardiovascular deaths worldwide.

Engines and Turbines

Engines and turbines account for over $50 billion in annual industry sales in the United States, but growth is expected to continue to be flat moving forward. Most of the big players in this industry produce giant diesel engines, such as Caterpillar and Cummings, and these engines account for nearly 30 percent of the sales. Caterpillar and Cummings both operate in turbine power generation, and the largest portion of revenues, at 32 percent, are generated from turbines and turbine-related products. GE's power division is most closely related to this industry, and to a lesser extent, GE's renewable division only because renewables currently do not count for a large portion of either GE's or the power generating industries revenues. Gas-powered turbines still dominate the industry with wind-powered turbines contributing practically nothing to overall industry revenues. Overall, power production has been a poor revenue-generating industry with flat growth expected.

Aviation

The aviation industry in the United States accounts for over $230 billion in annual revenues, with half of that revenue going to exports. Growth has been 4 percent but is expected to decline to 1 percent annually, moving from 2018 to 2023. The industry includes both aircraft builders and engine builders, with GE being the market leader on aircraft engine production. The industry has benefited from an improving U.S. economy and a growing middle class abroad in emerging markets. In total, around 60 percent of industry profits are derived from aircraft construction, while the other 40 percent is split evenly between engines and miscellaneous aircraft parts.

GE's largest aircraft engine competitor is Pratt &Whitney owned by United Technologies Corporation. Pratt & Whitney produces engines for commercial, military, and business. Rolls-Royce is also a player in the jet engine business, being about the same size as Pratt & Whitney, with both firms' combined revenues from jet engines being about the same as GE's. Both firms have larger revenues in the defense industry as a whole than GE. The three firms operate what some consider an oligopoly in the industry. However, Boeing, Airbus, and other airline customers do have bargaining power over the engine producers, so much so that engine manufacturers will even take a loss on the sale of engines to ensure long-term parts, repairs, and maintenance business.

GE also competes to a lesser extent with Boeing, Lockheed Martin, and many others on various aviation services—mostly in the defense-related business, where GE only ranks twenty-fourth globally. Military spending is increasing both domestically and globally with China, India, and Russia leading the way.

There has been significant and growing demand for passenger airlines over the last several years. Boeing has routinely had around 5,700 aircraft on backorder, annually, while over the same timeframe, Airbus has routinely had around 6,700 aircraft on backorder. With this strong demand, both airline producers are continuing to increase production. This is great news for firms like GE who produce the engines used on commercial aircraft. Two aircraft areas that are not performing as well are the jumbo jets and business jets. Engine suppliers are somewhat dependent on the airline manufacturers meeting demand in a timely manner. GE can be as efficient as possible on producing jet engines, but if the planes are not ready, GE suffers.

Global Trade Trends

There is an increased concern among corporations and nations over the rise in protectionism and nationalism. New fears of restrictions in global trade have made some business leaders such as GE's CEO uneasy. GE, for example, sells 60 percent of what they make abroad and would be hampered by new tariffs, reductions to NAFTA and even trade tensions between the United States and China. The United States recently imposed tariffs on steel and aluminum imports. According to GE's Global Innovation Barometer, 55 percent of executives around the world, ironically, indicate they believe further protectionist policies would be beneficial for their business operations. Global trade trends are, however, an issue to be mindful of going forward.

Global Opportunities for GE

While the world is significantly more developed than ever before, many people around the world still lack the basic necessities that many take for granted. Over 600 million people, for example, in sub-Saharan Africa, lack electricity, and in total, 1.5 billion people across the world, or about 20 percent of the world's population still lack basic healthcare, electricity, or modern transportation. Many countries around the world are adding new infrastructure, including the United States; China, for example estimates that by 2020 it will need 3 million additional hospital beds. Southeast Asia's infrastructure spending is increasing by $180 billion each year.

Barriers to Entry

A positive factor for GE going forward is that barriers to entry in both its healthcare and jet engine production are abnormally high. Several key reasons are both industries require high R&D expenditures along with legal and regulatory hurdles to jump. Smaller firms, even if they were able to produce viable products, would have to compete with the relatively few giant firms that produce these devices after extensive negotiations with potential customers. Medical devices also come with heavy patent protection and even if patents have expired, it is difficult to get doctors and hospitals to switch to products produced by a lesser-known firm if the products are not exceptionally better or less expensive upfront to operate. Product liability insurance for medical device manufacturers is higher than in other industries. The high barriers to entry in both industries offer some protection for legacy firms such as GE.

Future

In March 2018, GE Renewable Energy revealed plans to develop the largest, most powerful offshore wind turbine on the planet: the Haliade-X. This turbine features a 12 MW direct drive generator and an industry-leading gross capacity factor of 63 percent. The Haliade-X will produce 45 percent more energy than any other offshore turbine available today. GE is investing more than $400 million in 2018 to 2022 to develop and deploy the Haliade, which will tower 260 meters over the sea, more than five times the size of the iconic Arc de Triomphe in Paris, France. The new Haliade-X 12 MW will house a 220-meter rotor designed and manufactured by GE's LM Wind Power; the 107-meter-long blades will be the longest offshore blades in the industry. One Haliade-X 12 MW turbine will generate up to 67 GWh annually, enough clean power for up to 16,000 households per turbine, and up to 1 million European households in a 750 MW wind-farm configuration.

Between 2018 and 2020, GE plans to sell its 62.5 percent stake in Baker Hughes to strengthen its balance sheet and simplify operations. In July 2017, General Electric had acquired Baker Hughes and merged the affiliate with its oil and gas equipment and services businesses. However, share prices of both the companies plunged after the acquisition and Baker Hughes has lost 39.2 percent of its value in the twelve months following the acquisition.

GE needs a clear strategic plan to guide its path forward to reverse negative profitability. Shareholders, customers, employees, and creditors all expect GE top management to lead the way to a bright future.

Barwa Group—2022

barwa.com.qa

Headquartered in Doha, Qatar, the Barwa Group (Barwa), provides real-estate development, construction, and related financial services throughout the Middle East. With about 200 employees, the company builds residential housing, apartment complexes, condominiums, supermarkets, mosques, shopping centers, and tourist centers. Projects completed since 2012 include properties at Mesaleed, Mesaimeer, Barwa Al Baraha, Madinat Al Mawater, and Barwa Village.

At year-end 2020, Barwa's real-estate portfolio consisted of 8,148 residential apartments; 336,552 square meters of shops, showrooms, and office space; 445,779 square meters of warehouses; and 701 hotel rooms. The average occupancy rate for Barwa properties exceeds 90 percent, so the company is doing quite well. In fact, 81.5 percent of the company's revenue is generated from rental properties, 96.7 percent of the company's operating profit is generated through recurring rental, and the company has a low debt-to-equity ratio of 1:2.

A key part of Barwa's strategic plan for 2021 and beyond is to strengthen its partnership with the government of Qatar, which successfully bid for the 2022 FIFA World Cup, making it the first Muslim and Arab country to host the World Cup. This event is spurring real-estate development in Qatar, which is a further positive for Barwa. Qatar is also set to host the 2030 Asian Games.

Qatar is a country of 3 million people located in the Middle East, on a peninsula in the Persian Gulf. Qatar is known for its beautiful beaches, the Corniche waterfront promenade, the capital city of Doha, and ultramodern architecture. Qatar's neighbor to the south is Saudi Arabia; the island country of Bahrain is to Qatar's northeast. A very wealthy country due to its huge oil reserves, Qatar is basically surrounded by water in the Gulf of Bahrain. The world-renowned Al Jazeera Media Network is based in this country. The overwhelming majority of the country's residents are expatriates, with migrant laborers making up a significant percentage, hence the Barwa Al Baraha project in the next section.

History

Barwa was founded in 2005 and is today listed on the Qatar Stock Exchange with the ticker symbol BRES. In 2009, the company began building 1,000 residential housing units in Mesaimeer along with a supermarket, nursery, and mosque. In 2010, the company completed is Barwa Al Baraha project, a city designed for laborers, in the Al Wakrah area. In 2017, Barwa began building its Madinat Al Mawater project, designed to include hundreds of apartments as well as used-car lots, shops, and warehouses. Today, Barwa is Qatar's largest real-estate development and managing company.

Vision/Mission

Barwa strives to help implement the Qatar National Vision 2030 sponsored by His Highness Sheikh Tamim bin Hamad Al Thani, the Emir of Qatar. His family has ruled Qatar for two centuries.

In Barwa's vision statement, featured on the corporate website, the focus is on reliability, values, and sustainability, centered on its stakeholders.

Barwa's mission statement is a simple proposition of developing superior home, office, and entertainment spaces with efficiency. The vision and mission statements can be viewed on the company's website: www.barwa.com.qa/en.

Internal Issues

Key Projects

In their mid-year 2021 report, Barwa reported that work continues on several new projects, including the following:

1. The third phase of the Mawater City Project, which began in August 2019 on 418,000 square meters of land, includes 118 galleries, a hypermarket, car service centers, a car parts center, and a showroom for an automobile agency. This phase is an extension of Phases 1 and 2 of the project.
2. The Qatar Schools Project Development Agreement, implemented by Qatar's Public-Private Partnership system, is expected to complete in May 2022 and service 6,000 students, with Barwa receiving guaranteed rental income for a period of 25 years.
3. Construction work continues on Madinatna, within the city of Al-Wakra, which is intended as a residential city for families, and in Baraha Al Janoub, which is a workers' city. Development work on the two projects is expected to be completed in April 2022. Madinatna has capacity for accommodate 6,780 residential apartments that can house a total of 27,000 people. Barahat Al Janoub is to consist of 1,404 apartments and can accommodate 67,360 workers.
4. In 2020, Barwa started selling residential units of the Dara (A) project in Lusail City, consisting of 4 five-floor residential buildings that each comprise 271 apartments.
5. The Mukaynis Compound residential city project consists of 3,170 residential villas that can accommodate more than 100,000 workers.
6. Phase 2 of the Al Khor workers sports complex has 516 apartments, a hypermarket, and a multi-purpose hall.

Segments

Barwa operates under four broad segment categories: 1) real estate developments in Qatar, 2) international real estate, 3) business services, and 4) infrastructure services. However, the Barwa 2020 *Annual Report* discusses the company's segments in terms of 9 categories: 1) Residential, 2) Mixed Use & Commercial, 3) Industrial, 4) Worker Accommodation, 5) PPP Development Program, 6) Land Bank, 7) International Real Estate Investments, 8) Independent Subsidiaries, and 9) International Associate Companies.

The Residential segment includes Madinatna, Dukhan City Project, Alaqaria Tower, and Alaqaria Projects Mesaieed. The Mixed Use & Commercial segment includes Barwa Village, Madinat Mawater, and Barwa Al Sadd. The Industrial segment includes Umm Shahrain Warehouses (38 retail shops, 13 electrical substations, roads, and firefighting systems) and Al Baraha Workshops & Storage. The Workers Accommodation category includes Workers Accommodation in Barwa Al Baraha, Mukaynis Compound, Al Khor Workers Sports Complex, and Barahat al Janoub. "Public–Private Partnership" (PPP) Development includes the Qatar Schools operations. Land Bank includes Lusail Land and Phase 3 of Barwa Al Baraha, Phase 3 of Barwa City, Phase 2 of the Dara project, and Barwa Al Doha. International Real Estate Investments include North Row and Cavendish Property in London, Marrakesh Project and Fez Project in Morocco, Larnaca Land in Cyprus, Bahrain Bay Project in Bahrain, and Riyadh Land Plot in Riyadh. Independent Subsidiaries include Waseef and Qatar Project Management. International Associate Companies include Nuzul Holdings in Bahrain and Shaza Hotels Company in Saudi Arabia, Oman, and the United Arab Emirates.

As indicated in Exhibit 1, Barwa uses neither of the above-mentioned potential segment breakdowns when providing financial data to the public. Exhibit 1 provides revenue and profit information for Barwa by segment, but note that the segments are broad categories rather than specific projects, products, locations, cities, or regions. If the company has more revealing segment data, and it quite assuredly does, it does not make such information available to the public.

Organizational Structure

Barwa has various segments described in nebulous ways on its corporate website and in its 2020 *Annual Report*, and no organizational chart or clear specification of top executive responsibilities is given in either place. Based on what is provided, however, the company apparently operates

EXHIBIT 1 Barwa's Segments' Revenue and Profits for 2019 versus 2020 (in QR 000)

External Parties	Real Estate		Business Services		Other Services	
	2019	**2020**	**2019**	**2020**	**2019**	**2020**
Profit on sale of property	3,344	8,577	–	–	–	–
Rental income	1,179,581	1,334,131	–	–	–	–
Income from consultancy & other services	–	–	164,304	189,242	191,940	113,575
Finance lease income	20,101	10, 857	–	–	–	–
Net fair value gain on investment properties	1,142,600	786,413	(15,172)	–	–	–
Others	–	–	–	–	27,700	128,782
Internal Segment	100,395	118,923	–	–	–	–
Total revenues and gains	2,446,021	2,258,911	249,226	316,201	(219,640)	242,357
Segment profit	1,766,068	1,527,667	20,152	47,118	144,155	273,942

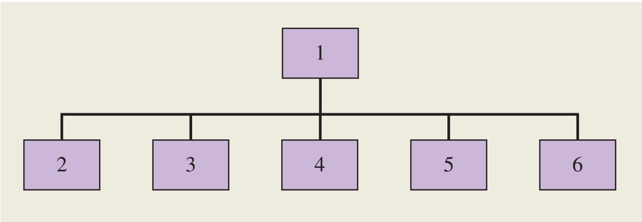
Source: Based on information in the Barwa 2020 *Annual Report*, pp. 107–108.

utilizing a functional (centralized) organizational design, because there are no divisional head persons listed by title or otherwise, either on the corporate website or in the company's 2020 *Annual Report*.

Based on all the segment information provided above, albeit disjointedly in the company's disclosures, Barwa is clearly a projects-oriented company, being a construction firm with various ongoing projects either in the construction phase or completed and managed. Historically, of all the types of organizational structure, a matrix-type design is generally the most effective and efficient for this type of firm.

Let us examine how Barwa is currently organized. Exhibit 2 provides a list and array of Barwa's top executives. Note that there are no top executives specified for the company's various projects, products, regions, or otherwise, thus indicating a very centralized operation. Executive titles do not align with company segments, which is a problem for the firm.

EXHIBIT 2 Barwa's Top Executives Listed and Arrayed



1. Abdullah Bin Jubara Al-Rumaihi, CEO of Barwa Real Estate Group
2. Yousuf Ahmad Al-Binali, Chief of Corporate Operations
3. Mohammed Ibrahim Al-Emadi, Chief Asset Management Officer
4. Ahmed Ibrahim Al Darwish, Chief Development Officer
5. Tamer Elsayed Mohamed, CFO
6. Dana Abdul-Aziz Al-Ansari, Director of Legal and Compliance

Source: Based on information at www.barwa.com.qa/en/AboutBarwa/BarwaManagement/ExecutiveManagement as well as the Barwa 2020 *Annual Report*, pp. 82–85.

Finances

In August 2021, Barwa released its financial results for the 6-month period ending June 30, 2021, revealing a net profit of QR 533 million, total assets of QR 35 billion, and total equity of over QR 20 billion. In the interim report, Barwa presented a 41 percent increase in rental income, accompanied by a 34 percent decrease in general and administrative expenses.

Barwa's recent fiscal year-end 2019 and 2020 financial statements are provided in Exhibits 3 and 4. Note the 8 percent drop in revenues and 19 percent drop in net income in 2020; the company says that COVID-19 was the root cause.

EXHIBIT 3 Barwa's Recent Income Statements (in thousands of QR)

Income Statement	12/31/19	12/31/20		Percent Change
Revenues	2,776,265	2,561,443	↓	–8%
Cost of Goods Sold	–	–	NA	NA
Gross Profit	2,776,265	2,561,443	↓	–8%
Operating Expenses	947,866	1,019,723	↑	8%
EBIT	1,828,399	1,541,720	↓	–16%
Interest Expense	308,497	299,877	↓	–3%
EBT	1,519,902	1,241,843	↓	–18%
Tax	14,762	27,142	↑	84%
Non-Recurring Events	–	–	NA	NA
Net Income	1,505,140	1,214,701	↓	–19%

Source: Based on Barwa's 2020 *Annual Report*, p. 101.

EXHIBIT 4 Barwa's Recent Balance Sheets (in thousands of QR)

Balance Sheet	12/31/19	12/31/20		Percent Change
Assets				
Cash and Short-Term Investments	1,254,716	746,157	↓	–41%
Accounts Receivable	529,728	602,122	↑	14%
Inventory	–	–	NA	NA
Other Current Assets	30,619	35,792	↑	17%
Total Current Assets	1,815,063	1,384,071	↓	–24%
Property Plant & Equipment	726,420	675,175	↓	–7%
Goodwill	–	–	NA	NA
Intangibles	132,411	132,411	↓	0%
Other Long-Term Assets	29,273,756	30,963,387	↑	6%
Total Assets	31,947,650	33,155,044	↑	4%
Liabilities				
Accounts Payable	1,671,610	1,834,249	↑	10%
Other Current Liabilities	61,014	42,800	↓	–30%
Total Current Liabilities	1,732,624	1,877,049	↑	8%
Long-Term Debt	9,736,129	10,082,855	↑	4%
Other Long-Term Liabilities	417,420	682,589	↑	64%
Total Liabilities	11,886,173	12,642,493	↑	6%
Equity				
Common Stock	3,891,246	3,891,246	↓	0%
Retained Earnings	9,781,402	10,186,699	↑	4%
Treasury Stock	–	–	NA	NA
Paid in Capital & Other	6,388,829	6,434,606	↑	1%
Total Equity	20,061,477	20,512,551	↑	2%
Total Liabilities and Equity	**31,947,650**	**33,155,044**	↑	4%

Source: Based on Barwa's 2020 *Annual Report*, p. 100.

At the end of 2020, Barwa has foreign currency risk exposure in 8 instruments, the largest being the U.S. dollar, as indicated in Exhibit 5. This degree of exposure reveals the company's degree of confidence in the respective currencies.

EXHIBIT 5 Barwa's Foreign Currency Risk Exposure in 2019 versus 2020 (in thousands of QR)

	2019	2020
USD	6,341,114	5,973,571
EURO	792	1,396
KWD	17,195	17,189
GBP	107,338	100,215
TRY	7,337	6,440
EGP	7,138	6,267
AED	1,995	2,000
SAR	83,490	101,882

Source: Based on Barwa's 2020 *Annual Report*, p. 155.

Strategy

Barwa is currently studying the economic feasibility of many development projects put forward by the Public Works Authority under Qatar's Public-Private Partnership system. Additionally, Barwa is studying its available space to determine optimal use, as the company owns large land holdings spread over various locations, including large plots in Lusail and other strategic sites in Qatar. Barwa says they strive to meet and exceed the needs of the Qatar real-estate market consistent with Qatar's National Vision 2030 and the company's desire for sustainable growth.

External Issues

Qatar is preparing for the FIFA 2022 World Cup by launching numerous large-scale infrastructure construction projects, including stadiums and other sporting facilities and significant investments in the expansion of the country's road, seaport, airplane, and rail networks. In fact, the Qatari construction market is expected to register a CAGR of 9.6 percent over the period 2019–2024, making it one of the fastest-growing global construction markets in the world. The Qatar National Vision 2030 is also spurring tremendous growth in the country, and Barwa is well-positioned to capitalize on this national mandate. In Lusail City, the 80,000-seat Lusail Stadium will host the opening and closing ceremonies for the 2022 FIFA World Cup. The stadium is nearing completion, and the city is home to a dozen hotels and more than 200,000 permanent residents. Also nearing completion is the Hamad International Airport Phase 1 expansion, intended to increase annual capacity to 53 million passengers by 2022, with Phase 2 increasing that still further to 60 million passengers by 2024.

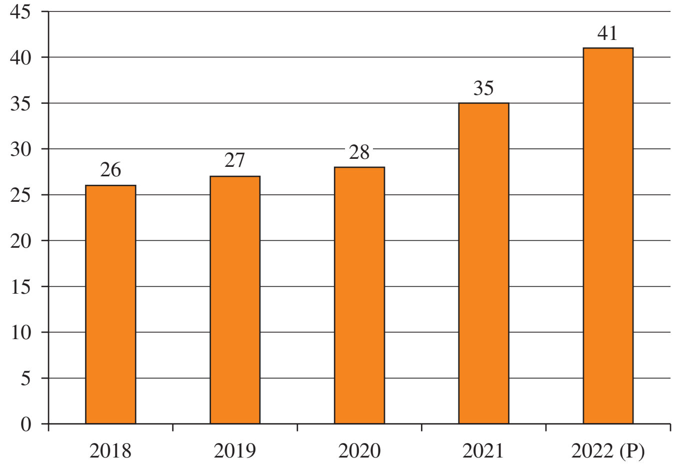
Qatar

Qatar has the third-highest GDP per capita in the world and is classified as a World Bank high-income economy. Although small, the country has the world's third-largest natural gas and oil reserves. The country is an absolute monarchy ruled by the House of Thani, or the Al Thani family, since 1868; today, Sheikh Tamim bin Hamad al-Thani holds all executive and legislative power and appoints both the prime minister and cabinet. Some 5-star luxury hotels in Qatar are allowed to sell alcohol to their non-Muslim customers. Qatar hosts the Al Udeid Air Base, where the United States and the United Kingdom hold strategic military operations.

Tourism

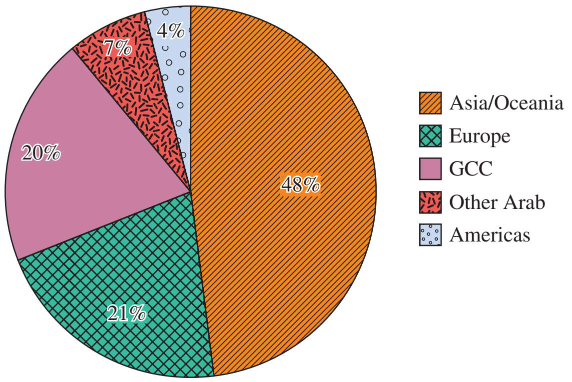
Summertime is the slowest tourist season for Qatar, so the government instituted a "Summer in Qatar" initiative to increase tourism during the summer, especially between Eid al-Fitr and Eid al-Adha. The country of Qatar has also introduced policies and laws to boost overall tourism, such as the introduction of visa-free travel from 80 countries. The demand for hotel rooms is outpacing supply in Qatar, which is to Barwa's advantage. Exhibit 6 provides information regarding the hotel room supply in Qatar. Exhibit 7 provides information regarding the source of Qatar's tourists and visitors.

EXHIBIT 6 Hotel Room Supply in Qatar (in 000 Keys)



Source: Based on information at various websites, including www.mordorintelligence.com/industry-reports/qatar-residential-real-estate-market and www.first-qatar.com/PDF/Qatar_Real_Estate_Market_Q1_2021.aspx.

EXHIBIT 7 The Source of Qatar's Visitors/Tourists by Region



Note:
GCC = Gulf Cooperation Council
EC = Economic Union, includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE)
Source: Based on information at various websites, including www.mordorintelligence.com/industry-reports/qatar-residential-real-estate-market and www.first-qatar.com/PDF/Qatar_Real_Estate_Market_Q1_2021.aspx.

Economy

Qatar is instituting reforms aimed at spurring economic development nationwide. QR 19.2 billion, 9.3 percent of the government's total budget, has been allocated to develop the education sector, which includes QR 6.8 billion for the construction of new schools within 5 years. Another QR 22.7 billion, or 11 percent of the total budget, is devoted to improving the country's healthcare sector, which includes the construction of 5 new health centers. Barwa has positioned itself to take advantage of the government's focus and expenditures on economic development. The government of Qatar in March 2019 increased the number of freehold zones from 3 to 10 in Lusail, West Bay, and the Onaiza region. In addition, foreign investors now can hold full ownership in Qatar's residential and commercial sectors, opening up new opportunities for Barwa to build more residential units under a built-to-sell (BTS) model.

The unemployment rate in Qatar is less than 1 percent, and no one lives below the poverty line. There are no taxes except on tobacco products and some junk foods. Qatar is an affluent country endowed with huge petroleum reserves and large refineries, all based in Umm Said. Qatar's main seaport is Hamad Port, and this area is growing fast, but the country's Ras Laffan Port on the northern coast exports more liquid natural gas (LNG) than any other facility in the world by a significant measure. Qatar Airways is one of the largest airlines in the world, and it often wins global best Airline of the Year awards. Qatar has the lowest illiteracy rate, about 3 percent for males and 4 percent for females, in the Arab-speaking world; the country also has an excellent RAND Corporation developed K-12 education system.

Qatar's residential real-estate market is growing by about 13 percent annually, boosted no doubt by the many people moving to the country. In 2021 alone, pending relief from COVID-19, about 8,200 new residential units were expected to become available in Qatar, especially in Lusail, The Pearl-Qatar, and in West Bay. About 530 new units were added in the country in Q4 2020, bringing the total residential stock to 303,015. The residential real-estate market in Qatar includes 1) condominiums, 2) villas, and 3) "other," with the primary cities being Doha, Al Wakrah, Al Rayyan, and Umm Salal Muhammad.

The Qatar Free Zones Authority is attracting increasing investments from around the world, such as France's Gaussin Advance Mobility Company and Qatar-based Al Attiya Motors, which recently opened the country's first assembly plant of electric vehicles at Ras Bu Fontas. Microsoft is now building a public cloud data center in Qatar, and Google is building a Google Cloud facility in Doha.

Competitors

Foreign firms are increasingly entering Qatar's residential real estate market, especially in West Bay Lagoon and The Pearl, but it has domestic rivals such as United Development Company and Al Mana Real Estate. However, the four major rivals to Barwa are AREDC, Ezdan, Msheireb, and Qatari Diar, as indicated below.

Al Asmakh Real Estate Development Company

The ISO-accredited Al Asmakh Real Estate Development Company (AREDC) is the top real-estate company in Qatar. AREDC has been on the market for more than 30 years and is involved in property management, leasing and selling, development and acquisition, consultancy, and asset management. ARECD manages properties all over Qatar, especially in Doha. AREDC's diverse portfolio consists of apartments, high-rise towers, compounds, villas, labor accommodations, commercial offices, and warehouses. Particularly renowned projects by AREDC include the Les Maisons Blanches compound in Lusail and the Paramount Residences at the Pearl Qatar, which consists of 196 luxurious properties.

Ezdan Holding Group

Ezdan is one of the largest real estate companies in the wider Persian Gulf region, with more than 29,000 real estate units in Doha, Al Wakrah, and other areas. Headquartered in Doha, Ezdan has 10,000 employees and is headed by CEO Ali Mohammed Al Obaidli. Notable major projects by Ezdan include The Curve, the Ezdan Palace, Ezdan Mall, and Ezdan Hotels. Ezdan's reported rental revenue of QR 1.177 billion in 2020 is down from QR 1.267 billion in 2019, and profits of QR 1.088 billion in 2020 are down from QR 1.305 billion the prior year. Ezdan develops, constructs, owns, rents, leases, and manages both residential and commercial properties, including apartments, hotels, restaurants, shopping malls, and commercial centers, mainly in Qatar but also as far away as Ethiopia.

Msheireb Properties Company

Established primarily to enable Qatar to achieve the country's 2030 Vision, Msheireb is a subsidiary of the Qatar Foundation. Msheireb has achieved ISO certification from the British Standards Institution for quality (ISO 9001:2015), environmental performance (ISO 14001:2015), occupational health and safety (BS OHSAS 18001:2007), and Risk Management Standards (ISO 31000:2009). Msheireb Downtown Doha is the company's prime example project for what it is doing to spur tourism and development in Qatar through 2030.

Qatari Diar Real Estate Company

Established in 2005 by the Qatar Investment Authority, the sovereign wealth fund of the State of Qatar, Qatari Diar is headquartered in Doha and has projects now spanning the globe, including in Washington DC, London, Dushanbe, and Tajikistan. The company's flagship project is Lusail City, which launched in December 2005 and is still being added onto and modernized, consistent with the company's primary mission to help Qatar fulfill its 2030 vision. In mid-2021, Qatari Diar had a shared capital of $8 billion, 50 investment projects under development in 22 countries, and a combined investment value of about $35 billion.

Conclusion

As indicated in the case, foreign firms are increasingly entering Qatar's residential and commercial real-estate market, and domestic rival firms such as United Development Company, Al Mana Real Estate, AREDC, Ezdan, Msheireb, and Qatari Diar are gaining momentum. Moreover, no top executives are specified for Barwa's various projects, products, regions, or otherwise, indicating a very centralized operation. Executive titles do not align with company segments, which is a problem for the firm. Despite a prosperous country and a growing economy, CEO Abdullah Bin Jubara Al-Rumaihi needs assistance reorganizing Barwa and developing a clear strategic plan for the future.

Given your expertise and based on what you have read in this book, prepare a comprehensive strategic plan for Mr. Al-Rumaihi. The CEO will appreciate your work because both local and global rivals are gaining market share and confidence. He needs a clear new vision and mission statement, a new research-based SWOT and BCG analysis, and projected financial statements to reveal the expected impact of your proposed strategic plan.

Profit margins in every industry become slimmer as competitiveness increases. Barwa's shareholders could defect unless some important strategy decisions are made to more effectively allocate resources across products, services, and regions in the area. Provide a 3-year roadmap to success for Mr. Al-Rumaihi to share with his top corporate comrades.

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Starbucks Corporation—2018

http://www.starbucks.com; SBUX

Headquartered in Seattle, Washington, and the world's largest coffee company, Starbucks is a premier roaster, marketer, and retailer of specialty coffee in the world, with over 24,000 stores in 76 countries. The company provides customers with the "Starbucks Experience"—comprised of excellent customer service, clean stores, appropriate music, and a comfortable setting. Currently, Starbucks in the United States segment generates about 69 percent of total revenues. Millions of people every day meet at Starbucks to talk, do business, and chat with friends. The music selected to play in the stores enhances the relaxed look and feel of the coffeehouse. Starbucks offers a full coffeehouse experience, complete with premium teas, fine pastries, and other sweets. The company also sells a variety of coffee and tea products through licensed stores, grocery stores, and foodservice accounts. Several brands associated with Starbucks are Teavana, Tazo, Seattle's Best Coffee, Evolution Fresh, La Boulange, and Ethos.

In February 2018, Starbucks and JP Morgan Chase began offering the Starbucks Rewards Visa Card, a co-brand credit card integrated directly into the Starbucks Reward loyalty program. Customers using this Visa card earn Stars with every purchase, both in and out of Starbucks stores, and can redeem their Stars for food and beverage items at more than 8,000 participating Starbucks locations. Cardholders also become members of the Starbucks Rewards loyalty program comprised of more than 14 million members. Later in 2018, Starbucks and Chase plan to offer a second co-branded product, the Starbucks Rewards Visa Prepaid Card.

Starbucks' strategic plan is to add about 600 new stores annually in China during 2018–2022, adding stores in 100 new cities to reach 230 cities across the country. The company plan is to more than triple revenue and more than double operating income in China between 2017 and 2022. This plan calls for the company to double the number of Starbucks stores in China from the end of FY2017 to 6,000.

Starbucks' fiscal year ends on September 30. For the company's fiscal Q1 2018 that ended December 31, 2017, revenues increased 6 percent to a record $6 billion, with comparable store sales up 2 percent. For that Q1, company's revenues from stores in China increased 30 percent, with comparable store sales up 6 percent. Starbucks as a whole is performing really well.

History

Starbucks was founded in Seattle in 1971 as a roaster and retailer of whole bean and ground coffee, teas, 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 siren from Greek mythology. The company was incorporated in 1985 and went public in 1992.

In November 2017, the company opened its first store in Jamaica and entered its seventy-sixth market globally. Together with its local business partner, Baristas del Caribe, LLC, Starbucks opened its first store in Puerto Rico.

In December 2017, Starbucks completed the sale of its Tazo Tea brand to Unilever; Starbucks desires to focus on a single tea brand, specifically its super premium tea brand, Teavana. Also that month, Starbucks was named fifth in *Fortune*'s World's Most Admired Companies survey. Additionally, the company completed its acquisition of the remaining 50 percent share of its East China business from long-term joint venture partners, Uni-President (UPEC) and President Chain Store Corporation (PCSC). With this transaction, Starbucks assumed 100 percent ownership of over 1,400 Starbucks stores in Shanghai and in the Jiangsu and Zhejiang Provinces, bringing the total number of company-owned stores in China to over 3,100. On this same day, UPEC and PCSC acquired Starbucks 50 percent interest in President Starbucks Coffee Taiwan Limited and assumed 100 percent ownership of Starbucks operations in Taiwan.

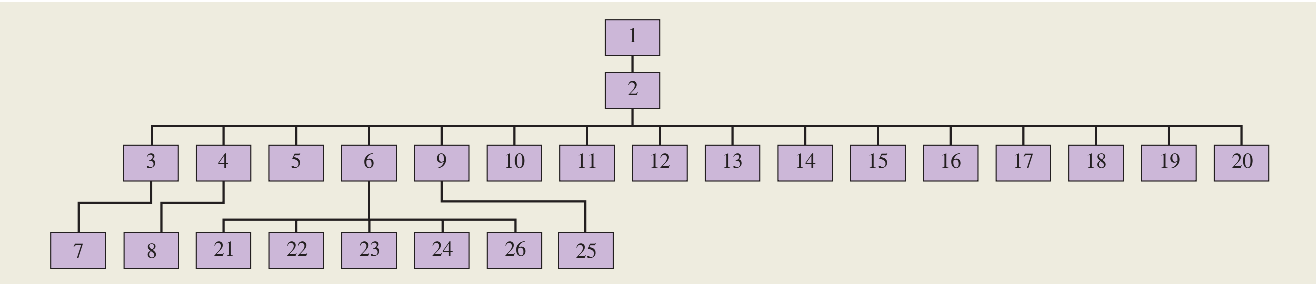
On December 5, 2017, Starbucks opened its Reserve Roastery in Shanghai, China, now the largest Starbucks store in the world. The Roastery features onsite baking by Italian food purveyor Rocco Princi, for the first time ever in China, and features onsite roasting and brewing of Starbucks Reserve coffees.

In April 2018, Starbucks opened its first store in Uruguay, the city of Montevideo. The new store offers Starbucks 100 percent Arabica coffees from Latin America and around the world. International retail and restaurant operator Alsea exclusively owns and operates Starbucks stores in the country. Starbucks plans to open 10 stores and create 130 new jobs in Uruguay by 2020.

Organizational Structure

As indicated in Exhibit 1, Starbucks operates from using a strategic business unit (SBU) type of organization with numerous regional Presidents reporting to four CEOs and four COOs in the company. An illustration of the Starbucks organizational structure is depicted in Exhibit 1. Probably no one but Starbucks insiders know exactly who reports to who—but what is important for students is to devise a recommended reporting relationship, perhaps deleting some positions and creating others, to more clearly reveal for all insiders and outsiders the Starbucks chain of command.

EXHIBIT 1 Starbucks' Top Executives and Organizational Chart



1. Howard Schultz, Executive Chairman
2. Kevin Johnson, CEO and President
3. Takafumi Minaguchi, CEO, Starbucks Japan
4. Belinda Wong, CEO, Starbucks China
5. Sumitro Ghosh, CEO, Tata Starbucks, Private Ltd.
6. Rosalind (Roz) Brewer, COO and Group President
7. Brady Brewer, COO, Starbucks Japan
8. Leo Tsoi, COO, Starbucks China
9. Jason Dunlop, COO, Starbucks EMEA
10. Chris Carr, EVP, Chief Procurement Officer
11. Michael Conway, EVP, President Licensed Stores, U.S. & Latin America
12. John Culver, Group President, Int. and Channel Development
13. Lucy Helm, EVP, Chief Partner Officer
14. Gerri Martin-Flickinger, EVP, Chief Technology Officer
15. Tony Matta, President, Global Channel Development
16. Scott Maw, EVP, CFO
17. Hans Melotte, EVP, Global Supply Chain
18. Sharon Rothstein, EVP, Global Chief Product Officer
19. Matthew Ryan, EVP, Global Chief Strategy Officer
20. Vivek Varma, EVP, Public Affairs
21. Mark Ring, President, Starbucks Asia Pacific
22. Rossann Williams, President, Starbucks Canada
23. Bernard Acoca, President of Teavana
24. Kris Engskov, President, U.S. Retail
25. Martin Brok, President, Starbucks EMEA
26. Cliff Burrows, Group President, Siren Retail

Source: Based on company information.

Values/Vision/Mission

Starbucks' vision statement is "To establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining uncompromising principles while we grow."

Starbucks' mission statement blends a grand and uplifting goal—nourish the human spirit—with a message about how it delivers this—by catering to its individual customers and communities. The vision can be viewed on the company's website, in the "About Us" section: https://www.starbucks.com/.

Segments

Starbucks is divided into four major operating segments:

1. Americas, including the United States, Canada, and Latin America
2. China/Asia Pacific (CAP)
3. Europe, Middle East, and Africa (EMEA)
4. Channel Development

All segments are comprised of stores, except "Channel Development" that includes all the Starbucks beverages and other branded products sold throughout the world through "channels" such as grocery stores, warehouse clubs, specialty retailers, convenience stores, and food-service accounts. The company has a few non-reportable operating segments, such as Teavana retail stores and Seattle's Best Coffee, and Siren Retail that offers taste testing operations. The non-reporting segments are simply classified as Other Segments in the company's financial reports. For fiscal 2017, Starbucks' revenues by segment as a percentage of total net revenues were as follows: Americas (70%), CAP (14%), EMEA (5%), Channel Development (9%), and All Other Segments (2%). Thus, the Americas is by far the dominant segment for Starbucks. The Americas, CAP, and EMEA segments include both company-operated and licensed stores.

In order to examine what Starbucks is doing currently, Exhibit 2 provides a summary of Starbucks operations across segments for Q1 2018. Notice that 700 new Starbucks stores were opened that quarter, but the company's overall operating income declined 1 percent, primarily due to the 11 percent drop in operating profits in the EMEA segment. That segment is lagging the others in overall performance.

Starbucks provides in their financial documents a breakdown of revenue by type of store. Revenue from company-operated stores accounted for 57 percent of total net revenues during fiscal 2017. Exhibit 3 reveals that there are slightly more licensed stores than company-owned stores because outside of the Americas, Starbucks prefers to utilize licensed stores rather than owning stores.

EXHIBIT 2 Starbucks' Operational Results Across Segments for Q1 2018

	Q1 2018	Q1 2017	Change
Total Company Data			
Net New Stores	700	649	51
Revenues $	6,074	5,733	+6%
Operating Income $	1,116	1,132	−1%
Americas Segment Data			
Net New Stores	278	271	27
Revenues $	4,266	3,991	+7%
Operating Income $	979	956	+2%
CAP Segment Data			
Net New Stores	300	303	(3)
Revenues $	844	771	+9
Operating Income $	197	163	+20
EMEA Segment Data			
Net New Stores	123	95	28
Revenues $	284	262	+8%
Operating Income $	39	44	−11%
Channel Development			
Revenues $	560	553	+1%
Operating Income $	243	243	–

Source: Based on the company's Q1 2108 quarterly report.

EXHIBIT 3 Starbucks' Number of Stores Across the World as of October 1, 2017

	Americas	%	CAP	%	EMEA	%	All Other	%	Total
Company-owned	9,413	57%	3,070	41%	502	17%	290	89%	13,275
Licensed	7,146	43%	4,409	59%	2,472	83%	37	11%	14,064
Total	16,559	100%	7,479	100%	2,974	100%	327	100%	27,339

Source: Based on the company's 2017 *Annual Report*, p. 3.

For Q2 2018 that ended 3-31-18, Starbucks reported that its same store sales increased 2 percent both globally and in the United States, and were up 4 percent in China. The company's revenues in Q2 increased 14 percent to a record $6 billion. Specifically for Q2, Starbucks' revenues from company-owned stores increased 15.1 percent to $4.828 billion, while revenues from licensed stores increased 14.4 percent to $625.6 billion. In the company's Americas and EMEA segments, the trend is to add licensed stores, but in the China/Asia segment, Starbucks is primarily adding company-owned stores.

Finance

During Q1 of fiscal 2018 that ended December 31, 2017, active membership in Starbucks Rewards in the United States grew 11 percent versus the prior year to 14.2 million, with member spending comprising 37 percent of U.S. company-operated sales, and Mobile Order and Pay representing another 11 percent of U.S. company-operated transactions. The Starbucks Card was used for 42 percent of U.S. and Canada company-operated transactions. During Q1 2018, Starbucks opened 700 net new stores globally, bringing total store count to 28,039 across 76 counties. Also, during Q1, the company returned a record $2 billion to shareholders through a combination of dividends and share repurchases. Specifically, Starbucks repurchased 28.5 million shares of common stock in Q1; approximately 52 million shares remain available for purchase under current authorizations.

Starbucks income statements and balance sheets for fiscal 2016 and 2017 are provided in Exhibit 4 and Exhibit 5, respectively. Notice all the green arrows pointing upward signifying that the company is performing quite well.

Coffee Industry Overview

Coffee is the most commonly consumed beverage worldwide. The coffee market can be segmented into growers, roasters, and retailers. On the coffee-growing level, South America was ranked as the major coffee-producing region. Brazil produced and exported 43.2 million 60-kg bags of coffee in 2016. Other major producers are Vietnam and Columbia. Exporting countries tend to consume less coffee than their importing counterparts.

The United States has the largest market share with 45.8 percent of global retail coffee sales in 2016, followed by single-cup coffee. Starbucks and Dunkin' Donuts dominate out-of-home retail market, with a combined market share of over 65 percent. Growth in coffee cup per capita consumption is recently up 18 percent in China, 13 percent in the United Kingdom, and 3.5 percent in Japan. Consumers drink, on average, 1.64 cups of coffee per day, reporting that they drink it at home, on the way to work, and at work. People drink coffee to wake up in the morning or receive a burst of energy throughout the day. People drink more and more coffee as they get older, with the over-60 age group drinking more coffee than any other group.

EXHIBIT 4 Starbucks' Income Statements (000 omitted)

Income Statement	10/2/16	10/1/17		Percent Change
Revenues	$21,315,900	$22,386,800	↑	5.02%
Cost of Goods Sold	8,511,100	9,038,200	↑	6.19%
Gross Profit	12,804,800	13,348,600	↑	4.25%
Operating Expenses	8,524,900	8,938,600	↑	4.85%
EBIT	4,279,900	4,410,000	↑	3.04%
Interest Expense	81,300	92,500	↑	13.78%
EBT	4,198,600	4,317,500	↑	2.83%
Tax	1,379,700	1,432,600	↑	3.83%
Non-Recurring Events	(1,200)	(200)	↓	−83.33%
Net Income	2,817,700	2,884,700	↑	2.38%

Source: Based on company documents.

EXHIBIT 5 Starbucks' Balance Sheets (000 omitted)

Balance Sheet	10/2/16	10/1/17		Percent Change
Assets				
Cash and Short-Term Investments	$2,263,200	$2,690,900	↑	19%
Accounts Receivable	768,800	870,400	↑	13%
Inventory	1,378,500	1,364,000	↓	−1%
Other Current Assets	347,400	358,100	↑	3%
Total Current Assets	4,757,900	5,283,400	↑	11%
Property Plant & Equipment	4,533,800	4,919,500	↑	9%
Goodwill	1,719,600	1,539,200	↓	−10%
Intangibles	516,300	441,400	↓	−15%
Other Long-Term Assets	2,784,900	2,182,100	↓	−22%
Total Assets	**14,312,500**	**14,365,600**	↑	**0%**
Liabilities				
Accounts Payable	2,975,700	2,932,200	↓	−1%
Other Current Liabilities	1,571,100	1,288,500	↓	−18%
Total Current Liabilities	4,546,800	4,220,700	↓	−7%
Long-Term Debt	3,185,300	3,932,600	↑	23%
Other Long-Term Liabilities	696,400	762,200	↑	9%
Total Liabilities	8,428,500	8,915,500	↑	6%
Equity				
Common Stock	1,500	1,400	↓	−7%
Retained Earnings	5,949,800	5,563,200	↓	−6%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	(67,300)	(114,500)	↑	70%
Total Equity	5,884,000	5,450,100	↓	−7%
Total Liabilities and Equity	**14,312,500**	**14,365,600**	↑	0

Source: Based on company documents.

From 2012 through 2016, coffee retail sales in the United States grew at a compounded annual growth rate (CAGR) of 4.6 percent. During this period of time, there was, however, a shift from single-cup coffee brands that made up just 21 percent of dollar sales, to now accounting for 41 percent. This means that all other categories of coffee shrunk during those 5 years. For example, instant coffee and whole beans were both down by 11 percent, while ground coffee declined 9 percent. However, the single-cup market has matured, and 2017 reveals virtually zero growth. A study by the National Coffee Association (NCA) shows that household penetration of single-cup brewing machines in the United States has peaked at around 30 percent, after growing rapidly from just 9 percent in 2011. Fewer consumers today are shifting from drip coffee makers or from instant coffee to single-cup, resulting in slowing growth rates.

Prices of single-cup coffee have declined over recent years to a level of what they were 10 years ago. Although retail sales are slowing, out-of-home channel sales of coffee are accelerating. U.S. foodservice coffee sales ended 2016 at around 3.3 percent higher than in 2015. This upward trend in out-of-home purchases of coffee is partly due to low unemployment and continued economic growth, both of which enable consumers to increase their coffee consumption out-of-home; this trend should continue in 2018–2019. Shifts in household composition are favoring the steady rise in out-of-home coffee sales. Additionally, more single households and fewer homes with underage children are reasons why fewer families have sit-down breakfast meals and choose foodservice alternatives in the morning, when the majority of coffee sales take place.

Competition

Starbucks' primary competitors for coffee beverage sales are specialty coffee shops and quick-service restaurants (QSRs). In almost all markets, there are hundreds of competitors in the specialty coffee beverage business, but Dunkin' Brands and McDonald's Corporation are the two major rivals to Starbucks. Exhibit 6 provides a market share breakdown of coffee market share across these companies. Note that Starbucks is in the lead, but not by much, and McDonald's leads outside the United States.

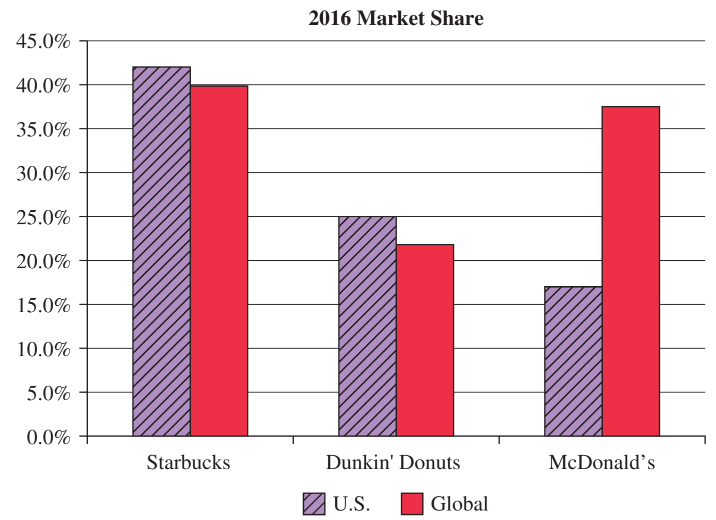
Dunkin' Brands Group (DNKN)

Based in Canton, Massachusetts and founded in 1950, Dunkin' Brands is arguably America's favorite all-day, everyday stop for coffee and baked goods—and is Starbucks' major rival firm. The Dunkin' Donuts segment of the company is a market leader in the hot regular/decaf/flavored coffee, iced coffee, donut, bagel, and muffin categories. The company has earned the number-one ranking for customer loyalty in the coffee, donut, bagel, muffin, and breakfast sandwich categories by Brand Keys for 9 years running. Dunkin has more than 11,500 restaurants in 40 countries worldwide. The other big segment of the company is Baskin Robbins. Actually the company operates through four segments: Dunkin' Donuts U.S., Dunkin' Donuts International, Baskin-Robbins International, and Baskin-Robbins U.S. Its restaurants offer hot and cold coffee, baked goods, donuts, bagels, muffins, breakfast sandwiches, hard-serve ice cream, soft-serve ice cream, frozen yogurt, shakes, malts, floats, and cakes.

In February 2018, Dunkin' Brands announced plans to add about 1,000 net new Dunkin' Donuts locations in the United States in 2018–2020 and says more than 90 percent will be built outside of the Northeast. In this same press release, Dunkin reaffirmed its intention to eventually have more than 18,000 Dunkin' Donuts restaurants in the United States. This is a shot over the bow to Starbucks.

Dunkin is determined to maintain and increase the U.S.-based Dunkin' Donuts share of the morning before-11 a.m. food and beverage sales, which account for 60 percent of Dunkin's system-wide sales—as well as strengthening the company's afternoon growth opportunities through menu innovation and national value offers. Dunkin is also doing the following in 2018–2020.

EXHIBIT 6 Coffee Market Share Across Three Rival Companies



Source: Based on information at a variety of sources.

1. Continued focus on Cold Brew, Iced Coffee, and Frozen Dunkin' Coffee, which resulted in its highest quarterly beverage comparable sales of the year in the fourth quarter of 2017. Extend its premium tea and frozen beverage lines and introduce more espresso products.
2. After a record year for breakfast sandwich sales in 2017, emphasize morning sandwiches, both new and returning favorites, like the early-2018 reintroduction of the Sweet Black Pepper Bacon Breakfast Sandwich, and offering additional flavored bacon on sandwiches throughout the year.
3. Being the largest retailer of donuts in America, heavily promote its annual calendar full of seasonal donut offerings ready-to-go, leveraging key holidays like Valentine's Day and Halloween, while ensuring that its Dunkin' Dozen—the brand's 12 best-selling donuts—are available in each restaurant.
4. Eliminate all synthetic dyes from its national food and beverage menu in the United States by the end of 2018.
5. Launch Dunkin' Deals, a series of value offers that are expected to be available at participating restaurants throughout the year. The first Dunkin' Deal of 2018 included two Egg and Cheese Wake-up Wrap® sandwiches for $2 and, to drive afternoon and evening traffic, a medium hot or iced latte for $2 from 2 p.m. to 6 p.m.

McDonald's Corporation (MCD)

McDonald's is the world's leading global food-service retailer with over 36,000 locations in over 100 countries. Millions of people enjoy going to McDonald's to get coffee. More than 80 percent of McDonald's restaurants worldwide are owned and operated by independent local businessmen and women. For the full year 2017, some financial highlights of McDonald's are as follows:

- Global comparable sales increased 5.3 percent, but consolidated revenues decreased 7 percent.
- Consolidated operating income increased 23 percent.
- Diluted earnings per share increased 17% (17% in constant currencies).
- Returned $7.7 billion to shareholders through share repurchases and dividends.
- Beginning in Q4 of 2017, began a 7 percent increase in its quarterly dividend to $1.01, demonstrating management's continued confidence in the company's performance.

For 2018, McDonald's plans to invest about $2.4 billion of capital, the majority of which will be dedicated to reinvesting in our existing locations through accelerated deployment of Experience of the Future in the United States. In addition, the company plans to open about 1,000 new McDonald's restaurants, 75 percent of which will be funded by licensees and affiliates around the world. Concurrently, the company plans to invest heavily in technology to modernize their customer experience and redefine convenience.

Headquartered in Oak Brook, Illinois, McDonald's operates and franchises restaurants in the United States, Europe, the Asia/Pacific, the Middle East, Africa, Canada, Latin America, and internationally. The company's restaurants offer various food products, soft drinks, coffee, and other beverages. The company operates close to 40,000 restaurants globally.

Keurig Green Mountain

The big news in 2018 in the beverage industry is that Keurig Green Mountain, the maker of Keurig K-Cup coffee machines, is acquiring Dr Pepper Snapple. Keurig is privately owned by JAB Holdings, one of Europe's largest investment firms; JAB also owns Peet's Coffee, Panera Bread, and Krispy Kreme doughnuts; JAB is a privately held fund that manages the money of the Reimann family, one of Germany's wealthiest families. This acquisition, pending approval in Q2 2018, is aimed directly at both Coca-Cola and Starbucks Corp. This acquisition puts Keurig in the global soda business and strengthens its coffee business. Euromonitor reports that sales of ready-to-drink coffees increased more than 17 percent in 2017. JAB's partner in Keurig is Mondelez International, who holds roughly 24 percent of the stock JAB, but that percentage will drop to about 14 percent when the Dr Pepper acquisition is finalized. Keurig's revenue for 2017 is estimated to be $4.1 billion, and its market share in the coffee-pod industry has declined from 40 percent in 2013 to 23 percent in 2017.

Future

On February 27, 2018, Starbucks opened (at its Seattle headquarters) its first Reserve store in the United States, a new store format from the company's Siren Retail business dedicated to its premium Reserve brand. Starbucks has announced plans to build 20–30 Roasteries and 1,000 Reserve stores, with 20 percent of the Starbucks store portfolio eventually becoming Starbucks Reserve bar locations. Starbucks recently opened its first international Reserve roastery in Shanghai and launched the first Princi location in the United States inside its Seattle Reserve roastery. The company is bringing stand-alone Princi stores to Seattle, Chicago, and New York and plans to open roasteries in Milan and New York in late 2018, in addition to Tokyo and Chicago in 2019.

The new Starbucks Reserve stores offer a new premium retail format with a marketplace-style environment offering Reserve roasteries, freshly baked artisanal Italian food from Rocco Princi and Third Place experience. The Reserve roasteries bring to life the theater of coffee roasting and brewing and packaging for customers. The Siren Retail segment also includes Starbucks Reserve bar locations and Princi bakeries. Reserve stores offer customers the full beverage menu available at the Seattle Reserve roastery, but with a few new items including Nitro Draft Latte and Spiced Ginger Cold Brew on tap, as well as new espresso drinks such as the Bianco Mocha. The Princi menu continues to offer customer favorites including cornetti, brioche, Pizza Mozzarella di Bufala, focaccia sandwiches; the space includes a full mixology bar serving traditional Italian Aperitivo, aromatic Italian cocktails such as Aperol Spritz, Milano Torino, and Negroni Sbagliato, for afternoon and evening customers.

Starbucks pays above the minimum wage in all states across the country. In April 2018, all eligible U.S. Starbucks hourly and salaried partners received a second wage increase in addition to the annual increases they have already received this fiscal year. The company also provided an additional 2018 stock grant for all eligible full-time, part-time, hourly, and salaried U.S. partners across their stores, plants, and support centers. In addition, all Starbucks retail partners received at least a $500 grant, store managers each received a $2,000 grant, and plant and support center partner (non-retail) grants varied depending on annualized salary or level. Starbucks has also announced plans to create more than 8,000 new part-time and full-time retail jobs and an additional 500 manufacturing jobs in its Augusta, Georgia, soluble coffee plant.

For store partners, the company recently expanded their parental leave policy to include all non-birth parents with up to 6 weeks of paid leave when welcoming a new child. These new human resource offerings are in addition to the nearly $7 billion of capital that Starbucks will deploy to build and renovate stores, manufacturing plants, and technology platforms in the United States over the next 5 years. Starbucks remains committed to providing opportunities to tens of thousands of Americans from disadvantaged backgrounds.

In May 2018, Starbucks announced its formation of a global coffee alliance with Nestlé S.A. to increase both the at-home and away-from-home coffee and related categories around the world. As part of the alliance, Nestlé obtains the rights to market, sell, and distribute Starbucks, Seattle's Best Coffee, Starbucks Reserve, Teavana, Starbucks VIA, and Torrefazione Italia packaged coffee and tea in all global at-home and away-from-home channels. In return, Nestlé pays Starbucks $7.15 billion, with Starbucks retaining a significant stake as licensor and supplier of roast and ground and other products going forward. The agreement also provides for the Starbucks' brands to be represented on Nestlé's single-serve capsule systems.

Dunkin' Brands has announced aggressive new growth initiatives aimed directly at capturing Starbucks' market share. Starbucks needs a clear strategic plan to effectively and efficiently manage its worldwide building of more than 1,000 Reserve stores, coupled with converting existing Starbucks restaurants to the new format, and doubling down on its human resource benefits offered.

PepsiCo, Inc.—2018

www.pepsico.com, PEP

Headquartered in Purchase, New York, PepsiCo is the second-largest carbonated soft-drink maker in the world, behind Coca-Cola Company. In North America, PepsiCo is the largest food and beverage company, having soft-drink brands that include Pepsi-Cola, Mountain Dew, and Diet Pepsi, as well as Tropicana orange juice, Gatorade sports drink, SoBe tea, and Aquafina bottled water. Unlike Coca-Cola, PepsiCo is diversified, owning Frito-Lay and Quaker Foods. Frito-Lay is the largest salty snack provider in the United States, having brands that include Lay's, Ruffles, Doritos, Cheetos, and Fritos; Quaker Foods offers breakfast cereals (Life, Quaker Oats), rice (Rice-A-Roni), and side dishes (Near East).

PepsiCo's products are available in more than 200 countries where the company specializes in innovating/changing products to match local tastes and cultures. For example, in Jordan, Bario, a nonalcoholic malt drink is popular, and Tropicana Pulp Sacs are popular in China. Fifty percent of company revenue comes from outside the United States and that percentage is increasing. PepsiCo is the largest food and beverage business in Russia, India, and the Middle East, is number two in Mexico, and is in the top five in Brazil, Turkey, and many other emerging markets like Vietnam, the Philippines, Thailand.

PepsiCo is forward integrated, owning its two largest bottlers, Pepsi Bottling Group and PepsiAmericas. Pepsi products are available worldwide through a variety of systems, including direct store delivery (DSD), broker-warehouse, food service, and vending machines. Twenty-two of PepsiCo's products have generated retail sales of more than $1 billion, including three brands that recently reached this milestone: Diet Mountain Dew, Brisk, and Starbucks ready-to-drink beverages.

On December 20, 2017, PepsiCo stock switched to trade on the Nasdaq Global Select Market rather than the New York Stock Exchange. PepsiCo stock continues to trade under the symbol PEP. PepsiCo has increased its annual dividend for over 41 consecutive years. PepsiCo reports its financial results across six segments:

1. FLNA: Frito-Lay North America
2. QFNA: Quaker Foods North America
3. NAB: North America Beverages
4. Latin America
5. ESSA: Europe Sub-Saharan Africa
6. AMENA: Asia, Middle East, and North Africa

History

The secret formula for Pepsi was developed in the 1880s by Caleb Bradham, a pharmacist in Newbern, North Carolina. Caleb named his product "Pepsi-Cola" in 1898. As his product gained popularity, he created the Pepsi-Cola Company in 1902 and registered a patent for his recipe in 1903. Interestingly, the formula for Coca-Cola was developed in 1886 by pharmacist John Pemberton in Columbus, Georgia. The Coca-Cola formula and brand was bought in 1889 by Asa Candler who incorporated The Coca-Cola Company in 1892. Pepsi-Cola Company was first incorporated in Delaware in 1919.

In 1965, the Pepsi-Cola Company merged with Frito-Lay, Inc., to become PepsiCo, Inc., as the company is known today. Between the late 1970s and the mid-1990s, PepsiCo expanded via the acquisition of restaurants and other businesses outside of its core focus of packaged food and beverage brands. This was a big strategic mistake and the company exited these noncore business lines largely in 1997, selling some and spinning off others into a new company that is now known as Yum! Brands. A few brands formerly owned by PepsiCo include Pizza Hut, Taco Bell, Kentucky Fried Chicken, D'Angelo Sandwich Shops, Wilson Sporting Goods, North American Van Lines, and Stolichnaya. In December 2005, PepsiCo surpassed Coca-Cola Company in market value for the first time in 112 years since both companies began to compete.

PepsiCo purchased Tropicana Products in 1998 and acquired Quaker Oats Company in 2001. In 2010, PepsiCo acquired its two largest bottlers in North America: Pepsi Bottling Group and PepsiAmericas. In 2011, PepsiCo made its largest international acquisition by purchasing Wimm-Bill-Dann Foods, a Russian food company that produces milk, yogurt, fruit juices, and dairy products. This acquisition made PepsiCo the largest food and beverage company in Russia. This acquisition boosted PepsiCo's nutrition portfolio. In January 2012, PepsiCo hired its first female CEO, Indra Nooyi, who remains CEO today.

PepsiCo is having trouble with its Gatorade brand whose sales in the United States declined 0.5 percent to $5.9 billion in 2017. This was the brand's first decline in annual sales since 2012. Gatorade accounts for about 20 percent of PepsiCo's North American drink volume. The company released Gatorade Organic in August 2016 and made $20 million on that product through the end of 2017. The sports-drink market is becoming highly competitive; even up-start BodyArmour, a distant third in market share, is gaining rapidly on PepsiCo in sports drinks, such as Gatorade.

In May 2018, PepsiCo acquired Bare Foods, Inc., which makes Bare Snacks, a line of healthy fruit and vegetable snacks. Headquartered in San Francisco, California, Bare Foods is owned and operated by Bob and Diana Carroll. The purchase of Bare fits into PepsiCo's strategy to diversify further into healthy and nutritious products. Bare began its business in 2001 by selling baked apple chips at local farmers' markets and steadily expanded, becoming a leader in apple, banana, and coconut snacks, and recently adding vegetable chips to its line. All Bare products are baked, not fried, and are also Non-GMO Project-verified. Bare will continue to operate independently from San Francisco, with its leadership reporting to PepsiCo's Frito-Lay North America Division.

Values, Vision, and Mission

Under the broad umbrella of "acting ethically and responsibly," PepsiCo describes its values as the principles of workplace respect, integrity in the marketplace, the golden rule, and responsibility to its shareholders.

A version of PepsiCo's vision and mission statements can be found at the following company website: https://www.pepsicoindia.co.in/. Its vision reflects the goals of ensuring superior financial performance and achieving a positive social and environmental impact. What PepsiCo describes as its mission reflects a focus on *product*, with an emphasis on the wide range of its food and beverage offerings around the world. It also states PepsiCo's long-term goal of success through investments in its employees, the company itself, and the communities of the markets it serves.

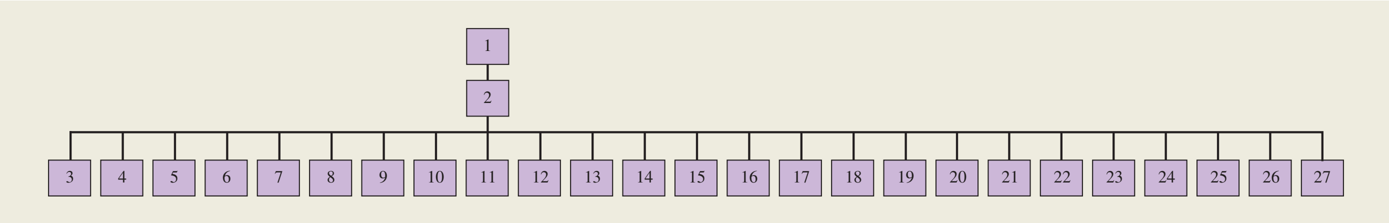
Organizational Structure

PepsiCo breaks down their business in the Americas by foods versus beverages, but their Latin America and outside North America business units include beverages, foods, and snacks. Yes, this is confusing and the company has changed it almost annually. PepsiCo's top executives are listed in Exhibit 1 along with an organizational chart. The chart depicted reveals only three levels: the CEO, the functional-level executives, and the line/regional-level executives. Probably no one but PepsiCo insiders know exactly who reports to who—but what is important for students is to devise a recommended reporting relationship, perhaps deleting some positions and creating others, to more clearly reveal for all insiders and outsiders the chain of command. Likely, PepsiCo would function best with a strategic business unit (SBU) type structure comprised of two SBU's—beverages and food—with regional presidents reporting to those two individuals. PepsiCo's executive titles should match with the company's segment titles FLNA, QFNA, NAB, Latin America, ESSA, and AMENA.

Segments

PepsiCo is transparent in its reporting of financial information by segment. PepsiCo monitors and reports results of their operations in six segments as given below. Note that in Latin America and outside North America, PepsiCo's beverages and snacks are combined as segments (ESSA and AMENA).

EXHIBIT 1 **PepsiCo's Top Executives and Organizational Chart**



1. Indra Nooyi, Chairman of the Board
2. Ramon Laguarta, CEO
3. Jim Andrew, EVP, Corporate Strategy and Chief Venturing Officer
4. Jon Banner, EVP, Communications
5. Umran Beba, Senior VP, Chief HR Officer for Human Capital Management Services and Operations
6. Jody Davids, Senior VP and Chief Information Officer
7. Ruth Fattori, EVP and Chief HR Officer
8. Marie Gallagher, Senior VP and Controller
9. Hugh Johnston, Vice Chairman and CFO
10. Dr. Mehmood Khan, Vice Chairman and Chief Scientific Officer, Global R&D
11. Eugene Willemsen, EVP, Global Categories and Franchise Management
12. Dave Yawman, EVP of Government Affairs, General Counsel and Corporate Secretary
13. Brian Newman, EVP, Finance and Operations, Latin America
14. Grace Puma, EVP, Global Operations
15. Albert Carey, CEO, PepsiCo North America
16. Sanjeev Chadha, Chairman, Asia, Middle East, and North Africa
17. Laxman Narasimhan, CEO, Latin America and Europe Sub-Saharan Africa
18. Mike Spanos, CEO, Asia, Middle East, and North Africa
19. Pedro Padierna, Chairman, PepsiCo Mexico
20. Vivek Sankaran, President and COO, Frito-Lay North America
21. Kirk Tanner, President and COO, North America Beverages
22. Paula Santilli, President, PepsiCo Mexico Foods
23. Silviu Popovici, President, Europe Sub-Saharan Africa
24. Anne Fink, President, Global Foodservice
25. Ram Krishnan, President, Greater China Region
26. Simon Lowden, President, Global Snacks Group
27. Luis Montoya, President, Latin America Beverages

Source: Based on the company's 2017 *Annual Report* and other documents.

Inside North America

1. North America Beverages (NAB)—sample products include Pepsi, Gatorade, Mountain Dew, Aquafina, 7UP (outside the United States), and Tropicana
2. Frito-Lay North America (FLNA)—sample products include Doritos, Cheetos, Tostitos, Ruffles, Fritos, SunChips, and Santitas
3. Quaker Foods North America (QFNA)—sample products include Quaker oatmeal, Aunt Jemima mixes and syrups, Quaker Chewy granola bars, Quaker grits, Cap'n Crunch cereal, Life cereal, and Rice-a-Roni side dishes
4. Latin America—includes many of the Frito-Lay and Quaker products

Outside North America

5. Europe Sub-Saharan Africa (ESSA)—includes many of the beverages and foods listed inside North America with many modified to match particular country culture and desires
6. Asia, Middle East & North Africa (AMENA)—includes many of the beverages and foods listed inside North America with many modified to match particular country culture and desires

Exhibit 2 provides a breakdown of PepsiCo's revenues by division for 2016 and 2017. Notice that NAB is the largest revenue contributor but this segment's revenues decreased in 2017. Note also that the ESSA segment reported the largest percentage increase in revenues in 2017. Note the 5 percent decrease in AMENA compared to the 8 percent increase in ESSA.

Exhibits 3 and 4 provide a breakdown of PepsiCo's 2017 operating profit (EBIT) compared to the prior year. Note the decrease in QFNA and NAB but the near doubling in AMENA. Note the 29 percent decrease in NAB for 2017 compared to the 173 percent increase in AMENA.

Finance

In early 2018, PepsiCo announced a new repurchase program of up to $15 billion of PepsiCo common stock commencing on July 1, 2018 and expiring on June 30, 2021. This will replace the $12 billion repurchase program which commenced on July 1, 2015 and expired on June 30, 2018. Also in early 2018, PepsiCo announced a 15 percent increase in its annual dividend per share to $3.71 from $3.22 per share, such that total dollar of dividends to be paid to shareholders in 2018 would be about $5 billion, compared to about $2 billion being devoted to buying back shares of stock.

EXHIBIT 2 PepsiCo's 2016 and 2017 Revenues by Division (in billions)

Division	2016	2017
1. FLNA = Frito-Lay North America	$15,549	$15,798
2. QFNA = Quaker Foods North America	$2,564	$2,503
3. NAB = North America Beverages	$21,312	$20,936
4. Latin America	$6,820	$7,208
5. ESSA = Europe Sub-Saharan Africa	$10,216	$11,050
6. AMENA = Asia, Middle East, and North Africa	$6,338	$6,030
Total	$19,515	$19,526

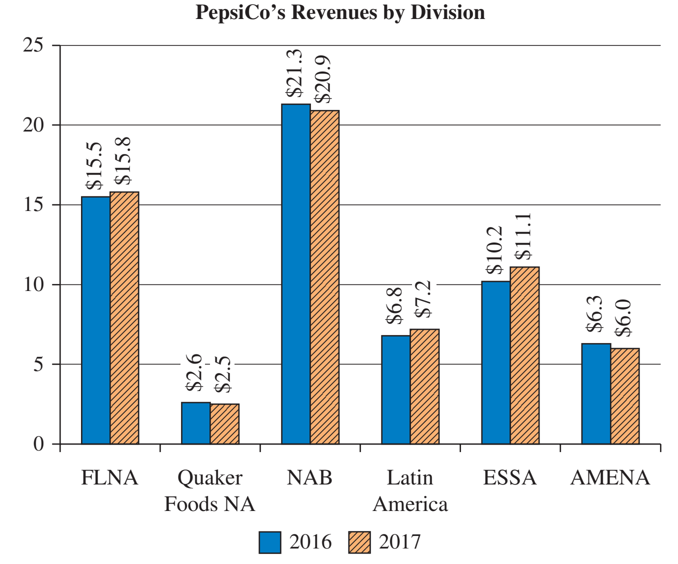
Source: Based on the company's 2017 *Annual Report* and other documents.

EXHIBIT 3 PepsiCo's 2016 and 2017 Operating Profit by Division (in billions)

Division	2016	2017
1. FLNA = Frito-Lay North America	$4,659	$4,823
2. QFNA = Quaker Foods North America	$653	$642
3. NAB = North America Beverages	$2,959	$2,707
4. Latin America	$887	$908
5. ESSA = Europe Sub-Saharan Africa	$1,108	$1,354
6. AMENA = Asia, Middle East, and North Africa	$619	$1,073
Total	$10,885	$11,507

Source: Based on the company's 2017 *Annual Report* and other documents.

EXHIBIT 4 PepsiCo's 2016 and 2017 Operating Profit by Division (in billions)



Source: Based on the company's 2017 *Annual Report* and other documents.

PepsiCo's recent income statements are provided in Exhibit 5. Note the slight increase in revenues, but the 23 percent decrease in net income.

PepsiCo's recent balance sheets are provided in Exhibit 6. Note the substantial and increasing amount of goodwill and long-term debt. Coupled with the decline in Paid-in-Capital the numbers reveal that PepsiCo prefers debt over equity to raise capital.

EXHIBIT 5 PepsiCo's Income Statements (in millions)

Income Statement	12/31/16	12/30/17		Percent Change
Revenues	$62,799	$63,525	⇧	1.16%
Cost of Goods Sold	28,209	28,785	⇧	2.04%
Gross Profit	34,590	34,740	⇧	0.43%
Operating Expenses	24,805	24,231	⇩	–2.31%
EBIT	9,785	10,509	⇧	7.40%
Interest Expense	1,232	907	⇩	–26.38%
EBT	8,553	9,602	⇧	12.26%
Tax	2,174	4,694	⇧	115.92%
Non-Recurring Events	(50)	(51)	⇧	2.00%
Net Income	6,329	4,857	⇩	–23.26%

Source: Based on the company's 2017 *Annual Report* and other documents.

EXHIBIT 6 PepsiCo's Balance Sheets (in millions)

Balance Sheet	12/31/16	12/30/17		Percent Change
Assets				
Cash and Short-Term Investments	$16,125	$19,510	⇧	21%
Accounts Receivable	6,694	7,024	⇧	5%
Inventory	2,723	2,947	⇧	8%
Other Current Assets	908	1,546	⇧	70%
Total Current Assets	26,450	31,027	⇧	17%
Property Plant & Equipment	16,591	17,240	⇧	4%
Goodwill	14,430	14,744	⇧	2%
Intangibles	12,196	12,570	⇧	3%
Other Long-Term Assets	3,823	4,223	⇧	10%
Total Assets	**73,490**	**79,804**	⇧	**9%**
Liabilities				
Accounts Payable	14,242	15,017	⇧	5%
Other Current Liabilities	6,893	5,485	⇩	–20%
Total Current Liabilities	21,135	20,502	⇩	–3%
Long-Term Debt	30,053	33,796	⇧	12%
Other Long-Term Liabilities	11,103	14,525	⇧	31%
Total Liabilities	62,291	68,823	⇧	10%
Equity				
Common Stock	24	24	⇨	0%
Retained Earnings	52,518	52,839	⇧	1%
Treasury Stock	(31,468)	(32,757)	⇧	4%
Paid in Capital & Other	(9,875)	(9,125)	⇩	–8%
Total Equity	11,199	10,981	⇩	–2%
Total Liabilities and Equity	**73,490**	**79,804**	⇧	9%

Source: Based on the company's 2017 *Annual Report* and other documents.

Pepsi's share price has struggled in the first half of 2018, down about 19 percent in the first five months of the year to just below $100 per share. The key reason why Pepsi's stock demise has been that the company's largest market segment, North American Beverages (NAB), consistently reports flat revenues and declines in operating profits. The NAB segment makes up more than 33 percent of the company's total revenue, and that segment's operating profit decreased 23 percent in Q1 of 2018 when compared to Q1 of 2017.

Competitors

Coca-Cola Company and Dr Pepper Snapple are Coke's two primary competitors, but other rival firms include Nestlé SA, Groupe Danone, Suntory Beverage & Food Limited ("Suntory"), and Monster Beverage Corporation. Unlike Coke, PepsiCo derives most of its revenues and growth from its snack food business rather than its beverages. 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 7 reveals the top 10 beverages sold in the United States. Note that Coke, inclusive of Coke Zero, Diet Coke, and other brands, lead among the top 10, but PepsiCo has four brands in the top 10. Down the percent change column in Exhibit 7, notice that bottled water has the largest growth.

As indicated in Exhibit 8, PepsiCo is 10 times larger than Dr Pepper Snapple and based on market capitalization (stock price times number of shares outstanding). However, PepsiCo is much larger than Coke on numerous other variables as given.

Coca-Cola Company (KO)

Headquartered in Atlanta, Georgia, Coca-Cola Company (Coke) is the world's largest producer and distributor of beverages, marketing over 500 nonalcoholic brands in more than 200 countries. Coke has 21 billion-dollar brands, 19 of which are available in lower- and no-sugar options. Four of the

EXHIBIT 7 PepsiCo versus Rival Firms on Top Beverage Brands Sold (2016 versus 2015)

		Millions of Gallons			Share in Total	
Brand	Firm	2015	2016	Percent Change	2015	2016
1. Coke (all types)	Coca-Cola	3,994	3,933	(1.5)	12.6	12.0
2. Pepsi (all types)	PepsiCo	1,946	1,859	(4.5)	6.1	5.6
3. Mountain Dew	PepsiCo	1,343	1,333	(0.7)	4.2	4.1
4. Dr Pepper (all types)	Dr Pepper Snapple	1,160	1,168	0.7	3.6	3.5
5. Nestlé Pure Life	Nestlé NAmerica	1,075	1,085	1.0	3.4	3.3
6. Gatorade	PepsiCo	1,042	1,082	3.8	3.3	3.3
7. Sprite	Coca-Cola	866	897	3.6	2.7	2.7
8. Poland Spring	Nestlé NAmerica	758	836	10.3	2.4	2.5
9. Dasani	Coca-Cola	707	743	5.0	2.2	2.3
10. Aquafina	PepsiCo	546	605	10.9	1.7	1.8
TOP 10		13,437	13,541	0.8	42.2	41.2
Others		18,387	19,364	5.3	57.8	58.8
TOTAL		31,824	32,904	3.4	100.0	100.0

Source: Based on information developed by Beverage Marketing Corporation.

EXHIBIT 8 A Comparison of PepsiCo to Two Big Rivals

	COKE	DR PEPPER	PEPSICO
$ Market Capitalization	197.0B	17.0B	167.0B
# Employees	100,300	20,000	264,000
$ Revenue	41.8B	6.6B	63.5B
% Profit Margin	10.68	11.73	10.97
$ EBITDA	10.9B	1.6B	12.6B
% Operating Margin	24.14	20.73	16.4
$ Net Income	6.5B	770M	47.0B
% ROA	6.23	9.09	8.56
$ EPS	0.95	4.17	4.84

Source: Based on a variety of sources.

top five beverages sold globally are Coca-Cola, Diet Coke, Fanta, and Sprite. Other Coke products include AdeS soy-based beverages, Ayataka green tea, Dasani waters, Del Valle juices and nectars, Fanta, Georgia coffee, Gold Peak teas and coffees, Honest Tea, Minute Maid juices, Powerade sports drinks, Simply juices, Glaceau Smartwater, Sprite, and Zico coconut water. However, the company's revenues for 2017 declined 15 percent so rumblings are spreading within the firm.

Coke brands sold mostly outside the United States include Ayataka green tea in Japan, I LOHAS water in Japan, Ice Dew water in China, FUZE TEA outside the United States, Minute Maid Pulpy in Asia Pacific, Georgia coffee in Japan, and Del Valle in Latin America. Five large independent bottling companies supply Coke with 39 percent of their bottling needs. The largest independent bottler is Coca-Cola FEMSA who supplies central Mexico and countries in Latin and South America.

Company revenues have declined every year for nearly a decade. Coke's net income also declined. Since 2005, sales of diet soda, in general, have dropped every year, a combined 34 percent. Although Diet Coke is the weakest link in the company's whole soda lineup, the brand is still the third-best selling carbonated drink in the United States.

Even environmentalists are complaining, saying Coke produces 110 million plastic bottles annually that end up in landfills and oceans. To combat this complaint, the company launched in 2018 its "World Without Waste" initiative. Coke needs a good strategic plan since its customer base is eroding and its shareholders want sustained 5 percent annual growth in revenues and profits—not declines every year.

Dr Pepper Snapple Group, Inc. (DPS)

Headquartered in Plano, Texas, DPS manufactures nonalcoholic beverages in the United States, Canada, Caribbean, and Mexico. It also markets ready-to-drink teas, juices, juice drinks, water, and mixers. The company offers brands such as: 7UP, A&W, Bai, Crush, Canada Dry, Schweppes, Sunkist, Squirt, Hawaiian Punch, and RC Cola. DPS manufactures and sells Mott's applesauce. DPS's revenues increased slightly from \$6.2 billion in 2014 to \$6.3 billion in 2015, to \$6.4 billion in 2016, to \$6.7 in 2017. DPS's net income also has increased slightly every year. DPS recently acquired Bai Brands for about \$1.7 billion. DPS currently has about 8.5 percent of the U.S. nonalcoholic beverage market, according to Euromonitor International.

DPS owns 7 of the top 10 non-cola soft drinks on the market. Third quarter (Q3) 2017 results showed DPS's carbonated soft drinks decreasing 1 percent while its non-carbonated beverages increased 6 percent. Q3 showed flat sales in the United States and Canada, but sales in Mexico and the Caribbean increased 2 percent. Also for Q3, the DPS brand named Clamato grew 7 percent and Mott's applesauce sales grew 5 percent, but Snapple sales declined 5 percent.

The big news in 2018 in the beverage industry is that Keurig Green Mountain, the maker of Keurig K-Cup coffee machines, acquired Dr Pepper Snapple in 2018. Keurig is privately owned by JAB Holdings, one of Europe's largest investment firms; JAB also owns Peet's Coffee, Panera Bread, and Krispy Kreme doughnuts. JAB is a privately held fund that manages the money of the Reimann family, one of Germany's wealthiest families. This acquisition, pending approval in Q2 2018, is aimed directly at both Coca-Cola and Starbucks Corp. This acquisition puts Keurig in the global soda business and strengthens its coffee business. Euromonitor reports that sales of ready-to-drink coffees increased more than 17 percent in 2017. JAB's partner in Keurig is Mondelez International that holds roughly 24 percent of the stock JAB, but that percentage dropped to about 14 percent when the Dr Pepper acquisition was finalized. Keurig's revenue for 2017 was about \$4.1 billion and its market share in the coffee-pod industry has declined from 40 percent in 2013 to approximately 23 percent in 2017.

Groupe Danone

Headquartered in Paris, France, Groupe Danone is the number-one producer of yogurt in the world, the number-two bottled water, and baby nutrition manufacturer, number-one in manufacturing 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. 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-2 ranking in the French low-calorie segment. Danone is present in over 130 markets and generated sales of €21.9 billion in 2016, with more than half of that revenue coming from emerging countries. Fresh dairy products represent about 50 percent of Danone's total sales, early life nutrition 22 percent, water 21 percent, and medical nutrition 7 percent.

Monster Beverage Company (MNST)

Headquartered in Corona, California, Monster Beverage develops, markets, sells, and distributes energy drink beverages, sodas and/or concentrates for energy drink beverages, under brand names such as Monster Energy, Monster Rehab, Monster Energy Extra Strength Nitrous Technology, Java Monster, Muscle Monster, Mega Monster Energy, Punch Monster, Juice Monster, Ubermonster, BU, Mutant Super Soda, Nalu, NOS, Burn, Mother, Ultra, Play and Power Play, Gladiator, Relentless, Samurai, BPM, and Full Throttle.

Coca-Cola owns 16.7 percent of the Monster Beverage, which it purchased in 2015 for approximately $2.15 billion. In October 2017, Coca-Cola transferred ownership of all of its worldwide energy businesses including NOS, Full Throttle, and nine smaller brands to Monster Beverage Company. At the same time, Monster transferred all of its non-energy drink businesses to Coca-Cola, including Hansen's natural sodas, Peace Tea, Hubert's Lemonade, and Hansen's juice products. As shown in Exhibit 10, energy drinks comprise 4.8 percent of all nonalcoholic beverages sold.

Monster Beverage's sales for Q3 2017 that ended September 30, 2017 increased 11.5 percent to $2.6 billion from $2.3 billion versus the prior year. Net income for Q3 was $619.4 million, compared with $539.7 million the prior year. Net sales for Monster's Strategic Brands segment, which includes the various energy drink brands acquired from Coke, increased 6.2 percent to $76.6 million for that Q3, up from $72.1 million the prior year. Monster's sales to customers outside the United States increased 36.3 percent to $260.1 million in that Q3, up from $190.8 million in the prior year period. Net income for Q3 increased 14.1 percent to $218.7 million from $191.6 million in the prior year period.

The Non-Alcoholic Beverage Industry

Exhibit 9 reveals the annual growth (or decline) in various categories of beverages. Notice declines in sales of carbonated soft drinks and fruit drinks, but rapid growth in sales of flavored and enhanced water and ready-to-drink coffee.

Bottled Water

In 2016, bottled water surpassed carbonated soft drinks as the largest beverage category in the United States by volume. Per capita consumption of bottled water reached more than 39.0 gallons annually, compared with around 38.5 gallons for carbonated soft drinks. Within the next decade, bottled water consumption per capita is expected to surpass 50 gallons. The U.S. bottled water market showed strong growth in terms of volume and revenues in the past 3 years. Bottled water sales are booming, up 7.3, 7.9, and 8.6 percent in 2014, 2015, and 2016, respectively. By comparison, carbonated soft drink volumes declined 2.1, 2.4, and 0.8 percent during those years.

EXHIBIT 9 Annual Percent Growth/Decline in Sales of Various Beverage Categories 2016 versus 2015 in the United States

Flavored & Enhanced Water	+12.3
Ready-To-Drink Coffee	+11.0
Bottled Water	+8.6
Energy Drinks	+4.8
Sports Drinks	+3.9
Ready-To-Drink Tea	+3.1
Carbonated Soft Drinks	−0.8
Fruit Drinks	−1.4
Total	+3.4

Source: Based on information developed by Beverage Marketing Corporation (BMC).

According to BMC, in 2017, bottled water sales are projected to grow 8 to 9 percent, remaining the top nonalcoholic beverage for years to come—further confirmation of the shift in consumer preference toward healthier and lower-calorie options.

Sparkling Water

Sparkling water is projected to outpace even bottled water in the next decade as consumers search for tastier but healthier options. In fact, sparkling water sales surged more than 20 percent in 2017. Flavored sparkling water sales grew by more than 15 percent in 2017 to $2.4 billion. To better reach this flavored sparkling water market, in early 2018, PepsiCo released its seltzer water brand called Bubly. Other beverages also growing in sales are flavored and enhanced water, ready-to-drink coffee, and energy drinks. Specifically, sales of flavored and enhanced water in the United States increased 12.3 percent in 2016, followed by ready-to-drink coffee up 11.0 percent, and energy drinks up 4.8 percent.

Given the above positive trends, carbonated soft drinks still account for 83.5 percent of the beverages industry's market capitalization as of September 2017. In 2016, soda consumption in the United States fell 0.8 percent, continuing the downward trend. Consequently, in Q2 2017, Coke reported a 16 percent drop in net revenues to $9.7 billion. In that Q2, Coke reported increased volume for juice, dairy, and plant-based beverages (with 3% growth), tea and coffee (2%), as well as water, enhanced water, and sports drinks (1%). Coke is shifting its portfolio toward smaller-sized packages and healthier beverages. In August 2017, Coke replaced its Coke Zero products with the zero-sugar and zero-calorie brand Coke Zero Sugar. For PepsiCo, food and snacks volume increased 2 percent in the first half of 2017, while beverages declined 1 percent.

R&D

To reverse revenue declines, beverage firms boosted R&D spending at an average annual rate of nearly 20 percent over the past 5 years. R&D spending is likely to remain high in 2017 and 2018 as beverage companies strive to rejuvenate revenue growth. Developing flavored sparkling waters is an example.

Outside the United States

In 2016, international operations represented 62 percent of total non-bottling revenues at Coke and 42 percent at PepsiCo. Coke does business in countries using currencies other than the U.S. dollar, including the euro, the Japanese yen, the Brazilian real, and the Mexican peso. Coke uses 72 currencies in addition to the U.S. dollar. Unfavorable foreign currency exchange rates can have a significant effect on reported revenue growth for global beverage manufacturers, especially since the U.S. dollar's value relative to foreign currencies is on average at a three-year low.

City, County, State, and Federal Taxes

Public health advocates are actively lobbying for soda tax referendums and legislation in more U.S. cities. Companies such as Coke and PepsiCo Soda spent nearly $70 million from 2009 to late 2016 lobbying against soda taxes and warning label measures in U.S. cities and states, as well as an average of about $15 million annually on federal lobbying, according to the consumer advocacy group Center for Science in the Public Interest (CSPI). For example, beverage companies spent about $9.4 million between January 2016 and June 2016 to oppose the Philadelphia City Council's soda tax proposal, according to CSPI's estimates. Philadelphia eventually imposed a soda tax in June 2016, the first major U.S. city (and the second city after Berkeley, California) to do so. In November 2016, three cities in California (San Francisco, Albany, and Oakland) passed their own soda tax laws, as did Cook County, Illinois (which includes Chicago) and Boulder, Colorado. In June 2017, Seattle implemented a tax of $1.75 cents per ounce on sugary drinks and soda. Chicago's soda tax began in Fall 2017.

Taxes on sugary beverages came into effect in Mexico on January 1, 2014, in an effort to combat obesity in the country; higher product costs are likely to dampen demand, and tax revenue could help to fund costs related to preventive actions and medical treatment. Mexico is the country with the biggest obesity problem in the world, according to the Food and Agriculture Organization of the United Nations. This will be a game changer for beverage companies exporting to Mexico (such as Coke). In 2015, soda sales in Mexico plummeted 12 percent. Price-sensitive consumers are turning away from buying soda products.

Beverage Caloric Intake in the United States

In December 2017, the American Beverage Association reported that the average American drank 201.2 calories a day in 2016, up slightly from 2015. More than offsetting the decline in sales of soda and juice in cans or bottles, sales of soda from fountains in restaurants are increasing. And Americans are drinking more and more sweet tea at restaurants. In terms of liquid intake, the average beverage calories consumed in the United States per capita, per day in 2016, was sodas (126.7), juice (42.5), teas (11.2), sports (10.6), and other (10.2)—according to the Beverage Marketing Corporation. Consumption of diet and low-calorie soda continues to fall, but consumption of sports and energy drinks continues to rise at a faster rate. Exhibit 10 reveals the soft drink industry breakdown by type of drinks.

Impulse Buying

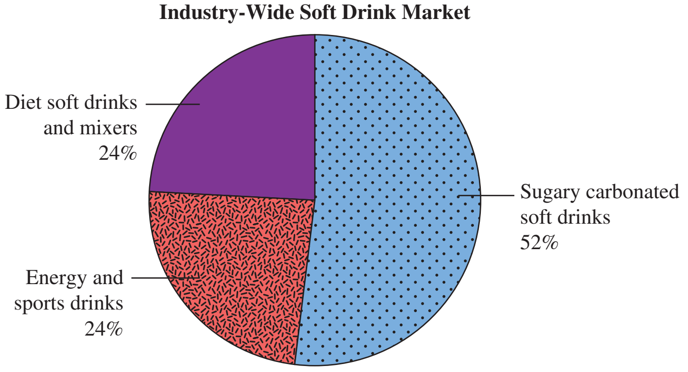
PepsiCo is reinvesting some of the millions of dollars it is saving under the new tax laws in e-commerce, which today accounts for roughly $1 billion in the company's annual retail sales. PepsiCo is also investing savings in training for workers, cash returns for shareholders, and $100 million in employee bonuses. The rise of online shopping is bad news for Coca-Cola and PepsiCo because impulse buying makes up roughly 30 percent of overall beverage sales. Without customers grabbing a Diet Pepsi while checking out at Walmart or a two-liter bottle of Coke Zero at the grocery store, the beverage companies would be in big trouble. Sales of soft drinks by volume have dropped for 12 consecutive years in the United States, so companies like Coca-Cola and PepsiCo need impulse buying, which is being eroded by more online shopping. Coca-Cola is currently investigating click-and-collect grocery sales, bundled deals (such as meal kits), and new impulse "triggers" online.

Future

International operations represent about 62 percent of total non-bottling revenues at Coca-Cola and 42 percent at PepsiCo. PepsiCo obtains approximately 60 percent of its revenues from its food divisions. Last year, PepsiCo and Coca-Cola invested in craft soda brands trying to reverse decreasing soda volume sales. After acquiring two craft soda brands from Monster Beverages, Coca-Cola recently relaunched Blue Sky and Hansen's. A few days later, PepsiCo launched the 1893 Original Cola and Ginger Cola lines, which are made with sparkling water, kola nut extract, and Fair Trade certified sugar.

In August 2016, PepsiCo released a craft carbonated beverage brand called Stubborn, primarily targeting millennials, who prefer healthy beverages. The product uses stevia leaf extract instead of artificial sweeteners; Stubborn is available in unusual flavors such as black cherry with tarragon, lemon berry acai, and orange hibiscus. According to PepsiCo, craft sodas are a growing product line opportunity.

EXHIBIT 10 A Breakdown of the Industry-Wide Soft Drink Market



Source: Based on a variety of sources.

PepsiCo is having trouble with its Gatorade energy drink brand whose sales in the United States declined 0.5 percent to $5.9 billion in 2017. This was the brand's first decline in annual sales since 2012. Gatorade accounts for about 20 percent of PepsiCo's North American drink volume. The company released Gatorade Organic in August 2016 and made $20 million on that product through the end of 2017. The sports-drink market is becoming highly competitive; even up-start BodyArmour, a distant third in market share, is gaining rapidly on PepsiCo in sports drinks, such as Gatorade.

The steady decline in consumption of carbonated beverages necessitates that PepsiCo formulate and implement new strategies going forward. The company needs a full-blown, comprehensive strategic plan in order to determine specific actions needed under the following general categories of strategies:

1. Further global expansion to tap markets not yet saturated
2. Continued product development to introduce new healthy drinks
3. Acquisition of small rival firms to gain growth in revenues
4. Continued market penetration with extensive advertising and promotion to shift consumer perception away from unhealthiness to treating yourself with a soda
5. Continued shift to smaller cans and package sizes
6. Perhaps diversification into snacks and foods as PepsiCo has successfully done
7. Push aggressively into bottled water to capitalize on rapid growth in that sector
8. Develop natural sweeteners to replace artificial sweeteners
9. Increase lobbying to curtail city, county, and state sugar taxes

National Audubon Society—2018

http://www.audubon.org/

Headquartered in New York City, the National Audubon Society (NAS) is a non-profit organization dedicated to conservation with special emphasis on bird protection. It is one of the oldest of such organizations in the world and uses science, education, and grassroots advocacy to advance its conservation mission. The organization is named in honor of John James Audubon, a Franco-American ornithologist and naturalist who painted, cataloged, and described the birds of North America birds in his famous book *Birds of America* published in sections between 1827 and 1838.

At the website www.audubon.org/news/how-birds-would-fare-under-white-house-budget-and-infrastructure-proposals, the NAS news release on February 14, 2018, named many birds that will be hurt if the Trump administration's infrastructure proposals get approved. Such birds mentioned include the tricolored blackbird common loon, yellow-billed cuckoo, snowy plover, reddish egret, and roseate spoonbill. NAS claims to be non-political but the flavor of their website reveals a strong Democratic backing. NAS opposes oil drilling, for example, along the U.S. Pacific and Atlantic coasts, etc. It might benefit NAS going forward to list on their website both side's arguments, such as benefits to communities and citizens versus benefits to birds, so as not to come across as being politically one-sided on key issues.

History

The year was 1896 and both Harriet Hemenway and her cousin Minna Hall were outraged—millions of water birds had been slaughtered in order to make plumes for women's hats. Harriet and Minna initiated a campaign targeted at convincing Boston society ladies to stop wearing hats with bird feathers. This campaign led to the establishment of the Massachusetts Audubon Society the same year. Within 2 years, what started as a series of talks during afternoon tea had grown and spread across the country. State-level Audubon Societies sprang up in New York, Washington, D.C., Pennsylvania, New Jersey, Connecticut, New Hampshire, Illinois, Maine, Wisconsin, Rhode Island, Ohio, Indiana, Tennessee, Minnesota, California, and Texas.

In 1900, Audubon member Frank M. Chapman proposed the first yearly Christmas Bird Count as an alternative to the Christmas "Side Hunt" tradition, the latter of which was a competition between hunters to kill as many mammals as possible, including birds. The Christmas Bird Count (CBC), which has become a long-standing tradition, involves volunteers from across North America counting bird sightings from December 14 to January 5 and creating a census of bird populations. Every November, tens of thousands of volunteers sign up on Audubon's website to participate in the CBC, even in the harshest of weathers. The Christmas Bird Count is the country's most lasting community science bird project, and it contributes a great deal to Audubon's work. It is funded completely by donations which go toward supporting compilers and volunteers on count day and maintaining technology infrastructure.

In 1903, the state-level Audubon Societies joined efforts to help establish the National Wildlife Refuge in Florida. To leverage their size and combined strength, the state-level societies came together and founded the National Association of Audubon Societies in 1905 with an agenda which prioritizes the protection of water birds, including gulls, terns, egrets, and herons.

The 1918 signing of the Migratory Bird Treaty Act (MBTA) by President Wilson constituted a regulatory landmark year in the efforts to protect North American birds. This law places all migratory birds under federal protection and still remains one of the strongest laws enacted to protect birds. Soon after its passing, the NAS started a system of waterbird sanctuaries in seven eastern states which initiated scientific conservation endeavors on a large-scale across the country. In 1940, the National Association of Audubon Societies officially became the National Audubon Society (NAS).

In 2011, NAS developed a strategic plan aimed at creating one Audubon, both in practice and in writing. This plan helped establish partnerships throughout the United States and fostered collaborations among chapters, and resulted in growth in NAS's annual budget from $73 million to over $100 million. Audubon's initiatives broadened focus from single local efforts to a focus on full-lifecycle conservation of birds across the Americas, including five habitats that birds need to thrive: Coasts, Working Lands, Water, Climate, and Bird-Friendly Communities.

In early 2018, there are 23 NAS state offices, 41 nature centers, 454 independent local chapters, and 23 sanctuaries, all of which work together.

Vision/Mission

NAS does not appear to have a formal vision statement. However, the organization's website states (paraphrased) that, "Our vision is to create a world in which people and wildlife thrive." NAS's mission is perhaps captured in a statement (paraphrased) saying "we strive to conserve and restore natural ecosystems, focusing on birds, other wildlife, and their habitats for the benefit of humanity and global biological diversity." Other wording could reflect upon the mission of NAS such as to protect birds and the places they need, today and tomorrow, throughout the Americas using science, advocacy, education, and on-the-ground conservation.

Audubon's state programs, nature centers, chapters, and partners reach millions of people each year to inform, inspire, and unite diverse communities in conservation action.

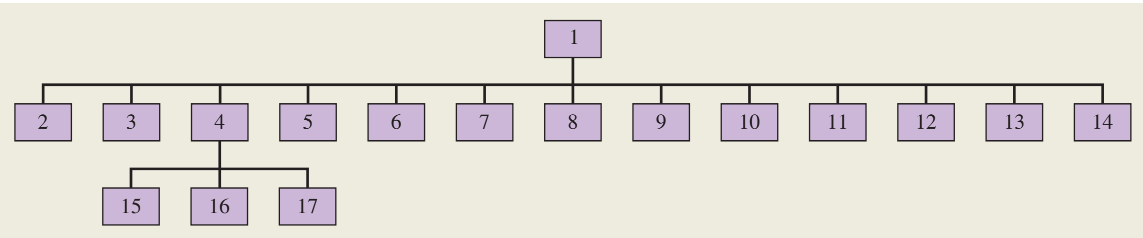
Internal Issues

Organizational Structure

In January 2018, NAS hired several new executives who come with extensive experience. For example, Sarah Rose, CEO of the California League of Conservation Voters, has years of experience forming important relationships with key public policy officials and politicians.

NAS appears to operate using a divisional organizational structure by flyway, yet the Atlantic and Pacific flyways are not represented in executive titles. Perhaps no one but NAS insiders know exactly who reports to whom among the current executives, but what is important in this case is for students to recommend an effective organizational structure going forward rather than trying to decipher the existing structure of the organization. Exhibit 1 provides a list of the NAS top executives and a possible existing organizational chart for the current organization.

EXHIBIT 1 NAS's Top Executives and Organizational Chart



1. David Yarnold, President and CEO
2. Jose Carbonell, CMO
3. Mary Beth Henson, CFO
4. Susan Lunden, COO
5. Peter Vincent, VP, HR
6. Lorraine Sciarra, VP, General Counsel
7. Sean O'Connor, Chief Development Officer
8. David O'Neill, Chief Conservation Officer
9. David Ringer, Chief Network Officer
10. Matthew Anderson, VP, Climate Change and Strategic Initiatives
11. Deeohn Ferris, VP, Equity, Diversity, and Inclusion
12. Sarah Greenberger, VP, Conservation Policy
13. Lisa Hardaway, VP, Communications
14. Gary Langham, VP, Chief Scientist
15. John Beavers, VP, International Alliances Program
16. Doug Meffert,VP, Gulf Coast and Mississippi Flyway
17. Brian Trusty, VP, Central Flyway

Source: Based on company documents.

Segment

NAS's financial statements given later in this case reveal the organization's revenues come from three sources: 1) contributions and grants, 2) bequests, and 3) earned income. However, each annual report of the organization reveals data by flyway as given in Exhibit 2. Revenue by

EXHIBIT 2 National Audubon Society Data by Flyway

	# State Offices		# Nature Centers		# Chapters	
Flyways	2017	2016	2017	2016	2017	2016
Pacific	3	3	4	4	92	94
Central	6	6	7	7	91	95
Mississippi	6	6	8	8	115	118
Atlantic	8	8	22	22	156	156
Total	23	23	41	41	454	445

Source: Based on company information.

flyway is not made public, but note the decline in the number of chapters from 2016 to 2017, indicating that NAS grew its number of chapters by nine in fiscal 2017.

Strategic Plan

NAS posts its strategic plan on the organization's website. Four key pillars are the focus of NAS's 2016–2020 strategic plan: Conservation, Network, Science, and Durable Public Will.

Conservation Programs

Conservation programs are NAS's largest expense, constituting 82 percent of total expenses in 2017, or $104.5 million. The conservation programs are categorized as either field conservation programs or national conservation programs. Field programs are implemented by NAS's 23 offices across different states and regions. The ultimate goal of field programs is to achieve complete lifecycle conservation for all bird species within its focus areas. Field programs constitute the majority (~70–75%) of conservation expenses, with national programs constituting the remaining 25–30 percent. Some of NAS's national conservation programs include: Climate Initiative, Network, Science, Policy, Marketing & Engagement, Hemispheric Strategy, and Diversity & Inclusion.

Network

Audubon's network consists of state offices, nature centers, volunteers, chapters, employees, donors, and partners. Recognizing the importance of its network, NAS recently added the new Chief Network Officer position which is held by David Ringer whose focus is on leading growth and expertise development across the Audubon network. He coordinates activities among NAS offices, centers, and chapters. Audubon's network includes its nature centers which receive one million visitors per year. NAS partners with BirdLife International to implement conservation programs in the United States. NAS contributes data and scientific research to other organizations both nationally and internationally, and partners with five countries on implementing policy changes that are favorable to bird populations.

Science

NAS leverages its volunteer-based bird monitoring to collect data which serves as the foundation for the organization's development of conservation and bird advocacy programs, while also fostering local engagement and building public interests in bird science. The organization conducts scientific research to influence strategic goals, and gathers data along flyways on bird habitat, how bird species are responding to changes in climate, etc. Through events such as the Christmas Bird Count (CBC) and Great Backyard Bird Count, NAS encourages local participation in data gathering, engages with communities and citizens, and strives to raise awareness in bird issues. Details gathered from science programs gives NAS a unique data point for its conservation efforts.

Durable Public Will

Public will is essential for bird well-being, so NAS works to ensure that public policy and private enterprises avoid engaging in activities which may be harmful to birds or their future environments. For example, in 2018, a jetty was to be constructed at Shallotte Inlet near Ocean Isle Beach, North Carolina, but a lawsuit by NAS alleging the jetty would harm nesting bird populations shut down the project to the dismay of many local boaters. NAS is an activist, continuously engaging with the public to keep bird and conservation-related issues at the top of citizens' minds throughout the Americas.

The NAS works to encourage the passage of bird-friendly policies and legislation that increase the use of renewable energy. Such efforts are bipartisan in nature and take full advantage of NAS's one million members and allies. NAS has achieved success over the years in areas such as: 1) restoring large ecosystems such as the Arctic Slope in Alaska, the Everglades wetlands, and the Mississippi River Delta; 2) protecting nearly 3,000 important bird areas covering approximately 400 million acres of public and private lands; and, 3) supporting laws like the Clean Air Act, Clean Water Act, Endangered Species Act, and the Neotropical Migratory Bird Conservation Act.

To accomplish its "durable public will" goals, engagement with grassroots supporters is key, but NAS also uses its website, social media platforms, marketing through email, and *AUDUBON* magazine, which has a readership of 1.5 million people. Through digital applications, the NAS has achieved over 1 million downloads of its nature guides.

Strategy

NAS strives to educate schoolchildren, families, and nature lovers of all ages by offering informative materials and programs at the Audubon centers and sanctuaries, as well as through the *Audubon Magazine*. Using its network, NAS develops conservation plans and then works with lawmakers and other agencies to implement programs to promote bird welfare and petition or file lawsuits against initiatives that could harm birdlife.

NAS volunteers and bird enthusiasts for more than a hundred years have participated in annual "citizen science programs" aimed at collecting census-type data of birds throughout the Americas. Today, this data is used by Audubon, as well as other wildlife agencies, conservation biologists, etc. to assess the current state of bird populations, identify trends in the evolution and health of bird species, reveal changes in migratory or flight patterns, and to ultimately guide the development of necessary conservation initiatives.

NAS's strategy for bird conservation focuses in five key areas: 1) Coasts, 2) Working Lands, 3) Water, 4) Climate, and 5) Bird-Friendly Communities. These areas aim to cover the full-lifecycle of bird breeding, wintering, and migration throughout the Americas.

Coasts

The NAS's conservation efforts on coasts are focused on protecting and rehabilitating coastlines to give shorebirds a better chance of survival. NAS does not like the rise in sea levels due to climate change and works its network to change policies at the local, state, and national level to favor birdlife. The NAS partners with organizations with similar interests in Latin America. Coastal area initiatives and programs represent the greatest cost to NAS, and it allocates $18–$20 million annually of its budget to conservation efforts in this regard.

Working Lands

Nearly half of the land in the lower 48 states are referred to by NAS as "working lands." Audubon partners with forest, ranch, and farm landowners, land managers, private industry organizations, and governmental agencies to enhance the condition of bird habitats, promote bird-friendly practices, and devise policies for large-scale land management conversation practices. NAS tries to get landowners to adopt methods that are beneficial to birds, and annually allocates about $8–10 million to "take care of birds on working lands."

Water

The NAS's conservation efforts in this area are around getting the public involved on water rights and improving the quality of water, rehabilitating bird habitats beside the rivers, and leveraging other open market initiatives that can help to achieve its goals. NAS allocates $12–15 million of its budget to these efforts.

Climate

NAS scientists have concluded that North American bird species face the possibility of losing at least half of their habitat by the year 2080 due to rising sea levels. To combat this, NAS spends between $10–12 million annually of curtailing global warming by working with local, state, and federal officials to help birds by reversing global warming. Some analysts say NAS is too harsh on Americans since much of the cause for global warming falls on other countries such as China. In Bangkok, Thailand, for example, air pollution was so bad in 2018 that residents were encouraged to wear masks outside of homes and buildings.

Bird-Friendly Communities

NAS allocates $12–14 million of its annual budget to the work of creating bird-friendly communities. The organization especially wants to protect breeding places for birds, especially along coastal areas.

Finance

NAS's fiscal year ends on June 30. The organization's income statements and balance sheets are provided in Exhibit 3 and Exhibit 4, respectively. NAS generated revenue of $112.2 million during 2017, up 9.33 percent from the previous year. Most of the revenue (69 percent) came from contributions and grants from donors and members; 12 percent came from bequests; 8 percent of the revenue stemmed from earned income; 9 percent from investment earnings, and the remaining 2 percent of revenue came from royalties. Total expenses in 2017 were $104.5 million, resulting in $7.7 million in earnings before tax. Eighty-two percent of expenses were from conservation programs (59 percent field programs and 23 percent national programs); 14 percent was for fundraising activities (5 percent for membership development and 9 percent for other development activities), and 4 percent was spent on general management expenses. Endowments for fiscal 2017 grew by $53.4 million to $185.3 million.

Notice on the balance sheets that NAS is very liquid having a current ratio over 7. Some select financial ratios are provided in Exhibit 5 and reveal that NAS is quite liquid, has improving margins, and has reduced its debt situation—so fiscal 2017 was an improvement from 2016 for the organization. Exhibit 6 provides a further breakdown of NAS's spending in 2016 and 2017.

EXHIBIT 3 NAS's Income Statements (000 omitted)

Income Statement	6/30/16	6/30/17		Percent Change
Revenues	$102,620	$112,196	⇧	9.33%
Cost of Goods Sold	0	0	NA	NA
Gross Profit	102,620	112,196	⇧	9.33%
Operating Expenses	97,442	104,532	⇧	7.28%
EBIT	5,178	7,664	⇧	48.01%
Interest Expense	0	0	NA	NA
EBT	5,178	7,664	⇧	48.01%
Tax	0	0	NA	NA
Non-Recurring Events	(24,386)	32,668	NA	NA
Excess of Unrestricted Support and Revenues over Expenses	(19,208)	40,332	NA	NA

Source: Based on company documents.

EXHIBIT 4 NAS's Balance Sheets (000 omitted)

Balance Sheet	6/30/16	6/30/17		Percent Change
Assets				
Cash and Short-Term Investments	$34,897	$36,949	↑	6%
Accounts Receivable	18,804	25,169	↑	34%
Inventory	0	0	NA	NA
Other Current Assets	2,748	2,927	↑	7%
Total Current Assets	56,449	65,045	↑	15%
Property Plant & Equipment	147,152	147,101	↓	0%
Goodwill	0	0	NA	NA
Intangibles	0	0	NA	NA
Other Long-Term Assets	252,630	277,606	↑	10%
Total Assets	**456,231**	**489,752**	↑	**7%**
Liabilities				
Accounts Payable	8,615	8,585	↓	0%
Other Current Liabilities	0	0	NA	NA
Total Current Liabilities	8,615	8,585	↓	0%
Long-Term Debt	6,307	6,524	↑	3%
Other Long-Term Liabilities	25,727	18,729	↓	−27%
Total Liabilities	40,649	33,838	↓	−17%
Net Assets				
Changes in Net Assets	(19,208)	40,332	NA	NA
Net Assets Beginning of Year	434,790	415,582	↓	−4%
Net Assets End of Year	415,582	455,914	↑	10%
Total Liabilities and Net Assets	**456,231**	**489,752**	↑	7%

* *Note:* Net assets includes Unrestricted, Temporarily Restricted, and Permanently Restricted assets. Nonprofit organizations do not have Retained Earnings per se but they do annually carry Net Assets over from the Income Statement to the Balance Sheet following the same process as for-profit firms.

Source: Based on company documents.

EXHIBIT 5 NAS's Current Financial Ratios

Historical Ratios		
	6/30/2016	6/30/2017
Current Ratio	6.55	7.58
Quick Ratio	6.23	7.24
Total Debt-to-Total-Assets Ratio	0.09	0.07
Total Debt-to-Equity Ratio	0.10	0.07
Total Assets Turnover	0.22	0.23
Accounts Receivable Turnover	5.46	4.46
Average Collection Period	66.88 days	81.88 days
Gross Profit Margin %	100	100
Operating Profit Margin %	5	7
ROA %	−4	8
ROE %	−5	9

Source: Based on company documents.

EXHIBIT 6 **NAS's Spending Activities in 2016 and 2017 (000 omitted)**

OPERATING ACTIVITIES	6/30/2016	6/30/2017	Percent Change
REVENUES, GAINS, AND OTHER SUPPORT			
Contributions and grants	$71,156	$77,187	8.48%
Bequests	$9,435	$13,361	41.61%
Earned income	$10,663	$9,149	−14.19%
Investment earnings on non-pooled funds, net	$2,337	$1,774	−24.09%
Investment earnings on pooled funds – appropriated, net	$8,137	$8,255	1.46%
Royalties, net and other revenue	$893	$2,469	176.43%
Net assets released from restrictions	–	–	
Total revenues, gains and other support	$102,620	$112,196	9.33%
EXPENSES			
Conservation programs:			
Field conservation programs	$53,564	$61,346	14.53%
National conservation programs	$24,780	$23,762	−4.11%
	$78,344	$85,108	8.63%
Fundraising:			
Membership development	$4,861	$5,813	19.58%
Other development	$9,479	$9,112	−3.87%
	$14,340	$14,925	4.08%
Management and general	$4,759	$4,500	−5.43%
Total expenses	$97,442	$104,532	7.28%
Changes in net assets from operations	$5,178	$7,664	48.01%
NON-OPERATING ACTIVITIES			
Sales of property	$4	−$14	−501.60%
Investment gain/loss on pooled funds not appropriated, net	−$15,479	$20,999	−235.66%
Charitable trust additions	$607	$579	−4.51%
Change in value of charitable trusts	−$5,906	$3,291	−155.72%
Changes in net assets before pension and postretirement related changes	−$15,598	$32,519	−308.49%
Pension and postretirement related changes other than net periodic costs	−$3,610	$7,813	−316.41%
Changes in net assets	−$19,208	$40,332	−309.97%
Net assets, beginning of year	$434,790	$415,582	−4.42%
Net assets, end of year	$415,582	$455,914	9.70%

Source: Based on company documents.

External Issues

In 2018, the White House is moving to expand oil drilling along the U.S. coasts. Audubon experts vehemently oppose vast oil offshore drilling, arguing that drilling could further stress an already fragile ecosystem by increasing the risk of oil spoils which could be devastating to the marine ecosystem as well as the habitats it provides for millions of shorebirds and marine mammals. NAS is helping communities rally against offshore drilling and working to pass policies prohibiting expanded offshore drilling.

In May 2018, the Secretary of the Interior, Ryan Zinke, announced a proposal to expand hunting and fishing opportunities to 30 National Wildlife Refuges, spanning more than 248,000 acres. Of the 30 refuges identified, 20 refuges in 19 states would begin to allow migratory game bird hunting opportunities beginning with the 2018–2019 hunting seasons. The White House would like Americans to have access to quality places to hunt and fish to help preserve our nation's hunting and fishing heritage. Dale Hall, CEO of Ducks Unlimited, says his organization "looks forward to working with the Department of the Interior to help identify opportunities to increase access for sportsmen and women."

National Wildlife Refuges in the United States currently have more than 53 million visitors a year. Among these lands, 337 wildlife refuges and 37 wetland management districts are open to hunting in accordance with state regulations. If the new proposal is approved, 377 refuges would be open for hunting opportunities. Greg Sheehan, U.S. Fish Wildlife Service (USFWS) principal deputy director, fully supports the proposal, saying "Hunters and anglers have provided critical funding for wildlife conservation in America for more than a century." The National Wildlife Refuge System is made up of about 750 million acres of water and 100 million acres of land in the United States. The USFWS is currently seeking public comments to the proposed rule for 30 days.

Philanthropic Giving

According to *Giving USA 2017: The Annual Report on Philanthropy for the Year 2016*, released on June 12, 2017, total charitable donations in the United States rose 2.7 percent in 2016 to $390.05 billion. *Giving USA* is the longest-running and most comprehensive report of its kind in the United States. The *Report* is published by Giving USA Foundation, part of The Giving Institute housed at the Indiana University Lilly Family School of Philanthropy. Details of the Report reveal that giving by individuals and foundations rose, but giving by bequest or estates fell sharply. The *Report* issued in June 2018 showed substantial increases in giving in the United States as the nation's economy and stock markets improved substantially. The Lilly School at Indiana University also publishes *The Philanthropy Outlook* that currently projects increases in giving in the United States.

Bird Watching

The Department of Interior's September 7, 2017, report shows that the largest increases in participation involve wildlife watching in recent years has come from observing and photographing wildlife. These activities surged 20 percent from 2011 to 2016, from 71.8 million to 86 million participants during that time. Expenditures by wildlife watchers rose sharply (28 percent) between 2011 and 2016, from $59.1 billion to $75.9 billion. Around-the-home wildlife watching increased 18 percent from 2011, from 68.6 million in 2011 to 81.1 million participants in 2016. Lower increases were reported for away-from-home wildlife watchers: 5 percent increase from 2011 to 2016, from 22.5 million to 23 million participants.

Competitors

NAS competes indirectly with all wildlife or conservation-oriented nonprofit organizations that depend on donations to fund operations, including World Wildlife for Nature, Sierra Club, National Wildlife Federation, Ocean Conservancy, Defenders of Wildlife, Nature Conservancy, Cornucopia Institute, Friends of the Earth, Duck's Unlimited, and even 350.org. However, one of these nonprofit organizations is most similar to NAS in focusing on bird conservation in North America; the entity is Duck's Unlimited.

Ducks Unlimited

DU is an American nonprofit, volunteer-based 501(c) organization dedicated to the conservation of wetlands and associated upland habitats for waterfowl, other wildlife, and people. Founded by Joseph Knapp in 1937, DU has maintained a worldwide presence of about 700,000 members and 40,000 volunteers. As of January 1, 2017, DU had 620,853 adult members and 45,357 youth members, whereas DU Mexico had 4,662 members and DU Canada had 130,000 members.

DU looks to partner with a wide range of corporations, governments, communities, landowners, and private citizens to restore and manage wetlands that have been degraded and to prevent further degradation. DU sources of revenue include federal and state habitat reimbursements, conservation easements, sponsors and members, major gifts and donations, and royalties/advertisement. Through its conservation activities, DU benefits biodiversity, water quality, the environment and the economy in the areas in which it is active.

DU is the world's largest private organization devoted to waterfowl habitat conservation. Although ducks and geese are the primary beneficiaries of DU operations all over North America, all kinds of wildlife, people, and communities benefit from DU programs and initiatives.

DU's fiscal year ends on June 30. The DU FY17 saw the organization's revenues decline slightly to $224 million as more than 58,000 DU volunteers hosted over 577,000 attendees at 4,050 events, a slight increase over the prior year's 3,900 events held. DU's FY17 also benefited from 5,000 major donors and 700,000 members contributing over $86 million to the organization, an increase of $1.8 million over the prior year. Fully, 83 percent of all DU revenues in FY17 went to conservation. DU has an important partnership with Bass Pro Shops (BPS); BPS promotes DU on its BPS Chevrolet at NASCAR's Coke Zero 400 in Daytona, Florida.

In FY17, DU obtained 39 percent of its revenue from federal and state habitat support and nongovernmental partnerships while 25 percent was derived from events, sponsorships, and memberships. About 19 percent of DU's funding came from donated conservation easements and public service announcements, while another 12 percent came from major gifts and endowments. The remaining 5 percent came from royalties, advertising, and other sources. DU's goal for its *Rescue Our Wetlands* campaign is to raise $2 billion for wetlands conversation by December 2018. DU's FY17 ended with $1.82 billion raised, so the organization is close to reaching its $2 billion goal.

Future

Karen Thorne, an ecologist with the U.S. Geological Survey, revealed in early 2018 that as sea levels rise, waters will inundate all coastal marshes in California and Oregon, and most of those in Washington by 2110. However, Thorne reports that sea level rise will progress slowly through 2050, then accelerate, giving today's managers enough time to prepare marshes, and their birds, for the changes to come. Aududon plans to be at the forefront of initiatives to save birds on the U.S. west, Gulf, and east coasts.

Some analysts suggest that Audubon should become less political in its approach to saving birds, being more compassionate to people affected by rising sea levels and other issues and initiatives. For example, Audubon often files lawsuits to shut down jetties being built in inlets and staunchly opposes oil drilling off the east coast of the United States, and a multitude of other initiatives. Analysts suggest that Audubon consult with local residents more genuinely before filing lawsuits, thus being less—or as some would say—staunch liberals.

Audubon is concerned that philanthropic giving and donations may drop precipitously in 2018–2020 given the new federal tax code that basically takes away philanthropic giving as a tax deduction. Audubon needs a clear strategic plan going forward as seas are rising and birds and people are being impacted.

MTN Group Limited—2022

www.mtn.com

Headquartered in Johannesburg, South Africa, and with nearly 20,000 employees, MTN Group Limited (MTN) is a large mobile telecommunications company that provides Africa, the Middle East, and Asia with phone and Internet services. At year-end 2020, MTN reported having 280 million subscribers, making it the eighth largest mobile network firm in the world, and by far the largest phone and Internet provider in South Africa. MTN is active in 20 countries, but in Nigeria, the firm has 35 percent market share, and the country contributes a third of MTN's total revenues. MTN's common stock is listed on the Johannesburg Stock Exchange (JSE) under JSE: MTN.

In August 2020, MTN divested its stakes in various companies in Syria, Afghanistan, and Yemen and also sold its 49 percent minority holding in Irancell over time. The reason given by MTN for these actions was that overall the Middle East contributed less than 4 percent to Group earnings in the first half of 2020.

In February 2021, MTN partnered with Mastercard to facilitate global e-commerce payments of the MTN customer base in 16 African countries. This business action included a Mastercard virtual payment platform being linked to MTN MoMo (Mobile Money) wallets.

In March 2021, MTN CEO Ralph Mupita announced that the group was considering spinning off its mobile money activities. The estimated value of the group's mobile money arm is at least $5 billion.

History

MTN was founded in 1994 when the South African government assisted a firm named M-Cell in beginning its operations. In 2009, MTN completed its purchase of Verizon Business South Africa, which provided network data services to five African countries. In both 2014 and 2015, MTN was named the Most Admired and Most Valuable Brand in Africa. In September 2020, MTN hired a new CEO, Ralph Mupita, to replace Rob Shuter, who had been the CEO of MTN for 4 years.

In 2020, MTN obtained 504 million licenses in Yemen, 1.19 billion in Ghana, 32 million in Nigeria, 24 million in Afghanistan, and 1.774 billion in Uganda, in comparison to the prior year's 31 million in Zambia, 51 million in Benin, 104 million in Ghana, 249 million in Nigeria, and 2 million in Uganda. MTN reported a profit after tax for 2020 of R$ 19.6 billion, up from the prior year's R$ 10.8 billion. The company paid no dividends to shareholders in 2020.

Mission/Vision Statement

MTN seemingly does not have a written, published vision or mission statement, so proposed statements are provided below:

Vision Statement

To provide everyone in Africa with an affordable, modern, quality, and connected life.

Mission Statement

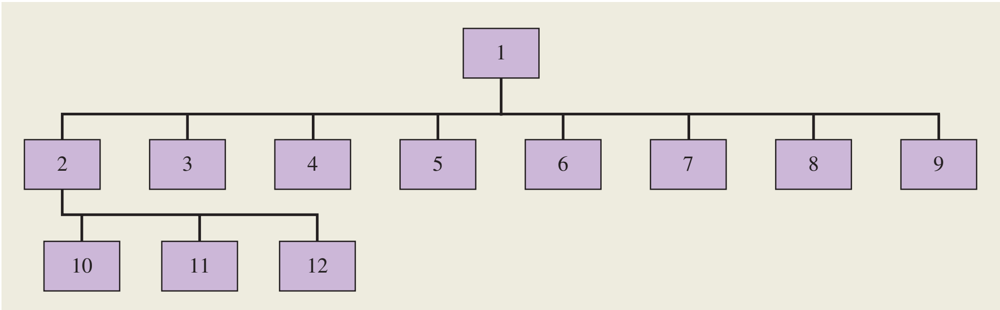
MTN is on a mission to provide leading digital solutions for Africa. We believe everyone in Africa deserves to have a modern, connected life through digital and financial inclusion. We will work diligently to fill the gaps and help supply Africa with more comprehensive coverage. We are working hard on providing 5G to our customers and achieve all we do through excellent and talented employees.

Internal Issues

Organizational Structure

T. Molefe took over as CFO of MTN in mid-2021. R.A. Shuter resigned from the position of Group President and CEO in August 2020 and was replaced by R.T. Mupita, who was previously CFO of MTN. Exhibit 1 provides an organizational chart for the company. Note that numbers 10, 11, and 12 report to number 2, indicating that the company operates from a divisional-by-region organizational design. However, only 3 of the 14 regional segments that are mentioned in the MTN *Annual Report* are clearly represented, so improvements are needed in the structural alignment of MTN. Four of the 12 top executives—Y. Cuba, Lele Modise, T. Molefe, and F. Sekha—are female, which is a positive start.

EXHIBIT 1 **MTN's Top Executives Listed and Arrayed**



1. R. Mupita, Group President and CEO
2. J. Schulte-Bockum, Group COO
3. T. Molefe, Group CFO
4. P.D. Norman, Group Chief HRM Officer
5. C. Molapisi, Group Chief Technology/Information Officer
6. Lele Modise, Group Chief Legal Counsel
7. F. Sekha, Group Chief Regulatory and Corporate Affairs Officer
8. K. Ndamase, Group Chief M&A and Business Development Officer
9. S. Dioum, Group Chief Digital and Fintech Officer
10. G. Motsa, CEO of MTN South Africa
11. K. Toriola, CEO of MTN Nigeria
12. Y. Cuba, Vice President of SEA

Source: Based on information at www.mtn.com/who-we-are/leadership/executive-committee.

Financial Data and Statements

As indicated in Exhibit 2, MTN reported an 18 percent revenue increase in 2020 and an 81 percent increase in net income versus the prior year, with Network Services accounting for most of the income. Recall from the chapters that shareholders expect at least a 5 percent top line (revenues) and bottom line (net income) growth from any firm annually, so MTN is doing very well based on that criteria.

MTN's balance sheets provided in Exhibit 3 reveal that the total equity in the firm increased 23 percent in 2020. The firm combines goodwill and intangibles into one line item, so the absence of intangibles on the reported balance sheet may not be entirely accurate.

Segments

MTN reports segment data annually by both region and product. The regions are 1) South Africa, 2) Nigeria, 3) South and East Africa and Ghana (SEAGHA), 4) West and Central Africa (WECA), and Middle East and North Africa (MENA). SEAGHA is now called SEA as Ghana has been moved to WECA.

Exhibit 4 provides a 2020 segment breakdown of MTN's revenues across both regions and products. Note the bulk of revenue is from Network Services, but don't forget about digital and fintech (financial technology). Fintech is a popular way to pay for goods and services across Africa and a key area of growth moving forward. Fintech is also related to and depends on the other divisions, so increases in fintech revenues will also increase revenues from the other segments.

EXHIBIT 2 MTN's Income Statement (in millions of ZAR)

Income Statement	12/31/19	12/31/20		Percent Change
Revenues	151,931	179,361	↑	18%
Cost of Goods Sold	11,929	11,093	↓	–7%
Gross Profit	140,002	168,268	↑	20%
Operating Expenses	108,573	123,673	↑	14%
EBIT	31,429	44,595	↑	42%
Interest Expense	13,692	15,509	↑	13%
EBT	17,737	29,086	↑	64%
Tax	6,908	9,439	↑	37%
Non-Recurring Events	–	–	NA	NA
Net Income	10,829	19,647	↑	81%

Source: Based on MTN's 2020 *Annual Report*, pp. 22–23.

EXHIBIT 3 MTN's Balance Sheets (in millions of ZAR)

Balance Sheet	12/31/19	12/31/20		Percent Change
Assets				
Cash and Short-Term Investments	21,739	30,990	↑	43%
Accounts Receivable	26,047	27,216	↑	4%
Inventory	2,995	1,534	↓	–49%
Other Current Assets	24,663	50,020	↑	103%
Total Current Assets	75,444	109,760	↑	45%
Property Plant & Equipment	98,312	100,576	↑	2%
Goodwill	36,866	39,069	↑	6%
Intangibles	–	–	NA	NA
Other Long-Term Assets	91,689	99,537	↑	9%
Total Assets	302,311	348,942	↑	15%
Liabilities				
Accounts Payable	36,630	41,880	↑	14%
Other Current Liabilities	47,209	66,419	↑	41%
Total Current Liabilities	83,839	108,299	↑	29%
Long-Term Debt	120,728	122,210	↑	1%
Other Long-Term Liabilities	11,644	12,208	↑	5%
Total Liabilities	216,211	242,717	↑	12%
Equity				
Common Stock	36,929	36,929	↓	0%
Retained Earnings	57,863	71,263	↑	23%
Treasury Stock	–	–	NA	NA
Paid in Capital & Other	(8,692)	(1,967)	NA	NA
Total Equity	86,100	106,225	↑	23%
Total Liabilities and Equity	**302,311**	**348,942**	↑	15%

Source: Based on MTN's 2020 *Annual Report*, p. 24.

EXHIBIT 4 MTN's 2020 Revenues by Region and by Product (in millions of ZAR)

Region	Network Services	Mobile Devices & Roaming	Interconnect	Digital & Fintech	Other	Total
South Africa	29,639	8,449	3,481	2,170	1,331	45,070
Nigeria	49,054	294	5,732	2,341	559	57,980
SEAGHA	23,485	332	1,659	7,777	781	34,034
Ghana	11,648	120	749	4,487	241	17,245
Uganda	5,570	53	437	2,135	125	8,320
Other SEACHA	6,267	159	473	1,155	415	8,469
WECA	20,107	183	2,581	3,921	835	27,627
Cote d'Ivoire	5,697	47	1,101	1,472	459	8,776
Cameroon	5,118	46	459	994	69	6,686
Other WECA	9,292	90	1,021	1,455	307	12,165
MENA	8,568	21	1,228	477	129	10,423
Syria	2,036	1	32	213	13	2,295
Sudan	2,526	11	623	119	27	3,306
Other MENA	4,006	9	573	145	89	4,822

Source: Based on information in the MTN *Annual Report 2020*, p. 39.

Analogous to Exhibit 4, Exhibit 5 provides a 2019 segment breakdown of MTN's revenues across both regions and products. Note the higher numbers in 2020 especially for Nigeria in all categories versus some declines in 2020 for South Africa.

Exhibit 6 reveals MTN's EBIT and capital expenditures by segment for 2020 versus 2019. Note that the company has increasing profits everywhere except Syria and increasing capital expenditures in 9 of 14 regions across Africa.

Strategy

Some of the strategic transactions reported by MTN in 2020 include the following:

1. Dilution of the company's interest in MTN Zambia by 8 percent
2. Disposal of the company's 18.9 percent interest in Jumia Technologies AG
3. Disposal of the company's 49 percent holdings in Uganda Tower InterCo and Ghana Tower InterCo

EXHIBIT 5 MTN's 2019 Revenues by Region and by Product (in millions of ZAR)

Region	Network Services	Mobile Devices & Roaming	Interconnect	Digital & Fintech	Other	Total
South Africa	27,926	9,017	4,381	2,066	1,635	45,025
Nigeria	39,545	88	4,995	1,584	484	46,696
SEAGHA	18,333	315	1,757	5,983	681	27,069
Ghana	9,275	90	915	3,326	214	13,820
Uganda	4,463	61	409	1,681	86	6,700
Other SEACHA	4,595	164	433	976	381	6,549
WECA	16,240	171	2,280	2,511	619	21,821
Cote d'Ivoire	4,535	37	899	1,041	405	6.917
Cameroon	4,248	62	457	571	51	5,389
Other WECA	7,457	72	924	899	163	9.515
MENA	7,520	37	1,006	343	71	8.977
Syria	2,745	-	51	167	23	2,986
Sudan	1,335	5	472	69	22	1,903
Other MENA	3,440	32	483	107	26	4,088

Source: Based on information in the MTN *Annual Report 2020*, p. 40.

EXHIBIT 6 MTN's 2020 vs. 2019 EBIT and Capital Expenditures (in millions of ZAR)

	EBIT		Capital Expenditures	
	2019	**2020**	**2019**	**2020**
South Africa	16,972	17,742	11,295	7,542
Nigeria	25,149	29,506	9,750	12,694
SEAGHA	12,136	16,802	5,554	6,063
Ghana	7,014	9,097	2,850	3.021
Uganda	3,150	4,118	1,147	1,328
Other SEAGHA	1,972	3,587	1,557	1,714
WECA	6,081	8,620	3,231	3,418
Cote d'Ivoire	1,814	3,042	918	1,064
Cameroon	1,635	2,149	573	950
Other WECA	2,632	3,429	1,740	1,404
MENA	2,836	3,352	1,989	1,642
Syria	1,173	574	939	751
Sudan	677	1,428	430	495
Other MENA	986	1,350	620	396

Source: Based on information in the MTN *Annual Report 2020*, pp. 42 and 43.

4. Reclassification of the company's 20 percent interest in Belgacom International Carrier Services (BICS) to non-current assets held for divestiture
5. Reclassification of the company's share of MTN Syria to non-current assets held for divestiture

Of MTN's revenue in 2020, outgoing voice calls led all income sources, accounting for over 64 percent more revenue than data, which was the second largest revenue driver. With the increased use of smartphones in Africa, which are slowly replacing feature phones, data will close in on voice calls as a revenue generator. At 20 percent, MTN's Fintech and Mobile Money (MoMo) is the mobile money arm of the firm. Many people across Africa do not have bank accounts and do not carry money around with them, so MTN's Fintech provides a secure, safe, and reliable way to pay for items. MoMo grew by 55 percent in the 2 years from March 2018 to March 2020, adding 12 million new active subscribers, with another 12 million added by March 2021, bringing the total number of customers using the service to 47 million.

Competitors

MTN has more than 50 competitors around the world, but in South Africa, the company's primary competitors are Vodacom, Cell C, and Telkom Mobile.

Vodacom South Africa

Headquartered in Johannesburg, South Africa, and founded in 1994, Vodacom is 60.5 percent owned by Vodafone, one of the world's largest telecommunications companies. Vodacom serves 296 million people in Africa, especially in South Africa, Tanzania, the Congo, Mozambique, Lesotho, and Kenya. In July 2021, Vodacom and Nokia announced their successful trial of a high-speed optical transmission network that will support 5G and high-tech transmissions from Midrand to Cape Town in Africa.

Vodacom spent R$ 67 million in their fiscal year that ended March 31, 2021, deploying 3G and 4G Internet services at new sites in deep rural areas in Bethlehem, Fouriesburg, Clocolan, Fauresmith, Griekwastad, Bothaville, Kroonstad, Portsmaburg, Jagersfontein, Parys, Qwa-Qwa, Prieska, Kgalagadi, Theunissen, Ubuntu, Joe Morolong, Siyancuma, Tokologo, Mangaung, Tswaing, Ga-Segonyana, Kagisono-Molopo, Dikgatlong, Matjhabeng, Sol Plaatje, Dihlabeng, and Naledi. Vodacom's Rural Coverage Acceleration Program is committed to expanding Internet coverage for people who live in deep rural areas of South Africa and beyond. This effort is having a significant positive societal impact in Africa: It allows tens of thousands of school-going children to access the Internet every day; people can now actively look for and apply for jobs using their smartphones; and people who previously had to travel long distances to avail basic banking services are now doing this on their smartphones at home.

Cell C

Founded in 2001 as a mobile communications company in South Africa, Cell C was appointed in March 2021 as one of the preferred service providers to the South African government for phone services from April 2021 to March 2026. One of the requirements for a firm looking to provide this nationwide phone service was that it had to already have at least 80 percent network coverage throughout South Africa.

Cell C reported revenues of R$ 13.8 billion in fiscal 2020, an 8 percent drop from the prior year, along with a net income loss of R$ 5.5 billion, on the heels of a loss of R$ 4 billion in fiscal 2019. Cell C reports revenue by five types: Prepaid, Contract, Broadband, Mobile, and Other, which in millions of rand in fiscal 2020 were 6,191, 3,451, 703, 10,345, and 2,644, respectively. All of these revenue numbers were down on average 11 percent from the prior year. However, the company's total subscriber base at the end of the fiscal year 2020 was 12.5 million, up from 11.7 million the prior year.

Telkom Mobile

Founded in October 2010 and headquartered in Centurion, South Africa, Telkom is a large mobile telecommunications company. Telkom provides voice and data products and services using 2G and 3G networks. The company offers both business and residential customers integrated voice, data, fixed voice, mobile IT, and data center solutions and services. Telkom reported revenues for their fiscal year that ended March 31, 2021, of R$ 43.2 billion, up from R$ 43.0 billion the prior year. The company's profits reported on that date were R$ 2.4 million, up from 540 million the prior year. The South African Government owns 40.5 percent of Telkom, while 49.6 percent of the company shares are held by institutional shareholders. Telkom's active mobile subscriber numbers were 9.7 million in fiscal 2019, 12.0 million in fiscal 2020, and 15.3 million in fiscal 2021, up 27.8 percent over those years, so the company is doing great. Telkom's broadband subscriber numbers were 6.4 million in fiscal 2019, 8.2 million in fiscal 2020, and 10.3 million in fiscal 2021, up 25.6 percent over those years, which is more evidence that this is a major rival to MTN.

External Issues

There is a high positive correlation between increased Internet access and economic growth, so by providing connectivity in rural areas of Africa, MTN and Vodacom are spurring prosperity on the continent. A World Bank study recently concluded that a 10-percent increase in fixed broadband penetration could increase gross domestic product (GDP) growth by 1.21 percent in developed economies and 1.38 percent in developing ones. New Internet services in Africa are benefiting all segments of society, such as e-health, e-education, and e-commerce.

Though spreading slowly throughout Africa, 5G delivers faster download and upload speeds, decreases the time it takes devices to communicate with wireless networks, and enables greater connectivity of devices than 4G or 3G networks; it would allow use of the cloud, big data, AI, and the Internet of Things (IoT), ultimately improving human lives.

The World Economic Forum (WEF) recently reported that 5G will change the world even more profoundly than 3G and 4G and that it will be as revolutionary as electricity or the automobile, benefiting entire economies and entire societies. Specifically, 5G will enable more efficient manufacturing through predictive intelligence, improve workplace and worker safety, and enhance operational effectiveness in industries. For example, in the African agriculture sector, 5G enables farmers to monitor the health of crops and livestock. An increase in broadband penetration is closely linked in Africa with job creation, improved education, better service delivery, and increased rural development.

The eventual rollout of mobile broadband across Africa will spur new businesses and promote existing ones such as Uber, Facebook, and AirBnB as well as virtual classrooms and remote medical service deliveries, changing the way people in Africa live. In fact, the WEF forecasts that 5G technology will create approximately R$ 55 trillion in economic output and 22.3 million jobs by 2035 in South Africa alone. For example, within the energy sector, utilities, towns, cities, and villages are turning to smart energy solutions such as smart metering and smart-grid communications.

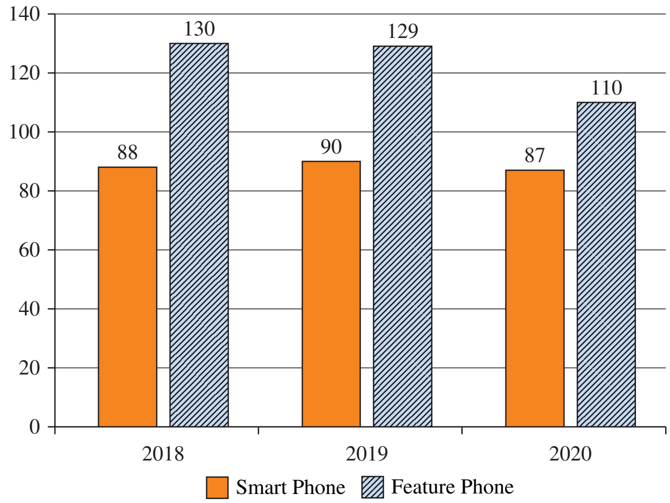
Investments in 5G networks by firms such as MTN and Vodacom will reach R$ 15 trillion worldwide by 2025, according to the Global System for Mobile Communication (GSM Association).

Mobile Phone Shipments in Africa

Smartphone shipments in Africa in 2018 and 2019 revealed that there were over 40 percent more feature phones shipped than smartphones. However, in 2020 this number declined to about 26 percent, and this trend is expected to continue, which will likely create increased demand for 4G and 5G capabilities as more consumers use these services. Major Chinese manufacturer Transsion leads all market share in Africa with 44 percent of the phone market as of Q1 2021 through its brands Tecno, Itel, and Infinix. Samsung, by comparison, held 23 percent of the market share during the same time. Chinese manufacturers Huawei, OPPO, and Xiaomi are all in the top 5 of market share in Africa. A major reason customers value these brands is that 42 percent of all smartphones in Africa can be purchased for less than $100.

Another reason for the increase in smartphones among Africans is simply that people generally do not have a personal bank but are able to use a Mobile Money account to store and transfer funds, with 200 million users in sub-Saharan Africa, the Middle East, and Northern Africa making over 27 billion transactions in 2020. Exhibit 7 reveals the breakdown of feature phones versus smartphones in Africa.

EXHIBIT 7 Mobile Phone Shipments in Africa (in millions of ZAR)



Source: Based on information across various Statista articles at www.statistica.com on 5G in Africa.

Mobile Phones Provide Financial Inclusion in Africa

Many people in Africa cannot afford to do business with a bank and carrying large amounts of cash around or even storing large amounts of cash at home is as much of a problem in Africa as in the rest of the world. In fact, in Nigeria alone, one of the richest nations in Africa, only 2.6 percent of adults own a credit card. Payments requiring even small amounts of cash are much safer to pay electronically, and much more convenient. The concept of mobile money is a growing solution to this problem in Africa, allowing millions to store, use, and transfer funds electronically. In 2020 alone, 200 million people in Africa and the Middle East made 28 billion transactions and a total of nearly $800 billion in transactions were made in 2020 through this medium, with $490 billion being exchanged in sub-Saharan Africa.

Nigerian Market

Nigeria, home to Africa's largest population and one of the youngest in the world, has a flourishing digital marketplace. The nation has excellent mobile infrastructure, with nearly 60 percent of residents having access to the Internet and around 50 percent owning a mobile phone. Nearly 75 percent of Internet access in Nigeria is over mobile devices, and this number is even higher for online purchases. However, much of the problem with the other 50 percent not owning a mobile phone stems from broadband coverage in more rural areas. There is a clear need for further investment and infrastructure in these areas. Between 2018 and 2019, the online food retail and personal care markets in Nigeria increased about 50 percent and the online fashion sector increased over 40 percent. In general, Nigerians hold positive feelings about online shopping, with travel as the most profitable online business.

Cash is still the primary payment method in Nigeria. Out of 137 nations, Nigeria ranked 118th on credit card usage, and just 27 percent of online retail purchases are made with credit cards. Online payments are extremely popular in Nigeria, with 10 percent of payments coming from e-wallets such as KongaPay and PayPal. There is a growing trend toward mobile money in Nigeria and many other African nations. Customers can now easily spend and send money over their mobile phone. Banks can provide the service, but telecom companies are increasingly the payment service provider in this scenario.

Conclusion

Strategy Considerations

Given the really strong competitors described in the case, MTN's CEO Mupita needs a quality strategy plan. MTN operates in one of the fastest-growing regions of the world, but it is also one where the GDP trails behind that of many other nations. The haves versus have-nots can present quite a large disparity across Africa and the Middle East. Recall from the segment data that most of MTN's revenues are generated from mobile devices, but fintech is an up-and-coming technology. Recall as well that mobile devices in South Africa generate significant income, but not so much in other regions. What nations do you think CEO Mupita should focus on? MTN, like all companies, has limited resources, and deciding which countries and services to further develop is paramount for success.

Even attempting to decide which customers to serve is important. Should MTN focus on wealthy, profitable customers only, or should they continue to push and develop in rural Africa? Providing Internet services to those who cannot pay is certainly a noble mission, but MTN has to earn sufficient profits to pay the bills and keep its shareholders happy.

What would you suggest CEO Mupita do with regard to acquiring new technology? Should new technologies be developed in-house, organically, through increased R&D, or can you identify organizations that MTN should try to purchase to quickly acquire the necessary technology? Deciding where to allocate resources, what markets to enter, to what extent to invest in R&D, and whether to purchase rival firms are only a few of the many major strategic issues facing MTN.

Help CEO Mupita develop a comprehensive 3-year strategic plan. Be sure not to simply report what the firm is doing or what you think the firm will be doing based on the news releases (unless you also agree with these plans based on your research and analyses). Develop a plan for what you think the firm needs to do, as if you were hired as a pricy consultant to develop and submit a roadmap for the future of MTN.

References

1. MTN Group Limited, *Annual Report 2020*, https://www.mtn.co.za/SiteCollectionDocuments/Foundation/reports/MTNSAFoundation2020.pdf.
2. www.statistica.com.

Glossary

Acquisition When a large organization purchases (acquires) a smaller firm; a merger.

Actionable responses Meaningful in terms of having strategic implications; suggestive of potential strategies to capitalize on or compensate for.

Activity ratios Inventory turnover and average collection period measure how effectively a firm is using its resources.

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 Short-term milestones that organizations must achieve to reach long-term objectives.

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.

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.

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 7, Chapter 9, Chapter 11, Chapter 12, and Chapter 13.

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.

Blue ocean strategy Actions that aim to target a new market where competition is not yet present thus creating a "blue ocean" as opposed to a red ocean where many firms are competing often on price and the gains of one firm are often at the expense of another. Blue ocean strategy is similar to being a first mover seeking market space not yet utilized by rivals.

Board of directors A group of individuals above the CEO who have oversight and guidance over management and who care for shareholders' interests; sometimes called governance.

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 multiplied by 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.

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 BCG and IE matrices.

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 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) 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) More an internal manager compared to a 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.

Collaborative machines Robots used in manufacturing operations; these robots are flexible, capable of doing a variety of tasks.

Combination strategy The pursuit of a combination of two or more strategies simultaneously.

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 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.

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.

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.

Core competence A value chain activity that a firm performs especially well.

Core values statement A document that specifies a firm's commitment to integrity, fairness, discipline, equal employment opportunity, teamwork, accountability, continuous improvement, and/or other such exemplary attributes.

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.

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. Strategists should strive to preserve, emphasize, and build on 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.

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 goes into the lower-left quadrant it suggests that the firm should pursue defensive strategies such as retrenchment.

De-integration Reducing the pursuit of backward integration; instead of owning suppliers, companies negotiate with several outside suppliers.

Differentiation One of Michael Porter's strategy dimensions that involves a firm producing products and services considered unique industrywide 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.

Discount If an acquiring firm pays less for another firm than the firm's stock price multiplied by its number of shares of stock outstanding (book value or market value), then that amount minus the actual purchase price is called a discount.

Distinctive competencies A firm's strengths that cannot be easily matched or imitated by competitors. One of the nine basic components needed for inclusion in a mission statement.

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 its existing business/industry. Related diversification is when the old versus new business value chains possess competitively valuable cross-business strategic fits; unrelated diversification is when the old versus 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.

Divisional (decentralized) 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.

Downstream activities The primary means for gaining and sustaining competitive advantages for most companies are shifting downstream. Recent research by Dawar reveals that in most industries today, *upstream activities* such as supply chain management, production, and logistics are being commoditized or outsourced by firms, whereas *downstream activities* related to consumer behavior are becoming the primary means for gaining and sustaining competitive advantage.

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 Process of conducting research and gathering and assimilating external information; also referred to as external audit.

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.

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.

Feng shui In China, this term refers to the practice of harnessing natural forces, which can impact how you arrange office furniture.

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.

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.

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.

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.

Gain sharing A form of incentive compensation whereby employees and/or managers receive bonuses when actual results exceed some pre-determined performance targets.

Generally accepted accounting principles (GAAP) A set of procedures or rules used by accountants, particularly in the United States, to develop financial statements.

Generally accepted auditing standards (GAAS) A set of accounting standards used by independent auditors to evaluate an organization's financial statements.

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, then 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 (HRM) 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.

Industry analysis Another term for external audit; conducting research to gather and assimilate external information.

Industry growth rate (IGR) The vertical axis in a BCG Matrix; the average percent increase or decrease in sales/revenues this year (versus last year) for a given industry.

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.

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 (IPO) 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-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.

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, and 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, and MIS, across a firm's products/regions/stores/facilities.

International financial reporting standards (IFRS) A set of procedures or rules used by accountants, particularly outside the United States, to develop financial statements.

International (or multinational) firms Firms that conduct business outside their own country.

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 be relied on 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.

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 on 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.

Management information system (MIS) A system that gathers, assimilates, evaluates, and converts external and internal data (facts/figures/trends) into useful information for decision making.

Market capitalization Number of shares outstanding multiplied by stock price.

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 value Number of shares outstanding multiplied by stock price.

Marketing mix variables Product, place, promotion, and 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.

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.

Matching stage Stage 2 of the strategy-formulation framework that focuses on generating feasible alternative strategies by aligning internal with external factors by utilizing five matrices: BCG, IE, SWOT, GRAND, SPACE.

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 An enduring statement of purpose that distinguish one business from other similar firms; a statement that identifies the scope of a firm's operations in product and market terms and addresses the question "What is our business?" A declaration of an organization's "reason for being."

Mission statement components (1) Customers; (2) products and services; (3) markets; (4) technology; (5) concern for survival, growth, and profitability; (6) philosophy; (7) distinctive competence; (8) concern for public image; and (9) concern for employees.

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 firms 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.

Organic growth A term denoting strategies that aim for a firm to build/growth from within rather than through acquisition.

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.

Outsourcing Refers to the practice of firms using/paying other firms to perform certain activities, such as managing payroll, call centers, or even R&D.

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 versus its rival firms in a schematic diagram in order to better determine effective marketing strategies.

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 the 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.

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 multiplied by its number 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 5 years.

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 versus its rival firms in a schematic diagram in order to better determine effective marketing strategies.

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.

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 predetermined 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 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; firms generally must decide whether to strengthen such divisions or sell them (hence a question is at hand).

Reconciliatory With regard to mission statements, the need for the statement to be sufficiently broad to "reconcile" differences effectively among diverse stakeholders; to appeal to a firm's customers, employees, shareholders, and 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 (RMSP) The horizontal axis in a BCG Matrix, which is the firm's particular segment's market share (or revenues or number of stores) divided by the industry leader's analogous number.

Research and development (R&D) Spending money to enhance existing products/services and/or create new and improved products.

Reshoring Refers to U.S. companies working offshore but planning to move some of their manufacturing back to the United States.

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-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.

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.

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 toward employees, consumers, environmentalists, minorities, communities, shareholders, and other groups.

Social responsibility 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.

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-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.

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, and 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.

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-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).

Strategy implementation Stage 2 of the strategic-management process. Activities include establishing annual objectives, devising policies, motivating 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.

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.

Sustainability report A form of annual report produced by organizations to reveal their progress and activities aimed at helping, rather than harming, 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.

Taking corrective actions Activity #3 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; is 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.

Unrelated diversification When a firm acquires a new business whose value chains are so dissimilar that no competitively valuable cross-business relationships exist.

Upstream activities The primary means for gaining and sustaining competitive advantages for most companies are shifting downstream. Recent research by Dawar reveals that in most industries today, *upstream activities* such as supply chain management, production, and logistics, are being commoditized or outsourced by firms, while *downstream activities* related to consumer behavior are becoming the primary means for gaining and sustaining competitive advantage.

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.

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.

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?"

Wa In Japan, this term 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.

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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