Chapter 1

The Strategic Management Process
Company's Business Model

Management's model of how strategy will allow the company to gain competitive advantage and achieve superior profitability

A business model encompasses how the company will:
- Select its customers
- Define and differentiate its product offerings
- Create value for its customers
- Acquire and keep customers
- Produce goods or services
- Deliver those goods and services to the market
- Organize activities within the company
- Configure its resources
- Achieve and sustain a high level of profitability
- Grow the business over time

Mission Statement

- A description or declaration of why a company is in operation
- Provides the framework or context within which strategies are formulated
- Has 3 main components:
  - Mission or vision
  - Values or guiding standards that drive and shape the actions and behavior of employees
  - Major goals or objectives

External and Internal Analysis

- External analysis
  - Identify strategic opportunities and threats
    » Industry environment
    » National environment
    » Socioeconomic or macroenvironment
- Internal analysis
  - Identify organizational strengths and weaknesses
  - Sources of competitive advantage: superior efficiency, quality, innovation, and responsiveness to customers

Abell's Framework-Defining the Business

The Five Steps of the Strategy Making Process

1. Select the corporate vision, mission, and values and the major corporate goals and objectives.
2. Analyze the external competitive environment to identify opportunities and threats.
3. Analyze the organization's internal environment to identify its strengths and weaknesses.
4. Select strategies that:
   - Build on the organization's strengths and correct its weaknesses – in order to take advantage of external opportunities and counter external threats
   - Are consistent with the organization's vision, mission, and values and major goals and objectives
   - Are congruent and constitute a viable business model
5. Implement the strategies.

Emergent and Deliberate Strategies


Strategic Shift at Charles Schwab
Major Goals and Objectives

- Goal: A desired future state or objective
- Four main characteristics of well-constructed goals:
  - Precise and measurable
  - Address crucial issues
  - Challenging but realistic
  - Specify a time period

Strategic Leadership

- Vision, eloquence, and consistency
- Commitment
- Being well informed
- Willingness to delegate and empower
- The astute use of power
- Emotional intelligence

Emotional Intelligence

- Self-awareness
- Self-regulation
- Motivation
- Empathy
- Social skills

Course Pack Item

- Larry Bossidy, CEO
- Allied Signal

Strategy Implementation

- After choosing strategies, managers must put them into action.
- The feedback loop—strategy is ongoing. Managers must monitor and reevaluate for the next round of strategy formulation and implementation.

Challenges to Strategic Decision Making

- Cognitive biases
  - Prior hypothesis bias
  - Escalating commitment
  - Reasoning by analogy
  - Representativeness
  - Illusion of Control
  - Hubris hypothesis
- Groupthink
Intelligence in Iraq

Group Think

Course Pack Item

Group Think at Imperial Tobacco

Closing Case

Planning for Chevy Volt

Course Pack Item

Jill Barad's Strategy for Mattel

Real World:

“How Traits that Helped Executive Climb the Ladder Came to Be Fatal Flaws”

“How CEO's Traits Helped, Hurt”

Course Pack Item

“He Really Got Harley Roaring”
Real World:

"Two Radically Different Business Models: Microsoft and Redhat Linux"
Wal-Mart

Wal-Mart is one of the most extraordinary success stories in business history. Started in 1962 by Sam Walton, Wal-Mart has grown to become the world's largest corporation. In the financial year ending January 31, 2004, the discount retailer whose mantra is "every day low prices" had sales of nearly $256 billion, five thousand stores in ten countries (almost three thousand are in the United States), and 1.3 million employees. Some 8 percent of all retail sales in the United States are made at a Wal-Mart store. Wal-Mart is not only large but also very profitable. In 2003, the company earned a return on invested capital of 14.7 percent, significantly better than rivals Costco and Target, which earned 9.4 percent and 10 percent, respectively (another major rival, Kmart, emerged from bankruptcy protection in 2004). As shown in the accompanying figure, Wal-Mart has been consistently more profitable than its rivals for years.

Wal-Mart's superior profitability reflects a competitive advantage that is based on the successful implementation of a number of strategies. In 1962 Wal-Mart was one of the first companies to apply the self-service supermarket business model developed by grocery chains to general merchandise (two of its rivals, Kmart and Target, were established in the same year). Unlike its rivals, who focused on urban and suburban locations, Sam Walton's Wal-Mart concentrated on small southern towns that were ignored by its rivals. Wal-Mart grew quickly by pricing lower than local mom-and-pop retailers, often putting them out of business. By the time Kmart and Target realized that small towns could support a large discount general merchandise store, Wal-Mart had preempted them. These towns, which were large enough to support one discount retailer, but not two, provided a secure profit base for Wal-Mart.

However, there is far more to the Wal-Mart story than location strategy. The company was also an innovator in information systems, logistics, and human resource practices. Taken together, these strategies resulted in higher productivity and lower costs than rivals, which enabled the company to earn a high profit while charging low prices. Wal-Mart led the way among American retailers in developing and implementing sophisticated product-tracking systems using bar-code technology and checkout scanners. This information technology enabled Wal-Mart to track what was selling and adjust its inventory accordingly so that the products found in a store matched local demand. By avoiding overstocking, Wal-Mart
PART 1 Introduction to Strategic Management

Profitability in the U.S. Retail Industry, 1994–2003

Data Source: Value Line Investment Survey.

Return on Invested Capital (%)

- Wal-Mart
- Target
- Costco


did not have to hold periodic sales to shift unsold inventory. Over time, it linked this information system to a nationwide network of distribution centers where inventory was stored and then shipped to stores within a 300-mile radius on a daily basis. The combination of distribution centers and information centers enabled Wal-Mart to reduce the amount of inventory it held in stores and devote more of that valuable space to selling and reducing the amount of capital it had tied up in inventory.

With regard to human resources, the tone was set by Sam Walton, who believed that employees should be respected and rewarded for helping to improve the profitability of the company. Underpinning this belief, Walton referred to employees as "associates." He established a profit sharing scheme for all employees, and after the company went public in 1970, he initiated a program that allowed employees to purchase Wal-Mart stock at a discount to its market value. Wal-Mart was rewarded for this approach by high employee productivity, which translated into lower operating costs and higher profitability.

As Wal-Mart grew larger, the sheer size and purchasing power of the company enabled it to drive down the prices that it paid suppliers and to pass on those savings to customers in the form of lower prices, which enabled Wal-Mart to gain more market share and hence demand even lower prices. To take the sting out of the persistent demands for lower prices, Wal-Mart shared its sales information with suppliers on a daily basis, enabling them to gain efficiencies by configuring their own production schedules to sales at Wal-Mart.

Already by the 1990s, Wal-Mart was the largest general seller of general merchandise in America. To sustain its growth, Wal-Mart started to diversify into the grocery business, opening 200,000-square-foot supercenter stores that sold groceries and general merchandise under the same roof. Wal-Mart also diversified into the warehouse club business with the establishment of Sam's Club. With its entry into Mexico in 1991, the company began expanding internationally. By pursuing these expansion strategies, Wal-Mart aims to increases sales to over $400 billion by 2010, up from $40 billion today, thereby solidifying its scale-based advantage.

Despite all of its success, Wal-Mart has experienced problems. In some parts of America, such as California and the Northeast, there has been a backlash against Wal-Mart, particularly by small town residents who see Wal-Mart as a threat to local retailers. Increasingly, Wal-Mart has found it difficult to get planning permission to open up new stores in these towns. In addition, despite the long-held belief that employees should be treated well, Wal-Mart has been the target of lawsuits from employees who claim that they were pushed to work long hours without overtime pay, and from female employees claiming that the culture of Wal-Mart discriminates against them. While some observers believe that these complaints have little merit, others argue that they are signs that the company has become too large and may be encountering limits to profitable growth.\(^1\)
1.1 STRATEGY IN ACTION

Strategic Analysis at Time Inc.

Time Inc., the magazine publishing division of media conglomerate Time Warner, has a venerable history. Its magazine titles include *Time*, *Fortune*, *Sports Illustrated*, and *People*, all long-time leaders in their respective categories. By the mid-2000s, however, Time Inc. recognized that it needed to change its strategy. By 2006, circulation at *Time* was down by 12%; *Fortune*, by 10%; and *Sports Illustrated*, by 17%.

An external analysis revealed what was going on. The readership of Time's magazines was aging. Increasingly, younger readers were getting what they wanted from the Web. This was both a threat for Time Inc., because its Web offerings were not strong, and an opportunity, because with the right offerings Time Inc. could capture this audience. Time also realized that advertising dollars were migrating rapidly to the Web. If the company was going to hold onto its share, its Web offerings had to be every bit as good as its print offerings.

An internal analysis revealed why, despite multiple attempts, Time had failed to capitalize on the opportunities offered by the emergence of the Web. Although Time had tremendous strengths, including powerful brands and strong reporting, development of its Web offerings had been hindered by a serious weakness—an editorial culture that regarded Web publishing as a backwater. At *People*, for example, the online operation was "like a distant moon" according to managing editor Martha Nelson. Managers at Time Inc. had also been worried that Web offerings would cannibalize print offerings and help accelerate the decline of magazine circulation, with dire financial consequences for the company. As a result of this culture, efforts to move publications onto the Web underfunded or stymied by a lack of management attention and commitment.

It was Martha Nelson at *People* who, in 2003, showed the way forward for the company. Her strategy for overcoming the weakness at Time Inc. and better exploiting opportunities on the Web started with merging the print and online newsrooms at *People*, thus removing the distinction between them. Then she relaunched the magazine's online site, made major editorial commitments to Web publishing, stated that original content should appear on the Web, and emphasized the importance of driving traffic to the site and earning advertising revenues. Over the next two years, page views at People.com increased fivefold.

Ann Moore, the CEO at Time Inc., formalized this strategy in 2005, mandating that all print offerings should follow the lead of People.com, integrating print and online newsrooms and investing significantly more resources in Web publishing. To drive this home, Time hired several well-known bloggers to write for its online publications. Moore's goal was to neutralize the cultural weakness that had hindered online efforts in the past at Time Inc. and to direct resources toward Web publishing.

In 2006, Time made another strategic move designed to exploit the opportunities associated with the Web when it started a partnership with the 24-hour news channel, CNN, putting all of its financial magazines onto a site that is jointly owned, CNNMoney.com. The site, which offers free access to *Fortune*, *Money*, and *Business 2.0*, quickly took the third spot in online financial Web sites behind Yahoo! finance and MSN. This was followed with a redesigned Web site for *Sports Illustrated* that has rolled out video downloads for iPods and mobile phones.

To drive home the shift to Web-centric publishing, in 2007 Time announced another change in strategy—it would sell off 18 magazine titles that, while good performers, did not appear to have much traction on the Web. Ann Moore stated that going forward Time would be focusing its energy, resources, and investments on the company's largest and most profitable brands, brands that have demonstrated an ability to draw large audiences in digital form.

**1.2 STRATEGY IN ACTION**

**Starbucks's Music Business**

Anyone who has walked into a Starbucks cannot help but notice that, in addition to various coffee beverages and food, the company also sells music CDs. Most Starbucks stores now have racks displaying about 20 CDs. Reports suggest that when Starbucks decides to carry a CD, it typically ranks among the top four retailers selling it. The interesting thing about Starbucks's entry into music retailing is that it was not the result of a formal planning process. The company's journey into music retailing started in the late 1980s when Tim Jones, then the manager of a Starbucks in Seattle's University Village, started to bring his own tapes of music compilations into the store to play. Soon Jones was getting requests for copies from customers. Jones told this to Starbucks's CEO, Howard Schultz, and suggested that Starbucks start to sell its own music. At first, Schultz was skeptical, but, after repeated lobbying efforts by Jones, he eventually took up the suggestion. Today, Starbucks not only sells CDs, it is also moving into music downloading with its "Hear Music" Starbucks stores, where customers can listen to and burn music from Starbucks's 200,000-song online music library while sipping their coffee.

1.3 STRATEGY IN ACTION

A Strategic Shift at Charles Schwab

In the mid-1990s, Charles Schwab was the most successful discount stockbroker in the world. Over 20 years, it had gained share from full-service brokers like Merrill Lynch by offering deep discounts on the commissions charged for stock trades. Although Schwab had a nationwide network of branches, most customers executed their trades through a telephone system called Telebroker. Others used online proprietary software, Street Smart, which had to be purchased from Schwab. It was a business model that worked well; then along came E*Trade.

E*Trade was a discount brokerage started in 1994 by Bill Porter, a physicist and an inventor, to take advantage of the opportunity created by the rapid emergence of the World Wide Web. E*Trade launched the first dedicated Web site for online trading. E*Trade had no branches, no brokers, and no telephone system for taking orders; thus it had a very low-cost structure. Customers traded stocks over the company’s Web site. Due to its low-cost structure, E*Trade was able to announce a flat $14.95 commission on stock trades, a figure significantly below Schwab’s average commission, which at the time was $65. It was clear from the outset that E*Trade and other online brokers, such as Ameritrade, which soon followed, offered a direct threat to Schwab. Not only were their cost structures and commission rates considerably below Schwab’s, but the ease, speed, and flexibility of trading stocks over the Web suddenly made Schwab’s Street Smart trading software seem limited and its telephone system antiquated.

Deep within Schwab, William Pearson, a young software specialist who had worked on the development of Street Smart, immediately saw the transformational power of the Web. Pearson believed that Schwab needed to develop its own Web-based software, and quickly. Try as he might, though, Pearson could not get the attention of his supervisor. He tried a number of other executives but found support hard to come by. Eventually he approached Anne Hennegar, a former Schwab manager who worked as a consultant to the company. Hennegar suggested that Pearson meet with Tom Seip, an executive vice president at Schwab who was known for his ability to think outside the box. Hennegar approached Seip on Pearson’s behalf, and Seip responded positively, asking her to set up a meeting. Hennegar and Pearson turned up expecting to meet with just Seip, but to their surprise, in walked Charles Schwab; the chief operating officer, David Pottruck; and the vice presidents in charge of strategic planning and the electronic brokerage arena.

As the group watched Pearson’s demo of how a Web-based system would look and work, they became increasingly excited. It was clear to those in the room that a Web-based system using real-time information, personalization, customization, and interactivity all advanced Schwab’s commitment to empowering customers. By the end of the meeting, Pearson had received a green light to start work on the project. A year later, Schwab launched its own Web-based offering, eSchwab, which enabled Schwab clients to execute stock trades for a low flat-rate commission.

Larry Bossidy, CEO

Larry Bossidy, the CEO of the diversified engineering company AlliedSignal, is reputed to be one of the most sought-after CEOs in corporate America. Since leaving the number two spot at General Electric in 1991 to join AlliedSignal, Bossidy has been approached by IBM, Merck, Kodak, and Westinghouse, all of which were looking for a new CEO. The reasons for so much attention are not hard to find. When Bossidy joined AlliedSignal, the company was widely perceived as a poorly performing enterprise based in a number of dull businesses in aerospace, auto parts, and engineered materials. At around $3.50 per share, the stock price was no higher than it had been in 1984, while the 1991 net profit of $342 million was well below the peak profit of $559 million earned in 1986. Under Bossidy's leadership, however, earnings surged to over $1.33 billion in 1998, while the stock price climbed to $60 per share by early 1999.

How has Bossidy done it? He has articulated a handful of challenging goals that he wants AlliedSignal to attain and then relentlessly pushed the managers of each of AlliedSignal's twenty-odd businesses, or divisions, to find ways of meeting those goals. The primary goal of AlliedSignal under Bossidy has been profitable growth. Bossidy wants to increase earnings per share by 15 percent annually. To achieve that, he reckons that AlliedSignal must grow sales of existing businesses by 8 percent per annum, increase productivity at an annual rate of 6 percent "forever," and achieve operating profit margins of at least 15 percent. These are challenging "stretch" goals for a company such as AlliedSignal, which is based in mature low-growth industries. To reach these goals, Bossidy has been pushing his managers to do four things: (1) enter foreign markets, particularly in Asia; (2) make selected niche acquisitions that can help to round out the product line of a business; (3) focus effort on improving efficiencies by driving waste and defects out of the manufacturing process; and (4) develop new products that can boost earnings growth, a particularly difficult challenge in a company that was once known for its aversion to new ideas.

Technically, Bossidy "negotiates" goals with the head of each of AlliedSignal's twenty businesses, but the reality is that he pushes them to accept goals that require a significant improvement in the performance of their businesses. He then tirelessly monitors his managers to make sure they follow through. Nearly every week, Bossidy visits at least one of AlliedSignal's businesses. He is known for vigorously probing managers in all-day meetings to find out what strategies they are adopting to meet the goals he has set for them. And if they fail? Well, they had better not. Bossidy bestows an award on business units that do not meet their cost of capital—it is called the "leaky bucket" award. More significantly, when people fail to meet his stretch targets, he fires them. In the automotive division, which makes brake parts and where profits are below par, Bossidy fired or transferred six of the top ten executives in the course of a year. Bossidy admits that he is demanding, relentless, and tough, but in his view this management style offers the only way forward for companies such as AlliedSignal that have to compete with aggressive low-cost foreign enterprises.
In October 2002, intelligence agencies in the United States issued a National Intelligence Estimate on Iraq's efforts to procure and build weapons of mass destruction (WMDs). The report concluded that there was good evidence that Iraq was actively pursuing a nuclear weapons program and, furthermore, had tried to procure uranium for its bomb-making efforts from the African nation of Niger. In addition, the report claimed that Iraq was stockpiling chemical weapons, including mustard, sarin, and nerve gas, and was actively pursuing a research program to produce biological weapons, including anthrax and smallpox viruses. The report was used by the Bush administration to help justify the 2003 invasion of Iraq, which culminated in the removal of Saddam Hussein's regime. The report also helped convince the U.S. Senate that Iraq was violating United Nations conditions imposed after the first Gulf War in 1991. On the basis of this intelligence, seventy-five senators voted to authorize the 2003 war.

By late 2003, however, it was becoming increasingly apparent that if there were WMDs in Iraq, they were very few in number and extremely well hidden. Had the prewar intelligence been wrong? In mid 2004, the Senate Intelligence Committee published a report evaluating the information contained in the October 2002 National Intelligence Estimate. The findings of the Senate report were endorsed by all seventeen members of the committee, nine Republicans and eight Democrats. In total, they constituted a damning indictment of the prewar intelligence provided by the CIA and others to the Bush administration and Congress.

The Senate report concluded that a “groupthink” dynamic inside American intelligence agencies generated a “collective presumption that Iraq had an active and growing weapons program.” This internal bias, according to the senators, prompted analysts, collectors, and managers in the CIA and other agencies to “interpret ambiguous evidence as being conclusively indicative of a WMD program as well as ignore or minimize evidence that Iraq did not have active or expanding weapons of mass destruction programs.” As a consequence, most of the key judgments in the October 2002 National Intelligence Estimate...
were "either overstated, or were not supported by the underlying intelligence reporting."

One of the most critical parts of the Senate report dealt with the prewar assessment of Iraq's nuclear weapons program. The report stated that the 2002 National Intelligence Estimate represented a sharp break from previous assessments, which had concluded that Iraq had not reconstituted its nuclear weapons program. The Senate report stated that the CIA made a significant shift in its assessment shortly after Vice President Dick Cheney began stating publicly that Iraq had actively reconstituted its nuclear weapons program. The implication was that the CIA gave the administration the information it thought it wanted, rather than accurate information. Moreover, the Senate report claimed that the CIA's leading advocate of the Iraqi nuclear weapons threat withheld evidence from analysts who disagreed with him, misstated the analysis and information produced by others, and distributed misleading information both inside and outside the agency. The committee also concluded that the CIA overstated what it knew about Iraq's attempts to procure uranium from Niger and that it delayed for months examining documents pertaining to those attempts that would later prove to be forgeries.

On the topic of biological weapons, the Senate report concluded that none of the claims about Iraq's biological weapons or capabilities was supported by intelligence and that claims that Iraq had restarted its chemical weapons program were the results of "analytical judgments" and not based on hard evidence. The intelligence on biological weapons came from a single Iraqi defector code-named "Curve Ball" who was apparently an alcoholic and, in the opinion of the one person who had interviewed him, a Pentagon analyst, "utterly useless as a source." When the same analyst saw information provided by Curve Ball included in a speech that Colin Powell made to the United Nations to justify war with Iraq, he contacted the CIA to express his concerns. A CIA official quickly responded in an e-mail: "Let's keep in mind the fact that this war's going to happen regardless of what Curve Ball said or didn't say. The powers that be probably aren't terribly interested in whether Curve Ball knows what he is talking about."

In sum, the Senate report painted a picture of intelligence institutions that selectively interpreted information to support what they thought administration policy was, while ignoring or dismissing contradictory information—sure signs of groupthink. At the same time, the report concluded that there was no evidence of undue political pressure by policymakers in the administration or Congress. Instead, the committee blamed intelligence leaders "who did not encourage analysts to challenge their assumptions, fully consider alternative arguments, accurately characterize the intelligence reporting, or council analysts who lost their objectivity." Be this as it may, an objective observer might also wonder why neither the Senate nor the administration asked hard questions about the quality and source of the intelligence information in the run-up to the war.
Groupthink at Imperial Tobacco

An example of groupthink concerns the 1979 acquisition of Howard Johnson by Britain's Imperial Group. In 1979, Imperial was the third largest tobacco company in the world, after British American Tobacco and Philip Morris. In the 1970s, Imperial began a diversification program designed to reduce its dependence on the declining tobacco market. Part of this program included a plan to acquire a major U.S. company. Imperial spent two years scanning the United States for a suitable acquisition opportunity. It was looking for an enterprise in a high-growth industry that had a high market share, a good track record, and good growth prospects and that could be acquired at a reasonable price. Imperial screened more than 30 industries and 200 different companies before deciding on Howard Johnson.

When Imperial announced its plans to buy Howard Johnson for close to $500 million in 1979, the company's shareholders threatened rebellion. They were quick to point out that at $26 per share Imperial was paying double what Howard Johnson had been worth only six months previously, when share prices stood at $13. The acquisition hardly seemed to be at a reasonable price. Moreover, the motel industry was entering a low- rather than a high-growth phase, and growth prospects were poor. Besides, Howard Johnson did not have a good track record. Imperial ignored shareholder protests and bought the lodging chain. Five years later, after persistent losses, Imperial was trying to divest itself of Howard Johnson. The acquisition had been a complete failure.

What went wrong? Why, after a two-year planning exercise, did Imperial buy a company that so patently did not fit its own criteria? The answer would seem to lie not in the planning, but in the quality of strategic decision making. Imperial bought Howard Johnson in spite of its planning, not because of it. The CEO decided independently that Howard Johnson was a good buy. A rather authoritarian figure who was overconfident of his ability (a case of hubris), the CEO surrounded himself with subordinates who agreed with him. In a clear sign that groupthink was at work, once he had made his choice his advisers concurred with his judgment and shared in developing rationalizations for it. No one questioned the decision itself, even though information was available to show that it was flawed. Instead, strategic planning was used to justify a decision that in practice did not conform with strategic objectives.45
Planning for the Chevy Volt

General Motors is a company in deep trouble. As car sales in North America collapsed in 2008, GM, which had already lost money in 2007, plunged deeply into the red. With losses estimated at $14 billion, the company was forced to go cap in hand to the government to beg for public finds to help it stave off bankruptcy. Fearing the economic consequences of a collapse of GM, the government agreed to loan funds to GM, but it insisted that the company have a clear plan charting its way back to profitability. Ironically, such a plan was already in place at GM. At the heart of it was a potentially huge gamble on a new type of car: the Chevy Volt.

The Chevy Volt, which is scheduled for market introduction in 2010, is a compact, four-door electric car with a reserve gasoline-powered engine. The primary power source is a large lithium ion battery (lithium ion batteries are typically found in small
electric appliances such as cell phones). The battery can be charged by plugging it into a wall socket for six hours; when fully charged, it will fuel the car for 40 miles, which is less than most people's daily commute. After that, a gasoline engine kicks in, providing both drive power and recharging the lithium ion battery. GM estimates fuel economy will be over 100 miles per gallon, and charging the car overnight from a power outlet would cost about 80% less than filling it with gas at $3 per gallon. The car will cost somewhere between $30,000 and $40,000; however, because it uses a battery-powered technology, buyers will be able to take $7,500 tax credit.

The Volt was the brainchild of two men, Bob Lutz, GM's vice chairman, and Larry Burns, the head of R&D and strategic planning at GM. Although Lutz in particular had always championed large gas-hungry muscle cars, GM's planning told them that the market would probably move away from the SUVs that had been a profitable staple at GM for most of the 1990s. A number of trends were coming together to make this scenario likely.

First, oil prices, and by extension, gas prices, were increasing sharply. While driving an SUV that gets 12 miles to the gallon might make economic sense when gas was priced at $1 a gallon, it did not for most people when gas was $4 per gallon. GM's planning suggested that due to growing demand in developed nations, including China and India, and limited new supplies, the days of cheap oil were over. Second, global warming was becoming an increasing concern, and it seemed possible that tighter regulations designed to limit carbon emissions would be introduced in the future. As a major source of greenhouse gases, such as carbon dioxide, automobiles powered by internal combustion engines could hardly escape this trend. Third, the cost of manufacturing lithium ion batteries was falling, and new technology was promising to make them more powerful. Finally, GM's major competitor, Toyota, with its best-selling hybrid, the Prius, had demonstrated that there was demand for fuel-efficient cars that utilized new battery technology (the Prius, however, uses a conventional fuel cell as opposed to a lithium ion battery).

Despite their analysis, when Lutz and Burns first proposed making the Volt in 2003, other managers at GM beat them down. For one thing, GM had already invested billions in developing fuel cells, and many in the company did not want to suddenly switch gears and focus on lithium ion batteries instead. Besides, said the critics, technologically it would be difficult to produce a large lithium ion battery. Others were skeptical given that GM had already had one failure with an electric car, the ill-fated EV1 introduced in the 1990s. Powered by a fuel cell, the EV1 had not sold well (according to many because the company had not put its weight behind it).

By 2006, however, the tide had started to turn. Not only were oil prices surging, as predicted by the strategic planning group, but also a small Silicon Valley start-up, Tesla Motors, had announced that it would be bringing a lithium ion sports car to market. Lutz' reaction was, "if a start-up can do it, GM can too!" So Lutz and Burns formed a skunk works within GM and quickly put together a Chevy Volt concept car, which they unveiled at the 2007 Detroit auto show. The concept car gained a lot of positive feedback, and Lutz used this to argue within the company that GM needed to commit to the project. Moreover, he argued, Toyota has gaining major benefits from its Prius, both in terms of sales, and the halo effect associated with making a green car. This time Lutz and Burns were able to persuade other senior managers to back the project, and it was officially launched in early 2007 with an aggressive goal of market introduction in 2010.

Case Discussion Questions
1. What does the Chevy Volt case tell you about the nature of strategic decision making at a large complex organization like GM?

2. What trends in the external environment favored the pursuit of the Chevy Volt project?

3. What impediments to pursuing this project do you think existed within GM?

4. The plan for the Chevy Volt seems to be based partly on the assumption that oil prices would remain high, and yet in late 2008, oil prices collapsed in the wake of a sharp global economic slowdown.
   a. What does this tell you about the nature of strategic plans?
   b. What do falling oil prices mean for the potential success of the Chevy Volt?
   c. Do you think oil prices will remain low?

5. What will it take for the Chevy Volt to be a successful car? In light of your analysis, how risky do you think this venture is for GM? What are the costs of failure? What are the costs of not pursuing the project?
On August 22, 1996, Jill Barad was named the next chief executive officer (CEO) of Mattel. At forty-five years of age, she had become one of the few women to head a major U.S. corporation. For Barad, the announcement was the fulfillment of a fifteen-year career at Mattel, during which she was best known for transforming Mattel's flagging line of Barbie dolls into the most profitable toy brand in the world. As product manager for Barbie, she had pioneered a brand extension strategy that had tripled Barbie sales to $1.4 billion between 1988 and 1993. In the process, she had gained a reputation for being a hard-driving manager and skilled marketing visionary. As CEO, one of Barad's first tasks was to decide on a strategy that would enable Mattel to grow earnings per share in line with the company's stated goal of 15 percent per annum compounded before the effects of any acquisitions.

Mattel is the world's largest toymaker with 1995 revenues of $3.64 billion. Historically, the company's strengths have been in its Barbie brand, its Fisher-Price line of toys for young children (which generated 1995 revenues of more than $1 billion), the Hot Wheels brand, and its Disney licenses. Negotiated in 1988, the
Disney licenses give Mattel exclusive rights to make products based on Disney's movies for children. In 1995, Mattel earned revenues of $450 million from its Disney connection. Between 1988 and 1995 these four core product areas helped power Mattel to a compound annual growth rate of 20 percent for sales and 38 percent for operating income. By 1996, Mattel commanded about 16 percent of the market share for toys sold in the United States, although its share in Europe, the other great toy market, was less than 8 percent.

Despite Mattel's glittering past and Jill Barad's own starring role in it, many knowledgeable observers of the toy industry believed that the company's goal of 15 percent growth in earnings before acquisitions represented a difficult challenge for the new CEO. Barad took over the top spot at a time when Mattel's growth rate appeared to be slowing. In June 1996, Mattel reported that sales for its most recent quarter would be "approximately the same as last year," marking the first time quarterly results had been flat in eight years. To be sure, part of the slowdown was due to lackluster sales of its toys based on Disney's latest film, The Hunchback of Notre Dame. This shortfall could have easily been made up by a strong showing from toys linked to future Disney films. However, critics charged that the toy industry seemed to be suffering from a chronic lack of creativity. Of the fifteen top-selling toys in 1996, only three were toy company inventions that originated within the previous year. Mattel was very much a case in point. The Barbie brand had been around since 1959, Hot Wheels and Fisher-Price had been acquired rather than developed internally, and the creative impulse behind the Disney line of toys clearly came from that company, not Mattel.

Of course, it can be argued that given the fickle nature of the toy business, where last year's megahit can become this year's bust (remember Cabbage Patch Kids?), Mattel was right to focus on established and enduring brands. Nevertheless, by emphasizing established brands over innovations, Mattel ran the risk of missing successful new blockbusters. That is what happened with video games. Having given up after some early forays into video games, Mattel watched Japanese companies like Nintendo and Sega take that business from zero to $6 billion in sales.

As articulated in 1996, Barad's initial strategy for Mattel had four main elements. First, she made it clear that she would continue with the highly profitable practice of extending the company's existing brands. For example, she had plans to further develop a line of collectible Barbie dolls. Second, she would develop new product categories, particularly in boys' toys and board games, two areas where Mattel had traditionally been weak. That could be accomplished through internal product development or by acquiring an emerging company and then growing its business through further investments. Third, she would focus more effort on expanding overseas markets, where Mattel's presence was more limited than in the United States. Her stated goal was to increase overseas sales to more than 50 percent of Mattel's total—up from 40 percent in 1995. Finally, she would try to increase earnings by driving down costs. Cost reductions were to be achieved by outsourcing production to low-cost foreign factories in places such as China, a major shift for Mattel, which in 1995 manufactured two-thirds of its core product lines in its own plant.

Three years into her tenure, Barad's strategy for Mattel was increasingly being questioned by stockholders. After peaking at $44 a share in early 1998, the stock fell to $23 per share by June 1999 despite a record bull market in American stocks. The catalyst for the decline had been Barad's announcement that Mattel's profit growth would fall below the 15 percent goal during 1998 and 1999. The slowing growth was due to a number of problems that had stymied Barad's strategy. Parents were buying fewer toys and more computer software and video games for their children. Total U.S. toy sales were flat in 1998, while sales of video games increased by 20 percent and sales of software for children rose by 7 percent. Disney's most recent animated movies had been less successful than expected, and related toy sales had suffered accordingly. Moreover, most significantly, the popularity of the Barbie brand had declined, partly because of changing fashions. Parents were shifting their spending to computer software for girls and competing dolls, such as Pleasant Company's highly successful line of American Girl dolls. However, missteps by Mattel also contributed to the decline.

Throughout the 1990s, a big driver of Mattel's sales growth had been a line of Barbie collectibles known as Holiday Barbie—a line that Barad had introduced in 1988. Priced at $30 to $35 each, compared with less than $10 for a regular Barbie, by 1997 Holiday Barbie was generating $700 million of the total $1.7 billion in Barbie sales. In 1996, Barad had stated that she believed Holiday Barbie sales could exceed $1 billion. Accordingly, at Barad's insistence, in 1997 production of the Holiday Barbie line was set at 3 million dolls, a 1 million increase from 1996. However, much of the rise in demand during 1996 and 1997 stemmed from double ordering by retailers that had suffered from shortages in prior years. When
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Introduction to Strategic Management

the expected demand growth failed to materialize in 1998, retailers were left with excess stock of Holiday Barbie and started to discount, while putting new orders on hold. Consequently, after years of growth, Barbie sales fell by 15 percent in the first half of 1998. More significantly perhaps, overproduction had destroyed the collectible value of Holiday Barbie, and it was unclear whether Mattel could rebuild it.

To try to salvage her growth strategy, Barad took several actions in 1998 and 1999. In mid 1998, Mattel acquired the Pleasant Company for $700 million. By this point, the Pleasant Company was the number two doll maker in the United States. According to Barad, the Pleasant Company’s highly successful American Girl brand was targeted at girls aged seven to twelve and was thus a perfect complement to Barbie, where the demographic was two- to seven-year-olds. This acquisition was followed in late 1998 by the acquisition of computer software maker The Learning Company for $3.5 billion. The Learning Company’s software titles include the popular Reader Rabbit series, Carmen Sandiego, and Myst. In April 1999, after the announcement of a 2 percent decline in sales and a first-quarter loss of $18 million, Barad also laid out plans to cut 3,000 jobs in order to realize cost savings of $400 million over three years. Around the same time, she announced the formation of an on-line venture, www.mattelstore.com, to tap into the growing volume of on-line sales. Barad believed that this venture would generate revenues of $60 million in its first year alone. The company also stated that it had entered into an alliance with Intel to develop a generation of interactive toys.

Case Discussion Questions

1. What was Jill Barad’s primary goal for Mattel in 1996? What strategies did she choose in order to pursue these goals?

2. Why did Barad’s strategies fail to generate the profit growth she had planned? Could better planning have helped Barad anticipate market trends?

3. Could better decision-making techniques have helped Barad avoid the decline in sales of Holiday Barbie?

4. How would you describe Mattel’s strategy as of mid 1999? Does this strategy make sense, given changing conditions in the toy market? Would you describe this strategy as an emergent strategy or a planned strategy?
How Traits That Helped Executive Climb Ladder Came to Be Fatal Flaws

‘You Learn to Be Self-Reliant’

By GEORGE ANDERS

PALO ALTO, Calif—Unshakable. Self-reliant. Comfortable in the spotlight. Fond of the dramatic gesture. Impervious to criticism. Passionate about the big picture. The kind of person who bounds from project to project, embracing change as a way of life.

Those traits helped Carly Fiorina win the top job at Hewlett-Packard Co. in 1999, an unexpected outsider brought in to run one of Silicon Valley’s oldest and most traditional companies. Now, with her sudden ouster from H-P, they are sure to be seen as flaws as well.

Plenty of business issues shaped Ms. Fiorina’s rise and fall. After the tech boom ended, shareholders blamed her for the sagging stock price. Longtime employees faulted her for upending the company’s paternalistic culture, known as “The H-P Way.” Industry analysts chided her for failing to mend H-P’s sluggish computer businesses, even after she pushed through a $19 billion merger with onetime archrival Compaq Computer Corp.

Yet she became front-page news—and a frequent cover story for business magazines—not so much because people cared about server-industry market shares, but because she epitomized an alluring, controversial new breed of chief executive officers who combine grand visions with charismatic but self-centered and demanding styles. Psychologist Michael Maccoby called them “productive narcissists” in a recent book, arguing that in the right settings, they can accomplish great things. In the wrong environments, he wrote, such leaders fail. Among his examples were America Online Inc.’s Steve Case and Apple Computer Inc.’s Steve Jobs.

This week, Ms. Fiorina finally lost her most crucial ally, the H-P board. Directors had bet heavily 5½ years ago that she, an outsider from Lucent Technologies Inc., would be the dynamic cure for H-P’s stodginess at the time. When criticism of her performance flared in 2001 and 2002, during the height of a shareholder proxy fight over the Compaq acquisition, directors publicly declared that Ms. Fiorina was on the right track. This time, they decided she had to go.

Yesterday, Ms. Fiorina didn’t return calls and e-mails seeking an interview. At her home in the Silicon Valley foothills, two security guards in sunglasses stood outside the gate to intercept visitors. Before her ouster, she had been scheduled to attend a meeting at the White House with members of the Business Roundtable.

People who have known Ms. Fiorina for years say that her spunk and go-it-alone grittiness can be traced back to her teenage years. Her father is a legal scholar and federal judge. During the late 1960s and early 1970s, he moved his family constantly, setting down briefly in California, North Carolina, London and Ghana as he pursued various legal projects. His three children had to make new friends, abandon them, then start over, again and again.

“I was always landing in a Whole new place,” Ms. Fiorina recalled in an interview several years ago. “Moving my senior year was really hard. It’s a time of stability for most people. But you learn to be pretty self-reliant. It didn’t scare me any more.”

Ms. Fiorina ended up in business by a roundabout journey. She majored in medieval history at Stanford and briefly attended law school before dropping out and later earning masters de-

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Rise and Fall

Birthdate: Sept. 6, 1954

Education: Bachelor’s degree in medieval history and philosophy, Stanford University, 1976; master’s in business administration, University of Maryland, 1980; master’s of science in management, Massachusetts Institute of Technology, 1989

Experience

1980-96: Saleswoman, marketing posts and other executive positions, including head of North American network systems, at AT&T

1996: Helped lead spinoff of equipment/research division into Lucent Technologies


1999: Named chief executive and president of Hewlett-Packard

2000: Given the title of chairwoman

Feb. 8, 2005: Resigns from the company under pressure from the board due to differences over executing its strategy.

How CEO’s Traits Helped, Hurt

Continued From First Page

grees in business. She was a rising star at Lucent in the 1990s and impressed people who watched her in boardroom settings with her decisiveness and her crisp presentational skills. But she lacked a technical background, and critics sometimes accused her of valuing boldness over precision or follow-through.

When H-P began a nationwide search for a new CEO in 1999, Ms. Fiorina rocketed to the top of the candidates’ list. She was 44 at the time, and her vitality seemed to directors to be what was needed to speed up the company’s way of doing things. Of all the finalists in the search, she spoke most respectfully of “the civic-minded values championed by H-P’s founders, David Packard and William Hewlett.”

But once she got the job, Ms. Fiorina’s efforts to fit in with the H-P Way hit some bumps. Soon after she arrived, an ad campaign featured her standing before what was portrayed as the one-car suburban garage where the company was founded in the 1930s. In fact, it was an ersatz garage erected on H-P property; camera crews couldn’t gain access to the real thing.

Ms. Fiorina aggressively reorganized H-P’s business units in her first year, then dismantled some of those changes when they created unexpected snags. She was forced to lay off 6,000 employees, about 7% of the work force, in 2001, as the economy stalled. It was H-P’s largest layoff ever and deeply jolted morale.

When she proposed the Compaq merger in September 2001, H-P’s stock stumbled badly at first. Powerful shareholders, led by Walter Hewlett, a co-founder’s son, waged a proxy battle to try to stop the deal.

Ms. Fiorina narrowly prevailed in a shareholder vote in March 2002, in part by portraying the merger as something that would help H-P achieve greatness. But close confidantes at the time say the merger battle took a toll on her. She became more brittle in confrontational settings, seldom giving ground, staying focused on facts, but doing little to warm her audiences.

With the merger falling short of expectations, Ms. Fiorina has repeatedly been on the defensive. Over time, that has grated on some H-P managers, causing them to jump ship and join competitors. Ms. Fiorina has said that she doesn’t believe H-P lost many valuable executives in the process.

As the head of an $80 billion company, she also has been held up as an icon to women in business—a label she has refused to embrace. In interviews, she has always said that leadership skills are gender neutral, and asked to be judged on her performance, not her sex.

What Ms. Fiorina will do now is anyone’s guess. She has enjoyed good working relations with both President Bush and California Gov. Arnold Schwarzenegger, leading to periodic questions about the possibility of political ambitions. In prior interviews, Ms. Fiorina has generally demurred, saying: “I’ve never thought about the next job. Never.”
COMMENTARY
BY JOSEPH WEBER

He Really Got Harley Roaring
CEO Jeffrey Bleustein is dismounting his hog after an exhilarating run

JEFFREY L. BLEUSTEIN KNOWS how to make an entrance. To deliver a 2002 commencement talk for engineering grads at Columbia University, the Harley-Davidson Inc. CEO roared out to the podium on a gleaming silver V-Rod, his company's newest rolling work of art. The Ivy Leaguers whooped, just as wowed as the black-jacketed, tattooed folk who have long been bike fans. And they warmed even more to the Harley mantras Bleustein brought them: Charge headlong into life, he urged, with a sense of freedom and individual expression. "This is your chance to soar with the eagles," he said.

Now, Bleustein, 65, is heading for the open road. The brainy New Yorker, who earned a PhD in engineering at Columbia and later taught at Yale University before going into business, will leave Harley's corner office on Apr. 30. He will be remembered for having co-authored one of the great American comeback stories: vaulting the 102-year-old Milwaukee bikemaker from the financial junkyard—a near-bankruptcy experience—to roaring success.

When Bleustein arrived as engineering vice-president in 1975, Harley was notorious for shoddy workmanship. He and his colleagues restored quality and introduced new models, making biking appealing to weekenders while keeping an outlaw image. Today, Harley-labeled gear is a hit for grannies and babies as well as grizzled bikers. The machines sell to Wall Streeters as well as to Southern California gangs. With the newest Fat Boy starting at $18,500, many Harleys go to the well-heeled, but you can still pick up something for $6,500. For that reason, Bleustein resists the luxury label: "We've worked hard to keep it a brand for the people."

Plenty of execs have been lionized, only to prove all too mortal when their game plans fell apart. And much can still happen to dim the glow surrounding Bleustein, who became CEO seven years ago. (He will stay on for a time as chairman but turns the job of running Harley over to CFO James L. Ziemer, 54.) It's not clear, for instance, whether his efforts to broaden the bikes' appeal to women and younger riders will pay off. Harley can't count on boomers forever. Typical customers are in their late 40s or older—not far from the group that buys Buicks.

But there's no doubt Bleustein & Co. have had an extraordinary run. For 19 years, Harley racked up unbroken gains in earnings and sales, hiking 2004 profits by 17%, to $900 million, and sales by 8.5%, to $5.02 billion. That explains why it has made the BusinessWeek 50 ranking of top-performing big companies for the past three years. Along the way, the shares—worth the equivalent of 39¢ back in late 1987, figuring in dividends and splits—have been lofted to more than $60 today.

Just as important, Harley is a case study for marketers of how to freshen up a timeworn product. Sports-car makers and collectibles producers should take note of the Harley Owners Group, clubs that let folks feed one another's rebel self-images while taking road trips and trading biking tips. Brewers could learn from Harley's moody print ads about how to turn products into personal statements. "It's a cult brand," says Northwestern University's Kellogg School of Management marketing Prof. Philip Kotler. "Every brand would love to be a cult brand."

Timing helped. In the post-feminism era, Harleys became vehicles for men to be men. Accountants could dress like James Dean on weekends. Harley softened the edges by backing charity runs and making riders look friendlier—but not too friendly. "You always needed to keep a little bit of the bad in the brand," says the CEO.

Any brand built on memories of Easy Rider has vulnerabilities. But Harley has shown a knack for adapting. Marketers should take some of Bleustein's ideas out for a spin—they've had a winning ride in Milwaukee.
Two Radically Different Business Models: Microsoft and Redhat Linux

MICROSOFT'S BUSINESS MODEL

Microsoft is one of the world's most successful and profitable companies, partly because of its dominant market position in operating system software for PCs—first DOS, then Windows 95 and Windows NT, and later Windows 2000. Microsoft's business model for its operating system products is based on the following elements:

- **Employ a cadre of highly skilled Microsoft programmers to develop proprietary code**: compensate them with premium pay and lucrative stock options. Keep the source code hidden from users.
- **Sell the resulting operating system to PC makers and to PC users at relatively attractive prices**—around $75 to PC makers and around $100 at retail to consumers. Since most of the costs are fixed (having been incurred in developing the code), each sale generates substantial margins—the variable costs of producing and packaging the CDs provided to users amount to only a couple of dollars per copy.
- **Provide technical support to users at no cost**.

REDHAT LINUX'S BUSINESS MODEL

Redhat Linux, a start-up company formed to market the Linux operating system in competition with Microsoft's Windows, employs a sharply different business model:

- **Give the Linux operating system away free of charge** to those who download it (but charge as much as $79 to users who prefer to buy the CD-ROM version—complete with an instruction manual). Redhat is in a position to give Linux away for free because Linux has been created and upgraded through the collaborative efforts of interested programmers from all over the world who volunteer their time and contribute bits and pieces of code to improve and polish the system. The guiding force and visionary of the confederation of volunteer programmers is Linus Torvalds, age 30, who started development of Linux in 1991 as a sideline hobby while a graduate student at the University of Helsinki and who has shepherded the cobbled-together of the code in the intervening years. Torvalds encouraged other programmers to download his software, use it, test it, fix bugs, modify it, add new features as they saw fit, and post their work on the Internet. As the Linux code developed, more and more programmers joined in, contributing their ideas and improvements. The thousands of programmers around the world who work on Linux in their spare time do what they do because they love it, because they are fervent believers that software should be free (as in free speech), and in some cases because they are anti-Microsoft and want to have a part in undoing what they see as a Microsoft monopoly. Their crusade for the cause of free software and competition means that Redhat, unlike Microsoft, essentially has zero product development costs.
- **Make the source code open and available to all users**, allowing them to make whatever changes they may wish to create a customized version of Linux. Linux users like the ability to modify the source code at will.
- **Employ a cadre of technical support personnel who provide technical support to users for a fee**. The Linux operating system is a bit quirky and buggy and is said to be hard to install and use in multiprocessor applications. Corporate users of Linux thus typically require quite a bit of handholding. Make money on technical support services, not the code.

WHO HAS THE BEST BUSINESS MODEL?

Microsoft's business model—sell proprietary code and give service away free—is a proven moneymaker. But can Redhat make money with a business model that gives software away free and charges users for technical support? What do you think?