Strategic Management Concepts and Cases 3rd edition Dyer Solutions Manual

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Chapter 1 – What is Business Strategy?
Class Exercise – Marketing Strategy at Delta

Teaching Note

Source for this exercise is in the Chapter 1 PowerPoint deck and textbook. (Mini Case: Marketing Strategy at Delta. See slide notes for additional information.) Comments from the slide notes are adapted for small group discussion and large group debrief. The students are instructed to read the chapter before coming to class. An option is to give students advance notice of an upcoming in-class exercise. Students are given approximately 15 minutes to discuss the questions and document answers in small groups (Bloom Comprehension and Application). A debrief is then conducted with the entire class. The debrief takes approximately 20-25 minutes.

Strategies are more likely to be successful when the plan explicitly takes into account four factors:

1. The attractiveness of a market
2. How to offer unique value relative to the competition
3. What resources or capabilities are necessary
4. How to sustain a competitive advantage once it has been achieved (i.e. How to create barriers to imitation to prevent other companies from offering that same value.)

This exercise focuses on "barriers to imitation", but could also include a discussion of how Delta addressed the other three factors: market, value proposition, resources & capabilities.

Mini Case

In the mid-1980s, Delta's market researchers found out that customers (particularly business customers) were strongly influenced to choose a particular airline by the airline's frequent flyer program. Consequently, to motivate customers to choose Delta, they teamed up with American Express (an exclusive arrangement) to offer a special program: customers could receive triple miles if they would fly on Delta and purchase the tickets using the American Express card.

How would you evaluate Delta's strategy? (Good or Bad?) Consider the following questions:

1. **Average Load Factor (# passengers vs available seats) = 78%. Why is this relevant?**

Unless demand (passenger #s) decreases significantly, the plane is flying whether it's 70% or 100% full. The marginal additional cost for more passengers is near zero. Same # of people to fly plane, fuel, etc., don't have to hire more people to manage the additional business. 1 more passenger = all profit.

2. On what does this new strategy depend in order for it to succeed? AND….how does it help me get the additional 22% load factor?

Have to consider:
- Will people use their Am Ex to fly w/ us?
- Will some people switch from another airline? (Don't have to fly more – just need to get them to switch).
- What if they don't switch? Are we just giving more perks to existing customers?
- How does this strategy help me get the additional 22% LF?

Other aspects of the program:
- Am Exp gives Delta lower card rate.
- They split promotional expenses for the marketing.
- Am Exp has large market share especially among business travelers (65-70%) but…… Delta doesn't have 65-70% of air travelers….this is a Big Opportunity for Delta to gain more customers.

3. If you were running other airlines, how would you respond to Delta's strategy?

Team with another credit card company:
- United Airlines – Visa
- Northwest Airlines – MasterCard
- Southwest Airlines – Visa.

Delta has AmEx – the dominant card used by business travelers – they typically pay higher fares, pay a yearly fee and fly during week. These are the target customers. What if you don't match the triple miles? Will you lose customers?

4. Do you think this strategy led to more customers for Delta? Explain.

Probably not once competition kicks in with their programs. Because you wouldn't necessarily attract more customers as business people are the ones paying – they or their company pays the yearly fee for Am Ex. The casual traveler probably isn't going to pay yearly fee to get triple miles.

So the program is attracting the same people who are already attracted to it:
1. Am Ex
2. Delta
3. Am Ex and fly other airlines.

Some people might go get the Am Ex and now they can get triple miles if they fly Delta.

5. **In the end – as a result of Delta's strategy, who were the biggest winners?**

The Customers. See Class Debrief Notes below.

What actually happened? (Class debrief)

1. Within a week every other major carrier announced they would offer triple miles AND they didn't care how you paid.

2. Now all of a sudden the Am Ex requirement was a weakness. With that in mind, what is the big issue with Delta's approach? There was NO BARRIER TO IMITATION.

3. When you take a strategic action, you have to ask, what's the barrier to imitation?
   a. If there is none, it can be imitated the next day by dropping price and there goes any advantage you had.
   b. If it can be quickly imitated, then there is no Cost Advantage.
   c. That was the case with the "triple mileage" program.
   d. Since all airlines matched the triple miles strategy, who was the big winner? CUSTOMERS!

<u>Conclusion:</u>

- This continued for about 2 years.
- The federal government stepped in and said: "you know what – this looks like a pretty big liability you are building up. You need to estimate and calculate the liability and put it on your balance sheet"
- Airlines started to calculate the liability – it was big so they changed the frequent flyer programs:
    1. Grandfathered you on your old miles.
    2. Got rid of triple miles.
    3. Increased # of miles needed to earn free trips.

- In the end, none of those companies were better off.
- Airlines thought these were strategic moves they had to make but in the end it didn't help any of them.
- These partnerships / relationships led to the co-branded credit cards we see today.
- You probably could argue that Delta was even a little worse off because they teamed up with Am Ex…and their fliers had to use Am Ex to get the triple miles.
    - And….could say that Delta did get some benefit of Am Ex who helped to fund the program…..so they did get some visibility.

References:

1. Dyer, J., Godfrey, P., Jensen, R., & Bryce, D. (2016). *Strategic Management Concepts and Tools for Creating Real World Strategy.* Hoboken, NJ: John Wiley & Sons, Inc.

Chapter 1: What Is Business Strategy?

Learning Objectives

Studying this chapter should provide you with the knowledge to:

- Define business strategy, including the importance of competitive advantage, the four choices that are critical to strategy formulation, and the strategic management process.
- Summarize the information that the company's mission and thorough external and internal analysis provide to guide strategy.
- Discuss how strategies are formulated and implemented in order to achieve objectives.
- Explain who is responsible for, and who benefits from, good business strategy.

Purpose

Although this is no one tool acquired in this chapter, the purpose of the lecture is to familiarize the student with what strategy is and instill the realization that being understanding strategy is vital to competitiveness.

Please note that the "Presenters Notes" in the PowerPoint slide deck give a brief script for lecture and can be used as a guide.

Outline

Strategy at Apple

WHAT IS BUSINESS STRATEGY?

  Competitive Advantage

Strategy in Practice: *Measuring American Home Products's Competitive Advantage*

  The Strategic Management Process

WHAT INFORMATION AND ANALYSIS GUIDES STRATEGY FORMULATION?

  Mission

  External Analysis

  Internal Analysis

Strategy in Practice: *Apple's Evolving Mission*

HOW ARE STRATEGIES FORMULATED

Answers to Review Questions

1. **Why is it important for you to understand business strategy**?
   When starting a company or being president or general manger within one, developing strategy is a primary job. As a junior officer in a company, developing and implementing ideas that are consistent with corporate strategy could lead to early promotions. You can also evaluate the potential success of companies that you may work for by understanding their strategy.

2. **How would you describe/define strategy?**
   A plan to achieve competitive advantage

3. **What are the four choices that are part of strategy formulation?**
   What markets or industries will the company pursue?
   What unique value should the company offer the customer in those markets?
   What resources and capabilities will allow the firm to deliver unique value better than competitors?
   How will the company sustain its advantage and prevent imitation of its strategy?

4. **What are the two generic strategies companies employ to offer unique value relative to competitors?**
   Low cost or differentiation

5. **Who is ultimately responsible for a company's strategy? Who does this individual (or individuals) call upon for help in formulating strategy for the firm?**
   Strategic leaders who develop strategy through the strategic management process. They usually turn to the Board of Directors and other top management for guidance.

6. **According to Michael Porter's "Five Forces" model, why do some firms earn higher profits than other firms?**
   Firms with higher profits may be in an industry with higher average profitability.

7. **What are resources and capabilities, what is the difference between them, and why do firms need to assess them?**
   Resources are the tangible and intangible assets a firm employs to create value and competitive advantage. Capabilities are the processes and activities that a firm develops using its resources. Firms need to assess resources and capabilities in order to allocate them properly to achieve key objectives.

8. **What are three keys to the successful implementation of a company strategy?**
   Functional strategies need to be well aligned with delivering the unique value identified in the overall strategy.
   Structure, systems, staff, skills, style, and shared values need to be designed to facilitate the execution of the strategy.

9. **Who are the four primary stakeholder groups that influence strategic decisions in a company?**
   Capital market stakeholders
   Product market stakeholders
   Organizational stakeholders
   Community stakeholders

Teaching Note

Walmart Stores: Gaining and Sustaining a Competitive Advantage

Teaching Objectives

This case is intended to be used as the first case in an introduction to strategy course or as a case to discuss cost advantage. The purpose of this case is for students to examine Walmart's strategy using the framework outlined in the textbook that defines strategy as a plan to achieve competitive advantage that involves making four strategic choices:

a) markets to pursue/compete in,
b) unique value (low cost or differentiation) the firm will offer in those markets,
c) the resources and capabilities required to offer that unique value better than competitors, and
d) ways to sustain the competitive advantage by preventing imitation." (see Real World Strategy, Chapter 1: What is Business Strategy?)

The case offers multiple reasons why Walmart has achieved a cost advantage but what students typically miss is the fact that many aspects of Walmart's cost advantage stems from Sam Walton's early decision to compete in rural markets where labor, rent, advertising costs were low (and where Walmart could price higher because of no competition from competitor discount stores because they avoided such markets because they weren't deemed large enough to support a discount store).

The Decision portion of the case is introduced towards the end of the case with the primary question being: How should Walmart respond to the growth of online purchases, and specifically to Amazon.com as a competitor? Is the acquisition of Jet.com enough to help Walmart successfully respond to the Amazon threat, or are more actions needed? This discussion allows for an examination of whether the resources and capabilities that Walmart developed to succeed in brick and mortar retail are transferable to online success (including a discussion of what new resources and capabilities Walmart must develop to succeed on line).

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Study Questions

1. Why has Walmart been successful? What is the single most important factor that has contributed to Walmart's phenomenal success? [LO1] [AACSB Reflective Thinking] [Difficulty: Easy] [Bloom's 2 Comprehension]

2. Why exactly are Walmart's costs lower than its competitors? Examine each element of the cost structure (e.g., COGS, labor, rent, advertising, distribution,

technology, etc. as a percentage of total sales) and assess where Walmart's costs are lower than competitors—and why. [LO1] [AACSB Analysis] [Difficulty: Medium] [Bloom's 4 Analysis]

3. Why can't Walmart's competitors (e.g., Sears, K-Mart) imitate Walmart and realize similarly high profits? If you were running Sears-Kmart what would you do differently? What, if anything, from Walmart would you want to imitate? [LO1] [AACSB Analytic] [Difficulty: Medium] [Bloom's 3 Application]

4. Why do you think Walmart has had difficulty succeeding in foreign markets, especially in emerging markets like Brazil and South Korea? [LO1] [AACSB Reflective Thinking] [Difficulty: Hard] [Bloom's 5 Synthesis]

5. What should Walmart do to respond to the emerging trend of online purchases, and more specifically to the threat of Amazon.com as the dominant online retailer? [LO1] [AACSB Analytic] [Difficulty: Hard] [Bloom's 6 Evaluation]

Multiple Choice Questions

1. Why has Walmart been successful?
    a. Store costs
    b. Distribution
    c. Supplier relationships
    d. All of the above

"Answer:" D

2. What is the single most important factor that has contributed to Walmart's phenomenal success?
    a. Choice of markets
    b. Differentiation
    c. Branding
    d. Innovation

"Answer:" A

3. Why exactly are Walmart's costs lower than its competitors? Examine each element of the cost structure (e.g., COGS, labor, rent, advertising, distribution, technology, etc. as a percentage of total sales) and assess where Walmart's costs are lower than competitors—and why.
    a. Because Walmart has very low store costs due to location
    b. Because Walmart has an extensive distribution network
    c. Because Walmart has great supplier relations
    d. Because Walmart uses cutting-edge information technology

"Answer:" A

4. Why can't Walmart's competitors (e.g., Sears, K-Mart) imitate Walmart and realize similarly high profits?
    a. Because of Walmart's economies of scale
    b. Because of Walmart's economies of scope
    c. Because of Walmart's brand awareness
    d. Because of Walmart's market locations

"Answer:" D

5. If you were running Sears-Kmart what would you do differently? What, if anything, from Walmart would you want to imitate?
    a. Imitate Walmart's scale
    b. Imitate Walmart's marketing efforts
    c. Imitate Walmart's human resource practices
    d. Imitate Walmart's distribution methods

"Answer:" D

6. Why do you think Walmart has had difficulty succeeding in foreign markets, especially in emerging markets like Brazil and South Korea?
    a. Because emerging markets do not recognize the Walmart brand
    b. Because emerging markets do not have sufficient suppliers
    c. Because emerging markets do not offer rural markets with growth potential
    d. Because emerging markets do not have the necessary infrastructure

"Answer:" C

7. What should Walmart do to respond to the emerging trend of online purchases, and more specifically to the threat of Amazon.com as the dominant online retailer?
    a. Imitate Amazon by eliminating brick-and-mortar stores
    b. Develop a web presence as ubiquitous as Amazon
    c. Leverage advantages through existing distribution
    d. Use brick and mortar presence as notes in a distribution network

"Answer:" D

Teaching Plan

I. Aspects of Walmart's competitive advantage	15-20 min
II. Sources of Walmart's competitive advantage	20-25 min
III. How Should Walmart respond to Amazon?	15-20 min
IV. Summary of Key Ideas	10-15 min

I. Aspects of Walmart's competitive advantage

Question: Assume that you are hired by Sears/Kmart to identify the key elements that drive Walmart's success. What is the single most important aspect of Walmart that you would recommend that Sears/Kmart imitate in order to experience similar success?

<u>Examples of Facilitating Questions:</u>

- How does (____) help lower Walmart's cost?
- How much lower is Walmart's cost because of (____)?
- What does (____) have to do with Walmart's success?
- Walmart spends less than the competition on advertising. How do they get away with that?

While students may or may not identify the key aspects of Walmart's strategy initially, the instructor should help students identify and quantify the varying aspects of Walmart's competitive advantage. A summary of Walmart's advantages, as well as questions to help facilitate discussion, is found below.

<u>Distribution</u>

- Each distribution center serves roughly 150 stores within a 150-mile radius. Technological innovations enable Walmart's efficient distribution. Analysts estimated in the mid-1990s that Walmart's inbound logistics expenses were roughly 1 percent less as a percentage of sales than its direct competitors. In 2011, Walmart was the world leader in cross docking procedures.

<u>Supplier Relationships</u>

- Walmart's ability to put a supplier's product on the shelves of over 10,900 stores gives it tremendous leverage with suppliers. Walmart's 'Worldwide Sustainability index' uses various methods to track all stages of the product life cycle, from raw materials to disposal, and holds suppliers accountable for any unnecessary costs added to the supply chain. Walmart's Electronic Data Interchange and RetailLink systems provided all of its suppliers with up to the minute, point of sale data from all Walmart locations worldwide. Walmart's Scan 'N' Pay system made it possible for each product to be owned by the supplier until the product was actually sold by Walmart.

<u>Information Technology</u>

- Walmart spent .1-.3% more on information technology, as a percentage of revenues, than competitors (5 to 10 times more than competitors in absolute dollars). Walmart was known to invest more in information technology to facilitate effective communication between its stores, distribution centers, and suppliers, thereby leading to more efficient distribution, fewer stock-outs, and lower inventories.

Human Resource Management

- Walmart's labor costs were 10.1% of sales compared to 11.2% of sales for its direct competitors. Walmart had no regional offices, which was estimated to save Walmart .5-1% of sales each year. Regional managers were located at Walmart's headquarters and spent roughly 200 days a year visiting stores. Members of the top management team typically earned more than 90% of their compensation from incentives based on their performance, and less than 10% as salary. Walmart's lower labor costs were possible in part because a large percentage of stores were located in rural markets where labor costs were lower than in suburban markets. In addition, Walmart worked actively to prevent its labor force from unionizing. In one example, Walmart simply closed its meat cutters division and outsourced the entire operation to an external supplier rather than allow a meat cutters union to form.

Marketing and Merchandising

- Walmart started with almost no investment in advertising which was unnecessary in small rural towns where advertising was unnecessary because EVERYONE in the town new Walmart had come to town. It was such a big deal, and advertising costs in 2010 were only 0.6% while Target's were 2.0%. To ensure prices were low every day, Walmart conducted weekly price checks in nearly 99% of its competitors' stores. In rural locations where Walmart was the only discount retailer in town, Walmart's prices were 6% higher than in locations where a direct competitor was nearby.

Store Costs

- A much larger percentage of Walmart's stores were located in rural towns where land is cheaper than in suburban areas. Thus, Walmart's cost of stores (land/rent) has been roughly .4% lower than for competitors.

Benchmarking Walmart's Cost Advantage

Inbound Logistics	+1%
Information Technology	-.1% to -.3%
Labor Costs	+1.1%
No Regional Offices	+1.5% to +2%
Advertising Costs	+1.4%
Higher Rural Prices*	+2.9%
Store Cost/Rental Rates	+0.4%
Total Cost Advantage	8.0%

*'Higher Rural Prices' advantage was calculated by multiplying the average price increase in rural Walmart stores (higher by 6%) by the percentage of total Walmart stores in rural areas (48.6%).

II. The key sources of Walmart's competitive advantage

The purpose of this section is to help students see that even though there are many aspects to Walmart's competitive advantage, the main source of these advantages has come from Walmart's choice of rural markets and its distribution system that supports its stores in those markets. The line of questioning below is meant to help students arrive at that conclusion.

Question: Assume that I am the owner of Walmart and that you are the senior management of Sears/Kmart. As owner, I am willing to give you some of the things that you identified. If I gave you ( ) would that be sufficient to effectively compete against Walmart?

Question: If I gave you ( ), why or why not would you be comfortable in your ability as Sears/Kmart to successfully compete against Walmart?

Question: What else would you need to be able to effectively compete against Walmart? Would ( ) be sufficient?

(The previous two questions may be repeated as students prioritize which of Walmart's resources and capabilities are most critical to success. The teacher may also volunteer resources to the students, such as offering the Walmart brand, to help facilitate the discussion)

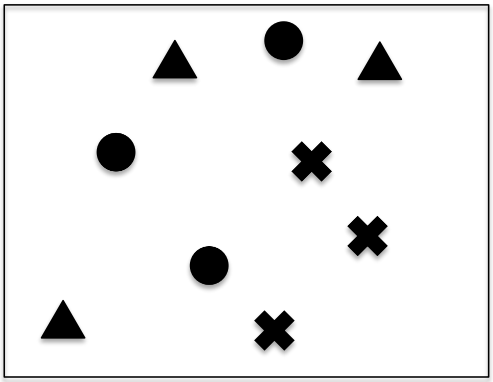
Question: What have I not given you?

Question: Why would Walmart's stores and distribution centers be the key to its competitive advantage?

At this point, it will be beneficial to show how the source of many of the cost advantages Walmart enjoys can be traced back to their choice of markets. Below are examples using each of the quantified advantages listed in the Benchmarking Walmart's Cost Advantage section above.

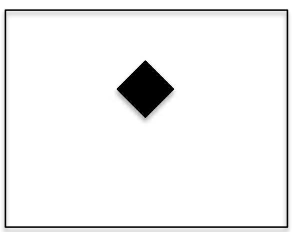
<u>Rural Markets vs. City Markets</u>

- In a typical large city market (such as Atlanta, Dallas, Philadelphia, Los Angeles), one would expect to find multiple discount retailers (an illustrative example of such a market is below).



*Each shape represents a different retailer such as Target, Sears, K-Mart, CostCo, Kohls, etc.

Compare this to a smaller rural city market where Walmart decided to locate, such as Rogers, Arkansas (its first store) or Sikeston, Missouri and Claremore, Oklahoma (its first stores outside of Arkansas).



Question: Which of these looks markets looks closest to perfect competition? To a monopoly?

After establishing the generic benefit of operating as a monopoly compared to operating in a competitive market, it should be much easier to see how many of the cost advantages Walmart enjoys comes from its decision to operate in these smaller markets.

Labor Costs

- Because Walmart is one of the largest, if not the largest, single consumer of labor in rural markets, it has significant bargaining power and can offer lower wages than it would be able to in large cities. It can also offer lower wages because the cost of living is lower in rural markets than larger cities.

<u>Advertising Costs</u>

- When a retailer builds a new store in a large market, they would typically need to not only signal to consumers that they are in that market, but also that they are better than the competition. For Walmart in rural markets, the store itself is most likely sufficient in letting consumers know that Walmart has arrived. There would also be less need, if any need, to signal to consumers that Walmart has lower prices if they are the only large retailer in the market.

<u>Prices</u>

- When there is significant competition and competitors are selling relatively homogenous goods, rivals will most likely compete on price. This leads to lower operating margins in the large city market. In the rural market, where Walmart is the only large discount retailer competing with a group of "mom & pop" retailers, they can raise prices without the worry of losing consumers to competitors which do not have the scale to offer lower prices.

<u>Store/Rental Costs</u>

- Real estate is cheaper in rural markets than it would be in large cities.

III. How Should Walmart Respond to Amazon and the growth of online?

Question: What is the current situation with regard to the online retailing market and Walmart's position in that market?

Walmart's success in the future will require that the company respond effectively to the growing trend towards online purchases and the emergence of Amazon.com as a major competitor. The online retailing market, 11.7% of total retail sales in 2016, is expected to grow from roughly $390 billion in 2016 to over $1 trillion by 2026. According to Internet Retailer, the problem for Walmart, and other companies trying to compete online, is that Amazon.com drove 65% of e-commerce growth in 2016. Walmart is losing to Amazon online in a big way.

In response to this trend towards online purchases, and to attempt to better connect with millennials, Walmart decided to purchase Jet.com for $3.0 billion. Like Amazon.com, Jet.com was an online discount retailer but one that focused on more price sensitive customers by attempting to provide better pricing than Amazon.com using a dynamic pricing model. One of the first things that CEO McMillon did after the acquisition was make Jet.com founder Marc Lore President of Walmart's U.S. e-Commerce business. But the acquisition of Jet.com—and putting Lore in charge of Walmart's e-commerce business—raised a number of questions going forward.

Question: If you were running Walmart, what actions would you take to compete more effectively online?

- Would you continue to run Jet.com as a completely separate site from Walmart.com? If so, for how long?

- Should Walmart.com adopt some of the innovative pricing approaches used by Jet.com?
- What other suggestions do you have for Walmart increasing its ability to compete effectively with Amazon.com?

IV. Summary of Key Ideas

It may be useful to use PowerPoint associated with this case as the key ideas are summarized in this section.

Walmart's Strategy: The inter-relatedness of Walmart's 4 strategic choices.

- **Choice of markets to serve**
    - First to locate stores in cities with less than 50,000 population
    - 1762 stores in rural America vs 476 stores for Kmart and 48 for Target
    - Higher prices in small markets
    - Lower costs in small markets

- **Walmart's Unique Value (Value Proposition)**
    - Everyday low prices for a broad range of goods that are always in stock in convenient locations; this explains WHY customers choose Walmart over other discount retailers.

- **Resources and capabilities to deliver that unique value**
    - Large footprint of rural stores
    - Distribution capabilities
    - Bargaining power over suppliers
    - Fewer layers of management
    - Culture of cost reduction
    - All these things are important, but the key to Walmart's strategy is the choice of Walmart's markets which allowed all of these things to become a success

- **Sustainable competitive advantage; what prevents imitation by competitors**
    - Competitors rationally refuse to enter Walmart's towns
    - First mover advantage which created a barrier to entry through a natural geographic monopoly
    - Success was initially driven by its choice of markets and its ability to offer lower prices than local competitors in those markets due to a more efficient business model

Note: Walmart has struggled globally because much of Walmart's strategy/ business model is hard to replicate in international markets, especially the small-town strategy. For example, this has not worked well in countries like Brazil an S. Korea due to:
- Lack of income in small markets in most countries
- Lack of vehicles for customer to drive to shop at a Walmart store

- Distribution is difficult w/ poor infrastructure in rural areas
- Managing in a foreign market is difficult, but even more difficult to find capable management in small towns