1 The strategy concept

Learning points

- Discuss diverse strategy perspectives
- Trace the roots of strategic management
- Outline the analytical foundation of the field
- Provide a basis for further studies

Strategy is important. The term *strategy* or *strategic* is used every so often to give things a more imposing flair. Just think about terms such as strategic marketing, strategic operations, strategic human resource management, strategic finance, etc. So, something being "strategic" is supposed to indicate that this thing is more important than every other thing. How this came about is possibly worth a thought. After all, the academic field now commonly referred to as *strategic management* started out as something as mundane as "business policy."

If we ask a group of intelligent people with managerial experience, say a class of MBA students, what their understanding of the term "strategy" is, a substantial portion of them will most likely answer: a plan. While this implies that strategy arises from conscious human deliberation, and that strategy makers think before they act, there are many other ways to interpret how strategy comes about. A reference from a prominent dictionary explains that strategy is "the art of planning operations in war, especially of the movement of armies and navies into favorable positions for fighting." By comparison, a tactic is an "expedient; means of achieving an object".[1] A comparable source notes that strategy is "the art of planning and moving forces, etc. especially in war, politics, etc."[2] Or, strategy is "the science or art of military command as applied to the overall planning and conduct of large-scale combat operations" where a tactic is "an expedient for a goal; a maneuver."[3] The dictionary may also explain that strategy derives from the Greek word *stratēgia*, office of a general, and *stratēgos*, general. In other words, strategy is something that takes place around the highest management echelons, anchored at the general's office and administrative staff, and deals with the ability to move entire armies around for (hopefully) victorious outcomes and (positive) long-lasting effects.

Claus von Clausewitz refers to war as "an act of violence intended to compel our opponent" where "the compulsory submission of the enemy to our will is the ultimate object."[4] This is very much seen from the commander's perspective where military genius and leadership skills support the men under command and help them accommodate unruly battle conditions. He distinguishes between *strategy* as "the use of combats for the object of the war" and *tactics*, which refers to "the use of military forces in combat." Hence, the commander develops the *strategic plan* that settles "when, where, and with what forces a battle is to be delivered." The forces should be disciplined and maintain "a certain strength of body and mind" but otherwise ordinary soldiers are not seen to play any strategic roles in battle. The commander motivates and scales efforts for the battle as "the sum of available means and the strength of the will" are assessed in view of the enemy's position. Similarly, the ancient Chinese warrior philosopher Master Sun argues that the one who uncovers many favorable strategic factors at headquarters before battle will win. Or, as expressed by the classical Taoist *Book of Changes*: "Leaders plan … consider problems, and prevent them."[5] From this summary discussion, we may discern the contours (and origins) of a strategic planning perspective that to a large extent prevails under the present-day conditions. Hence, we can trace the war-like aspirations to outmaneuver and displace market opponents in contemporary competitive analysis.

Strategy interpreted from the commander's perspective considers the effect of military genius where alert commanders in instantaneous decisiveness can change the course of events. The implied importance ascribed to individual managerial intervention and entrepreneurial initiative is also reflected in the earlier economic literature. Frank Knight ascribes the ability of entrepreneurs to deal with the uncertainty of future business activities as the underlying reason for residual income, or profit, consisting of excess rents obtained over the market price paid for different production inputs. As he explains: "When … the managerial function comes to require the exercise of judgment involving *liability to error* … the nature of the function is revolutionized; the manager becomes an entrepreneur."[6] And he argues: "His income will normally contain in addition to wages a pure *differential* element designated as 'profit' by the economic theorist."

The importance of individual entrepreneurs to industrial development is echoed by Joseph Schumpeter, a pre-eminent economist in the first half of the twentieth century, who saw economic growth as deriving from innovation and entrepreneurial activities. He explained how industries and organizations continue to change and to challenge stability with profits falling to those who instigate change and build new rewarding businesses. In his own words: "They have … employed existing means of production differently, more appropriately, more advantageously. They have *carried out new combinations*. They are entrepreneurs."[7] In short, the importance of entrepreneurial spirit in corporate leadership has been recognized for quite some time.

The strategy perspective of the supreme commander, or the chief executive in the corporate jargon, continues to permeate the strategy view. The corporate historian Alfred Chandler, who is considered one of the initial founders of corporate strategy, reinforced such a rationalistic top-down logic.[8] He defined strategy as "the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals."[9] He distinguished between *formulation*, where top management deliberates and outlines the strategy, and *implementation*, where lower-level managers engage to carry out the strategy. This distinction between initial executive strategic considerations and subsequent execution by managers throughout the organization remains a feature of the strategy models depicted in most strategy textbooks today. In his studies, Chandler described how large corporate conglomerates evolved in the US economy during the late nineteenth and early twentieth centuries and noted that the strategic decisions seemed to determine how corporate structures were established to achieve the expected economic payoffs. This observation laid the foundation for the so-called SSP dictum stating that organizations develop strategy before they make structural adjustments to accommodate the strategy, and that the adopted organizational structure subsequently affects performance outcomes. That is, Strategy–Structure–Performance (SSP), and in that order.

Igor Ansoff was a contemporary scholar and another pioneer in early conceptualizations of corporate strategy making and is often considered the "father" of strategic planning. Somewhat inspired by decision theory, he made normative descriptions of the strategy process as it ought to be carried out in large organizations. Ansoff's depiction of strategy was ascribed to "decision rules and guidelines, which guide the process of development of an organization" and he argued that "strategy is one of several sets of decision-making rules for guidance of organizational behavior."[10] Accordingly, he outlined a formal *strategic decision-making process* with sequential steps of objective setting, using gap identification between current and intended firm positions, while assessing alternative solutions to reduce identified *gaps*. He proposed a *cascading approach* whereby preliminary decisions deal with overarching issues, such as corporate purpose, and then decide on business, product, and customer choices before specifying organizational structure, systems, processes, etc. This logical sequence of increasingly detailed analytical steps also implies that the firm eventually specifies functional strategies, e.g., in marketing, operations, finance, etc. Ansoff shaped the idea to assess future growth opportunities along dimensions of geography, market needs, and product/service technologies. He also subtly pointed out that everyday operational problems attract management attention automatically whereas strategic issues remain in the background and thus need conscious effort to attract high-level attention. Hence, strategic focus and initiative is something that must be assumed by (top) management itself, and gaining this is crucial unless the firm wants to be mindlessly driven by events that happen in the surrounding business environment.

The view of strategy as something that derives from the executive echelons is contrasted in Chester Barnard's earlier discussion of the executive role.[11] He defined a *formal organization* as "a system of consciously coordinated activities or forces of two or more persons" and noted that the "willingness of persons to contribute efforts to the cooperative system is indispensable." So, people matter for the way business is carried out in the organization and those people need an acceptable purpose to motivate collaboration and individual contributions. The *informal organization* formed by personal contacts and their operating interactions was deemed equally important for the creation of supportive social norms. That is, authority can be gained only when the internal communication is consistent with an overarching acceptable corporate purpose. This in turn makes strategy making a function of the *morality* in executive governance. Philip Selznick backed this view when he argued: "The setting of institutional *goals* cannot be divorced from the enunciation of governing *principles*. Goal-setting, if it is institutionally meaningful, is framed in the language of character or identity, that is, it tells us what we should 'do' in order to become what we want to 'be'."[12] In short, mission, purpose, and values constitute cornerstones of effective strategy-making processes.

Business policy

The era of *business policy* developed during the 1950s and 1960s from essential management courses that confronted students in business administration with managerial issues involving the entire organization. The business policy classes required students to apply insights from different fields of study, including decision making, organizational behavior, accounting, marketing, operations, corporate finance, etc., in dealing with overarching organizational challenges and complex business problems. This required inclusion of insights from different topical fields across essential functional areas handled in different parts of the firm, often supported by case studies developed for teaching purposes to consider different competencies and concerns, including human resource management and general leadership challenges.[13]

In the words of Kenneth Andrews: "Business policy is the study of the functions and responsibilities of the senior management in a company, the crucial problems that affect the success of the total enterprise, and the decisions that determine its direction, shape its future, and produce the results desired."[14]

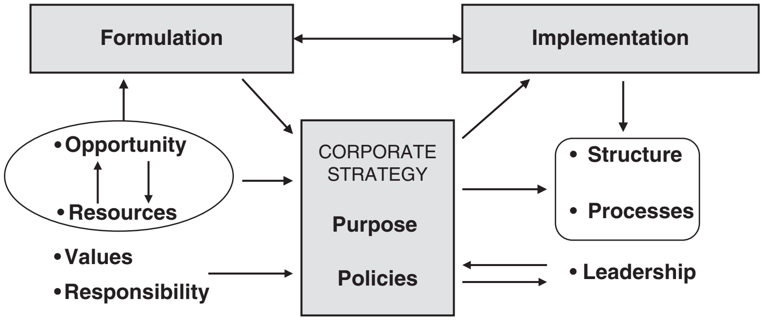


Figure 1.1 Andrews' corporate strategy model. Source: adapted from Andrews (1971/1987)

This implies that it is a primary task for top management to impose coordinated policies that tie the organization together for successful business outcomes and high performance. Hence, Andrews argued: "Corporate strategy is the pattern of decisions in a company that determines and reveals its objectives, purposes, or goals, produces the principal policies and plans for achieving those goals." Here we can trace the relationship to corporate decisions noted by Ansoff as well as the role of purpose emphasized by Barnard. Andrews placed these decisions within a more structured model of corporate strategy making that is quite consistent with the SSP dictum introduced by Chandler. He clearly distinguished between *formulation* as a distinct activity deciding what to do and *implementation* where the decisions subsequently are carried out through concrete actions (Figure 1.1). Strategic alternatives to be decided upon are determined through identification of opportunities and risks in the business environment held against available competences and resources assessed by strengths and weaknesses. This constitutes the precursor to the well-known SWOT analysis. The adaptation of organization structure and internal processes then follows from the execution of strategic decisions as proposed by Chandler. Andrews' original model recognized the importance of personal values and social responsibility and he reasoned: "It is increasingly clear that government regulation is not a good substitute for knowledgeable self-restraint."

The business policy teaching at the Harvard Business School was leading the way at the time and offered one of the dominant textbooks by Learned *et al*.[15] They defined strategy as "the pattern of objectives, purposes, or goals and major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be."[16] This view of strategy recognized the importance of organizational purpose while emphasizing the conscious development of corporate policies and plans as the means by which to achieve the overarching strategic aims.

Strategic management

By the end of the 1970s two established business policy scholars, Dan Schendel and Charles Hofer, argued that the field needed a new paradigm to advance research and practice in an increasingly dynamic business environment.[17] The business policy perspective was too limiting and they argued: "It is good strategy that ensures the formation, renewal, and survival of the total enterprise." To deal with this, they organized a conference with leading policy scholars at the time to outline the contours of a new field of study they called s*trategic management*.[18] The proposed paradigm defined strategic management as "a process that deals with the entrepreneurial work of the organization, with organizational renewal and growth, and more particularly, with developing and utilizing the strategy which is to guide the organization's operations." This paradigm set out a sequential structure of tasks in the strategic management process: goal formation, environmental analysis, strategy formulation, strategy evaluation, strategy implementation, and strategic control (Figure 1.2).

Their main argument for the formal strategic management process was that businesses were facing major environmental changes and therefore needed a more structured approach to better deal with the potential effects of change. As they noted: "Enormous, almost calamitous change has taken place in the rate at which technological, social, political, and economic events occur." So, dynamic changes in surrounding market conditions and higher interdependencies in environmental relations combined with increasingly complex organizational contexts would call for

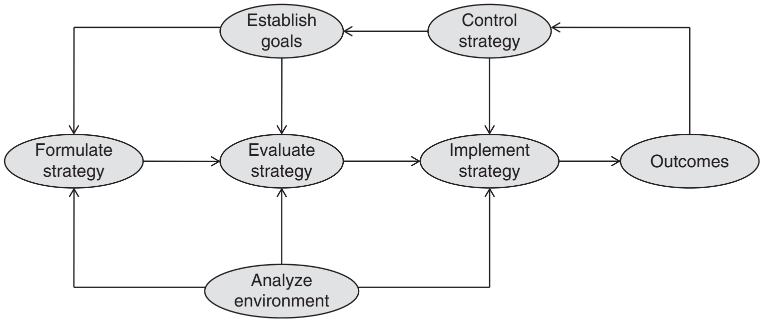


Figure 1.2 A model of the strategic management process. Source: adapted from Schendel and Hofer (1979)

more stringent environmental analysis as a necessary prerequisite to identify alternative strategic choices. Schendel and Hofer observed a need to consciously consider all those environmental factors that are beyond corporate control. In other words, the initial model had more of an external than internal emphasis even though strategy implementation was considered paramount for eventual success.

The areas of social responsibility and governance as well as strategic control were consciously toned down at the conference due to time constraints where only the more central elements of the strategic management process could be accommodated. It is interesting to note that these aspects of the strategic management model have remained relatively subdued areas of research in the strategy field. Different approaches to strategic control have frequently been addressed by scholars in management accounting whereas corporate governance and corporate social responsibility (CSR) gradually have evolved into rather specialized academic disciplines in their own right. However, the corporate strategy model promoted by Andrews (1987) already had a strong focus on purpose, ethics, and responsibility as central areas of concern. He argued: "The presidential functions involved include establishing or presiding over the goal-setting and resource-allocation processes of the company, making or ratifying choices among strategic alternatives, and clarifying and defending the goals of the company against external attack or internal erosion." Similarly, the rational analytical model of the strategic management process outlined by Schendel and Hofer emphasized the importance of strategic control as a way to monitor and assess strategy development in a dynamic business environment. So, while these areas may have received relatively limited attention as the scholarly strategy field evolved, they constitute central elements of the overarching strategy framework.

Another outcome from the discussions at the strategy conference was to identify a clearer distinction between different levels of strategy that remains in use among many scholars today. This strategy framework distinguishes between four strategy levels: enterprise strategy dealing with the overarching role of business in society, corporate strategy dealing with the issue of what business activities the firm should engage in, business strategy dealing with questions about how to compete in a given product market, and functional strategies dealing with the specific strategic requirements imposed on different functional entities (Figure 1.3).

The systematic approach to the strategy-making process formed the basis for a generic strategic management model that continues to be taught in business schools around the world (Figure 1.4). Look to any MBA curriculum in strategic management and you will find this model as a core element of the course that figures prominently in all major strategy textbooks in some version or the other. That is, we typically teach strategy making as deriving from a systematic, orderly process where we first set ambitions and goals, then determine the best strategic position for the firm to achieve these objectives based on rational analytical efforts, stake out and plan the actions required to realize the aims, and then monitor outcomes and adjust actions as required to stay on course. The general perception is that the formal process will integrate all aspects of forthcoming decisions aimed to achieve the overarching goals, i.e., "strategy is a timed sequence of internally consistent and conditional resource allocation decisions that are designed to fulfill an organization's objectives." The process is seen as a way to coordinate future organizational activities and optimize the ability to achieve desired outcomes. Hence, "a strategic planning system (SPS) is a set of interrelated organizational task definitions and procedures for seeing that pertinent information is obtained, forecasts are made, and strategy

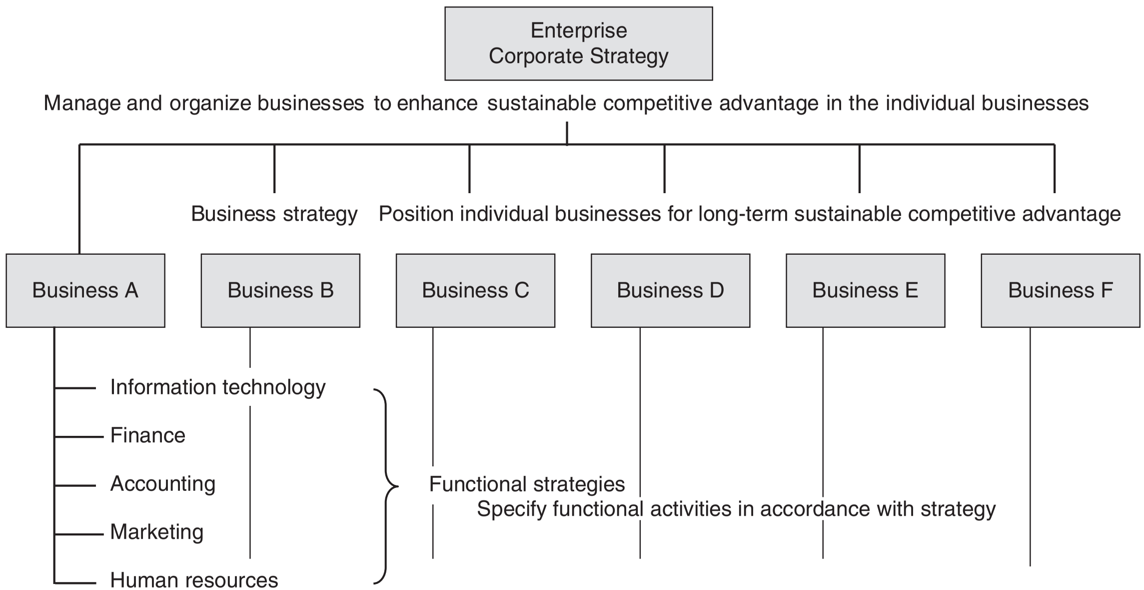


Figure 1.3 Different levels of strategy

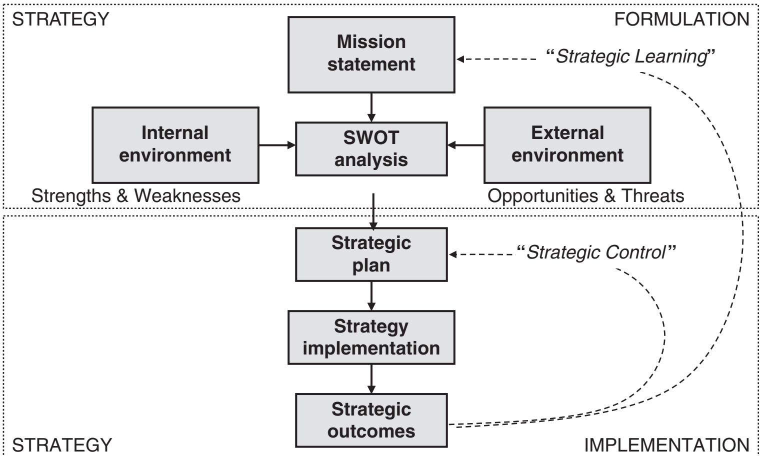


Figure 1.4 The strategic management model

choices are addressed in an integrated, internally consistent, and timely fashion."[19]

Indeed, it is a nice way of presenting strategic management because it sets out a very orderly, logical, and generally accepted way of perceiving how the strategy-making process ideally should proceed (see Box 1.1 *The basic elements of the generic strategic management model*). It is also convenient for teaching because it is possible to gather information about the business environment that allows for a lot of shrewd analyses adopting a variety of models and analytical techniques that can point to new solutions for a future strategy (see Chapter 2). However, everybody who has been involved in practice knows that achieving real results hinges upon an ability to execute and take actions that eventually can realize the strategic intentions. Furthermore, reality is typically more ambiguous than foreseen at the time of planning. The often very intricate dynamic, complex, and interrelated decision processes associated with business execution during implementation are simply too complicated to reproduce in a classroom setting. So, it is often omitted from the learning process and consequently quite a few students graduate in the belief that the generic strategic management model tells the whole truth. As we will see later, the strategic management model has a lot of merit, but it is only part of the story. Strategic planning as a rational analytical approach to strategy making works and it creates value. So, we can teach this strategy approach with a good conscience, realizing, however, that it is not a sufficient condition for effective strategy making that will achieve successful outcomes and superior firm performance.

The strategic management model builds around rational analyses of the external environment and the internal environment to identify potentially superior positions in the market place and to find ways in which firm competencies can be used effectively to assume these positions. This approach also incorporates the Andrews tradition to consider corporate values and guidelines as instrumental in the development of an overarching mission statement. While this generic model has formed the basis for much of the conventional classroom teaching, many nuances and alternative perspectives on the strategy process have emerged to strengthen the underlying analyses.

Market position and resources

Michael Porter introduced his path-breaking analytical frameworks on competitive forces and market positioning around the same time and shaped a period dominated by analyses of industry conditions and their competitive context.[20] Porter's insights were deduced from industrial economics where differences in industry profitability could be explained by the competitive structure within those industries. By extension, managers should try to exploit the underlying economic forces and devise strategies to position the firm in the industry in ways that could improve returns. This arguably entailed basic choices between generic strategies of *cost leadership* based on low prices and *differentiation* based on unique products (Figure 1.5). Cost leadership was aimed at a market posture where the firm exploits superior volume-driven operating efficiencies as lower average costs provide a more powerful competitive position. Differentiation was aimed at a market posture where the competitive position is enhanced by developing unique product and service features, albeit at the expense of standardization economies. The analytical framework was refined

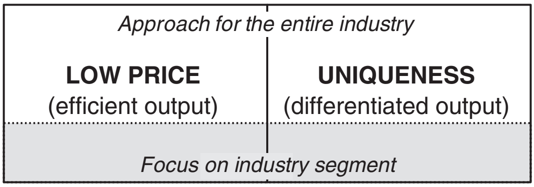


Figure 1.5 The generic strategies proposed by Porter. Source: adapted from Porter (1980/2004)

by outlining a cohesive practical approach for *competitor analysis* and identification of *strategic groups* adhering to comparable strategies. The strategic considerations were extended to consider the effect of *industry life cycle*, arguing that the underlying competitive dynamic depends on whether the industry is under emergence, is in transition to maturity, or is in a phase of decline. This cohesive analytical apparatus was instantaneously adopted as a core element of formal strategy analysis and has proven its durability over time.[21]

In the ongoing development of an analytical framework, Porter deliberated about internal firm conditions that could support *competitive advantage* defined as an ability to outperform close competitors in the industry. In this context, he introduced the *value chain* concept and specified the different components of a linked production process, ranging from purchasing, manufacturing, distribution, marketing, and sales, to after-sales service. He argued that competitive advantage could be associated with specific value chain activities whereby the firm might gain specific economic efficiencies or differentiate its market offerings. In other words, the value chain perspective could be linked to the generic strategies of cost leadership and differentiation.[22]

The idea of firm-specific advantages has some resemblance to Philip Selznick's work on *organization character* where habitual responsive actions are shaped over time as the firm relates to the environment. In this work he coined the term *distinctive competence*. He states: "In studying character we are interested in the distinctive competence or inadequacy that an organization has acquired" and this constitutes an examination of "the commitments that have been accepted in the course of adaptation to internal and external pressures."[23] That is, Selznick entertained the now well-established idea that firms adapt by considering both external and internal environmental conditions as reflected in the strategic management model. He also considered what may be seen as a precursor to the concept of competitive advantage, which is an engrained element of the strategy vocabulary today. The firm perspective on strategy development can also be traced to Edith Penrose, who introduced resources as the essential corporate building blocks. Her basic view was that an organization is comprised of a collection of resources used to supply goods and services in accordance with internal plans. The resources can be tangible things, including land, buildings, equipment, raw materials, semi-finished goods, waste, by-products, and finished goods in stock. However, they also comprise human resources, such as unskilled and skilled labor, administrative and technical staff, and management. The resources can be combined in different ways to serve the firm but Penrose argued: "It is never the *resources* themselves that are the 'inputs' in the production process, but only the *services* that the resources can render. The services yielded by resources are a function of the way in which they are used."[24] This fits neatly with Porter's contention that the way the firm organizes, structures, and manages its internal processes can create competitive advantage. Hence, according to Penrose, the organization uses its own internal resources together with various inputs acquired from outside the firm to produce and sell goods and services in the market at a profit.

This *resource-based view* was revived by Birger Wernerfelt as he introduced a basic framework that links internal resources to different product markets and vice versa as a fundamental way to assess the firm's strategic situation (Figure 1.6).[25] He defined resource as "a strength or weakness of a given firm" and thereby linked the assessment of firm resources to the core element of the strategic management model where internal resources are contrasted to external market threats and opportunities. The new thing was the inside-out perspective that contrasted with the outside-in perspective enhanced by Porter's work. However, the combination of the two views essentially corresponds to and extends the SWOT analytical approach practiced by Andrews and others. This internal look at corporate value creation was developed and refined

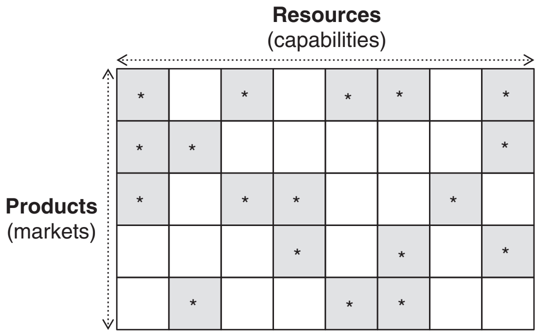


Figure 1.6 The firm's resource–product matrix. Source: adapted from Wernerfelt (1984)

by Jay Barney. The positioning view assumes that the firm can maneuver around the competitive forces in the industry and thereby create durable excess return conditions for the firm. However, this depends on how effectively the needed resources are deployed to this end. Hence, it is argued that the efficient acquisition and deployment of resources from the so-called *strategic factor market* to implement a given strategy is a source of competitive advantage (see Box 1.2 *The economic logics of the market positioning and resource-based perspectives*). If the underlying resources are valuable, relatively rare, hard to imitate, and can be organized for economic exploitation, then the competitive advantage becomes easier to *sustain* over time. Therefore, the analysis of the firm's internal skills and competencies provides a good basis for assessing the firm's long-term strategic viability.[26]

The focus on firm resources has been extended with a *knowledge-based* perspective considering that the increasing need for specialization and development of organizational capabilities depends on knowledge and an ability to integrate and deploy this knowledge within the organization. To the extent specific knowledge as an essential resource resides with individual employees, knowledge management as a strategic discipline will pose new governance challenges for corporate executives because the employees then effectively control important parts of the knowledge base that supports the value-creating activities in the firm.[27]

Alternative views

The preceding sections include and refer to a number of scholarly contributions that have provided essential inputs toward the development of the strategy concepts that prevail today. This should provide general insights into some of the basic roots of the field and its evolving nature. It outlines the core elements of the generic strategic management model that continues to be practiced and explains how it evolved over time. This model represents a cohesive approach to strategy formulation and implementation that suggests a dynamic process of ongoing monitoring and updating of activities in a strategic control process. The generic model framework can be presented in different ways, often guided by a genuine aim to discuss the strategy process more eloquently or to personalize the presentation of strategy making. In most cases, however, the proposed framework remains true to the basic principles of the strategic management model. Hence, an alternate form of the strategy process could look like the model shown in Figure 1.7.[28] Whereas this model may appear different from the generic strategic management model, it pretty much contains the same elements. The real difference is that the sequential steps of the model are presented sideways, left to right, as opposed to horizontally, top to bottom. So, the models

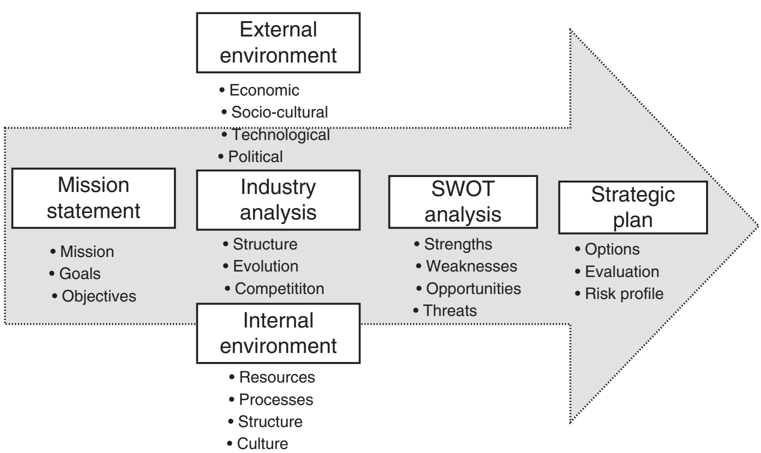


Figure 1.7 Alternate forms of the strategy model. Source: inspired by De Kluyver (2000)

are largely identical and merely represent variations of the same basic framework. When studying other strategy textbooks, it is noticeable that most of them adopt the generic strategy model and discuss the strategy process from that same vantage point. This book is no exception, but we will extend this framework later.

The strategic management model follows a logical sequence of steps analyzing the environmental context and formulating an "optimal" strategy for subsequent pursuit through orderly implementation as organizational members execute the strategic steps outlined in the strategic plan. That is, we assume that top management is in a position whereby they can stipulate a future strategic path and devise a series of corporate actions that will make the planned intentions come true. Similarly, when we try to analyze organizational developments after the fact, we often assume that the observed corporate actions arose on the basis of an initial grand plan brought to life in the executive suite. However, when strategy development has been studied as *a pattern in a stream of decisions* it has often uncovered a less orderly amalgam of strategic events.[29] Hence, the reality is that much of the strategy as developed in the strategic planning process is never realized by the organization because environmental conditions change or initial assumptions turn out not to hold true as the organization starts to execute the strategic action steps. That is, a substantial part of the *intended strategy* may end up as *unrealized strategy* (Figure 1.8). Yet an observant and responsive organization will be able to react to

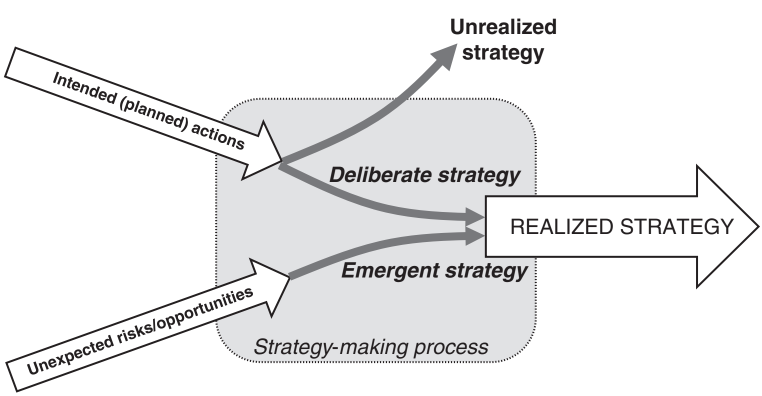


Figure 1.8 Deliberate and emergent strategy. Source: adapted from Mintzberg (1978)

new environmental developments as they unfold, which often may occur rather abruptly and unexpectedly. To the extent the firm is able to respond to the changing circumstances and exploit new business opportunities that arise from shifts in competitive conditions, the effects from these responsive actions can be referred to as *emergent strategy*. Hence, the strategic outcomes observed after the fact, i.e., the *realized strategy*, will comprise elements of the *deliberate strategy* devised in the strategic planning process together with strategic initiatives that emerged from implementation or ongoing execution of business activities. This interplay between intended and realized strategy may help us better understand the complexity of the strategy-making process.

By perceiving strategy as a pattern of decisions and ensuing (resource-committing) actions, we allow for a more nuanced view of how strategy actually happens. One might argue that the distinction between *formulation* and *implementation* is a false or at least an incomplete depiction of what is going on, because once the organization starts to take action to fulfill and realize the strategic intentions, the underlying assumptions and expected effects are confronted with the reality of a dynamic market place. The environmental context often turns out to react and behave differently from expectations and thereby provides opportunities for the organization to observe, learn, and experiment along the way. Hence, an *organizational learning* perspective could be a relevant approach to complement the conventional planning model considering the fact that specialized knowledge residing among the human resources in the firm might be paramount for effective execution. It tries to explain how an organization can learn about and adapt to changing conditions and unexpected events, probably entailing an ability to sense weak signals about subtle environmental changes and using them to modify activities in the organization in ways that accommodate the new conditions. This may suggest an *information-processing* perspective to better understand how organizational actors absorb, analyze, interpret, monitor, store, and disseminate knowledge flows in effective strategic decision-making processes that drive responsive actions in the firm.

In other words, strategy can also be interpreted as the result of *managerial decisions* taking place across different hierarchical levels and functional areas in the firm where the resulting actions have consequences and generate organizational outcomes over time that can be observed in retrospection. From this perspective it is apparent that the underlying decision-making processes are likely to be influenced by the views and beliefs held by the various organizational decision makers, i.e., the *cognition* of influential managers will make a difference. This provides a basis for studying effective decision making in a strategic management context. It also provides the foundation for *institutional theory*, where cognition and culture explain organizational (and strategic) behavior based on the idea that to succeed, firms must conform to prevailing norms and beliefs in a given business environment.[30] This relates to a *resource dependency* perspective that sees organizations as embedded in interdependent networks of social relationships where managers act to gain and preserve access to resources important for the firm.[31] The analysis of organizational actions as a way to secure needed resources considers effects of power structure, political influence, negotiation strengths, etc., and thus provides a link between concerns for market positions, internal competencies, and managerial behaviors. The perspective discards the idea of strategic decision makers as rational actors often subsumed in classical economics and normative strategy models.

Herbert Simon, the influential social scientist (and so far the only non-economist to receive the Nobel price in economics), coined the term *bounded rationality*. The term reflects the view that decision makers usually act on incomplete information where emotions can cloud their judgment as they act under circumstances that are a far cry from the perfect information or actuarial clarity implied by rationalistic decision models. That is, strategic decisions are circumscribed by many uncertainties. When decisions are based on anticipated future consequences coupled with a poor understanding of the alternatives available to the firm, it becomes difficult and possibly meaningless to optimize decision outcomes. Instead, decision makers engage in *satisficing* behavior with an aim of reaching acceptable interim decision outcomes that satisfy or exceed predetermined performance hurdles. So, Simon is confronting us with the reality of organizational decision making and proposes a theoretical framework to understand and describe these situational contexts. In his own words: “It is precisely in the real world where human behavior is *intendedly* rational, but only *boundedly* so, that there is room for a genuine theory of organization and administration.”[32]

Another issue related to strategic decision making is the fact that managers act on behalf of business owners, or policy communities, that often are distant from the specific organizational decision situations. In financial economics this frames the so-called *principal–agent problem* created by the separation of shareholders in limited companies from the day-to-day managerial decisions taken by professional managers in the firm. The separation between ownership and resource-committing decisions can give rise to *asymmetric information flows*, where hired managers in principle can exploit insights gained on the job for their own benefit at the expense of the owners, thereby creating potential problems of *moral hazards* and conflicts of interest.[33] In finance, this issue is typically discussed as a concern between corporate executives and the shareholders.[34] However, from a strategy perspective, the potential *agency conflicts* can be extended to include several other managerial layers, including the board of directors, line and middle managers, functional managers, and indeed any employee in charge of essential tasks and possessing important knowledge. A common solution is to try to align the interests of the agents that act on behalf of the firm with those of the actual owners (principals). This might comprise commissions, performance pay, profit sharing, stock ownership, and other incentives as well as performance monitoring and behavioral supervision by managers in the corporate hierarchy. Hence, the agency problem is relevant in most employee relationships and particularly so in situations where authority and decision power is delegated.

Considering the many potential limitations to rational decision making and optimal strategic behavior, some organizational views give limited credence to models of conscious strategy making as executives often seem to adhere to prevailing norms in their business environment. Instead, strategy development might be better understood in the context of evolutionary theory as applied in the natural sciences to uncover the dynamics of populations as they interact with the environment over time. This *population ecology* perspective adopts a longitudinal view of organizations characterized by firm *births* (start-ups, spin-offs, etc.) and *deaths* (bankruptcies, restructurings, etc.) within a given industry (population). It can also be extended to consider *migration* of firms between different industries (populations). Hence, new firms arise from entrepreneurial activities where the “genetic code” consists of competencies, routines, market offerings, and knowledge elements, possibly developed in other organizations, and then agglomerated in start-ups pursuing new business concepts. This may happen, for example, when an experienced employee becomes frustrated with corporate reluctance to use his innovative concept and therefore starts his own firm to pursue this business opportunity. If the venture is well received in the surrounding environment, it will be successful and will continue to be so as long as the concept satisfies basic needs in demand. If the business runs into trouble because the products, services, or operations become obsolete and outdated, the firm may cease to exist as an independent entity. However, the assets of the restructured firm usually prevail where many resources and competencies are carried forward and become part of existing corporate businesses or form new start-ups. Strategic renewal is thus shaped by entrepreneurial activities and the competitive environment acts as a selection mechanism where only the successful firms survive as time goes by.[35] That is, strategy as conscious decision making plays a limited role here.

This diversity of perspectives has inspired a particular view of strategy as something people do in organizations in some form or another possibly circumscribed by behavioral rituals around annual planning sessions, strategic retreats, and the like. Here strategy derives from complex processes that often involve many individuals throughout the organization rather than from one-off decisions by top management that will then permeate down through the organization. This view is often referred to as *strategy as practice* and has as a central aim to uncover how strategy actually happens in organizations and thereby creates a better description of the often highly convoluted organizational processes we refer to as corporate strategy making.[36] In short, strategic management is not simple but more often than not a complicated amalgam of activities influenced and affected simultaneously by many different factors. Hence, the alternative ways to see strategy can provide greater nuance as we try to interpret what is going on, and it may thereby help the analyst better understand what it takes to make strategy happen by considering different views.

Conclusion

Strategic management is conceived from the perspective of top management to consider how business and functional entities can work together to achieve sustainable, long-term results for the entire organization. We trace the historical roots of strategy from military affairs where the general uses his armies to dominate his adversaries. Strategy as a field evolved from business policy courses where management students were challenged in a last integrative course before graduation to think about the challenges associated with organizational success where many specialized entities and individuals must work together. This will typically require the integration of functional activities toward a common goal and coordination of organizational activities in efficient execution.

Hence, strategic management is introduced as a rational analytical process aimed at identifying viable market opportunities and deploying company resources to exploit those opportunities and thereby gain a stronger market position for the firm. While market positioning can be seen as a major strategic aim, the deployment of company resources toward that end will challenge the involvement of people across the organization to take the actions necessary to achieve the overarching strategic goals and in doing so they must gain new insights and learn about what can work and adapt activities to ensure that the organization is effectively moving toward the stated objectives. The complexity of this strategic adaptation process has inspired a variety of alternative views to understand many particular aspects of the strategy-making process.[37] By engaging alternative views and considering different angles to the strategy-making process, we may be able to triangulate our analysis by incorporating multiple aspects to better understand how things work.

While this chapter has provided a general background for strategic management, the next chapter will focus on how different types of analyses can support the strategy-making process, including appropriate tools and model frameworks for effective strategy analysis.

Box 1.1 The basic elements of the generic strategic management model

Mission statement: The mission statement should give direction for all organizational activities and arguably contains three things: (1) a basic corporate purpose explaining why the organization exists, (2) aspirations and goals to ideally be achieved by the organization, and (3) a set of values and guidelines setting a yardstick for preferred organizational behavior.

External analysis: Tries to understand the environmental context typically construed at three levels: (1) the macro-environment with political, economic, social, and technological trends that can affect general business conditions, (2) the competitive dynamic in the specific industry (or network of industries) where the firm conducts business, and (3) assessing performance compared with that of close (and potential) competitors. This will be able to say something about how the competitive position can support economic value and how this may change over time under uncertain external conditions.

Internal analysis: Takes an inward look to understand the conditions under which the firm performs its business transactions and may include an overview of organizational structure, governance, management and decision practices, operational and innovation processes, support functions, information and communication systems, reporting and control frameworks, etc. The analysis may provide an overview of productive assets, competencies, and know-how (*resources*) essential to corporate value creation.

SWOT analysis: Combines internal analysis (strengths, weaknesses) with external analysis (opportunities, threats) and provides a basis for understanding how the competitive context and deployment of firm resources may support high performance over longer time for *sustainable competitive advantage*. It can also identify gaps between strengths/ weaknesses and between opportunities/threats that need attention while serving as an analytical framework to identify alternative strategies and their requirements. It can serve as a platform for strategic decisions and the choice of a particular strategic path.

Strategic plan: Once the corporate decision makers have chosen a specific strategic path, the ensuing planning process should outline the necessary steps to be taken by the organization to reach the new strategic position. The plan can contain detailed actions for functional entities and may contain time schedules, goal specifications, and expected outcomes from actions.

Strategy implementation: Once the plan is developed it must be executed by the organization as relevant actors in the firm take concrete actions. The plan is communicated and actions are taken in accordance with the plans, although modifications must be envisioned if prior assumptions need reconsideration and if environmental conditions develop in a direction different from initial expectations.

Strategy outcomes: The initial planning and subsequent execution of decisions taken during implementation lead to strategic actions that affect the firm's market position and operating efficiencies. The performance effects of these actions constitute the outcomes of the preceding strategy process.

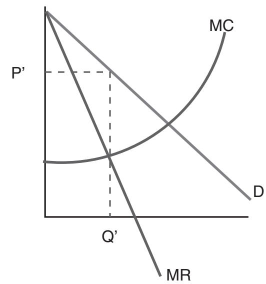
Strategic control: The strategic outcomes registered after the strategic implementation phase has been accomplished can be compared with the initial strategic aims in the strategic plan to identify discrepancies and assess the possible causes for them. This follow-up process can be used to consider whether there is a need for adjustments to the strategic action plans, with the aim of getting closer to the strategic aims established from the outset.

Strategic learning: If the strategic outcomes are substantially different from the planned aims due to fundamental changes in assumptions and expectations it may lead to rethinking of the entire strategy. This way the organization can learn from potential discrepancies between realized and expected outcomes to adjust the strategic path.

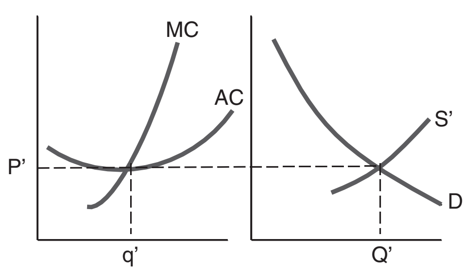
Box 1.2 The economic logics of the market positioning and resource-based perspectives

According to classical economic theory, the price (P) and quantity (Q) of a product exchanged in the market are determined by aggregate supply and demand in the market. The downward-sloping demand curve (D) reflects the collective trade-off between the desired quantities of the good at different price levels. The upward-sloping supply curve (S) reflects diminishing returns of resource inputs and that firms have different production efficiencies. A higher quantity of the supplied good requires delivery from the next most efficient supplier, i.e., as the supplied quantity increases, so does the price because more and more marginal producers are invited into the market. That is, under *perfect competition* the least efficient firm supplying the industry will not make any excess returns but will receive only revenues sufficient to pay for the productive inputs, e.g., land, labor, and capital, required in the production process. However, under *monopolistic conditions* the only firm in the industry to supply the good can set the price so as to optimize its profit. That is, where the marginal cost (MC) is equal to the marginal revenue (MR). The latter position is clearly more attractive.

<u>Industry structure and competitive forces</u>: The *market positioning* strategy is based on the idea that the firm can deal with counterparts in the economy to enhance the monopolistic traits of the firm's competitive position. For example, securing sole access to an important input for production may create such an advantage, while devising the product in ways that make customers more dependent is another way, as is reducing compatibility with alternative products. Similarly, the firm could try to *differentiate* its products and make them truly unique, which would tend to make the firm a sole supplier of a particular good or service. In these cases, the firm would try to create conditions of a distinct demand curve that resembles monopoly with the purpose of gaining a higher return.



The value creation of resources: The *resource-based* strategy is supported by the idea that the firm can hone its resources and thereby realize excess returns through unique economic efficiencies that create a durable position of excess returns beyond that of most other firms in the industry. The acquisition, development, and deployment of firm-specific resources are often part of a *path-dependent* process where the generation of new resources evolves from a prior set of resources in use. So, a strong resource position with positive economic efficiencies can be extended to subsequent periods into the future. If the underlying development process is complex and hard to emulate, it can lead to sustainable effects of excess economic returns.



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