Crafting and Executing Strategy - Concepts and Cases 22nd edition Thompson Solutions Manual

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chapter 2 lecture notes

Charting a Company's Direction: Its Vision and Mission, Objectives, and Strategy

Chapter Summary

Chapter Two presents an overview of the managerial tasks associated with developing and executing company strategies. Special attention is given to the importance of a clear vision for the company and the strategic and financial objectives that will guide the way. The importance of setting objectives at all levels of the organization is explored along with the role of operating excellence in the successful execution of strategy. The chapter wraps us with an exploration of the role of the company's board of directors in overseeing the strategic management process.

Lecture Outline

I. Introduction—Crafting and executing a strategy are the heart and soul of managing a business enterprise.

II. What Does the Process of Crafting and Executing Strategy Entail?

connect ACTIVITY

Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Crafting and executing a company's strategy consists of five interrelated stages:
   a. Developing a strategic vision of the company's long term direction, a mission that describes the company's purpose, and a set of values to guide the pursuit of the vision and mission.
   b. Setting objectives and using them as yardsticks for measuring the company's performance and progress.
   c. Crafting a strategy to achieve the objectives and move the company along the strategic course that management has charted.
   d. Executing the chosen strategy efficiently and effectively.
   e. Monitoring developments, evaluating performance, and initiating corrective adjustments in the company's vision and mission, objectives, strategy, or execution in light of actual experience, changing conditions, new ideas, and new opportunities.

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2. **Figure 2.1, The Strategy-Making, Strategy-Executing Process** illustrates this process.

III. Stage 1: Developing a Strategic Vision, A Mission Statement, and a Set of Core Values

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Developing a Strategic Vision

   a. Top management's views and conclusions about the company's long-term direction and what product–market–customer mix seems optimal for the road ahead constitute a **strategic vision** for the company.

   b. A number of factors need to be considered in deciding what words to use when creating the vision which will tell the company 'where we are going.' **Table 2.1, Wording a Vision Statement**—the Dos and Don'ts, explores some of these critical word choices.

CORE CONCEPT

A **strategic vision** describes management's aspirations for the company's future and the course and direction charted to achieve them.

ILLUSTRATION CAPSULE 2.1

Examples of Strategic Visions—How Well Do They Measure Up?

Discussion Question 1: What appears to be missing from the Whole Foods vision statement presented in Capsule 2.1?

Answer: (1) Brevity—the statement is very long which makes it difficult to keep the attention of the audience. (2) Memorable—the statement cannot be easily reduced to a few choice lines or a one-phrase slogan.

Discussion Question 2: What is effective in the Nike vision statement presented in Capsule 2.1?

Answer: The statement is short, making it focused and memorable. The vision described is feasible and flexible.

2. Communicating the Strategic Vision

   a. A strategic vision has little value to the organization unless it's effectively communicated down the line to lower-level managers and employees.

   b. An effectively communicated vision is a valuable management tool for enlisting the commitment of company personnel to engage in actions that move the company forward in the intended direction.

   c. A Expressing the Essence of the Vision in a Slogan The task of effectively conveying the vision to company personnel is assisted when management can capture the vision of where to head in a catchy or easily remembered slogan.

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d. The Vision Statement Matters: A well thought-out, forcefully communicated strategic vision pays off in several respects: (1) It crystallizes senior executives' own views about the firm's long-term direction; (2) it reduces the risk of rudderless decision making; (3) it is a tool for winning the support of organization members to help make the vision a reality; (4) it provides a beacon for lower-level managers in setting departmental objectives and crafting departmental strategies that are in sync with the company's overall strategy; and (5) it helps an organization prepare for the future. When management is able to demonstrate significant progress in achieving these five benefits, it can count its efforts to create an effective vision for the company as successful.

3. Developing a Company Mission Statement

a. The distinction between a strategic vision and a mission statement is fairly clear-cut: A **strategic vision** portrays a company's aspirations for its *future* ("where we are going"), whereas a company's **mission** describes its *purpose* and its *present* business ("who we are, what we do, and why we are here").

b. A company mission statement should ideally (1) identifies the company's products/services, (2) specifies the buyer needs that it seeks to satisfy and the customer groups or markets it serves, and (3) gives the company its own identity.

4. Linking the Vision/Mission with Company Values

a. By **values or core values**, we mean the beliefs, traits, and ways of doing things that management has determined should guide the pursuit of its vision and mission.

CORE CONCEPT

A company's values are the beliefs, traits, and behavioral norms that company personnel are expected to display in conducting the company's business and pursuing its strategic vision and mission.

b. Most companies have articulated four to eight core values that company personnel are expected to display and that are supposed to be mirrored in how the company conducts its business.

ILLUSTRATION CAPSULE 2.2

TOMS Shoes: A Mission with a Company

Discussion Question: TOMS Shoes presents the following mission statement: *With every product you purchase, TOMS will help a person in need. One for One.*® In what way is this mission ingrained in the company?

Answer: The student should be able to identify that since inception, TOMS Shoes has built the cost of giving away a pair of shoes into the price of each pair they sell. It is a core component of their business model and is expanded into new products as they go into the market place to include eye-ware, coffee, and backpacks. The mission is clearly and consistently communicated inside and outside the company.

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IV. Stage 2: Setting Objectives

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. The managerial purpose of setting **objectives** is to convert the strategic vision into specific performance targets. Objectives reflect management's aspirations for company performance in light of the industry's prevailing economic and competitive conditions and the company's internal capabilities.

CORE CONCEPT

Objectives are an organization's performance targets—the specific results management wants to achieve.

CORE CONCEPT

Stretch objectives set performance targets high enough to *stretch* an organization to perform at its full potential and deliver the best possible results. **Extreme stretch goals** are warranted only under certain conditions.

2. Well-stated objectives are specific, quantifiable or measurable and contain a deadline for achievement.

3. Concrete, measurable objectives are managerially valuable for three reasons: (1) They focus efforts and align actions throughout the organization, (2) they serve as *yardsticks* for tracking a company's performance and progress, and (3) they motivate employees to expend greater effort and perform at a high level.

CORE CONCEPT

A company exhibits **strategic intent** when it relentlessly pursues an ambitious strategic objective, concentrating the full force of its resources and competitive actions on achieving that objective.

4. Setting Stretch Objectives—The experiences of countless companies and managers teach that one of the best ways to promote outstanding company performance is for managers to deliberately set performance targets high enough to stretch an organization to perform at its full potential and deliver the best possible results.

5. What Kinds of Objectives to Set

   a. Two very distinctive types of performance yardsticks are required:

      - Those relating to financial performance
      - Those relating to strategic performance

   b. A company's set of financial and strategic objectives should include both near-term and longer-term performance targets.

   c. When trade-offs have to be made between achieving long-term objectives and achieving short-term objectives, long-term objectives should generally take precedence.

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d. **Table 2.2 - Common Financial and Strategic Objectives** provides several examples of both type of objectives.

CORE CONCEPT

Financial objectives relate to the financial performance targets management has established for the organization to achieve.
Strategic objectives relate to target outcomes that indicate a company is strengthening its market standing, competitive vitality, and future business prospects.

5. The Need for a Balanced Approach to Objective Setting—Of equal or greater importance than financial performance is a company's strategic performance—outcomes that indicate whether a company's market position and competitiveness are deteriorating, holding steady, or improving.

CORE CONCEPT

The **Balanced Scorecard** is a widely used method for combining the use of both strategic and financial objectives, tracking their achievement, and giving management a more complete and balanced view of how well an organization is performing.

CORE CONCEPT

The four dimensions of a **Balanced Scorecard**: 1. Financial, 2. Customer, 3. Internal Process, 4. Organizational (formerly called Growth and Learning).

ILLUSTRATION CAPSULE 2.3

Examples of Company Objectives

Discussion Question 1: What is the prominent purpose of an organization's stated objectives?

Answer: Objectives identify an organization's performance targets. They serve to function as measures for tracking the organization's performance and progress toward achievement of desired goals.

Discussion Question 2: What are some specific examples of top level objectives that are included in the Capsule:

Answer: The student should be able to locate the top level objective for each firms and then the measureable strategic and financial objectives that support it:

Jetblue—Produce above average industry margins by offering a quality product at a competitive price. They go on to set very specific financial and strategic goals that are measureable.
Lululemon—Optimize and strategically grow square footage in North America. They go on to set very specific financial and strategic goals that are measureable.
General Mills—To drive future growth, focus on Consumer First strategy to gain a deep understanding of consumer needs and respond quickly to give them what they want.

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connect ACTIVITY

Consider adding a File Attachment assignment requiring the student to develop a response to this Illustration Capsule. You can post instructions for the student within the assignment and collect their attachments for grading.

7. **Setting Objectives at Every Organizational Levels**

   a. Objective setting should not stop with top management's establishing of companywide performance targets.

   b. Each area of the organization does its part and contributes directly to the desired companywide outcomes and results.

   c. This means setting performance targets for each organization unit that support, rather than conflict with or negate, the achievement of companywide strategic and financial objectives.

V. Stage 3: Crafting a Strategy

connect ACTIVITY

Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Strategy is the result of piecing together critical 'how' statements such as how to attract and please customers, how to compete against key rivals, how to position the company in the marketplace, and many more. Speed and entrepreneurship are key elements in growing in fast paced markets. Therefore, strategy formulation should involve Managers at all organizational levels and relies on innovative thinking.

2. In most companies, crafting strategy is a *collaborative team effort* that includes managers in various positions and at various organizational levels. Crafting strategy is rarely something only high-level executives do.

CORE CONCEPT

Corporate strategy establishes an overall game plan for managing a *set of businesses* in a diversified, multi-business company.

Business strategy is primarily concerned with strengthening the company's market position and building competitive advantage in a single business company or a single business unit of a diversified multi-business corporation.

3. The larger and more diverse the operations of an enterprise, the more points of strategic initiative it will have and the more managers at different organizational levels will have a relevant strategy-making role. **Figure 2.2, A Company's Strategy Making Hierarchy** illustrates this concept.

4. A Company's Strategy Making Hierarchy—In these diversified, multi-business companies where the strategies of several different businesses have to be managed, the strategy-making task involves four distinct types or levels of strategy, each of which involves different facets of the company's overall strategy:

   a. Corporate strategy establishes an overall game plan for managing a set of businesses in a diversified, multi-business company.

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b. Business strategy is primarily concerned with strengthening the company's market position and building competitive advantage in a single business company or a single business unit of a diversified multi-business corporation.

c. Functional-area strategies concern the actions related to particular functions or processes within a business.

d. Operating strategies concern the relatively narrow strategic initiatives and approaches for managing key operating units.

5. In single-business enterprises, the corporate and business levels of strategy making merge into one level—business strategy. Thus, a single-business enterprise has only three levels of strategy:

   a. Business strategy for the company as a whole.

   b. Functional-area strategies for each main area within the business.

   c. Operating strategies undertaken by lower echelon managers to flesh out strategically significant aspects for the company's business and functional-area strategies.

6. Uniting the Strategy-Making Hierarchy

   a. Ideally, the pieces and layers of a company's strategy should fit together like a jigsaw puzzle. Anything less than a unified collection of strategies weakens company performance.

   b. Achieving unity in strategy making is partly a function of communicating the company's basic strategy theme effectively across the whole organization and establishing clear strategic principles and guidelines for lower-level strategy making.

7. A Strategic Vision + Objectives + Strategy = A Strategic Plan

   a. Developing a strategic vision and mission, setting objectives, and crafting a strategy are basic direction-setting tasks. Together, they constitute a strategic plan for coping with industry and competitive conditions, the expected actions of the industry's key players, and the challenges and issues that stand as obstacles to the company's success.

CORE CONCEPT

A **strategic plan** lays out its direction, business model, competitive strategy, and performance targets for some specified period of time.

   b. In companies committed to regular strategy reviews and the development of explicit strategic plans, the **strategic plan** may take the form of a written document that is circulated to managers and perhaps, to selected employees.

   c. In small, privately owned companies, it is rare for strategic plans to exist in written form.

VI. Stage 4: Executing the Strategy

connect ACTIVITY

Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Managing the implementation of a strategy is easily the most demanding and time consuming part of the strategy management process.

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2. Converting strategic plans into actions and results tests a manager's ability to direct organizational action, motivate people, build and strengthen competitive capabilities, create and nurture a strategy-supportive work climate, and meet or beat performance targets.

3. In most situations, managing the strategy execution process includes the following principal aspects:

   - Creating a strategy-supporting structure.
   - Staffing the organization to obtain needed skills and expertise.
   - Developing and strengthening strategy-supporting resources and capabilities.
   - Allocating ample resources to the activities critical to strategic success.
   - Ensuring that policies and procedures facilitate effective strategy execution.
   - Organizing the work effort along the lines of best practice.
   - Installing information and operating systems that enable company personnel to perform essential activities.
   - Motivating people and tying rewards directly to the achievement of performance objectives.
   - Creating a company culture and work climate conducive to successful strategy execution.
   - Exerting the internal leadership needed to propel implementation forward.

4. Good strategy execution requires diligent pursuit of operating excellence and it is a job for a company's whole management team.

VII. Stage 5: Evaluating Performance and Initiating Corrective Adjustments

connect ACTIVITY

Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. The fifth component of the strategy-management process, monitoring new external developments, evaluating the company's progress, and making corrective adjustments, is the trigger point for deciding whether to continue or change the company's vision and mission, objectives, strategy, and/or strategy execution methods.

2. As long as the company's strategy continues to pass the three tests of a winning strategy, simply fine-tuning the strategic plan and continuing with efforts to improve strategy execution are sufficient.

VIII. Corporate Governance: The Role of the Board of Directors in the Strategy-Making, Strategy-Executing Process

connect ACTIVITY

Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Although senior managers have lead responsibility for crafting and executing a company's strategy, it is the duty of the board of directors to exercise strong oversight and see that the five tasks of strategic management are done in a manner that benefits shareholders, in the case of investor-owned enterprises, or stakeholders, in the case of not-for-profit organizations.

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2. A company's board of directors has four important obligations to fulfill:
   a. Oversee the company's financial accounting and financial reporting practices.
   b. Critically appraise the company's direction, strategy, and business approaches.
   c. Evaluate the caliber of senior executives' strategic leadership skills.
   d. Institute a compensation plan for top executives that rewards them for actions and results that serve shareholder interests.

CORE CONCEPT

A company's **stakeholders** include its stockholders, employees, suppliers, the communities in which the company operates, and society at large.

3. Every corporation should have a strong independent board of directors that:
   a. Is well informed about the company's performance.
   b. Guides and judges the CEO and other top executives.
   c. Has the courage to curb management actions the board believes are inappropriate or unduly risky.
   d. Certifies to shareholders that the CEO is doing what the board expects.
   e. Provides insight and advice to management.
   f. Is intensely involved in debating the pros and cons of key decisions and actions.

ILLUSTRATION CAPSULE 2.4

Corporate Governance Failures at Volkswagen

Discussion Question 1: In what way did the Board of Directors at Volkswagen contribute to the Emission Test scandal in 2015?

Answer: The primary cause is the absence of a strong group of independent directors. Based upon German Corporate law, governance is provided by a Management Board and a Supervisory Board, with employees making up 50% of the Supervisory Board. This should have allowed for at least 50% of the Supervisory Board to be fully independent. While staying within the 'letter of the law', they sidestepped the 'spirit of the law' by cycling recent former senior executives through the Supervisory Board Chairmanship position and other board positions. This had the effect of removing truly independent oversight.

A secondary cause is that 50 % of voting shares are controlled by the Porsche family. Family members, acting as Chairman of the Board, will regularly remove an independent CEO and replaced them with unqualified family members. This has the effect of removing qualified and independent senior management oversight.

connect ACTIVITY

Use the Question Bank to build a quiz for the chapter to measure and reinforce learning. Consider using the questions you select to build a comprehensive mid-term and final exam for the course. The assignment can be graded and posted automatically.

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ASSURANCE OF LEARNING EXERCISES

1. Using the information in Table 2.1, critique the adequacy and merit of the following vision statements, listing effective elements and shortcomings. Rank the vision statements from best to worst once you complete your evaluation.

connect ACTIVITY

This Assurance of Learning exercise is available as a Connect Assignment. The assignment can be graded and posted automatically.

Response:

The student should produce a table similar to the following:

Company Name	Effective Elements	Shortcomings
American Express	• Easy to Communicate • Feasible • Easy to communicate	• Vague • Not distinctive
Hilton Hotels Corporation	• Directional • Focused • Feasible • Desirable	• Not forward-looking • Not distinctive
MasterCard	• Easy to Communicate	• Vague
BASF	• Directional • Focused • Desirable	• Not forward looking

The student might rank vision statements from best to worst as: Hilton Hotels Corporation, BASF, American Express, MasterCard.

2. Go to the company investor relations websites for Starbucks (investor.starbucks.com), Pfizer (www.pfizer.com/investors), and Salesforce (investor.salesforce.com) to find examples of strategic and financial objectives. List four objectives for each company, and indicate which of these are strategic and which are financial.

Response:

The student should identify objectives similar to the following:

Starbucks, From their 2015 Annual Report

- Revenue growth of 10 for Fiscal 2016 (financial)
- Addition of approximately 1800 new stores in 2016 with nearly half in the developing China/Asia Pacific segment (strategic)
- Improved operating profits increasing earnings per share by $0.06 per share for 2016 (financial)

Starbucks, From their 2015 Annual Letter to Shareholders

- Continue to focus on Corporate Social Responsibility and Sustainability, adding an 8th farmer support center in Mexico in 2016 (strategic)
- Full year revenue growth of 10% on a 52 week basis (financial)

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Salesforce, From their 2015 Annual Report:

- Offer multiple versions of business solutions at different price points to target wider range of customers (Strategic)
- Focus expansion into high growth markets including marketing, communities, business intelligence, and cloud platforms (Strategic)
- Salesforce, From their Fiscal 2016 First Quarter Results:
- Increase revenue to $6.55 Billion for Fiscal 2016 (Financial)
- Increase EPS to $0.17 to $0.18 for Fiscal 2016 (Financial)

Pfizer, From their 2015 Annual Review: Improving the performance of the innovative core by transforming R&D focusing on Oncology, Inflammation & Immunology, Cardiovascular & Metabolic Disease, Neuroscience & Pain, Rare Disease, Vaccines, and Biosimilars (strategic)

Pfizer, From their 1st Quarter 2016 Results: Growth in projected revenue for 2016, up from $49B - $51B to $51B - $53B (financial)

3. Boeing has been recognized by Forbes and other business publications as one of the world's best managed companies. The company discusses how its people and organizational units bring to bear the "best of Boeing" to its customers in 150 countries at www.boeing.com/company. Prepare a one- to two-page report that explains how the company has become a leader in commercial aviation through tight coordination of strategic initiatives at various organizational levels and func-tional areas.

   Response:

   The student should identify overall strategic initiatives need to be broken down into performance targets and objectives for each of the organization's separate business units, functional departments, individual work units, and employees within various functional departments and individual work units. This is because the larger and more diverse the operations of an enterprise, the more points of strategic initiative it will have and the more managers at different organizational levels will have a relevant strategy-making role. This is illustrated in figure 2.2, A Company's Strategy Making Hierarchy.

   A careful examination of the Corporate Overview provides insight into how the company is organized in a way that allows it to fulfill its strategic initiatives:

   > Strategic Initiatives: Four primary initiatives are presented in their vision; 1) Connect 2) Protect 3) Explore 4) Inspire
   >
   > Business Units: Three business units are present to fulfill the initiatives; 1) Commercial Airplanes 2) Defense, Space, and Security (BDS) 3) Boeing Global Services
   >
   > Supporting Units: Two supporting units provide the necessary services for the three business units to meet their objectives; 1) Boeing Capital Corporation 2) Shared Services

   The student should be able to discuss the objectives of each of the business units and supporting units and make the connection between those objectives and each of the four primary initiatives the company is driving towards.

4. Go to the investor relations website for Walmart (http://investors.walmartstores.com) and review past presentations it has made during various investor conferences by clicking on the Events option in the navigation bar. Prepare a one- to two-page report that outlines what Walmart has said to investors about its approach to strategy execution. Specifically what has management discussed concerning staffing, resource allocation, policies and procedures, information and operating systems, continuous improvement, rewards and incentives, corporate culture, and internal leadership at the company?

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Response:

The student should be able to identify core strategic elements focused on low cost and value:

- Walmart Discount Stores: Wide, clean, brightly-lit aisles and shelves stocked with a variety of quality, value-priced general merchandise
- Walmart Superstores: Convenient, one-stop family shopping featuring our famous Every Day Low Prices
- Walmart Neighborhood Markets: quick and convenient shopping experience for customers who need groceries, pharmaceuticals, and general merchandise all at our famous Every Day Low Prices.
- Walmart Express Stores: offer low prices every day in a smaller format store that provides convenient access for fill-in and stock-up shopping trips in rural and urban areas.
- Marketside: Small community pilot grocery stores specializing in fresh, delicious meals at great prices.
- Walmart.com: The convenience, great merchandise selection, friendly service and Every Day Low Prices of your neighborhood Walmart to the Internet.

The student should be able to identify core cultural elements that impact all aspects of life as a Walmart employee (Source: http://walmartstores.com/AboutUs/295.aspx)

- Open Door: Our management believes open communication is critical to understanding and meeting our associates' and our customers' needs. Associates can trust and rely on the open door; it's one of the most important parts of our culture.
- Sundown Rule: Observing the Sundown Rule means we do our best to answer requests by the close of business on the day we receive them. Whether it's a request from a store across the country or a call from down the hall, we do our very best to give each other and our customers same-day service. We do this by combining our efforts and depending upon each other to get things done.
- Grass Roots Process: Sam's philosophy lives on today in Walmart's Grass Roots Process, our formal way of capturing associates' ideas, suggestions and concerns.
- 3 Basic Beliefs & Values: Our unique culture has helped make Walmart one of the world's most admired companies. Since Sam Walton opened Walmart in 1962, our culture has rested on three basic beliefs. We live out these beliefs each day in our interactions with our customers and each other.
- 10-Foot Rule: The 10-foot Rule is one of our secrets to customer service. During his many store visits, Sam Walton encouraged associates (employees) to take this pledge with him: "I promise that whenever I come within 10 feet of a customer, I will look him in the eye, greet him, and ask if I can help him."
- Servant Leadership: Sam Walton believed that effective leaders do not lead from behind their desks. "It's more important than ever that we develop leaders who are servants, who listen to their partners – their associates – in a way that creates wonderful morale to help the whole team accomplish an overall goal," Sam said.
- Teamwork: Sam Walton, our founder, believed in the power of teamwork. As our stores grow and the pace of modern life quickens, that philosophy of teamwork has only become more important over the years.
- Walmart Cheer: Don't be surprised if you hear our associates shouting this enthusiastically at your local Walmart store. It's our cheer, and while it might not sound serious, we take it seriously. It's one way we show pride in our company.

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5. Based on the information provided in Illustration Capsule 2.4, describe the ways in which Volkswagen did not fulfill the requirements of effective corporate governance. In what ways did the board of directors sidestep its obligations to protect shareholder interests? How could Volkswagen better select its board of directors to avoid mistakes such as the emissions scandal in 2015?

connect ACTIVITY

This Assurance of Learning exercise is available as a Connect Assignment. The assignment can be graded and posted automatically.

Response:

The student should be able to identify the characteristics of an effective independant Board of Directors:

- Is well informed about the company's performance.
- Guides and judges the CEO and other top executives.
- Has the courage to curb management actions the board believes are inappropriate or unduly risky.
- Certifies to shareholders that the CEO is doing what the board expects.
- Provides insight and advice to management.
- Is intensely involved in debating the pros and cons of key decisions and actions.

The student should then be able to provide a detailed discussion of the failures of the Board of Directors. Leading failures resulting in the Emmissions Scandal include:

- The primary cause is the absence of a strong group of independent directors. Based upon German Corporate law, governance is provided by a Management Board and a Supervisory Board, with employees making up 50% of the Supervisory Board. This should have allowed for at least 50% of the Supervisory Board to be fully independent. While staying within the 'letter of the law', they sidestepped the 'spirit of the law' by cycling recent former senior executives through the Supervisory Board Chairmanship position and other board positions. This had the effect of removing truly independent oversight.
- A secondary cause is that 50 % of voting shares are controlled by the Porsche family. Family members, acting as Chairman of the Board, will regularly remove an independent CEO and replaced them with unqualified family members. This has the effect of removing qualified and independent senior management oversight.

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case 2 • Case Assignment Questions

Airbnb in 2018

Assignment Questions

1. How would you illustrate and compare the business models for Airbnb, large hotel chains such as Marriott and Hilton, and bed & breakfast operators? Use the example chart in the textbook for business models as a guide (Concepts & Connections 1.1)
2. What are the general strengths and weaknesses of a) large, hotel chains such as Marriott and Hilton, b) bed & breakfasts, and c) Airbnb? Explain how you would compare and contrast those businesses.
3. In what ways has the lodging consumer changed, and how does Airbnb's customer value-proposition meet this change?
4. What key factors may determine the success or failure of Airbnb?
5. What recommendations would you make to Airbnb to improve its competitiveness in the accommodation market while mitigating any current and future risks?

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case 2 teaching note

Airbnb in 2018*

Overview

Airbnb was founded in 2008 when Brian Chesky and a friend decided to rent their apartment to guests for a local convention. To accommodate the guests, they used air mattresses and referred to it as the "Air Bed & Breakfast." It was that weekend when the idea– and the potential viability– of a peer-to-peer room-sharing business model was born. By 2018 Airbnb had seen immense growth and success in its 10-year existence. The room-sharing company had expanded to over 190 countries with more than 4 million listed properties, and had an estimated valuation of $31 billion. Airbnb seemed poised to revolutionize the hotel and tourism industry through its business model that allowed hosts to offer spare rooms or entire homes to potential guests, in a peer-reviewed digital marketplace.

This case is meant to introduce students to the sharing economy. Students can compare and contrast Airbnb's business model with traditional models employed by bed and breakfast and hotel chain operators. Instructors should note that technology and the legal environment can lead to opportunities, as well as challenges for an upstart like Airbnb. The case opens and closes with quotes from CEO and co-founder Chesky, to juxtapose for students how rapid advances in technology can lead to changes in competitive strategies for business, yet, how the legal environment can both lag behind, and obstruct such strategies.

The case provides an overview of the accommodation market (i.e. hotels, motels and bed & breakfasts) to illustrate such strategic considerations as competitor size and market segmentation. The case then presents the comparative costs of operating traditional hotels/motels to bed & breakfasts to illustrate Airbnb's potential to attain and sustain competitive advantage using its technology-based business model. Yet Airbnb faces continuing challenges to obtain permits and overcome regulatory barriers. While it continues to demonstrate a growth trajectory that could result in an IPO, Airbnb will need to develop new strategic approaches to build out its model and surmount competitive forces.

Suggestions for Using the Case

Students should find Airbnb in 2018 an interesting case because of their own experiences with smartphones and companies such as Lyft, Uber or Airbnb. We recommend using the case immediately following your coverage of Chapter 1. As this case specifically addresses the sharing economy, it lends itself well to discussions of smartphones, technology and their impact on competitive positions for both new and incumbent competitors. It may also lead to discussion of disruptive innovation.

We believe that Airbnb in 2018 is an excellent leadoff case for the course (other choices are Robin Hood, Mystic Monk and Wil's Grill). This case is ideal for exploring the concepts of sustainable competitive advantage, competing differently, and business models. Instructors can drill students on such topics as customer value proposition, profit formula and compare and contrast Airbnb's approaches with those of traditional lodging operators.

*This teaching note primarily reflects the thinking and analysis of Professor John D. Varlaro, Johnson & Wales University. We are most grateful for his insight, analysis and contributions to how the case can be taught successfully.

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This case can also be used to explore factors within the general environment and how external analysis is important for incumbents and new entrants alike.

The assignment questions and teaching outline presented below reflect our thinking and suggestions about how to conduct the class discussion and what aspects to emphasize.

To provide students with guidance in what to think about and which analytical tools to utilize in preparing the Airbnb in 2018 case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they develop good notes/answers to these questions in preparing for class discussion of the case.

To facilitate your use of study questions and to make them available to students, we have posted a file of the assignment questions contained in this teaching note for the Airbnb in 2018 case in the instructor resources section of the Connect Library. (We should also point out that there is a set of study questions posted in the student section of the OLC for each of the 32 cases included in the 22nd Edition.)

You may also find it beneficial to have your class read the Guide to Case Analysis that is also posted in the instructor resources section of the Connect Library. Students will find the content of this Guide particularly helpful if this is their first experience with cases and they are unsure about the mechanics of how to prepare a case for class discussion, oral presentation, or written analysis.

Videos for Use with the Airbnb in 2016 Case. There are two videos that you may consider having students view prior to class discussion of the case (or you may choose to open the class discussion with one of the two videos). Both videos are posted at YouTube and can be access through the following links:

- Three Business Lessons You Can Learn from Aribnb is a 2:25 minute video posted at YouTube (https://https://www.youtube.com/watch?v=J9wIOu7VLnY).
- How Airbnb is Attacking the Hotel Industry is a 2:20 minute video posted at YouTube (https://www.youtube.com/watch?v=9aedQGRu0vQ).

Because the case is relatively short, it is well suited for use as a leadoff case on the first day of class, or for an in-class written case, or a final exam case. Our recommended questions for written assignments are as follows:

1. Marriott management has asked you to assess the threat of Airbnb. Please prepare a 5-6 page report that includes a description of both Marriott's and Airbnb's business models, with an emphasis on an evaluation and comparison of disparate customer demands and user profiles. Marriott's management also asks that you make a recommendation as to how best to mitigate the growing appeal of Airbnb, and how to potentially reach millennials and other potential users of Airbnb.
2. As a new member of Airbnb's management team, you have been asked to prepare an analysis of its competitive position and potential threats. Your 2-3 page executive summary should list strategic issues confronting Airbnb and make recommendations to address both opportunities and challenges. The executive summary should be supported by your analysis of the lodging industry.

Assignment Questions

1. How would you illustrate and compare the business models for Airbnb, large hotel chains such as Marriott and Hilton, and bed & breakfast operators? Use the example chart in the textbook for business models as a guide (Concepts & Connections 1.1)
2. What are the general strengths and weaknesses of a) large, hotel chains such as Marriott and Hilton, b) bed & breakfasts, and c) Airbnb? Explain how you would compare and contrast those businesses.

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3. In what ways has the lodging consumer changed, and how does Airbnb's customer value-proposition meet this change?
4. What key factors may determine the success or failure of Airbnb?
5. What recommendations would you make to Airbnb to improve its competitiveness in the accommodation market while mitigating any current and future risks?

Teaching Outline and Analysis

1. How would you illustrate and compare the business models for large hotels chains such as Marriott and Hilton, bed & breakfast operators, and Airbnb? Use the example chart in the textbook for business models as a guide (Concepts & Connections 1.1)

Students should be able to identify the following:

	Chain Hotels / Motels	Bed & Breakfast (single proprietor)	Airbnb
Customer Value Proposition	• Familiar brands • International brands to which customers are accustomed and potentially feel affinity and loyalty • Global reach with loyalty programs	• One location, offering unique, local accommodation • Intimate accommodation, with proprietor sometimes serving multiple roles, including ambassador to area • If in rural area, may be only accommodation	• Use of technology to which users are familiar • Smaller, more intimate stays • Varying and different locales in which to stay, both local and international reach • Cheaper accommodations • Unique accommodations
Profit Formula	• Revenue generation dependent on renting rooms and overall occupancy • Cost structure extensive, composed of wages and high fixed costs associated with the purchase and upkeep of multiple physical assets/locations • Other costs would include food and beverage, marketing, taxes, licenses • Global costs further complicate structure, including operating across multiple legal and physical jurisdictions	• Revenue generation dependent on renting rooms and overall occupancy • Cost structure associated with operating brick and mortar physical location, food and beverages, marketing • Possibly wages if large enough to necessitate staff	• Revenue generation transaction fee charged to users whom offer and rent accommodations through app • Cost structure associated with developing and updating software and technology, marketing and adversting, wages for engineers, professional management and staff
Profit Margin	• Dependent on generating sufficient revenues across multiple locations to cover fixed and variable costs globally. Profitable locations may be used to offset losses and unprofitable locations	• Dependent on generating revenues sufficient to cover fixed and variable costs. Lack of profitability several jeopardizes business as owned by sole proprietor	• Not contingent upon the fixed costs associated with operating hotels/ bed & breakfasts. Instead, profitability associated with percentage of revenue generated by all participating users offering accommodations

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Students should be reminded that, as stated in Chapter 1 of the text:

- ***The appeal of a strategy or business model that yields a sustainable competitive advantage is that it offers the potential for an enduring edge over rivals.***
  - However, Chesky as CEO must be willing and ready to modify the strategy in response to the unexpected moves of competitors, shifting buyer needs and preferences, emerging market opportunities, new ideas for improving the strategy, and mounting evidence that the strategy is not working well.
  - Most of the time, a company's strategy evolves incrementally as management fine-tunes various pieces of the strategy and adjusts the strategy to respond to unfolding events.

Here is a good opportunity to ask students to compare and contrast the strengths and weaknesses of Airbnb's business model to those of its direct competitors.:

2. What are the general strengths and weaknesses of large hotel chains such as Marriott and Hilton, bed & breakfasts, and Airbnb? Explain how you would compare and contrast those businesses.

Students should be able to identify the following:

	Large Hotel Chains	Bed & Breakfast (single proprietor)	Airbnb
Strengths	• Familiar, International brands • Brand loyalty • Global reach • Perception of safe, comfortable and/or reliable accommodations • Corporate accounts	• One location, offering unique, local accommodation • Intimate accommodation, with proprietor sometimes serving multiple roles, including ambassador to area • If in rural area, may be only accommodation	• No fixed costs associated with operating hotels, thus greatly reduced cost structure • Leveraging technology when consumers are more smartphone dependent • Market leader perception in technology • Ubiquitous, as user can access anytime through app • Offering both low-cost accommodations, as well as unique experiences
Weaknesses	• High cost structure, further exacerbated by global operations and presence • If consumer has bad experience with one location, all locations may be viewed as terrible • Need at times to compete on price through discount offerings	• Revenue generation dependent on renting rooms and overall occupancy, highly associated with travel trends in the area • Cost structure which is highly sensitive to fluctuations, as a sole proprietor has very little room for shifts in revenue and costs	• Perception of at times unsafe experiences • Users may be hesitant to use Airbnb in specific locations, opting for a more familiar brand • Legal exposure through individual hosts not following laws, such as anti-discrimination • Legal exposure as cities and towns determine if renting rooms through Airbnb is legal, and the potential for it to be illegal • Business model is relatively easy to copy, as demonstrated by Uber and Lyft in the ride-sharing space

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Here is a good opportunity to recap Chapter 1 and also preview some concepts covered Chapter 2:

- ***In choosing among opportunities and addressing the hows of strategy, strategists must embrace the risks of uncertainty and the discomfort that naturally accompanies such risks.***
  - Bold strategies involve making difficult choices and placing bets on the future.
  - Good strategic planning is not about eliminating risks, but increasing the odds of success. In sorting through the possibilities of what the company should and should not do, managers may conclude some opportunities are unrealistic or not sufficiently attractive to pursue.
  - However, innovative strategy-making that results in a powerful customer value proposition or pushes the company into new markets will likely require the development of new resources and capabilities and force the company outside its comfort zone..

That an innovative strategy has its basis in a powerful customer value proposition leads nicely into the next question.

3. In what ways has the lodging consumer changed and how does Airbnb's customer value-proposition meet this change?

Students should be able to identify the following changes in the profile of lodging customers:

- ***Desire for unique experiences, not focused on ownership***. should be able to discuss their experiences as consumers of the sharing economy (not only with Airbnb, but also Uber, Lyft, and other similar companies).
  - Airbnb provides customers with opportunities to experience multiple, unique accommodations not typically associated with larger chain brands.
  - Smaller sole proprietors such as bed & breakfasts may be accessed through the app.
  - Those offering accommodations as hosts share in the desire to not only have a unique experience with a guest, but also to invite a stranger into their own home or apartment
- ***Desire to access experiences immediately through smartphone technology***. Students should note that a company like Airbnb could only exist since the advent of Internet and smartphone technologies.
  - Apps and smartphones have provided the consumer the opportunity to have immediate access, such as purchasing songs immediately only after hearing them on the radio, or even the simple act of "googling" and looking-up information.
- ***Familiarity with apps and fluency with life/smartphone integration***. Consumers — especially the Millennial age group (i.e. those consumers born between the early 1980s and the early years of the 21st century)— are less technology-averse, use smartphones and apps, and are more willing to experiment and embrace the "experience economy" than previous generations, and this trend should continue to occur.
  - As younger generations whom have used smartphones from childhood age and get older, technology and businesses such as Airbnb will seem less unusual and more commonplace.

Students should conclude that these consumer changes position Airbnb very strongly to compete effectively, especially given its unique business model (as identified in Question #1).

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4. What key factors may determine the success of Airbnb?

Factors that are necessary for competitive success for Airbnb:

- ***Mitigation of legal threat***. Any regulation that inhibits or prevents Airbnb users/hosts from offering their rooms on Airbnb represents a significant barrier. Students should observe that:
  - Both domestic and international legislation did not account for, and had yet to catch up to, more progressive and potentially disruptive business models utilized by companies like Airbnb.
  - Complicated legal issues existed at the local, state, and federal levels, both within the U.S. and outside the U.S.
  - Competitors, among them sole proprietor and large hotel chains, had already invested, and would most likely continue to invest in, lobbying to exclude Airbnb and create severe barriers to its expansion and growth.
  - While communities and jurisdictions might well bar or set quotas for the number of Airbnb permits to operators, Airbnb could promote the fact that its operators added to local revenues through occupancy taxes, as well as the probably economic multiplier effects that would also benefit local restaurants, retailers, and tourist attractions.
- ***Use of smartphone and other technology for differentiation***. Due to its business model, Airbnb was already differentiated from traditional competitors. In addition, continuing innovations based on current and emergent technologies were essential to maintaining current users, while expanding into new users. Students should also recognize that user experience with the app, including ease of use, was an essential component of its competitive advantage. Students should be reminded that:
  - Most large hotel and motel chains as well as consolidators such as Priceline, HotelTonight, Hotel.com, and VRBO (Vacation Rental by Owner) also offered mobile apps that provided booking and ratings portals in direct competition to Airbnb.
  - According to case Exhibit 2, B&Bs in the United States catered primarily to domestic travelers in 2017, while 20% of international travelers frequented hotel and motel chains, so Airbnb may have an opportunity to capture some of the international segment.
  - Inasmuch as Airbnb operates as a global enterprise, it is exposed to political and regulatory and currency risks that could impact fee revenue generation in both domestic and international markets.
- ***Expansion of Users and Accommodations***. Overall expansion of users who offer accommodations and those who use Airbnb to book accommodations was critical to its success. Students should observe that:
  - While continued growth will be necessary to ensure profitability, it is not clear that Airbnb can sustain triple- or even double-digit growth rates over the long term.
  - As revenue had continued to increase through 2017, bookings growth had decreased, foreshadowing the potential slowing of extreme revenue growth (exhibit 3).
- ***Brand image***. Image was also a critical factor in helping consumers choose which accommodation to patronize. Included within this image was reliability, quality of stay and safety. Students should observe that:
  - Given the sheer immensity of the user base, and how each location represented a unique offering, Airbnb had a significant challenge in continually ensuring both quality and safety when consumers used Airbnb.

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- While Airbnb achieved break-even profitability in 2016, it may want to revisit and revise upwards the expenses allocated to safety and quality as well as its efforts to prevent discrimination against customers and operators. (See exhibit 1 for the ranking of expenses incurred by B&B operators vs. hotel and motel chains).

- ***Financial health***. Rapid growth businesses require capital. A 2016 cash infusion of $850 million in Airbnb and a pre-IPO valuation of about $31 billion (see exhibit 4), the fact that the company only recently reached break-even signals the need for permanent capital to continue to scale its business model. Students should observe that:

  - It is unclear whether or not the $31 billion valuation is realistic or due to a "tech bubble." A severe downturn in the financial markets could result in the closing of the window for future IPOs and greatly impact Airbnb in its effort to scale.

  - Airbnb's $31 billion pre-market valuation still lags behind Marriott's $49 billion, but Marriott is an established company (see exhibit 4) and is now growing by acquisition.

  - Students should note that Airbnb's estimated revenues in exhibit 3, while slowing incrementally, remained strong.

  - Airbnb's cost structure combined for a very solid competitive position.

Instructors may choose to foreshadow a key learning outcome from Chapter 2 here: A company's vision, objectives, strategy, and approach to strategy execution are never final; managing strategy is an ongoing process, not an every-now-and-then task.

5. What recommendations would you make to Airbnb to improve its competitiveness in accommodation market while mitigating any current and future risks?

- Continue to lobby and advocate for friendly legislation, while proactively supporting legal compliance, such as it began in 2018 with collecting taxes automatically through its platform.

  - Identify business organizations, such as chambers' of commerce, as large, pro-business groups could be leveraged to gain legislative support.

  - Identify platform enhancements, such as the automatic collection of taxes, that take advantage of its technological differentiation to further reinforce its value proposition for its users, while protecting itself legally.

- Attract and enroll single-proprietor establishments, and devise methods to provide added value for such businesses, e.g. in utilizing Airbnb as a platform for marketing and offering accommodations.

  - Doing so could mitigate the legislative risk while growing the user base and potential future revenues (as in the bullet above).

  - Doing so could also enable Airbnb to leverage its investments in technologies such as yield management and dynamic pricing systems across a wider base of proprietors.

- Pursue the business and international traveler segments (exhibit 2), as it is an essential component of the market,

  - Business travelers and extended stay guests present opportunities for increased user base and revenue growth.

  - However, given Airbnb's current position, it is not as business friendly as rival hotel/motel chains, has not developed a customer loyalty program, and would potentially need to change its user interface and invoicing systems to accommodate corporate accounts.

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- Make continued investments in technology to maintain its differentiation/focus generic strategy.
  - These investments will not only be in smartphone and computer interfaces, but also in emergent technologies that employ big data and customer preference algorithms.
  - For example, some students might discuss how virtual reality (VR) could be leveraged to advertise accommodations, or even improve brand aspects such as quality and safety.
- Find ways to mitigate competition between larger hotels and Airbnb. This can reduce legislative and competitive risk, while potentially expanding user base and revenues.
  - For example, students might suggest that Airbnb create a user interface that refers customers seeking lodging in high demand locations (such as resorts and cities) to established chain hotels during peak periods when regular Airbnb rooms are unavailable.
  - Students could argue that by doing so, Airbnb mitigates legislative risk and competitor retaliation, while also expanding into the business segment with minimal internal changes and investments.

Instructors can wrap-up the discussion by asking students if they strongly feel that CEO Chesky could well suffer from an "If it ain't broke don't fix it" mentality. That is, will Airbnb continue "business as usual," and if its revenue and bookings growth rates continue on their current declining trajectories, will the company likely make slower progress towards its goal of achieving a competitive advantage and superior returns, as reflected in an IPO or possible sale to a rival technology or lodging firm?

Chesky and his team may also be betting on rather slim odds that:

- Other rivals in the online lodging industry will not identify the same emerging segments for "sharing economy" accommodations.
- Rivals will not copy Airbnb's business model and then strive for a low-cost provider strategy in Airbnb's current niche.
- Rivals will not catch up and perhaps overtake Airbnb on service and prices to both buyers (guests) and sellers (proprietors of lodging establishments).

Remind students that Airbnb's handling of the strategy implementation process can be considered successful if things go smoothly enough that the company meets or beats its strategic and financial performance targets and shows good progress in achieving management's strategic vision.

Epilogue

There was nothing new to report at the time this teaching note went to press, although similar news articles continued to appear discussing the aspects within the case.

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case 2 • Case Assignment Questions

Airbnb in 2018

Assignment Questions

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