

ENVIRONMENT

The environment in which an organization exists can be broken into the internal environment, over which it exercises great control, and the external environment, over which it has little power.

The internal environment comprises the resources and capabilities that are under the organization's control. Resources include its workers, managers, and capital.

The external environment includes demographics, political forces, legal trends, competitors, emerging technology, customers, the macroeconomy of the country in which it operates, existing and potential rivals, and suppliers.

COMPETITIVE ADVANTAGE

An organization's competitive advantage is what allows it to be more successful than its competitors. If all competitors within an industry were identical—that is, if none had a competitive advantage—their profits, in theory, would be the same. Competitive advantages may appear to be deeply rooted, but they are always temporary; nothing lasts forever. Maximizing sustainable competitive advantage is an important goal of any organization.

Intuitively, we can think of many ways that a company might enjoy a competitive advantage over its rivals. It might have a better location, closer to its suppliers, or closer to its customers, or closer to transportation. It might have clever marketing, an enduring image or catchy slogan. It might have a unique product, or patent protection for an innovation.

TWO PERSPECTIVES

You might wonder: which is more important to competitive advantage, the internal environment or external environments? There are two broad views of strategy.

Industrial Organization (I/O) theory focuses on the external environment of competitors within an industry. The I/O approach is rooted in Economics, and it was through I/O that Strategy was born. I/O examines with the structure of an industry, such as its size, growth, and profitability. From this perspective, competitive advantage derives from an organization's relative position within an industry.

The second approach, called Resource Dependence, focuses on the internal environment. Competitive advantage depends on an organization's unique resources and/or capabilities add value, are rare, are difficult to duplicate and can be exploited by the firm.

PRICE FLEXIBILITY

Of all the competitive advantages that an organization might enjoy, one of the most important is price flexibility. What can you or your competitors charge for an item? There is no single answer; you can charge a range of prices. For example, I might pay 25¢ for a 12-ounce Coke[®], if I bought it by the case in a grocery store, or I might pay \$4.50 for the same amount at the local ballpark. Same product, different price. Clearly, there is no set price for anything; prices fall within a range.

What is the least a firm can charge for a product? The least you can charge for something, the floor price, is the cost of production. Assuming I have other products that can bear the overhead, the floor price would be the variable cost of production. I wouldn't make any profit, but I could sell it forever at that price. I can even reduce my price by lowering my variable cost of production. The important point here is that this floor price depends entirely on the organization's resources and capabilities.

What is the most I can charge for a product? The ceiling price is the price of the next-best alternative. I may even be able to charge a slight premium, due to brand loyalty. The ceiling price depends on the external environment of the firm. I am able to raise the ceiling price by differentiating my product in the marketplace.

The greater the range of possible prices between the ceiling and the floor, the greater my competitive advantage, and the greater the organization's strategic flexibility. It might select a high-volume, low price approach. It might try to differentiate its product and charge a premium. Both strategies are common.

But it is not merely the range that matters. From Economics, we know that the low-cost producer will ultimately win in a competitive market. This means that cutting costs is not merely a strategic variable; it is also tactical. Therefore one constant job of management is to relentlessly cut real costs every day, in every way. By lowering costs, an organization can under-price its competitors and put them out of business, while making a profit yourself, or charge more and enjoy even greater profits or invest more in research and development.

Note that "real costs" are not the same as nominal costs. Saving money by buying inferior parts may produce savings on the income statement, but it may not save you much after you factor in the cost of returns and lost customers.

In summary, we see that expanding the possible range of prices by cutting real costs (to lower the floor) and by differentiating your product (to raise the ceiling) are important competitive advantages. Cutting costs is a function of your internal environment. Differentiating your product is a function of your external environment.

As we can see from this illustration, prices have very little, if anything, to do with costs, contrary to popular thought.

ENVIRONMENTAL ANALYSIS

It seems obvious that we should examine where we stand before contemplating where we are going, by assessing one's internal environment in terms of:

- strengths, and,
- weaknesses;

and one's external environment in terms of:

- opportunities, and,
- threats.

This so-called "SWOT" analysis creates a context for the strategic plan. SWOT provides the base upon which a consensus of stakeholders will be developed.

SELF-APPRAISAL

SWOT analysis is an important tool, but self-analysis is always problematic. The results are predictable:

- the list of strengths will be much, much longer than the list of weaknesses; and,
- one conclusion will be that the administration is clearly outstanding.

After all, who is your audience? Anyone can come with a long list of strengths that is as impressive as it is meaningless. A candid assessment may be politically impossible, and a committee that writes a bold assessment becomes a Cassandra.

To prevent a SWOT analysis from becoming a sham, we must be very specific to define our terms carefully. Strengths and weaknesses have three characteristics:

- They clearly differentiate organizations from their competitors;
- they are visible to customers or stakeholders; and,
- they provide value sufficient to change behavior.

If it does not do all three, it is not a strength or a weakness!

Another problem with SWOT analysis is that it produces a snapshot, a static analysis of the present, without regard to the future. "State-of-the-art" computer facilities are, indeed, a strength—but that adjective can age faster than fish.

Finally, in a complex environment, physical measures that are essential to performance are easily overlooked.

MISSION & VISION

The Mission Statement provides a purposeful context to strategic management. It states an organization's purpose, its

reason for existing. A mission statement forms the basis for practical and ethical decisions, guiding the enterprise through the challenge of failure and the perils of success. In the vernacular, it's a reality check. Ideally, a Mission Statement would be:

- clearly stated;
- aligned with organization's values and culture;
- memorable; and,
- consistent with institutional resources.

If the organization is a component of a larger organization, its mission must be consonant with the mission of the larger institution.

WRITING MISSION STATEMENTS

There is a reason they call it the "mission statement," and not the "mission essay." A good mission statement is simple, clear, and precise. Just because it's about intangibles, doesn't mean it's vague.

It is not unusual for a mission statement to take months to develop in a large organization. Often, the longer it takes, the worse the results. Here are some other things you can do to foul up the process:

- **Make it complicated.** If it requires footnotes, a thesaurus, or disclaimers, you have done it wrong.
- **Produce a compromise.** It's better to have nothing at all than mealy-mouthed mush that tries to be all things to all people and ends up saying nothing. A mission statement is more about values than specifics. Compromise the language, and you may compromise the underlying values.
- **Carve it in stone.** We all want our guides in life to be as constant as the North Star, but unless it was delivered to you from a thunderclap at the top of a sacred mountain, your mission statement not only can refined and freshened, it should be reviewed periodically and revised as necessary. It's a guide, not a prison.
- **File it away.** A compass doesn't do any good in a drawer.