# American Public Education, Inc.
## Instructor's Guide

Case Summary

This case provides an interesting "strategic" overview at two points in time of one of the rising stars in the proprietary [for-profit] collegiate education industry, and particularly the exclusively-online segment of that industry. American Public Education, Inc. [APEI]'s forerunner, American Military University, was started in West Virginia in 1991 by retired USMC Major Jim Etter. It enrolled its first students in 1993, formed a second university [American Public University] to better appeal to civilians [public service like police, emergency responders, firemen, etc.] in 2002, and consolidated both as APEI universities and then went public in 2005.

The case is presented in two Parts. Part I gives a basic assessment of APEI by Investor's Business Daily in 2009 that also includes a summary of enrollment trends, and overview of its rather unique business model which emphasizes low costs, convenience, overhead tied to student enrollment, primarily an active duty military-student focus, and limited physical infrastructure. Part II looks at APEI since 2008 through 2011, and includes APEI's need to face the widely publicized, post "Great Recession" federal & congressional scrutiny of the proprietary [for-profit] education industry in the U.S.

The case also provides financial information on its operations since 2004; with detailed financials for 2006 through 2010.

Key points

- The importance of internal assessment (Chapter 6)
- The importance of financial analysis (Chapter 6)
- Managing the impact of change in the External Environment (Chapter 4)
- Choosing a business strategy based on sustainable competitive advantages (Ch. 8)

Related Chapters

Chapter 1: Strategic Management, Chapter 2: Company Mission, Chapter 5: Forecasting, Chapter 7: Long-term Objectives and Strategies, Chapter 8: Business Strategy, Chapter 11: Organizational Structure, and Chapter 14: Innovation and Entrepreneurship

How to use the case

The case provides a good, easy to understand way to discuss strategy in the context of a setting and industry, education, that all students "understand" or have lengthy involvement with. APEI provides a unique example of a potentially disruptive new player, or at least a good example of a entrant with a solid focus strategy serving a niche market with a service offering that has competitive advantages which may be leveraged into numerous other similar niche educational area.

This APEI case works quite well as a two-case set with the case on the Apollo Group (University of Phoenix) and the Adult Education Market. You could spend 2-3 class sessions on this two case set. One day on each company and the industry .. then a third day on where the industry is likely to head and what strategies are most recommended for each company; or some other combination.

At the same time, should you decide not to use the Apollo/UOP case, this case can stand alone just fine. You may however want to assign your students to read the mid-section of the Apollo/UOP case, entitled "The Adult Education Market," as useful industry and regulatory background in discussing APEI.

## Conducting Class and Case Discussion

*The case is presented in two parts. Part I reprints Investor's Business Daily's favorable examination of APEI in early 2009 after its completion of 2 years since its IPO. Part II covers AEPI since that time, to include the major challenges to the industry from the federal government. It would be interesting with your management of the class to target your questions toward "what happen .." or "what is/was .." with the remainder of the question focusing first on the "early years" [aka Part I], and then "what has changed .." or "how is it different ..." in the most recent period [aka Part II].*

**1. A initial basic set of questions with this approach could start with:**

**a. "*What was unique about APEI as a university offering pre-2009 [Part I]*?"**

Students should describe its focus on active duty military personnel; its growing focus on other professions involving service personnel [e.g. teachers, firemen, policemen, etc.]; its emphasis on online instruction; and its use of professors with practical experience in the areas for which it has degree offerings.

It sought to serve working adults, & their spouses, with a particular focus as noted above.

It had no big campuses; no sports teams; no fraternities and sororities; standard academic administrative overhead; no emphasis on research and publication.

It was inexpensive; intended to cost exactly what military personnel get as course & supplies reimbursement benefits. That made it "no cost" to active duty military personnel.

Completely online. Little promotion; relied mostly on word of mouth marketing; it had minimal Title IV participation, and that was mostly through it civilian APU.

***b. "How has that changed at APEI by 2012 [Part II]?"*** Little …….

Students still majority active duty military; but growth in civilian side; professors still the same backgrounds and practical emphasis, although more hype about academic profs too;

Still targets working adults with a particular focus on active military and public service

None of the traditional college and university trappings; same admin structure; no R&Pub

Adhered to standard for active duty military to have "no cost;" credit costs equal military reimbursement level after ten years. Some slight increase at the graduate level.

AEPI is still completely online in 2011; It has recently had a rather significant increase in marketing and promotion expense by 2010; but it still relies heavily on word of mouth; still, it has chosen to begin spending on other promotional means; slightly increasing reliance on Title IV, particularly with civilian student emphasis, has happened. But it is still well below proprietary industry norm in this regard.

***c. What do the financial numbers suggest?***

1. AEPI is doing an excellent job on several revenue and cost fronts:

   i. Revenues have increased 500% since 2006; doubling since 2008

   ii. Instructional costs have grown, but are a lower percentage of revenue than in 2006 [~45% vs. 38%] and than in 2008 [~41% vs. 38%].

   iii. G&A down from ~23% in 2006, and ~20% in 2008, to 16% in 2010.

   iv. Operational Income, 7% in 2006, reached 25% in 2010

   v. Net income after tax, 4.5% in 2006, reached 15% in 2010

2. AEPI's only rise of note, selling and promotion, went from 12.2% of 2006 revenue to 17.3% of 2010 revenue, a rise from approx. $5million to $34million. It represented a 67% increase from 2009, the previous year. They had this to say about that rise in their AR2010:

   *"This increase was primarily due to an increase in internet advertising expense targeting our APU brand, an effort that we undertook when we began to observe a decline in the growth of net course registrations from active duty military students."*

   So you need to point out here that AEPI's efforts to promote the civilian school resulted based on their concern about the decline in growth from new active duty military students. Does this mean UOP & others are grabbing military students?

You can point to other examples of firms that have pioneered a new technology or approach only to have larger competitors move in to take over once the new market or market niche is proven – ask how many know of Lotus 123 spreadsheets; or the original maket leading word processing leader instead of MSWord; or the social networking leader before Facebook; and so forth.

Then ask if this suggests AEPI is headed toward a similar fate? No easy answer, but probably not; they have a rather solid infrastructure, and first mover advantage. More likely an acquisition target if decline sets in. Still, they are not taking it lightly as their rise in ad expenditure suggests.

Related to this, the case points out that UOP's 2010 adv/promotion expenditure is almost $1.2 billion, or 6Xs APEI's total revenue; 24Xs APEI's PBTax; AND 35Xs APEI's selling and promo expenditures the previous year. APEI has a powerful competitor and industry leader!

3. Balance Sheet wise, APEI looks strong

    i. Cash position is strong, up 7Xs since 2006; almost 2Xs since 2008;

    ii. ARs have only doubled since 2006; well managed apparently

    iii. Liquidity ratio .. CA/CL is 2.5 .. looks real good

    iv. Debt / Equity is .45 .. looks solid

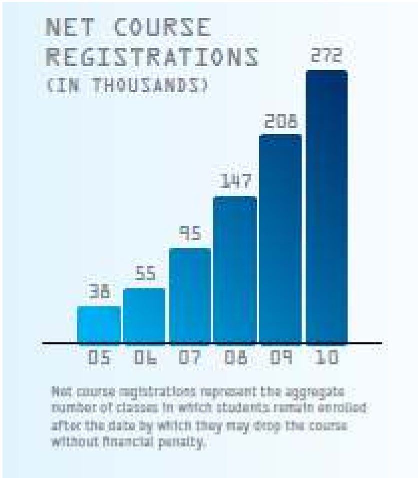
    v. Assets / Liabilities is 3Xs .. looks solid

    vi. No significant long term debt .. looks solid

4. How about enrollments in Part I vs. Part II?

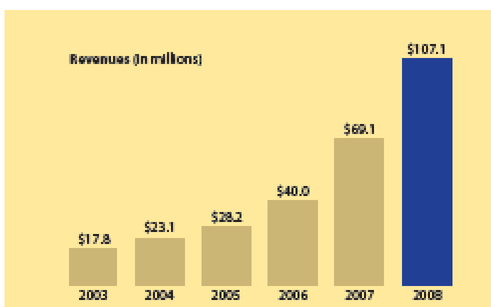
A graph from IBD in the case summaries APEI's impressive growth in the 2003-2008 time frame. And, a key point to make from the case is marketing – they have little and rely on word of mouth! That can give UOP pause for concern, at least a little bit.

2009 and 2010 show continued enrollment [net course registrations] growth overall,

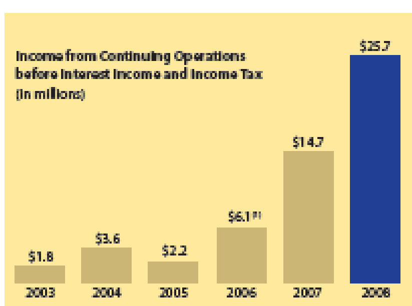


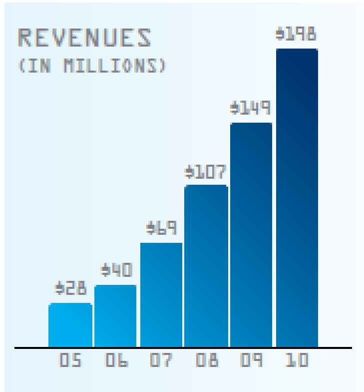

You might then ask: "*How has enrollment growth translated into revenue and profitability?"* These two sets of charts provide you with an easy summary of the same information in the case's financials for Part I, 2002-2008; and Part II, 2009 – 2011..

APEI experienced steadily growing revenue and profitability in Part I through 2008, even while it follows a low- price strategy. That growth was even more dramatically so compared to brick and mortar universities who saw stable enrollments, or slight declines; and this growth was impressive even compared to direct competitors like UOP.



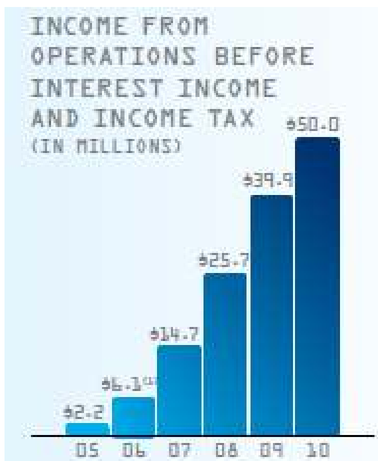

Overall, profitability during this Part I, 2002-08 period was very impressive too.






Revenues in Part II, 2009-2010 continued a pattern of impressive growth. $107M to $198M in this period.

And, profitability evidenced a similarly impressive continued pattern of growth during a very difficult economic time period, virtually doubling in two years.




$25M in operating income rose to $50M in just two years; during a major recession.

**2. The next set of questions primarily focus on Part II, 2009-2011.**

***"Conducting a strategic analysis on APEI, what would you consider their strengths to be going forward?"***

**Focus** – Emphasis on Military and Public Service working adults and related brand recognition appears a powerful attribute building APEI's ability to succeed.

As was noted in Part I, the number of active duty military personnel has held steady at about 2.1 million, with a churn [new recruits; others leaving after 3-4 year commitment] is about 300 thousand annually. That is a good niche market.

**Affordable tuition** – Even with expansion in its APU, still close to costs for non-Title IV related education reimbursement rules in the military and other public service sectors.

**Exclusively Online** – Increasingly expert in offering an acceptable online alternative to traditional class approaches; and that compete with existing online leaders – UOP

**Impressive cost structure**, even with increasing selling and promotion expense.

….. ***Three other strengths mentioned in the case*** as reported by APEI management make sense and are as follows:

**Scalability**. Operating fully online, and able to fairly easily add or cut back on instructors [note instructors are paid based on the number of students in their class(s)], making instructional costs almost variable.

**Proprietary IT system**. Online education is convenient, but not necessarily engaging in a timely manner. It is not typically set up to monitor the weekly behavior/engagement of students, and so forth. APEI's system has developed more sophisticated features that make it more interactive, student friendly, student monitoring capable with more in depth connection. These features should result in greater student retention, satisfaction, etc. That, in turn, makes word of mouth promotion all the more effective. They adopted in 2011 the open source Sakai Learning Management System which is expected to enhance their IT strength.

**Commitment to Academic Excellence**. APEI makes a clear effort to have organizational elements [Board of (credible) Trustees] that monitor academic programs, and apparently do so in a serious fashion. Its use of competency tests to gauge outcomes, and surveying of alumni employers about outcomes all suggest an added level of attention to relative "excellence" in their academic work.

**Title IV related thresholds are favorable**. AEPI is well below regulatory thresholds that would mean noncompliance on all these new regulations. Others, notably UOP, are not so fortunate.

***… Then you could follow up with this question: "Are there obvious weaknesses?"***

**Size?** As pointed out earlier, UOP's 2010 adv/promotion expenditure is almost $1.2 billion, or 6Xs APEI's total revenue; 24Xs APEI's PBTax; AND **35Xs APEI's selling and promo expenditures** the previous year. APEI has a powerful competitor and industry leader that appears increasingly interested in the military market! UOP and others could put pressure to make sure it has equal access to these students; could afford expensive, concentrated promotion that attempts to distinguish itself positively from APEI for military and public service personnel.

**Regulatory dependence**. APEI's future is very dependent upon multifaceted legal, regulatory, and accreditation oversight at the federal and state levels. Their ability to influence this, to lobby for their interests, is limited. Yet their success and ability to operate is highly dependent on these factors.

**Overall, APEI seems to be in a good position of strength** .. mostly strengths; steadily leveraging its focus into stronger ties to an attractive market niche. It seems well below proximity to regulatory thresholds like the 90/10 rule and the cohort default rate and any gainful employment issue.

***3. "How does APEI compare to the University of Phoenix?"***

The companion case in the book is on *The Apollo Group – University of Phoenix*. They provide an interesting two case set to discuss. UOP is the big player in this working student, online educational niche having pioneered the playing field. APEI has chosen a niche within that playing field to very efficiently serve while the UOP has positioned itself with much broader market coverage, and a global player. It is good to compare and contrast the two initially when covering APEI, and returning again to APEI to debate "David vs. Goliath" once students have read about UOP.

The information provided on the next page is available to you but has not been provided to your students in exactly this form [it can be created from the information provided in the two cases but is not specifically in either case since all the financial information for UOP is not in the APEI case and vice versa]. But if you do both cases as a set then all the cost as a percent of revenue is provided; and growth rate easily computed from information in the case.

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| ***REVENUE in millions*** | | | | | |
| **APEI Revenue in millions** | $40 | $69 | $107 | $149 | $198 |
| **Growth Rate** | | 73% | 55% | 39% | 33% |
| **UOP Revenue in millions** | $2,478 | $2,724 | $3,133 | $3,954 | $4,926 |
| **Growth Rate** | | 10% | 15% | 26% | 25% |
| **UOP vs. APEI in Revenue** | $2,438 | $2,655 | $3,026 | $3,805 | $4,728 |
| *[UOP Rev is $ ___ more than APEI's]* | | | | | |
| **UOP ÷ APEI on size of Rev.** | 62Xs | 39Xs | 29Xs | 27Xs | 25Xs |
| *[UOP Rev is ___ Xs APEI Rev]* | | | | | |
| ***COSTS AS % OF REVENUE:*** | | | | | |
| **Instructional cost as % rev.** | | | | | |
| **APEI** | 44.8% | 42.6% | 40.7% | 39.2% | 38.0% |
| **UOP** | 44.8% | 45.4% | 43.1% | 39.7% | 43.1% |
| **Selling and Promotional** | | | | | |
| **APEI** | 12.2% | 9.8% | 11.5% | 13.7% | 17.3% |
| **UOP** | 22.0% | 24.2% | 25.6% | 24.1% | 22.6% |
| **General and Admin** | | | | | |
| **APEI** | 22.8% | 22.2% | 19.9% | 16.8% | 16.2% |
| **UOP** | 6.2% | 7.4% | 7.2% | 6.8% | 7.2% |
| **Litigation, writeoffs, fines** | | | | | |
| **APEI** | 7.9% | 0.0% | 0.0% | 0.0% | 0.0% |
| **UOP** | 0.0% | | | 2.0% | 3.6% |
| **Operating Income** | | | | | |
| **APEI** | 7.3% | 25.4% | 24.0% | 26.8% | 25.2% |
| **UOP** | 26.2% | 23.0% | 24.5% | 27.0% | 20.5% |
| **Net Income [after tax]** | | | | | |
| **APEI** | 4.5% | 25.4% | 15.1% | 16.2% | 15.1% |
| **UOP** | 16.7% | 15.0% | 15.1% | 15.2% | 11.2% |

APEI has higher revenue growth, as would be expected with a much smaller base. The impressive thing is how UOP is increasing and not far off APEI in 2009 and 2010. Plus, UOP's size dwarfs APEI – 25Xs larger in 2010.

Instructional costs are similar, although APEI's are steadily dropping % of Rev wise, while the UOP is seeing a significant increase, probably due to efforts to keep classes small to lessen drop out; or increased costs for higher degreed instructors; or ????

Selling and Promotional is one of the key comparision areas. UOP spends significantly more in absolute terms; but also in % of Rev terms – about 30% more. APEI is seeing a steady increase in expenditures and, what had been a word of mouth approach is now having to explain itself and its options to more civilians and more people.

General and Admin is interesting. UOP is doing much better than APEI here. Part is the large revenue base over which UOP can allocate admin responsibilities. APEI's is steadily reducing, which would suggest this is slowly happening there too as enrollment and revenue grow. But, APEI emphasizes a "academic" organization for its schools that may a bit more like traditional universities in terms of heavy, and mostly well paid admin folk. So that may explain its higher expenditure on a percentage basis a little here too.

Operating income is rather similar for both – mid twenties as a percent of revenue.

Net Income is similar, at least until 2010 when UOP had to write off some litigation expense and also increased its G&A overhead as well as its instructional costs in all likelihood to help aggressively address the regulatory issues in Title IV revenues; recruitment; advisement; class-based oversight; etc.

UOP is much closer to dangerous regulatory thresholds like the 90/10 rule than APEI, which in turn means the UOP has to focus on adjusting its student composition, raise its tuition, increase its admission standards, and discourage student borrowing in order to cope with the thresholds they face, all the while spending much more on intense lobbying for favorable regulatory change. APEI doesn't have this problem. So this could mean two things for APEI regarding UOP's response – 1] UOP becomes sufficiently distracted with its need to manage their closeness to these thresholds that it ignores aggressively going after APEI; or 2] UOP aggressively pursues APEI's student mix as a means to improve its compliance numbers given the attractive nature of APEI's student mix in this regard.

A third, interesting question in this regard, given The Apollo Group's use of acquisition for expansion from time to time, is the possibility of them looking to acquire APEI as an immediate way to grow, and to obtain the benefits having APEI would mean on UOP's compliance with Title IV related concerns. There are a host of considerations for such a move – combining brands; technologies; operating practives; etc. But, UOP could become like an academic system [think SEC; Big Ten; or Higher Ed. System of California, etc.], with multiple colleges and universities under its auspices all combined for Title IV compliance reasons but treated separately for market/brand reasons.

Related to this third notion, the opposite interesting question might be, "Is APEI positioning itself to be bought by UOP [The Apollo Group] at some future date?"

> The key, attractive thing for APEI, relative not only to UOP but to all the other public proprietary institutions is APEI's excellent compliance performance todate on the 90/10 rule, the cohort default rate, and the gainful employment thresholds. Finally, its ability to generate leads and its word of mouth recruitment practices are "stellar"

compared to the historical practices that garnered the attention of regulators a few years ago at the UOP and other proprietary institutions, resulting in intensified federal scrutiny on the industry. Bottom-line, APEI could be an interesting acquisition target for many players in the industry, or in complementary industries. It's 2010AR made this observation regarding the impetus for all the U.S. DOE's Title IV and recruiting investigations, making particular note in the comment of the fact that APEI was NOT chosen for investigation:

*"There has been an increased focus in recent months over for-profit educational institutions from the Department of Education and the U.S. Congress. The substantial amount of federal funds disbursed through Title IV programs, the large number of students and institutions participating in these programs and allegations of fraud and abuse by certain for-profit institutions have caused Congress to require the Department of Education to exercise considerable regulatory oversight over for-profit institutions of higher learning and initiate a congressional investigation into for-profit institutions. In 2010, both the U.S. Senate and the U.S. House of Representatives held separate hearings related to for-profit postsecondary education institutions. In addition, the Government Accountability Office released a report in 2010 based on a three-month undercover investigation of recruiting practices at forprofit schools, concluding that employees at a non-random sample of 15 for-profit schools (which did not include American Public University System) made deceptive statements to students about accreditation, graduation rates, job placement, program costs, or financial aid."*

Nonetheless, as is pointed out in the case, APEI is also feeling [and concerned about] the attention other competitors are placing on "its" military market; and apparently starting to feel that attention may be the reason behind a slowing of APEI's growth rate in new course registrations among its military customer target market. They had this to say in their 2010AR:

*"A number of our competitors have recently begun to expand their outreach and marketing efforts to the active duty and reserve component military and veteran population. We believe this is related to a growing desire among for-profit institutions to seek new sources of revenue outside of Title IV programs, which is driven by concerns with a compliance obligation under the Higher Education Opportunity Act, commonly referred to as the "90/10 Rule," which prohibits proprietary institutions from deriving from Title IV funds, on a cash accounting basis (except for certain institutional loans) for any fiscal year, more than 90% of its revenues (as computed for 90/10 Rule purposes). We believe that for-profit schools are increasingly seeking to attract military students in order to comply with the 90/10 Rule, as currently DoD tuition assistance and veterans education benefits do not count towards the 90% limit."*

4. **Greater discussion of the 90/10 rule**; the gainful employment rule; student default and the cohort default rate; and recruitment/enrollment practice regulation could be done in this case if you teach it without the UOP case; or more likely in conjunction with the UOP case. This APEI case offers modest coverage of all of these issues and generally makes the point that APEI is favorably positioned on each of them.

   Rather than repeating some of the analytical guidance on the issues we have provided in the Instructor's Guide to the Apollo Group (University of Phoenix) case, we would simply refer you to that teaching guide for additional preparation assistance on these topics and issues.

The bottom- line for APEI is that it is not close on any threshold the industry, and particularly UOP, face regarding the 90/10 rule [it probably has less than 35% of its students receiving Title IV associated funding]; Cohort Default Rate [it has just reached 3 years when some of its students use Title IV funding and so it estimates its Cohort Default Rate will be below 5% in the next few years, well below the threshold resulting in any problem]; and the Gainful Employment Test [a particular strength for APEI because the majority of its students work fulltime in the military or civilian public sector jobs].

It is important to note, however, that APEI's continued effort to grow in the civilian public service arena carries with it an increasing number of students needing Title IV type financing of their education, in part because of employing entities that do not provide tuition reimbursement support while actively employed like the military services do. APEI's 2010AR had these comments in this regard:

*"Since the founding of American Military University, we have gradually transitioned from a military focus to a more broad-based focus on the military and public services communities. We expect the percentage of our students that are not eligible for tuition assistance programs of the Department of Defense or DoD to continue to increase, particularly as a result of our eligibility to participate in Title IV programs. Furthermore, because our students who use the DoD tuition assistance programs generally take fewer courses at one time than our other students, they represent a smaller percentage of our net enrollment than they do of our total student body."*

5. **Where you have members of the military in your class,** it is an excellent added value to the class discussion of APEI and the proprietary education to draw them out to add their experiences with APEI, with educational options, and so forth. They are an impressive group of young people as a whole, and we have found to be some of our most dedicated, talented students in our strategy classes. Let them know in the process, where you can do so without fanfare, how much their service is appreciated.

6. While as noted above expansion into public service communities will introduce some change in its **military intensive focus,** it is still unlikely that such a focus will dramatically change for some time to come. APEI's 2010AR offers some interesting commentary that you might find useful to read here as a preparation reference before class. Parts of this are of course developed in Part I and Part II of the case, but your reading it here accelerates and depends your familiarity with APEI:

*"There are more than 2.2 million active and reserve military professionals in the United States Armed Forces. Each year, approximately 300,000 new service members are enlisted or commissioned to replace retiring and separating members. We believe that the unpredictable and demanding work schedules of military personnel and their geographic distribution make online learning and asynchronous teaching particularly attractive to them. Military leaders and policies promote voluntary education programs as a means for service members to gain the knowledge and skills that will improve their military performance as well as prepare them for a career following their military service. Academic achievement can also result in increased rank and pay for service members. The United States Armed Forces recognize academic achievement through awarding promotion points for academic credits, specifying education*

*level eligibility requirements for assignments, promotions, and service schools, and entering remarks on performance appraisals.*

*Active duty and reserve component military personnel are eligible for tuition assistance through the Uniform Tuition Assistance Program of the DoD. DoD policy allows for payment of 100% of a military student's tuition costs, up to $250 per semester credit hour and a maximum benefit of $4,500 per fiscal year. Our undergraduate tuition per course is designed so that the tuition assistance paid by the service branches covers the cost of our courses for service members up to the annual maximum benefit. Military students who are eligible for the Veterans Administration's GI Bill Entitlement Program may apply those funds to pay for tuition costs above the DoD limits through the GI Bill's Top-Up feature. Most military veterans are also eligible to use their GI Bill entitlements in continuing their education after retirement or separation. We believe that national security, homeland security, and public safety professionals also represent a large and growing market for online education. As with their military counterparts, these individuals have unique program requirements as well as unpredictable and demanding work schedules that often prevent them from attending traditional universities".*

7. And, **APEI remains unquestionably committed to an online only focus**. In their 2010AR, they made several mentions about this, for example:

   *"Within the postsecondary education market, we believe that there is significant opportunity for growth in online programs. We believe that increasing requirements for workers to have job mobility, combined with the growing acceptance of online learning from employers and the flexibility associated with online learning should attract more students, both traditional and adult, to distance learning."*

8. Finally, the **financials** provided in the case and analyzed for you above in item # 1c **are reproduced** on the next few pages for your convenience:

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| *(In thousands, except per share and net registration data)* | 2006 | 2007 | 2008 | 2009 | 2010 |
| **Statement of Operations Data:** | | | | | |
| Revenues | $40,045 | $69,095 | $107,147 | $148,998 | $198,174 |
| Costs and expenses: | | | | | |
| Instructional costs and services | 17,959 | 29,479 | 43,561 | 58,383 | 75,309 |
| Selling and promotional | 4,895 | 6,765 | 12,361 | 20,479 | 34,296 |
| General and administrative | 9,150 | 15,335 | 21,302 | 25,039 | 32,045 |
| Write-off of software development project[1] | 3,148 | — | — | — | — |
| Depreciation and amortization | 1,953 | 2,825 | 4,235 | 5,231 | 6,502 |
| Total costs and expenses | 37,105 | 54,404 | 81,459 | 109,132 | 148,152 |
| Income from continuing operations before interest income and income taxes | 2,940 | 14,691 | 25,688 | 39,866 | 50,022 |
| Interest income, net | 289 | 888 | 706 | 94 | 111 |
| Income from continuing operations before income taxes | 3,229 | 15,579 | 26,394 | 39,960 | 50,133 |
| Income tax expense | 771 | 6,829 | 10,207 | 16,017 | 20,265 |
| Income from continuing operations attributable to common stockholders | 2,458 | 8,750 | 16,187 | 23,943 | 29,868 |
| Loss from discontinued operations, net of income tax benefit | (660) | — | — | — | — |
| Net income attributable to common stockholders | $ 1,798 | $ 8,750 | $ 16,187 | $ 23,943 | $ 29,868 |

| Percent of Sales Analysis | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| **REVENUES** | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| **Costs and Expenses** | | | | | |
| **Instructional Costs & Services** | 44.8% | 42.6% | 40.7% | 39.2% | 38.0% |
| **Selling and Promotional** | 12.2% | 9.8% | 11.5% | 13.7% | 17.3% |
| **General and administrative** | 22.8% | 22.2% | 19.9% | 16.8% | 16.2% |
| **Write off software developmt** | 7.9% | | | | |
| **Depreciation and Amortiz.** | 4.9% | | 3.9% | 3.5% | 3.3% |
| **Total Costs and Expenses** | 92.6% | 74.6% | 76.0% | 73.2% | 74.8% |
| **Income from oprns before II & Txs** | 7.3% | 25.4% | 24.0% | 26.8% | 25.2% |
| **Interest Income, net** | 0.7% | | 0.6% | 0.1% | 0.1% |
| **Income from perations bef. Taxes** | 8.1% | 25.4% | 24.6% | 26.9% | 25.3% |
| **Income Tax Expense** | 1.9% | | 9.5% | 10.7% | 10.2% |
| **Income from continuing operations** | 6.1% | 25.4% | 15.1% | 16.2% | 15.1% |
| **Loss from discontinued operations** | -1.6% | | | | |
| **NET INCOME** | 4.5% | 25.4% | 15.1% | 16.2% | 15.1% |

APEI CONSOLIDATED BALANCE SHEET [in thousands]

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current Assets** | | | | | |
| Cash and cash equivalents | $ 11,678 | $ 26,951 | $ 47,714 | $ 74,866 | $ 81,352 |
| Accounts receivable, net | $ 5,448 | $ 4,896 | $ 6,188 | $ 8,664 | 10,269 |
| Prepaid Expenses | $ 856 | $ 1,596 | $ 2,156 | $ 2,990 | $ 4,233 |
| Income tax receivable | $ 679 | $ 1,089 | $ 1,306 | $ 863 | $ 780 |
| Deferred income taxes | $ 299 | $ 309 | $ 640 | $ 999 | $ 1,369 |
| **Total current assets** | $ 18,960 | $ 34,841 | $ 58,004 | $ 88,382 | $ 98,003 |
| Property and Equipment, net | $ 9,363 | $ 13,364 | $ 19,662 | $ 25,294 | $ 42,415 |
| Other assets | $ 427 | $ 775 | $ 1,187 | $ 2,077 | $ 1,421 |
| **Total assets** | $ 28,750 | $ 48,980 | $ 78,853 | $ 115,753 | $ 141,839 |
| **LIABILITIES & STOCKHOLDER EQTY** | | | | | |
| Current Liabilities | | | | | |
| Accounts payable | $ 1,502 | $ 2,471 | $ 4,946 | $ 6,756 | $ 9,422 |
| Accrued liabilities | $ 3,165 | $ 2,770 | $ 5,250 | $ 8,003 | $ 9,349 |
| Accrued bonuses | | $ 1,553 | $ 1,825 | | |
| Deferred rev. & student deposits | $ 3,852 | $ 6,614 | $ 9,626 | $ 14,204 | $ 18,815 |
| Current portion of L-term debt | $ 29 | | | | |
| **Total current liabilities** | $ 8,548 | $ 13,408 | $ 21,647 | $ 28,963 | $ 37,586 |
| Deferred Taxes | $ 1,437 | $ 2,065 | $ 3,691 | $ 4,772 | $ 6,953 |
| Long-term debt | $ 1,944 | | | | |
| **Total Liabilities** | $ 11,929 | $ 15,473 | $ 25,338 | $ 33,735 | $ 44,539 |
| **Commitments & Contingencies** | | | | | |
| Stockholder equity | $ 118 | $ 177 | $ 180 | $ 183 | $ 186 |
| Additional paid-in capital | $ 26,378 | $ 128,005 | $ 132,078 | $ 136,380 | $ 141,757 |
| Less share repurchase | | | $ (295) | | $ (19,966) |
| Accumulated deficit | $ (9,675) | $ (94,675) | $ (78,488) | $ (54,545) | $ (24,677) |
| **Total stockholders' equity** | $ 16,821 | $ 33,507 | $ 53,475 | $ 82,018 | $ 97,300 |
| **Total Liabilities & Stockhldrs' equity** | $ 28,750 | $ 48,980 | $ 78,813 | $ 115,753 | $ 141,839 |

# Chapter 1

# Strategic Management

## Chapter Summary

Strategic management is the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives. Because it involves long-term, future-oriented, complex decision making and requires considerable resources, top-management participation is essential. This chapter describes strategic management as a three-tier process involving corporate-, business-, and functional-level planners, and support personnel. At each progressively lower level, strategic activities are more specific, narrow, short-term, and action-oriented, with lower risks but fewer opportunities for dramatic impact.

The strategic management model presented in this chapter serves as the structure for understanding and integrating all the major phases of strategy formulation and implementation. The chapter provides a summary account of these phases, each of which is given extensive individual attention in subsequent chapters. Finally, the chapter stresses that the strategic management process centers on the belief that a firm's mission can be best achieved through a systematic and comprehensive assessment of both its internal capabilities and its external environment.

## Learning Objectives

1. Explain the concept of strategic management.
2. Describe how strategic decisions differ from other decisions that managers make.
3. Name the benefits and risks of a participative approach to strategic decision making.
4. Understand the types of strategic decisions for which managers at different levels of the company are responsible.
5. Describe a comprehensive model of strategic decision making.
6. Appreciate the importance of strategic management as a process.
7. Give examples of strategic decisions that companies have recently made.

## Lecture Outline

I. The Nature and Value of Strategic Management

A. **Exhibit 1.1, Strategy in Action** gives an example of how a poor decision affected Xerox to the tune of $107 billion. **Strategic management** is defined as the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives.

1. Strategic management comprises nine critical tasks:

   a) Formulate the company’s mission, including broad statements about its purpose, philosophy, and goals.
   b) Conduct an analysis that reflects the company’s internal conditions and capabilities.
   c) Assess the company’s external environment, including both the competitive and the general contextual factors.
   d) Analyze the company’s options by matching its resources with the external environment.
   e) Identify the most desirable options by evaluating each option in light of the company’s mission.
   f) Select a set of long-term objectives and grand strategies that will achieve the most desirable options.
   g) Develop annual objectives and short-term strategies that are compatible with the selected set of long-term objectives and grand strategies.
   h) Implement the strategic choices by means of budgeted resource allocations in which the matching of tasks, people, structures, technologies, and reward systems is emphasized.
   i) Evaluate the success of the strategic process as an input for future decision making.

2. As these tasks indicate, strategic management involves the planning, directing, organizing, and controlling of a company’s strategy-related decisions and actions.

   a) **Strategy** means managers’ large-scale, future-oriented plans for interacting with the competitive environment to achieve company objectives.
   b) A strategy is a company’s game plan. It does not precisely detail all future deployments, but it does provide a framework for managerial decisions.
   c) A strategy reflects a company’s awareness of how, when, and where it should compete; against whom it should compete; and for what purposes it should compete.

B. Dimensions of Strategic Decisions

1. Typically, strategic issues have the following dimensions:

   a) Strategic issues require top-management decisions.

      (1) Because strategic decisions overarch several areas of a firm’s operations, they require top-management involvement.
      (2) Usually only top management has the perspective needed to understand the broad implications of such decisions and the power to authorize the necessary resource allocations.

b) Strategic issues require large amounts of the firm's resources.

   (1) Strategic decisions involve substantial allocations of people, physical assets, or moneys that either must be redirected from internal sources or secured from outside the firm.
   (2) Strategic decisions commit the firm to actions over an extended period.
   (3) Strategic decisions require substantial resources.
   (4) In highly competitive service-oriented businesses, achieving and maintaining customer satisfaction frequently involve a commitment from every facet of the organization.

c) Strategic issues often affect the firm's long-term prosperity.

   (1) Strategic decisions ostensibly commit the firm for a long time, typically five years; however, the impact of such decisions lasts much longer, for better or worse.
   (2) Once a firm has committed itself to a particular strategy, its image and competitive advantages are usually tied to that strategy.
   (3) Firms become known in certain markets, for certain products, with certain technologies. They would jeopardize their previous gains if they shifted from these markets, products, or technologies by adopting a radically different strategy.

d) Strategic issues are future oriented.

   (1) Strategic decisions are based on what managers forecast, rather than on what they know.
   (2) In strategic decisions, emphasis is placed on the development of projections that will enable the firm to seek the most promising strategic options.
   (3) In the turbulent and competitive free enterprise environment, a firm will succeed only if it takes a proactive (anticipatory) stance toward change (see **Exhibit 1.2, Strategy in Action** for an example of this).

e) Strategic issues usually have multifunctional or multi-business consequences.

   (1) Strategic decisions have complex implications for most areas of the firm.
   (2) Decisions about such matters as customer mix, competitive emphasis, or organizational structure necessarily involve a number of the firm's strategic business units (SBUs), divisions, or program units. All of these areas will be affected by allocations or reallocations of responsibilities and resources that result from these decisions.

f) Strategic issues require considering the firm's external environment.

(1) All business firms exist in an open system. They affect and are affected by external conditions that are largely beyond their control.
(2) To successfully position a firm in competitive situations, its strategic managers must look beyond its operations and consider what relevant others (competitors, customers, suppliers, creditors, government, and labor) are likely to do.

2. Three Levels of Strategy

a) The decision-making hierarchy of a firm typically contains three levels.

(1) Corporate level: composed principally of a board of directors and the chief executive and administrative officers.

(a) They are responsible for the firm's financial performance and for the achievement of nonfinancial goals, such as enhancing the firm's image and fulfilling its social responsibilities.
(b) To a large extent, attitudes at this level reflect the concerns of stockholders and society at large.
(c) In a multi-business firm, this level determines the businesses in which the firm should be involved. They also set objectives and formulate strategies that span the activities and functional areas of these businesses.
(d) These managers attempt to exploit the firm's distinctive competencies by adopting a portfolio approach to the management of its businesses and by developing long-term plans.

(2) The business level is in the middle of the decision-making hierarchy. It is composed principally of business and corporate managers.

(a) These managers must translate the statements of direction and intent generated at the corporate level into concrete business objectives and strategies for individual business divisions (SBUs).
(b) In essence, business-level strategic managers determine how the firm will compete in the selected product-market arena.
(c) They strive to identify and secure the most promising market segment within that arena.
(d) This segment is the piece of the total market that the firm can claim and defend because of its competitive advantages.

(3) The functional level is at the bottom of the decision-making hierarchy. It is composed principally of managers of product, geographic, and functional areas.

(a) These managers develop annual objectives and short-term strategies in such areas as production, operations, research and development, finance and accounting, marketing, and human relations.
(b) The principal responsibility of these managers is to implement or execute the firm's strategic plans.
(c) Managers at the functional level center their attention on "doing things right" (whereas managers at the other levels focus on "doing the right things").

(d) These managers address such issues as the efficiency and effectiveness of production and marketing systems, the quality of customer service, and the success of particular products and services in increasing the firm's market shares.

b) **Exhibit 1.4, Alternative Strategic Management Structures**, depicts the three levels of strategic management as structured in practice.

(1) Alternative 1

(a) Here, the firm is engaged in only one business and the corporate- and business-level responsibilities are concentrated in a single group of directors, officers, and managers.
(b) This is the organizational format of most small businesses.

(2) Alternative 2

(a) This depicts the classical corporate structure, comprising three fully operative levels: corporate, business, and functional.
(b) The approach taken throughout this text assumes the use of this alternative.
(c) Wherever appropriate, topics are covered from the perspective of each level of strategic management throughout the text.

3. Characteristics of Strategic Management Decisions

a) The characteristics of strategic management decisions vary with the level of strategic activity considered.
b) As shown in **Exhibit 1.5, Hierarchy of Objectives and Strategies,** decisions at the corporate level tend to be more value oriented, more conceptual, and less concrete than decisions at the business or functional level.

c) Corporate-level decisions

(1) Corporate-level decisions are often characterized by greater risk, cost, and profit potential; greater need for flexibility; and longer time horizons.
(2) Corporate-level decisions include the choice of businesses, dividend policies, sources of long-term financing, and priorities for growth.

d) Functional-level decisions

(1) Functional-level decisions implement the overall strategy formulated at the corporate and business levels. They involve action-oriented operational issues and are relatively short range and low risk.
(2) Functional-level decisions incur only modest costs, because they depend upon available resources. They are usually adaptable to ongoing activities and can be implemented with minimal cooperation.
(3) Functional-level decisions are relatively concrete and quantifiable; therefore, they receive critical attention and analysis even though their comparative profit potential is low.
(4) Common functional-level decisions include decisions on generic versus brand name labeling, basic versus applied research and development (R&D), high versus low inventory levels, general-purpose versus specific-purpose production equipment, and close versus loose supervision.

e) Business-level decisions

(1) Business-level decisions help bridge decisions at the corporate and functional levels.
(2) Such decisions are *less* costly, risky, and potentially profitable than corporate-level decisions, but they are *more* costly, risky, and potentially profitable than functional-level decisions.
(3) Common business-level decisions include decisions on plant location, marketing segmentation and geographic coverage, and distribution channels.

C. Formality in Strategic Management

1. The formality of strategic management systems varies widely among companies.

a) **Formality** refers to the degree to which participation, responsibility, authority, and discretion in decision-making are specified in strategic management.
b) Formality is an important consideration in the study of strategic management, because greater formality is usually positively correlated with the cost, comprehensiveness, accuracy, and success of planning.

2. A number of forces determine how much formality is needed in strategic management.

   a) The size of the organization, its predominant management styles, the complexity of its environment, its production process, its problems, and the purpose of its planning system all play a part in determining the appropriate degree of formality.
   b) Formality is associated with the size of the firm and with its stage of development.

      (1) Some firms, especially smaller ones, follow an **entrepreneurial mode**.

         (a) They are basically under the control of a single individual, and they produce a limited number of products or services.
         (b) In such firms, strategic evaluation is informal, intuitive, and limited.

      (2) Very large firms usually follow the **planning mode**.

         (a) In these firms, strategic evaluate is part of a comprehensive, formal planning system.

      (3) Medium-sized firms in relatively stable environments follow the **adaptive mode**.

         (a) The identification and evaluation of alternative strategies are closely related to existing strategy.

   c) It is not unusual to find different modes within the same organization.

3. The Strategy Makers

   a) The ideal strategic management team includes decision makers from all three company levels.
   b) Because strategic decisions have at tremendous impact on a company and require large commitments of company resources, top managers must give final approval for strategic action.
   c) **Exhibit 1.5, Hierarchy of Objectives and Strategies,** aligns levels of strategic decision makers with the kinds of objectives and strategies for which they are typically responsible.

      (1) Planning departments are common in large firms, headed by a corporate vice president for planning.
      (2) At least one full-time staff member spearheads strategic data-collection efforts in medium-sized firms.
      (3) Strategic planning is spearheaded by an officer or a group of officers designated as the planning committee in small firms or less progressive larger firms.

d) Managers at different levels have different responsibilities in the strategic planning process at the corporate and business levels.

(1) Top management shoulders broad responsibility for all the major elements of strategic planning and management.
(2) Top management develops the major portions of the strategic plan and reviews, and they evaluate and counsel on all other portions.
(3) General managers at the business level typically have principal responsibilities for developing environmental analysis and forecasting, establishing business objectives, and developing business plans prepared by staff groups.

e) A firm's president or CEO characteristically plays a dominant role in the strategic planning process. In many ways, this is desirable.

(1) The CEO's principal duty often is defined as giving long-term direction to the firm.
(2) The CEO is ultimately responsible for the firm's success and the success of its strategy.
(3) CEOs are typically strong-willed, company-oriented individuals.

f) When the dominance of the CEO approaches autocracy, the effectiveness of the firm's strategic planning and management processes is likely to be diminished. Establishing a strategic management system implies the CEO will allow managers at all levels to participate.

g) In implementing a company's strategy, the CEO must have an appreciation for the power and responsibility of the board, while retaining the power to lead the company with the guidance of informed directors.

(1) The interaction between the CEO and board is key to any corporation's strategy.
(2) Empowerment of non-managerial employees has been a recent trend across major management teams.

D. Benefits of Strategic Management

1. Using the strategic management approach, managers at all levels of the firm interact in planning and implementing.

a) The behavioral consequences of strategic management are similar to those of participative decision making.

b) An accurate assessment of the impact of strategy formulation on organizational performance requires not only financial evaluation criteria but also nonfinancial evaluation criteria—measures of behavior-based effects.

(1) Promoting positive behavioral consequences enables the firm to achieve its financial goals.
(2) Regardless of the profitability of strategic plans, several behavioral effects of strategic management improve the firm's welfare:

(a) Strategy formulation activities enhance the firm's ability to prevent problems.
(b) Group-based strategic decisions are likely to be drawn from the best available alternatives.
(c) The involvement of employees in strategy formulation improves their understanding of the productivity-reward relationship in every strategic plan and, thus, heightens their motivation.
(d) Gaps and overlaps in activities among individuals and groups are reduced as participation in strategy formulation clarifies differences in roles.
(e) Resistance to change is reduced.

II. The Strategic Management Process

A. Businesses vary in the processes they use to formulate and direct their strategic management activities.

1. Sophisticated planners have developed more detailed processes than less formal planners of similar size.
2. Small businesses that rely on the strategy formulation skills and limited time of an entrepreneur typically exhibit more basic planning concerns than those of larger firms in their industries.
3. Firms with multiple products, markets, or technologies tend to use more complex strategic management systems.

B. Despite differences in detail and the degree of formalization, the basic components of the models used to analyze strategic management operations are very similar.

1. Because of the similarity among the general models of the strategic management process, it is possible to develop an eclectic model representative of the foremost thought in the strategic management area.
2. **Exhibit 1.6, Strategic Management Model**, serves three major functions.

a) It depicts the sequence and the relationships of the major components of the strategic management process.
b) It is the outline for this book.

c) The model offers on approach for analyzing the case studies in this text and thus helps the analyst develop strategy formulation skills.

C. Components of the Strategic Management Model

1. This section will define and briefly describe the key components of the strategic management model.

a) Company Mission

(1) The mission of a company is the unique purpose that sets it apart from other companies of its type and identifies the scope of its operations.
(2) **Company mission** describes the company's product, market, and technological areas of emphasis in a way that reflects the values and priorities of the strategic decision makers.
(3) Social responsibility is a critical consideration for a company's strategic decision makers since the mission statement must express how the company intends to contribute to the societies that sustain it.
(4) A firm needs to set social responsibility aspirations for itself, just as it does in other areas of corporate performance.

b) Internal Analysis

(1) The company analyzes the quantity and quality of its financial, human, and physical resources.
(2) The company also assesses the strengths and weaknesses of its management and organizational structure.
(3) Finally, it contrasts the company's past successes and traditional concerns with its current capabilities in an attempt to identify the company's future capabilities.

c) External Environment

(1) A firm's external environment consists of all the conditions and forces that affect its strategic options and define its competitive situation.
(2) The strategic management model shows the external environment as three interactive segments: the remote, industry, and operating environments.

d) Strategic Analysis and Choice

(1) Simultaneous assessment of the external environment and the company profile enables a firm to identify a range of possibly attractive interactive opportunities.
(2) These opportunities are *possible* avenues for investment. However they must be screened through the criterion of the company mission to generate a set of possible and *desired* opportunities.

(3) Strategic analysis and choice in single or dominant product/service businesses center around identifying strategies that are most effective at building sustainable competitive advantage based on key value chain activities and capabilities—core competencies of the firm.
(4) Multi-business companies find their managers focused on the question of which combination of businesses maximizes shareholder value as the guiding theme during their strategic analysis and choice.

e) Long-Term Objectives

(1) The results that an organization seeks over a multiyear period are its **long-term objectives**.
(2) Such objectives typically involve some or all of the following areas: profitability; return on investment; competitive position; technological leadership; productivity; employee relations; public responsibility; and employee development.

f) Generic and Grand Strategies

(1) Many businesses explicitly and all implicitly adopt one or more generic strategies characterizing their competitive orientation in the marketplace.
(2) Low cost, differentiation, or focus strategies define the three fundamental options.
(3) Enlightened managers seek to create ways their firm possesses both low cost and differentiation competitive advantages as part of their overall generic strategy.
(4) They usually combine these capabilities with a comprehensive, general plan of major actions through which their firm intends to achieve its long-term objectives in a dynamic environment. This is called the grand strategy, which is a statement of means indicating how the objectives are to be achieved.
(5) 14 basic approaches can be identified: concentration, market development, product development, innovation, horizontal integration, vertical integration, joint venture, strategic alliances, consortia, concentric diversification, conglomerate diversification, turnaround, divestiture, and liquidation.

g) Short-Term Objectives

(1) **Short-term objectives** are the desired results that a company seeks over a period of one year or less.
(2) Companies typically have many short-term objectives to provide guidance for their functional and operational activities.
(3) Thus, there are short-term marketing activity, raw material usage, employee turnover, and sales objectives, to name just four.

h) Action Plans

(1) Action plans translate generic and grand strategies into action.

(2) They do this by using four elements

(3) The identify specific functional tactics and actions, establish a clear time frame to complete each action, assign responsibility for each action, and link action to specific objectives

i) Functional Tactics

(1) Within the general framework created by the business's generic and grand strategies, each business function needs to undertake activities that help build a sustainable competitive advantage.
(2) These short-term, limited-scope plans are called **tactics**.
(3) Managers in each business function develop tactics that delineate the functional activities undertaken in their part of the business and usually include them as a core part of their action plan.
(4) **Functional tactics** are detailed statements of the "means" or activities that will be used to achieve short-term objectives and establish competitive advantage.

j) Policies that Empower Action

(1) Speed is a critical necessity for success in today's competitive, global marketplace.
(2) One way to enhance speed and responsiveness is to force/allow decisions to be made whenever possible at the lowest level in the organizations.
(3) **Policies** are broad, precedent-setting decisions that guide or substitute for repetitive or time-sensitive managerial decision making.
(4) Creating policies that guide and preauthorize the thinking, decisions, and actions of operating managers and their subordinates in implementing the business's strategy is essential for establishing and controlling the ongoing process of the firm in a manner consistent with the firm's strategic objectives.
(5) Policies often increase managerial effectiveness by standardizing routine decisions and empowering or expanding the discretion of managers and subordinates in implementing business strategies.

k) Restructuring, Reengineering, and Refocusing the Organization

(1) Here, the process of strategic management takes an internal focus—doing work efficiently and effectively.
(2) The intense competition in the global market place has made internally focused questions recast themselves with unprecedented attentiveness to the marketplace.

(3) Downsizing, restructuring, and reengineering are terms that reflect the critical stage in strategy implementation wherein managers attempt to recast their organization.
(4) The company's structure, leadership, culture, and reward systems may all be changed to ensure cost competitiveness and quality demanded by unique requirements of its strategy.

l) Strategic Control and Continuous Improvement

(1) **Strategic control** is concerned with tracking a strategy as it is being implemented, detecting problems or changes in its underlying premises, and making necessary adjustments.
(2) In contrast to post-action control, strategic control seeks to guide action on behalf of the generic and grand strategies as they are taking place and when the end results are still several years away.
(3) The rapid, accelerating change of the global marketplace of the last 10 years has made continuous improvement another aspect of strategic control in many organizations.
(4) **Continuous improvement** provides a way for managers to provide a form of strategic control that allows their organization to respond more proactively and timely to rapid developments in hundreds of areas that influence a business's success.

D. Strategic Management as a Process

1. A **process** is the flow of information through interrelated stages of analysis toward the achievement of an aim.

a) The strategic management model in **Exhibit 1.6, Strategic Management Model,** depicts a process.
b) In the strategic management process, the flow of information involves historical, current, and forecast data on the operations and environment of the business.
c) Managers evaluate these data in light of the values and priorities of influential individuals and groups—often called **stakeholders**—that are vitally interested in the actions of the business.
d) The interrelated stages of the process are the 11 components discussed in the previous section.
e) Finally, the aim of the process is the formulation and implementation of strategies that work, achieving the company's long-term mission and near-term objectives.

2. Viewing strategic management as a process has several important implications.

a) First, a change in any component will affect several or all of the other components.

(1) Most of the arrows in the model point two ways, suggesting that the flow of information is usually reciprocal.

(a) The external environment has affected the company's mission, and the revised mission signals a competitive condition in the environment. (example)

b) A second implication is that strategy formulation and implementation are sequential.

(1) The process begins with development or reevaluation of the company mission.

(a) This step is associated with, but essentially followed by, development of a company profile and assessment of the external environment.
(b) Then follow, in order, strategic choice, definition of long-term objectives, design of the grand strategy, definition of short-term objectives, design of operating strategies, institutionalization of the strategy, and review and evaluation.

(2) The apparent rigidity of the process must be qualified.

(a) A firm's strategic posture may have to be reevaluated in response to changes in any of the principle factors that determine or affect its performance.
(b) Entry by a major new competitor, the death of a prominent board member, replacement of the CEO, and a downturn in market responsiveness are among the thousands of changes that can prompt reassessment of the firm's strategic plan.
(c) No matter where the need for a reassessment originates, the strategic management process begins with the mission statement.
(d) Not every component of the strategic management process deserves equal attention each time planning activity takes place.
(e) Firms in an extremely stable environment may find that an in-depth assessment is not required every five years.
(f) Companies are often satisfied with only a minimal amount of time addressing this subject.
(g) While formal strategic planning may be undertaken only every five years, objectives and strategies usually are updated each year, and rigorous reassessment of the initial stages of strategic planning rarely is undertaken at these times.

c) A third implication is the necessity of feedback from institutionalization, review, and evaluation to the early stages of the process.

(1) **Feedback** can be defined as the analysis of post-implementation results that can be used to enhance future decision making.
   (a) Therefore, as indicated in **Exhibit 1.6**, strategic managers should assess the impact of implemented strategies on external environments.
   (b) Future planning can reflect any changes precipitated by strategic actions.
   (c) Strategic managers also should analyze the impact of strategies on the possible need for modifications in the company mission.

d) A fourth implication is the need to regard it as a dynamic system.

(1) The term **dynamic** characterizes the constantly changing conditions that affect interrelated and interdependent strategic activities.
(2) Managers should recognize that the components of the strategic process are constantly evolving but that formal planning artificially freezes those components, much as an action photograph freezes the movement of a swimmer.
(3) Since the change is continuous, the dynamic strategic planning process must be monitored constantly for significant shifts in any of its components as a precaution against implementing an obsolete strategy.
(4) **Exhibit 1.9, Strategy in Action** describes the consequences of a merger.

## Questions for Discussion

1. Read an article in the business press about a major action taken by a corporation. Be prepared to briefly describe this action to your professor and name the key strategic management terms that the author used in the article.

   Student responses will vary. For example, consider the August 13, 2009 article titled, "Samsung's Plan to Strengthen its Weaknesses." Samsung is the number two global player in the cellphone handset market behind Nokia, with a market share of 19 percent. Its revenues and profits have increased even in the global economic downturn. And yet, J.K. Shin, the company's handset business chief is making plans to strengthen Samsung's position.

   Students should be able to identify strategic management terms such as low cost strategy, focus, external environmental analysis, etc. as these terms are indicated both by the article writer as well as by Samsung's managers.

2. In what ways do you think the subject matter in this strategic management-business policy course will differ from that of previous courses you have taken?

   Students should be able to identify two differences. The first is the integrative nature of the strategic management course. All aspects of strategic management involve inputs from various functional areas and levels in the business. Students may have taken courses in any number of these functional areas, including finance and production. Such courses usually involve "silo" thinking—delving deeply into a specific subject area. The focus in the strategic management course, however, is on integration.

The second difference is the level in the organization in which strategic decisions are made. Usually strategic decisions are made at the highest organizational level. Particularly astute students will also find out that this course is more analytical than some of the other courses they have had. There is usually no one right answer to most strategic issues.

3. After graduation, you are not likely to move directly to a top-level management position. In fact, few members of your class will ever reach the top-management level. Why, then, is it important for all business majors to study the field of strategic management?

   The section titled "Benefits of Strategic Management" helps with this discussion. Key reasons include the following: the strategic management approach used in the text necessitates that managers at all levels of the firm interact in planning and implementing; participation in the process enhances the firm's ability to prevent problems; and involvement in the strategic management process increases their motivation. Today, most firms use a participatory approach to the strategic management process. Regardless of what business level students enter upon graduation, they are likely to participate in the process somehow. Hence it is important to study and understand that process.

4. Do you expect outstanding performance in this course to require a great deal of memorization? Why or why not?

   The instructor should stress the fact that the subject matter involves a fair amount of analysis. This is a course that emphasizes application. There is usually no one correct answer in strategy. While memorization will help students remember key terms or labels, it will not help the students analyze the problems that a company faces and suggest solutions for these problems.

5. You undoubtedly have read about individuals who seemingly have given single-handed direction to their corporations. Is a participative strategic management approach likely to stifle or suppress the contributions of such individuals?

   The section titled "Benefits of Strategic Management" highlights the advantages accruing from the participatory nature of strategic management. While the firm's president or CEO characteristically plays a dominant role in the strategic planning process, when this dominance approaches autocracy it could lead to poor results. In a participative style, dominant individuals may indeed feel stifled; however, in the long run, a participative style may result in several benefits for the company.

6. Think about the courses you have taken in functional areas, such as marketing, finance, production, personnel, and accounting. What is the importance of each of these areas to the strategic planning process?

   Functional areas develop annual objectives and short-term strategies. Functional-level strategies (see "Three Levels of Strategy") are used to implement the firm's strategic plans. Each course that the student has had in a functional area allows him/her to appreciate this aspect of the strategic management process and see how that functional area participates. While strategy is an integrative product, functional areas help implement the strategy.

7. Discuss with practicing business managers the strategic management models used in their firms. What are the similarities and differences between these models and the one in the text?

   It is likely that students will identify differences in the following areas: who formulates the strategy; how participative is the process; and how formal is the process. In the section "Formality in Strategic Management", the text discusses Mintzberg's entrepreneurial, planning, and adaptive modes. Students are likely to encounter firms in each of these modes whose strategic management style may be different.

8. In what ways do you believe the strategic planning approach of not-for-profit organizations would differ from that of profit-oriented organizations?

   The basics of strategic planning should be the same for both not-for-profit and profit-oriented firms. Thus, steps such as developing a mission, external and internal analysis, strategic analysis and choice, implementation, and control should be common to both types. The content of these steps would be different, however. The mission statement of a not-for-profit, for example, may not include all the elements typically found in a profit-oriented firm's mission. The focus may not be on explicitly creating a competitive advantage, but on how best to serve the constituency.

9. How do you explain the success of firms that do not use a formal strategic planning process?

   Mintzberg's discussion of the three modes – entrepreneurial, planning, and adaptive – can be used to explain the success of those firms that do not use a formal strategic planning process. Smaller firms follow an entrepreneurial mode, in that the strategy process is informal, intuitive, and limited. They may succeed because they are flexible and are created because of a breakthrough product or service. Also, luck may play a role in the success of some firms that do not have a formal strategic planning process.

10. Think about your post-graduation job search as a strategic decision. How would the strategic management model be helpful to you in identifying and securing the most promising position?

    The strategic management model (Exhibit 1.6) can be useful in job hunting. The candidate needs to have a mission (what he/she wants to do in life), do an external (market) and internal (personal strengths and weaknesses) analysis and identify the choices available. The choice must be consistent with the person's mission and must also give the candidate a competitive advantage in the job market. Once the desirable position is identified, the candidate must implement his/her strategy of obtaining the job. The strategic control process provides feedback such as whether the job meets the candidate's expectations.