

chapter 1 lecture notes

What Is Strategy and Why Is It Important?

Chapter Summary

Chapter 1 defines the concept of strategy and describes its many facets. The chapter explains what is meant by a competitive advantage, discusses the relationship between a company's strategy and its business model, and introduces the student to the kinds of competitive strategies that can give a company an advantage over rivals in attracting customers and earning above-average profits. The chapter examines what sets a winning strategy apart from others and why the caliber of a company's strategy determines whether it will enjoy a competitive advantage over other firms or be burdened by competitive disadvantage. By the end of this chapter, the student will have a clear idea of why the tasks of crafting and executing strategy are core management functions and why excellent execution of an excellent strategy is the most reliable recipe for turning a company into a standout performer over the long term.

Lecture Outline

I. Introduction

Chapter one explores the fundamental concepts surrounding organizational strategy. It begins with an explanation of the term strategy and discusses why companies need a distinctive strategy in order to compete successfully. Next, it explores why a company must have a viable business model and the five most dependable strategic approaches for setting a company apart. The chapter wraps up with an illustration of how a company's strategy tends to evolve over time due to changing business conditions and the three tests for winning strategies.

II. What Do We Mean by 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. A company's **strategy** is the coordinated set of actions that its managers take in order to outperform the company's competitors and achieve superior profitability. In effect, it represents a managerial commitment to an integrated array of considered choices about how to compete.
2. Normally, companies have a wide degree of strategic freedom in choosing the "hows" of strategy:
 - How to position the company in the marketplace.
 - How to attract customers.
 - How to compete against rivals.
 - How to achieve the company's performance targets.

- How to capitalize on opportunities to grow the business.
- How to respond to changing economic and market conditions.

CORE CONCEPT

A company's **strategy** is the coordinated set of actions that its managers take in order to outperform the company's competitors and achieve superior profitability.

3. **Strategy Is about Competing Differently**—A strategy stands a better chance of succeeding when it is predicated on actions, business approaches, and competitive moves aimed at:
 - a. appealing to buyers in ways that set a company apart from its rivals and
 - b. staking out a market position that is not crowded with strong competitors.
4. **Figure 1.1—Identifying a Company's Strategy—What to Look For**, shows what to look for in identifying the substance of a company's overall strategy. These are the visible actions taken that signal what strategy the company is pursuing.

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.

III. Strategy and the Quest for Competitive Advantage

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 heart and soul of any strategy is the actions and moves in the market place that managers are taking to improve the company's financial performance, strengthen its long-term competitive position, and gain a competitive edge over rivals.
2. A company achieves a competitive advantage whenever it has some type of edge over rivals in attracting buyers and coping with competitive forces.
3. Strategy is about competing differently from rivals or doing what competitors don't do or, even better, can't do. In this sense, every strategy needs a distinctive element that attracts customers and produces a competitive edge.
4. What makes a competitive advantage **sustainable** (or durable), as opposed to temporary, are elements of the strategy that give buyers lasting reasons to prefer a company's products or services over those of competitors

CORE CONCEPT

A company achieves a **competitive advantage** when it provides buyers with superior value compared to rival sellers or offers the same value at a lower cost to the firm. The advantage is **sustainable** if it persists despite the best efforts of competitors to match or surpass this advantage.

5. Five of the most frequently used strategic approaches to setting a company apart from rivals and achieving a sustainable competitive advantage are:
 - a. Low Cost Provider—Achieving a cost-based advantage over rivals.
 - b. Broad Differentiation—Seeking to differentiate the company’s product or service from rivals’ in ways that will appeal to a broad spectrum of buyers.
 - c. Focused Low Cost—Concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by having lower costs than rivals and thus being able to serve niche members at a lower priced.
 - d. Focused Differentiation—Concentrating on a narrow buyer segment (or market niche) and out-competing rivals by offering niche members customized attributes that meet their tastes and requirements better than rivals’ products.
 - e. Best Cost Provider—Giving customers more value for the money by satisfying buyers’ expectations on key quality/features/performance/service attributes, while beating their price expectations.

ILLUSTRATION CAPSULE 1.1

Apple Inc.: Exemplifying a Successful Strategy

Discussion Question: Describe Apple’s strategic approach in the computer industry

Answer: The student should be able to discuss that Apple uses a Focused Differentiation strategic approach. The company focuses on the upper end of the computer buyer market and offers a premium product. The company designs its own operating system, hardware, and application software through continuous investments in R&D. These higher cost approaches to the market place are offset by premium pricing that the niche market can support.

IV. Why a Company’s Strategy Evolves over Time

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. Every company must be willing and ready to modify the strategy in response to changing market conditions, advancing technology, unexpected moves by competitors, shifting buyer needs, emerging market opportunities, and mounting evidence that the strategy is not working well.
2. Most of the time, a company’s strategy evolves incrementally from management’s ongoing efforts to fine-tune the strategy and to adjust certain strategy elements in response to new learning and unfolding events.
3. Industry environments characterized by high velocity change require companies to repeatedly adapt their strategies.
4. The important point is that the task of crafting strategy is not a one-time event but always a work in progress.

V. A Company's Strategy Is Partly Proactive and Partly Reactive

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 evolving nature of a company's strategy means that the typical company strategy is a blend of (1) *proactive*, planned initiatives to improve the company's financial performance and secure a competitive edge, and (2) *reactive* responses to unanticipated developments and fresh market conditions.

CORE CONCEPT

A company's **deliberate strategy** consists of *proactive* strategy elements that are both planned and realized as planned; its **emergent strategy** consists of *reactive* strategy elements that emerge as changing conditions warrant.

2. The biggest portion of a company's current strategy flows from ongoing actions that have proven themselves in the marketplace and newly launched initiatives aimed at building a larger lead over rivals and further boosting financial performance.—Deliberate Strategy
3. Managers must always be willing to supplement or modify the proactive strategy elements with as-needed reactions to unanticipated conditions.—Emergent Strategy
4. In total, these two elements combine to form the company's Realized Strategy. **Figure 1.2, A Company's Strategy is a Blend of Proactive Initiatives and Reactive Adjustments**, illustrates the elements of strategy that become the Realized Strategy.

VI. Strategy and Ethics: Passing the Test of Moral Scrutiny

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. Managers must be careful to embrace actions that can pass the test of moral scrutiny. This goes beyond just staying within the bounds of what is legal.
2. Ethical and moral standards are not fully governed by what is legal, they are concerned with right vs. wrong and a sense of duty.
3. While the legal realm deals with must or must not, the ethical/ moral realm deals with should or should not.
4. Senior executives with strong ethical convictions are generally proactive in linking strategic action and ethics.

VII. What Makes a Strategy a Winner?

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.

CORE CONCEPT

A company's **business model** sets forth the logic for how its strategy will create value for customers, while at the same time generate revenues sufficient to cover costs and realize a profit.

1. A business model is management's blueprint for delivering a valuable product or service to customers in a manner that will generate revenues sufficient to cover costs and yield an attractive profit.
2. The two elements of a company's business model are (1) its customer value proposition and (2) its profit formula.
3. The customer value proposition lays out the company's approach to satisfying buyer wants and needs at a price customers will consider a good value.
4. The profit formula describes the company's approach to determining a cost structure that will allow for acceptable profits, given the pricing tied to its customer value proposition.
5. Figure 1.3 illustrates the elements of the business model in terms of what is known as the Value-Price-Cost Framework highlighting the relationship between the Customer's Value Proposition (V-P) and the Profit Formula (P-C).

ILLUSTRATION CAPSULE 1.2

Pandora, Sirius XM, and Over-the-Air Broadcast Radio: Three Contrasting Business Models

Discussion Question 1: What is the prominent difference between the business models of these three organizations?

Answer: While all three provide essentially the same type of entertainment service, the business models employed by Pandora, Sirius XM, and Over-The-Air Broadcast Radio are completely different. In the area of value proposition (what the customer sees), Sirius XM provides commercial free entertainment with some local content based upon a monthly fee, while Broadcast Radio provides entertainment with some local content with interruptions for commercials without a fee. Pandora bridges these two methods. In one mode it operates more like Over-the-Air Broadcast Radio in that it provides entertainment without a fee that includes targeted advertisements, with the added benefit of allowing the listener to customize the music mix. In the other mode, listeners can elect to go ad-free for a fee using Pandora One.

For profit, Sirius XM must attract a large enough customer base in order to cover costs and provide profit, while Broadcast Radio must attract a large enough advertiser base to cover costs and provide profit. Pandora, once again bridging the two, generates profit by either an advertiser base or through ad-free services.

VIII. What Makes a Strategy a Winner?

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. Three questions can be used to test the merits of one strategy versus another and distinguish a winning strategy from a losing or mediocre strategy:
 - a. The Fit Test: How well does the strategy fit the company's situation? To qualify as a winner, a strategy has to be well matched to industry and competitive conditions, a company's best market opportunities, and other aspects of the enterprise's external environment.
 - b. The Competitive Advantage Test: Is the strategy helping the company achieve a sustainable competitive advantage? The bigger and more durable the competitive edge that a strategy helps build, the more powerful and appealing it is.
 - c. The Performance Test: Is the strategy producing good company performance? Two kinds of performance improvements tell the most about the caliber of a company's strategy: (1) gains in profitability and financial strength and (2) gains in the company's competitive strength and market standing.
2. Strategies that come up short on one or more of the above questions are plainly less appealing than strategies passing all three test questions with flying colors.

IX. Why are Crafting and Executing Strategy Important?

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 strategy are top priority managerial tasks for two big reasons
 - a. High-performing enterprises are nearly always the product of astute, creative, and proactive strategy making
 - b. Even the best-conceived strategies will result in performance shortfalls if they are not executed proficiently.
2. Good Strategy + Good Strategy Execution = Good Management
 - a. Crafting and executing strategy are core management functions.
 - b. Among all the things managers do, nothing affects a company's ultimate success or failure more fundamentally than how well its management team charts the company's direction, develops competitively effective strategic moves and business approaches, and pursues what needs to be done internally to produce good day-to-day strategy execution and operating excellence.

X. The Road Ahead

1. Throughout the remaining chapters and the accompanying case collection, the spotlight is trained on the foremost question in running a business enterprise: What must managers do, and do well, to make a company a winner in the marketplace?
2. The mission of this book is to provide a solid overview of what every business student and aspiring manager needs to know about crafting and executing strategy.

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.

ASSURANCE OF LEARNING EXERCISES

1. Based on your experiences and/or knowledge of Apple's current products and services, does Apple's strategy (as described in Illustration Capsule 1.1) seem to set it apart from rivals? Does the strategy seem to be keyed to a cost-based advantage, differentiating features, serving the unique needs of a niche, or some combination of these? What is there about Apple's strategy that can lead to sustainable competitive advantage?

connect ACTIVITY

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

Response:

Setting Itself Apart—The student should be able to discuss that Apple uses a Focused Differentiation strategic approach. The company focuses on the upper end of the computer buyer market and offers a premium product. They strategically place stores in areas where their target market frequent and staff them with knowledgeable people. The firm is also committed to CSR and sustainability throughout its supply chain.

Elements of Strategy—The student should identify that some of key elements of Apple's strategy include a strong focus on R&D, providing a complete hardware/software/service solution, and a strong brand identity. These elements, along with the focus on CSR and sustainability combine to form a high end value proposition for consumers that allows for premium pricing.

Sustainable Competitive Advantage—The student should identify that developing a sustainable competitive advantage relies on a) building competitively valuable capabilities that rivals cannot readily match and b) having a distinctive product offering. Further, they should be able to highlight that the two areas described above are both distinctive and difficult to match.

2. Elements of eBay's strategy have evolved in meaningful ways since the company's founding in 1995. After reviewing the company's history at www.ebayinc.com/our-company/our-history and all of the links at the company's investor relations site (investors.ebayinc.com), prepare a one- to two-page report that discusses how its strategy has evolved. Your report should also assess how well eBay's strategy passes the three tests of a winning strategy.

Strategy Evolution—From the information found in the links provided, the student's report should include information similar to the following.

The company was founded in 1995 with the mission of bringing together buyers and sellers in an honest and open marketplace. By mid 1996, the company had already sold \$7.2 million worth of goods, and in late 1997, the name AuctionWeb was replaced with the now iconic ebay name. In 1998, the company began to focus more on the customer experience through its first of many strategic acquisitions. By mid 1999, ebay had begun its overseas expansion with moves into Germany, Australia, and the UK. In 2001, ebay continued to customize the customer experience by providing eBay stores for its sellers. The period from 2001 through 2016 are marked by continued strategic acquisitions that bolster the company's product and service offerings including paypal, stubhub, and most recently, corrigan just to name a few of the more prominent ones. Global expansion continues today with ebay available in 180 countries.

The student should conclude that all of these innovations follow a careful underlying strategy of adding services and features to the overall product mix that leverage and take advantage of developments in personal and business technology and devices as well as shifting consumer demands. The company's strategy has evolved from a simple mission of providing a market place on the internet to being a comprehensive solution for engaging in commerce, making the financial transaction as smooth as possible, and moving the merchandise effectively.

Strategy Assessment—The student’s report should include specific indications that the company’s strategy is a winner as follows.

- a. Does the strategy fit the company’s situation? Yes, the company’s strategy fits the evolving world of technology, consumer behavior, and market demands.
 - b. Does the strategy helping the company achieve a sustainable competitive advantage? Yes, the growing base of customers and revenue streams from various services and platforms is led by continuous innovation which differentiates the company well. The growing profit stream indicates that the strategy is sustainable.
 - c. Does the strategy producing good company performance? Yes, but the company needs to address profit margins. The 2017 Annual Report shows that market growth is steady with \$9.56 Billion for fiscal year 2017 up from \$8.79 Billion in 2014. Gross profit for fiscal year 2017 was \$7.34 Billion up slightly from \$7.13 Billion in 2014, and operating profit for fiscal year 2017 was \$2.26 Billion down slightly from \$2.48 Billion in 2014. Taken together, these financial measures indicate market growth but increases in cost of sales which is driving down operating profits
3. Go to investor.siriusxm.com and check whether the SiriusXM’s recent financial reports indicate that its business model is working. Are its subscription fees increasing or declining? Is its revenue stream advertising and equipment sales growing or declining? Does its cost structure allow for acceptable profit margins?

connect ACTIVITY

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

Response:

General—The responses developed by the students may include information such as the following. SiriusXM is a leading satellite media company that provides commercial free music from numerous genres, live play by play sports, news and talk shows, and other forms of audio entertainment streaming to the consumer’s home, auto, business, or even boats within 200 miles of the coast.

Is the business model working—The student should note that the company’s annual revenue has increased steadily over the last three reporting periods from \$4.57B in 2015 to \$5.42B in 2017, while net income has grown from \$509M to \$647M over the same period. This is an increase in net profit from 11.1% in 2015 to 11.9% in 2017. This illustrates an increasing value proposition (revenue) as well as an effective and growing profit formula (earnings). The conclusion the student should reach is that the business model is working effectively.

Subscription Fees—The student should identify that the company had subscription revenue of \$3.8B in 2015 and \$4.47B in 2017, representing a 5.86% average annual growth.

Revenue Stream from Advertising—The student should identify that the company had advertising revenue of \$122M in 2015 and \$160M in 2017, representing a 10.3% average annual growth.

Revenue from Equipment—The student should identify that the company had revenue from equipment of \$111M in 2015 and \$131M in 2017, representing a 6% average annual growth.

Cost Structure and Profit Margins—The student should identify that the company had consistently growth in Operating Profit with \$1.3B in 2013 and \$1.68B in 2015, representing a 9.7% average annual growth. This demonstrates that the company’s cost structure allows for attractive profit margins.



case 1 • Case Assignment Questions

Mystic Monk Coffee

Assignment Questions

1. Has Father Daniel Mary established a future direction for the Carmelite Monks of Wyoming? What is his vision for the monastery? What is his vision for Mystic Monk Coffee? What is the mission of the Carmelite Monks of Wyoming?
2. Does it appear that Father Daniel Mary has set definite objectives and performance targets for achieving his vision?
3. What is Father Prior's strategy for achieving his vision? What competitive advantage might Mystic Monk Coffee's strategy produce?
4. Is Mystic Monk Coffee's strategy a money-maker? What is MMC's business model? What is your assessment of Mystic Monk Coffee's customer value proposition? its profit formula? its resources that enable it to create and deliver value to customers?
5. Does the strategy qualify as a winning strategy? Why or why not?
6. What recommendations would you make to Father Daniel Mary in terms of crafting and executing strategy for the monastery's coffee operations? Are changes needed in its long-term direction? its objectives? its strategy? its approach to strategy execution? Explain.



SECTION 6

Case Teaching Notes
for Chapters 1-32

Mystic Monk Coffee

Overview

This 24-page case requires that students consider the future direction of a monastery located in Clark, Wyoming and evaluate the vision, strategy, and business model of the fledgling Mystic Monk coffee business. As the case unfolds, students will learn of Father Daniel Mary's vision to build a new Mount Carmel in the Rocky Mountains and transform the small brotherhood of 13 monks living in a small home used as makeshift rectory into a 500-acre monastery that would include accommodations for 30 monks, a Gothic church, a convent for Carmelite nuns, a retreat center for lay visitors, and a hermitage. Father Daniel Mary had identified a nearby ranch for sale that met the requirements of his vision perfectly, but its listing price of \$8.9 million presented a financial obstacle to creating a place of prayer, worship, and solitude in the Rockies. Father Daniel Mary hoped to fund the purchase of the ranch through charitable contributions to the monastery and through the profits of its Mystic Monk coffee business, which had earned nearly \$75,000 during its first year of operation.

Suggestions for Using the Case

This case was written as a leadoff case and was carefully crafted by the case author to require students to draw upon most all of the concepts discussed in Chapters 1 and 2 to sufficiently prepare for a class discussion of the case. The case involves issues relating to mission, vision, objectives, strategy, business models, and decisive strategic leadership; the need for an action plan is obvious—these are the very things one looks for in a good leadoff case. And the nature of the case virtually guarantees the stimulating kind of class discussion one needs to get the course off on the right foot.

We think Mystic Monk Coffee (MMC) is an excellent leadoff case for the course (other good choices are Robin Hood, Airbnb in 2016, and Amazon.com's Business Model and Its Evolution—which also require that students draw upon the material covered in Chapters 1 and 2). The unusual topic of the business ventures of cloistered monks, student familiarity with the coffee industry, and the very close connection between the case and the material in Chapters 1 and 2 make this an especially good leadoff case. You may want to consider covering Chapter 1 in your first day's lecture, Chapter 2 on your second day's lecture, and then assigning Mystic Monk Coffee for class discussion on Day 3.

We suggest use of a teaching plan that focuses on Father Daniel Mary's strategic vision for the monastery and its coffee operations and Mystic Monk Coffee's strategy and business model. Of course, there is the opportunity for students to make recommendations regarding the strategic issues confronting the monastery and its coffee venture.

The assignment questions and teaching outline presented in upcoming sections of this TN reflect our thinking about how to conduct the class discussion of the Mystic Monk Coffee case.

It is really very difficult to have an insightful and constructive class discussion of the Mystic Monk Coffee case unless students have not only read the case but also conscientiously worked their way through a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments.

To facilitate your use of study questions and making them available to students, we have posted a file of the Assignment Questions contained in this teaching note for the Mystic Monk Coffee 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 posted in the Connect Library and in the textbook immediately following Chapter 12. 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.

Auto-Graded Connect Case Exercise. The 21st Edition includes a fully auto-graded Connect case exercise for 14 cases included in the text. The auto-graded exercises closely follow the assignment questions and analysis included in the teaching note for the case. *The auto-graded exercise for the Mystic Monk Coffee case requires that students answer a series of multiple choice questions related to Assignment Questions 1-5.* Question 6 is left as an open ended question that allows students to fully discuss recommendations concerning improvements to the company's coffee operations, changes in its long-term direction, objectives, strategy, or approach to strategy execution.

Students should be expected to spend about 45 minutes to complete the exercise, assuming they have done a conscientious job of reading the case and absorbing the information it contains. All of the questions are automatically graded, and the grades are automatically recorded in your Connect grade book, which makes it easy for you to evaluate each class member's ability to apply many of the concepts discussed in Chapters 1 and 2.

The length of the case makes it ideal for an in-class written case or a final exam case. Our suggested written assignment questions are as follows:

1. As a new business school graduate who has relocated to Cody, Wyoming and supports the local foundation to benefit the Wyoming Carmelites, you have been asked to prepare a strategic review and action plan for the Father Daniel Mary's consideration. Your report to Father Prior should include an evaluation of the monastery's mission, its vision for Mystic Monk Coffee, objectives for the monastery and the coffee operations, and MMC's strategy and business model. You should also propose recommendations to improve Mystic Monk Coffee's vision, objectives, strategy, business model, or approach to strategy execution. It is your job to convince Father Daniel Mary to pursue your proposed plan; hence your report should include full justification and arguments to support your recommended course of action.
2. Cody, Wyoming business owners have noted your quickly developing skills of analysis and growing business acumen and have asked that you prepare a report for Father Daniel Mary that evaluates Mystic Monk Coffee's mission, vision, strategy, business model, and operations. Your report should also make recommendations concerning strategic issues related to:
 - The vision and mission of the monastery and its coffee operations,
 - MMC's strategic and financial objectives,

- MMC's strategy and business model, and
- The action steps that will need to be taken to implement the strategy effectively.

Please provide supporting analysis and persuasive argument for your recommended course of action (you must convince Father Daniel Mary to do what you suggest!) and you need to be specific about what to do and how to do it.

Assignment Questions

1. Has Father Daniel Mary established a future direction for the Carmelite Monks of Wyoming? What is his vision for the monastery? What is his vision for Mystic Monk Coffee? What is the mission of the Carmelite Monks of Wyoming?
2. Does it appear that Father Daniel Mary has set definite objectives and performance targets for achieving his vision?
3. What is Father Prior's strategy for achieving his vision? What competitive advantage might Mystic Monk Coffee's strategy produce?
4. Is Mystic Monk Coffee's strategy a money-maker? What is MMC's business model? What is your assessment of Mystic Monk Coffee's customer value proposition? its profit formula? its resources that enable it to create and deliver value to customers?
5. Does the strategy qualify as a winning strategy? Why or why not?
6. What recommendations would you make to Father Daniel Mary in terms of crafting and executing strategy for the monastery's coffee operations? Are changes needed in its long-term direction? its objectives? its strategy? its approach to strategy execution? Explain.

Teaching Outline and Analysis

1. **Has Father Daniel Mary established a future direction for the Carmelite Monks of Wyoming? What is his vision for the monastery? What is his vision for Mystic Monk Coffee? What is the mission of the Carmelite Monks of Wyoming?**

Students should have little trouble recognizing that Father Daniel Mary's vision for the Carmelite Monks of Wyoming is to recreate Mount Carmel in the U.S. Rocky Mountains and transform the *small brotherhood of 13 monks living in a small home used as makeshift rectory into a 500-acre* monastery that would include accommodations for 30 monks, a Gothic church, a convent for Carmelite nuns, a retreat center for lay visitors, and a hermitage. However, students should also recognize that there is no clear evidence in the case that Father Daniel Mary has articulated a vision for Mystic Monk Coffee.

If you are using this case as your lead-off case for the course, you may find that many students don't distinguish between the monastery and MMC and believe the Prior's general vision applies to the monk's coffee operations. To clear up this confusion and *to illustrate the lack of an appropriate vision for MMC, please have students compare Father Prior's vision to Howard Schultz's vision for Starbucks*. Howard Schultz's vision of bringing the Italian Espresso bar experience to America very accurately described his intended course and direction and helped stakeholders understand "where we are going." Schultz's vision for Starbucks was graphic, focused, desirable, and easy to communicate. The same can be said for Father Daniel Mary's vision for the Carmelite Monks, but not for its coffee business. Initially doubting students should concede that Father Daniel Mary has yet to spell out a long-term direction for Mystic Monk Coffee. There's merit to having students critique both visions using the information in Table 2.1 presented in Chapter 2 of the text.

You'll likely find that most students readily recognize that the *ultimate mission of the cloistered monks is to worship God*. Some may wish to begin a debate on the role of the monastery's coffee operations in pursuit of this mission, but we've found it's best to hold this discussion for the very end of the case discussion. We prefer to have students consider this dilemma after they've recommended an action plan that would help the monastery achieve its vision of creating a new Mount Carmel in the Rocky Mountains.

2. Does it appear that Father Daniel Mary has set definite objectives and performance targets for achieving his vision?

Students will find it very difficult to argue that Father Daniel Mary has set definite objectives or performance targets for achieving the vision. Other than the broad goal of obtaining funds to purchase the \$8.9 million Lake Irma Ranch, there isn't any evidence that the monks have set short-term or long-run goals for developing charitable contributions or for its MMC business.

3. What is Father Prior's strategy for achieving his vision? What competitive advantage might Mystic Monk Coffee's strategy produce?

Students will generally agree that Father Daniel Mary is relying on charitable contributions to the monastery and profits from its Mystic Monk Coffee enterprise to fund the purchase of the Irma Lake Ranch. Students should also recognize that *MMC does have a deliberate strategy, although it may be only tacitly understood among the monks*. The case doesn't discuss to what extent Father Prior has articulated the strategy to Brother Java (Brother Elias) and the other monks involved with MMC's operations, but students *should be able to identify the following elements of MMC's focused differentiation strategy*:

- Exclusive use of high quality fair trade Arabica and fair trade organic Arabic beans
- Variety of blends, roasts, and flavors to appeal to a broad range of coffee preferences
- Focus on U.S. Catholic consumers and those wishing to support the mission of the Carmelite Monks of Wyoming. An appeal was made to Catholics "to use their catholic coffee dollar for Christ and his Catholic church."
- Word of mouth advertising among loyal customers in Catholic parishes across the U.S.
- Majority of sales made through MMC's Web site
- Telephone orders accepted
- Affiliate program that provided 18 percent commissions to secular Web site operators allowing MMC banner and text ads to appear on their sites
- ShareASale participation program that allowed affiliates to refer new affiliates and earn 56 percent of the new affiliate's commission
- Wholesale sales to churches and local coffee shops
- Product line extension that included sales of T-shirts, mugs, gift cards, and CDs featuring the monastery's
- Gregorian chants

Students will generally approve of MMC's *focused differentiation* strategy and suggest that it is capable of building competitive advantage. The use of *high quality coffee beans, the variety of blends, roasts, and flavors and the Mystic Monk image produce a number of tangible and intangible benefits* for MMC customers. Students will also recognize that *MMC's focus on the 69 million members of the Catholic Church in the United States* makes the target market sufficiently large to earn attractive profits. Students

should conclude that *even though MMC is incapable of sustaining an advantage in the industry based upon the quality of its coffee alone, its monastic relationship would be very difficult for a rival seller to imitate.*

4. Is Mystic Monk Coffee's strategy a money-maker? What is MMC's business model? What is your assessment of Mystic Monk Coffee's customer value proposition? its profit formula? its resources that enable it to create and deliver value to customers?

Even though MMC's business model has a compelling customer value proposition, there is reason for students to challenge the overall soundness of the business model. *MMC's attractive differentiating features and competitive pricing create a strong customer value proposition, but its profit formula is suspect.* Other than the lack of labor expense, MMC enjoys no cost advantage and many of its non-differentiating activities involve higher than normal costs because of its low production volume. The company's cost of sales of 30 percent, broker fees of 3 percent, and inbound shipping costs of 19 percent contributed to a cost of goods sold of 52 percent. Even though students might argue that some indirect operating expenses (37 percent of revenues) are largely fixed and might go down as volume increases, most of these expenses are somewhat variable and will increase with volume. *MMC's current sales and 11 percent net profit margin are quite insufficient to generate \$8.9 million in cumulative earnings within a reasonable amount of time.*

Students are also likely to note that *MMC generates losses on all sales coming from affiliate Web sites* since the company pays an 18 percent commission on these sales, but has a net profit margin of only 11 percent.

Students will also question whether the monastery possesses sufficient resources to operate a thriving coffee roasting and sales business. Current monthly sales of \$56,500 suggest that MMC sells about 4,250 pounds of coffee each month at a retail price of \$9.95 per 12-ounce bag. The capacity of the coffee roaster will allow for production of 540 pounds per day, which is about 22.5 pounds per hour. Brother Elias (Brother Java) is able to work for only 6 hours per day, which limits production to about 135 pounds per day. *At a rate of 135 pounds per day, it appears that Brother Java is working 7 days per week to meet MMC's current monthly sales!!* Students will also note that a larger roaster could be purchased that would push production to 130 pounds per hour, which would *increase daily production by a factor of 6.* Still there is much labor involved in packaging the coffee and preparing daily shipment pickups for UPS or the US Postal Service. *There is strong reason to believe that the monk's monastic constraints would prevent a six-fold increase in daily production, even if demand permitted such an increase in daily production.*

Students' overall assessment of the business model should recognize its flaws and conclude that MMC's current business model severely limits its ability to make a meaningful contribution to the purchase of Lake Irma Ranch. However, MMC's average monthly profits of slightly more than \$5,000 should go a long way to supporting the current operating expenses of the monastery. *Students may conclude that the business model is quite sufficient should Father Daniel Mary choose to scale back his vision.*

5. Does the strategy qualify as a winning strategy? Why or why not?

There's merit in directing students to the three tests of a winning strategy presented on page 9 of Chapter 1 of the text if you've chosen to schedule Mystic Monk Coffee as the lead-off case for the course. Assessments made by students may include the following arguments and comments:

- *Does the strategy fit the company's situation?* You should find the class more or less evenly divided in whether to classify MMC's strategy as a winner. The strategy fits the external situation nicely since the market for *specialty coffees had grown at an annual rate of 32 percent between 2000 and 2007 to reach \$13.5 billion.* Also, students should note that the retail sales of organic specialty coffee had grown to \$1 billion by 2007. MMC's focus on Catholic consumers in the United States represents a large market for MMC—and one that would arguably become very loyal customers. *Students who suggest MMC lacks a winning strategy are likely to point to a poor fit between MMC's strategy and its internal situation that requires monks to devote most of their day prayer and worship.*

- ***Has the strategy yielded a sustainable competitive advantage?*** There should be little disagreement that the strategy has the *potential to yield sustainable competitive advantage*, although it's debatable if such an advantage has been achieved at that time of the case. But students who say it's still unclear if any competitive advantage exists should concede that the company's \$56,500 average monthly sales suggest MMC has a growing and loyal following among Catholic consumers.
- ***Has the strategy produced good financial performance?*** Students' assessment of MMC's ability to pass the third test of a winning strategy depends heavily upon their perceptions of "excellent company performance." Students who are impressed with MMC's average monthly sales of \$56,500 and its average profit margin of 11 percent will suggest that the strategy has produced good financial performance. Those who are focused on the need to generate profits sufficient to generate funds to purchase the Irma Lake Ranch will argue forcefully that MMC's strategy has failed this test.

We tend to agree with students who find that MMC's strategy is a winning strategy and that its limitations to generate sufficient funds to purchase Irma Lake Ranch result from flaws in its business model. All evidence suggests that the strategy is a winner, but that the business model must be revised substantially if MMC is to experience dramatic increases in sales and earnings.

6. What recommendations would you make to Father Daniel Mary in terms of crafting and executing strategy for the monastery's coffee operations? Are changes needed in its long-term direction? its objectives? its strategy? its approach to strategy execution? Explain.

Student recommendations are likely to fall into two groups, with one group suggesting that the vision be scaled back dramatically and the other group recommending an action plan to dramatically increase MMC's revenues and earnings.

Students arguing that Father Daniel Mary's vision should be scaled back drastically will be able to support such a recommendation with several facts from their analysis:

- The monastery does not have the human resources necessary to roast, package, and ship the volume of coffee necessary to accrue \$8.9 million.
- Additionally, Father Daniel Mary nor the other Carmelite brothers have the necessary business experience to manage a large coffee operation capable generating annual earnings in the millions of dollars.
- There is nothing in the case to suggest that the Carmelite brothers share Father Daniel Mary's vision to build a new Mount Carmel in the Rockies. It is quite likely that the brothers would prefer to pursue traditional monastery life rather than to be concerned with increasing Mystic Monk Coffee's annual sales and profits.
- Mystic Monk Coffee's operations are capable of supporting the expenses of the existing monastery without dramatic revenue and volume growth. Perhaps, Father Daniel Mary should be satisfied with MMC's currently monthly profits.
- Father Daniel Mary could choose to use the monastery's recent \$250,000 donation to expand the current rectory to provide additional living space for existing monks and any new monks joining the monastery. The Carmelites' current 42-acre parcel of land could be used to construct a larger rectory if the current ranch-style four-bedroom home could not be expanded.

Students arguing that Father Daniel Mary should stick with his current vision must make a number of recommendations for improving Mystic Monk Coffee's strategy and business model. Appropriate recommendations include:

- Before making specific recommendations to revise MMC's strategy and business model, ***students must first determine to what extent donations can be relied upon to generate funds necessary to purchase the Irma Lake Ranch.*** In our calculations, we've assumed that one-half of the funds necessary to purchase the ranch will come from charitable contributions.
- Father Daniel Mary should request that the Catholic Church send priests or others not constrained by a cloistered life to develop a strategy with Cody, Wyoming business people to maximize the potential of the foundation established for the benefit of the monastery. It's likely that the Cody, Wyoming business people don't have the know-how or time to generate substantial contributions to the foundation.
- Father Daniel Mary should also utilize the resources of the Catholic Church to find major donors willing to contribute to the creation of a new Mount Carmel. However, Father Daniel Mary's efforts might be limited by the Catholic Church's charitable giving requests for competing projects and needs.
- Assuming that charitable giving will account for 50 percent of the funding requirements to purchase the \$8.9 million Irma Lake Ranch, it would take MMC nearly 67 years to accrue \$5 million in earnings if its level of annual profits remains at \$75,000. Students going forward with recommendations to make MMC's profits a major contributor to the \$8.9 million purchase price should propose a plan that will allow MMC to record net earnings of \$1 million annually, at a minimum.
- The purchase of the larger 130-pound per hour roaster will not allow MMC's annual profits to increase to \$1 million since Brother Java's 6-hour shift will allow only 780 pounds of coffee to be roasted each day (130 pounds/hr x 6 hours). This level of production would allow MMC to sell up to 1,040 12-ounce bags of coffee each ((780 pounds x 16 ounces)/12 ounces = 1,040 12-ounce bags). This level of production at \$9.95/bag allows for daily revenues of \$10,348 and a daily profit of \$1,138 given the current profit margin of 11 percent. So, MMC's annual profits could arguably increase to about \$415,000 if demand could be increased to match the 6-hour capacity of the larger roaster. (A more simple calculation to project MMC's profits if sales increase by a factor of 6 involves merely multiplying MMC's current annual profits of \$75,000 by 6 to arrive at a projected annual profit of \$450,000.)
- Students should recommend that MMC use ***its improved bargaining power stemming from any volume increases to negotiate better terms with its suppliers, shippers, and its coffee broker.*** The case doesn't provide enough detail for students to make an exact determination about to what extent cost of goods sold could be decreased, but students should be able to come up with some easily supported assumptions. In general, students should be able to justify a reduction in MMC's cost of goods sold from 52 percent to about 48 percent – 50 percent because of enhanced buyer leverage as volume increases.
- Utilities, telephone, and Web site maintenance are indirect expenses that will increase as sales and production increase, but still ***might offer some economies of scale opportunities.*** Students should be able to justify a decline in operating expenses from 37 percent to about 33 percent to 35 percent because of scale economies.
- Students making the assumption that increased volume will allow MMC's net profit margin to improve from 11 percent to 15 percent - 19 percent, will note that MMC's daily net profit will increase to \$1,552
 - \$1,996 based on daily sales of \$10,348. The improvement in margins would result in an annual net income for MMC of \$566,000 - \$717,500.
- Most students will recommend that MMC immediately ***reduce commissions paid to affiliate Web sites,*** since the current 18 percent commission cannot be supported.
- Students should recognize that even under the most favorable scenario, Father Daniel Mary will be ***required to schedule additional 6-hour shifts*** for MMC reach \$1 million in annual profits.

- Students should also recommend strategies that will allow MMC to increase sales to support higher levels of production. Possible recommendations include:
 - Send e-mails to Catholic churches in the U.S. asking that MMC coffee be used for church events and that parish members be told of MMC's Internet coffee sales.
 - Provide churches purchasing MMC coffee with a sign promoting MMC that could be placed near a coffee urn. The sign could improve awareness of MMC among members of Catholic parishes.
 - Target coffee shops located in communities with large Catholic populations for wholesale purchases.
 - Promote the Wyoming Carmelite's vision of a new Mount Carmel and MMC coffee at Catholic religious conferences. MMC might consider providing conferences with free MMC coffee and promotional materials.
 - Students may suggest that MMC obtain permission to place banner ads or links to MMC on church and parish websites.
- Some students may recommend that MMC change its business model because of its resource limitations discussed in Assignment Question 4. Father Daniel Mary could adopt a business model that would allow the monks to develop new blends, roasts, and flavors at the monastery and have the production and shipping performed by a contract manufacturer such as First Colony Coffee and Tea. Such an arrangement would allow MMC to receive royalties much like First Colony's fine department store and specialty retailer customers do. MMC's *value proposition* would remain largely intact since the coffee blends, roasts, and flavors would be developed by the monks and some portion of the purchase price would go to support the monks and Father Daniel Mary's vision for a new Mount Carmel. The *profit formula* for a business model that relies on contract manufacturing would be more viable than MMC's current profit formula. Students should easily recognize that a contract manufacturer with a proven track record would have the *resources* necessary to produce and ship large volumes of packaged coffee.
- Students supporting contract manufacturing may also suggest that First Colony or similar coffee producer might be able to help Mystic Monk Coffee gain access to specialty retailers who might wish to carry the brand.
- Students who argue forcefully against contract manufacturing should be challenged by the instructor to consider the logistical problems should the Wyoming Carmelites be able to purchase Irma Lake Ranch and move MMC's operations to the new Mount Carmel. ***The ranch was at the end of a 7-mile private gravel road. Inbound and outbound logistics during much of the year would likely be extremely difficult given the duration of Wyoming's winters.***
- As a final question to the group of students who may be against contract manufacturing, you should ask if MMC's increased volume would present a conflict with the overall mission of the monastery. ***How would the demands of operating a very successful coffee producer interfere with the men's vows and requirement to spend their lives in prayer and worship?***

Epilogue

Mystic Monk Coffee has added several new blends and coffee accessories at its Web site since the close of the case. You can visit www.mysticmonkcoffee.com to see the monastery's latest coffee offerings.

The monastery had also established the New Mount Carmel Foundation, Inc. to support Father Daniel Mary's vision of creating a new Mount Carmel in the Rocky Mountains. The foundation website (<http://www.newmountcarmelfoundation.org>) provides photo galleries, videos, news and other information related to the foundation's efforts to develop funding to build the mountain monastery.