

4

Operations Strategy

LEARNING OUTCOMES

After studying this chapter, you should be able to:

- 4-1 Explain how organizations seek to gain competitive advantage.
- 4-2 Explain approaches for understanding customer wants and needs.
- 4-3 Describe how customers evaluate goods and services.
- 4-4 Explain the five key competitive priorities.
- 4-5 Explain the role of OM, sustainability, and operations in strategic planning.
- 4-6 Describe Hill's framework for operations strategy.

After you finish this chapter go to **PAGE 89** for **STUDY TOOLS**

Over the past two decades, the transformation to a digital society has caused many companies to redefine their strategy. Some have had to completely reinvent themselves. For example, the demise of film cameras caused Kodak to change to digital cameras. However, with stiff competition from Sony, Samsung, and others, Kodak ended up filing for Chapter 11 bankruptcy protection and has changed its strategy to focus on large commercial inkjet printers, digital printing presses, workflow software, and package printing. Likewise, Xerox, long known for its paper copy machines, has reinvented itself and branched out

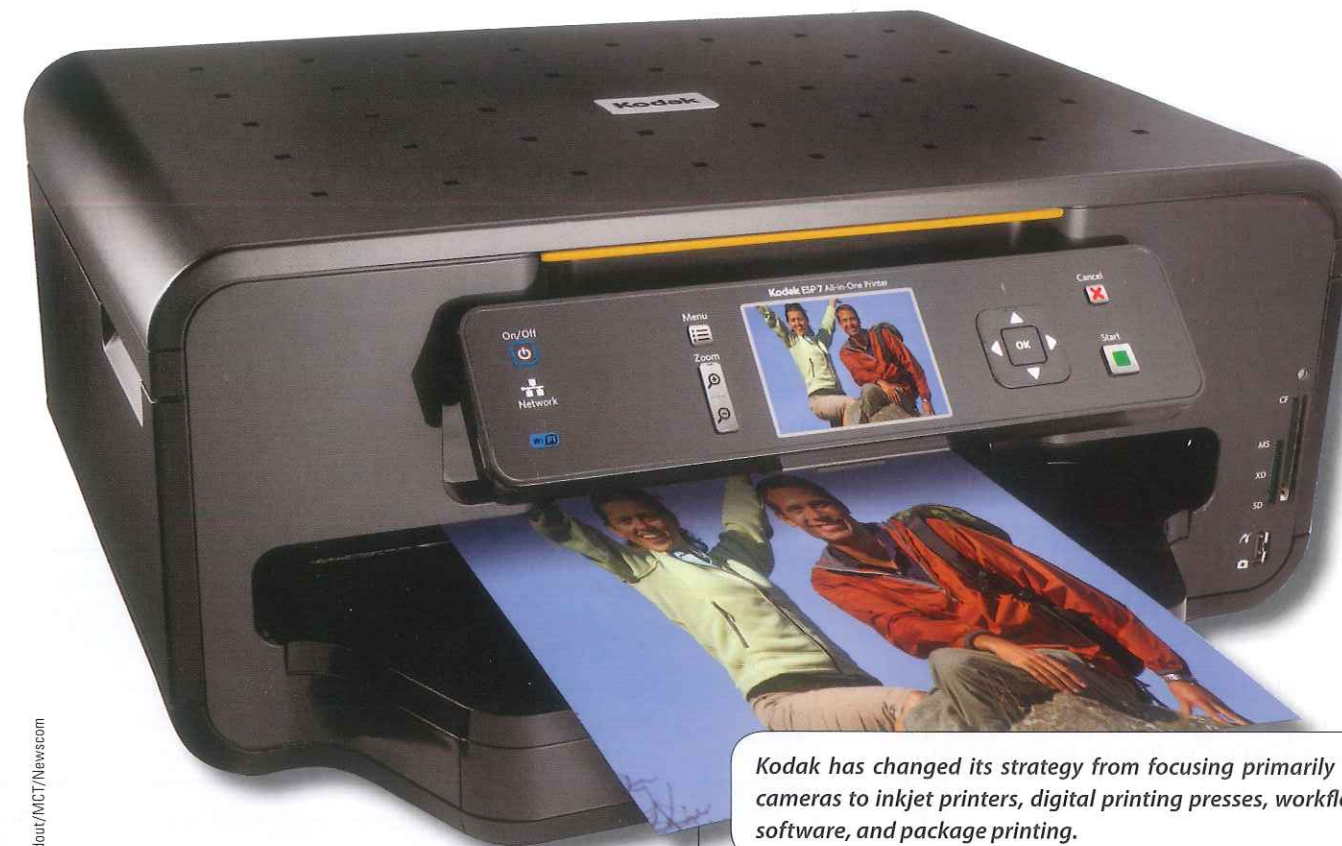
into new but risky business services, including commercial information technology, document outsourcing, finance, human resources (HR), transportation, and health care.

Changing a corporate strategy has many implications for operations and the entire

value chain. Facilities may have to be reconfigured or new ones built; new technology may have to be acquired; new processes and jobs must be designed; and so on. Looking back at Exhibit 2.4, we also see that all aspects of preproduction services, production processes, and postproduction services will be affected.

WHAT DO YOU THINK?

How do you see the digital society affecting education? For example, what implications are emerging technologies, such as e-books and distance learning, having? Can you think of others?



Handout/MCT/Newscom

Kodak has changed its strategy from focusing primarily on cameras to inkjet printers, digital printing presses, workflow software, and package printing.

4-1

GAINING COMPETITIVE ADVANTAGE

Competitive advantage denotes a firm's ability to achieve market and financial superiority over its competitors. In the long run, a sustainable competitive advantage provides above-average performance and is essential to survival of the business. Creating a competitive advantage requires a fundamental understanding of two things. First, management must understand customer needs and expectations—and how the value chain can best meet these through the design and delivery of attractive customer benefit packages. Second, management must build and leverage operational capabilities to support desired competitive priorities.

Every organization has a myriad of choices in deciding where to focus its efforts—for example, on low cost, high quality, quick response, or flexibility and customization—and in designing its operations to support its chosen strategy. The opening scenario suggests that organizations have many strategic choices in

designing and operating their domestic and global value chains. These choices should be driven by current and emerging customer needs and expectations. In particular, what happens in operations—on the front lines and on the factory floor—must support the strategic direction the firm has chosen.

Any change in a firm's customer benefit package, targeted markets, or strategic direction typically has significant consequences for the entire value chain and for operations.

Although it may be difficult to change the *structure* of the value chain, operations managers have considerable freedom in determining what components of the value chain to emphasize, in selecting technology and processes, in making human resource policy choices, and in making other relevant decisions to support the firm's strategic emphasis.

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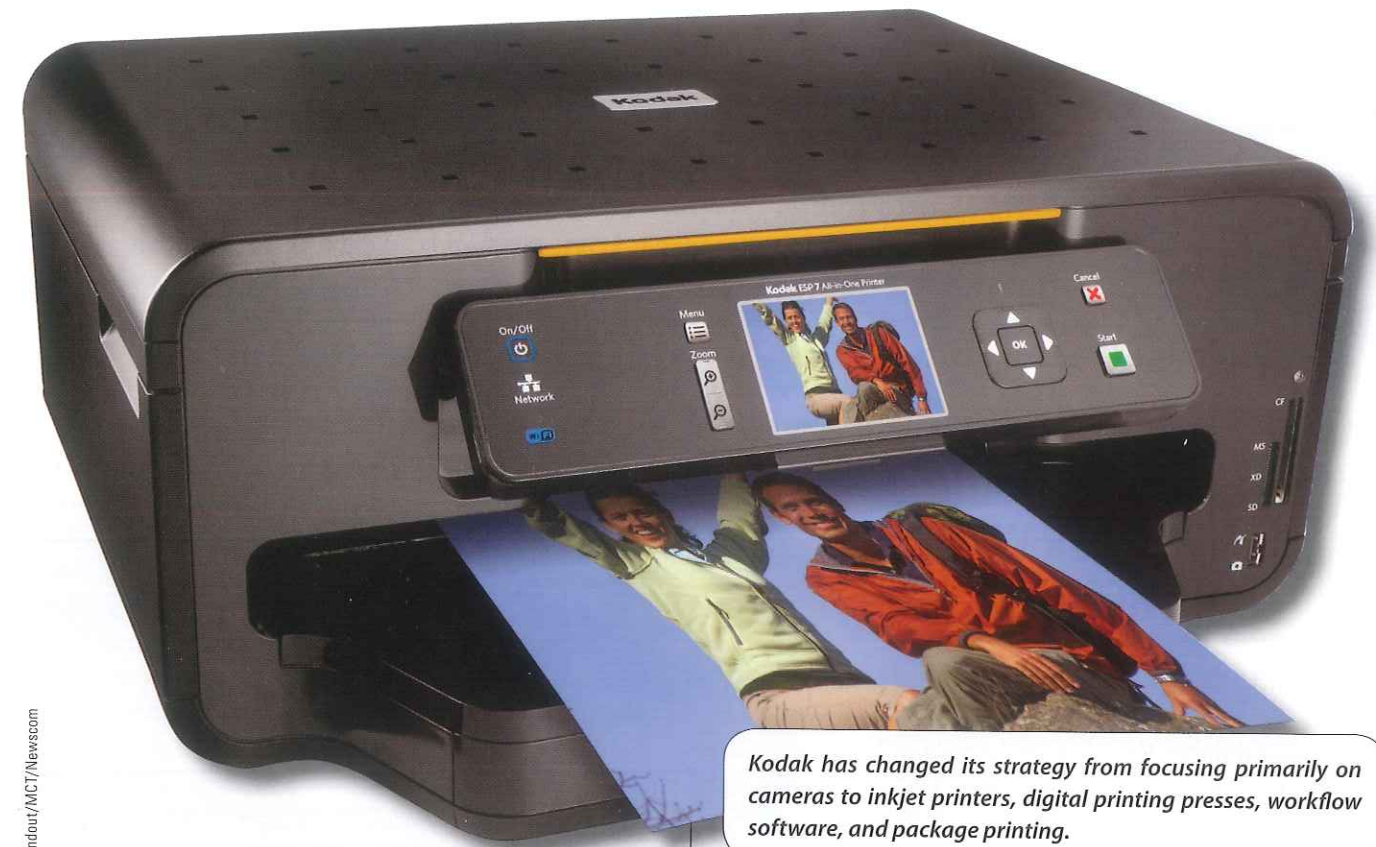
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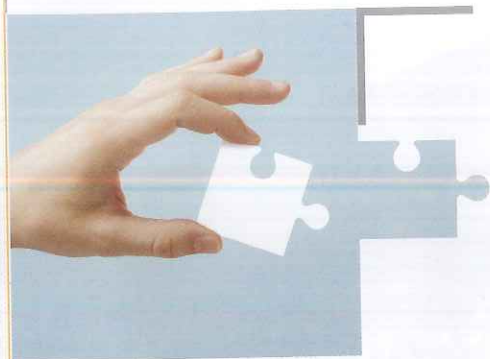
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4-2 UNDERSTANDING CUSTOMER WANTS AND NEEDS

Because the fundamental purpose of an organization is to provide goods and services of value to customers, it is important to first understand customer desires and also to understand how customers evaluate goods and services. However, a company usually cannot satisfy all customers with the same goods and services. Often, customers must be segmented into several natural groups, each with unique wants and needs. These segments might be based on buying behavior, geography, demographics, sales volume, profitability, or expected levels of service. By understanding differences among such segments, a company can design the most appropriate customer benefit packages, competitive strategies, and processes to create the goods and services to meet the unique needs of each segment.

To correctly identify what customers expect requires being “close to the customer.” There are many ways to do this, such as having employees visit and talk to customers, having managers talk to customers, and doing formal marketing research. Marriott Corporation, for example, requires top managers to annually work a full day

or more in the hotels as bellhops, waiters, bartenders, front-desk service providers, and so on, to gain a true understanding of customer wants and needs, and the types of issues that their hotel service providers must face in serving the customer. Good marketing research includes such techniques as focus groups, salesperson and employee feedback, complaint analysis, on-the-spot interviews with customers, videotaped service encounters, mystery shoppers, telephone hotlines, Internet monitoring, and customer surveys.

*Basic customer expectations are generally considered the minimum performance level required to stay in business and are often called **order qualifiers**.* For example, a radio and driver-side air bag are generally expected by all customers for an automobile; for a hotel, customers expect that the room will be safe and clean. The unexpected features that surprise, entertain, and delight customers by going beyond the expected often make the difference in closing a sale. **Order winners** are goods and service features and performance characteristics that differentiate one customer benefit package from another and win the customer's business. Collision avoidance systems or a voice-activated music system in an automobile, for example, or free Internet and gaming devices in a hotel, can be order winners. Over time, however, order winners eventually become order qualifiers as customers begin to expect them. Thus, to stay competitive, companies must continually innovate and improve their customer benefit packages.

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4-3 EVALUATING GOODS AND SERVICES

Research suggests that customers use three types of attributes in evaluating the quality of goods and services: search, experience, and credence.¹ **Search attributes** are those that a customer can determine prior to purchasing

Papa John's: Focus on the Order Winner

John Schnatter, founder of Papa John's Pizza, described how he got started in the pizza business and identified Papa John's key competitive priority as now reflected in the slogan “Better ingredients, better pizza, Papa John's.” In 1983, John's father hired him to run a bar he co-owned that was nearly bankrupt. Thinking back to his college days when he had a dream of starting a pizza business (where he came up with the name, menu, and recipes), he believed if they could sell \$5 pizzas and 50-cent beer, they'd make a fortune. So he installed a pizza oven and began selling Papa John's pizza. He realized early on that Domino's had the speed, Little Caesars had the price, and Pizza Hut had variety, and yet they made up only 35 percent or 40 percent of the market. He didn't understand why pizzas with better ingredients didn't win every time. He thought if you had a national chain that acted like an independent as far as quality,

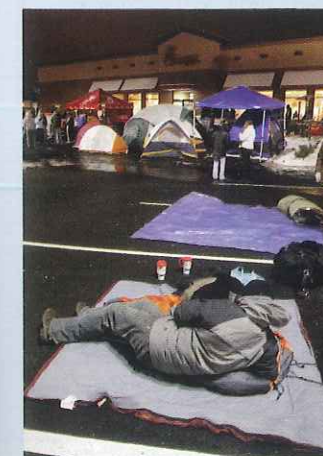


AP Images/Patti Longmire

then you'd have the best of all worlds. The bar was like a laboratory where they would try things out. He tried pasta, fried zucchini, and salads as well as sit-down service. But the customers told him early on, “We like your pizza delivered—you're a delivery chain.” So he focused on the pizza. Papa John's strategy is to provide a high-quality product (the order winner) with efficient delivery in a competitive market (the order qualifier).²

LISTEN TO YOUR CUSTOMERS—CREATIVELY!

At IDEO, one of the world's leading design firms (which designed Apple's first mouse and stand-up toothpaste tubes as just two examples), design doesn't begin with a far-out concept or a cool drawing. It begins with a deep understanding of the people who might use whatever product or service eventually emerges from its work, drawing from anthropology, psychology, biomechanics, and other disciplines.



AP Images/Lew Stamp/Akron Beacon Journal

When former Disney executive Paul Pressler assumed the CEO position at Gap, he met with each of Gap's top 50 executives, asking them such standard questions as “What about Gap do you want to preserve and why?” “What about Gap do you want to change and why?” and so on. But he also added one of his own: “What is your most important tool for figuring out what the consumer wants?” Some companies use unconventional and innovative approaches to understand customers. Texas Instruments created a simulated classroom to understand how mathematics teachers use calculators; and a manager at Levi Strauss used to talk with teens who were lined up to buy rock concert tickets. The president of Chick-fil-A spends at least one day each year behind the counter, as do all of the company's employees, and has camped out overnight with customers at store openings. At Whirlpool, when customers rate a competitor's product higher in satisfaction surveys, engineers take it apart to find out why. The company also has hundreds of consumers fiddle with computer-simulated products while engineers record the users' reactions on videotape.³

the goods and/or services. These attributes include things like color, price, freshness, style, fit, feel, hardness, and smell. **Experience attributes** are those that can be discerned only after purchase or during consumption or use. Examples of these attributes are friendliness, taste, wearability, safety, fun, and customer satisfaction. **Credence attributes** are any aspects of a good or service that the customer must believe in but cannot personally evaluate even after purchase and consumption. Examples include the expertise of a surgeon or mechanic, the knowledge of a tax advisor, or the accuracy of tax preparation software.

This classification has several important implications for operations. For example, the most important search and experience attributes should be evaluated during design, measured during manufacturing, and drive key operational controls to ensure that they are built into the good with high quality. Credence attributes stem from the nature of services, the design of the service system, and the training and expertise of the service providers.

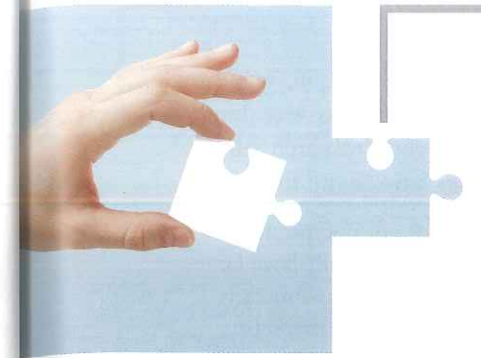
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These three evaluation criteria form an evaluation continuum from easy to difficult, as shown in Exhibit 4.1. This model suggests that goods are easier to evaluate than services and that goods are high in search qualities, whereas services are high in experience and credence attributes. Of course, goods and services are usually combined and configured in unique ways, making for an even more complex customer evaluation process. Customers evaluate services in ways that are often different from goods. A few ways are summarized below along with significant issues that affect operations.

- Customers seek and rely more on information from personal sources than from nonpersonal sources when evaluating services prior to purchase. Operations must ensure that accurate information is available and that experiences with prior services and service providers result in positive experiences and customer satisfaction.
- Customers perceive greater risks when buying services than when buying goods. Because services are intangible, customers cannot look at or touch them prior to the purchase decision. They experience the service only when they actually go through the process. This is why many are hesitant to use online banking or bill paying.

Dissatisfaction with services is often the result of customers' inability to properly perform or co-produce their part of the service. A wrong order placed on the Internet



General Electric discovered that 75 percent of its manufacturing costs is determined by design.

can be the result of customer error despite all efforts on the part of the company to provide clear instructions. The design of services must be sensitive to the need to educate customers on their role in the service process.

These insights help to explain why it is more difficult to design services and service processes than goods and manufacturing operations.

4-4 COMPETITIVE PRIORITIES

Competitive priorities represent the strategic emphasis that a firm places on certain performance measures and operational capabilities within a value chain. Understanding competitive priorities and their relationships with customer benefit packages provides a basis for designing the processes that create and deliver goods and services. Every organization is concerned with building and sustaining a competitive advantage in its markets. A strong competitive advantage is driven by customer needs and aligns the organization's resources with its business opportunities. A strong competitive advantage is difficult to copy, often because of a firm's culture, habits, or sunk costs.

Competitive advantage can be achieved in different ways, such as outperforming competitors on price or quality, responding quickly to changing customer needs in designing goods and services, or providing rapid design or delivery. In general, organizations can compete on five key competitive priorities:

1. Cost
2. Quality
3. Time
4. Flexibility
5. Innovation

All of these competitive priorities are vital to success. For example, no firm today can sacrifice quality simply

to reduce costs, or emphasize flexibility to the extent that it would make its goods and services unaffordable. However, organizations generally make trade-offs among these competitive priorities and focus their efforts along one or two key dimensions. For example, Dell Computer manufactures PCs (1) configured to customer specifications, (2) with high goods quality, and (3) tries to deliver them quickly to customers. However, they are not always the least-expensive machines available, and customers must wait longer to get a Dell computer as opposed to picking one off the shelf at a retail store. Hence, high goods quality and flexibility are top competitive priorities at Dell, whereas cost and delivery time are of somewhat lesser importance.

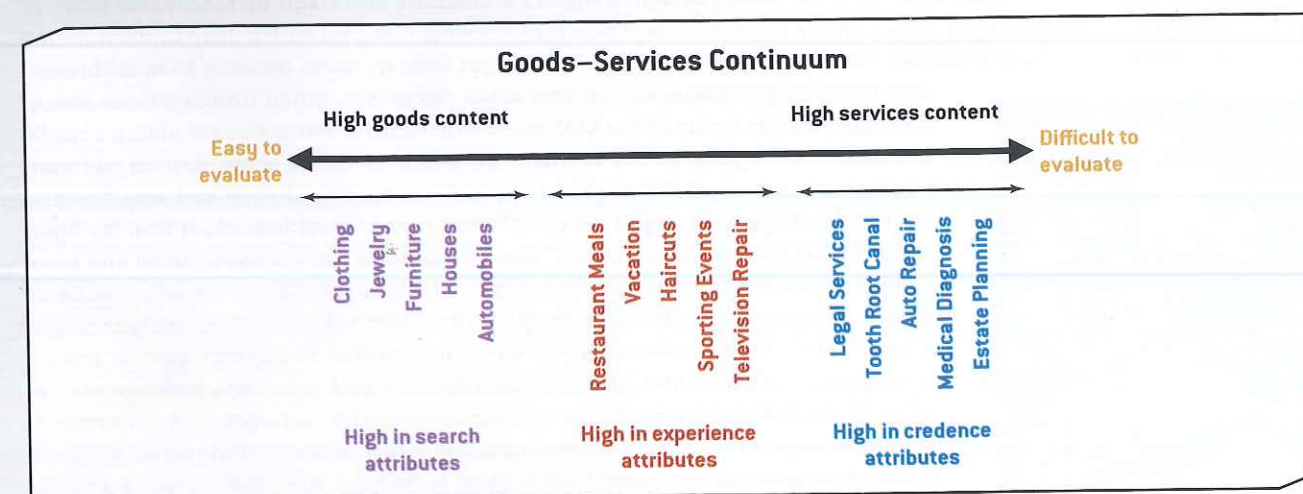
4-4a Cost

Many firms, such as Walmart, gain competitive advantage by establishing themselves as the low-cost leader in an industry. These firms handle high volumes of goods and services and achieve their competitive advantage through



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Exhibit 4.1
How Customers Evaluate Goods and Services



Source: Adapted from V. A. Zeithamel, "How Consumer Evaluation Processes Differ Between Goods and Services," in J. H. Donnelly and W. R. George, eds., *Marketing in Services*, published by the American Marketing Association, Chicago, 1981, pp. 186–199. Reprinted with permission from the American Marketing Association.

Southwest Airlines: Competing with Low Cost

The only major U.S. airline that has been continuously profitable over the last several decades is Southwest Airlines. Other airlines have had to collectively reduce costs by \$18.6 billion, or 29 percent of their total operating expenses, to operate at the same level (cost per mile) as Southwest. The high-cost airlines such as United and American face enormous pressure from low-fare carriers such as Southwest Airlines. Mr. Roach, a long-time industry consultant, says "The industry really is at a point where survival is in question." In recent years, airlines have reduced capacity, cut routes, and increased fees for peripheral services like baggage and food. We have also seen mergers, such as between Delta and Northwest and between United and Continental, to reduce system-wide costs.⁴



David Osborn/Alamy

low prices. Although prices are generally set outside the realm of operations, low prices cannot be achieved without strict attention to cost and the design and management of operations. General Electric, for example, discovered that 75 percent of its manufacturing costs is determined by design. Costs accumulate through the value chain, and include the costs of raw materials and purchased parts, direct manufacturing cost, distribution, postsale services, and all supporting processes. Through good design and by chipping away at costs, operations managers help to support a firm's strategy to be a low-price leader. They emphasize achieving economies of scale and finding cost advantages from all sources in the value chain.

Low cost can result from high productivity and high-capacity utilization. More important, improvements in quality lead to improvements in productivity, which in turn lead to lower costs. Thus, a strategy of continuous improvement is essential to achieve a low-cost competitive advantage.

4-4b Quality

The role of quality in achieving competitive advantage was demonstrated by several research studies.⁵ Researchers have found that

- Businesses offering premium-quality goods usually have large market shares and were early entrants into their markets.
- Quality is positively and significantly related to a higher return on investment for almost all kinds of market situations.
- A strategy of quality improvement usually leads to increased market share, but at a cost in terms of reduced short-run profitability.
- Producers of high-quality goods can usually charge premium prices.

Exhibit 4.2 summarizes the impact of quality on profitability. The value of a good or service in the marketplace is influenced by the quality of its design. Improvements in performance, features, and reliability will differentiate the good or service from its competitors, improve a firm's quality reputation, and improve the perceived value of the customer benefit package. This allows the company to

command higher prices and achieve an increased market share. This, in turn, leads to increased revenues that offset the added costs of improved design. Improved conformance in production leads to lower manufacturing and service costs through savings in rework, scrap, and warranty expenses. The net effect of improved quality of design and conformance is increased profits.

In many industries, strategies often lead to trade-offs between quality and cost; some company strategies are willing to sacrifice quality in order to develop a low-cost advantage. Such was the case with new automobile start-ups, especially with Hyundai Motor Co. However, goods quality has evolved over the years and now is generally considered to be an order qualifier. Operations managers deal with quality issues on a daily basis; these include ensuring that goods are produced defect-free or that service is delivered flawlessly. In the long run, it is the design of goods and service processes that ultimately defines the quality of outputs and outcomes.

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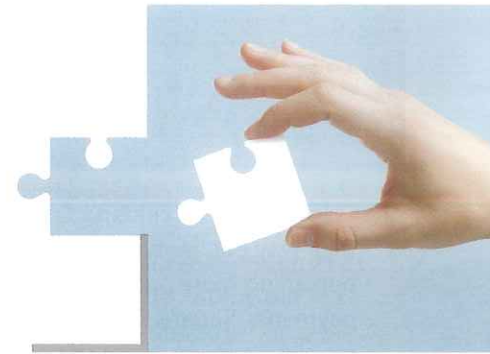
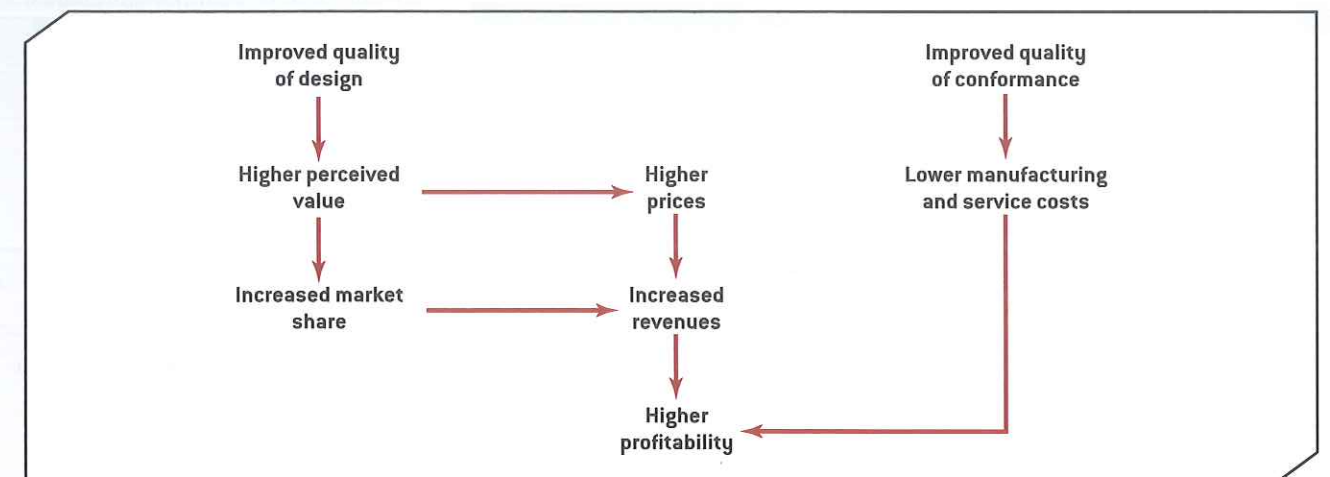


Exhibit 4.2

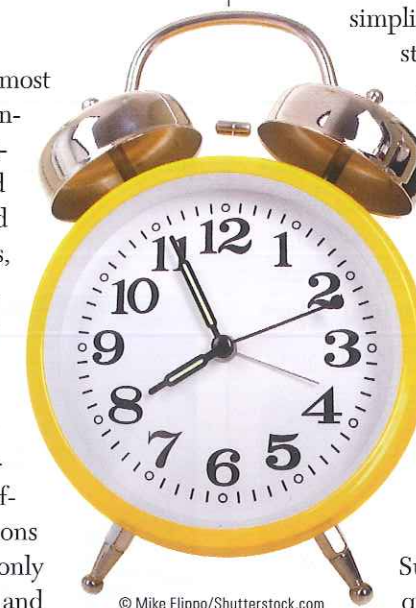
Interlinking Quality and Profitability Performance



4-4c Time

In today's society, time is perhaps the most important source of competitive advantage (see the box on Your Cell Phone Becomes Your Wallet). Customers demand quick response, short waiting times, and consistency in performance. Many firms, such as CNN, FedEx, and Walmart, know how to use time as a competitive weapon to create and deliver superior goods and services.

Speeding up work processes improves customer response. Deliveries can be made faster, and more often on time. However, time reductions in processes and value chains can only be accomplished by streamlining and



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simplifying them to eliminate non-value-added steps such as rework and waiting time. This forces improvements in quality by reducing the opportunity for mistakes and errors. By reducing non-value-added steps, costs are reduced as well. Thus, time reductions often drive simultaneous improvements in quality, cost, and productivity. Designing processes and using technology efficiently to improve speed and time reliability are some of the most important activities for operations managers.

4-4d Flexibility

Success in globally competitive markets requires both design and demand flexibility.

Your Cell Phone Becomes Your Wallet

Credit and debit cards and other magnetic-strip-based cards are on their way out. Mobile payment devices, including your cell phone, are becoming more prevalent, dramatically speeding up the time to process payments. Square, for example, provides a small reader that plugs into a mobile phone or tablet to process cab fares quickly. Google Wallet uses wireless technology for quick payments and has tied this capability to Google Offers, which searches for immediate coupon discounts. Many other competitors are entering the market, as total U.S. mobile payments are expected to double each year.⁶

In the automobile industry, for example, new models are constantly being developed. Companies that can exploit flexibility by building several different vehicles on the same assembly line at one time, enabling them to switch output as demand shifts, will be able to sell profitably at lower volumes.

Flexibility is manifest in mass-customization strategies that are becoming increasingly prevalent today. **Mass customization** is being able to make whatever goods and services the customer wants, at any volume, at any time for anybody, and for a global organization, from any place in the world.⁷ Some examples include Sign-tic company signs that are uniquely designed for each customer from a standard base sign structure; business consulting; Levi's jeans that are cut to exact measurements; personal Web pages; estate planning; Motorola pagers customized in different colors, sizes, and shapes; personal weight-training programs; and modular furniture that customers can configure to their unique needs and tastes. Customer involvement might occur at the design (as in the case of custom signs), fabrication (Levi's jeans), assembly (Motorola pagers), or postproduction (customer-assembled modular furniture) stages of the value chain. Mass customization requires

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companies to align their activities around differentiated customer segments and design goods, services, and operations around flexibility.

4-4e Innovation

Innovation is the discovery and practical application or commercialization of a device, method, or idea that differs from existing norms. Over the years, innovations in goods (such as telephones, automobiles, computers, optical fiber, satellites, and cell phones) and services (self-service, all-suite hotels, health maintenance organizations, and Internet banking) have improved the overall

quality of life. Within business organizations, innovations in manufacturing equipment (computer-aided design, robots and automation, and smart tags) and management practices (customer satisfaction surveys, quantitative decision models, and the Malcolm Baldrige criteria) have allowed organizations to be more efficient and better meet customers' needs.

Many firms, such as Apple, focus on research and development for innovation as a core component of their strategy. Such firms are on the leading edge of product technology, and their ability to innovate and introduce new products is a critical success factor. Product performance, not price, is the major selling feature. When competition enters the market and profit margins fall, these companies often drop out of the market while continuing to introduce innovative new products. These companies focus on outstanding product research, design, and development; high product quality; and the ability to modify production facilities to produce new products frequently.



4-5

OM AND STRATEGIC PLANNING

The direction an organization takes and the competitive priorities it chooses are driven by its strategy. The concept of strategy has different meanings to different people. **Strategy** is a pattern or plan that integrates an organization's major goals, policies, and action sequences into a cohesive whole.⁸ Basically, a strategy is the approach by which an organization seeks to develop the capabilities required for achieving its competitive advantage. Effective strategies develop around a few key competitive priorities, such as low cost or fast service time, which provide a focus for the entire organization and exploit an organization's **core competencies**, which are the strengths that are unique to that organization. Such strengths might be a particularly skilled or creative workforce, customer relationship management, clever bundling of goods and services, strong supply chain networks, extraordinary service, green goods and services, marketing expertise, or the ability to rapidly develop new products or change production output rates.

Strategic planning is the process of determining long-term goals, policies, and plans for an organization. The objective of strategic planning is to build a position that is so strong in selected ways that the organization can achieve its goals despite unforeseeable external forces that may arise. Strategy is the result of a series of hierarchical decisions about goals, directions, and resources; thus, most large organizations have three levels of strategy: corporate, business, and functional. At the top level, *corporate strategy* is necessary to define the businesses in which the corporation will participate and develop plans for the acquisition and allocation of resources among those businesses. The businesses in which the firm will participate are often called strategic business units (SBUs) and are usually defined as families of goods

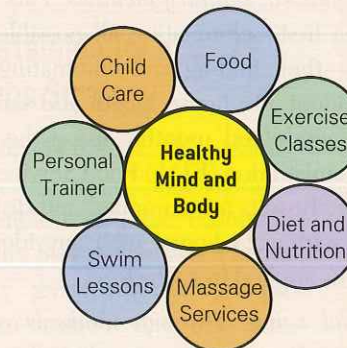
Strategy is a pattern or plan that integrates an organization's major goals, policies, and action sequences into a cohesive whole.

Core competencies are the strengths that are unique to an organization.

SOLVED PROBLEM

Define the customer benefit package (CBP) for a health club, recreation center, or gymnasium you frequent. (Check out the web of your favorite club, center, or gym for more information.) Use this information to help describe the organization's strategic mission, strategy, competitive priorities, and how it wins customers.

One example is depicted below.



Mission: The mission of our health club is to offer many pathways to a healthy living style and body.

Strategy: We strive to provide our customers with superior:

- ways to improve and maintain the health and well-being of the body and mind.
- friendly professional staff that care about them.
- clean facilities, equipment, uniforms, parking lot, food service, and the like.
- customer convenience (location, food, communication, schedules, etc.).

Competitive Priorities: #1 Priority: many pathways to healthy living and a healthy body (design flexibility); #2 Priority: friendly, professional staff and service encounters (service quality); #3 Priority: super clean (goods, facility, and environmental quality); #4 Priority: customer convenience in all respects (time); and #5 Priority: price (cost).

How to win customers? Providing a full-service health club with superior service, staff, and facilities. (Although you would not see this in company literature, this health club provides premium service at premium prices.)

Remember that each primary or peripheral good or service in the customer benefit package requires a process to create and deliver it to customers, and therefore OM skills are needed.

or services having similar characteristics or methods of creation. For small organizations, the corporate and business strategies frequently are the same.

The second level of strategy is generally called *business strategy* and defines the focus for SBUs. The major decisions involve which markets to pursue and how best to compete in those markets—that is, what competitive priorities the firm should pursue.

Finally, the third level of strategy is *functional strategies*, the means by which business strategies are accomplished. A functional strategy is the set of decisions that each functional area (marketing, finance, operations, research and development, engineering, etc.) develops to support its particular business strategy.

Our particular focus will be on *operations strategy*—how an organization's processes are designed and organized to produce the type of goods and services to support the corporate and business strategies.

4-5a Operations Strategy

An **operations strategy** defines how an organization will execute its chosen business strategies. Developing an operations strategy involves translating competitive priorities into operational capabilities by making a variety of choices and trade-offs for design and operating decisions. That is, operating decisions must be aligned with achieving the desired competitive priorities. For example, Progressive automobile insurance has developed a competitive advantage around superior customer service. To accomplish this, its operating decisions have included on-the-spot claims processing at accident sites; “Total Loss Concierge” service to help customers with unreparable vehicles get a replacement vehicle; and the industry's first Web 2.0 site, with easier navigation, customization, and video content.

What kind of an operations strategy might a company like Pal's Sudden Service (see Chapter 1) have? Consider the operations management implications of key elements of the company's vision: *To be the preferred quick-service restaurant in our market, achieving the largest market share by providing*⁸

1. *The quickest, friendliest, most accurate service available.* To achieve quick and accurate service, Pal's needs highly standardized processes. The staff at each

An **operations strategy** defines how an organization will execute its chosen business strategies.

Pal's facility is organized into process teams along the order-taking, processing, packaging, and order-completion line. The process layout is designed so that raw materials enter through a delivery door and are worked forward through the store, with one process serving the next. Employees must have clearly defined roles and responsibilities, understanding of all operating and service procedures and quality standards, and job flexibility through cross-training, to be able to respond to volume cycles and unplanned reassignments to work activities. To ensure friendly service, Pal's uses specific performance criteria to evaluate and select employees who demonstrate the aptitude, talents, and characteristics to meet performance standards; invests heavily in training; and pays close attention to employee satisfaction.

2. *A focused menu that delights customers.* Employees must understand their customers' likes and dislikes of their products and services as well as those of their competitors. Operations must address such questions as: What capabilities will we need to support a new menu offering? Do our suppliers have the capacity to support this new offering? Is the appropriate technology available?
3. *Daily excellence in product, service, and systems execution.* Successful day-to-day operations require employees to effectively apply Pal's online Quality Control process, consisting of four simple steps: standardize the method or process, use the method, study the results, and take control. Each employee is thoroughly trained and coached on precise work procedures and process standards, focusing on developing a visual reference to verify product quality.
4. *Clean, organized, sanitary facilities.* Pal's focuses on prevention first—eliminating all possible causes of accidents—then finding and eliminating causes of actual incidents. In-house health and safety inspections are conducted monthly using the Food and Drug Administration (FDA) Food Service Sanitation Ordinance. Results are compiled and distributed to all stores within 24 hours, with any identified improvements applied in each store.
5. *Exceptional value.* Through methods of listening and learning from customers and studies of industry standards and best practices, Pal's has designed the following items into its operations: convenient locations with easy ingress and egress, long hours of operation (6:00 a.m. to 10:00 p.m.), easy-to-read 3-D menus, direct face-to-face access to order taker and cashier/order deliverer, fresh food (cooked hot dogs



PhotoDisc/Getty Images

are discarded after 10 minutes if not purchased), a 20-second delivery target, and a website for contacting corporate office and stores. Pal's selects suppliers carefully to ensure not only product quality and on-time delivery but also the best price for the volume level purchased. Overall supply chain costs are minimized by maintaining only a few, long-term core suppliers.

From this discussion of Pal's Sudden Service, it is clear that how operations are designed and implemented can have a dramatic effect on business performance and achievement of the strategy. Therefore, operations require close coordination with functional strategies in other areas of the firm, such as marketing and finance.

4-5b Sustainability and Operations Strategy

Sustainability is defined in previous chapters using three dimensions—environmental, social, and economic sustainability. Stakeholders such as the community, green advocacy groups, and the government drive environmental sustainability. Social sustainability is driven by ethics and human ideals of protecting the planet and its people for the well-being of future generations. Economic sustainability is driven by shareholders such as pension funds and insurance companies.

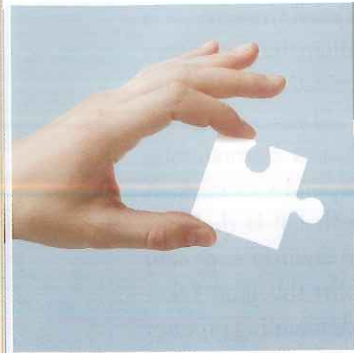
Therefore, sustainability is an organizational strategy—it is broader than a competitive priority. Sustainability requires major changes in the culture of the organization (see box on General Electric).

Many companies, such as Dell, Kaiser Permanente, and Nike, view sustainability as a corporate strategy. A majority of global consumers believe that it is their responsibility to contribute to a better environment and would pay more for brands that support this aim. Likewise, retailers and manufacturers are demanding greener products and supply chains. In 2007, Walmart Stores Inc. announced that it would transition toward selling only concentrated laundry detergents, which use much less water and therefore require less packaging and space for transport and storage. Every major supplier in the detergent industry was involved. Government actions are also

New Strategies for Environmental Sustainability

Many durable products, such as cell phones, televisions, and refrigerators, contain hazardous materials and cannot be easily reused or recycled. As a result, organizations need to rethink strategically the environmental challenges that result from obsolete durable goods. Cell phones, for example, become obsolete quickly as a result of manufacturers making rapid improvements in design and service providers offering new incentives. The value chain is complex, and includes original equipment manufacturers (OEMs), retailers, service providers, remanufacturers, recyclers, and waste-management companies. Some new strategies that have been suggested include:

- Creating better designs that focus on ease of disassembly and lower costs for refurbishing and recycling. This might include modular designs that make it easier to reuse parts rather than have to recycle them, or to recover valuable materials more easily.
- Incorporating refurbishing and recycling activities into manufacturers' value chains. As many as 130 million phones are retired each year, with significant waste and environmental implications.
- Creating more secondary markets for refurbished phones. This can increase profits by enticing users of voice-only phones to upgrade to data plans if the price of the phones can be reduced.
- Developing new processes to collect and refurbish old phones. For example, ReCellular Inc. has partnered with Verizon, Motorola, Walmart, and others, but still it only captures 5 percent of retired phones, suggesting that the cell phone value chain has not matured.⁹



Sustainability is an organizational strategy—it is broader than a competitive priority.

driving these initiatives. The 2009 U.S. stimulus package earmarked \$70 billion for the development of renewable and efficient energy technologies and manufacturing. The European Union has set targets for reducing emissions to 20 percent of 1990 levels by 2020.

Companies that have embraced sustainability pursue this strategy throughout their operations. For example, computer maker Dell Inc. has announced that it is committed to becoming “the greenest technology company on the planet.” Such a strategy often requires considerable innovation in value chains, operations design, and day-to-day management. For example, Dell launched a program called Design for the Environment that seeks to minimize adverse impacts on the environment by controlling raw material acquisition, manufacturing processes, and distribution programs while linking green policies with consumer use and disposal. This framework encourages Dell’s product designers to consider the full product life cycle, and it provides them with a platform for collaborating with suppliers, supply chain experts, and external recycling experts and other downstream partners to help them fully understand the environmental implications of their design decisions.¹⁰

Operations design choices are the decisions management must make as to what type of process structure is best suited to produce goods or create services.

Companies are also paying closer attention to ethical issues of outsourcing, particularly the human resource practices of off-shore suppliers, which may include unreasonable work hours or unsafe working conditions. Such issues are more difficult to monitor when control is relinquished to an off-shore manufacturer.

4-6 A FRAMEWORK FOR OPERATIONS STRATEGY

A useful framework for strategy development that ties corporate and marketing strategy to operations strategy was proposed by Professor Terry Hill at Templeton College, Oxford University, and is shown in Exhibit 4.3.¹¹ It was originally designed for goods-producing organizations; however, it can also be applied to service-providing firms. This framework defines the essential elements of an effective operations strategy in the last two columns—*operations design choices* and *building the right infrastructure*.

Operations design choices are the decisions management must make as to what type of process structure is best suited to produce goods or create services. It typically addresses six key

General Electric: Green Starts at the Top

Jeffrey Immelt, the CEO of General Electric, proposed a green business strategy and plan to his 35 top executives in 2004, and they voted against it. Immelt refused to take no for an answer and overruled his executives. The result of his efforts is now defined in GE’s highly successful Ecomagination initiative. Ecomagination (<http://ge.ecomagination.com>) is a business strategy designed to drive innovation and the growth of profitable environmental solutions while engaging stakeholders. GE invests in innovation through its R&D efforts and outside venture capital investments. The resulting goods

and services enable GE and its customers to reduce emissions while generating revenue from their sale. Combining profits and energy savings, GE continues to invest in environmental solutions, perpetuating the cycle. Specific green and measurable targets have been established by year. For example, GE’s greenhouse gas (GHG) target set in 2008 has been exceeded by 30 percent.



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Exhibit 4.3 Hill’s Strategy Development Framework

Corporate Objectives	Marketing Strategy	How Do Goods and Services Quality and Win Orders in the Marketplace?	Operations Strategy	
			Operations Design Choices	Infrastructure
<ul style="list-style-type: none"> • Growth • Economic sustainability (survival)* • Profit • Return on investment • Other market and financial measures • Social (welfare) sustainability* • Environmental sustainability* 	<ul style="list-style-type: none"> • Goods and services markets and segments • Range • Mix • Volumes • Standardization versus customization • Level of innovation • Leader versus follower alternatives 	<ul style="list-style-type: none"> • Safety • Price (cost) • Range • Flexibility • Demand • Goods and service design • Quality • Service • Goods • Environment • Social (community) • Brand image • Delivery • Speed • Variability • Technical support • Pre- and postservice support 	<ul style="list-style-type: none"> • Type of processes and alternative designs • Supply chain integration and outsourcing • Technology • Capacity and facilities (size, timing, location) • Inventory • Trade-off analysis 	<ul style="list-style-type: none"> • Workforce • Operating plans and control system(s) • Quality control • Organizational structure • Compensation system • Learning and innovation systems • Support services

*Note: We have added sustainability criteria to Professor Hill’s original framework.

Sources: Adapted from T. Hill, *Manufacturing Strategy: Text and Cases*, 3rd ed., Burr Ridge, IL: McGraw-Hill, 2000, p. 32; T. Hill, *Operations Management: Strategic Context and Managerial Analysis*, 2nd ed., Prigame MacMillan, 2005, p. 50.

areas—types of processes, value chain integration and outsourcing, technology, capacity and facilities, inventory and service capacity, and trade-offs among these decisions.

Infrastructure focuses on the nonprocess features and capabilities of the organization and includes the workforce, operating plans and control systems, quality control, organizational structure, compensation systems, learning and innovation systems, and support services. The infrastructure must support process choice and provide managers with accurate and timely information to make good decisions. These decisions lie at the core of organizational effectiveness, and suggest that the integrative nature of operations management is one of the most important aspects of success. Operations design and infrastructure criteria and decisions in Prof. Hill’s strategy framework define the value chain that supports environmental, social, and economic sustainability.

A key feature of this framework is the link between operations and corporate and marketing strategies. Clearly, it is counterproductive to design a customer benefit package and an operations system to produce and deliver it, and then discover that these plans will not achieve corporate and marketing objectives. This

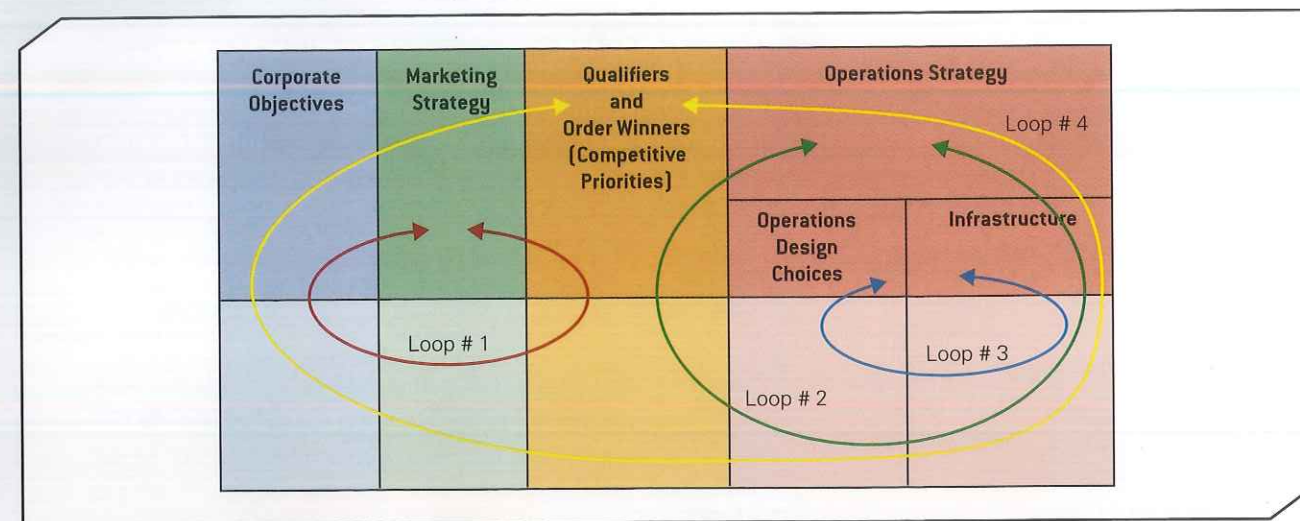
linkage is described by the four major decision loops illustrated in Exhibit 4.4. Decision loop #1 (shown in red) ties together corporate strategy—which establishes the organization’s direction and boundaries—and marketing strategy—which evaluates customer wants and needs and targets market segments.

The output of red loop #1 is the input for green loop #2. Decision loop #2 (green) describes how operations evaluates the implications of competitive priorities in terms of process choice and infrastructure. The key decisions are “Do we have the process capability to achieve the corporate and marketing objectives per target market segment? Are our processes capable of consistently achieving order-winner performance in each market segment?”

Infrastructure focuses on the nonprocess features and capabilities of the organization and includes the workforce, operating plans and control systems, quality control, organizational structure, compensation systems, learning and innovation systems, and support services.

Exhibit 4.4

Four Key Decision Loops in Terry Hill's Generic Strategy Framework



Decision loop #3 (blue) lies within the operations function of the organization and involves determining if process choice decisions and capabilities are consistent with infrastructure decisions and capabilities. The fourth decision loop (yellow loop #4) represents operations' input into the corporate and marketing strategy. Corporate decision makers ultimately decide how to allocate resources to achieve corporate objectives.

4-6a Operations Strategy at McDonald's

McDonald's Corporation is the world's leading food-service retailer, with sales of almost \$23 billion in more than 32,000 restaurants in 117 countries, employing 1.6 million people.¹² The company's vision provides the basis for its strategy:

McDonald's vision is to be the world's best quick-service restaurant experience. Being the best means providing outstanding quality, service, cleanliness, and value, so that we make every customer in every restaurant smile. To achieve our vision, we focus on three worldwide strategies:

1. Be the Best Employer

Be the best employer for our people in each community around the world.

2. Deliver Operational Excellence

Deliver operational excellence to our customers in each of our restaurants.

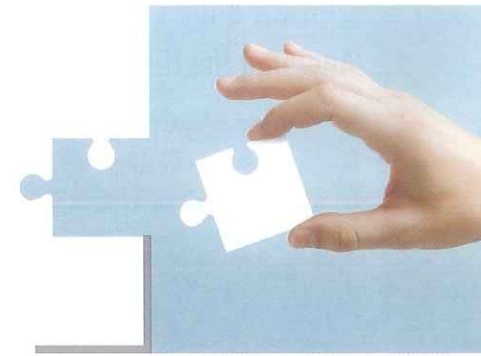
3. Achieve Enduring Profitable Growth

Achieve enduring profitable growth by expanding the brand and leveraging the strengths of the McDonald's system through innovation and technology.

McDonald's also defines its "Values in Action" policies, program, and practices, which is basically "doing the right thing." In its Corporate Responsibility Report, it defines the following four sustainability initiatives:

- *Build a sustainable McDonald's that involves all facets of our business.* For example, McDonald's is developing an environmental scorecard that drives greater awareness of resource use (energy, water, air emission, and waste), with the ultimate goal of reducing the environmental impact of its supply chains.
- *Commit to a three-pronged approach—reduce, reuse, and recycle.* For example, 82 percent of McDonald's packaging is made from renewable materials. In some global markets, McDonald's delivery trucks use their own reprocessed cooking oil for fuel.
- *Strive to provide eco-friendly workplaces and restaurants.* Better recycling efforts have diverted over 58 percent of waste normally targeted for a landfill to other recycling uses. Green facilities have been built in countries such as Brazil, Germany, and France.
- *Work with suppliers and outside experts to continuously improve purchasing decisions and evaluation of supplier performance regarding animal welfare.* Animal welfare scorecards and supplier audits in addition to better designs of animal-handling facilities are two examples of this initiative.

The ultimate objective of operational excellence is satisfied customers. Operational excellence includes the value chain, process, equipment, and job efficiencies, as well as superior people-related performance—all focused to support the service-encounter level.



McDonald's also actively participates in social media platforms to share information about its sustainability policies and initiatives.

What is the CBP that McDonald's offers? Exhibit 4.5 shows the CBP, in which goods and service content (food and fast service) are equally important to the primary mission, and are supported by peripheral goods and services.



Brand X Pictures/Jupiter Images

Exhibit 4.6 illustrates how Hill's strategy framework can be applied to McDonald's.

One corporate objective is profitable growth. The marketing strategy to support profitable growth consists of adding both company-owned and franchised McDonald's and Partner

Brand restaurants. McDonald's is committed to franchising as a key strategy to grow and leverage value chain capabilities. Over 75 percent of McDonald's restaurants worldwide are owned and operated by independent business-people—franchisees.

The core competency to profitable growth is maintaining low-cost and fast service. To support this strategy, McDonald's has many operational decisions to

make, such as: Does it adopt an assembly-line approach to process design? Does it standardize store design to make process flow, training, and performance evaluation consistent among stores? Does it standardize equipment and job design work activities? The french fryer equipment and procedure are a good example of standardizing equipment design. There is "only one way to make french fries" in 32,000 stores worldwide, and this contributes to consistent goods quality, fast service, and a standardized training program. Likewise, ordering by the numbers and digital printouts of customer orders in the drive-through improves order accuracy and speed of service. Of course, the entire human resource function is built around the needs of the McDonald's value chain and operating systems. McDonald's has been identified as one of the best places to work by *Fortune* and *The American Economic Review*. Examples of supportive infrastructure include good hiring criteria, recognition and reward programs, training, and promotion criteria.

A second corporate objective is *operational excellence*. The ultimate objective of operational excellence is satisfied customers. Operational excellence includes value chain, process, equipment, and job efficiencies, as well as superior people-related performance—all focused to support the service-encounter level.

Exhibit 4.5

McDonald's Customer Benefit Package

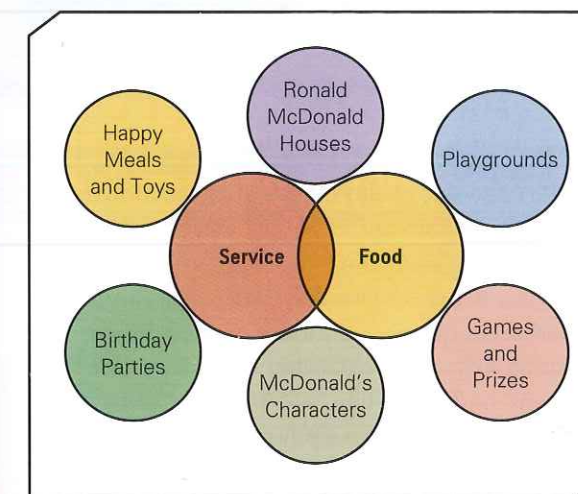


Exhibit 4.6

Applying the Hill's Strategy Development Framework to McDonald's

Corporate Objective Examples	Marketing Strategy Examples	How Do Goods and Services Quality and Win Orders in the Marketplace?	Operations Strategy	
			Operating Design Choice Examples	Infrastructure Examples
Profitable Growth	Add worldwide 1,000 McDonald's restaurants using company-owned and franchised stores	Competitive priorities tie the corporate and marketing strategies to the operational strategy	<ul style="list-style-type: none"> Flow shop process design Standardized store design Equipment design Job design Order-taking process Capacity and facility size, location, and clusters 	<ul style="list-style-type: none"> Hiring process and criteria First job training Recognition and rewards Training for the unexpected Keeping it simple Manager trainee program Coaching and counseling Teamwork e-mail capabilities
Operational Excellence	Ideal store location, best training and employee well-being programs	<ul style="list-style-type: none"> #1 Low prices #2 Quick service (delivery speed) #3 High service quality 	<ul style="list-style-type: none"> Global value chain coordination Suppliers Resource scheduling Inventory placement and control Distribution centers Standardized operational and job procedures 	<ul style="list-style-type: none"> Operating plans and control system(s) Shift management Supplier relations and negotiation Equipment maintenance Online network capability Distribution centers
Leverage Strengths through Innovation and Technology	Develop new food items, store and food mix Tie demand analysis to promotions	<ul style="list-style-type: none"> #4 High goods quality 	<ul style="list-style-type: none"> Store equipment technology Value chain information systems to tie stores, distribution centers, and suppliers together New food products 	<ul style="list-style-type: none"> Quality control Laboratory testing Organizational structure Compensation systems Online network capability
Diversity	Long-standing commitment to a diverse workforce	<ul style="list-style-type: none"> #5 Demand flexibility 	<ul style="list-style-type: none"> Training and franchising Process performance Career paths 	<ul style="list-style-type: none"> Learning and innovation systems Hamburger University
Sustainability	Values in Action policies and initiatives	<ul style="list-style-type: none"> #6 Brand image 	<ul style="list-style-type: none"> Greener supply chains Recycling processes Reduce energy use Animal welfare 	<ul style="list-style-type: none"> Greener buildings Ronald McDonald House Mobile health centers Youth camps

McDonald's strategy is to deliver exceptional customer experiences through a combination of great-tasting food, outstanding service, being a good place to work, profitable growth, and consistent value. McDonald's service goals also include extended or 24-hour service to make McDonald's the most convenient food-service choice for customers. To put sparkle in McDonald's service, initiatives include training for the unexpected and keeping it simple.

A third corporate objective is leveraging innovation and technology capabilities. In the United States, McDonald's has 40 distribution centers to support more

than 12,000 restaurants and about 350 suppliers. More than 2,000 safety and quality checks surround McDonald's food as it moves through its supply chains (from farms to restaurants). Information technology is used to coordinate the activities of McDonald's value chain.

Another corporate objective is developing and maintaining a diverse workforce. Diversity at McDonald's means understanding, recognizing, and valuing the differences that make each person unique. Hamburger University, located in Oak Brook, Illinois, has trained over 275,000 managers in 22 different languages and also manages 10 international training

centers in places such as Australia, England, Japan, and Germany.

McDonald's supports its social responsibility objective with over 200 Ronald McDonald House Charities. Social responsibility activities also include funding immunization programs for 1 million African children, Olympic youth camps, disaster relief, and sponsored mobile health centers in underserved areas. Other corporate objectives not shown in Exhibit 4.6 include a high return on investment, exploring nontraditional locations for stores, and commitment to the environment.

Competitive priorities are derived from McDonald's vision statement and strategy. The ranking in Exhibit 4.6 reflects their importance. The competitive priorities tie the corporate and marketing



AP Images/PRNewsFoto/McDonald's Corporation

strategies to the operations strategy. The competitive priorities provide direction on key operations-strategy issues listed in the last two columns of Exhibit 4.6.

Discussion Questions

1. Select a business with which you are familiar, and identify examples of customers using search, experience, and credence quality to evaluate the good or service. You might also look up the businesses on the Internet or visit the library.
2. Select a business with which you are familiar, and identify examples of order qualifiers and winners. You might also look up the businesses on the Internet or visit the library.
3. Explain the interlinking model of quality and profitability (Exhibit 4.2). How does it connect to

- business and operations strategy? Can you provide any examples of goods and services that support and add credibility to this model?
4. Is it possible for a world-class organization to achieve superiority in all five major competitive priorities—price (cost), quality, time, flexibility, and innovation? Explain your reasoning. Provide examples pro or con.
 5. Why is sustainability a strategy and not a competitive priority? Explain your reasoning.

Problems and Activities

1. Research and write a short paper (two pages maximum) about your cell phone provider. What are its mission, strategy, and competitive priorities? How is sustainability incorporated into its strategy, value chain, and operations?
 2. What might the competitive advantage be for each of the following companies?
 - a. eBay
 - b. Southwest Airlines

- c. Starbucks
 - d. Apple
 - e. Facebook
3. Choose an organization with which you are familiar that falls into *one* of the following categories:
 - sporting goods store
 - haircut salon
 - college bar or restaurant

- pizza business
- a sports team
- wireless telephone service

Define the firm's strategic mission, strategy, and competitive priorities. What are the order qualifiers and winners? What would operations have to be good at to make this a successful business or organization?

- Research and explain the logic behind the statement, "General Electric discovered that 75 percent of its manufacturing costs is determined by design."
- How does a package-delivery service such as UPS or FedEx use the competitive priority of "time" to its competitive advantage? Research, then explain and provide examples in a short paper (maximum of two typed pages).
- How does Walmart use the competitive priority of "cost" to its competitive advantage? Research, then explain and provide examples in a short paper (maximum of two typed pages).
- How does Procter & Gamble use the competitive priority of "quality" to its competitive advantage? Research, then explain and provide examples in a short paper (maximum of two typed pages).
- How does your cell phone provider use the competitive priority of "flexibility" to its competitive advantage? Research, then explain and provide examples in a short paper (maximum of two typed pages).
- How does General Electric use the competitive priority of "innovation" to its competitive advantage? Research, then explain and provide examples in a short paper (maximum of two typed pages).
- Explore the websites for several competing companies on the Fortune 500 list. Based on the information you find, on which competitive priorities do these firms appear to focus? What can you say about their operations strategies (either explicit or implied)? Report your findings in a short paper (maximum of two typed pages).
- Research and write a short paper on a company that has a clear strategy based on social and ethical sustainability.
- Apply Hill's strategy framework to one of the companies in question 2. This will require research to identify corporate objectives and competitive priorities. See the McDonald's example in the chapter for guidance, and make sure that you emphasize OM concepts, capabilities, and execution. Report your findings in a short paper (maximum of two typed pages).
- Identify two competing organizations (e.g., AT&T and Sprint, TaylorMade and Callaway golf club manufacturers, or Starbucks and McDonald's). Explain the differences in their missions, strategies, and competitive priorities, and how their operations strategies might differ. Use the Internet or business magazines to research the information you need. Report your findings in a short paper (maximum of two typed pages).
- Research Apple and define its strategic mission, vision, corporate strategy, competitive priorities, and operations strategy. What can you say about Apple's strategy and practices regarding sustainability? You might use the Internet or visit the library. Report your findings in a short paper (maximum of two typed pages).
- Using the information about Pal's Sudden Service provided in this chapter, apply Hill's generic strategy framework in a manner similar to the McDonald's example. How do the strategies of Pal's and McDonald's appear to differ? What differences exist in their operations strategies and decisions? Report your findings in a short paper (maximum of two typed pages).

Sustainable Lawn Care Case Study

"Chris, we make the highest-quality grass seed and fertilizer in the world. Our brands are known everywhere!" stated Caroline Ebelhar, the vice president of manufacturing for The Lawn Care Company. "Yeah! But the customer doesn't have a Ph.D. in organic chemistry to understand the difference between our grass seed and fertilizer compared to those of our competitors! We need to also be in the lawn-care application service business, and not just the manufacturer of super-perfect products," responded Chris Kilbourne, the vice president of marketing, as he walked out of Caroline's office. This ongoing debate among Lawn Care's senior management

team had not been resolved, but the chief executive officer, Mr. Steven Marion, had been listening very closely. Soon they would have to make a major strategic decision.

The Lawn Care Company, a fertilizer and grass seed manufacturer with sales of almost \$1 billion, sold some of its products directly to parks and golf courses. Customer service in this goods-producing company was historically very narrowly defined as providing "the right product to the right customer at the right time." Once these goods were delivered to the customer's premises and the customer signed the shipping documents, Lawn Care's job was done. For many park and golf course customers, a

local subcontractor or the customers themselves applied the fertilizer and seed. These application personnel often did the job incorrectly, using inappropriate equipment and methods. The relationship among these non-Lawn Care application service personnel, The Lawn Care Company, and the customer also was not always ideal.

When claims were made against The Lawn Care Company because of damaged lawns or polluted lakes and streams, the question then became one of who was at fault. Did the quality of the physical product or the way it was applied cause the damage? Either way, the customers' lawns or waterways were in poor shape, and in some cases, the golf courses lost substantial revenue if a green or hole was severely damaged or not playable. One claim filed by a green advocacy group focused on a fish kill in a stream near a golf course.

One of Lawn Care's competitors began an application service for parks and golf courses that routinely



The competitor bundled application service to the primary goods—fertilizer and grass seed.

Sport/Getty Images

applied the fertilizer and grass seed for its primary customers. This competitor bundled the application service to the primary goods, fertilizer and grass seed, and charged a higher price for this service. The competitor delivered and applied the fertilizer on the same day to avoid the liability of storing toxic fertilizer outside on the golf course or park grounds. The competitor learned

the application business in the parks and golf course target market segment and was beginning to explore expanding into the residential lawn-care application service target market. The Lawn Care Company sold the "highest-quality physical products" in the industry but it was not currently in either the professional park and golf course or the residential "application service" lawn-care market segments. The Lawn Care Company considered its value chain to end once it delivered its products to the job site or non-Lawn Care application service. The competitor sold the customer "a beautiful lawn with a promise of no hassles." To the competitor, this included an application service bundled to grass seed and fertilizer.

STUDY TOOLS 4

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- Key Term Flash Cards
- Practice Quizzes to prepare for tests
- "Beat the Clock" and "Quizbowl" to master concepts
- "Crossword Puzzle" to review key terms
- Spreadsheet Templates
- Videos of real-company OM examples

CASE QUESTIONS FOR DISCUSSION

- Define Lawn Care's current strategic mission, strategy, competitive priorities, value chain, and how it wins customers. What are the order qualifiers and winners? Draw the major stages in its value chain without an application service.
- What problems, if any, do you see with Lawn Care's current strategy, vision, customer benefit package and value chain design, and pre- and postservices?
- Redo questions (1) and (2) and provide a new or revised strategy and associated customer benefit package and value chain that is more appropriate for today's marketplace.
- What does operations have to be good at to successfully execute your revised strategy?
- What are your final recommendations?