GLOBAL EDITION

Strategic Management

A Competitive Advantage Approach, Concepts

SIXTEENTH EDITION

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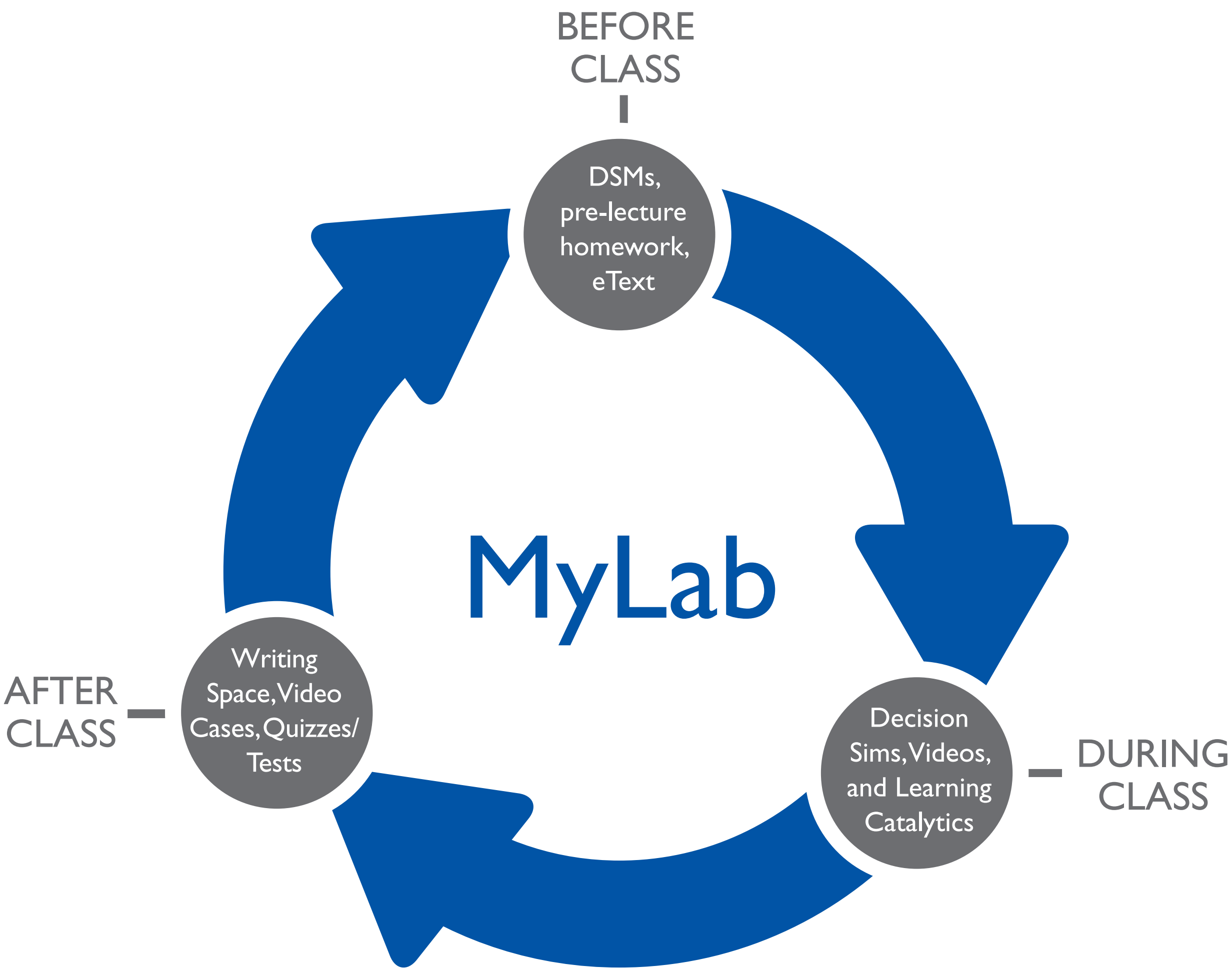

2. The number of suppliers is small and the number of competitors is large.
3. An organization competes in an industry that is growing rapidly; this is a factor because integrative-type strategies (forward, backward, and horizontal) reduce an organization's ability to diversify in a declining industry.
4. An organization has both capital and human resources to manage the new business of supplying its own raw materials.
5. The advantages of stable prices are particularly important; this is a factor because an organization can stabilize the cost of its raw materials and the associated price of its product(s) through backward integration.
6. Present suppliers have high profit margins, which suggest that the business of supplying products or services in a given industry is a worthwhile venture.
7. An organization needs to quickly acquire a needed resource.

Horizontal Integration

Seeking ownership of or control over a firm's competitors, horizontal integration is arguably the most common growth strategy. Thousands of mergers, acquisitions, and takeovers among competitors are consummated annually. Nearly all these transactions aim for increased economies of scale and enhanced transfer of resources and competencies. Kenneth Davidson makes the following observation about horizontal integration:

> The trend towards horizontal integration seems to reflect strategists' misgivings about their ability to operate many unrelated businesses. Mergers between direct competitors are more likely to create efficiencies than mergers between unrelated businesses, both because there is a greater potential for eliminating duplicate facilities and because the management of the acquiring firm is more likely to understand the business of the target.[6]

In the cigarette industry, Reynolds American recently acquired Lorillard for $25 billion. The merger combined Reynolds' Pall Mall and Camel brands (with 8.1 percent market share each in the United States) with Lorillard's Newport brand (with 12.2 market share) to combat industry leader Altria's Marlboro brand that commands 40.2 percent market share in the United States. As part of the transaction, to combat antitrust concerns, Reynolds CEO Susan Cameron said her company will divest Lorillard's Blu e-cigarette to Imperial Tobacco (another rival firm), while keeping and growing Reynolds' Vuse e-cigarette. Reynolds also divested its Kool, Winston, Salem, and Maverick brands to Imperial.

Both Dollar General and Dollar Tree recently competed for months to acquire Family Dollar. The winner, Dollar Tree, is reducing prices and converting Family Dollar stores into bright, clean, friendly places. Dollar Tree still sells more items for a dollar or less, whereas Family Dollar sells more branded merchandise. About 5,000 Dollar Tree stores and 8,300 Family Dollar stores now compete with industry leader Dollar General's 11,500 stores.

Charter Communications (CHTR) recently acquired (1) Time Warner Cable (TWC) for $55.33 billion and (2) Bright House Networks for $10.4 billion, creating a giant U.S. TV and Internet firm. The new Charter has nearly 24 million customers, below the leader Comcast's (CMCSK) 27.2 million customers. Comcast owns NBCUniversal. Charter also lags AT&T (T), whose recent merger with DirecTV (DTV) gave AT&T 26.4 million TV customers and 16.1 million fixed Internet customers, as well as tens of millions of wireless customers. Several major factors are spurring horizontal integration in the TV and Internet business, including that cable providers are rapidly losing TV subscribers, and pressure from online video services such as Netflix (NFLX), Hulu, and Amazon is increasing dramatically.

The following five guidelines indicate when horizontal integration may be an especially effective strategy:[7]

1. An organization can gain monopolistic characteristics in a particular area or region without being challenged by the federal government for "tending substantially" to reduce competition.
2. An organization competes in a growing industry.
3. Increased economies of scale provide major competitive advantages.
4. An organization has both the capital and human talent needed to successfully manage an expanded organization.

5. Competitors are faltering as a result of a lack of managerial expertise or a need for particular resources that an organization possesses; note that horizontal integration would not be appropriate if competitors are doing poorly because in that case overall industry sales are declining.

Intensive Strategies

Market penetration, market development, and product development are sometimes referred to as **intensive strategies** because they require intensive efforts if a firm's competitive position with existing products is to improve.

Market Penetration

A **market penetration** strategy seeks to increase market share for present products or services in present markets through greater marketing efforts. This strategy is widely used alone and in combination with other strategies. Market penetration includes increasing the number of salespersons, increasing advertising expenditures, offering extensive sales promotion items, or increasing publicity efforts. For example, Anheuser annually purchases several $4.5+ million, 30-second advertising slots during the Super Bowl.

Tiffany & Co. recently began using same-sex couples in advertising, preceded by J. Crew casting one of its designers and his boyfriend in a catalogue. Gap uses a handsome couple in a billboard, and Jeremiah Brent and Nate Berkus appear in a Banana Republic advertising campaign.

The following five guidelines indicate when market penetration may be an especially effective strategy:[8]

1. Current markets are not saturated with a particular product or service.
2. The usage rate of present customers could be increased significantly.
3. The market shares of major competitors have been declining while total industry sales have been increasing.
4. The correlation between dollar sales and dollar marketing expenditures historically has been high.
5. Increased economies of scale provide major competitive advantages.

Market Development

Market development involves introducing present products or services into new geographic areas. For example, Whirlpool recently acquired Indesit, an Italian company that sells appliances, in order to double Whirlpool's size in Europe, where the company has struggled to compete against Electrolux AB of Sweden, LG Electronics Inc. of South Korea, and Haier Group of China. Indesit had 13 percent of the major appliance market share in eastern Europe and Whirlpool had 5 percent, so now 18 percent of the major appliances sold in eastern Europe are Whirlpool. In western Europe, the Indesit acquisition gave Whirlpool a 17 percent market share behind the leader, BSH Bosch & Siemens Hausgerate GmbH's 20 percent.

The largest online video-streaming company, Netflix, recently launched it services into France, Germany, Belgium, and Switzerland, as well as eastern and southern Europe, and expects to be a global service provider by 2018. Netflix's major rival in Europe is Vivendi SA's pay-TV unit Canal Plus that offers Netflix-like services through its Canal Play services.

These six guidelines indicate when market development may be an especially effective strategy:[9]

1. New channels of distribution are available that are reliable, inexpensive, and of good quality.
2. An organization is successful at what it does.
3. New untapped or unsaturated markets exist.
4. An organization has the needed capital and human resources to manage expanded operations.
5. An organization has excess production capacity.
6. An organization's basic industry is rapidly becoming global in scope.

Product Development

Product development is a strategy that seeks increased sales by improving or modifying present products or services. Product development usually entails large research and development expenditures. Walt Disney Company recently developed a Disney Baby line of products and services that it expects to become a powerful baby brand for customers ages 0 to 2. Bob Chapek, president of Disney Consumer Products, stated, "This gives Disney the opportunity to reach out to moms when magical moments begin; there is no more special occasion than the birth of a baby."

The action camera company, GoPro, recently unveiled new high- and low-end cameras. GoPro is the leading producer of wearable and durable high-definition video cameras used by outdoor enthusiasts such as scuba divers and surfers. Based in San Mateo, California, GoPro's rival firms include Sony, Canon, Garmin, and Polaroid, but GoPro is doing great by selling products in more than 100 countries and through more than 25,000 retail outlets.

The new Apple Watch is actually a wrist-top computer, and now competes with various Android-powered devices from Motorola and Samsung Electronics. "Wearable computers" are good for the people to monitor their healthiness among countless other things. The firm Sensoria is making smart garments, including smart socks, which yes, are washable. Opportunities for product development strategies are endless, given rapid technological changes occurring daily.

These following five guidelines indicate when product development may be an especially effective strategy to pursue:[10]

1. An organization has successful products that are in the maturity stage of the product life cycle; the idea here is to attract satisfied customers to try new (improved) products as a result of their positive experience with the organization's present products or services.
2. An organization competes in an industry that is characterized by rapid technological developments.
3. Major competitors offer better-quality products at comparable prices.
4. An organization competes in a high-growth industry.
5. An organization has especially strong research and development capabilities.

Diversification Strategies

The two general types of **diversification strategies** are **related diversification** and **unrelated diversification**. Businesses are said to be *related* when their value chains possess competitively valuable cross-business strategic fits; businesses are said to be *unrelated* when their value chains are so dissimilar that no competitively valuable cross-business relationships exist.[11] Most companies favor related diversification strategies to capitalize on synergies as follows:

- Transferring competitively valuable expertise, technological know-how, or other capabilities from one business to another
- Combining the related activities of separate businesses into a single operation to achieve lower costs
- Exploiting common use of a well-known brand name
- Cross-business collaboration to create competitively valuable resource strengths and capabilities[12]

Diversification strategies are becoming less popular because organizations are finding it more difficult to manage diverse business activities. In the 1960s and 1970s, the trend was to diversify to avoid being dependent on any single industry, but the 1980s saw a general reversal of that thinking. Diversification is still on the retreat. Michael Porter, of the Harvard Business School, commented, "Management found it couldn't manage the beast." Businesses are still selling, closing, or spinning off less profitable or "different" divisions to focus on their core businesses. For example, ITT recently divided itself into three separate, specialized companies. At one time, ITT owned everything from Sheraton hotels and Hartford Insurance to the maker of Wonder Bread and Hostess Twinkies. About the ITT breakup, analyst Barry Knap said, "Companies generally are not very efficient diversifiers; investors usually can do a better job of that by purchasing stock in a variety of companies." Rapidly appearing new technologies, new products, and fast-shifting buyer preferences make diversification difficult.

Diversification must do more than simply spread business risks across different industries; after all, shareholders could accomplish this by simply purchasing equity in different firms across different industries or by investing in mutual funds. Diversification makes sense only to the extent that the strategy adds more to shareholder value than what shareholders could accomplish acting individually. Any industry chosen for diversification must be attractive enough to yield consistently high returns on investment and offer potential across the operating divisions for synergies greater than those entities could achieve alone. Many strategists contend that firms should "stick to the knitting" and not stray too far from the firms' basic areas of competence.

A few companies today, however, pride themselves on being conglomerates, from small firms such as Pentair Inc. and Blount International to huge companies such as Textron, Berkshire Hathaway, Allied Signal, Emerson Electric, GE, Viacom, Amazon, Google, Disney, and Samsung. Conglomerates prove that focus and diversity are not always mutually exclusive. In an unattractive industry, for example, diversification makes sense, such as for Philip Morris, because cigarette consumption is declining, product liability suits are a risk, and some investors reject tobacco stocks on principle.

Related Diversification

Alcoa recently diversified further into the jet-engine parts industry by acquiring Firth Rixson Ltd. for nearly $3 billion. The move away from total reliance on aluminum puts Alcoa in position to become a major player in the aerospace jet-engine market. Jet engines utilize a lot of aluminum but still this strategy is best classified as related diversification rather than forward integration due to the new high-tech competencies required.

With its new Apply Pay product being linked with iBeacon so stores can detect and locate iPhone users via a Bluetooth wireless signal as they enter the premises, Apple recently entered the online payments business, competing directly with PayPal. Using their iPhone and/or Apple Watch, consumers can now make retail purchases by tapping their device at participating checkout registers. Apple is basically diversifying into the banking business with these new products, but the threat to PayPal in particular is spurring eBay and Google to cooperate in this arena.

The guidelines for when related diversification may be an effective strategy are as follows.[13]

1. An organization competes in a no-growth or a slow-growth industry.
2. Adding new, but related, products would significantly enhance the sales of current products.
3. New, but related, products could be offered at highly competitive prices.
4. New, but related, products have seasonal sales levels that counterbalance an organization's existing peaks and valleys.
5. An organization's products are currently in the declining stage of the product's life cycle.
6. An organization has a strong management team.

Unrelated Diversification

Privately held Mars Inc., best known for its M&M chocolates and its Mars and Snickers candy bars, recently became the world's largest pet-food company, purchasing 80 percent of Procter & Gamble's pet-food brands for $2.9 billion, to go with its own Whiskas, Pedigree, and Royal Canin pet brands. Mars has over 25 percent market share in the global pet-food industry, slightly ahead of Nestlé S.A., which owns Purina and Friskies.

Google now offers an electric-powered driverless car that has no steering wheel, brake, or gas pedal; rather, the car is equipped with buttons for go and stop, and travels at a top speed of 25 mph. Further diversifying, Google recently acquired Skybox Imaging to collect and provide data from the sky using satellites that collect daily photos and video of the Earth. With the acquisition, Google is also trying to cover the globe with fast Internet access from the sky, using balloons, drones, and satellites.

Honda Motor Company diversified in 2015 by developing, producing, and marketing its first business jet, named the HondaJet HA-420 that has a range of 1,180 miles and a top speed of 420 knots, and can carry seven passengers. This new product competes directly with the Cessna Citation M2 and Embraer Phenom 100E business jets. These business jets sell for about $4.5 million each.

An unrelated diversification strategy favors capitalizing on a portfolio of businesses that are capable of delivering excellent financial performance in their respective industries, rather than striving to capitalize on value chain strategic fits among the businesses. Firms that employ unrelated diversification continually search across different industries for companies that can be acquired for a deal and yet have potential to provide a high return on investment. Pursuing unrelated diversification entails being on the hunt to acquire companies whose assets are undervalued, companies that are financially distressed, or companies that have high-growth prospects but are short on investment capital.

Given below are 10 guidelines when unrelated diversification may be an especially effective strategy.[14]

1. Revenues derived from an organization's current products or services would increase significantly by adding the new, unrelated products.
2. An organization competes in a highly competitive or a no-growth industry, as indicated by low industry profit margins and returns.
3. An organization's present channels of distribution can be used to market the new products to current customers.
4. New products have countercyclical sales patterns compared to an organization's present products.
5. An organization's basic industry is experiencing declining annual sales and profits.
6. An organization has the capital and managerial talent needed to compete successfully in a new industry.
7. An organization has the opportunity to purchase an unrelated business that is an attractive investment opportunity.
8. Financial synergy exists between the acquired and acquiring firm. (Note that a key difference between related and unrelated diversification is that the former should be based on some commonality in markets, products, or technology, whereas the latter is based more on profit considerations.)
9. Existing markets for an organization's present products are saturated.
10. Antitrust action could be charged against an organization that historically has concentrated on a single industry.

Defensive Strategies

In addition to integrative, intensive, and diversification strategies, organizations also could pursue defensive strategies such as retrenchment, divestiture, or liquidation.

Retrenchment

Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a *turnaround* or *reorganizational strategy*, retrenchment is designed to fortify an organization's basic distinctive competence. During retrenchment, strategists work with limited resources and face pressure from shareholders, employees, and the media. Retrenchment can involve selling off land and buildings to raise needed cash, pruning product lines, closing marginal businesses, closing obsolete factories, automating processes, reducing the number of employees, and instituting expense control systems.

Levi Strauss & Co. recently cut 20 percent of its nonretail and nonmanufacturing workforce as part of a retrenchment strategy aimed at streamlining the firm's operations and generating cost savings of nearly $200 million per year. The 160-year-old company headquartered in San Francisco is having trouble competing in the intensely competitive retail clothing industry, marked by fleeting fashions and "sale only" shoppers.

Cisco Systems recently removed 6,000 employees from its payrolls, comprising 8 percent of the company's total workforce. The routing and switching system company is experiencing declining revenue and profits. The Turner Broadcasting division of Time Warner recently deleted 1,475 jobs, or 10 percent of its workforce. The Turner division generates about half of Time Warner's operating profit and has more than 5,000 full-time employees in its home city of Atlanta. Staples closed 170 stores in North America in 2014, and closed another 55 stores in 2015.

In some cases, declaring **bankruptcy** can be an effective retrenchment strategy. Bankruptcy can allow a firm to avoid major debt obligations and to void union contracts. There are five major types of bankruptcy: Chapter 10, Chapter 11, Chapter 2, Chapter 12, and Chapter 13. The first type, *Chapter 10 bankruptcy*, is a liquidation procedure used only when a corporation sees no hope of being able to operate successfully or to obtain the necessary creditor agreement. All the organization's assets are sold in parts for their tangible worth. Several hundred thousand companies declare Chapter 10 bankruptcy annually.

Chapter 11 bankruptcy applies to municipalities. Detroit, Michigan, is the largest U.S. city to declare bankruptcy, but others include Stockton, California, and Birmingham, Alabama.

Chapter 2 bankruptcy allows organizations to reorganize and come back after filing a petition for protection. Quiznos recently filed Chapter 2 bankruptcy as its 2,100 stores simply cannot compete with rival Subway's 41,000 stores. Quiznos collects a 7 percent royalty fee and another 4 percent advertising from is disgruntled franchisees, compared to the industry average 6 percent royalty fee and 2 percent marketing fee. The average Quiznos store has about $300,000 in annual revenue, down from $425,000 a few years ago.

Also, Sbarro recently filed Chapter 2 bankruptcy for a second time in less than three years. The pizza chain blamed its recent financial troubles on "an unprecedented decline in mall traffic." Based in Melville, New York, Sbarro is a privately held firm with about 800 stores in more than 40 countries.

An artificial-sapphire producer for Apple, GT Advanced Technologies, recently filed for bankruptcy, soon after Apple decided to go with glass screens rather than sapphire. GT's stock price dropped 93 percent the same day the bankruptcy news released. By using sapphire, Apple was hoping for a more scratch- and shatter-resistant cover for its smartphones, but decided instead to use hardened glass.

Chapter 12 bankruptcy was created by the Family Farmer Bankruptcy Act of 1986. This law provides special relief to family farmers with debt equal to or less than $1.5 million.

Chapter 13 bankruptcy is a reorganization plan similar to Chapter 2, but it is available only to small businesses owned by individuals with unsecured debts of less than $100,000 and secured debts of less than $350,000. The Chapter 13 debtor is allowed to operate the business while a plan is being developed to provide for the successful operation of the business in the future.

Five guidelines for when retrenchment may be an especially effective strategy to pursue are as follows:[15]

1. An organization has a clearly distinctive competence but has failed consistently to meet its objectives and goals over time.
2. An organization is one of the weaker competitors in a given industry.
3. An organization is plagued by inefficiency, low profitability, poor employee morale, and pressure from stockholders to improve performance.
4. An organization has failed to capitalize on external opportunities, minimize external threats, take advantage of internal strengths, and overcome internal weaknesses over time; that is, when the organization's strategic managers have failed (and possibly will be replaced by more competent individuals).
5. An organization has grown so large so quickly that major internal reorganization is needed.

Divestiture

Selling a division or part of an organization is called **divestiture**. It is often used to raise capital for further strategic acquisitions or investments. Divestiture can be part of an overall retrenchment strategy to rid an organization of businesses that are unprofitable, that require too much capital, or that do not fit well with the firm's other activities. Divestiture has also become a popular strategy for firms to focus on their core businesses and become less diversified.

The largest consumer-products company in the world, Procter & Gamble (P&G), is in the process of divesting (selling) more than half of its brands (nearly 100) in order to focus on its core brands (about 80). With brands such as Pampers, Tide, Era, Cheer, Metamucil, Clairol, Wella, Oral-B, Duracell, Fixodent, Ivory, and Clearblue (pregnancy tests), P&G has 23 brands that have more than $1 billion annual sales each. Ivory might be divested, as Americans have increasingly opted for body washes and liquid hand soap over plain bar soaps.