GLOBAL EDITION

Strategic Management and Business Policy

Globalization, Innovation, and Sustainability

SIXTEENTH EDITION

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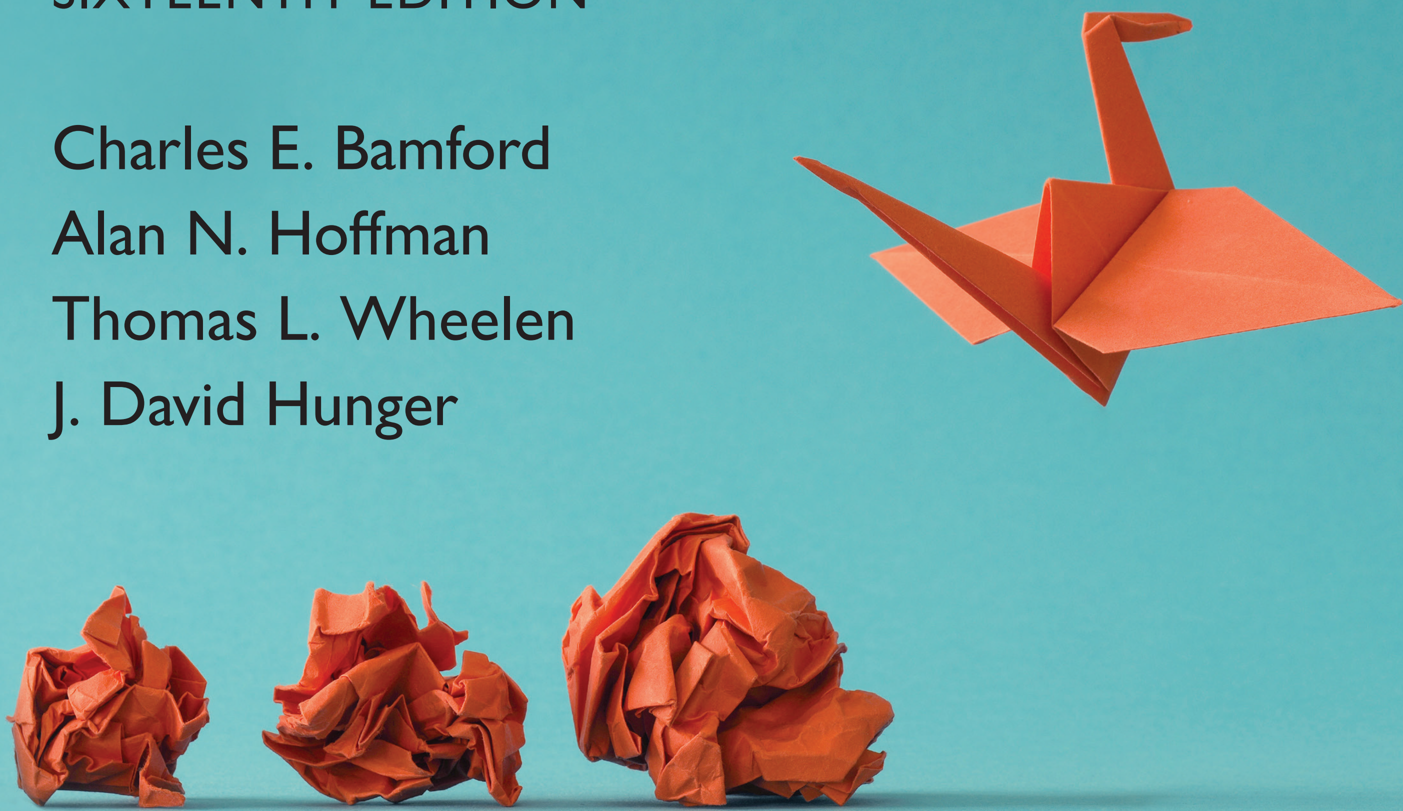

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INNOVATION issue

TO RED HAT OR NOT?

By 2010, many established organizations including IBM, Hewlett-Packard, Oracle, and Intel were looking closely at acquiring a business that had grown to a US$1 billion business in a niche area of the industry. Red Hat was a business founded on supporting what amounts to a free software system called Linux.

The precursor to the Internet was born in 1968, and in 1969 a researcher at Bell Labs created UNIX as an open-source operating system. Being open sourced meant that anyone who wanted to volunteer their time could add to the capability of the software. Fast forward to 1995 and a new company called Red Hat was born as an accessory, books, and magazine company focused on what had then become known as Linux—the latest version of Unix.

Red Hat, based in the Raleigh-Durham area of North Carolina, released its own version of Linux in 1995 and promised to support companies who used that version. It was still freeware, but now it had a company of engineers to support it at that particular point in time. This became the core of the business. The company would freeze Linux periodically and then support that "version" for a 10-year period of time. This gave corporate managers the confidence to use Linux as their operating system.

The company experienced phenomenal growth by focusing on Data Centers and supporting each version with more than 150 engineers. Red Hat charged a substantial premium to its customers who pay a subscription fee for Red Hat support.

With the winds of a potential acquisition behind it, the company's share price surged 66% between 2010 and 2012. Red Hat was the only company that had found a business model that made substantial profits using open-sourced software. Red Hat revenues hit US$2.9 billion in 2018 when IBM made an offer to acquire the company. At that point IBM had no viable plan for growth. The company sales had been flat for years. They tried many of the retrenchment moves we talk about in this chapter. They spent US$100 billion buying back stock to bolster the price but needed acquisitions to grow.

It came at a substantial cost. IBM paid a 62% premium on the stock, culminating in a deal that would cost them US$34 billion. IBM claimed that Red Hat would continue to operate as a separate division of the organization. Then, three months after the acquisition closed, IBM named Red Hat CEO Jim Whitehurst, President of IBM. Most people assumed he would become the next CEO of IBM. Cloud revenue for IBM soared to over US$25 billion in 2020, which was a 20% growth year-over-year. The Red Hat portion at IBM had revenue growth of over 18%. The two companies are polar opposites; the IBM group focuses on bundling consultancies, services, and hardware and the Red Hat group has an employee-empowered, open organization with open-source software as its revenue driver. Whitehurst was passed over for the CEO role in late 2021 and planned to leave the company. It will be interesting to see if IBM can capitalize on this innovative company they have acquired.[78]

has a great deal of power in this relationship. If there is a good fit between the parent's skills and resources and the needs and opportunities of the business units, the corporation is likely to create value. If, however, there is not a good fit, the corporation is likely to destroy value.[79] Research indicates that companies that have a good fit between their strategy and their parenting roles are better performers than those companies that do not have a good fit.[80] This approach to corporate strategy is useful not only in deciding what new businesses to acquire but also in choosing how each existing business unit should be best managed. This appears to have been one of the key elements to the success of General Electric during the twenty years that Jack Welch was CEO.

The primary job of corporate headquarters is, therefore, to obtain synergy among the business units by providing needed resources to units, transferring skills and capabilities among the units, and coordinating the activities of shared unit functions to attain economies of scope (as in centralized purchasing).[81] This is in agreement with the concept of the learning organization discussed in **Chapter 1** in which the role of a large firm is to facilitate and transfer the knowledge assets and services throughout the corporation.[82] This is especially important given that 75% or more of a modern company's market value stems from its intangible assets—the organization's knowledge and capabilities.[83]

At Proctor & Gamble, for example, the various business units are expected to work together to develop innovative products. Proctor & Gamble, with products such as Crest White strips, controlled a commanding 35% of the at-home tooth-whitening market in 2022. The products were based on the P&G laundry division's knowledge of whitening agents.[84]

DEVELOPING A CORPORATE PARENTING STRATEGY

The search for appropriate corporate strategy involves three analytical steps:

1. **Examine each business unit (or target firm in the case of acquisition) in terms of its strategic factors:** People in the business units probably identified the strategic factors when they were generating business strategies for their units. One popular approach is to establish centers of excellence throughout the corporation. A **center of excellence** is "an organizational unit that embodies a set of capabilities that has been explicitly recognized by the firm as an important source of value creation, with the intention that these capabilities be leveraged by and/or disseminated to other parts of the firm."[85]
2. **Examine each business unit (or target firm) in terms of areas in which performance can be improved:** These are considered to be parenting opportunities. Two business units might be able to gain economies of scope by combining their sales forces. In another instance, a unit may have good, but not great, manufacturing and logistics skills. A parent company having world-class expertise in these areas could improve that unit's performance. The corporate parent could also transfer some people from one business unit who have the desired skills to another unit that needs those skills. People at corporate headquarters may, because of their experience in many industries, spot areas where improvements are possible that even people in the business unit may not have noticed. Unless specific areas are significantly weaker than the competition, people in the business units may not even be aware that these areas could be improved, especially if each business unit monitors only its own particular industry.
3. **Analyze how well the parent corporation fits with the business unit (or target firm):** Corporate headquarters must be aware of its own strengths and weaknesses in terms of resources, skills, and capabilities. To do this, the corporate parent must ask whether it has the characteristics that fit the parenting opportunities in each business unit. It must also ask whether there is a misfit between the parent's characteristics and the critical success factors of each business unit.

HORIZONTAL STRATEGY AND MULTIPOINT COMPETITION

A **horizontal strategy** is a corporate strategy that cuts across business unit boundaries to build synergy between business units and to improve the competitive position of one or more business units.[86] When used to build synergy, it acts like a parenting strategy. When used to improve the competitive position of one or more business units, it can be thought of as a corporate competitive strategy. In **multipoint competition**, large Multibusiness corporations compete against other large Multibusiness firms in a number of markets. These multipoint competitors are firms that compete with each other not only in one business unit, but also in a number of business units. At one time or another, a cash-rich competitor may choose to build its own market share in a particular market to the disadvantage of another corporation's business unit. Although each business unit has primary responsibility for its own business strategy, it may sometimes need some help from its corporate parent, especially if the competitor business unit is getting heavy financial support from its corporate parent. In this instance, corporate headquarters develops a horizontal strategy to coordinate the various goals and strategies of related business units.

P&G, Kimberly-Clark, Scott Paper, and Johnson & Johnson (J&J) compete with one another in varying combinations of consumer paper products, from disposable diapers to facial tissue. If (purely hypothetically) J&J had just developed a toilet tissue with which it chose to challenge Procter & Gamble's high–market share Charmin brand in a particular district, it might charge a low price for its new brand to build sales quickly. P&G might not choose to respond to this attack on its share by cutting prices on Charmin. Because of Charmin's high market share, P&G would lose significantly more sales dollars in a price war than J&J would with its initially low-share brand. To retaliate, P&G might challenge J&J's high-share baby shampoo with P&G's own low-share brand of baby shampoo in a different district. Once J&J had perceived P&G's response, it might choose to stop challenging Charmin so that P&G would stop challenging J&J's baby shampoo.

Multipoint competition and the resulting use of horizontal strategy may actually slow the development of hypercompetition in an industry. The realization that an attack on a market leader's position could result in a response in another market leads to mutual forbearance in which managers behave more conservatively toward multimarket rivals and competitive rivalry is reduced.[87] There are examples of multipoint competition that have resulted in firms being less likely to exit a market. "Live and let live" replaced strong competitive rivalry.[88]

Multipoint competition is likely to become even more prevalent in the future, as corporations become global competitors and expand into more markets through strategic alliances.[89]

End of Chapter SUMMARY

Corporate strategy is primarily about the choice of direction for the firm as a whole. It deals with three key issues that a corporation faces: (1) the firm's overall orientation toward growth, stability, or retrenchment; (2) the industries or markets in which the firm competes through its products and business units; and (3) the manner in which management coordinates activities and transfers resources and cultivates capabilities among product lines and business units. These issues are dealt with through directional strategy, portfolio analysis, and corporate parenting.

Managers must constantly examine their corporation's entire portfolio of products, businesses, and opportunities as if they were planning to reinvest all of its capital.[90]

KEY TERMS

acquisition (p. 226)
backward integration (p. 227)
bankruptcy (p. 235)
BCG (Boston Consulting Group) Growth-Share Matrix (p. 237)
captive company strategy (p. 235)
cash cows (p. 238)
center of excellence (p. 243)
concentration (p. 226)
concentric diversification (p. 230)
conglomerate diversification (p. 231)
corporate parenting (p. 241)
corporate strategy (p. 224)
directional strategy (p. 224)
diversification (p. 226)
divestment (p. 235)
dogs (p. 238)
forward integration (p. 227)
full integration (p. 227)
growth strategies (p. 225)
horizontal growth (p. 229)
horizontal integration (p. 229)
horizontal strategy (p. 243)
liquidation (p. 236)
long-term contracts (p. 228)
merger (p. 225)
multipoint competition (p. 243)
no-change strategy (p. 233)
parenting strategy (p. 224)
pause/proceed-with-caution strategy (p. 232)
portfolio analysis (p. 224)
profit strategy (p. 233)

quasi-integration (p. 228)
question marks (p. 237)
retrenchment strategies (p. 225)
sell-out strategy (p. 235)
SPAC (p. 232)
stability strategies (p. 225)
stars (p. 238)
taper integration (p. 227)
transaction cost economics (p. 227)
turnaround strategy (p. 234)
vertical growth (p. 226)
vertical integration (p. 226)

DISCUSSION QUESTIONS

7-1. List the means available to a company for horizontal growth and explain why a company might pursue one over another.

7-2. Evaluate the types of retrenchment strategies that might be used by companies in stagnant industries.

7-3. How is a diversification strategy related to the sustainable growth and development of an organization?

7-4. What are the major factors that an organization needs to analyze before it can consider entering a foreign market?

7-5. Is stability really a strategy or just a term for no strategy?

7-6. How is corporate parenting different from portfolio analysis? How is it alike? Is it a useful concept in a global industry?

STRATEGIC PRACTICE EXERCISE

7-7. Form into small groups in the class to discuss the future of electronic publishing.

7-8. Consider the following questions as discussion guides:

- What are the pros and cons of electronic publishing?
- What is the impact of electronic publishing on the environment?
- Should newspaper and book publishers completely convert to electronic publishing over paper? (*The New York Times* and *The Wall Street Journal* publish in both paper and electronic formats. Why have they been successful when so many others have not been able to make money with this approach?)
- Would you prefer this textbook and others in an electronic format? What prevents you from making this move?
- What business model should publishers use to make money by publishing electronically?

7-9. Present your group's conclusions to the class.

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