Arab World Edition

Strategic Management
Concepts and Cases

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Strategic Management

CONCEPTS AND CASES

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5. When buyers incur low costs in switching their purchases from one seller to another
6. When buyers are large and have significant power to bargain down prices
7. When industry newcomers use introductory low prices to attract buyers and build a customer base.

A successful cost leadership strategy usually permeates the entire firm, as evidenced by high-efficiency, low-overhead, limited perks, intolerance of waste, intensive screening of budget requests, wide spans of control, rewards linked to cost containment, and broad employee participation in cost-control efforts. Some risks of pursuing cost leadership are that competitors may imitate the strategy, thus driving overall industry profits down; that technological breakthroughs in the industry may make the strategy ineffective; or that buyer interest may swing to other differentiating features besides price. Examples of firms that are well known for their low-cost leadership strategies are SABIC, franchisees of McDonald's in the GCC area, Al Haramain perfumes, and the Reda Group.

Differentiation Strategies (Type 3)

Different strategies offer different degrees of differentiation. Differentiation does not guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible. Durable products protected by barriers to quick copying by competitors are best. Successful differentiation can mean greater product flexibility, greater compatibility, lower costs, improved service, less maintenance, greater convenience, or more features. Product development is an example of a strategy that offers the advantages of differentiation.

A differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product that features the desired attributes. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty because consumers may become strongly attached to the differentiation features. Special features that differentiate one's product can include superior service, availability of spare parts, engineering design, product performance, useful life, or ease of use.

A risk of pursuing a differentiation strategy is that the unique product may not be valued highly enough by customers to justify the higher price. When this happens, a cost leadership strategy easily will defeat a differentiation strategy. Another risk of pursuing a differentiation strategy is that competitors may quickly develop ways to copy the differentiating features. Firms thus must find durable sources of uniqueness that cannot be imitated quickly or cheaply by rival firms.

Common organizational requirements for a successful differentiation strategy include strong coordination among the R&D and marketing functions and substantial amenities to attract scientists and creative people. Firms can pursue a differentiation (Type 3) strategy based on many different competitive aspects. For example, the Emirates Palace in Abu Dhabi, UAE, offers a unique experience and excellent service, Alshaya stores carry global brand names and have a wider choice of goods, and Etisalat offers its customers comprehensive IT services and has convenient distribution locations across UAE.

The most effective differentiation bases are those that are hard or expensive for rivals to duplicate. Competitors are continually trying to imitate, duplicate, and outperform rivals along any differentiation variable that has yielded competitive advantage. For example, in the United States, when U.S. Airways cut its prices, Delta quickly followed suit. When Caterpillar instituted its quick-delivery-of-spare-parts policy, John Deere soon followed suit. To the extent that differentiating attributes are tough for rivals to copy, a differentiation strategy will be especially effective, but the sources of uniqueness must be time-consuming, cost prohibitive, and simply too burdensome for rivals to match. A firm, therefore, must be careful when employing a differentiation (Type 3) strategy. Buyers will not pay the higher differentiation price unless their perceived value exceeds the price they are paying.[30] Based upon such matters as attractive packaging, extensive advertising, quality of sales presentations, quality of website, list of customers, professionalism, size of the firm, and/or profitability of the company, perceived value may be more important to customers than actual value.

A Type 3 differentiation strategy can be especially effective under the following conditions:[31]

1. When there are many ways to differentiate the product or service and many buyers perceive these differences as having value
2. When buyer needs and uses are diverse
3. When few rival firms are following a similar differentiation approach
4. When technological change is fast paced and competition revolves around rapidly evolving product features.

Focus Strategies (Type 4 and Type 5)

A successful focus strategy depends on an industry segment that is of sufficient size, has good growth potential, and is not crucial to the success of other major competitors. Strategies such as market penetration and market development offer substantial focusing advantages. Midsize and large firms can effectively pursue focus-based strategies only in conjunction with differentiation or cost leadership-based strategies. All firms in essence follow a differentiated strategy. Because only one firm can differentiate itself with the lowest cost, the remaining firms in the industry must find other ways to differentiate their products.

Focus strategies are most effective when consumers have distinctive preferences or requirements and when rival firms are not attempting to specialize in the same target segment. Starbucks, one of the world's leading coffeehouse chains, is pursuing a focus strategy. Based in Seattle, Starbucks in the Arab world entered into licensing arrangements with the Alshaya Group, recognized as one of the leading and most influential retailing franchisees in the region and operating more than 300 Starbucks stores in the region. Starbucks utilizes its arrangement with Alshaya to have access to premium locations in malls and airports, etc.

In contrast to Royal Jordanian Airlines, which utilizes cost leadership, Qatar Airlines employs a differentiation strategy by focusing on quality service and a relaxing atmosphere. It is a five-star airline and has one of the best fleets in the world. This fact gives it an advantage for serving travelers who are willing to pay extra money for a comfortable journey and first-rate services. Al Arabia Airline, with its slogan "Pay less. Fly more," is the first and only low-fare airline in the Arab world. It serves a special niche and limited markets.

Pharmamed (Lebanon), a pharmaceutical sales company, prides itself on offering a unique mix of specialized pharmaceutical knowledge, strong client and vendor relationships, and providing first-rate customer service. The company, in its quest to avoid competition, focuses on markets that are mostly ignored by major distributors. It was one of the first companies to get generic medications and, particularly, generic anti-cancer medications into Lebanon, and specializes in chemotherapy, cardiology, neurology, and anesthesiology.

Risks of pursuing a focus strategy include the possibility that numerous competitors will recognize the successful focus strategy and copy it or that consumer preferences will drift toward the product attributes desired by the market as a whole. An organization using a focus strategy may concentrate on a particular group of customers, geographic markets, or product-line segments to serve a well-defined but narrow market better than competitors who serve a broader market.

A low-cost (Type 4) or best-value (Type 5) focus strategy can be especially attractive under the following conditions:[32]

1. When the target market niche is large, profitable, and growing
2. When industry leaders do not consider the niche to be crucial to their own success
3. When industry leaders consider it too costly or difficult to meet the specialized needs of the target market niche while taking care of their mainstream customers
4. When the industry has many different niches and segments, thereby allowing a focuser to pick a competitively attractive niche suited to its own resources
5. When few, if any, other rivals are attempting to specialize in the same target segment.

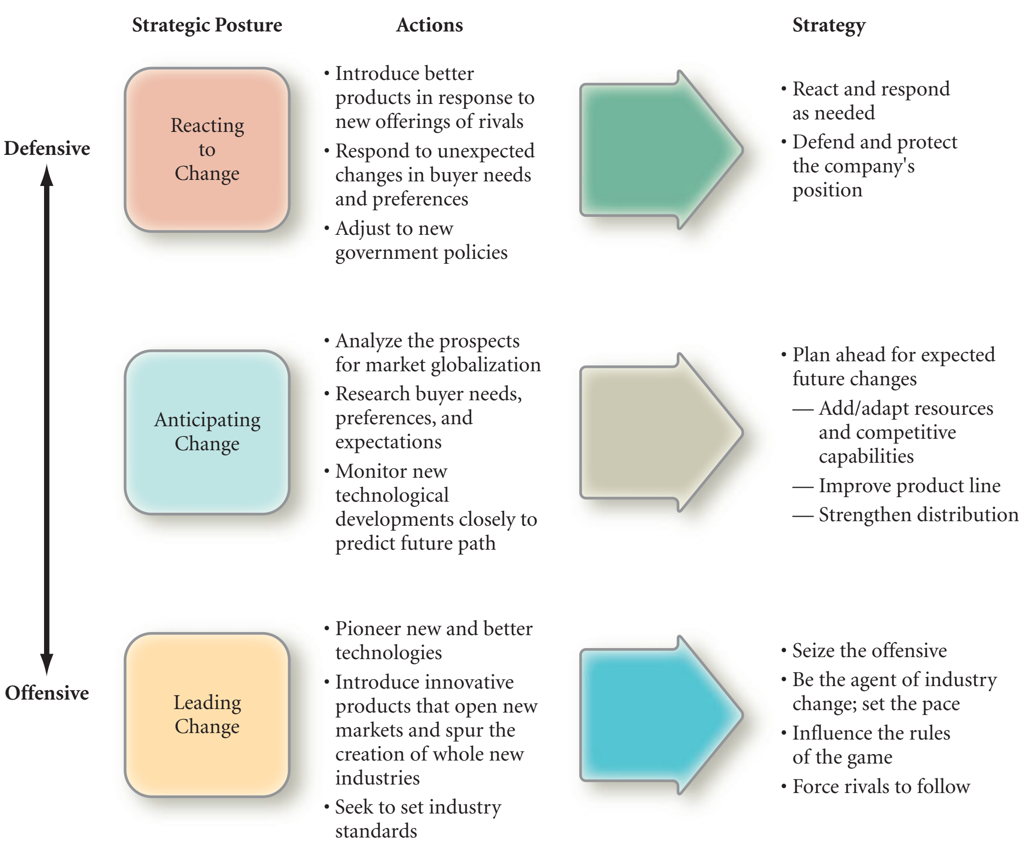
Strategies for Competing in Turbulent, High-Velocity Markets

The world is changing more and more rapidly, and consequently industries and firms themselves are changing faster than ever. Some industries are changing so fast that researchers call them **turbulent, high-velocity markets**, such as telecommunications, medicine, biotechnology, pharmaceuticals, computer hardware, software, and virtually all internet-based industries. High-velocity change is clearly becoming more and more the rule rather than the exception, even in such industries as toys, phones, banking, defense, publishing, and communication.

As illustrated in **Figure 6-3**, meeting the challenge of high-velocity change presents the firm with a choice of whether to react, anticipate, or lead the market in terms of its own strategies. To primarily react to changes in the industry would be a defensive strategy used to counter, for example, unexpected shifts in buyer tastes and technological breakthroughs. The react-to-change strategy would not be as effective as the anticipate-change strategy, which would entail devising and following through with plans for dealing with the expected changes. However, firms ideally strive to be in a position to lead the changes in high-velocity markets, whereby they pioneer new and better technologies and products and set industry standards. As illustrated, being the leader or pioneer of change in a high-velocity market is an aggressive, offensive strategy that includes rushing next-generation products to market ahead of rivals and being continually proactive in shaping the market to one's own benefit. Although a lead-change strategy is best whenever the firm has the resources to pursue this approach, on occasion even the strongest firms in turbulent industries have to employ the react-to-the-market strategy and the anticipate-the-market strategy.

FIGURE 6-3

Meeting the Challenge of High-Velocity Change



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In the long term, however, a lead-change strategy is more appropriate to position a company as a leader of market change – the one that not only shapes competition but also changes the competitive game. While resource availability is a condition for effective competition, foresighted executives are essential for developing and executing a lead-change strategy.

Means For Achieving Strategies

Joint Venture/Partnering

Joint venture is a popular strategy that occurs when two or more companies form a temporary partnership or consortium for the purpose of capitalizing on some opportunity. Often, the two or more sponsoring firms form a separate organization and have shared equity ownership in the new entity. Other types of **cooperative arrangements** include R&D partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia. In 2009, Moroccan telecom Meditel formed a deal with Rotana in its quest to lure young subscribers with diverse mobile content and internet services. The cooperation also allows Meditel to compete with its two primary competitors: Maroc Telecom and Wana.

The Syrian Petroleum Company, in agreement with Shell and other foreign companies, established the Al-Furat Petroleum Co. (AFPC) as a joint venture in 1985 to explore and produce oil in Syria. AFPC has been instrumental in technology transfer and in raising Syria's capacity for oil production.

Joint ventures and cooperative arrangements are being used increasingly because they allow companies to improve communications and networking, to globalize operations, and to minimize risk. Joint ventures and partnerships are often used to pursue an opportunity that is too complex, uneconomical, or risky for a single firm to pursue alone. Such business creations also are used for achieving and sustaining competitive advantage when an industry requires a broader range of competencies and know-how than any one firm can marshal. Armani's joint venture with Emaar Hotels & Resorts LLC aimed to create, among others, the tallest building in the world: now the 828-meter-tall hotel, Burj Khalifa.

Kathryn Rudie Harrigan, professor of strategic management at Columbia University, summarizes the trend toward increased joint venturing:

> In today's global business environment of scarce resources, rapid rates of technological change, and rising capital requirements, the important question is no longer "Shall we form a joint venture?" Now the question is "Which joint ventures and cooperative arrangements are most appropriate for our needs and expectations?" followed by "How do we manage these ventures most effectively?"[33]

In a global market tied together by the internet, joint ventures, and partnerships, alliances are proving to be a more effective way to enhance corporate growth than mergers and acquisitions.[34] Strategic partnering takes many forms, including outsourcing, information sharing, joint marketing, and joint R&D. Many companies, such as Eli Lilly, now host partnership training classes for their managers and partners. There are today more than 10,000 joint ventures formed annually, more than all mergers and acquisitions. There are countless examples of successful strategic alliances, such as General Electric's partnerships and agreements with Arab-based companies. For example, GE signed a cooperative procurement with Aramco to supply it with turbo machinery equipment and services, to enable Aramco to increase its production of oil and gas in Saudi Arabia. General Electric also entered into an agreement with the Qatar Foundation to develop next-generation healthcare technologies and to build local R&D capabilities. A major reason why firms are using partnering as a means to achieve strategies is globalization. Carrefour partnered with the Majid Al Futtaim Group, a pan-regional conglomerate, to dominate the GCC market. The venture has been successful due to the Al Futtaim Group's familarity with retailing in the region, and the ability to adapt to socioeconomic conditions and situate Carrefour in shopping malls.

Evidence is mounting that firms should use partnering as a means for achieving strategies. In the Arab world, this has been the case. Unlike many U.S. counterparts, Arab corporations have sought cooperative and joint venture agreements with global corporations. In recent years, however, Arab corporations have gained rich experience at home and in regional markets, and because of the availability of capital, have tended to engage in mergers and acquisitions.

Joint ventures among once-rival firms are commonly being used to pursue strategies ranging from retrenchment to market development.

Although ventures and partnerships are preferred over mergers as a means for achieving strategies, certainly they are not all successful. The good news is that joint ventures and partnerships are less risky for companies than mergers, but the bad news is that many alliances fail. *Forbes* has reported that about 30 percent of all joint ventures and partnership alliances are outright failures, while another 17 percent have limited success and then dissipate due to problems.[35] There are countless examples of failed joint ventures. A few common problems that cause joint ventures to fail are as follows:

1. Managers who must collaborate daily in operating the venture are not involved in forming or shaping the venture
2. The venture may benefit the partnering companies but may not benefit customers, who then complain about poorer service or criticize the companies in other ways
3. The venture may not be supported equally by both partners. If supported unequally, problems arise
4. The venture may begin to compete more with one of the partners than the other.[36]

Six guidelines for when a joint venture may be an especially effective strategy to pursue are:[37]

- When a privately owned organization is forming a joint venture with a publicly owned organization; there are some advantages to being privately held, such as closed ownership; there are some advantages of being publicly held, such as access to stock issuances as a source of capital. Sometimes, the unique advantages of being privately and publicly held can be synergistically combined in a joint venture.
- When a domestic organization is forming a joint venture with a foreign company; a joint venture can provide a domestic company with the opportunity for obtaining local management in a foreign country, thereby reducing risks such as expropriation and harassment by host-country officials.
- When the distinct competencies of two or more firms complement each other especially well.
- When some project is potentially very profitable but requires overwhelming resources and risks; the Alaskan pipeline is an example.
- When two or more smaller firms have trouble competing with a large firm.
- When there exists a need to quickly introduce a new technology.

Mergers and Acquisitions

Mergers and acquisitions (M&As) are two commonly used ways to pursue strategies. A **merger** occurs when two organizations of about equal size unite to form one enterprise. An **acquisition** occurs when a large organization purchases (acquires) a smaller firm, or vice versa. When a merger or acquisition is not desired by both parties, it can be called a **takeover** or **hostile takeover**. In contrast, if the acquisition is desired by both firms, it is termed a **friendly merger**. Most mergers are friendly.

One of the major hostile takeovers in 2010 was when Astellas Pharma, the Japanese drug maker, persuaded, after several attempts, the board of OSI Pharmaceutical to accept its bid to acquire OSI for US$4 billion in cash. The Japanese-based company was finally successful after it raised its offer by more than 10 percent to US$57.50 a share. The first offer, US$52 a share, was rejected by the U.S.-based company. There are, however, several examples of unsuccessful takeovers. In 2007, a Canadian metal firm, Alcan, rejected a US$33 billion-dollar hostile bid by its U.S. rival Alcoa to create the world's biggest aluminum company. The company indicated that the unsolicited takeover failed to reflect the firm's values. In the Arab world hostile takeovers are not yet common due to the nature of social and business networking which appear not to favor, at this time, hostile attitudes. Likewise, the local stock exchange is a recent phenomenon and the procedures have not yet been set for engaging unfriendly takeover.

There are numerous and powerful forces driving once fierce rivals to merge around the world. Some of these forces are deregulation, technological change, excess capacity, inability to boost profits through price increases, a depressed stock market, and the need to gain economies of scale. Other forces spurring acquisitions include increased market power, reduced entry barriers, reduced cost of new product development, increased speed of products to market, lowered risk compared to developing new products, increased diversification, avoidance of excessive competition, and the opportunity to learn and develop new capabilities.

The year 2007 witnessed more cross-border M&As than ever, reaching a peak of US$470 billion. The amount of cross-border M&As, however, declined to a level of US$291 billion in 2008 due to the financial crisis which started in the United States. In particular, there was a global decrease in the number and value of mega deals (i.e. cross-border M&As valued at more than US$1 billion) in 2008. The value of such deals dropped by 31 percent and their number by 21 percent. The remarkable reduction in total cross-border M&As has had a significant impact on foreign direct investment flows. The latter is correlated closely with the value of cross-border M&A transactions.[38]

In developed countries private equity firms have played a bigger-than-ever role in the merger frenzy, with a hand in 20 percent of the world's acquisitions, and 27 percent in the United States.[39] The number of Arab private equity firms has increased in recent years. These firms are found primarily in Egypt (e.g. Oasis, Turnaround Fund, Delta, EK Holding, Citadel Capital, etc.), Saudi Arabia (e.g. Amwal Alkhaleej, Jarir Investments, Swicorp), and UAE (e.g. Daman Investment, Abraaj Capital, Dubai Group).

In China, there were 2,263 acquisitions in 2006, up from 1,786 in 2005.[40] The 2006 dollar total of acquisitions reached US$103.8 billion, up 68 percent from 2005. Stephen Green, an economist with Standard Chartered, commented regarding the surge in acquisitions in China: "It should make things more efficient. You're looking for economies of scale, horizontal and vertical integration, improving quality of management, and also the ability to wipe out your competitors and gain pricing power."[41] This comment reveals the motivation for most acquisitions in the United States and Europe.

In Japan, companies in 2006–2008 started acquiring other firms worldwide after a lull in this activity in 2000–2005. Japanese firms bought more than 300 foreign companies for a total exceeding US$20 billion in 2006, double the figure in 2004. For example, Japan's largest tobacco company, Japan Tobacco, has acquired Gallaher Group of Britain in the largest Japanese deal ever for a foreign company. Unheard of prior to 2006 in Japan, hostile takeovers are also being tried. Oji Paper recently launched an unsolicited US$1.4 billion bid for rival Hokuetsu Paper Mills. This was the first hostile takeover battle between two Japanese blue-chip companies.

In Japan, new guidelines in 2007 make it much easier and actually encourage Japanese firms to merge. There were 2,775 deals in 2006, up 1.8 percent from 2005 and much higher than the 1,752 in 2002. M&A deals involving Japanese companies reached $138bn in 2009, a 15 percent decline from the prior year. However, M&A activities are expected to increase in the coming years as Japanese companies seek to dominate the growing Asian market.[42]

Sirius and XM Satellite Radio, two fierce rival firms in the satellite radio business, merged in 2007, creating a company valued at more than US$13 billion. Neither company had made a profit prior to the merger, and each firm's satellite radios were designed for it and cannot receive the other's signal. General Motors, Toyota, and Honda were big XM subscribers, while Ford, DaimlerChrylser, and VW/Audi were exclusive Sirius customers. The combined company is developing radio receivers that receive input from both XM and Sirius satellites.

Private Equity Acquisitions

Among the world's largest 300 private equity firms in 2010, six were from the Arab world (see **Table 6-4**). These are Abraaj Capital (UAE), Arcapita (Bahrain), Citadel Capital (Egypt),