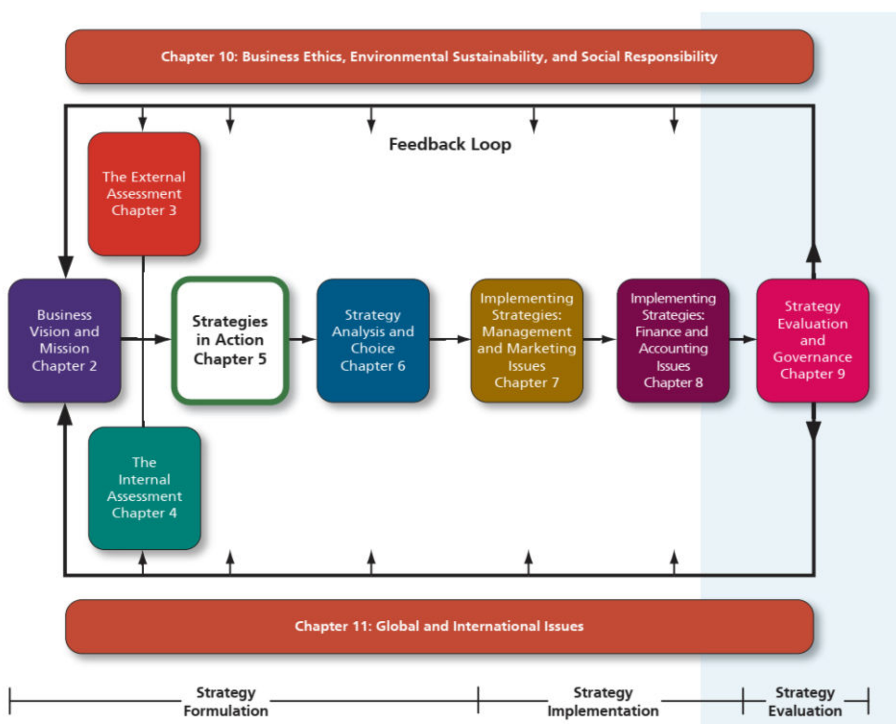
Chapter 5

Strategies in Action

The Comprehensive, Integrative Strategic-Management Model



Learning Objectives

- *After studying this chapter, you should be able to do the following:*
  - *Identify and discuss 5 characteristics and 10 benefits of clear objectives.*
  - *Define and give an example of 11 types of strategies.*
  - *Explain when diversification is an effective business strategy.*
  - *Explain value chain analysis and benchmarking in strategic management.*
  - *Identify and discuss Porter's two generic strategies: cost leadership and differentiation.*
  - *Discuss first-mover advantages and disadvantages.*
  - *Explain how strategic planning differs in for-profit, not-for-profit, and small firms*

Preface

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Long-Term Objectives

- *Long-term objectives represent the results expected from pursuing certain strategies.*
- *Strategies represent the actions to be taken to accomplish long-term objectives.*
- *The time frame for objectives and strategies should be consistent, usually from 2 to 5 years.*
- *Without long-term objectives, an organization would drift aimlessly toward some unknown end or become too focused on short-term fads and stray away from the firm's mission.*

Clarity in Objectives

- *It is hard to imagine an organization or an individual being successful without clear objectives.*
- *You probably have worked hard the last few years striving to achieve an objective to graduate with a business degree.*
- *Success rarely occurs by accident; rather, it is the result of hard work directed toward achieving certain objectives.*

Five Characteristics of Objectives

1. *Quantitative: measurable*
2. *Understandable: clear*
3. *Challenging: achievable*
4. *Compatible: consistent vertically and horizontally in a chain of command*
5. *Obtainable: realistic*

Financial versus Strategic Objectives

- *Two types of objectives are especially common in organizations: financial and strategic objectives.*
- *Financial objectives:*
  - *growth in revenues*
  - *growth in earnings*
  - *higher dividends*
  - *larger profit margins*
  - *greater return on investment*
  - *higher earnings per share*
  - *a rising stock price*
  - *improved cash flow*
- *Strategic objectives:*
  - *larger market share,*
  - *quicker on-time delivery than rivals,*
  - *lower costs than rivals,*
  - *higher product quality than rivals,*
  - *wider geographic coverage than rivals,*
  - *achieving technological leadership, getting new or improved products to market ahead of rivals.*

Trade-off between Financial and Strategic Objectives

- *The dangers associated with trading off long-term strategic objectives with near-term bottom-line performance are especially severe if competitors relentlessly pursue increased market share at the expense of short-term profitability.*
  - *Amazon, for example, operated for decades without concern for profits, instead concentrating on gaining market share.*

The best way to sustain competitive advantage is to relentlessly pursue strategic objectives that strengthen a firm's business position over rivals.

Types of Strategies

- *Strategies that an enterprise could pursue can be categorized into 11 actions:*
  - *forward integration,*
  - *backward integration,*
  - *horizontal integration,*
  - *market penetration,*
  - *market development,*
  - *product development,*
  - *related diversification,*
  - *unrelated diversification,*
  - *retrenchment,*
  - *divestiture,*
  - *liquidation.*

Types of Strategies

Strategy	Definition	Example
Forward Integration	Gaining ownership or increased control over distributors or retailers	Nike opening 100 outlet stores and selling 30% more products on its website
Backward Integration	Seeking ownership or increased control over suppliers	Boeing building 80% of its wing flap motors in-house
Horizontal Integration	Seeking ownership or increased control over competitors	Nestlé purchasing Sweet Earth Foods
Market Penetration	Seeking increased market share for present products in present markets through greater marketing	Cristiano Ronaldo and LeBron James sign lifetime endorsement deal with Nike
Market Development	Introducing present products into new geographic area	Publix building 20 new supermarkets in North and South Carolina
Product Development	Seeking increased sales by improving present products or developing new ones	Ford shifting one-third of its scheduled R&D budget on gas/diesel engines to electric engines

Types of Strategies

Strategy	Definition	Example
Related Diversification	Adding new but related products	Walmart acquired Jet.com for $3.3 billion
Unrelated Diversification	Adding new, unrelated products	CVS pharmacy acquiring Aetna insurance
Retrenchment	Regrouping through cost and asset reduction to reverse declining sales and profit	Eli Lilly laying off 3,500 employees
Divestiture	Selling a division or part of an organization	Toshiba aims to sell its memory-chip unit to Bain Capital
Liquidation	Selling all of a company's assets, in parts, for their tangible worth	Ringling Bros. and Barnum & Bailey Circus liquidated (last performance was on May 21, 2017)

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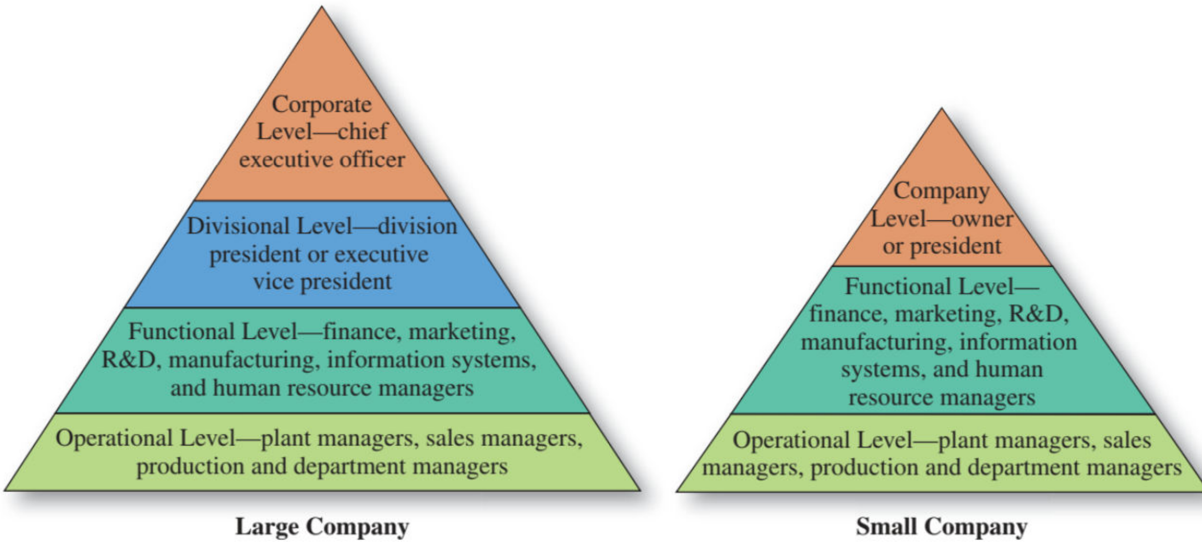
Levels of Strategies

- *Strategy making is not just a task for top executives.*
- *Middle- and lower-level managers also must be involved in the strategic-planning process to the extent possible.*
- *In large firms, there are actually four levels of strategies:*
  - *corporate,*
  - *divisional,*
  - *functional,*
  - *operational.*

Levels of Strategies



Integration Strategies

- *Vertical integration strategies allow a firm to gain control over distributors and suppliers,*
- *Horizontal integration refers to gaining ownership or control over competitors.*

- *Forward integration and backward integration are sometimes collectively referred to as vertical integration.*
- *Vertical integration strategies have been difficult to implement because of the firm operating in businesses out of its core competency, and because large fixed costs are generally associated with such strategies.*

Integration Strategies

- *Types of integration strategies:*
  - *Forward Integration:*
    - *gaining ownership or increased control over distributors or retailers as a means of moving closer to the end customer and cutting out the middleman.*
    - *an effective means of implementing forward integration is franchising.*
  - *Backward Integration*
    - *strategy of seeking ownership or increased control of a firm's suppliers.*
    - *appropriate when a firm's current suppliers are unreliable, too costly, or cannot meet the firm's needs.*
  - *Horizontal Integration*
    - *aimed at gaining control over a firm's competitors*
    - *the most common growth strategy*

📖*Present guidelines indicate when/where integration strategies are effective.*

Intensive Strategies

- *They require intensive efforts if a firm's competitive position with existing products is to improve.*
- *Types of intensive strategies:*
  - *Market Penetration*
  - *Market Development*
  - *Product Development*

💣*Intensive strategies are normally good options because they involve a firm sticking to what it does best with the only variation being*

1. *redoubling your effort (market penetration),*
2. *taking what it does best on the "road" (market development),*
3. *improving on what it does best (product development).*

Intensive Strategies

- *Types of intensive strategies:*
  - *Market Penetration:*
    - *seeks to increase market share for present products or services in present markets through greater marketing efforts.*
    - *includes increasing the number of salespersons, increasing advertising expenditures, offering extensive sales promotions, or increasing publicity efforts.*
  - *Market Development*
    - *involves introducing present products or services into new geographic areas.*
    - *market development means adding facilities and operations globally.*
  - *Product Development*
    - *a strategy that seeks increased sales by improving or modifying present products or services.*

Diversification Strategies

- *Businesses are said to be <u>related</u> when their value chains possess competitively valuable cross-business strategic fits; businesses are said to be <u>unrelated</u> when their value chains*
- *Types of diversification strategies:*
  - *Related Diversification: Walt Disney (21st Century Fox's film) and General Electric*
  - *Unrelated Diversification: Amazon and CVS (Aetna)*

- *Most companies favor related diversification strategies to capitalize on synergies such as follows:*
  - *Transferring competitively valuable expertise, technological know-how, or other capabilities from one business to another*
  - *Combining 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*

Defensive Strategies

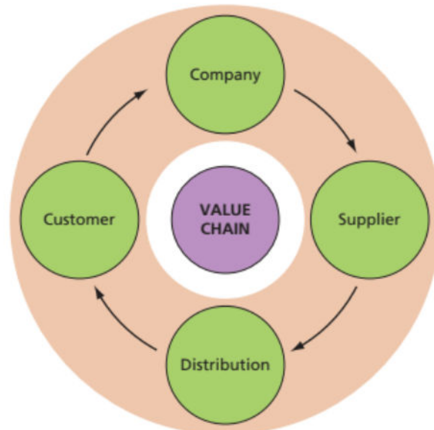
- *In addition to integrative, intensive, and diversification strategies, organizations also could pursue defensive strategies such as retrenchment, divestiture, or liquidation.*
- *Types of defensive strategies:*
  - *Retrenchment*
  - *Divestiture*
  - *Liquidation*

Defensive Strategies

- *Types of defensive strategies:*
  - *Retrenchment (turnaround): occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. (Eli Lilly)*
  - *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. (Volkswagen)*
  - *Liquidation: Selling all of a company's assets, in parts, for their tangible worth is called liquidation. Liquidation is a recognition of defeat and consequently can be an emotionally difficult strategy. (Ringling)*

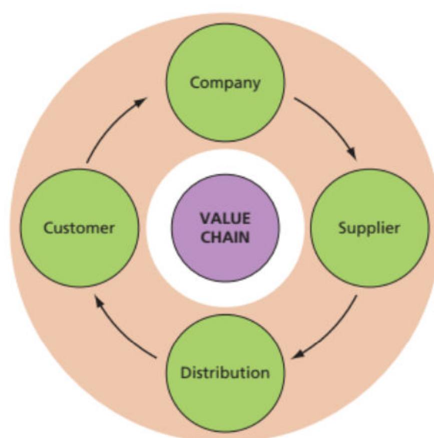
Value Chain

- *Whenever a customer buys a product, it is because that consumer feels the "value" to be derived from that product in terms of price paid versus benefits received is worthwhile.*
- *However, the ultimate price paid by a consumer for a product is determined from scores of activities that went into producing that product, from raw materials to suppliers, to production processes, to distributors, etc.*
- *This collection of activities that leads to the ultimate price of a product is commonly referred to as a firm's value chain.*



Value Chain Analysis

- *Value chain analysis (VCA) can be defined as the process whereby a firm determines the value (price minus cost) of each and all activities that went into producing and marketing a product, from purchasing raw materials to manufacturing, distributing, and marketing those products.*
- *VCA is an excellent way to identify both external opportunities, threats, and internal strengths, weaknesses of a firm.*



💣*Value activities" are not easily imitable!*

Value Chain Analysis

- *Firms strive to create value (price minus cost) that can ultimately be transferred to the end user (customers), so customers will buy the product at some price to obtain the perceived value.*
- *Cost and price differences among rival firms can have their origins in activities performed by suppliers, distributors, creditors, or even shareholders.*

- *Five Guys made to order burgers with high quality*
- *McDonald's premade burgers with low service-time*

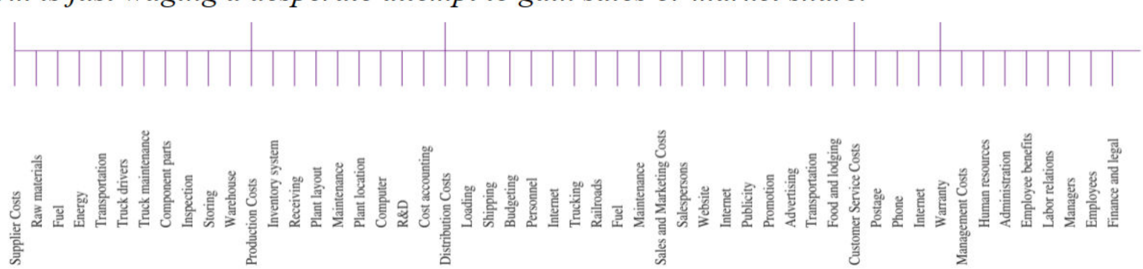
FIVE GUYS® BURGERS and FRIES

McDonald's™

Value Chain Analysis

1. *Divide a firm's operations into specific activities or business processes.*
2. *Attempts to attach a cost of each discrete activity versus the price to be paid; the costs could be in terms of both time and money.*
3. *Convert the "value data" into information by looking for competitive opportunities/threats and/or strengths/weaknesses that may yield competitive advantage or disadvantage.*

- *When a major competitor or new market entrant offers products or services at low prices, this may be because that firm has substantially lower value chain costs or perhaps the rival firm is just waging a desperate attempt to gain sales or market share.*



Michael Porter's Two Generic Strategies

- *Michael Porter says strategies allow organizations to gain competitive advantage from two different bases: cost leadership and differentiation.*
- *Porter calls these bases generic strategies because generally firms should be mindful it is often best to develop product lines that compete on cost or compete on unique value; it is difficult to compete on both simultaneously.*
  - ***Cost Leadership** emphasizes producing standardized products or services at a low per-unit cost for consumers who are price sensitive.*
  - ***Differentiation** is a strategy aimed at producing products and services considered unique to the industry and directed at consumers who are relatively price insensitive.*

Cost Leadership

- *There are two types of cost leadership strategies.*
  - *Type 1 is a broad lowcost strategy that offers products or services to a wide range of customers at one of the lowest prices available on the market. (Walmart)*
  - *Type 2 is a narrow or focused low-cost strategy that offers products or services to a small range of customers at one of the lowest prices on the market. (Dollar General)*

A cost leadership strategy aims to offer customers a range of products or services at the lowest price available compared to a rival's products with similar attributes.

Differentiation

- *There are two levels of a successful differentiation strategy:*
  - *Type 3 having a wide target market (BMW)*
  - *Type 4 having a narrow target market (Louis Vuitton)*

Under differentiation strategies, firms are not as reliant on economies of scale, so targeting a small group of customers can be advantageous if they are willing to pay a premium for the products or services offered.

	Generic Strategies	
	Cost Leadership	Differentiation
Market Segments		
Broad	Type 1	Type 3
Narrow	Type 2	Type 4

Means for Achieving Strategies

- *Companies are under continual pressure from stockholders to maintain top line (revenues) and bottom line (net income) growth (usually 4+ percent) and pay higher dividends.*
- *To accomplish this end, firms are often faced with a BUILD, BORROW, or BUY decision.*
  - *Build from Within to Grow: growing internally (organically) (Netflix, Southwest, eBay, and Amazon)*
  - *Borrow from Others to Grow: growing externally using means such as partnerships, joint ventures, and alliances (Qualcomm-Guizhou, Coca-Cola-Nestlé, Microsoft-SAP)*
  - *Buy Others to Grow: including mergers and acquisitions (Halliburton-Baker Hughes,)*

Chapter Summary

- *Long-term Objectives*
  - *Characteristics: Quantitative, understandable, challenging, compatible, obtainable.*
  - *Benefits: Direction, synergy, evaluation, priority-setting, conflict reduction, resource allocation.*
  - *Financial vs. Strategic Objectives: Balance short-term profitability (e.g., revenue growth) with long-term competitive advantage (e.g., market share).*
- *Types of Strategies*
  - *Integration Strategies*
    - *Forward (control distributors: Nike's direct sales, restaurant delivery apps).*
    - *Backward (control suppliers: Starbucks' coffee farms, Boeing's parts production).*
    - *Horizontal (acquire competitors: Walgreens-Rite Aid merger, Cineworld-Regal acquisition).*
  - *Intensive Strategies*
    - *Market Penetration (increase share in current markets: Verizon's ad campaigns).*
    - *Market Development (expand geographically: Tesla in China, Dollar General stores).*
    - *Product Development (improve/modify products: Ford's electric R&D, Kellogg's RXBAR acquisition)*

Chapter Summary

- *Types of Strategies*
  - *Diversification*
    - *Related (synergistic products: Disney's 21st Century Fox acquisition).*
    - *Unrelated (new industries: Amazon entering pharmaceuticals, CVS-Aetna merger).*
  - *Defensive Strategies*
    - *Retrenchment (cost/asset reduction: Eli Lilly layoffs, GoPro exiting drones).*
    - *Divestiture (sell divisions: Toshiba's chip unit sale, Nestlé's chocolate segment divestment).*
    - *Liquidation (sell all assets: Ringling Bros. circus, Toys "R" Us closure).*
- *Analytical Tools*
  - *Value Chain Analysis (VCA):*
    - *Identifies cost/value at each production/marketing stage to pinpoint competitive advantages (e.g., Walmart's inventory control).*
    - *Converts core competencies (e.g., Apple's design) into distinctive competencies (sustainable advantages).*

Chapter Summary

- *Analytical Tools*
  - *Porter's Generic Strategies:*
    - *Cost Leadership: Broad (Walmart) or focused (Dollar General) low-cost production.*
    - *Differentiation: Broad (BMW) or niche (Rolex) unique value propositions.*
- *Growth Strategies*
  - *Build (Organic Growth):*
    - *Develop internally (e.g., Apple's blue ocean strategies like iPhone).*
    - *Requires alignment with core competencies.*
  - *Borrow (Partnerships/Alliances):*
    - *Joint ventures (Qualcomm-China chip venture) and strategic alliances (Microsoft-SAP cloud partnership).*
    - *Guidelines: Access new markets, share risks, leverage complementary skills.*
  - *Buy (Mergers & Acquisitions):*
    - *Benefits: Market share, technology access, economies of scale.*
    - *Risks: Integration challenges, cultural clashes, debt burdens (e.g., Halliburton-Baker Hughes).*
    - *Leveraged Buyouts (LBOs): Private equity acquisitions (e.g., Ruby Tuesday, Buffalo Wild Wings).*

Topics for Further Collaboration …

- *Tim Cook, CEO of Apple, Inc. (Page 156 – David Book)*
- *How Can a Firm Determine Where to Initiate New Business? (Page 164 – David Book)*
- *Are CEOs Less Ethical Today Than in the Past? (Page 176 – David Book)*