

5

Strategies in Action

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Discuss the value of establishing long-term objectives.
2. Identify 16 types of business strategies.
3. Identify numerous examples of organizations pursuing different types of strategies.
4. Discuss guidelines when particular strategies are most appropriate to pursue.
5. Discuss Porter's five generic strategies.
6. Describe strategic management in nonprofit, governmental, and small organizations.
7. Discuss joint ventures as a way to enter the Russian market.
8. Discuss the Balanced Scorecard.
9. Compare and contrast financial with strategic objectives.
10. Discuss the levels of strategies in large versus small firms.
11. Explain the First Mover Advantages concept.
12. Discuss recent trends in outsourcing.
13. Discuss strategies for competing in turbulent, high-velocity markets.

ASSURANCE OF LEARNING EXERCISES

Assurance of Learning Exercise 5A

Develop Hypothetical Disney Strategies

Assurance of Learning Exercise 5B

Evaluate Disney Divisions in Terms of Porter Strategies

Assurance of Learning Exercise 5C

What Strategies Should Disney Pursue in 2013?

Assurance of Learning Exercise 5D

Examine Strategy Articles

Assurance of Learning Exercise 5E

Classify Some Year 2011 Strategies

Assurance of Learning Exercise 5F

How Risky Are Various Alternative Strategies?

Assurance of Learning Exercise 5G

Develop Alternative Strategies for My University

Assurance of Learning Exercise 5H

Lessons in Doing Business Globally

Hundreds of companies today, including Sears, IBM, Searle, and Hewlett-Packard, have embraced strategic planning fully in their quest for higher revenues and profits. Kent Nelson, former chair of UPS, explains why his company has created a new strategic-planning department: "Because we're making bigger bets on investments in technology, we can't afford to spend a whole lot of money in one direction and then find out five years later it was the wrong direction."¹

This chapter brings strategic management to life with many contemporary examples. Sixteen types of strategies are defined and exemplified, including Michael Porter's generic strategies: cost leadership, differentiation, and focus. Guidelines are presented for determining when it is most appropriate to pursue different types of strategies. An overview of strategic management in nonprofit organizations, governmental agencies, and small firms is provided. ExxonMobil is an example company that for many years has exemplified excellent strategic management.

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 two to five years.

Excellent Strategic Management Showcased

ExxonMobil CORPORATION

Founded in 1870 and headquartered in Irving, Texas, ExxonMobil engages in the exploration, production, transportation, and sale of crude oil, natural gas, olefins, aromatics, polyethylene, polypropylene plastics, and electric power generation. ExxonMobil is the largest and most profitable publicly traded oil company in the world. Exxon supplies fuel to 28,000 gas stations in 100 countries, is substantially larger than Royal Dutch Shell or BP, has 83,600 employees, and is led by CEO and Chairman of the Board Rex Tillerson. Exxon's 2010 profits increased an incredible 59.7 percent to \$30.5 billion, while the company's revenues increased 23 percent to \$383 billion.

Exxon earned \$10.65 billion in profits in the first quarter of 2011. That compares with \$6.3 billion, or 1.33 per share. Revenue increased 26 percent to \$114 billion. The quarter was Exxon's best since earning a record-setting \$14.83 billion in 2008's third quarter. It comes at a time when some drivers are paying \$4 or more for gas. Earnings grew across the company's business segments as profits from its exploration and production business gained 49 percent to \$8.7 billion, while the company's downstream business, which includes refineries, posted a huge 30-fold jump to more than \$1.1 billion.

As escalating political unrest in the Middle East threatens to disrupt fuel supplies, oil and gas prices could rise further. ExxonMobil produces more oil when prices are high. Protests that started in Tunisia and Egypt have spread to Syria, Yemen, Bahrain, Iran, and Jordan. Protesters in Libya ousted Moammar Gaddafi, the longest-ruling Arab leader, following the ouster of Hosni Mubarak in Egypt.

Exxon's 2010 EPS increased 55 percent to \$6.22, while the company's capital and exploration expenditures were \$32.2 billion, up 19 percent. Exxon is a gigantic, money-making, money-investing, well oiled, strategic management machine that has been incredibly successful

for more than 14 decades. And, Exxon pays about 35 percent of its net income in federal taxes every year, rather than being intent on avoiding taxes.

A key ingredient of ExxonMobil's strategic plan is the company's bet that natural gas will overtake coal as the world's second-largest source of energy by 2030. That is why Exxon recently purchased XTO Energy for \$25 billion. XTO has a patented procedure to extract natural gas from shale in an economical manner. Exxon also recently acquired the shale producer Ellora Inc. for \$695 million and purchased the natural-gas shale assets of Petrohawk Energy Corp. for \$575 million. Exxon predicts that the world will consume about 35 percent more energy in 2030 than today, and that natural gas will quench 26 percent of the world's demand for energy, up from 21 percent today.

Ukraine's state-run energy firm Naftogaz and ExxonMobil recently signed a memorandum of cooperation to explore for shale gas deposits in Ukraine. That country imports 60 percent of its energy from Russia at arguably too-high import prices. ExxonMobil is also helping Ukraine look for methane gas deposits in coalmines.

Source: Company documents. Also, Angel Gonzalez, "Exxon Predicts Gas Use Will Surpass Coal's," *Wall Street Journal*, January 27, 2011, B3.



The Nature of Long-Term Objectives

Objectives should be quantitative, measurable, realistic, understandable, challenging, hierarchical, obtainable, and congruent among organizational units. Each objective should also be associated with a timeline. Objectives are commonly stated in terms such as growth in assets, growth in sales, profitability, market share, degree and nature of diversification, degree and nature of vertical integration, earnings per share, and social responsibility. Clearly established objectives offer many benefits. They provide direction, allow synergy, aid in evaluation, establish priorities, reduce uncertainty, minimize conflicts, stimulate exertion, and aid in both the allocation of resources and the design of jobs. Objectives provide a basis for consistent decision making by managers whose values and attitudes differ. Objectives serve as standards by which individuals, groups, departments, divisions, and entire organizations can be evaluated.

Long-term objectives are needed at the corporate, divisional, and functional levels of an organization. They are an important measure of managerial performance. Many practitioners and academicians attribute a significant part of U.S. industry's competitive decline to the short-term, rather than long-term, strategy orientation of managers in the United States. Arthur D. Little argues that bonuses or merit pay for managers today must be based to a greater extent on long-term objectives and strategies. A general framework for relating objectives to performance evaluation is provided in Table 5-1. A particular organization could tailor these guidelines to meet its own needs, but incentives should be attached to both long-term and annual objectives.

Without long-term objectives, an organization would drift aimlessly toward some unknown end. It is hard to imagine an organization or individual being successful without clear objectives (see Tables 5-2 and 5-3). Success only rarely occurs by accident; rather, it is the result of hard work directed toward achieving certain objectives.

Financial versus Strategic Objectives

Two types of objectives are especially common in organizations: financial and strategic objectives. *Financial objectives* include those associated with 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, and so on; while *strategic objectives* include things such as a larger market share, quicker on-time delivery than rivals, shorter design-to-market times

TABLE 5-1 Varying Performance Measures by Organizational Level

| Organizational Level | Basis for Annual Bonus or Merit Pay |
|----------------------|---|
| Corporate | 75% based on long-term objectives 25% based on annual objectives |
| Division | 50% based on long-term objectives 50% based on annual objectives |
| Function | 25% based on long-term objectives 75% based on annual objectives |

TABLE 5-2 The Desired Characteristics of Objectives

| |
|---------------------------------|
| 1. Quantitative |
| 2. Measurable |
| 3. Realistic |
| 4. Understandable |
| 5. Challenging |
| 6. Hierarchical |
| 7. Obtainable |
| 8. Congruent across departments |

TABLE 5-3 The Benefits of Having Clear Objectives

1. Provide direction by revealing expectations
2. Allow synergy
3. Aid in evaluation by serving as standards
4. Establish priorities
5. Reduce uncertainty
6. Minimize conflicts
7. Stimulate exertion
8. Aid in allocation of resources
9. Aid in design of jobs
10. Provide basis for consistent decision making

than rivals, lower costs than rivals, higher product quality than rivals, wider geographic coverage than rivals, achieving technological leadership, consistently getting new or improved products to market ahead of rivals, and so on.

Although financial objectives are especially important in firms, oftentimes there is a trade-off between financial and strategic objectives such that crucial decisions have to be made. For example, a firm can do certain things to maximize short-term financial objectives that would harm long-term strategic objectives. To improve financial position in the short run through higher prices may, for example, jeopardize long-term market share. 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. And there are other trade-offs between financial and strategic objectives, related to riskiness of actions, concern for business ethics, need to preserve the natural environment, and social responsibility issues. Both financial and strategic objectives should include both annual and long-term performance targets. Ultimately, the best way to sustain competitive advantage over the long run is to relentlessly pursue strategic objectives that strengthen a firm's business position over rivals. Financial objectives can best be met by focusing first and foremost on achieving on strategic objectives that improve a firm's competitiveness and market strength.

Not Managing by Objectives

An unidentified educator once said, "If you think education is expensive, try ignorance." The idea behind this saying also applies to establishing objectives. Strategists should avoid the following alternative ways of "not managing by objectives."

- **Managing by Extrapolation**—adheres to the principle "If it ain't broke, don't fix it." The idea is to keep on doing the same things in the same ways because things are going well.
- **Managing by Crisis**—based on the belief that the true measure of a really good strategist is the ability to solve problems. Because there are plenty of crises and problems to go around for every person and every organization, strategists ought to bring their time and creative energy to bear on solving the most pressing problems of the day. Managing by crisis is actually a form of reacting rather than acting and of letting events dictate the what and when of management decisions.
- **Managing by Subjectives**—built on the idea that there is no general plan for which way to go and what to do; just do the best you can to accomplish what you think should be done. In short, "Do your own thing, the best way you know how" (sometimes referred to as *the mystery approach to decision making* because subordinates are left to figure out what is happening and why).
- **Managing by Hope**—based on the fact that the future is laden with great uncertainty and that if we try and do not succeed, then we hope our second (or third) attempt will succeed. Decisions are predicated on the hope that they will work and that good times are just around the corner, especially if luck and good fortune are on our side!²

The Balanced Scorecard

Developed in 1993 by Harvard Business School professors Robert Kaplan and David Norton, and refined continually through today, the Balanced Scorecard is a strategy evaluation and control technique.³ *Balanced Scorecard* derives its name from the perceived need of firms to “balance” financial measures that are oftentimes used exclusively in strategy evaluation and control with nonfinancial measures such as product quality and customer service. An effective Balanced Scorecard contains a carefully chosen combination of strategic and financial objectives tailored to the company’s business.

As a tool to manage and evaluate strategy, the Balanced Scorecard is currently in use at Sears, United Parcel Service, 3M Corporation, Heinz, and hundreds of other firms. For example, 3M Corporation has a financial objective to achieve annual growth in earnings per share of 10 percent or better, as well as a strategic objective to have at least 30 percent of sales come from products introduced in the past four years. The overall aim of the Balanced Scorecard is to “balance” shareholder objectives with customer and operational objectives. Obviously, these sets of objectives interrelate and many even conflict. For example, customers want low price and high service, which may conflict with shareholders’ desire for a high return on their investment. The Balanced Scorecard concept is consistent with the notions of continuous improvement in management (CIM) and total quality management (TQM).

Although the Balanced Scorecard concept is covered in more detail in Chapter 9 as it relates to evaluating strategies, firms should establish objectives and evaluate strategies on criteria other than financial measures. Financial measures and ratios are vitally important in strategic planning, but of equal importance are factors such as customer service, employee morale, product quality, pollution abatement, business ethics, social responsibility, community involvement, and other such items. In conjunction with financial measures, these “softer” factors comprise an integral part of both the objective-setting process and the strategy-evaluation process. A Balanced Scorecard for a firm is simply a listing of all key objectives to work toward, along with an associated time dimension of when each objective is to be accomplished, as well as a primary responsibility or contact person, department, or division for each objective.

Types of Strategies

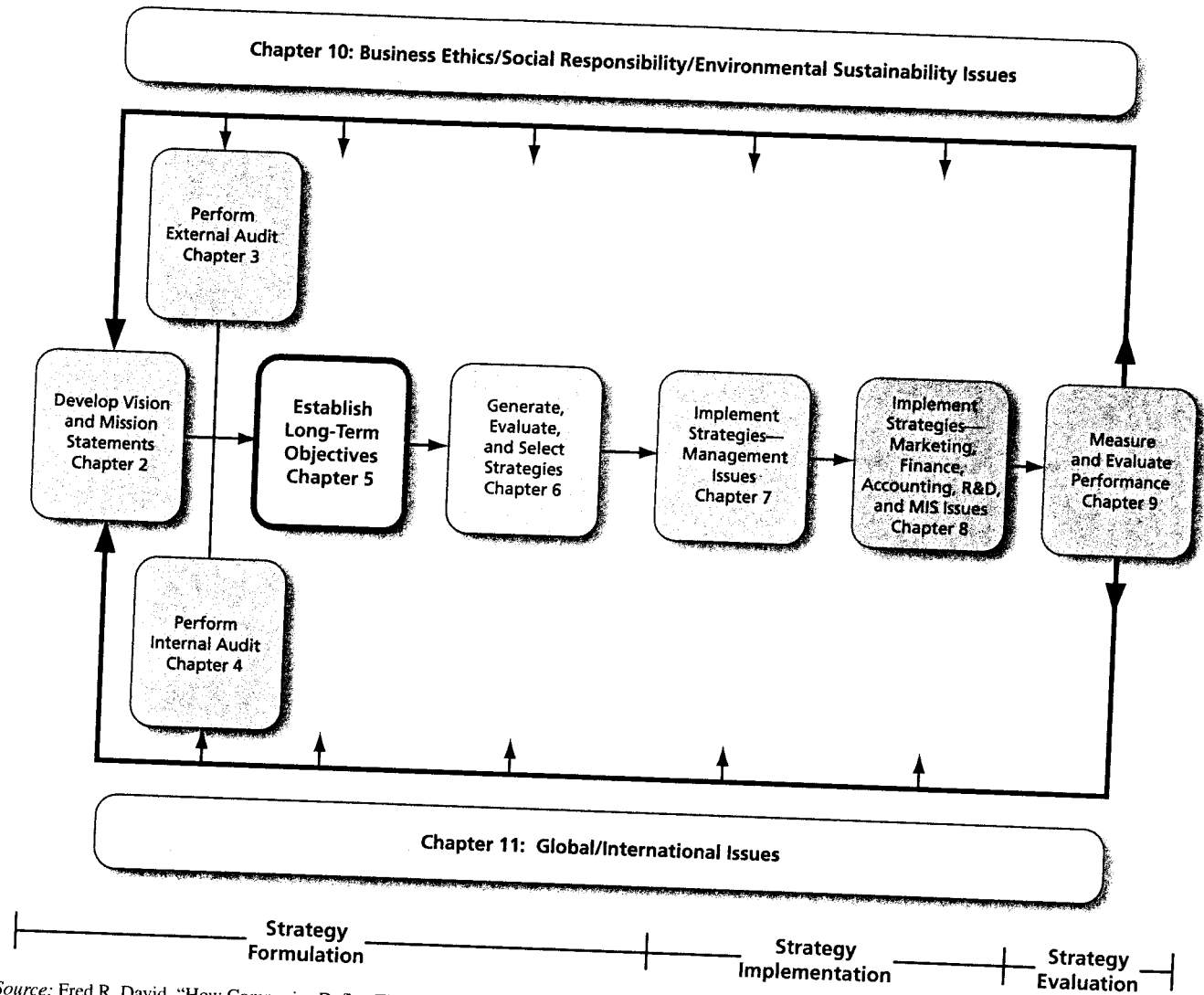
The model illustrated in Figure 5-1 provides a conceptual basis for applying strategic management. Defined and exemplified in Table 5-4, alternative strategies that an enterprise could pursue can be categorized into 11 actions: forward integration, backward integration, horizontal integration, market penetration, market development, product development, related diversification, unrelated diversification, retrenchment, divestiture, and liquidation. Each alternative strategy has countless variations. For example, market penetration can include adding salespersons, increasing advertising expenditures, couponing, and using similar actions to increase market share in a given geographic area.

Many, if not most, organizations simultaneously pursue a combination of two or more strategies, but a *combination strategy* can be exceptionally risky if carried too far. No organization can afford to pursue all the strategies that might benefit the firm. Difficult decisions must be made. Priority must be established. Organizations, like individuals, have limited resources. Both organizations and individuals must choose among alternative strategies and avoid excessive indebtedness.

Hansen and Smith explain that strategic planning involves “choices that risk resources” and “trade-offs that sacrifice opportunity.” In other words, if you have a strategy to go north, then you must buy snowshoes and warm jackets (spend resources) and forgo the opportunity of “faster population growth in southern states.” You cannot have a strategy to go north and then take a step east, south, or west “just to be on the safe side.” Firms spend resources and focus on a finite number of opportunities in pursuing strategies to achieve an uncertain outcome in the future. Strategic planning is much more than a roll of the dice; it is a wager based on predictions and hypotheses that are continually tested and refined by knowledge, research, experience, and learning. Survival of the firm itself may hinge on your strategic plan.⁴

FIGURE 5-1

A Comprehensive Strategic-Management Model



Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

Organizations cannot do too many things well because resources and talents get spread thin and competitors gain advantage. In large, diversified companies, a combination strategy is commonly employed when different divisions pursue different strategies. Also, organizations struggling to survive may simultaneously employ a combination of several defensive strategies, such as divestiture, liquidation, and retrenchment.

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, and operational—as illustrated in Figure 5-2. However, in small firms, there are actually three levels of strategies: company, functional, and operational.

In large firms, the persons primarily responsible for having effective strategies at the various levels include the CEO at the corporate level; the president or executive vice president at the

TABLE 5-4 Alternative Strategies Defined and Exemplified

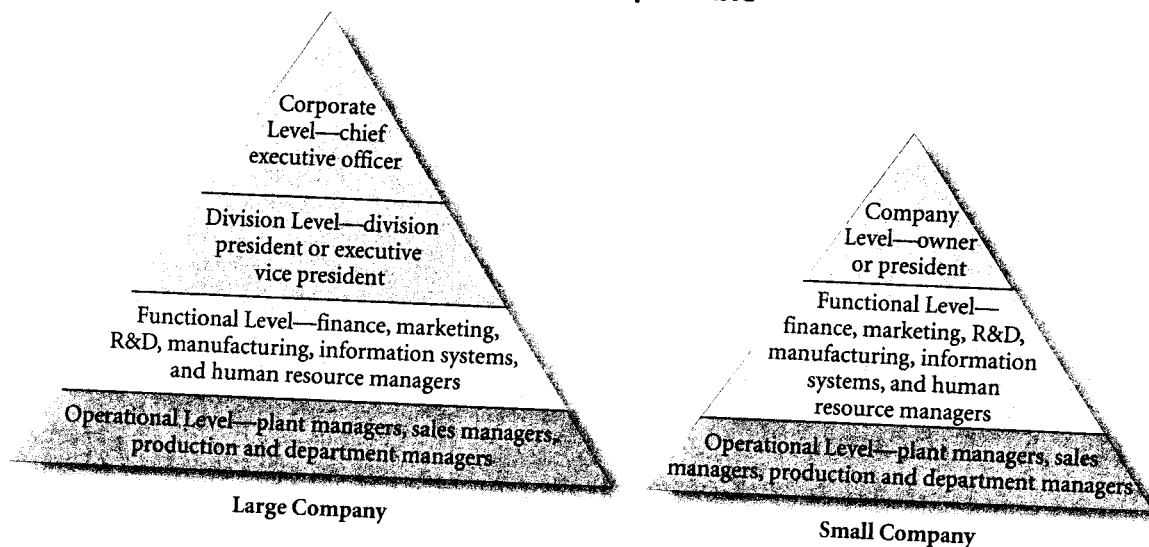
| Strategy | Definition | 2011 Examples |
|---------------------------|--|--|
| Forward Integration | Gaining ownership or increased control over distributors or retailers | Forward Integration—Starbucks reached a deal with Green Mountain Coffee Roasters for that firm to sell packs of Starbucks Tazo-branded coffee and tea in their brewers |
| Backward Integration | Seeking ownership or increased control of a firm's suppliers | Backward Integration—Dell Inc. acquired network security (virus protection) producer Secure Works Inc. |
| Horizontal Integration | Seeking ownership or increased control over competitors | Horizontal Integration—French drugmaker SanofiAventis purchased U.S. biotech drugmaker Genzyme for \$20.1 billion |
| Market Penetration | Seeking increased market share for present products or services in present markets through greater marketing efforts | Market Penetration—Neiman Marcus (NM) launched NM Daily to attract less-affluent customers and hired a new "Managing Editor of Social Media" (Jean Scheidnes) to tweet and post for NM |
| Market Development | Introducing present products or services into new geographic area | Market Development—Hawaiian Airlines began offering flights from Hawaii to Seoul, Korea, and Tokyo, Japan—rather than mostly flying to and from the U.S. mainland |
| Product Development | Seeking increased sales by improving present products or services or developing new ones | Product Development—Apple introduced the new iPad 2 |
| Related Diversification | Adding new but related products or services | Related Diversification—Amazon.com began allowing users to pay \$79 per year for "Amazon Prime," which allows users to stream over 5,000 movies and TV shows |
| Unrelated Diversification | Adding new, unrelated products or services | Unrelated Diversification—Many banks now own, by default, many properties, putting many banks reluctantly in the real estate and/or property management business |
| Retrenchment | Regrouping through cost and asset reduction to reverse declining sales and profit | Retrenchment—Borders closed 200 of its 488 superstores and laid off 6,000 of its 19,500 employees |
| Divestiture | Selling a division or part of an organization | Divestiture—Marriott sold its timeshare business, creating the world's largest autonomous timeshare business, consisting of 71 properties with 33,000 rooms |
| Liquidation | Selling all of a company's assets, in parts, for their tangible worth | Liquidation—Blockbuster Inc. barely escaped liquidation in March 2011 |

divisional level; the respective chief finance officer (CFO), chief information officer (CIO), human resource manager (HRM), chief marketing officer (CMO), and so on at the functional level; and the plant manager, regional sales manager, and so on at the operational level. In small firms, the persons primarily responsible for having effective strategies at the various levels include the business owner or president at the company level and then the same range of persons at the lower two levels, as with a large firm.

It is important that all managers at all levels participate and understand the firm's strategic plan to help ensure coordination, facilitation, and commitment while avoiding inconsistency, inefficiency, and miscommunication. Plant managers, for example, need to understand and be supportive of the overall strategic plan (game plan), while the president and the CEO need to be knowledgeable of strategies being employed in various sales territories and manufacturing plants.

FIGURE 5-2

Levels of Strategies With Persons Most Responsible



Integration Strategies

Forward integration, backward integration, and horizontal integration are sometimes collectively referred to as *vertical integration* strategies. Vertical integration strategies allow a firm to gain control over distributors, suppliers, and/or competitors.

Forward Integration

Forward integration involves gaining ownership or increased control over distributors or retailers. Increasing numbers of manufacturers (suppliers) today are pursuing a forward integration strategy by establishing websites to directly sell products to consumers. This strategy is causing turmoil in some industries. For example, Apple Inc. recently began selling its iPad and iPhone through Verizon Wireless's 2,000 stores and AT&T's 2,200 stores. Apple's forward integration strategy aims to capitalize on its lead in tablets before the rival BlackBerry and Motorola versions are released.

Based in Herzogenaurach, Germany, Adidas plans to add 2,500 stores in China between 2011 and 2015 as the company widens its distribution in that country from 500 cities currently to over 1,400. As part of its new forward integration strategy in China, Adidas plans also to boost its presence in basketball, a sport that Adidas emphasizes less than competitors such as Nike and Li Ning Company, China's leading sports-apparel maker. Adidas recently sponsored the Beijing Marathon, the company's first running competition in China.

Chrysler Group LLC in 2011 opened its first company-owned dealership, Motor Village of Los Angeles, a four-level facility in downtown Los Angeles that houses all of Chrysler's brands, including Fiat. This dealership sells and services all Chrysler vehicles and is a test facility for showroom innovations.

Wal-Mart Stores recently began allowing customers to buy merchandise online at www.walmart.com and have it delivered free of charge to urban FedEx Corp. locations. Wal-Mart has never been very successful in large cities, and the company sees this new forward integration strategy as beneficial. Wal-Mart is test marketing this new strategy in Boston and Los Angeles, where the company has no stores.

The Washington Post Co. recently launched a free news-aggregation website called Trove that lets readers build their own news site based on particular topics they choose. Battered by declining revenues, newspaper companies are using forward integration to provide services that tailor the news experience to each individual reader. Trove sifts through more than 10,000 news sources and delivers articles to a personalized customer page.

An effective means of implementing forward integration is *franchising*. Approximately 2,000 companies in about 50 different industries in the United States use franchising to

distribute their products or services. Businesses can expand rapidly by franchising because costs and opportunities are spread among many individuals. Total sales by franchises in the United States are annually about \$1 trillion.

The International Franchise Association Educational Foundations reports that the number of franchise businesses in the United States is expected to grow 2.5 percent in 2011 to 784,802. However, a growing trend is for franchisees, who for example may operate 10 franchised restaurants, stores, or whatever, to buy out their part of the business from their franchiser (corporate owner). There is a growing rift between franchisees and franchisers as the segment often outperforms the parent. For example, McDonald's today owns only about 20 percent of its 32,800 restaurants. Restaurant chains are increasingly being pressured to own fewer of their locations. Companies such as McDonald's are using proceeds from the sale of company stores/restaurants to franchisees to buy back company stock, pay higher dividends, and make other investments to benefit shareholders.

The following six guidelines indicate when forward integration may be an especially effective strategy:⁵

- When an organization's present distributors are especially expensive, or unreliable, or incapable of meeting the firm's distribution needs.
- When the availability of quality distributors is so limited as to offer a competitive advantage to those firms that integrate forward.
- When an organization competes in an industry that is growing and is expected to continue to grow markedly; this is a factor because forward integration reduces an organization's ability to diversify if its basic industry falters.
- When an organization has both the capital and human resources needed to manage the new business of distributing its own products.
- When the advantages of stable production are particularly high; this is a consideration because an organization can increase the predictability of the demand for its output through forward integration.
- When present distributors or retailers have high profit margins; this situation suggests that a company could profitably distribute its own products and price them more competitively by integrating forward.

Backward Integration

Both manufacturers and retailers purchase needed materials from suppliers. *Backward integration* is a strategy of seeking ownership or increased control of a firm's suppliers. This strategy can be especially appropriate when a firm's current suppliers are unreliable, too costly, or cannot meet the firm's needs.

Wal-Mart recently announced that over the next five years the company will double the amount of food bought from local farmers in the United States. This backward integration strategy complements the company's plan to build hundreds of new, smaller Wal-Mart Express stores in small towns across the U.S. Wal-Mart hopes to reverse the booming business of Family Dollar, Dollar General, and Dollar Tree—which together have caused Wal-Mart's U.S. revenues to decline.

The largest coffee company in the world and, based in Switzerland, Nestle is training thousands of farmers over the next 10 years and providing them with new coffee trees. With this backward integration strategy, Nestle does not own the plantations or bind farmers into long-term contracts, but CEO Paul Bulcke says the relationship the firm develops with farmers will lead them to sell to Nestle. This may be a wise strategy for Nestle because rival firms such as Unilever and Kraft Foods struggle to obtain better control of raw materials. Nestle's coffee strategy comes just after the firm's backward integration strategy of recently spending \$106 million to replant cocoa trees in Ivory Coast in West Africa.

Some industries in the United States, such as the automotive and aluminum industries, are reducing their historical pursuit of backward integration. Instead of owning their suppliers, companies negotiate with several outside suppliers. Ford and Chrysler buy over half of their component parts from outside suppliers such as TRW, Eaton, General Electric, and Johnson Controls. *De-integration* makes sense in industries that have global sources of supply. Companies today shop around, play one seller against another, and go with the best deal.

Global competition is also spurring firms to reduce their number of suppliers and to demand higher levels of service and quality from those they keep. Although traditionally relying on many suppliers to ensure uninterrupted supplies and low prices, American firms now are following the lead of Japanese firms, which have far fewer suppliers and closer, long-term relationships with those few. "Keeping track of so many suppliers is onerous," says Mark Shimeloni, formerly of Xerox.

Seven guidelines when backward integration may be an especially effective strategy are:⁶

- When an organization's present suppliers are especially expensive, or unreliable, or incapable of meeting the firm's needs for parts, components, assemblies, or raw materials.
- When the number of suppliers is small and the number of competitors is large.
- When 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.
- When an organization has both capital and human resources to manage the new business of supplying its own raw materials.
- When 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.
- When present supplies have high profit margins, which suggests that the business of supplying products or services in the given industry is a worthwhile venture.
- When an organization needs to quickly acquire a needed resource.

Horizontal Integration

Horizontal integration refers to a strategy of seeking ownership of or increased control over a firm's competitors. One of the most significant trends in strategic management today is the increased use of horizontal integration as a growth strategy. Mergers, acquisitions, and takeovers among competitors allow 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.⁷

Consolidation is intensifying weekly in the airline industry. Dallas, Texas-based Southwest Airlines recently paid \$1.4 billion in cash and stock to acquire AirTran Holdings based in Orlando, Florida. AirTran also had a hub at the world's largest airport—Atlanta International Airport in Georgia. Fierce rivals United Airlines and Continental Airlines recently combined forces to eclipse Delta as the world's largest airline. Southwest now flies more passengers inside the United States (105 million) annually than any other airline.

Horizontal integration is becoming the strategy of choice in countless industries to achieve economies of scale and efficiencies. Unilever PLC, for example, just acquired the U.S. hair-care firm Alberto Culver, moving into direct competition with Procter & Gamble and L'Oreal SA in shampoo and other personal products. Although known primarily for food products such as Ben & Jerry's ice cream and Lipton tea, Unilever is a huge personal-care products firm having months earlier purchased Sara Lee Corp.'s deodorant and body care products for \$1.73 billion.

Canadian banks in general came through the recession in excellent shape and are aggressively looking to acquire U.S. banks. The Bank of Montreal recently purchased Milwaukee-based Marshall & Ilsley Corp. for \$4.1 billion and there are many similar examples. Unlike U.S. banks, Canada's banks did not require bailout funds and avoided the subprime-mortgage crisis due to conservative lending practices and tight regulations.

These five guidelines indicate when horizontal integration may be an especially effective strategy.⁸

- When 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.
- When an organization competes in a growing industry.
- When increased economies of scale provide major competitive advantages.
- When an organization has both the capital and human talent needed to successfully manage an expanded organization.
- When competitors are faltering due to 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. United Parcel Service (UPS) recently launched its largest marketing campaign ever, replacing its memorable slogan “What can Brown do for you?” with the slogan “We [Heart] Logistics”. Advertisements promoting this new slogan are running worldwide on both television and digital-media outlets. The television ads feature a new UPS jingle set to the tune of the Dean Martin classic “That’s Amore” sung in Mandarin, Spanish, or English as appropriate.

The maker of Guinness beer recently launched its largest marketing push ever in the United States, including a sports-themed advertising campaign that features ex-footballer Jerome Bettis and ex-NFL coach Bill Cowher. Guinness has long been associated with soccer and rugby, but now wants to be associated with football and basketball.

Starbucks is tripling its number of outlets in China. Dunkin’Brands, which owns both Dunkin’ Donuts and Baskin-Robbins, also is opening thousands of new outlets in China.

These five guidelines indicate when market penetration may be an especially effective strategy:⁹

- When current markets are not saturated with a particular product or service.
- When the usage rate of present customers could be increased significantly.
- When the market shares of major competitors have been declining while total industry sales have been increasing.
- When the correlation between dollar sales and dollar marketing expenditures historically has been high.
- When increased economies of scale provide major competitive advantages.

Market Development

Market development involves introducing present products or services into new geographic areas. For example, Ford Motor is introducing eight new vehicles in India between 2011 and 2015 to capitalize on increasing demand in the fast-expanding car market. Ford also has begun exporting its new Figo small car from India to 50 new markets, including Mexico, North Africa, and the Middle East. Ford’s new market development strategy is aimed at taking advantage of fast-growing emerging markets while insulating the firm from slow-growing U.S. and European markets.

The oldest American beer brewer, D.G. Yuengling & Son, recently expanded beyond its 13-state footprint in the Eastern U.S. Pronounced ying-ling, the 181-year-old regional beer brewer bought a former Coors brewery in Memphis, Tennessee, more than doubling its overall capacity and enabling an aggressive market development strategy. Yuengling has about 250 employees compared to about 700 at rival firm Samuel Adams.

Based in Sweden, Volvo is building three new assembly plants in China and increasing its number of vehicles in that country from 24,000 to 300,000 in the next three years. Volvo desires to become one of China's largest car manufacturers and is launching 24 new models in that country between 2011 and 2015. Volvo used to be owned by Ford.

Las Vegas Sands Corp. recently built the only casino in Singapore, the famous city-state that has a global reputation for being crime-free and family-friendly. Called the Marina Bay Sands, this casino was a booming success in 2010–2011 and expectations are that as early as 2012, Singapore may take in more gaming revenues than Las Vegas. Another new casino in Singapore is the \$4.4 billion Resorts World Sentosa owned by Malaysia's Genting Bhd.

Both Subway and Dunkin' Brands recently opened their first restaurants in Vietnam. Subway also just opened its first outlet in Bahrain. Subway expects its number of international restaurants to surpass its number of U.S. restaurants by 2020. Many customers say it is hard to beat Subway's \$5 foot-long sandwiches in terms of value and nutrition. Starbucks expects to open its first restaurants in India within 12 months.

These six guidelines indicate when market development may be an especially effective strategy:¹⁰

- When new channels of distribution are available that are reliable, inexpensive, and of good quality.
- When an organization is very successful at what it does.
- When new untapped or unsaturated markets exist.
- When an organization has the needed capital and human resources to manage expanded operations.
- When an organization has excess production capacity.
- When 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. Google's new Chrome OS operating system illuminates years of monies spent on product development. Google expects Chrome OS to overtake Microsoft Windows by 2015.

Product development is perhaps the most important strategy for high-tech firms such as Acer. To compete with Apple's iPad and tablets, the world's second-largest PC maker by shipments, Acer, released in 2011 a tablet running Microsoft Windows software with a 10.1-inch screen. Acer also released two tablets using Google's Android software. Acer expects to sell about 50 million tablets worldwide in 2011. Historically, Acer had relied on netbooks (tiny, low-priced laptops). Also recently, Acer released a smartphone with a 4.8-inch screen running on Android software.

The world's largest hotel chain, Holiday Inn, recently completed a \$1 billion upgrade to all of its 3,400 hotels. The mandatory upgrades includes new bedding, flat-screen TVs, better shower fixtures, and sleeker roadside signs. The product development strategy also includes closing 700 older, outdated hotels and adding 1,100 new, deluxe Holiday Inn hotels so the average age of Holiday Inn hotels is now 15 years.

Hilton Worldwide recently opened its first new hotel brand in 20 years—a Home2 Suites in Fayetteville, North Carolina. Home2 Suites moves Hilton into the mid-tier extended-stay market, although the company already owns Homewood Suites, aimed at the upscale extended-stay segment. Hilton opened about 10 new Home2 Suites in the U.S. in 2011.

In total, there were 40,820 new products introduced in the United States in 2010, up from 38,738 in 2009, and expected to exceed 45,000 in 2011.¹¹ Social media, especially Facebook, Twitter, and YouTube, is being used extensively by companies to both generate new ideas and market resultant new products, such as Colgate's new foaming toothpaste called Colgate MaxClean SmartFoam.

These five guidelines indicate when product development may be an especially effective strategy to pursue:¹²

- When 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.
- When an organization competes in an industry that is characterized by rapid technological developments.
- When major competitors offer better-quality products at comparable prices.
- When an organization competes in a high-growth industry.
- When an organization has especially strong research and development capabilities.

Diversification Strategies

There are two general types of *diversification strategies*: related and unrelated. 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.¹³ Most companies favor related diversification strategies in order 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.¹⁴

Diversification strategies are becoming less popular as 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 now on the retreat. Michael Porter, of the Harvard Business School, says, "Management found it couldn't manage the beast." Hence businesses are selling, or closing, less profitable divisions to focus on core businesses.

The greatest risk of being in a single industry is having all of the firm's eggs in one basket. Although many firms are successful operating in a single industry, new technologies, new products, or fast-shifting buyer preferences can decimate a particular business.

Diversification must do more than simply spread business risk across different industries, however, because 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 the strategy adds more to shareholder value than what shareholders could accomplish acting individually. Thus, the chosen industry 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.

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, Allied Signal, Emerson Electric, General Electric, Viacom, and Samsung. Conglomerates prove that focus and diversity are not always mutually exclusive.

Many strategists contend that firms should "stick to the knitting" and not stray too far from the firms' basic areas of competence. However, diversification is still sometimes an appropriate strategy, especially when the company is competing in an unattractive industry. Hamish Maxwell, Philip Morris's former CEO, says, "We want to become a consumer-products company." Diversification makes sense for Philip Morris because cigarette consumption is declining, product liability suits are a risk, and some investors reject tobacco stocks on principle.

Related Diversification

In the 2010–2015 era, firms are generally moving away from diversification to focus. That dismantling is a clear trend. For example, ITT Corp. recently divided itself into three separate, specialized companies. ITT once 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.”

Bucking the trend however is Berkshire Hathaway, a holding company for diverse companies that include Dairy Queen, Burlington Northern Santa Fe Railroad, and Geico Insurance. Also bucking the trend, Panasonic Corp. recently diversified into hand-held, online videogames with a new product called the Jungle. Panasonic for years had focused on rechargeable batteries for electric cars as well as solar cells for home and industry, but with the Jungle, the firm is re-entering a business that it abandoned more than a decade ago.

PepsiCo in 2011 diversified into the dairy market by acquiring the Russian firm Wimm-Bill-Dann for \$5.4 billion. This acquisition establishes PepsiCo as the largest food-and-beverage firm in Russia, and that country becomes PepsiCo’s largest revenue generator outside of the United States. This acquisition comes soon after PepsiCo’s \$2 billion acquisition of the Russian fruit-juice maker OAO Lebedyansky. PepsiCo and Coke are fierce rivals in Russia, and of course around the world.

Electricity producer, NRG Energy Inc., recently entered the car-charging business, creating a network of 150 public charging points in Houston, Texas, and New York City. This is a “first mover” strategy because it signals that car charging may follow a subscription-based business model, rather than the price-per-unit model that has been used for decades to sell gasoline. NRG’s customers will have a choice of three subscription plans, each with a three-year contract, beginning with a \$49 monthly fee.

Based in Peoria, Illinois, Caterpillar recently diversified beyond its core areas of construction and mining machinery by acquiring a maker of railroad locomotives, Electro-Motive Diesel, and by also acquiring MWM Holding GmbH, a German maker of power-generation equipment. Caterpillar had cash and short-term investments of \$2.27 billion and preferred to use those monies “to fund attractive growth initiatives” rather than to repurchase stock or increase dividend payouts.

Intel Corp. recently diversified beyond providing chips for personal computers by acquiring for \$7.68 billion the security-software company McAfee, well known for its virus protection software. As part of this diversification strategy away from personal computer chips, Intel also acquired a Texas Instruments division that sells cable-modem chips as well as Infineon Technologies, AG’s wireless chip business. Intel is also working with Google to supply chips that enable people to more easily navigate through websites and TV programs.

In a related diversification move, Tyson Foods recently entered the dog food business, selling refrigerated pet food targeted to consumers who give their pets everything from clothes and car seats to cemetery graves. Prior to this move by Tyson, meatpacking companies had been content to sell scraps such as chicken fat and by-products to makers of canned and dry pet food. Scott Morris of Freshpet Company in Secaucus, New Jersey, says this move by Tyson will change the fact that “pet food today looks the same as it did 30 years ago.”

Six guidelines for when related diversification may be an effective strategy are as follows.¹⁵

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

Unrelated Diversification

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, or companies that are financially distressed, or companies that have high growth prospects but are short on investment capital. An obvious drawback of unrelated diversification is that the parent firm must have an excellent top management team that plans, organizes, motivates, delegates, and controls effectively. It is much more difficult to manage businesses in many industries than in a single industry. However, some firms are successful pursuing unrelated diversification, such as Walt Disney, which owns ABC, and General Electric, which owns NBC Universal. GE also produces locomotives, airplanes, appliances, and MRI machines and offers consumer finance, media, entertainment, oil, gas, and lighting products and services.

Tyson Foods recently launched a new diversification strategy, successfully opening a manufacturing plant that makes diesel and jet fuel from chicken fat, beef tallow, and leftover food grease from the firm's meat-processing plants. Tyson's new Louisiana factory can produce 75 million gallons of fat-based fuel annually. Working with Syntroleum Corp, Tyson is using heat to change the molecular structure of fats and oils so their new product performs like conventional fuels rather than similar biodiesel products.

In early 2011, Deutsche Bank opened a \$4 billion, 3,000-room casino called the Cosmopolitan on the Las Vegas Strip. The huge German bank was originally just funding the project, but when developers defaulted on their loans, Deutsche decided to finish the last two years of work on the project and own and operate the new casino themselves. The new Cosmopolitan features a three-story, crystal-strewn bar meant to evoke the inside of a chandelier. Other financial institutions worldwide perhaps should consider unrelated diversification also by taking over some of their gone-bad projects rather than taking huge losses. Many more firms have failed at unrelated diversification than have succeeded due to immense management challenges.

Ten guidelines for when unrelated diversification may be an especially effective strategy are:¹⁶

- When revenues derived from an organization's current products or services would increase significantly by adding the new, unrelated products.
- When an organization competes in a highly competitive and/or a no-growth industry, as indicated by low industry profit margins and returns.
- When an organization's present channels of distribution can be used to market the new products to current customers.
- When the new products have countercyclical sales patterns compared to an organization's present products.
- When an organization's basic industry is experiencing declining annual sales and profits.
- When an organization has the capital and managerial talent needed to compete successfully in a new industry.
- When an organization has the opportunity to purchase an unrelated business that is an attractive investment opportunity.
- When there exists financial synergy 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.)
- When existing markets for an organization's present products are saturated.
- When 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 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 entail 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.

Abbott Laboratories in 2011 cut about 3,000 jobs, or 3 percent of its workforce, as part of a major retrenchment strategy to streamline operations and improve efficiencies. Based in Abbott Park, Illinois, the company says most of the layoffs will be in its European operations. Abbott recently acquired Solvay SA's pharmaceutical division for about \$6.1 billion. Abbott restructuring included closure of the Solvay facility in Marietta, Georgia.

A total of 157 banks in the United States ceased operations in 2010 due to financial insolvency. Many more banks followed suit in 2011, such as First Tier Bank in Louisville, Colorado and Enterprise Banking in McDonough, Georgia.

In some cases, *bankruptcy* can be an effective type of 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 7, Chapter 9, Chapter 11, Chapter 12, and Chapter 13.

Chapter 7 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. Chapter 7 is also the bankruptcy provision most frequently used by individuals to wipe out many types of unsecured debt.

Chapter 9 bankruptcy applies to municipalities. Prichard, Alabama (near Mobile), recently declared Chapter 9 bankruptcy when it "simply ran out of money to pay its pension obligations." Five municipalities in the United States filed Chapter 9 bankruptcy in 2010, but this part of the bankruptcy code is largely untested in courts. In fact, 21 states currently do not allow municipalities to file Chapter 9 bankruptcy. More than a dozen towns/cities in California, however, are expected to declare bankruptcy in the next 12 months., including San Diego, San Jose, and San Francisco.

Jefferson County in Alabama is home to Birmingham. The county is on the verge of declaring bankruptcy, as its fiscal soundness has deteriorated way beyond repair. Several Jefferson County former officials have been convicted of corruption charges related to sewer-bond dealings, which, coupled with inept management over many years, has led to the County's predicament. Norfolk, Virginia is in serious financial trouble, as is Reno, New York City, and Detroit.

Chapter 11 bankruptcy allows organizations to reorganize and come back after filing a petition for protection.

Chapter 12 bankruptcy was created by the Family Farmer Bankruptcy Act of 1986. This law became effective in 1987 and 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 11, 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.

Based in Los Angeles, California, Metro-Goldwyn-Mayer (MGM) Inc. recently declared Chapter 11 bankruptcy. MGM owns more than 4,100 movie titles, including the *James Bond* and *Rocky* franchises, but the firm's huge debt situation became too high to service.

Publisher of the *National Enquirer* and the *Star and Men's Fitness* magazines, American Media Inc. recently declared Chapter 11 bankruptcy. Based in Boca Raton, Florida, American Media told its advertisers, employees, customers, and vendors to expect "business as usual" during its restructuring.

Based in Secaucus, New Jersey, Urban Brands recently filed bankruptcy and is closing most of its 210 Ashley Stewart stores in 26 states. The stores primarily provide apparel for plus-size urban women.

The fast-food pizza chain, Sbarro Inc., recently declared Chapter 11 bankruptcy. Founded in the late 1950s by the Sbarro family, the company had grown to operate more than 1,000 stores in 40 countries, becoming a common sight in malls. Based in Melville, New York, Sbarro employs about 5,000 people.

Some of the largest bankruptcies in the United States in 2010 were: Ambac Financial Group, Corus Bankshares, FirstFed Financial, Blockbuster, Great Atlantic & Pacific (A&P) Tea, Mesa Air Group, and Affiliated Media. However, there were only 106 public U.S. companies filing bankruptcy in 2010, less than half the 211 public firms that filed the prior year, according to BankruptcyData.com. Owners of the Viceroy resort on the Caribbean island of Anguilla recently declared Chapter 11 bankruptcy protection in Delaware.

Five guidelines for when retrenchment may be an especially effective strategy to pursue are as follows:¹⁷

- When an organization has a clearly distinctive competence but has failed consistently to meet its objectives and goals over time.
- When an organization is one of the weaker competitors in a given industry.
- When an organization is plagued by inefficiency, low profitability, poor employee morale, and pressure from stockholders to improve performance.
- When 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).
- When 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*. Divestiture often is 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. For example, the New York-based entertainment company, Viacom, recently divested of its Harmonix videogame division, which had produced the popular "Rock Band" line of games. Harmonix's "Rock Band" had been locked in brutal competition with a rival video game, "Guitar Hero," from Activision Blizzard, which is 60 percent owned by Vivendi SA.

Based in Downers Grove, Illinois, Sara Lee Corp. recently divested its North American bread division to Mexican bakery giant Grupo Bimbo for nearly \$1 billion. Sara Lee continues to divest nonfood and low-margin units in order to focus on top brands such as Jimmy Dean, Ballpark hot dogs, and Hillshire Farm. Sara Lee is using much of those proceeds to buy back 2.5 million shares of their own stock (because the smaller, more focused company is a candidate for a takeover).

Based in Louisville, Kentucky, the maker of Jack Daniel's whiskey, Brown-Forman Corp., is trying to divest its wine business, which consists of eight wine brands that generated \$310 million in sales in fiscal 2011. The company's flagship wines include Fetzer, Boneterra, and Sonoma-Cutrer. The wine business is challenging because it is capital intensive and wine consumers commonly experiment with different brands.

The private-equity fund Cerberus Capital Management LP recently sold its Chrysler Financial Corp. division to Toronto, Canada-based Toronto-Dominion Bank for roughly \$80 billion. The acquisition by Canada's second-largest bank makes it one of the five biggest auto lenders in the U.S.

Clorox Company recently divested its auto-care division to private-equity firm Avista Capital Partners for about \$780 million. Clorox desires to focus on its health-and-wellness products and desires to buy back some of its own stock. Clorox's auto-care brands that included STP and Armor All generated global sales of about \$300 million.

Yum Brands is trying to divest its Long John Silver's and A&W Restaurants chains so the firm can focus on its KFC, Pizza Hut, and Taco Bell international businesses.

Historically firms have divested their unwanted or poorly performing divisions, but the global recession has witnessed firms simply closing such operations. For example, Home Depot is shutting down its Expo home-design stores; defense and aerospace manufacturer Textron Corp is closing groups that financed real estate deals; Pioneer Corp. will soon stop making televisions; Praxair Inc. is closing some of its service-related businesses outside the United States; even Google recently halted efforts to sell advertising on radio stations and in newspapers. Saks, the luxury clothing chain, recently closed 16 of its 18 bridal salons, leaving open only its departments in Manhattan and Beverly Hills.

Six guidelines for when divestiture may be an especially effective strategy to pursue follow:¹⁸

- When an organization has pursued a retrenchment strategy and failed to accomplish needed improvements.
- When a division needs more resources to be competitive than the company can provide.
- When a division is responsible for an organization's overall poor performance.
- When a division is a misfit with the rest of an organization; this can result from radically different markets, customers, managers, employees, values, or needs.
- When a large amount of cash is needed quickly and cannot be obtained reasonably from other sources.
- When government antitrust action threatens an organization.

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. However, it may be better to cease operating than to continue losing large sums of money. For example, based in Mayodan, North Carolina, General Tobacco (GT) liquidated in 2011, as the maker of low-priced cigarettes failed to make payments owed to states under a massive industry settlement. Some GT brands were Bronco, Silver, and GT One.

Thousands of small businesses in the United States liquidate annually without ever making the news. It is tough to start and successfully operate a small business. In China and Russia, thousands of government-owned businesses liquidate annually as those countries try to privatize and consolidate industries.

These three guidelines indicate when liquidation may be an especially effective strategy to pursue:¹⁹

- When an organization has pursued both a retrenchment strategy and a divestiture strategy, and neither has been successful.
- When an organization's only alternative is bankruptcy. Liquidation represents an orderly and planned means of obtaining the greatest possible cash for an organization's assets. A company can legally declare bankruptcy first and then liquidate various divisions to raise needed capital.
- When the stockholders of a firm can minimize their losses by selling the organization's assets.

Michael Porter's Five Generic Strategies

Probably the three most widely read books on competitive analysis in the 1980s were Michael Porter's *Competitive Strategy* (Free Press, 1980), *Competitive Advantage* (Free Press, 1985), and *Competitive Advantage of Nations* (Free Press, 1989). According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Porter calls these bases *generic strategies*.

Cost leadership emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive. Two alternative types of cost leadership strategies can be defined. Type 1 is a *low-cost* strategy that offers products or services to a wide range of customers at the lowest price available on the market. Type 2 is a *best-value* strategy that offers products or services to a wide range of customers at the best price-value available on the market; the best-value 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. Both Type 1 and Type 2 strategies target a large market.

Porter's Type 3 generic strategy is *differentiation*, a strategy aimed at producing products and services considered unique industrywide and directed at consumers who are relatively price-insensitive.

Focus means producing products and services that fulfill the needs of small groups of consumers. Two alternative types of focus strategies are Type 4 and Type 5. Type 4 is a *low-cost focus* strategy that offers products or services to a small range (niche group) of customers at the lowest price available on the market. Examples of firms that use the Type 4 strategy include Jiffy Lube International and Pizza Hut, as well as local used car dealers and hot dog restaurants. Type 5 is a *best-value focus* strategy that offers products or services to a small range of customers at the best price-value available on the market. Sometimes called "focused differentiation," the best-value focus strategy aims to offer a niche group of customers products or services that meet their tastes and requirements better than rivals' products do. Both Type 4 and Type 5 focus strategies target a small market. However, the difference is that Type 4 strategies offer products or services to a niche group at the lowest price, whereas Type 5 offers products/services to a niche group at higher prices but loaded with features so the offerings are perceived as the best value. Examples of firms that use the Type 5 strategy include Cannondale (top-of-the-line mountain bikes), Maytag (washing machines), and Lone Star Restaurants (steak house), as well as bed-and-breakfast inns and local retail boutiques.

Porter's five strategies imply different organizational arrangements, control procedures, and incentive systems. Larger firms with greater access to resources typically compete on a cost leadership and/or differentiation basis, whereas smaller firms often compete on a focus basis. Porter's five generic strategies are illustrated in Figure 5-3. Note that a differentiation strategy (Type 3) can be pursued with either a small target market or a large target market. However, it is not effective to pursue a cost leadership strategy in a small market because profits margins are generally too small. Likewise, it is not effective to pursue a focus strategy in a large market because economies of scale would generally favor a low-cost or best-value cost leadership strategy to gain and/or sustain competitive advantage.

Porter stresses the need for strategists to perform cost-benefit analyses to evaluate "sharing opportunities" among a firm's existing and potential business units. Sharing activities and resources enhances competitive advantage by lowering costs or increasing differentiation.

FIGURE 5-3

Porter's Five Generic Strategies

- Type 1: Cost Leadership—Low Cost
- Type 2: Cost Leadership—Best Value
- Type 3: Differentiation
- Type 4: Focus—Low Cost
- Type 5: Focus—Best Value

| | | GENERIC STRATEGIES | | |
|----------------|-------|--------------------|-----------------|------------------|
| | | Cost Leadership | Differentiation | Focus |
| SIZE OF MARKET | Large | Type 1 Type 2 | Type 3 | — |
| | Small | — | Type 3 | Type 4 Type 5 |

Source: Based on Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980), 35-40.

In addition to prompting sharing, Porter stresses the need for firms to effectively “transfer” skills and expertise among autonomous business units to gain competitive advantage. Depending on factors such as type of industry, size of firm, and nature of competition, various strategies could yield advantages in cost leadership, differentiation, and focus.

Cost Leadership Strategies (Type 1 and Type 2)

A primary reason for pursuing forward, backward, and horizontal integration strategies is to gain low-cost or best-value cost leadership benefits. But cost leadership generally must be pursued in conjunction with differentiation. A number of cost elements affect the relative attractiveness of generic strategies, including economies or diseconomies of scale achieved, learning and experience curve effects, the percentage of capacity utilization achieved, and linkages with suppliers and distributors. Other cost elements to consider in choosing among alternative strategies include the potential for sharing costs and knowledge within the organization, R&D costs associated with new product development or modification of existing products, labor costs, tax rates, energy costs, and shipping costs.

Striving to be the low-cost producer in an industry can be especially effective when the market is composed of many price-sensitive buyers, when there are few ways to achieve product differentiation, when buyers do not care much about differences from brand to brand, or when there are a large number of buyers with significant bargaining power. The basic idea is to underprice competitors and thereby gain market share and sales, entirely driving some competitors out of the market. Companies employing a low-cost (Type 1) or best-value (Type 2) cost leadership strategy must achieve their competitive advantage in ways that are difficult for competitors to copy or match. If rivals find it relatively easy or inexpensive to imitate the leader’s cost leadership methods, the leaders’ advantage will not last long enough to yield a valuable edge in the marketplace. Recall that for a resource to be valuable, it must be either rare, hard to imitate, or not easily substitutable. To employ a cost leadership strategy successfully, a firm must ensure that its total costs across its overall value chain are lower than competitors’ total costs. There are two ways to accomplish this:²⁰

1. Perform value chain activities more efficiently than rivals and control the factors that drive the costs of value chain activities. Such activities could include altering the plant layout, mastering newly introduced technologies, using common parts or components in different products, simplifying product design, finding ways to operate close to full capacity year-round, and so on.
2. Revamp the firm’s overall value chain to eliminate or bypass some cost-producing activities. Such activities could include securing new suppliers or distributors, selling products online, relocating manufacturing facilities, avoiding the use of union labor, and so on.

When employing a cost leadership strategy, a firm must be careful not to use such aggressive price cuts that their own profits are low or nonexistent. Constantly be mindful of cost-saving technological breakthroughs or any other value chain advancements that could erode or destroy the firm’s competitive advantage. A Type 1 or Type 2 cost leadership strategy can be especially effective under the following conditions:²¹

1. When price competition among rival sellers is especially vigorous.
2. When the products of rival sellers are essentially identical and supplies are readily available from any of several eager sellers.
3. When there are few ways to achieve product differentiation that have value to buyers.
4. When most buyers use the product in the same ways.
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. Several example firms that are well known for their low-cost leadership strategies are Wal-Mart, BIC, McDonald's, Black & Decker, Lincoln Electric, and Briggs & Stratton.

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, spare parts availability, engineering design, product performance, useful life, gas mileage, 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, Mountain Dew and root beer have a unique taste; Lowe's, Home Depot, and Wal-Mart offer wide selection and one-stop shopping; Dell Computer and FedEx offer superior service; BMW and Porsche offer engineering design and performance; IBM and Hewlett-Packard offer a wide range of products; and E*Trade and Ameritrade offer Internet convenience. Differentiation opportunities exist or can potentially be developed anywhere along the firm's value chain, including supply chain activities, product R&D activities, production and technological activities, manufacturing activities, human resource management activities, distribution activities, or marketing activities.

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, 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.²² Based on 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:²³

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. Milwaukee, Wisconsin-based Johnson Controls focuses on being a supplier of car interior products. Johnson Controls recently purchased Germany's Keiper Recaro Group's auto-parts business, which added 4,750 employees in seven countries producing devices that recline and adjust automobile seats. Johnson Controls now sells about \$18 billion in auto-related products annually, although it also has a heating and ventilation equipment segment of the business.

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 on particular 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:²⁴

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, medical, 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.

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. 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.

An example turbulent, high-velocity market is the tablet computer, with more than 100 companies trying to emulate Apple's iPad and tablet products. Sales of tablet computers exceeded 20 million units in 2010 and 60 million units in 2011. A version of Google's Android operating system is now powering tablets, including Google's Honeycomb system. Apple utilizes a lead-change strategy as one of the strongest firms in the turbulent computer tablet industry, with firms such as Samsung and Toshiba aggressively pursuing a react-to-change strategy. The first laptop computers running on Google's Chrome OS were manufactured by Acer Inc. and Samsung Electronics and went on sale in mid-2011. Google is working with Verizon Wireless to ensure that Chrome laptops always stay online.

One strategy to compete in a turbulent industry is to acquire rivals, thus gaining economies of scale and improved efficiencies. For example, AT&T just acquired rival T-Mobile USA for \$39 billion, creating the largest U.S. cellphone company, and Charles Schwab Corp. acquired online brokerage services provider OptionsXpress for \$1 billion.

Means for Achieving Strategies

Cooperation Among Competitors

Strategies that stress cooperation among competitors are being used more. For collaboration between competitors to succeed, both firms must contribute something distinctive, such as technology, distribution, basic research, or manufacturing capacity. But a major risk is that unintended transfers of important skills or technology may occur at organizational levels below where the deal was signed.²⁵ Information not covered in the formal agreement often gets traded in the day-to-day interactions and dealings of engineers, marketers, and product developers. Firms often give away too much information to rival firms when operating under cooperative agreements! Tighter formal agreements are needed.

Perhaps the best example of rival firms in an industry forming alliances to compete against each other is the airline industry. Today there are three major alliances: Star, SkyTeam, and Oneworld, but other alliances are forming, such as the new trans-Atlantic joint venture among American Air, British Air, and Iberia Air formed by Oneworld. There is also a new trans-Pacific joint venture among American, Japan Air, United Continental, and All Nippon Air.

The idea of joining forces with a competitor is not easily accepted by Americans, who often view cooperation and partnerships with skepticism and suspicion. Indeed, joint ventures and cooperative arrangements among competitors demand a certain amount of trust if companies are to combat paranoia about whether one firm will injure the other. However, multinational firms are becoming more globally cooperative, and increasing numbers of domestic firms are joining forces with competitive foreign firms to reap mutual benefits. Kathryn Harrigan at Columbia University says, "Within a decade, most companies will be members of teams that compete against each other." Once major rivals, Google's YouTube and Vivendi SA's Universal Music Group have formed a partnership called Vevo to provide a new music-video service. Google provides the technology and Universal Music provides the content, and both firms share the revenues. The two firms now operate the stand-alone site Vevo.com.

U.S. companies often enter alliances primarily to avoid investments, being more interested in reducing the costs and risks of entering new businesses or markets than in acquiring new skills. In contrast, *learning from the partner* is a major reason why Asian and European firms enter into cooperative agreements. U.S. firms, too, should place learning high on the list of reasons to be cooperative with competitors. U.S. companies often form alliances with Asian firms to gain an understanding of their manufacturing excellence, but Asian competence in this area is not easily transferable. Manufacturing excellence is a complex system that includes employee training and involvement, integration with suppliers, statistical process controls, value engineering, and design. In contrast, U.S. know-how in technology and related areas can be imitated more easily. U.S. firms thus need to be careful not to give away more intelligence than they receive in cooperative agreements with rival Asian firms.

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 research and development partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia. Facebook Inc. and Skype SA recently combined their communications services more closely under a new partnership that allows Facebook members to sign into Skype through their Facebook Connect account and then send text messages or set up voice chats and video chats with their Facebook friends from within Skype. The partnership puts pressure on Google because it links Skype's 580 million registered users with Facebook's 500 million members. For the first time ever, U.S. Internet users spent 41.1 billion minutes on Facebook in August 2010, surpassing Google's 39.8 billion minutes.²⁶

The world's largest cellphone maker, Nokia Corp., recently formed a partnership with the world's largest software company, Microsoft, whereby the Finnish company will receive billions of dollars from Microsoft to develop and market smartphones using Microsoft's operating system. Nokia still has the largest market share in the handset business but is losing ground. The partnership is designed to compete with Google's Android mobile-phone operating system and with Apple Inc.'s iPhone. Nokia's new smartphones will use Window Phone as their principal operating system, replacing its own Symbian software and Intel's MeeGo operating system. About the Nokia-Microsoft partnership, Google executive Vic Gundrota said, "Two turkeys do not make an eagle."

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 when achieving and sustaining competitive advantage when an industry requires a broader range of competencies and know-how than any one firm can marshal. Kathryn Rudie Harrigan, 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?"²⁷

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.²⁸ Strategic partnering takes many forms, including outsourcing, information sharing, joint marketing, and joint research and development. 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 Internet coverage.

A major reason why firms are using partnering as a means to achieve strategies is globalization. Wal-Mart's successful joint venture with Mexico's Cifra is indicative of how a domestic firm can benefit immensely by partnering with a foreign company to gain substantial presence in that new country. Technology also is a major reason behind the need to form strategic alliances, with the Internet linking widely dispersed partners. The Internet paved the way and legitimized the need for alliances to serve as the primary means for corporate growth.

Striving to compete with Google, Microsoft and Facebook recently unveiled a plan to improve the results of Microsoft's Bing search engine by including peoples' social connections on Facebook. The sharing of personal data between Microsoft and Facebook raises privacy concerns because the partnership gives Bing access to all public information about a Facebook user, including their friends' names and photos. Bing powers both Microsoft searches (11.2 percent) and Yahoo searches (16.7 percent), but Google's share of U.S. searches is 66.1 percent.

Evidence is mounting that firms should use partnering as a means for achieving strategies. However, the sad fact is that most U.S. firms in many industries—such as financial services,

forest products, metals, and retailing—still operate in a merger or acquire mode to obtain growth. Partnering is not yet taught at most business schools and is often viewed within companies as a financial issue rather than a strategic issue. However, partnering has become a core competency, a strategic issue of such importance that top management involvement initially and throughout the life of an alliance is vital.²⁹

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. 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.³⁰

Six guidelines for when a joint venture may be an especially effective means for pursuing strategies are:³¹

- 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.
- When two or more smaller firms have trouble competing with a large firm.
- When there exists a need to quickly introduce a new technology.

Merger/Acquisition

Google acquired 48 companies in 2010 and is on pace to eclipse that number in 2011, as the firm seeks ways to boost revenue growth and compete more aggressively in social networking. That may be a record annual number of acquisitions for any company ever. Cisco had 23 acquisitions back in 2000, Microsoft had 18 in 2008, and Oracle had 13 in 2005, but 48 is unreal. Despite Google's 48 acquisitions, the company's stock price dropped 4 percent in 2010—even when the stock market was roaring back.

Merger and acquisition 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. For example, two Japanese steel producers, Nippon Steel Corp. and Sumitomo Metal Industries Ltd., recently merged in friendly fashion to form the world's second largest steel producer behind ArcelorMittal. Canada's Valeant Pharmaceuticals International recently made a hostile takeover bid of \$5.7 billion for smaller rival Cephalon, or \$73 per share, a 24.5 percent premium to Cephalon's stock price of \$58.

There were numerous examples in 2011 of hostile takeover attempts. For example, the French pharmaceutical giant Sanofi-Aventis SA recently launched an \$18.5 billion hostile takeover bid for the U.S. biotech company Genzyme Corp. Sanofi has offered \$69 per share for Genzyme, but analysts say that bid may have to increase to \$85 to seal the deal.

Nasdaq, with help from IntercontinentalExchange (ICE), which operates a global futures exchange and over-the-counter (OTC) markets and derivatives clearing houses, plans to place a hostile takeover bid for the New York Stock Exchange (NYSE) Euronext. Any Nasdaq bid, however, would face significant obstacles, including possible antitrust problems, since nearly every U.S. stock is listed on either the NYSE or Nasdaq. There has been a recent merger frenzy in the stock exchange business. Deutsche Boerse and NYSE Euronext desire to merge to create the world's largest exchange operator in a deal worth \$10.2 billion. There is speculation that Nasdaq might even merge with another international exchange, such as the London Stock Exchange (LSE). The LSE is eyeing a takeover of Nasdaq after recently merging with the Canadian TMX Group, which operates the Toronto and Montreal stock exchanges.

With hundreds of companies flush with excess cash, the year 2010 saw a 13 percent increase in mergers and acquisitions in the United States; 2011 is on pace to exceed that percentage as firms increasingly use mergers to quickly tap into new businesses and reach new markets, both top priorities as companies were previously hunkered down during the recession.

General Electric continues to acquire diverse firms, including its recent purchase of oil-and-gas equipment maker Dresser Inc. for \$3 billion. Based in Dallas, Texas, about 60 percent of Dresser's revenues come from outside the United States. General Electric desires to scale back its big finance business at GE Capital and beef up its industrial and infrastructure operations.

White knight is a term that refers to a firm that agrees to acquire another firm when that other firm is facing a hostile takeover by some company. For example, recently Palo Alto, California-based CV Thereapeutics Inc., a heart-drug maker, was fighting a hostile takeover bid by Japan's Astellas Pharma. Then CVT struck a friendly deal to be acquired by Forest City, California-based Gilead Sciences at a higher price of \$1.4 billion in cash. Gilead is known for its HIV drugs, so its move into the heart-drug business surprised many analysts.

Not all mergers are effective and successful. For example, even 12 months after PulteGroup recently bought rival Centex Corp. for \$1.3 billion in stock, creating the largest home builder in the United States, PulteGroup's profits are still negative and the company's stock price is 30 percent lower than the week of the acquisition. PulteGroup's dismal performance is in sharp contrast to rival firms such as Toll Brothers and Lennar Corp., whose stock price is up 22 percent during the same period. Many analysts say that PulteGroup's acquisition of Centex was poorly timed and a mistake. So a merger between two firms can yield great benefits, but the price and reasoning must be right. Some key reasons why many mergers and acquisitions fail are provided in Table 5-5.

Among mergers, acquisitions, and takeovers in recent years, same-industry combinations have predominated. A general market consolidation is occurring in many industries, especially banking, insurance, defense, and health care, but also in pharmaceuticals, food, airlines, accounting, publishing, computers, retailing, financial services, and biotechnology. For example, There are many potential benefits of merging with or acquiring another firm, as indicated in Table 5-6.

TABLE 5-5 Key Reasons Why Many Mergers and Acquisitions Fail

- Integration difficulties
- Inadequate evaluation of target
- Large or extraordinary debt
- Inability to achieve synergy
- Too much diversification
- Managers overly focused on acquisitions
- Too large an acquisition
- Difficult to integrate different organizational cultures
- Reduced employee morale due to layoffs and relocations

TABLE 5-6 Potential Benefits of Merging With or Acquiring Another Firm

-
- To provide improved capacity utilization
 - To make better use of the existing sales force
 - To reduce managerial staff
 - To gain economies of scale
 - To smooth out seasonal trends in sales
 - To gain access to new suppliers, distributors, customers, products, and creditors
 - To gain new technology
 - To reduce tax obligations
-

The volume of mergers completed annually worldwide is growing dramatically and exceeds \$1 trillion. There are annually more than 10,000 mergers in the United States that total more than \$700 billion. The proliferation of mergers is fueled by companies' drive for market share, efficiency, and pricing power, as well as by globalization, the need for greater economies of scale, reduced regulation and antitrust concerns, the Internet, and e-commerce.

A *leveraged buyout (LBO)* occurs when a corporation's shareholders are bought (hence *buyout*) by the company's management and other private investors using borrowed funds (hence *leverage*).³² Besides trying to avoid a hostile takeover, other reasons for initiating an LBO are senior management decisions that particular divisions do not fit into an overall corporate strategy or must be sold to raise cash, or receipt of an attractive offering price. An LBO takes a corporation private.

Private-Equity Acquisitions

As stock prices increased and companies became cash-rich in 2010–2012, private-equity firms such as Kohlberg Kravis Roberts (KKR) jumped aggressively back into the business of acquiring and selling firms. Private-equity firms have unleashed a wave of new initial public offerings (IPO), such as the IPO of Nielsen Holdings BV, the largest private-equity-backed IPO in the United States in five years. Apollo Global Management is a large private-equity firm that owns many companies. Some private-equity owned firms expected to go public soon include BankUnited Inc., Kinder Morgan Inc., and Toys "R" Us Inc.

The intent of virtually all private-equity acquisitions is to buy firms at a low price and sell them later at a high price, arguably just good business. Many if not most acquisitions in 2010–2012 were by large private-investment firms. For example, 3G Capital Management acquired Burger King Holdings for about \$3.3 billion. CKE Restaurants, owner of the Carl's Jr. and Hardee's burger chains, was acquired by an affiliate of Apollo Management LLC for almost \$700 million. Goldman Sachs's private-equity arm acquired Apple American Group, the largest franchisee (269 restaurants) of Applebee's Neighborhood Grill and Bar based in Independence, Ohio.

First Mover Advantages

First mover advantages refer to the benefits a firm may achieve by entering a new market or developing a new product or service prior to rival firms.³³ As indicated in Table 5-7, some advantages of being a first mover include securing access to rare resources, gaining new

TABLE 5-7 Benefits of a Firm Being the First Mover

-
1. Secure access and commitments to rare resources
 2. Gain new knowledge of critical success factors and issues
 3. Gain market share and position in the best locations
 4. Establish and secure long-term relationships with customers, suppliers, distributors, and investors
 5. Gain customer loyalty and commitments
-

knowledge of key factors and issues, and carving out market share and a position that is easy to defend and costly for rival firms to overtake. First mover advantages are analogous to taking the high ground first, which puts one in an excellent strategic position to launch aggressive campaigns and to defend territory. Being the first mover can be especially wise when such actions (1) build a firm's image and reputation with buyers, (2) produce cost advantages over rivals in terms of new technologies, new components, new distribution channels, and so on, (3) create strongly loyal customers, and (4) make imitation or duplication by a rival hard or unlikely.³⁴

To sustain the competitive advantage gained by being the first mover, a firm needs to be a fast learner. There are, however, risks associated with being the first mover, such as unexpected and unanticipated problems and costs that occur from being the first firm doing business in the new market. Therefore, being a slow mover (also called *fast follower* or *late mover*) can be effective when a firm can easily copy or imitate the lead firm's products or services. If technology is advancing rapidly, slow movers can often leapfrog a first mover's products with improved second-generation products. However, slow movers often are relegated to relying on the first mover being a slow mover and making strategic and tactical mistakes. This situation does not occur often, so first mover advantages clearly offset the first mover disadvantages most of the time. Apple Inc. has always been a good example of a first mover firm.

Nokia, the world's largest mobile phone maker by units, has been a late mover in the smartphone industry, following Apple, by introducing the Nokia N8 smartphone. The N8 is a sleek phone with a 12-megapixel camera and high-definition video recording feature. Also a late mover, Hewlett-Packard (H-P) introduced its first tablet computer and first smartphone in 2011, well behind Apple and Google. Apple sold 14 million iPad computers before the H-P announcement. Sales of iPads are forecasted to reach 24.1 million in 2011 and eclipse 44 million annually by 2015 according to Forrester Research.

Based in Santa Clara, California, Intel is a first mover firm in terms of introducing new production processes sooner than competitors. Intel is investing \$7 billion between 2011 and 2014 to upgrade its manufacturing plants in the United States and build a new research facility in Oregon. Intel is moving beyond PCs into chips for smartphones and other products.

First mover advantages tend to be greatest when competitors are roughly the same size and possess similar resources. If competitors are not similar in size, then larger competitors can wait while others make initial investments and mistakes, and then respond with greater effectiveness and resources.

Outsourcing

Business-process outsourcing (BPO) involves companies taking over the functional operations, such as human resources, information systems, payroll, accounting, customer service, and even marketing of other firms. Companies are choosing to outsource their functional operations more and more for several reasons: (1) it is less expensive, (2) it allows the firm to focus on its core businesses, and (3) it enables the firm to provide better services. Other advantages of outsourcing are that the strategy (1) allows the firm to align itself with "best-in-world" suppliers who focus on performing the special task, (2) provides the firm flexibility should customer needs shift unexpectedly, and (3) allows the firm to concentrate on other internal value chain activities critical to sustaining competitive advantage. BPO is a means for achieving strategies that are similar to partnering and joint venturing. The worldwide BPO market exceeds \$173 billion.

Many firms, such as Dearborn, Michigan-based Visteon Corp. and J.P. Morgan Chase & Co., outsource their computer operations to IBM, which competes with firms such as Electronic Data Systems and Computer Sciences Corp. in the computer outsourcing business. 3M Corp. is outsourcing all of its manufacturing operations to Flextronics International Ltd. of Singapore or Jabil Circuit in Florida. 3M is also outsourcing all design and manufacturing of low-end standardized volume products by building a new design center in Taiwan.

U.S. and European companies for more than a decade have been outsourcing their manufacturing, tech support, and back-office work, but most insisted on keeping research and development activities in-house. However, an ever-growing number of firms today are outsourcing their product design to Asian developers. China and India are becoming increasingly important suppliers of intellectual property. For companies that include Hewlett-Packard, PalmOne, Dell, Sony, Apple, Kodak, Motorola, Nokia, Ericsson, Lucent, Cisco, and Nortel, the design of personal computers and cameras is mostly outsourced to China and India.

Companies pay about \$68 billion annually in outsourcing operations to other firms, but the details of what work to outsource, to whom, where, and for how much can challenge even the biggest, most sophisticated companies.³⁵ And some outsourcing deals do not work out, such as the J.P. Morgan Chase deal with IBM and Dow Chemical's deal with Electronic Data Systems. Both outsourcing deals were abandoned after several years. Lehman Brothers Holdings and Dell Inc. both recently reversed decisions to move customer call centers to India after a customer rebellion. India has become a booming place for outsourcing. A recent *Wall Street Journal* article reported that roughly 85 percent of all Americans believe "outsourcing of production and manufacturing work to foreign countries is a major reason the U.S. economy is struggling and more people are not being hired."³⁶ However, organizations that outsource are seeking to realize benefits or address the following issues:³⁷

- Cost savings — Access lower wages in foreign countries.
- Focus on core business — Focus resources on developing the core business rather than being distracted by other functions.
- Cost restructuring — Outsourcing changes the balance of fixed costs to variable costs by moving the firm more to variable costs. Outsourcing also makes variable costs more predictable.
- Improve quality — Improve quality by contracting out various business functions to specialists.
- Knowledge — Gain access to intellectual property and wider experience and knowledge.
- Contract — Gain access to services within a legally binding contract with financial penalties and legal redress. This is not the case with services performed internally.
- Operational expertise — Gain access to operational best practice that would be too difficult or time consuming to develop in-house.
- Access to talent — Gain access to a larger talent pool and a sustainable source of skills, especially science and engineering.
- Catalyst for change — Use an outsourcing agreement as a catalyst for major change that cannot be achieved alone.
- Enhance capacity for innovation — Use external knowledge to supplement limited in-house capacity for product innovation.
- Reduce time to market — Accelerate development and/or production of a product through additional capability brought by the supplier.
- Risk management — Manage risk by partnering with an outside firm.
- Tax benefit — Capitalize on tax incentives to locate manufacturing plants to avoid high taxes in various countries.

Strategic Management in Nonprofit and Governmental Organizations

Nonprofit organizations are basically just like for-profit companies except for two major differences: 1) nonprofits do not pay taxes and 2) nonprofits do not have shareholders to provide capital. In virtually all other ways, nonprofits are just like for-profits. Nonprofits have competitors that want to put them out of business. Nonprofits have employees, customers, creditors, suppliers, and distributors as well as financial budgets, income statements, balance sheets, cash flow statements, and so on. Nonprofit organizations embrace strategic planning just as much as for-profit firms, and perhaps even more, since equity capital is not an alternative source of financing.

The strategic-management process is being used effectively by countless nonprofit and governmental organizations, such as the Girl Scouts, Boy Scouts, the Red Cross, chambers of commerce, educational institutions, medical institutions, public utilities, libraries, government agencies, and churches. The nonprofit sector, surprisingly, is by far America's largest employer. Many nonprofit and governmental organizations outperform private firms and corporations on innovativeness, motivation, productivity, and strategic management.

Compared to for-profit firms, nonprofit and governmental organizations may be totally dependent on outside financing. Especially for these organizations, strategic management provides an excellent vehicle for developing and justifying requests for needed financial support.

Religious Facilities

A recent *Wall Street Journal* article reveals that the number of religious facilities having to close their doors is surging as many borrowed too much and built too big during boom times.³⁸ Chris Macke, a real-estate strategist at CoStar, recently said, “religious organizations may be subject to the laws of God but they are also subject to the laws of economics.” Religious denominations of all kinds have suffered in recent years from consumer hardships, including high unemployment and underemployment, which translates into less money in the offering plate and declining attendance.

Six states in particular had 15 or more religious facilities foreclosed upon in the 2006–2010 period: California (29), Michigan (23), Florida (23), Georgia (19), Texas (17), and Ohio (15). Religious facilities are like businesses in many ways, including: 1) they can be foreclosed upon if their finances fall into disarray, and 2) they need effective strategic planning.

Educational Institutions

Educational institutions are more frequently using strategic-management techniques and concepts. Richard Cyert, former president of Carnegie Mellon University, said, “I believe we do a far better job of strategic management than any company I know.” Population shifts nationally from the Northeast and Midwest to the Southeast and West are but one factor causing trauma for educational institutions that have not planned for changing enrollments. Ivy League schools in the Northeast are recruiting more heavily in the Southeast and West. This trend represents a significant change in the competitive climate for attracting the best high school graduates each year.

Online college degrees are common place and represent a threat to traditional colleges and universities. “You can put the kids to bed and go to law school,” says Andrew Rosen, chief operating officer of Kaplan Education Centers, a subsidiary of the Washington Post Company.

Many American colleges and universities have now established campuses outside the United States. For example, Yale University and the National University of Singapore will establish a joint campus in Singapore in 2013. The institution will be Singapore’s first liberal-arts college and Yale’s first campus outside the Ivy League institution’s New Haven, Connecticut home.

Medical Organizations

The \$200 billion U.S. hospital industry is experiencing declining margins, excess capacity, bureaucratic overburdening, poorly planned and executed diversification strategies, soaring health care costs, reduced federal support, and high administrator turnover. The seriousness of this problem is accentuated by a 20 percent annual decline in use by inpatients nationwide. Declining occupancy rates, deregulation, and accelerating growth of health maintenance organizations, preferred provider organizations, urgent care centers, outpatient surgery centers, diagnostic centers, specialized clinics, and group practices are other major threats facing hospitals today. Many private and state-supported medical institutions are in financial trouble as a result of traditionally taking a reactive rather than a proactive approach in dealing with their industry.

Hospitals—originally intended to be warehouses for people dying of tuberculosis, smallpox, cancer, pneumonia, and infectious diseases—are creating new strategies today as advances in the diagnosis and treatment of chronic diseases are undercutting that earlier mission. Hospitals are beginning to bring services to the patient as much as bringing the patient to the hospital; health care is more and more being concentrated in the home and in the residential community, not on the hospital campus. Chronic care will require day-treatment facilities, electronic monitoring at home, user-friendly ambulatory services, decentralized service networks, and laboratory testing. A successful hospital strategy for the future will require renewed and deepened collaboration with physicians, who are central to hospitals’ well-being, and a reallocation of resources from acute to chronic care in home and community settings.

Current strategies being pursued by many hospitals include creating home health services, establishing nursing homes, and forming rehabilitation centers. Backward integration strategies that some hospitals are pursuing include acquiring ambulance services, waste disposal services, and diagnostic services. Millions of persons annually research medical ailments online, which is causing a dramatic shift in the balance of power between doctor, patient, and hospitals. The

number of persons using the Internet to obtain medical information is skyrocketing. A motivated patient using the Internet can gain knowledge on a particular subject far beyond his or her doctor's knowledge, because no person can keep up with the results and implications of billions of dollars' worth of medical research reported weekly. Patients today often walk into the doctor's office with a file folder of the latest articles detailing research and treatment options for their ailments.

Governmental Agencies and Departments

Federal, state, county, and municipal agencies and departments, such as police departments, chambers of commerce, forestry associations, and health departments, are responsible for formulating, implementing, and evaluating strategies that use taxpayers' dollars in the most cost-effective way to provide services and programs. Strategic-management concepts are generally required and thus widely used to enable governmental organizations to be more effective and efficient.

Strategists in governmental organizations operate with less strategic autonomy than their counterparts in private firms. Public enterprises generally cannot diversify into unrelated businesses or merge with other firms. Governmental strategists usually enjoy little freedom in altering the organizations' missions or redirecting objectives. Legislators and politicians often have direct or indirect control over major decisions and resources. Strategic issues get discussed and debated in the media and legislatures. Issues become politicized, resulting in fewer strategic choice alternatives. There is now more predictability in the management of public sector enterprises.

Government agencies and departments are finding that their employees get excited about the opportunity to participate in the strategic-management process and thereby have an effect on the organization's mission, objectives, strategies, and policies. In addition, government agencies are using a strategic-management approach to develop and substantiate formal requests for additional funding.

Strategic Management in Small Firms

The reason why "becoming your own boss" has become a national obsession is that entrepreneurs are America's role models. Almost everyone wants to own a business—from teens and college students, who are signing up for entrepreneurial courses in record numbers, to those over age 65, who are forming more companies every year.

As hundreds of thousands of people have been laid off from work in the last two years, many of these individuals have started small businesses. The *Wall Street Journal* recently provided a 10-page article on how to be a successful entrepreneur.³⁹ Not only laid off employees but also college graduates are seeking more and more to open their own businesses.⁴⁰

Strategic management is vital for large firms' success, but what about small firms? The strategic-management process is just as vital for small companies. From their inception, all organizations have a strategy, even if the strategy just evolves from day-to-day operations. Even if conducted informally or by a single owner/entrepreneur, the strategic-management process can significantly enhance small firms' growth and prosperity. Because an ever-increasing number of men and women in the United States are starting their own businesses, more individuals are becoming strategists. Widespread corporate layoffs have contributed to an explosion in small businesses and new ideas.

Numerous magazine and journal articles have focused on applying strategic-management concepts to small businesses. A major conclusion of these articles is that a lack of strategic-management knowledge is a serious obstacle for many small business owners. Other problems often encountered in applying strategic-management concepts to small businesses are a lack of both sufficient capital to exploit external opportunities and a day-to-day cognitive frame of reference. Research also indicates that strategic management in small firms is more informal than in large firms, but small firms that engage in strategic management outperform those that do not.

Special Note to Students

There are numerous alternative strategies that could benefit any firm, but your strategic management case analysis should result in specific recommendations that you decide will best provide the firm competitive advantages. Since company recommendations with costs comprise

the most important pages/slides in your case project, introduce bits of that information early in the presentation as relevant supporting material is presented to justify your expenditures. Your recommendations page(s) itself should therefore be a summary of suggestions mentioned throughout your paper or presentation, rather than being a surprise shock to your reader or audience. You may even want to include with your recommendations insight as to why certain other feasible strategies were not chosen for implementation. That information too should be anchored in the notion of competitive advantage and disadvantage with respect to perceived costs and benefits.

Conclusion

The main appeal of any managerial approach is the expectation that it will enhance organizational performance. This is especially true of strategic management. Through involvement in strategic-management activities, managers and employees achieve a better understanding of an organization's priorities and operations. Strategic management allows organizations to be efficient, but more important, it allows them to be effective. Although strategic management does not guarantee organizational success, the process allows proactive rather than reactive decision making. Strategic management may represent a radical change in philosophy for some organizations, so strategists must be trained to anticipate and constructively respond to questions and issues as they arise. The strategies discussed in this chapter can represent a new beginning for many firms, especially if managers and employees in the organization understand and support the plan for action.

Key Terms and Concepts

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|--|--|
| Acquisition (p. 155) | Hostile Takeover (p. 155) |
| Backward Integration (p. 139) | Integration Strategies (p. 138) |
| Balanced Scorecard (p. 135) | Intensive Strategies (p. 141) |
| Bankruptcy (p. 146) | Joint Venture (p. 153) |
| Business-Process Outsourcing (BPO) (p. 158) | Leveraged Buyout (LBO) (p. 157) |
| Combination Strategy (p. 135) | Liquidation (p. 148) |
| Cooperative Arrangements (p. 154) | Long-Term Objectives (p. 132) |
| Cost Leadership (p. 148) | Market Development (p. 141) |
| De-integration (p. 139) | Market Penetration (p. 141) |
| Differentiation (p. 149) | Merger (p. 155) |
| Diversification Strategies (p. 143) | Product Development (p. 142) |
| Divestiture (p. 147) | Related Diversification (p. 143) |
| Financial Objectives (p. 133) | Retrenchment (p. 146) |
| First Mover Advantages (p. 157) | Strategic Objectives (p. 133) |
| Focus (p. 149) | Takeover (p. 155) |
| Forward Integration (p. 138) | Turbulent, High-Velocity Markets (p. 152) |
| Franchising (p. 138) | Unrelated Diversification (p. 143) |
| Friendly Merger (p. 155) | Vertical Integration (p. 138) |
| Generic Strategies (p. 148) | White Knight (p. 156) |
| Horizontal Integration (p. 140) | |

Issues for Review and Discussion

1. List and describe six major benefits that a firm may reap from outsourcing some of its operations.
2. How are for-profit firms different from nonprofit firms in terms of business? What are the implications for strategic planning?
3. If the CEO of a beverage company such as Dr Pepper/Snapple asked you whether backward or forward integration would be better for the firm, how would you respond?
4. In order of importance, list six "characteristics of objectives."

5. In order of importance, list six “benefits of objectives.”
6. Called de-integration, there appears to be a growing trend for firms to become less forward integrated. Discuss why.
7. Called de-integration, there appears to be a growing trend for firms to become less backward integrated. Discuss why.
8. If a company has \$1 million to spend on a new strategy and is considering market development versus product development, what determining factors would be most important to consider?
9. What conditions, externally and internally, would be desired/necessary for a firm to diversify?
10. Could a firm simultaneously pursue focus, differentiation, and cost leadership? Should firms do that? Discuss.
11. There is a growing trend of increased collaboration among competitors. List the benefits and drawbacks of this practice.
12. List four major benefits of forming a joint venture to achieve desired objectives.
13. List six major benefits of acquiring another firm to achieve desired objectives.
14. List five reasons why many merger/acquisitions historically have failed.
15. Can you think of any reasons why not-for-profit firms would benefit less from doing strategic planning than for-profit companies?
16. Discuss how important it is for a college football or basketball team to have a good game plan for the big rival game this coming weekend. How much time and effort do you feel the coaching staff puts into developing that game plan? Why is such time and effort essential?
17. Why are more than 60 percent of Fortune 500 firms headquartered in Wilmington, Delaware?
18. Define and give a hypothetical example of a “white knight” in the fast-food industry.
19. How does strategy formulation differ for a small versus a large organization? How does it differ for a for-profit versus a nonprofit organization?
20. Give recent examples of market penetration, market development, and product development.
21. Give recent examples of forward integration, backward integration, and horizontal integration.
22. Give recent examples of related and unrelated diversification.
23. Give recent examples of joint venture, retrenchment, divestiture, and liquidation.
24. Do you think hostile takeovers are unethical? Why or why not?
25. What are the major advantages and disadvantages of diversification?
26. What are the major advantages and disadvantages of an integrative strategy?
27. How does strategic management differ in for-profit and nonprofit organizations?
28. Why is it not advisable to pursue too many strategies at once?
29. Consumers can purchase tennis shoes, food, cars, boats, and insurance on the Internet. Are there any products today that cannot be purchased online? What is the implication for traditional retailers?
30. What are the pros and cons of a firm merging with a rival firm?
31. Compare and contrast financial objectives with strategic objectives. Which type is more important in your opinion? Why?
32. Diagram a two-division organizational chart that includes a CEO, COO, CIO, CSO, CFO, CMO, HRM, R&D, and two division presidents. *Hint:* Division presidents report to the COO.
33. How do the levels of strategy differ in a large firm versus a small firm?
34. List 11 types of strategies. Give a hypothetical example of each strategy listed.
35. Discuss the nature of as well as the pros and cons of a “friendly merger” versus “hostile takeover” in acquiring another firm. Give an example of each.
36. Define and explain “first mover advantages.”
37. Define and explain “outsourcing.”
38. What strategies are best for turbulent, high-velocity markets?

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ASSURANCE OF LEARNING EXERCISES

Assurance of Learning Exercise 5A



Develop Hypothetical Disney Strategies

Purpose

Table 5-4 identifies, defines, and exemplifies 11 key types of strategies available to firms. This exercise will give you practice formulating possible strategies within each broad category.

Instructions

- Step 1** On a clear sheet of paper, develop an 11 x 2 matrix where two Disney divisions are along the top and the 11 Table 5-4 strategies are along the left side of your paper. In other words, along the top you will have any two of the following five captions: 1) Media Networks, 2) Parks & Resorts, 3) Studio Entertainment, 4) Consumer Products; and 5) Interactive Media, and along the left side of your paper, simply write the basic Table 5-4 strategy types as described in the chapter.
- Step 2** Review the text material related to Table 5-4. Also, review the Disney divisional information provided in both the company *Annual Report* and *Form 10K*.
- Step 3** In each of the 22 cells within your 11 x 2 matrix, write in a hypothetical strategy for the respective business segment indicated.

Assurance of Learning 5B



Evaluate Disney Divisions in Terms of Porter's Strategies

Purpose

Figure 5-3 and associated narrative describe Porter's five generic strategies. Disney has five business segments. This exercise will give you practice assessing the degree or extent that various segments or divisions of a business utilize or follow Porter's generic strategies.

Instructions

- Step 1** On a clear sheet of paper, develop a 5 × 5 matrix where the five Disney divisions are along the top and the five Porter strategies are along the left side of your paper. In other words, along the top you will have the captions 1) Media Networks, 2) Parks & Resorts, 3) Studio Entertainment, 4) Consumer Products; and 5) Interactive Media and along the left side of your paper simply write Type 1, Type 2, Type 3, Type 4, and Type 5 that refer to Porter's basic strategy types as described in the chapter.
- Step 2** Review the text material that explains Porter's five strategies. Also, review the Disney divisional information provided in the company *Annual Report* and *Form 10K* as well as in the Cohesion Case.
- Step 3** In each of the 25 cells within your 5 × 5 matrix, write the word High, Medium, or Low to indicate the extent or degree that the respective Disney division utilizes or follows the respective Porter strategy.
- Step 4** Write a one to two page Executive Summary that reveals your rationale for your assigned High, Medium, and Low assessments, as well as your overall evaluation of the effectiveness of the Disney strategy—particularly in light of the conditions listed in the chapter for each Porter strategy in terms of when it is most attractive.
- Step 5** In your 5 × 5 matrix, consider adding a sixth row along the bottom to indicate what grade (A, B, C, D, or F) you would give each Disney segment for their overall strategy formulation and implementation efforts.

Assurance of Learning Exercise 5C



What Strategies Should Disney Pursue in 2013?

Purpose

In performing strategic management case analysis, you can find information about the respective company's actual and planned strategies. Comparing *what is planned* versus *what you recommend* is an important part of case analysis. Do not recommend what the firm actually plans, unless in-depth analysis of the situation reveals those strategies to be best among all feasible alternatives. This exercise gives you experience conducting library and Internet research to determine what Disney is doing in 2012 and should do in 2013.

Instructions

- Step 1** Look up DIS using the websites provided in Table 4-5. Find some recent articles about Disney. Also review recent news releases at the DIS website.
- Step 2** Summarize your findings in a three-page report entitled "My Thoughts on Strategies Being Pursued by Disney in 2013."

Assurance of Learning Exercise 5D

Examine Strategy Articles

Purpose

Strategy articles can be found weekly in journals, magazines, and newspapers. By reading and studying strategy articles, you can gain a better understanding of the strategic-management process. Several of the best journals in which to find corporate strategy articles are *Advanced Management Journal*, *Business Horizons*, *Long Range Planning*, *Journal of Business Strategy*, and *Strategic Management Journal*. These journals are devoted to reporting the results of empirical research in management. They apply strategic-management concepts to specific organizations and industries. They introduce new strategic-management techniques and provide short case studies on selected firms.

Other good journals in which to find strategic-management articles are *Harvard Business Review*, *Sloan Management Review*, *California Management Review*, *Academy of Management Review*, *Academy of Management Journal*, *Academy of Management Executive*, *Journal of Management*, and *Journal of Small Business Management*.

In addition to journals, many magazines regularly publish articles that focus on business strategies. Several of the best magazines in which to find applied strategy articles are *Dun's Business Month*, *Fortune*, *Forbes*, *BusinessWeek*, *Inc.*, and *Industry Week*. Newspapers such as *USA Today*, *Wall Street Journal*, *New York Times*, and *Barrons* cover strategy events when they occur—for example, a joint venture announcement, a bankruptcy declaration, a new advertising campaign start, acquisition of a company, divestiture of a division, a chief executive officer's hiring or firing, or a hostile takeover attempt.

In combination, journal, magazine, and newspaper articles can make the strategic-management course more exciting. They allow current strategies of for-profit and nonprofit organizations to be identified and studied.

Instructions

- Step 1** Go to your college library and find a recent journal article that focuses on a strategic-management topic. Select your article from one of the journals listed previously, not from a magazine. Copy the article and bring it to class.
- Step 2** Give a 3-minute oral report summarizing the most important information in your article. Include comments giving your personal reaction to the article. Pass your article around in class.

Assurance of Learning Exercise 5E

Classify Some Year 2011 Strategies

Purpose

This exercise can improve your understanding of various strategies by giving you experience classifying strategies. This skill will help you use the strategy-formulation tools presented later. Consider the following sixteen actual year-2011 strategies by various firms:

1. General Electric sold its NBC Universal division to Comcast for \$6.5 billion.
2. Vision Airlines added more than 40 new cities to its flight destination portfolio.
3. J.C. Penney closed many of its stores, outlets, call centers, and its catalog business.
4. Citigroup sold its EMI Group Ltd. music company.
5. Nestle S.A. acquired CM&D Pharma Ltd., the first move by Nestle to sell foods that target diseases.
6. Caterpillar recently acquired Bucyrus International, another mining equipment maker.
7. Limited Brands opened its first Victoria's Secret in Canada.
8. Wal-Mart opened 40 new supercenters in Canada.
9. The top four advertisers (in order) during Super Bowl XLV were Anheuser-Busch (InBev), PepsiCo, General Motors, and Paramount Pictures, each having at least five 30-second ads.
10. Grocery-store chain SuperValu Inc. is closing underperforming stores and laying off employees.
11. General Motors entered the entertainment business by producing the "Inside the Vault" television series.
12. Caesars Entertainment opens its first noncasino hotel in Asia.
13. AOL laid off 20 percent of its work force in mid-2011.
14. Wal-Mart's 40 new Express stores opened at a cost of \$1.2 million each; each store has a pharmacy, grocery section, 75 parking spaces, and three or four checkouts.
15. Dell Inc. spent \$1 billion to move away from its PC focus to providing cloud-computing services.
16. Siemens sold its Osram lighting unit, which had generated \$6.6 billion in 2010.

Instructions

- Step 1** On a separate sheet of paper, number from 1 to 16. These numbers correspond to the strategies described.
- Step 2** What type of strategy best describes the sixteen actions cited? Indicate your answers.
- Step 3** Exchange papers with a classmate, and grade each other's paper as your instructor gives the right answers.

Assurance of Learning Exercise 5F

How Risky Are Various Alternative Strategies?

Purpose

This exercise focuses on how risky various alternative strategies are for organizations to pursue. Different degrees of risk are based largely on varying degrees of *externality*, defined as movement away from present business into new markets and products. In general, the greater the degree of externality, the greater the probability of loss resulting from unexpected events. High-risk strategies generally are less attractive than low-risk strategies.

Instructions

- Step 1** On a separate sheet of paper, number vertically from 1 to 10. Think of 1 as “most risky,” 2 as “next most risky,” and so forth to 10, “least risky.”
- Step 2** Write the following strategies beside the appropriate number to indicate how risky you believe the strategy is to pursue: horizontal integration, related diversification, liquidation, forward integration, backward integration, product development, market development, market penetration, retrenchment, and unrelated diversification.
- Step 3** Grade your paper as your instructor gives you the right answers and supporting rationale. Each correct answer is worth 10 points.

Assurance of Learning Exercise 5G

Develop Alternative Strategies for My University

Purpose

It is important for representatives from all areas of a college or university to identify and discuss alternative strategies that could benefit faculty, students, alumni, staff, and other constituencies. As you complete this exercise, notice the learning and understanding that occurs as people express differences of opinion. Recall that *the process of planning is more important than the document*.

Instructions

- Step 1** Recall or locate the external opportunity/threat and internal strength/weakness factors that you identified as part of Exercise 1D. If you did not do that exercise, discuss now as a class important external and internal factors facing your college or university.
- Step 2** Identify and put on the chalkboard alternative strategies that you feel could benefit your college or university. Your proposed actions should allow the institution to capitalize on particular strengths, improve upon certain weaknesses, avoid external threats, and/or take advantage of particular external opportunities. List 10 possible strategies on the board. Number the strategies as they are written on the board.
- Step 3** On a separate sheet of paper, number from 1 to 10. Everyone in class individually should rate the strategies identified, using a 1 to 3 scale, where 1 = *I do not support implementation*, 2 = *I am neutral about implementation*, and 3 = *I strongly support implementation*. In rating the strategies, recognize that your institution cannot do everything desired or potentially beneficial.
- Step 4** Go to the board and record your ratings in a row beside the respective strategies. Everyone in class should do this, going to the board perhaps by rows in the class.
- Step 5** Sum the ratings for each strategy so that a prioritized list of recommended strategies is obtained. This prioritized list reflects the collective wisdom of your class. Strategies with the highest score are deemed best.
- Step 6** Discuss how this process could enable organizations to achieve understanding and commitment from individuals.
- Step 7** Share your class results with a university administrator, and ask for comments regarding the process and top strategies recommended.

Assurance of Learning Exercise 5H

Lessons in Doing Business Globally

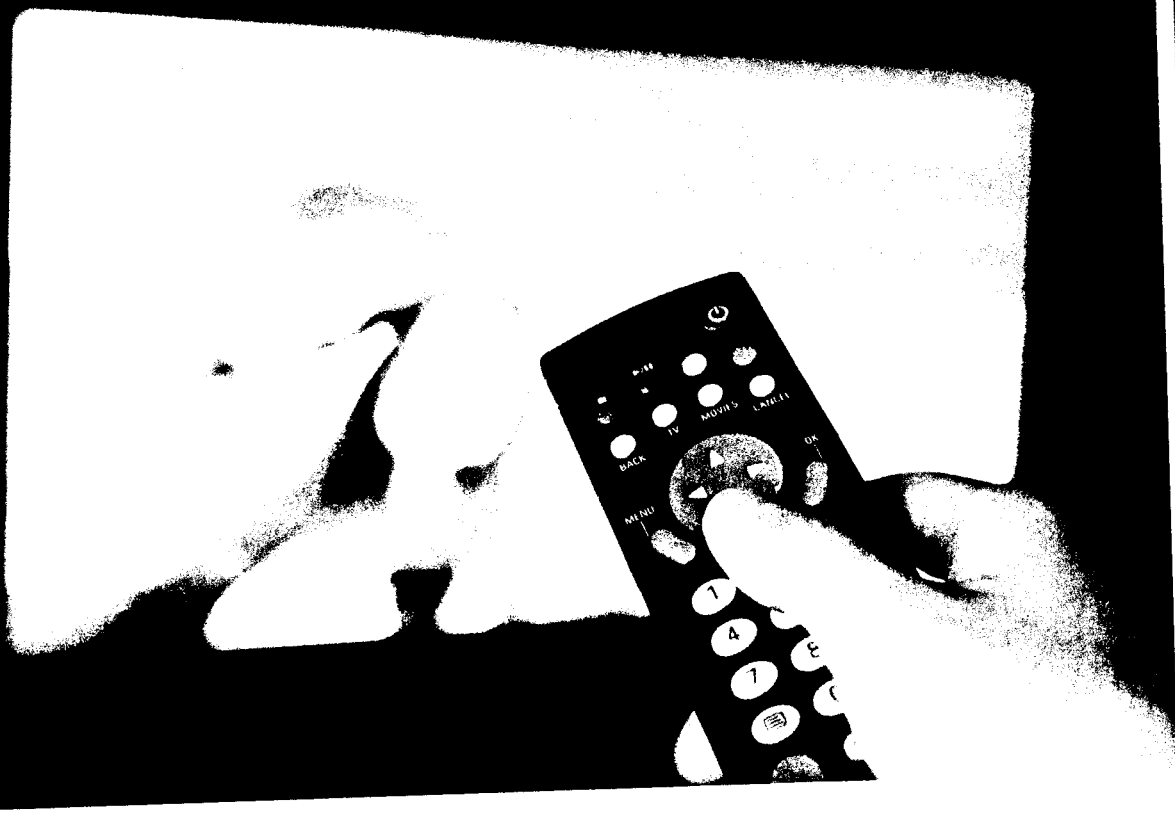
Purpose

The purpose of this exercise is to discover some important lessons learned by local businesses that do business internationally.

Instructions

Contact several local business leaders by phone. Find at least three firms that engage in international or export operations. Visit the owner or manager of each business in person. Ask the businessperson to give you several important lessons that his or her firm has learned in globally doing business. Record the lessons on paper, and report your findings to the class.

Source: hfig/Shutterstock.com



“NOTABLE QUOTES”

“Strategic management is not a box of tricks or a bundle of techniques. It is analytical thinking and commitment of resources to action. But quantification alone is not planning. Some of the most important issues in strategic management cannot be quantified at all.”

—Peter Drucker

“Objectives are not commands; they are commitments. They do not determine the future; they are the means to mobilize resources and energies of an organization for the making of the future.”

—Peter Drucker

“Life is full of lousy options.”

—General P. X. Kelley

“When a crisis forces choosing among alternatives, most people will choose the worst possible one.”

—Rudin's Law

“Strategy isn't something you can nail together in slapdash fashion by sitting around a conference table.”

—Terry Haller

“Planning is often doomed before it ever starts, either because too much is expected of it or because not enough is put into it.”

—T. J. Cartwright

“Whether it's broke or not, fix it—make it better. Not just products, but the whole company if necessary.”

—Bill Saporito