Chapter 5
Strategies in Action

Strategic Management: Concepts & Cases
12th Edition
Fred David
Long-Term Objectives

Objectives –

- Quantifiable
- Measurable
- Realistic
- Understandable
- Challenging
Long-Term Objectives

Objectives –

- Hierarchical
- Obtainable
- Congruent/fitting
- Timeline
Objectives

- Objectives are commonly stated in terms such as growth in assets, growth in sales, profitability, market share, degree and nature of diversification, and so on.
## Varying Performance Measures by Organizational Level

<table>
<thead>
<tr>
<th>Organizational Level</th>
<th>Basis for Annual Bonus or Merit Pay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate</td>
<td>75% based on long-term objectives</td>
</tr>
<tr>
<td></td>
<td>25% based on annual objectives</td>
</tr>
<tr>
<td>Division</td>
<td>50% based on long-term objectives</td>
</tr>
<tr>
<td></td>
<td>50% based on annual objectives</td>
</tr>
<tr>
<td>Function</td>
<td>25% based on long-term objectives</td>
</tr>
<tr>
<td></td>
<td>75% based on annual objectives</td>
</tr>
</tbody>
</table>
Financial vs. Strategic Objectives

Financial Objectives

- Growth in revenues
- Growth in earnings
- Higher dividends
- Higher profit margins
- Higher earnings per share
- Improved cash flow
Strategic objectives

- such as:
  1. larger market share,
  2. quicker on-time delivery than rivals,
  3. quicker design-to-market times than rivals,
  4. lower costs than rivals,
  5. higher product quality than rivals,
  6. wider geographic coverage than rivals, etc.

- 3. There is frequently a tradeoff between financial and strategic objectives.
Not Managing by Objective

- Strategists should avoid the following alternative ways of “not managing by objectives.”

- Managing by Extrapolation – “If it ain’t broke, don’t fix it.” Continue in same way of doing things.

- Managing by Crisis – The true measure of a good strategist is the ability to fix problems. Reaction.

- Managing by Subjectives – “Do your own thing, the best way you know how.”. Sometimes left as a mystery approach to subordinates.

- Managing by Hope – The future is full of uncertainty and if first you don’t succeed, then you may on the second or third try. Managing by luck.
The balanced scorecard is a strategy evaluation and control technique that derives its name from the perceived need of firms to “balance” financial measures, which are oftentimes used exclusively in strategy evaluation and control with non-financial measures such as product quality and customer service.
The Balanced Scorecard

- A balanced scorecard for a firm is simply a listing of all key objectives to work towards 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.
FIGURE 5-1

A Comprehensive Strategic-Management Model

Perform External Audit—Chapter 3

Develop Vision and Mission Statements—Chapter 2

Perform Internal Audit—Chapter 4

Establish Long-Term Objectives—Chapter 5

Generate, Evaluate, and Select Strategies—Chapter 6

Implement Strategies—Management Issues—Chapter 7

Implement Strategies—Marketing, Finance, Accounting, R&D, and MIS Issues—Chapter 8

Measure and Evaluate Performance—Chapter 9

Strategy Formulation

Strategy Implementation

Strategy Evaluation

Types of Strategies

A Large Company

- Operational Level
- Functional Level
- Division Level
- Corp Level
Types of Strategies

A small Company

- Operational Level
- Functional Level
- Company
Vertical Integration Strategies

- Forward integration
- Backward integration
- Horizontal integration
Strategies in Action

**Forward Integration**

**Defined**
- Gaining ownership or increased control over distributors or retailers

**Example**
- General Motors is acquiring 10% of its dealers.
Guidelines for Forward Integration

- Present distributors are expensive, unreliable, or incapable of meeting firm’s needs
- Availability of quality distributors is limited
- When firm competes in an industry that is expected to grow markedly
- Advantages of stable production are high
- Present distributor have high profit margins
Backward Integration

Defined

- Seeking ownership or increased control of a firm’s suppliers

Example

- Motel 8 acquired a furniture manufacturer.
Guidelines for Backward Integration

- When present suppliers are expensive, unreliable, or incapable of meeting needs
- Number of suppliers is small and number of competitors large
- High growth in industry sector
- Firm has both capital and human resources to manage new business
- Advantages of stable prices are important
- Present supplies have high profit margins
Horizontal Integration

Defined

• Seeking ownership or increased control over competitors

Example

• Hilton recently acquired Promus.
Guidelines for Horizontal Integration

- Firm can gain monopolistic characteristics without being challenged by federal government
- Competes in growing industry
- Increased economies of scale provide major competitive advantages
- Faltering/losing due to lack of managerial expertise or need for particular resources
Strategies in Action

Intensive Strategies

- Market penetration
- Market development
- Product development
**Market Penetration**

**Defined**
- Seeking increased market share for present products or services in present markets through greater marketing efforts.

**Example**
- Ameritrade, the online broker, tripled its annual advertising expenditures to $200 million to convince people they can make their own investment decisions.
Guidelines for Market Penetration

- Current markets not saturated
- Usage rate of present customers can be increased significantly
- Market shares of competitors declining while total industry sales increasing
- Increased economies of scale provide major competitive advantages
Strategies in Action

**Market Development**

**Defined**
- Introducing present products or services into new geographic area

**Example**
- Khuzendar Tiles maker introduce his product to Gulf markets.
Guidelines for Market Development

- New channels of distribution that are reliable, inexpensive, and good quality
- Firm is very successful at what it does
- Untapped or unsaturated markets
- Capital and human resources necessary to manage expanded operations
- Excess production capacity
- Basic industry rapidly becoming global
Strategies in Action

Product

Development

Defined

• Seeking increased sales by improving present products or services or developing new ones

Example

• Apple developed the G4 chip that runs at 500 megahertz.
• Khuzendar Tiles maker introduce Ceramic as a new product.
Guidelines for Product Development

- Products in maturity stage of life cycle
- Competes in industry characterized by rapid technological developments
- Major competitors offer better-quality products at comparable prices
- Compete in high-growth industry
- Strong research and development capabilities
Diversification Strategies

- Concentric diversification
- Conglomerate diversification
- Horizontal diversification
Concentric Diversification

Defined
- Adding new, but related, products or services

Example
- National Westminster Bank PLC in Britain bought the leading British insurance company, Legal & General Group PLC.
Guidelines for Concentric Diversification

- Competes in no- or slow-growth industry
- Adding new & related products increases sales of current products
- New & related products offered at competitive prices
- Current products are in decline stage of the product life cycle
- Strong management team
Strategies in Action

Conglomerate Diversification

Defined

- Adding new, unrelated products or services

Example

- Consultant Construction Engineering acquired El-Awda Bisects Co.
Guidelines for Conglomerate Diversification

- Declining annual sales and profits
- Capital and managerial talent to compete successfully in a new industry
- Financial synergy between the acquired and acquiring firms
- Exiting markets for present products are saturated
Horizontal Diversification

**Defined**
- Adding new, unrelated products or services for present customers

**Example**
- The El-Awda Co. merging with Palestinian Islamic Bank.
Guidelines for Horizontal Diversification

- Revenues from current products/services would increase significantly by adding the new unrelated products.
- Highly competitive and/or no-growth industry with low margins and returns.
- Present distribution channels can be used to market new products to current customers.
- New products have counter cyclical sales patterns compared to existing products.
Defensive Strategies

- Joint venture
- Retrenchment
- Divestiture
- Liquidation
Joint Venture

**Defined**
- Two or more sponsoring firms forming a separate organization for cooperative purposes

**Example**
- Lucent Technologies and Philips Electronic NV formed Philips Consumer Communications to make and sell telephones.
Joint Venture

- 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.
- Other types of cooperative arrangements include R&D partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia.
Joint Venture

- Joint ventures and cooperative arrangements are being used increasingly because they allow companies to improve communications and networking, to globalize operations and minimize risk.
Many, if not most, organizations pursue a combination of two or more strategies simultaneously, 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. Priorities must be established. Organizations, like individuals, have limited resources. Both organizations and individuals must choose among alternative strategies and avoid excess indebtedness.
Joint ventures may fail when:

- Managers who must collaborate regularly are not involved in the venture.
- The venture may benefit partnering companies but not the customers.
- Both partners may not support the venture equally.
- The venture competes with one of the partners.
Joint ventures are especially effective when:

- A privately owned organization forms one with a public organization.
- A domestic organization works with a foreign company.
- The distinct competencies of the firms complement each other especially well.
- Some project is potentially profitable but requires much risk.
- Two or more smaller firms wish to compete against a larger firm.
- There is a need to introduce a new technology quickly.
Guidelines for Joint Venture

- Combination of privately held and publicly held can be synergistically combined
- Domestic forms joint venture with foreign firm, can obtain local management to reduce certain risks
- Distinctive competencies of two or more firms are complementary
- Overwhelming resources and risks where project is potentially very profitable (e.g., Alaska pipeline)
- Two or more smaller firms have trouble competing with larger firm
- A need exists to introduce a new technology quickly
Strategies in Action

Retrenchment (turnaround)

Defined
- Regrouping through cost and asset reduction to reverse declining sales and profit. Sometimes it is called turnaround or reorganizational strategy.

Example
- El-Awda sold off a land and 4 apartments to raise cash needed. It introduce expense effective control system.
Guidelines for Retrenchment

- Firm has failed to meet its objectives and goals consistently over time but has distinctive competencies.
- Firm is one of the weaker competitors.
- Inefficiency, low profitability, poor employee morale, and pressure from stockholders to improve performance.
- When an organization’s strategic managers have failed.
- Very quick growth to large organization where a major internal reorganization is needed.
Divestiture

**Defined**

- Selling a division or part of an organization

**Example**

- Harcourt General, the large US publisher, is selling its Neiman Marcus division.
Guidelines for Divestiture

- When firm has pursued retrenchment but failed to attain needed improvements
- When a division needs more resources than the firm can provide
- When a division is responsible for the firm’s overall poor performance
- When a division is a misfit with the organization
- When a large amount of cash is needed and cannot be obtained from other sources.
**Liquidation**

**Defined**
- Selling all of a company’s assets, in parts, for their tangible worth

**Example**
- El-Ameer Block factory sold all its assets and ceased business.
Guidelines for Liquidation

- When both retrenchment and divestiture have been pursued unsuccessfully
- If the only alternative is bankruptcy, liquidation is an orderly alternative
- When stockholders can minimize their losses by selling the firm’s assets
Mergers and acquisitions

- Mergers and acquisitions 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.
Reasons for mergers and acquisitions

1. a. To provide improved capacity utilization
2. b. To make better use of an existing sales force.
3. c. To reduce managerial staff.
4. d. To gain economies of scale.
5. e. To smooth out seasonal trends in sales.
6. f. To gain access to new suppliers, distributors, customers, products, and creditors.
7. g. To gain new technology.
8. h. To reduce tax obligations.
Mergers and acquisitions may fail due to the following reasons:

1. Integration difficulties
2. Inadequate evaluation of target
3. Large debt
4. Inability to achieve synergy
5. Too much diversification
6. Managers overly focused on acquisitions
7. Too large of an acquisition
8. Difficulty integrating different cultures
9. Reduced employee morale due to layoffs and relocations
Leveraged Buyouts (LBOs)

1. An LBO occurs when a corporation’s shareholders are bought out (hence *buyout*) by the company’s management and other private investors using borrowed funds (hence *leveraged*).

2. Besides trying to avoid a hostile takeover, other reasons for the initiation of a LBO by senior management are that particular divisions do not fit into an overall corporate strategy, must be sold to raise cash, or receive an attractive offering price. A LBO takes a corporation private.
First Mover Advantages

1. First mover advantages refers to the benefits a firm may achieve by entering a new market or developing a new product or service prior to rival firms.

2. The advantages of being a first mover include securing access to rare resources, gaining new knowledge of key factors and issues, and carving out market share and a position that is easy to defend and costly for rival firms overtake.
Outsourcing

- Business-Process Outsourcing (BPO): Companies take over functional operations such as human resources, information systems, and marketing for other firms.
- Outsourcing can be less expensive, can allow firms to focus on core businesses, and enables firms to provide better services.
Michael Porter’s Generic Strategies

- **Cost Leadership Strategies**
  - *(Low-Cost & Best-Value)*

- **Differentiation Strategies**

- **Focus Strategies**
  - *(Low-Cost Focus & Best-Value Focus)*
**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

Cost leadership emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive.

There are two types of cost leadership strategies.

a. A low-cost strategy offers products to a wide range of customers at the lowest price available on the market.

b. A best-value strategy offers products to a wide range of customers at the best price-value available on the market.
Cost leadership

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.
Cost leadership

- The basic idea behind a cost leadership strategy is to underprice competitors or offer a better value and thereby gain market share and sales, driving some competitors out of the market entirely.

5. To successfully employ a cost leadership strategy, firms must ensure that total costs across the value chain are lower than that of the competition. This can be accomplished by:
   a. performing value chain activities more efficiently than competition, and
   b. eliminating some cost-producing activities in the value chain.
Differentiation

Differentiation is aimed at producing products that are considered unique. This strategy is most powerful with the source of differentiation is especially relevant to the target market.
Differentiation

- A successful differentiation strategy allows a firm to charge higher prices for its products to gain customer loyalty because consumers may become strongly attached to the differentiation features.

- 3. 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.
Differentiation

- Common organizational requirements for a successful differentiation strategy include strong coordination among the R&D and marketing functions and substantial amenities/services to attract scientists and creative people.
Focus

1. Focus means producing products and services that fulfill the needs of small groups of consumers.
2. There are two types of focus strategies.
   a. A low-cost focus strategy offers products or services to a small range (niche) of customers at the lowest price available on the market.
   b. A best-value focus strategy offers products to a small range of customers at the best price-value available on the market. This is sometimes called focused differentiation.
Focus strategies are most effective when the niche is profitable and growing, when industry leaders are uninterested in the niche, when industry leaders feel pursuing the niche is too costly or difficult, when the industry offers several niches, and when there is little competition in the niche segment.
FIGURE 5-4
Meeting the Challenge of High-Velocity Change

<table>
<thead>
<tr>
<th>Strategic Posture</th>
<th>Actions</th>
<th>Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defensive</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Reacting to Change| • Introduce better products in response to new offerings of rivals  
                         • Respond to unexpected changes in buyer needs and preferences  
                         • Adjust to new government policies |
|                   |         | • React and respond as needed  
                         • Defend and protect the company's position |
| Offensive         |         |          |
| Anticipating Change| • Analyze the prospects for market globalization  
                         • Research buyer needs, preferences, and expectations  
                         • Monitor new technological developments closely to predict future path |
|                   |         | • Plan ahead for expected future changes  
                         — Add/adapt resources and competitive capabilities  
                         — Improve product line  
                         — Strengthen distribution |
| Leading Change    | • Pioneer new and better technologies  
                         • Introduce innovative products that open new markets and spur the creation of whole new industries  
                         • Seek to set industry standards |
|                   |         | • Seize the offensive  
                         • Be the agent of industry change; set the pace  
                         • Influence the rules of the game  
                         • Force rivals to follow |

### TABLE 5-4  The Largest Mergers Completed Globally in 2007

<table>
<thead>
<tr>
<th>Acquiring Firm</th>
<th>Acquired Firm</th>
<th>Price (In Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT&amp;T (U.S.)</td>
<td>BellSouth Corp. (U.S.)</td>
<td>72.7</td>
</tr>
<tr>
<td>E.On (Germany)</td>
<td>Endesa (Spain)</td>
<td>46.9</td>
</tr>
<tr>
<td>Suez (France)</td>
<td>Gaz de France (France)</td>
<td>39.5</td>
</tr>
<tr>
<td>Banca Intesa (Italy)</td>
<td>SanPaolo IMI (Italy)</td>
<td>37.6</td>
</tr>
<tr>
<td>Porsche (Germany)</td>
<td>Volkswagen (Germany)</td>
<td>36.8</td>
</tr>
<tr>
<td>Mittal Steel (Netherlands)</td>
<td>Arcelor (Luxembourg)</td>
<td>33.8</td>
</tr>
<tr>
<td>Investor Group (U.S.)</td>
<td>TXU (U.S.)</td>
<td>32.1</td>
</tr>
<tr>
<td>Statoil (Norway)</td>
<td>Norsk Hydro (Norway)</td>
<td>30.8</td>
</tr>
<tr>
<td>America Movil (Mexico)</td>
<td>America Telecom (Mexico)</td>
<td>30.5</td>
</tr>
<tr>
<td>Freeport-McMoran (U.S.)</td>
<td>Phelps Dodge (U.S.)</td>
<td>25.8</td>
</tr>
<tr>
<td>Wachovia (U.S.)</td>
<td>Golden West Financial (U.S.)</td>
<td>25.5</td>
</tr>
<tr>
<td>CVS (U.S.)</td>
<td>Caremark Rx (U.S.)</td>
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<tr>
<td>Iberdrola (Spain)</td>
<td>Scottish Power (U.K.)</td>
<td>22.2</td>
</tr>
<tr>
<td>Airport Develop (Spain)</td>
<td>BAA (U.K.)</td>
<td>21.8</td>
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<tr>
<td>Investor Group (U.S.)</td>
<td>HCA (U.S.)</td>
<td>21.2</td>
</tr>
<tr>
<td>Bayer (Germany)</td>
<td>Schering (Germany)</td>
<td>20.6</td>
</tr>
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</table>
Review

- How does strategy formulation differ for a small versus large organization? For a for-profit versus a nonprofit organization?
- Strategy formulation is conceptually the same for both small and large organizations. However, for large firms, there are more variables to include in both the external and internal audits. The process is usually more formal in a large firm.
Give recent examples of forward integration, backward integration, and horizontal integration.

Forward integration means purchasing or developing a distributor for a product. For instance, Nike now has its own retail stores in various locations. Backward integration means owning a supply source for production. For instance, recently garment producers in Sri Lanka began seeking to purchase textile mills in India. Horizontal integration means acquiring like operations. For instance, a hospital group may purchase another hospital.
Do you think hostile takeovers are unethical? Why or why not?

It can best be argued that hostile takeovers are ethical. Usually, only weak companies face hostile takeovers, and, typically, shareholders and customers of the company benefit from the new organization. Most employees and managers benefit, too, but some employees and top managers usually lose their jobs when the takeover is consummated. From this angle, some students may argue that hostile takeovers are unethical.
Why is it not advisable to pursue too many strategies at once?

Organizational resources are spread too thin when more than a few strategies are pursued at the same time. All organizations have limited resources. No organization can pursue all the strategies that may benefit the firm. Similarly, no individual can take on an unlimited amount of debt to obtain goods and services. No more than a few strategies can be financed, marketed, and managed effectively at the same time. Some practitioners say only a single strategy should be pursued at a given time by a single organization.
What strategies are best for turbulent, high-velocity markets?

Firms in this type of market have a choice of whether to react, anticipate, or lead the market in terms of its own strategies. These choices are reflected in Figure 5-4. If a firm primarily responds to the turbulent market by responding to changes in the industry defensively. The react-to-change strategy would not be as effective as the anticipate change strategy, which entails devising and following through with plans for dealing with the expected changes. Ideally, a firm will strive to lead the market, by pioneering new and better technologies and products.