STRATEGIC MANAGEMENT

LIBFEXDLMBSME01

The London Institute of Banking & Finance

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Publisher:
The London Institute of Banking & Finance
8th Floor, Peninsular House
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London
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LIBFEXDLMBSME01
Version No.: 001-2023-1212
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INTRODUCTION

WELCOME

SIGNPOSTS THROUGHOUT THE COURSE BOOK

This course book contains the core content for this course. Additional learning materials can be found on the learning platform, but this course book should form the basis for your learning.

The content of this course book is divided into units, which are divided further into sections. Each section contains only one new key concept to allow you to quickly and efficiently add new learning material to your existing knowledge.

At the end of each section of the digital course book, you will find self-check questions. These questions are designed to help you check whether you have understood the concepts in each section.

For all modules with a final exam, you must complete the knowledge tests on the learning platform. You will pass the knowledge test for each unit when you answer at least 80% of the questions correctly.

When you have passed the knowledge tests for all the units, the course is considered finished and you will be able to register for the final assessment. Please ensure that you complete the evaluation prior to registering for the assessment.

Good luck!

REQUIRED READING

UNIT 1

Porter, M. (1996). What is strategy? *Harvard Business Review, 74*(6), 61–78.

UNIT 2

Porter, M. (2008). The five competitive forces that shape strategy. *Harvard Business Review, 86*(1), 78–93.

UNIT 3

Zook, C. (2007). Finding your next CORE business. *Harvard Business Review, 85*(4), 66–75.

UNIT 4

Kim, W. C., & Mauborgne, R. (2005). Blue ocean strategy: From theory to practice. *California Management Review, 47*(3), 105–121.

UNIT 5

Levitt, T. (2004). Marketing myopia. *Harvard Business Review, 82*(7/8), 138–149.

UNIT 6

Kaplan, R. S., Norton, D. P., & Rugelsjoen, B. (2010). Managing alliances with the balanced scorecard. *Harvard Business Review, 88*(1/2), 114–120.

UNIT 7

Christensen, C. M., Alton, R., Rising, C., & Waldeck, A. (2011). The new M&A playbook. *Harvard Business Review, 89*(3), 48–57.

UNIT 8

Mintzberg, H. (2009). Rebuilding companies as communities. *Harvard Business Review, 87*(7/8), 140–143.

LEARNING OBJECTIVES

Developing a strategy is a company's main priority as it is a strategy that will act as a map for the future. The course **Strategic Management** will demonstrate the significance of a corporate strategy and explore who is involved in developing it.

You will discover what information companies require to develop a strategy and how to generate this information. Furthermore, you will gain insight into various models, analyses, and techniques that help in collating this data.

Using various case studies from different fields of practice, you will learn what foundations should be established in order to develop a strategy and what considerations influence the decision-making process.

Moreover, you will become more familiar with the international business environment and the strategic opportunities it offers companies. In addition, you will learn how strategies are evaluated and what is essential for the successful implementation of a strategy.

The recommended reading will add a further dimension to the concepts that constitute this course by introducing you to the most important authors and articles in the field of strategy.

UNIT 1

WHAT IS STRATEGY?

STUDY GOALS

On completion of this unit, you will have learned …

- the various definitions of strategy.
- what is important when making strategic decisions.
- which organizational level is responsible for which strategic decisions.
- what information is necessary in order to develop a solid strategic plan.

1. WHAT IS STRATEGY?

Case Study

Components
These are additional parts, which are integrated to make a final product.

Core technology
This is a main technology around which a product is developed.

CASE STUDY

The German-based company Alfred is a medical equipment manufacturer. The equipment Alfred manufactures consists of various **components**. One component is Alfred's **core technology** for which Alfred is the market leader. However, in order to make this core component applicable for medical treatment, it is necessary to integrate it with three additional components which are supplied by three different manufacturers from the USA, Italy, and Germany. Alfred has been very happy with two of the suppliers, but there are continuous issues regarding the quality of components supplied by the US manufacturer.

A quality control check is carried out when the purchased components are supplied; only if the components are supplied as specified does Alfred integrate them into their system. The integration process is very complex as all components have to be adjusted to provide a functional final product.

Xion provides a similar component to Alfred's US supplier. However, Xion is neither a supplier to Alfred, nor does it provide a product for the same market segment as Alfred. Xion is two hours away from Alfred and faces bankruptcy. Alfred's management sees this as an opportunity and buys Xion, with one of the goals being to replace the US supplier and integrate Xion's component into all its systems.

After two years, a full integration of the Xion systems still has not been carried out. Furthermore, the hospital market now requires additional data management systems. Alfred has not developed any expertise in data management as their entire focus was on the integration of the acquired company Xion. Alfred is forced to close Xion due to the increased financial burden.

What happened?

1.1 What is a Corporate Strategy?

A **corporate strategy** is like a map that an organization draws in order to reach a specific goal in the future. The strategy therefore shows the long-term direction of the organization. A strategic plan is never static as the environment and the markets are constantly changing. This requires organizations to review strategic plans and make adjustments and changes in order to meet these new demands.

Corporate strategy
A corporate strategy defines the future goals of an organization.

The three leading corporate strategists – Alfred Chandler, Michael Porter, and Henry Mintzberg – define strategy as follows:

- Alfred Chandler: "Strategy can be defined as the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of **resources** necessary for carrying out these goals" (Chandler, 1963, p. 13).

Resources
These are means that are available to an organization.

Product line
A product line is a group of products with a similar purpose.

This means that if an organization starts producing one product or a **product line** and the demand for the product increases, the size of the organization and its complexity increases accordingly. Eventually, the structure of the organization will also have to change in line with the new strategic outlook. If the structure of an organization is not adapted to its strategy, the organization will face major problems.

- Michael Porter: Strategy is defined in relation to competition. "Strategy is the creation of a unique and valuable position, involving a different set of activities" (Porter, 1996, p. 1).

Michael Porter takes a different view when it comes to defining the purpose of a corporate strategy. It is not the long-term view itself that is important in a strategy but the goal of developing a **competitive advantage** over time. A corporate strategy should focus on developing and maintaining a competitive advantage that is based on one clear, distinctive feature.

Competitive advantage
A competitive advantage provides the organization with a better position in the market compared to its competitors.

- Henry Mintzberg: Strategy is "a pattern in a stream of decisions" (Mintzberg, 2007, p. 3).

In Mintzberg's view, it all starts with a vision that is fully understood. The decision patterns required to reach the vision constitute the corporate strategy. If the environment changes or an extraordinary opportunity arises and the envisioned goal becomes unattainable, the vision may need adjusting. Often, the more flexible and adaptable the corporate strategy, the better it is for the organization. An explicit strategy is often too rigid and cannot be changed easily. Such a strategy ties organizations psychologically to their predefined goals, even if these could lead to disadvantages. Therefore, it is necessary to keep a corporate strategy flexible and open to changes.

If we apply these definitions to our case study at the beginning of this chapter, we can see that Alfred did not adapt its structure to a new strategy. On the contrary, it changed the corporate structure by acquiring Xion and then tried to develop a strategy out of this new situation.

If we look at our example through the eyes of Michael Porter, Alfred did not develop a competitive advantage by investing in its core competency or by developing a competency in data management systems, which was a trend visible on the horizon. The company invested in a component that did not add any value for the customer, thus forgoing the opportunity of developing a competitive advantage in the long term.

Many corporate decisions are made too fast, without a thorough analysis of all factors and scenarios available at the time. In order to develop successful strategies, companies need detailed information and adequate time to analyze it.

A corporate strategy has many aspects. To develop a sound strategic plan, management needs to study and analyze all these aspects. In the following chapters, you will learn various techniques that were developed to enable managers to take a closer look at various corporate issues and market developments in order to make better decisions for the future.

1.2 What Has To Be Taken Into Consideration When Making Strategic Decisions?

When managers make strategic decisions they look at the following:

- long-term orientation of the organization
- purpose of the organization
- attainment of a competitive advantage
- adaptability to changes
- expandability of resources and the efficiency of the organization
- **corporate philosophy**
- expectations of stakeholders

Corporate philosophy
The corporate philosophy defines the main principles by which an organization functions.

Vertical integration
This means that a company acquires a supplier or a distributor.

It would be interesting to find out Alfred's long-term orientation. Looking at the long-term vision might have answered the question about whether a **vertical integration**, in this case purchasing a component manufacturer, made sense and whether it was a good fit for the company strategy. A different option could have been to increase the pressure on the US supplier of the component to supply the component at a consistently higher quality.

The purpose and the markets of the two companies, Alfred and Xion, were too different to integrate. Both supplied products for hospitals and private practices, but they were serving very different segments and very different customers.

Alfred's competitive advantage is clearly its core technology, which made it the market leader in the company's specific field. The additional components to this core technology did not add value for the customer in order for Alfred to gain a further share of the market.

In this specific case, the changes in the market did not take place in the components that were acquired by Alfred. The company should have looked at the entire environment and where new developments were taking place, namely in data management systems. The company invested in the wrong technology and therefore showed very little adaptability to change.

Looking at the expandability of resources and the efficiency of the two organizations, there was little competence in either company that could bridge the two technologies or corporate cultures. The technical integration of the products from Alfred and Xion caused major problems as the systems are complex and the core competences of the two companies lay in two very different areas.

Companies have very different cultures and philosophies; it is often difficult to integrate them in the event of an acquisition. In our case, this was part of the reason why the takeover failed.

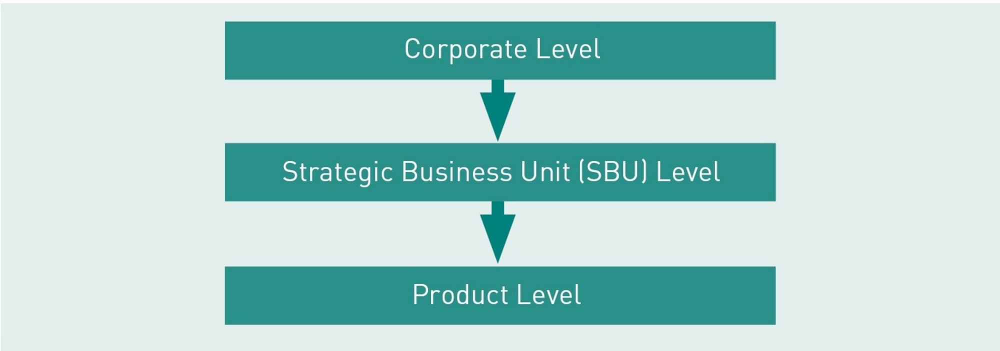
Alfred's stakeholders favored the acquisition as it expanded the range of products; however, they underestimated the integration problems. Additionally, the distribution networks of both companies were different as they served varying market segments. There was no possibility of increasing efficiency by combining the distribution networks.

A clear corporate strategic plan could have circumvented many of the problems faced by Alfred. Sound strategic decisions are based on a solid strategic plan.

1.3 Who Takes Part in Developing a Strategy?

Depending on the size of the organization, there are various levels of strategic development. These various levels all contribute to the strategic planning process.

Figure 1: Strategic Levels



Source: Created on behalf of IU (2015).

The upper level of strategic planning is the corporate level. Decisions regarding the overall purpose and the development of the organization are made at this level. This level defines the vision and the mission as well as the purpose of the organization. The corporate level analyzes the **strategic business units (SBUs)** in terms of their growth potential in the future, and decisions are made accordingly regarding the budgets for the SBUs. The more promising SBUs are allocated larger budgets, the more they receive greater financial support.

Strategic business unit
A strategic business unit is a unit of a business that could act independently of the other units in the market place.

The SBUs look at the threats (risks) and opportunities in their respective business environments. They also analyze the strengths and weaknesses of their own resources and contribute competitive analyses to the strategic plan.

The marketing plans are developed at the product level. These include situation analyses, the marketing strategy, and business plans for the respective products. They also define the mechanisms required to implement these plans.

All levels are involved in the strategic planning process. Therefore, all managers at each level, from top to bottom, need to be familiar with the strategic planning process. Strategic plans are either developed internally by the organization itself or coached and managed by external consultants.

1.4 What is Included in a Solid Strategic Plan?

To develop a solid strategic plan, an organization has to answer important questions regarding their position in the market and their strategic resources and possibilities as well as how to implement the strategy. Strategic planning is a long-term process as it takes time to assemble all the information required in order to develop a solid overall strategy.

The strategic position of the company in the market place

In order to understand the strategic position in its entirety, it is important to analyze

- the strengths and weaknesses of your organization,
- the opportunities and threats present in the business environment,
- the influence of the corporate strategy on the environment and the corporate culture,
- whether the existing resources can sufficiently support the strategic goals of the organization, and
- whether the strategic plan fits the purpose (mission) of the organization.

The strategic capabilities

In order to understand the availability of the strategic resources, it is important to analyze

- whether the portfolio of the business units fits well with the strategic objectives,

- whether the business units are adequately positioned in the market place to support the strategy,
- the international markets in which the organization aims to operate,
- what strategic alliances should be formed, and
- whether the organization is active in the right areas of innovation.

The implementation

In planning the implementation of the strategic plan, it is important to analyze

- what process is necessary to develop a strategy,
- what strategy is a good fit for the organization and what is feasible,
- what corporate structure and systems in the organization are necessary to implement the strategic plan,
- how best to manage the implementation process,
- how to evaluate the strategy, and
- who is responsible for the implementation process.

SUMMARY

The strategic plan can be compared to a road map that an organization draws up in order to reach its strategic goals. The strategic goals show where the organization wants to be in the near future.

Three leading business strategists – Chandler, Porter, and Mintzberg – look at strategy from different perspectives; for Chandler, it is important that the structure of the organization fits its strategy while Porter looks at strategy in comparison to the organization's competitors, and Mintzberg sees strategy as a dynamic process.

Many different factors influence the strategic outlook of an organization. Therefore, the managers of any organization need to be familiar with the organization itself and the markets in which the organization operates in order to make sound strategic decisions.

All levels of an organization participate in the strategic planning process: the corporate level defines the mission and vision of the organization, the strategic business units evaluate the strengths and weaknesses of the organization and the opportunities and threats in its environment, and the product management level draws up the marketing plans for the products.

A solid strategic planning process requires an analysis of the company's position in the market place, an evaluation of its strategic capabilities, and a detailed implementation plan.

UNIT 2

THE STRATEGIC ENVIRONMENT

STUDY GOALS

On completion of this unit, you will have learned …

- what factors in the macroenvironment influence the strategy.
- what a PESTEL analysis is.
- what factors in the microenvironment influence the strategy.
- how Porter’s Five Forces model works.
- how to critically evaluate Porter’s Five Forces model.

2. THE STRATEGIC ENVIRONMENT

Case Study

Real estate
This refers to property such as land, buildings, and apartments which cannot be moved.

CASE STUDY
One of the strategic business units of the Lars Bank deals with financing **real estate**. Turkey announces major changes in the legal framework for financing property sales. These changes will make it easier for European banks to finance real estate in Turkey. The manager of the Lars Bank orders one of the employees to investigate further factors that influence the real estate financing business in Turkey and to draw up a list of questions that include all the necessary information. The employee draws up a preliminary list of questions:

1. What business opportunities will open up for foreign financial services providers as a result of the change in the legal framework?
2. Is the market economically attractive?
3. Would Turkish customers accept foreign financial service providers?
4. Which customers should we target: private investors or real estate companies?
5. How could the customers influence the financing terms of the bank?
6. What competition already exists in the Turkish market?
7. What other European competitors might become active in the Turkish market? To what extent and how?
8. What alternative financing options are available to Turkish customers?
9. How are real estate projects sold? Who mediates real estate projects in Turkey?
10. Would the Turkish market be of interest to Lars Bank?

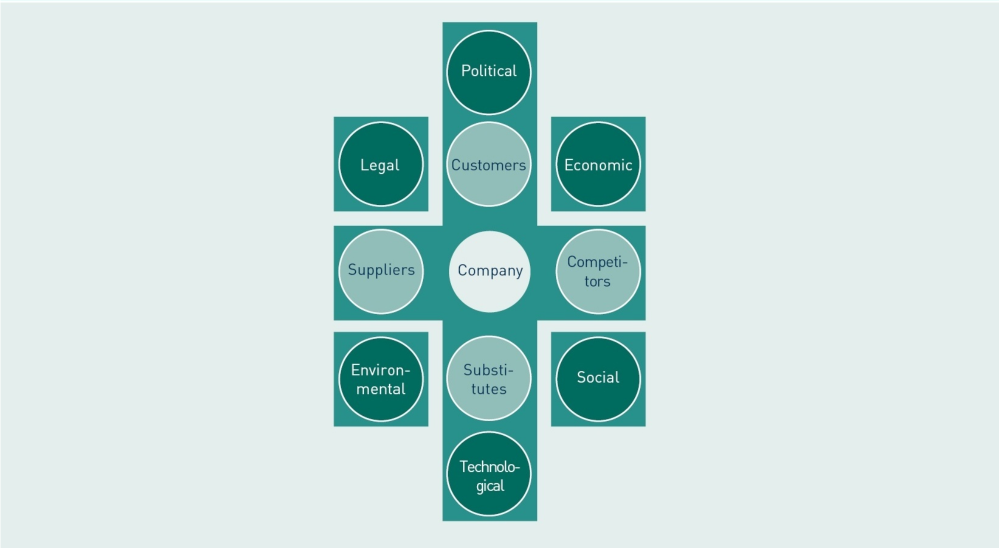
2.1 Where Are We in the Market Place? The Macroenvironment

Organizations do not exist in isolation – they exist within the environment in which they operate. The environment, in turn, influences the corporate strategy. A comparison can be made with the solar system, with our organization being the center and various factors orbiting around it, just as the planets move around the sun. Each of these factors influences our strategic plan.

The factors closer to the organization – namely competitors, **substitute products**, suppliers, and buyers – are in the microenvironment. The macroenvironment consists of political, economic, social, technological, environmental, and legal factors that influence how business is conducted.

Substitute products
These can be used as replacements for existing products.

Figure 2: The Macroenvironment of an Organization



Source: Created on behalf of IU (2015).

The PESTEL analysis can be used to analyze the macroenvironment of our organization. PESTEL is an acronym of the first letters of all the factors in the macroenvironment of an organization:

- political factors
- economic factors
- social factors
- technological factors
- environmental or ecological factors
- legislative or legal factors

The PESTEL analysis is a strategic and **qualitative method** that helps to align the organization with its environment or with developments in the environment. It also looks at changes in the environment that may influence the future success or failure of the organization.

Qualitative methods
These involve interpreting and understanding connections.

PESTEL Analysis of an Airline

The following section applies a PESTEL analysis to an airline, exploring what is considered in each category.

Political factors

This involves an analysis and forecast of political developments and trends. If the government enforces higher security standards in the airline industry, our company will have to invest more in its security measures. Investments in other projects will therefore need to be reduced or cut completely. This has a direct impact on the company strategy.

Economic factors

This involves an analysis and forecast of economic developments and trends. Changes in the price of oil will influence the price of aviation gasoline. Since the price of gasoline is a critical factor for airline profitability, the oil price will have an influence on the bottom line of an airline company. If gas prices go up, airlines are forced to increase ticket prices. This could lead to a decline in air travel, which impacts the strategy of an airline.

Social factors

Demography
This looks at the development of a population in terms of age, structure, etc.

This involves an analysis and forecast of sociocultural developments such as trends in the areas of **demography** or changes in values of the customers. In the Western world, the population is aging, and many retire earlier. As such, there are many more elderly people traveling today than in the past. Airlines have to accommodate this customer group and cater to their specific needs by providing wheelchairs and luggage services.

Technological factors

Check-in
This is the process of registering travelers and their luggage in order to confirm their presence on the flight.

This involves an analysis and forecast of technological developments and trends. The **check-in** process for flights has changed through the widespread use of the Internet for this procedure. A few years ago, a traveler had to be at the airport on time in order to go through the check-in process at the airline counter. There were often long lines in front of the check-in counters. Today, most airlines offer online check-in in order to process the passengers at the airport faster. Airlines are forced to invest in the technology required to support online check-in procedures, which again influences the strategic plan.

Ecological factors

This involves an analysis and forecast of ecological developments and trends. The airline industry is faced with flight restrictions over certain areas such as larger cities and nuclear power plants. Therefore, they are forced to reroute planes and engage in major planning efforts to align operations with ecological developments. This leads to stronger investments in the planning department and takes resources away from other departments.

Legal factors

This involves an analysis and forecast of legal developments regionally, domestically, or internationally. Domestic airlines are often given preference when it comes to airport access. Smaller airlines are thus forced to resort to smaller, more remote airports. Cheaper charter airlines, such as Irish company Ryanair, build this factor into their strategy and operate from smaller airports.

The PESTEL analysis is comprehensive and extensive. Its usage is not limited to one organization or one competitive situation; it can also be applied to a team or a department within the organization. A brainstorming session often forms part of a PESTEL analysis with the goal of finding specific features or trends in any of the six areas. These can then be evaluated to inform a specific decision or situation. The PESTEL analysis is therefore a tool that can be used for location decisions as well as for strategic decisions, such as the product portfolio or technological innovations.

In our case study, the first three questions concern the macro-environment of Lars Bank.

The first question, "What business opportunities will the change in the legal framework open up for foreign financial services providers?," addresses the political and legal aspects of such an investment in Turkey. The changes in the legal framework for financing real estate should make it easier for European banks to finance real estate in Turkey.

The second question, "Is the market economically attractive?," looks at the economic aspects of an investment decision. Even if the legal framework supports foreign investments, it might not be economically lucrative for the organization.

The third question, "Would Turkish customers accept foreign financial service providers?," looks at the socio-cultural implications of the investment. Financial services companies need to establish a relationship of trust with the customer in order to succeed. Despite today's global markets, it might be difficult for a foreign bank to gain the trust of Turkish customers. This question needs to be explored further before making the decision to enter the Turkish market.

2.2 Where Are We in the Market Place? The Micro-Environment

The direct environment in the market place impacting an organization is called the micro-environment. This includes the buyers or customers of an organization, the competitors, possible substitute products, and the suppliers.

The Five Forces Model

Michael Porter's (1979) Five Forces model takes a look at the micro-environment and helps analyze various strategies for the strategic planning process. This model is built on the following assumptions:

- The market's attractiveness is defined by its structure.
- The structure of the market in turn impacts the strategic behavior of an organization operating in this market.
- Since the market structure is defined by the competition, the competitive strategy of an organization is decisive for its success.

Porter's model analyzes the forces in the micro-environment that impact a specific market. The information gained through this model analysis allows organizations to make decisions regarding activities that influence forces in their micro-environment.

The attractiveness of a business is identified by the following five forces:

1. Buyers/customers: analysis of their buying power
2. Competitors: analysis of the degree of rivalry among existing competitors
3. New market entrants: analysis of threats from new competitors
4. Substitutes: analysis of threats from substitute products
5. Suppliers: analysis of their negotiating power

The stronger these five forces are, the less attractive the business is and the more difficult it is for an organization to build and maintain a competitive advantage. These forces are now explained in greater depth.

Buyers/customers

Customers are the direct buyers of the products or services of an organization; however, they are not necessarily the **consumers**. When buyers are powerful (i.e., they buy large amounts), they can enforce lower prices for the products. This would lead to a decrease in the profits of the organization.

Consumer
The consumer is the individual using the product or service. In many families, mothers are often the grocery shoppers who buy the chocolate. In this instance, the mother is the direct buyer; however, it is the children who are the consumers of the chocolate.

Buyers have purchasing power over an organization when

- they buy large quantities,
- the producer has high fixed costs and little flexibility in lowering the price for the product or service,
- the product is undifferentiated and can easily be replaced by substitute products,
- the switch to an alternative product is simple and inexpensive,
- the **margins** are relatively small,
- the customers could produce the product or service themselves,
- the product or service is not of high value to the customer,
- the customer knows the production cost of the product, or
- a **backward integration** is possible for customers.

Margin
Margin is the difference between the production costs and the sales price.

Backward integration
This means that customers produce the product or service themselves by buying the company or developing it.

Competition

This force describes the intensity of the competition among the current players in the market. High competitive pressure, which is often reflected in price competition, leads to shrinking margins and profits for all the organizations in the business.

The competitive pressure in a business is high when

- there are numerous companies of similar size in the market,
- the companies have similar strategies,
- the business sector shows little growth, and therefore, an increase in sales is only possible if business is taken away from a competitor,

- the products or services offered in the market are undifferentiated, and therefore, all companies compete on price,
- the exit barriers for the organization to leave the business and switch to a different business are very high (e.g., highly specialized machines or personnel are required to produce the product or service).

New market entrants

When the competitive pressure by new market entrants on existing organizations is higher, the easier it is for new companies to enter a certain sector. Important elements in the market such as market share, price levels, customer base, etc. can be changed when new companies enter the market. There is a constant pressure on the existing organizations to react and adjust to this pressure. The threat of new market entrants is defined by business specific market entry barriers.

Market entry barriers are high if there are

- **economies of scale** (i.e., organizations need to be a certain size in order to be more efficient)
- high initial costs and high fixed costs;
- cost advantages of existing organizations through experience effects or through employment of depreciated but still functioning machines and equipment;
- **brand-loyal customers**;
- patents, licenses, etc. which protect the intellectual property of organizations;
- scarce resources (e.g., qualified human resources);
- controlled resources by existing organizations;
- controlled distribution channels by existing organizations;
- close customer relationships through service or maintenance contracts;
- high **switching costs** for customers who want to change suppliers in the business.

Economies of scale
These occur when the production volume depends on the number of production factors deployed. Production costs do not necessarily decrease when the production volume increases.

Brand-loyal customers
These have a close relationship to a company or brand.

Switching costs
These are the costs involved when a customer switches to a different supplier. These costs are monetary and psychological.

Substitutes

The threat of substitute products is critical if the substitute is cheaper or more effective than the current product. These may then replace a large portion of the sales volume of the existing product and thus reduce sales and profit of existing organizations.

Similar to the threats of new market entrants, the threat of substitute products depends on various factors such as

- the degree of customer loyalty,
- the **intensity** of the customer relationship, or
- how high the switching costs are for the customer.

Intensity
This describes the degree and frequency of the customer contact.

Suppliers

Input
This includes all efforts such as materials, personnel, etc. that are necessary to produce the product or service.

Suppliers are all the supply sources that are necessary for an organization to be able to produce the product or service. Suppliers provide the necessary **input** to make the product. Powerful suppliers can increase the prices for their products and therefore reduce the profit of the organization to which they supply the product.

Suppliers are powerful if

- the market is dominated by few large suppliers,
- the product supplied is highly specialized or rare,
- the company that buys from the supplier is small and insignificant to the supplier,
- there are no substitutes for this specific input,
- the switching costs to a new supplier are high,
- a forward integration is feasible for the supplier, meaning that the supplier could buy the company to whom it supplies.

The example of forward integration is evident in the case of charter airlines. Many airlines do not sell through travel agents as a distribution channel but rather sell directly to the traveler via the internet. This example demonstrates how these airlines have forward-integrated their distribution.

If a supplier is powerful, the businesses that operate in this market experience a high pressure on their profit margins. It is more difficult to maintain a profitable business. The relationship with important suppliers can have a strong impact on the strategic plan of an organization.

Let us return to our case study of the Lars Bank, which is looking at opportunities for financing real estate in Turkey. Questions four to ten on the employee’s list concern Porter’s Five Forces model.

Firstly, the questions “Which customers should we target, private investors or real estate companies?” and “How could the customers influence the financing terms of the bank?” look at the customer and how much power he has. Small private customers who are buying a home will certainly have less power than large real estate companies. Real estate companies regularly invest in large apartment buildings and therefore have a great deal more power in negotiating financing terms with the bank. The bank has to decide who their customer is.

The next questions, “What is the competition like in the Turkish market?” and “What other European competitors might become active in the Turkish market? To what extent and how?,” evaluate both the existing competitive situation in Turkey and potential new competitors. Certainly, Lars Bank will not be the only bank to consider entering the Turkish market once the legal changes are finalized. Therefore, a possible strategy has to look at the competitive landscape.

The next question, “What alternative financing options are available to Turkish customers?,” is concerned with possible substitutes or, in this case, other financing options. Other financing options may be available in Turkey, such as loans supported by the employer.

The second to last question, “How are real estate projects sold? Who mediates real estate projects in Turkey?,” looks at the supply situation. In this case, the bank needs to find out where and how to get information on real estate projects.

2.3 Analysis, Strategic Capabilities, and the Five Forces Model

The analysis of Porter’s Five Forces in business can be used for three areas of a strategic plan:

1. **Analysis of the market attractiveness (static):** The model helps to define the market attractiveness of a business. It helps with decisions concerning entering or remaining in a specific market segment. The model also allows the analysis of the influence of the forces on the individual organization and on its competitors. This helps to determine the organization’s position in the market. Different companies have different resources and competences that permit different strategic decisions. The strategic decisions of the companies in turn influence the competitive structure of a business.
2. **Analysis of the development of the market attractiveness (dynamic):** Together with the PESTEL analysis, the Five Forces model can show developments and changes in a business. This trend analysis can be used to look at the attractiveness of the business in the future. The political, economic, social, technological, ecological, and legal developments can influence one or several of the five forces. This can significantly influence the distribution of power of the forces.
3. **Analysis of the strategic possibilities:** The analysis of the intensity of the different forces on the organization provides insight into opportunities to influence or use the forces to the organization’s advantage. This might lead to a completely new strategic orientation, which could influence the **position** of the organization in the market place, or the differentiation of the products or services, or even the decision to form strategic partnerships. In our case study, the Lars Bank is investigating the question “Would the Turkish market be of interest to Lars Bank?” This is the basic strategic question that follows the macro- and micro-analysis of the environment.

Position
This is the active communication of a product or brand to the market place.

Thus, Porter’s model allows a systematic and structured analysis of the competitive situation and position of an organization. As stated earlier, the model can be used to analyze a specific situation, a specific market segment, or a specific region.

What Are The Strategic Options For an Organization?

After thoroughly examining the current and possibly future development of the five forces, the organization can develop strategies to influence one or several of the forces. Possible strategies should not just take the environment into account but should also look at the internal resources, capabilities, and goals of the organization.

The following strategies are available to organizations:

Reducing the power of the suppliers

- The organization can form partnerships with companies that use the same supplier, enabling them to buy higher quantities at lower prices. Edeka is a buying partnership of several supermarkets in Germany. The partnership started in 1898, and Edeka is now Germany's largest food retailer.
- Systems integration: organizations can try to integrate (i.e., computer systems, ordering processes, etc.) with their supplier. This will streamline the process and make it cheaper for both companies. At the same time, it will become more difficult and more costly for the supplier to switch customers. Systems integration consolidates the relationship between companies.
- An example of successful systems integration is Wal-Mart, a US-based retailer. In June 2003, Wal-Mart announced that its 100 largest suppliers would have to supply all their products with radio frequency identification (RFID) technology by January 2005. RFID allows products to be identified and located automatically. The reordering process is therefore automated as the system recognizes when the shelf is empty and products need to be reordered.
- Companies can try to obtain knowledge regarding the production costs and methods of the supplier in order to use this information in negotiations.
- The organization can try to backward-integrate (i.e., it can try to purchase the supplier). For example, a shoe manufacturer could acquire a leather supplier to ensure consistent quality and deliveries.

Reducing the power of buyers

- Organizations can form partnerships with other suppliers to reduce the buying power of customers. These cooperatives can be seen in many areas. For example, olive farmers in Italy deliver the olives together to the oil producer to guarantee the same prices for all farmers.
- System integration works in both directions: from buyer to supplier and from supplier to buyer. It leads to optimized processes and lowers the costs for both parties. It makes switching more difficult for both supplier and buyer. In the medical equipment market, some manufacturers of medical imaging equipment also supply data management systems to hospitals. The imaging systems are then compatible with the patient data management system of the hospital. This creates a close relationship between manufacturer and hospital.
- Increasing customer loyalty will also reduce the power of buyers and tie the buyer to the organization. Loyal customers who buy repeatedly reduce the purchasing costs of an organization as they are familiar with the process and know how to order. This decrea-

ses the process costs and increases the profitability of the organizations. Organizations can increase loyalty by consolidating relationships and by offering loyalty benefits to the customer.
- The decision to purchase a specific product should not be based on the price. Apple understood that the highly competitive consumer electronics market is price-driven. However, through excellent marketing, they created a trendy image for their products and evaded price competition with the many other electronic companies in the market.
- Organizations can also try to bypass influential distributors and sell directly to the customers. We have already provided the example of charter airlines that no longer sell tickets through travel agencies but directly to the customer.

Reducing the threat of new market entrants

- Organizations can weaken the threat of new market entrants by building a brand and creating customer loyalty. Both will make it more difficult for new entrants to establish a customer base.
- Patents and licenses protect products and processes for a limited time and make it impossible for new entrants to sell similar products in the respective markets.
- Organizations can increase the barriers to entry (see above).
- **Alliances** with complementary products and services can improve customers' choice of product from a single source. Travel agencies often have alliances with insurance companies to be able to offer travel insurance policies to their customers.
- Alliances with suppliers or distributors build closer relationships, making it more difficult for new companies to enter the market.
- Increasing efficiency in producing the product or service will give the organization cost and time advantages over new entrants. This can be attained through constant quality and process management.

Alliance
An alliance is a partnership between two companies with similar interests and goals.

Reducing the threat from substitutes

- In order to reduce the threat from substitutes, organizations can again integrate systems with their customers to make it more difficult for them to switch to substitute products.
- Creating industry standards makes it difficult for substitutes to gain a market share. Wal-Mart's RFID technology has expanded in the retail business in the US and has become an industry standard.
- Forming alliances is another strategy to protect the organization from possible substitutes.
- Market research and constant analyses of customer preferences can also protect from substitutes.
- Organizations may decide to enter the substitute market themselves. Some manufacturers of glass bottles have invested in the production of plastic containers.

Reducing the pressure from existing competitors

- Companies should avoid price competition.
- Differentiating products from competitive products as Apple has done with many of their products, avoids direct competition.

- Taking over a competitor is another strategy to ease the pressure as the organization becomes larger.
- Focusing on specific market segments (niche marketing) will avoid head-on competition in these smaller market segments.
- Communicating with competitors establishes better relationships and avoids fierce competition.

Critical Issues

Porter's Five Forces model has received some criticism. Its main weakness is a result of the historic context it was created in. At the beginning of the 1980s, the world economy was shaped by strong competition and cyclical growth patterns. Therefore, organizations' primary goal was to guarantee their existence and profitability. They had to optimize their strategy in relation to the competition.

Today's market is quite different. It is much more dynamic and less stable and predictable in its development. Therefore, the Five Forces model has limited applicability in today's market place.

- The model is based on a stable and static market structure. It is difficult to apply it to today's dynamic markets. The technological advances and aggressive new market entries by companies from different businesses change the markets constantly. The internet as a selling tool has put many established brick-and-mortar companies that ignored this trend completely out of business.
- The Five Forces model is best used to analyze simply-structured markets. It is difficult to analyze complex businesses with many intertwined structures and networks, products, and distribution structures using this model.
- Moreover, the model is also based on the classic free market. The stronger a business is regulated, the less effectively the model can be used to design sound strategies.

MORE INFORMATION
Porter's answer to such criticism can be found in Porter (2008).

SUMMARY
Each organization exists within an environment which influences its strategy. The environment can be divided into the micro-environment (direct influences) and the macro-environment (factors in the wider environment of the organization). There are various methods of analyzing these factors.

The PESTEL analysis helps to examine the macro-environment. It looks at factors in the wider environment, such as trends and developments that influence the company strategy. The PESTEL analysis looks at political, economic, social, technological, ecological, and legal aspects that influence strategic decisions. The PESTEL analysis is broad and can be used to make decisions on locations, product portfolios, technological concepts, and other projects.

Michael Porter's Five Forces model helps to analyze the strategy of an organization and make planning decisions. The basic assumption of the model is that the business structure influences the attractiveness and the strategic behavior of companies operating in the business. The attractiveness of the market is influenced by five factors: buyers, competitors, new market entrants, substitutes, and suppliers.

A thorough analysis of the five forces and their scope of influence allows organizations to evaluate the attractiveness of the market. In combination with the PESTEL analysis, a company can also evaluate trends in the market. Thus, the company can define the strategic possibilities and try to influence one or several of the five forces. The goal is to weaken suppliers' and customers' power over the organization, to minimize the threat from new market entrants and substitutes, and to minimize the pressure from existing competitors on the organization.

Porter's model has been criticized as it is based on static and stable market conditions. Therefore, it cannot be applied to today's complex and dynamic markets.

UNIT 3

THE POSITION IN THE MARKET

STUDY GOALS

On completion of this unit, you will have learned …

- the difference between a mission, a vision, and a statement of values.
- how to define goals.
- what the organization’s position in the market means.
- how to segment consumer and business markets.
- how to carry out a SWOT (strengths, weaknesses, opportunities, and threats) analysis.
- what benchmarking is.

3. THE POSITION IN THE MARKET

Case Study

The Bar School Takes a New Direction

The board of a private school continues to have different views about the strategic focus of the school from those of the school's president and leadership team. The board (representing the parents) finds the attitude among the students and between the student and teachers unacceptable. The president and the leadership team are mainly concerned with a higher quality education. The task of a school is to educate children in the best possible way. In the parents' opinion, education encompasses not just academic learning but also the social and emotional development of students.

In order to find a common future direction, the school and the board decide to develop a strategic plan together. Five days are set aside for this task, and the school leadership, board representatives, teachers, parents, and students take part in developing a plan that is supported by all parties.

The participants agree on the following mission statement: "The mission of the Bar School is to inspire and empower students to become balanced, responsible, and global-minded members of society. This is accomplished by offering a high-quality, internationally accepted education."

The mission statement always reflects the values of the organization. The values of the Bar School have been defined in the following way:

- Every person is of value and has unique potential.
- Good conduct, teamwork, cooperation, and respect are important factors for success; education is a partnership between students, parents, and teachers.

After the mission statement, the goals for the future are generated:

- All students display behavior that reflects the mission and the values of the school.
- The students' performance in three years will be above the level of similar schools.

Next, the school looks at all the factors that influence the strategy of the school by carrying out a SWOT analysis. The group generates a list of factors in a brainstorming session. Smaller groups then sort the results of the brainstorming session by common topic. The topics are then prioritized and aligned with the goals. Finally, the topics are grouped into action plans, which will be enacted over the three years by assigned groups.

The strategic plan is a success due to the support by all constituents. After one year, attitudes within the school have improved; after two years, the students' performance starts to improve.

3.1 Why Do We Exist?

The top level of an organization, the founders or the corporate level, formulate the guiding philosophy. This guiding philosophy defines the values of the organization and dictates how the organization should view itself. It also formulates the future direction of the organization. The guiding philosophy provides an internal orientation for the employees, guidance for their behavior, and motivation. To the outside world, the guiding philosophy shows what the organization stands for. It is the basis for **corporate identity.**

Corporate identity
This defines the identity of an organization. The identity is defined through all the characteristics of an organization that distinguish it from other organizations.

Mission

The mission is the heart of a strategy; it explains why the organization exists and provides clarity to its purpose. It defines the organization to all who are directly or indirectly connected to it: employees, suppliers, customers, distributors, shareholders, etc., otherwise referred to as **stakeholders**.

Stakeholders
These are individuals or organizations that are connected to or affected by the organization.

The mission answers the following five questions:

1. Why do we exist?
2. What is our purpose?
3. Why are we different from others?
4. What do we want to achieve?
5. How do we achieve it?

The Bar School provides us with an example of a good mission statement. The first part, "The mission of the Bar School is to inspire and empower students to become balanced, responsible and global-minded members of society," answers the question of why the school exists and what its purpose is. The second part of the mission statement, "This is accomplished by offering a high-quality, internationally accepted education," describes how the school will accomplish its mission.

Vision

While the mission statement looks at the purpose of an organization from the present-day perspective, the vision looks at the future of an organization and where it aims to be. The vision should inspire and unite everyone involved with the organization and should challenge the organization's resources.

The vision answers the following questions:

- What do we want to accomplish in the future?
- Where do we see our organization in five, ten, 15, or even 20 years?

The vision is the guiding philosophy of the organization, which must reflect the values of an organization and is influenced by the strengths and weaknesses of the organization.

An example of a vision: “We will provide the highest quality product/service in the market.”

Values

The value statement communicates the values and principles of an organization. It defines its guidelines for conducting business. These values should not change or be adapted as they provide the basis for each strategy.

The values of the Bar School are the following:

1. Every person is of value and has unique potential.
2. Good conduct, teamwork, cooperation, and respect are important factors for success; education is a partnership between students, parents, and teachers.

Goals

Many organizations have neither a mission, vision, nor a value statement. However, every organization has goals. Goals are specific to each layer or department of the organization, as illustrated in the following figure.

Figure 3: Goal Hierarchies

Source: Created on behalf of IU (2015).

The corporate or strategic goals should be specific to what should be attained. They can be developed around many criteria such as the following:

- market position goal (i.e., market share, sales volume, developing new markets)
- profit goals (i.e., profit margin, return on sales)
- financial goals (i.e., level of liquidity, credit-worthiness)
- social goals (i.e., employee satisfaction, employment security)
- goals relating to power and prestige (i.e., image building, changing dependency on other organizations)

These corporate goals are then translated into goals for the SBUs. The SBUs are most often separate entities responsible for respective profits or losses, and therefore, each SBU will have goals specific to their unit.

The corporate goals could also be translated into functional goals (e.g., human resource goals, financial goals, and production goals). A functional goal for human resources could be to increase employee satisfaction.

Below the goals for the SBUs are the marketing goals specific to actions or measures. These marketing goals are specific to activities within the **marketing mix**. These goals are more short-term and usually outnumber corporate goals. These goals serve to guide the individual marketing activities of an organization and allow for the measurement of these activities. Typical examples are the response rate to a specific mailing to customers, the increase in sales due to a special promotion, or the increase in brand awareness due to an advertising campaign.

Marketing mix
The marketing mix includes activities regarding product, price, distribution, and promotion.

The goals of the Bar School are specific to the original problem encountered by the school. The goals of the board were different from the goals of the school's leadership. The board was concerned regarding the interaction patterns within the school, and the president was concerned about the performance of the students. This led the school to set two goals:

1. All students display behavior that reflects the mission and the values of the school.
2. The students' performance in three years will be above the level of similar schools.

Integrating these goals into the strategic plan of the school helped to change them from conflicting goals to complementing goals. The systematic approach of the strategic plan, which was designed by the entire school community, helped to reach the first goal after one year and the second goal after three years.

3.2 What is Our Position in the Market?

Each organization occupies a specific position in the marketplace in which it operates. The position depends on the market itself and the competitors operating in this industry. This means that if the market changes, for example, through technological changes such as introduction of the Internet, the position of companies operating within this market changes. Organizations that adapt faster to the new technology gain a better position than those that adapt slowly. The better-adjusted competitors then put pressure on the strategic position of the organization.

To show the position of an organization in comparison to its competitors, companies draw positioning maps. Positioning maps place the products or services of a company alongside those of their competitors on a chart. The chart has two axes; these axes may have different dimensions and depict specific characteristics or customer preferences (i.e., price, quality, speed of service, etc.), which are generated through a thorough **target group** preference analysis. The distance of the products or services show fairly realistically the differences perceived by the target group.

Target group
A target group is a specific, homogeneous group of customers, which can be defined and reached with a specific marketing communication mix.

Figure 4: Positioning Map (Case Study: Palace Hotel)

Source: Created on behalf of IU (2015).

The development and implementation of a positioning strategy is a company-controlled method of building a specific reputation in the market. It is based on customer experiences and preferences as well as the communication strategy of the company.

Companies should actively manage their reputation or image compared to the competition. A clear positioning strategy gives organizations a competitive advantage. Positioning a product or service is therefore a controlled process to build an image in the market place. The position is defined and communicated to the main target groups. Positioning is a strategic process that influences the actions of the organization and affects all functions of an organization.

Organizations with a clear market position are usually more successful than their competitors. However, it often happens that companies make the mistake of giving up a clearly successful position. The market leader for copying machines, Xerox, decided to enter the personal computer market a few years ago. A great deal of financial capital and energy went into building the new business. At the same time, the market share in the **core business** of the copying machine business continued to decline.

Core business
The core business is the company's main business, which usually also provides the largest financial contribution to the overall business.

Most companies offer several products or services. The complexity of a positioning strategy becomes evident in companies that offer several product lines. Lufthansa is a large organization. It lends its name to many areas of its business that reflect the Lufthansa image of high quality and exclusivity (i.e., Lufthansa Technik, Lufthansa Cargo, etc.). Other Lufthansa companies that do not match that image carry different names, such as the charter airline Germanwings, which is also part of the Lufthansa group.

When designing a positioning strategy, organizations should adopt a structured approach. This requires an analysis of their strengths and weaknesses as well as anticipation of trends and changes in the market using quantitative and qualitative methods. Information should be collected internally and externally. In the process, the position or the desired position should be communicated through a positioning statement. This positioning statement should be clear, understandable, unique, and reflect customer needs. It should be realistic and differentiate the product or service from the competition.

The customer needs are defined by analyzing their preferences. These preferences are evaluated for the company as well as for the competition and are projected onto the positioning map.

3.3 What Information Does the Company Need?

Quantitative Market and Customer Analysis

The first step in a thorough market and customer analysis is the quantitative recording of relevant data. The quantitative analysis is fairly straightforward as the recorded data on customers and the market is usually available. It does not require expansive and expensive research as the data is usually available through internal sources or can be easily acquired externally. Internal sources are employees with market or customer data, sales information, distributors, etc. External sources are **umbrella organizations**, government or business statistics, industry experts, annual reports of competitors, etc.

Umbrella organization
An umbrella organization can be either specific to a business or to a region.

Independent of the business, global indicators (such as gross national product or population growth) can also be used as indicators for a market analysis. A market analysis employs the following key figures:

- market volume (market size, monetary or volume size)
- market potential (maximum size of the market including all segments)
- market growth (annual growth rate in %)
- market share of the main competitors (monetary or volume)
- degree of concentration of the competition (percentage of sales of the ten largest competitors)
- average **return on sales** in a specific business (can be deducted from the annual reports of the competitors)
- size of the main customer segments (i.e., private customers/business customers)

Return on sales
This describes the ratio of profit to sales. It shows how much profit an organization generates compared to its sales over a given period of time.

Market Segmentation

The market of an organization is divided into so-called market segments. A market segment consists of customers that have similar needs or preferences. Market segments can be defined for both consumer and **business-to-business** markets according to the following criteria:

Business-to-business
This describes the business relationship of two companies with each other.

Table 1: Market Segments

Factor of Segmentation	Consumer Market	Business-to-Business Market
Personal characteristics/business characteristics	• age and gender • income • size of the household • stage in the life cycle • place of residence • lifestyle	• industry • location • size • technology • profitability • management
Purchase situation/ usage	• purchasing volume • loyalty • purpose of use • purchase behavior • value of the product • product choice criteria	• purchasing volume • purchase process • purpose of use • frequency of purchase • value of the product • product choice criteria • distribution channel (direct or intermediary)
User preferences	• brand preferences • desired properties • quality • price preferences • comparability of the product	• brand preferences • desired properties • quality • service • product requirements • support requirements (i.e., by intermediaries)

Source: Created on behalf of IU (2015).

In the consumer market, we segment according to socio-demographic characteristics such as age, gender, stage in the lifecycle, where they live, etc. We could also segment by usage, for example, how much the customer buys, whether the customer buys repeatedly and is loyal, what the product is used for (e.g., the product is a present for someone else), how much value does the product have for the customer, and what are important choice criteria.

Another way to segment the consumer market is by user preferences. We have to investigate how our products compare to competitive products, what are the customer's price or brand preferences, and what properties are sought after in the product. Finally, the quality of the product or service also plays a role.

In today's crowded markets, organizations spend fewer resources on mass marketing, and instead they focus more on micro-segmenting their markets. This means that companies segment by using several of these criteria, i.e., families who purchase in larger quantities and are price sensitive.

In business-to-business markets, companies segment their customers as well, but some of the criteria differ from consumer market segmentation. Segmentation criteria look at business characteristics such as the type of industry, location (i.e., domestic or international), the size of the company, the technological standard (e.g., do they use a similar software that can be integrated?), the profitability (e.g., is the company profitable and is it advisable to expand the cooperation?), or the management (e.g., is it privately owned?).

We can also segment by usage, such as defining the value of the product (i.e., is it important?), the purchase volume or frequency (i.e., do they order continuously or twice a year?), how they order (i.e., internet or telephone), why they choose our product, and what distribution channels do they use (i.e., direct or distributors).

Another way to segment in business-to-business marketing is by user preferences. These criteria are product or support requirements (i.e., do they require online service), what are brand preferences, and what product properties are required. This category also includes the quality requirements of the product or service.

When segmenting, it is important to consider that the segments can be measured and may be differentiated from each other. Moreover, the segments have to be reachable through the available communication channels and should be sufficiently large, such that it is worthwhile for the company to define a marketing mix for the specific segment.

3.4 What Capabilities Does the Company Have?

As a next step, an organization has to understand its own capabilities and resources. The SWOT analysis is a tool in the evaluation of a company or a specific project.

SWOT

The SWOT analysis requests a thorough analysis of the strengths and weaknesses of the organization as well as the opportunities and threats in the environment. The organization carries out this analysis internally.

Internal resources are

- physical resources such as machines, equipment, buildings, raw materials, patents, computers, etc., that determine the efficiency, productivity, and flexibility of the organization;
- financial resources such as the balance sheet, **cash flow**, and financial support that determine the financial management of the organization and whether financial support is available (i.e., from banks);
- human resources such as employees, managers, partners, etc. that determine whether an organization has the right people, what training is required, or how the organization can motivate its employees.

Cash flow
The cash flow looks at the liquidity that an organization has in a specific period of time.

The analysis of all these factors provides an understanding of the capabilities of the organization and what strategic possibilities are available for and compatible with the organization. The SWOT matrix can also be used for a competitive analysis to look at the strengths and weaknesses of the competitors in the market and compare these with one's own organization.

The analysis of opportunities and threats scrutinizes developments in the micro- and macro-environment of the organization that influence strategic decisions. Opportunities and threats refer to trends in the market. This part of the SWOT analysis can be supported by the PESTEL analysis and Porter's Five Forces model.

The following questions are helpful for this part of the analysis:

- What important trends does the company have to follow in order to continue to exist in this market?
- What are the biggest risks? How can the company minimize these risks?
- Who are the competitors? What do the existing competitors do? Are there potential new market entrants or substitutes?

Here is a SWOT analysis of a university that wants to offer an online distance learning program and has no experience in this specific field. One factor is listed for each category of the SWOT as an example. There are usually many factors in each category.

The SWOT analysis is mostly carried out in a brainstorming session with members from different parts of the organization, as in the case study of the Bar School. The ideas generated in the brainstorming session are then organized into specific topics. In the example of the Bar School, topics included how to improve the school atmosphere and goal-setting among students, topics that arose in relation to the unacceptable attitude of students and the students' performance.

Table 2: Case Study: SWOT Analysis of a University

Strengths Experience in existing study programs	**Weaknesses** No existing online program in the field to use as a model
Opportunities Little competition in the online study program market in this specific field	**Risks** Accreditation of the program needs to be ensured

Source: Created on behalf of IU (2015).

Topics are then prioritized, which is frequently a problematic process in organizations as the various departments have different priorities and often consider the issues affecting their own department more urgent than those of other departments. However, prioritization is important and allows management to see what needs to be done first. Each organization has limited resources and therefore projects need to be prioritized.

The SWOT analysis has some disadvantages. The brainstorming session can generate long lists of topics and it is often difficult to set priorities. Frequently, the input is purely opinion, and the moderator has to be careful that the brainstorming does not turn into a grievance session. As already mentioned, different departments view strengths and weaknesses in the organization differently and often hide their own departments' shortfalls. They also see priorities differently. In order to address these shortfalls, there should be a general analysis of issues before the SWOT analysis is done. This helps to identify real issues and generates indicators and figures to support particular arguments.

Defining Core Competency

In order to conduct an effective strategic planning cycle, a company has to know its core competencies. A core competency is a capability of the organization that is unique or superior to the competition. This core competency is a competitive advantage for the organization. Therefore, many organizations focus on their core competencies as a strategy, especially in a difficult economic environment.

If an organization has a core competency, this means that the company has resources and capabilities that

- increase the value of the product or service to the customer,
- differentiate the organization from the competition, and
- can be expanded in the future.

This results in a competitive advantage.

3.5 What Capabilities Do Others Have?

Benchmarking

Reference
This means to relate the company to another organization.

Benchmarking is a method that enables specific comparisons between companies and selects the best one as a **reference** in order to optimize the company's performance. These comparisons may help an organization to better understand itself, identify superior methods and practices utilized by other organizations, and allow certain processes to be adapted.

There are four types of benchmarking:

1. Internal benchmarking
2. Competitive benchmarking
3. Functional benchmarking
4. Generic benchmarking

Internal benchmarking

Internal benchmarking is performed within your organization. An example is an international building material manufacturer comparing the cement production units of its own manufacturing units. The advantage of internal benchmarking is that the data, figures, and numbers, are readily available. A comparison of the indicators within the same organization is straightforward as the processes and structures between the units are similar. One disadvantage might be the lack of acceptance of such a benchmarking process as managers might feel that it is not the processes or units but their management practices that are being compared. It could be seen as an open criticism, which might compromise the working relationships.

Another form of internal benchmarking is corporate benchmarking. This type of benchmarking is not limited to the same business, as in the example of the building material manufacturer. Corporate benchmarking extends into the entire organization − for example, the production unit of the medical division could be compared to the production unit of telecommunications in the same organization. However, quantitative comparisons are limited because the units belong to different businesses and are therefore structured differently.

Competitive benchmarking

Benchmarking partners are companies that operate in the same industry and service the same or similar markets. In both cases, important figures or indicators are compared. This might prove difficult as competitive information could be limited or not available at all. In some industries, competitive benchmarking is a commonplace practice − for example, most car manufacturers provide new models to their competition to compare these in terms of technical development, features, and handling with their own models in that specific category.

Competitive benchmarking needs much preparation work. Moreover, it requires an open communication between competitors in order to be effective. It is important that the participants give and receive an equal amount of information. The advantage of competitive benchmarking is that it provides organizations with a clear picture of their position in the market. However, it is often difficult to compare key figures and processes with direct competitors. Furthermore, the information gained through competitive benchmarking with existing products has no novelty and does not contribute much to innovation or address future trends and developments.

Functional benchmarking

Here, companies compare organizational functions such as comparing their own logistics department with the logistics of an online shop. This type of benchmarking allows for much learning and innovation and provides organizations with new ideas and suggestions.

Generic benchmarking or best practice benchmarking

Generic benchmarking goes beyond the functional areas of the organization and the industry it operates within to comparing unrelated companies in unrelated industries. Southwest Airlines in the USA carried out a classic example of generic benchmarking. The airline compared the turnaround time of their airplanes, which includes unloading and reloading, refueling, cleaning, and safety checks, to the pit stops of racing cars at Formula One car races. This analysis enabled Southwest Airlines to reduce the turnaround time of their planes by 50%. More than 20 years on, the airline is still benefiting from this process of improvement.

A value chain analysis is a prerequisite for benchmarking processes. The value chain analysis looks at which steps in the process of creating a product add value for the customer and thus contribute to the value creation of the organization. At Apple, production is responsible for product quality, the logistics department is responsible for the speed of delivering the product to the customer, and the marketing and communication department is responsible for the creation of emotional aspects for the consumer. The value chain is an analysis process that connects effectiveness (i.e., what creates value from the perspective of the customer) and efficiency (i.e., where can processes that waste resources be eliminated).

Standard process for benchmarking

The process of a benchmarking project can be divided into the following four phases and its steps:

1. Goal-setting/preparation phase
   a) definition of the problem and internal analysis
   b) selecting the benchmarking partners and appointing the benchmarking team
2. Comparison phase (quantitative benchmarking)
   a) definition of the figures and numbers and indicators to be investigated
   b) data generation

   c) data analysis
   d) ranking
   e) selection of ‘best performers’
3. Analysis phase (qualitative benchmarking)
   a) analysis of the best processes and strategies
   b) deduction of the ‘best practices’
4. Improvement and implementation phase
   a) definition of the improvement measures
   b) implementation of the improvement measures
   c) controlling progress and results

It is vital that the features or processes important to the customer are accurately identified in order to select the most relevant competitors and benchmarking partners for comparison. Additional considerations should be made when benchmarking against poorly performing competitors; if an organization fares better in some areas than its competitors, it should not be assumed that the organization in fact exceeds customer expectations.

SUMMARY

It is advisable to define a vision and mission for the organization before starting a strategic planning cycle. Together with the corporate values, the vision and the mission are the guiding philosophies for the strategic plan. The goals of the organization are divided into a few corporate goals, goals for the SBUs, and many marketing goals at the product level.

When developing strategic options, a company has to understand its own position in the market. This position depends on the sector it operates in and on the competition. A structured approach using quantitative and qualitative market research is necessary to define the position of an organization. Organizations must understand customer preferences and use this information to compare themselves with the competition. Positioning maps provide a visual representation of an organization’s market position in relation to its competitors.

Quantitative market research provides information such as market volume, potential, growth, market share, degree of competitive concentration, average return on sales in the sector, and the size of its market segments. Qualitative market research further defines the market segments and extracts information about consumers’ needs and product/service preferences. Market segments in the consumer and business-to-business markets are defined by looking at personal or business characteristics, the purchase situation or usage, and user preferences. The segments have to be measurable, distinguishable, and reachable, and they should be of a certain size.

The capabilities of an organization may be analyzed by means of a SWOT analysis. The analysis of strengths and weaknesses examines the organization internally, while the analysis of opportunities and threats examines the organization's environment.

In order to conduct a thorough SWOT analysis, an organization must know its core competencies. Core competencies help differentiate an organization from the competition and provides a competitive advantage.

Finally, benchmarking is a management method with the goal of optimizing processes by making comparisons with other organizations. There are four types of benchmarking: internal, competitive, functional, and generic benchmarking. Companies can compare their departments or processes with other organizations. A solid benchmarking process requires setting goals, conducting comparisons and data analyses, and then using the data to optimize processes.

UNIT 4

WHAT STRATEGIC OPTIONS ARE AVAILABLE TO THE STRATEGIC BUSINESS UNIT (SBU)?

STUDY GOALS

On completion of this unit, you will have learned …

- what strategic options are available to the SBU.
- what cost leadership, differentiation, and focus strategy mean.
- which strategies are available in a market that is hypercompetitive.
- what type of alliances exist.
- the phases of the product life cycle (PLC).

4. WHAT STRATEGIC OPTIONS ARE AVAILABLE TO THE STRATEGIC BUSINESS UNIT (SBU)?

Case Study

Bhutan's Decision
Bhutan is a small country sandwiched between Tibet and India. It has a population of approximately 700,000. In 2008, Bhutan changed from being a kingdom to a constitutional monarchy with the king as head of state and a prime minister. Bhutan's economy is mainly based on agriculture and forestry, tourism, and hydropower. Most of the electricity from hydropower is exported to India. Agriculture is still the main source of income for 80% of the population. Bhutan had a gross national product of $1.4 billion in 2008 and $8.7 billion by 2021 according to the World Bank and a per capita income of $2,082 in 2008 and $3,298 by 2021. Bhutan exports electricity, crafts, and spices. The total export was approximately $170 million (2000; $345 million in 2021). Imports such as gas, grain, machinery, cars, etc. were $215 million (2000; $1.12 billion in 2021).

Paro airport was the first international airport in Bhutan. Paro is located in the west of the country, which has a better infrastructure than the eastern part of the country. The general infrastructure of Bhutan is not very good; there are few roads, which are in poor condition due to the harsh climate, and the roads through the mountains are under constant repair. However, Bhutan opened three more airports (Yongphulla, Bathpalathang, and Gelephu) to improve the country's infrastructure. The Lateral Road is Bhutan's main road, which extends east to west and connects the southwest of the country with the eastern districts. The road passes through many towns, which slows down traffic. The Lateral Road, like many other Bhutanese roads, has safety issues due to the poor road surface, hairpin curves, slopes, weather, and landslides.

Bhutan has a unique and rich cultural heritage that has been well preserved due to the isolated location of the country. The main attractions for tourists are the culture and traditions of the people, which are deeply rooted in their Buddhist heritage.

Bhutan's mission

Bhutan is a model of proactive environmentalism in Asia. It is internationally recognized for its commitment to preserve its diversity of species and for declaring 40% of its land as national parks.

Gross national happiness

A prior king of Bhutan introduced the evaluation of the country's performance in terms of gross national happiness (GNH) instead of gross domestic product (GDP). The GNH serves to capture the progress of the quality of life of the Bhutanese population and to complement the purely financial view of the GDP. The GNH is captured by conducting regular interviews with the residents of Bhutan. The questionnaires are extensive and investigate the following areas of daily life:

- psychological well being (e.g., life enjoyment vs. distress)
- health (e.g., disabilities, number of healthy days per month)
- time use (e.g., tracking time use for sleep, education, religious acts)
- education (e.g., education attainment, folk and historical literacy)
- culture (e.g., dialect use, traditional sports, artisan skill, value transmission)
- good governance (e.g., government efficacy, honesty, quality, human rights, corruption)
- ecology (e.g., natural resources available, pressures on ecosystem, afforestation)
- community vitality (e.g., safety, family life, trust, social support)
- standard of living (e.g., income, room ratio, house ownership, food security)

The results of the regular surveys serve to provide information for political decision-making, such as whether the government should build more hospitals or invest in the infrastructure of the country.

Tourism has become a large source of income for the country. In 1974, 287 tourists travelled to Bhutan; in 2008 the figure was 27,636, and in 2022 it was 40,665. The tourism sector should therefore be further developed. The country needs finances to improve the infrastructure for the tourists.

Today, tourists can book a trip to Bhutan through international and national agents. The target group of tourists to Bhutan is the high-end traveler who is educated, has an interest in the country's culture, and is environmentally conscious. Every tourist who travels to Bhutan has to spend $200 per person per day. The expenses are charged by the travel agencies and cover hotel costs, excursions, transportation, trekking, camping equipment, guides, etc. Travelling in Bhutan is only possible with local guides. Due to the $200 tariff, the travel providers compete on service rather than price. Therefore, the tourists enjoy excellent service when visiting Bhutan, and feedback is positive despite the high costs.

4.1 What Strategic Options Does the SBU Have?

A strategic business unit is a unit that provides specific products or services in a specific business or market. Small companies often consist of one strategic business unit, whereas larger corporations have many SBUs. Strategic business units are defined by having similar customers or competitors or by having similar strategic capabilities. An example of a SBU is the medical division of a large corporation which serves hospitals.

SBUs make decisions on product portfolios and on the markets they serve. They can make decisions about which strategy to use in their markets in order to meet corporate goals. They are the experts in their markets and know their customers. SBUs are evaluated on the sales and profits they generate and are responsible for the results of their business.

The strategies that the SBUs pursue are either generic (i.e., strategies regularly employed by organizations) or interactive (i.e., the organization's direct response to changes in the market or the competitive environment). The interactive strategy influences the market itself and necessitates a high level of flexibility by the organization to react quickly to these changes. The strategy serves to make marketing decisions for the individual SBUs of an organization.

Generic Strategies

Michael Porter (1996) coined the term 'generic strategy' to describe those strategies most often deployed by organizations. He systemized possible strategies that lead to a competitive advantage in the market. Porter classifies the defined strategies according to the strategic goals that organizations set for themselves and by the strategic advantage the company pursues in order to reach its goal. From Porter's point of view, there are three main strategies:

1. Cost leadership (being cheaper)
2. Differentiation (being different)
3. Focus (being better)

Cost/price leadership

In order to pursue cost leadership, companies have to produce the product or service at the lowest costs in the market so as to provide the lowest prices to the customers. Cost leadership can be reached by ...

- ... low purchasing costs: the more a company purchases from a supplier, the more pressure they can exert on the supplier and the purchase prices.
- ... economies of scale: the more a product or service is produced by a company, the more the product or service improves. This is called economies of scale because failure rates and costs go down.
- ... experience: the more experience an organization gains, the better it gets at anticipating market fluctuations and reacting to them. By analyzing accumulated experience, companies can look to optimize internal processes and save costs.

ALDI
This is a German-based discount retailer that operates worldwide.

CASE STUDY: ALDI

One example of a successful implementation of the cost/price leadership strategy is the retailer **ALDI**. ALDI pursues several principles, the main being to guarantee low prices to its customers. To drive down purchasing costs, the company has an international purchasing department, negotiates low transportation costs, and offers a limited product range in its stores. Further cost savings are achieved through very simple, sparse layout of their stores and their cheap location at the periphery of cities and towns where the rent is affordable. ALDI consistently strives to optimize and simplify internal processes. It has neither a controlling nor a staff unit. Instead of forecasting, ALDI runs its business on current data.

Differentiation

A differentiation strategy forces organizations to offer something unique. This unique product or service has to be of such value to the customers that they are willing to pay a higher price for the product or service.

One advantage of this strategy is that companies create a unique market position, which allows them to operate with high profit margins due to higher prices charged. Disadvantages are the relatively high investment costs to build an image and brand in the market and the risk that others will copy the strategy and the company will lose its unique position.

CASE STUDY: SOUTHWEST AIRLINES

Southwest Airlines is one of the most successful airlines in the US. Southwest excels due to its service attitude and punctuality. Even though the airplanes are equipped with just one seating class, no seating reservations are possible, and only snacks are served during flights, the service is well received by the customers as all Southwest staff are trained to be extremely friendly. Punctuality is excellent as the turnaround time for the airplanes was drastically reduced via a major company initiative. This strategy has rewarded Southwest Airlines with a positive balance sheet. It has created a unique position in the crowded US airline market and differentiated itself from the competition.

The focus strategy

Companies pursuing a focus strategy direct their attention towards a small market segment or niche and offer a product or service that is designed specifically for this small group of customers. The position in a small market niche protects the organization from the competition. It can concentrate fully on its customers and charge higher prices as it offers high-quality products and services. The disadvantages of this strategy are that growth may be limited and changes in the market will impact sales of these high-end products or services.

Generic strategies can be combined. Southwest Airlines does not just excel by reason of its service and punctuality but also by offering low prices. Bhutan also combines strategies by setting itself apart from other tourist destinations, offering superior service and focusing on a very specific market segment. Different SBUs in a corporation can pursue different generic strategies, depending on their cost structure and the markets they serve. Lufthansa has a high-quality image and is positioned in the high-end segment of air travel. Nevertheless, the company decided to enter the low-cost air travel market when buying the charter airline Germanwings.

Moreover, technological developments influence the cost efficiency of companies and the quality of the products and services offered. This could change the generic strategy of an organization.

MORE INFORMATION
Additional strategic options for SBUs can be found in the article by Porter (1996).

4.2 Interactive Strategies

Interactive strategies require an organization to react to the strategies pursued by its competitors. Interactive strategies can be observed in highly competitive and volatile markets. In these markets, companies compete in two areas – namely, price and quality. If a company reduces its prices for a specific product, all the competitors follow suit. The same holds true for product quality or new functions. If, for example, one company integrates a camera into its mobile phones, other mobile phone manufacturers are forced to do the same in order to compete in this market.

Hypercompetition

A business environment with fierce competition is called a hypercompetitive environment. In a hypercompetitive environment, competitive advantages are created and destroyed at a fast pace. Companies that operate in a hypercompetitive market cannot defend their competitive edge for long and are forced to compete on price and quality.

To be successful in this market environment, organizations have to be flexible, react fast, and be prepared to take risks. Even outstanding organizations may fail if they hold onto success strategies of the past instead of looking to the future. A prime example of a hypercompetitive market is the consumer electronics market. The following excerpt describes the battle between the two giants, Samsung and Apple.

BATTLE OF THE TECH GIANTS
Mobile platforms are hitting critical mass across smartphones and tablets. Globally in the fourth quarter (Q4) of 2010, smartphone and tablet shipments exceeded desktop and PC shipments. In 2011, it is estimated that approximately 480 million smartphones and tablets were shipped as opposed to approximately 380 million desktop and PCs. As the mobility trend heats up, we see the mobile tech giants battle it out to try and gain more market share in the industry.

With the Samsung Galaxy Nexus banned in the United States, consumers are losing out as it hampers competition and innovation. The patent wars between Apple and Samsung have gone on for a while now and have assumed ridiculous proportions.

For Apple, this is a fight for survival and profitability, since Samsung is quite capable of flooding the worldwide market with quality alternatives to the iPad, that too at varying price points – something Apple has yet to do.

Samsung has already done this quite successfully if you take a look at the sales of its Galaxy SII smartphone and Galaxy tablet devices. This is expected to continue for some time if there is no intervention from government or regulatory authorities [such as the recent verdict against Samsung].

What this brings into question is the legality of seemingly generic patents that have been filed by all manufacturers over the years, and not just Apple, something that does not look like it will get settled soon.

Source: Frost & Sullivan (2012).

Strategic Alliances

In order to reduce the number of competitors in an environment of hypercompetition, companies can form strategic alliances, which are a type of partnership between companies. Alliances allow companies to bring together competencies. The primary goal of an alliance is to combine the strengths of the organizations to develop a competitive advantage in existing or new markets.

Successful strategic alliances require an analysis of

- the fundamental fit of the organizations (i.e., forming the partnership results in a competitive advantage),
- the strategic fit (i.e., the strategies and goals of both partners are similar or identical), and
- the cultural fit (i.e., the corporate cultures of the two organizations can be united without much friction).

CASE STUDY: STAR ALLIANCE

In 1997, the first network of international airlines was formed under the name Star Alliance. Due to national restrictions, it was not permitted for foreign airlines to serve domestic routes in a country. The Star Alliance allowed passengers to book connecting flights in foreign countries through the domestic airline. The

Horizontal alliance
Horizontal strategic partnerships are alliances between companies at the same economic stage.

larger the Star Alliance became, the more positive the effects for the network and its passengers. This **horizontal alliance** of airlines is today the largest network of airlines worldwide.

The Star Alliance is a so-called horizontal alliance. Vertical alliances can be formed in two directions, either upstream or downstream from the perspective of the organization; upstream means with a supplier, downstream means with a distributor. An example of an upstream alliance is the cooperation of a pharmaceutical company in the area of research and development. The pharmaceutical organization partners with a research institute to conduct research for specific projects. A downstream alliance would be an internet shop cooperating with **PayPal** as a form of payment method offered on their internet platform.

PayPal
This is a digital payment system that allows online shoppers to pay through an online PayPal account.

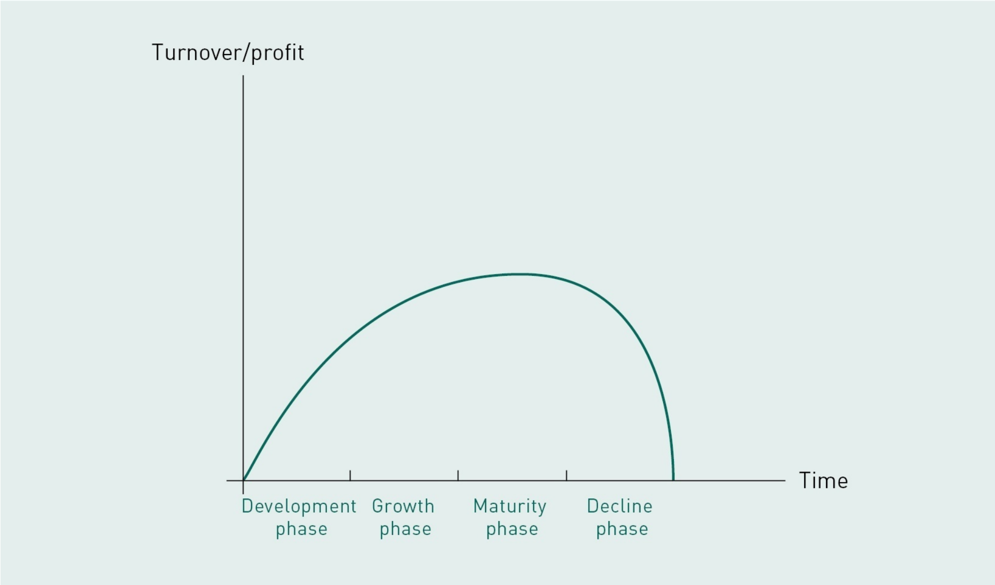
4.3 Product Life Cycle

In order to make decisions on the product level, companies can analyze their products according to the model of the product life cycle (PLC). The product life cycle model presumes that products follow a similar cycle to living beings. The cycle starts with the development of the product, then it watches the product grow and mature, and finally, it ends with its decline.

The product life cycle is an important marketing concept and provides information on the competitive dynamics of a product. It helps make decisions on prices, the product portfolio, markets, technology, capacity, and marketing and promotional measures.

Let us look at the phases in the product life cycle:

Figure 5: Product Life Cycle



Source: Created on behalf of IU (2015).

Each phase has opportunities and threats regarding the marketing strategy. Even though few products actually follow the exact product life cycle, the model is used for forecasting sales and formulating strategies.

Development Phase

The product or service is born and enters the market. This phase can take a long time and often shows low growth rates. The high marketing costs to launch, establish, and distribute the product eat up the profit in this phase. There are usually few competitors in the market, especially when the product is new to the world. In this phase, the organization needs a well-defined marketing plan that takes into consideration all the parts of the marketing mix (product, price, promotion, and distribution) and which clearly positions the product in the market.

Growth Phase

A successfully introduced product moves into the growth phase. Sales increase in line with the demand for the product. The number of competitors also increases as the market for the product or service grows. The increase in sales and production of the product or service reduces the production costs. The company benefits from these economies of scale and profits rise. Companies try to prolong this phase as it promises profits. To keep the product interesting, companies need to increase marketing and promotional expenditures.

Maturity Phase

The product or service is established and accepted in the market. The growth curve flattens and the climax of profitability is reached. Competition becomes fierce and products are less differentiated. Companies must therefore fight for market share.

Organizations try to extend this phase by introducing improvements or by introducing new marketing measures such as relaunches. The relaunch is a reintroduction of the product that was modified. A relaunch helps stabilize the slow growth in this phase. Further reasons for a product relaunch may be that customer preferences change or the company has to adjust the product or service to meet new regional demands if the product is sold internationally. Developing new markets or new market segments for the product prolong the duration of this phase.

Decline Phase

Sales decline during this phase as the product or service is considered outdated or customer preferences have changed. In this phase, it is important for companies to monitor and control sales, costs, and profit margins in order to be able to make strategic product decisions.

The company has several options in this phase. It can take the product or service off the market or it can drive down the costs of production to increase the profit margin and keep the product in the market. If a company can maintain this strategy long enough, it might see rival products leave the market until their product is the only one available to a small segment of loyal buyers. A third strategy is for companies to just introduce a product that succeeds the old one once it is taken off the market.

SUMMARY

The strategic business units (SBUs) make decisions regarding products and markets. The strategies for specific businesses may be categorized into generic strategies which most organizations pursue and interactive strategies which react to competitive market moves. Generic strategies are price/cost leadership, differentiation, and the focus strategy.

Companies that use an interactive strategy adjust their strategies in line with competitive action. Interactive strategies are mostly seen in highly competitive and volatile markets, which force competitors to compete on price and quality. To be successful in these markets, companies have to be flexible, fast, and risk takers.

In hypercompetitive markets, strategic alliances offer an opportunity to reduce the number of competitors. These partnerships can be formed between companies at the same economic stage, which is called a horizontal alliance, or with suppliers or buyers, which is called a vertical alliance.

According to the product life cycle model, products follow a similar life cycle as living beings. An analysis of the stages in the product life cycle helps companies make strategic and marketing decisions. The phases of the product life cycle for products and services are divided into the developing, growth, maturity, and decline stages.

UNIT 5

WHAT STRATEGIC OPTIONS ARE AVAILABLE TO THE CORPORATION?

STUDY GOALS

On completion of this unit, you will have learned …

- what strategic options are available at the corporate level.
- what is meant by market penetration, product and market development, and diversification.
- what advantages can be gained by outsourcing.
- how to analyze product and business portfolios.
- how to make strategic decisions regarding the areas of the company to invest in.

5. WHAT STRATEGIC OPTIONS ARE AVAILABLE TO THE CORPORATION?

Introduction

WHAT DO MEDICAL OUTSOURCING TRENDS MEAN FOR HOSPITALISTS?
X-ray has left the building

Medical outsourcing is a growing trend in American hospitals, driven by shortages of on-call radiologists and intensivists, economic pressures, and advances in telemedicine. Hospitalists will likely encounter – if they have not already – outsourced services that range from off-site medical transcription and language interpreters to long-distance radiology and, increasingly, electronic intensivist services. What are the implications for quality patient care and collegial interface when hospitals contract with outsourced providers? What are the advantages, possible disadvantages, and opportunities for hospitalists as teleradiology and eICUs become facts of life? […]

Off-site X-ray reads common

According to the American College of Radiology, teleradiology has become a fixture in most practices and hospitals. Some institutions have retained their own radiologists, who take advantage of teleradiology by reading digitized radiographs and CT scans from home instead of within the hospital building. A shortage of radiologists has led others to contract with off-site providers of teleradiology services. Those who provide services at night are sometimes called "nighthawk" companies. Outsourcing radiology, Dr. Wachter believes, is a logical step due to technological advances, although he admits that visiting the radiology department in his hospital often yields educational and collegial opportunities that online X-ray reading does not.

At Saint Clare's Hospital in Weston/Wasau, Wis., a new, 107-bed, state-of-the-art facility built by Ministry Health Care, Richard Bailey, MD, is medical director of Inpatient Care and Hospitalist Services. Radiology and other ancillary specialist services are provided by the Diagnostic and Treatment Center (DTC), jointly owned by Ministry Health Care and the Marshfield Clinic. The DTC, through a relationship with a radiology group in Hawaii, provides night coverage for full reads of radiographs and scans from 5 p.m. to 5 a.m. The interactions are virtually seamless, according to Dr. Bailey. "We don't even notice they're in Hawaii," when conferring with radiologists on the phone, he reports.

Off-site radiology also created an opportunity for his hospitalist group, says Dr. Bailey. Saint Clare's hospitalist group provides supervision of contrast administration when needed during night and weekend coverage times. "This is one more way our hospitalist program supports the hospital and provides value beyond just seeing patients," he says.

Overseas outsourcing a 'hot button'

Using an overseas teleradiology company offers many advantages, says Sunita Maheshwari, MD, a consulting pediatric cardiologist and director of Teleradiology Solutions, a four-year-old teleradiology company located in Bangalore, India. The company's radiologists mostly carry out preliminary night-reads but also do final-reads on approximately 20% of their cases. If contrast must be administered for an imaging study at the client hospital, a local tech, emergency department physician, or resident usually handles the procedure, with the Teleradiology Solutions radiologist in constant voice contact.

"The time zone advantage is huge," says Dr. Maheshwari. With the 12.5-hour time difference between the United States and India, Teleradiology Solutions' radiologists work regular day shifts and are able to cover 10–20 hospitals simultaneously, depending on how busy their client hospitals are.

> You don't have to have one radiologist who stays up all night to be able to read two CT scans and one X-ray, who will [then] be groggy the next morning for his [or her] regular day shift," she says. It makes a great deal of sense from the standpoint of human resource efficiency to not waste several nights of several doctors covering multiple hospitals.

Dr. Maheshwari reports that American hospital staff are often pleasantly surprised to find a "cheerful, awake" radiologist on the other end of the phone.

Despite these benefits, however, Dr. Maheshwari and her colleagues have noticed a political backlash stemming from the outsourcing of US jobs to Asia that colors Americans' reactions to overseas teleradiology. In her company's first two years, some physicians questioned the company's level of quality and lashed out because it is located in India, reports Dr. Maheshwari.

"Our work speaks for itself," she says. "We have not lost a client, and, in fact, our hospitals have managed to grow because they have been able to take their radiologists off the night shift, and they take on more day work."

Like several overseas teleradiology companies, Teleradiology Solutions retains a staff of US-trained radiologists and goes through the same licensing and credentialing (they are JCAHO-accredited) as American companies.

The company now has 40 US hospitals as clients and includes in its client mix some remote hospitals in India and Singapore, where the Ministry of Health is experiencing a similar shortage of radiologists. […]

Source: Henkel (2006).

5.1 Areas to Consider When Formulating a Strategy

Strategy planning is a demanding entrepreneurial task, which decides whether the organization or the strategic business unit will be successful in the future. Planning strategy does not provide the management of an organization with one ideal strategic decision. Strategy planning always involves looking at various alternatives and scenarios. Deciding which path to take lies with the management. The history of the organization, its culture, and its management are the factors usually influencing strategic decisions.

In order to plan the strategic process systematically, management has to define individual tasks that should be performed. There are several areas that need to be included in the strategy planning process.

Customer-Oriented Strategies

The most important aspect of the marketing strategy is focusing on customer orientation. This means how the organization deals with its customers. The main decision is whether the organization markets to all customers and segments (e.g., Coca-Cola) or whether it should focus on specific market segments (e.g., Schweppes).

Competitive Strategies

Besides the customers, the competition also plays a major role in the strategic process. The organization has to decide how it plans to deal with its competitors. One strategic option to gain a market share is to challenge a competitor directly by targeting their customers.

A contrary option is to draw up a cooperation strategy that attempts to secure the existence of all organizations in the market. One such example in the German market was the so-called Rail Cartel, which was composed of several steel corporations. Corporations in this cartel were fined by the Federal Cartel Office for having come to a joint agreement regarding prices for rails and points. Examples of legal cooperation include airline alliances, like Star Alliance. This type of cooperation may serve to prevent an overly intensive price competition.

A further approach for companies is to avoid direct competition by specializing in serving small niche markets. Small market niches usually have fewer competitors as larger organizations focus on the large market segments.

Distribution Strategies

Depending on the sector, distributors or trading companies may play a major role in terms of strategy planning. An example is the consumer goods market in Germany. The grocery retail market is dominated by large organizations and buying groups such as Edeka. These large buyers wield a great deal of power over the consumer goods companies. As they buy in large quantities, they often dictate the price and packaging of the products, which reduces the flexibility of the consumer goods companies to respond to changes in the market place.

Stakeholder Strategies

Stakeholders have enormous influence over consumers and the environment of an organization. Managing the stakeholders of an organization is a critical component of the corporate strategy.

The strategic options for managing stakeholder interests are manifold and extend from open confrontation to cooperation. Open confrontation is often used by environmental (e.g., Greenpeace) or consumer protection agencies (e.g., Stiftung Warentest in Germany or the FTC in the USA). The risk of major damage to the company's reputation due to negative information in the media is high.

When employing a cooperative strategy, there are various possibilities for organizations to work with stakeholders. One option is to integrate critical stakeholders into your own organization. In 2008, the German **Schufa Holding AG**, an organization that was viewed critically by many stakeholders, founded a consumer advisory council that consists of politicians, scientists, and members of protection agencies.

Schufa Holding AG
This is a protection agency for the general insurance of the credit business. It provides credit information on individuals and organizations.

A company can choose to operate in an environment in which there are few critical stakeholders. This is often the case in business-to-business environments where there is little or no involvement of consumers. Negative word-of-mouth or damaging media campaigns are therefore rare in these environments.

5.2 Strategic Options

It is not only large corporations that look for new areas to expand into; small companies also try to obtain broader market exposure in order to minimize their risk. When operating in multiple markets, companies can compensate the decline in sales in one area with increases in another. For example, if a construction company serves both the private and the public sectors, it can offset government budget cuts for public building projects by focusing on the private sector and vice versa. Thus, its existence is not compromised if one area experiences a strong decline.

When an organization expands its current range of products or services into new markets or sectors, this is referred to as **diversification**. Companies can diversify in four directions with regards to products and markets:

Diversification
Product diversification means increasing the range of products offered.

1. Market penetration
2. Developing new products or services
3. Developing new markets
4. Diversification

Market Penetration

The first strategic option for expansion is market penetration where companies try to increase the market share of their current products or services. The company can rely on its current resources and capabilities to increase its presence in the market by increasing its market share. An increase in market share equals an increase in power over the market itself and over its distributors. Market penetration can be implemented by lowering costs and increasing profit margins through economies of scale. However, the risk is that the competitors will increase their pressure on the organization and a battle over prices might ensue. Furthermore, most countries have legal restrictions for monopolistic behavior and monopolies are tightly regulated.

Developing New Products or Services

Companies can also expand by offering modified or new products or services in their existing markets. This allows them to increase sales by acquiring new customers or by getting existing customers to buy more products. For example, bookstores today are being forced to find new ways of selling books. Many try to sell through online stores, which is an expensive and risky option. The competence of small bookstores lies in providing information and advice to the consumer. The following article illustrates the battle of survival of large bookstores in the US.

WHY BORDERS FAILED WHILE BARNES & NOBLE SURVIVED

It appears to be all over for the Borders bookselling chain. The company will be liquidated − meaning sold off in pieces − and almost 11,000 employees will lose their jobs. The chain's 400 remaining stores will close their doors by the end of September.

The retailer's first bookstore opened in Ann Arbor, Mich., 40 years ago. Along with competitor Barnes & Noble, Borders pioneered the book megastore business. But Borders made some critical missteps over the years that cost it the business.

The vast tracts of retail space that Borders will soon vacate speak to a gargantuan business that essentially killed itself. At one time, size was its advantage. Borders built a reputation on offering a huge variety of books − tens of thousands of titles in a single store − at a time when most bookstores could afford to stock a fraction of that.

Borders also had an early technical advantage: a superior inventory system that could optimize, and even predict, what consumers across the nation would buy.

But in the mid-1990s, Borders lost its edge.

“It made a pretty big bet in merchandising. [Borders] went heavy into CD music sales and DVD, just as the industry was going digital. And at that same time, Barnes & Noble was pulling back,” says Peter Wahlstrom, who tracks Barnes & Noble for the investment research firm Morningstar.

He says Barnes & Noble also invested in beefing up its online sales. Eventually, it also developed its own e-reader, the Nook.

Borders did not. Instead, it expanded its physical plant, refurbished its stores, and outsourced its online sales operation to Amazon.

“In our view, that was more like handing the keys over to a direct competitor,” Wahlstrom says.

Indeed, outside a Borders bookstore in Arlington, Va., shoppers say they rarely buy books the old-fashioned way.

“I’ll go to Borders to find a book, and then I’ll to go to Amazon to buy it, generally,” customer Jennifer Geier says.

With so many people going online to buy books, Borders lost out. The last time it turned a profit was 2006. In February of this year, it filed for bankruptcy protection.

Those who bemoaned the rise of bookselling giants might see irony in Border’s demise. With one of the major players gone, there might be some room, once again, for the little guys.

“I think there are a bunch of different niches around that can still be sustained, but I don’t think there’s a need for the mass-book seller to be as prevalent or as apparent as they were five or 10 years ago,” Wahlstrom says.

Wahlstrom says Borders is disappearing at a time when, as consumers, readers are more empowered than ever. He says he still reads paper books but also reads on his iPhone, computer, or tablet.

“Just as I’m probably device agnostic, I am supplier agnostic. I can go online, I can go to Barnes & Noble, I can go to Apple, or I can go to Google. Or I can borrow it from a friend or I can go to a library,” he says.

Dan Raff, a management professor at The Wharton School, argues that smaller-town America will suffer from the loss of a chain bookstore.

“The big-box store was a glorious thing while it lasted. To people in many parts of America, they were a kind of Aladdin’s cave,” Raff says. At Borders, people could access literary variety, contrary to smaller, independent bookstores.

With Barnes & Noble staking its future on digital technology, Raff says, it's likely the big bookstore will only live on in big cities.

Source: Noguchi (2011).

Developing New Markets

Companies have the option of offering existing products in new markets in order to expand the usage of the current product or service. One example is the use of the medical laser to coagulate blood and stop bleeding during surgeries. Lasers have been used in this area for many years. Through product modification, the lasers are now used also for the removal of body hair and pigmentation marks.

In order to sell an existing product in a new market, companies have to either modify the product or at least the product design and packaging to appeal to the new market segment. Often, an organization has to establish a new distribution network or a new marketing mix in order to reach the target market. When looking at our example of surgical lasers, the customers were no longer the surgeons and hospitals but rather private practices, plastic and cosmetic surgeons, and dermatologists. The medical companies had to expand their distribution network drastically to meet the increase in customers. They also had to hire sales people familiar with this new field. As evidenced in this example, developing new markets requires a large commitment on the part of the company.

Diversification

Corporate diversification describes the strategy of entering new markets with new products. Complete changes in company strategy are rarely successful, as seen in the unsuccessful 2000 merger between Time Warner and AOL. The largest traditional media company, Time Warner, and the most successful new media provider at the time, AOL, merged. The world was in an internet bubble and the merger was celebrated as a milestone for the transformation of the **old** into the **new economy** (Institute of Media and Communications Policy, 2015). The merger was unsuccessful as the corporation failed to create **synergy** between the two very different companies.

Old economy
These are the traditionally operating companies.

New economy
This is a new economic development shaped by the globalization of markets, computer technology, and new media channels.

Synergy
This is the combination of two organizations in order to take advantage of common benefits. Positive synergy effects occur when the combination of the two organizations creates more value than each individual organization added together.

Despite the many risks, diversification strategies offer enormous opportunities if they are managed well. The three main reasons for companies to diversify are the following:

1. Increase efficiency
2. Utilize management competencies
3. Increase market power

Increase efficiency

Organizations have the opportunity of increasing efficiency by expanding their existing resources and capabilities into new markets, products, or services. Using current capabilities to expand results is called the composite or network effect. If the organization has unused or underutilized resources or capabilities that cannot be sold to other users and do not contribute to generating profits, companies have the option to diversify into new markets or businesses. The network effect leads to cost savings and other advantages through so-called synergy effects. Synergy describes the effect that bundling activities will have on the efficiency of the process. Positive synergetic effects occur when the unity or the bundling creates more value than each of the units or activities separately.

To illustrate this concept, let us look at McDonald’s McCafé. McDonald’s does not just sell hamburgers and chicken nuggets but also coffee and pastries. The costs for McDonald’s to offer both their standard restaurant and McCafé in one of its franchises are less than the costs of running a separate hamburger booth alongside a coffee shop. The reason for the lower costs are that all products are offered in the same restaurant, by the same employees, whereas the hamburger booth and the coffee shop both pay rent and each have their own employees, thereby duplicating many functions and activities.

Utilize management competencies

The competencies of an organization’s management team might also be used to develop new markets, products, or services. Managers have the competency to not just manage one but several products or services. The French luxury goods company Moët Hennessy · Louis Vuitton S.A, better known as LVMH, owns many companies and brands, from champagne manufacturers to fashion labels and perfumes and even finance media companies. All these companies use few common resources or production competencies. However, LVMH increases the value of the organization by utilizing their management competencies to build and maintain brands and to develop the creative potential among their employees.

Increase in market power

The market power of an organization increases the larger it is. If a corporation owns and operates a number of businesses, it can offset the businesses that do not generate as much profit with other more profitable divisions. In this way, the company that operates at a less profitable level receives financial support, which creates a competitive advantage in the market. Its market power increases and it can threaten financially weaker competitors. However, government regulations help reduce the market power of very large organizations.

THE ANATOMY OF THE GE-HONEYWELL DISASTER

On the evening of Wednesday, June 13, Jack Welch, CEO of General Electric, retreated to his room at the Conrad Hilton hotel in Brussels and wrestled with an unfamiliar feeling − one of impending defeat. Just eight months before, he had, it seemed, pulled off a stunning coup. Welch had always coveted Honeywell International, whose business making advanced electronics for the aviation industry, he thought, made a perfect fit with GE, one of three leading global manufacturers of airplane engines. In October 2000, during a visit to the New York Stock Exchange, he had learned that United Technologies Corp. − whose

Pratt & Whitney division is another huge engine maker − planned to buy Honeywell. Within 45 minutes, on the phone from his car, Welch had lined up his board to make a counter-offer. Two days later he had Honeywell in the bag; it would be the largest ever merger between two industrial companies. Welch delayed his retirement to oversee the integration of GE and Honeywell − and to set the capstone on his legendary career.

And now, in the European capital, his last big deal was falling apart. On that day in June, Welch had met twice with Mario Monti, the European Union's Commissioner for Competition. Monti believed that the combination of Honeywell's cockpit controls with GE's engines and powerful aircraft financing division would stifle competition. In other words, he viewed with suspicion precisely those synergies that, for Welch, made the deal so attractive. Monti would approve the merger only if Welch made the kind of concessions that, from GE's standpoint, wrecked its whole point. The next morning Monti called Welch once more, to discuss how the apparent breakdown in talks should be handled. GE issued a statement saying that attempts at compromise fell "far short" of Monti's "extraordinary demands."

Welch placed a call to Andrew Card, chief of staff to President Bush, who was about to sit down with European leaders in Goteborg, Sweden. As the GE boss recounted the conversation to TIME, he told Card that he would appreciate"whatever help you can give us". In the formal meetings in Sweden, GE never came up. But on June 15, in Warsaw, Bush said he was "concerned" that the Europeans had rejected the merger. Monti was furious − not with Bush, he told TIME, but with those who had sought the President's help. Three days later Monti said he "deplore[d] attempts to … trigger political intervention." And though the case dragged on for two more weeks, the deal was dying a slow death.

Welcome to globalization. The collapse of the GE-Honeywell merger shows that companies that benefit from a global market can now be governed in all they do by any of the countries or regions in which they do business. There's no settled code of rules in the global marketplace, just a haphazard collection of local practices and habits. Still, the GE case is extraordinary. Never before have officials outside the US nixed a merger between two giant American corporations already approved by the DOJ. Never before have US companies lobbied so ferociously against their U.S. rivals in a foreign capital. And that's why, for any company that seeks to profit from globalization, there are abundant lessons in the story of how Jack fell down.

For months, nobody thought he would. After Welch stole Honeywell from United Technologies, he said: "This is the cleanest deal you'll ever see." Honeywell and GE were both industrial conglomerates, but their product lines had few overlaps. A combined company, however, would be a powerful force. So United Technologies, Rolls-Royce of Britain – the third of the trio that dominates jet engines – and other businesses were determined to stop the deal.

They didn't find the going easy on either side of the Atlantic. "At the beginning, we weren't invited in the front door or the back door," says an executive with a competitor. (With legal actions still a possibility, many of those interviewed for this story insisted on anonymity.) In Washington, the antitrust division of Justice would wait until June 14 for the arrival of a new head − Charles James, Bush's nominee, who was considered to be pro-business. "The DOJ would not and did not meet with us," says John Briggs, who represented Rockwell, an American competitor of Honeywell. "There was just no real constituency for taking on Jack Welch without political leadership in place."

Things looked no better in Brussels. Since 1990 the European Commission, the executive arm of the 15-nation European Union, has exercised jurisdiction over all mergers between firms with combined revenues of $4.2 billion, of which $212 million must be within Europe. The GE-Honeywell deal easily met the criteria. When US lawmakers ask what business it is of the Europeans if two US companies want to merge, part of the answer is that GE alone employs 85,000 people in Europe and collected $25 billion in revenue there last year.

Still, Commissioner Monti wasn't looking for a fight. The Italian economics professor is sufficiently conservative that he was offered the foreign ministry in Silvio Berlusconi's new right-wing Italian government. Moreover, Monti was proud of the working relationship he had forged with his American counterparts; he told TIME he had "profound respect" for the US regulators and described his own agency as a "junior institution". Before Christmas, when GE's competitors called on the case officer assigned to the merger, Enrique Gonzalez-Diaz, to persuade him to start a lengthy "phase two" investigation of the deal, Gonzalez-Diaz accused them of whining.

That wasn't good. For the merging companies and their opponents, Gonzalez-Diaz was the man to see. The Spaniard, 39, a native of the Canary Islands, is known as a brilliant mathematician and lawyer, hardworking and intensely ambitious. One source (on the losing side of this case) also calls him "deeply cynical about the motivation of business and a nightmare to deal with." GE's opponents knew they would never convince Monti without first winning over Gonzalez-Diaz. The principals came to a rough division of labor: Rolls-Royce stressed the dangers of allowing GE to "bundle" engines and avionics in packages that other firms couldn't match, and United Technologies concentrated on GE's role as a buyer of planes through GE Capital Aviation Services, its finance and leasing subsidiary. GECAS, it was argued, would insist that those from whom it bought aircraft should buy both GE engines and Honeywell avionics, hence reducing consumer choice and stifling technological innovation.

"I got the impression that Enrique was interested when we explained to him that GECAS was frequently a launch customer for airplanes," said a lawyer. "He said, 'Really? I thought they only dealt in secondhand machines.'" GECAS, according to Welch, has only an 8% share of the new-plane market. Yet GE's competitors were starting to make headway. GE, for its part, was beginning to discover that while Monti was always a gentleman, his staff could be as hard as nails. On Feb.

26, all parties met in Brussels. Monti, said Welch, "listened carefully to our case … I thought we had a shot." But at 6:30 that evening, GE and Honeywell were called back to the Commission's offices. Armed with answers to the detailed questionnaires Gonzalez-Diaz's staff had sent to competitors and customers, Monti was going to phase two, a full-blown investigation.

The European capital then experienced the most intense politicking old hands there have seen. "There were journalists, lobbyists, and lots of arbitragers from Wall Street calling constantly," says a lawyer.

Gonzalez-Diaz's team visited Rockwell's operations in Cedar Rapids, Iowa. By this point, sources close to the case say, Monti's team had not only heard an earful from GE's competitors but had also registered concerns from 15 airlines, whose identities were kept secret from GE. On May 8, the Commission issued a 155-page statement of objections to the merger, and on May 29, the parties gathered for a two-day hearing.

Source: Elliott (2001).

5.3 Outsourcing

Outsourcing is a strategy where a company decides to have an outside organization perform an activity that the company has previously performed itself for a fee. In today's global world, outsourcing is a very successful strategic decision to reduce costs. With the internet and the telecommunication capabilities, many service areas can be outsourced. The case study at the beginning of the chapter about medical outsourcing illustrates the advantages of this concept quite well.

India: A Hotbed for Outsourcing

India is a popular country for outsourcing services. Companies from English-speaking countries in particular benefit from the language advantage of India, which was formerly part of the British Empire. If you call the computer hotline of a US-based company, you will most likely speak to a service employee in Bangalore, India. Many US tax consulting companies have the standard tax procedures performed by tax consultants in India and sent electronically to the US office, where the exceptions and more complicated parts are added in. As described in the case study, if you check into a hospital in the US at night and they need to take an X-ray image, there is often no radiologist on duty at that time. The image is instead sent to India to a radiologist who assesses the image and sends the report electronically back to the US hospital within the hour.

The reasons why India is so popular for outsourcing are manifold. India has a large, well-educated, English-speaking workforce. At the same time, the wage level is significantly below the level in developed countries. Wage-related costs are also lower. India offers stable economic and political conditions and a well-functioning IT infrastructure. Furthermore, India enforces laws to protect patents and intellectual property.

Disadvantages of Outsourcing

Outsourcing can compromise the quality of products and services and therefore their position in the market. The US automotive industry has outsourced since the 1990s and, since then, their competitive position in the automotive market has continued to decline. Successful outsourcing has to be done carefully by developing relationships with the outsourcing partner firms. In 1991, the corporation General Motors (GM) outsourced most of the production of its components. Its strong market position at the time was used to pressure the new component suppliers to offer the products at the lowest price possible. This reduced the costs of production for GM, but in 2007, GM reported huge losses. One of the reasons for this development was that GM never built partnerships with their suppliers. Many of GM's automotive companies had open conflicts with their suppliers that extended many years. They kept inviting tenders from different suppliers to obtain the lowest price and provided little exchange of information. The suppliers, constantly pressured on prices, did not invest in new technologies or align their systems with those of GM. This development led to the poor quality of many American cars, which resulted in a large decline in the demand for US-manufactured automobiles.

5.4 Product Portfolio Analysis Using the BCG Matrix

Portfolio analysis is a planning tool that enables an organization to make recommendations on how to allocate its resources (financial, human resources, etc.) to the various business units. The goal of the portfolio analysis is to decide on the optimal combination of products for the organization, to reduce company risk through diversification of the portfolio, and to assure long-term sources of revenue.

Portfolio
This describes the collection of all products offered by a company.

Portfolio analyses use information about environment and corporate resources to evaluate the success of products and businesses. They provide answers as to which products or businesses are the most promising and valuable for the organization to invest in. Portfolio analyses provide a direction for investment and budget decisions and can be seen as a preliminary step to the strategic plan.

The BCG matrix is a portfolio analysis that was invented by the Boston Consulting Group. The model depicts the position of businesses in relation to their market share and growth potential of the business. The relative market share is an internal indicator of the competitiveness of the organization. It compares the companies' own market share to their main competitors. The underlying idea is that companies with a large market share benefit from economies of scale and can offer their products at a lower and more competitive price than the competition. The growth potential of the market is the external indicator of the attractiveness of the market or business. Growth potential is derived from the product life cycle model of markets, with a high growth rate being more attractive than markets with a lower growth rate.

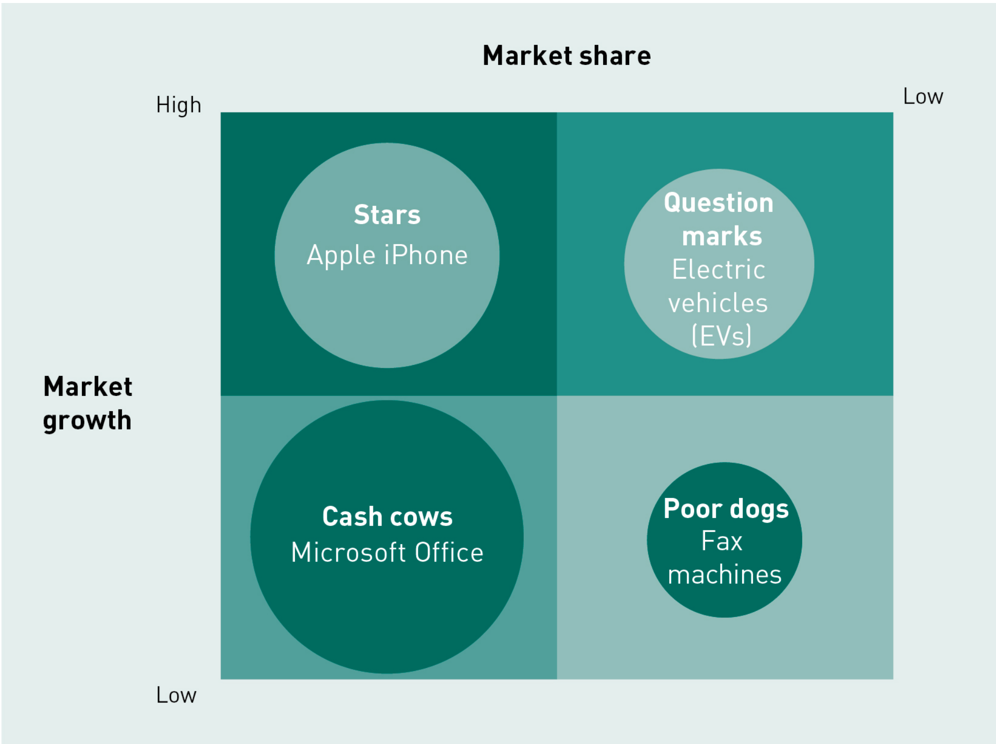
The three factors are considered in the matrix:

1. The growth potential of the business or market growth rate (Y axis)
2. The relative market share of the product or business (X axis)
3. The revenue contribution of the business or product to the organization (the size of the circle around the product).

These parameters combined provide information about the strategic position of the organization's products, services, or businesses and the financial requirements of the individual products/businesses to balance the company's cash flow. The BCG matrix also indicates the ideal situation with a balanced product portfolio. A balanced portfolio includes enough products that generate profits (cash cows) for the organization to be able to finance new products (stars and question marks).

Each of the four quadrants of the BCG matrix suggests standard strategies that can be guidelines for strategic measures. The matrix will be further explained using a fictional example from the consumer electronics market.

Figure 6: BCG Matrix (Case Study: Consumer Electronics Market]



Source: Created on behalf of IU (2015).

Stars

Stars are products or businesses with a large share of a market that show high growth potential − in other words, established products or services in an attractive market. Stars often require high investment costs for marketing and promotional measures, but they provide high earnings to the organization due to their high percentage of the market share. In order to expand this position in the market, the company needs to strengthen and secure their competitive advantage for these products or services.

A company should have enough stars in their portfolio so as to provide financial leverage for the future. If the growth potential of the market flattens, the stars become the cash cows. It is important for companies to develop large circles in the BCG matrix with their stars and cash cows as these are the main revenue contributors. In the area of consumer electronics, an example of a star would be electronic books (e-books). In today’s consumer marketplace, e-books are a product with very large growth potential.

Question Marks

Question marks are products with a small share of a market with high growth potential. These are mostly new products or services that need a large financial commitment to be established in the market. The risk of failure is high in this quadrant, as is the possibility of a market exit. Management have to decide which question marks will be successful in the future and make the financial commitment required to build their market share. Management also has to take the questions marks with little chance of success off the market. In theory, question marks bring tomorrow’s growth and thus need further investment to increase the market share. The financial means for this investment usually come from the cash cows.

An example of a question mark technology in the consumer electronics market are Blu-ray discs. The Blu-ray disc is a digital optical storage disc, which was developed as a high-definition medium to replace the DVD. Its benefits over the DVD are higher data volume and storage capability. Blu-ray discs can be used to store movies with very high resolution and offer the viewer outstanding image quality. Because of the need for high marketing costs, which were not available to the companies producing Blu-ray discs, the technology had an initial low growth rate. Despite rivals such as Apple’s iTunes, which directly competes with Blu-ray, there has been a gradual upward trend ever since.

Cash Cows

Cash cows have a high share of a market with a lower growth rate. These are established products or businesses in a market with a declining attractiveness. Due to their established position in the market, the financial investments are fairly low for the organization and the revenue situation is very good. Since the market does not grow much, the cash flow surplus from these products or services should be used for the development of new products. A company should have several cash cows to finance the question marks and stars, which are the future revenue generators for the organization. The cash cows should ideally have large areas in the BCG matrix that reflect a healthy revenue contribution to the organization.

A cash cow in the area of consumer electronics is the flat screen television. Flat screen TVs have been popular for many years and generated large sales numbers. Due to fierce competition, the prices for flat screen TVs have gone down dramatically. Today, there is very moderate growth in this sector and companies invest little in product improvements as the market is all but sated.

Poor Dogs

Poor dogs are products or businesses showing low market growth and have a low market share. These are unattractive products or services in unattractive markets with little future potential. The revenue contribution of these products or services is negative or balanced, but the organization does not make profit with a poor dog. Companies should not invest in products in this quadrant. The financial surpluses should go into the stars and question marks. The resources that go into the production of poor dogs should be freed up and used for the production of more promising or successful products. The circles around the poor dogs in the BCG matrix should be small as the revenue contribution is not significant.

In the sector of consumer electronics, the poor dogs are, for example, the Discman, a portable disc player which has been replaced by the MP3 player.

Critical Evaluation

The BCG matrix offers a picture of the product portfolio or even entire business portfolio of a company that can facilitate planning decisions. It displays a great deal of complex information in a simple matrix structure. It provides a good overview of the current product portfolio in order to make strategic investment decisions.

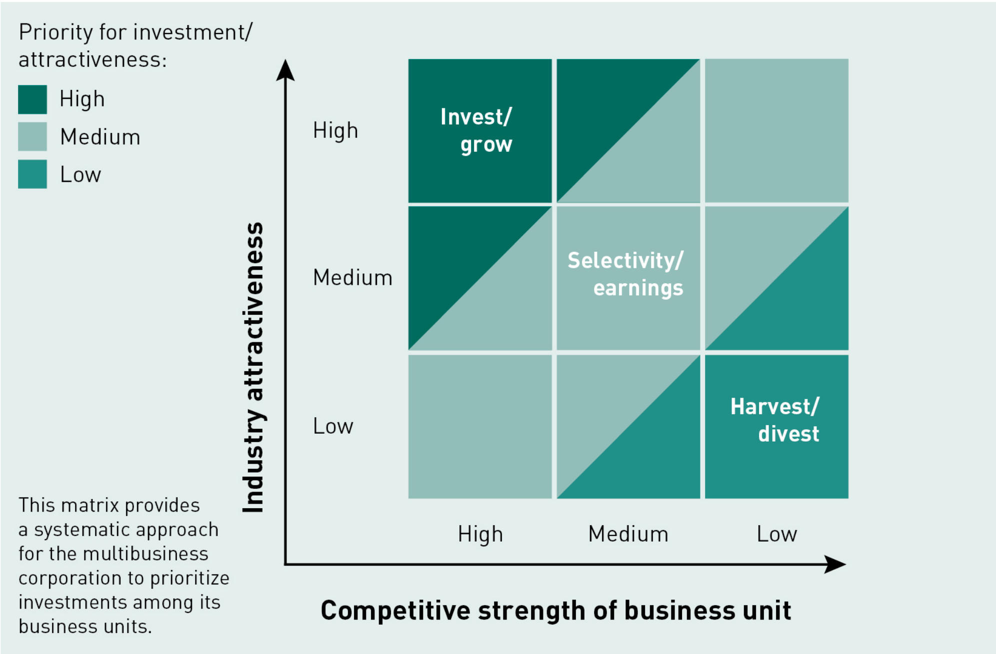
A criticism of the BCG matrix is that it only considers the relative market share and the market growth potential. Other important market or trend information is not included as it has the potential to falsely influence decisions. Furthermore, the portfolio matrices do not take into consideration connections between products or businesses (i.e., **composite effects**). The BCG matrix focuses on currently existing products and provides no information on new products or market trends. Finally, the standardized strategies for the quadrants provide very simplistic recommendations for strategic decisions.

Composite effects
These refer to the qualitative impact of individual activities with regard to several products at the same time on the benefit for the market participants.

5.5 Product Portfolio Analysis Using the GE-McKinsey Matrix

Based on the BCG matrix, the consulting company McKinsey and the American corporation General Electric developed a matrix using two indicators: (1) market attractiveness and (2) competitive strengths. This matrix, like the BCG matrix, has the goal of facilitating investment decisions for product or business developments. However, the external analysis is not restricted to the growth potential of the market, as in the BCG matrix, but includes many factors under the umbrella term market attractiveness, such as market volume, profitability, and the intensity of the competition. The internal analysis was also developed further. Instead of just looking at the relative market share, as in the BCG matrix, the GE-McKinsey matrix analyzes the relative competitive strengths of the organization over the competition. This includes not only the relative market share but also the relative product quality, the image of the company, and its financial strength. Furthermore, the GE matrix with its 3 x 3 = 9 sections is more detailed than the BCG matrix with its 2 x 2 = 4 sections.

Figure 7: GE-McKinsey Matrix



Source: Created on behalf of IU (2015).

Depending on the results of the analyses of the market attractiveness and the relative competitive strength, the business units or the products of a company are depicted in one of the nine sections of the matrix. The strategic recommendation from the matrix is: the more attractive the market and the stronger the competitive position of the business or product, the more should be invested. If the market attractiveness is low and the competitive position weak, the business unit or product should be divested. The financial means that are freed up from divesting unattractive products or businesses should be invested in the more promising areas. The products and businesses that are positioned in the middle segments of the matrix are more difficult to evaluate and more detailed analyses are required in order to make a final decision as to whether to invest in the business or product or whether to divest it.

Critical Evaluation

The main advantage of the GE-McKinsey matrix is that it concentrates a great deal of complex information into a clear and comprehensible overview of the product portfolio of a company. Thus the matrix can be utilized to facilitate strategic decisions regarding investments in various businesses or products/services.

However, there are several disadvantages to this matrix. One disadvantage is that a great deal of complex information is concentrated within the matrix. Many products or businesses are in the middle segments which need further analysis. This does not allow for immediate strategic decisions to be made. The concentration of information also leads to a loss of individual data about the business or product that might be important for decision-making. Moreover, trends and future developments in the market are not included or considered (e.g., changes in the technological sector, such as the internet, have had a strong impact on the attractiveness of many sectors and yet are not considered in the matrix).

A further disadvantage is that, just like the BCG matrix, connections between products or businesses are not taken into consideration. There is the possibility that products from different business units are produced on the same assembly line. If one of the products is divested for cost reasons, the assembly line still has to be maintained to produce the other product. The logic of the portfolio matrix does not hold for this example as the desired cost savings cannot be realized in such situations.

SUMMARY

The strategic plan is one of the most important management tasks and determines the future success or failure of a company. Areas to take into consideration in strategic planning are customers, competitors, distributors, and stakeholders.

Expanding into new products or new sectors is called diversification. Companies can pursue various expansion strategies, such as further market penetration with the existing products, new product or service development, new market development, or complete diversification with new products in new markets. Companies diversify in order to increase the efficiency of their operations, to exploit their management competencies, or to increase the power in the market.

Another strategic decision to take into consideration is outsourcing. When outsourcing, companies have activities that were previously provided internally, performed by an outside organization to save costs. Outsourcing is a very successful strategy in today's global business environment. However, quality issues often occur when outsourcing, and therefore, companies that outsource should have well-established quality management systems.

Portfolio analyses help managers make decisions on the optimal combination of products or businesses offered by an organization. They provide a great deal of information about the external business environment and illustrate the internal features of the organization in a clear, comprehensible matrix. The BCG matrix, with the indicators market growth and market share, segments the products into stars (in which the

company should invest), cash cows (which provide the financial means to develop new products), poor dogs (which should be divested), and question marks (whose development is still unclear).

Using the indicators market attractiveness and competitive strength, the GE-McKinsey matrix offers a more detailed view with nine segments. In addition, the two indicators for this matrix combine more information than the BCG matrix.

Portfolio analyses offer a great overview over the product portfolio, but they ignore connections between products, and therefore, clear decisions are sometimes difficult.

UNIT 6

WHAT INTERNATIONAL STRATEGIES ARE AVAILABLE?

STUDY GOALS

On completion of this unit, you will have learned …

- why companies increasingly go international.
- what companies have to consider when pursuing an international strategy.
- which factors provide a competitive advantage.
- what options are available for an international strategy.
- what the advantages and the disadvantages of an international strategy are.

6. WHAT INTERNATIONAL STRATEGIES ARE AVAILABLE?

Introduction

WAL-MART FINDS THAT ITS FORMULA DOESN'T FIT EVERY CULTURE

Three days after Wal-Mart Stores announced that it would pull out of Germany, Roland Kögel was wandering through the aisles of a somewhat threadbare Wal-Mart in a strip mall in this western German city.

"Why are they giving up now?" he asked. "They have good prices and a good variety of products."

Yet Mr. Kögel, 54, confessed that he never bought groceries at Wal-Mart. Food is cheaper at German discount chains. He also does not visit this store often because it is on the edge of town and he does not own a car. His one purchase for the day was tucked under his arm: a neck pillow.

Shoppers like Roland Kögel help explain why Wal-Mart raised the white flag in Germany, the site of the company's first foray into Europe.

After nearly a decade of trying, Wal-Mart never cracked the country – failing to become the all-in-one shopping destination for Germans that it is for so many millions of Americans. Wal-Mart's problems are not limited to Germany. The retail giant has struggled in countries like South Korea and Japan as it discovered that its formula for success – low prices, zealous inventory control and a large array of merchandise – did not translate to markets with their own discount chains and shoppers with different habits.

Over all, Wal-Mart is still expanding outside the United States, particularly in markets where it entered by acquiring a strong retailer. Still, given Wal-Mart's formidable record at home, the company's recent setbacks have exposed a rare vulnerability overseas.

Some of Wal-Mart's problems stem from hubris, a uniquely powerful American enterprise trying to impose its values around the world. At Wal-Mart's headquarters in Bentonville, Ark., however, the message from these missteps is now registering loud and clear.

In particular, Wal-Mart's experience in Germany, where it has lost hundreds of millions of dollars since 1998, has become a sort of template for how not to expand into a country.

“It is a good, important lesson, a turning point,” an international spokeswoman for Wal-Mart, Beth Keck, said. “Germany was a good example of that naïvete.”She added, “We literally bought the two chains and said, ‘Hey, we are in Germany, isn’t this great?’”

Among other things, she said, Wal-Mart now cares less whether its foreign stores carry the name derived from its founder, Sam Walton, as the German Wal-Marts do. Seventy percent of Wal-Mart’s international sales come from outlets with names like Asda in Britain, Seiyu in Japan or Bompreço in Brazil.

Wal-Mart is also trying to integrate acquisitions with more sensitivity – a process that involves issues like deciding whether to consolidate multiple foreign head-quarters and how aggressively to impose Wal-Mart’s corporate culture on non-American employees.

In Germany, Wal-Mart stopped requiring sales clerks to smile at customers – a practice that some male shoppers interpreted as flirting – and scrapped the morning Wal-Mart chant by staff members.

“People found these things strange; Germans just don’t behave that way,” said Hans-Martin Poschmann, the secretary of the Verdi union, which represents 5,000 Wal-Mart employees here.

Wal-Mart’s changes came too late for Germany but they could help it crack other markets, like China, where it already has 60 stores and 30,000 employees. Far from being chastened by its setbacks, Wal-Mart is forging ahead with an aggressive program of foreign acquisitions.

In a single week last fall, Wal-Mart completed the purchase of the Sonae chain in Brazil, bought a controlling stake in Seiyu of Japan and became a partner in the Carcho chain in Central America. The deals added 545 stores and 50,000 employees to Wal-Mart’s overseas empire.

“I’m hard pressed to name a US-based general merchandise retailer that is doing better than Wal-Mart International,” said Bill Dreher, who follows Wal-Mart for Deutsche Bank in New York.

Starting from scratch 14 years ago, Wal-Mart International has grown into a $63 billion business. It is the fastest-growing part of Wal-Mart, with nearly 30 percent sales growth in June, compared with the same month last year. Even subtracting one-time gains from acquisitions, it grew at nearly 12 percent, about double the rate of Wal-Mart’s American stores.

Sustaining that pace is critical for Wal-Mart because high fuel prices have helped sap the buying power of Americans. In June, store traffic in its home market declined. Wal-Mart estimated that its sales in the United States in stores open at least one year would increase only one percent to three percent in July.

Wal-Mart Germany, with 85 stores and $2.5 billion in sales, is almost a footnote for a company focused on Asia and Latin America. But the problems it encountered here have echoes elsewhere. For example, it never established comfortable relations with its German labor unions.

“They didn’t understand that in Germany, companies and unions are closely connected,” Mr. Poschmann said. “Bentonville didn’t want to have anything to do with unions. They thought we were communists.”

Ms. Keck said Wal-Mart did cultivate good relations with the leaders of the works’ council, which represents the unionized work force, and changed policies in response to employee concerns.

Wal-Mart will soon get another chance to deal with organized labor, albeit of a less independent sort. In China, the state-controlled All-China Federation of Trade Unions is organizing workers in Wal-Mart’s stores.

Germany also provides a lesson in the perils of buying existing chains. Wal-Mart’s purchase of Wertkauf and Interspar saddled it with stores in undesirable locations. The Wiesbaden outlet is worlds away from a squeaky-clean American Wal-Mart: nearby are a couple of sex shops.

“These were some of the least attractive of the big-box retailers out there,” said James Bacos, director of the retail and consumer goods practice at Mercer Management Consulting in Munich.

Compounding the problem, Wal-Mart shut down the headquarters of one of the chains, infuriating employees who opted to quit rather than move. Such a decision would have been routine in the United States, where Ms. Keck said, “moving is a big part of the Wal-Mart culture.” In Germany, she said, it prompted an exodus of talented executives.

In South Korea, Wal-Mart had only 16 stores – a small presence that contributed to its decision in May to sell out to a Korean discount chain. Many Koreans have never heard of Wal-Mart. In Seoul, a sprawling area of 10 million, there is only a single store.

This lack of scale causes another problem that has afflicted Wal-Mart in several countries: its inability to compete with established discounters, like the ALDI chain in Germany and E-Mart in Korea.

The obvious lesson is to try to bulk up. In Brazil, Wal-Mart opened only 25 stores in its first decade there and struggled to compete against bigger local rivals. Then, in 2004, it bought Bompreço, giving it a presence in the country’s poor, but fast-growing, northeast.

Wal-Mart did not change the names of the stores, which range from neighborhood grocers to large American-style hypermarkets. But with 295 stores in Brazil, Wal-Mart now ranks third in the market, after Carrefour of France and the market leader, Companhia Brasileira de Distribução.

Size has given Wal-Mart increased leverage with suppliers there, though analysts say the company needs even more stores to be in a position to undercut local discounters on the prices it offers customers.

At a Wal-Mart store in suburban Rio de Janeiro the other day, Ana Paula Cunha de Almeida, a 26-year-old housewife, had loaded her shopping cart with rice, beans, and flour. But she was also carrying a bag from a smaller grocery store, where she had bought meat, cheese, and cold cuts.

“These are always cheaper somewhere else,” she said.

The grocery business has proven the most difficult for Wal-Mart to crack. ALDI, with 4,100 stores in Germany, undercuts Wal-Mart on price, while still offering high-quality food.

Even in Canada, where Wal-Mart steamrolled local department store chains when it entered the country as a nonfood retailer in 1994, the grocery trade looms as a challenge. Wal-Mart recently announced plans to build supercenters that will also sell groceries. But analysts predicted Wal-Mart would face stiff competition from Canada’s largest chain, Loblaw.

Bernie Skelding, a vacationer shopping at a Wal-Mart in Huntsville, Ontario, north of Toronto, said he liked going to the store when he had a varied shopping list. But he added, “If I’m looking for food, I go to Loblaw’s.”

Wal-Mart’s most successful markets, like Mexico, are those in which it started big. There, the company bought the country’s largest and best-run retail chain, Cifra, and has never looked back. This year, Wal-Mart is spending more than $1 billion in Mexico to open 120 new stores.

Taking over Cifra “gave them a critical mass to build from,” said Tufic Salem, an analyst at Credit Suisse First Boston in Mexico City. “The management stayed, and they knew the market very well.”

Perhaps the most striking example of a Wal-Mart success is Asda, which was Britain’s No. 1 discount chain when Wal-Mart acquired it in 1999. With sales of $26.8 billion, Asda now accounts for 43 percent of Wal-Mart’s international revenue.

Wal-Mart’s German experience also taught it to use local management. The company initially installed American executives, who had little feel for what German consumers wanted.

"They tried to sell packaged meat when Germans like to buy meat from the butcher," Mr. Poschmann said.

Some of Wal-Mart's missteps − selling golf clubs in Brazil, where the game is unfamiliar, or ice skates in Mexico − are so frequently mentioned, they have become the stuff of urban legend. But even more subtle differences in shopping habits have tripped up the company.

In Korea, Wal-Mart's stores originally had taller racks than those of local rivals, forcing shoppers to use ladders or stretch for items on high shelves. Wal-Mart's utilitarian design − ceilings with exposed pipes − put off shoppers used to the decorated ceilings in E-Mart stores.

Beyond the ambience, Wal-Mart's shoes-to-sausage product line does not suit the shopping habits of many non-American shoppers. They prefer daily outings to a variety of local stores that specialize in groceries, drugs, or household goods, rather than shopping once a week at Wal-Mart.

"They have stacks of goods in boxes," said Lee Jin Sook, 46, a housewife sitting on a subway in Seoul. "That may be good for some American housewives who drive out in their own cars." But Koreans, she said, prefer smaller packages: "Why would you buy a box of shampoo bottles?"

"I heard Wal-Mart later tried to change their style," Ms. Lee added, "but I guess it was too late."

Source: Landler & Barbaro (2006).

6.1 Why Do Companies Go International?

The world has grown closer together thanks to improvements in infrastructure and the widespread growth of internet use. Even small organizations now have the opportunity to go international. Going international and being successful requires a global strategy, which defines where and in which form the company expands internationally from its home country origins. The international expansion needs to be considered carefully and planned in great depth as it requires a strong commitment to undertaking **coordination** tasks.

Coordination
This is the organization of human resources, economic, and technical tasks in an organization.

Increasingly, a greater number of companies are entering the international arena. The reasons for the increase in this international exposure of companies are manifold and include the following:

- trade agreements
- unification
- economies of scale

- infrastructure
- local differences
- the world growing closer together
- standardization
- global marketing

Trade Agreements

An increasing number of international **trade agreements** have made it easier for companies to do business in other countries and across regions. For example, after many years of poor economic relations, China and Taiwan agreed on an historic trade agreement in 2010. The agreement eliminates customs duties for more than 800 products. This will accelerate the trade between mainland China and Taiwan.

Trade agreements
These regulate the trade between countries.

Unification

There has been an increase in the formation of **free trade zones** between various countries. These unifications, such as the EU (European Union) or the NAFTA (North American Free Trade Agreement) that allow free trade between the countries within the union, lead to the standardization of trade regulations. This in turn lowers the costs for organizations, for example, the common quality standards in the EU allow companies to offer one product for all countries in the union. Patents, brand names, etc. do not have to be registered in each individual country but can be registered for the entire union.

Free trade zone
A free trade zone allows the free traffic of goods and services between the countries included in the union.

Economies of Scale

The possibility of offering one product to various countries, without major adaptations for each single market, allows companies to benefit from economies of scale and increases efficiency. In particular, companies that have high investment or development costs for their products or services benefit from the opportunity to sell the product in many countries.

The case study clearly illustrates how economies of scale work for Wal-Mart in Mexico. When they entered the market as a big chain with many stores, they were immediately able to compete with local supermarkets due to the large volumes being sold.

Infrastructure

The **infrastructure** of worldwide trade has improved tremendously over the past decades. The international container shipping business has profited from an enormous boom in international trade. Container shipping is fairly cost efficient due to new technologies speeding up the loading and unloading process. This has reduced the time and costs for the ships in the port. The efficiency of the shipping business has greatly reduced the costs for transporting goods.

Infrastructure
This includes the transportation and human resources necessary to run an economy.

Local Differences

Improvements in the infrastructure allow organizations to transport goods cheaply across the globe. They can thus decide where they want certain processes performed. Most textiles today are made in Asia as the costs of production are much lower. However, the design and marketing are still carried out and coordinated in the original home countries.

The World is Growing Closer Together

eBay
This is the world's largest Internet auction house.

The Internet revolution of the 1990s brought the world even closer together. Today, consumers can access and compare products and services worldwide. Trade coordinators such as **eBay** make it possible, for example, for a German resident to acquire a product from a French designer via the US website from a seller in Belgium. The buyer should not be surprised if the product is shipped from a location in Bulgaria.

Standardization

Uniform quality standards and quality systems enable companies to save costs. For example, a Japanese car manufacturer can purchase a standardized component from an Italian manufacturer and have it delivered to all its manufacturing plants worldwide for assembly.

The opportunity to purchase products worldwide is called global sourcing. The benefit for companies is that they can purchase at the lowest prices and take advantage of location advantages, i.e., low-wage countries or local specializations.

Global Marketing

Globalization makes standardized marketing possible. McDonald's and Coca-Cola are global brands that are as easily recognized in Taiwan as they are in Turkey or Tunisia. However, most companies expanding into international markets will encounter the global–local dilemma. Companies have to decide what can be standardized and what has to be adapted to local standards, as the case study with Wal-Mart's entry into the German market illustrates. Global organizations have to "think global, act local" (i.e., have a global strategy but adapt it to local conditions). For example, McDonald's could design a global advertising campaign featuring soccer, which is popular in almost all countries. From this global theme it could then show local players in the advertisements for respective country. However, international companies also face risks such as dependencies and global competition.

Dependencies

International companies are interlinked and therefore affected by fluctuations in remote regions. In March 2011, when Japan was hit by an earthquake, a tsunami, and a nuclear disaster, there were problems with the delivery of products from Japan. Toyota stopped production in factories in England, France, and Turkey from April to May 2011 due to delivery shortages from Japan.

Global Competition

The pressure from international companies is enormous because they have large financial resources. However, the case study with Wal-Mart's attempt to enter the German market showed that even these large companies could fail due to the established and strong local competition.

6.2 What Factors Contribute to the Decision About Which Country to Invest In?

General Factors

The answer to the question "Which markets would be interesting for companies?" depends on a variety of factors. Just like the analysis of the micro- and macroenvironment of the organization, companies have to research the international environment in order to make informed strategic decisions.

Political situation

When companies make decisions on where to expand internationally, they need to look at the political situation. There are many countries in which the political environment changes quickly and governments rapidly alter the investment situation for foreign companies. Companies that operate internationally need to be aware of the risks and weigh their chance of success against that of failure.

Legal situation

Similar to the political situation, the legal situation plays an important role in the decision to go international. There are large differences in the legal system of different countries, and companies need to be well informed about the legal framework when entering a new market. This can help in obtaining a better understanding of the risks involved, as Helmerich and Payne learned in Venezuela:

VENEZUELA TO NATIONALIZE US FIRM'S OIL RIGS

Venezuela will nationalize a fleet of oil rigs belonging to the US company Helmerich and Payne, the latest takeover in a move towards socialism as President Hugo Chavez struggles with lower oil output and a recession.

A former soldier inspired by Cuba's Fidel Castro, Chavez has made energy nationalization the linchpin in his 'revolution'. He has also taken over assets in telecommunications, power, steel, and banking.

The eleven drilling rigs have been idle for months following a dispute over pending payments by the OPEC member's state oil company PDVSA. Oil Minister Rafael Ramirez said on Wednesday that the rigs, the Oklahoma-based company's entire Venezuelan fleet, were being nationalized to bring them back into production.

Ramirez said companies that refused to put their rigs into production were part of a plan to weaken Chavez's government.

"There is a group of drill owners who have refused to discuss tariffs and services with PDVSA and have preferred to keep this equipment stored for a year," Ramirez told reporters in the oil producing state of Zulia. "That is the specific case with US multinational Helmerich and Payne."

The company was not immediately available for comment.

Chavez, who faces legislative elections in September, often pushes ahead with radical plans during election campaigns.

The 55-year-old leader is having a hard time in his eleventh year in power. Venezuela's economy is the worst performing in Latin America this year, a problem exacerbated by a drop in oil output since 2008, power outages, and soaring inflation.

The takeover of Helmerich and Payne's rigs was not a surprise, considering Chavez' penchant for nationalizations and the company's refusal to work before being paid the $49 million it has invoiced PDVSA.

Helmerich and Payne is a small player in the drilling industry but global giants like Halliburton, Schlumberger, and Baker Hughes also have a presence in Venezuela. Halliburton and Schlumberger have avoided public spats with the government. Chavez has kept pressure up on the private sector in recent months, blaming a "parasitic bourgeoisie" for Venezuela's recession and 30 percent annualized inflation.

He has threatened to nationalize Polar, the top brewer and food processor in the country of 30 million. The government has also seized a bank belonging to an owner of the leading opposition TV station and put an arrest warrant out for his partner, who is now on the run.

In 2007, Chavez nationalized multi-billion dollar projects in Venezuela's vast Orinoco oil region, persuading companies such as BP Plc, to accept minority stakes in facilities they had built.

Last year, he ordered the takeover of dozens of smaller oil service companies as PDVSA, reeling from a sharp plunge in oil prices, struggled to pay contractors.

When he was flush with oil cash during a boom in oil prices that ended in 2008, Chavez often compensated nationalized companies fairly, although the 2007 takeovers led to lawsuits from ConocoPhillips and Exxon Mobil.

More recently, Venezuela has been slower in paying compensation.

Source: Rondon (2010).

Economic situation

The economic situation in the country provides information on the benefits of an investment. Generally, the GDP and the per capita income give an idea of the market size and potential. A company should carry out a thorough analysis of the economic situation or consult an external expert. The economic analysis should also provide an outlook to the future, information on possible import or export restrictions, payment modalities and practice, taxation, etc.

Social situation

When looking at international investments, an analysis of the social situation should not be restricted to facts and figures. The number of inhabitants and the demographic structure provide a first impression, but the cultural and social factors are also extremely important. The market might exist and be big enough, but what if the buying habits are very different from your own country? Wal-Mart learned a very expensive lesson in Germany, as our case study illustrates.

Factors That Lead to Competitive Advantages

Internationally successful companies often benefit from local competitive advantages. These local competitive advantages occur as a result of regional factors. Some regions are predestined for specific business sectors and promote their success. Michael Porter (1998) identifies four factors that lead to a sustainable competitive advantage for companies:

1. Local factors
2. Local demand
3. Supporting industry
4. Local strategy, structure, and competition

Local factors

Some regions are particularly well equipped to produce a specific product or service. They have ready access to raw materials needed for production or have a supply of desired resources, such as human resources or knowledge resources. Switzerland, for example, is known for its banking industry. One factor that certainly promoted its growth was the **banking secrecy law** and Switzerland's status of neutrality. A further prerequisite for the expansion of the private wealth sector is the linguistic ability of the Swiss population. Three languages − German, French, and Italian − are spoken in this small country. This

Banking secrecy law
The banking secrecy law is a legal commitment to maintain the secrecy of bank customers and their financial information, protecting this information even from governments.

capacity for providing services in multiple languages no doubt fostered the growth of the financial business as discussing private wealth information is, for most people, very personal, and they prefer to converse about it in their mother tongue. This is why Switzerland continues to be one of the countries of choice for private wealth management, despite the fact that banking secrecy laws are not absolute (Caputo, n.d.).

Local demand

The local demand for certain products or services often favors the establishment of specific business in the area. The advantage for the business is that a part of the demand is already satisfied locally. Therefore, the location advantage creates a competitive edge for the local industry. In 1886, the German inventor Carl Benz filed a patent for the first motorized vehicle, marking the birth of the modern automobile. A world-renowned car industry was henceforth established in southern Germany. The strong connection of the German people to locally produced automobiles (which still exists today), paired with the German sense of quality, has led to and perpetuated the competitive advantage of German companies in the automotive industry.

Supporting industry

The development of an industry in a specific region often leads to the establishment of suppliers in the same location. In the example of the German automobile industry, when a company begins manufacturing cars in a region, adjunct businesses, such as engineers who start up their own company, are often established soon after in the surrounding area. The proximity of such supporting businesses to the producer facilitates cooperation and enhances innovation. Thus, a location advantage is created for the industry.

Clustering
This describes a local aggregation of similar businesses.

An interesting example of such a development (which is called **clustering**) is located in the Italian village of Montebelluna. A hiking boot manufacturing business has developed into a cluster of companies making ski boots. Today, there are about 400 companies in Montebelluna that cover an unbelievable 75% of the world market for ski boots.

Local strategy, structure, and competition

The characteristics of the local businesses, such as the focus of the German automobile industry on quality and innovation, as well as the structure of the industry lead to a further competitive advantage. Moreover, in an environment of aggregate businesses, the local competition forces companies to constantly improve and develop in order to survive, thus further fostering innovation.

6.3 How Can a Company Invest Internationally?

There are various ways in which a company can expand internationally. Some options are more risky than others. Each option of expanding internationally has advantages and disadvantages – companies have to decide on the degree of investment and what best matches their strategy. We will now explore the following four options for international expansion:

1. Exports
2. Joint ventures/alliances
3. Licenses
4. Foreign direct investments

Exports

Exporting is the easiest way to operate internationally. The product is created in the home country, then marketed and sold in another country. Exporting is best suited to products that can easily be transported. The advantage is that the company does not have to invest in a production facility abroad, and the financial investment is relatively small. The company benefits from economies of scale in the home country due to the expansion and the increase in sales. The internet facilitates communication with distributors and aids international marketing and sales efforts.

However, exporting also has disadvantages. Companies that export products or services forgo the location benefits of many foreign countries. A company that does not make their products in the foreign country gains no tax advantage or cost saving as a result of lower employee wages abroad. Furthermore, companies are dependent on local distributors, who might sell more than one product or service and may not realize the maximum possible sales. Exporting companies might also encounter trade barriers and have to pay customs fees, which will make the products more expensive compared to local products. An additional cost factor that might make the product more expensive in the foreign country are transport costs associated with distribution.

Despite these disadvantages, exporting is the most popular way of being present in international markets. Often, companies will allow local distributors to make their own decisions regarding prices, packaging, and marketing. This strategy can be used if a coordinated marketing program does not add any value. Examples of this strategy are found in the case of raw materials or agricultural products that are often marketed locally.

Joint Ventures/Alliances

Joint ventures or alliances with local companies have many advantages for companies who want to expand internationally. A partnership with a local company splits the investment risk between two organizations. Both partners benefit from complementing competencies and resources. Companies from abroad can, for example, provide the technical

Joint ventures
These are organizations that are founded by at least two legally separate entities.

know-how, and the local company provides the distribution and local market know-how. In some countries, joint ventures or alliances are stipulated by law in order to enter the market (e.g., China).

It is often not simple for companies to find a suitable partner, one who is trustworthy and contributes in the same manner to a common goal and common success. To establish a functioning partnership, companies have to be prepared to engage in relationship management and invest in the coordination of the partners. However, partnerships often have problems associated with integration and coordination; the transfer of know-how can be exploited by the local partner, which leads to a loss of the competitive advantage in this particular market.

MORE INFORMATION
For additional information about successful alliances, please refer to the article by Kaplan, Norton, and Rugelsjoen (2010).

Licenses

License agreements
These define the rights and regulations to market or sell a product or service.

If companies do not want to sell their products or services directly in a foreign market, they can use **license agreements** with foreign partners. The most popular license agreement is the so-called franchise agreement. A well-known example of a franchise system is the fast food chain McDonald's. Other brands that use the franchising system to sell their products are Mister Minit, Tchibo, or Baumarkt in Germany. The advantage of a franchising system is that the partners share the risks and costs. The license agreement defines the payments to the company in exchange for using the brand.

Especially in foreign countries, it can be difficult for companies to find good franchise partners that respect the intellectual property rights of the brand, adhere to its quality standards, and try to maximize sales. A further disadvantage is that the company that wants to expand internationally cannot exploit local benefits, such as low wages, as the franchising or licensing partner reaps these benefits. Furthermore, the company may lose its competitive edge in the market if the franchisee does not deliver the product or service that was promised by the organization or if the franchisee copies the system and opens his or her own business. Constant quality controls are the key to a successful franchise system.

Foreign Direct Investments

Foreign direct investments are capital investments made by a company in a foreign country. Thus the influence and control over the operation in the foreign country rests with the investor. The investing company also transfers know-how and technology; revenue goals are therefore key to the investment decision.

Advantages of the foreign direct investment include complete control over the operation and the possibility of coordinating a full integration, which will show a long-term commitment. The company has the opportunity of entering a new market quickly by investing directly. An additional advantage is that foreign direct investments are often **subsidized**.

Subsidy
This refers to governmental financial support for a new operation which does not need to be paid back.

However, foreign direct investments usually require a large financial and coordination commitment. The full integration of a foreign company often fails despite all efforts as companies have to contend with not only a different culture in the foreign country, but also a unique corporate culture. Foreign direct investments are thus a risky and expensive option for organizations to expand internationally.

SUMMARY

The world has grown closer together, and improvements in the infrastructure and the Internet have made it possible even for small companies to operate internationally. Trade agreements and free trade zones facilitate the internationalization of businesses. Companies that operate internationally benefit from economies of scale as they are able to increase sales and may benefit from local differences, such as lower wages. The globalization of business also has disadvantages, such as interdependencies and increasing competition.

When companies decide to expand internationally, they should analyze the political, legal, economic, and social factors in those regions they want to invest in. Furthermore, local factors such as resources and the local demand for the product or service need to be investigated. Local suppliers and the local strategy, structure, and competition are factors that can potentially offer a competitive advantage to producers.

Choosing an option for its international expansion depends on how much risk the company is ready to take. Exporting is the easiest way of offering products or services internationally. There is also the option of founding a partnership with a local company in the form of an alliance or a joint venture. Many companies use the franchise system to sell in foreign countries through franchise partners. The most costly way to invest in a foreign country is through foreign direct investments.

UNIT 7

DO-IT-YOURSELF, BUY, OR ALLY?

STUDY GOALS

On completion of this unit, you will have learned …

- the advantages and disadvantages of organic growth.
- what reasons lead to mergers and acquisitions.
- what strategies of integration are available for acquisitions.
- why companies form alliances.
- what factors influence the decision in favor of strategic growth.

7. DO-IT-YOURSELF, BUY, OR ALLY?

Introduction

TEN REASONS MERGERS AND ACQUISITIONS FAIL: THE MOST COMMON CAUSES FOR COMPANIES FAILING TO INTEGRATE AND PROFIT FROM M&A ACTIVITY.

Having spent the first 17 years of his career reshaping companies acquired by an international group before focusing on M&A consultancy across several industries, Paul J. Siegenthaler has seen his fair share of M&A pitfalls. Here's his take on the most common causes behind the fact that the majority of company integrations fail.

Ignorance. While the parties in a merger or acquisition cannot exchange commercially sensitive information prior to being under common ownership, there is enough crucially important and legally permissible preparation work to keep an integration team busy for several months before day one. Most chief executives don't know this and they waste time that could be put to good use while waiting for clearance from the regulatory authorities. Good preparation means the integration can kick off on day one. Speed matters.

No common vision. In the absence of a clear statement of what the merged company will stand for, how the organization will operate, what it will feel like, and what will be different compared to how things are today, there is no point of convergence on the horizon and the organizations will never blend.

Nasty surprises resulting from poor due diligence. This sounds basic, but happens so often.

Team resourcing. Resource requirements are very often underestimated. It can take two or three months to release the best players from daily business to join the integration team(s), find a backfill for them, sign up contractors to fill the gaps, and set up the team's infrastructure. Most companies start too late and are not ready when the deal is completed.

Poor governance. Lack of clarity as to who decides what and no clear issue resolution process. Integrating organizations brings up a myriad of issues that need fast resolution or else the project comes to a standstill. Again, speed matters, but with a sound decision-making process.

Poor communication. Messages too frequently lack relevance to their audience and often hover at the strategic level when what employees want to know is why the organization is merging, why a merger is the best course action it could take, how the company will be better after the merger, how it will 'feel', how the merger will affect their work, and what support they will receive if they are adversely impacted.

Poor program management. Insufficiently detailed implementation plans and failure to identify key interdependencies between the many work streams brings the project to a halt or requires costly rework, extends the integration timeline, and causes frustration.

Lack of courage. Delaying some of the tough decisions that are required to integrate two organizations can only result in a disappointing outcome. Making those decisions will not please everyone but has the advantage of clarity and honesty and allows those who do not find the journey and destination appealing to step off before the train gathers too much speed.

Weak leadership. Integrating two organizations is like sailing through a storm: you need a strong captain, someone whom everyone can trust to bring the ship to its destination, someone who projects energy, enthusiasm, clarity and who communicates that energy to everyone. If senior managers do not walk the talk, if their behavior and ways of working do not match the vision and values the company aspires to, all credibility is lost and the merger's mission is reduced to meaningless words.

Lost baby with bathwater. Companies contemplating a merger or acquisition too often omit to pinpoint what particular attributes make the other party attractive and define how they will ensure those attributes do not get lost when the organization and the culture have changed. Culture cannot be bought − it needs to be embraced.

Source: Siegenthaler (2010).

7.1 Do-It-Yourself

In order to embark on the path of strategic growth, organizations have three different options:

1. They can decide to grow organically.
2. They can merge with or acquire another organization.
3. They can form a strategic alliance.

This section looks at the organic growth option, otherwise known as the 'do-it-yourself' (DIY) approach.

Organic growth is the investment into the development and growth of the company's own resources and capabilities. The advantages of this strategic growth option are that the organization takes the time to grow into new areas and builds up its own experience. The slow growth allows companies to spread the investment costs over time, making this growth much easier to finance than other growth options. The company does not need to find a suitable partner in order to form an alliance or merge. It stays independent and can continue on its strategic path.

Amazon
This is an online store that started as a bookstore. Today, anything can be purchased through the Amazon website.

e-book
An e-book is a book that is available in electronic form and can be accessed with an e-book reading device.

One example of an organization that decided to grow organically is **Amazon**. Amazon developed the **e-book** reader 'Kindle' and its own e-book store. This expansion into the e-book market came through the internal development of the Kindle reading device. Amazon used its experience from the online book business and its software competence. After many years of being an online store for all products, Amazon went back to its roots with this new technology. The Kindle is a hugely successful product and sales are growing continuously. Amazon founder Jeff Bezos attributed the growth to the low price of the Kindle reader compared to other devices (such as the Apple iPad), the large number of e-books available to customers, and fast delivery. Organic growth, however, did not come without expense for Amazon. The company invested a great deal of money in digital offers and e-books.

The example of Amazon clearly illustrates that organic growth is not easy. Often, the resources to grow into innovative new markets, to diversify, or enter international markets are not readily available. To succeed in growing organically, companies need an innovative and entrepreneurial corporate culture. They also have to be prepared to invest heavily in these new projects and wait a long time until the product or service is ready to enter the market.

7.2 Mergers and Acquisitions (M&A)

In addition to organic growth as an option for expansion, companies can also grow by merging with another organization or acquiring another organization. A merger is defined as the formation of a larger organization by two companies that operate as more or less equal partners. This is different to an acquisition of a company, which is the takeover of one company by another. If it is supported by both organizations, this is known as a 'friendly takeover'. A 'hostile takeover' is one that is not welcomed by the assumed target and happens mostly by one company acquiring a majority of the shares of the other company.

Motives for Mergers and Acquisitions

There are various strategic reasons for mergers and acquisitions. In addition to these strategic reasons, there are usually financial implications and most often additional personal reasons for deciding to merge with or acquire a company. As a general rule, all three factors will play a role in the decision.

Strategic motives

Companies can expand their range of products through mergers and acquisitions. They can also enter new markets and businesses or expand internationally into new countries or regions. These strategic motives look at increasing the size of the organization in order to benefit from economies of scale. In the example of the Chinese motor company Geely, the acquisition of Volvo demonstrates an expansion into a different country.

GEELY BUYS VOLVO. BELIEVE IT OR NOT, IT COULD WORK

Mergers and acquisitions in the car business have a terrible record. Daimler-Chrysler stands tall as the worst example of a bad marriage. General Motors made a hash of Saab and Hummer and its tie-ups with Isuzu, Suzuki, and Subaru didn't yield much either. Tata has struggled with Jaguar and Land Rover and now that Ford is sending Volvo off in a boat to China, we have to ask, can Geely make a go of this?

It's going to be a tough job. Geely is paying $1.8 billion for the brand. Volvo sales of 335,000 globally are off 11% this year and 27% off their peak, according to this Bloomberg story. The Swedish carmaker has lost $2.6 billion during the last two years. The brand hasn't been a real moneymaker for a very long time. Its costs are high and prices are strong but Volvo doesn't command luxury premiums for its cars.

On paper, at least, this could be a very good deal for Volvo. Be clear about one thing. Zhejiang Geely Holding Co., not the carmaker, is buying Volvo. This is an important distinction, says Jim Hall, principal of 2953 Analytics in Birmingham, Mich. It indicates that Volvo won't just be folded into Geely and lose the brand's strong Nordic identity. Geely Chairman Li Shufu said with unintentional humor that, "I see Volvo as a tiger. It belongs to the forest and shouldn't be contained in the zoo," Li said in Mandarin. "The heart of the tiger is in Sweden and Belgium."

Volvo will keep its own management team, board of directors and headquarters in Gothenburg, Sweden. That would indicate that Volvo will keep its Swedish heritage and cachet. European and American Volvo loyalists will still be buying cars engineered in Gothenburg and built in Europe.

What that would mean, however, is that Geely is buying Volvo and lingering on with the same money-losing structure. That's where China comes in. The Chinese luxury market is booming and still has room for some other players to come in and build a brand. Geely will assemble Volvo cars in China using cheaper manufacturing, Hall says. The brand is upscale and Geely ownership might even be seen as preferable by Chinese consumers. So the company can increase sales and get larger margins in China. That makes the business case work better than it ever did either under Ford or as an independent carmaker.

After so many failed auto deals, this one has the makings of a success. Of course, it means Geely can't manhandle Volvo. They need to rely on Ford and the Swedes for technology that will make the Chinese cars real Volvos. In short, they should manage it as a separate subsidiary the way Volkswagen Group runs Audi AG. Give it autonomy and let the tiger run. Volvo is a niche brand and will never be a cash cow. But it certainly could work if Geely gives it some independence.

Source: Welch (2010).

Companies try to optimize their business model and become more efficient through a merger or an acquisition. For example, departments such as administration or logistics can often merge their resources and benefit from increased efficiencies. Increasing an organization's size through a merger or acquisition boosts its market power. If a company acquires a competitor, the effect is multiplied: the organization reduces the competition by means of the acquisition and augments its power to negotiate lower prices with suppliers through its increased size. Through an increase in economies of scale, the company sells larger quantities and can influence the market price for the product or service offered, thus increasing its profit margin.

A further reason for mergers and acquisitions is the expansion of the company's capabilities. Amazon could have merged with an electronics company such as Sony or acquired the smaller French pioneer Bookeen in the e-book business. In choosing this option, Amazon would have acquired the capability instead of developing it. However, the organic growth option made Amazon an expert in the e-book business.

Financial motives

In addition to strategic goals, mergers and acquisitions often have financial goals. Corporations may increase their financial efficiency by offsetting the profits of one entity with losses from another. Thus, the entity that made a loss can pay its liabilities with the profits of the other entity in the corporation. The corporation benefits from the growth in size by acquiring the indebted entity and both sides benefit from the merger.

Further financial considerations for a merger or acquisition are possible tax advantages. A company that operates in a country with high taxes may merge with or acquire a company in a country with low taxes in order to pay their taxes in that country.

Hostile takeovers often aim at increasing the assets of the acquiring company. This is done by breaking up the acquired entities into parts and selling these parts off. The individual parts of the organization are often worth more than the entire company. As such, the acquiring company makes a profit from the sale of these parts.

Personal/management motives

General management motives also influence the decision in favor of a merger or acquisition. The personal ambition of a **CEO** may play a role in M&A decisions. Managers are often evaluated on short-term growth results and the target share price. To achieve the growth goal fast, the company can merge with or acquire another company instead of trying to grow organically over a long period of time. Successful takeovers boost the reputation of the manager as the name appears in the media. At times, the pressure from the shareholders might be strong if M&A are a trend in the industry and managers could succumb to the pressure and participate in the trend.

CEO
This stands for Chief Executive Officer. The CEO is the top manager of a corporation who defines and directs the overall strategy.

What Criteria Play a Role in the Selection of a Company for M&A?

If companies want to grow through M&A, they should develop a strategy that defines exactly what they are looking for. In order to integrate two organizations successfully, similar corporate cultures are a prerequisite. Only through the cooperation of all parties involved in the M&A can friction be avoided and common goals reached. Furthermore, an analysis of the fundamental, strategic, and cultural fit between the organizations is required.

Fundamental fit

The fundamental fit looks at the organizations' willingness and readiness to merge. Basic indicators such as size, history, and capabilities are checked for compatibility. If the company to be bought is generally opposed to the acquisition, the integration process of the acquisition will most likely fail.

Strategic fit

The strategic fit describes the strategic goals of the organization to be acquired and its management know-how in order to direct and implement these goals. Both organizations need to know their core competencies and strengths as well as weaknesses. Furthermore, the position in the market, the competitive environment, and related strategy play a major role in evaluating the strategic fit. Before an M&A is decided, the company should determine whether the strategies of the two organizations are compatible and could strengthen their market position.

Cultural fit

The cultural fit includes questions regarding corporate cultures and their management. The areas to analyze are communication style, openness, management style, the ability to delegate and work in teams, and the mission, values, and vision of the organization. It is very difficult to integrate companies with very different organizational cultures. Even the integration of companies with similar cultures has to follow a detailed plan.

Integration Strategies

The integration process of two organizations depends on the strength of their strategic interdependence and their need for organizational autonomy. Depending on how distinct these two aspects are with respect to each of these organizations, the acquired organization will either adapt fairly quickly to the new strategy, culture, and systems, or not at all. There are four integration scenarios:

1. Maintenance
2. Symbiosis
3. Absorption
4. Holding

Maintenance

If merging companies have little strategic interdependence, maintenance (also called preservation) is the strategy of choice. Often, these companies operate in different businesses and are not dependent on each other's products or services. Moreover, the acquired company has a high need for organizational autonomy, which means it is better to preserve the strategies, corporate cultures, and systems of both organizations separately. Integration occurs at a minimum level (e.g., common financial reporting), and both companies continue to operate as separate entities.

Symbiosis

A strategy of symbiosis is recommended if the two companies show high strategic interdependence and have a marked need for organizational autonomy. In this case, the two companies are mutually dependent; certain processes and systems have to be integrated in order to increase the efficiency of the M&A. The companies can learn and benefit from each other's strengths and build on the available capabilities. The symbiosis is a long and difficult integration process.

Absorption

If merging companies are strategically very interdependent and have little need for organizational autonomy, one company may completely absorb the other company. The integration process may happen fast and the company that is absorbed needs to be prepared to adopt the strategy, culture, and processes of the new owner or company it merged with.

Holding

Holding describes a situation where the companies show little interdependence and need for organizational autonomy. In this situation, integrating the company does not bring any additional benefit or advantage. The company thus holds the new entity for a while and sells it in due course. The acquired company does not undergo any changes. For example, a manufacturing company buys a laser producer in order to optimize its own production processes that require precision lasers. The acquired laser company happens to have a medical laser division. This is of no extra value to the manufacturing company and will be held before being sold, maybe to another medical company.

7.3 Strategic Alliances

A strategic alliance is formed when two companies share resources or activities to reach a common goal. There are many types of strategic alliances. One example is a research and development alliance where both companies benefit from sharing the costs for the research and development of a product.

Types of Alliances

There are two types of strategic alliances in terms of the ownership structure: equity alliances and non-equity alliances. An equity alliance describes the creation of a new entity, which belongs to both alliance partners. For example, two pharmaceutical companies invest together in a research institute. Non-equity alliances are partnerships that do not involve a claim to a property, such as a research institute. Non-equity alliances are merely contract bound. An example of a non-equity alliance is The Leading Hotels of the World (LHW). LHW is an alliance of luxury hotels, resorts, and spas worldwide that offer member hotels certain services, such as providing marketing measures for the group, consultation, and a central reservation system. The expertise of LHW is quality analyses of the member hotels, which guarantee hotel guests a specific quality standard.

Motives for Alliances

The motives for alliances are similar to those of M&A. However, an alliance requires a much lower financial commitment from companies.

Alliances benefit from economies of scale. The LHW group provides centralized marketing, consultation, reservation, and quality inspection to all the member hotels. This reduces, for example, the costs of printing advertising material for each individual hotel as this is provided by the LHW catalog of hotels or website.

Access alliances offer companies distribution channels in foreign countries. They can sell their products or services through distribution partners and do not have to invest in a direct sales force in these countries. The franchise system is a good example of an access alliance of two partners. Companies like McDonald’s have expanded worldwide into all regions through a franchise system. Investing in all the countries they are represented in today would have been an impossible financial burden for the company.

Complementary alliances consist of individual companies that provide one component each to the partnership. All components provided complement each other and form the final product or service. These alliances exist in complex markets in which individual companies are unable to provide all components or resources in order to be successful in the market. Complementary alliances are successful if the increase in benefits through the alliance outweighs the costs of coordinating the alliance partners. A complementary alliance for example could be with medical imaging companies, i.e., ultrasound, X-ray, MRI manufacturers, and a provider of digital hospital networks. All agree on a common interface in order to facilitate the integration of all systems and make it possible to digitally attach all images to the patients’ files.

7.4 How to Decide Whether to Buy, Ally, or Do-It-Yourself?

Deciding which strategic growth option is the best for the organization depends on various factors. One factor is how fast a company wants to grow, which describes the urgency to expand. Uncertainties in specific regional markets or technologies or market fluctuations also influence which strategy to pursue. The types of capabilities to be acquired, i.e., soft capabilities (such as employees or know-how) or hard capabilities (such as machines or production facilities), play a major role in the strategic decision-making process. Finally, the degree of **modularity** of the capabilities influences the decision.

Modularity
This is the degree to which something can be separated into individual parts.

Urgency

If the growth strategy has a high degree of urgency, the organic growth option will take too long. Therefore, an alliance or M&A would be the better, faster option. The Chinese auto manufacturer Geely could have invested a lot of time and money to establish itself as a reliable car manufacturer in the European market. It would have been very difficult to build an image of high quality as a Chinese company. The decision to acquire Volvo allowed Geely to be present in the European market immediately and start gathering market information.

Uncertainty

If you try to enter uncertain or fluctuating markets, alliances represent the best option. When forming an alliance, the partners usually share the risk. No company is solely responsible for the success or failure of the business. If the alliance proves to be successful over time, the company has the option of acquiring the alliance partner. In an environment of high uncertainty, companies should refrain from expanding independently and making direct foreign investments as the investment costs are then fully borne by the company and lost if the development fails. The example of Helmerich & Payne clearly illustrates how a do-it-yourself (DIY) strategy fails in uncertain markets. Helmerich & Payne lost all its investments to the government of Venezuela. It would have been advisable to look for a possible alliance partner in Venezuela, thereby sharing the risk of the investment with a second company.

Type of Capabilities

If a company needs hard capabilities (such as machines or a production facility) in order to grow, it would be advisable to acquire these through M&A. On the other hand, if the company needs soft capabilities (such as know-how) it would be best to take a DIY approach and hire employees with expertise. If the company tries to form an alliance with or acquire an organization that has the soft capabilities, it might encounter integration problems as corporate cultures differ.

The following example illustrates the types of capabilities that led to a strategic alliance between two quite different companies. After many years of partnership between the Swiss pharmaceutical company Roche and the California-based Genentech, Roche decided to acquire the company in 2009. The Genentech employees have a very different corporate culture from the conservative Swiss employees at Roche and enjoyed a great deal of freedom, such as the opportunity to spend time on their personal research projects one day a week. They describe themselves as cowboys. However, over the years of the partnership, Roche has learned to accept the differences of corporate cultures. As Steven Burrill, chief executive officer of a San Francisco life sciences venture firm, observed in the San Francisco Chronicle: "The assets of Genentech walk out in tennis shoes every night, and you hope they walk back in, in the morning" (Tansey, 2009).

ROCHE AGREES TO BUY GENENTECH FOR $46.8 BILLION

Roche Holding's agreement on Thursday to acquire full ownership of Genentech for $46.8 billion is the third big drug industry merger this year. But it is different from the other two – Pfizer's $68 billion proposal to acquire Wyeth and Merck's $41 billion deal with Schering-Plough – in crucial ways.

Pfizer and Wyeth are strangers, and Merck and Schering have a joint venture on cholesterol drugs but are otherwise not related. And in both those deals, executives describe potential costs savings as a big benefit.

But Roche has owned a majority of Genentech since 1990, and it says cost savings, expected to be $750 million to $850 million a year, are not the main goal of the deal; the goal is to improve coordination on product development. That could make it easier to integrate the two companies.

"It should be very easy because practically the entire portfolio is in common," said Viren Mehta, managing member of Mehta Partners, a consulting firm that advises drug companies and investors. "These two companies have grown up closer than any two independent companies could be expected to be."

And yet the challenge for Roche, a big Swiss company, will be in integrating the two companies without ruining Genentech's freewheeling and innovative culture and sending its top managers and scientists out the door. The culture clash between Roche and Genentech could be greater than that between Pfizer and Wyeth or between Merck and Schering-Plough, all of which are traditional, big drug companies.

Laurence Lasky, a Silicon Valley venture capitalist who spent 20 years as a scientist at Genentech, said he expected top managers of Genentech to leave Roche. "They're Swiss and Genentech is a bunch of entrepreneurial California cowboys."

Genentech, which was founded in 1976, said its executives would not comment.

After eight months of resistance, Genentech agreed Thursday to a deal in which Roche will pay $95 a share for the 44 percent of Genentech that it does not own. The deal would end the independent existence of what is widely considered the world's oldest and most successful biotechnology company.

Genentech shareholders must still tender their shares but they are expected to do so because a committee of Genentech's directors recommended the deal.

The new price is higher than the $89 Roche offered in July and a bit higher than its offer last Friday of $93. While Genentech directors initially asked for $112, they came to realize that price was unrealistic in the face of sharply falling world stock markets, according to a regulatory filing by Genentech.

Franz B. Humer, Roche's chairman, said in an interview that he would meet with Arthur D. Levinson, Genentech's chief executive, and Genentech's top scientists. One issue, he said, would be to come up with an alternative to the stock options that have been a big financial incentive for Genentech employees.

Roche has said Genentech's research and early clinical trial operations will retain autonomy so the culture can be preserved. It has also said the combined United States commercial business of both companies will be based at Genentech's headquarters in South San Francisco, Calif., rather than in Nutley, NJ, where Roche's American business is based. The drug portfolios of Roche will be sold under the Genentech brand in the United States.

Pfizer and Merck have said their acquisitions will move them more into drugs made by biotechnology, which have more protection from generic competition than the chemical-based drugs companies now sell. Roche goes further, saying its purchase of Genentech will make it the largest biotechnology company in the world.

Pfizer and Merck will also get other diversification from their deals, picking up vaccines in the case of Pfizer and consumer products in the cases of both Pfizer and Merck. Some big drug companies have been hoping that consumer products, generic drugs, or medical devices might shield them from the storms buffeting their industry, with patent expirations, pricing pressures, and tougher regulatory hurdles.

Roche, by contrast, says it has no interest in generic drugs or consumer products and wants to stick to its specialty.

"You go deep rather than broad," Bill Burns, the head of Roche's pharmaceutical business, said in an interview last month. The one exception is that Roche has become a leader in diagnostics, which increasingly will be used to tell which patients should receive a drug.

Roche sells many of its own drugs and has others in development, such as ones for rheumatoid arthritis and diabetes.

But Roche’s three best-selling drugs − the cancer medicines Avastin, Herceptin, and Rituxan − come from Genentech. And many of the late-stage clinical trials being conducted by Roche involve Genentech products. Roche’s main growth could come from extended use of Avastin.

Roche now has first dibs on marketing rights outside the United States for drugs developed by Genentech. That arrangement was set to expire in 2015, another reason Roche wanted to own the whole company.

Source: Pollack (2009).

Modularity of Capabilities

In the event the capabilities that the company is seeking can be separated into smaller parts, i.e., the capabilities are highly modular, alliances are the best option to pursue. Joint ventures can, for example, be used to combine required capabilities with those existing in the company in order to create more value. The other parts of the companies are managed as usual and operate in their established markets. An acquisition might lead to problems as the entire operation will have to be acquired, which might lead to integration problems. If capabilities are modular, it might be advantageous to do-it-yourself as the company could build one separate department to develop the component. The advantage of the modularity is that only part of the organization is affected by and involved in the new development. Amazon did this when it developed the Kindle. The company still operated as an online store as usual, but it founded a separate department to develop the Kindle.

The decision regarding which strategic growth option to pursue also depends on other factors, such as finding a suitable partner to work with, which is often difficult. In the case of non-profit organizations or charities, a change of ownership is difficult to execute, which limits their growth options to forming alliances and do-it-yourself.

SUMMARY

Companies have several growth options. The organic growth option, do-it-yourself, offers the advantage that the company develops its own competency in the field and can continue to pursue its strategy. However, organic growth takes time and requires an innovative and entrepreneurial corporate culture.

Mergers and acquisitions are another growth option for companies. The various motives for M&A are strategic motives (such as the development of new markets), financial motives (such as reducing the tax burden), or personal/management motives (such as short-term growth goals). When choosing a company to acquire or to merge with, companies should analyze the fundamental, strategic, and cultural fit. The fit often determines the success of the M&A. The integration of the two companies is challenging and depends on their strategic interdependence and their need for organizational autonomy.

Another option for companies to grow is through a strategic partnership or alliance. Alliances can be equity alliances, which involve the investment of both partners in a new entity, or non-equity alliances, which are contractual agreements. Alliances are formed for similar reasons as M&A as companies try to benefit from economies of scale, access new markets, or complement their product offers.

Which growth option a company chooses depends on various factors. The urgency of the expansion plays a major role as well as possible uncertainties in the markets or technologies. Furthermore, the types of capabilities a company is looking for, soft or hard, and the modularity of these influence the strategic decision. Finally, the availability of a suitable partner plays a role in the decision to grow.

UNIT 8

HOW TO EVALUATE STRATEGIES?

STUDY GOALS

On completion of this unit, you will have learned …

- how to evaluate strategies.
- what suitability, acceptability, and feasibility mean in the context of evaluating a strategy.
- what is important to consider when implementing strategies.

8. HOW TO EVALUATE STRATEGIES?

Introduction

SCHAEFFLER SELLS 10% CONTINENTAL STAKE FOR $2 BILLION
Schaeffler AG, a German industrial bearings maker, sold a 10.4 percent stake in Continental AG (CON) for 1.6 billion euros ($2 billion) to reduce debt after a failed takeover of the tire producer.

M.M. Warburg and Bankhaus Metzler disposed of the 20.8 million Continental shares they were holding on Schaeffler's behalf for 77.50 euros apiece, the Herzogenaurach-based company said today in a statement. That was 4.9 percent less than Continental's 81.49 euro closing price yesterday.

Family-owned Schaeffler gained control of Continental, Europe's second-biggest car-parts supplier, in 2008 at the height of the financial crisis. The takeover bid backfired when more investors than Schaeffler expected accepted the offer as markets collapsed, leaving it with more than 90 percent of the shares and more than 10 billion euros in debt. Cash from the stake sale will cut debt at the Schaeffler Holding parent company by 31 percent to 3.5 billion euros, it said today.

"This share sale makes sense, because Schaeffler is still highly indebted," Tim Schuldt, an analyst with Frankfurt-based Equinet Bank AG, said today by phone. "The dividend yield is less than their cash costs on the loans, which means that they actually have to insert cash to service the debt."

Stock Declines
Continental fell as much as 4.9 percent to 77.47 euros, the biggest intraday drop since July 23, and was trading down 4.6 percent at 2:30 p.m. in Frankfurt. The stock, which re-entered Germany's benchmark DAX Index (DAX) yesterday, has gained 62 percent this year, valuing the company at 15.6 billion euros.

Schaeffler's bonds rose to a record and were the top three gainers in the Bank of America Merrill Lynch high-yield index. The manufacturer's 400 million euro 8.75 percent notes due 2019 gained 1.2 cents to 113.47 cents on the euro, pushing the yield down to 6.3 percent, according to data compiled by Bloomberg.

The German bearing maker refinanced debt in February with about 8 billion euros of loans, including a 1.4 billion euro loan sold to institutional investors, and 2 billion euros of high-yield bonds, according to data compiled by Bloomberg. In June, the company added three banks to its loan facility, raising the total to eleven. Schaeffler's stock isn't traded.

Banks' Holdings
Schaeffler's direct stake in Hanover, Germany-based Continental was limited to just less than 50 percent under a four-year agreement between the two manufacturers in August 2008, intended to settle the takeover dispute. Banks held the excess Continental stock that investors had sold to Schaeffler.

The share sale and the end of any contractual agreements between the two banks and Schaeffler will reduce "complexity in the participation structure," Schaeffler Chief Financial Officer Klaus Rosenfeld said in today's statement.

The amount of Continental's freely traded stock increases to 50.1 percent from 39.7 percent. The Schaeffler family agreed to keep its current 49.9 percent holding in the auto-parts maker for the next six months, remaining its biggest shareholder, the company said.

"Our participation in Continental is of long-term and strategic nature for the Schaeffler family," owners Maria-Elisabeth Schaeffler and Georg Schaeffler said in the statement.

Cooperation Work
The companies are involved in more than 30 joint industrial projects at different stages of development, including turbo chargers and an electronic parking brake, said Hannes Boekhoff, a Continental spokesman. The manufacturers have also teamed up in purchasing, which led to savings of 350 million euros to 400 million euros in the three years through 2011.

"Our successful cooperation in a variety of topics and projects continues as before," Boekhoff said by phone.

Continental, which is also Europe's second-largest tire maker, raised its 2012 revenue and profit forecasts in August after second-quarter earnings jumped because of lower raw-material costs. The growth, and a 1.1 billion euro share sale in 2010, helped Continental reduce debt to 6.88 billion euros in June from a peak of 10.9 billion euros in 2007, following the acquisition of the VDO car-parts business from Siemens AG.

Chief Executive Officer Elmar Degenhart said this month that he expects Continental to continue to grow faster than global car markets by four to five percentage points next year. Degenhart forecast an increase in worldwide light-vehicle production of as much as three percent in 2013 as expansion in North America and Asia offsets stagnation in Europe.

Schaeffler Forecast
Schaeffler reiterated its full-year forecast on Aug. 28 as demand outside Europe helped sales rise. The company is targeting sales growth of more than five percent to about 11.2 billion euros this year. Earnings before interest and taxes should exceed 13 percent of sales

Source: Tschampa (2012).

8.1 How to Evaluate Strategy?

There will always be several strategic possibilities available for companies to consider. However, management has to decide which strategy to pursue. Whether choosing a specific strategy was the right decision will only become evident later, after it has been implemented. So how then can management limit the risk of implementing a strategy that might fail?

There are various evaluation criteria that analyze the suitability, acceptability, and feasibility of the strategic options, which we will explore in this section.

Suitability

The suitability of a strategy evaluates whether it is a good fit for the strengths and weaknesses of the organization as well as the opportunities and threats of the market environment. The techniques described earlier in the course (the PESTEL analysis, Porter's Five Forces, SWOT analysis, an analysis of the strategic possibilities, the product life cycle, benchmarking, and the definition of the competitive advantages) help in carrying out this assessment. All this information makes it possible to rank the various strategic possibilities and see which are best and worst suited for implementation.

Let us illustrate this with the example of Shell, which intends to pursue an expansion strategy. If the oil price declines because the demand for oil goes down or there are substitute products available in the market, it would not be advisable for Shell to expand through large direct foreign investment.

The best strategies available to organizations are flexible and adaptable. If we take the example of Shell, we would advise the company to choose a strategy that can be pursued fairly independently of the oil price development. An expansion option that does not require enormous investments would be an alliance with a contractual partner in order to enter a foreign market. This leaves the option of acquiring the partner if the alliance proves successful. Shell also has the flexibility to leave the alliance without great losses if it is unsuccessful.

Acceptability

An acceptability evaluation looks at the expected performance results of the strategy. It should meet the expectations of the stakeholders of the organization. It looks at the risk, the return, and the reactions of shareholders.

The risk indicates whether and how accurately the strategy forecasts the expected results of the strategy. Questioning and testing the assumptions of the strategic plan or analyzing how the strategy influences the liquidity of the organization provides important information on the risk level of the strategy.

Let us look at the example of Shell again. In order to decide how to expand, Shell should analyze how far its **liquidity** will be reduced if it opts for a direct foreign investment. Then it should look at the impact of a sinking oil price on the organization's results and at which price level the company would still be able to survive the crisis.

Liquidity
This describes the financial means that are readily available to an organization.

Return refers to the financial impact of the strategy on the **shareholders**. The 'return on capital employed' (ROCE) is a financial indicator that looks at how effectively and profitably the organization uses its invested capital. The question for Shell is how much it will gain in profits in the long term from using its liquid means for a direct foreign investment. The company could then calculate the long-term profits of an alliance. This will show the long-term financial situation of the organization and helps in weighing up the expansion decision.

Shareholder
The shareholder is the owner of a share of an organization.

The financial situation of a company influences the share price and the **dividends** paid to the shareholders. The shareholders have a strong interest in seeing their share of the company increase in value (i.e., the share price goes up). Managers are therefore responsible for justifying their strategic decisions to the shareholders as they are the direct beneficiaries of potential profits.

Dividend
This is the part of the profit that is shared with the shareholders as a payment.

Feasibility

A feasibility analysis looks at the capabilities and the resources of an organization to pursue the strategy. The study of feasibility is preceded by a detailed SWOT analysis and a product life cycle (PLC) analysis. The feasibility analysis looks at the financial means of an organization but also at its human resources and capacity to realize a strategic decision. The PLC looks at the product portfolio and asks how many products generate profits for the organization in order to allow further investments.

Furthermore, the company needs to consider whether it has the right people to implement a strategy or whether it needs to hire further staff. Topics like training and development of personnel as well as incentives and promotions need to be considered in order to make a strategic decision. Some people might have to be sent to foreign countries for a certain period of time – a budget will be required for this decision.

It is not easy to evaluate strategies. Often, conflicts can arise between managers and shareholders as they have different goals for the organization. Management is responsible for making decisions to the best of their knowledge that are in the best interests of the entire organization as well as communicating such decisions to the shareholders and stakeholders.

8.2 Implementing Strategy

In order to effectively implement the tasks of the strategic analysis and realize goals and strategies, the structure and processes of the organization have to be considered and redesigned. The formation of the internal structures and processes are part of the implementation plan. Four main areas need to be considered in this plan:

1. Organization
2. Human resource management
3. Controlling systems
4. Corporate culture

Organization

The structure and processes of the organization need to be aligned with the strategic requirements. A central task in the implementation process is to appoint a team in charge and define their status and range of authority. The team should take a central role as a service provider of all planning and controlling tasks for the functions and divisions of the organization. Cross-functional teams are recommended in order for the implementation of the strategy to penetrate all departments of the organization.

Human Resource Management

A program needs to be developed that defines the necessary training, selection, and development of new or current employees and reward systems in order to facilitate the implementation. The effectiveness of the implementation depends on the employees in the organization and their willingness to put the plan into action. Therefore, the employees need to be involved, evaluated, and rewarded in terms of the strategic implementation process.

Controlling Systems

Controlling
This is a financial management and steering system for the management of an organization in order to control the organization.

It is also important to define the **controlling** methods which help the management to follow the implementation process through financial indicators as well as action plans. The controlling system is a key part of the implementation process and needs to be defined before the implementation process starts. For the internal controlling, this is a goal-oriented support system for the management to supervise the implementation process.

Corporate Culture

The infrastructure of the organization should be designed in such a way that the employees think, feel, and act according to the goals set by the organization. Therefore, management has to clearly communicate what the company goals are and what values the organization stands for. Only by doing this will a supportive corporate culture be created that is ready to put strategy into practice.

SUMMARY

In order to evaluate whether the strategies are suitable, the organization has to look at various criteria. The suitability analysis provides information as to whether the strategy fits with the strengths and weaknesses of the organization and considers the opportunities and threats of the strategic decision. The best options for companies are flexible strategies that can always be adjusted. The acceptability analysis looks at the expected performance results of the strategy. It looks at the risk, the long-term return, and the reaction of the shareholders with regards to the strategy. The feasibility analysis deals with the capabilities and the human resource potential of the organization. It provides information on the financial means and the human resource potential of the organization with regards to the implementation of the strategy.

Once the strategic decision is made, the implementation phase starts. The structure and processes of the organization have to be aligned with the strategic goals. A team has to be nominated and the range of authority of the team defined. The selection, development, and training of the employees starts. At the same time, controlling methods have to be defined to support the steering of the strategic implementation by the management. It is important for management to communicate the values of the organization as well as the strategic goals in order to evaluate the employees accordingly.

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