Chapter Two:

Strategies in Action

Chapter outline

- ✓ *Types of strategies*
- ✓ *Michael Porter's generic strategies*

2.1 Types of strategies

1. Integration Strategies

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

Benefits of vertical integration strategy

Allow a firm to gain control over:

- Distributors (forward integration)
- Suppliers (backward integration)
- Competitors (horizontal integration)

Types of Integration Strategies

A. Forward integration

Forward integration involves gaining ownership or increased control over distributors or retailers. It also refers to the transactions between the customers and firm.

Guidelines for the use of integration strategies:

Six guidelines when forward integration may be an especially effective strategy are:

- When an organization's present distributors are especially expensive, or unreliable, or incapable of meeting the firm's distribution needs
- When the availability of quality distributors is so limited as to offer a competitive advantage to those firms that integrate forward
- When an organization competes in an industry that is growing and is expected to continue to grow markedly; this is a factor because forward integration reduces an organization's ability to diversify if its basic industry falters
- When an organization has both the capital and human resources needed to manage the new business of distributing its own products
- When the advantages of stable production are particularly high; this is a consideration 0because an organization can increase the predictability of the demand for its output through forward integration

- When present distributors or retailers have high profit margins; this situation suggests that a company profitably could distribute its own products and price them more competitively by integrating forward

B. *Backward Integration*

Backward integration is a strategy of seeking ownership or increased control of a firm's suppliers. This strategy can be especially appropriate when a firm's current suppliers are unreliable, too costly, or cannot meet the firm's needs.

Guidelines for Backward Integration

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

- ✓ When an organization's present suppliers are especially expensive, or unreliable, or incapable of meeting the firm's needs for parts, components, assemblies, or raw materials
- ✓ When the number of suppliers is small and the number of competitors is large
- ✓ When an organization competes in an industry that is growing rapidly; this is a factor because integrative-type strategies (forward, backward, and horizontal) reduce an organization's ability to diversify in a declining industry
- ✓ When an organization has both capital and human resources to manage the new business of supplying its own raw materials
- ✓ When the advantages of stable prices are particularly important; this is a factor because an organization can stabilize the cost of its raw materials and the associated price of its product through backward integration
- ✓ When present supplies have high profit margins, which suggests that the business of supplying products or services in the given industry is a worthwhile venture
- ✓ When an organization needs to acquire a needed resource quickly

C. *Horizontal Integration*

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

Increased control over competitors means that you have to look for new opportunities either by the purchase of the new firm or hostile take over the other firm. One organization gains control of other which functioning within the same industry. It should be done that every firm wants to increase its area of influence, market share and business.

Guidelines for Horizontal Integration

Four guidelines when horizontal integration may be an especially effective strategy are:

- When an organization can gain monopolistic characteristics in a particular area or region without being challenged by the federal government for "tending substantially" to reduce competition
- When an organization competes in a growing industry
- When increased economies of scale provide major competitive advantages
- When competitors are faltering due to a lack of managerial expertise or a need for particular resources that an organization possesses; note that horizontal integration would not be appropriate if competitors are doing poorly because overall industry sales are declining

2. ***Intensive Strategies***

Market penetration, market development, and product development are sometimes referred to as *intensive strategies* because they require intensive efforts to improve a firm's competitive position with existing products.

Types of Intensive Strategies

A. ***Market Penetration***

A *market-penetration* strategy seeks to increase market share for present products or services in present markets through greater marketing efforts. This strategy is widely used alone and in combination with other strategies. Market penetration includes increasing the number of salespersons, increasing advertising expenditures, offering extensive sales promotion items, or increasing publicity efforts.

Guidelines for Market Penetration

Four guidelines when market penetration may be an especially effective strategy are:

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

There are two aspects of market penetration:

Rapid market penetration: based on two assumptions, to lower the price and promotional activities can be increased.

Slow market penetration: also based on two assumptions, to lower the price but promotional activities are not changed.

B. Market Development

Market development involves introducing present products or services into new geographic areas.

Guidelines for Market Development

Six guidelines when market development may be an especially effective strategy are:

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

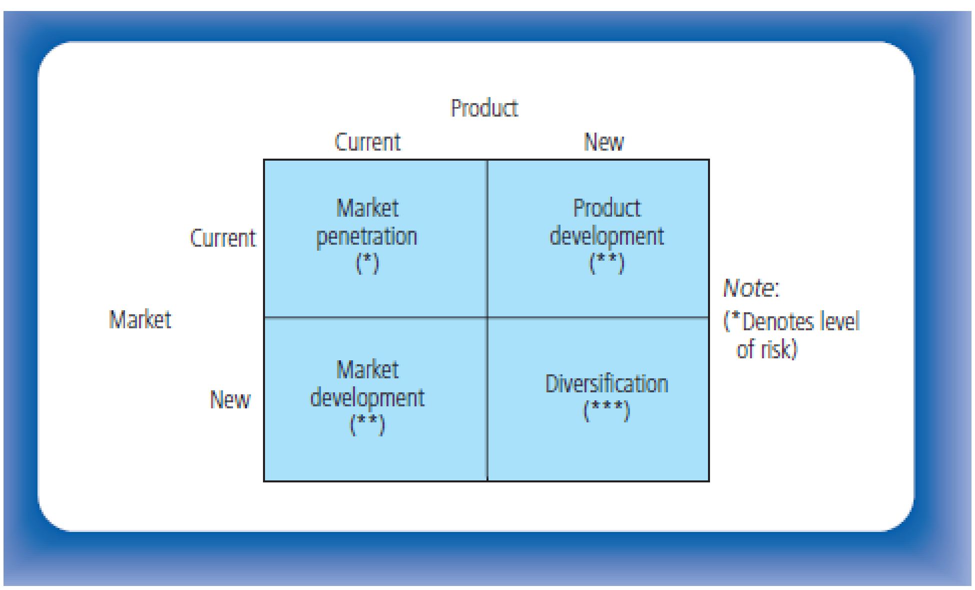
C. Product Development

Product development is a strategy that seeks increased sales by improving or modifying present products or services. Product development usually entails large research and development expenditures.

Guidelines for Product Development

Five guidelines when product development may be an especially effective strategy to pursue are:

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



3. *Diversification Strategies*

There are three general types of *diversification strategies:* concentric, horizontal, and conglomerate. Over all, diversification strategies are becoming less popular as organizations are finding it more difficult to manage diverse business activities. In the 1960s and 1970s, the trend was to diversify so as not to be dependent on any single industry, but the 1980s saw a general reversal of that thinking. Diversification is now on the retreat.

A. *Concentric Diversification*

Adding new, but related, products or services is widely called *concentric diversification*

Guidelines for Concentric Diversification

Five guidelines when concentric diversification may be an effective strategy are provided below:

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

B. *Conglomerate Diversification*

Adding new, unrelated products or services is called *conglomerate diversification.* Some firms pursue conglomerate diversification based in part on an expectation of profits from breaking up acquired firms and selling divisions piecemeal.

Guidelines for Conglomerate Diversification

Four guidelines when conglomerate diversification may be an effective strategy are provided below:

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

C. *Horizontal Diversification*

Adding new, unrelated products or services for present customers is called *horizontal diversification.* This strategy is not as risky as conglomerate diversification because a firm already should be familiar with its present customers.

Guidelines for Horizontal Diversification

Four guidelines when horizontal diversification may be an especially effective strategy are:

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

4. **Defensive Strategies**

In addition to integrative, intensive, and diversification strategies, organizations also could pursue retrenchment, divestiture, or liquidation.

A. Retrenchment

Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a turnaround or reorganization strategy, retrenchment is designed to fortify an organization's basic distinctive competence. During retrenchment, strategists work with limited resources and face pressure from shareholders, employees, and the media. Retrenchment can entail selling off land and buildings to raise needed cash, pruning product lines, closing marginal businesses, closing obsolete factories, automating processes, reducing the number of employees, and instituting expense control systems.

Guidelines for Retrenchment

Four guidelines when retrenchment may be an especially effective strategy to pursue are as follows:

- Firm has failed to meet its objectives and goals consistently over time but has distinctive competencies
- Firm is one of the weaker competitors
- Inefficiency, low profitability, poor employee morale and pressure from stockholders to improve performance.
- when an organization’s strategic managers have failed

B. Divestiture

Selling a division or part of an organization is called *divestiture*. Divestiture often is used to raise capital for further strategic acquisitions or investments. Divestiture can be part of an overall retrenchment strategy to rid an organization of businesses that are unprofitable, that require too much capital, or that do not fit well with the firm's other activities.

Divestiture has become a very popular strategy as firms try to focus on their core strengths, lessening their level of diversification.

Guidelines for Divestiture

Five guidelines when divestiture may be an especially effective strategy to pursue are listed below:

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

C. Liquidation

Selling all of a company's assets, in parts, for their tangible worth is called *liquidation.* Liquidation is recognition of defeat and, consequently, can be an emotionally difficult strategy. However, it may be better to cease operating than to continue losing large sums of money.

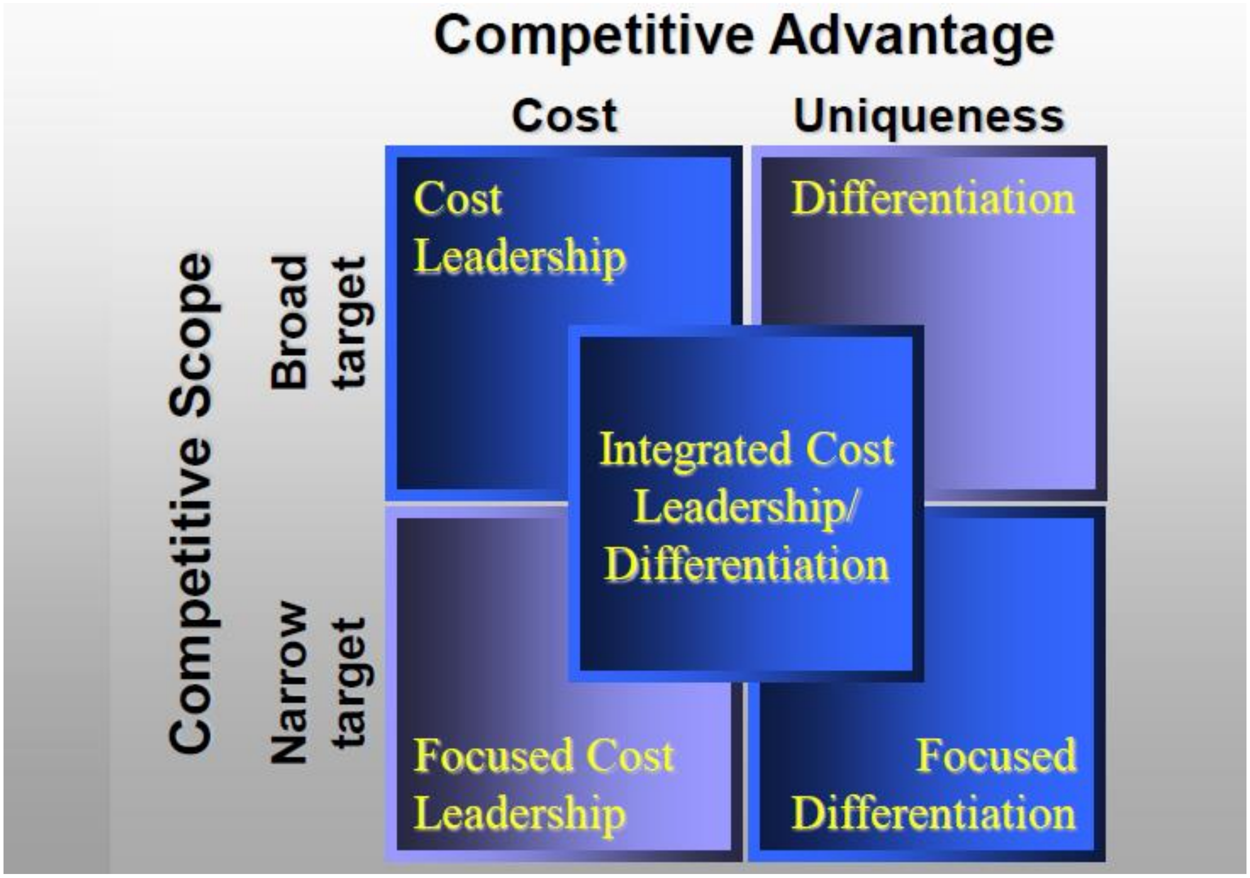
Guidelines for Liquidation

Three guidelines when liquidation may be an especially effective strategy to pursue are:

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

2.2 Michael Porter's generic strategies

Companies pursue a business-level strategy to gain a competitive advantage that enables them to outperform rivals and achieve above-average returns. They can choose from three basic generic competitive approaches—cost leadership, differentiation, and focus—although, as we will see, these can be combined in different ways. These strategies are called *generic* because all businesses or industries can pursue them, regardless of whether they are manufacturing, service, or nonprofit enterprises. Each of the generic strategies results from a company's making consistent choices on product, market, and distinctive competences—choices that reinforce each other.



Cost Leadership Strategy

A company's goal in pursuing a cost-leadership strategy is to outperform competitors by doing everything the company can to produce goods or services at a cost lower than those of competitors. An integrated set of actions designed to produce or deliver goods or services at the lowest cost, relative to competitors with features that are acceptable to customers.

- Relatively standardized products
- features acceptable to many customers
- lowest competitive price

Cost saving actions required by this strategy

- ✓ Building efficient scale facilities ,
- ✓ Tightly controlling production costs and overhead,
- ✓ Minimizing costs of sales, R&D and service,
- ✓ building efficient manufacturing facilities,
- ✓ monitoring costs of activities provided by outsiders
- ✓ simplifying production processes

Risks of Cost Leadership Strategy

- ✓ Processes used by the cost leader to produce and distribute its good or service could become obsolete because of competitors' innovations
- ✓ Too much focus by the cost leader on cost reductions may occur at the expense of trying to understand customers' perceptions of "competitive levels of differentiation
- ✓ Competitors may learn how to successfully imitate the cost leader's strategy

Differentiation Strategy

The objective of the generic **differentiation strategy** is to achieve a competitive advantage by creating a product that is perceived by customers to be *unique* in some important way. The differentiated product's ability to satisfy a customer's need in a way that its competitors cannot means that the company can charge a *premium price*—a price considerably above the industry average.

An integrated set of actions designed by a firm to produce or deliver goods or services (at an acceptable cost) that customers perceive as being different in ways that are important to them

- Price for product can exceed what the firm's target customers are willing to pay
- Non standardized products
- customers value differentiated features more than they value low cost
- Value provided by unique features and value characteristics
- Command premium price
- High customer service
- Superior quality
- Prestige or exclusivity
- Rapid innovation

Differentiation actions required by this strategy:

- developing new systems and processes
- shaping perceptions through advertising
- quality focus
- capability in R&D
- maximize human resource contributions through low turnover and high motivation

Major Risks of Differentiation Strategy

- Experience may narrow customer's perceptions of the value of differentiated features of the firm's products
- Makers of counterfeit goods may attempt to replicate differentiated features of the firm's products

Focused Strategies

In this strategy the firm concentrates on a select few target markets. It is also called niche strategy. It is hoped that by focusing your marketing efforts on one or two narrow market segments and tailoring your marketing mix to these specialized markets, you can better meet the needs of that target market. The firm typically looks to gain a competitive advantage through effectiveness rather than efficiency. It is most suitable for relatively small firms but can be used by any company. As a focus strategy it may be used to select targets that are less vulnerable to substitutes or where a competition is weakest to earn above-average return on investments.

A focus strategy must exploit a narrow target's differences from the balance of the industry by:

- isolating a particular buyer group
- isolating a unique segment of a product line
- concentrating on a particular geographic market
- finding their "niche"

Major Risks of Focused Strategies

- Firm may be "out focused" by competitors
- Large competitor may set its sights on your niche market
- Preferences of niche market may change to match those of broad market

Integrated Strategy

A firm that successfully uses an integrated cost leadership/differentiation strategy should be in a better position to:

- adapt quickly to environmental changes
- learn new skills and technologies more quickly
- effectively leverage its core competencies while competing against its rivals

Benefits of Integrated Strategy

- Successful firms using this strategy have above-average returns
    - Firm offers two types of values to customers some differentiated features (but less than a true differentiated firm)
    - relatively low cost (but now as low as the cost leader's price

Major Risks of Integrated Strategy

- An integrated cost/differentiation business level strategy often involves compromises (neither the lowest cost nor the most differentiated firm)

- The firm may become "stuck in the middle" lacking the strong commitment and expertise that accompanies firms following either a cost leadership or a differentiated strategy