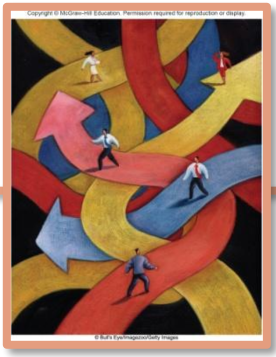
CHAPTER 6

STRENGTHENING A COMPANY'S COMPETITIVE POSITION:

STRATEGIC MOVES, TIMING, AND SCOPE OF OPERATIONS

Learning Objectives



THIS CHAPTER WILL HELP YOU UNDERSTAND:

LO 1 Whether and when to pursue offensive or defensive strategic moves to improve a company's market position.

LO 2 When being a first mover or a fast follower or a late mover is most advantageous.

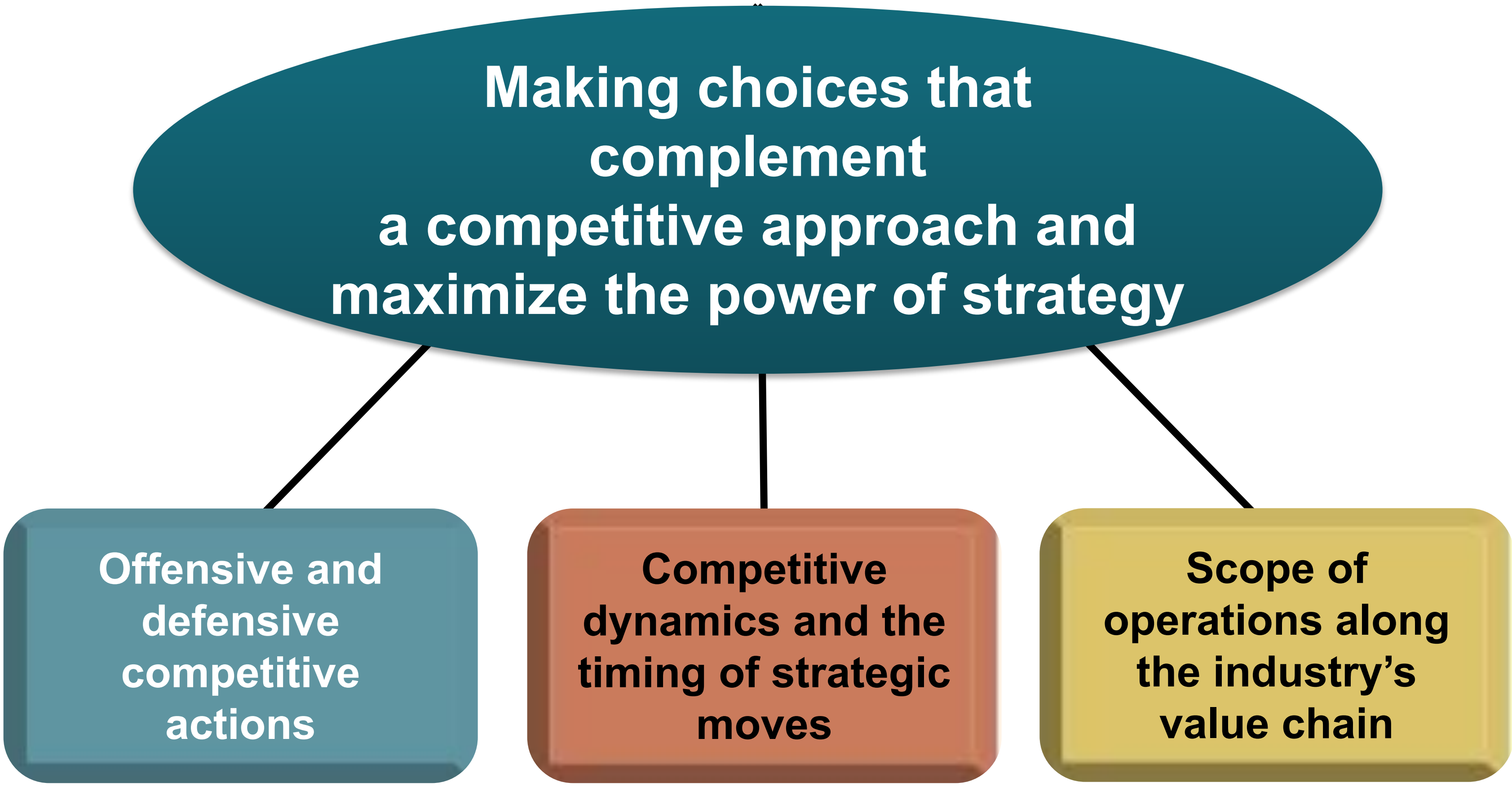
LO 3 The strategic benefits and risks of expanding a company's horizontal scope through mergers and acquisitions.

LO 4 The advantages and disadvantages of extending the company's scope of operations via vertical integration.

LO 5 The conditions that favor outsourcing certain value chain activities to outside parties.

LO 6 When and how strategic alliances can substitute for horizontal mergers and acquisitions or vertical integration and how they can facilitate outsourcing.

MAXIMIZING THE POWER OF A STRATEGY



CONSIDERING STRATEGY-ENHANCING MEASURES

- Whether and when to go on the offensive strategically.
- Whether and when to employ defensive strategies.
- When to undertake strategic moves—first mover, a fast follower, or a late mover.
- Whether to merge with or acquire another firm.
- Whether to integrate backward or forward into more stages of the industry's activity chain.
- Which value chain activities, if any, should be outsourced.
- Whether to enter into strategic alliances or partnership arrangements.

LAUNCHING STRATEGIC OFFENSIVES TO IMPROVE A COMPANY'S MARKET POSITION

- Strategic Offensive Principles:
  - Focusing relentlessly on building competitive advantage and then striving to convert it into sustainable advantage.
  - Applying resources where rivals are least able to defend themselves.
  - Employing the element of surprise as opposed to doing what rivals expect and are prepared for.
  - Displaying a capacity for swift, decisive, and overwhelming actions to overpower rivals.

STRATEGIC MANAGEMENT PRINCIPLE

- Sometimes a company's best strategic option is to seize the initiative, go on the attack, and launch a strategic offensive to improve its market position.

CHOOSING THE BASIS FOR COMPETITIVE ATTACK

- Avoid directly challenging a targeted competitor where it is strongest.
- Use the firm’s strongest strategic assets to attack a competitor’s weaknesses.
- The offensive may not yield immediate results if market rivals are strong competitors.
- Be prepared for the threatened competitor’s counter-response.

STRATEGIC MANAGEMENT PRINCIPLE

- The best offensives use a company’s most powerful resources and capabilities to attack rivals in the areas where they are weakest.

PRINCIPAL OFFENSIVE STRATEGY OPTIONS

1. Offer an equally good or better product at a lower price.
2. Leapfrog competitors by being first to market with next-generation products.
3. Pursue continuous product innovation to draw sales and market share away from less innovative rivals.
4. Pursue disruptive product innovations to create new markets.
5. Adopt and improve on the good ideas of other companies (rivals or otherwise).
6. Use hit-and-run or guerrilla marketing tactics to grab market share from complacent or distracted rivals.
7. Launch a preemptive strike to secure an industry's limited resources or capture a rare opportunity

CHOOSING WHICH RIVALS TO ATTACK

Best Targets for Offensive Attacks

- Market leaders that are in vulnerable competitive positions
- Runner-up firms with weaknesses in areas where the challenger is strong
- Struggling enterprises on the verge of going under
- Small local and regional firms with limited capabilities

BLUE-OCEAN STRATEGY— A SPECIAL KIND OF OFFENSIVE

- The business universe is divided into:
  - An existing market with boundaries and rules in which rival firms compete for advantage.
  - A “blue ocean” market space, where the industry has not yet taken shape, with no rivals and wide-open long-term growth and profit potential for a firm that can create demand for new types of products.

ILLUSTRATION CAPSULE 6.1

Gilt Groupe's Blue-Ocean Strategy in the U.S. Flash Sale Industry

- Given the rapidity with which most first-mover advantages based on Internet technologies can be overcome, what would have led Gilt Groupe to expect to build a sustainable competitive advantage based on its initial business model?
- Is Gilt Groupe a "one-trick pony" business that the ephemeral nature of a first-mover advantage strategy tends to favor?
- How critical is timing to first-mover advantage?

CORE CONCEPT

- A **blue-ocean strategy** offers growth in revenues and profits by discovering or inventing new industry segments that create altogether new demand.

STRATEGIC MANAGEMENT PRINCIPLE

- Good defensive strategies can help protect a competitive advantage but rarely are the basis for creating one.

DEFENSIVE STRATEGIES—PROTECTING MARKET POSITION AND COMPETITIVE ADVANTAGE

Purposes of Defensive Strategies

- Lower the firm's risk of being attacked
- Weaken the impact of an attack that does occur
- Influence challengers to aim their efforts at other rivals

STRATEGIC MANAGEMENT PRINCIPLE

- There are many ways to throw obstacles in the path of would-be challengers.

BLOCKING THE AVENUES OPEN TO CHALLENGERS

- Adopt alternative technologies as a hedge against rivals attacking with a new or better technology.
- Introduce new features and models to broaden product lines to close gaps and vacant niches.
- Maintain economy-pricing to thwart lower price attacks.
- Discourage buyers from trying competitors' brands.
- Make early announcements about new products or price changes to induce buyers to postpone switching.
- Challenge quality and safety of competitor's products.
- Grant discounts or better terms to intermediaries who handle the firm's product line exclusively.

SIGNALING CHALLENGERS THAT RETALIATION IS LIKELY

- Signaling is an effective defensive strategy when the firm follows through by:
  - Publicly announcing its commitment to maintaining the firm’s present market share.
  - Publicly committing to a policy of matching competitors’ terms or prices.
  - Maintaining a war chest of cash and marketable securities.
  - Making a strong counter-response to the moves of weaker rivals to enhance its tough defender image.

STRATEGIC MANAGEMENT PRINCIPLE

- To be an effective defensive strategy, signaling needs to be accompanied by a *credible commitment* to follow through.

CORE CONCEPT

- Because of **first-mover advantages and disadvantages**, competitive advantage can spring from *when* a move is made as well as from *what* move is made.

TIMING A FIRM'S OFFENSIVE AND DEFENSIVE STRATEGIC MOVES

- Timing's Importance:
  - Knowing when to make a strategic move is as crucial as knowing what move to make.
  - Moving first is no guarantee of success or competitive advantage.
  - The risks of moving first to stake out a monopoly position must be carefully weighed.

CONDITIONS THAT LEAD TO FIRST-MOVER ADVANTAGES

1. When pioneering helps build a firm’s reputation and creates strong brand loyalty.
2. When a first mover’s customers will thereafter face significant switching costs.
3. When property rights protections thwart rapid imitation of the initial move.
4. When an early lead enables movement down the learning curve ahead of rivals.
5. When a first mover can set the technical standard for the industry.

ILLUSTRATION CAPSULE 6.2 Amazon.com's First-Mover Advantage in Online Retailing

- Which first-mover advantages did Jeff Bezos have in starting Amazon.com?
- What first-mover disadvantages did Bezos have to watch for after starting Amazon.com?
- Why was the learning curve so steep for Amazon.com?
- When do you predict that Amazon will become profitable?

THE POTENTIAL FOR LATE-MOVER ADVANTAGES OR FIRST-MOVER DISADVANTAGES

- When pioneering is more costly than imitating and offers negligible experience or learning-curve benefits.
- When the products of an innovator are somewhat primitive and do not live up to buyer expectations.
- When rapid market evolution allows fast followers to leapfrog a first mover’s products with more attractive next-version products.
- When market uncertainties make it difficult to ascertain what will eventually succeed.
- When customer loyalty is low and first mover’s skills, know-how, and actions are easily copied or surpassed

TO BE A FIRST MOVER OR NOT

- Does market takeoff depend on complementary products or services that currently are not available?
- Is new infrastructure required before buyer demand can surge?
- Will buyers need to learn new skills or adopt new behaviors?
- Will buyers encounter high switching costs in moving to the newly introduced product or service?
- Are there influential competitors in a position to delay or derail the efforts of a first mover?

STRENGTHENING A FIRM'S MARKET POSITION VIA ITS SCOPE OF OPERATIONS

Defining the Scope of the Firm's Operations

- Range of its activities performed internally
- Breadth of its product and service offerings
- Extent of its geographic market presence and its mix of businesses
- Size of its competitive footprint on its market or industry

CORE CONCEPT

- The scope of the firm refers to the range of activities that the firm performs internally, the breadth of its product and service offerings, the extent of its geographic market presence, and its mix of businesses.

CORE CONCEPTS

- **Horizontal scope** is the range of product and service segments that a firm serves within its focal market.
- **Vertical scope** is the extent to which a firm's internal activities encompass one, some, many, or all of the activities that make up an industry's entire value chain system, ranging from raw-material production to final sales and service activities.

HORIZONTAL MERGER AND ACQUISITION STRATEGIES

- Merger
  - Is the combining of two or more firms into a single corporate entity that often takes on a new name.
- Acquisition
  - Is a combination in which one firm, the acquirer, purchases and absorbs the operations of another firm, the acquired.

STRATEGIC OJECTIVES FOR HORIZONTAL MERGERS AND ACQUISITIONS

1. Creating a more cost-efficient operation out of the combined companies.
2. Expanding the firm's geographic coverage.
3. Extending the firm's business into new product categories.
4. Gaining quick access to new technologies or other resources and capabilities.
5. Leading the convergence of industries whose boundaries are being blurred by changing technologies and new market opportunities.

BENEFITS OF INCREASING HORIZONTAL SCOPE

- Increasing a firm's horizontal scope strengthens its business and increases its profitability by:
  - Improving the efficiency of its operations
  - Heightening its product differentiation
  - Reducing market rivalry
  - Increasing the firm's bargaining power over suppliers and buyers
  - Enhancing its flexibility and dynamic capabilities

ILLUSTRATION CAPSULE 6.3

Bristol-Myers Squibb's "String-of-Pearls" Horizontal Acquisition Strategy

- Which strategic outcomes did Bristol-Myers Squibb pursue through its "string-of-pearls" acquisition strategy?
- Why did Bristol-Myers Squibb choose to pursue a acquisition strategy that was different from its industry competitors?
- How did increasing the horizontal scope of Bristol-Myers Squibb through acquisitions strengthen its competitive position and profitability?

WHY MERGERS AND ACQUISITIONS SOMETIMES FAIL TO PRODUCE ANTICIPATED RESULTS

- Strategic Issues:
  - Cost savings may prove smaller than expected.
  - Gains in competitive capabilities take longer to realize or never materialize at all.
- Organizational Issues
  - Cultures, operating systems and management styles fail to mesh due to resistance to change from organization members.
  - Loss of key employees at the acquired firm.
  - Managers overseeing integration make mistakes in melding the acquired firm into their own.

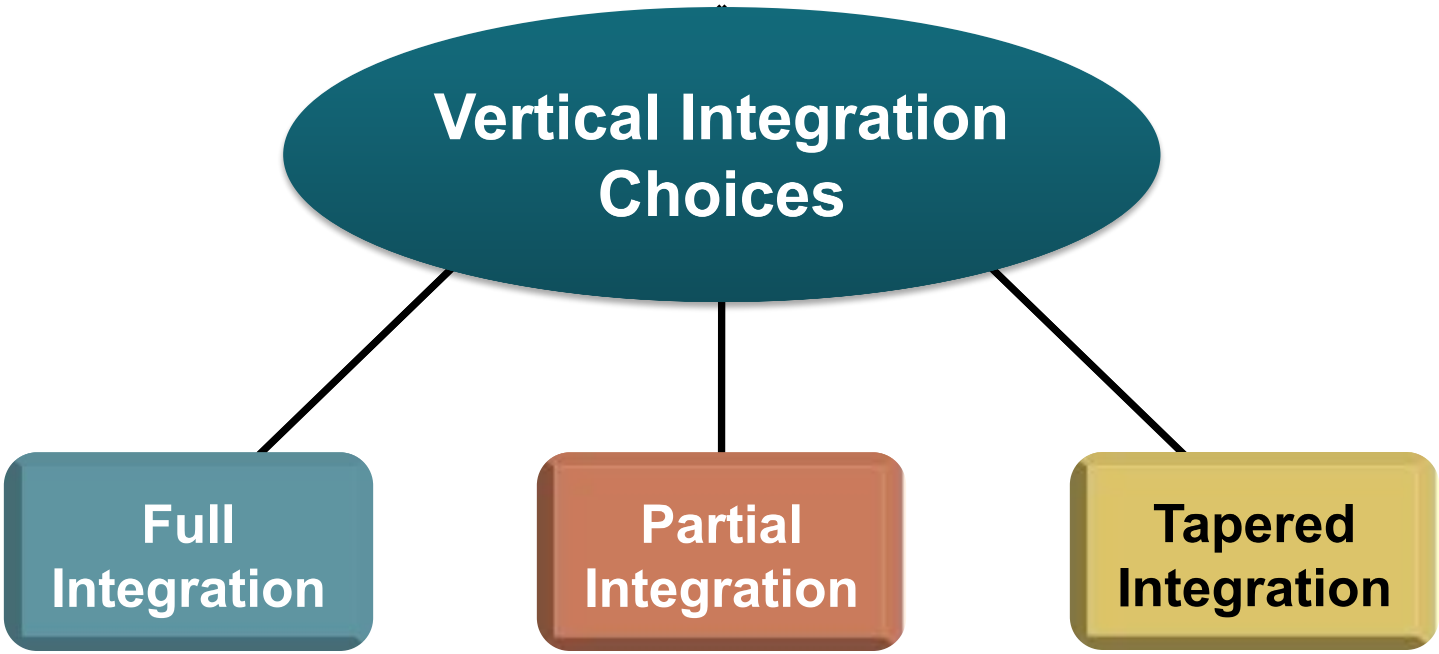
CORE CONCEPT

- A **vertically integrated firm** is one that performs value chain activities along more than one stage of an industry's value chain system.

VERTICAL INTEGRATION STRATEGIES

- Vertically Integrated Firm
  - Is one that participates in multiple segments or stages of an industry's overall value chain.
- Vertical Integration Strategy
  - Can expand the firm's range of activities backward into its sources of supply and/or forward toward end users of its products.

TYPES OF VERTICAL INTEGRATION STRATEGIES



TYPES OF VERTICAL INTEGRATION STRATEGIES

- Full Integration
  - A firm participates in all stages of the vertical activity chain.
- Partial Integration
  - A firm builds positions only in selected stages of the vertical chain.
- Tapered Integration
  - Involves a mix of in-house and outsourced activity in any stage of the vertical chain.

THE ADVANTAGES OF A VERTICAL INTEGRATION STRATEGY

Benefits of a Vertical Integration Strategy

- Add materially to a firm's technological capabilities
- Strengthen the firm's competitive position
- Boost the firm's profitability

CORE CONCEPTS

- **Backward integration** involves entry into activities previously performed by suppliers or other enterprises positioned along earlier stages of the industry value chain system
- **Forward integration** involves entry into value chain system activities closer to the end user

INTEGRATING BACKWARD TO ACHIEVE GREATER COMPETITIVENESS

- Integrating Backwards By:
  - Achieving same scale economies as outside suppliers—low-cost based competitive advantage.
  - Matching or beating suppliers' production efficiency with no drop-off in quality—differentiation-based competitive advantage.
- Reasons for Integrating Backwards:
  - Reduction of supplier power
  - Reduction in costs of major inputs
  - Assurance of the supply and flow of critical inputs
  - Protection of proprietary know-how

INTEGRATING FORWARD TO ENHANCE COMPETITIVENESS

- Reasons for Integrating Forward:
  - To lower overall costs by increasing channel activity efficiencies relative to competitors.
  - To increase bargaining power through control of channel activities.
  - To gain better access to end users.
  - To strengthen and reinforce brand awareness.
  - To increase product differentiation.

DISADVANTAGES OF A VERTICAL INTEGRATION STRATEGY

- Increased business risk due to large capital investment.
- Slow acceptance of technological advances or more efficient production methods.
- Less flexibility in accommodating shifting buyer preferences that require non-internally produced parts.
- Internal production levels may not be reach volumes that create economies of scale.
- Efficient production of internally-produced components and parts hampered by capacity matching problems.
- New or different resources and capabilities requirements .

WEIGHING THE PROS AND CONS OF VERTICAL INTEGRATION

- Can vertical integration enhance the performance of strategy-critical activities in ways that lower cost, build expertise, protect proprietary know-how, or increase differentiation?
- What is the impact of vertical integration on investment costs, flexibility and response times?
- What administrative costs are incurred by coordinating operations across more vertical chain activities?
- How difficult it will be for the firm to acquire the set of skills and capabilities needed to operate in another stage of the vertical chain?

ILLUSTRATION CAPSULE 6.4

Kaiser Permanente's Vertical Integration Strategy

- What are the most important strategic benefits that Kaiser Permanente derives from its vertical Integration strategy?
- Over the long term, how could the vertical scope of Kaiser Permanente's operations threaten its competitive position and profitability?
- Why is a vertical integration strategy more appropriate in some industries and not in others?

CORE CONCEPT

- **Outsourcing** involves contracting out certain value chain activities that are normally performed in-house to outside vendors.

OUTSOURCING STRATEGIES: NARROWING THE SCOPE OF OPERATIONS

- Outsource an activity if it:
  - Can be performed better or more cheaply by outside specialists.
  - Is not crucial to achieving sustainable competitive advantage.
  - Improves organizational flexibility and speeds time to market.
  - Reduces risk exposure due to new technology and/or buyer preferences.
  - Allows the firm to concentrate on its core business, leverage key resources, and do even better what it already does best.

THE BIG RISKS OF OUTSOURCING VALUE CHAIN ACTIVITIES

- Hollowing out resources and capabilities that the firm needs to be a master of its own destiny.
- Loss of direct control when monitoring, controlling, and coordinating activities of outside parties by means of contracts and arm's-length transactions.
- Lack of incentives for outside parties to make investments specific to the needs of the outsourcing firm's value chain.

STRATEGIC MANAGEMENT PRINCIPLE

- A company must guard against outsourcing activities that hollow out the resources and capabilities that it needs to be a master of its own destiny.

CORE CONCEPTS

- A **strategic alliance** is a formal agreement between two or more separate companies in which they agree to work cooperatively toward some common objective.
- A **joint venture** is a partnership involving the establishment of an independent corporate entity that the partners own and control jointly, sharing in its revenues and expenses.

FACTORS THAT MAKE AN ALLIANCE "STRATEGIC"

An strategic alliance:

1. Facilitates achievement of an important business objective.
2. Helps build, sustain, or enhance a core competence or competitive advantage.
3. Helps remedy an important resource deficiency or competitive weakness.
4. Helps defend against a competitive threat, or mitigates a significant risk to a company's business.
5. Increases the bargaining power over suppliers or buyers.
6. Helps open up important new market opportunities.
7. Speeds the development of new technologies and/or product innovations.

BENEFITS OF STRATEGIC ALLIANCES AND PARTNERSHIPS

- Minimize the problems associated with vertical integration, outsourcing, and mergers and acquisitions.
- Are useful in extending the scope of operations via international expansion and diversification strategies.
- Reduce the need to be independent and self-sufficient when strengthening the firm’s competitive position.
- Offer greater flexibility should a firm’s resource requirements or goals change over time.
- Are useful when industries are experiencing high-velocity technological advances simultaneously.

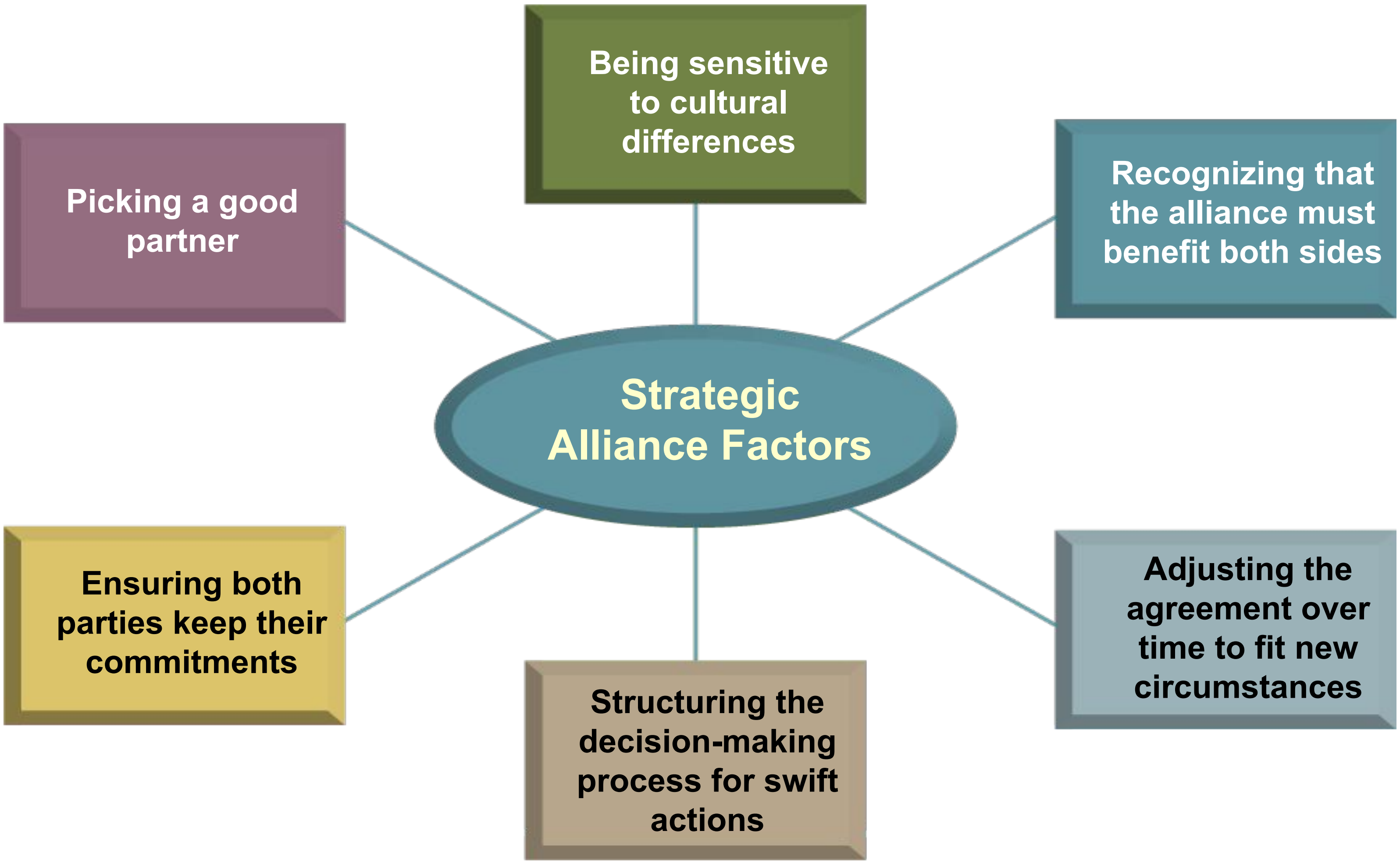
STRATEGIC MANAGEMENT PRINCIPLE

- Companies that have formed a host of alliances need to manage their alliances like a portfolio.

WHY AND HOW STRATEGIC ALLIANCES ARE ADVANTAGEOUS

- Strategic Alliances:
  - Expedite development of promising new technologies or products.
  - Help overcome deficits in technical and manufacturing expertise.
  - Bring together the personnel and expertise needed to create new skill sets and capabilities.
  - Improve supply chain efficiency.
  - Help partners allocate venture risk sharing.
  - Allow firms to gain economies of scale.
  - Provide new market access for partners.

CAPTURING THE BENEFITS OF STRATEGIC ALLIANCES



STRATEGIC MANAGEMENT PRINCIPLE

- The best alliances are highly selective, focusing on particular value chain activities and on obtaining a specific competitive benefit.
- Alliances enable a firm to build on its strengths and to learn.

REASONS FOR ENTERING INTO STRATEGIC ALLIANCES

- When seeking global market leadership:
  - Enter into critical country markets quickly.
  - Gain inside knowledge about unfamiliar markets and cultures through alliances with local partners.
  - Provide access to valuable skills and competencies concentrated in particular geographic locations.
- When staking out a strong industry position:
  - Establish a stronger beachhead in target industry.
  - Master new technologies and build expertise and competencies.
  - Open up broader opportunities in the target industry.

PRINCIPLE ADVANTAGES OF STRATEGIC ALLIANCES

1. They lower investment costs and risks for each partner by facilitating resource pooling and risk sharing.
2. They are more flexible organizational forms and allow for a more adaptive response to changing conditions.
3. They are more rapidly deployed—a critical factor when speed is of the essence.

STRATEGIC ALLIANCES VERSUS OUTSOURCING

- Key Advantages of Strategic Alliances:
  - The increased ability to exercise control over the partners’ activities.
  - A greater commitment and willingness of the partners to make relationship-specific investments as opposed to arm’s-length outsourcing transactions.

ACHIEVING LONG-LASTING STRATEGIC ALLIANCE RELATIONSHIPS

Factors Influencing the Longevity of Alliances

- Collaborating with partners that do not compete directly
- Establishing a permanent trusting relationship
- Continuing to collaborate is in the parties' mutual interest

THE DRAWBACKS OF STRATEGIC ALLIANCES AND PARTNERSHIPS

- Culture clash and integration problems due to different management styles and business practices.
- Anticipated gains do not materialize due to an overly optimistic view of the potential for synergies or the unforeseen poor fit of partners' resources and capabilities.
- Risk of becoming dependent on partner firms for essential expertise and capabilities.
- Protection of proprietary technologies, knowledge bases, or trade secrets from partners who are rivals.

HOW TO MAKE STRATEGIC ALLIANCES WORK

- Create a system for managing the alliance.
- Build trusting relationships with partners.
- Set up safeguards to protect from the threat of opportunism by partners.
- Make commitments to partners and see that partners do the same.
- Make learning a routine part of the management process.