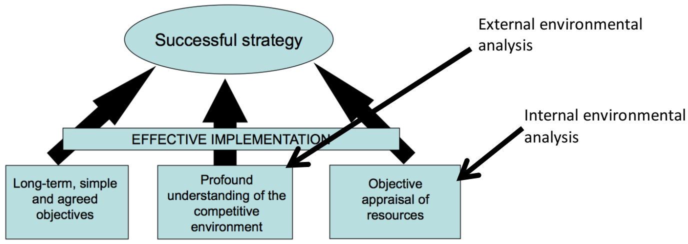
MODULE TWO: STRATEGY AND GLOBAL STRATEGY

⇒ What is strategy? What is global strategy? What are the fundamental issues in strategy?
⇒ How can we account for the competitive advantage of firms?
⇒ What are the three perspectives in strategy explaining the behaviour of firms and sources of competitive advantage of firms?

What is strategy?

1. From military strategy to strategic management/ business competition
2. Strategy as action – operational strategy
3. Strategy of theory (mixture of 1 and 2)
   - Integration of action and planning
   - Requiring replication (planning) and experimentation (action)



What makes successful strategy?

1. Long term, simple and agreed objectives
2. Profound understanding of the competitive environment
3. Objective appraisal (unbiased judgement) of resources

- *The basic framework strategy*: the link between the firm and its environment:
  - Strategy is the link/bridge between internal (firm) and external (environment). A good strategy must be a <u>fit</u> within/between the two → a good strategy is based on its <u>ability to fit</u> the dynamic environment
  - The firm: goals and values, resources and capabilities, structure and systems.
  - The industry environment: competitors, customers and suppliers.

- Strategic misfit and strategic failure:
  - **Case Study -** Misfit with *external* environment: why all Japanese brands have disappeared in the mobile phone industry in China and Motorola as an early-mover is struggling? Why Nokia is dead?
    - Their strategies cannot fit/failed to adapt to external environment → copy and paste strategy failed.
    - They were too slow to adapt and learn about the external changing environment and therefore failed to adapt to shift in consumer behaviour/needs: from traditional use (phone call) to new use (search/application engine).
    - Mobile phone technology itself was mature such as speed storage, function etc → however the external Dynamics that they failed to address was:
      - Dynamic nature of consumer behaviour
      - Market competition
      - Branding, marketing and relationship with the customer
    - They needed to focus on integration and application on an external platform but instead they failed.
    - Operational system needed to be upgraded/transformed → needed to be fast and flexible, not slow and rigid.

  - **Case Study -** Misfit with *internal* environment: Why Hyundai's ambitious plan to enter luxury automobile segment (e.g. compete with BMW) is questionable and dangerous?
    - A change in market segment focus is a problem for branding and customer perception.
    - Doubts about this move → internal assets (resources capabilities) that support Hyundai now may not support move into luxury vehicle. Can branding be transformed? Can mass-market successes be applied or do new strategies need to be created?
    - New strategy must be founded on what you already have (internal fit). Strategic misfit may lead to failure.

Evolution of Strategic Management:

The 3 main changes:

1. Changing concept of strategy
2. Changing processes of strategy formulation
3. New tools of strategy analysis

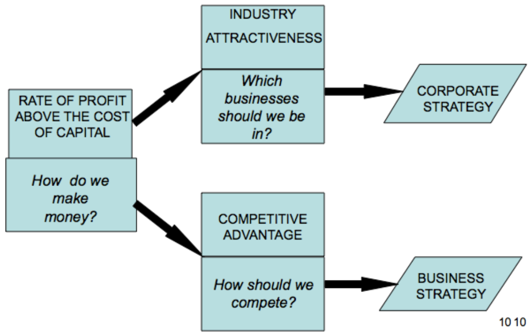
History:

- **1950s =** financial planning/ budgeting: operational budgeting, capital budgeting (the wonders of DCF).
- **1960s** and early **1970s** = corporate planning: corporate plans based on 5-10year economic forecasts, diversification.
- Late **1970s** and **1980s** = strategic management: industry analysis, competitive positioning, strategic priorities (locating in attractive industries and establishing market leadership).
- **1990s**, early **2000s** up to **now** = quest for shareholders (refocusing, outsourcing), quest for competitive advantage (emphasis on resources and capabilities, flexibility and innovation, collaboration with alliances, networks and succeeding in dynamic markets).

What is strategy?

- Distinguishing strategy from tactics:
  - Strategy is the overall plan for developing resources to establish a favourable position.
  - Tactic is a scheme for a specific manoeuvre.
- Characteristics of strategic decisions:
  - Involve a significant commitment of resources.
  - Not easily reversible.

Sources of superior profitability: functional strategy is the fourth strategy not included across →



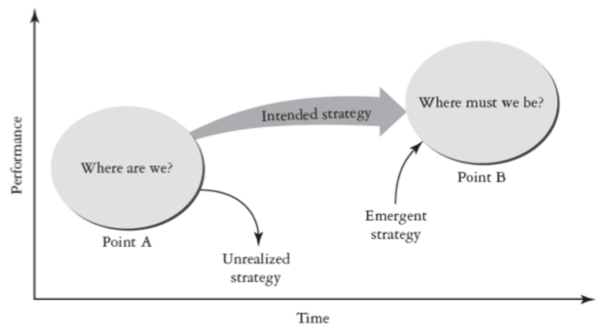
Describing the essence of strategy: competing for the present, preparing for the future.

- Static → competing for the present:
  - Where are we competing? Product market scope, geographical scope and vertical scope.
  - How are we competing? What is the basis of our competitive advantage?
- Dynamic → preparing for the future:
  - What do we want to become? Vision statement.
  - What do we want to achieve? Mission statement, performance goals.
  - How will we get there? Guidelines for development, priorities for capital expenditure (R&D), growth modes (organic growth, M&A, alliances).

Need to compete for present and prepare for future

The Essence of Strategy

- **Case Study – Microsoft Windows Smart Phone**
- Where are we → Have clear understanding of where you are in relation to industry, competitors, customers and technology
- Where do we want to go → do you still want to remain in smartphone business and if so, how can we win market share? If not, then which segment do we want to enter and how can win the competition with the current resources we have? What is our core competencies and how can we leverage them?



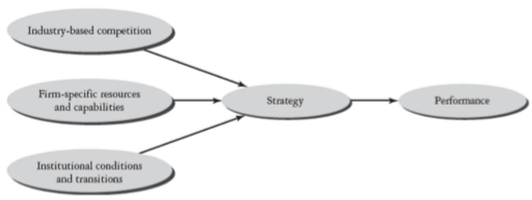
- How can we get to where we <u>intend</u> to go → intended strategy
- Unrealized strategy →strategies that do not fit the market
- Emergent strategy → any factor that may emerge and need to incorporate into existing strategy

Dynamically modify essence of strategy to get to point B → How do we get from where we are (unrealized strategy) to where we want to be (emergent strategy)?

Four fundamental issues in strategy → "DIBS"

1. Why do firms differ? → Purposes of strategy is to explain differences and understand them

2. How do firms behave? Largely to do with maximising opportunities and minimising threats



3. What determines the scope of the firm? → associated with degree of integration and relative bargaining power.
    - Industry scope (diversify into different industries or focus on small boundary)
    - Vertical integration/activities scope (what activities to internalise or outsource?)
    - Geographical scope (expand outside country boundary?)
4. What determines the international success or failure of firms?
    a. Acquiring and leveraging competitive advantage
        i. The key is sustaining such an advantage over time and across countries through replication and innovation

Three theoretical perspectives in strategy

a. Adaptation (adapting to the local environment), Aggregation (producing a standardised product) and Arbitrary (take advantage of the differences around the world to make profit, by lowering cost and/or increasing revenues).

INDUSTRY BASED VIEW OF STRATEGY – and the IO Model

Industry Competition and the Industrial Organisation (IO) model

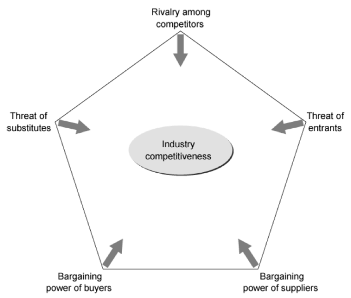
Structure-Conduct-Performance (SCP) Model is the primary contributor to the IO model:

- Structure – structural attributes of an industry
- Conduct – the firm's actions
- Performance – the result of the firm's conduct in response to industry structure

M,E. Porter → *Using Porter's Five Forces to evaluate industry competition*

- KEY PROPOSITION: The focal firm performance critically depends on the degree of competitiveness of the five forces within the industry → the stronger and more competitive these forces are, the less likely the focal firm is able to earn above average return
- Five forces model predicts that the structure of industry will determine strategy which will determine performance
- The Five Forces Model → translated from SCP Model by M Porter in 1980
- Although firms benefit from a favourable Five Forces environment in their industry, they are not simply passive recipients of those competitive forces.
    - Firms can use the Five Forces Model to evaluate what new industries to enter.
    - Firms can also use the Five Forces Model to compete more effectively within their industry.
- Industry Organisation Strategy (IO Strategy) tends to overemphasize threats and downplay opportunities

Threats indicative of strong competition (that can depress industry profitability)



⇒ Rivalry among competitors
- A large **number of competing firms**
- **Rivals** are similar in **size, influence and product offerings**
- High **price**, low **frequency purchases** → products are big ticket items and purchased infrequently
- **Capacity** is added in large increments
- High cost competitive actions and reactions → game theory
- Industry slow **growth** or decline
- High **exit costs** – as cost to exit in industries requiring highly specialised material, firms are unlikely to exit until absolutely necessary
- E.g Convergence of competitors in smartphone business has largely decreased the profitability of apple.
- Example: members of perfect competition industry and game theory → competitive dynamics → strategy of P&G will influence the strategies of all other competitors in the same industry

⇒ Threat of potential entry will exist if the following sources of entry barriers are weak:
- Little **scale based low cost advantages** (economies of scale: cost advantages per unit as production and efficiency accumulates)
- Little **non scale based low cost advantages**
- **Brand Equity/loyalty** is a culture capital and symbol therefore acting as entry barrier – intangible factors discouraging new entrants
- **Product Proliferation** → a strategy used to threaten potential entrants
- Insufficient **product differentiation**
- Little fear of **retaliation**
- No **government policy** banning or discouraging entry

- Innovation/ entrepreneurship – companies with this will move them ahead of competitors
- Substantial switching costs → if cost to substitute product is high, entrance threat lowers

⇒ <u>Bargaining power of suppliers</u>
- Small **number of suppliers**
- Suppliers provide **unique, differentiated products** → The extent of suppliers product differentiation will determine their amount of bargaining power
- Focal firm is not an important customer of suppliers
- Suppliers are willing and able to **vertically integrate forwards** (a form of vertical integration which involves the supplier taking direct control of the distribution of products)

⇒ Bargaining power of buyers
- Small **number of buyers**
- Products provide little **cost savings or quality of life enhancement**
- Buyers purchase **standard, undifferentiated** products from focal firm
- Buyers have **economic difficulties** → transfer back to firm as customers become aggressive and therefore attain strong bargaining power
- Buyers are willing and able to **integrate backwards** → backwards intergration involves taking control of a firms own inputs e.g woolworths creating their own brand and becoming their own supplier or COSTCO directly competing with their suppliers (such as P&G) by creating their own store-brand products such as

⇒ Threat of substitutes
- Substitutes superior to **existing products in quality and function**
- **Switching costs to** use substitutes are low

- Lessons from the Five Forces Framework
  - Δ Not all industries are equal in terms of potential profitability
  - Δ Strategists must assess opportunities and threats underlying each competitive force affecting an industry – and then estimate the likely profit potential of the industry
  - Δ Key – stake out a position that is less vulnerable to attack from head to head opponents, whether established or new, and less vulnerable to erosion from the direction of buyer, suppliers and substitutes
- Five Forces Model and firm strategy: firms are not passive recipients of competitive forces, firms can use model to evaluate what new industries to enter and to compete more effectively.

Generic strategies: Cost leadership, Differentiation, Focus

	Explanation	**Advantages**	**Disadvantages**
Cost leadership	• EDLP – Every Day Low Price • Centres on low costs and prices • A high volume, low margin approach • Firms undertaking this strategy are very innovative on the production process side of business	Cost leader can successfully minimise threats from five forces Many companies attempt with few successes	Danger of being outcompeted on costs: • Forces cost leader to continuously search for ways to reduce cost • **Continuous** attempt to lower cost means cost leader may make trade offs that compromise the value customers perceive in its products or services and hurt sales
Differentiation	• Strategically focusing on how to deliver products that are valuable or different • A low volume, high margin approach • Targets a small, well defined customer segment willing to pay premium prices • R&D and marketing/sales are important functional areas • The less a differentiator resembles its rivals, the more protected the products are		1.Difficulty sustaining the basis of differentiation in the long run • Customers may decide that the price differential between differentiator and cost leader is not worth paying for • Differentiation has to confront relentless efforts of competitive imitation → rapid diffusion of operational efficiency and competitive convergence 2. As the overall quality of the industry increase, brand loyalty to differentiators may decline
Focus Strategy	• Serves the needs of a particular segment or <u>niche</u> of an industry, such as geographical market, type of		

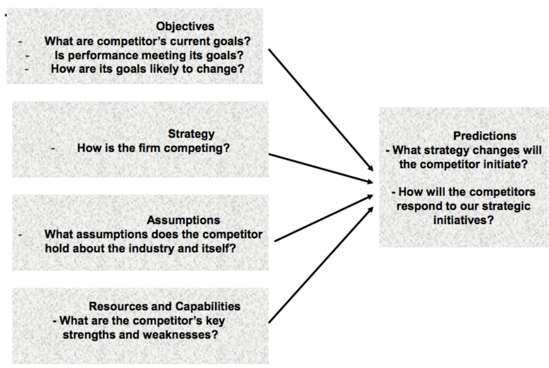
	customer, or product line 1. Focus + Differentiation = Specialised differentiator → smaller, narrower and sharper focus than a large differentiator 2. Focus + Cost = Specialised cost leader → narrower segment compared with the traditional cost leader • Focusing may be successful when a firm possesses intimate knowledge about a particular segment → maintain relationship with target customers	

→ They key is to choose one dimension (cost or differentiation) and execute on it consistently. Companies drifting in the middle of the two either have no strategy or are drifting strategically.

	PRODUCT DIFFERENTIATION	MARKET SEGMENTATION	KEY FUNCTIONAL AREAS
COST LEADERSHIP	Low (mainly by price)	Low (mass market)	Manufacturing, and materials management
DIFFERENTIATION	High (mainly by uniqueness)	High (many market segments)	Research and development, marketing and sales
FOCUS	Low (mainly by price) or high (mainly by uniqueness)	Low (one or a few segments)	Any kind of functional area

Strategic Group Analysis

- **Strategic group** = the group of firms in an industry following the same or a similar strategy along the strategic dimensions
- **Strategic dimension** = variables that best distinguish business strategies and competitor positioning of the firms within an industry
- **Groups:**
    - Mass market → Chrysler, Ford, GM, Honda, Hyundai, Nissan, Toyota
    - Luxury → Audi, BMW, Mercedes, Lexus, Porsche,
    - Ultra luxury → Bentley, Ferrari, Lamborghini
    - New group: Cost Innovation → low cost but higher quality
- Implications of strategic group analysis for strategy
    - Competition mainly forms members of the same strategic group
    - Performance difference persists across different groups
    - Mobility barriers lead to the persistent difference
    - Help understand the competitive responses by different firms within an industry
    - Potential migration from one group to another
    - Industry structure and strategy group evolve
    - Sub group and segment analysis useful



Competitor Analysis

- Objectives: → **"CEPT"**
    - Competitor's current goals
        - Is performance meeting goals
        - How are the goals likely to change?
    - Strategy
        - How is the firm competing?
    - Assumptions
        - What assumptions does the competitor hold about the industry? Will it Evolve/ transformation?? → this will determine the speculative potential of an industry shaping entry
    - Resource and capabilities
        - What are the competitor's key strengths and weaknesses → SWOT
- These four factors should lead to **predictions**
    → What strategy changes will the competitor initiate? → game theory to understand key players and base your reactions on their moves
    → How will the competitors respond to our strategic initiative?

- Red Ocean (market competing strategic moves) → margins are shrinking, competition increasing → acceptance of already existing strategy → assumption that success = most differentiated or cost efficient