

## Chapter Fourteen: Strategic Management

### Mini Case 14(i): The industry structure of petrol retailing

#### Discussion points

#### **Are oligopolistic industry structures good for the consumer?**

It could be argued that in some industries, such as defence and nuclear power, that the dominance of a few firms may actually be beneficial to the consumer, as very few firms are likely to have the capital, know-how, and expertise to deliver quality outputs. Nevertheless, an oligopolistic structure necessarily vests economic power in the hands of the few with the potential for exploiting it in the form of higher prices. Whilst it is illegal to formally agree price structures, firms who are part of an oligopoly have subtle ways of sending economic signals to each other to maintain high and stable prices. Consumers lose out due to the lack of competition which would drive down prices, increase choice and spread economic wealth.

In the petrol retailing industry the emergence of supermarkets as petrol retailers broke up the existing oligopolistic structure, although it is clear that BP, Shell, and ESSO still dominate the forecourts.

#### **Should government intervene to ensure minimum levels of competition exists within industry?**

Various governments do intervene in the market to ensure minimum levels of competition. In the UK, the Competition Commission is an independent body

set up by government to investigate the effects on competition of proposed mergers and acquisitions. In the USA, the Anti-Trust laws are stringent in ensuring that excessive domination of an industry by one company is avoided. For example, Microsoft was forced to break up part of its software development business to allow for more competition.

There is a strong case for governments to intervene when one company starts to dominate an industry. Excessive power can lead to exploitation through higher prices, low levels of governance, political lobbying power, and lack of innovation. News International provides an example of excessive power being vested in one organization with their dominance of the media industry in the UK. This raised questions of pluralism whereby the broadest range of views and perspectives are allowed to be aired in a free and democratic media. If one firm dominates then the political and social views expressed in the editorial may only reflect one perspective. In the case of News International, it has been seen that excessive power also led to poor internal governance and ethics, arguably leading to the so-called 'phone hacking scandal'.

### **Questions and tasks**

#### **Describe what strategy is.**

Strategy is the determination of long-term aims and objectives of an organization and the plan of action to achieve them. Strategy usually involves significant amounts of resource allocations and high levels of risk and benefits.

#### **Choose an industry and undertake a Five Forces analysis.**

A Five Forces analysis can be undertaken for most industries where competition exists. The chapter highlighted a Five Forces analysis for the petrol retailing industry. Other particularly suitable industry sectors for analysis includes the airline industry, high street fashion retailing, pharmaceuticals, car manufacturing, consultancies, and brewing, among others. Each will have their own distinct characteristics and the way the Five Forces plays out will be different in their scope and intensity. The task requires some effective research beyond what can be found on the internet. Sometimes it is necessary to source information from reliable stakeholders such as government bodies, trade associations, consultancies, universities, interest groups and so on. A Five Forces analysis is only effective if it relates to what is actually happening in an industry at any given time. Consequently, it requires updating frequently to remain relevant. However, it is a good exercise to carry out a Five Forces analysis as it hones research and analytical skills around strategic issues.

**Explain how to apply the value chain model for a company in a chosen industry.**

To be able to analyse competitive advantage effectively, it is necessary to apply a value chain model to separate an organization's activities into ones that are detailed and discrete. Thus, a value chain model helps managers to break down activities in some detail. The value chain is divided into primary and support activities. Primary activities include inbound and outbound logistics, operations, marketing and sales and service. Support activities include infrastructure, human resource management, technology, and procurement. Each of these activities has to be analysed to determine what added value is derived from them. Also, the total combined value of all the activities has to be determined against the cost of delivering the product or service. This latter analysis informs the level of profit margin the organisation

can expect from undertaking the activities. The value chain analysis can also help managers to identify the strengths and weaknesses of the organisation so that strategies can be developed to exploit the former and deal with the latter.

**Outline the limitations of the Five Forces model.**

One of the key assertions made by Porter (1980) was that the five forces model enabled the assessment of the potential profitability of a particular industry. Although some evidence exists to support this claim, equally, there is evidence to suggest that company-specific factors (such as individual competences) are more important to profitability than industry factors (Rumelt, 1991). Also, the model implies that the Five Forces will apply equally to all competitors whereas, in reality, the strength of the forces differs markedly from business to business. For example, the model suggests that if supplier power is strong then this will apply equally to all businesses across the industry. This is far from the truth as large businesses face less of a threat from powerful suppliers compared to small businesses.

The application of the Five Forces model is only relevant when the macroenvironment is stable, a scenario that is most rarely observed. The dynamic nature of the macroenvironment determines that the model needs to be constantly updated to preserve any relevance, a weakness acknowledged by Porter. Finally, the model assumes that all firms are in competition with each other. In light of changes in the nature of industry competition in the last decade or so, Porter revisited the model to take cognisance of the fact that partnerships, alliances and joint ventures are a common feature of the environment. That the model is still widely used as a means of analysing the competitive environment by managers in the modern

business environment is testimony to Porter's rigour in updating and revising the model as the macroenvironment evolves.

Porter, M.E. (1980) *Competitive Strategy: Techniques for Analysing Industries and Competitors*, Free Press, New York, NY.

Rumelt, R.P. (1991) How much does industry matter? *Strategic Management Journal*, 12(3).

### **Mini Case 14(ii): AESCargo Hungary**

#### **Discussion points**

**How important is the role of distribution to determining competitive advantage?**

In a globalised environment, the importance of distribution has taken on added significance in the drive towards competitive advantage. Customers have high expectations regarding delivery times of products and much of the competitive pressures stem from the demand for meeting fulfilment times. Accessing those distribution channels that can deliver on time is an important strategic issue for firms. Access allows them to compete effectively for customers in lead markets, attain high brand loyalty and build market share. These all have important implications for performance including profitability. In some industries, such as electrical white goods and sports apparel, the distribution channels are dominated by partnerships between established industry leaders. New rivals find it extremely difficult to access the markets in the way that established firms can. This acts as a barrier to entry and helps incumbents to sustain a competitive advantage. The importance of

distribution in the value chain has resonated with a number of companies, which compete to establish partnerships with companies who seek to distribute their products to key markets as quickly and efficiently as possible.

**Is it possible to sustain a competitive advantage by successfully linking key activities in a value chain?**

The purpose of linking value chain activities is to achieve a competitive advantage. Many companies have successfully resourced and managed activities in the value chain to achieve this outcome. The competitive advantage stems from the distinctive capability that is derived by the added value of linking the activities in a manner that rivals find difficult to match. However, sustaining competitive advantage through linking activities in the value chain is rather more difficult, as it requires not just a distinctive capability to emerge but a core competence. A core competence is added value that rivals find almost impossible to match, such as the brand of Coca Cola, the engineering expertise of Mercedes Benz, or the marketing of Disney. Distinctive capability is capable of being eroded over time as rivals realign their resources, build new competences and challenge the existing competitive advantage. Rivals may even imitate the value-adding activities to try to undermine the competitive advantage. A core competence has a much more robust and long-lasting characteristic ensuring that sustained competitive advantage can be achieved.

**Questions and tasks**

**Choose two rival companies at the same level of supply in the same industry and compare and contrast their value adding activities.**

Students have a wide scope for undertaking this task as most industries have a number of rivals operating at the same level in the supply chain. Here, it is important to understand what these levels are. For example, across a vertical supply chain in the brewing industry, it is possible to identify firms who produce hops, brew beer, or run pubs. This takes in the supply chain from raw material to serving the customer. Other industries exhibit different activities across the supply chain.

If using the brewing example, the student may focus on the value-adding activities of two pubs or two breweries. Note that geographical location may play an important role in determining the rivalry - for example, independently run pubs will only be close rivals if they are located relatively close to each other. If, however, they are part of a chain of pubs run by a large company, then the rivalry will be spread across a wider area as other chains provide the competition.

**Explain the rationale behind the chosen linkages in the value chain for AESCargo Hungary.**

The linkages in the value chain for AESCargo are clearly inbound and outbound logistics supported by technology. The main aim of the company is to deliver cargo to clients as quickly and efficiently as possible. The company has developed software that allows them to automatically track each item from pick-up point to the client. The inbound and outbound logistics are managed electronically so that each item can be tracked by the company and the client at any part of its journey. Technology underpins the ability of the company to provide a range of added value services to clients such as offering different prices for different distribution services, tracking services, interactive communications, automated responses to repeat orders, and after delivery services and customer relationship. The linkage between

inbound and outbound logistics and the technology helps the company to compete in a highly competitive industry.

**What distinct advantage does Hungary have as a centre for distribution in Europe?**

The geographical location of Hungary is a distinct advantage in the distribution industry as it lies in the heart of Europe. It has rail links to Eastern, Western and Southern Europe; it sits on the Danube River, which flows through eight countries from Germany to the Black Sea port of Constanta; there are road links in all directions in Europe; and there is a high quality telecommunications infrastructure. Logistics and distribution has become so important to the Hungarian economy that specialist courses are run in universities throughout the country, producing high quality graduates to feed into the industry.

**Mini Case 14(iii): The rise and rise of Air Asia**

**Discussion points:**

**During times of economic downturn do budget airlines fare better than premium priced ones?**

The success of any airline depends on how well they can fill capacity on all their scheduled routes. The margins on this can be as little as one passenger. Budget airlines and premium priced airlines are not direct competitors as they usually service different routes (short haul rather than long haul) and target different types of customers (premium priced airlines tend to target business travellers, for example). However, during times of recession some passengers that traditionally would have travelled premium priced may be tempted to

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switch to a budget airline. For example, BA flies from London to Paris Charles De Gaulle, but Ryanair flies from London Stansted to Paris Beauvais. Whereas BA offers superior service and a destination close to the city, Ryanair offer the cheaper fare. Much depends on the demand characteristics of consumers. Budget airlines thrive because of the low cost business model and the cheap fares they offer. However, this model has been put under pressure as the operating costs have escalated leading to an upward movement in fares. For examples, budget airlines have had their unique selling proposition undermined by the rising cost of fuel. During times of recession, when disposable income is falling, passengers may decide to use a substitute where possible, such as ferries, buses, and trains. Premium priced airlines are even more affected by recession, as fewer businesses send their staff on flights, preferring cheaper alternatives such as teleconferencing.

**Discuss the key factors that are required to underpin the success of a budget airline.**

Budget airlines must get as close to capacity on each of their schedules flights or risk failing to break even. Invariably, budget airlines operate a low cost strategy where each activity in the value chain is operated at least cost. This may require the company to minimise the number of employees, reduce training of staff to the bare minimum, offer flight only with 'no frills', charging for baggage over a set minimum, operating from low cost airports, automating operations such as ticketing and check-in, and reducing marketing budgets. Some budget airlines, such as Ryanair, have attracted criticism for the aggressive manner in which they have pursued a low cost strategy.

**Questions and tasks**

**Identify some disadvantages of a cost leadership strategy.**

There are some risks associated with a cost leadership strategy that could place a firm at a disadvantage. Firstly, continuous innovation means that there are always new forms of product differentiation becoming available and the emphasis on cost by customers may diminish as a result. Changes in tastes and fashions and levels of disposable incomes have an important effect on whether or not customers are attracted to low cost products. Customers may have low brand loyalty to low cost products. Similarly, the focus may switch from cost to differentiation. Technical changes may allow products to be produced at low cost right across the industry, thereby switching the emphasis to differentiation. If a competitive advantage is evident in an industry characterised by a least cost producer, rivals will switch their attention to finding new ways of lowering cost. Competition thus increases and the competitive advantage may be short lived.

**Research Air Asia and identify the key destinations for the airline.**

The key destinations for Air Asia are domestic flights in Malaysia, mostly departing from the capital Kuala Lumpur to Penang, the islands, and to Malaysian-owned territories in Borneo. The company has expanded to take in most of the capitals in South East Asia such as Bangkok (Thailand), Ho Chi Minh City (Vietnam), Jakarta (Indonesia), as well as numerous destinations in smaller cities in these countries. Further afield, the company flies to the Philippines and Hong Kong and it is expanding into the Chinese market.

**List the low cost activities of Air Asia.**

The main ways the Air Asia reduces costs is to have ticketless flights whereby everything is automated and boarding can be accessed through mobile phones, laptops, or other types of digital technology. Flights have a quick turnaround schedule to minimise airport costs and to ensure maximum capacity. There is a 'no frill' approach to customer service. The company is

able to make quick decisions regarding which routes they wish to maintain based on passenger numbers. New destinations are constantly being explored, based on costs and projected passenger numbers. The region of South East Asia has a high population density spread over a relatively small area, characterised by many small and medium sized cities in areas not previously serviced by airlines. Customers in those areas are presented with mobility choices previously unavailable, and smaller airports offer a much cheaper alternative than the major hub airports such as Bangkok. The company employ as few staff as possible with minimal training required. Where automation can achieve operational outputs, it is installed and used effectively.

### **Case Study: Amazon.com**

#### **Discussion points**

**Amazon.com only exists today because of the goodwill it maintained with key shareholders throughout its early unprofitable years. Discuss.**

It is true that for the first eight years, Amazon failed to register a profit and that their continued existence relied on the goodwill of investors. However, the business model was deemed sufficiently robust that there was never a time when the entire investor portfolio lost confidence. During the 'dot com crash' of the late 1990s many investors turned away from the internet as a source of returns as many newly established firms failed to achieve the growth required to remain viable. Amazon, however, managed to weather the storm and emerged even stronger as fewer suppliers were chasing the growing demand. As e-commerce took off in the 2000s, Amazon was well positioned

to take full advantage and the trust of their investors has been rewarded with year on year profits ever since.

### **Is online book buying destroying traditional bookshops?**

The added value of online bookshops such as Amazon is the squeeze they exert on the supply chain, whereby the costs associated with searching are almost eliminated. For the majority of book buyers the convenience, range of books, and pricing that Amazon can offer provides an added value that traditional bookshops find difficult to match. Traditional bookshops have been affected by online book buying (witness the demise of Borders bookshops in 2009) with many seeing their margins diminished as a result. However, what bookshops can offer that Amazon cannot is the whole browsing experience. Many buyers enjoy the experience of browsing through physical bookshops where they can handle the product, seek advice, relax in the bookshop café, and so on. Traditional bookshops remain a feature of the high street, there are just fewer of them.

### **Questions and tasks**

**Identify the key value adding activities of Amazon.com that underpins the company's competitive advantage.**

There are a number of added value activities that Amazon undertakes to help create a competitive advantage. The most important is the inbound and outbound logistics whereby the fulfilment of demand is processed and executed in a quick and efficient timeframe. The company enjoys a high level of brand loyalty as customers gain from the quick order fulfilment capability. Customers can track their order from the warehouse to their door. The company also hosts literally millions of products which customers can

browse for quickly and easily on the website. The choice is immense and each comes with user generated reviews and summaries of products. No traditional retailer can match the range of products and services offered. The website also offers interactive facilities whereby customers can communicate with other customers, the company or any partner along the supply chain. Amazon also offers specialist advice and support for suppliers and partners such as book publishers, distributors, packagers and so on. The customer relationship management system ensures that customers receive marketing information on the types of products and services they have browsed for or bought previous. The system also allows for related types of products to be marketed. This increases the brand loyalty as customers are not bombarded with offerings they are not interested in. Customers can become involved in the marketing process through permission marketing or request marketing whereby the company respond to the types of products and services that customers want information on.

**What key innovations have Amazon.com implemented that underpins their sustained competitive advantage?**

Some of the key innovations implemented by Amazon include the 'one click' technology that allows customers to fulfil the transaction with one click based on information previously entered on the website such as name and address. The technology has been awarded a patent in the USA thereby creating a monopoly right to its use in that country. Amazon has also created a powerful customer relationship management (CRM) system to support its on-going communications with customers. This feeds into the bank of knowledge that underscores their marketing effort. Other systems such as bespoke Enterprise Resource Planning (ERP) and Supply Chain Management (SCM) systems are used for back office and distribution and logistics purposes respectively.

**Undertake a SWOT analysis for Amazon.com.**

**Strengths:**

- first mover advantages have ensured that Amazon remains among the world's foremost recognised websites, offering a wide range of products and services, the brand of Amazon is enhanced with every click of interest;
- superior logistics and distribution service ensures a high level of brand loyalty;
- patent for 'one click' technology in the USA ensures that rivals cannot directly replicate this source of competitive advantage;
- market share and high volume sales ensures cost advantages that rivals find difficult to match.

**Weaknesses:**

- working conditions and 'no unions' rules have damaged the reputation of the company as an ethical employer;
- pressure to expand and innovate may undermine core activities.

**Opportunities:**

- the internet economy is still growing with new markets (such as in South America) emerging all the time. Amazon is well placed to exploit the commercial opportunities in new regions;
- the brand of Amazon attracts partners who can deliver superior services;

- new technologies and developments in social media present opportunities for Amazon to explore new media platforms for extended their reach;
- the successful business model of Amazon attracts investors thereby increasing their potential for innovation and exploring new opportunities.

**Threats:**

- Creeping regulation of internet economy may have a negative effect on trading;
- Increasing competition from established and new brands offering customers a new experience;
- heavily reliant on vision and energy of founder Jeff Bezos, which is always a risk should he leave the company (e.g. for retirement, illness, death, etc.);

**What, if any, core competence does Amazon.com possess?**

Amazon is essentially a logistics company which specialises in fulfilling the demand of customers by ensuring that their orders are processed and shipped more quickly and efficiently than any rivals. Their core competence lies in the company's unrivalled ability to develop software that enables the process to be fulfilled. This is further enhanced by the distribution partnerships the company has with a wide range of companies who can deliver to the customer in any region of the globe as quickly as possible.

**Chapter questions and tasks**

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**Discuss the advantages to managers of undertaking analysis based on Porter's Five Forces model.**

Advantages of Porter's Five Forces model for strategists in organisations include offering a framework for compiling a checklist of how different parts of the industry relate to each other. It helps in the process of identifying and understanding the forces that have the greatest impact on the industry. It helps strategists to understand how the PEST factors affect the Five Forces. It also helps analysis of the relative position of each of the industry members within the industry structure. More detailed analysis can reveal how each industry member can influence the five forces. It can also help analysis of relative attractiveness of other industries.

**Outline the key elements of the strategic process and discuss the value it offers to managers.**

Key elements of strategic process include formulating a mission statement and overall purpose of the organisation; undertaking internal and external analysis; analysing the range of options available; choosing a strategic option and implementing measures to achieve the aims and objectives and evaluating the performance of the chosen strategy. Key stages are formulation, implementation and evaluation and control. The value of undertaking a strategic process is that it allows managers to follow a systematic pathway to achieving stated objectives. By following a strategic process, managers can evaluate each stage towards goal attainment. It helps to clarify what is feasible and desirable for their organisation and focuses attention on the key elements for analysis by the company.



**Identify and discuss the roles of business level and functional level managers in an organisation.**

The key differences in business level and functional level strategies are reflected in the different levels of decision-making power delegated to managers at these levels. The business level is comprised of both corporate managers and business managers and it is their task to translate the statements of direction and intent generated at corporate level into objectives and strategies to be implemented at the functional level. Business level strategies set out how the company intends to compete in the selected product/market arena. They must secure the best available market segment and control it to ensure they maintain a competitive advantage. Functional strategies are sometimes referred to as tactics because of their distance from corporate level strategy. Business strategists are link between corporate and functional managers. Functional managers are responsible for product, geographical and productive areas of operations. Functional managers develop short-term objectives based on annual targets for production, accounting, marketing, human relations, etc.

This is the way firms can measure and control short term performance. The data provided forms the basis for evaluation of performance and corrective action.

**Highlight some examples relating to each of Yip's global drivers.**

Some examples of key drivers include:

**Market**

Common customer needs

**Costs**

Economies of scale

Global customers and distribution	Efficiency savings in logistics
Transferable marketing techniques	Advantageous exchange rates
Presence in lead countries development costs	Lower product

### **Government**

Trade policy & political ideology  
activity

Free market principles dominate

Formation of trading blocs (EU, NAFTA)

### **Competition**

Level of import & export

Competition from other  
countries

Interdependence of  
economies

### **Describe the concept of core competence and evaluate how it can help an organisation sustain a competitive advantage.**

Core competence refers to the ability of a firm to sustain a competitive advantage over the long-term by adding value to consumers that other rivals find difficult to match. An organisation can achieve a core competence by focusing on excellence in one or more parts of the value chain. There is usually a coherent link between the primary and support activities that underpin the value adding for customers.

Examples include linking inbound and outbound logistics with technology (FedEx); linking human resource management with service (professions); linking operations with management (car industry); or linking the marketing function with procurement (Tommy Hilfiger). These firms all

excel at their core activities such that their reputation is enhanced, and customers recognise the added value and brand loyalty results.