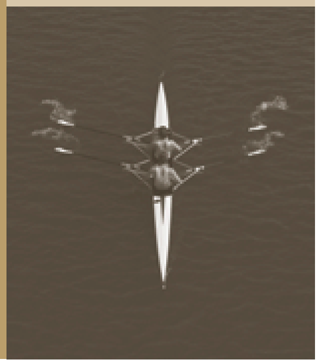
12

Competitive Advantage in Mature Industries



We are a true "penny profit" business. That means that it takes hard work and attention to detail to be financially successful – it is far from being a sure thing. Our store managers must do two things well: control costs and increase sales. Cost control cannot be done by compromising product quality, customer service, or restaurant cleanliness, but rather by consistent monitoring of the "vital signs" of the business through observation, reports, and analysis. Portion control is a critical part of our business. For example, each Filet-O-Fish sandwich receives 1 fluid ounce of tartar sauce and 0.5 ounces of cheese. Our raw materials are fabricated to exacting tolerances, and our managers check them on an ongoing basis. Our written specification for lettuce is over two typewritten pages long. Our French fries must meet standards for potato type, solid and moisture content, and distribution of strand lengths.

—EDWARD H. RENSI, PRESIDENT AND CHIEF OPERATING OFFICER, MCDONALD'S U.S.A.[1]

OUTLINE

Introduction and Objectives

Although technology-based industries grab the attention of both business journalists and strategy researchers, if importance is measured by share of GDP rather than share of press coverage, mature industries – food, energy, construction, vehicles, financial services, and restaurants – retain their preeminence, even in the advanced industrialized nations.

Despite their heterogeneity – they range from massage parlors to steel – mature industries present several similarities from a strategic perspective. The purpose of this chapter is to explore the characteristics of mature industries, the strategies through which competitive advantage can be established within them, and the implications of these strategies for structure, systems, and leadership style. As we shall see, maturity does not imply lack of opportunity. Companies such as Hennes & Mauritz (fashion clothing), Ryanair (airlines), Starbucks (coffee shops), and Nucor (steel) have prospered on the basis of innovative strategies. Coca-Cola, Exxon Mobil, and General Electric were founded in the 19th century, yet, over the past decade, have achieved combinations of profitability and growth that would make most high-tech companies envious. Nor does maturity mean lack of innovation: as we shall see, many mature industries have been transformed by new technologies and new strategies.

By the time you have completed this chapter, you will be able to:

- Recognize the principal strategic characteristics of mature industries.
- Identify key success factors within mature industries and formulate strategies directed toward their exploitation.
- Locate and analyze opportunities for strategic innovation in mature industries to establish competitive advantage.
- Design organizational structures and management systems that can effectively implement such strategies.

Competitive Advantage in Mature Industries

Our analysis of the industry life cycle (Chapter 10) suggests that maturity has two principal implications for competitive advantage: first, it tends to reduce the number of opportunities for establishing competitive advantage; second, it shifts these opportunities from differentiation-based factors to cost-based factors.

Diminishing opportunities for sustainable competitive advantage in mature industries stem from:

- Less scope for differentiation advantage resulting from increased buyer knowledge, product standardization, and less product innovation.
- Diffusion of process technology means that cost advantages based on superior processes or more advanced capital equipment methods are difficult to obtain and sustain. Once a cost advantage is established, it is vulnerable to exchange rate movements and the emergence of low-cost overseas competitors.
- A highly developed industry infrastructure together with the presence of powerful distributors makes it easier to attack established firms that occupy particular strategic niches.

Using different terminology, Warren Buffett – "The Sage of Omaha" – describes the same process of maturity leading to eroding competitive advantage as enterprises' transition from "franchises" into "businesses" (see Strategy Capsule 12.1).

This trend toward deteriorating industry profitability is a constant threat in mature industries. As rivalry encourages overinvestment in capacity, international competition increases, and differentiation is undermined by commoditization, attaining a competitive advantage becomes essential to achieving positive economic profits.

STRATEGY CAPSULE 12.1

The Transition of "Franchises" into "Business": The Media Sector

In assessing the profit prospects of a firm, Warren Buffett distinguishes "Franchises" from "Businesses":

> *An economic franchise arises from a product or service that (1) is needed or desired; (2) is thought by customers to have no close substitute; and (3) is not subject to price regulation. Franchises earn high rates of return on capital . . . [and] can tolerate mismanagement . . . In contrast, "a business" earns exceptional profits only if it is a low-cost operator or if supply of its product or service is tight. And a business, unlike a franchise, can be killed by poor management.*

Buffett identifies this erosion of competitive advantage within the media sector – newspapers, television, and magazines – "as retailing patterns change and entertainment choices proliferate." The problem is that as the businesses have transformed from "franchises" into "businesses," consumers "enjoy greatly broadened choices as to where to find them." Unfortunately, demand can't expand in response to the new supply: "500 million American eyeballs and a 24-hour day are all that's available. The result is that competition has intensified, markets have fragmented, and the media industry has lost some – though far from all – of its franchise strength."

Source: Letter to Shareholders, Annual Report of Berkshire Hathaway Inc., 1991.

Cost Advantage

If cost is the overwhelmingly important key success factor in most mature industries, what are the primary sources of low cost? Three cost drivers tend to be especially important:

- *Economies of scale*. In capital-intensive industries, or where advertising, distribution, or new product development is an important element of total cost, economies of scale are important sources of interfirm cost differences. The increased standardization that accompanies maturity greatly assists the exploitation of such scale economies. The significance of scale economies in mature industries is indicated by the fact that the association between ROI and market share is stronger in mature industries than in emerging industries.[2]
- *Low-cost inputs*. Where small competitors are successful in undercutting the prices of market leaders in mature industries, it is frequently through their access to low-cost inputs. Established firms can become locked into high salaries and benefits, inefficient working practices and bloated overheads inherited from more prosperous times. New entrants into mature industries may gain cost advantages by acquiring plant and equipment at bargain-basement levels and by cutting labor costs. Valero Energy Corporation is the largest oil refiner in the United States: it acquired loss-making refineries from the majors at below-book prices then operated them with rigorous cost efficiency. A lower cost of capital can also be a key source of cost advantage. The acquisition of retailers, hotels, hospital groups, and chemical firms by private equity funds has been motivated in part by the attractions of substituting low-cost debt for high-cost equity.[3]
- *Low overheads*. During the early 1990s, some of the most profitable companies in mature industries tended to be those that had achieved the most substantial reductions in overhead costs. In discount retailing, Wal-Mart is famous for its parsimonious approach to overhead cost. Among the oil majors, Exxon is known for its rigorous control of overhead costs. Exxon's headquarters cost (relative to net worth) was estimated at less than one-quarter that of Mobil's.[4] When Exxon merged with Mobil, it was able to extract huge cost savings from Mobil. In newspaper and magazine publishing, newcomers such as EMAP in the UK and Media News Group (run by "Lean Dean" Singleton) have aquired a host of titles then slashed overhead costs.

Because cost inefficiencies tend to become institutionalized within mature enterprises, cost reduction may require drastic interventions. *Corporate restructuring* – intensive periods of structural and strategic change – typically involves cost reduction through outsourcing, headcount reduction, and downsizing – especially at corporate headquarters.[5] Successful turnaround strategies typically involve aggressive cost cutting. Among mature US businesses, Hambrick and Schecter identified three successful approaches:

- *Asset and cost surgery* – aggressive cost reduction through reduction of excess capacity; halting of new investment in plant and equipment; and cutbacks in R&D, marketing expenditures, receivables, and inventories.
- *Selective product and market pruning* – refocusing on segments that were most profitable or where the firm possessed distinctive strength.

- *Piecemeal productivity moves* – adjustments to current market position rather than comprehensive refocusing or reorganizing, including reductions in marketing and R&D expenditures, higher capacity utilization, and increased employee productivity.[6]

Among British Companies, cost reduction was also a key feature of turnaround strategies. Sharp upturns in performance ("sharpbender") were typically the result of, first, changes in top management and, second, intensive efforts to reduce production costs.[7]

Segment and Customer Selection

Sluggish demand growth, lack of product differentiation, and international competition tend to depress the profitability of mature industries. Yet, even unattractive industries may offer attractive niche markets with strong growth of demand, few competitors, and abundant potential for differentiation. As a result, segment selection can be a key determinant of differences in the performance of companies within the same industry. Wal-Mart's profitability was boasted by locating its stores in small and medium-sized towns where it faced little competition. In the auto industry, there is a constant quest to escape competition by creating new market segments with "crossover" vehicles that span existing segments. Opportunities for establishing new segments can arise from the strategies of market leaders. The more that incumbents focus on the mass market, the more likely it is that new entrants can carve out new market niches by supplying underserved customer needs.[8]

The logic of segment focus implies further disaggregation of markets – down to the level of the individual customer. Information technology permits new approaches to *customer relationship management* (CRM), making it possible to analyze individual characteristics and preferences, identify individual customers' profit contribution to the firm, and organize marketing around individualized, integrated approaches to customers. In the same way that Las Vegas casinos have long recognized that the major part of their profits derives from a tiny minority of customers – the "high rollers" – so banks, supermarkets, credit card companies, and hotels increasingly use transactions data to identify their most attractive customers, and those that are a drag on profitability.

The next stage in this process is to go beyond customer selection to actively target more attractive customers and transform less valuable customers into more valuable customers. Alan Grant and Leonard Schlesinger point to the need for companies to optimize their *value exchange* – the relationship between the investment a company makes in a customer relationship and the return that investment generates.[9] For example:

- Credit card issuer Capital One has long been a leader in using data warehousing, experimentation, simulation, and sophisticated statistical modeling to adjust the terms and features of its credit card offers to the preferences and characteristics of individual customers. Capital One estimates the life-time profitability of each customer and analyzes the four key events in the credit card life cycle: acquiring the customer, stimulating the customer's card use, retaining the customer, and managing default.[10]
- Amazon.com uses information on customers' prior transactions and comparisons with other customers making similar purchases to generate individualized purchase suggestions.

The Quest for Differentiation

Cost leadership, we noted in Chapter 9, is difficult to sustain, particularly in the face of international competition. Hence, differentiating to attain some insulation from the rigors of price competition is particularly attractive in mature industries. The problem is that the trend toward commoditization narrows the scope for differentiation and reduces customer willingness to pay a premium for differentiation:

- In tires and domestic appliances, companies' investments in differentiation through product innovation, quality, and brand advertising reputation have generated disappointing returns. Vigorous competition, price-sensitive customers, and strong, aggressive retailers have limited the price premium that differentiation will support.
- Attempts by airlines to gain competitive advantage through offering more legroom, providing superior in-flight entertainment, and achieving superior punctuality have met little market response from consumers. The only effective differentiators appear to be frequent flier programs and services offered to first- and business-class travelers.

Standardization of the physical attributes of a product and convergence of consumer preferences constrains, but does not eliminate, opportunities for meaningful and profitable differentiation. Product standardization is frequently accompanied by increased differentiation of complementary services – financing terms, leasing arrangements, warranties, after-sales services, and the like. In consumer goods, maturity often means a shift from physical differentiation to image differentiation. Entrenched consumer loyalties to specific brands of cola or cigarettes are a tribute to the capacity of brand promotion over long periods of time to create distinct images among near-identical products.

The intensely competitive retail sector produces particularly interesting examples of differentiation strategies. The dismal profitability earned by many retail chains (Toys-R-Us, J. C. Penny, and Circuit City in the US; J. Sainsbury, Mothercare, and Kingfisher in the UK; Royal Ahold in the Netherlands) contrasts sharply with the sales growth and profitability of stores that have established clear differentiation through variety, style, and ambiance (Target, Lowe's, TJX, and Bed, Bath and Beyond in the US; Zara-Inditex from Spain; Hennes & Mauritz and IKEA from Sweden). A further lesson from highly competitive mature sectors such as retailing is that competitive advantage is difficult to sustain. Most of the outstandingly successful retailers of the previous decade – Toys-R-Us, Body Shop, and Marks & Spencer – have been displaced in the affections of consumers and investors by the rising stars of retail.

Innovation

We have characterized mature industries as industries where the pace of technical change is low. In many mature industries – steel, textiles, food processing, insurance, and hotels – R&D expenditure is below 1% of sales revenue, while in US manufacturing as a whole just three sectors – computers and electronics, pharmaceuticals, and aerospace – account for 65% of R&D spending.[11] In recent years, this conventional view of mature industries as lacking technological dynamism has come under attack. McGahan and Silverman show that, measured by patenting activity, mature industries are as innovative as emerging industries.[12] Certainly in mature products such as tires,

STRATEGY CAPSULE 12.2

Innovation in Mature Industries: Brassiere Technology

The first patent for a "breast-supporting device" was issued in the United States in 1864. However the first patent relating to an undergarment named "brassiere" was issued to Mary Phelps Jacob in 1913. By 1940 over 550 US patents for brassieres and related breast supporters had been issued.

The technological quest for a better bra continued into the 21st century – the US Patent Office has issued over 200 patents relating to brassieres since January 2000. The design innovations of recent years include:

- Wonderbra (owned by Sara Lee) introduced a "variable cleavage" bra equipped with a system of pulleys.
- The Airotic bra designed by Gossard (also owned by Sara Lee) features "twin air bags as standard" – these are inflatable by a "unique G-pump system."
- Charnos's Bioform bra replaces underwiring with soft molded polypropylene around a rigid ring – a design inspired by the Frisbee and engineered by Ove Arup, who also engineered London's Millennium Bridge (which had to be closed because of excessive wobbling).
- The Ultimo bra, designed by Scottish model Michelle Mone assisted by a team of German scientists, is equipped with silicone gel pads.
- A number of new brassieres use "spacer fabric" which comprises "two outer textile layers separated by a ventilated inner layer of spacer yarns, to allow heat and moisture to escape. Various properties can be added to the fabrics, including anti-microbial, anti-mildew, anti-static, flame-retardant, absorptive, water-repellent, and abrasion-resistant attributes . . ."

Sources: "Bra Wars," *Economist* (December 2, 2000): 112; salon.com (August 28, 2000); US Patent Database.

brassieres, and fishing rods, continuing technological development is indicated by a steady flow of new patents (see Strategy Capsule 12.2).

What is clear is that the pressure of competition and the limited opportunities for technology-based advantage create impetus for innovation in other areas of competitive strategy. The quest for new ways of doing business – "new game strategies" – was referred to in Chapter 6. In relation to the innovation cycles identified by Abernathy and Utterback (see Figure 10.2 in Chapter 10),[13] it is possible that there is a third phase of innovation – *strategic innovation* – which becomes most prominent once product and process innovation have begun to slacken. Because strategic innovation requires strategic initiatives that are new and unique, it is difficult to apply systematic, analytical approaches to their discovery and design. Value chain analysis can assist the identification of "new game strategies" that reconfigure the sequence of activities undertaken by the firm.

Strategic innovation may also result from redefining markets and market segments.[14] This may involve:

- *Embracing new customer groups*. Harley-Davidson has created a market for expensive motorcycles among the middle aged and Sony has extended video gaming from teenage boys to girls, adults and retirees. The most rapidly growing churches – e.g. Jehova's Witnesses in Russia and Amway Christian Fellowship in America – tend to be those that recruit among underserved social and demographic groups.
- *Adding products and services that perform new but related functions*. In the US, Arco was an innovator in recreating the gas station as a convenience store. In book retailing, large stores such as Barnes and Noble as well as some small neighborhood bookstores have redefined book retailing by adding additional products and services. Many of these innovative forms of differentiation involve the creation of entirely new customer experiences – at restaurant chains such as Hard Rock Café and Planet Hollywood the food is a relatively minor contributor to the customer experience. Pine and Gilmore identify a progression of economic value that begins with commodities and leads through products and services before arriving at *experiences*. In the *experience economy*, companies go beyond providing a product or service that meets a clearly defined customer need and involve their customers in a process that engages them at the emotional, intellectual, even spiritual, level.[15]

Baden-Fuller and Stopford show that strategic innovation in mature businesses often results from the reconciliation of multiple (often opposing) performance goals. Their case analysis of successful mature companies concludes:

1. Maturity is a state of mind, not a state of the business; every enterprise has the potential for rejuvenation.
2. It is the firm that matters, not the industry. The industry sets a context, not a prison for the firm. Not only can the creative firm achieve success within a hostile industry environment, it can transform its industry environment (e.g. Honda in motorcycles).
3. Strategic innovation is the basis for competitive advantage in industries where the potential for competitive advantage seems limited. The essence of strategic innovation is reconciling alternatives: quality at low cost (Toyota), variety at low cost (Courtaulds), speed at low cost (Benetton), and so on.
4. Businesses should be selective in choosing their strategic territory. An island kingdom is more defensible than the Hapsburg Empire. The firm's market scope needs to be limited by its resources and capabilities.
5. The pursuit of strategic innovation requires an entrepreneurial organization with freedom to experiment and the capacity to learn.[16]

Rejuvenation represents as formidable a challenge to a mature enterprise as it does to an aging university professor. Indeed, change is likely to be even more difficult for organizations than for individuals. In Chapter 10, we noted the resistance to change caused by organizational inertia. Resistance to innovation and renewal arises not just from entrenched structures and systems but also from the propensity for managers to be trapped within their industry's conventional thinking about key success factors and business practices. Chapter 4 noted how established firms' responses to competitive threats may be limited by industry-wide systems of belief. J.-C. Spender refers to these common cognitive patterns as "industry recipes."[17] Studies of cognitive maps – the mental frameworks through which managers perceive and think about their environments and their companies – yield insights into why some firms are able to adapt better than others. A study of organizational renewal among railroad companies found that the ability of managers to learn in the form of changing their mental models of the business was critical to their capacity to renew themselves.[18]

The ability to break away from conventional wisdom and establish a unique positioning or novel form of differentiation may be critical in mature industries. Costas Markides identifies several examples of such contrarian thinking, including the following:

- Edward Jones, with 2,000 offices, mostly in the US but also in Canada and the UK, has rejected the brokerage industry's infatuation with economies of scale, product diversification, integration with investment banks, and e-commerce. Each office has just one investment adviser; there are no proprietary investment products; and no online investing. Edward Jones' strategy has been built on face-to-face relationships, motivating its office managers to develop their local business, and ambitious growth targets.[19]
- Enterprise Rent-A-Car has adopted a location strategy that is quite different from its major competitors Hertz and Avis. Rather than concentrate on serving the business traveler through locating at airports and downtown, Enterprise concentrates on suburban locations, where it caters primarily to the consumer market.[20]

How do companies break away from their traditional mindsets and achieve strategic innovation? According to Gary Hamel, the role of strategy should be to foster revolution through reorganizing the strategy-making process. This means breaking top management's monopoly over strategy formulation, bringing in younger people from further down the organization, and gaining involvement from those on the periphery of the organization.[21] Strategic innovation may be best thought of as a process that involves a sequence of managerial actions: "journeys of strategic renewal" and "trajectories of transformation."[22] Common to all these approaches is recognition that strategic innovation goes beyond rethinking strategies; it also requires new approaches to structuring and managing the mature business.

Strategy Implementation in Mature Industries: Structure, Systems, and Style

If the key to success in mature industries is achieving operational efficiency and reconciling this with innovation and customer responsiveness, achieving competitive advantage in mature businesses requires implementing structures, systems, and management styles that can mesh these multiple performance goals.

Efficiency through Bureaucracy

If maturity implies greater environmental stability, slower technological change, and an emphasis on cost efficiency, what types of organization and management approaches are called for? As we observed in Chapter 6, the conventional prescription for stable environments was "mechanistic" organizations characterized by centralization, well-defined roles, and predominantly vertical communication.[23] Henry Mintzberg describes this formalized type of organization dedicated to the pursuit of efficiency as the *machine bureaucracy*.[24] Efficiency is achieved through standardized routines, division of labor, and close management control based on bureaucratic principles. Division of labor extends to management as well as operatives – high levels of vertical and horizontal specialization are typical among managers. Vertical specialization is evident in the concentration of strategy formulation at the apex of the hierarchy, while middle and junior management supervise and administer through the application of standardized rules and procedures. Horizontal specialization takes the form of functional structures.

The machine bureaucracy as described by Mintzberg is a caricature of actual organizations – probably the closest approximations are found in government departments performing highly routine administrative duties (e.g., the Internal Revenue Service or departments of motor vehicle licensing). However, in most mature industries, the features of mechanistic organizations are evident in highly routinized operations and application of highly detailed rules and procedures. McDonald's may not be a typical bureaucracy, but it certainly operates with highly standardized and refined operating procedures that govern virtually every aspect of how it does business (see the quotation that introduces this chapter). The characteristics of mechanistic organization and principles of bureaucracy are prominent among the large enterprises found in most mature industries, whether we are looking at DaimlerChrysler, Exxon Mobil, or HSBC. The key features of these mature organizations are summarized in Table 12.1.

Beyond Bureaucracy

As was noted in Chapter 6, the past two decades have seen growing unpopularity of bureaucratic approaches to management, especially in mature industries. Factors contributing to this trend include:

- *Increased environmental turbulence.* Bureaucracy is conducive to efficiency in stable environments. However, the centralized, structured organization cannot readily adapt to change. Achieving flexibility to respond to external change requires greater decentralization, less specialization, and looser controls.
- *Increased emphasis on innovation.* The organizational structure, control systems, management style, and interpersonal relationships conducive to efficiency are likely to hinder innovation. As mature enterprises sought new opportunities for competitive advantage, so the disadvantages of formalized, efficiency-oriented organizations became increasingly apparent.
- *New process technology.* The efficiency advantages of bureaucratized organizations arise from the technical virtues of highly specialized, systematized production methods. The electronics revolution has changed the conditions for efficiency. Computer-integrated manufacturing processes permit cost efficiency with greater product variety, shorter runs, and greater flexibility. As automation displaces labor-intensive, assembly-line manufacturing techniques, there is less need for elaborate division of labor and greater need for job flexibility. Simultaneously, the electronic revolution in the office is displacing the administrative bureaucracy that control and information systems once required.

TABLE 12.1 Strategy Implementation in Mature Industries: Conventional Features of Organization and Management

STRATEGY	Primary goal is cost advantage through economies of scale, capital-intensive production of standardized product/service. Dichotomization of strategy formulation (the preserve of top management) and strategy implementation (carried down the hierarchy).
STRUCTURE	Functional departments (e.g., production, marketing, customer service, distribution). Distinction between line and staff. Clearly defined job roles with strong vertical reporting/delegation relationships.
CONTROLS	Performance targets are primarily quantitative and short term and are elaborated for all members of the organization. Performance is closely monitored by well-established, centralized management information systems and formalized reporting requirements. Financial controls through budgets and profit targets particularly important.
INCENTIVES	Incentives are based on achievement of individual targets and are in the form of financial rewards and promotion up the hierarchy. Penalties exist for failure to attain quantitative targets, for failure to adhere to the rules, and for lack of conformity to company norms.
COMMUNICATION	Primarily vertical for the purposes of delegation and reporting. Lateral communication limited, often achieved through interdepartmental committees.
MANAGEMENT	Primary functions of top management: control and strategic decision making. Typical CEO: the administrator – who guides the organization through establishing and operating organizational systems and principles and building consensus (e.g., Alfred Sloan Jr. of General Motors); and the autocrat – whose primary role is decision making and who leads through aggressive use of power and sheer force of personality (Lee Iacocca of Chrysler and Al Dunlap of Sunbeam).

- *Alienation and conflict*. The dependence of bureaucracy on departmentalization, layering, and the control of some employees by others is conducive to alienation and conflict.

Companies in mature industries have undergone substantial adjustment over the past decade. Among large, long-established corporations management hierarchies have been pruned, decision making decentralized and accelerated, and more open communication and flexible collaboration fostered. The trend began in North America, spread to continental Europe, and is now evident in Japan and Korea. The changes are apparent in:

- Strategic decision processes that increase the role of business-level managers and reduce the role of corporate management; an emphasis on the strategy formulation process as more important than strategic plans per se.

- This shifting of decision-making power to the business level has been accompanied by shrinking corporate staffs.
- Less emphasis on economies of large-scale production and increased responsiveness to customer requirements together with greater flexibility in responding to changes in the marketplace.
- Increased emphasis on teamwork as a basis for organizing separate activities to improve interfunctional cooperation and responsiveness to external requirements.
- Wider use of profit incentives to motivate employees and less emphasis on controls and supervision.

Despite the changes, the primary emphasis on cost efficiency remains. However, the conditions for cost efficiency have changed. The most powerful force for organizational change in mature industries has been the inability of highly structured, centralized organizations to maintain their cost efficiency in an increasingly turbulent business environment. As we observed in Chapter 9, the requirements for dynamic efficiency are different from the requirements for static efficiency. Dynamic efficiency requires flexibility, which necessitates higher levels of autonomy and nonhierarchical coordination. A feature of the revitalization efforts of Jack Welch at General Electric, Carlos Ghosn at Nissan and Renault, Stuart Rose at Marks & Spencer, John Browne at British Petroleum, and Sandy Weill at Citigroup has been combining strong central direction with increased decision-making autonomy at the business level. By relying more on performance targets and less on approvals and committees, the old corporate empires have become more flexible and responsive while maintaining a strong focus on efficiency.

Strategies for Declining Industries

The transition from maturity to decline can be a result of technological substitution (typewriters, railroads), changes in consumer preferences (men's suits), demographic shifts (babyware in Italy), or foreign competition (cutlery in Sheffield, England). Shrinking market demand gives rise to acute strategic issues. Among the key features of declining industries are:

- Excess capacity.
- Lack of technical change (reflected in a lack of new product introduction and stability of process technology).
- A declining number of competitors, but some entry as new firms acquire the assets of exiting firms cheaply.
- High average age of both physical and human resources.
- Aggressive price competition.

Despite the inhospitable environment offered by declining industries, research by Kathryn Harrigan has uncovered declining industries where at least some participants earned surprisingly high profits. These included electronic vacuum tubes, cigars, and leather tanning. However, elsewhere – notably in prepared baby foods, rayon, and meat processing – decline was accompanied by aggressive price competition, company failures, and instability.[25]

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What determines whether or not a declining industry becomes a competitive blood-bath? Two factors are critical: the balance between capacity and output, and the nature of the demand for the product.

Adjusting Capacity to Declining Demand

The smooth adjustment of industry capacity to declining demand is the key to stability and profitability during the decline phase. In industries where capacity exits from the industry in an orderly fashion, decline can occur without trauma. Where substantial excess capacity persists, as has occurred in the steel industries of America and Europe, in the bakery industry, in gold mining, and in long-haul bus transportation, the potential exists for destructive competition. The ease with which capacity adjusts to declining demand depends on the following factors:

- *The predictability of decline*. If decline can be forecast, it is more likely that firms can plan for it. The decline of traditional photography with the advent of digital imaging was anticipated and planned for. Conversely, the long-term decline of the US and Western European steel industries has been obscured by periodic cyclical upswings – most notably that of 2002–6. The more cyclical and volatile the demand, the more difficult it is for firms to perceive the trend of demand even after the onset of decline.
- *Barriers to exit*. Barriers to exit impede the exit of capacity from an industry. The major barriers are:
  - Durable and specialized assets. Just as capital requirements impose a barrier to entry into an industry, those same investments also discourage exit. The longer they last and the fewer the opportunities for using those assets in another industry, the more companies are tied to that particular industry.
  - Costs incurred in plant closure. Apart from the accounting costs of writing off assets, substantial cash costs may be incurred in redundancy payments to employees, compensation for broken contacts with customers and suppliers, dismantling the plant, and environmental clean-up.
  - Managerial commitment. In addition to financial considerations, firms may be reluctant to close plants for a variety of emotional and moral reasons. Resistance to plant closure and divestment arises from pride in company traditions and reputation, managers' unwillingness to accept failure, and loyalties to employees and the local community.
- *The strategies of the surviving firms*. Smooth exit of capacity ultimately depends on the decisions of the industry players. The sooner companies recognize and address the problem, the more likely it is that independent and collective action can achieve capacity reduction. In European gasoline retailing, for example, the problem of excess capacity was partially solved by bilateral exchanges of service stations among the major oil companies. Stronger firms in the industry can facilitate the exit of weaker firms by offering to acquire their plants and take over their after-sales service commitments. A key strategy among private equity firms has been initiating "roll-ups" in declining industries – consolidating multiple acquisitions.

The Nature of Demand

Where a market is segmented, the general pattern of decline can obscure the existence of pockets of demand that are not only comparatively resilient, but also price inelastic. For example, despite the obsolescence of vacuum tubes after the adoption of transistors, GTE Sylvania and General Electric earned excellent profits supplying vacuum tubes to the replacement and military markets.[26] In fountain pens, survivors in the quality pen segment such as Cross and Mont Blanc have achieved steady sales and high margins through appealing to high-income professionals and executives. Despite overall decline of the cigar market, quality cigars have benefited from strong demand and attractive margins.

Strategies for Declining Industries

Conventional strategy recommendations for declining industries are either to divest or to harvest, i.e., to generate the maximum cash flow from existing investments without reinvesting. However, these strategies assume that declining industries are inherently unprofitable. If profit potential exists, then other strategies may be attractive. Harrigan and Porter[27] identify four strategies that can profitably be pursued either individually or sequentially in declining industries.

- *Leadership*. By gaining leadership, a firm is well placed to outstay competitors and play a dominant role in the final stages of the industry's life cycle. Once leadership is attained, the firm is in a good position to switch to a harvest strategy and enjoy a strong profit stream from its market position. Establishing leadership can be done by acquiring competitors, but a cheaper way is to encourage competitors to exit (and then acquire their plants). Inducements to competitors to exit may include showing commitment to the industry, helping to lower their exit costs, releasing pessimistic forecasts of the industry's future, and raising the stakes – e.g., by supporting more stringent environmental controls that make it costly for them to stay in business.
- *Niche*. Identify a segment that is likely to maintain a stable demand and that other firms are unlikely to invade, then pursue a leadership strategy to establish dominance within the segment. The most attractive niches are those that offer the greatest prospects for stability and where demand is most inelastic.
- *Harvest*. By harvesting, a firm maximizes its cash flow from existing assets, while avoiding further investment. A harvesting strategy seeks to boost margins wherever possible through raising prices and cutting costs by rationalizing the number of models, number of channels, and number of customers. Note, however, that a harvest strategy can be difficult to implement. In the face of strong competition, harvesting may accelerate decline, particularly if employee morale is adversely affected by a strategy that offers no long-term future for the business.
- *Divest*. If the future looks bleak, the best strategy may be to divest the business in the early stages of decline before a consensus has developed as to the inevitability of decline. Once industry decline is well established, finding buyers may be extremely difficult.

FIGURE 12.1 Strategic alternatives for declining industries

		COMPANY'S COMPETITIVE POSITION	
		Strengths in remaining demand pockets	Lacks strength in remaining demand pockets
INDUSTRY STRUCTURE	Favorable to decline	LEADERSHIP or NICHE	HARVEST or DIVEST
	Unfavorable to decline	NICHE or HARVEST	DIVEST QUICKLY

Choosing the most appropriate strategy requires a careful assessment both of the profit potential of the industry and the competitive position of the firm. Harrigan and Porter pose four key questions:

- Can the structure of the industry support a hospitable, potentially profitable decline phase?
- What are the exit barriers that each significant competitor faces?
- Do your company strengths fit the remaining pockets of demand?
- What are your competitors' strengths in these pockets? How can their exit barriers be overcome?

Selecting an appropriate strategy requires matching the opportunities remaining in the industries to the company's competitive position. Figure 12.1 shows a simple framework for strategy choice.

Summary

Mature industries present challenging environments for the formulation and implementation of business strategies. Competition – price competition in particular – is usually strong and competitive advantage is often difficult to build and sustain: cost advantages are vulnerable to imitation, differentiation opportunities are limited by the trend to standardization. Stable positions of competitive advantage in mature industries are traditionally associated with cost advantage from economies of scale or experience, and differentiation advantage through brand loyalty. Such strategies are typically implemented through hierarchical organizations, with high levels of specialization and formalization, and centralized decision making directed toward maximizing static efficiency.

Increased dynamism of mature industries resulting from international competition, economic turbulence, and greater pressure for innovation has had two consequences. First, the conditions for cost efficiency have changed. In a dynamic environment, cost efficiency is less dependent on scale, specialization, and rigid control, and more on rapid adjustment to change. Second, as competition has become more intense, companies (especially those in the advanced industrialized countries) have been forced to seek new sources of competitive advantage through innovation and differentiation. Reconciling the pursuit of scale economies with the need for responsiveness and flexibility, and the requirements of cost efficiency with the growing need for innovation and differentiation, poses complex strategic and organizational challenges. Some of the most successful companies in mature industries – Wal-Mart in retailing, BP in oil and gas, Nike in shoes and sportswear, and Coca-Cola in beverages – are companies that have achieved flexibility through dismantling bureaucratic structures and procedures, exploited new technology to combine variety and flexibility with efficiency, encouraged high levels of employee commitment, and relentlessly pursued financial targets. We return to some of these challenges and firms' responses to them in Chapter 17.

Self-Study Questions

1 The clothing manufacturers of northern Italy are facing rapid decline as retail chains and fashion houses increasingly outsource to China and other low-cost countries. What strategies would you recommend to small and medium-sized Italian garment manufacturers to assist them in surviving the onslaught of low-cost foreign competition?

2 Under Jacques Nasser, Ford's response to intensifying competition in the auto industry was to acquire a stable of luxury brands and forward integrate into car rental (Hertz), car repair (Kwik Fit), and financial services. Under the present CEO, Bill Ford, the reverse strategy is being pursued: Ford is divesting car rental, car repair, and financial services, and seeking buyers for several of its luxury brands (including Aston Martin and Jaguar). Given the characteristics of the industry and the company, examine the relative merits of each strategy and explain which strategy you would favor.

3 In both Europe and North America, established airlines are desperately cutting costs to compete with the increasing number of budget airlines. However, it is highly unlikely that these airlines will ever match the cost efficiency of Southwest, Jetblue, or Ryanair. What opportunities are there for established airlines to improve their competitive position through differentiation strategies? Make specific proposals for how established airlines can differentiate their customer offerings more effectively.

4 Department stores (e.g. Federated Department Stores and Mays in the US, Selfridges and House of Fraser in the UK) face increasing competition from specialized chain retailers and discount stores. What innovative strategies might department stores adopt to revitalize their competitiveness?

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