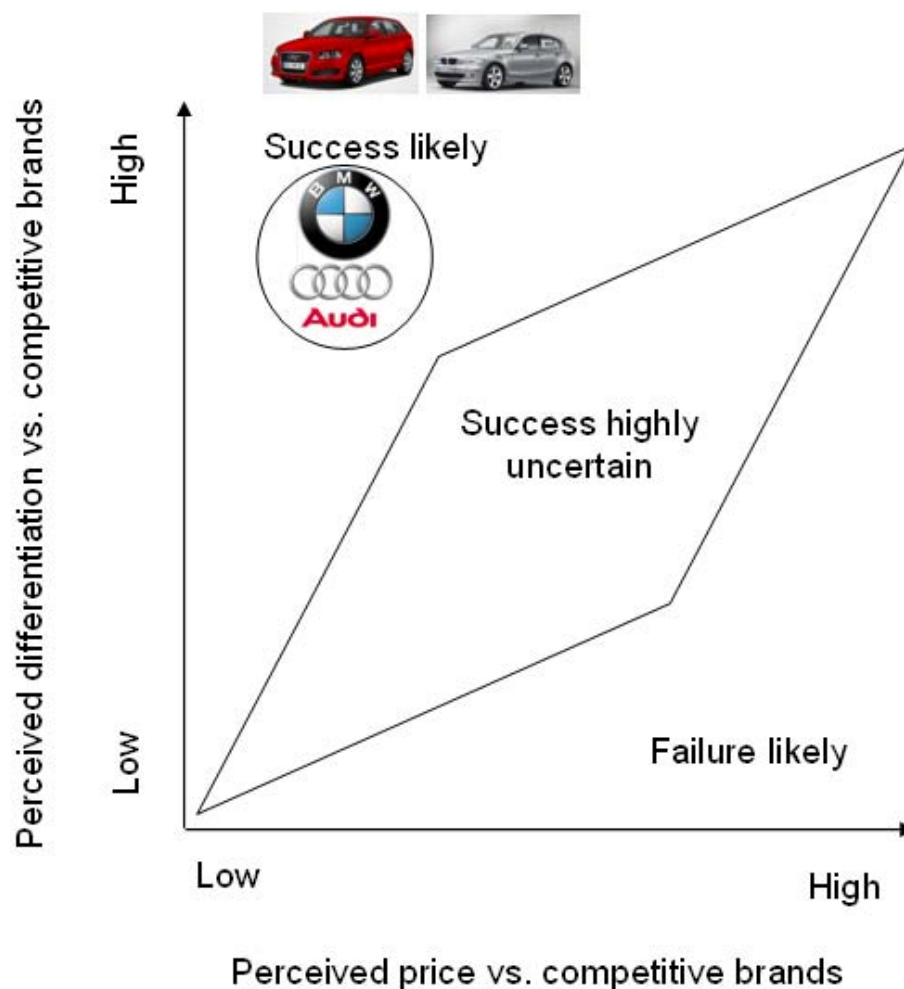


Strategic Management Stage 3**June 2009****Solutions****SECTION A (34 marks)****Question A1**

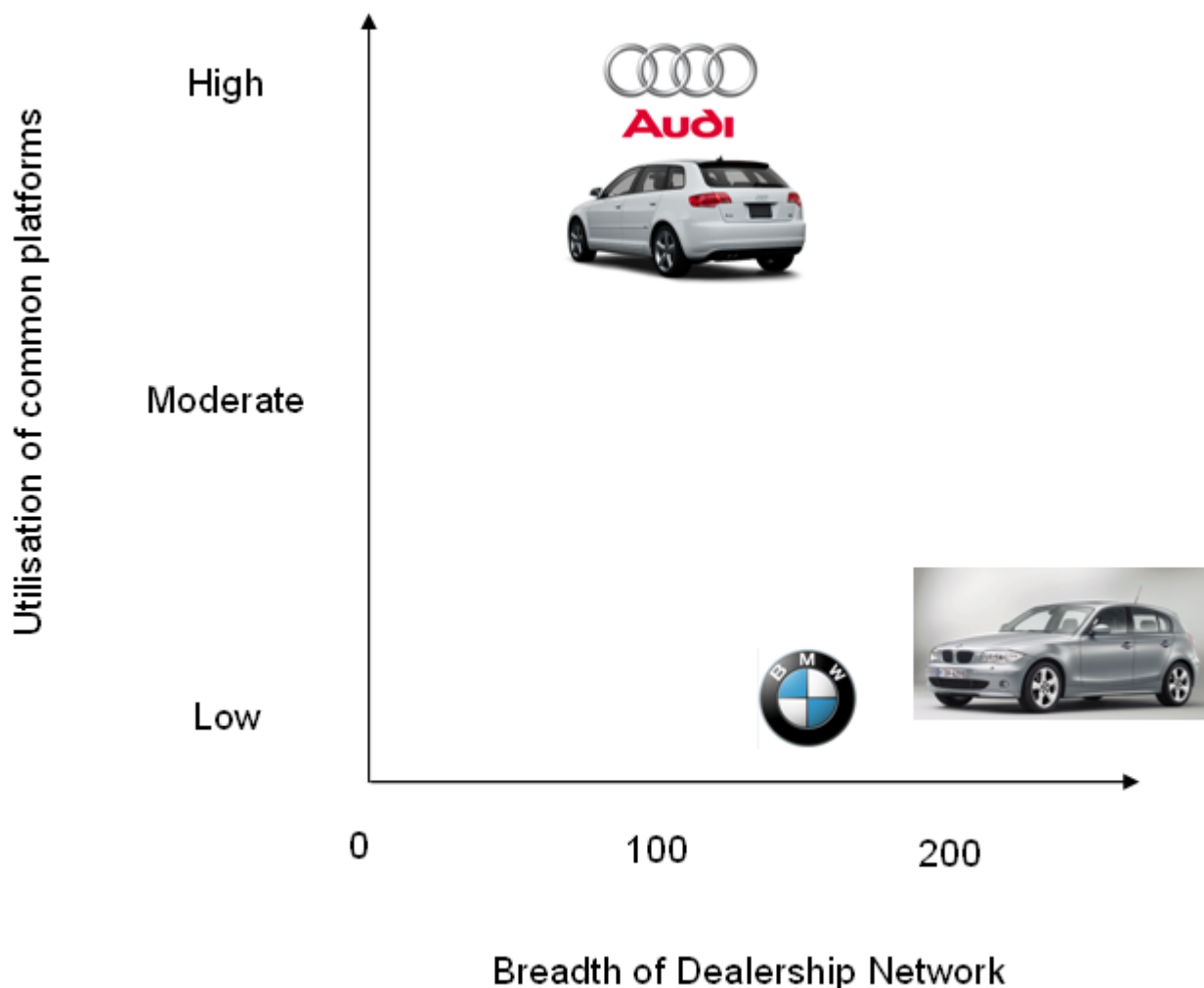
- (a) Audi and BMW can be positioned in the same strategic group (see Figure 1). Customers perceive the A3 and 1-series vehicles produced by Audi and BMW respectively as being upmarket brands that offer “better” quality than other c-segment vehicles. Moreover, the case study states that the Audi A3 and BMW 1-series are generally several thousand pounds more expensive than equivalently powered and equipped c-segment vehicles. From the aforementioned discussion Audi and BMW would appear to be the main rivals competing in the premium c-segment of the automotive industry. Despite the recession the popularity and appeal of these vehicles amongst customers is expected to remain buoyant. Based on the aforementioned discussion Figure 1 was constructed, which illustrates the perceived price and differentiation matrix for the UK’s premium c-segment of the automotive industry was constructed.

Figure 1: Perceived price/differentiation matrix for the UK’s premium c-segment of the automotive industry



The construction of various strategic group maps revealed that the competitive characteristics of both Audi and BMW are very similar. Nevertheless an evaluation of the case study reveals an important point of difference between the two automotive manufacturers. The point of difference focuses on the utilization of common platforms. To illustrate this competitive difference Figure 2 was constructed. In summary, the competitors within UK's premium c-segment generally employ similar strategies, but their component and chassis sharing philosophies are distinct, so could be placed within separate strategic groups for the premium c-segment industry sector.

Figure 2: Strategic group map of the utilisation of common platforms and distribution outlets in the United Kingdom's premium c-segment industry sector



- (b) With the issues raised in question (a) in mind the following analysis using Porter's five forces was constructed for Audi within United Kingdom's premium c-segment motor vehicle industry sector.

- **Supplier bargaining power - Low**

The key issue for both Audi and BMW is the ease with which they can switch between different suppliers and the relative bargaining power of each party. The case study indicates that Audi and BMW cultivate close working relationships with suppliers via interdisciplinary company teams. A close relationship is required because many suppliers to Audi and BMW provide complex, technically sophisticated components. The sophistication of these components would suggest that suppliers would appear to be able to exert considerable bargaining power. However, a danger for automotive suppliers is that they can become too dependent on a single or limited number of manufacturers as a source of income. Thus the relationship between supplier and manufacturer can become so intertwined that a mutual interdependence develops whereby the manufacturer's interests become the predominant focus. In this situation the suppliers bargaining power is low, because their wishes become subservient to the manufacturers requirements. Suppliers of commodity components like spark plugs and generic light bulbs will also have low bargaining power.

Not mentioned in the case are labour unions which are an important source of supplier power. Both German automotive manufacturers have a high percentage of unionised employees and this reduces their profitability as well. Furthermore, the acquisition activities of the global steel manufacturer, Mittal, means that its influence over the automotive industry has greatly increased over the years. Mittal's degree of influence has moved from a position of low bargaining power to moderate, or even high, depending on the type of steel required.

- **Threat of substitutes - High**

The threat of substitutes for Audi and BMW in the premium c-segment motor vehicle industry sector is high. The greatest threat is from other strategic groups or sectors of the industry. In particular, the vehicles available from other c-segment manufacturers provide a substantial threat for Audi and BMW. The case study detailed the numerous automotive manufacturers' that market vehicles in the c-segment like Ford Focus, Vauxhall Astra, Citroen C4, Peugeot 307 and Renault Mégane. The existence of substitutes means customers will switch to substitutes in response to price increases i.e., demand is elastic with respect to price.

Moreover, numerous other forms of substitute transportation are available. However, substitute transportation available does not offer the utility, convenience, independence, and value afforded by automobiles. The switching costs associated with using a different mode of transportation, such as train, may be high in terms of personal time (i.e., independence), convenience, and utility (e.g., luggage capacity) as well.

- **Industry rivalry - Moderate**

Currently, the market for premium c-segment vehicles is dominated by Audi and BMW (duopoly). Price competition is restrained by a “parallelism” of pricing decisions. Specifically, the prices charged across both model ranges tend to be similar. Competition between Audi and BMW focuses on advertising, promotion, product development and technology. In other words competition between Audi and BMW concentrates on building perceived differences rather than price competition. The premium c-segment market has also grown strongly over the years, so gaining sales has not been at the expense of either competitor. Declining sales is unlikely to see Audi and BMW heavily discounting their vehicles to maintain market share. Instead Audi and BMW’s will continue to maintain or gain share by focusing on their long-term strategy of differentiation as stated above. However, the cost conditions confronting Audi will be more advantageous than BMW’s. Since Audi gains advantages from the Volkswagen Group’s common platform strategy and other company-wide synergies it will gain economies of scale and scale efficiencies that will yield superior profit margins compared to its competitor BMW. Sales figures and the case study suggest the common platform strategy has not damaged the creditability and appeal of Audi or Volkswagen vehicles.

- **Threat of new entrants - High**

Audi and BMW are established firms possessing the advantage of brand recognition and customer loyalty within the premium c-segment. Both manufacturers have also clearly differentiated themselves from the volume automotive manufacturers in the c-segment. Complementing the aforementioned advantages is the possession of a coherent distribution network that matches the marketing efforts of Audi and BMW. However, moderating the aforementioned advantages is the prospect of major manufacturers such as Toyota’s Lexus and Mercedes entering the premium c-segment. These automotive manufacturers have the capital, reputation and distribution networks to challenge Audi and BMW. Certainly, market growth rates in the premium c-segment have already attracted the entrance of Volvo and Alfa Romeo with their C30 and 147 models respectively. Audi possesses an advantage over its rival BMW if new competitors enter as it is owned by the Volkswagen Group. The Volkswagen Group generates valuable synergies across its seven automotive brands including Audi, which produce valuable economies of scales and absolute cost advantages to sustain profits if more competitors arrive.

- **Customer bargaining power - Moderate**

Generally, the final customer exerts high power over automotive manufacturers and dealers. The purchase of a motor vehicle, particularly an up-market one, is a substantial cost so most buyers are sensitive about the price paid. Due to the recession, constricting sales in the premium c-segment is likely to intensify the competition between Audi and BMW, so some minor discounting or incentives may be offered. The recession will also cause some switching (due to low switching costs) to less expensive brands or the deferring of vehicle purchases as price-sensitive customers reduce their spending on luxury items. However, perceived product differences and brand loyalty means Audi and BMW customers are likely to view them as being “quality” vehicles worth the extra money. Certainly Audi and BMW customers are likely to be loyal to these automotive manufacturers if the marketing, design and quality of vehicles offered are aligned with their expectations. Moreover, customers for premium c-segment vehicles are likely to be less price sensitive than most. Part of the success of these two vehicles has been their luxury connotations in a small economical package. It is anticipated that the recessionary environment will encourage customers of large luxury vehicles to trade-down to these smaller vehicles to both economise and retain a “quality” image. Hence, the case study’s comment that sales of Audi A3 and BMW 1-series vehicles are expected to remain relatively buoyant despite the recession. Therefore, low switching costs for customers is expected to be moderated by perceived product differences and brand loyalty.

Not noted in the case study, but another reason why sales of these vehicles are expected to be buoyant is due to corporate customers. Corporate customers can attract considerable discounts when they go direct to manufacturers for bulk fleet purchases. In part the good sales of the Audi A3 and BMW 1-series have been due to corporate purchases. For corporate clients the Audi A3 and BMW 1-series represent ideal vehicles for middle ranking executive, i.e. because they are cheaper to run and service than larger luxury models, but still have an up-market image. Furthermore, most Audi A3 and BMW 1-series models possess excellent green credentials due to their low CO₂ emissions and fuel consumption. These green attributes mean executives owning these vehicles paid less personal tax to the UK government.

- (c) The analysis undertaken of United Kingdom’s premium c-segment automotive market indicates a relatively attractive industry sector as it is characterised by moderate competition, relatively loyal customers and low dealer and supplier power. However, the capacity of the sector is under threat; i.e. the threat of substitutes is high due to the many strategic groups or sectors within the automotive industry. A further threat is the potential for a major luxury rival to enter the sector. Looking at each of these issues in detail reveals that a favourable bargaining relationship with suppliers and loyal customers mean Audi and BMW can retain and potentially increase profits when they transact with the aforementioned parties. The highly differentiated strategies of both manufacturers’ mean the degree of rivalry is moderate, so again reasonable profit margins maybe extracted. Profits are largely competed away via both manufacturers marketing and product development effort, rather than by price.

The capacity of the sector is determined by its entrance barriers, rivalry and substitutes. Currently, while rivalry is moderate, the threat of new entrants is high as major rivals have the means and product knowledge to enter the sector. Furthermore, the threat of substitutes is high as numerous manufacturers offer a wide diversity of vehicles which may look more attractive if their prices decrease relative to the Audi A3 and BMW 1-series. Overall the analysis indicates that the sector is currently an attractive investment or sector for Audi and BMW; however, in the future it has the potential to become rapidly unattractive due to capacity increases from substitutes and the arrival of major competitors that possess the reputation, capital, infrastructure and product knowledge to enter.

SECTION B

Question B1

(a) Chapter 9 of Strategic Management

For a *pioneer* company to survive and prosper it needs a strong research and development capability. To support and nurture this capability a firm's management must be prepared to fund research and accept the risk of failure. A research capability requires a company to maintain and recruit high quality people who are allowed sufficient organisational slack to allow them to be creative. The company should also have sufficient organisational slack to be able to shift people around as priorities change as a result of competitive responses. These companies need to obtain regular basis information about their competitive environment and in particular the research efforts of competitors. If at all possible pioneer companies should make extensive use of patent lawyers to provide them with legal protection against copycat products. This will give them a legal monopoly for a period of time and enable them to recoup their research and development costs.

In many cases the pioneering company's finished product will not be completely perfect but will be introduced as early as possible to obtain an advantage over its competitors. The ability to introduce a product early relies on a pioneering company having close co-ordination and co-operation between its production, engineering and marketing functions. A further important requirement for a pioneer company is their willingness to continue to fund the ongoing development of a product so it can be upgraded once it is in the marketplace.

As opposed to *pioneer* companies, *follow-the-leader* companies concentrate their resources on the development of an existing product. Their strategy is to wait and observe what products *pioneer* company's launch. If they decide the product has potential for success, heavy investment in its development will occur. These companies can afford to invest heavily in product development because they are not funding the activities required to undertake fundamental research. Important capabilities these types of companies must possess include a strong market intelligence gathering function that tracks technological developments and advances. These companies will also employ patent lawyers to write legally enforceable patents and to investigate loopholes or ways around competitors' patents.

To support these activities *follow-the-leader* companies require substantial resources for market development purposes. *Pioneer* companies that establish a reputation associated with a product's introduction and early growth have an advantage over *follow-the-leader* companies due to their later entry. To overcome later entry into the market place, *follow-the-leader* companies must swiftly deploy their resources into development projects that rapidly secure market share.

(b) Chapter 11 of Strategic Management

Competing retailers will be attracted to the market; with their entry they begin to undertake marketing activities that collectively build awareness of the product and this further helps to grow demand. New competitors can obtain relatively easy entry based on this unfilled demand.

Due to the increasing number of competitors in the market, retailers start to emphasise their own company brands in their advertising and promotional activities rather than general product awareness. Since the product or service appears to be similar and may have standardised levels of performance and features, retailers begin to enhance the image of themselves as providers in the minds of consumers. So advertising is increasingly used to differentiate a company's competitive position relative to its competitors at this stage of market evolution.

In summary, intense rivalry is not a feature of early growth because there is sufficient demand to allow all companies to survive and grow. In other words growth is derived from the expanding market and not at the cost of another company's sales or market share.

(c) Chapter 14 of Strategic Management

Some companies in a declining industry may become involved in mergers if they are pursuing a leadership strategy option. The leadership strategy option suggests a firm should attempt to dominate an industry. The firm pursuing the leadership position wants to be either the only company or one of the few remaining in the industry. The basis of this strategy is that by dominating the industry a firm is in a much better position to retain a viable level of sales i.e., a strong firm will obtain a more profitable position by forcing out weaker companies and taking possession of their market share.

The acquisition of competitors (horizontal integration) enables a firm to buy market share and obtain economies of scale. For example, discussed in your textbook were the actions of American defence companies, which have been involved in a series of mergers and acquisitions in order to consolidate and rationalise their operations. The rationalisation and consolidation has eliminated excess cost for these American companies, allowing them to compete aggressively on price. In addition, the larger companies are involved in the continuous development of new products such as aircraft or missile defence systems, which require the investment of substantial sums of money. The R&D costs are often prohibitive for smaller firms. As a result, many smaller defence

companies are being forced to divest, seek alliances, diversify into other industries or sell their capacity to these larger companies.

(d) Chapter 13 of Strategic Management

Cost

Cost is an important contributor to achieving competitive advantage in most mature industries. Cost efficiency is determined by five factors (often called cost drivers) which tend to be very important.

(i) Economies of scale

Within manufacturing organisations a traditional source of cost advantage is found in economies of scale, since the high capital cost of plant needs to be recovered over a high volume of output.

(ii) Supply costs

A firm's overall cost position can be greatly influenced by its supply costs. Organisations where the value added through their own activities is small, such as intermediaries, need to identify and manage their input costs very carefully if they are going to be successful.

(iii) Low overheads

Companies which have been the most profitable in mature industries tended to be those that have achieved substantial reductions in overhead costs. Inefficiency in mature firms can be pervasive; it often requires an external shock to a firm's existence to stimulate change.

(iv) Product/process design

The cost position of a mature firm can also be influenced by innovations in the way products and processes are designed. This process considerably reduces cost and project development lead times.

(v) Experience

Organisations undertaking any activity learn over time how to do it more efficiently; thus from accumulated experience they may attain a cost advantage. Companies that have a higher market share than their competitors are able to accumulate more experience, so it is very important to gain and hold market share.

Differentiation

It is particularly attractive for mature industries to escape the constant threat of price competition and obtain some sort of protection through a degree of differentiation. The search for differentiation may involve the identification of attractive and profitable segments. In addition, the search for differentiation within mature industries often necessitates the introduction of an innovation. These innovations may include the identification of new activities or re-configuring old activities in new ways that are unique to the industry i.e., image change, revamped retail concept, new approaches to customer segmentation, or distributing products in distinctly different ways.

SECTION C

Question C1

- (a) Drawing upon the material in Chapter 1 of the provided reading material, answers should consider models such as Simple Stage Theory, International Product Life Cycle Theory, Internalisation Theory and The Eclectic Paradigm or OLI model as explanations for business globalisation, and illustrate their answer with particular reference to country- and company-specific incentives to globalisation, distinguishing between home-country push factors and host-country pull factors. Good answers should offer some critical analysis of the relative merits of the various theories and also provide a range of company/industry examples.
- (b) With regard to the choice of structural form for new country market entry, answers should outline the principal contractual, organisational and managerial features of wholly-owned subsidiaries, international strategic alliances and international joint ventures. Good answers in this section should indicate that the choice among these possibilities will depend upon a range of product/market characteristics, and such answers should also include appropriate examples.

Question C2

Drawing upon Chapter 7 of the core reading material provided, answers should refer to the range of ethical issues faced by internationalising firms. This includes issues of factor market dominance (including labour and other supply markets), relations with local competitors, the range of relationships with host-country governments, legal and taxation authorities, broader issues of the cultural impact of large, international companies on small host economies, and also the negative impact of such inward investment on the natural environment of the host country. Specific practices that may be analysed include the employment of child 'sweatshop' labour, corruption of local officials, dominant relations with local trade unions, and ignoring of important host-country cultural values and insufficient care of the host-country environment. Good answers should provide a range of examples - different countries and business situations - to support their analysis.

Internationalising companies may argue that they will not secure contracts in overseas host countries unless they engage in certain of the above business practices, including corrupt relations with influential host-economy nationals. They may also feel with regard to a range of employment practices that they are simply 'paying the local host-economy going rate for the job'. However, such companies should recognise the damage that can be done to public relations in general and also their wider brand image in particular unless they publicise and formally adopt appropriate 'Western' codes of practice relating to the above range of matters, including environmental issues.