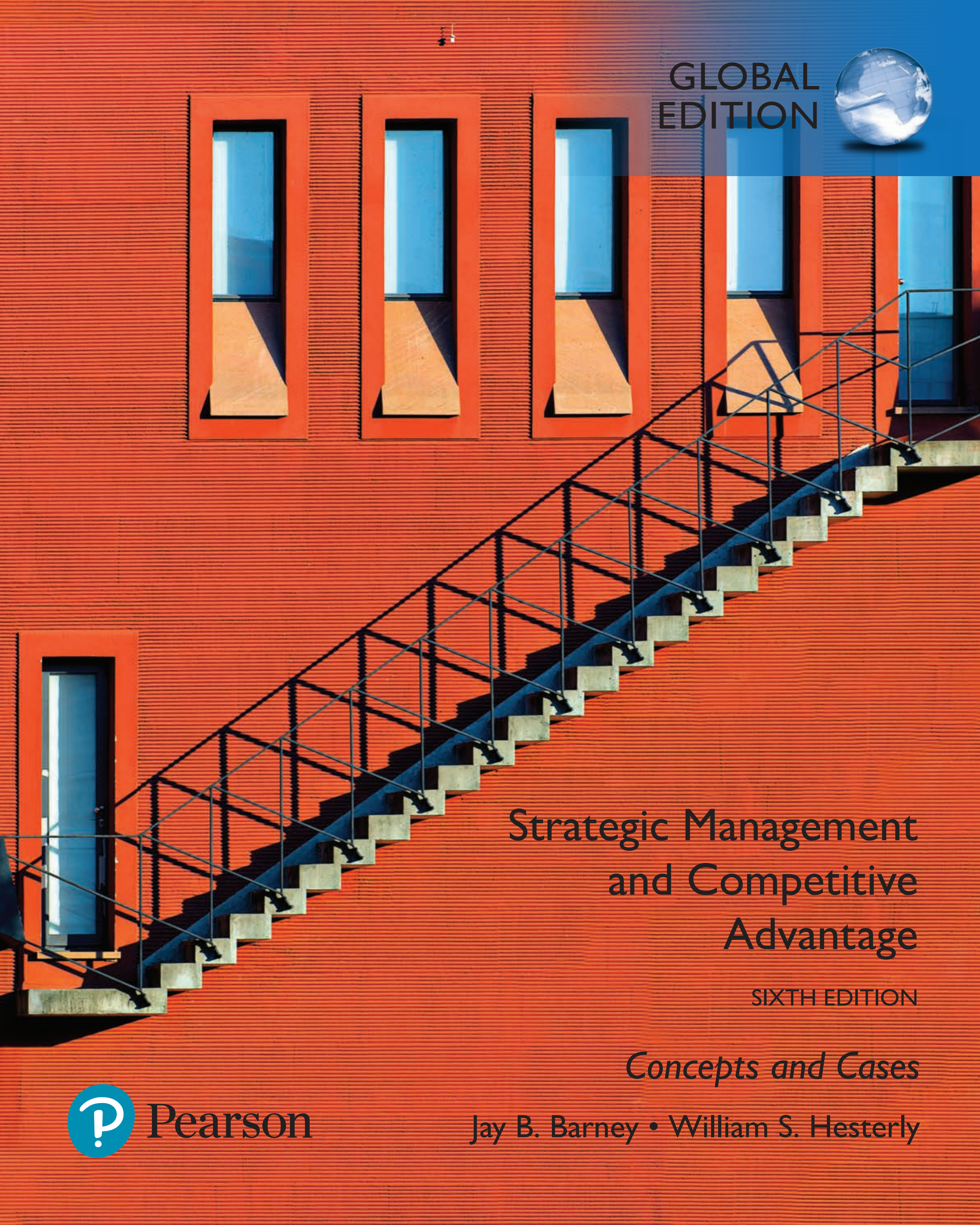

GLOBAL EDITION

Strategic Management and Competitive Advantage

SIXTH EDITION

Concepts and Cases

Jay B. Barney • William S. Hesterly

Pearson

V R I O

"**V**ALUE. **R**ARITY. **I**MITABILITY. **O**RGANIZATION."

What Is It?

This book is not just a list of concepts, models, and theories. It is the first undergraduate textbook to introduce a **theory-based, multi-chapter organizing framework** to add additional structure to the field of strategic management.

"VRIO" is a mechanism that integrates two existing theoretical frameworks: the positioning perspective and the resource-based view. It is the primary tool for accomplishing internal analysis. It stands for four questions one must ask about a resource or capability to determine its competitive potential:

1. **The Question of Value:** Does a resource enable a firm to exploit an environmental opportunity, and/or neutralize an environmental threat?
2. **The Question of Rarity:** Is a resource currently controlled by only a small number of competing firms?
3. **The Question of Imitability:** Do firms without a resource face a cost disadvantage in obtaining or developing it?
4. **The Question of Organization:** Are a firm's other policies and procedures organized to support the exploitation of its valuable, rare, and costly-to-imitate resources?

What's the Benefit of the VRIO Framework?

The VRIO framework is the organizational foundation of the text. **It creates a decision-making framework for students** to use in analyzing case and business situations.

Students tend to view concepts, models, and theories (in all of their coursework) as fragmented and disconnected. Strategy is no exception. This view encourages rote memorization, not real understanding. VRIO, by serving as a consistent framework, connects ideas together. This encourages real understanding, not memorization.

This understanding enables students to better analyze business cases and situations—the goal of the course.

Within each chapter, the VRIO framework makes it possible to discuss the formulation and implementation of a strategy simultaneously.

Because the VRIO framework provides a simple integrative structure, we are actually able to address issues in this book that are largely ignored elsewhere—including discussions of vertical integration, outsourcing, real options logic, and mergers and acquisitions, to name just a few.

Table 2 North American Women's Fiction Market Size Estimate, 1993 (as a percentage of overall segment sizes in US$ millions)

	General Fiction	Romance	Mystery	Sci-Fi	Total Fiction
Total Segment Size	**2,222**	**1,220**	**353**	**476**	**4,271**
Estimated Women's Fiction Share of Segment	60%	100%	60%	38%	69%

Harlequin's Single-Title Task Force

Faced with slow or no growth in series romance, a Harlequin task force convened in 1992 to study the feasibility of launching a new women's fiction single-title program. To begin, they examined why Worldwide had failed and concluded that overall lack of success was attributable to: editorial parameters that were too broad; less than optimal North American retail distribution; very few Worldwide titles distributed through the direct-to-reader channel; global support for the program was not timely and universal; and the selection of authors and titles was unsuccessful. The task force report stated:

> *In the past few years, sell-through efficiencies in the supermarket channels are not as great as the sell-through efficiencies in both mass merchandisers and bookstores. The more efficient retailer knew that the consumer was spending her discretionary reading dollar to buy a diversity of romantic reads, including those that had previously been thought of as mainstream.*
>
> *Since a single-title strategy requires a single-title solicitation from the sales force and more expensive single-title packaging, two of Harlequin's strategic lynchpins of our earlier decades have to be rethought (for single-title): standing order program and same format production. However, Harlequin can still capitalize on its global base and its ability to distribute widely to points of purchase that women visit on a regular basis.*

MIRA Launch Decision

The task force was preparing its recommendation for MIRA, Harlequin's proposed women's fiction single-title program. The addition of single titles would make a welcome contribution to overhead costs. Currently, indirect overhead costs per series novel were $0.09 per book. Because infrastructure was already in place, it was estimated that MIRA novels would not incur additional indirect overhead costs. Printing costs for single-titles were expected to be $0.71 per book (350 pages on average). Estimated advertising and promotional costs for new single-titles were six percent of (the higher) retail price.

Author Management

In the single-title market, authors were categorized into three groups, based on their sales potential: brand new, mid-list, and best-seller (see Exhibit 8). Depending on the author group royalties, sales, and promotional support varied. Best-selling authors were expected to sell more than a million books. Publishers were known to sign established authors for up to a five-book contract with large multimillion dollar advances. It had not been determined whether MIRA should follow suit. In addition to author advances, typical royalties per MIRA-type book were estimated to be 13 percent of the $6.75 retail price.

Exhibit 8 General Industry Contract Terms for Fiction Category by Author Group

	Brand-New Author	Mid-List Author	Best-Selling Author
Advance	$10,000 to $30,000	$80,000 to $200,000	$1 million to $5 million
Royalties	5% to 13%	8% to 15%	10% to 17%
Overseas Publishing Schedule	Within 18 months	Within 12 months	Simultaneous
Overseas Publishing Markets	Major markets	All markets	All markets
Minimum Distribution	30,000 to 80,000	100,000 to 400,000	>1 million
Promotional Support per book	Possibly some support (up to $50,000)	Support ($100,000)	Very strong support (more than $300,000)

Sources: Industry sources and casewriter estimates.

A Different Format

Women's fiction books were expected to have many differences from well-defined series romance books. Unlike series romance, topics would cover a broader range of segments including general fiction, science fiction, and mystery. Women's fiction books would be longer in length: 100,000 to 400,000 words compared with a series romance book length of 75,000 words. Naturally, book sizes would be bigger in terms of page length: from 250 to 400 pages versus a norm of 192 to 304 pages for series romance.

Distribution

Harlequin had a strong distribution network for its series romances through supermarkets, drugstores, and discount department stores. Single-title women's fiction novels required more mainstream distribution focusing on retail bookstores. In addition, standing order distribution, a hallmark of Harlequin's series romance business model, would have to be abandoned in favor of relying on orders generated by the distributor's sales force for single-titles.

Success in the United States would be key for MIRA, and in this market, Harlequin relied upon Simon and Schuster's sales force. Since S&S was a major single-title publisher, Harlequin did not know how much support MIRA would be afforded. Harlequin was considering offering better margins to the distributors than those it offered for series romance distribution. Expenses for single-title distribution were expected to be $0.27 per book.

MIRA books would rely more heavily upon distribution through bookstores when distributed through the same channels as the series product. Retailers would be encouraged to shelve MIRA books separately from the series offering. The more intensive selling effort for single titles would require four percent of the single title retail price. The new single-title program planned to offer $3.38 in margin to the distribution channel for single-title books (50 percent of the typical retail price of $6.75) versus $2.42 for series books (45 percent of the $4.40 suggested retail price).

Acquiring Single-Title Rights

Harlequin subsidiaries in some countries were already buying rights to publish single titles. By launching MIRA Harlequin could negotiate better global-author deals. The task force report added, "By acquiring mainstream titles through a central acquiring office, the collective clout of Harlequin could create the likelihood of better-selling mainstream titles marketed by all countries in the global enterprise."

Harlequin's author and editor relationships remained strong, so much so that many series authors were enthusiastic about maintaining a long-term relationship with a trusted editor as they pursued their break-out mainstream book. With MIRA, these authors could remain loyal to Harlequin.

How Best to Proceed

There were many issues to be resolved prior to any launch of MIRA. Most pressing was the question of whether Harlequin had the resources and capabilities to succeed in its new women's fiction segment. Certainly there were elements of its series business model that could be transferred to the broader women's fiction market. But what were the gaps? What else did Harlequin need?

Hayes had several options if MIRA was launched. Several established best-selling authors had begun their writing careers with Harlequin and had moved on to writing single-title books. These authors had established reputations. Harlequin could approach one or more of these authors to sign with MIRA/Harlequin. Such an arrangement would involve a multi-book contract and substantial advances. While risky, this approach would ensure that MIRA's launch attracted attention.

A different, seemingly less risky alternative was to tap into Harlequin's extensive back-list collection and reissue a selection of novels by current best-selling authors currently signed with rival single-title publishers. The physical size of the book and page length could be extended to 250 pages from 192 by adjusting format. In addition, a new, MIRA-branded cover could be produced to repackage the books. Coincident with the launch of this back-list, Harlequin's editors would cultivate and develop existing series authors, encouraging them to write single-title books for MIRA.

Returning to the strategic dilemma that Harlequin faced, Swift commented on the challenge of successfully launching MIRA:

> *Our biggest challenge is the requirement to publish on a title-by-title basis. Every new book will have to stand on its own, with its own cover, a new marketing plan and possibly even an author tour. Can we as a company develop the flexibility to remain nimble? How patient should we be in waiting for success? Given Worldwide's poor results, how should we approach this challenge?*

End Notes

1. To protect confidentiality, all financial information within this case study has been disguised.
2. This section is adapted from the Richard Ivey School of Business case # 9A87M002. Harlequin Enterprises Limited—1979, Peter Killing.
3. All amounts are a percentage of the suggested retail price.
4. Numbers are for the typical paperback. Hardcover books cost more to produce, but as a percentage of its higher retail price, printing costs were roughly the same proportion.
5. All amounts in Canadian dollars unless otherwise specified.

PART

2 BUSINESS-LEVEL STRATEGIES

CHAPTER

4 Cost Leadership

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

4.1 Define business level strategies.

4.2 Define cost leadership as a business level strategy and identify six reasons firms can differ in their costs.

4.3 Describe how cost leadership can create economic value for a firm.

4.4 Identify the bases of cost leadership that are more likely to be rare and costly to imitate and those that area less likely to be rare and costly to imitate.

4.5 Explain how firms use a functional organizational structure, formal and informal management controls, and compensation policies to implement cost leadership strategies.

Brathwait: A Transparent Watchmaker

Brathwait is a new entrant into the minimalist watch segment, but it has a significant competitive advantage—the low price of its watches. Brathwait's mission is to bring transparency into the field of watchmaking by informing their customers about the total breakdown of the production costs and the amount of profit they make per item. According to Henrik Torp, the founder and CEO, Brathwait minimizes the watches' costs to give the customer an excellent watch at a much lower price in comparison to traditional brands, which charge exceptionally high prices. Industry insiders believe that Brathwait is poised to make a big splash in the minimalist segment of the global wristwatch market, and it's all down to their transparent marketing strategy.

The unlikely inspiration for a brand of exquisitely designed minimalist watches came from a book called *The English Gentleman*, authored by Richard Brathwait in 1631. His codes of etiquette were a huge influence on the way people were expected to behave in society. The watch brand is named after him not only to acknowledge his legacy but also to reflect the values of the modern gentleman and gentlewoman who follows the heritage of those codes of etiquette—and, of course, wears Brathwait watches.

The watch industry is going through the second phase of disruptive innovation due to the arrival of smartwatches. The traditional watchmaking industry has entertained

a gloomy outlook for the last two years, but the industry experienced a similar disruptive phase during the 1970s with the advent of Japanese quartz movement technology—a quartz watch is powered by an electronic oscillator synchronized by a quartz crystal. The more recent disruptions in the industry have not stopped Brathwait's entry into a market dominated by Swiss manufacturers. In addition, recent performance data shows a rebound of traditional watches in the market. The Swiss watch industry has reported CHF 5.0 billion in exports in the second quarter of 2017, compared to CHF 4.8 billion in 2016.

ruzanna/Shutterstock

Manufacturing watches only costs a fraction of the total cost; a substantial proportion of it is spent on exclusive promotions and advertising. A Swiss quartz movement with extra-long battery life can cost as little as $10, and Chinese-made quartz movements are even cheaper at $3. However, due to celebrity endorsements and other branding activities, the final price of an average Swiss watch can be fifty times the original cost or even higher.

Brathwait keeps costs low by manufacturing its watches in China, excluding intermediaries (like retailers and stockists) and using an advertisement strategy that focuses on social media. The components are sourced from Italy (leather straps), Switzerland (quartz movement), and Japan (automatic movement). Their cost breakdown, available on its Web site, shows a total cost of $92.35 for the Classic Swiss model.

To gain market share at the higher end of Swiss-made watches, Brathwait launched a few limited editions of automatic watches powered by the Sellita Sw260-1 high beat movement; the higher number of jewels in Sellita reduces the friction in automatic winding, increasing reliability. The strategy for the limited-edition Brathwait watches is to offer the elegance of the Swiss watches at an affordable price.

Brathwait's story is an intriguing for its dual proposition of breaking the secrecy of watchmaking and offering watch-lovers high-quality timepieces at an affordable price. However, it should be said that the company is still a new entrant, and it may face numerous entry barriers and growth pains in the future.[1]

The Brathwait watch company has been able to grow in an industry traditionally dominated by Swiss watch manufacturers such as Swatch and Tissot. Brathwait's success so far is attributed to its stylish wristwatches that are considerably less expensive than its more established rivals. Brathwait is a classic example of a low-cost strategy.