

# Market-Driven Management and Global Economies of Scale

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## Abstract

*In market-driven management, dominated by competitive customer value, economies of intensity of sharing, or synergies, can be linked to global economies of scale.*

*A market-driven management strategy radically alters the interpretation perspective of the issue of synergies. In market-driven management, synergies or economies of intensity of sharing do not derive from 'pooling resources' in order to saturate manufacturing capacity better, but from exploiting a store of skills to support different businesses.*

*The cases presented (Geox and Yamamay) regard companies that can be defined as competitive customer value oriented, partly as a result of their capacity to exploit economies of intensity of sharing, by synergetic recourse to their basic skills.*

**Keywords:** Market-Driven Management; Global Economies of Scale; Over-Supply; Competitive Customer Value; The Yamamay Case; The Geox Case

## 1. The Role of Synergies in the Formulation of Strategies

This analysis focuses on the role of synergies in the context of a market-driven management strategy dominated by competitive customer value. In a market-driven management strategy dominated by competitive customer value, economies of intensity of sharing, or synergies, can be linked to global economies of scale. But economies of intensity of sharing should be linked to intangible assets, whose value does not increase in relation to the degree of exploitation of elementary manufacturing factors, but in relation to the 'intensity of sharing' of specific resources in a networking system, i.e. in an organisation where there is a close collaborative relationship between internal and external structures and co-makership (Brondoni, 2004 p. 20).

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This article proposes an analysis that traces the evolution of the question of economies of intensity of sharing, otherwise known as synergies (Ansoff 1964, Porter, 1982, 97, Prahalad and Bettis, 1986; Goold and Campbell, 1987, Hax and Majluf, 1991, Grant, 1994, Zook 2004), and focuses attention on a possible interpretation of the issue in the context of a market-driven management orientation. Compared to traditional interpretations, a market-driven management strategy dominated by competitive customer value radically alters the interpretation perspective of the issue of synergies. In market-driven management, synergies or economies of intensity of sharing do not derive from ‘pooling resources’ in order to saturate manufacturing capacity better, but from exploiting a store of skills to support different businesses. The corporate portfolio is not evaluated as a portfolio of businesses, but as a portfolio of skills (which in turn feed/generate different businesses). The problem is not that of saturating a resource that is not used, but of exploiting and instilling value in skills. Synergies or economies of intensity of sharing derive from the possibility of applying the same managerial style, the same systems of governance and communication, and in general the same intangible assets, in different but similar businesses. In practice, choosing businesses that are similar (non necessarily from a technological viewpoint) implies the possibility of applying similar ‘knowledge’.

The article becomes more specific, developing from a theoretical analysis to a concrete analysis, studying two corporate case studies. The cases presented regard companies that can be defined as competitive customer value oriented, partly as a result of their capacity to exploit economies of intensity of sharing, by synergetic recourse to their basic skills. This is the case of successful companies like Geox and the Inticom group that operates on the market under the Yamamay trademark. The companies examined operate in mature, over-supplied markets and are exposed to global competition. The success of these companies is linked to their ability to organise their activities on the market, overcoming the spatial and functional barriers of competition. Their success can basically be put down to the application of market-driven management strategies dominated by competitive customer value and to the appearance of synergetic effects.

The concept of synergies has been known and used, albeit often with different terminology, in Italian and international management theory for some time (Rispoli 1989). Synergy is a word with Greek roots (a compound of *syn*, together, and *ergon*, work), and means simultaneous activity, force, action or combined effect (Ansoff 1965). The term synergy is generally used to indicate a force, an action capable of producing – generally, but not necessarily – a result that is larger than the sum of the individual components and in any case an exaltation of their characteristics. For Ansoff (1965), synergy is one of the most important elements of the strategy related to the combination of a company’s product with its market; it regards the characteristics of adaptation that are demanded of a company in order to enter the market. Hofer and Shendel (1978) defined synergy as one of the constituent elements of strategy, seen as a fundamental system of the current and planned use of assets and of interaction with the environment whose constituent elements are: radius of action, investments of assets, competitive advantages and synergy.

The central nature of the issue of synergies in the context of strategy formulation is probably linked to the fact that, following on to Chandler's work (1962), the US model of the large diversified business has spread to the Western world since the 1960s. Diversification strategies appear as strategic choices that strive for maximum 'exploitation' of the factors through the quest for synergies (Ferrucci 2000). However, in the first strategic formulations, analysis of the synergetic effects, which is included in the study of the advantages that derive from the decision to diversify, adopted the approach of a business that employs transactions associated to the Ford-Taylor business model. The link between the decision to develop diversification strategies and the emergence of the synergetic effects described in Ansoff's work (1965), can therefore be seen in the context of a transnational corporation that tries primarily to maximise efficiency. At the basis of decisions to diversify, there was, on a par with what happened when strategic orientations were developed on the basis of manufacturing standardisation, a conviction that competitive advantage could not be separated from attention to costs. The idea behind this approach was that a business with a broad product range could benefit from larger total income volumes and/or lower costs than competitor companies operating in a single product/market combination. The analysis of the synergetic effects was based on the identification of the methodology that made it possible to 'measure' the advantages associated with the presence of a business in more than one market<sup>1</sup>. The concept that was introduced, referring to the emergence of synergetic effects, was that of economies of scope. Economies of scope, in the strictest sense of the term, were considered among the main advantages of the decision to diversify and produced specific cost advantages<sup>2</sup>, on a par with economies of scale.

The cost advantages associated to economies of scale are the result of the repetition of the operations and products developed, while the cost advantages associated to economies of scope derive from interrelations between the business units of the diversified corporation. The economies of scope are typically tied to the joint use of certain manufacturing and marketing factors, the complete utilisation of resources, the reduction of non-operating times and the elimination of some repeated activities. Even in Ansoff's work (1965), when he mentions the effects of the decision to diversify, referring to sales synergies, operating synergies and investment synergies, he is essentially referring to a concept of synergies ascribable to the effects of the economies of scope in the strictest sense of the term, i.e. a reduction in costs achieved as a result of an increase in the variety of outputs produced. The concept of economies of scope, in this more limited sense of the term, is unable to take into account all the 'synergetic' effect that are generated, due to the implementation of diversification strategies. Ansoff himself mentions not only sales synergies, operating synergies and investment synergies, but also the managerial synergy that is generated as a result of the emergence of operating problems that are at least partially similar to those already dealt with in other operating contexts.

Subsequent to Ansoff's work, in the context of Porter's analysis and in what was still a conventional perspective, the following can be seen to emerge in diversified corporations (Genco, 2008):

- tangible interrelations triggered by the opportunity to spread common activities over several business units within a single chain of value (Porter, 1985, 1987; Grant, 1994; Hax and Majluf, 1991);
- intangible interrelations that imply the sharing of knowledge between businesses with independent chains of value. In particular Porter felt that it was possible to transfer accumulated expertise from one business to another if certain basic similarities existed: the same basic strategy, the same type of customer, a similar chain of value configuration, and important value-generating activities. Typical examples of intangible interrelations regard the corporate brand and image, technological knowledge, managerial capabilities (at a functional level and with regard to governance of the company), and the corporate culture.

In tangible interrelations, the prevailing viewpoint is the traditional division of costs, whereas in intangible interrelations the exploitation effect starts to emerge. Intangible assets and intangible interrelations resources increase with use (for example: the more trademark is used for different but related businesses, the more the value of the trademark itself is reinforced). The corporate portfolio is not assessed as a business portfolio but as a portfolio of skills, which in turn feed/generate different businesses. Skills thus emerge as a particular case of synergy that creates value by developing and extending capabilities and knowledge in a portfolio of different businesses.

The perspective changes compared to previous approaches. Synergy no longer derives from combining to saturate a manufacturing capacity better, but from exploiting a group of skills to support different businesses. The skills grow and increase in value with use. In the new business conception, unlike the Ford conception, the only concretely significant source of value is the cognitive heritage accumulated that can be developed by each business. Knowledge, unlike other sources of competitive advantage, has more chance to grow and develop because of its dissemination. In other words, the more companies manage to spread and share the heritage of accumulated knowledge within a system of relationships, the greater the possibilities the businesses themselves have of exploiting the knowledge accumulated and of developing it as a consequence<sup>3</sup>. Economies of intensity of sharing therefore, even if they are observed from inside the model of a global corporation structured in divisions, can develop within a model of a competitive customer-value-oriented business in which the competitive capacity comes to depend on the capacity to share cognitive resources and to reveal *an extra something* that would otherwise be unobtainable, from the relations established with the market and the resulting innovative processes.

## **2. Synergies in the Context of a Market-Driven Management Strategy**

In the context of this new economy and these new competitive logics, the critical element of success is the sharing of the acquired knowledge among the players in the system<sup>4</sup>. While a physical asset ceases to be possessed when it is sold, an idea, a piece of information or knowledge continues to be possessed even if it is passed

on and can be reproduced infinite times. The spreading and sharing of innovative developments (application of the knowledge) constitutes a way of creating standards and increasing the innovative process exponentially (the spread of knowledge generates new knowledge and therefore new value). On the other hand, reserved management of the cognitive progress achieved risks generating a scarce value which will probably be rapidly exhausted. The problem is not therefore to saturate an asset that is not used, but to exploit and increase the value of skills (Prahalad and Bettis, 1986). The quest for synergies, tied to knowledge and skills, therefore becomes a fundamental source of corporate development. Synergies therefore seem to emerge as important means of achieving what can be defined as 'corporate metamorphoses' (Garzella 2001). In an attempt to strengthen the positions of competitive advantage, 'corporate metamorphoses' identify new development processes, and new business to explore, focusing on the interrelations that can be established between today's strategies and those that may prove winners in the future, combining the whole in a strategic design in which the conditions for the latter can be identified in the former (Garzella 2001). In fact, the reference to the phenomenon of metamorphosis derives from the awareness that although it is true that the company can change its physiognomy so radically, internally and in relation to the outside world, it is also true that in most cases an evolutionary leitmotif can be identified, more or less clearly (Garzella 2001). Additional theoretical analyses thus emerge, like the so-called neighbourhood theory, according to which development can only take place in neighbouring businesses, in order to incrementally exploit the knowledge developed in their core businesses (Zook 2004). Neighbourhoods are basically *geographical areas* (internationalisation) or the *steps of the chain* (vertical integration) (Zook 2004). A strategy's success rate decreases the further it is from the core business, because it is less possible to exploit and raise the value of the knowledge and resources matured in the core business (Zook, 2004). The exploitation of skills translates into the activation of a virtuous circle of innovation and development (the resources and skills acquire value and are developed with use) and makes it possible to activate a system of internal consistency characterised by relations of complementarity and supermodularity of the resulting function. It is obviously necessary to avoid the emergence of the phenomenon of the 'mirage' or 'amnesia'. In some cases the presence of a simple mutual relationship is sufficient, combined with a 'thirst for growth', to induce us to overestimate its synergetic potential and to underestimate difficulties, risks and costs generating the so-called 'mirage of synergies' which induces us to consider easy and achievable situations which actually present a high level of strategic-organisational difficulties (Garzella 2001). In other cases, after having performed an accurate analysis of the interrelations in order to identify the potential and synergetic risks, the economic entity seems to forget the actions and attentions necessary to transform potential synergies into actual synergies, as if struck by a sort of 'amnesia' (Garzella 2001).

In conditions of hyper-competition, a market-driven management strategy has a 'market-oriented management philosophy', characterised by a direct, continuous comparison with competitors. Market-driven management focuses on an outside-in vision based on: the identification of products with a higher value than that of the competitors to force the convergence with demand; the creation of the maximum

temporary value and planning and offering assets to instable aggregates of clientele; the time-based acquisition of market knowledge (Brondoni 2007). In short, in situations of extremely dynamic competition, successful businesses are those which, by satisfying instable aggregates of clientele, base their competitive dynamism on the ability to continuously and synergetically instil value in the system of corporate intangible assets in the various businesses. Relations based on complementarity and the synergetic exploitation of skills in the management of corporate processes characterised by specific product-consumer relations and great volatility were at the heart of the analysis. Synergies can be considered as a critical driver of a strategic dimension of 'time based competition', characterised by continuously innovative processes and changeable demand.

Analysis of synergies in the relationship with consumers, in the light of the market-driven management paradigm, may find useful examples, over and above theoretical arguments, in concrete cases and experiences. The exploitation of intangible potential derives from a capacity to exploit managerial synergies with reference to the value acknowledged by the customer. As in the case of synergetic effects, *an extra something* is generated inside a systematic business/customer relationship, which is basically the consequence of a co-evolutionary process that involves the corporate system in its relations with the market<sup>5</sup>.

### **3. Market-Driven Management and Over-Supply. The Cases of Yamamay and Geox**

The case histories presented to support our theoretical analysis regard companies that can be defined as oriented to competitive customer value thanks to a capacity to synergetically instil value in their basic skills. This is true of successful companies like the Inticom group, which is represented on the market by the Yamamay trademark, and the Geox group.

The businesses considered operate in mature, over-supplied market sectors, they are exposed to global competition and over time they have succeeded in enhancing the skills possessed by the way they manage relations with consumers, synergetically and incrementally exploiting the knowledge acquired<sup>6</sup>. Both Geox and Yamamay were born from a capacity to create products with a value higher than that of the competition, and a capacity to identify the innovative intersection of supply vacuums and customers' unsatisfied needs. In both the cases analysed, the factors that determine their success include particular managerial capabilities, in other words a range of accumulated skills that translate into the definition of brand whose value identifies the company product and the acquisition of specific channels for relations with the market that translate into the capacity to acquire information that is vital for the company. Yamamay bases the creation of value primarily on a capacity for time-based acquisition of market knowledge and a capacity to offer consumers the products they want in real time. Geox on the other hand, strives constantly to create a product with a higher value than that of its competitors, and to translate this into value perceived by the market. By two different methods, both cases reveal that synergetic relations with the market are essential in a logic that implements 'market-driven' managerial models. Briefly,

Yamamay seems to focus on extensive distribution logics that characterise the corporate supply system, while Geox focuses more on identifying innovative supply systems. Neither Yamamay nor Geox addresses a specific market target, and both stand out for their transverse customer target.

If we wish to consider the origins and effects of the synergies in the two cases of market-oriented businesses, it may be useful to briefly summarise their corporate histories, highlighting their principal managerial characteristics.

### 3.1 The Case of Yamamay

Yamamay is the trademark under which the Inticom group operates in the retail sector, selling lingerie, nightwear and beachwear. The Inticom group was created in 2001 by the merger of two families with strong, complementary skills in the lingerie market: industrial competence and marketing and distribution competence. Thanks to its extensive and comprehensive product range, the transverse nature of its consumer target and the perceived quality/price ratio, the Yamamay brand and shop have rapidly become absolute leader of the Italian underwear and beachwear market. In just six years, Inticom has created a network of over 470 single-brand outlets (Company Profile, 2008). The figures contained in a recent study reveal that Yamamay has a 17% share of the Italian lingerie chain market in terms of points of sale, and 13% in terms of business volume (Assofranchising 2007). The data that emerge from an analysis of the reputation, frequentation and image of the major chains of shops specialising in lingerie and beachwear are even more significant: the Yamamay brand is in second place in this sector, behind the market leader, Calzedonia (DOXA 2007).

But how is synergy reflected in the management of the Inticom group? Examination of the case study in the light of the market-driven management orientation, reveals that a first intangible asset emerges from the skills accumulated through the experience gained by the group's governance organs. One of the two families that contributed to the share capital had already successfully experimented the development formula of the Original Marines trademark in the casual clothing market, also gaining similar experience in the handbag, suitcase and leather goods sector with the Carpisa brand. The experience gained in the launch of Original Marines and Carpisa was basically repeated successfully in the development of the Yamamay brand. At the time the traditional marketing formula of the lingerie market, which had been dominated for many years by non-specific outlets, was changing. Strong competition from retail chains, combined with difficulties met by wholesalers to restructure their organisations, created opportunities for more evolved manufacturers, who began to understand the importance of interacting directly with the end customer. The establishment of a direct manufacturer/consumer relationship also allowed a new conception of the product to emerge. The way lingerie was used acquired new contents and meanings. Like other fashion products, it began to be conceived as an accessory to be displayed, in other words, it became socially acceptable for lingerie to be visible (*Company Profile*, 2008).

In the case of Yamamay, the portfolio of skills accumulated by part of the stockholder base contributed significantly to the emergence of new market trends

and a new concept of lingerie. The skills and knowledge were thus applied to different businesses. In other terms, the experience accumulated in the casual clothing and handbag sector was rapidly replicated, successfully and innovatively, in the lingerie market. In other words economies of intensity of sharing (or synergies) typically referable to intangible assets, whose value does not increase in relation to the degree of exploitation of elementary manufacturing factors, but in relation to the 'intensity of sharing'. Synergies respond to a learning logic, on the basis of which they are refined and grow through use and sharing, unlike tangible assets which suffer wear and tear as a result of their use, they primarily consist of information, which has the property of increasing through the exchange process. A company's specific assets and its core competence represent the foundations on which to build and strengthen its position and, at the same time, the base from which to expand its field of action. If we analyse Yamamay's success in the light of these observations, we can see that the experience accumulated in the development of the Original Marines and Carpisa brands has proved to be a precious synergetic intangible asset for the launch and development of the Yamamay brand. Even if we consider the synergies between the two governance groups that contributed to the share capital, we still find synergetic and complementary logics. The commercial skills of one of the two families that founded the Inticom group merged with manufacturing/industrial skills possessed by the other stockholder, making it possible to develop a product that was technologically advanced at a competitive price.

### **3.2 The Case of Geox**

Like Yamamay, the case of Geox is an interesting example of a business that has succeeded in defining an innovative set of corporate decisions. Geox is a company that has succeeded in modifying conventional business models, from inside a mature sector, becoming the protagonist of a process that has 'de-matured' the sector. The management was able to grasp the changes in the competitive environment and to maximise the yield of its own assets and skills, synergetically exploiting its store of technological knowledge.

Shoe companies have traditionally chosen to position themselves in a single segment (for example, classic men's shoes, children's shoes, leisure time footwear, sports footwear, etc.) and to concentrate its innovation on the design of the most visible part of a shoe: the upper (Camuffo, Furlan, Romano, Vinelli, 2004). Geox followed a strategy that was entirely different from that of the competition. It created the 'shoe that breathes' and applied its technologically innovative sole to what were traditionally considered separate business lines (Camuffo, Furlan, Romano, Vinelli, 2004). (The Geox system couples a perforated rubber sole with an innovative membrane that lets sweat out but is waterproof, thus creating a healthy shoe that solves the problem of perspiration.) By focusing on the fact that anyone who wears shoes with rubber soles needs healthier shoes, Geox managed to put in place a multiple positioning strategy, competing in market segments that were extremely different in terms of expectations and needs, and selling shoes to different customer segments: children, men and women. Geox thus satisfied existing segments, but also 'invented' new segments, by establishing the need for



‘healthy’ shoes in consumer segments that would never have felt the need if it had not been for Geox shoes (Camuffo, Furlan, Romano, Vinelli, 2004). Its advertising also focused on a unique selling proposition: the jet of steam that issues from the sole of the shoe, the patent symbol and the term ‘breathes’, which explain the product’s competitive advantage clearly and intuitively, conveying the technology and the unique benefit that Geox offers its consumers (Camuffo, Furlan, Romano, Vinelli, 2004). Focusing on a single message had the dual advantage of underlining the differentiation of the Geox product, and of spreading a single product image all over the world, in all the markets it served, increasing the recognition and therefore the value of the brand (Camuffo, Furlan, Romano, Vinelli, 2004). Where distribution was concerned, Geox chose to combine single-brand and multi-brand channels, achieving excellent complementarity between the two forms of distribution. The single-brand shop makes it possible to introduce the Geox world to the consumer immediately and very effectively. Consistent with the communications strategy and the technological innovation of its soles, Geox Shops also ‘breathe’, through large display ‘sails’ on all the walls. The sail creates the idea of an amphitheatre, an architectural construction that is projected forward towards the public and which, in the case of Geox, allows the consumer to see and touch all the collections, for men, women and children (Camuffo, Furlan, Romano, Vinelli, 2004).

In the case of Geox, technological complementarity triggered marketing synergy and a high level of market penetration (in just a few years, Geox became the leader of the Italian market and began to turn its attention to foreign markets). The synergies and significant economies of scope are the fruit not so much and only of shared physical input but rather of intense technological interrelations. Geox strives for the same factor of differentiation in all the various businesses in which it operates; these businesses are linked by the fact that they leverage on a particular technological skill or group of skills that are used as the basis for differentiation to position its products. The Geox case also shows that competitive positioning, founded on synergetic supply systems, can be much more sustainable and harder for the competition to imitate than those founded on individual choices. But we can without question sustain that the case histories presented regard global corporations whose management philosophy is market-oriented and in which a competitive customer value approach prevails. The main assets present in the cases analysed are referable to a capacity to create value thanks to the emergence of synergetic effects of intensity of sharing. In the case of Yamamay, the synergies or economies of intensity of sharing can be attributed to the managerial experience accumulated, which is successfully applied to the management of the lingerie market, making a different business emerge. In the case of Geox, technological expertise is successfully applied in the footwear sector, revealing a need for a ‘healthy’ shoe in consumer segments which, without the Geox shoe, would not have felt the need. In both cases, it is the system of the intangible assets that is identified as the critical element from which the business system takes its value.

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## Notes

<sup>1</sup> 'The general approach ...consists in measuring each significant synergetic effect separately and then ... providing a method to apply these measurements jointly to the global evaluation of a programme. Before the synergies can be evaluated, the synergetic effects are first grouped together according to the main functional areas of the company: general management, research and development, marketing and operations... The measurement of a force of a particular effect should, wherever possible, be the result of numerical values. If it is not possible to proceed in this way, the individual items can be matched with values taken from appropriate quality scales, i.e. quality evaluations Ansoff 1965, pages 99-100. We can also quote Penrose (1959) and Andrews (1971).

<sup>2</sup> ‘The theory most frequently associated to diversification sustains the existence of benefits tied to the sharing of assets. If a specific input is used to produce two products and the input in question is only available in lots with a certain minimum size, then an individual company that produces both products may share the cost of the input over a large output volume, thus reducing the unit cost of both products. Economies of scope are therefore entirely similar to economies of scale (Grant 1999).

<sup>3</sup> ‘In a dynamic perspective, and in the presence of an industrial organisation founded on networks of independent units, the innovative strategy is based on the decision to speed up dissemination by involving numerous partners. This is all the more evident when a business has developed a broad vision of the market and dissemination processes, but the perception of the means with which newly created knowledge is also connected somehow to a system of interests that involves: customers (who have to share the knowledge of the manufacturing company when they adopt its products); suppliers (who have to share the knowledge of the manufacturing process); complementaries (who have to share the knowledge of both the product and the process) and competitors (who are tied to the system both because they often have common technological parts and shared knowledge, and because they share the same codes of practice, associations, qualified personnel, etc.) (Golfetto 2000, page 218).

<sup>4</sup> ‘The new context of relationships generated by networking actually makes it more convenient for companies – large and small, manufacturing or service – to specialise their field of competence, turning increasingly to others for whatever falls outside it (outsourced operations, services, increasingly complex and significant skills). Part of the profits generated by the technological changes taking place are therefore the fruit of more efficient forms of knowledge management, that entail the specialisation, connection, integration and governance of the chain, so as to efficiently manage the network of interdependence that are concentrated on a single nucleus (Rullani 2001, page 10).

<sup>5</sup> ‘Coevolution is a typical process among species that live in complex adaptive systems. In these systems, interdependence between the species produces *non-linear* effects that translate into even exponential amplifications of the leverage of their respective capabilities. This can be demonstrated by observing how the agility and creativity of a system can increase when connections intensify. Complex proactive systems are all the more effective the more intelligence is decentralised. These concepts can be transferred to a company that uses co-evolution with other businesses as a means to develop new enterprise in its own or in new ecosystems (Valdani 2000, page 234).

<sup>6</sup> Empirical evidence shows that in mature sectors companies often tend to converge their strategic positions and organisational forms on consolidated business models. Businesses tend to become entrenched in consolidated choices that regard both ways of remaining consistent to the market and relations between internal decisional variables. This leads to an overall rigidity in the sector, in which the prevailing business model tends to be taken for granted (Camuffo, Furlan, Romano, Vinelli, 2004).