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# Strategy Formulation in Declining Industries<sup>1</sup>

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*Because the environments of declining industries differ, many different strategies could be appropriate for coping with declining demand. Demand and customer traits, product traits, supplier behavior, competitor traits, and exit barriers must be taken into account by a firm in a declining industry. Strategy alternatives include early exit, milking the company's investment, shrinking selectively, holding the present position, and increasing investments. Some possible strategies must be adopted early if they are to succeed.*

The structural environments of declining industries and the experiences of competitors therein differ. Thus it is not surprising that many different strategies could be appropriate for coping with declining demand. What is somewhat surprising, however, is the successes some companies have achieved by increasing their investment in declining businesses [Harrigan, 1979]. I discuss such aggressive strategies, as well as less aggressive ones, which might be appropriate responses for firms within industries facing declining demand, in relation to the types of decline and to firms' strategic postures, in order to suggest which decline strategies might be most effective, given the presence of key industry structural traits.

Firms have renovated plants and machinery, acquired the assets of competitors, or otherwise increased their commitment to a business for whose products aggregate demand is falling due to obsolescence, demographics, or cultural changes, where structural circumstances have been

favorable. Some of these firms have accurately diagnosed the outlook for the various market segments of their business and analyzed where enduring demand might exist despite a general "Chicken Little" attitude regarding the overall industry's fortunes.

Demand could endure where products appealed to customers who would switch products with great reluctance or only if use of the substitute product were clearly more desirable. Examples of such lucrative niches of demand include: electronic receiving tubes for high fidelity amplification uses, or as replacement components in color television; leather goods and apparel designed and merchandised for the haute couture market; premium-branded cigars (retailing for \$2.00 per cigar); belted, nonradial tires merchandised through discount outlets; hypoallergenic infant formula; sterling silver electric percolator coffee-makers and plastic percs; shiny acetate fabrics for disco wear and rayon filament fibers for high-quality menswear lining fabrics; and leather military boots.

Identification of these types of market niches is desirable, but they do not exist in all declining businesses. A framework suggesting strategic alternatives suitable for various combinations of industry traits is desirable in order for a firm to

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recognize where the industry's context offers little hope for carving out an advantageous position during decline, and when to exit if the industry is not favorable.

An industry would be favorable for continued competition if (1) demand were somewhat price insensitive, (2) it were clear that replacement units would be needed for a predictable time into the future, and (3) cadres of loyal customers existed and were likely to endure. It would be less favorable if (1) demand were highly price sensitive and a history of volatile price wars was established, (2) demand for the declining product plummeted abruptly, creating sizeable write-off losses for firms that were forced to exit, (3) substantial reinvestment requirements (such as pollution control devices) could force firms to exit prematurely, or (4) great uncertainty regarding the duration of demand induced other firms to increase their investments in the industry, thus exacerbating the deterrent effect of exit barriers.

### **Demand Characteristics**

If there were relative certainty regarding (1) which pockets of demand would decline first, (2) how rapidly demand would decline for different market niches, and (3) whether demand would be likely to revitalize, then competition within the declining industry would be less likely to be volatile and the timing of exits would be more likely to be orderly. But where there is substantial uncertainty concerning whether demand would revitalize and when and who should exit, chaos is more likely to ensue.

If firms experience great uncertainty concerning the duration of demand, they might increase or maintain the levels of their asset and managerial commitments to the troubled business. These investments can constitute exit barriers [Porter, 1976] that could make a timely exit difficult if demand suddenly soured. Ownership of underutilized assets that are costly to retire might induce remaining firms to cut prices, increase promotional activities, and heat up competition in the industry in order to fill the excess capacity. Particularly damaging behaviors are likely to occur if single-business firms choose to fight for a larger per-

centage of a shrinking customer base. If competitors were strongly committed to being in a particular business and were expecting demand to revitalize, but were uncertain when it would do so, they would be more likely to continue to operate their plants at low capacities for many years rather than sell them, retire them, or otherwise reduce their commitment to the business.

The presence of pockets of demand where customers' switching costs are financially high (or are perceived as being high owing to the disadvantage of a degradation of quality) would determine whether the declining industry would be hospitable to a range of strategies that might include reinvestment. Favorable declining business environments contain at least one pocket of enduring product demand of viable size.

### **Structural Characteristics**

In addition to demand traits, the following structural characteristics of the industry will determine whether these desirable pockets of demand exist and can be defended by the "right" firm.

#### **Product Traits**

The market niche that protects the firm from potential entrants best in a declining demand context is established when the firm has effectively differentiated its product or holds patents that deter rival products from attaining a similar state of acceptability with the enduring customer group. If this niche is effectively fortified, competitors will be unable to hurdle the barrier using price-cutting alone. Brand loyalties, although effective, would be eroded more rapidly than barriers based on true physical differentiation.

#### **Customer Traits**

Continuing customer demand may be advantageous if customers can afford to bear the increased costs manufacturers sustain in providing the declining product while underutilizing assets. If the higher costs cannot be passed on to customers, there are fewer advantages to remaining in the industry. If competitive marketing practices have formerly included financing the inven-

tories of customers, the advantages of enduring pockets of demand for declining products may, at best, be illusory.

If customers react unfavorably to a firm's discontinuation of a product by avoiding the firm's other products, the inherent market power of those customers can constitute an exit barrier that would delay a firm's timely exit and may result in subnormal economic returns (or losses) for the firm. Retailers or grocers who might use their market power to extract higher margins for more slowly turning inventories could constitute an enduring pocket of demand whose true economic benefit to the firm may be illusory.

### **Supplier Behavior**

If supplier industries are relatively dependent on firms operating within declining businesses for the majority of their sales, firms might exercise their relative bargaining power to induce suppliers to help them weather competitive turbulence in industries that they believe to be favorable even in decline. Suppliers might assist such customers by financing their sales, by advertising on their behalf, or by extending discounts and other forms of assistance if they expect that demand for the declining products will revitalize or that the firms serve promising customer niches that will endure.

### **Exit Barriers**

Relatively new, unsaleable physical assets could deter some firms from exiting, particularly if the cost of exit represented a real cash outflow that could be avoided (or deferred) by continuing to operate underutilized plants and by competing for remaining customers. The thin resale market for highly specific and inflexible assets might discourage firms from exiting if they are adverse to sustaining a substantial loss on disposal.

Where marginal competitors are locked into an adverse competitive situation by such exit barriers, a stronger firm could remove these barriers and allow the marginal competitors to exit by purchasing the assets that constitute barriers. Such a tactic must be predicated on an analysis of the declining industry environment that suggests that the acquiring firm serves an enduring niche of demand most advantageously and hence is justified in in-

creasing the level of its commitment to the industry.

Analysis of the potential deterrent effects of acquired assets on subsequent timely exit would be particularly desirable before a firm contemplated acquisition of companies that are composed largely of assets used in declining businesses. Although such acquisitions frequently are consummated as a means of obtaining access to a newer, related technology, the obsolescent business's assets could curtail the firm's overall success if the expected performance of the newer venture does not materialize. Hence, analysis of the business outlook and structural context of each of the major businesses constituting a potential acquisition candidate could induce caution or the creation of provisions for asset disposal problems that might otherwise go unheeded and produce contorted maneuvers later when rapid exit becomes imperative.

### **Competitors' Traits**

Decisions regarding strategies for declining businesses must be made with full consideration of the probable responses of the other industry members. The presence of single-business firms who face substantial exit barriers could increase the likelihood that a volatile competitive environment will develop. The highly committed firms are more likely to try to penetrate other firms' promising market niches, using price-cutting in lieu of the attractiveness of other product or service traits to gain entree [Newman, 1978].

## **Strategy Alternatives**

From consideration of these and other industry and competitor factors, an assessment of the relative attractiveness of the declining business may be made. If consumption levels seem likely to be slowly declining in the niche served and price levels are not expected to drop precipitously, the industry environment is relatively more attractive. If the firm's objective is to earn the best return on its assets, this objective should be relatively easier to attain where its physical assets are already highly depreciated, assuming that no reinvestments must be made for maintenance of physical assets, for

pollution control, or as renovations that could constitute undesirable exit barriers later. If the firm's analysis does not determine that the industry environment has undesirable conditions that mandate immediate exit, the firm may consider the more aggressive approaches sketched below in Figure 1 for coping with industry decline.

**Early exit** The firm may wish to exit from a declining business quickly if competitors are cutting their prices or otherwise impairing the profitability of the industry. Early exit may become imperative if the firm hopes to recover much of its assets' values. If industry structural traits do not appear to make the business hospitable for other strategies (noted below), and if competitive vigor reduces the likelihood that later exits will not produce better performance in the business, it may be advantageous to cash in on a declining business early, before other firms reach the same conclu-

sions, as Raytheon did in electronic receiving tubes or Du Pont in rayon acetate [Harrigan, 1980].

The objective of divestiture is prudent timing. It could mean a sale of business assets or their abandonment. The firm may even sell its assets to competitors, if necessary, or junk them, as Diamond Shamrock did in acetylene [Harrigan, 1980], to avoid sustaining chronic losses and to release working capital to other uses yielding better returns.

**Milk the investment** A firm may try to increase the return on investment by surrendering market share or may attempt to funnel as much cash as possible to other projects quickly. In such cases, the firm tries to harvest its business. Milking strategies commonly occur when immediate exit seems too disadvantageous to the firm. The risk in pursuing a milking strategy within a declining business is that if uncontrollable adverse events

### ENVIRONMENTAL TRAITS

- |  |   |
|--|---|
| •demand price insensitive  | demand price sensitive•                     |
| •replacement units likely to be needed by some customers for a long time | demand could deteriorate abruptly•          |
| •loyal customer demand likely to endure                                  | low customer switching costs•               |
| •revitalization likely, albeit remote                                    | competition usually volatile•               |
| •firm serves protected (high entry barriers) market niche alone          | competitors face high exit barriers•        |
| •suppliers willing to help firm compete                                  | customers likely to exert bargaining power• |



**Figure 1**  
**Relating Strategy Alternatives to Environmental Conditions within a Declining Industry**

force a firm to shut down early, it may be unable to extract all of the value it may have invested. Examples of firms who milked their businesses before finally exiting include Spencer Products in its United States leather-tanning venture and Corning Glass Works in percolator coffee-makers [Harrigan, 1979].

**Shrink selectively** If demand within some market niches seems to be enduring, a firm pursuing a wide product-line posture could reposition itself to concentrate on serving the most desirable customer groups while retrieving the value of investments used formerly to serve less attractive customer groups within the now declining industry, as Celanese did in rayon. In order to do so, the firm must make additional investments in some aspects of the declining business. The objective of this strategy is to capture the most promising markets before competitors can identify them, as Mead, Johnson did with infant formula when it abandoned Pablum and Bib juices [Harrigan, 1980]. The most desirable customers in a declining industry are those who are least likely to convert soon to a substitute product, owing to high switching costs.

**Holding patterns** Holding strategies are pursued when the firm decides it is already in the best strategic posture to compete in the declining business or when the firm is waiting to take more dramatic actions until some key uncertainty is resolved. In this strategy of defensive reinvestment, the firm matches competitors' price changes and marketing expenditures and makes maintenance investments in its plants to compensate for losses of operating efficiency. The firm will probably not thin its product line or shut down plants to consolidate its position, because of expectations that demand will soon increase or that sacrificed market share would be difficult to recover if desired later when industry conditions improve. Courtaulds, for example, held its position in rayon and gained customers when other plants were forced to close [Harrigan, 1979].

**Increased investments** A firm might pursue market dominance by increasing its investment level in the declining business if it believed there were a longer-term advantage in doing so. Typical-

ly, such a firm will purchase the assets of competitors who wish to exit or will make other investments to ensure that the declining business does not become volatile when competitors experience difficulty in filling their plants' capacities. (Alternatively, the firm may use price cutting to encourage marginal competitors to exit earlier.) Dow Chemical increased its acetylene investment, Gerber increased its baby foods investment, and GTE Sylvania helped other receiving tube competitors to exit from the declining industry by purchasing their assets [Harrigan, 1979]. In synthetic soda ash, marginal competitors were squeezed out when prices did not rise in proportion with increasing energy costs.

Increased investment strategies usually occur where (a) there seem to be enduring pockets of demand for the declining product, (b) the cost of repositioning to serve these niches most advantageously seems likely to be recovered rapidly or is not substantial and (c) few other competitors are capable of or positioned to serve the customer niches advantageously. Thus, a firm may choose to increase the level of its investment in a declining business if it is quite cost-efficient in manufacturing the endgame product and sells a patented or branded product to loyal customers in a declining industry that has relatively low exit barriers, few maverick competitors, high switching costs for customers, and other favorable characteristics.

Increased investment strategies have been rewarding in declining industries such as baby foods, replacement electronic receiving tubes, and acetylene production, among others. The attractiveness of these declining industries has been enhanced for remaining firms by their willingness to purchase competitors' assets, to act as a source for competitors who have discontinued production but continue to merchandise declining products, and to produce for private brand merchandisers.

## **The Timing of Strategies For Declining Demand**

Some of the strategy alternatives sketched above necessitate early execution if they are to succeed. Most notably, where reinvestments or repositioning will be required in order to remain in the industry, the firm must commit its resources

before competitors can maneuver into a more advantageous position. Similarly, exits should be executed before the asset resale market sours. Although it may seem desirable for the firm to wait for the situation to become less uncertain, waiting could be detrimental. The firm cuts off its strategy options (and their respective promises of profitable performance) by waiting.

As demand shrinks, only a few competitors' plants will be needed to satisfy remaining demand. If a firm could communicate its binding industry commitment to its rivals *early*, it may be able to prevent competitors from occupying the most desirable market niches and to signal in an unambiguous fashion that it intends to fight bitterly to retain these niches, once occupied. The firm may even be able to avert bloodshed if an industry consensus is recognized among rivals and is considered important to maintain for the mutual profitability of the remaining participants.

This means that if a firm wishes to dominate a declining business, it pays to *start early*. If one in-

tends to divest, it means that one should sell out before asset values drop too precipitously. Although desirable cash flow could be enjoyed by firms in some declining industries, there is empirical evidence also that other competitors have suffered losses in these same industries by not understanding the interrelationships of the forces in this environment as they affect the success of the firm's strategy.

Strategy formulation for firms in declining industries should include consideration of the industry's structure and demand characteristics, as well as analysis of their competitors' and their own strengths and weaknesses. Successful implementation of a strategy requires timely commitments and appropriate tactics. The risk of erring could be formidable. In practice, exit barriers make implementation of these strategies difficult. Overcoming these exit barriers is part of the challenge of managing a profitable business in a declining industry.

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