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THE GENERATION OF INTRA-INDUSTRY HETEROGENEITY:

THE ROLE OF STRATEGIC EXPERIMENTATION

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Research question

How can firms that are virtually identical for past history and business model, embark in diverging strategic paths that lead in one case to market leadership, in the other case to sudden failure?

The aim of the study is to build on a variety of conceptual frameworks to search for the emergence of intra-industry heterogeneity among firms starting from similar initial conditions: e.g. the internal venturing perspective (Bower, 1970; Burgelman, 1983a), the evolutionary economics (e.g. Ginsberg and Baum, 1994; Nelson and Winter, 1982) and dynamic capabilities perspective (e.g. Teece, Pisano, Shuen, 1997; Zott, 2003).

The intent is to focus on the development of two Italian toy companies in order to investigate the dynamics that promote divergent and convergent decisions between competitors within the same industry. Intra-industry heterogeneity issues (Schmalensee, 1985; Wernerfelt and Montgomery, 1988; Rumelt 1991; Powell, 1996) and evolution along different strategic trajectories issues (e.g. Noda and Collis, 2001), have been widely addressed in the past literature, yet there are not many studies focusing on comparative, longitudinal analysis of the strategic decisions, and the strategic processes of firms competing in the same industry.

As showed by Noda and Collis (2001), most studies up to now have tried to deal with intra-industry differences without taking into account internal organizational processes at firm-level. This way, the company is treated like a 'black box' or viewed as an "individual metaphor" (Barney, 1994) and inner drivers of divergence less likely to emerge from such an analysis. Although Amit and Shoemaker (1993) and other researchers have tried to include organizational perspectives in the discussion about

the evolution of intra-industry differences, their analyses do not link directly with the organizational forces that shape the creation and sustainability of differences (with some exceptions, e.g. Noda and Collis, 2001).

The study tries to shed light on the issues at the roots of the creation of variety and the forces driving conformity in the strategic patterns of competing companies, and on the underlying intra-organizational dynamics, as well as the links between the external environmental pressures and the organizations.

I argue that the toy companies selected for the study (Giochi Preziosi and Gig) represent an ideal setting for the study. The two firms started competing in the toy and in the gaming console markets by deploying similar strategies. From 1990 on, their strategic behavior started to differ according to different responses to changed market conditions. Despite communication channels between the two competitors, and similar market results, the two companies' paths radically diverged. In response to a market slow-down in 1997, Gig failed while Giochi Preziosi survived. Giochi Preziosi then acquired Gig facilities and underwent new strategic trajectories.

Exposing the firms' mutual interdependence and competition, the process of strategic decision-making, managerial mindset and internal sources of strategic innovation, I will try to contribute to the ongoing debate.

Chapter 1. Theoretical overview

1. Intra-industry diversity: perspectives from past and present research in management and economics

Why are firms different at business-level? The answer to this question continues to elude researchers in strategic management despite more than two decades of empirical and theoretical research (Rumelt, Schendel, and Teece, 1994).

a. Frameworks for intra-industry diversity in Economics and Sociology

Economics

Conventional Economics

Economics views a company as a unitary actor, driven by profit-maximizing behavior, supposed to decide rationally or even hyper-rationally (Winter, 1988; Shapiro, 1989). Information is costless, information processing is immediate and with no computational limitations. Given these assumptions, firms competing in the same environment will face the same portfolio of decisions, thus deciding and behaving in an identical way. When environments differ, companies behave differently, but only because of different external conditions, and not because of some discretionary power of their management (Nelson, 1994).

Industrial organization

Industrial organization theories inherit most of the basic assumptions of conventional economics, so that firm diversity within an industry is not taken into account.

According to IO, firms can limit production by means of oligopolistic competition, collusion, or monopoly, and therefore reaps profits (while conventional economics yield to zero profit equilibriums). Firm diversity is limitedly considered according to differences in size, differentiation, vertical integration and diversification, following the classic structure-conduct-performance paradigm by Mason and Bain (Mason, 1939; Bain, 1956). While some discretionary power of the individual firm is allowed, this autonomous decision-making power is limited to pricing, advertising behavior, and R&D investments (Scherer and Ross, 1990; Williams, 1994).

Limits of economics perspectives

The assumptions of Economic theories are simply not realistic. A firm is not a unitary decision-maker, but is made of members working at different levels of hierarchy, who feature different personal interests (which can lead to opportunistic decisions), power, competencies, and managerial mindsets. A firm an "olympically rational decision-maker" (Simon, 1976) because information gathering and evaluation is costly and subject to limitations in computational capabilities. Decisions are made on the basis of satisfaction, not optimization (Simon, 1976). Also, a firm typically faces uncertainties that cannot be avoided, or even ambiguities that cannot be handled even with risk management practices. Technology, for example, is not a variable that can be easily forecasted by the firms (Schumpeter, 1934; Nelson, 1994), because outcomes are risky and their payoffs cannot be estimated in advance, or just because it is not possible to foresee the portfolio of possible outcomes of an R&D investment. Finally, firms can differ because of asset specificity (Williamson, 1975, 1985), according to which a corporate asset can be firm-specific, so not easily transferable to other organizations because tailored to the idiosyncratic way activities are organized.

So Economics basically lacks a set of fundamental effects that, in real life, affects firms behavior: information asymmetry, opportunism, organizational conflict, unavoidable uncertainty or ambiguity, bounded rationality, local search, and asset specificity.

Sociology

Organizational sociology

Organizational sociology has been traditionally involved in the study of social structures and their behavior. The focus of its early founders (Weber, 1947; Parsons, 1937; Merton, 1940) was primarily the theoretical and empirical generalization of the structural composition of organizations, the influence of organization on individuals, and the subjective meaning of goals.

Diversity among firms was eventually something not interesting to research on, especially for those who studied intra-organizational phenomena. At first, the assumption was that all organizations are basically identical, and that there is an ideal-type of organization that represents the highest level of organizational effectiveness (Aldrich and Marsden, 1988).

Contingency theory

The coming of the contingency theory (Lawrence and Lorsch, 1967) deliberately put into the debate intra-industry differences in organizational form and effectiveness. The basic argument is that it is the "fit" between the external context in which the company is operating and the organizational structure is a predictor of its performance and survival. So, it is the external environment that dictates which organizational form is viable, while firms can survive and prosper or decline and fail because they adhere or not to this context-specific organizational solution. Hence, no equifinality is considered and the discretionary power of the individual firm is limited:

i.e. the fact that different firms can fit to the environment by means of different and equally effective structures that capitalize on firm specificities is not allowed.

Ecological theories

At the extreme, population ecology scholars have formally deleted firms differences by reducing variations to a logic of selection, birth and death of a whole population of firms (e.g. Hannan and Freeman, 1977, 1989).

b. Frameworks in Management

Contrary to the Sociology and Economics field, the field of business administration and strategic management explicitly acknowledges the (empirically obvious) differences among firms.

Differences among firms operating in the same business were firstly addressed by the early scholars of strategic management. Strategy is variously defined as "the pattern of decisions in a company that determines and reveals its objectives, purposes, or goals, producing the principal policies and plans for achieving these goals, and defining the range of business the company is to pursue, the kind of economic and non-economic contribution it intends to make to its shareholders, employees, customers and communities" (Andrews 1971, p.13). By selecting different corporate and business strategies or differently implementing them, firms naturally differ in their behavior and performance.

Also Chandler (1962) investigated the role taken by the top management in leading organizational growth. According to Chandler, strategy is "the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals" (p.13). Forms of new strategy include: expansion of volume and growth through geographical dispersion, vertical integration and product differentiation. The

strategy is shaped in response of opportunities and needs created by the environmental changes; strategy creates new administrative demands and different organizational structures. Hence, strategy is one of the drivers that justify the different development of a firm, provided that top managers decide to plan and apply different types of strategies.

However, these studies did not provide systematic proof of a connection between strategic commitment and performance. Without showing that strategic commitment brings superior performance, this stream of research did not provide much aid for practitioners.

Competitive strategy

M. E. Porter (1980) poured the results of industrial organization into management, creating the concept of competitive strategy. Performance across different industries and differential performance within an industry can be explained in terms of industry forces and relative positioning within the sector. Competitive strategy is "to take offensive or defensive actions to create a defendable position in an industry, to cope successfully with the five competitive forces and thereby yield a superior return on investment of the firm" (p.34). Porter explained that companies could realize imperfect competition and therefore above average results by restricting rivalry along the five forces. Three competitive stances (cost advantage, differentiation, segmented focus) were regarded as the most successful. In the light of the Porterian model, intra-industry differences originate from the different relative positioning the firms assume in order to reach higher returns. Again, it is the realized strategy that generates this divergence, whereas the typology of the three main competitive postures justifies the generation of variation among the behavior of the population. In other words, different specializations (cost advantage, differentiation,

focus) are needed for firms to assume a relative competitive positioning, while actions towards the mitigation of the five forces generates safe boundaries that raises the overall industry returns.

Resource-based view

The Resource-based view of the firm (Wernerfelt, 1984; Barney, 1991; Conner, 1991; Collis, 1991; Grant, 1991; Peteraf, 1993) is one of the most successful attempt to explore firm diversity by "opening the black box".

The framework originates from the empirical attempt to quantify how much of the variance in the performance of firms is due to the industry, to the parent firm, and to business-unit differences (Schmalensee, 1985; Wernerfelt and Montgomery, 1988; Rumelt 1991; Powell, 1996). According to these studies, the variance due to business-level differences was greater that the variance due to industry effects, leading to the conclusion that the firm matters more than the industry.

The Resource-based view is also rooted in the classic work of Edith Penrose "The growth of the firm" (1959), in which the process of growth of the firm is viewed from an economic perspective and explains the dynamic of the business by means of the exploitation of specific, non-transferable tangible/intangible assets built internally through learning.

According to RBV, a company is an idiosyncratic bundle of resources and capabilities that are developed over time; the RBV framework argues that companies that build and exploit valuable resources will enjoy superior performance.

While industrial organization scholars viewed above normal returns as a consequence of monopolistic or oligopolistic rents, RBV sees them as Ricardian rents due which accrue to such valuable resource endowments (Teece, Pisano and Shuen, 1990; Peteraf, 1993).

Moreover, these above average results will last as long as these resources are hard to imitate, or it is hard to build a set of equivalent resources (un-substitutability). Therefore, firms with valuable, rare, non-imitable and non-substitutable resources develop sustained competitive advantage, leading to sustained superior profits.

Superior rents are generated by ex-ante limits to competition, which ensure that the cost of acquiring resources is kept lower than their benefits, and ex-post limits to competition (as imperfect mobility and inimitability), which ensure that resources are not easily duplicated or transferred to other firms (Peteraf, 1993).

RBV explains intra-industry differences in terms of different portfolio of resources and capabilities that explains differential competitive advantages and performance.

The dynamic capabilities' perspective

Another framework shedding light on the roots of firms' differences and different evolutions is the one the Dynamic capabilities perspective (Teece, Pisano and Shuen, 1997). The Dynamic capabilities perspective argues that in turbulent and resource-constrained environments, firms compete by reallocating available resources according to environmental and demands change (Fowler et al., 2000; Prahalad and Ramaswamy, 2004). Corporations continuously adapt, innovate, and reconfigure their sets of resources, skills, and business models to closely meet markets and technologies' challenges in order to compete and survive (Eisenhardt and Tabrizi, 1995; Galunic and Eisenhardt, 2001). As environmental turbulence increases, this becomes even more challenging and rewarding (Mendelson 2000), as the value of dynamic capabilities vis-à-vis other explanatory frameworks becomes particularly valuable. Dynamic capabilities represent '*the ability to integrate, build, and reconfigure internal and external competencies to address rapidly-changing*

environments' (Teece et al., 1997, p. 517). Presently, the exact nature of dynamic capabilities is still not well understood, but their visible outcome is meant to be the transformation or reconfiguration of existing resources into new, functional, competencies that better match the environment (Eisenhardt and Martin, 2000).

The dynamic capabilities framework is permeated by the idea of Schumpeterian competition (Schumpeter, 1934), where competitive advantage is originated by a process of 'creative destruction' of existing resources and 'novel recombination' of new competencies. The dynamic capabilities view can also be interpreted as an extension of the resource-based view (Makadok, 2001). While the resource-based view emphasizes 'resource picking' or 'resource selection and acquisition' (selecting and accumulating synergistic combinations of resources) (Barney, 1991), the dynamic capabilities view highlights the importance of 'resource renewal' by reconfiguring existing resources into new functional competencies (Teece, Pisano and Shuen, 1997).

The distinction between dynamic capabilities and functional competencies is important here. Functional competencies are defined as 'purposive combinations of resources that enable accomplishing a given task', and are necessary for conducting operational activities (e.g., manufacturing, sales, logistics, human resource management). Dynamic capabilities, on the other hand, are the ability to revamp functional competencies. Other scholars also distinguish between dynamic capabilities that connote change (first-order), and functional (zero-order) competencies (King and Tucci, 2002; Winter, 2003). Henderson and Clark (1990) distinguish between component (functional competencies) and architectural knowledge (how functional competencies are integrated and linked together into a coherent whole).

Dynamic capabilities can reconfigure resources (e.g., manufacturing facilities, financial capital) (Prahalad and Ramaswamy, 2004), while knowledge, as a intangible resource, may play a crucial role (Galunic and Rodan, 1998; Glazer, 1991). Leonard-Barton (1992) argues that the less tangible, visible, and explicitly codified the resource, the easier reconfigure (p. 121). According to the knowledge-based view (Grant 1996), reconfiguring knowledge into new knowledge sets can develop productive new skills.

This framework, introduced in 1997, presently suffers some conceptual and empirical limitations. Dynamic capabilities are complex and tacit (Dierickx and Cool 1989), and have been referred to as 'hidden' or 'invisible' processes (Itami, 1987), 'causally ambiguous', and 'difficult to observe' (Simonin, 1999), 'meta-routines' (Collis 1994). Since they are difficult to conceptualize, operationalize and measure, they have been studied ex-post, often viewed as a 'black box' measure of superior performance (D'Adderio, 2001). As Winter (2003) explains: "*probably some of the mystery and confusion surrounding the concept of dynamic capability arises from linking the concept too tightly to notions of generalized effectiveness at dealing with change and generic formulas for sustainable competitive advantage. The argument here is that clarity is served by breaking this linkage*" (p. 994).

Galunic and Eisenhardt (2001) argue that the existence of dynamic capabilities is assumed without specifying the particular processes that form these capabilities. Despite the potentially important role of dynamic capabilities in rapidly changing environments, the concept still remains a 'black box' around which there is much conceptual fuzziness and little operationalization and measurement. The mechanisms by which dynamic capabilities impact competitive advantage are still not well understood (Zott 2003), and the dynamic capabilities view has been criticized for

being tautologically linked to performance (Williamson 1999). Even in the strategy field there is a lack of clarity about the nature of dynamic capabilities, and disagreement about whether such capabilities even exist (Winter 2003, p. 991). Dynamic capabilities have also been criticized for a lack of empirical grounding (Priem and Butler, 2000; Williamson, 1999).

Dynamic capabilities explains the heterogeneity of firms in terms of differential sets of resources, products, organizational routines/competences, that are originated by firms' ability to reconfigure, revamp themselves. With Teece, Pisano and Shuen's words, '*We define dynamic capabilities as the firms' ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments. Dynamic capabilities thus reflect an organization's ability to achieve new and innovative forms of competitive advantage given path dependencies and market positions (Leonard-Barton, 1992).*' (Teece, Pisano and Shuen, 1997). Strategic differences are accumulated through selection and pursuing of long-term paths or trajectories of competence development (Teece, Pisano and Shuen, 1997) or the ability to manage the switch from a trajectory to a new one, especially in the technology field (e.g. Christensen and Bower, 1996; Henderson and Clark, 1990). Thus, firms with same initial assets of resources, skills etc. can develop different strategic paths depending on the degree to which they can reconfigure their assets to meet an ever changing environment.

c. A rationale for firms' heterogeneity generation and persistence

We can identify two different orders of reason explaining why firms should differ, either from a static point of view and from a processual or dynamic point of view.

Static viewpoint

If we consider strategic decision making from a static point of view, the question reduces to what reasons cause top managers and the firm select particular strategic options as the most appropriate course of action, and how does this strategic commitments bring to different resource portfolios or competitive positions.

Initial conditions

Obviously, firms can behave differently because they are different ex-ante a strategic decision. How does initial heterogeneity sustain final heterogeneity? Penrose (1959) argues that resources and competencies decides the way the firm interpret the external world via cognitive frameworks, thus biasing the way reactions to external stimuli are decided. Among substantial differences that sustain final heterogeneity we may find, for example, financial resources, past experience in other businesses, past learning in same business, path dependency, company culture.

Internal and external perspective

Firms can be different because their internal structure, activities, people, and culture are different. Also, top management teams are different and can select different alternatives. On the other hand, different environmental conditions can also be a source of divergence.

Some of these causes can be deterministic, others can be discretionary. In other words, some scholars view these influences as constraining the future path of the firm, while others claim that there is large discretion in driving an organization.

The fundamental question here is whether and to what degree the top management can steer the firm and have an impact on it, apart from the mechanistic processes due, for example, to organizational inertia and external influence, that are partially or totally out of management control.

Research has fed the debate between the strategic choice vs. environmental determinism, organizational adaptation vs. environmental selection (Astley and Van de Venn, 1983).

Internal perspective

Sources of variation can be internal to the firm. As we stated, processes, activities, people, top management, culture can variously influence the development of an organization.

As the strategic choice stream argues, managers have great capabilities in defining the future of a company. They set objectives, long-run goals, and develop incentives and investments that allow the organization to fill the gap between what is planned and what the organization is (Barnard, 1938; Learned, Christensen, Andrews and Guth, 1965; Andrews, 1971), design structure and administrative processes (Chandler, 1962) and take fundamental actions in critical moments for the company (Selznick, 1957; Andrews, 1971). The toolbox of the manager is made of strategic options (the choice of organizational purpose, goal and areas of activities), structural options (organizational design) and performance options (regarding the choice of allocation of resources and setting of performance standards) (Child, 1972; Miles, 1982).

Others have compared the role of strategic choice vs. other explanations of the internal dynamics of a firm (Eisenhardt and Zbaracki, 1992) for example the whole political approach (Child, 1965; Cyert, and March, 1963), where decisions are made according to the dominant coalition and reflects the balance of power within the organization, or the fuzzy, loosely coupled paradigm of the garbage can Cohen, March and Olsen, 1972) where ambiguity and multiple decision-makers conflicting

with personal issues create a scenario in which organizations decide, put in a unclear, quasi-random way.

External perspective

The external perspective prescribes that a firm's course of action depends largely on a set of external influences. Companies are driven by external forces. The discretionary power of top management is really limited.

Traditionally, in Economics and Industrial Organization the role of external influence is widely acknowledged. A firm is subject to Porter's five forces (Porter, 1980) and therefore its profits are due to the selection of a particular industry.

Resource-dependence theory poses different arguments (e.g., Pfeffer and Salancik, 1978): an organization is entirely dependent on external entities, that are the ultimate wielder of power and provide all the financial, social, etc. resources needed for the company to stay alive. The theory implies that organizations adapt to these external, social constraints in order to get legitimacy. Managerial decisions are in reality constrained to adhere to external constituents, such as customers, capital markets, labor unions, and suppliers of key materials. Failing to listen to external powers means failure.

Also, institutional studies underline the role of legitimacy in organizations (e.g. Meyer and Rowan, 1977; DiMaggio and Powell, 1983), but implying a ex-post deletion of differences among firms. Organizations that fail to reach legitimacy are labeled as "socially unviable" and therefore subject to the hostility of society. As a consequence, over time organizations tend to grow in homogeneity, trying to become similar to successful, socially legitimated firms. From this viewpoint, managers can decide for particular choices only if these choices are socially acceptable (effectiveness is not at stake). For example, the decision to sell unused patents can be

pursued only in the case many other companies, or the market leader, has previously decided to do so. The peculiarity of this theory is that ex-ante heterogeneity ends with ex-post homogeneity, due to convergent social forces. However, the unit of analysis is not company performances (except in the case of bankruptcy), but structure, processes, and people.

Finally, the assumption that firms in the same industry should face the same environmental stimuli is unrealistic. As made clear from several studies (e.g. the whole stream of research on strategic groups (e.g. Cool and Schendel, 1987; Thomas and Venkatraman, 1988; see also strategic blocks, Noria and Garcia-Pont, 1991), firms can compete in the same business, but may have different primary markets, production locations, competitive niches, and therefore deal with different sub-groups of external influences.

Dynamic viewpoint

Analyzing the issue from a dynamic point of view, the pattern of evolution of firms in a industry becomes the focus of research. The process of divergent behavior and its antecedents are the object of study.

Nature of evolution

By studying a firm longitudinally, the researcher may highlight the different forces that had impact on the process of development. We can analyze three important antecedents: path dependency, inertia, and momentum.

Path dependence

Path dependence (see Dosi, Teece and Winter, 1990; Ghemawat, 1991; Dosi, Teece, Rumelt and Winter, 1994) implies that the past history (and decisions) of the firms in both an enabler and a constraint on the portfolio of possible future alternatives. There might be several explanations for this phenomenon. From a

cognitive point of view, learning is dependent on the set of experiences and events the organization faced in the past. Knowledge is supposed to grow incrementally (Cyert and March, 1963; Nelson and Winter, 1982), in the sense that it is built cumulatively on the basis of past knowledge. These knowledge is embedded in routines ("patterns of interactions which represent successful solutions to particular problems" as stated by Dosi, Teece and Winter, 1990) and is the social outcome of an organizational joint effort (Levitt and March, 1988). Routines change over time and this influence the future behavior of the firm (ibidem).

Also Penrose (1959) underlined the progressive, partially unpredictable path of a firm which is growing due to experimentation and the exploitation of slack resources, new knowledge, and firm-specific assets.

The Resource-based View argues a similar argument. The resources developed or acquired by a firm constrain the subsequent set of choices it will face, making tomorrow's actions dependent on today's choices. Idiosyncratic, specific assets which are not easily transferable becomes "irreversible investments" that are to be taken into account when foreseeing the future development of a firm's asset portfolio. Thus, strategy depends on the current level of resources (Collis, 1991).

Inertia

Organizations do not change easily when the time comes. An internal resistance to change was early acknowledge by Stinchcombe (1965), who argued that an organization is born with a set of goals, structures and beliefs that persist even when external environmental conditions that supported those traits have changed. Inertial forces have been radicalized by population ecology theorists, such that in some cases adaptation and change is considered as "impossible" (firms are inevitably selected out) (Hannan and Freeman, 1977, 1984).

Inertia has variously been labeled as core rigidities (Leonard-Barton, 1992), or administrative heritage (Bartlett and Ghoshal, 1989). From a cognitive point of view, routines are the memory where past experience is stored. Exploitation of knowledge is more certain and (in the short-term) rewarding than experimentation, so the interest towards alternative practices and actions gradually falls down, leading to organizational myopia (Levinthal and March, 1981, 1993).

Inertia can also be explained in the framework of irreversible investment (Ghemawat, 1991). Given some initial investments, exploitation could be preferred to further experimentation because of economic and practical reasons. There investments could also be social in nature. Rumelt (1995) describes cognitive, economic, organizational, political, and administrative sources of inertia, identifying five different "frictions": distorted perceptions, dulled motivation, failed creative response, political deadlocks, and action disconnects.

Momentum

Firms tend to reinforce or expand the scope of successful actions, processes, and choices (Miller and Friesen, 1984). From an evolutionary perspective, momentum, once initiated, acts as a selection-retention mechanism which guides patterns of organizational variation and makes exploration of alternatives difficult (Ginsberg and Baum, 1994). This phenomenon may also be explained, although the connection has not been extensively proven, by means of positive feedbacks. Positive feedbacks (Arthur, 1990) are systems of recurring chain effects that, instead of stabilizing the system on a fixed or predictable level (for example, as a human driver gradually acts on the car brakes in order to stop the vehicle), magnifies small initial effects. Positive feedbacks make for many possible equilibrium outcomes, due to initial random fluctuations.

Momentum has been studied recently (Noda and Bower, 1996; Noda and Collis, 2001), showing that managerial commitment grows thank of initial success of new ventures, leading to a greater allocation of resources that raises the likelihood that new positive outcomes will come from the same venture; this will enhance management confidence in the venture, leading to a greater allocation of resources, etc. It is a situation called “success breeds success” (Senge, 1990).

According to momentum, small initial differences, outcomes, and events can have a strong impact on initial choices, and therefore influence right from the beginning the future course of action of the firm, or the future “alternatives space” in which the company will have to take decisions.

Origin of divergence

Momentum, inertia and path dependence can be drivers explaining why firms tend to evolve differently over time. Noda (1996), presents two different explanations of diversity: local environment, and management decision.

Local environment

As described by Porter (1990, 1994) competitive firms are often clustered in specific geographical areas, countries or regions. The origin of a firm’s competitive advantage can be dependent on the initial local environment; Porter proposes four characteristics that would have a fundamental effect on the ability to innovate of a firm: the presence of highly specialized factors, home demand, home-based suppliers and related industries, and the context for competition (managerial practices, common forms of organization, local rivalry, local goal setting).

Management decision

On the other hand, Barney (1986) argues that firm success is to be traced back to asymmetric expectations (meaning the economic value of the resource that the firm

held at the time it acquired the resource) or pure luck. Asymmetrical expectations allows firms to gain resources at a price that is unfeasible for other firms, but convenient for those managers who believe in a superior future benefit extracted by this resource. Without asymmetric expectation (or luck), firms would acquire resources only in the case the price of the resource is equal to its potential economic value.

Persistence of divergence

Why should differences persist? Williamson (1984) argues that the profit target of firms inevitably attracts imitators and rivalry, leading to convergence in firms' evolution. Also institutional scholars (e.g. DiMaggio and Powell, 1983) speak about a convergent search process of legitimacy that leads firms to homogeneity, i.e. towards the organizational solution that the external social environment considers to be the most viable.

Divergence implies the inability of a firm to change its path in order to reach a (successful) competitor. Some explanations have been advanced in theory.

The concept of "causal ambiguity" has been introduced by Lippman and Rumelt (1982) in order to explain the difficulty for a firm to identify and duplicate the competitive advantage of the leader. Leaders can eventually ignore why they outperform competitors.

Momentum and inertia can prevent a firm from experimenting new paths. Learning myopia (Levinthal and March, 1981, 1993); competency traps (Levinthal, 1994), because of which the firm is not able to learn alternatives because specialization has constrained its cognitive capabilities, and a process of "unlearning" (Hedberg, 1981; Levitt and March, 1988) or "double-loop learning" (Argyris, 1992) might be needed; irreversibility in costly investments (Ghemawat, 1991); time

(Dierickx and Cool, 1989); and absorptive capacity (Cohen and Levinthal, 1990), i.e. the capability of acquiring external knowledge facilitated by existing knowledge bases. Rumelt (1984,1987) discusses differences in sustainability of operations due to a number of isolating mechanisms, for instance: response lags, scale economies, channel crowding.

d. Limitations of previous research

Most studies up to now have tried to deal with intra-industry differences without taking into account internal organizational processes at firm-level. This way, the company is treated like a 'black box' or viewed as an "individual metaphor" (Barney, 1994) and inner drivers of divergence less likely to emerge from such an analysis. Although Amit and Shoemaker (1993) and some other researchers have tried to include organizational perspectives in the discussion about the evolution of intra-industry differences, their analyses do not link directly which organizational forces shape the creation and sustainability of differences (with some exceptions, e.g. Noda and Collis, 2001).

2. From strategy to intra-industry diversity: perspectives from past and present research in strategic decision-making

The exploration of the strategy process of development in the context of modern business corporation requires the researcher to open the black box of the firm in order to investigate the internal processes that shaped the behavior of the company. Nor can the firm be seen as a unique actor that takes decisions according to a single mind (the "individual metaphor" as defined by Barney, 1994).

The analysis of the process of strategy is confused by the lack of a common language among researchers, who often come from very different fields and have

different backgrounds. We can distinguish between two main specific streams of research: the design (planning) school, developed by scholars like Andrews (1971) and Ansoff (1965), and the learning school, whose main supporter was Mintzberg (1978). Apart from that, relevant contributors in the field of decision-making and strategy were also Cohen, March and Olsen (1972) and Lindblom (1959).

a. Top-down strategizing: Rational and bounded-rational decision-making

The top-down perspective on strategy emphasizes the directive process of strategy definition and implementation as performed by the top management of the firm. Chandler's (1962) theories suggested that top managers develop strategies in response to opportunities and needs created by changes in the environment. Accordingly, they modify the organizational structure in order to manage the administrative needs generated by the new strategy (Structure follow strategy). The role of the CEO is to set long-run goals and allocate resources in order to pursue those goals. Strategy is created in the mind of top managers and its implementation is a separate step in the process. Planning activities and organizational design are the major tasks involved in the strategy formulation phase. Little or no importance is given to implementation.

This viewpoint was developed by the members of the policy group at Harvard (e.g. Learned, Christensen, and Guth, 1965; Andrews, 1971). Strategy is viewed as a rational, analytical and top-down task whose aim is to fix objectives and design organizational structure. This theory was later to be challenged by early scholars of the bottom-up approach.

b. Alternative views: Politics and power, Garbage cans, Behavioral theories

Alternative perspectives are the ones proposed by Lindblom (1959) and Child (1982) and also Cohen, March and Olsen (1972).

Politics and power

According to Lindblom (who focused on policy), decisions are taken by "muddling through". Instead of a rational, comprehensive method for evaluation alternatives, he argues that in real life, and especially in policy making, decision is taken by successive limited comparisons. Goals and analysis are inter-twinned, means and ends are chosen simultaneously; choice based on agreement, rather than efficiency or goal-sharing, analysis is limited (as in the Cyert and March's argument) and theory is neglected. Decisions are taken instead by means of a series of successive comparisons that allow for a theory-free approach, and solutions change in time only incrementally.

On the other side, Child argues that strategic choice cannot be explained without dealing with the political process of power-holders; the main focus is on the leading role of the "dominant coalition", which can trade off organizational efficiency with power requirements.

Multilevel managerial activities, Information asymmetry and possible goal incongruence

As Barnard (Barnard, 1938) discovered early on, there is a fundamental problem in the possible decoupling between different hierarchical levels of the management. Different actors working in the same organization can behave differently according their role. Chakravarthy and Lorange (1991) identified two main sources of issues: information asymmetry and goal incongruence. Top managers are forced to take decisions often lacking grounded, updated information about the external environment (Jensen and Meckling, 1976). Conversely, front-line managers

often acquire this knowledge, but might have different goals from the top management ones, or lack authority to take decisions.

To the extreme, organizations can work as organized anarchies, according to the model of garbage can (Cohen, March and Olsen, 1972). In circumstances of unclear technology and processes, problematic preferences of multiple actors, and fluid participation, the organization is so plagued by ambiguity that decisions are taken in a complex, random-like manner.

Cyert and March's behavioral approach

On the other hand, many scholars with a behavioral background argued that organizational decisions were much more complex. Cyert and March (1963) pioneered a behavioral theory of the firm were the decision making process is described by the struggle between coalitions of members with various demands, needs, attention and "bounded rationality" (Simon, 1945). Accordingly, organizations feature behavioral "traits" described as quasi-resolution of conflicts, uncertainty avoidance, problematic search of solutions and organizational learning.

Quasi resolution of conflicts implies that dealing sequentially with problems and avoiding any comparison with overall goals, missions, or long-run objectives solve conflicts over organizational goals.

Firms focus on short-run decisions and issues, so reducing the amount of uncertainty to deal with (uncertainty avoidance). Due to limited computational capabilities, and information costs and asymmetry, the search for solutions is restricted to near and satisfying, rather than optimizing, solutions. Successful solutions are incorporated in the repertoire of the firm and generate learning. As a result, short-term attitude towards contingency decisions impedes the development of a vision/long term strategy. The role of the top management is strictly constrained.

c. *Mintzberg's Learning School*

The learning school emphasized the role of emergent strategic initiatives due to learning processes in the implementation phase of the strategy process. As Mintzberg (1987) argues, top-down strategies are complemented by bottom-up emerging strategies that contribute to the final realization of strategy (realized strategy). Therefore, strategy is basically a learning by doing process, there is no clear distinction between planning and implementing, and realized strategies are influenced both by intended actions and unpredictable events and problem solving decisions that occur on the way.

d. *The strategy process field of research*

These past studies can enhance our understanding of the complexities of modern organizations, but only indirectly address some fundamental aspects of the corporate strategy process, as the role of multilevel managerial activities, and the interplay between emergent and deliberate strategies at different level of the hierarchy. The process school of business policy, initiated by Bower's (1970) study on strategic planning and capital investment, presents a first framework for understanding processes of the "black box" according to a multiple-actor perspective.

Bower's model

Bower's model represents simultaneous, interlocking, and sequential managerial activities along multiple levels of organizational hierarchy. In the model, top-down and bottom-up processes of strategy merge in three different organizational tasks: definition impetus, and structural context. Strategic initiatives emerge in the definition phase from front-line managers. In the impetus phase, middle managers struggle for resources to be allocated to new initiatives. For structural context, Bower

refers to organizational mechanisms, which are mainly set up by the top management and its staff.

From a cognitive perspective, front-line managers, shaping the emergence of new initiatives, filter the information from the market and environment. From a socio-political viewpoint, middle managers struggle for credibility in order to sustain these initiatives. The top management has to authorize or suppress these new activities, and in order to do so, provided that they have limited information about the business environment, they decide on the basis of the past records and credibility of the "product" (or "initiative") champion. They also influence the process of initiative generation by setting the structural context, i.e. the rules and the incentives to generate and create momentum.

Burgelman's model

Burgelman (1983a) elaborated an extended version of the Bower's model in the study of internal corporate venturing. In this model, besides the 2 bottom-up phases and the structural context, a strategic context variable is introduced. The strategic context determination phase refers to the political process by the which middle managers try to convince the top management that the current corporate strategy needs to be changed to accommodate successful new ventures (p.238). Burgelman (1983b) also distinguishes between two types of bottom-up strategic initiatives, induced and autonomous. The first are included in the perimeter of the firm's vision and scope of corporate strategy, while the second do not fall into the scope of the actual strategy and challenge the current vision of the corporation. Burgelman argues that middle managers try to convince top managers to retroactively rationalize initiatives by modifying the concept of corporate strategy. Ex-post

rationalization reconciles the gap between the existing corporate scope and the actual corporate behavior (Burgelman, 1983c).

From an ecological point of view, different emerging strategic initiatives compete for the allocation of resources and support from the top management. Competition can be seen according to the popular variation-selection-retention paradigm of the evolutionary theory (Campbell, 1969; Aldrich, 1979; Weick, 1979).

Limitations of the process models

These models show some limitations. First, the process by which the strategic intent (top-down) of the top management is generated is ignored; corporate strategy is only modified according to new successful ventures. There is almost no relationship between top managers' ex ante intent and the course of action a company actually takes. Second, the role of external forces in shaping definition, and more importantly, momentum (commitment) by middle managers is taken into account, but not analyzed in detail. The missing link with economic performance and strategic posture is also relevant.

Chapter 2. Research context and methodology

1. Research context: a brief history of Italian toymaking industry

The toy industry and, particularly, in its Italian setting, is a valuable environment in which to study the evolutionary convergence or divergence of corporate strategies as a response to exogenous shocks.

First, the final user of a toy is usually a kid, but kids do not earn money. Parents are mediators in the process of consumption. Nowadays, the young grows earlier and stops playing with toys very early, embracing new rites of consumption, as music and clothes, for instance. On the other side, adults are starting to play again (a phenomenon called "kidult"). In designing a toy, the inventor has to take into account rigorous and idiosyncratic "taken-for-granted" social rules: for example, there is a clear-cut separation between toys for females and males. But, creativity is also a fundamental competence. Toy companies usually update or substitute more than 50% of the product portfolio each year. There is quite a lot of complexity to deal with.

Second, recent trends have changed many old rules. Kids are growing faster and are fewer, adults are looking back to youth and start to play, fashions and characters are coming from movies, cartoons and other entertainment industries and become influential sources of revenues for merchandising. The videogame market has also skyrocketed dramatically in recent years.

Third, some specificity is also remarkable in the Italian case. Seasonality is higher than most markets: 60-70% of the revenues are collected in the Christmas

period. The distribution channel is more fragmented, and the average consumption attitude toward toys is lower than in the other western countries.

As a result, the incoming stimuli of the changing environment have put pressure on toy companies. The Italian setting provided even more complexity than in other larger, more standard markets. Thus, we argue that this setting represents sort of a "critical incident" context in which the underlying drivers of strategic evolution are more likely to be exposed and be "transparently observable" than in other settings (Pettigrew, 1988). Particularly, we focused on the dynamics that led the two target firms to "extreme situations", as sustained leadership in one case, and sudden decline from leadership to failure in the other case.

2. Methodology

a. Research design: Case study methodology – Yin, Eisenhardt

Research tool selection: case study

We selected a comparative, longitudinal, retrospective, embedded case-study methodology (Yin, 1989) as the most appropriate research strategy to investigate the evolution of the strategy dynamics within two corporations.

Usefulness of case study research

Case-study research is useful when little is known about a phenomenon (Eisenhardt, 1989), or "when the boundaries between phenomenon and context are not clearly evident" (Yin, 1989:23). Particularly, this approach is especially useful for studying the area of longitudinal change processes (Van de Ven and Poole, 1990).

Case study research vs. cross-sectional research

The scientific study of a set of cases, if properly done, allows the inference or rich and reliable models (Yin, 1989). Moreover, cross-sectional analysis are less likely to trace the dynamics of positive and negative feedback processes, since

phenomena like momentum and commitment can be highly iterative and non-linear in nature and therefore hardly traceable by means of statistical, cross-sectional tools (Stacey, 1995: 492).

What other researchers have done case in this field

Also, the adoption of this grounded, both qualitative and quantitative methodology has been successfully pursued in the field of strategy making and organizational evolution in order to produce valid and rigorous research (see, for example, Burgelman's study of intra-corporate venturing, 1983a; Mintzberg and McHugh's description of strategy making in adhocracy at the National Film Board of Canada, 1985; Eisenhardt and Burgeois's study of high velocity environments in the case of seven micro computer firms, 1988; Gersick's study on group development in project teams, 1988; Jelinek and Schoonhoven's study on the innovation processes of five semiconductor firms over time; Lovas and Goshal's study on strategy as "guided evolution", 2000; Noda and Bower's, 1996 and Noda and Collis', 2001 study of the seven baby Bells).

Thus, we partially traded concerns about external validity against the chance to gather rich and insightful data in order to explore a yet incompletely investigated phenomenon. We stepped into the empirical world with the goal of developing analytic themes on the observed patterns of behavior. We relied on the idea that "the higher the level of intrusion, involvement or participation in an organization, the higher the level of understanding, the greater the degree of sense-making, and the richer the descriptive and analytical possibilities for the data" (Rouse and Daellenbach, 1999:490; see also Rouse and Daellenbach, 2002).

Justification for using a theoretical model and not a totally grounded theory approach

On an ideal level, theory-building research should begin as much as possible with “a no-theory, no-hypothesis” approach. Literally, if the researcher commits to a grounded theory building generation by means of the general comparative analysis method originally introduced by Glaser and Strauss (1967), the researcher should “[…] at first, […] ignore the literature of theory and fact on the area under study, in order to assure that the emergence of categories will not be contaminated by concepts more suited to different areas“ (p. 37).

Admittedly, it is impossible to completely fulfill such a clean theoretical state (Eisenhardt, 1989). While trying to keep an open-minded, non-preordained theoretical perspective in order to avoid biases and limitations in the findings, we capitalized on a extensive review of past literature in order to identify the constructs that were more useful for the selected level of analysis. Thus, we developed a well-defined and rigorous specification of the core constructs to be measured in order to track the evolution of strategic initiatives in the organizational context.

The choice of a clear and defined focus for data gathering is not new, as early stated by Mintzberg (1979). As required by recent re-conceptualization of theory-building, case-study research methods, the researcher should define a-priori constructs to provide a better grounding of construct measures; a-priori specification of constructs also helps to shape the initial design of theory-building research (Eisenhardt, 1989). Thus, we relied on literature mainly for methodological issues, and not for pre-built hypothesis and relationships among constructs.

Indeed, case-study research building on previous theory is not new, not also at methodological level, but also at a substantive level (e.g. Noda and Bower, 1996), and can lead to extensions or revisions of the framework, as far as the applicability of the model is verified.

More details on the type of case-study

We studied the evolution and processes of top-down and emergent strategies in two Italy- based toy firms. These companies started in very similar settings and pursued the same business models. By capitalizing on successful strategic initiatives, they both conquered the leadership in the national market, whereas in the rest of the world the US global competitors usually dominate. Abandoning homogeneity, the paths of the two companies started to diverge by developing different responses to the same external stimuli, or by enacting the same initiatives in different moments in time.

As a result of the evolution of the market, one company failed, while the other one experienced sustained leadership, the two representing polar cases in which extreme patterns of behavior are more likely to make the underlying causes transparently observable (Pettigrew, 1995).

Multiple cases for a replication logic, and analytical generalization

The two cases can therefore be treated as replication of the same experimental conditions, leading to different results.

Replication vs. sampling logic

By relying on a replication logic (i.e. the cases are treated as a series of independent experiments that confirm or disconfirm emerging conceptual insights) we are dealing with a very different approach from sampling logic. Sampling logic estimates the properties of an entire population by means of a representative sample, which is collectively considered as a single experiment. Replication logic considers instead multiple cases like multiple experiments, whose outcomes can be similar or different for predictable reasons.

Analytical vs. statistical generalization

The power of replication logic relies on analytical generalization of findings, while sampling logic builds on statistical generalization. Analytical generalization builds on pattern-matching and explanation-building, in order to establish external validity (Yin, 1984; 1989).

Theoretical vs. literal replication

In this case, the two companies started from similar initial conditions, leading to different outcomes. If control for heterogeneity is adopted, theoretical replication is achieved (as opposed to literal replication), enhancing the robustness of the findings.

Multiple units of analysis for an embedded design … structural level

The study was also designed as a embedded analysis, that is, several layers of investigation focusing on the different levels of each firm: we documented managerial activities at multiple levels in the organizations, i.e. at corporate and business level, at the top management, middle and low management level.

… and process level

Beside the hierarchical embedded design, we also explored the so-called "process" unit of analysis. In fact, the longitudinal approach allowed us to track the history and evolution of each strategic initiative, from its birth in the strategic planning meetings, in the top managers' learning-by-doing, or in the lower levels of the organizational context (or even in the influences of the external environment); to its development and implementation in practice, and finally to its outcomes and feedbacks in the strategy evolution.

Hierarchical (top/medium/bottom) and process (detailed history of strategic initiatives) layers of analysis are intermeshed and therefore more complex to analyze, meaning the risk of failing to return to a higher level of analysis; the benefit, however,

is that embedded designs permit induction of rich and reliable models (Yin, 1984; 1989).

The two-case selection: number of cases vs. richness of data

In case-study methodology, the number of cases involves an important trade-off between the depth and breadth of the study. In general, multiple-case analysis reduces the resources and time allocated to each case, thus pauperizing the contribution, richness and depth of each study.

Justification of one case

A single study can be extremely valuable if it investigates little explored phenomena, or an extreme situation, or if it becomes the critical test for an established theory; in synthesis, what Yin (1989) describes as the critical, extreme, unique, or revelatory case .

Also, an embedded research design is a useful tool to enhance depth and sensitivity of analysis of one case, since it treats the several sub-unit of analysis within the organization as a set of different cases.

On the other hand, a multiple-case approach solidifies relationships uncovered in particular cases, and reduces chance occurrences (Eisenhardt, 1989) .

After careful evaluation of the trade-off between depth and breadth in this particular field of inquiry, we selected an embedded, two-case analysis. Apart from serendipitous and contingent research constraints (discussed in the “Case selection” section), we believed that the richness and depth of understanding of longitudinal processes that we could develop during the investigation process would counterbalance limitations due to a broader but shallower analysis of a larger number of cases; furthermore we were also convinced that a one-case solution, even if

reinforced by multiple sub-units of analysis, would have undermined the robustness of the findings.

As a consequence, we partially traded issues on external validity against the opportunity to dig a comprehensive and reliable set of empirical data. We did not skim on the surface of a huge but narrow series of cases, but focused all our efforts to enact a three-dimensional view on the similarities and differences in the patterns within and across the firms.

Thus, we undertook an intensive process of investigation across multiple level of analysis of the two leading competitors, which started from similar environmental contexts and business models, eventually reacted in divergent or in convergent ways according to a number of evolving internal an external stimuli, and finally reached opposite outcomes: sustained market leadership and failure.

b. Research process

Sample selection: the process

The process of company selection involved rational choices and serendipitous discoveries. First, one researcher had the chance to study at industry level the aggregate trends of the Italian toy industry and market during the development of a joint project with the Italian toy industry association that enabled him to get acquainted with the history and the dynamics of the local industry from the multiple perspectives of competition, production, marketing, distribution, and procurement from the post WWII period to the year 2000, and particularly for the period 1980-1999. The study involved also a comprehensive appraisal of the dynamics at European level, and global level in the period 1990-1999; furthermore, the researcher extended his knowledge in some related industries (the local toy craftsmanship industry, the Italian and local computer games, video games markets and industries,

the local and global home console markets and industries), again for the period 1990-1999.

Primary sources were interviews with the CEO of the local toy industry association, CEOs and top managers of Italian companies and multinational subsidiaries, a R&D manager of a boardgames manufacturer, and several toy retail business owners. Almost all interviews were conducted on site, while a few were made at the phone. Additional information was collected from secondary sources as newspapers, publicly available accounts, trade journals, company financial reports, consulting reports, and academic studies.

From that point in time, we concentrated on gathering data about these four companies. Given the limited number of cases which can usually be studied, we chose the companies that showed extreme situations and in which the underlying process was more likely to be "transparently observable" (Pettigrew, 1988; Eisenhardt, 1989).

Thus, we selected two of these four firms on the basis of the following reasons: (1) both were originally Italy-based firms; (2) they shared a number of common features in their business history and culture that showed a higher degree of homogeneity than multinational subsidiaries, thus permitting a theoretical replication; (3) even if many phases of the value chain activities were localized outside the country, the headquarters and top level decision making, along with a number critical functions, like product development, marketing, and some capital-intensive productions, were centralized locally; (4) more fundamentally, their history revealed extreme outcomes while starting from similar initial conditions: sustained market leadership and failure. In the research perspective, the companies showed many features which could be explained as a "critical incident": both the industry, the

country and the firms showed peculiar details that in our opinion were to underline and expose particular features of the strategic evolutionary processes.

On the other side, we selected out the remaining two firms for the following reasons: (1) strategic decision making and key decision about product lines and segments that were made abroad and at hierarchical higher levels; (2) low impact of local top management on the strategic context of the firms; (3) low presence of key activities within the country boundaries (e.g., only Mattel had established a production and assembling facility at European level, but the two units were organizationally independent).

At the time the case selection was over, Gig, which failed in 1998, has already been acquired by Giochi Preziosi, i.e., the new market leader had bought the assets of the former leader. These allowed us an easier access to both the organizations, which at the time of the research investigation were maintained as separate entities. Of course, this peculiarity raised some methodological issues that persuaded us to take special precautions in the data gathering phase (see Data gathering session).

Preliminary contacts with the selected organizations were made early on in the summer of 2001, when interviews were granted with the middle management of Giochi Preziosi and a few top managers that were formerly owners of Gig, and at the time in the highest levels of the holding group. This allowed us to get an early sketch of the evolution of both firms, while increasing our confidence in the case selection choice and in the research program overall.

Early case-histories were developed from a broad perspective, tracing the major strategic initiatives that succeeded or failed from the birth of the companies to year 1999. Case histories were circulated among informants for validation. The case-study writing process and review took about 7 months to complete.

After that, the research process experienced a break during which we suspended further analysis and data gathering to refresh our thinking, refocus our research program, and verify our research question. While scholars claim that the research question may shift during the process (Eisenhardt, 1989), we found that basically, our initial research drivers were coherent with the initial findings. Only, we consolidated the basic constructs and made explicit the additional data/informants we needed in develop the analysis.

After the break, we resumed the investigation by contacting the top management of Giochi Preziosi holding. Again, we took advantage of the managers of the two companies being employed in the same group. After the initial contact, we traced the profile of possible informants in both organizations. Since some managers of Giochi Preziosi and all most of the middle management of Gig were no more working in the group, we tried to take contacts outside the company by means of the national toy organization.

c. *Data gathering and analysis*

The data gathering process involved iterative stages consisting in data collection and coding, data analysis and interpretation, and a refocusing phase which was intended to appraise and challenge the emerging interpretation of evidence, to specify the additional kind of data we needed to develop the investigation, and to define further hypothesis to be verified/falsified empirically by means of theoretical sampling. The process was iterated up until theoretical saturation was reached (Glaser and Strauss, 1967; Eisenhardt, 1989) and the empirical validation procedures ensured internal coherence and external validity of the findings.

Starting point: tracking the strategy

First, we traced the past flow of the strategic processes and initiatives of the two firms, starting with the development of the chronological listings over the whole period (from foundation to 1999), of the important decisions and actions undertaken by the organizations, and of the other of important events and trends in the environment, as described by Mintzberg (1978). The appraisal of environmental events and trends at industry-level was significantly made easier by the prior knowledge one researcher had already developed in the field; the role of the other researcher was instead to challenge the taken-for-granted knowledge and check the gaps between the trends as perceived by the company managers and the ones reported by news and studies on the field.

General mindset and methodology for data gathering

Building on our a-priori specification of constructs, we shaped the data collection process, specifying questionnaire and interview questions, scheduling priorities in interviewing informants, and specifying the types of secondary data we needed. Besides, we tried to keep an open and exploratory mindset and go beyond the methodological framework we based on. Because of this, data collection methods were kept flexible and opportunistic (Eisenhardt, 1989).

In the data gathering phase we aimed at collecting processual, comparative, pluralist, historical and contextual data (Pettigrew, 1995); i.e. we focused the development on action and change over time, continuously making comparisons among strategic initiatives within a firm and across firms, drawing from multiple perspectives and competing versions given by actors and data, emphasizing the change in meaning, opinion, and interpretations of different actors about the same issue over time, and examining the reciprocal relations between processes and contexts at different levels in the hierarchy of the organizations.

Data collection

Multiple sources of information

Multiple data collection methods were employed in order to minimize biases and post-hoc rationalization by informants, errors in the interpretation of reports, and internal documents; they were also necessary to solve for conflicting patterns of interpretation, and generally to enhance the reliability of the data.

Interviews and internal records were adopted as the main sources of information.

Sometimes, questionnaires were delivered to middle and low managers in order to appraise quickly emerging topics and issues, and in order to increase our confidence that we were not solely relying on the interpretation of top or middle managers.

Besides, we kept field notes as a tool to record the "ongoing stream of consciousness commentary" about what was happening during the research; these field notes were separated into an "observation" and an "analysis" section, as suggested by van Maanen (1988). These notes also captured some of the real-time observation we made while being in the company environment.

Finally, we also relied in the whole body of information included in the sources we used for the preliminary data collection: interviews of managers of other companies and associations, newspapers, publicly available accounts, trade journals, company financial reports, consulting reports, and academic studies.

Triangulation of sources

In order to increase the reliability of the information, we performed a comparative analysis of the sources at different levels and in various moments in time: first, we made cross checks between oral accounts and written reports; second,

among the internal informants; third, between internal and external informants, and finally, between our data and all available secondary sources. The underlying logic was to reach a safe triangulation of sources (Jick, 1979) to strengthen construct validity.

Interview protocol: against researcher's, informant's, and retrospective biases (process)

Ethnographic notes

After the meeting, the researcher used to take notes in order to jot down fresh impressions about the data collected, problems in the interviewing process, and hints for research.

Multiple investigators

In the case two interviewers were on site, one researcher had the role of asking questions, while the other one had the responsibility of taking notes of the answers and asking clarifying questions. Their roles were reversed each time. In this way, we tried to prevent researcher's biases and point of view to distort the process.

24-hour interpretation rule, transcription, and follow ups

During the whole process, we observed the rules of interviewing and qualitative data handling as described by Spradley (1979), Yin (1984), and Bourgeois and Eisenhardt (1988). Interviews were audiotaped and transcribed. Evidence and notes were always examined within 24-hours to take advantage of the immediacy of the data. If possible, we interviewed each informant more than once in order to revise interpretations and seek clarifications on ambiguous issues. If not possible, we conducted follow-ups by phone.

Use of tables and graphs for feedback from informants

Moreover, we also summed up the interview's findings in tabular and graphic form as a tool for the follow up process, allowing informants to review responses for lapse in memory, and thereby protecting against possible retrospective biases.

Coding the data

For data codification, we followed the general recommendations by Gersick (1988), Leonard-Barton (1988), and Eisenhardt (1989). We arranged data systematization by means of chronological tables including all events the found in oral and written evidence, structured by construct and by informant or source. The tabulation process was again highly iterative and time-consuming, but allowed the researchers to keep a clear and comprehensive grasp of the findings and issues.

All the collected data were filed in an electronic database. The developing of a case study database is, according to Yin (1989), a common requirement to ensure the reliability of the findings.

Tactics for validity and reliability in data collection and analysis

Since case study-based scientific research was skeptically approached in the past because of a reputed lack of rigor in methodology (Yin, 1989), we tried throughout the research process to state and clearly address the possible biases in the data collection, analysis and interpretation phases, according to the methodological guidelines suggested in literature (Glaser and Strauss 1967; Jick, 1979; Spradley, 1979; Yin, 1981, 1984, 1989; Miles and Huberman, 1984; Harris and Sutton, 1986; Strauss, 1987; Sutton and Callahan, 1987; Bourgeois and Eisenhardt, 1988; Gersick, 1988; Pettigrew, 1988; van Maanen, 1988; Eisenhardt, 1989; Van de Ven and Poole, 1990; Golden, 1992; Huber and Van de Ven, 1995).

Triangulation for construct validity and against post-hoc rationalization

First, we seek for triangulation of sources (field notes included), particularly of quantitative and qualitative data (Pettigrew, 1988). Multiple data collection methods provides stronger substantiation of constructs and hypothesis, increase reliability, and reduce post-hoc rationalization of informants.

Feedbacks and informants validation (internal/external) build construct validity, destroy "fiction" of self-reports and retrospective biases

We also looked for feedbacks and follow-ups with informants, presenting data analysis in tabular and chronological form to reduce retrospective biases (Golden, 1992). Case histories were circulated among informants for validation. In addition, I made presentations of my findings to the participating firms. External informants were also interviewed. By relying on external informants, experts and former employees, we tried to control for the "fiction" often associated with subjective accounts (van Maanen, 1979).

Multiple investigators against researcher's bias (method bias)

The use of two investigators reduced biases due to researcher's prior hypothesis. As Eisenhardt (1989) stated, "multiple investigators [...] enhance the creative potential of the study [...] and their different perspectives increase the likelihood of capitalizing on any novel insights which may be in the data. Second, the convergence of observations [...] enhances confidence in the findings".

Devil's advocate for internal validity

In this particular case, one researcher was more knowledgeable than the other; thus, we decided that the second researcher should have played the role of the "devil's advocate" (Sutton and Callahan, 1987) who was the official "challenger" of all emerging explanations. We were especially interested in competing interpretations; the two researchers independently generate explanations form the data set and compare their hypotheses.

Internal validity test: independent researcher building on existing data set

Furthermore, we asked another researcher to generate an independent explanation starting from the original material, thus enhancing internal validity.

Construct validity test: Yin's suggestion

Finally, we early drafts of the study were circulated among business informants, but also scholars for feedback.

Limitations of methodology

Limitations in retrospective methodology

Some limitations are to be acknowledged. The first is about the longitudinal, retrospective design, which makes it difficult for the researcher to establish causal relations in the findings. In fact, as time passes, informants forget key elements; sometimes they do not recognize an event as important when it occurs and thus, cannot recall it afterwards (Leonard-Barton, 1990). Their retrospective bias or justification often prevents researchers from determining cause and effect from reconstructed events (Golden, 1992).

Limitations due to sample: the acquisition and failure problem

Second, the two organizations under study were at the time of the research under the same ownership. During this period of time, the two structures were provisionally kept separated, but the ongoing reorganization plans were sketching the future of the two firms. Because of this, perspectives could retain some biases, especially in the case of the failed company, because of the recent issues of reorganization. We argue that this bias is limited because top managers acknowledged that internal inertia was substantial and deliberately forecasted a slow, long-run oriented reorganization plan, reducing and delaying possible intra-organizational stress.

Third and more fundamental, people are not happy to talk about a company's failure: since the event is likely to arouse emotional involvement in the managers, much caution should be taken in approaching a delicate issue as a company's fundamental mistake.

Anyway, this kind of bias is less likely to influence the recollection of the distant past of the failed organization; this influence can be somehow regarded as a tendency to celebrate the past successes and the past "way of doing things".

In order to cope with this issue and to limit the effect of sensitive questions or social desirable answers, we followed Philips' (1971, p.140), Sudman and Bradburn's (1974; 1982), and Bradburn's and Sudman's (1979) suggestions about the wording, the structure, the difficulty and length of questions as well as their position in the interview process.

During the investigation, the trust and confidentiality developed in the relationship with the informants also helped the researcher to delve deeper into the matter; sometimes we had the chance to engage in frank and informal discussions with the managers involved in the bankruptcy, thus gathering other insights for explanation building.

Data analysis

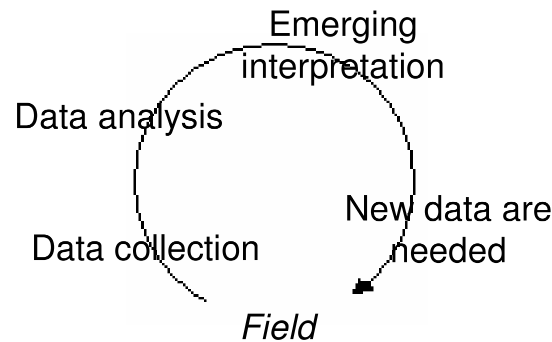
The analysis of the data was performed contextually with the data collection and aimed at finding the causal links underlying the process of strategy formation.

Iterative and joint process of data gathering and analysis

Field research requires joint collection, classification, and analysis of data, and at the same time paves the way for further data to be collected, leading to the development of the emerging, substantive theory (Fig. 1). Theory is conceptualized

and formulated as it gradually emerges from the data. Theoretical sensitivity is "forever in continual development" (Glaser and Strauss, 1967).

Fig. 1 The iterative flow from empirical field to theory generation.



Analytic induction, theoretical sampling and theoretical saturation

This process is driven by analytic induction: the emerging set of hypotheses is grounded in the available data; then the hypotheses are tested with an expanded set of data consisting of numbers of new, clearly defined and carefully selected areas of the phenomena, appraised by theoretical sampling (Glaser and Strauss, 1967). The process reaches an end when additional evidence and information do no more add value to the emerging framework (theoretical saturation).

Data analysis was performed throughout the whole process of investigation. First, the tracking of the evolution of strategic initiatives was conducted having in mind the goal of explaining the various antecedents that led to the particular strategic outcome; e.g. processes, hierarchies, decisions, outcomes, and perceptions. Second, we proceeded across strategic initiatives to develop a within-case analysis of each company. Third, convergent or divergent patterns of behaviors were compared across companies to develop cross-case analysis. The linkages across different hierarchical levels were also analyzed in order to count for different processes at top and lower levels of the organizations.

Since each level of analysis required iterative phases of data collection, analysis, extrapolation, and further data collection to challenge, develop and refine the emerging analytical framework, the articulation of the process was hard to record, and consisted in several nested processes of data collection and analysis going from the empirical word to theory, and from theory to the empirical world (see Fig.3).

As anticipated, the data analysis phase was iterated a number of times during the research process. We examined singular accounts with content analysis techniques (cf. Miles and Huberman, 1984), to ascertain explanations for various events and activities that occurred. Internal coherence was verified for each account, then cross informants comparisons and cross information sources checks were made according to the procedure described in the "Data collection" section. This procedure was executed by repetitive or 'constant comparison' methods (Conrad, 1982; Glaser and Strauss, 1967), wherein the data from different sources and different times were repeatedly compared to discern the major themes or processes involved. Also, several drafts synthesizing the history of each initiative were prepared. Decision stories were developed by combining informants' accounts into a time line that included all events, and then circulated for validation.

In this phase, no attempt was made by the constant comparative method to ascertain either the universality or the proof of suggested causes or other properties. Instead, the systematical analysis allowed the researchers to decide what data to collect next and where to find them, in order to challenge and develop the emerging interpretation of events. The process followed the theoretical sampling procedure as described by Glaser and Strauss (1967).

First-level: Data analysis and interpretation of the strategic initiatives

The final outcome of the iterative process of analysis, in this stage, provided the basic record of the evolution in time of the relevant strategic initiatives in the two firms. Building on this collection of processes, decisions, outcomes, and perceptions, we proceeded with within-case and cross-case analyses.

Second-level: Within-case analysis (company-level)

The process of within-case analysis resembled on a higher level the methods applied in the previous section. Iterative explanations were built by comparing different initiatives that were appraised, decided and implemented in different moments in time; they were also challenged and revised jointly as results from the strategic initiatives level were ready. Again, the theory development required new steps of data collecting and data gathering, which were performed in close connection with other low-level data collection.

Controlling for contingent variables

The comparison among strategic initiatives was cautiously performed, in the attempt to control for changes in the organizational setting. Particularly, we took into account the levels of hierarchy involved, personnel changes, time, personal conflicts among managers, competition among strategic initiatives, past history, and changes in the external environment. The aim was to jump from a pure chronological account of “what happened” to the development of analytic themes (Pettigrew, 1995), and the detection of patterns of explanations.

Other details

After the development of these tentative propositions, each case was revisited to see if the data confirmed the proposed relationship, and if they did, we used the cases to improve the understanding of the underlying dynamics.

Finally, we asked another researcher to read through the original material and create an independent interpretation of each case. The emerging explanation was cross-checked, leading to a further refinement. We then used this view in order to cross-check the emerging interpretation and enhance internal validity.

Cross-case analysis (across companies)

The comparison between the two cases was made by searching for patterns of convergence and divergence of behavior in response to similar or different stimuli; we relied on the suggestions by Miles and Huberman (1984) and Eisenhardt (1989).

Controlling for heterogeneity

In cross-case analysis, differences and similarities of cases plays a fundamental role. One can not compare cases without controlling for all the variables that explains the heterogeneity of the firms. In trying to sharpen our mind about this delicate issue, we also relied on external and internal informants' perceptions about the main differences between Gig and Giochi Preziosi. The goal was to track the gaps in the initial conditions of the two firms to ensure what influence they had in the development of strategy. We tried to extract the effect of this differences to clean our understanding of the patterns of convergence/divergence of the two firms, as in a quasi-experimental design.

Linking to existing literature

Some time before the end of the analysis, but after a number of iterations between data and propositions, we referred to existing literature to sharpen the insights emerged in the inductive process. As in deductive research, the emergent model fit the evidence but did not perfectly explain the cases (Sutton and Callahan, 1987). This substantive theory (Glaser and Strauss, 1967) was compared to existing literature to seek for divergent or convergent results.

Literature discussing similar findings is important because it ties together underlying similarities in phenomena not associated with each other. The result is often a theory with stronger internal validity, wider generalizability, and higher conceptual level. On the other hand, conflicting literature represents an opportunity (Eisenhardt, 1989). The link between our findings and the current debate are presented in the Discussion session.

Chapter 3. Case-study analysis

1. Comparative case-study analysis: Overview of strategic trajectories of Gig and Giochi Preziosi

In this section, an overall comparative analysis of the strategic and organizational issues of both companies will be undertaken; in particular, I will focus on the similarities and differences in the strategic trajectories of the two firms and on the factors influencing the decision making processes of the two firms.

Up until 1990 (see table 1), the two firms pursued similar strategic actions along the same development trajectory: their core business was focused on selection and import of toys from the Far East; which were sold through aggressive tv advertising; the second step was to develop a product development unit that started designing own toys, enter the videogame console distribution business, and open owned franchising retail chains. These activities took place in the timeframe 1978-1990, with a maximum time lag of two years.

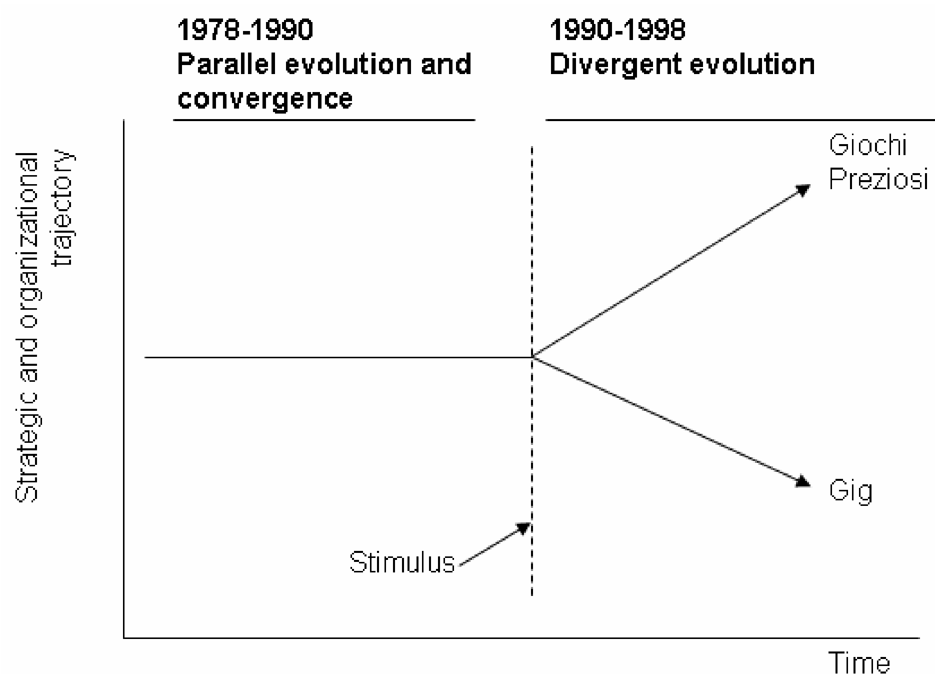
This relatively stable period paved the way to a more dynamic and uncertain period starting from the beginning of the 1990s. Mutated market conditions and competition urged companies to develop divergent strategies, or similar strategies at different points in time. For example, Gig undertook a structure rationalization project that enhanced the efficiency of the operations and focused on distribution, to the point that in 1996 became the licensee of the Toys'R'Us brand in Italy by opening more than 20 large-size stores throughout Italy. Giochi Preziosi chose to enlarge the product development unit and to pursue a vertical integration strategy, selling large-

size stores and focusing on small retailers. Eventually, in 1999 they reverted to large-store size and began the process of related diversification.

Along with these divergent strategies, the two companies pursued distribution agreements to keep cross-selling of their own products effective, while trying to revise their debt and shareholders structure to allow for a future IPO.

As a result of market stagnation and high leverage on the Toys'R'Us chain, Gig failed; Giochi Preziosi instead survived the market slow-down, took advantage of Gig's difficult situation and acquired most of Gig operations (included Toys'R'Us stores) at a bargain price. Interestingly, after the turnaround period, Gig division went back to profitability and growth.

a. Quasi-experimental conditions: assessing pre-1990 similarities and post-1990 divergence



The quasi-experimental framework poses that an experimental type of research is injected in real-life conditions; participants are monitored before and after the occurrence of the experimental stimulus. Given that the experiment is not set in

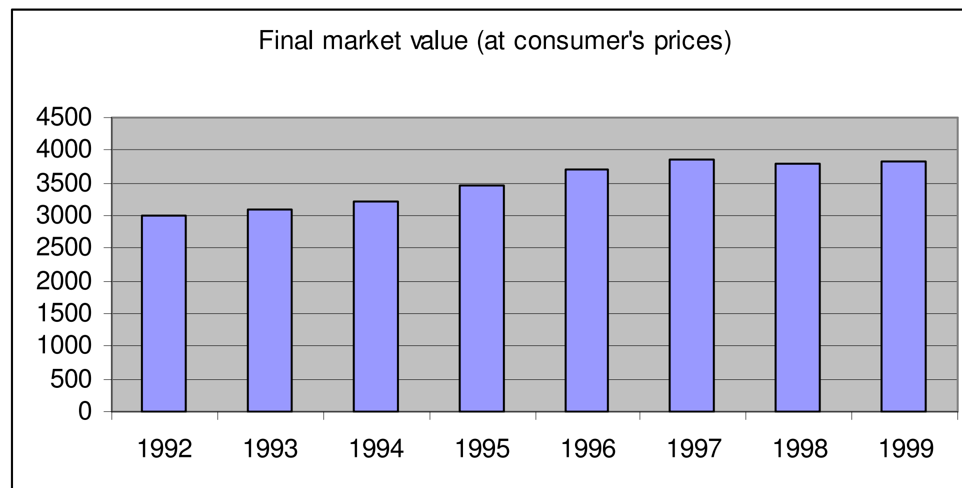
aseptic laboratory settings, particular attention must be paid both on the stimulus side and a set of control variables.

Environmental stimulus

The stimulus is intended to be a real-life stimulus and therefore the nature of it must be fully understood in order to draw inferences on the effect of the stimulus on the sample.

Events influencing toy market and industry dynamism	Effects on industry
– Raise of competition from Far East producers (especially from 1990) – Entry of global players (Mattel, Hasbro) during 1980s – Market slowdown – Italian Lira devaluation (1993-1995) – Raise of Retailing – Drop in kids' playtime – Drop in births	– Reduction of number of incumbents due to: ▪ Failures ▪ Mergers and acquisitions – Margin erosion – SMEs re-focusing on high-end and high-volatile products – Outsourcing of manufacturing – Rise of advertising expenditures

Market slowdown: During the period 1970-1990, the Italian toy market experienced steady growth throughout the period, high margins, and stable returns. The 1990s were a period of increased uncertainty both at the Italian and world level; major competitors like Mattel and Lego suffered major losses. From the double-digit growth experienced in the'80s, in the 1996-1998 period the Italian market experienced the first significant slow-down, with compounded annual real growth rates between -1% and +3%.

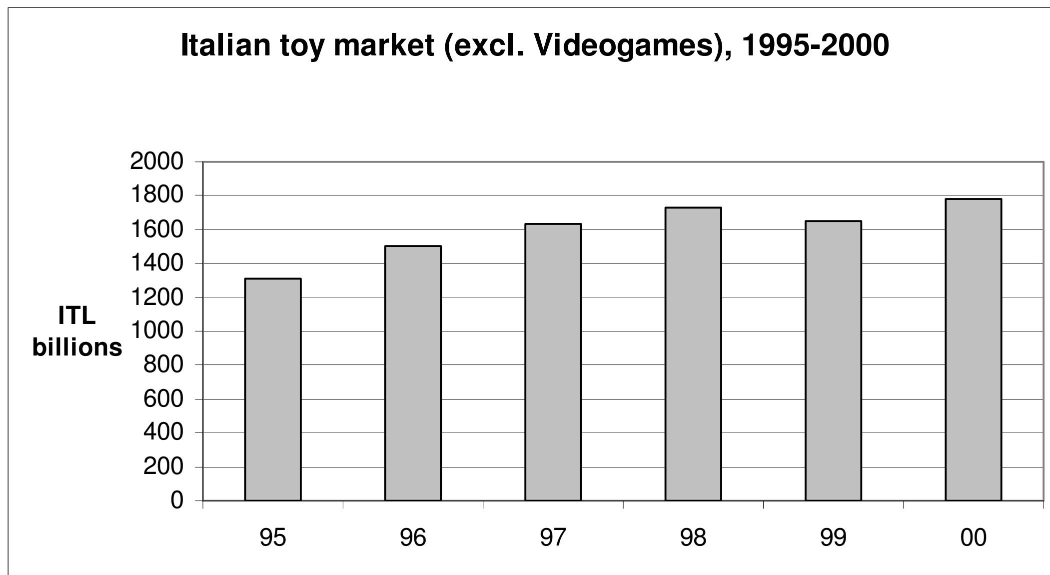


Source: Assogiocattoli

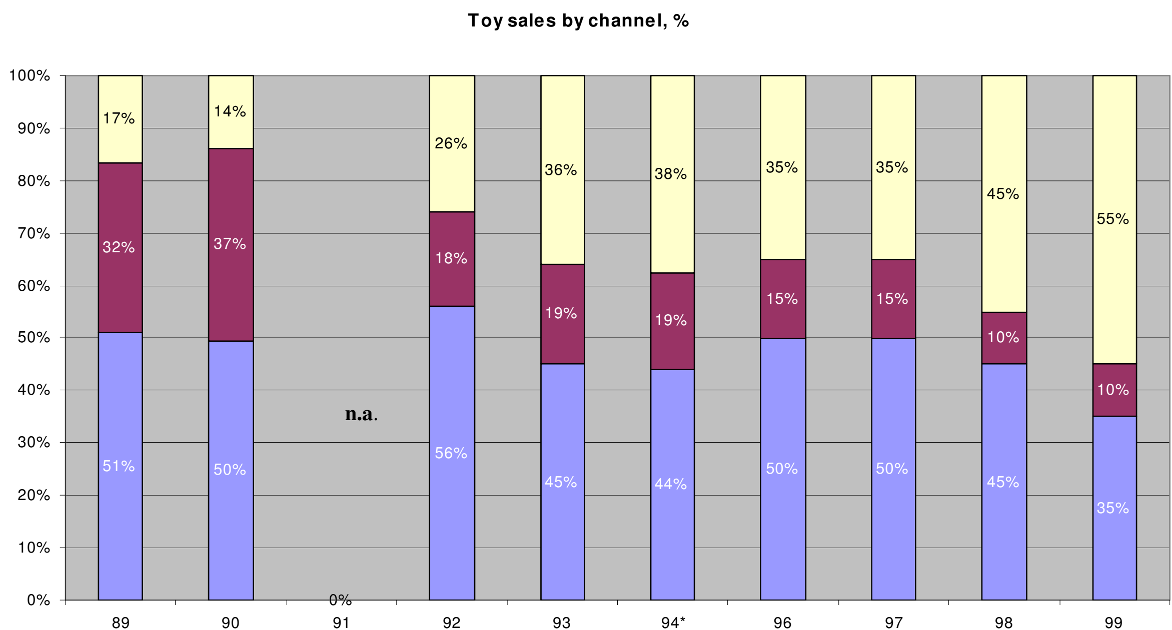
Raise of retailing: By the end of the 1980s the surge of large retailers ("Grande Distribuzione") started to challenge the distribution channel landscape, insofar steadily fragmented in specialized toy stores and unspecialized commodity stores. Large retailers' share increased from 17% in 1989 to 35% in 1997, straining non-specialized stores and forcing specialized toy stores to rethink their strategy, often re-focusing on small profitable product niches.

Raise of competition from Far East producers: Also, Far East producers started to export aggressively towards European Union countries, building pressure on existing toy producers. Most toy producers relied heavily on labor costs, with disruptive consequences on the overall industry and also on distributors that mastered the art of selecting and importing toys from the very same countries, hugely investing in advertising. This effect was in part compensated by the **Italian Lira devaluation** (1993-1995), which nevertheless put additional burden on Italian distributors, usually focused on the Italian market only and on Far Eastern suppliers.

Entry of global players (Mattel, Hasbro) during 1980s: During the 80s Mattel and Hasbro create their own subsidiary in the country, therefore putting incumbents on a defensive stance.



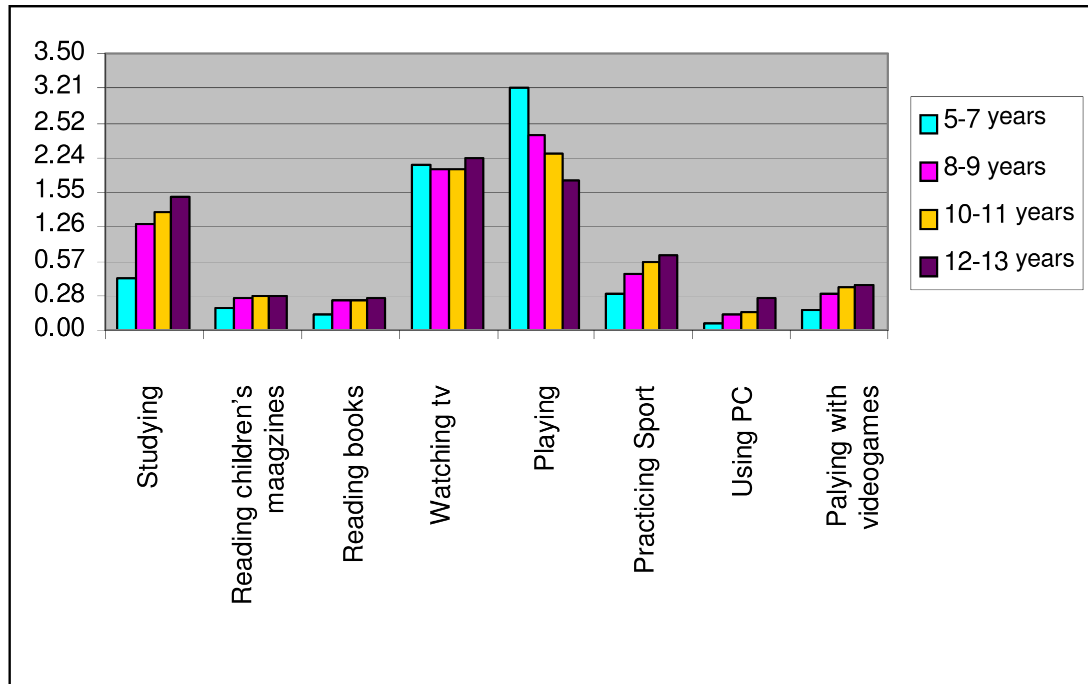
Source: Databank



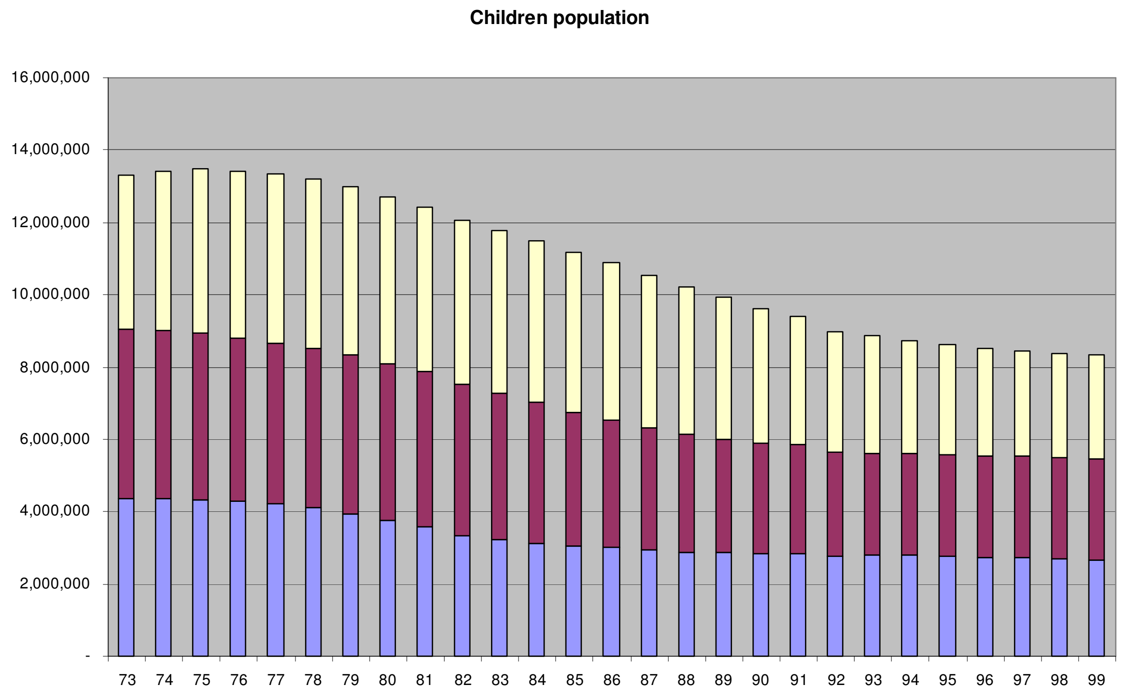
Key: top value = large retailers; middle value = residual non-food stores; bottom value = specialized toy shops

Source: Assogiocattoli

Drop in kids' play time: Following a gradual shift in consumption habits, toys gradually became less influent in the day of the typical kid; the average time dedicated by children to playing considerably dropped in favor of other activities like sport, music, videogaming and, more importantly, watching tv.



Drop in births: a substantial drop in births causes a significant reduction in the pool of consumers.

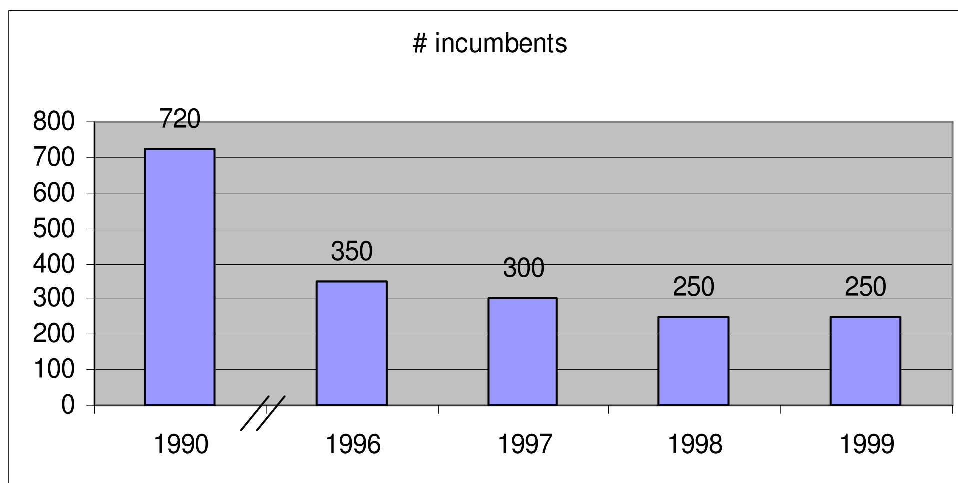


Key: top value= age 10-14 , middle value = age 5-9, bottom value = age 0-4

Source: ISTAT

As a result, the industry experienced in time:

Reduction in the number of competitors (from 720 in 1990 to 250 in 1999), due mainly to failures of medium players and artisans, and consolidation through mergers and acquisitions.

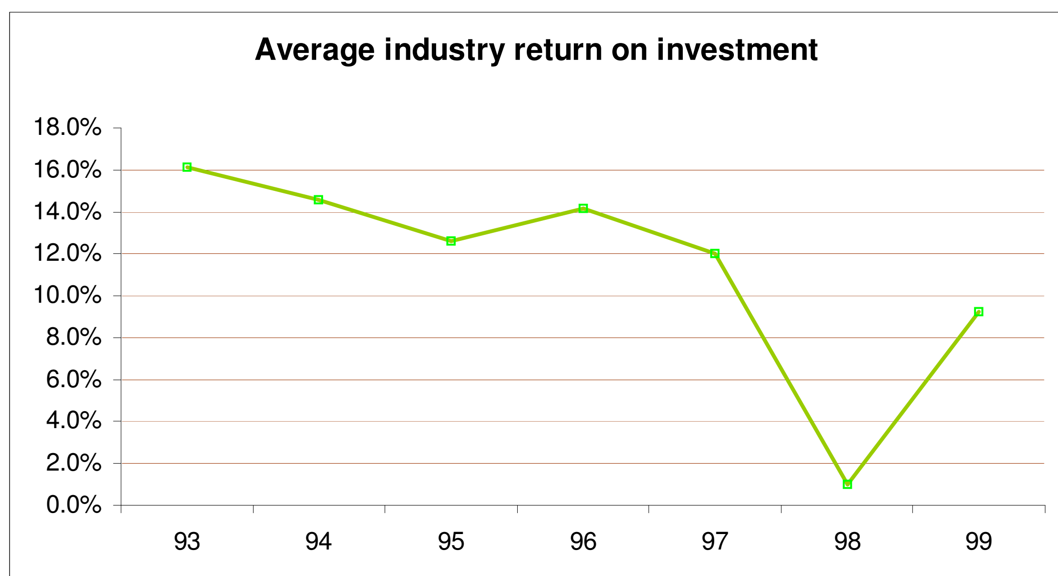


Source: Ceris, Assogiocattoli

Main M&A in the toy industry, 1990-2000		
Target	**Acquirer**	**Year**
Furga	Grazioli	92
Ceppi Ratti	Giochi Preziosi	92
Adica Pongo	Fila	94
Harbert	Giochi Preziosi	94
Migliorati	Giochi Preziosi	94
Arnold	Rivarossi	95
Juef	Rivarossi	95
Sevi	Trudi giocattoli	98
Linea Gig	Giochi Preziosi	00
Giocoplast	Giochi Preziosi	00
Rivarossi	Lima	n.a.

Source: Press releases

Margin erosions: Despite consolidation, higher competition on prices, rising bargaining power of the retailers and, for those companies which relied on export, fiercer competition from Far East exporters in the target markets drove down significantly the average return on investment in the industry (from 16% in 1993 to 1% in 1998, and back to 9% in 1999).



Source: Aida

Product refocus: From the product point of view, companies increasingly refocused their offering to high-end or highly volatile toys and games, trying to elevate entry barriers to entry in smaller niches that were more easily defendable from competition. For instance, Trudy focused on high-end plushes whose quality outperformed Chinese manufacturers, therefore justifying higher labor costs and facilities. Giochi Preziosi launched high-end fashion doll Tanya; Editrice Giochi focused on new product lines for children below 6.

Outsourcing: With increasingly fierce competition, a number of incumbents gradually close down plants and facilities in Italy and outsource productions in the Far East, keeping in the country only high value activities and R&D departments.

The two companies' initial similarities

Until 1990, the two companies developed along the same strategic lines, often imitating each other in the struggle to grow. At the end of the '80s and during the first years of the '90s, Gig and Giochi Preziosi have reached market leadership along with Mattel and Hasbro, with comparable market shares (6.6% and 9.7% in 1989[1], 19% and 14.8% in 1992[2]) and revenues (230 vs. 180 billion liras of specific turnover in 1992, 305 vs. 243 consolidated revenues in 1993). Gig had a higher number of employees, mainly employed in the regional platforms (Giochi Preziosi's figure does not account personnel employed in owned toy stores). Giochi Preziosi had warehouses in the headquarters in Milan, while Gig had just rationalized its own and opened a large warehouse in Lachiarella, again near Milan, despite its headquarters were in Florence. Both companies owned a franchising chain, Giocheria focused on a smaller number of middle-size stores, some of them directly owned, while Gig was focused on the very many small toy stores (near 600), none of them owned directly.

[1] Source: company data
[2] Source: Databank reports

Both companies had dedicated advertising units and product development and marketing units, and had deployed similar product lines, as well as exclusive licenses for distribution of the major console platforms (Nintendo and Sega).

From that point on, the paths of the two companies start to diverge. Giochi Preziosi and Gig no longer pursue the same strategic decisions, but instead focus their efforts in a series of divergent strategies that will lead to lock-in and opposite outcomes.

	1992	
	GP	**GIG**
Size		
Revenues	230	177
Market Share	19%	14.8%
Employees	*100*	*200*
Distribution and warehouses		
Main warehouses	Warehouses in Milan: - Cogliate - Limbiate	Warehouse in Lachiarella (Milan)
Retail		
Franchising store chain	Giocheria (mid-size stores)	Amico Giò (small stores)
Franchising stores	160	600
- of which owned ones	35	0
Large stores (owned)	4	0
Advertising unit		
Advertising units	- Quarter (publishing) - Winter (tv ads)	- Publikids
Advertising expenses	49	*38*
Procurement unit		
Units in Hong Kong	√	√

Products**	1992 GP	1992 GIG
Product lines		
Electronic games		
- electronic games	games	games, agendas
- consoles and videogames	Sega Master System 2, Megadrive	Nintendo Super NES, Gameboy
Dolls	Cicciobello	Mondo Rosa
Fashion dolls	Tanya	-
Peluches	multiple lines	multiple lines
Action figures and characters	multiple lines	multiple lines
Board games and puzzles	-	-
Pre-school games	-	-
Race vehicles	-	Gig Nikko remote control cars
Constructions	-	-
Models (trains, cars, etc.)	-	-
Activity and open-air games	Cooking lines, skaters	multiple lines
Carnival costumes and games	multiple lines	-
Console exclusive licenses	Sega	Nintendo

** Toy and game categories adapted from Assogiocattoli and Toy Industries of Europe

Controlling for initial differences

Controlling variables should be adequately assessed in order to capture variances that might explain part of the sample's reaction to the stimulus.

Applying this concept to the research setting, some elements of difference between the original organizational set-up of the two companies are to be acknowledged.

Initial differences in companies' strategic posture.

Gig	Giochi Preziosi
– Location: Florence, Italy – Initially created as consortium – Started in 1968 – Higher investment in warehouses than GP	– Location: Milan, Italy – Created as a company – Started in 1978

– Higher number of customers than GP	

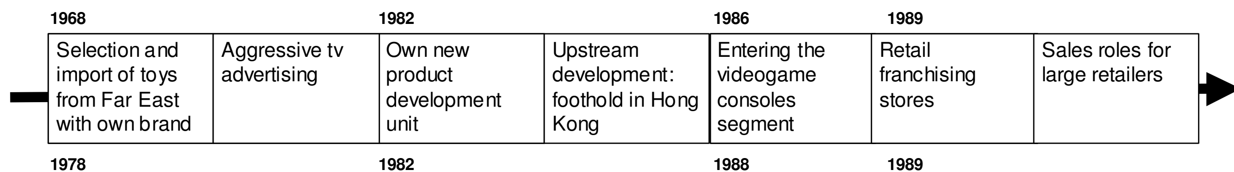
First, the two companies headquarters were housed in different locations in Italy; GP's headquarters were in Milan (Italy's economic centre) while Gig's headquarters were in Florence (a smaller city in the middle of the country). Cultural differences may be in place, as well as different access to network and resources (given that Milan has historically been the fulcrum of the toy industry and the biggest market for plastics procurement). On the other hand, Gig had facilities in Milan too; in particular, Gig's largest warehouse was in Lacchiarella, not far from Milan.

There is also a time-lag between the foundation of the two companies. Gig was in fact launched ten years ahead of GP, while GP had a faster start-up that allowed it to reach Gig's turnover in the late '80s. Technically, Gig was started up as a consortium of toy distributors, who integrated later on to create a single company. The individual distributors gave up to their company in order to acquire shares of the Gig holding.

Last, Gig had historically a higher number of customers and larger facilities for handling distribution; in particular, Gig had a greater share of very small toy store clients, while GP focused on large clients and wholesalers.

b. Stable growing market and parallel evolution: the 1978-1990 period

SIMILAR INITIAL CONDITIONS AND CONVERGENT EVOLUTION



From the '80s on, the Italian toy industry faces a period of stable growth. Along with the market growth, a number of incumbents, mainly Italian toy manufacturers, enjoy large expansion (Migliorati, Lima, Rivarossi, Ceppi Ratti, Harbert, Furga, Editrice Giochi) despite import from the Far East is a stable growing trend allowing wholesalers to introduce at lower-costs technologic and plastic-based toys mainly produced in Chinese factories, where labor costs are considerably lower and large scale economies can be reached through worldwide sales. Core products of the Italian manufacturing companies are dolls, plastic toys, and boardgames, while Chinese companies focus on plastic toys as well, besides the first electronic games. Advertising is a major driver of sales volume and is pursued both by manufacturers and a variety of local, regional, or national distributors like Falp, Fantastiko, and of course both Gig and Giochi Preziosi. Seasonality is remarkable and sales are concentrated in the Christmas and May-June (children first Eucharist and end of school) timeframe. While US multinationals are already in the country, they also rely heavily on the wholesaler channel and on Gig as a way to quickly reach the final market. By the end of the period, from 1985 on, it is clear that large retailers (Esselunga, Carrefour, Coop, etc.) are introducing an effective way to market huge volumes to the final consumers, often adopting the strategy of discounting toys, especially in the Christmas season, as a way to drive traffic in their stores. Finally, in

the videogame industry the first experiments with consoles and PCs (Atari Vertrex, ZX Spectrum, Commodore VIC20, Commodore 16, Commodore 64, Amiga) have already established videogames as an attractive market for kids; Nintendo and Sega are introducing their blockbuster models (Sega Master System and Famicom) that will eventually establish the dominant standard in the industry.

During this period, Gig and Giochi Preziosi enjoy fast growth in volumes and revenues. Both companies follow similar strategies that, by business sense or imitation of the other competitor, lead both companies to market leadership, overcoming US subsidiaries of Hasbro and Mattel and defining the unique peculiarity of the Italian toy market, the only one in Western world dominated by national incumbents.

Convergent strategies

Strategies pursued by Giochi Preziosi and Gig during this period are similar and convergent:

- **Selection and import of toys from Far East, with development of a foothold in Hong Kong** - Both companies serve wholesalers and toy stores, extending their control on the supply chain by establishing headquarters in Hong Kong to better manage product selection, negotiation, and supply management. As said before, control of the supply side is a key competence and a key driver of the business success, as the opportunity to screen the best products ahead of competitors, to achieve substantial cost savings through high volume orders and savvy order management, and to obtain exclusive distribution licensing for the Italian markets are fundamental to outpace competitors.
- **Aggressive tv advertising** - Their advertising strategies, crafted by their independent advertising agencies (Publikids for Gig, Quarter and Winter for

Giochi Preziosi) share the majority of the whole tv advertising investments in the industry. The two units develop substantial competences to market toys to the kids segment (mostly, 6 to 16 years old)

- **Development of own product development unit** – The logical step after the product selection phase is to expand in the broader area of product adaptation for the Italian market and new product development. Both companies set up their own internal units, that besides leveraging a network of freelance toy creators also exploits business contacts with Far Eastern and other foreign toy companies (in particular, Hasbro for Gig). While the emphasis on these units is pretty similar in these initial phases, in the *second (divergent) period* we will analyze how Giochi Preziosi will start to leverage its product development unit to create synergies with newly acquired manufacturing companies (from 1990 on) and to acquire the rights to create licensed products for cartoon series. The first step in this path, that from 1990 on will clearly emerge as a divergent strategic trajectory with respect of Gig, is the license obtained from Bandai in 1998 for its Turtles and Zodiac Knights cartoon series. On the other side Gig will establish partnerships with Far Eastern companies to market co-branded products for the Italian market; in particular, Gig will develop the capability to push credible and successful brands over the medium term (e.g. with the remote control car models "Gig Nikko", a partnership with Nikko Company), while Giochi Preziosi will eventually focus on more trendy products characterized by shorter product life-cycles.

- **Entering the videogame market** – As explained, in the '80s the first experiments by Sinclair, Commodore, and Atari were already in place and the videogame market, while lacking well-accepted standards and relying on different

and incompatible technological standards, was already enlarging from a small niche to a growing market. Success by the new incumbents Sega and Nintendo, the Japanese suppliers previously focused on coin-ops, brought both Gig and Giochi Preziosi to actively seek distribution agreements to market the new consoles, Nintendo Famicom (NES) and Sega Master System, in the Italian marketplace. The well developed distribution channels, the advertising and marketing experience of the two companies were surely appreciable to the Japanese console leaders which started long-term relationships that in the case of Sega were compromised only in the late '90s (when its license was revoked as the Japanese company suspected that Giochi Preziosi favored the Nintendo brand obtained through the acquisition of Gig in 1998). Both companies distributed consoles and videogames and nurtured the market with advertising campaigns that were surpassed only by Playstation from 1996 on.

- **Opening franchising stores** – in 1988 Giochi Preziosi opened Giocheria franchising network, soon emulated by Gig's Amico Giò network. Besides the willingness to leverage a new business model (franchising had been recently introduced in Italy), Giochi Preziosi's idea was to develop a compelling value proposition for medium-sized stores as a way to gain more control over the distribution channel and secure shelf space for its own products at the expense of the competitors. Giochi Preziosi initially owned some of the stores, and acted as a supplier/wholesaler for its affiliates not only for Giochi Preziosi's products, but also for competitors' products (thereby taking supplier's risk). Giochi Preziosi gained approximately 300 subscriptions. Gig immediately imitated the competitor not to lose control over the distribution channel as well, and launched Amico Giò

with a similar business model focused on smaller stores located in attractive downtown locations. Amico Giò attracted 800 subscriptions.

- **Serving large retailers** – The coming of the large retailers ("Grande distribuzione") challenged the equilibrium of the distribution channels of the Italian market. Focusing on large stores and high volumes, the new entrants enforced a stronger battle for survival among traditional medium and small-size stores. As a response, both companies created a dedicated interface to deal with these large customers, which were unusually strong in terms of buying power and unusually demanding in terms of products. Large retailers became a quick way to enlarge volumes and revenues to the expenses of the competing channels (wholesalers, stores) and margins, but also introduced significant friction as distributors were serving both the new and the more traditional channels, with obvious discontent of the latter.

To sum up, the two companies' strategies were mostly convergent during the 1978-1990 period, as major decisions were pursued along the direction of:

1. development of existing business (development of supply control, product development unit, advertising unit)
2. seizing new opportunities that had worked in other foreign markets (videogames, large retailers)
3. imitation of competitors (franchising networks).

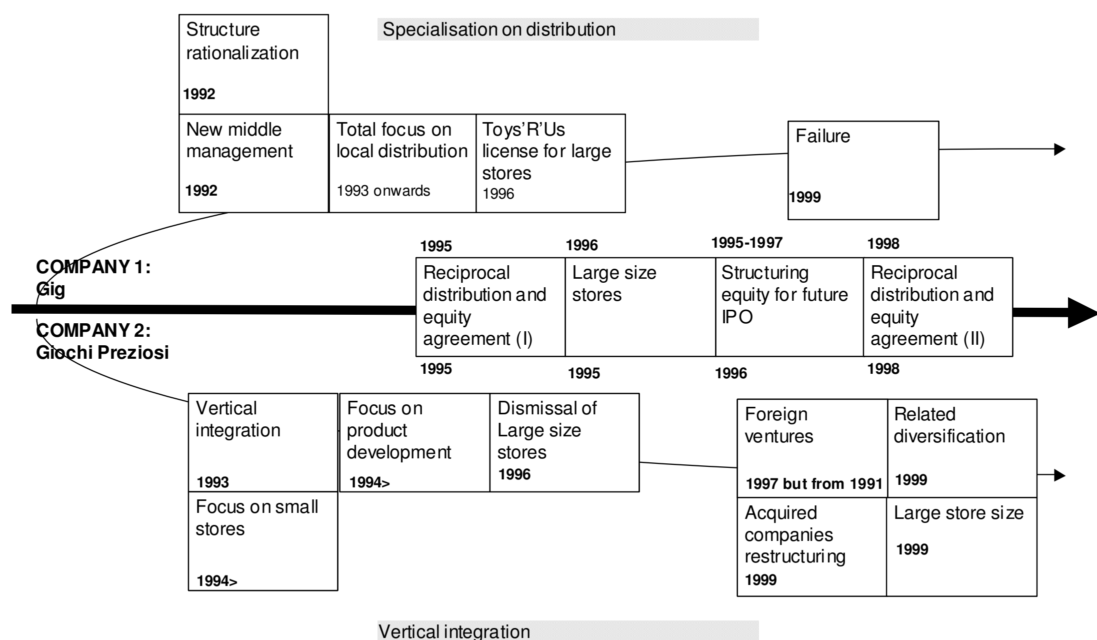
c. Increased uncertainty and divergent evolution: the 1990-1998 period

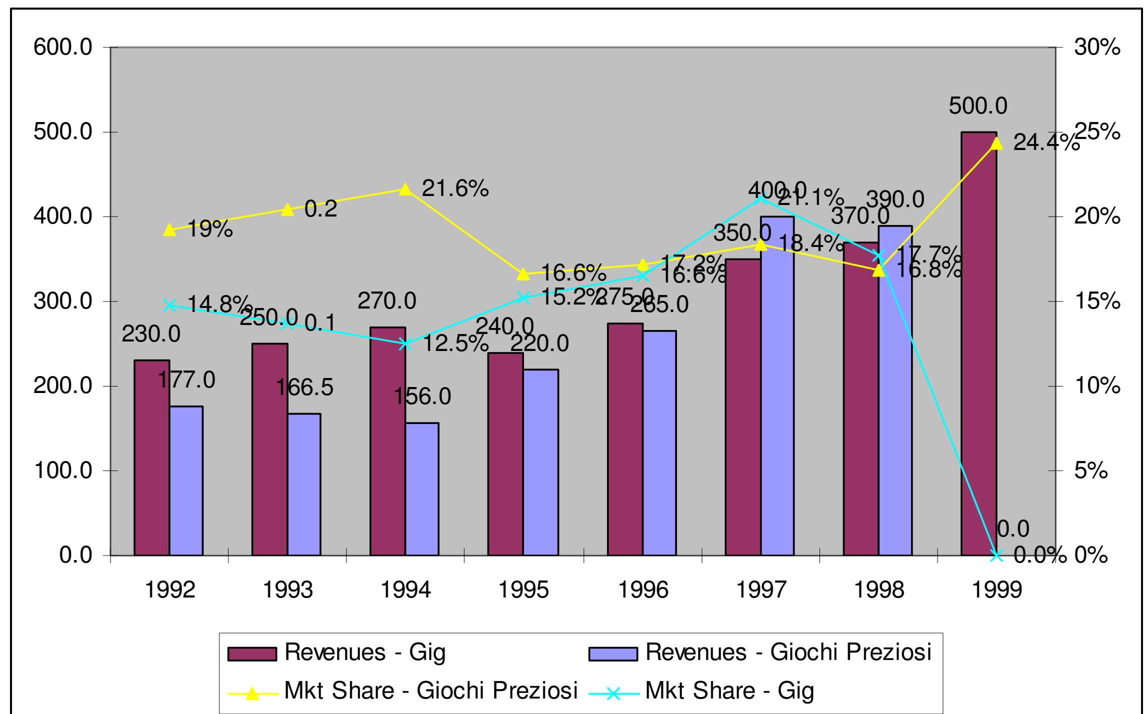
From 1990 on, the toy industry faces a period of increased uncertainty as competition becomes stronger, currency issues undermine industry margins, large retailers become increasingly threatening, while consumer purchases and

consumption undergo substantial changes (see p. 61). Further consolidation occurs, while companies need to rethink their strategies, address a more volatile market where price elasticity stays the same, traditional distribution channels are at a strain and kids fundamentally play much less than in the past. The four industry leaders (Gig, Giochi Preziosi, Hasbro, Mattel) are the players of the struggle for market share, while small niche leaders focus on exports (mainly in the European markets) not be driven out of the market.

During this turbulent period, Gig and Giochi Preziosi deploy very different portfolio of strategic initiatives: some of them are mere experiments, others are successful attempts to innovate product offering, business strategy or markets. Besides, both companies realize to be the only two large Italian players in the arena and pursue a set of common strategies to limit competition by Hasbro and Mattel, the two US-based companies that enjoy market leadership in mostly every other market of the Western countries.

DIVERGENT EVOLUTION AND DIFFERENT STRATEGIC LOCK-INS





Convergent strategies

- **Reciprocal distribution and equity agreements**: in 1996 and in 1988 (shortly before Gig's failure), Gig and Giochi Preziosi converged in a collaboration agreement that tries to secure control over the distribution channels by the two largest Italian companies to limit competition by other players, namely Far East importers and US companies. Both agreements are made up of two components:

  – A cross-distribution agreement whose function is to enable easier and faster cross-distribution of their products through their own distribution platforms (both large retail, wholesalers and franchising chains), to the expense of other competitors

  – An equity exchange, by the which Gig acquires a stake in Giochi Preziosi and Giochi Preziosi acquires a stake in Gig's companies, plus receiving from Gig a cash refund. The rationale behind this equity

agreement is to keep open the option to integrate the two companies' structures to better face competition in the home market and to start a international venture to address foreign markets; the news were publicly available and generated some perplexity from a antitrust viewpoint[3], but Gig failed soon after the announcement, making easy for Giochi Preziosi to rent its assets. At the time the strategic directions going forward for both Gig and Giochi Preziosi's top management teams[4] were to join forces and subsequently specialize the two companies (Gig taking control of all the distribution unit, Giochi Preziosi taking control of all production and design unit) by reallocating activities (namely, moving Gig's product development unit under Giochi Preziosi and moving Giochi Preziosi's distribution under Gig) to leverage the distinctive competences that by 1998 the two companies had deployed through divergent strategies.

The two companies had never been strangers, since its top management had known each other for a long time and between the two companies a heightened feeling of rivalry was perceptible:

> *"Gig was perceived as the traditional leader of the industry, while Giochi Preziosi was seen as the rising star that had matched the leader… therefore a lot of envy and competition was going on between the two"*[5]

And again:

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[3] Source: IlSole24Ore, 29 Oct 1998, "Giochi Preziosi, merge with Gig and then IPO"; IlSole24Ore, 17 Jun 1994, "From Gig and Giochi Preziosi a new leader is born" [Author's translation]
[4] Author's translation of interviews with the two companies' top management
[5] Author's translation of industry expert at Italian Toy Industry Association

> *"[About Giochi Preziosi's opinion]: Communication between the two companies dates back a long time, but between the two there has always been a lot of competition, especially in the electronic game segment."*
>
> *"[About Gig's opinion]: In our industry customer services are key, this is why we aim at nurturing our synergies with Giochi Preziosi"*[6]

Despite reciprocal envy, admiration and competition, the two companies had so far (and would have again) failed to reach a consistent agreement for collaboration against competition, as *"at the end of the day, we were always fighting on the negotiation table to get the better deals with common suppliers"*[7].

- **Large size stores**: Both companies develop a focus on large toy stores during this period, but the timeframe of their commitment varies. Back in 1994 Giochi Preziosi already owned Agosti's and Grazzini's (two very successful toy entrepreneurs) large stores as a way to develop a foothold in the distribution, besides building capabilities in managing stores (capabilities that already started to build by acquiring some of Giocheria's stores). Rumors about Toys'R'Us, the US category killer, willing to enter the Italian market pushed Giochi Preziosi towards the decision to preempt the potential competitor and leverage the existing portfolio of stores to build a larger network of large stores with the brand "ToyCenter", while performing a reality check on its ability to manage such a

[6] Author's translation of press release, IlSole24Ore, 17 Jun 1994
[7] Author's translation of interview with top manager at GP

sophisticated business model. The strategic rationale for the move is to secure a first-mover advantage in order to either buy Toys'R'Us license at a cheaper price or sell the chain to the US company in case the market would not be perceived attractive anymore. At the same time, Gig was making moves to contact Toys'R'Us and scan possible partnership opportunities. Toys'R'Us faced the opportunity to evaluate both Italian companies as potential business partners, but as a deal with Giochi Preziosi proved to be impossible (Giochi Preziosi's management considered the license royalties to be too expensive while Toys'R'Us refused to enter in a joint-venture with the company), Gig closed the deal (a joint-venture with 15% participation by the US company). Gig's rationale was to reinforce its grasp of the distribution channel, implement a store format that allowed to push sales and reduce seasonality, and gain substantial business contacts through its US partner to enlarge its scope of action internationally (starting from access to a broader selection of suppliers at lower costs). At the same time, Giochi Preziosi decided to partially withdraw from the focus on large stores and to re-focus on its Giocheria chain of medium-size stores. To do this, it dismissed part of its ToyCenter stores by selling 49% of its controlling entity, Holding dei Giochi (1995), to Standa (a retail subsidiary of Fininvest conglomerate). As a counterpart, Giochi Preziosi received the 49% stake Standa had in Giocheria, regaining total control of the chain and focusing on turnaround. On the other side, Gig started an aggressive store opening strategy with its Toy Service joint-venture, opening 16 Toys'R'Us stores in 1996 and reaching 24 stores in 1997. After Gig's failure, Giochi Preziosi will eventually refocus on large stores by acquiring Toys'R'Us stores (Toy Service, 1999), disregarding Toys'R'Us brand and re-buying Standa's stake in Holding dei Giochi (1999).

- **Structuring equity for future IPOs**: At multiple points in their development, both companies recurrently advertised through the press their willingness to go for an IPO at the Italian stock exchange. The rationale of this intent was mainly to access cheaper capital to push their growth strategies. To do so, both companies audited their accounting procedures and looked for external audit certifications (as requested by regulation); they also searched for financial investors and venture capitalists that could assist them in the process: in 1995Gig welcomed Sopaf (Jody Vender's Milan-based merchant bank) in its equity, with the aim of going public before 1999; in 1995 Giochi Preziosi agreed with Gemina, Berger Trust and Felofin to subscribe for a convertible loan that eventually gave 30% of the equity to the new partners. Remarkably, neither of the two companies came to the IPO as Gig failed and Giochi Preziosi decided to privilege large bond emission to immediate IPO.

Divergent strategies

On the other side, the two companies embarked in fairly different strategic initiatives that profoundly changed their strategic postures and marked the end of the convergence the two players experienced so far.

GIG

- **Structure rationalization**, **new management hiring, focus on distribution**: at the beginning of the '90s Gig decided to restructure its operations to achieve a greater level of flexibility in face of a markedly turbulent environment. On one side, the logistic platform was redesigned to eliminate inefficiencies and rationalize the geographic scope of each regional sales unit. Gig Distribuzione was spun off to supervise distribution; a huge automated warehouse was opened in Lacchiarella, near Milan, to achieve higher scale economies. All

inventories scattered in regional centers were evaluated and centrally managed, and later on regional warehouses were dismantled. On the other side, in Linea Gig all marketing, procurement, and product selection and development activities were concentrated. All shareholding participations by partners that were dispersed in the various companies of the group were restructured to create a general holding, Gig Toy Group. While Aldo Horvat remained at in his leadership position, new middle management was hired from other industries to cope with the increased scope of the business and the more bureaucratic scale of operations. Hiring fro different industries was perceived as a way to introduce “super partes” management that could overcome potential conflict among partners. Besides the need to overcome inefficiencies, duplication of activities and departments scattered through regional offices and become leaner, one of the goals was also to become more flexible than Giochi Preziosi, so far perceived as having a flexibility advantage over Gig:

> *“One of the causes of Gig restructuring was [...] the perceived need to match Giochi Preziosi’s leaner cost structure, due to more centralized control.”*[8]

Restructuring continued through 1994-1995, when Sopaf entered with a stake in the company to help Gig in the consolidation of its activities. Overall, this approach privileged rationalization and streamlining of existing activities, to the expense of experimentation with other strategic opportunities. In this period, Gig fell behind the opportunity to scan foreign markets (it began only in 1997, close to failure) and improve its product development activities. Also, it substantially

[8] Author’s of interview to product selection manager at Gig.

misunderstood the coming of Sony Playstation, the competitor that eventually won the leadership of the console market; the company did not realize that Sony's target were not kids and teens, as it had always been, but adults. As a result, its Nintendo line would have fallen aside due to its obsolete kids-oriented advertising. Gig's extreme specialization on the distribution side of the business emerged as a dominant pattern that, besides having always been at the core of Gig's strategic intent, will remain dominant throughout the '90s.

- **Toys'R'Us license**: As said before, while both Gig and Giochi Preziosi were interested in Toys'R'Us, Gig committed to the new venture. As we will discuss in the next section, while its top manager had mixed feelings about grasping the skills needed to compete in the large store business, very strong commitment and drive came from one of the members of the top management team, the experienced Guido Dentis. It is interesting to discuss the entry strategy that Gig selected at that time (1995-1996). Counting on support from the Spanish subsidiary of Toys'R'Us, Gig embarked in a two-year plan to open 24 stores Italy-wide. Given the fundamentally new job the company was going to undertake, the competitive pressure posed by Giochi Preziosi and Standa, which already controlled 27 similar stores, it is not surprising that the enterprise was undertaken with speed, little attention on format adaptation, and ambitious goals. We will discuss more in detail how Toys'R'Us affected the failure of Gig in the next section.

Giochi Preziosi

- **Vertical integration**: Beginning from 1991, Giochi Preziosi is involved in more than a dozen acquisitions of toy companies. Long established

brands like Migliorati, Ceppi Ratti, Harbert, Comogiochi and products like the best seller doll CiccioBello permanently enter the product line. Main targets are:

- Italian toy manufacturers (like Ceppi Ratti): for these companies, the strategic rationale is to acquire flourishing or distressed companies to be turnaround; their product portfolio can be then leveraged through Giochi Preziosi's distribution platform and advertising machine to reach a wider audience and sell more. As a consequence, Giochi Preziosi acquires precious skills in toy manufacturing and toy design, that will be crucial in its decision to focus on product development, production and international distribution. In time, toy companies will be restructured, gradually giving up production facilities but continuously leveraging their R&D departments that will remain crucial for the development of new successful ideas, as "Walking Tanya" (at the development of which contributed even the previous owner of Migliorati). The companies' structures are gradually integrated in Giochi Preziosi, but retain for a long time substantial autonomy.
- Italian wholesalers and stores (like Harbert, Fantastiko): the rationale behind these acquisition is to leverage, in the case of wholesalers, their client base to market Giochi Preziosi's offering; in the case of stores, to leverage Giocheria's early store management skills to set forth a foothold in the distribution channel. Again, the companies' structures will be gradually integrated in Giochi Preziosi, but will retain for a long time substantial autonomy.

- **Focus on small stores**: In 1994-1995, as Holding dei Giochi is created together with Standa to manage ToyCenter stores and Toys'R'Us license is not

acquired, Giochi Preziosi gains 100% control of Giocheria franchising chain and transforms it into a division of Giochi Preziosi. New focus on the chain's small stores is given by the management, that substantially restructures the division that until that moment included owned stores and franchising stores at the same time. The value proposition for the franchisees is innovated in order to deliver more compelling products and reduce complexity of operations.

- **Focus on product development**: Taking advantage of the Italian production facilities acquired through Ceppi Ratti/Migliorati (mainly dolls) and Harbert (mainly cooking lines), Giochi Preziosi develops a strong emphasis on product design, either entirely new products or toys derived from major cartoon series. To do this, Giochi Preziosi created creative partnerships with foreign leaders (for instance Thinkway in Canada, Character Group in UK), and acquires licenses from media companies (called Master Toy licenses). The rationale behind this choice is to expand the reach of Giochi Preziosi (which will now market products all over Europe) and develop capabilities that will enable the company to survive a stronger competition. The initiative also allows Giochi Preziosi to independently design and market those "trendy" toys (characters, and fancy games whose lifecycle lasts less than 12 months) that will become mainstream in the end of the '90s (Pokemons are one example).

- **Foreign market experiments**: The decision to pursue Master toy licenses forced Giochi Preziosi to establish a European network of third party distributors to market its own products. Besides, the company likes to experiment by opening stores in strategic locations (Spain, US, Hong Kong, France between 1991 and 1997) or buying stakes in foreign distributors (EuroPlayToys – Germany, 1991) or agree on cross-distribution deals. The outcome of these

experiments are not always successful: stores are opened and closed frequently in the following years. From 1995 on, also Master toy licenses are scaled down to avoid manufacturing constraints.

- **Other experiments**: Giochi Preziosi embarks in other strategic experiments that are not pursued by Gig, namely distribution agreement to sell toys through Avon's catalogue, a 70% stake in the children tv network "Junior Tv" for control of the advertising medium.

- **Diversification initiatives**: In 1998 Giochi Preziosi acquires Auguri Mondadori, a company focused on school products for children. This acquisition opens up a new period (that goes beyond the timeframe of our research) of related diversification in new niches, in order to leverage its distribution licenses and attack markets not as easily saturated as the toy market, that from 1996 will face very slow growth.

To sum up, the two companies' strategies were mostly divergent during the 1990- 1998 period, as major decisions were pursued along the direction of:

1. Specialization on the distribution channel, pursued by both companies with different strategies or different timeframes
2. Goal of IPOs
3. Company restructuring for specialization on the distribution and logistic side of the business, pursued by Gig
4. Vertical integration, foreign market experiments, and diversification pursued by Giochi Preziosi, even if with alternate results.

2. Company case-study n.1: Decision making and strategic initiatives at Gig

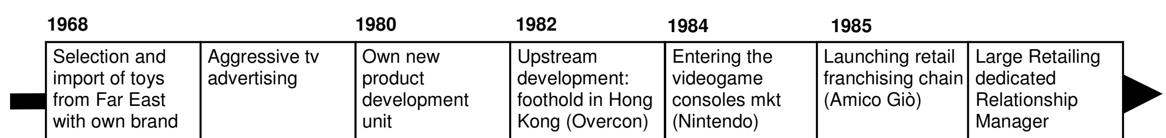
At the end of the '70s, the Italian toy industry was highly fragmented both on the retail and on the distribution side; small city stores were dominant and mainly sold high margin products with low turnover, long product cycle and track record of profitable sales over a long period of time. Advertising was at its beginnings, and focused on the local Disney's magazine "Topolino". Wholesalers were dominant player in the industry, pioneering the first importing strategies from the Far East.

Gig was founded in 1968 as a consortium of wholesalers operating in different regions of Italy. The company originally consisted mainly of a product selection and procurement platform that developed targeted advertising campaigns at national level through the Gig brand, while sales were delegated to the regional platforms.

a. The first period (foundation to 1990) – a synthesis

Foundation

In its first phase of development, Gig focused on product selection from Far Eastern suppliers and toy development companies (mainly Japanese and US); Gig's scale of operations and capillarity of distribution platforms granted the company exclusive rights to sell the selected products in the Italian market. As private television networks were on the rise and broadcasting targeted to children arose (mainly Japanese cartoons), the company decided to undertake aggressive tv advertising, an innovative practice for those times. Rapidly, the company evolved from a procurement platform aimed at achieving cost savings in procurement to product selection.



Historically, the company has been dominated by Horvat and Dentis, heirs of the original founders of Gig and owners of the largest distribution platforms (who also acquired other shareholders platforms in time).

Linea Gig: procurement and product selection platform

Linea Gig, the unit dedicated to product selection and supply, operated as a procurement platform and product selection agent for the distribution platforms; while initially procurement is subject to the approval of each platform, from the 1975 on centralization occurs, and Linea Gig begins to autonomously manage selection, procurement and marketing, planning and forecasting inventories requirements by geographic area and distribution platform them on the base of sales historical data (both volumes and product mix). Linea Gig also originated Overcon, founded in Hong Kong during the ‘80s to better manage the interaction with suppliers in the Far East.

Gig’s product development activities

By developing a direct foothold in the Far Eastern markets, Gig enters an international network of toy makers, toy creators, and distributors. Among all, Japanese and US toy creators will be key to understand that Gig can evolve to a more active role in the definition and adaptation of the product.

Linea Gig gradually evolves from pure procurement tasks to marketing and product selection activities, to product development pursued jointly with Far East manufacturers. New product development is focused both on concept creation and ideas selection from external third parties, and adaptation of existing products to tastes and peculiarities of the Italian market. Initially, product development activities as aimed at building entry barriers to product imitation; a branded, customized Gig toy in fact reaps the benefits of advertising investments without indirectly favor second-tier importers which could potentially offer similar but cheaper products

benefiting from the Gig's ad campaigns (advertising costs could add up to 15% of the price).

A joint-venture with Hasbro, called Promotoys, specifically targeted product customization (including packaging), advertising and market research for the Italian market. Product development activities at Gig expanded as agreements and joint-ventures with toy manufacturers opened the way to long-term partnerships for the development of entirely new product lines, usually co-branded (e.g. Gig Nikko partnership for remote control car models). Besides internal R&D, new products are introduced by scanning the network of freelance toy inventors looking for companies willing to manufacture their ideas.

Gig develops in time a distinctive capability to anticipate the Italian market trends, search among its suppliers the offering that better suits these market expectations, and tailor or design products to hit the market with huge advertising efforts. Its capabilities will enable the company to beat Sharp and Casio in the new-born niche of digital agendas for kids in the beginning of the '90s.

Entering the videogaming market

In 1988 Linea Gig pioneered the console segment by acquiring exclusive rights to sell the first Nintendo gaming console, the Nintendo Famicom (also called NES), at that time unsuccessfully distributed from Mattel. At the same time, Giochi Preziosi was introducing the first Sega console. Gig distributed Nintendo videogames cartridges and consoles until 1998, following Nintendo in each product release (NES, Super NES, Nintendo 64, Game Boy).

Distribution: franchising and large retailers

Until the end of the '80s, Gig's stronghold had been the capillarity of its distribution platform. The coming of the large retailers put a threat on this structure as

besides being an additional channel, it cannibalized sales in the small store channel and drove margins down. Large retailers heavily leveraged toys as an attractive product to discount in order to attract customers at the point of sale. Besides setting-up a dedicated salesforce for large retailers, Gig launched a franchising chain called Amico Giò. Amico Giò was introduced as a response to Giochi Preziosi's Giocheria network. Targeting city small stores, Amico Giò got 800 subscriptions to its program. The introduction of this privileged channel brought of course additional strain on the residual small stores that were Gig's traditional clients. On the other side, Gig struggled with the challenge of offering to the franchisee network a compelling offer without killing margins.

b. The second period (1990 to failure) – a synthesis

1992		1993	1995	1996	1998	1999
Structure rationalization	New middle management	Total focus on distribution	Reciprocal distribution and equity agreement (I)	Large size stores openings (Toys'R'Us)	Distribution and equity agreement with Giochi Preziosi	Failure

<u>*Restructuring and foundation of the Holding*</u>

From the end of the '80s on, Gig opted to eliminate inefficiencies in its structure by completing the integration program it underwent in the previous years. What was left of the regional platforms was merged in Gig Distribuzione, the centralized decisionmaking unit for inventory management, distribution and sales, while maintaining Linea Gig as product platform and creating a superimposed holding (Gig Toy Group), where all shareholders' equity was concentrated. As a result, warehouse structure was rationalized, regional platforms were redesigned, and duplications of resources were abolished. The new structure was meant to be more flexible to more demanding market requirements. Besides, new middle management hiring brought new personnel in the company with business experience, even if not

directly related to the toy industry. The task considerably put on strain the entire organization, limiting the opportunity to pursue new strategic initiatives:

> *"Gig did not pursue the strategy of acquiring toy makers as Giochi Preziosi did… back in the '90s, we did not have enough time, given the market, the restructuring, and in the end the Toys'R'Us stores, to evaluate whether to pursue similar acquisitions as our competitor did […]"[9].*

Toys' R' Us

> *"[The decision to acquire Toys'R'Us license…] proved to be a true auto-goal[10]"*

From approximately 1992 onwards, Toys'R'Us, the US-based toy category killer, is expanding in Europe. Considerable attention is given by the major Italian toy companies as the coming of Toys'R'Us would potentially bring higher sales but also a formidable incumbent in the distribution channel. Gig partnered with Toys'R'Us in 1996. Differently from what happened in the other European countries, Toys'R'Us only acquired 15% of the joint-venture, considerably relying on the partner's capabilities to start the new venture. Gig was expecting to reinforce its grasp of the distribution channel, to enhance sales of its own products and to gain substantial business contacts through its US partner to enlarge its scope of action internationally (starting from access to a broader selection of suppliers at lower costs). So far, Toys'R'Us format had been successful in Spain (a similar market, where nevertheless labor costs were lower than Italy), while it had not worked in France. Assuming that

[9] Author's translation of interview to top manager at Gig.
[10] Author's translation of an early interview to Aldo Horvat, conducted in November 2001.

the Italian market was more similar to the Spanish compared to the French market, Gig secured the rights to use the trademark and managerial support from Toys' R' Us Spain. As the top managers of Linea Gig recalls:

> *"We were not quite sure to master the know-how required to run such a large store format… I expressed my feelings to Toys'R'Us CEO, who told me 'Let us talk about it… I want you to be glad, not concerned, to join the network'… He conversely promised help from Spain. But […] the Spanish CEO died […] and the new manager was too busy in taking control of the Spanish subsidiary than in helping us…"*[11]

Contrary to expectations, Gig was left with little aid from Toys'R'Us for new store openings. Sixteen new stores were opened in 1996, becoming 24 in 1997. As specialized press pointed out after the company went bankrupt, the store format was too large to tackle with the high set up costs of an Italian store. First, store size did not justify the turnover; labor costs were high and fix; due to the joint-venture capital structure, the company could not divert inventories to other European Toys'R'Us stores but could only manage to coordinate with Gig's inventories. As Linea Gig's manager pointed out:

> *"We forecasted the chain's results not to be profitable for the first two years, but as actual results were far worse that expectations, the*

[11] Author's translation of interview to top manager at Gig.

> *whole Gig group was badly affected by this strategy […] the third year was even worse"*[12].

As a Giochi Preziosi's manager suggests:

> *"They had huge inefficiencies… store furniture, as instance, was coming directly from the US… incredibly expensive"*[13].

On one hand, the store format was crafted for the US market rather than the specificities of the Italian market. Its cost structure was heavy, since store size was huge and labor costs higher than the US market. Because of this factors, it was difficult to maximize inventory and shelf turnover (turnover per square meter) without competing with large retailers. Instead of the traditional "every day low price" concept pursued by the US partner, the stores soon focus on heavy discounts on very attractive products to drive traffic to their locations at the expense of the large retailers. Heavy advertising investments did not manage to increase volumes apart from the usual Christmas timeframe, while volumes were the main driver for such a store concept to be profitable.

The failure

In 1997 Gig reached a turnover of 400 billion liras[14]; its dramatic increase (from 250 billion liras in 1995) was mainly due to Toys'R'Us. At the same time, Aldo Horvat announced that the company could not comply anymore with its credit obligations and was filing for bankruptcy. The news came totally unexpected and caused considerable surprise in the business community. As the head of the Italian toy association (Assogiocattoli) commented:

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[12] Author's translation of interview to sales director at Gig.
[13] Author's translation of marketing manager at GP.
[14] Turnover related to toy sales only; source: Company report, Databank report

> *"We are surprised by the sudden crisis of one of the major national competitors. The crisis of Gig leaves all the industry with a huge gap in product offering and marketing […] this event negatively affects us all […] We are trying to build consensus among business partners to evaluate the possibility to intervene from a financial standpoint."*[15]

The company's sudden failure seemed indeed to be an unforeseen event on top of a very successful 5-year growth strategy, creating a huge void in product offering and distribution capabilities. On a closer investigation, it is clear that Gig's crisis was based on a more subtle shift in its risk profile, both from the new stores and the other traditional business units. Horvat's perspective clarifies how different market conditions and store management issues compromised all main business units of the company:

> *"As far as the stores were concerned, we were losing money at the gross contribution margin level: this meant that the more we sold, the more money we were losing. […] On top of this, in 1997 our Nintendo console was surpassed by Playstation; the rest of the toy market and traditional channels were stagnating; Toys'R'Us stores were meant to*

[15] Author's translation of press release, 1998

> *save us… but given those financial premises, they did not.[16]"*

At the end of 1998, Toys'R'Us stores generated 2.5 billion liras in losses every month. It is not clear whether the failure came from mismanagement of the stores only: while overall losses declared by the group amounted to 80 billions liras, only 30-40 billions were due to Toys'R'Us stores; the rest came from the excess inventories of traditional channels. Again, it is not easy to compute the real effect of the large stores on the overall financial structure of the group, as structures and inventories were of course superimposed. As an insider explained[17]:

> *"Gig fell under its weak financial structure, heavily relying on wide use of client's supply credit, bank credit lines and mismanagement of its inventories, which […] by nature rapidly become obsolete."*

As a consequence, Toys'R'Us tried to acquire control of Toy Service, the subsidiary managing the stores, only to retire because of huge capital injection needed to save the company. Gig's personnel went on strike, while attempts to save the group ended up having Giochi Preziosi, Gig's first competitor, renting Linea Gig and Gig Distribuzione's assets for a year.

Lawsuits in the traditional business units came also on the front, as major misinterpretations arose with clients about inventories; in fact, both Gig and its clients could not easily agree on data about goods shipped and/or billed to them in the very

[16] Author's translation of Gig top manager
[17] Interview to Stefano Pierattini, formerly head of Firenze's branch of Gig Distribuzione, in a overview on Gig's crisis

last months of activity. Parallely, Firenze's law court began investigation to clarify the role of large repayments done to Gig's lending banks immediately before the failure.

Giochi Preziosi subsequently bought the Linea Gig and Gig Distribuzione, leaving Publikids (the advertising unit), All Right (publishing) and Overced (IT) going bankrupt. The new owner completely laid off the middle management and downsized personnel. Giochi Preziosi finally bought Toy Service and took control of Toys'R'Us stores, which were rebranded "Toy Centers", and successfully turning around the business in the following years.

Last, some external observers[18] note that Gig's restructuring may have hidden flawed evaluations in each shareholder's share of the company. Namely, the evaluation of each shareholder's inventory, still owned by the regional platforms, could have been compromised by the pressure put by the management to attain a quick restructuring that did not generate discontent among shareholders. If so, Gig's financial structure could have been even more weakened.

Managerial perspective on Gig's failure

How did Gig embark in a strategic trajectory that led to failure? In this section we will interpret Gig's failure from a managerial viewpoint.

First, Gig was famous for setting very ambitious goals and high expectations. During its last full year of operations before the crisis, it declared a goal of 1,000 billion liras in revenues (as opposed as 250 billions reached in 1996) and IPO with stringent deadlines. Top managers were driven on one side by ambitious growth expectations, given the efficiency gains that company restructuring should have brought to the company.

[18] Interview to industry experts (conducted through toy industry association)

Second, Gig's managers had historically developed a bias on the distribution side of the business. An excessive focus on distribution in the Italian market caused Gig to avoid scanning for foreign markets, to invest heavily in product development, and to embrace the Toys'R'Us challenge without setting thresholds past which reconsider the investment decision in large stores. As said by a Giochi Preziosi's ex-managing director,

> *"Both Giochi Preziosi and Gig have always focused on distribution first. Even Giochi Preziosi, despite its competencies in product development (beyond Gig's capacity), eventually encountered problems in production planning and inventories."*[19]

Third, Gig fundamentally lacked the skills to run large stores, not to speak of the fact that according to industry experts, the format was not suited to the Italian market. Lacking help from the Spanish Toys'R'Us partners, embarking in a new venture with ambitious goals, Gig did not manage to build in-house or acquire skills to turnaround its stores, which have been turnaround later by Giochi Preziosi, but without achieving a tailored, Italian market-specific new format. As Giochi Preziosi manager previously working in Gig points out:

> *"… and by the way the former Toys'R'Us (now Toy Center) stores generate a lots of problems even nowadays… we turnarounded them, but never really managed to fix the format… even Toys'R'Us America has also been bought in*

[19] Author's interview to Maurizio Cellai, former manager at GP.

> *later years, as its stores failed to deliver consistent results over time."*[20]

Similarly to Gig's stores, also US-based Toys'R'Us company suffered from major losses in 1997-1998. The success of the format backfired as competition from large retailers and the internet drove prices down.

Fourth, managerial conflict was in part responsible of the lock-in of Gig's strategy. The responsible of the large stores division, Guido Dentis, while sharing long-term experience of Gig, was perceived as being significantly optimistic about the stores despite the discouraging financial results. His personality was so strong that Horvat could not interfere with his strategy, being only able to verify the financial crisis *a posteriori*. As he mentions:

> *"I regret not to have opposed Dentis' strategy as strong as I could have done […] He was so stubborn about his store opening strategy."*[21]

And about the whole strategy Gig put in place from 1996 onwards:

> *"We were riding fast on a derailing train, and we could not manage to steer in time to change direction."*[21]

c. *Perspectives on Gig after the acquisition*

After a one-year rental of Gig's assets, Giochi Preziosi acquired at the end of '99 Gig Distribuzione and Linea Gig. One year after, it also acquired Toy Service, Toys'R'Us licensed store company.

[20] Author's interview to Maurizio Cellai, former manager at GP.
[21] Author's interview to top manager at Gig.

> *"At the time of the crisis, Giochi Preziosi could acquire all Gig's assets at a low cost, as the company was to be liquidated. In particular, we had the opportunity to come to friendly agreements with the unions about personnel, and bought inventories that we sold gradually in time without flooding the market."*[22]

Middle management was fired, Gig's other ventures (Overced, Publikids) were dismantled. In its first year of operations after the failure, Gig already reached 200 billion liras in revenues. From that point on, Giochi Preziosi successfully re-launched Gig's brand. Gig's stores (both Amico Giò and Toys'R'Us) were bought and turnarounded. It is interesting to note how Gig's assets, managed by Giochi Preziosi, were capable of becoming profitable in such a short period of time.

[22] Author's translation of interview to GP's former product development manager.

Time frame	Foundation and expansion (1968-1990)	Organization streamlining (1990-1995)	Overspecialization (1995-1998)
Environment	* Italian distribution is fragmented and inefficient * Toy market on the rise	* Italian lira on the fall (1993-1995) * Toys'R'Us enters Europe, arousing fear among distributors * Large retailers becoming increasingly influent on marketing policies * Gig, Giochi Preziosi, Mattel and Hasbro contending market leadership * Market growth, with intensified competition and lower margins for importers	* Italian lira realigned in SME (1995) * Fast market growth (1995-1997) followed by market slowdown (1998-1999) * Toys'R'Us looking for Italian partner * Hasbro interested in buying a stake in Gig (1995)
Strategic intent	* Achieve cost savings, brand awareness and sales boost through centralized procurement and advertising through new private tv networks	* Integration and streamlining of operations and procurement for further development of distribution and achieving superior scale of operations * Goal of Initial Public Offering for 1994	* Ambitious target of 1000 ITL mld revenues for 1998 * Limiting the competition from Far East exporters and foreign competitors through distribution agreements with Giochi Preziosi
Strategy	* Creation of procurement and product selection unit * Aggressive television advertising * Toy import from Far East * Main headquarters established in Sesto Fiorentino (1980) * Creation of product development unit * Creation of Overcon in Hong Kong for supply chain and new product dev. management (1982) * Licensing agreement for distribution of Nintendo NES console (1984) * Joint-venture agreement with Hasbro for R&D and market surveys * Creation of Publikids, owned advertising agency * Creation of AmicoGiò, owned franchising small store chain (1985) * Introduction of Relationship manager for Large retailers	* License agreement for distribution of Nintendo SuperNes (1992) * Creation of Gig Distribuzione for further rationalization of operations along with new automated distribution center in Milan (Lacchiarella) (1992) * Creation of Linea Gig for streamlining of product selection and product development (1992) * Middle management reshuffling (1992) * Capital structure rationalization (1992) * Creation of the first electronic agendas for kids product line (1993)	* Cross distribution agreement and own stock exchange (6% of equity) with Giochi Preziosi (1996) * Joint-venture agreement with Toys'R'Us for start-up of large store chain in Italy * Opening to international activities: Gig exhibits for the first time at Nurnberg's international fair * Gig holding created (1997) * Spin-off of IT service comany (Overced) (1997) * 17 new Toys'R'Us stores opened (1997) * Merge with Giochi Preziosi is evaluated (1998) * Private equity Sopaf acquires a share of Gig, planning future IPO (1995)
Performance	* Gig becomes nation-wide distributor * Dominant market positioning	* Rationalization of assets * Gig dominates in the newly created kid electronic agenda segment, beating technology leader as Sharp and Casio (1993) * Sustained growth of revenues	* Huge losses on Nintendo consoles due to yen cross rate (1995) * Low returns on Nintendo consoles due to Playstation (1997-1998) * High leverage reached (1998) * Huge losses on Toys'R'Us stores (1997-1998) * Huge losses due to inventory surplus (across Gig and Toys'R'Us stores) (1998) * FAILURE (Jan 1999)

3. Company case-study n.2: Decision making and strategic initiatives at Giochi Preziosi

Among all Italian incumbents, Giochi Preziosi is considered to be the star which saved Gig from failure and developed in time a diversified group revolving around children and their needs. Founded in 1978, the company grew rapidly along the lines of Gig and the other Italian incumbents; from 1990 on competition in the industry was a battle between Gig, Giochi Preziosi, Hasbro and Mattel. By deploying strategic experiments at several points of its history, Giochi Preziosi built a comprehensive set of competencies and resources as to survive the market slowdown at the end of the '90s and finally took leadership of the industry.

a. The first period (foundation to 1990) – a synthesis

1978		1982		1988	1989	
Selection and import of toys from Far East with own brand	Aggressive tv advertising	Own new product development unit	Upstream development: foothold in Hong Kong (Overcon)	Entering the videogame consoles mkt (Nintendo)	Launching retail franchising chain (Amico Giò)	Large Retailing dedicated Relationship Manager

Foundation

> *"The history of Giochi Preziosi is that of a "typical growth". Initially, Giochi Preziosi was not a manufacturer, but only an importer/distributor. The strategy underlying its success has been brand development and focus on marketing activities to push toys and trendy toys".*[23]

[23] Author's translation of interview to Maurizio Cellai, former GP manager

In 1978 Enrico Preziosi founded his toy company in Seveso, near Milan. In its first phase of development, Giochi Preziosi quickly imitates the steps other incumbents have followed in the business: leveraging contacts with Far Eastern toy producers and distributors, the company starts selling its own imported toys to local toy stores and grows its platform, acquiring exclusive licenses to distribute toys under its "Giochi Preziosi" brand and leveraging significant investments in advertising to achieve larger scale of operations. In 1989 the company opens new headquarters in the near Cogliate town. With this respect, Giochi Preziosi already knows what is the "blueprint" of successful competition in the industry as it can scan Gig's moves and follow them. By the end of the '80s, Giochi Preziosi and Gig are competing as peers in the market, with similar market shares near 10%.

Giochi Preziosi's licensing and product development activities

Imitating one of the most successful strategies of Gig, Giochi Preziosi is born as a distributor and soon starts acquiring exclusive licenses to distribute toys in the Italian market. To do this, Giochi Preziosi achieves consistent scale of operations in the first part of the '80s. At that point, the only consistent option for further growth, as its founder explains, could only be to go for exclusive licensing rights; as its founder underlines:

> *"[The company reached 21 billion liras in turnover in 1987…] And it was not possible to do better, given the company size and the market at that time. It was time to make a decision. We had to decide whether to stay*

there, being okay with what the market allowed

to earn, or to innovate the company further."[24]

Thank of sound product selection (bestsellers like Festival's microphone, cooking lines, a transformable watch and Baby Bua doll, selling 300,000 pieces a year) marketed under exclusive rights for the Italian market, the company grows to 37 billion liras in revenues, investing 10 billions in advertising. By leveraging its distribution platform, the company pushes forward its licensing strategy winning Bandai's license for Turtles and Zodiac knights characters in 1988.

Parallely, the company has developed a first set of skills to customize and develop new products by leveraging its contacts with Far East suppliers. Scanning the Italian market to anticipate future trends, Giochi Preziosi grasps expectations about what the market will demand next and actively pursue the strategy of "putting the product together". A network of freelance inventors is also another source of ideas. Success of these initial experiments will convince the company to bet on integration on the production side from 1990 on.

Entering the videogaming market

In 1998 Giochi Preziosi follows Gig's acquisition of exclusive rights for Nintendo, agreeing with Sega for distribution of its Sega Master System console and videogames. At the time, consoles and home PCs were already present in the market, and both Nintendo and Sega consoles proved to be very successful in foreign markets. By its side, Giochi Preziosi could offer its robust distribution platform and marketing capabilities to target children to Sega. The agreement was only the first step of a long-term relationship (Giochi Preziosi marketed also each subsequent generation of consoles, Sega Master System 2, Sega Megadrive, and Sega Dreamcast) that ended

[24] Author's translation of interview to GP's founder released to the press on Oct 15, 2001

only at the end of the '90s, when the acquisition of Gig and Gig's rights for Nintendo put Giochi Preziosi in conflict of interests.

Distribution: franchising and large retailers

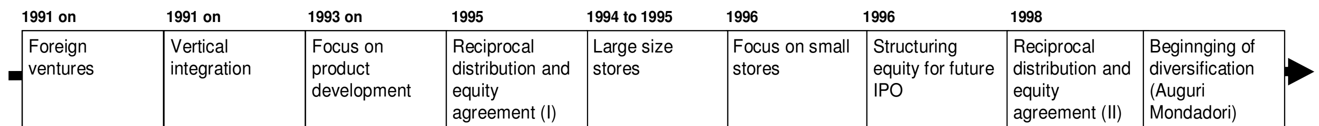
At the end of the '80s franchising had become a widespread reality in Italy, from being perceived as the last management fad to a managerial practice that was increasingly adopted by businesses. Adopting the practice, the company started in 1988 Giocheria's franchising stores as a way to build a dedicated channel to push sales, gather market info, establish strong relationships with store owners and have preferred access for its products. Initially, Giocheria targeted mid-size toy stores and built a procurement center, acting as a wholesaler for its franchisees not only for Giochi Preziosi's, but also for its competitors' toys. The company directly owned some of the stores, and carried the burden of its franchisee's insolvency risk. The number of stores in the network started with 21 (5 billion liras in revenues) and reached 140 (40 billions in revenues) in 1990; in 1998 the chain had more than 250 stores. To compete with Giocheria's threat, Gig quickly introduced its own franchising network focused on small, downtown stores, Amico Giò.

Secondly, Giochi Preziosi responded to the coming of the large retailers by actively targeting the new channel with dedicated products. As said before, large retailers heavily leveraged toys as an attractive product to discount in order to attract customers at the point of sale. While driving margins, down, large retailers were also an attractive opportunity to grow volumes.

b. The second period (1990 to acquisition of Gig) – a synthesis

In 1990 Giochi Preziosi is the largest advertising spender (44% of traditional toys ad expenses, 62,1% of electronic games), closely followed by Gig. From 1990 on Giochi Preziosi develops a broad portfolio of strategic experimentations, fluidly

entering and exiting business ventures that will allow the company to build a comprehensive set of skills both in the distribution, foreign markets and production side.



Experiments abroad

From 1991 on Giochi Preziosi repeatedly attempted to enter foreign markets by opening stores, acquiring stakes in foreign distributors (EuroPlayToys – Germany, 1991), or by striking distribution deals with foreign distributors. The company is driven to this by the drive of Preziosi to think internationally, and by the necessity to leverage the Master Toy licenses by increasing volumes in order to reduce the incidence of fix costs.

> *"Production activities call for an international market, as fix costs (mainly moulds) are high. […] This is why Giochi Preziosi created a network of third-party distributors to sale our products in other countries."*[25]

While third-party agreements are very successful, new stores are not always profitable. From Barcelona, Hong Kong to Paris, New York and Chicago (these latter two were opened after deregulation in '95), management of these stores reveal to be difficult; in particular, the US stores are closed down within 3 years. After the acquisition of Gig, international operations will boost as distribution agreements with distributors will bring to the creation of several local joint-ventures (for instance, with

[25] Author's translation of GP's product manager.

Moby in France, Ideal in Spain, but also in Germany, Greece, Brazil, and Eastern Europe). In 1998 foreign revenues will account for 20% of the total.

Vertical integration

From 1991, Giochi Preziosi decides to buy stakes in Italian toy manufacturers in order to add traditional and well established brands in its product line and gain manufacturing and design competencies. Companies like Migliorati (Tanya dolls), Ceppi Ratti (Cicciobello dolls), Harbert (Harbert's cooking lines), and Comogiochi (carnival products) permanently enter the product line. An attempt to buy out Tyco's Italian branch is stopped because of legal issues. Companies are subsequently bought out their original founders, while usually maintaining considerable autonomy in their production and marketing decisions. In time, Giochi Preziosi outsourced part of the production in China, keeping in Italy value-added manufacturing facilities and R&D departments. R&D units allow Giochi Preziosi to acquire significant competencies in product development.

Secondly, the company acquires several small wholesalers (e.g. Fantastiko, Gubbio Giochi, Amendola) to get access to their customer base.

Product development, fashion toys, and master toy licenses

Product development activities are boosted with the acquisition of Ceppi Ratti and Migliorati. Giochi Preziosi's marketing unit grows to cope with the challenge of switching from marketing and license management to product design. Besides technological partnerships with foreign players (for instance Thinkway in Canada, Character Group in UK), Giochi Preziosi aims at expanding by creating toys and merchandising for major cartoon series (Spiderman, Action man, Pokemon, etc.): the concept is called "Master toy licenses". By acquiring rights to develop products and market them internationally, the company will have a major push towards expanding

its operations abroad. Tackling manufacturing, Giochi Preziosi can leverage skills acquired through its Italian toy makers, even though its skills are not sophisticated enough to achieve excellence:

> *"From 1995 on our emphasis on Master Toy Licenses scaled down, as we realized we needed a lager scale of operations and a strong presence in the United States to take full advantage of them. Among the problems we faced, besides a better coverage of fix costs by means of lager production outputs, also issues in production planning due to different timing in the launch of cartoon series in different countries. In managing these issues, Giochi Preziosi suffered from the fact that it was not born with a production-oriented mindset".*[26]

Despite production issues, product development became core competence of the firm. In 1998 70% of products were developed in-house.

Apart from designing for licensing, brand new ideas are also outputs of the company's R&D units. The most compelling example is Tanya, the fashion doll originally introduced by Migliorati at the beginning of the '90s. The R&D department, led by the former owner of Migliorati, considered to be a genius in his own field, created a doll that could walk alone by means of a small electrical engine, self-supporting on its legs and on a cart. The company had suddenly accomplished what Mattel had tried for years with its Barbie doll. Very soon a new model, that

[26] Author's translation of Maurizio Cellai, former GP manager.

allowed the doll to walk on its legs with no external support, was developed. Walking Tanya became as a consequence the mean for Giochi Preziosi to enter the US market. As a reaction, Mattel offered to acquire Giochi Preziosi in order to take control of the product; then used its influence on US distributors to strangle its sales.

Tanya is one example of the focus on trendy toys the company decided to emphasize in the '90s. Fashion products and characters have generally shorter product life-cycles (3 to 12 months), are generally linked to media events (movies, cartoons, and so on) and allow sellers to charge a premium.

Focus on large stores

Giochi Preziosi acquired Grazzini and Agosti's large stores in 1992 and 1994 to develop a foothold in the distribution. Already owning some Giocheria's stores, the rationale of the decision was to integrate downstream. Another rationale was to preempt Toys'R'Us possible move in the country and to check the ability to manage a business perceived complex by the management. The stores, branded "Toy Center", were more than 20.

> *"We thought that in the case Toys'R'Us was coming to Italy, it would have come to an agreement with us first, rather than other players (like Gig), as we already controlled several large-size stores. We knew Agosti, who was very good at managing his own stores. But managing thirty-forty large stores is a different thing than managing a single super-store. We were not sure Agosti or we had the skills to do that. So we prepared for Toys'R'Us to come*

> *and offer its license. Even the brand "Toy Center" was designed so that it could have been easily changed in Toys'R'Us".*[26]

But the company refused to make a deal with the US category killer:

> *"They sat at the table willing only to offer their store format and receive royalties in exchange. They did not want to be involved in the management, nor to put equity in the venture. We asked them to participate with a stake in the venture and get earnings, not royalties, out of it. They refused. We reasoned that we knew the market, not them; and we had something to offer them, not the contrary. So we refused the license, and Gig eventually got it".* [26]

Giochi Preziosi's prudent management, and self-assurance of its bargaining power and knowledge of the market was in a sense a antidote to the failure Gig faced.

By the time it was clear that Gig was going to open the Toys'R'Us stores, Giochi Preziosi managed to strike a deal with Standa (an Italian large retailer) which entered in the Toy Center large store subsidiary Holding dei Giochi with a 49% stake. After Gig's failure, Giochi Preziosi will eventually refocus on large stores by acquiring Toys'R'Us stores (Toy Service, 1999), disregarding Toys'R'Us brand and re-buying Standa's stake in Holding dei Giochi (1999).

Focus on small stores

At the same time, the deal with Standa allowed Giochi Preziosi to buy Standa's 49% stake in Giocheria, gaining total ownership of the franchising chain.

From 1994 on the company focused on turning around the chain, reducing inefficiencies and offering a more compelling value proposition to its franchisees.

> *"Differently from a typical franchising, Giocheria could not be a single brand chain. It had to offer all competitors' toys as well. So the platform acted as a wholesaler for its franchisees, buying and distributing products from our competitors, with all the complexity and issues that this brought in the company: high number of product references to manage, credit risk towards franchisees, low distinctiveness of our offering with respect of 'non-Giocheria' stores".*[27]

In 1994 the chain is transformed into a division of the holding, all stores owned by the company are sold and the terms between the company and the franchisees are revised. Giochi Preziosi does not act anymore as a wholesaler, instead it uses its bargaining power to secure significant discounts for its franchisees, who autonomously manage their procurement. Also, the company buys low-cost, long-lasting , "white label" toys in the Far East, brand them with the Giocheria brand, and offer them to franchisees without investing in advertising. As a result franchisees can take advantage of higher margins on these toys. The company instead introduces strict requirements in terms of shelf space for its own toys.

As a consequence of the turnaround, and despite sales of owned stores, Giocheria will count more than 250 stores at the end of '98.

[27] Author's translation of interview to Giocheria manager.

Structuring equity for future IPOs

The idea to go to the stock exchange has always been in the company's scope. Back in '92[28], Preziosi had already expressed the willingness to go for an IPO, followed by similar considerations by Gig. The rationale is access to cheaper capital to finance acquisitions. To do so, Giochi Preziosi started auditing its reports and searched for financial investors that could assist it in the process: in 1995 Giochi Preziosi agreed with Gemina, Berger Trust and Felofin to subscribe for a convertible loan that eventually granted them 30% of the equity.

Diversification initiatives

Before 1998, Giochi Preziosi embarks in distribution agreements to sell toys through Avon's catalogue, and acquire a 70% stake in the children tv network "Junior Tv" . These initiatives will be followed in 1998 by acquisition of Auguri Mondadori, a company focused on school products for children. The intent that the company has in the latter period of our timeframe is to diversify the business in new niches, in order to leverage its distribution licenses and attack markets not as easily saturated as the toy market, that from 1996 will face very slow growth.

After this study timeframe, Giochi Preziosi will go further with this intent by launching an ambitious campaign of acquisitions in related businesses (Giocoplast, Villa Collodi, Mitica Food).

[28] Press release on Mondo Economico, 8 Feb 1992

Timeframe	Foundation and expansion (1978-1990)	Integration and experimentation (1990-1994)	Foreign markets and survival (1995-1999)
Environment	* Italian distribution is fragmented and inefficient * Toy market on the rise, despite existing competitors' presence * Console and gaming markets on the rise * Franchising as innovative managerial practice	* Italian lira on the fall (1993-1995) * Toys'R'Us enters Europe, arousing fear among distributors * Large retailers becoming increasingly influent on marketing policies * Gig, Giochi Preziosi, Mattel and Hasbro contending market leadership * Market growth, with intensified competition and lower margins for importers	* Italian lira realigned in SME (1995) * Fast market growth (1995-1997) followed by market slowdown (1998-1999) * Toys'R'Us looking for Italian partner * Hasbro interested in buying a stake in Gig (1995)
Strategic intent	* Rapid growth and expansion * Search for exclusive licensing agreements with foreign business partners	* Acquire foothold in manufacturing, to acquire competencies and to enrich product offering * Foreign expansion, to leverage exclusive licenses and owned manufacturing capabilities	* Focus on large stores to preempt Toys'R'Us, then refocus on small stores and franchising * Focus on acquiring licenses for product development/manufacturing of characters * Future IPO & merge with Gig * Erect defenses against foreign competitors (Mattel and Hasbro) * Focus on foreign sales * Forify foreign presence through cross-distribution agreements with foreign distributors
Realized strategy	* Focus on distribution for small stores * Aggressive tv advertising * Exclusive licenses for Bandai's products ("Turtles" and "Zodiac Knights") (1988) * Exclusive agreement for Sega Master System distribution (1988) * Creation of Giocheria franchising chain (1989) * Creation of main warehouse in Cesano Maderno (1982) * Creation of foothold in Hong Kong for management of Far East business partners * Set up of own development unit * Early focus on large retailers	* Opening of 1st foreign store in Barcellona (1991) * Acquisition of stake in EuroPlayToys (Germany, 1991) * First time balance sheet is certified as required for future IPOs (1991) * Toy manufacturers acquisitions: Migliorati, Ceppi Ratti (1993), Comogiochi * Acquisitions: Gubbio Giochi, Amendola, Fantastiko (wholesaler) (1993) * Acquisition of Harbert (toy maker) (1994) * Attempt to acquire Tyco Italy (stopped in 1994) * Acquisition of Grazzini and Agosti (large stores) (1994) * Agreement for Sega MS 2 and Megadrive	* Creation of Holding dei Giochi (joint-venture with Standa) for large stores (1995) * Sales agreements with Avon and IBM (1995) * Partnership with Thinkway (Canadian toy creation company) for product development of technology-based toys * Dismissal of Holding dei Giochi's share and total acquisition of Giocheria (1996) * Acquisition of stake in Junior tv, kids tv network (1996) * Cross-distribution agreement with Gig and equity exchange (6%) (1996) * Partnership with Character Group (UK) for product development and licensing (1997) * Opening of new foreign stores (US, Hong Kong, France) (1997) * Evaluation of merge with Gig (1998) * Acquisition of Gig and Toy Service (Toys'R'Us) (1999) * Acquisition of Auguri Mondadori (school diaries and bags) (1999) * Agreement for Sega Dreamcast (1999)
Performance	* Giochi Preziosi becomes the third Italian competitor in 1989 * Second competitor in console market (with Sega) * Giochi Preziosi considered the fastest-growing company in the industry	* Sustained growth of revenues	

Chapter 4. Discussion of the findings

1. Bridging the gap: perspective on the companies' divergent/convergent evolution

What have been the dynamics underlying the two companies' strategic evolution? How do the companies select similar strategies to cope with the environment? How do companies select different strategies instead? What forces determine the company's divergence or convergence to the strategies of its competitor? As we have seen, despite a period of relative convergence, from 1990 on both incumbents pursue portfolios of strategies that were only partially overlapping.

Strategic initiatives	Gig	GP
I period (1978-1990):		
• Selection of toys from Far East	- Since foundation	- Since foundation
• Aggressive tv advertising	- Since foundation	- Since foundation
• Development of foothold in Hong Kong for supply management	- Early '80s	- Early '80s
• Creation of own product development unit	- Early '80s; jv with Hasbro	- Middle '80s
• Entry in console and videogame segment	- '84	- '88
• Launch of franchising store chain	- '89	- '89
II period (1990-1998):		
• Acquisition of toy manufacturers	- NO	- from '90
• Acquisition of large stores	- '96 (T'R'Us)	- '94 to '96, then from '98
• Focus on franchising stores	- stable	- turnaround ('94)
• Corporate restructuring	- from '90	- NO
• New product development, licenses	- marginal	- main focus
• Efficiency and capillarity in distribution	- main focus	- marginal
• Foreign distribution	- NO	- from '91

The strategic intent behind the main strategic decisions was the following:

Selection of toys from Far East, aggressive tv advertising, development of foothold in Hong Kong: In the first period, both companies develop their business model focused on import strategies and tv advertising. This orientation has been Gig's main innovation and source of competitive advantage, while Giochi Preziosi imitated Gig as being a successful business model, considered to be superior to the traditional wholesaler's or distributor's.

Strategic decision: Selection of toys from Far East, aggressive tv advertising, development of foothold in Hong Kong	
Giochi Preziosi: reason why	**Gig**: reason why
Imitation of Gig's successful business model	Initial business idea based on knowledge of the market

Creation of own product development unit: in both companies, the creation of the product development unit has been a direct development of the existing business model. Having acquired business contacts in the Far East and having developed sound skills in market scanning, both companies can anticipate the market and try to design their own products, which can be tailored to the taste of the Italian consumer.

Strategic decision: Creation of own development unit	
Giochi Preziosi: reason why	**Gig**: reason why
Need for adaptation to Italian market	Need for adaptation to Italian market

Entry in console and videogame segment: for both companies, striking deals with main Japanese console companies was a consequence of the success these products had abroad, and the distribution platform they had already developed in the

market. Imitation worked as both companied entered the segment to cope with competitors' threat to do the same.

Strategic decision: Entry in console and videogame segment	
Giochi Preziosi: reason why	**Gig**: reason why
Consoles being an attractive segment… Gig having already entered with Nintendo	Nintendo being the console leader … Gig being the distribution leader

Launch of franchising store chain: while Giochi Preziosi initiated the franchising idea as a way to create a stronger presence in the channel, Gig followed not to be left behind.

Strategic decision: Launch of franchising store chain	
Giochi Preziosi: reason why	**Gig**: reason why
Better control of the channel, privileged distribution platform for own toys	Imitation of Giochi Preziosi

Acquisition of toy manufacturers: Giochi Preziosi initially acquired toy companies (healthy or in distress) in order to leverage its distribution platform and insert new product in its offering; as a side advantage, it did this to reinforce its capabilities in toy design. Gig, on the other side, never acquired other companies, because first, its management was historically more focused on distribution than manufacturing, and second the corporate restructuring early on and Toys'R'Us venture afterwards drained resources for launching an acquisition strategy:

> *"Gig did not pursue the strategy of acquiring toy makers as Giochi Preziosi did… back in the '90s, we did not have enough time, given the market, the restructuring, and in the end*

the Toys'R'Us stores, to evaluate whether to pursue similar acquisitions as our competitor did […] While Giochi Preziosi had a majority partner, we did not so decision making over high-level strategies had always been a little slower"[9].

Strategic decision: Acquisition of toy manufacturers	
Giochi Preziosi: reason why	**Gig**: reason why not
Market opportunity, expansion of product offering, acquisition of new capabilities	Managerial mindset focused on distribution; managerial attention focused on ongoing initiatives; slowness of decision making

Acquisition of large stores: both companies were interested in a stronger presence in the distribution channel as a way to limit the threat of large retailers, of Hasbro and Mattel, and new entrants. While Giochi Preziosi acquired stores since 1991 and developed the business in order to preempt Toys'R'Us and be on a strong position for negotiations, Gig started to be interested in 1994-1995, when it contacted Toys'R'Us with the strategic rationale of coping with Giochi Preziosi's strategy and acquiring a large international business partner for procurement advantages and future internationalization. After the Toys'R'Us license was given to Gig, Giochi Preziosi maintained its stores, but dismissed 49% of the venture to regain total ownership of Giocheria from Standa. After Gig's failure, despite acquiring Gig's stores was in fact paying its multibillion losses, Giochi Preziosi bought them anyway in order to better control distribution:

> *"I remember completely disagreeing with Preziosi on the acquisition of Toy Service*[29] *[…] I told him the stores were at loss, buying them was expensive, and by the way whoever had acquired them would have had to buy toys from us, as we were Giochi Preziosi and Gig at the same time… but he wanted to control the channel"*[30].

Strategic decision: Acquisition of large stores	
Giochi Preziosi: reason why	**Gig**: reason why
Control of channel, preemption of Toys'R'Us	Control of channel, copying Giochi Preziosi, international partnership

Focus on franchising stores: While both companies had strong interest in their franchising chains, only Giochi Preziosi focused on development of its Giocheria chain after failing to acquire Toys'R'Us license. On the contrary, Gig was already focused on the new large stores venture and did not try to solve the several problems of its chain (mainly, the difficulty to offer a compelling proposition to franchisees due to conflicts with the wholesalers and large retailers channels).

Strategic decision: Focus on franchising stores	
Giochi Preziosi: reason why	**Gig**: reason why not
Re-focus after Gig won Toys'R'Us license; issues in the management of the chain	Focus on Toys'R'Us, despite issues in Amico Giò's management

[29] Gig's company managing Toys'R'Us stores
[30] Author's translation of interview to former GP manager, Maurizio Cellai

Corporate restructuring: The decision to undergo a comprehensive restructuring is unique of Gig's and comes from the perception that, in order to be more competitive, the company had to achieve a more efficient structure and hire external managers. On the other side Giochi Preziosi did not perceived the same need and freed up resources for other strategic initiatives.

Focus on new product development, licenses: While both companies had in place product development units (and in particular, Gig had a dedicated joint-venture with Hasbro), Giochi Preziosi put more emphasis on new products and on specifically on designing toys for cartoon series, which proved to be very successful. On the other side, Gig's activities relied mainly in the launch of product lines that were stable in time and did not follow the fashion or the latest trend. As a consequence, while Giochi Preziosi leveraged its Master Toy licenses to expand abroad, Gig remained in Italy and focused solely on distribution.

Strategic decision: Focus on new product development, licenses	
Giochi Preziosi: reason why	**Gig**: reason why not
Opportunity to get competitive advantage and expand internationally	Focus on distribution and search of fashion products among existing suppliers

Efficiency and capillarity in distribution: Gig had always had a main focus on distribution. Its corporate restructuring allowed it to reach superior efficiency in its distribution platform, to the point that it focused on distribution and on its large stores to reap the best return on its investment. This emphasis will bring the company to overspecialization and, as the market slowed down, to financial difficulties, while Giochi Preziosi enjoyed a more diversified portfolio of strategic initiatives and managed grow despite environmental uncertainty.

Foreign distribution, diversification: Besides always having had international markets in the management's mind, Giochi Preziosi explores other markets because of the need to leverage its licenses. On the other side, Gig is more focused on local distribution and therefore starts to look for international markets only from 1997, when it starts to exhibit at the international fair of Nürnberg. Also, by 1998 Giochi Preziosi has sufficient resources to think about diversification (and therefore acquires Auguri Mondadori, the first of a long series of acquisitions), while Gig is struggling against its financial distress.

Strategic decision: Foreign distribution, diversification	
Giochi Preziosi: reason why	**Gig**: reason why not
Managerial aspirations, leverage of Master Toy licenses, availability of resources due to market success	Focus on Italian distribution, lack of resources

2. A tale of failure despite an impressive strategic posture

How did happen what happened? How did Giochi Preziosi survived a period of growing instability in the market, while Gig did not?

The question is even more valuable as we analyze the two firms' strategic stances after 1990. On one side, Gig had ten more years of experience in the field, owned exclusive distribution rights for the most successful console (Nintendo super NES and Gameboy) before the coming of Playstation, had a "lubricated" distribution machine in place, wide advertising and procurement experience and had outperformed not only traditional competitors (like Hasbro, Mattel, Lego), but also non-conventional ones (like Casio and Sharp in the introduction of electronic diaries). Besides, Gig had a franchising chain of 600 stores (vs. 250 of Giochi Preziosi), more than 20 large stores, and a product development unit. Still, it failed.

On the other hand, Giochi Preziosi had pursued experiments in foreign markets (with alternate results), acquired toy manufacturers with costly manufacturing facilities and embarked in a licensing strategy that paid off until 1995, when the company started to decrease its commitment towards it. It had large stores as well with an experience of a couple of more than Gig, and had refocused on small stores as Toys'R'Us was not anymore an option for it. And it survived.

In this study we have tried to find an answer by tracing back the factors that drove divergence of convergence between the two firm, the rationale for their strategic commitments, and the intra-organizational dynamics underlying these commitments.

3. Heterogeneity generation within the Italian toy industry: a perspective on convergence, divergence, momentum and lock-in

We will now evaluate the findings to investigate the drivers of heterogeneity and strategic lock-in that happened in the Italian toy industry among its two market leaders.

a. Factors driving convergence/divergence in the first period (1978-1990)

In the first period, companies were busy in building their business model and grow in scale to compete at national level. Market is relatively stable and foreseeable; by structural development of the existing business, seizing of new opportunities that were successful in foreign markets or imitation of competitors, the two companies pursued the very similar portfolios of strategies in the same timeframe.

Convergence

Main forces driving *convergence* are:

- **Same environmental conditions:** except for the very first years (1978-1981), when Giochi Preziosi is scaling up and therefore for a short period of time faces an environment that is slightly narrower (regional market) than the national environment Gig was facing, the two companies face the very same environmental conditions. Being focused on the same business model to compete in the industry and notbeing focused in different niches, the environmental conditions of the market, industry, macroeconomic, etc. affect them equally.

- **Relative "understandability" of the environment**: as stated by top managers of both companies and industry experts, in the '80s the environmental conditions revolving around the Italian toy industry were quite stable and easy to understand. Low uncertainty about where the market or the environment were going led managers to a confident and accurate understanding of what was "going on out there". As the environment became more turbid, management understanding of it became less clear and reliance on own judgment and competitor's benchmarking became more important.

- **Similar perception of the environment**: besides being subject to the same environmental stimuli, in this period the top management of the two firms is paying attention to the same issues; their way of thinking or managerial mindset selects the same information to evaluate threat/opportunities of the environment (e.g. the fact that console and videogame market was booming and there were Sega and Nintendo winning in foreign markets; the importance of addressing the small store channel; the importance of expanding to product development, exclusive licensing, and better managing relationship with suppliers in Hong Kong); secondly, they share similar managerial mindsets in evaluating these stimuli and engaging in similar strategic decisions.

- **Similar company assets/structures**: another driver of convergence is of course the fact that both companies had deployed very similar portfolios of assets, competences, and resources to compete in the market.

- **Relative "transparency" of own companies**: the fact that their business was somehow clearly defined (advertising, procurement, distribution in a stable channel) and the presence, in both companies, of fewer managerial layers offered to the top management the ability to clearly understand their companies and identify their strengths and weaknesses (we could say there was low "causal ambiguity" in that)

- **Similar perception of own companies**: besides, the shaping of the strategic trajectory of the companies relied not only on the way managers saw the environment, but also on the way they saw their own company, and their company's capabilities, core competences, and core rigidities. Pursuing new strategies depended on the appraisal of whether the company had sufficient in-house capabilities or could acquire capabilities to go for the new strategic initiative

- **Possibility and ability to scan competitor's moves**: on one side, competing in a clear and well-defined market, in an stable environment with low uncertainty that could be understood, offered more chances to companies to benchmark with their competitors (Hasbro, Mattel, and the other Italian company) to monitor each other's moves. In principle, one could hypothesize that having low causal ambiguity, competitors were easily "detected" and their moves, capabilities, and rigidities easily assessed from outside. Besides the chance to monitor competitors, both companies had also a strong incentive to do this. At the time, Giochi Preziosi and Gig were considered to be the two stars of the system

and envy and competition among them were relevant. Giochi Preziosi was catching Gig and therefore carefully imitating its business model, assessing its weaknesses and trying to overcome them, while Gig was monitoring the new industry star, guessing to what extent it could represent a real threat to leadership.

- **Ability to imitate competitors**: at that time, imitation was fluid: Giochi Preziosi imitated Gig in entering the console segment, Gig quickly imitated Giochi Preziosi in launching a dedicated franchising chain. Apart from these two cases, where top management explicitly admitted the replication of the competitor's behavior, it is not always clear to what extent imitation was simply a consequence of reacting to the same environmental stimulus with same managerial frameworks or a consequence of deliberate imitation. Besides, both companies had in place skills and commitment to closely watch each other and react fast to any competitor's move not to be left behind in the competition for leadership. In a sense, the emphasis at the time was more on "doing first the next new thing" or "catching up fast with competition" in a stable environment, rather than "selecting the right thing", or "trying experiments" in a uncertain environment as it will be later on.

b. Factors driving convergence/divergence, momentum, and lock-in in the second period (1990-1998)

In the second period, the market and the industry are less easy to understand and foresee, credible threats are posed by US and Far East companies, currency instability, and change in consumer behavior.

Sources of convergence were the same as in the previous period, but where attenuated as environmental uncertainty but at strain managerial understanding of the

environment. As the two companies embarked in different strategic trajectories, mutual understanding of each other's business model became slightly more difficult.

Convergence

Still, a major driver of *convergence* is:

Existence of a communication channel between competitors: Companies interacted a long way (at least from 1995 to1998) to evaluate the possibility of a merger. Considerable flow of information was exchanged by the two top management teams in order to evaluate and negotiate the terms of such an agreement, as the two companies were evaluating their stance, their strategic similarities or differences and possible synergies in such a deal. These events have been an extraordinary opportunity for both top management teams (who already knew each other from a long time) to scan its main competitor. Nevertheless, as this communication channel did not help Gig in re-evaluating its strategy.

Divergence

On the other side, *divergence* takes place. Main drivers are:

- **Higher environmental dynamism/uncertainty**: being more turbulent, fast-paced, and less clear to understand, the environment influenced the way companies perceived, and in the end evaluated, the external environment. Among the different factors, changing consumer needs and willingness to spend, changing currency rates, radicalization of competition among the first four competitors, consistent decrease in number of children, slowdown of number of large retailers point of sales openings.

- **Selective attention to the environment**: being the environment more "turbid" and less easily understood, managerial perception of the environment was different. Selective attention to particular stimuli steered managerial focus on

different issues and therefore encouraged Gig in focusing on distribution and Giochi Preziosi focusing on upstream integration.

- **Different speed in decision making/delayed imitation**: different pace in decision making (slower and more cautious in Gig, faster in Giochi Preziosi), caused by a different approach to tackle with an unstable environment, caused the two companies to lag in imitation due to the different lists of priorities they were facing. On the other side, when the two companies pursued the same strategies with a time lag (as it happened for large stores and Toys'R'Us), magnified, rather than limit, the differences between the two companies, as Giochi Preziosi moving forward from large stores decided to refocus on small stores, while Gig (the imitator) focused solely on large stores. Also, Gig management stated that they did not "have time enough" to decide whether to pursue other strategies Giochi Preziosi was independently pursuing due to "slower decision making"[31].

- **Different aspiration levels**: interestingly, Giochi Preziosi always put forth growth objectives in the order of +30%, while Gig always projected growth of +50% or more. In 1998 it had an ambitious +100% goal in revenues. The pressure to grow in Gig put on strain the entire organization, enhancing the likeliness that focus on existing business and on fast growth made some other strategic initiatives (as product development) starved of resources, besides loosening up control on the strategic course of the company ("*We were riding fast on a derailing train*", as a manager commented ex-post[21])

- **Different resource allocation (inhibiting competing strategic courses)**: as already appraised by Noda and Bower (1996), the resource allocation

[31] It should be acknowledged, however, that differences in decision making were "latent" in the two companies and were only magnified by environmental stimuli (more uncertainty, faster speed of change)

process is fundamental in shaping a company strategic trajectory as initial success can breed more success and initial failure can breed more failure. The emphasis here is not on initial success or failure of new initiatives, but rather on resource constraints put on other strategies "left in the background". In the case of Gig, exclusive focus on restructuring, distribution and large stores left other initiatives starving of resources (and of managerial attention), inhibiting them from affecting the corporate strategy.

c. Momentum

Given the initial difference created among the two companies' strategies, their trajectories start to diverge. These differences became magnified as momentum built around them. Identified drivers of ***momentum*** were:

- **Increasingly different environmental conditions faced by the two companies**: as companies' trajectories started to diverge, the composition of their business also started to be different. Giochi Preziosi started to sell internationally, therefore being less dependent on the national market; it also focused more on the licensing side and on fashion products, that proved to be high margin, growing products. On the other side Gig relied more on the Italian market, on slightly different product offerings. Other factors (like the Lira devaluation, affecting in particular the import price of consoles) continued to affect both companies. In general, the way the environment stimulated the two companies started to differ as the two companies pursued different strategies and developed their business portfolio in a different way. Positive feedback gradually magnified the divergence to the point that in 1998 market slowdown differently affected Gig (which failed) from Giochi Preziosi (which survived).

- **Increasingly different "attention bias":** different strategies, and environmental stimuli contributed in changing management emphasis on strategy and selective attention to the environment. While Giochi Preziosi started to carefully scan international markets and embark in international experiments (despite being not always successful), and to watch the Italian market paying more attention to the dynamics of fashion products and characters, Gig did focus more on the distribution side, growing more emphasis on its logistics and operations unit and scanning the environment for opportunities to reinforce its foothold in the distribution with large stores. The extent to which this change in managerial attention and receptiveness towards the environment affected more broadly **managerial mindset and cognitive models** is of course hard to determine.

- **Increasingly different strategic assets**: magnified differences in initial strategies, environmental stimuli, managerial attention and focus brought again to the development of new (and even more different) strategies. Some strategies can lead to the development of other new strategies almost in a deterministic sense. For example, the acquisition of licenses for production of characters and toys of cartoon series forced Giochi Preziosi to go abroad in the attempt to achieve larger volumes of production that eased the burden of high fix production costs (mainly due to moulds for plastic).

- **Increasingly different competencies broadening the set of strategic alternatives (capability momentum)**: conversely, new strategies (vertical integration for example) made the companies develop new set of competences, that opened the set of alternatives each firm was facing. For example, the first acquisitions by Giochi Preziosi led the organization to deploy particular skill sets in due diligence and post-acquisition management that encouraged the company to

acquire more toy manufacturers and later on to start related diversification by acquisition of Auguri Mondadori (and more than ten other companies after 1998). On the other side Gig did not access those competencies. This **capability momentum** reinforced the companies willingness to develop existing strategies as management was more confident about companies' ability to cope with them.

- **Increasingly different evaluation of own firm**: as strategies, assets, and competencies change, management's awareness of the firm changes, reinforcing the divergence.

- **Higher difficulty in competitor's scanning bringing to lower imitation**: as the environment becomes more turbulent and companies' strategies diverge, company's perception about its main competitor started to be less accurate, as the understanding of its business could not be as clear as when the companies were similar. In our scenario, Giochi Preziosi and Gig managed to attenuate the problem by engaging in mutual communication. Even so, Gig did not follow Giochi Preziosi's strategy of foreign expansion and licensing as it did not completely understand its business rationale and model.

d. Lock-in

Divergent factors, attenuated by convergent factors, eventually prevailed. Gig and Giochi Preziosi pursued very different strategies, leading on one side to an efficient, "lubricated" distribution machine that expanded in the large store business with the Toys'r'Us brand, on the other side to a vertical integrated company with strong foothold in distribution, designing its own licensed products for the Italian and other European markets, and starting to diversify into related "children-focused" businesses. Eventually, Gig failed in 1998, leaving Giochi Preziosi leader of the

market. How did the lock-in occur? Why did Gig failed to change its course of action? Identified drivers of the *lock-in* are:

- **Confirmation and consolidation of managerial mindset**: success and development of one course of action allowed managers to be more confident with their practices of scanning the environment and the company, evaluating strategic alternatives and deciding. This was helped by the fact that both companies enjoyed consistent growth in revenues during the period[32]. Gig enhanced its focus on distribution, strengthening its vision of "distribution excellence, complete integration of company structure, and global quality"[33] and embarking in hyperspecialization in an environment that was becoming more and more uncertain. As success bred success, managerial mindsets were reinforced. The company somehow missed the chance to challenge its mindset, and to understand the context-specific factors underlying its success, namely the presence of a stable and foreseeable environment. On the other hand, first experiences of Giochi Preziosi paved the way for the definition in 1996 of a vision of "covering the children business at 360°"[34], an extension of the company first focus on production, foreign distribution, and innovative products.

- **Socio-psychological momentum leading to irreversible commitment**: as already discovered by Noda and Collis (2001), factors underlying management psychology and social groups may drive "stickiness" to the company's existing strategies. In the case of Gig, while financial figures proved to be far worse than expected for two years in a row, a series of factors impeded the top management team from turnarounding the company strategy:

[32] Or where revenues decreased, the overall market decrease more than proportionally as well.
[33] Source: Company statements
[34] Source: Company statements, and websites

first, emotional attachment on Toys'R'Us venture by its manger, Guido Dentis; second, escalation of commitment with regard of their business partner Toys'R'Us Europe, with which Gig agreed on a ambitious strategy of new store openings; the pressure put on the entire structure, the ambitious goals and resource constraints due to the completion of the company restructuring did not allow management to set frequent "reality checks" about the company strategy in order to evaluate the feasibility of their actions; moreover conflict among the top management team (especially between Horvat and Dentis, but also with Testi) inhibited the possibility to openly address the company financial performance and re-evaluate its strategy.

- **Capability lock-in vs. dynamic capabilities**: the development of competencies opened new set of strategic alternatives for the companies. On one side, Giochi Preziosi was particularly good at managing the development of these capabilities: competencies in due diligence, acquisition and post-acquisition management allowed it to pave the way for further diversification, while competencies on small stores management paved the way for acquiring and managing large stores. First experiments in foreign markets (foreign stores) paved the way to distribution agreements for marketing Giochi Preziosi's licensed products in new markets, and later on to define cross-distribution agreements with foreign distributors and finally (from 1999, beyond the scope of this research) the formation of joint-ventures in France, Spain and other markets. In a sense, Giochi Preziosi elicits superior dynamic capabilities in the sense that it has been able to carefully manage the deployment of new skills and competences to enhance its business. Fluid experimentation, entering and exiting strategic initiatives as a way to test and develop initial skills in new fields, allowed the company to excel. On

the other side, Gig focused on its existing set of skills (distribution, advertising, supply) without trying to acquire new skills besides franchising management. In acquiring Toys'R'Us license to step in the world of large stores, Gig did not have previous experience, nor had experience in managing small stores as it never owned them, and relied on its existing management (and also middle managers who came not from the toy industry, but other manufacturing industries) and on Toys'R'Us Spain to manage a business that was not prepared to conduct. As stated by Aldo Horvat:

> *"We were not quite sure to master the know-how required to run such a large store format… I expressed my feelings to Toys'R'Us CEO, who told me 'Let us talk about it… I want you to be glad, not concerned, to join the network'… He conversely promised help from Spain. But […] the Spanish CEO died […] and the new manager was too busy in taking control of the Spanish subsidiary than in helping us…"*[35]

As a consequence of this ambitious "leap" in competence building (from wholesaling and distribution to retail), Toys'R'Us stores did not deliver the expected results:

> *"We forecasted the chain's results not to be profitable for the first two years, but as actual results were far worse that expectations, the*

[35] Author's translation of interview to Aldo Horvat.

whole Gig group was badly affected by this strategy […] the third year was even worse”[36]

“As far as the stores were concerned, we were losing money at the gross contribution margin level: this meant that the more we sold, the more money we were losing. […] On top of this, in 1997 our Nintendo console was surpassed by Playstation; the rest of the toy market and traditional channels were stagnating; Toys’R’Us stores were meant to save us… but given those financial premises, they did not.[36]*”*

Of course it is not clear whether Gig would have survived have not had the large store chain in place, given its sole focus on distribution; but it is widely accepted that Toys’R’Us losses were the main driver of failure.

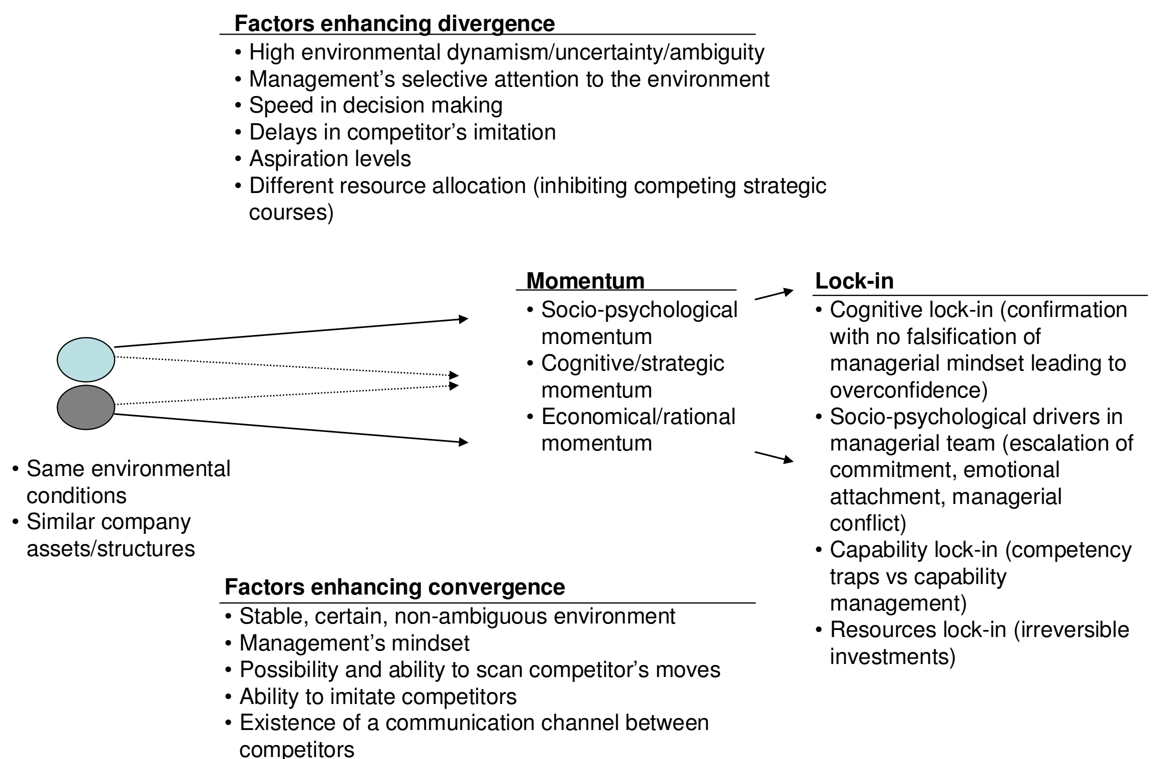
“Gig fell under its weak financial structure, heavily relying on wide use of client’s supply credit, bank credit lines and mismanagement of its inventories, which […] by nature rapidly become obsolete.”[37]

In synthesis, Gig developed a focused portfolio of strategies concentrating on distribution efficiency and distribution channels, while Giochi Preziosi focused on managing a more varied portfolio of experiments in foreign markets, in production,

[36] Author’s translation of Gig Distribution manager.
[37] Interview to Stefano Pierattini, formerly head of Firenze’s branch of Gig Distribuzione, in a overview on Gig’s crisis

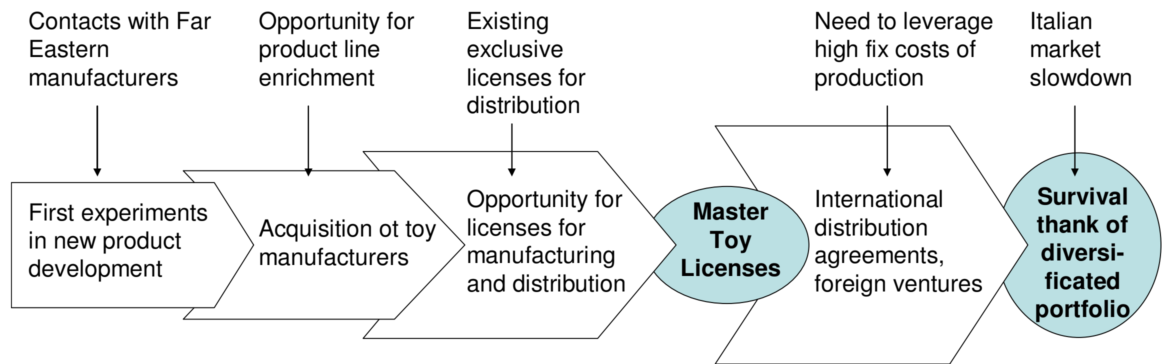
and distribution as well. Therefore, the two companies pursued strategies that diverged consistently in time. Lock-in on fit strategies allowed Giochi Preziosi to enjoy growth and diversification, while lock-in on overly specialized strategies and lack of good management of firm's competences portfolio sunk Gig.

e. The generation of intra-industry heterogeneity in the Italian toy industry



Giochi Preziosi embarked in several strategic experiments during the 1978-1998 period. Leveraging early contacts with Far Eastern manufacturers, it evolved its marketing unit in a product development unit, utilizing the knowledge of the Italian market to extract concepts and trends for anticipating the market. This concepts were used to design new products, whose production was outsourced in the Far East.

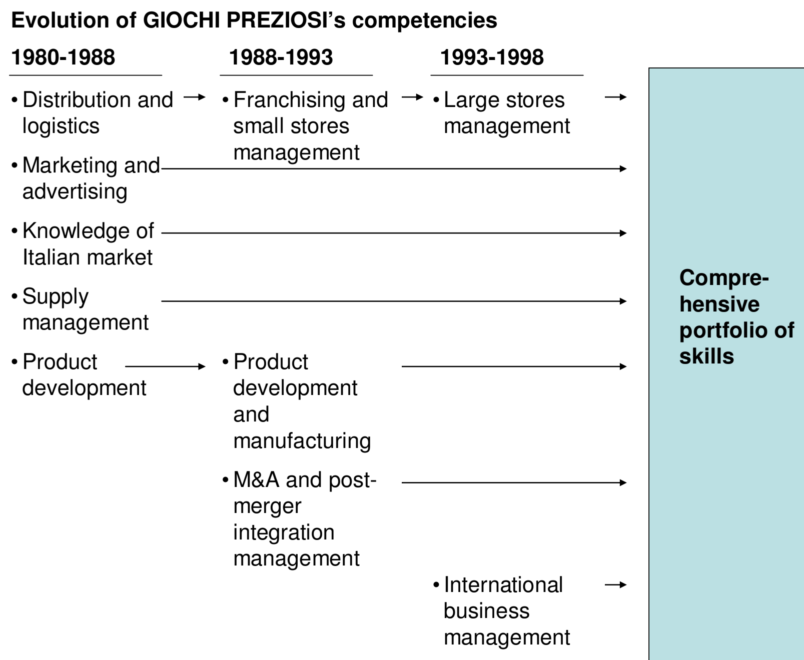
GIOCHI PREZIOSI
Momentum and strategy lock-in



This early investment in competencies allowed the company to "magnify" its return in the investment of Italian toy manufacturers, mainly acquired under the logic of product line enrichment. R&D and manufacturing facilities, jointly with the in-house development unit, enable the company to switch from the acquisition of exclusive distribution licenses for the Italian market to the acquisition of exclusive design, manufacturing and distribution licenses for the European market (or even worldwide): the so-called Master Toy Licenses.

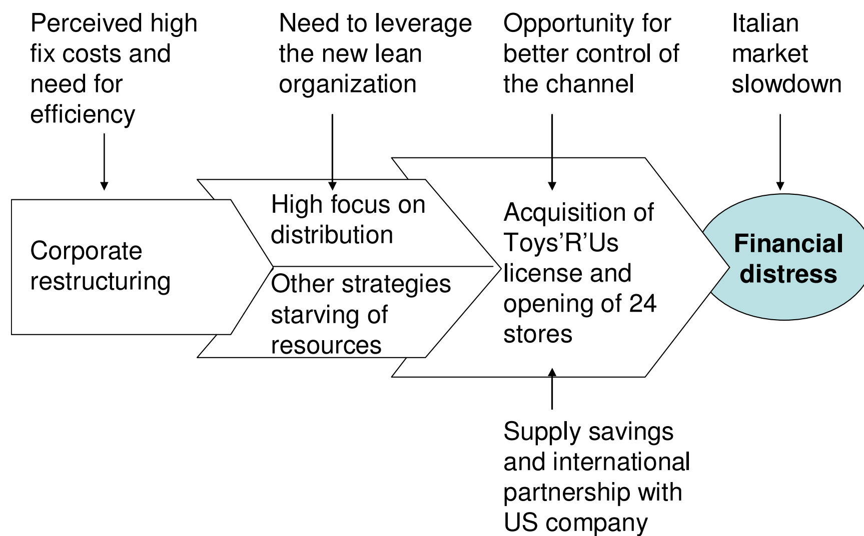
Evolution of GIOCHI PREZIOSI's competencies

Period	Business activities	Skills developed
1980-1988	• Wholesaling • Tv advertising • Importing	• Distribution and logistics • Marketing and advertising • Knowledge of Italian market • Supply management • Product development
1988-1993	• Giocheria franchising and owned small stores • Own product development unit/ toy manufacturers acquisitions	• Franchising and small stores management • Product development and manufacturing • M&A and post-merger integration management
1993-1998	• Acquisition of Agosti and Grazzini's large stores • Launch Master Toy licenses and experimentations in foreign markets	• Large stores management • International business management



Conversely, this investment in design, manufacturing and distribution competencies drove the company in the search for foreign markets, foreign ventures, and cross-distribution agreements. Giochi Preziosi became a balanced portfolio of strategic initiatives that could survive the difficult 1995-1998 period.

On the other side, initial acquisitions brought Giochi Preziosi to the development of robust skills in company due diligence, acquisition and post-acquisition management. From small stores, to large stores, to toy manufacturers, to toy wholesalers and other related business companies, these competencies acted as an enabler of a broader series of acquisitions in the distribution channel, in upstream and downstream integration, and after 1998 in diversification and international joint-ventures.

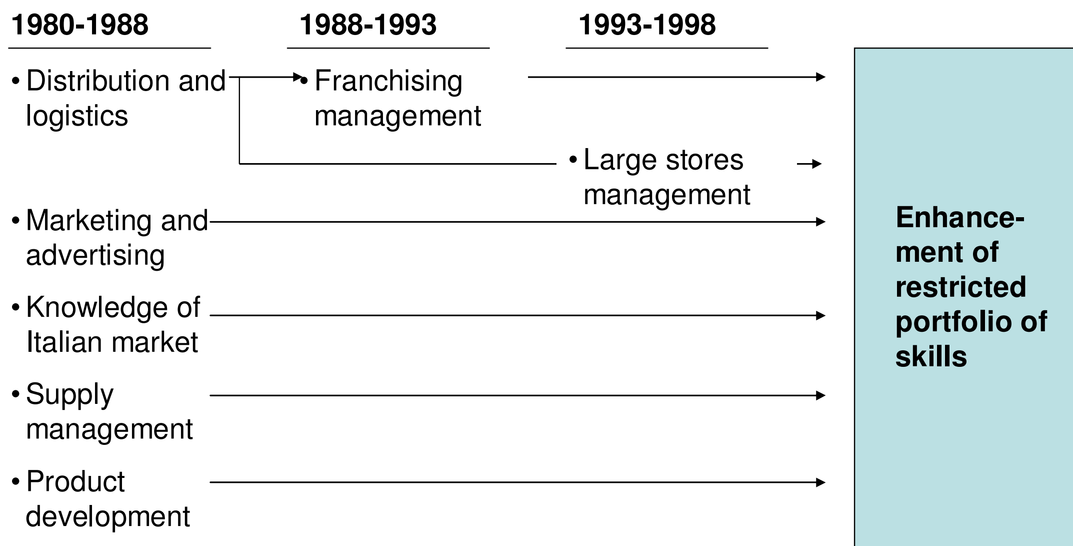


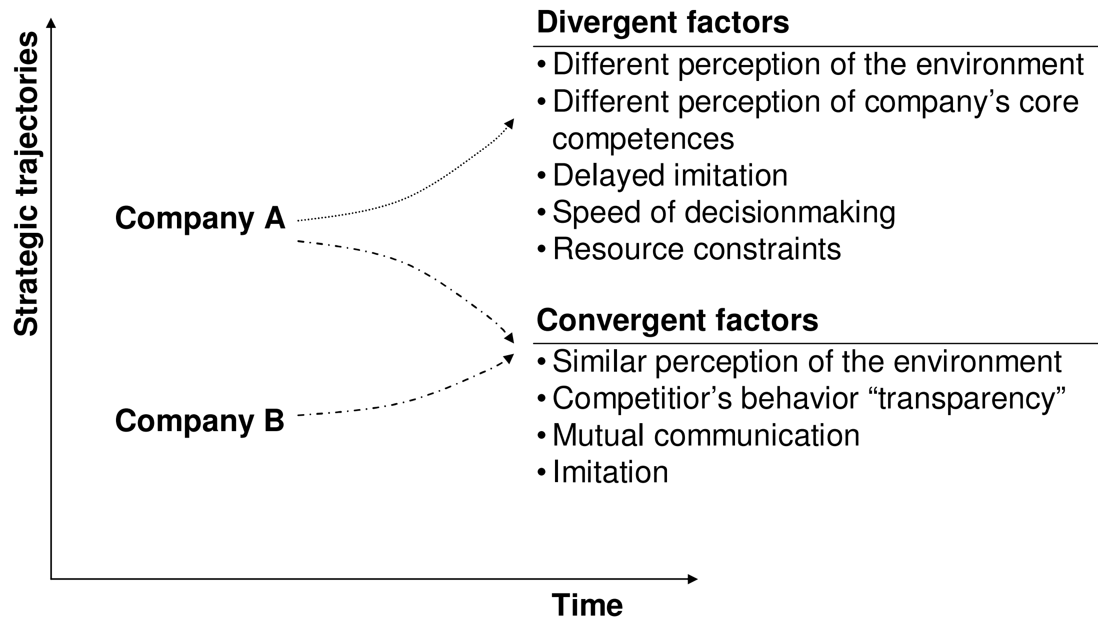
Momentum in Gig acted in a very different way. Corporate restructuring, driven by the necessity to drive down costs, brought the company to focus more on distribution while leaving aside other fundamental activities like product-development and international expansion. As a consequence, distribution became the sole focus of the company, which acquired Toys'R'Us license to better control the channel. In opening Toys'R'Us large stores, Gig tried to force the development of skills in retailing without counting on previous experience (as Giochi Preziosi had because it owned some Giocheria stores and had acquired Toy Center stores). This attempt failed and contributed in the failure of a company that was already hyperfocused on distribution as a result of managerial's reinforcement of their own mental models.

Evolution of GIG's competencies

Period	Business activities	Skills developed
1980-1988	• Wholesaling • Tv advertising • Importing	• Distribution and logistics • Marketing and advertising • Knowledge of Italian market • Supply management • Product development
1988-1993	• Amico Giò franchising • Own product development unit/ Promotoys joint-venture with Hasbro	• Franchising management • (Product development)
1993-1998	• Toys'R'Us license	• Large stores management

Evolution of GIG's competencies




FACTORS DRIVING CONVERGENCE AND DIVERGENCE
Strategic trajectories
Company A
Company B
Divergent factors
• Different perception of the environment
• Different perception of company's core competences
• Delayed imitation
• Speed of decisionmaking
• Resource constraints
Convergent factors
• Similar perception of the environment
• Competitior's behavior "transparency"
• Mutual communication
• Imitation
Time

Conclusions

Why do firms differ and how is difference or similarity achieved?

This study represents a seminal contribution in the attempt to explore the factors driving the **generation of differences among competitors in the same industry**.

Differences have been explained from in the main fields of research of strategic management: in the **Resource-Based View** as, for instance, factor market imperfections generating Ricardian rents, co-specialization of resources, and causal ambiguity (e.g. Amit and Shoemaker, 1993; Dierickx and Cool, 1989; Peteraf, 1993); in the **Dynamic Capabilities** perspective as differences in the ability to re-configure and manage internal and external competences (e.g. Teece et al., 1997; Winter, 2003); in the **Organizational Learning** perspective as different learning routines (Levitt and March, 1988), path-dependency, cognitive mechanisms (such as organizational myopia, absorptive capacity, competency traps) and organizational mechanisms enabling exploration or exploitation (March, 1991).

Recent contributions from the **Process Strategy** stream of research has highlighted the role of structural context, resource allocation processes, and more in general positive feedback systems generating organizational momentum (Burgelman, 1983, 1985, 1991; Noda and Bower, 1996; Noda and Collis, 2001).

By exploring the **dynamics of convergent and divergent evolution** of the two leading companies (Gig and Giochi Preziosi) of the **Italian toy industry in the 1990s**, this study has tried to explain the generation and persistence of intra-industry firms' differences as a way to analyze in a longitudinal perspective the evolution of

similar firms into different strategic trajectories leading to opposite business outcomes: sustained market leadership and failure.

Differently from past research (and in particular from the study of the Bell company break-up into the seven "Baby Bells" and their venture in the new mobile telephony business – Noda, 1994 –, a study rooted into new high-tech businesses, and US-based large bureaucratic organizations), this study has focused on a rather "traditional" and low-tech sector (the toy industry, and partly in the game console sector as well), in a different country (Italy), using as research vehicle medium/large-size firms (according to US classification) where, instead of the unpredictability of a novel business (as it was for the mobile telecommunication business at that time), divergence is promoted by increased uncertainty and competitiveness in a mature market.

With the aim of conducting a study that took into account the theoretical frameworks discussed so far (e.g. Yin, 1984), but also open to grounded empirical theorizing (Glaser and Strauss, 1967), I ventured in the matter of tracking the strategic evolution of the two companies in the attempt to conceptualize the accumulation of differences that, in the timeframe of a few years, locked the two competitors in different strategic postures.

After **ten years of imitation**, the two companies (Gig and Giochi Preziosi) had developed very similar assets:

- a distribution platform for the Italian market
- established advertising, media and marketing units with particular expertise in crafting TV commercials for cartoon networks
- long-term partnership agreements with the major game console manufacturers (Nintendo and Sega)

- product development units able to design new toys according to the needs appraised in the market by a competent and capillary salesforce
- subsidiaries in Hong Kong for managing the procurement process and the deals with local Far Eastern manufacturers to produce toys designed in-house
- franchising chains of toy stores (Amico Giò and Giocheria)
- specific sales units for dealing with the new, aggressive large retailers.

From 1990 on, the environment where the two companies are used to compete is under the influence of a multitude of factors. Increased competition from Far East manufacturers importing non-branded toys from abroad, and from global players (Mattel, Hasbro), the exchange rate penalizing procurement first, and then export; changes in consumption behaviors of kids and parents, and the rise of Sega Playstation (overcoming Sega and Nintendo). As a result, many companies are acquired or closed, return on investment drops, small incumbents refocus on niche products, and more emphasis is put on advertising as a way to push sales.

Under the influence of more uncertain environment, the **companies' strategic trajectories also start to diverge**. Initial small differences in the two companies, and different strategic orientation result in the two companies embarking in different decisions: Giochi Preziosi starts acquiring some toy manufacturers, while Gig focuses on process re-engineering to improve its distribution platform. Driven by the accumulation of capabilities and constrained by their resource allocations, the two companies acquire momentum until the strategic options they face have little in common: Giochi Preziosi could evaluate whether to design and manufacture more sophisticated, licensed toys; try an ambitious licensing program, expand abroad; Gig could count on a 'oiled' distribution platform that enhances its choice to open the

Italian subsidiary of Toys'R'Us category killer large stores. Driven in part by managerial explicit strategizing, in part by the momentum and by the opportunities opened by/ the constraints posed by the portfolio of acquired skills and competences, the two companies did not look alike anymore. The transition happened through an "incubation" period, where the initial strategic moves allowed building new sets of skills that paved the way for new strategic experimentations; which in turn renovated the skill sets, etc.

Giochi Preziosi represents a case where strategic experimentation paved the way to the acquisition of a broad set of skills that helped in sustained market leadership. Starting from the acquisition of a toy manufacturer with the intent of adding new product lines to the ones available in its offering, the company subsequently had the opportunity to produce toys, and then to acquire licenses for "characters", i.e. toys representing popular cartoon series or events (e.g. Turtles). The M&A and post-merger acquisition capabilities developed in the course of the initial acquisitions of manufacturers and stores paved the way to a broad acquisition of manufacturers, toy wholesalers, and large stores too. On the other side, the need to leverage scale economies to reduce the impact of the high fix costs of licensing (mainly because of plastic moulds) required the company to expand abroad to take full advantage of the irreversible investment it made. In this venture, skills developed through the initial, and unsuccessful, internationalization attempts helped in the effort to found new subsidiaries and joint-venture deals across Europe. On the other side, initial ownership of some of the Giocheria stores helped the company in gathering knowledge and expertise to acquire a large store. After having developed this foothold in the retail part of the business, the company decided to enter the large store business anticipating the coming of Toys'R'Us, the major US category killer which was

looking for an Italian partner. Superior knowledge of the market and of the business challenges (developed through past strategic experimentations) convinced Giochi Preziosi to refuse the burden of a partnership with the US retailer, and re-focusing on small stores by selling 49% of Toys Center (Preziosi's large stores) for acquiring full control of Giocheria's small store franchising chain. From mid-late '90s the company started the related diversification process with the acquisition, for instance, of the school division of Mondadori, Auguri Mondadori. The company thrived well the 1998-1999 years where the market, even if boosted by Gig and its Toys'R'Us venture, suffered from a radical slowdown. After 1999, Giochi Preziosi was even able to acquire Gig's best assets, plus the money-hungry Toys'R'Us stores, and successfully turned around the once-feared competitor.

Giochi Preziosi elicits a pattern of **strategic experimentation** driver in part by managerial intent, in part by unforeseen business opportunities generated by the environment or by past strategic decisions, and by economic necessity (e.g. the need to achieve scale in order to limit the impact of manufacturing fix costs for licensing – an irreversible investment). The path followed by the company resembles what explained by Penrose (1959) as a growth process driven by accumulation of resources that, by various mechanisms (e.g. in the simplest approach, through scope economies; or through combination or re-combination of resources), open the way to the expansion in new strategic opportunities. Initial divergence is in part fed by small differences with Gig (imperfection in resource markets – Peteraf, 1993, e.g. Giochi Preziosi had to strike a deal with Sega, and not the leading Nintendo, in the console business because Gig had already secured a deal with the latter; or the fact that Giochi Preziosi owned part of its franchising stores due to scarce capital available to investors to expand the franchising network), managerial intent and business

opportunity. Without being completely aware of the process of skill building the company was deploying, the management embarked in a series of strategic experiments, some of them being successful (e.g. acquisition of Migliorati), some of them being unsuccessful (e.g. first internationalization attempts in Germany). In both cases, new skills were retained and experience used a basis for learning. The generation of a varied portfolio of capabilities opened the way to new experimentations (e.g. licensing, expansion in France, large stores) outside the core business that generated a capability momentum in the organization. For example, Giochi Preziosi has continued acquiring companies (whether small wholesalers, or stores, or manufacturers, and from the end of the '90s even specialized niche toy makers and sweet producers) leveraging the due diligence and M&A skills developed.

Through a positive feedback (the type of "success breeds success" – Senge, 1990), successful initiatives gained momentum and attracted more resources to scale up. Failing initiatives were kept in the "managerial memory" as lessons learned, and divesting was early done. This type of exploratory attitude (March, 1991) opened nevertheless the company to new influences (e.g. foreign markets) and information, allowing the management to broaden the scope of their managerial thinking and sustaining once again the expansion of the company. For example, Giochi Preziosi avoided to take the place of Gig in the Toys'R'Us failing endeavor thanks of the better information it deployed regarding large store management, an information it developed by tapping new "niches" and "environments" like the retail business, thanks of previous experience had with the Agosti's large stores. As a consequence, the exploratory mindset sustained itself helping Giochi Preziosi avoid costly mistakes and providing access to new information and expertise. Staged-growth through active strategic experimentation happened in part thanks of managerial action, in part

through momentum derived by business opportunity, resource allocation, and economic necessity. Despite the failure of some of its endeavors, the company thrived and found itself in 1998-1999 (year of market slowdown and failure of Gig) with a portfolio of initiatives that did not suffer from the economic stall.

Gig's case is rather opposite. In the early '90s the decision to focus on the existing distribution platform and to improve its efficiency brought to a demanding program of internal restructuring. Regional warehouses were shut down, while a huge, centralized warehouse was opened at Lacchiarella (near Milan). Regional operations were restructured too. A highly efficient distribution platform was the result. The effort derived from the managers' philosophy of "total quality and efficiency for the distribution in the Italian market". In the meanwhile, the resource drain implied by the program left other initiatives starved of resources. Some business opportunities, like acquiring toy manufacturers, were overlooked as managerial focus and attention was devoted to the management of everyday's business and the restructuring. From 1994, Gig could take advantage of its "oiled" and lean distribution to explore other opportunities, which had to fall within the narrower structural context allowed by its mission. In an effort to enhance the distribution focus of the company, seen as the core competence of the company, the management engaged in the attempt to get the license to open the first "Toys'R'Us" stores in Italy. While the initiative fitted in the strategic framework, the capabilities needed to manage large stores as Toys'R'Us were outside the skill portfolio of the firm, and the absence of past experience (such as Giochi Preziosi's) and so of 'absorptive capacity' (Cohen and Levinthal, 1990; Zahra and George, 2002) did not help. High expectations and managerial ambition, sided by the willingness to take advantage of the synergies of the partnership, prompted Gig into ambitiously open of 16 stores in the 1996, to become 24 in the

following year. The large real-estate and inventory investment, jointly with the acritical adoption of a store format that was ill-suited to the Italian market. As a result, after three years of losses the company filed for bankruptcy, in part due to the unprofitable large stores, in part for the excess inventory due to the market slowdown. The ambitious goal of reaching 1000 ITL billions in revenues (more than double the revenues of the previous year hit the limitations of the business model facing adverse market conditions. Gig failed both for the unfit of the Toys'R'Us model with the Italian market and the inability of the management to deploy alternative sources of profit while the traditional ones (the Italian distribution, including the revenues from the Nintendo console that was surpassed by Sony Playstation), notwithstanding the inability to foresee the incoming failure.

Gig's strategic posture has been the one of an exploiter for the first period, enhancing its distribution platform to achieve high efficiency and cut down costs. Managerial focus, linked to a narrow mission, did not allow the management to consider, foster, or promote strategic initiatives that were out of the distribution focus (Bower, 1970). Other activities, like the own product development unit which was popular for its success in pushing innovative product lines for long periods of time (e.g. the Gig-Nikko remote control cars; and the personal diaries for kids), did not have the chance to be developed and initiate a cascade of skill acquisition that was the case of Giochi Preziosi. Most of the time and resources went into the 'lean distribution' program. Moreover, the management heavily relied on the assumption that being the past modus operandi successful, future success was certain due to Gig's improved scalability of its platform. High confidence in its distribution capabilities associated with the ambitious goal to reach 1000 billions in revenues fin 3 years (from 1996), along with the very much advertised aspiration of an IPO, led managers to

overconfidence. The Toys'R'Us deal was not entirely a matter of confidence, though. While acknowledging the lack of previous expertise in the field, Gig fell into a competency trap (Levinthal, 1994) trying to learn a new job by its own. Some unforeseen events (e.g. the lack of help and coaching promised by Toys'R'Us Spain) worsened the picture. Conflict among managers and a tendency not to challenge and verify the other manager's performance led to three years of losses for the stores. Despite losses were every year worse than expected, managers refused disconfirmation and increased commitment in the Toys'R'Us venture. This escalation (Staw, 1976) eventually brought to a failure that came unexpected to the public as it was to Gig's managers. Lock-in was brought by medium-term strategic reasons and more immediate reasons linked to the management team. On one side, Gig did not embark in strategic experimentation to acquire skills and broaden its set of strategic alternatives. The more focused set of skills (mainly distribution, marketing, and sales) which were tailored to the market the company thrived in until that point, did become less prominent in managing a more uncertain business. Gig became locked into its strategy in the moment it committed a vast majority of its resources and managerial attention in its Toys'R'Us venture. From that point on, escalation of commitment, lack of expertise, inability to acquire the necessary skills (e.g. did not hire new experienced management), and managerial issues (conflict among managers and attitude against disconfirmation) set Gig on the path to failure.

> *"…We were riding fast on a derailing train, and we could not manage to steer in time to change direction."*[38]

[38] The Gig case study in the previous sections.

Did Gig have other opportunities? Managerial focus was in part narrowed by the excess inclination for distribution; and because the lack of strategic experimentation did not allow the company to test and try other environments where it could have acquired information and knowledge about other strategic alternatives.

As a conclusion Gig failed despite for a long time it had the best game console on the market (Nintendo), the efficiency and capillarity of its distribution, and three years of "bad" signals from its new business. Giochi Preziosi thrived despite its Sega console was being pushed out by Sony, and despite its sometime non-profitable international operations and its production below optimal scale.

The emergence of intra-industry divergence has been driven, in the case of the Italian toy industry, by a difference in the management of strategic experimentation. This, combined with some initial differences driven, for example, by imperfections in the factor market (Barney, 1986), initiated a process of gradual accumulation of new skills. In the case of Giochi Preziosi, these skills were related to new fields (e.g. production), while in the case of Gig they were mostly competence-enhancing skills (Tushman and Anderson, 1986). The divergence prompted the companies to develop different perspectives on the business despite a channel of mutual communication that was present at the time[39]. Momentum in terms of a "capability momentum", was in part driven by unforeseen consequences of business decisions and acquisition of new capabilities, namely business opportunity, and economic necessity: e.g. the need to achieve production scale brought Giochi Preziosi to venture in the licensing niche of the market; the active use of manufacturing capabilities was secondary to the intent of the management of acquiring new product lines that the company could not procure at

[39] Which also brought to two cross-distribution agreements in 1995 and 1998 and a merging attempt in 1998.

that time. In the case of Gig, momentum was driven by organizational and cognitive factors, such as the high aspiration levels and the need to fulfill them by the management, a narrow structural context not allowing freedom in strategic experimentation (and therefore only enhancing existing competence-enhancing initiatives), resource allocation processes privileging distribution, the escalation of commitment, the inability to acquire the skills necessary to cope with a new business, lack of managerial checks on the business risk of the company and an optimism resistant to disconfirmation. As a consequence, the two very different 1998 companies grew solidly (Giochi Preziosi) or at the expense of its financial structure (Gig).

On the resource side, we have seen how resources, irreversible investment and specialization have helped the generation of differences through a combination of factor market imperfections and path dependency. From a capabilities' perspective, the different evolution of capabilities have generated new skills and capabilities that very rapidly enlarged the gap between the firms by constraining the strategic alternatives available to them. From an organizational and cognitive perspective, managerial biases, competency traps, overconfidence and managerial conflict favored the "stickiness" of past decisions and therefore strategic lock-in.

The evolution of a firm is inherently path-dependent (Penrose, 1959; March, 1991). To the extent to which competitors pursue the same strategic decisions or not, incumbents in the same industry may converge or diverge and consequently their assets, capabilities, products, and cultures. Reasons for why companies diverge or converge are multifaceted; companies may converge for institutional reasons and legitimization (e.g. DiMaggio and Powell, 1983), may imitate the industry leader in search for a viable business model, may do so for adaptation reasons; or in industries

characterized by positive feedbacks, demand-side increasing returns or 'network effects', may do so because of the "bandwagon effect" or the necessity to 'jump' on the right technological standard. On the other hand, companies may diverge in search for safe small niches, or specialize to distinguish themselves from competition (in search for the non-imitable, non-substitutable, valuable and rare competitive advantage). Even so, companies very often vary to the extent to which they can implement the same strategic decisions in the same way due to path dependency (e.g. Levitt and March, 1988), causal ambiguity (Dierickx and Cool, 1989), or information asymmetry. Moreover, cognitive factors may influence the way companies perceive themselves and their competitors, the markets, and the opportunities; managerial mindsets and styles may influence decision making.

This study has tried to contribute to the discussion on the generation of differences among incumbents of the same industry by adopting multiple conceptual lenses and examining field results of opposite, extreme cases (Yin, 1984) in order to enrich the body of data available in this stream of research by selecting a specific country, business, and setting not common with other studies in the field.

The results have hinted at the importance of strategic experimentation as a way to feed divergence through the multiple and diverse strategic alternatives that the branching of newly developed capabilities open up to the firm. The study has also delved in the dynamics that may drive strategic momentum and lock-in, underlining that in the case of failure organizational and cognitive factors may enhance capability disadvantages, not allowing companies with strong core competences to change strategic direction and survive a more uncertain environment.

The **managerial implication** of the findings imply that a deliberate effort in trying to foresee the branching paths generated by present strategic decisions may be of help when trying to define the "irreversible threshold", i.e. the point past which the strategic direction of a company becomes irreversible, as well as defining an organic growth path of the firm in environments where a rich and varied set of skills and capabilities may be necessary to compete. Thinking about the long-term implications of a decision not only on the profit and capabilities, but also on the uncertain aspect of skills and competencies that may be available or developed as consequents, whether these could be seen in advance or not, may help managers running companies in rapid, turbulent environments as well.

Another implication is about managerial overconfidence. Sticking to past ideas and mindsets, especially when disconfirmation is not well accepted is not helpful in identifying failing strategies and correcting them. Escalation and the need to fulfill extremely high goals may cause unnecessary risk-taking and detachment from "sound and rational" managerial decision making. The awareness of these issues and setting up specific tools, rules and cultures that act as a fail-safe would help in reducing their impact in risky situations, as lock-in would be less likely to occur.

Limitations of the study. This study offers an interpretation on the generation of intra-industry differences in a very specific context, namely the low-tech, mature toy industry of Italy in the period 1978-1998, analyzing the two main competitors, which were at the time medium size businesses (approximately 250 million euros in revenues). As a consequence, results may be specific to the case selected, and generalizability may be only established when additional field studies are conducted in different industries and countries or large sample hypothesis-testing studies are

conducted. The study carries some limitations derived from the research methodology as well: idiosyncratic to case-study methodology is the longitudinal, retrospective design that makes it difficult for the researcher to establish causal relations in the findings, as informants forget key elements, do not recognize an event as important when it occurs and thus, cannot recall it afterwards (Leonard-Barton, 1990). Retrospective biases or justifications often prevents researchers from determining cause and effect from reconstructed events (Golden, 1992). The two organizations under study were at the time of the research under the same ownership. During this period of time, the two structures were provisionally kept separated, but the ongoing reorganization plans were sketching the future of the two firms. Because of this, perspectives could retain some biases, especially in the case of the failed company, because of the recent issues of reorganization. Third, some limitations must be acknowledged in investigating a company's failure in spite of the emotional attachment of its previous management.

Another limitation arises from the inevitable tradeoff of the research design. The study controlled some variables (initial differences) to reduce the "noises" from original company differences in strategy making. It is possible that influences of the controlled variables are missed in this study.

Future research could further explore the multifaceted dynamics of momentum and lock-in from other perspectives, other businesses (or multi-business) and other countries (or multi-national) in search for a systematic, dynamic framework on the evolution of firms. For example, divergence, momentum and lock-in could be explored in the setting of high-tech start-up companies operating in ambiguous environment. Further longitudinal studies that take into account strategic, cognitive,

organizational, and resource-based factors would help in deriving a more comprehensive theory for explaining the complex, path-dependent evolution of firms with varying environmental conditions, technologies, organizational factors, strategic factor markets, interpreting thresholds and boundaries generating momentum, stabilization, or lock-ins in different equilibria.

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