Corporate Strategy

Corporate Strategy

- The decisions & actions taken to gain & sustain competitive advantage in several industries and markets simultaneously
- Addresses where to compete along three dimensions:
  - Products and services
  - Industry value chain
  - Geography (regional, national, or global markets)

Questions That Executives Ask to Determine Corporate Strategy

- In what stages of the industry value chain should we participate?
  - Related to the topic of vertical integration
- What range of products and services should the we offer?
  - Related to the topic of diversification
- Where should we compete geographically?
  - Related to the topic of geographic scope

Why Firms Need to Grow

- Increase profits
- Lower costs
- Increase market power
- Reduce risk
- Motivate management

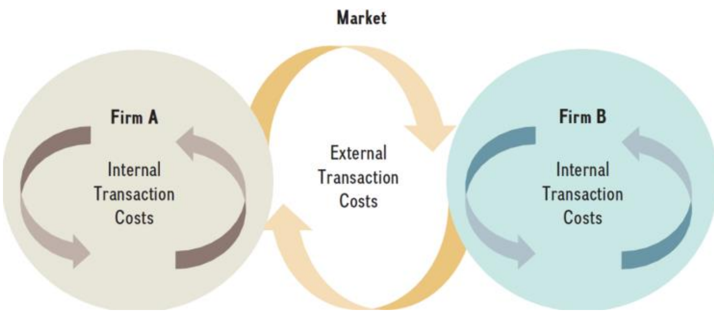
Three Dimensions of Corporate Strategy

- Core Competencies (Chapter 4)
- Economies of Scale (Chapter 6)
- Economies of Scope (Chapter 6)
- Transaction Costs
  - Determine whether it is cost effective to:
    - Vertically integrate
    - Diversify

The Boundaries of the Firm

Exhibit 8.2 Transaction Cost Economies

- Helps explain & predict boundaries of the firm
- Helps managers decide
  - Which activities to perform in-house
  - Services & products to obtain from the external market



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Transaction Costs

- Costs associated with an economic exchange
- Can be within or external to a firm
- External transaction costs
  - Searching for a firm individual to contract with
  - Negotiating, monitoring, and enforcing the contract
- Internal transaction costs
  - Recruiting and retaining employees
  - Paying salaries and benefits
  - Setting up a shop floor
  - Providing office space and computers, etc.

Firms Vs. Markets: Make Or Buy?

- If $C_{in\text{-}house} < C_{market}$, vertically integrate
  - Own production of the inputs or
  - Own output distribution channels
- When firms are more efficient than the market, vertically integrate
- Example: Google in-house programmers

Exhibit 8.3 Organizing Economic Activity: Firms vs. Markets

	Firm	Markets
Advantages	• Command and control - Fiat - Hierarchical lines of authority • Coordination • Transaction-specific investments • Community of knowledge	• High-powered incentives • Flexibility
Disadvantages	• Administrative costs • Low-powered incentives • Principal–agent problem	• Search costs • Opportunism - Hold-up • Incomplete contracting - Specifying & measuring performance - Information asymmetries • Enforcement of contracts

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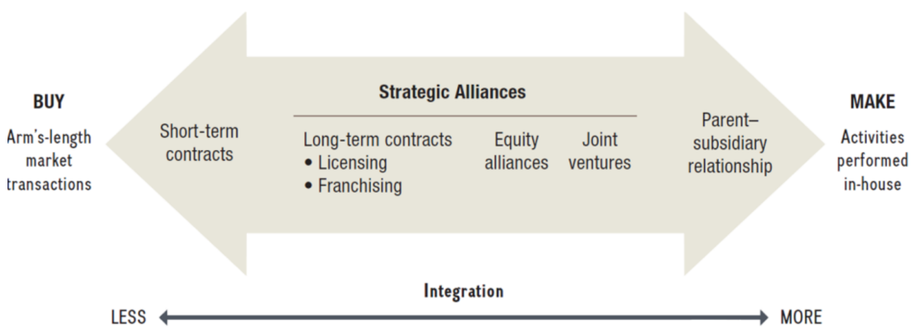
Alternatives on the Make-or-buy Continuum (1 of 2)

- Short Term Contracts
- Strategic Alliances
  - Long term contracts
    - Licensing
    - Franchising
  - Equity alliances
  - Joint Ventures
- Parent-Subsidiary Relationships

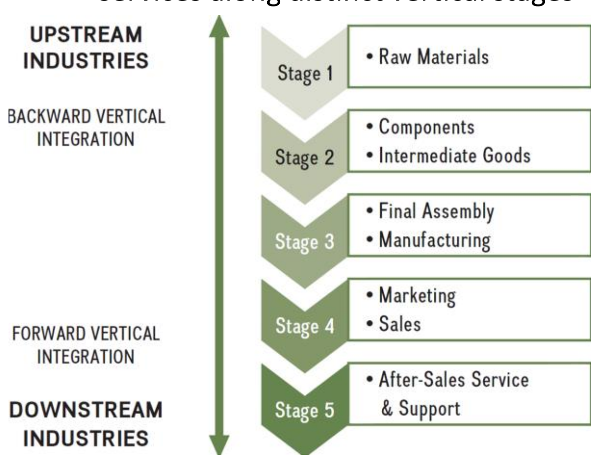
Exhibit 8.4 Alternatives on the Make-or-buy Continuum (2 of 2)



Vertical Integration along the Industry Value Chain

Exhibit 8.5 A Vertical Value Chain

The transformation of raw materials into finished goods and services along distinct vertical stages



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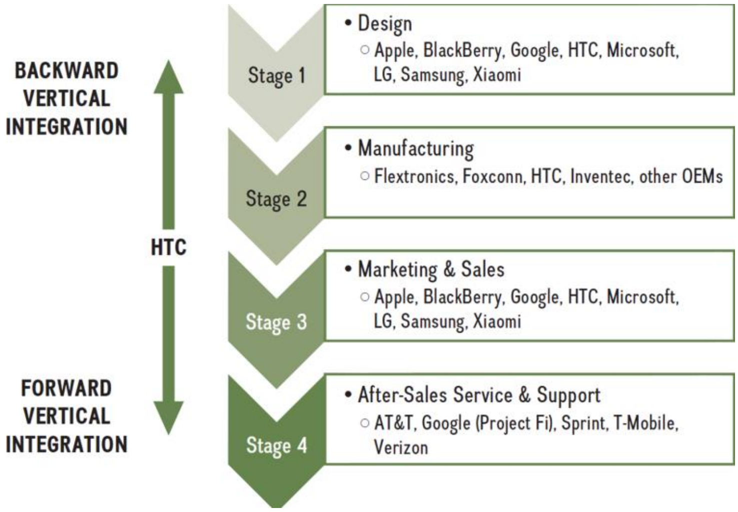
The Vertical Value Chain of Your Cell Phone

- Raw materials
  - Chemicals, ceramics, metals, oil for plastic
- Intermediate goods and components
  - Integrated circuits, displays, touchscreens, cameras, and batteries
- Original equipment manufacturing firms
  - Assembly of cell phones under contract
- Service provider
  - AT&T, Sprint, T-Mobile, Verizon, etc.

Types of Vertical Integration

- Backward Vertical Integration
  - Moving ownership of activities upstream to the originating inputs of the value chain
- Forward Vertical Integration
  - Moving ownership of activities closer to the end customer

Exhibit 8.6 Forward and Backward Integration: The Smartphone Industry



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Benefits of Vertical Integration

- Lowers costs
- Improves quality
- Facilitates scheduling and planning
- Facilitates investments in specialized assets
  – Reference the next slide for more information
- Secures critical supplies and distribution channels

Specialized Assets

- Unique assets with high opportunity cost:
  - They have significantly more value in their intended use than in their next-best use.
- 3 Types:
  - Site specificity
    - Co-location requirements (Machine collaboration)
  - Physical asset specificity
    - Unique physical & engineering properties (Coca-Cola Bottle)
  - Human asset specificity
    - Investments made in human capital (knowledge & skills for a specific process)

Risks of Vertical Integration

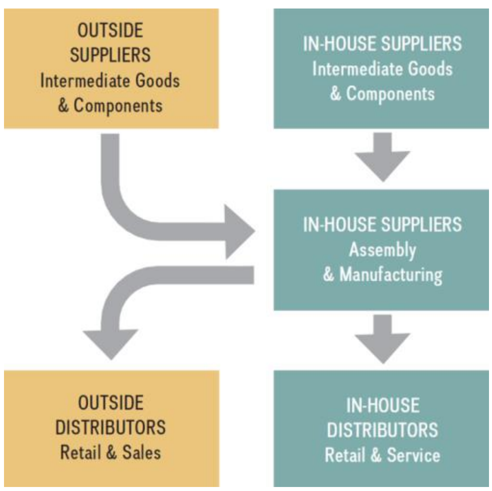
- Increase in costs
- Reduction in quality
- Reduction in flexibility
- Increase in the potential for legal repercussions

When Does Vertical Integration Make Sense?

- When there are shortages of raw materials
  - Ex. Henry Ford ran mining operations
- To enhance the customer's experience
  - Eliminate annoyances & poor interfaces

Exhibit 8.7 Tapering Integration

- An alternative to vertical integration
- Involves either:
  - Backward integration & relying on others for supplies
  - Forward integration & relying on others for distribution



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Strategic Outsourcing

- Moving one or more internal value chain activities outside the firm's boundaries to other firms in the industry value chain
- Example: Off-shoring
- Most active sectors of off-shoring:
  - Banking & financial services
  - IT
  - Health Care

Diversification

- Increase in:
  - The variety of products / services a firm offers, or
  - The markets / geographic regions in which it competes
- Can be targeted towards:
  - Products
  - Geography
  - Product-Market

Four Main Types of Business Diversification

1. Single business
   – Single business leverages its competencies
2. Dominant business
   – Dominant & minor businesses share competencies
3. Related diversification
   A. Related Constrained: all businesses share competencies
   B. Related Linked: some businesses share competencies
4. Unrelated diversification (conglomerate)
   – No businesses share competencies

Examples of the Four Main Types of Business Diversification

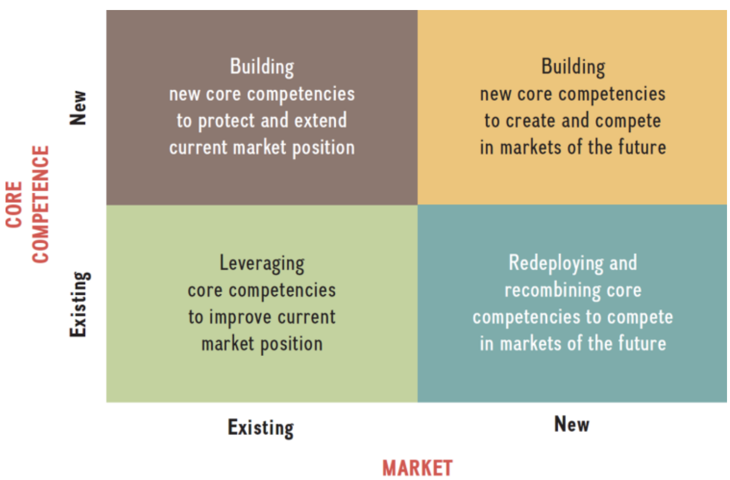
1. Single business
   – Coca-Cola, Google, Facebook
2. Dominant business
   – Harley Davidson, Nestle, UPS
3. Related diversification
   A. Related Constrained: ExxonMobile, Nike
   B. Related Linked: Amazon, Disney
4. Unrelated diversification: (conglomerate)
   – Berkshire Hathaway

Strategy Highlight 8.2

The Tata Group: Integration at the Corporate Level

- A multinational conglomerate in Mumbai, India
  - Activities: tea, hospitality, steel, IT, communications, power, and automobiles
- Tata Motors
  - Bought Jaguar and Range Rover from Ford (2008)
  - Created the Tata Nano a small, no-frills car
    - 50% cheaper than their next-lowest cost car
  - Pursue differentiation & low cost strategies simultaneously

Exhibit 8.9 Leveraging Core Competencies For Corporate Diversification



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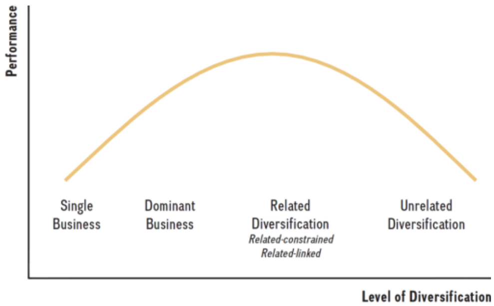
SOURCE: Adapted from G. Hamel and C.K. Prahalad (1994), Competing for the Future (Boston, MA: Harvard Business School Press).

Exhibit 8.10 Corporate Diversification and Firm Performance

- Does corporate diversification indeed lead to superior performance?
  - High and low levels of diversification = lower performance
  - Moderate levels of diversification = higher firm performance



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SOURCE: Adapted from L.E. Palich, L.B. Cardinal, and C.C. Miller (2000), "Curvilinearity in the diversification-performance linkage: An examination of over three decades of research," Strategic Management Journal 21: 155–174.

How Diversification Can Enhance Firm Performance

- Provide economies of scale: reduces costs
- Exploit economies of scope: increases value
- Reduce costs and increase value

Exhibit 8.11 Vertical Integration and Diversification: Sources of Value Creation and Costs

Corporate Strategy	Sources of Value Creation (*V*)	Sources of Costs (*C*)
Vertical Integration	• Securing critical supplies and distribution channels • Lowering costs • Improving quality • Facilitating scheduling and planning • Facilitating investments in specialized assets	• Increasing costs • Reducing quality • Reducing flexibility • Increasing potential for legal repercussions
Related Diversification	• Economies of scope • Economies of scale • Financial economies ▪ Restructuring ▪ Internal capital markets	• Coordination costs • Influence costs
Unrelated Diversification	• Financial economies ▪ Restructuring ▪ Internal capital markets	• Influence costs

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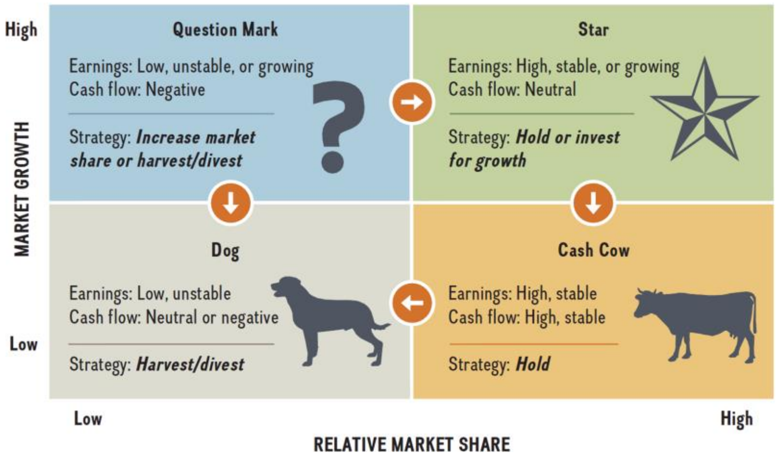
Financial Economies of Scale Can Be Achieved Through Restructuring

- Restructuring:
  - Reorganizing & divesting business units & activities
  - Refocuses a company on its core competencies
- Executives can restructure the business portfolio.
- Boston Consulting Group (BCG) growth-share matrix:
  - Helps guide portfolio planning
  - Each category warrants a different investment strategy.

Exhibit 8.12 Boston Consulting Group (BCG) Growth-share Matrix



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Executives Make Important Choices Along Three Dimensions

- Degree of vertical integration: the stages of the industry value chain to participate in
- Type of diversification: the range of products and services to offer
- The geographic scope: where to compete