CORPORATE STRATEGIES

Fit between a parent and its businesses is a two-edged sword; a good fit can create value; a bad fit can destroy it.
Campbell, Goold and Alexander (2000)

CORPORATE STRATEGIES: Strategic Management at the Corporate Level

OBJECTIVES
- Achieve desired portfolio of businesses
- Improve long-term performance of the firm
- Capture strategic fit benefits
- Effective allocation of corporate resources among businesses

THE DOMAIN OF CORPORATE STRATEGY

- CORPORATION’S SCOPE
  - What mix of businesses?
  - Scope expansion and contraction

- THE RELATEDNESS OF PARTS
  - On what basis should units be related to one another?

- METHOD OF MANAGING SCOPE AND RELATEDNESS
  - Acquisitions, strategic alliances, divestment etc.
DEVELOPMENT OF CORPORATE STRATEGY

Concentration on Single Business in Single market → Some Combination of
- Vertical Integration
- Related Diversification
- Unrelated Diversification → CRISIS → Restructuring (including Divestiture) to Regain Competitiveness and Control

CONCENTRATION

- Attractive, growing industry
- Distinctive competencies result in
  - high degree of internal efficiency
  - substantial competitive advantage
- Scale efficiency benefits
- Fill resource gaps through horizontal acquisition

CONCENTRATION – BENEFITS AND PITFALLS

BENEFITS
- Low risk option
- Directional clarity/unity of purpose
- Top management know business

PITFALLS
- Growth prospects can be limited
- May stifle employee development
- Vulnerability to environmental changes
- May miss opportunities to create value by leveraging competencies
CORPORATE STRATEGY

CONCENTRATION – APPROACHES

INTERNAL EXPANSION
- State-of-the-art technology
- No assimilation problems
- No antitrust restriction

HORIZONTAL MERGERS/ACQUISITIONS
- Quick
- Saves cost associated with new product development
- Potential synergies
- Does not adversely affect supply-demand equilibrium
- Reduces competition

GROWTH – OPTIONS

CONCENTRATION
- Internal Growth
- Mergers and Acquisitions
- Joint Ventures/Strategic Alliances

Vertical Integration
- Related diversification

Unrelated/diversified diversification

DIVERSIFICATION – THE LOGIC

- Value through better resource allocation
- Capitalize on core competencies
- Economies of scope/synergies
- Risk reduction/profit stability
- Maintaining growth
- Enhanced market power
- Counterbalancing cyclicality
- Improve financial efficiency
DIVERSIFICATION -- MANAGERIAL MOTIVES

“Tremendous allure to mergers and acquisitions. It’s big play, the dramatic gesture. With one stroke of the pen you can add billions to size, get a front page story, and create excitement in the market.” Michael Porter

- Desire to increase power and status
- Desire to increase salary and bonuses
- Desire to reduce employment risk
- Craving for more interesting and challenging management environment

DIVERSIFICATION -- PITFALLS

- Inefficient way to reduce shareholder risk
- Growth may not be consistent with profit maximization
- Control loss
- Overestimating synergies

DIVERSIFICATION -- ROUTES

- Mergers and acquisitions
  - Buying a business in a related or unrelated industry
- Internal development/ Internal start-ups
  - Building new business from the ground up
- Strategic alliances/ joint ventures
  - Entity jointly owned by two or more companies
VERTICAL INTEGRATION

Extension of the stages of production and distribution in which a firm operates

- Forward and backward integration
- "Taper/partial" versus "full" integration
  - Taper when there are independent suppliers (buyers) as well as company owned suppliers (buyers)

VERTICAL INTEGRATION – INCENTIVES

- Building barriers to entry
- Greater organizational control/ protecting product quality
- Reduced production and inventory costs
- Stable production
- Lower market/transaction costs
- Information access
- Protection of proprietary technology
CORPORATE STRATEGY

VERTICAL INTEGRATION – PITFALLS

- Reduced organizational flexibility
- Compounding risk -- vulnerability to environmental/technological changes
- Unbalanced capacities
- Coordination costs
- Cost disadvantages; inefficiencies in the absence of market disciplining mechanisms
- Core competencies may not be relevant

RELATED/CONCENTRIC DIVERSIFICATION

**BENEFITS**
- Some knowledge of the new business
- Synergies/ economies of scope
- Employee development opportunities

**PITFALLS**
- Difficulties in realizing synergies
- Related industries may also be unattractive

CONCENTRIC DIVERSIFICATION

Most likely to create value when:
- Sales force, advertising and distribution can be shared
- Technologies are closely related
- Brand name and reputation can be easily transferred
- New business uniquely helps position of existing business and vice versa

Notes
CORPORATE STRATEGY

COMPARING VALUE CHAINS TO IDENTIFY STRATEGIC FITS

Bus A
- Purchasing
- Technology
- Operations
- Marketing
- Distribution
- Service

Opportunities to combine purchasing activities and gain leverage with suppliers
Opportunities to share technology, transfer technical skills, combine R&D
Opportunities to combine/share sales, marketing and distribution channels

Bus B
- Purchasing
- Technology
- Operations
- Marketing
- Distribution
- Service

Bus C
- Purchasing
- Technology
- Operations
- Marketing
- Distribution
- Service

HONDA: LEVERAGING CORE COMPETENCIES

OUTBOARD MOTORS
SNOW BLOWERS
SNOWMOBILES
CARS
MOTORCYCLES
ENGINE
POWER TILLERS

CREATION OF MULTI-BUSINESS SYNERGY

- By leveraging capabilities
  - Superior resource allocation
  - Replicating resources/capabilities
- By improving bargaining position
  - Market power over buyers
  - Market power over suppliers
- By integrating activities
  - Sharing value-adding activities
  - Linking value-adding activities
CREATION OF SYNERGY

Managerial Actions to Share Tangible Resources or Intangible Knowledge and Skills

Benefits Resulting from Economies of Scale and/or Shared Knowledge or Reputation

Synergy and Improved Performance

Costs Associated with Creating Synergy and Administrative Overhead

Efficiency and Lower Performance

UNRELATED/ CONGLOMERATE DIVERSIFICATION

Entering new and very different industry

BENEFITS
- Quick growth
- Financial synergies
- “Corporate parenting”
- Lower cost of capital

PITFALLS
- Administrative and control problems
- Minimal operating synergies

RELATED AND UNRELATED PORTFOLIOS

RELATED
Johnson & Johnson
- Baby products
- Band-Aids
- Stayfree, Carefree
- Non-prescription drugs
- Surgical & hospital products
- Reach dental products
- Accuvue contact lenses
- Skin care products

UNRELATED
Textron Inc.
- Bell Helicopters
- Cessna Aircraft
- E-Z-Go Golf Carts
- Missile Reentry systems
- Specialty fasteners
- Textron Financial Services
- Jacobson Turf Care equipment
- Tanks and armored vehicles
M&A: SHAREHOLDER VALUE

<table>
<thead>
<tr>
<th>CAPTURE</th>
<th>CREATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>◾ Shifting value from previous shareholders and other stakeholders</td>
<td>◾ Long term phenomenon that results from managerial actions and interaction between firms</td>
</tr>
</tbody>
</table>

ACQUISITION SEARCH AND JUSTIFICATION

ACQUISITION OBJECTIVES
- Consistent with strategy
- Domain strengthening
- Domain extension
- Domain exploration

IDENTIFYING CANDIDATES
- Electronic Data bases
- Industry experts
- Investment bankers
- Trade publications

STRATEGIC EVALUATION
- Industry growth
- Segmentation analysis
- Industry structure
- Core competencies
- Competitive position

DUE DILIGENCE AND VALUATION
- Expected synergy benefits
- Verification of Asset Ownership
- Audit of financials

NEGOTIATION AND FINALIZATION
- Financing alternatives
- Structure of transactions

PROBLEMS IN THE ACQUISITION DECISION PROCESS

ANALYSIS
- PROBLEMS
  ◾ Fragmented perspectives
  ◾ Increasing momentum
  ◾ Ambiguous expectations

NEGOTIATIONS

JUSTIFICATION
- Strategic assessment
- Organizational conditions
- Valuation and maximum price
PROBLEMS IN THE ACQUISITION INTEGRATION PROCESS

- Inappropriate atmosphere
- Leadership vacuum
- Determinism
- Resource sharing
- Skill transfer
- Combination benefits

ORGANIZATIONAL ATMOSPHERE

- Reciprocal organizational understanding
- Willingness to work together
- Cause-effect understanding of benefits
- Discretionary resources

SELECTING DIVERSIFICATION OPPORTUNITIES

- Attractiveness test
  - Industries must be structurally attractive or capable of being made attractive
- Cost of entry test
  - Cost of entry must not capitalize all future profits
- Better-off test
  - New business must gain competitive advantage from its association with the corporation or vice versa
CORPORATE STRATEGY

**DIVERSIFIED EXPANSION**

- **RESOURCES**
  - On which of the firm’s resources?
  - Will it contribute to competitive advantage?
  - Can resources be developed further?

- **BUSINESSES**
  - Are there attractive opportunities for expansion?
  - Could a defensible position be built?
  - How does it relate to firm’s existing businesses?
  - Additional resources required?
  - How will they be acquired? At what cost?

- **PLAN**
  - What is the overall plan?
  - Into what markets and in what sequence?

*From: Collis and Montgomery, 1998*

**EXIT STRATEGIES**

- Divestment (spinoff)
- Harvest
- Liquidation

**DIVESTITURE**

- Poor performance
- Division needs more resources than the company can provide
- Division is a misfit
- Reduce corporate debt or raise cash quickly
- Government antitrust action
- Balance portfolio
END GAME STRATEGIES: HARVEST AND LIQUIDATION

- **Harvest**
  - Controlled disinvestment - optimize cash flow as company exits
    - No new investment
    - Manage for cash flow
    - Reduce maintenance
    - Reduced advertising
- **Liquidation**
  - Closing down of operations and asset sell off

DEVELOPMENT OF CORPORATE STRATEGIES

<table>
<thead>
<tr>
<th>YEAR</th>
<th>ISSUES</th>
<th>CONCEPTS</th>
<th>APPROACH</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>Quest for growth</td>
<td>General management skills</td>
<td>Diversification</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Synergy</td>
<td>Conglomerate Concentric</td>
</tr>
<tr>
<td>1970</td>
<td>Resource allocation</td>
<td>Portfolio planning</td>
<td>“Balanced” portfolios</td>
</tr>
<tr>
<td></td>
<td>problems</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>Value gaps and</td>
<td>Deconglomeration</td>
<td>Corporate restructuring</td>
</tr>
<tr>
<td></td>
<td>raiders</td>
<td>Value based planning</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>Defining the core</td>
<td>Dominant Logic</td>
<td>Manageable and linked portfolios</td>
</tr>
<tr>
<td></td>
<td>business</td>
<td>Core competencies</td>
<td></td>
</tr>
</tbody>
</table>

CORPORATE RESTRUCTURING: DRIVERS

- Demise of the “loyal” stockholder/breakdown of investor confidence
- Aggressive portfolio managers and greater institutional holdings
- Power shift from jobholders to stockholders
- Increased competition
- Corporate raiders and threat of hostile takeovers
- Active board of directors
CORPORATE STRATEGY

CORPORATE RESTRUCTURING: CONSEQUENCES

- Return of larger amounts of capital to equityholders
- Cutback on unrelated diversification
- Shifts in capital structure
- Superior performance
- Delayering

MCKINSEY RESTRUCTURING FRAMEWORK

1. Current Market Value
2. Company Value As Is
3. Potential Value With Internal Improvements
4. Potential Value With External Improvements
5. Optimal restructured value of company