Introduction to the Business Strategy Course

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Business Strategy Handouts

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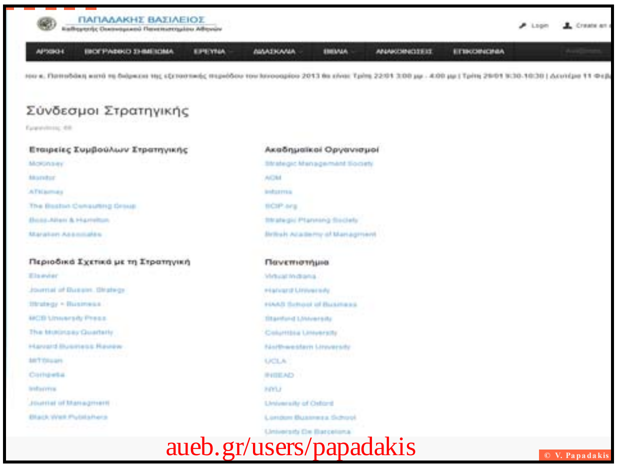
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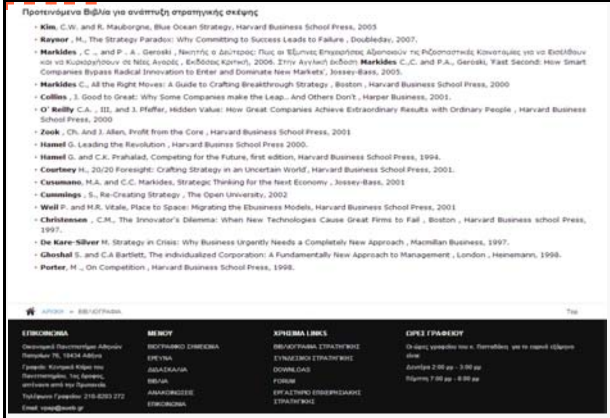

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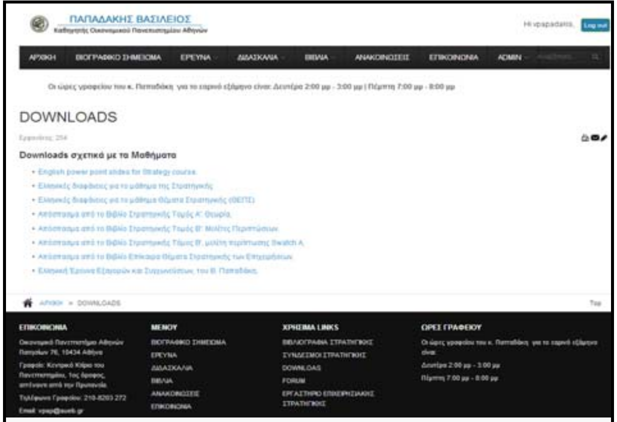

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The 21st-Century Competitive Landscape

- A Perilous Business World
  - Rapid changes in industry boundaries and markets
  - Conventional sources of competitive advantage losing effectiveness
  - Enormous investments required to compete globally
  - Severe consequences for failure
- Developing and Implementing Strategy
  - Allows for planned actions rather than reactions
  - Helps coordinate business unit strategies

Introduction to Strategy

Chapter 1 – V.Papadakis

1. The First Strategists

Practical Lessons

Pericles

Opportunity waits for no man

Pericles

Do not make any conquests during the war

Epaminondas

Defeat the enemy at the strongest point, not at the weakest

Alexander the Great

Decisions can only be made when the circumstances arise

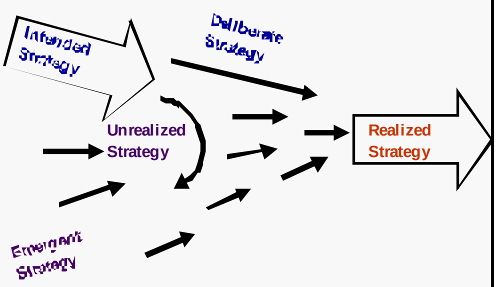
"Without a strategy the organization is like a ship without a rudder, going around in circles."

Joel Ross and Michael Kami

Strategy is about…

- Positioning an organization for competitive advantage
- Deciding what to do and what NOT to do
  - Which industries to participate in
  - What products and services to offer
  - How to allocate resources, add value
- Creating value for shareholders and other stakeholders by providing value to customers

Not all strategy can be planned…



Intended and Emergent Strategies

- Intended or Planned Strategies
  - Strategies an organization plans to put into action
  - Typically the result of a formal planning process
  - Unrealized strategies are the result of unprecedented changes and unplanned events after the formal planning is completed
- Emergent Strategies
  - Unplanned responses to unforeseen circumstances
  - Serendipitous discoveries and events may emerge that can open up new unplanned opportunities
  - Must assess whether the emergent strategy fits the company's needs and capabilities
- Realized Strategies
  - The product of whatever intended strategies are actually put into action and of any emergent strategies that evolve

A DEFINITION OF STRATEGY

Strategy is the direction and scope of an organization over the long term which achieves advantage for the organization through its configuration of resources within a changing environment to meet the needs of markets and to fulfill stakeholders expectations.

Source: Johnson and Scholes, 1999

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Strategic Analysis of the External Environment

Papadakis Chapter 2

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Why External Analysis?

External analysis allows firms to:

- discover threats and opportunities
- see if above normal profits are likely in an industry
- better understand the nature of competition in an industry
- make more informed strategic choices

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Competitive Analysis: Key Questions
Who Are Our Competitors?
What are Their Major Strengths?
How Have They Behaved In The Past?
How Might They Behave in the Future?
How Will This affect Us?
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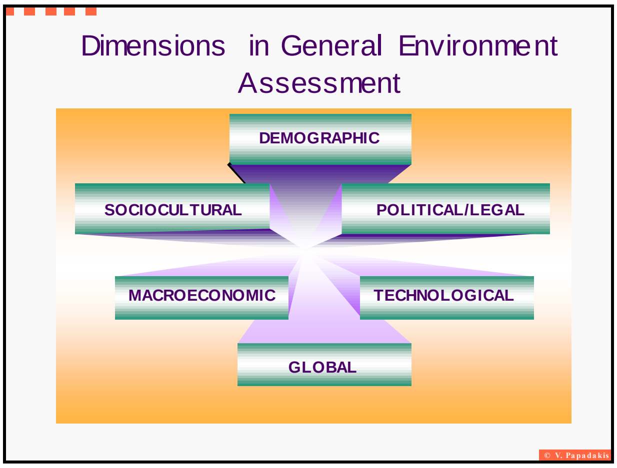
Dimensions in General Environment Assessment
DEMOGRAPHIC
SOCIOCULTURAL
POLITICAL/LEGAL
MACROECONOMIC
TECHNOLOGICAL
GLOBAL
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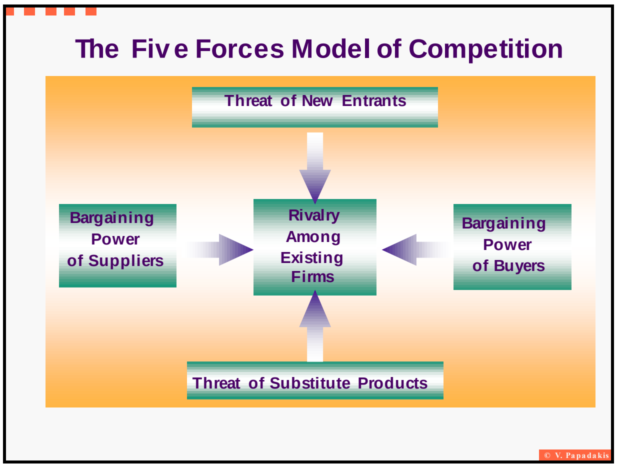
The Five Forces Model of Competition
Threat of New Entrants
Bargaining Power of Suppliers
Rivalry Among Existing Firms
Bargaining Power of Buyers
Threat of Substitute Products
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Analysis of the Macro Environment (PEST)

1. What environmental factors are affecting the opposition?
2. Which of these are the most important at the present time? In the next few years?

Political/legal
- Monopolies legislation
- Environmental protection laws
- Taxation policy
- Foreign trade regulations
- Employment law
- Government stability

Economic factors
- Business cycles
- GNP trends
- Interest rates
- Money supply
- Inflation
- Unemployment
- Disposable income
- Energy availability and cost

Sociocultural factors
- Population demographics
- Income distribution
- Social mobility
- Lifestyle changes
- Attitudes to work and leisure
- Consumerism
- Levels of education

Technological
- Government spending on research
- Government and industry focus of technical effort
- New discoveries/ development
- Speed of technology transfer
- Rates of obsolescence

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Some characteristics for identifying strategic groups

- Extent of product or service diversity
- Extent of geographical coverage
- Number of market segments served
- Distribution channels used
- Extent (number) of branding
- Marketing effort (e.g. advertising spread, size of salesforce)
- Extent of Vertical Integration
- Product or service quality
- Technological leadership (e.g. leader or follower)
- R&D capability (extent of innovation in product or process)
- Cost Position (e.g. extent of investment in cost reduction)
- Utilization of capacity
- Pricing policy
- Level of gearing
- Ownership structure
- Relationship to influence groups (e.g. government, the City)
- Size of Organization

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Components of the General Environment

Demographic Segment	♦ Population size ♦ Age structure ♦ Geographic distribution	♦ Ethnic mix ♦ Income distribution
Economic Segment	♦ Inflation rates ♦ Interest rates ♦ Trade deficits or surpluses ♦ Budget deficits or surpluses	♦ Personal savings rate ♦ Business savings rates ♦ Gross domestic product
Political/Legal Segment	♦ Antitrust laws ♦ Taxation laws ♦ Deregulation philosophies	♦ Labor training laws ♦ Educational philosophies and policies
Sociocultural Segment	♦ Women in the workforce ♦ Workforce diversity ♦ Attitudes about work life quality	♦ Concerns about the environment ♦ Shifts in work and career preferences ♦ Shifts in preferences regarding product and service characteristics
Technological Segment	♦ Product innovations ♦ Applications of knowledge	♦ Focus of private and government-supported R&D expenditures ♦ New communication technologies
Global Segment	♦ Important political events ♦ Critical global markets	♦ Newly industrialized countries ♦ Different cultural and institutional attributes

Five Forces Analysis (1)

The threat of entry ...

Dependent on barriers to entry such as:

- Economies of scale
- Capital requirements of entry
- Access to distribution channels
- Cost advantages independent of size (eg the "experience curve")
- Expected retaliation
- Legislation or government action
- Differentiation

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Five Forces Analysis (2)

Buyer power is likely to be high when:

- There is a concentration of buyers
- There are many small operators in the supplying industry
- There are alternative sources of supply
- Components or materials are a high percentage of cost to the buyer leading to "shopping around"
- Switching costs are low
- There is a threat of backward integration

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Five Forces Analysis (3)

Supplier power is high when:

- There is a concentration of suppliers
- Switching costs are high
- The supplier brand is powerful
- Integration forward by the supplier is possible
- Customers are fragmented and bargaining power low

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Five Forces Analysis (4)

Threat of substitutes

Substitutes take different forms:

- Product substitution
- Substitution of need
- Generic substitution
- Doing without

Five Forces Analysis (5)

Competitive Rivalry is high when:

- Entry is likely
- Substitutes threaten
- Buyers or suppliers exercise control
- Competitors are in balance
- There is slow market growth
- Global customers increase competition
- There are high fixed costs in an industry
- Markets are undifferentiated
- There are high exit barriers

Five Forces Analysis: Key Questions and Implications

- What are the *key forces* at work in the competitive environment?
- Are there *underlying forces* driving competitive forces?
- Will competitive *forces* change?
- What are the *strengths and weaknesses* of competitors in relation to the competitive forces?
- Can *competitive strategy* influence competitive forces (eg by building barriers to entry or reducing competitive rivalry)?

Strategic Group Analysis

Strategic Group Analysis is useful to:

- Identify firms with similar strategic characteristics
- Therefore identify the most direct competitors
- Identify mobility barriers
- Identify strategic opportunities ("strategic spaces")
- Strategic threats and problems

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Guidelines: Strategic Group Maps

- Variables selected as axes should ***not*** be highly correlated
- Variables chosen as axes should expose ***big*** differences in how rivals compete
- Variables do ***not*** have to be either quantitative or continuous
- Drawing sizes of circles proportional to combined sales of firms in each strategic group allows map to reflect relative sizes of each strategic group
- If more than two good competitive variables can be used, several maps can be drawn

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Interpreting Strategic Group Maps

- Driving forces and competitive pressures often favor some strategic groups and hurt others
- Profit potential of different strategic groups varies due to strengths and weaknesses in each group's market position
- The closer strategic groups are on map, the stronger the competitive rivalry among member firms tends to be

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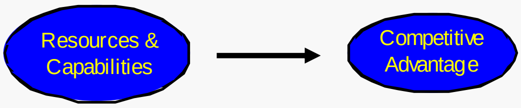
Internal Analysis: Resources, Capabilities, Competencies, and Competitive Advantage

Παπαδάκης Κεφάλαιο 3

The Resource-Based View

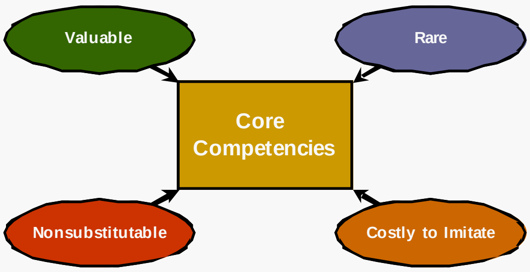


- Valuable
- Rare
- Costly to Imitate
- Organized to Exploit

CA will be sustained if:

- other firms' costs of imitation are greater than benefit of imitation
- the firm is organized to exploit advantages

Criteria for Resources and Capabilities That Become Core Competencies



Competences and Core Competences

- Competences exist in *activities*
- Resources are deployed to create competences
- Core competences underpin competitive advantage
  - only *some* competences are core
  - core varies with *strategy*
  - core varies with *time*
  - core can be exploited in *several* ways
- Mismatches resolved by
  - changing core competences
  - changing strategy

The VRIO Framework

Valuable?	Rare?	Costly to Imitate?	Exploited by Organization?	Competitive Implications	Economic Implications
No			No	Disadvantage	Below Normal
Yes	No			Parity	Normal
Yes	Yes	No		Temporary Advantage	Above Normal
Yes	Yes	Yes	Yes	Sustained Advantage	Above Normal

Sustainability of Competitive Advantage

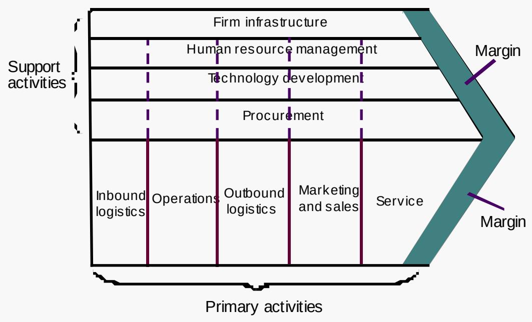
Depends on:

- Robustness of the competences
- Extent to which they can be imitated
- Extent to which they are embedded in routines, tacit knowledge and culture

SWOT Analysis-What to Look For

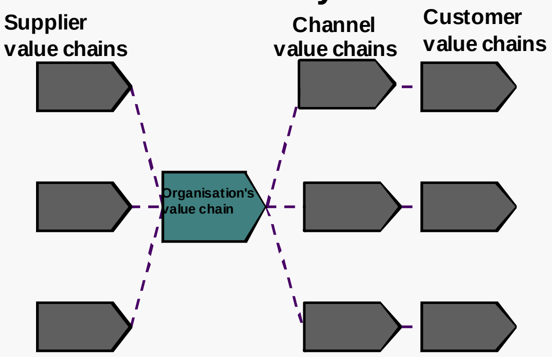
Potential Resource Strengths	Potential Resource Weaknesses	Potential Company Opportunities	Potential External Threats
• Powerful strategy • Strong financial condition • Strong brand name image/reputation • Widely recognized market leader • Proprietary technology • Cost advantages • Strong advertising • Product innovation skills • Good customer service • Better product quality • Alliances or JVs	• No clear strategic direction • Obsolete facilities • Weak balance sheet; excess debt • Higher overall costs than rivals • Missing some key skills/competencies • Subpar profits . . . • Internal operating problems . . . • Falling behind in R&D • Too narrow product line • Weak marketing skills	• Serving additional customer groups • Expanding to new geographic areas • Expanding product line • Transferring skills to new products • Vertical integration • Openings to take MS from rivals • Acquisition of rivals • Alliances or JVs to expand coverage • Openings to exploit new technologies • Openings to extend brand name/image	• Entry of potent new competitors • Loss of sales to substitutes • Slowing market growth • Adverse shifts in exchange rates & trade policies • Costly new regulations • Vulnerability to business cycle • Growing leverage of customers or suppliers • Shift in buyer needs for product • Demographic changes

Figure 4.4 The value chain



Source: ME Porter, Competitive Advantage, Free Press, 1985 Used with permission of The Free Press, a division of Macmillan, Inc. Copyright 1985 Michael E Porter.

The value system



Source: Adapted from M. E. Porter, Competitive Advantage, Free Press, 1985.

Outsourcing

- The purchase of a value-creating activity from an external supplier
  - Few organizations possess the resources and capabilities required to achieve competitive superiority in all primary and support activities.
- By performing fewer capabilities:
  - A firm can concentrate on those areas in which it can create value.
  - Specialty suppliers can perform outsourced capabilities more efficiently.

Strategic Rationales for Outsourcing

- Improving business focus
  - Helps a company focus on broader business issues by having outside experts handle various operational details.
- Providing access to world-class capabilities
  - The specialized resources of outsourcing providers makes world-class capabilities available to firms in a wide range of applications.

Strategic Rationales for Outsourcing (cont'd)

- Accelerating re-engineering benefits
  - Achieves re-engineering benefits more quickly by having outsiders—who have already achieved world-class standards—take over process.
- Sharing risks
  - Reduces investment requirements and makes firm more flexible, dynamic and better able to adapt to changing opportunities.
- Freeing resources for other purposes
  - Redirects efforts from non-core activities toward those that serve customers more effectively.

Outsourcing Issues

- Seeking greatest value
  - Outsource only to firms possessing a core competence in terms of performing the primary or supporting the outsourced activity.
- Evaluating resources and capabilities
  - Do not outsource activities in which the firm itself can create and capture value.
- Environmental threats and ongoing tasks
  - Do not outsource primary and support activities that are used to neutralize environmental threats or to complete necessary ongoing organizational tasks.

Outsourcing Issues (cont'd)

- Nonstrategic team resources
  - Do not outsource capabilities critical to the firm's success, even though the capabilities are not actual sources of competitive advantage.
- Firm's knowledge base
  - Do not outsource activities that stimulate the development of new capabilities and competencies.

Mission-Vision: Strategic Necessity or Unnecessary?

Papadakis Chapter 4

Vision & Mission

That business mission is so rarely given adequate thought is perhaps the most important single cause of business frustration.

—Peter Drucker—

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Vision & Mission (Cont'd)

Mission statement answers the question:

"What is our business?"

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Vision & Mission (Cont'd)

Vision statement answers the question:

"What do we want to become?"

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VISION AND MISSION

- **Vision**
  - A simple statement or under-standing of what the firm will be in the future. A statement of vision is forward looking and identifies the firm's desired long-term status
- **Mission**
  - A declaration of what a firm is and stands for – of its fundamental values and purpose

- Because it's hard to execute a strategy if it can't be described or understood, firms with clearly and widely understood vision and mission find it easier to make strategic decisions entailing difficult trade- offs

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VISION, MISSION AND STRATEGY

Vision and Mission
- Fundamental purpose
- Values
- View of future

Strategic Goals and Objectives
- Specific targets
- Measurable outcomes

Strategy
- he central, integrated, ernally oriented concept o ow the firm will achieve its objectives. Consists of 5 elements: arenas, vehicles, differentiators, staging, and economic logic

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VISION – USES OF AMBITION AND AMBIGUITY

- **Sony's vision in early 1950s:**
- "becoming the company that most changes the worldwide image of Japanese products as being of poor quality."

- **CitiBank's vision in 1915:**
- "the most powerful, the most serviceable, the most far-reaching world financial institution the world has ever seen."

- Vision statements
- generally express long-term action horizons
- are **ambitious** and force the firm to stretch
- their **ambiguity** allows flexibility for changing strategy or implementation tactics

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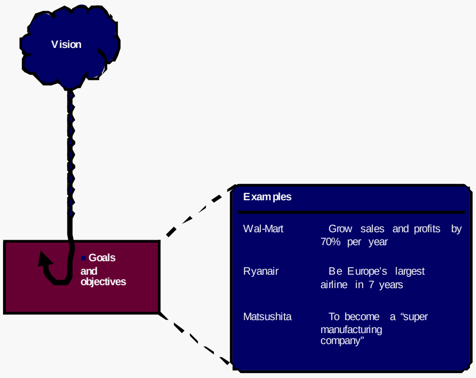
GERSTNER'S 1993 VISION

- IBM will not be split up and its many parts will be even more closely coordinated.
- IBM will reassert its identity as customers' primary computing resource.
- The company will be the dominant supplier of technology in the industry.
- PowerPC, a new microprocessor design, will be IBM's centerpiece. Built into many future computers, it will run a wide range of standard industry software. It will steeply cut manufacturing costs.
- Mainframes are no longer central to the strategy, but IBM will still make them, now with microprocessors.
- IBM is its own worst enemy. Employees must waste fewer opportunities, minimize bureaucracy, and put the good of the company before their division's.

VISION ANCHORED IN GOALS AND OBJECTIVES



REASONS TO CRAFT CLEAR VISIONS AND MISSIONS

- To crystallize and disseminate the firm's strategy among employees
- To provide a shared logic for the firm's view of its internal and external environments and of its treatment of stakeholders
- To galvanize concerted strategic action
- To link strategy formulation to implementation by tying vision and mission to specific and measurable goals and objectives

Vision & Mission (Cont'd)

- Many companies develop both
- Shared vision can motivate employees
- Develops a commonality of interests
- Helps focus on opportunity & challenge

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Developing Vision & Mission

- Clear mission is needed before alternative strategies can be formulated and implemented
- Important to have as broad range of participation as possible among managers in developing the mission

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Characteristics of a Mission Statement

- Defines ***current*** business activities
- Highlights ***boundaries*** of current business
- Conveys
  - ***Who*** we are,
  - ***What*** we do, and
  - ***Where*** we are now
- Company ***specific***, not generic — so as to give a company its own identity

A company's mission is *not* to make a profit !

The real mission is always—*"What will we do to make a profit?"*

Business Mission: Cardinal Health

- Cardinal Health is a leading provider of services supporting health care worldwide.
- The company offers a broad array of services for health-care providers and manufacturers to help them improve the efficie and quality of health care.
- These services include pharmaceutical distribution, health-care product manufacturing and distribution, drug delivery systems development, . . . , retail pharmacy franchising, and health-care information systems development.

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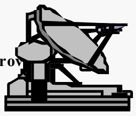
Business Mission:



- **JDS Uniphase is the leading provider of advanced fiber optic components and modules.**
- **These products are sold to the world's leading telecommunications and cable television system pro . .**
- **Our products perform both optical-only functions and optoelectronic functions within fiber option networks.**
- **Our products include semiconductor lasers, . . . , and isolators for fiber optic applications.**
- **In addition, we design, manufacture, and market laser subsystems for a broad range of OEM applications, which include . . .**

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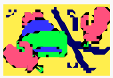
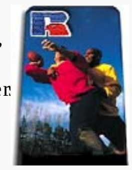
Business Mission: Russell Corp.



- Russell Corporation is a vertically integrated international designer, manufacturer, and marketer of athletic uniforms, . . . , and a comprehensive line of lightweight, yarn-dyed woven fabrics.
- The Company's manufacturing operations include the entire process of converting raw fibers into finished apparel and fabrics.
- Products are marketed to sporting goods dealers, department and specialty stores, mass merchandisers, . . . , and other apparel manufacturer.



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Broad or Narrow Mission Statements?

- **Narrow** enough to specify **real arena** of interest
- Serve as
  - **Boundary** for what to do and not do
  - **Beacon** of where top management intends to take firm
- **Diversified** companies have **broader** business definitions than single-business enterprises

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Definitions: Broad vs. Narrow Scope

Broad Definition	Narrow Definition
Furniture	Wrought-iron lawn furniture
Telecommunications	Long-distance telephone service
Beverages	Soft drinks
Global mail delivery	Overnight package delivery
Travel & tourism	Caribbean cruises

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Business Mission: The McGraw Hill Companies (a diversified firm)

- **The McGraw-Hill Companies is a global publishing, financial, information and media services company with such renowned brands as Standard & Poor's, Business Week, and McGraw-Hill educational and professional materials.**
- **The Company provides information via various media platforms: books, magazines and newsletters; on-line; via television, satellite and FM sideband broadcast; and software, videotape, facsimile and CD-ROM products.**
- **The Company now creates more than 90 % of its information on digital platforms and its business units are represented on more than 75 Web sites.**

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Business Mission: FDX Corporation (FedEx diversified firm)

- FDX is composed of a powerful <u>family of companies</u>: FedEx, RPS, Viking Freight, FDX Global Logistics and Roberts Express.
- These companies offer logistics and distribution solutions on a regional, national and global scale: fast, reliable, time-definite express delivery; . . . expedited same-day delivery; . . . ; and integrated information and logistics solutions
- With all this expertise under one umbrella, the FDX companies can provide businesses with the competitive advantage they need by providing streamlined solutions that are on the cutting edge of technology.

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Example: Mission Statement

Pfizer

Pfizer is a research-based, global pharmaceutical company.

We discover and develop innovative, value-added products that improve the quality of life of people around the world and help them enjoy longer, healthier, and more productive lives.

The company has three business segments: health care, animal health and consumer health care. Our products are available in more than 150 countries.

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Example: Mission Statement

Ritz-Carlton Hotels

The Ritz-Carlton Hotel is a place where the genuine care and comfort of our guests is our highest mission.

We pledge to provide the finest personal service and facilities for our guests who will always enjoy a warm, relaxed yet refined ambiance.

The Ritz-Carlton experiences enlivens the senses, instills well-being, and fulfills even the unexpressed wishes and needs of our guests.

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Example: Mission Statement

Apple Computer

Apple Computer, Inc., ignited the personal computer revolution in the 1970s with the Apple II, and reinvented the personal computer in the 1980s with the Macintosh.

Apple is now committed to its original mission--to bring the best personal computing products and support to students, educators, designers, scientists, engineers, business persons and consumers in over 140 countries around the world.

Example: Mission Statement

The Gillette Company

The Gillette Company is a globally focused consumer products company that seeks competitive advantage in quality, value-added personal care and personal use products. We compete in four large, worldwide businesses: personal grooming products, consumer portable power products, stationery products and small electrical appliances.

As a company, we share skills and resources among business units to optimize performance. We are committed to a plan of sustained sales and profit growth that recognizes and balances both short- and long-term objectives.

Example: Mission Statement

The Gillette Company

Our *mission* is to achieve or enhance clear leadership, worldwide, in the existing or new core consumer product categories in which we choose to compete. Current core categories are:

- Male grooming products - blades and razors, electric shavers, shaving preparations and deodorants . . .
- Female grooming products - wet shaving products, hair removal and hair care appliances and deodorants . . .
- Alkaline and specialty batteries and cells.
- Writing instruments and correction products.
- Certain areas of the oral care market - toothbrushes . . .
- Selected areas of the high-quality small household appliance business - coffeemakers . . .

Examples: Mission and Vision Statements

Microsoft

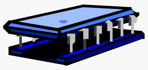
Microsoft Corporation

Empower people through great software anytime, anyplace, and on any device.

Examples: Mission and Vision Statements

intel

Intel



Our *vision*: Getting to a billion connected computers worldwide, millions of servers, and trillions of dollars of e-commerce. Intel's core *mission* is being the building block supplier to the Internet economy and spurring efforts to make the Internet more useful. Being connected is now at the center of people's computing experience. We are helping to expand the capabilities of the PC platform and the Internet.

Mission Statements for Functional Departments

- Spotlights department's
  - ***Role*** and ***scope of activities***
  - ***Direction*** which department needs to pursue
  - ***Contribution*** to firm's overall mission

Mission Statements of Functional Departments

HUMAN RESOURCES

To contribute to organizational success by developing effective leaders, creating high performance teams, and maximizing the potential of individuals.

CORPORATE SECURITY

To provide services for the protection of corporate personnel and assets through preventive measures and investigations.

Why is a Strategic Vision Important?

- A managerial imperative exists to ***look beyond*** *today* and ***think strategically*** about
  - Impact of new technologies
  - How customer needs and expectations are changing
  - What it will take to outrun competitors
  - Which promising market opportunities ought to be aggressively pursued
  - External and internal factors driving what a company needs to do to prepare for the future

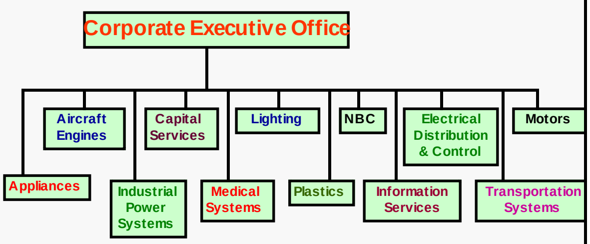
What is Strategy?

(Corporate Level Strategy)

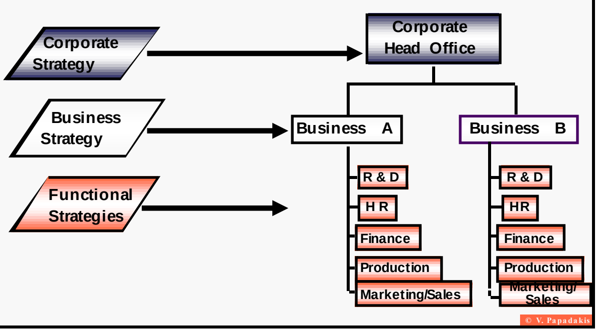
Papadakis, Chapters 6 and 7

Corporate Strategy

General Electric's Business Units, 2004



Three Levels of Strategy



LEVELS OF STRATEGY (1)

Corporate Level strategic decisions are concerned with:

- overall purpose and scope
- adding value to shareholder investment
- portfolio issues
- resource allocation between SBUs
- structure and control of SBUs
- corporate financial strategy

LEVELS OF STRATEGY (2)

Business Unit strategy is concerned with:

- competitive strategy
- developing market opportunities
- developing new products/services
- resource allocation within the SBU
- structure and control of the SBU

LEVELS OF STRATEGY (3)

Operational Strategies are concerned with:

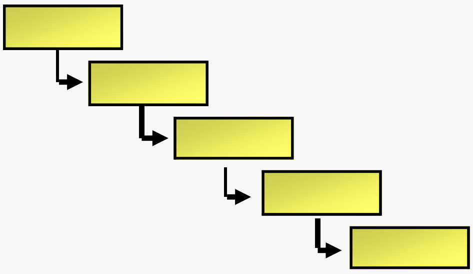
- the integration of resources, processes, people and skills
- to implement strategy

Growth Strategies

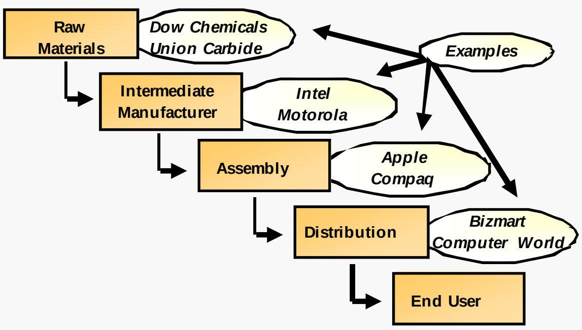
- Vertical Integration
- Horizontal Integration
- Related Diversification
- Unrelated Diversification
- Market Penetration
- New Market Growth
- New Product Development

Vertical Integration

- Vertical Integration Defined



The Raw Material to Consumer Value Chain in the PC Industry



The Costs and Benefits of Vertical Integration: BENEFITS

- Technical economies from integrating processes e.g. iron and steel production
  - -- but doesn't necessarily require common ownership
- Superior coordination
- Avoids transactions costs of market contracts from:
  - -- small numbers of firms
  - -- transaction-specific investments
  - -- opportunism and strategic misrepresentation
  - -- taxes and regulations on market transactions

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The Costs and Benefits of Vertical Integration: COSTS

- Differences in optimal scale of operation between different stages prevents balanced VI
- Strategic differences between different vertical stages creates management difficulties
- Inhibits development of and exploitation of core competencies
- Limits flexibility -- in responding to demand cycles
  -- in responding to changes in technology, customer preferences, etc.

  (But VI may be conducive to *system-wide flexibility)*
- Compounding of risk

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When is Vertical Integration More Attractive than Outsourcing?

How many firms are available to undertake the activities?	→	The fewer the companies the more attractive is VI
Is transaction-specific investment needed?	→	If yes, VI more attractive
Does limited information permit cheating?	→	VI can limit opportunism
Are taxes or regulation imposed on transactions?	→	VI can avoid them
Do the two stages have similar optimal scale of operation?	→	Greater the similarity, the more attractive is VI
Are the two stages strategically similar?	→	Greater the strategic similarity ---the more attractive is VI
How uncertain is market demand?	→	Greater the unpredictability ----the more costly is VI
Does VI increase risk?	→	If heavy investment required and risks between stages are inter-related----VI increases risk.

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Designing Vertical Relationships: Long-Term Contracts and Quasi-Vertical Integration

- Intermediate between spot transactions and vertical integration are several types of vertical relationships ---such relationships may combine benefits of both market transactions and internalization
- Key issues in designing vertical relationships
  - -- How is risk allocated between the parties?
  - -- Are the incentives appropriate?

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Recent Trends in Vertical Relationships

- From *competitive contracting* to *supplier partnerships,* e.g. in autos
- From vertical integration to outsourcing (not just components, also IT, distribution, and administrative services).
- Diffusion of franchising
- Technology partnerships (e.g. IBM- Apple; Canon- HP)
- Inter-firm networks

General conclusion:- boundaries between firms and markets becoming increasingly blurred.

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Diversification Strategy

OUTLINE

- Introduction: The Basic Issues
- The Trend over Time
- Motives for Diversification
  - - Growth and risk spreading
  - - Diversification and Shareholder Value: Porter's Three Essential Tests.
- Competitive Advantage from Diversification
- Diversification and Performance: Empirical Evidence
- Relatedness in Diversification

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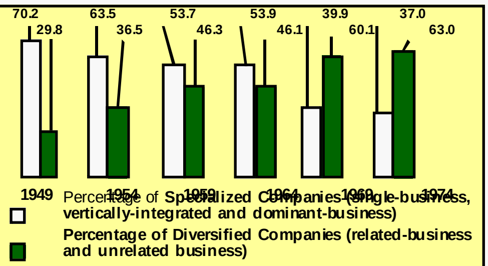
Introduction: The Basic Issues

Diversification decisions involve two basic issues:

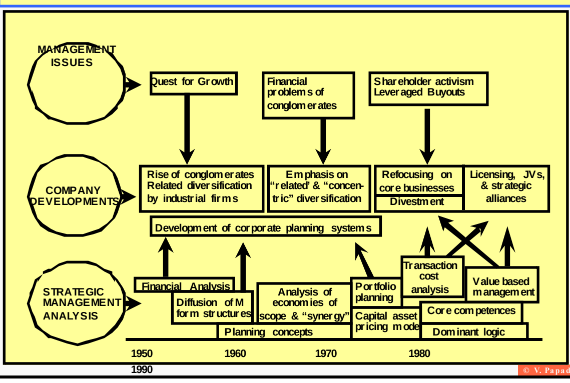
- ***Is the industry to be entered more attractive than the firm's existing business?***
- ***Can the firm establish a competitive advantage within the industry to be entered? (i.e. what synergy's exist between the core business and the new business?)***

The Trend Over Time: Diversified Companies among the Fortune 500



BUT **Since late 1970's, diversification has declined.**

Corporate Strategy & Diversification: A Time-Line of Management Thought & Practice



Motives for Diversification

GROWTH	--The desire to escape stagnant or declining industries has been one of the most powerful motives for diversification (tobacco, oil, defense).
	--*But*, growth satisfies *management* not *shareholder* goals.
	--Growth strategies (esp. by acquisition), tend to destroy shareholder value
RISK SPREADING	--Diversification reduces variance of profit flows
	--*But*, does not normally create value for shareholders, since shareholders can hold diversified portfolios.
	--Capital Asset Pricing Model shows that diversification lowers *unsystematic risk* not *systematic risk*.
PROFIT	--For diversification to create shareholder value, the act of bringing different businesses under common ownership & must somehow increase their profitability.

Diversification and Shareholder Value: Porter's Three Essential Tests

If diversification is to create shareholder value, it must meet three tests:

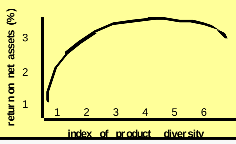
1. *The Attractiveness Test*: diversification must be directed towards actual or potentially-attractive industries.

2. *The Cost of Entry Test*: the cost of entry must not capitalize all future profits.

3. *The Better-Off Test*: either the new unit must gain competitive advantage from its link with the corporation, or vice-versa. (i.e. *synergy* must be present)

Diversification and Performance: Empirical Evidence

- Diversification trends have been driven by ***beliefs*** rather than evidence:- 1960s and 70s diversification believed to be profitable; 1980s and 90s diversification seen as value destroying.
- Empirical evidence inconclusive-- no consistent findings on impact of diversification on profitability, or on related vs. unrelated diversification.
- Some evidence that high levels of diversification detrimental to profitability
- Diversifying acquisitions, on average, destroy shareholder value for acquirers
- Refocusing generates positive shareholder returns



Competitive Advantage from Diversification

MARKET POWER	• Predatory pricing • Reciprocal buying • Mutual forbearance	Evidence of these is sparse
ECONOMIES OF SCOPE	• Sharing tangible resources (research labs, distribution systems) across multiple businesses • Sharing intangible resources (brands, technology) across multiple businesses • Transferring functional capabilities (marketing, product development) across businesses • Applying general management capabilities to multiple businesses	
ECONOMIES FROM INTERNALIZING TRANSACTIONS	• Economies of scope not a sufficient basis for diversification ----must be supported by transaction costs • Diversification firm can avoid transaction costs by operating internal capital and labor markets • Key advantage of diversified firm over external markets--- superior access to information	

Relatedness in Diversification

Synergy in diversification derives from two main types of relatedness:

- *Operational Relatedness*-- synergies from sharing resources across businesses (common distribution facilities, brands, joint R&D)
- *Strategic Relatedness*-- synergies at the corporate level deriving from the ability to apply common management capabilities to different businesses.

Problem of operational relatedness:- the benefits in terms of economies of scope may be dwarfed by the administrative costs involved in their exploitation.

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The Determinants of Strategic Relatedness

CORPORATE MANAGEMENT TASKS	DETERMINANTS OF STRATEGIC SIMILARITY
Resource Allocation	-Similar sizes of capital investment projects -Similar time spans of investment projects -Similar sources of risk -Similar management capabilities required by different businesses
Strategy Formulation	-Similar key success factors -Businesses are at similar stages of their industry life cycles -Similar competitive positions occupied by each business within its industry
Monitoring & Control of Business Units	-Similar performance goals & performance variables -Similar time horizons for performance targets

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Adding Value by Diversification

Diversification most effectively adds value by either of two mechanisms:

- By developing economies of scope between business units in the firms which leads to synergistic benefits
- By developing market power which leads to greater returns

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Alternative Diversification Strategies

Related Diversification Strategies

- Sharing Activities
- Transferring Core Competencies

Unrelated Diversification Strategies

- Efficient Internal Capital Market Allocation
- Restructuring

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Alternative Diversification Strategies
Sharing Activities

Key Characteristics:

- Sharing Activities often lowers costs or raises differentiation

  Example: Using a common physical distribution system and sales force such as Procter & Gamble's disposable diaper and paper towel divisions

- Sharing Activities can lower costs if it:
  - **Achieves economies of scale**
  - **Boosts efficiency of utilization**
  - **Helps move more rapidly down Learning Curve**

  Example: General Electric's costs to advertise, sell and service major appliances are spread over many different products

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Alternative Diversification Strategies
Sharing Activities

Key Characteristics:

- Sharing Activities can enhance potential for or reduce the cost of differentiation

  Example: Shared order processing system may allow new features customers value or make more advanced remote sensing technology available

- Must involve activities that are crucial to competitive advantage

  Example: Procter & Gamble's sharing of sales and physical distribution for disposable diapers and paper towels is effective because these items are so bulky and costly to ship

Alternative Diversification Strategies
Sharing Activities

Assumptions:

- Strong sense of corporate identity
- Clear corporate mission that emphasizes the importance of integrating business units
- Incentive system that rewards more than just business unit performance

Alternative Diversification Strategies

Related Diversification Strategies

- Sharing Activities
- Transferring Core Competencies

Unrelated Diversification Strategies

- Efficient Internal Capital Market Allocation
- Restructuring

Alternative Diversification Strategies
Transferring Core Competencies

Key Characteristics:

- Exploits ***Interrelationships*** among divisions
- Start with ***Value Chain*** analysis
  - Identify ability to transfer skills or expertise among similar value chains
  - Exploit ability to ***transfer activities***

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Alternative Diversification Strategies
Transferring Core Competencies

Assumptions:

Transferring Core Competencies leads to competitive advantage only if the similarities among business units meet the following conditions:

- Activities involved in the businesses are similar enough that sharing expertise is meaningful
- Transfer of skills involves activities which are important to competitive advantage
- The skills transferred represent significant sources of competitive advantage for the receiving unit

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Alternative Diversification Strategies

Related Diversification Strategies

- Sharing Activities
- Transferring Core Competencies

Unrelated Diversification Strategies

- Efficient Internal Capital Market Allocation
- Restructuring

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Alternative Diversification Strategies
Efficient Internal Capital Market Allocation

Key Characteristics:

Firms pursuing this strategy frequently diversify by acquisition:

- Acquire sound, attractive companies
- Acquired units are autonomous
- Acquiring corporation supplies needed capital
- Portfolio managers transfer resources from units that generate cash to those with high growth potential and substantial cash needs
- Add professional management & control to sub-units
- Sub-unit managers compensation based on unit results

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Alternative Diversification Strategies
Efficient Internal Capital Market Allocation

Assumptions:

- Managers have more detailed knowledge of firm relative to outside investors
- Firm need not risk competitive edge by disclosing sensitive competitive information to investors
- Firm can reduce risk by allocating resources among diversified businesses, although shareholders can generally diversify more economically on their own

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Alternative Diversification Strategies

Related Diversification Strategies

- Sharing Activities
- Transferring Core Competencies

Unrelated Diversification Strategies

- Efficient Internal Capital Market Allocation
- Restructuring

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Alternative Diversification Strategies
Restructuring

Key Characteristics:

- Seek out undeveloped, sick or threatened organizations or industries
- Parent company (acquirer) intervenes and frequently:
  - Changes sub-unit management team
  - Shifts strategy
  - Infuses firm with new technology
  - Enhances discipline by changing control systems
  - Divests part of firm
  - Makes additional acquisitions to achieve critical mass
- Frequently sell unit after making one-time changes since parent no longer adds value to ongoing operations

Alternative Diversification Strategies
Restructuring

Assumptions:

- Requires keen management insight in selecting firms with depressed values or unforeseen potential
- Must do more than restructure companies
- Need to initiate restructuring of industries to create a more attractive environment

Incentives to Diversify

External Incentives:

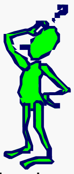
- Relaxation of Anti-Trust regulation allows more related acquisitions than in the past
- Before 1986, higher taxes on dividends favored spending retained earnings on acquisitions
- After 1986, firms made fewer acquisitions with retained earnings, shifting to the use of debt to take advantage of tax deductible interest payments

Internal Incentives:

- Poor performance may lead some firms to diversify to attempt to achieve better returns

When to Diversify?

- ***When it makes sense to diversify*** depends on
  - ***Growth potential*** in present business
  - Attractiveness of opportunities to ***transfer*** existing ***competencies*** to new businesses
  - Potential ***cost-saving opportunities*** to be realized by entering related businesses
  - ***Availability*** of adequate financial and organizational ***resources***
  - ***Managerial expertise*** to cope with complexity of operating a multi-business enterprise



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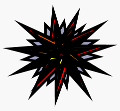
Why Diversify?

- To build ***shareholder value***
  - **Make 2 + 2 = 5**
- Diversification is ***capable*** of increasing ***shareholder value*** if it passes three tests:
  1. Attractiveness Test
  2. Cost of Entry Test
  3. Better-Off Test



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Attractiveness of Related Diversification

What makes related diversification attractive is the opportunity to turn strategic fit into competitive advantage!

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Common Approaches to Related Diversification

- Sharing of sales force, advertising, or distribution activities
- Exploiting closely related technologies
- Transferring know-how and expertise from one business to another
- Transferring brand name and reputation to a new product/service
- Acquiring new businesses to uniquely help firm's position in existing businesses

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Benefits of Related Diversification

- Preserves ***unity*** in its business activities
- Reap ***competitive advantage*** benefits of
  - Skills transfer
  - Lower costs
  - Common brand name usage
- ***Spread*** investor ***risks*** over a broader base
- Achieve ***consolidated performance*** greater than the sum of what individual businesses can earn operating independently

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Concept: Economies of Scope

- Arise from ability to ***eliminate costs*** by operating two or more businesses under same corporate umbrella
- Exist when it is ***less costly*** for two or more businesses to operate under centralized management than to function independently
- ***Cost saving*** opportunities can stem from interrelationships anywhere along businesses' ***value chains***

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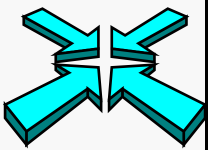
Concept: Strategic Fit

- Exists among different businesses when their ***value chains*** are sufficiently ***similar*** to offer opportunities
- Offers ***competitive advantage potential*** of
  - ***Lower costs***
  - Efficient ***transfer*** of
    - Key skills
    - Technological expertise
    - Managerial know-how
  - Use of a **common brand name**



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Technology Fits

- Offer potential for sharing common technology or transferring technological know-how
- Potential benefits
  - Cost-savings in technology development and new product R&D
  - Shorter times in getting new product to market
  - Interdependence between resulting products leads to increased sales
  - Technology-transfer allows more efficient performance of value chain activities

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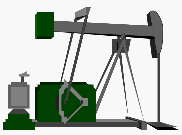
Operating Fits

- Offer potential for activity sharing or skills transfer
  - Procuring materials
  - Conducting R&D
  - Improving production processes
  - Manufacturing components
  - Assembling finished goods
  - Performing administrative support functions



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Potential Benefits of Operating Fits

- Cost savings
- Tapping into more scale economies and/or economies of scope
- Increased operating efficiency
- Most important skills transfer opportunities
  - If supply chain management or manufacturing expertise can benefit another business

Distribution and Customer-Related Fits

- Arise when value chains of different businesses overlap so products are
  - Used by same customers
  - Distributed through common dealers and retailers
  - Marketed or promoted in similar ways
  - Sold under a common brand name

Potential Benefits of Distribution and Customer-Related Fits

- Single sales force for related products
- Advertising related products together
- Use of common brand name
- Joint delivery and shipping
- Combining after-sale service and repair work
- Joint order processing and billing
- Joint promotional tie-ins
  - Cents-off couponing, trial offers, specials
- Combining dealer networks

Managerial Fits

- Emerge when different business units require comparable types of
  - Entrepreneurial know-how
  - Administrative know-how
  - Operating know-how
- Allow accumulated managerial know... one business to be useful in managi... another business

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Capturing Benefits of Strategic Fit

- ***Benefits don't occur by themselves !***
  - Businesses with sharing potential must be reorganized to coordinate activities
  - Means must be found to make skills transfer effective
- Benefits of some ***strategic coordination*** must exist to justify sacrificing business-unit autonomy
- ***Competitive advantage*** potential exists
  - To expand resources and strategic assets and
  - To create new ones faster and cheaper than rivals

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Comment: Trend in Diversification

The present *trend toward narrower diversification* has been driven by a growing preference to gear diversification around creating strong competitive positions in a few, well-selected industries as opposed to scattering corporate investments across many industries!

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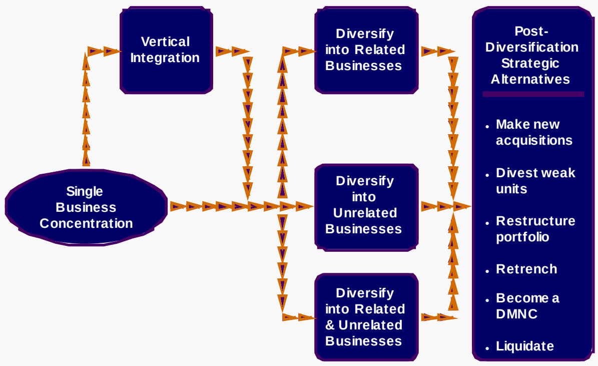
Strategic Management Principle

To create shareholder value, a diversifying firm must get into businesses that can perform ***better*** under common management than they could perform operating as independent stand-alone enterprises!

Corporate Strategy Alternatives



Strategies in Action

Intensive Strategies

- Market penetration
- Market development
- Product development

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Strategies in Action

Market Penetration

Defined

- Seeking increased market share for present products or services in present markets through greater marketing efforts

Example

- Ameritrade, the on-line broker, tripled its annual advertising expenditures to $200 million to convince people they can make their own investment decisions.

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Strategies in Action

Guidelines for Market Penetration

- ✓ Current markets not saturated
- ✓ Usage rate of present customers can be increased significantly
- ✓ Market shares of competitors declining while total industry sales increasing
- ✓ Increased economies of scale provide major competitive advantages

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Strategies in Action

Market Development

Defined

- Introducing present products or services into new geographic area

Example

- Britain's leading supplier of buses, Henlys PLC, acquires Blue Bird Corp. North America's leading school bus maker.

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Strategies in Action

Guidelines for Market Development

- ✓ New channels of distribution that are reliable, inexpensive, and good quality
- ✓ Firm is very successful at what it does
- ✓ Untapped or unsaturated markets
- ✓ Capital and human resources necessary to manage expanded operations
- ✓ Excess production capacity
- ✓ Basic industry rapidly becoming global

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Strategies in Action

Product Development

Defined

- Seeking increased sales by improving present products or services or developing new ones

Example

- Apple developed the G4 chip that runs at 500 megahertz.

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Strategies in Action

Guidelines for Product Development

- ✓ Products in maturity stage of life cycle
- ✓ Competes in industry characterized by rapid technological developments
- ✓ Major competitors offer better-quality products at comparable prices
- ✓ Compete in high-growth industry
- ✓ Strong research and development capabilities

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Strategies in Action

Diversification Strategies

- Concentric diversification
- Conglomerate diversification
- Horizontal diversification

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Strategies in Action

Concentric Diversification

Defined

- Adding new, but related, products or services

Example

- National Westminister Bank PLC in Britain bought the leading British insurance company, Legal & General Group PLC.

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Strategies in Action

Guidelines for Concentric Diversification

- ✓ Competes in no- or slow-growth industry
- ✓ Adding new & related products increases sales of current products
- ✓ New & related products offered at competitive prices
- ✓ Current products are in decline stage of the product life cycle
- ✓ Strong management team

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Strategies in Action

Conglomerate Diversification

Defined

- Adding new, unrelated products or services

Example

- H&R Block, the top tax preparation agency, said it will buy discount stock brokerage Olde Financial for $850 million in cash.

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Strategies in Action

Guidelines for Conglomerate Diversification

- ✓ Declining annual sales and profits
- ✓ Capital and managerial talent to compete successfully in a new industry
- ✓ Financial synergy between the acquired and acquiring firms
- ✓ Exiting markets for present products are saturated

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Strategies in Action

Retrenchment

Defined

- Regrouping through cost and asset reduction to reverse declining sales and profit

Example

- Singer, the sewing machine company, declared bankruptcy.

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Strategies in Action

Guidelines for Retrenchment

- ✓ Firm has failed to meet its objectives and goals consistently over time but has distinctive competencies
- ✓ Firm is one of the weaker competitors
- ✓ Inefficiency, low profitability, poor employee morale, and pressure from stockholders to improve performance.
- ✓ When an organization's strategic managers have failed
- ✓ Very quick growth to large organization where a major internal reorganization is needed.

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Strategies in Action

Divestiture

Defined

- Selling a division or part of an organization

Example

- Harcourt General, the large US publisher, is selling its Neiman Marcus division.

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Strategies in Action

Guidelines for Divestiture

- ✓ When firm has pursued retrenchment but failed to attain needed improvements
- ✓ When a division needs more resources than the firm can provide
- ✓ When a division is responsible for the firm's overall poor performance
- ✓ When a division is a misfit with the organization
- ✓ When a large amount of cash is needed and cannot be obtained from other sources.

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Strategies in Action

Liquidation

Defined

- Selling all of a company's assets, in parts, for their tangible worth

Example

- Ribol sold all its assets and ceased business.

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Strategies in Action

Guidelines for Liquidation

- ✓ When both retrenchment and divestiture have been pursued unsuccessfully
- ✓ If the only alternative is bankruptcy, liquidation is an orderly alternative
- ✓ When stockholders can minimize their losses by selling the firm's assets

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Strategy Alternatives for a Company Looking to Diversify

Strategy Options for a Company Looking to Diversify

Diversify into Related Businesses

- Build shareholder value by capturing cross-business strategic fits
  - Transfer skills and capabilities from one business to another
  - Share facilities or resources to reduce costs
  - Leverage use of a common brand name
  - Combine resources to create new competitive strengths and capabilities

Diversify into Unrelated Businesses

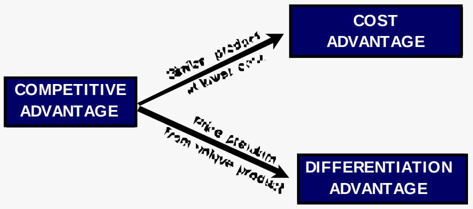
- Spread risks across diverse businesses
- Build shareholder value by doing a superior job of choosing businesses to diversify into and of managing the whole collection of businesses in the company's portfolio

Diversify into Both Related and Unrelated Businesses

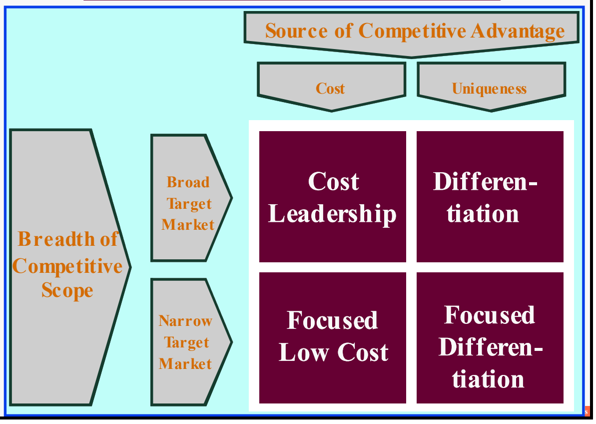
Competitive Strategy

Papadakis, Chapter 8

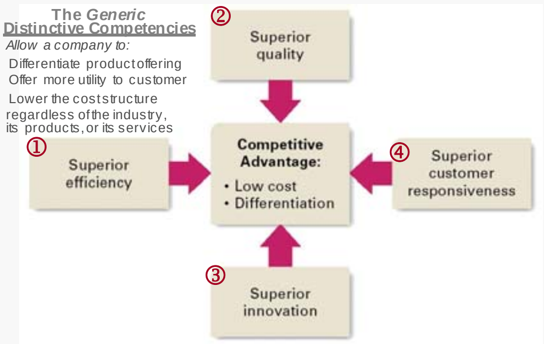
Sources of Competitive Advantage



Generic Business Level Strategies



Building Blocks of Competitive Advantage



① Efficiency

- Measured by the quantity of inputs it takes to produce a given output:

  Efficiency = Outputs / Inputs

- Productivity leads to greater efficiency and lower costs:
  - Employee productivity
  - Capital productivity

Superior efficiency helps a company attain a competitive advantage through a lower cost structure.

② Quality

Quality products are goods and services that are:

- Reliable *and*
- Differentiated by attributes that customers perceive to have higher value

The impact of quality on competitive advantage:

- High-quality products ***differentiate*** and increase the value of the products in customers' eyes.
- Greater efficiency and lower unit costs are associated with reliable products.

Superior quality = customer perception of greater value in a product's attributes
Form, features, performance, durability, reliability, style, design

③ Innovation

Innovation is the act of creating new products or new processes

- Product innovation
  - Creates products that customers perceive as more valuable *and*
  - Increases the company's pricing options
- Process innovation
  - Creates value by lowering production costs

Successful innovation can be a major source of competitive advantage – by giving a company something ***unique,*** something its competitors lack.

④ Responsiveness to Customers

Identifying and satisfying customers' needs – *better than the competitors*

- Superior quality and innovation are integral to superior responsiveness to customers.
- Customizing goods and services to the unique demands of individual customers or customer groups.

Enhanced customer responsiveness
Customer response time, design, service, after-sales service and support

Superior responsiveness to customers differentiates a company's products and services and leads to brand loyalty and premium pricing.

Cost Leadership Business Level Strategy

Requirements:

Constant effort to reduce costs through:

- Building efficient scale facilities
- Tight control of production costs and overhead
- Minimizing costs of sales, R&D and service
- State of the art manufacturing facilities
- Monitoring costs of activities provided by outsiders
- Simplification of processes

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How to Obtain a Cost Advantage

1. Determine and Control Cost Drivers
2. Reconfigure the ***Value Chain*** as needed

- Alter production process
- Change in automation
- New distribution channel
- New advertising media
- Direct sales in place of indirect sales
- New raw material
- Forward integration
- Backward integration
- Change location relative to suppliers or buyers

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Choices That Drive Costs

- Economies of scale
- Asset utilization
- Capacity utilization pattern
  - Seasonal, cyclical
- Interrelationships
  - Order processing and distribution
- Value chain linkages
  - Advertising & Sales
  - Logistics & Operations
- Product features
- Performance
- Mix & variety of products
- Service levels
- Small vs. large buyers
- Process technology
- Wage levels
- Product features
- Hiring, training, motivation

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Major Risks of Cost Leadership Business Level Strategy

- **Dramatic technological change could take away your cost advantage**
- **Competitors may learn how to imitate Value Chain**
- **Focus on efficiency could cause Cost Leader to overlook changes in customer preferences**

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Differentiation Business Level Strategy

Key Criteria:

- Value provided by unique features and value characteristics
- Command premium price
- High customer service
- Superior quality
- Prestige or exclusivity
- Rapid innovation

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Drivers of Differentiation

Examples:

- Unique product features
- Unique product performance
- Exceptional services
- New technologies
- Quality of inputs
- Exceptional skill or experience
- Detailed information

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Major Risks of a Differentiation Business Level Strategy

- **Customers may decide that the cost of "uniqueness" is too great**
- **Competitors may learn how to imitate Value Chain**
- **The means of uniqueness may no longer be valued by customers**

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Approach 2: Revamping the Value Chain

- Simplify product design
- Offer basic, no-frills product/service
- Shift to a simpler, less capital-intensive, or more streamlined technological process
- Find ways to bypass use of high-cost raw materials
- Use direct-to-end user sales/marketing approaches
- Relocate facilities closer to suppliers or customers
- Reengineer core business processes---be creative in finding ways to eliminate value chain activities
- Use PC technology to delete works steps, modify processes, cut out cost-producing activities

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Types of Differentiation Themes

- *Unique taste* -- Dr. Pepper
- *Special features* -- America Online
- *Superior service* -- FedEx, Ritz-Carlton
- *Spare parts availability* -- Caterpillar
- *More for your money* -- McDonald's, Wal-Mart
- *Engineering design and performance* -- Mercedes
- *Prestige* -- Rolex
- *Quality manufacture* -- Honda , Toyota
- *Technological leadership* -- 3M Corporation, Intel
- *Top-of-the-line image* -- Ralph Lauren, Chanel

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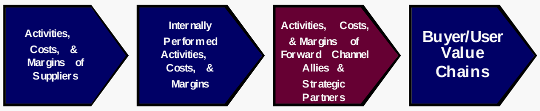
Where to Find Differentiation Opportunities in the Value Chain

- Purchasing and procurement activities
- Product R&D activities
- Production R&D; technology-related activities
- Manufacturing activities
- Outbound logistics and distribution activities
- Marketing, sales, and customer service activities



Competitive Strategy

Risks of the Generic Strategies

Risks of Cost Leadership	Risks of Differentiation	Risks of Focus
Cost leadership is not sustained • competitors imitate • technology changes • other bases for cost leadership erode	Differentiation is not sustained • competitors imitate • bases for differentiation become less important for buyers	The focus strategy is imitated The target segment becomes structurally unattractive • structure erodes • demand disappear
Proximity in differentiation is lost	Cost proximity is lost	Broadly targeted competitors overwhelm the segment • the segment's differences from other segments narrow • the advantages of a broad line increase
Cost focusers achieve even lower cost in segments	Differentiation focusers achieve even greater differentiation in segments	New focusers sub segment the industry

Choosing a Generic Business-Level Strategy (Continued)

Table 6.1: Product/Market/ Distinctive-Competency Choices and Generic Competitive Strategies

	Cost Leadership	Differentiation	Focus
Product Differentiation	Low (Principally by Price)	High (Principally by Uniqueness)	**Low to High (Price or Uniqueness)**
Market Segmentation	Low (Mass Market)	High (Many Market Segments)	**Low (One or a Few Segments)**
Distinctive Competency	Manufacturing and Materials Management	R&D, Sales and Marketing	**Any Kind of Distinctive Competency**

Mergers and Acquisitions

Papadakis, Chapter 10

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Mergers & Acquisitions Defined

Mergers

Acquisitions

- two firms are combined on a relatively co-equal basis

- one firm buys another firm

- the words are often used interchangeably even though they mean something very different
- merger sounds more amicable, less threatening

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Mergers & Acquisitions Defined

Mergers

- parent stocks are usually retired and new stock issued
- name may be one of the parents' or a combination
- one of the parents usually emerges as the dominant management

Acquisitions

- can be a controlling share, a majority, or all of the target firm's stock
- can be friendly or hostile
- usually done through a tender offer

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Do Mergers and Acquisitions Create Value?

The Empirical Evidence

M&A Activity creates value, on average, as follows:

Acquiring Firms
- no value created

Target Firms
- value increases by about 25%

- related M&A activity creates more value than unrelated M&A activity

M&A activity creates value, but target firms capture it

Do Mergers and Acquisitions Create Value?

Expected versus Operational Value

April 2000: Wells Fargo offers to acquire First Security Bank for about $3 billion

Expected

The Deal:

Stock values were:
Wells Fargo: $43.69
First Security: $15.50

.355 shares of WF for each share of FS stock

Wells Fargo: down $0.25 to $39.50
First Security: up $1.19 to $13.38

Operational

	Stock Price	Market Cap.
12/1999	$40.44	$65.7 B
12/2000	$56.69	$95.2 B
12/2001	$43.60	$74.0 B
12/2002	$46.87	$82.0 B
12/2003	$58.89	$100.0 B
12/2004	$62.15	$105.0 B

Why is M&A Activity So Prevalent?

If managers know that acquiring firms do not capture any value from M&A's, why do they continue to merge and acquire?

Survival
- avoid competitive disadvantage
- avoid scale disadvantages

Free Cash Flow
- cash generating, normal return investment

Why is M&A Activity So Prevalent?

If managers know that acquiring firms do not capture any value from M&A's, why do they continue to merge and acquire?

Agency Problems
- managers benefit from increases in size
- managers benefit from diversification

Managerial Hubris
- managers believe they can beat the odds

Why is M&A Activity So Prevalent?

If managers know that acquiring firms do not capture any value from M&A's, why do they continue to merge and acquire?

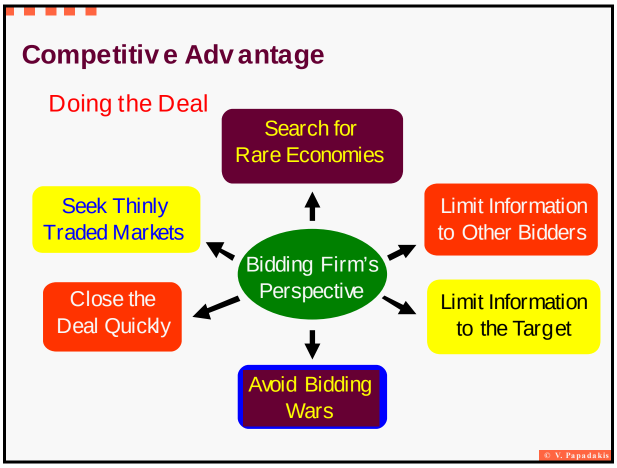
Above Normal Profits
- some M&A activity does generate above normal profits (expected and operational over the long run)
- proposed M&A activity may satisfy the logic of corporate level strategy
- managers may see economies that the market can't see

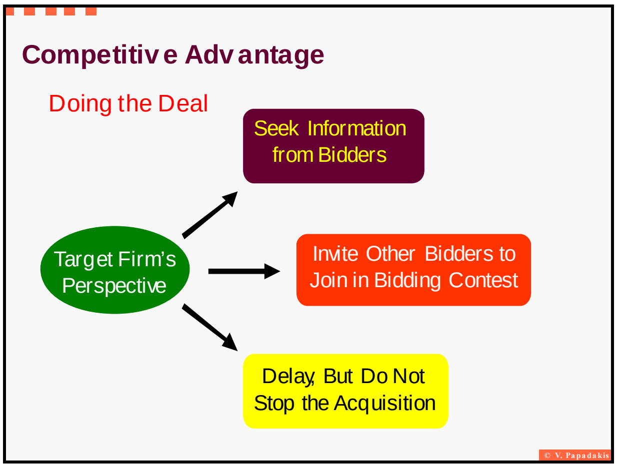
Competitive Advantage

Can an M&A strategy generate sustained competitive advantage?

Yes, if managers' abilities meet VRIO criteria

1. Managers may be good at recognizing & exploiting potentially value-creating economies with other firms
2. Managers may be good at doing 'deals'
3. Managers may be good at both





Attractive Acquisition Targets

- Companies with undervalued assets
  - Capital gains may be realized
- Companies in financial distress
  - May be purchased at bargain prices and turned around
- Companies with bright prospects but limited capital

Reasons for Acquisitions (1/2)

Increased Market Power

Acquisition intended to reduce the competitive balance of the industry

Overcome Barriers to Entry

Acquisitions overcome costly barriers to entry which may make "start-ups" economically unattractive

Lower Cost and Risk of New Product Development

Buying established businesses reduces risk of start-up ventures

Reasons for Acquisitions (2/2)

Increased Speed to Market

Closely related to Barriers to Entry, allows market entry in a more timely fashion

Diversification

Quick way to move into businesses when firm currently lacks experience and depth in industry

Avoiding Excessive Competition

Firms may acquire businesses in which competitive pressures are less intense than in their core business

Problems with Acquisitions

Integration Difficulties

Differing cultures can make integration of firms difficult

Inadequate evaluation of Target

"Winners Curse" bid causes acquirer to overpay for firm

Large or Extraordinary Debt

Costly debt can create onerous burden on cash outflows

Problems with Acquisitions

Inability to Achieve Synergy
Justifying acquisitions can increase estimate of expected benefits

Overly Diversified
Acquirer doesn't have expertise required to manage unrelated businesses

Managers Overly Focused on Acquisitions
Managers lose track of core business by spending so much effort on acquisitions

Too Large
Large bureaucracy reduced innovation and flexibility

Characteristics of Effective Acquisitions

Complementary Assets or Resources
Buying firms with assets that meet current needs to build competitiveness

Friendly Acquisitions
Friendly deals make integration go more smoothly

Careful Selection Process
Deliberate evaluation and negotiations is more likely to lead to easy integration and building synergies

Maintain Financial Slack
Provide enough additional financial resources so that profitable projects would not be foregone

Characteristics of Effective Acquisitions

Low-to-Moderate Debt
Merged firm maintains financial flexibility

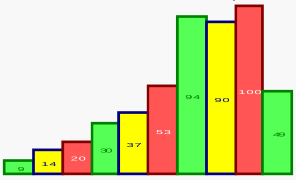
Flexibility
Has experience at managing change and is flexible and adaptable

Emphasize Innovation
Continue to invest in R&D as part of the firm's overall strategy

Why we need a systematic approach

More and More M&A Activity

(Data From Thomson Financial)



Relative Size of M&A Activity
1992-2001
1.7 Trillion spent in 2000 in US

- Key reasons why more M&A activity:
  - Strong economy producing investment capital
  - Technology explosion, complementary products, and speed to market
  - Regulatory changes
  - Globalization & geographic expansion
  - Synergies

Most M&A's Fail to Deliver

- ***Michael Porter, 1987:***
  - Studied 33 large, prestigious U.S. companies 1950-1986
  - Most had divested many more acquisitions than they had kept
- ***Mercer/Business Week Study, 1995:***
  - 150 recent deals valued at $500MM+
  - Half destroyed shareholder wealth
- ***LaJoux, 1998:***
  - Cites 14 major studies on success and failure of M&A's
  - Reports failure rates from 40-80%

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Most M&A's Fail to Deliver

Business Week 1995:

- **Inadequate due diligence by the acquirer**
- **Lack of compelling strategic rationale**
- **Unrealistic expectations of possible synergies**
- **Paying too much**
- **Conflicting corporate cultures**
- **Failure to quickly meld the two companies**

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Most M&A's Fail to Deliver

SHRM/Towers 2001

- Inability to sustain financial performance (65%)
- Loss of productivity (60%)
- Incompatible cultures (55%)
- Clash of managerial styles or egos (53%)
- Slow decision making (51%)
- Wrong people selected for key jobs (50%)

Most M&A's Fail to Deliver

Business Week/Sirower, Oct 2002

- 61% of buyers destroyed their own shareholders' wealth. A year after their deals, the losers' average return was 25% below their industry peers
- Companies that paid for their acquisitions solely with stock –65% of these cases lagged behind their peers by 8%.
- The average premium was 36% above the seller's market price one week before the deal

Strategy Evaluation

Papadakis, Chapter 13

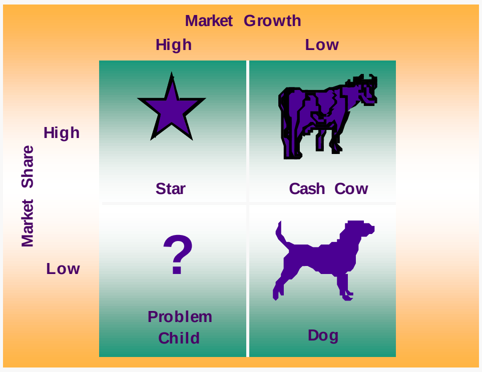
Corporate Strategy
Criteria for Evaluation

I.	Is the strategy identifiable and has it been made clear either in words or in practice?
II.	Does the strategy exploit fully domestic and international environment opportunity?
III.	Is the strategy consistent with corporate competence and resources, both present and projected?
IV.	Is the strategy and the program of major policies internally consistent?
V.	Is the chosen level of risk feasible in economic and personal terms?
VI.	Is the strategy appropriate to personal values and aspirations of the key managers?
VII.	Is the strategy appropriate to the desired level of contribution to society?
VIII.	Does the strategy constitute a clear stimulus to organizational effort and commitment?
IX.	Are there early indications of the responsiveness of markets and market segment to the strategy?

Portfolio Techniques for Strategic Decision Making

Papadakis, Chapter 15

The Growth-Share Matrix



Industry Attractiveness Factors

- Market size and projected growth
- Intensity of competition
- Emerging opportunities and threats
- Seasonal and cyclical factors
- Resource requirements
- Strategic fits and resource fits with present businesses
- Industry profitability
- Social, political, regulatory, and environmental factors
- Degree of risk and uncertainty

Procedure: Rating the Relative Attractiveness of Each Industry

Step 1: Select industry attractiveness factors

Step 2: Assign weights to each factor (sum of weights = 1.0)

Step 3: Rate each industry on each factor (use scale of 1 to 10)

Step 4: Calculate weighted ratings; sum to get an overall industry attractiveness rating for each industry

Example: Rating Industry Attractiveness

Industry Attractiveness Factor	Weight	Attractiveness Rating	Weighted Industry Rating
Market size and projected growth	0.15	5	0.75
Intensity of competition	0.30	8	2.40
Emerging industry opportunities and threats	0.05	2	0.10
Social, political, regulatory, and environmental factors	0.05	6	0.30
Seasonality and cyclical influences	0.05	4	0.20
Resource requirements	0.15	7	1.05
Industry profitability	0.15	4	0.60
Degree of risk and uncertainty	0.10	5	0.50
Sum of weights	1.00		
Industry attractiveness rating			5.90

Rating Scale: 1 = Unattractive; 10 = Very attractive

Internationalization strategies

Papadakis Chapter 9

Globalization of Markets

Basic Assumptions

- *Technology* is the major force that drives the world toward a *converging commonality*
- The result of this force is the emergence of *global markets* for standardized consumer products on a previously unimagined scale of magnitude
- This trend toward globalization is *the beginning of the end* for *multinational corporations*, only global firms will survive
- Our age can be characterized as '*The Republic of Technology (whose) supreme law … is convergence, the tendency for everything to become more like everything else* (**Daniel. J. Boorstin**)

The Myth of Globalization

Underlying Assumptions and Pitfalls

Homogenization of the world's wants

Pitfalls
- *Lack of evidence of homogenization.* Some industries developed indeed global products, but most did not.
- *Growth of intracountry segmentation price sensivity.* There still exists considerable diversity within and between countries.

Universal preference for low price at acceptable quality

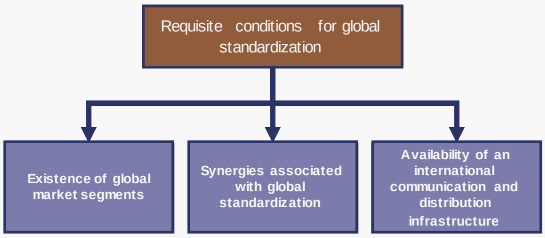
Pitfalls
- *Lack of evidence of increased price sensivity.* There is no evidence that customers are willing to trade off specific product features for a lower price.
- *Low price positioning is a highly vulnerable strategy.* Low price strategy in international markets offers no long-term competitive advantage.
- *Standardized low price can be overpriced in some countries and underpriced in others.*

Economies of scale of production and marketing

Pitfalls
- *Development in flexible factory automation.* Recent developments in flexible factory automation methods have lowered the minimum efficient scale of operation.
- *Production costs are often a minor component of total costs.* In many consumer and service industries, production costs are a small fraction of the total sum.
- *The standardization philosophy is primarily product driven.* It ignores key strategy variables

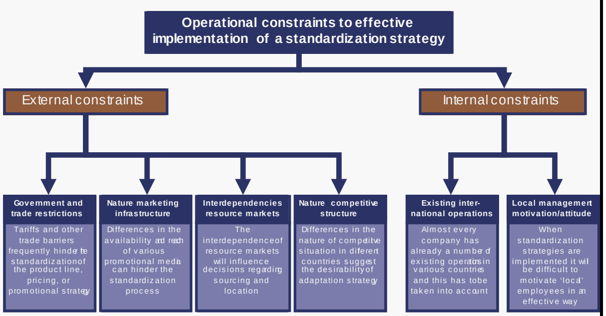
The Myth of Globalization

Requisite conditions for Global Standardization



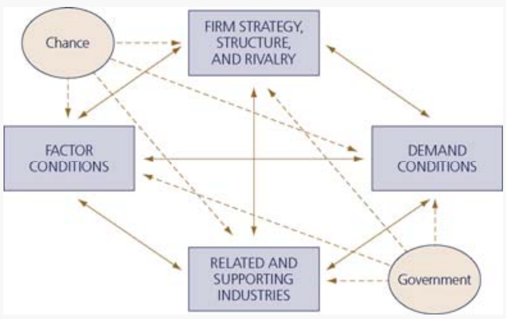
The Myth of Globalization

Operational Constraints



Competitive Advantage of Nations

The Diamond



Competitive Advantage of Nations

New Rules for Innovation

1. Sell to the most sophisticated and demanding buyers and channels
2. Seek out the buyers with the most difficult needs
3. Establish norms of exceeding the toughest regulatory hurdles or product standards
4. Source from the most advanced and international home-based suppliers
5. Treat employees as permanent
6. Establish outstanding competitors as motivators

Competitive Advantage of Nations

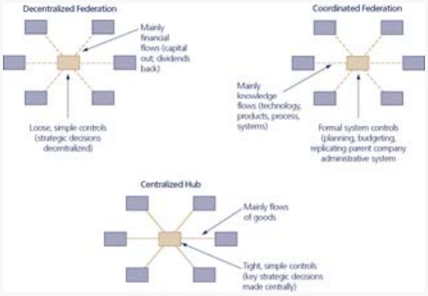
The Home Base Diamond

Transnational Management

International Structural Stages Model

Transnational Management

Organizational Configuration Models



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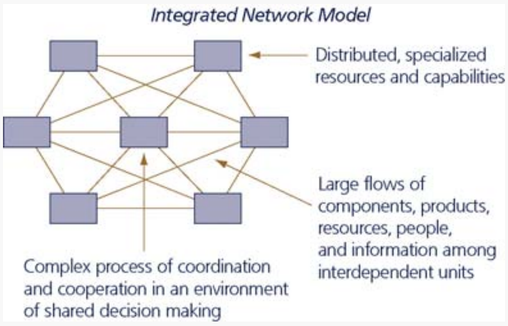
Transnational Management

Integrated Network Model



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The International Context

Influencing Factors in an International Context

1. Level of Nationalism
2. Size of Country
3. Preference for Central Decision-Making

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