Undergraduate Diploma in
Business Administration

# [Module 5 – Strategic Management]

## Lectures Title 7 :

**Selecting Corporate-Level Strategies
PART A**

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21 ACADEMY

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# Lecture 7 – Selecting Corporate-Level Strategies Part A

1. What is corporate-level strategy and how does it differ from business-level strategy?
2. What is vertical integration and what benefits can it provide?
3. What are the three types of diversification and when should they be used?
4. What are four methods that a firm can use to implement its corporate strategy?
5. What is portfolio planning and why is it useful?

# Intro: A Focus on Strategic Planning

- ***Strategic planning as a broad concept consists of*** *strategy formulation and strategy implementation*
- *Strategic planning in analytical in nature*
- *Strategic planning is done by top level management*
- *A strategic plan is different from a business plan.*

- ***Strategic planning is the art and science of***

- *A. creating specific business strategies*
- *B. implementing specific business strategies*
- *C. evaluating results of executed plans*

- ***in regard to a company's overall long-term goals or desires.***

# How To Create A Strategic Plan?

# Example Airbnb

- https://www.youtube.com/watch?v=4q5t2W-W2aE

- The preceding lectures focused on generic business-level, also referred to as generic competitive strategy: how firms compete head-to-head on products and services they offer.

- The intent is to develop strategies that provide a competitive advantage, so that buyers will purchase what a business has to offer instead of purchasing from a competitor.

- However, there are three types of strategy: business-level, corporate-level, and international strategy.

- In this session, the focus is on corporate-level strategy.
- Corporate-level strategy is a paradigm shift from business-level strategy.
- It asks: what businesses should the firm be in, and how can being in those businesses create synergy and improve performance?
- Diversification is the key in corporate strategy.
- There are several ways that a corporate diversification strategy can be implemented that will be examined here. The third and final type of strategy following business-level and corporate-level strategies is international strategy.

# Corporate-Level Strategy Defined

- Corporate Strategy
- Specifies actions taken by the firm to gain a competitive advantage by selecting and managing a group of different businesses in several industries and/or product markets.
- In corporate-level strategy, executives seek to answer two basic questions, and then three more detailed questions.

# A. What business(es) should we be in?

- With respect to the first question A, what business(es) should we be in, firms must ask:

1. *In what stage of the industry value chain should we participate?*
2. *What range of products and services should we offer?*
3. *Where geographically should we compete?*

# B. How should we manage the portfolio to achieve synergy/create value?

- Synergy in the business context means the cooperation or interaction of two or more business units so that they perform more effectively together than they would if independent.

- For example, if a larger company acquires a similar smaller company, some of the administrative overhead expenses such as accounting or human resources can be combined and operate more efficiently.

- Another synergy produced is overall reduced marketing expenses since they can market their products together.

- The foundational issue in *corporate-level strategy is diversification: how can the organization diversify, and in doing so, create synergy?*

- Diversification can address geographic questions, such as how Disney established theme parks in France, Japan, and China.

- Also, moving a firm into other industries, outside the home industry, is another way to diversify. Warren Buffet’s company Berkshire Hathaway owns businesses as diverse as real estate, insurance, and a railroad.

- Additionally, a firm may expand into business areas within its value chain, by acquiring suppliers upstream in the supply chain or distributors or retailers downstream.

- For example, when Disney launched its streaming service Disney+, it diversified downstream in its value chain to control and provide an outlet for the movie content it produced.

- The executives in charge of a firm such as The Walt Disney Company must decide whether to remain within their present domains or venture into new ones.

- In Disney's case, the firm has expanded from its original business (films) and into television, theme parks, cruise lines, and several others. In contrast, many firms never expand beyond their initial choice of industry.

- Disney executives could consider further diversifying geographically, diversifying into additional industries, and diversifying deeper into its value chain, for example, by acquiring some of its suppliers.

- In all these considerations, Disney needs to evaluate if and how synergy can be produced.

# Diversification

- There are a variety of reasons a company may consider diversification.
- Diversification strategies can help mitigate the risk of a company operating in only one industry.
- If an industry experiences issues or slows down, being in other industries can help soften the impact.
- Companies can also diversify within their own industry.

# There are three types of diversification:

1. Related Diversification - Diversifying into business lines in the same industry; Volkswagen acquiring Audi is an example.

2. Unrelated Diversification - Diversifying into new industries, such as Amazon entering the grocery store business with its purchase of Whole Foods.

3. Geographic Diversification - Operating in various geographic markets, which is the corporate strategy of Starbucks, Target, and KFC.

- In all three diversification strategies, the goal is to achieve synergy.

- How can the firm operate more efficiently and effectively through its diversification efforts?

# Three Tests for Diversification

- A proposed diversification move must first answer three questions to determine if it should be accepted or rejected (Porter, 1987).

1. *How attractive is the industry that a firm is considering entering?*

Unless the industry has strong profit potential, entering it may be very risky. Porter’s Five Forces Analysis can help with this assessment.

2. *How much will it cost to enter the industry?*

Executives need to be sure that their firm can recoup the expenses that it absorbs in diversifying. When Philip Morris bought 7Up, it paid four times what 7Up was actually worth. Making up these costs proved to be impossible and 7Up was sold less than 10 years later.

3. *Will the new unit and the firm be better off?*

Unless at least one side gains a competitive advantage, diversification should be avoided. In the case of Philip Morris and 7Up, for example, neither side benefited significantly from joining together.

# Related Diversification

- Related diversification occurs when a firm moves into a new industry that has important similarities with the firm's existing industry or industries.
- Because films and television are both aspects of entertainment, Disney's purchase of ABC is an example of related diversification.
- Some firms that engage in related diversification aim to develop and exploit a core competency to become more successful.
- A core competency is a skill set that is difficult for competitors to imitate, can be leveraged in different businesses, and contributes to the benefits enjoyed by customers within each business.

- Honda Motor Company provides a good example of leveraging a core competency through related diversification.

- Although Honda is best known for its cars and trucks, the company actually started out in the motorcycle business.

- Through competing in this business, Honda developed a unique ability to build small and reliable engines.

- When executives decided to diversify into the automobile industry, Honda was successful in part because it leveraged this ability within its new business.

- Honda also applied its engine-building skills in the all-terrain vehicle, lawn mower, and boat motor industries.

- Honda Case study https://www.youtube.com/watch?v=wlvog-Qd0zw

# Unrelated Diversification

- *"Don't put all your eggs in one basket"* is often a good motto for individual investors.
- By building a portfolio of stocks, an investor can minimize the chances of suffering a huge loss.
- Some executives take a similar approach.
- Rather than trying to develop synergy across businesses, they seek greater financial stability for their firms by owning an array of companies.
- Warren Buffett's Berkshire Hathaway has long enjoyed strong performance by purchasing companies and improving how they are run.

- Why would a soft-drink company buy a movie studio?

- It’s hard to imagine the logic behind such a move, but Coca-Cola did just this when it purchased Columbia Pictures for $750 million.

- This is a good example of unrelated diversification, which occurs when a firm enters an industry that lacks any important similarities with the firm’s existing industry or industries.

- Luckily for Coca-Cola, its investment paid off -Columbia was sold to Sony for $3.4 billion just seven years later

- Most unrelated diversification efforts, however, do not have happy endings.
- Harley-Davidson, for example, once tried to sell Harley-branded bottled water.
- Starbucks tried to diversify into offering Starbucks-branded furniture.
- Both efforts were disasters.
- Although Harley-Davidson and Starbucks both enjoy iconic brands, these strategic resources simply did not transfer effectively to the bottled water and furniture businesses.

# Geographic Diversification

- Firms may also diversify through expanding geographically.
- Starbucks and KFC have found success with international expansion as well as domestic expansion.
- Synergy is developed in several ways.
- Many of the administrative functions such as logistics, procurement, human resources, and legal can be consolidated at the corporate level, so they do not need to be duplicated at each location.
- New store development is also made easier. Having already developed new stores, the firm can establish a process that it has learned from previously establishing stores, and can implement this best practice to efficiently build out, equip, and supply new stores.

# Summary of Diversification

- https://www.youtube.com/watch?v=ZDExLnS9IC0

# Groups Activity

- Give a business example of a successful:

1. Related Diversification

2. Unrelated Diversification

3. Geographic Diversification

# Horizontal Integration: Mergers and Acquisitions

- Horizontal integration refers to pursuing a diversification strategy by acquiring or merging with a rival.
- The term merger is generally used when two similarly sized firms are integrated into a single entity.
- In an acquisition, a larger firm purchases and absorbs a smaller firm.

# Horizontal Integration Examples

- ExxonMobil is a direct descendant of John D. Rockefeller’s Standard Oil Company. It was formed by the 1999 merger of Exxon and Mobil. As in many mergers, the new company name combines the old company names.

- Starbucks acquired competitor Seattle’s Best Coffee - which had a presence in Borders Bookstores and Subway Restaurants - in order to target a more working-class audience without diluting the Starbucks brand.

- https://www.youtube.com/watch?v=JVqv58T3yYs

# Vertical Integration Strategies

- When pursuing a vertical integration strategy, a firm gets involved in new portions of the value chain.
- This approach can be very attractive when a firm's suppliers or buyers have too much power over the firm and are becoming increasingly profitable at the firm's expense.
- By entering the domain of a supplier or a buyer, executives can reduce or eliminate the leverage that the supplier or buyer has over the firm.
- Considering vertical integration alongside Porter's five forces model highlights that such moves can create greater profit potential.
- Firms can pursue vertical integration on their own, such as when Apple opened stores bearing its brand, or through a merger or acquisition, such as when eBay purchased PayPal.

- When using vertical integration, firms get involved in different elements of the value chain.

- This concept gets top billing at American Apparel, a firm that describes its business model as "vertically integrated manufacturing."

- The elements of their integrated process for designing, manufacturing, wholesaling, and selling basic T-shirts, underwear, leggings, dresses, and other clothing and accessories for men, women and children.

- Today, oil companies are among the most vertically integrated firms.

- Firms such as ExxonMobil and ConocoPhillips can be involved in all stages of the value chain, including

- crude oil exploration,
- drilling for oil,
- shipping oil to refineries,
- refining crude oil into products such as gasoline,
- distributing fuel to gas stations, and
- operating gas stations.

- The risk of not being vertically integrated is illustrated by the 2010 Deepwater Horizon oil spill in the Gulf of Mexico.

- Although the US government held BP responsible for the disaster, BP cast at least some of the blame on drilling rig owner Transocean and two other suppliers: Halliburton Energy Services (which created the cement casing for the rig on the ocean floor) and Cameron International Corporation (which had sold Transocean blowout prevention equipment that failed to prevent the disaster).

- In April 2011, BP sued these three firms for what it viewed as their roles in the oil spill.

- Vertical Integration

# Backward Vertical Integration

- A backward vertical integration strategy involves a firm moving back along the value chain and entering a supplier's business.
- Some firms use this strategy when executives are concerned that a supplier has too much power over their firms.
- In the early days of the automobile business, Ford Motor Company created subsidiaries that provided key inputs to vehicles such as rubber, glass, and metal.
- This approach ensured that Ford would not be hurt by suppliers holding out for higher prices or providing materials of inferior quality.

# Forward Vertical Integration

- A forward vertical integration strategy involves a firm moving further down the value chain to enter a buyer's business.
- Disney has pursued forward vertical integration by operating more than three hundred retail stores that sell merchandise based on Disney's characters and movies.
- This allows Disney to capture profits that would otherwise be enjoyed by another store. Each time a Frozen book bag is sold through a Disney store, the firm makes a little more profit than it would if the same book bag were sold by a retailer such as Target.

# Key Takeaways

- Diversification strategies involve a firm stepping beyond its existing industries and entering a new value chain.

- Generally, related diversification (entering a new industry that has important similarities with a firm's existing industries) is wiser than unrelated diversification (entering a new industry that lacks such similarities). Geographic diversification is another strategy to drive synergy.

- A horizontal diversification strategy involves trying to compete successfully within a single industry. • Mergers and acquisitions are popular moves for executing a concentration strategy, but executives need to be cautious about horizontal integration because the results are often poor.

- Vertical integration occurs when a firm gets involved in new portions of the value chain. By entering the domain of a supplier (backward vertical integration) or a buyer (forward vertical integration), executives can reduce or eliminate the leverage that the supplier or buyer has over the

# Implementing Corporate Strategy

- Once a firm decides which corporate strategy to pursue, it must implement that strategy successfully.

- As noted earlier, many attempts to diversify end in failure. Executing a good implementation plan successfully is key.

- There are various ways that a firm can implement their corporate diversification strategy.

- These are:
- Internal Development
- Strategic Alliance
- Joint Venture
- Merger and Acquisition

# Strategies for Getting Smaller

- *"In what industry or industries should our firm compete?"* is the central question addressed by corporate-level strategy.
- In some cases, the answer that executives arrive at involves exiting one or more industries.

# Retrenchment

- Firms following a retrenchment strategy shrink one or more of their business units.

- Much like an army under attack, firms using this strategy hope to make just a small retreat rather than losing a battle for survival. It is also commonly referred to as “downsizing” or “rightsizing.”

- Retrenchment is often accomplished through laying off employees.

# Restructuring

- Spin-offs occur when businesses create a new firm from a piece of their operations.
- Because some diversified firms are too complex for investors to understand, breaking them up can create wealth by resulting in greater stock market valuations.
- Spinning off a company also reduces management layers, which can lower costs and speed up decision making.

# Examples of Spin Offs

- There are 17 billion of Freescale Semiconductor’s chips in use around the world. The firm was spun-off from Motorola.
- Toyota started in the car business, right? Wrong.
- The firm was spun-off in the 1930s from Toyoda Automatic Loom Works - a company that produced commercial weaving looms.
- Delphi Automotive - an automotive parts company headquartered in Troy, Michigan - is a spin-off from General Motors.

# Portfolio Planning and Corporate-Level Strategy

- Top Level Management in charge of firms involved in many different businesses must figure out how to manage such portfolios.

- General Electric (GE), for example, competed in a very wide variety of industries, including financial services, insurance, television, theme parks, electricity generation, lightbulbs, robotics, medical equipment, railroad locomotives, and aircraft jet engines.

- When leading a company such as GE, executives must decide which units to grow, which ones to shrink, and which ones to abandon.

- Portfolio planning can be a useful tool.

- Portfolio planning is a process that helps executives assess their firms' prospects for success within each of its industries, offers suggestions about what to do within each industry, and provides ideas for how to allocate resources across industries.

- Portfolio planning first gained widespread attention in the 1970s, and it remains a popular tool among executives today.

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# The Boston Consulting Group Matrix

- The Boston Consulting Group (BCG) Matrix is the best-known approach to portfolio planning.

- Using the matrix requires a firm's businesses to be categorized as high or low along two dimensions: its share of the market and the growth rate of its industry.

- The BCG Matrix has four quadrants or categories:

- ***The BCG Matrix is based on*** *Industry Growth rate & Relative market share*

- Cash Cows: High market share units within slowgrowing industries are called cash cows. Because their industries have bleak prospects, profits from cash cows should not be invested back into cash cows but rather diverted to more promising businesses.

- Dogs: Low market share units within slowgrowing industries are called dogs. These units are good candidates for divestment.

- Stars: High market share units within fastgrowing industries are called stars. These units have bright prospects and thus are good candidates for growth.

- Question Marks: Finally, low-market-share units within fast-growing industries are called question marks. Executives must decide whether to build these units into stars, hold them, or to divest them.

- The various business units that a company has are plotted on the matrix.
- Once plotted, decisions can be made about the portfolio of businesses the company operates, such as where more investment would be beneficial, and which units may be candidates to divest.
- The Boston Consulting Group matrix is the best-known approach to portfolio planning - assessing a firm’s prospects for success within the industries in which it competes.
- The matrix categorizes businesses as high or low along two dimensions - the firm’s market share in each industry and the growth rate of each industry.
- Suggestions are then offered about how to approach each industry.

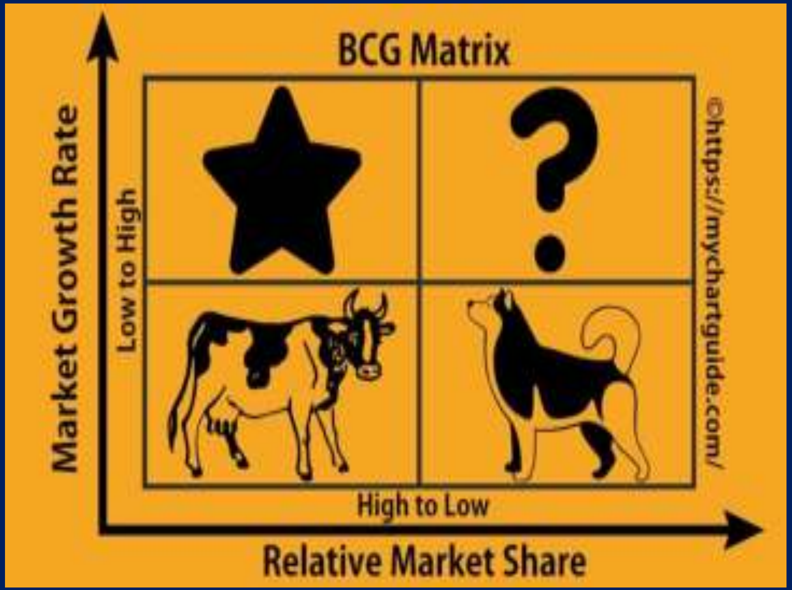
# The Boston Consulting Group Matrix

- Low Relative Market Share
- *High Industry Growth Rate*
- Question marks should be resolved by executives by deciding whether to foster or sell these units.
- *Low Industry Growth Rate*
- It sounds mean, but dogs should be sold if possible and abandoned if necessary

- <u>High Relative Market Share</u>

- *High Industry Growth Rate*
- Stars should be funded and encouraged to grow

- *Low Industry Growth Rate*
- Cash cows should be "milked" to supply funds to more promising businesses.



- To use the BCG Matrix, the company needs to know the market share for each of its business lines and the relative growth rate.

- It is important to set the scales on both axes so that the midpoints are roughly in the middle of the range of the market share and growth rates of the business units.

- Once the axes are set, the business units are plotted on the matrix relative to each other.

- BCG Matrix with examples
- https://www.youtube.com/watch?v=j_mac7OWX3g

# Limitations to Portfolio Planning

- Although portfolio planning is a useful tool, this tool has important limitations.
- First, portfolio planning oversimplifies the reality of competition by focusing on just two dimensions when analyzing a company's operations within an industry. Many dimensions are important to consider when making strategic decisions, not just two.
- Second, portfolio planning can create motivational problems among employees. For example, if workers know that their firm's executives believe in the BCG Matrix and that their subsidiary is classified as a dog, then they may give up any hope for the future.
- Similarly, workers within cash cow units could become dismayed once they realize that the profits that they help create will be diverted to boost other areas of the firm.
- Third, portfolio planning does not help identify new opportunities. Because this tool only deals with existing businesses, it cannot reveal what new industries a firm should consider entering.

# Key Takeaway

- Portfolio planning is a useful tool for analyzing a firm’s various business units, but this tool has limitations.

- The BCG matrix is one of the most widely used approaches to portfolio planning.