

Strategic Management CB4303

WEEK 9: CORPORATE LEVEL STRATEGY II

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In-Class Quiz

- Please download the LockDown Browser if you have not already
- Then follow the steps below:
 1. Open LockDown Browser from the computer
 2. Log in Canvas and then navigate to the quiz
 - Access our course -> Quizzes -> In-Class Quiz #2
 3. Quiz will start at 12:10PM and end at 12:30PM
 - 13 multiple-choice questions

Note on Plagiarism

- Students must observe the University's policy on academic honesty in all areas relating to the course
- Any allegation of academic dishonesty will be referred to the appropriate University Officer for action
- Proven offence will subject to the disciplinary procedures stated in the Code of Student Conduct

Group Report Deadline

Group presentation dates & report due dates

- Group report due one week after the presentation

Presentation Date	Groups	Report Due Date
November 16	7, 8, 10, 12, 15	November 23, 12PM
November 23	1, 3, 4, 6, 13	November 30, 12PM
November 30	2, 5, 9, 11, 14	December 7, 12PM

Group Report Format

- Format
 - 12 pages max (double-spaced, one-inch margins, 12-point Times New Roman font), excluding title/cover page, figures, tables, and references
- Evaluation criteria for the report
 - Analysis (appropriate use of frameworks, appropriate use of supporting data)
 - Recommendation (precise recommendation argued coherently)
 - Writing (structure, general quality)
- Group leaders: email and submit a hard copy of the report to me by one week after the date of your team's presentation
 - Late assignment is subject to 5% penalty per calendar day after the due date
 - If your report is due on December 7, please put in my mailbox in MGT office BEFORE 12PM (11th Floor – Lau Ming Wai Bldg)

Recap

Corporate Strategy

Goal-directed actions that they take in the quest for competitive advantage

Main question: where to compete?

Boundaries of the firm

- Vertical integration
- Product (Horizontal) diversification
- Geographic scope

Three Dimensions of Corporate Strategy

Vertical integration

- In what stages of the industry value chain should the company participate?

Product (horizontal) diversification

- What range of products and services should the company offer?

Geographic scope

- Where should the company compete geographically in terms of regional, national, or international markets?

Transaction Costs: Make or Buy?

If $\text{Costs}_{\text{in-house}} < \text{Costs}_{\text{market}}$:

- Vertically integrate
- Own production or distribution channels
- Coordination vs. principal-agent problem

If $\text{Costs}_{\text{market}} < \text{Costs}_{\text{in-house}}$:

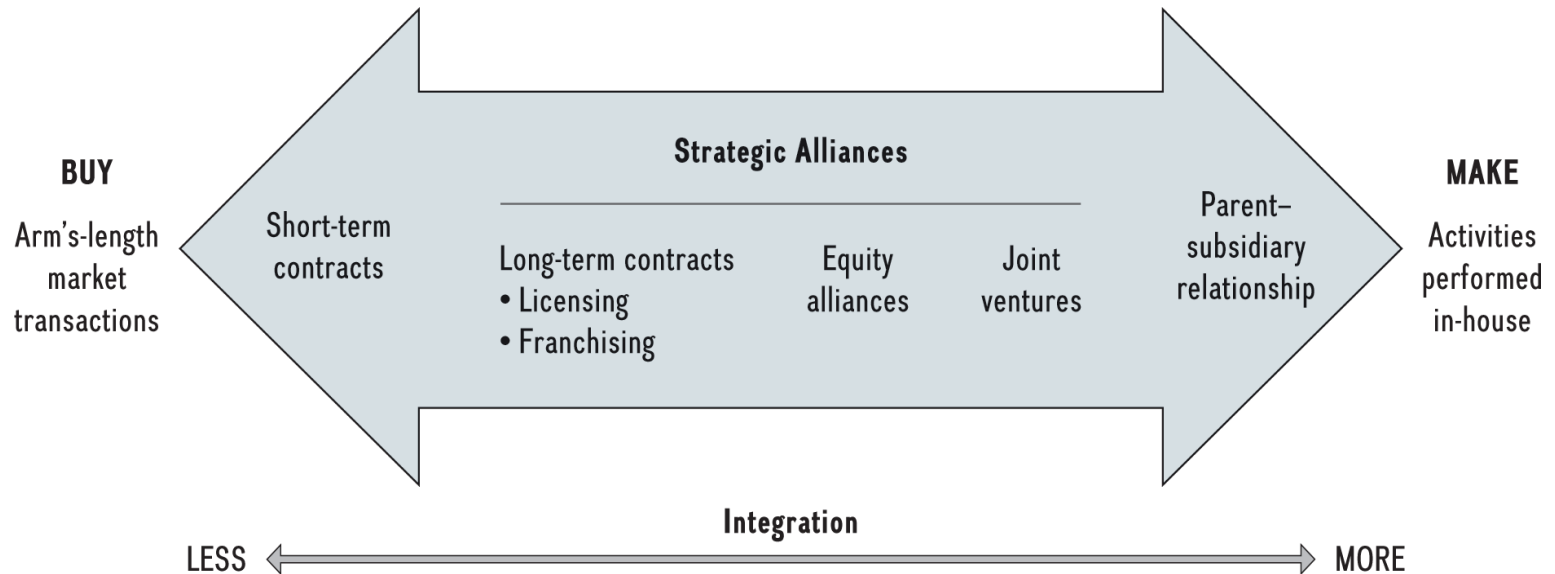
- Consider purchasing instead
- Flexibility vs. information asymmetry

Example: Google

- Hires programmers to develop software code in-house
- Proprietary algorithms
- vs. salaries & benefits
- Owns software development capabilities
- Transferable to different AI-based service offerings

Alternatives on the Make-or-Buy Continuum

Exhibit 8.5



Vertical Integration

The ownership of inputs or distribution channels

- “What percentage of a firm’s sales is generated within the firm’s boundaries?”
- Degree of vertical integration: number of industry value chain stages in which a firm directly participates

Backward Vertical Integration:

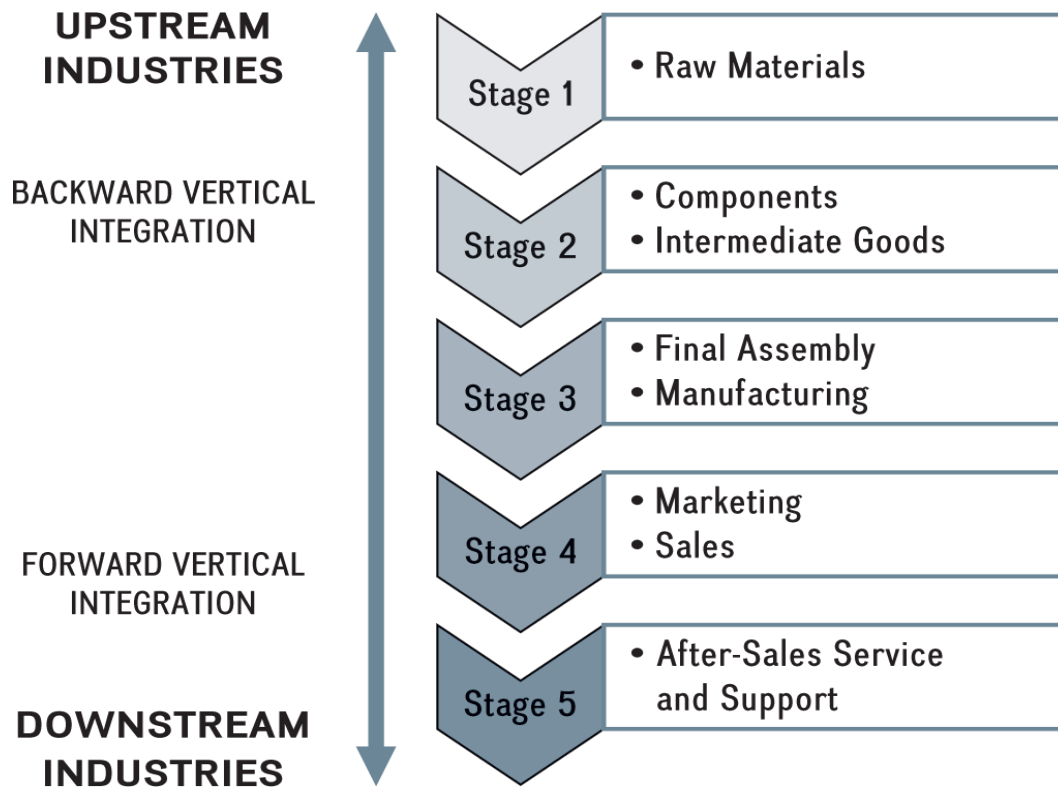
- Owning inputs of the value chain

Forward Vertical Integration:

- Owning activities closer to the customer

Backward and Forward Vertical Integration along an Industry Value Chain

Exhibit 8.6



Types of Corporate Diversification

Developed by Richard Rumelt

Classification according to two variables

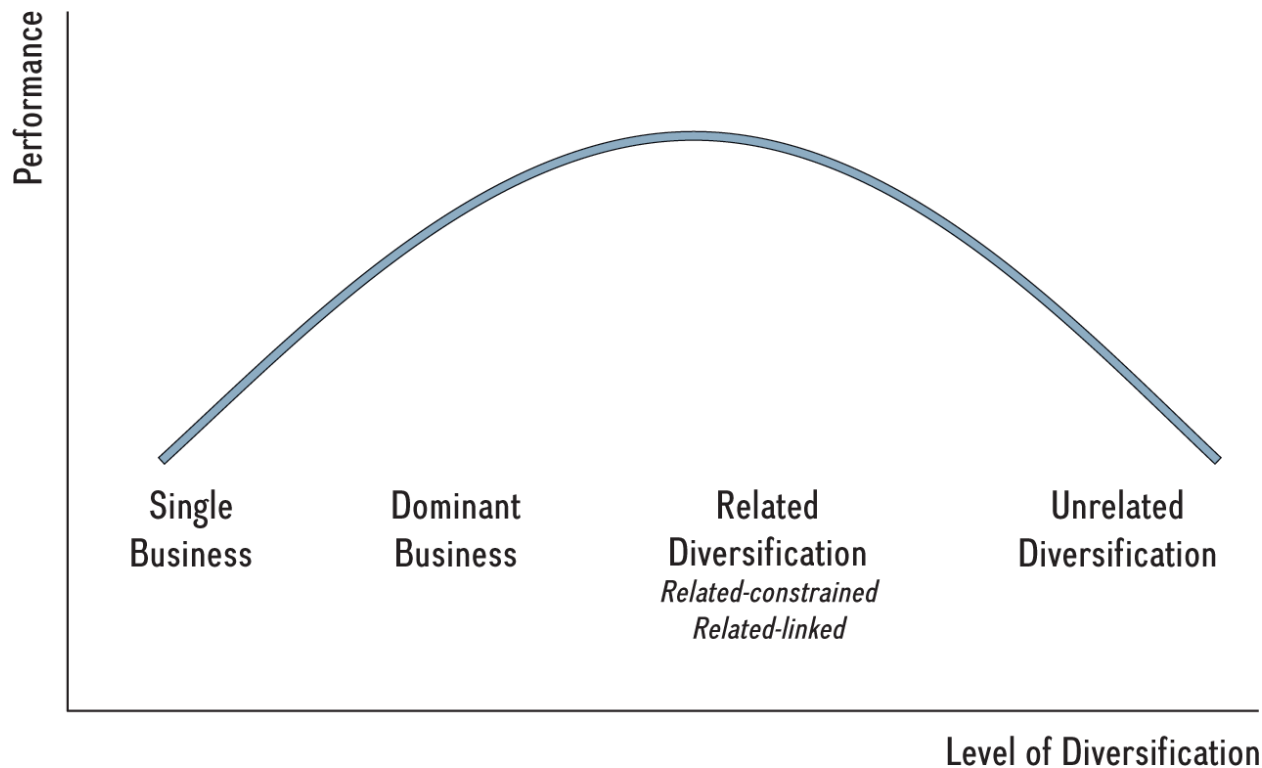
- % of revenue from dominant / primary business
- Relationship of the core competencies across business units

Four types of diversification

- Single business
- Dominant business
- Related diversification
- Unrelated diversification (conglomerate)

The Diversification-Performance Relationship

Exhibit 8.13



Source: Author's adaptation from L.E. Palich, L.B. Cardinal, and C.C. Miller (2001), "Curvilinearity in the diversification-performance linkage: An examination of over three decades of research," *Strategic Management Journal* 21: 155–174.

Agenda for Today

- Topic: Alliances and M&A
 - ✓ Apply the Build-Borrow-Buy framework to guide corporate strategy
 - ✓ Define strategic alliances, explain why firms enter into them
 - ✓ Describe the three phases of alliance management and how an alliance management capability can lead to a competitive advantage
 - ✓ Define horizontal integration and evaluate the advantages and disadvantages of this option to execute corporate-level strategy
 - ✓ Explain why firms engage in acquisitions

Build-Borrow-Buy Framework

Build-Borrow-Buy Framework

**Identify a strategic resource gap – how do we acquire this resource?
Build, borrow, or buy?**

Build:

- Internal organic growth through development

Borrow:

- External growth through a contract / strategic alliance

Buy:

- External growth through acquiring new resources, capabilities, and competencies

Build-Borrow-Buy Framework: Questions

Relevancy:

- How relevant are the firm's existing internal resources to solving the resource gap?

Tradability:

- How tradable are the targeted resources that may be available externally?

Closeness:

- How close do you need to be to your external resource partner?

Integration:

- How well can you integrate the targeted firm should you determine to acquire?

Relevance

Are the firm's internal resources highly *relevant*?

- If so, the firm should develop the required resources internally
- If not, consider **Tradability**

Internal resources are relevant if:

- They are similar to those the firm needs to develop
- They are superior to those of competitors in the targeted area

Tradability

Is a resource highly **tradable**?

- Yes: then the resource should be **borrowed** via a licensing agreement or other contractual agreement
- No: consider either a deeper strategic alliance through an equity alliance or a joint venture, or an outright acquisition (ask the question of **closeness**)

The firm creates a contract to:

- Transfer ownership
- Allow use of the resource

Contracts support borrowing resources:

- Example: Licensing and franchising, or contracts

Closeness

How close do you need to be to a resource partner?

- If a lower degree of closeness: take action to borrow by forming an equity alliance or joint venture
- If a high degree of closeness required: ask the next question of *integration*

Closeness can be achieved through alliances

- Equity alliances
- Joint ventures

Integration

How well can the target firm be integrated?

- If high, buy resource through acquisition
- If low, revisit the options or reformulate strategies

Conditions for integrating the target firm:

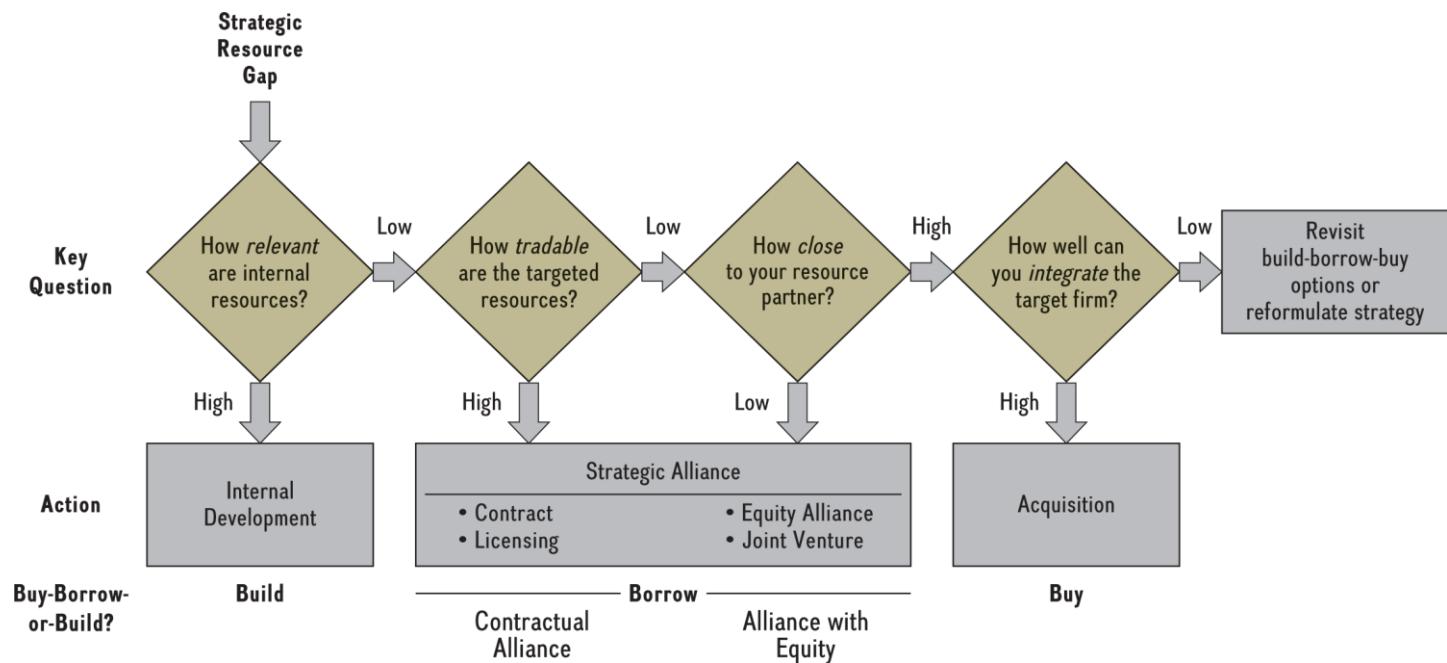
- Low relevancy
- Low tradability
- High need for closeness

Consider other options first!

- Examples of post integration failures abound

Guiding Corporate Strategy: The Build-Borrow-Buy Framework

Exhibit 9.1



Source: Author's adaptation from L. Capron and W. Mitchell (2012), *Build, Borrow, or Buy: Solving the Growth Dilemma* (Boston: Harvard Business Review Press).

Alliances

What Are Strategic Alliances?

A voluntary arrangement between firms involves the sharing of:

- Knowledge
- Resources
- Capabilities

To develop:

- Processes, products, services

Over 80% of Fortune 1000 CEOs indicate that more than 25% of their firm's revenues were derived from strategic alliances

Why Do Firms Enter Strategic Alliances?

Strengthen competitive position:

- Change industry structure, influence standards

Enter new markets:

- Product, service, or geographic markets

Hedge against uncertainty:

- Breaks down investment into smaller decisions

Access critical complementary assets:

- Marketing, manufacturing, after-sale service
- Helps complete the value chain

Learn new capabilities:

- Co-opetition: cooperation among competitors

What are the Risks?

Divergent goals and interests

- Choosing wrong partners

Potential partner opportunism

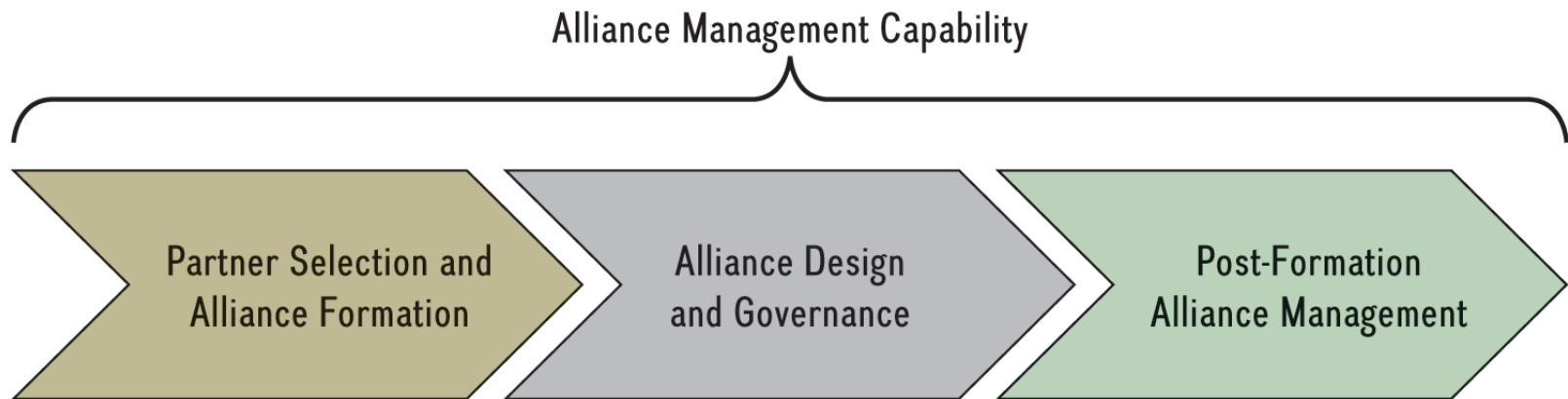
- Partner acting in their self-interest

Risks of nurturing competitors

- Learning race: A race in which partners aim to outrun each other by learning the “tricks” from the other side as fast as possible

3 Phases of Alliance Management

Exhibit 9.3



Partner Selection and Alliance Formation

Five reasons for alliance formation:

1. Strengthen **competitive position**.
2. Enter **new markets**.
3. Hedge against **uncertainty**.
4. Access critical **complementary resources**.
5. Learn **new capabilities**.

But, expected benefits must exceed the costs

Partner compatibility: cultural fit between different firms

Partner commitment: willingness to make available necessary resources and to accept short-term sacrifices to ensure long-term rewards

Alliance Design and Governance

- Non-equity alliance
 - Contractual agreements
 - Supply agreements, distribution agreements, and licensing agreements
- Equity alliance
 - One partner takes partial ownership in the other
- Joint venture
 - A standalone organization, jointly owned by two or more companies

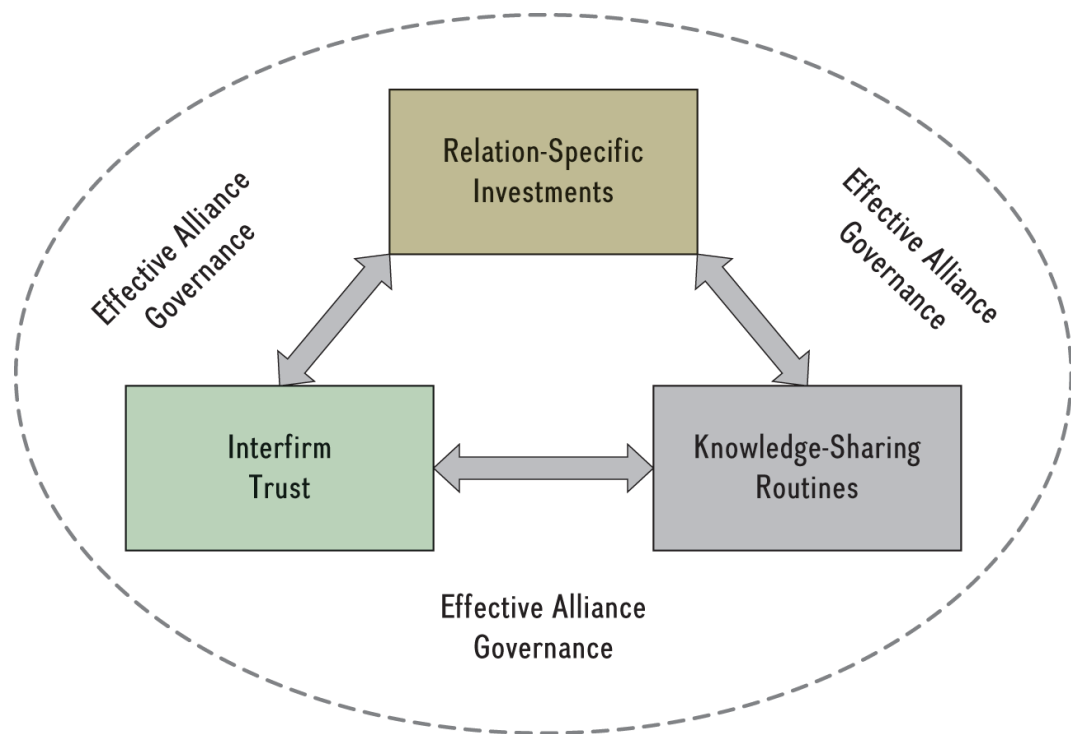
Inter-organizational trust is a critical dimension of alliance success

Post-Formation Alliance Management

To be a source of competitive advantage, the alliance needs to create VRIO resource combinations:

- Make relation-specific investments
- Establish knowledge-sharing routines
- Build interfirm trust

Exhibit 9.4



Source: Author's adaptation from J.H. Dyer and H. Singh (1998), "The relational view: Cooperative strategy and the sources of intraorganizational advantage," *Academy of Management Review* 23: 660–679.

Mergers & Acquisitions

Mergers and Acquisitions

Merger:

- Joining of two independent companies
- Forms a combined entity
- Tends to be friendly

Acquisition:

- Purchase or takeover of one company by another
- Can be friendly or unfriendly
- Considered a hostile takeover when the target firm does not wish to be acquired

Why Do Firms Merge with Competitors?

Horizontal integration:

- The process of merging with a competitor
- Occurs at the same stage of the value chain

Three main benefits:

1. Reduction in competitive intensity
2. Lower costs
3. Increased differentiation

Why Do Firms Acquire Other Firms?

To access new markets & distribution channels

- To overcome entry barriers
- To access new capabilities or competencies

Access to a new capability or competency

To preempt rivals (example: Facebook vs. Google)

- Facebook acquired: Instagram (photo & video sharing), WhatsApp (text messaging service), Oculus (virtual reality headsets)
- Google acquired: YouTube (video sharing), Motorola (mobile technology), Waze (interactive mobile maps)

What does M&A bring?

Why companies conduct M&A:

- The desire to overcome competitive disadvantage
- When acquiring a firm, you buy an entire “resource bundle,” not just a specific resource
- This resource bundle, if obeying VRIO principles and successfully integrated, can then form the basis of competitive advantage

However, M&A often fail:

- Do not create competitive advantage
- Do not realize anticipated synergies
- Result in destroyed shareholder value

Why do Most M&A Fail?

Pre-acquisition Issues

- Principal-agent problem
- Inadequate pre-acquisition screening
- Poor strategic fit: effective matching of complementary strategic capabilities

Post-acquisition Issues

- Organizational fit: similarity in cultures, systems, and structures
- Failure to address multiple stakeholder groups' concerns

Principal-Agent Problems with M&A

Managers may have personal incentives to acquire:

- To build a larger empire
- To receive prestige, power, and higher pay

Managerial hubris:

- A form of self-delusion
- May lead to ill-fated business deals