

Corporate strategy

CORPORATE STRATEGY - WHAT YOU MUST BE ABLE TO DO ON THE EXAM

Source: Whittington (2023) chapter 8 pages 155-169, Campbell, Goold and Alexander (1995) pages 129-132, videos 4.0 to 4.3 and College 4. Chapters 8.7 and 8.8 (internationalisation, entry modes) belong to module 5.

How is this tested?

In the sample exam (question 4, 25 points) a company with an acquisition was described, with four sub-questions:

- a. Explain with Coase why the company exists or does an activity internally (5 points, 20 words).
- b. Determine which Ansoff direction it is and name the advantages (10 points, 75 words).
- c. Name a factor that hinders growth (5 points, 20 words).
- d. Name a diversification driver (5 points, 20 words).

The marking scheme rewards the link to the book. A good answer without that link yields only part of the points (in the sample +3 or +1). So use the English terms and show which concept you are applying.

1. Coase and transaction costs

- Companies exist because the market costs something: **transaction costs**.
- Three kinds: **search costs** (finding a partner), **bargaining costs** (negotiating and recording) and **enforcement costs** (enforcing compliance).
- If the costs of the market are higher than those of internal coordination, you carry out the activity yourself.
- Limit to size: internal **overhead** and errors grow along. Coase looks for the optimal balance between internal and external contractual relationships.
- This is the first reason to grow or diversify.

2. Williamson and vertical integration

- **Transaction cost economics**: the risk of the market is **opportunism**.
- Opportunism is large with (1) few alternatives, (2) complex and changeable circumstances and (3) **asset specificity**.
- High risk: **vertical integration**. **Backward integration** goes towards suppliers, **forward integration** towards buyers. Low risk: **outsourcing**.
- The choice also depends on the relative resources and capabilities: who can do it better?

- Horizontal integration is a form of diversification.

3. Ansoff matrix

Direction	Characteristic	Risk or constraint
Market penetration	Existing product, existing market	Retaliation, legal constraints, economic constraints
Product development	New product, existing market	New resources and capabilities, project management
Market development	Existing product, new market (new users or geographies)	Unknown market
Diversification	New product, new market (zone D)	Unrelated diversification (conglomerate diversification) ; zones B and C (product and market development) are related diversification

Examples from the lecture: Wayne Huizenga and Waste Management (an **industry roll-up**, consolidating a fragmented sector), Apple (product development), Catawiki (market development) and DSM (diversification).

Exam tip: for an Ansoff question, first name the direction, then give one or two advantages with case evidence (for example market share and scale with penetration, new customers with market development), and only then the constraint.

4. Diversification drivers

Value-creating (four):

1. **Economies of scope:** the same resources or capabilities serve more activities. Tangible (for example a factory, Uber Eats with drivers and app) or intangible (brand, knowledge, for example Unilever). Limitation: De Vegetarische Slager did not fit.
2. **Stretching corporate management capabilities:** deploying the head office's skills more widely. The limit is the **dominant logic** of Prahalad and Bettis: the management's way of thinking does not fit every business.
3. **Exploiting superior internal processes:** the parent is a miniature capital market (**internal capital market**) and allocates capital better than the external market, through better information and lower transaction costs.
4. **Increasing market power: mutual forbearance** (multi-market competitors restrain each other), cross-subsidising, cheaper borrowing, bulk buying and serving one large customer.

Value-destroying (three): responding to market decline, spreading risk and **managerial ambition** (pay rises with size). The lecturer adds a caveat to the first two: they are not always value-destroying.

Synergies (example: Disney and Marvel) are the benefits of businesses that together achieve more than apart.

Practice question: name a driver and substantiate with the case. One driver is enough if one is asked for; give the name in English.

5. The corporate parent

The lecturer's core question: what is the value of the head office?

- **Value-adding:** envisioning (vision and direction), facilitating synergies, coaching, central services and resources, intervening.
- **Value-destroying:** management costs, bureaucratic complexity and clouding the financial performance (obscuring).
- **Parenting advantage:** the business does better under this parent than under another.
- If this is missing, the **market for corporate control** threatens (takeover or break-up).

Three parenting roles

Role	Size	Emphasis
Portfolio manager	Small head office	Investing and intervening (private equity)
Synergy manager	Large	Cross-links and cooperation between units
Parental developer	Large	Downward: central capabilities to develop the units

Formative test: the role that emphasises central capabilities is the **parental developer**. The conglomerate is not trusted because the added value of the parent is not clear.

6. Parenting-fit matrix (Campbell)

Assess each business on three points:

- **Critical success factors** (CSFs; in the lecture: key success factors, KSFs): what the business needs to win.
- **Parenting opportunities:** where the parent can improve something.
- **Parenting characteristics:** what the parent can do and does.

The axes are fit with the opportunities (horizontal) and misfit with the KSFs (vertical). Five types:

Type	Opportunities	Misfit KSFs	Advice
Heartland	High fit	None	Core, keep
Edge of heartland	Partial	Limited	Review carefully
Ballast	No fit	None	No harm, no value
Alien territory	No fit	Misfit	Divest
Value trap	Fit	Misfit	Looks wonderful; often divest

Examples from the lecture: Unilever and Calvin Klein; a hotel business as value trap.

7. BCG matrix

- **Star**: high growth, high share. **Question mark**: high growth, low share. **Cash cow**: low growth, high share. **Dog**: low growth, low share.
- Criteria for a portfolio: **balance** (cash cows pay for stars and question marks), **attractiveness** and **fit**.
- Four problems: the definition of high and low, the assumption that financing must be internal, motivation problems in cash cows and dogs and ignoring commercial links.
- Use in the lecture: the BCG matrix and the parenting-fit matrix were both used to decide on divesting or acquiring.

8. The Chipotle case at McDonald's (Illustration 8.3)

- Investment of 50 million dollars in 1998; from 13 to 500 outlets; in 2005 McDonald's had 90 percent.
- Initiatives: drive-through, breakfast and advertising; eight failed franchises; supply problems.
- McDonald's sold Chipotle (in the book: "a McSplit") and received 1.5 billion dollars after an investment of 360 million dollars; in 2021 Chipotle was worth 53.4 billion dollars.
- Analysis: McDonald's was not a good parental developer for Chipotle: fit with the opportunities, but misfit on the KSFs. That is a **value trap**, so divest. In Lecture 4 the lecturer also calls "edge of heartland" a good reading; both can be defended if you justify it.

How to build an answer

1. Name the concept in English (for example transaction costs, retaliation, parental developer).
2. Give the meaning in one sentence, in your own words.
3. Link it to a fact from the case (a number, a name, an activity).

4. Close with the conclusion or judgement that the question asks for.

If the word limit does not fit, drop the repetition of the question and keep steps 1, 3 and 4. With 20 words, one concept with one case fact is enough.

Common mistakes

- Naming the concept without linking it to the case.
- Mixing up Coase and Williamson: Coase is about transaction costs and company size, Williamson about opportunism and asset specificity.
- Confusing market development and diversification: with market development the product stays the same.
- Naming all three roles when one is asked for. Choose the role that fits the description in the case.
- Describing a value trap as something bad: it looks attractive, that is the point.