Corporate Strategy Framework

Business level strategy is about how to build a sustainable competitive advantage in a discrete and identifiable market. Corporate strategy is the overall plan for a diversified company. Corporate strategy is the way a company creates value through the configuration and coordination of its multimarket activities.

Vision: Provides direction, describes the domain (markets, businesses in which the firm will and will not operate); gives guidance on ethical values as well. Goals refer to qualitative intentions such as ‘improve NPD capabilities’, ‘become a global organization’, etc. Objectives are short-and-medium term quantitative targets, such as ‘obtain a 40% debt/equity ratio’, ‘achieve 6-sigma by 1999’, etc.

Resources: Assets, Skills, Capabilities of a firm. They determine NOT what the firm wants to do, but what it CAN do. Resources are the source of sustainable competitive advantage. Key things to ask yourself: is a resource rate? Is it hard to copy? What makes a resource valuable? Value is created in the intersection of 3 sets: when a resource is demanded by customers, when it cannot be copied by competitors, and when it generates profits that are captured by the firm.

Businesses side of the corporate strategy framework triangle refers to industries in which the firm operates, as well as the competitive strategy it adopts in each of those industries.

Structure refers to the way the corporation is divided into discrete units. It describes the formal organization chart that delineates the allocation of authority inside the corporation hierarchy. Systems are the set of formal policies and routines that govern organizational behavior. They are the set of rules that govern how tasks, from strategic planning to personnel evaluations are to be fulfilled.

Processes describe the informal elements of an organization’s activities (network of personal relationships inside a company).

3 questions a firm should ask to test whether or not it possesses a corporate advantage:

- Does ownership of the business create benefit somewhere in the corporation?
- Are those benefits greater than the cost of corporate overhead?
- Does the corporation create more value with the business than any other possible corporate parent or alternative governance structure?

Scale & Scope Economies

Economies of Scale: Exist when the average cost of producing each unit declines as more units of a good / service is produced. Cost reductions that accompany increases in total current output.

Learning / Experience curve: Cost reductions that occur as cumulative volume rises. Scale, in principle can be quickly replicated but not experience or learning, which must be built over time (path dependent?).

Economies of scope: Exist when cost of producing and selling multiple products together is lower than cost of producing and selling the same quantity of goods individually.

- Firms err by expanding into market segments that appear to be related to their existing business, and in fact, are quite different. This mistake is made when firms define relatedness on the basis of product characteristics rather than on resources. Listing all the discrete activities in the value chain of the two businesses or segments under consideration allows for an accurate identification of those that are similar enough to be subject to scope economics.

Diversification

- External inducements to diversification can be via strengths—the firm wants to pursue attractive opportunities that allow it to leverage its resource strengths in new businesses (offensive move)—or via threats—the demand for the firm’s primary market is down and so it wants to diversify revenue sources (defensive move).
- Internal inducements to diversification arise from a firm’s desire to more fully employ and exploit its resource base.
- To be basis for diversification, Resources must pass key tests:
  - Resources should be competitively superior in the new business.
  - Resources being leveraged into the new business should be key success factors in that business
  - When entering a new business, the firm must compete on ALL resources that are required to produce & deliver the product or service.
  - Leveraging the firm’s resources should be feasible in the new business.
- Diversified expansion into new product markets is justified only when contractual costs of selling / renting excess resources are high. Activities should be performed inside the firm, rather than accessed on a market, when performing the activity inside the firm is more efficient than in the market.

When to integrate vertically?

- Firms should be vertically integrated into those activities where their resources are the source of value creation (comp. Adv.)
- Even if a firm is not able to earn an abnormal return from a particular activity, it should be performed inside the firm if there are asset-specific investments (location, human capital, physical assets) or other forms of market failure (high transaction costs lead to market failures in general; in such cases, the vertical hierarchy is preferred).
- An activity should be performed inside the firm if there are substantial requirements for ongoing coordination (agency costs).

Judging Effective Corporate Strategy

- Vision: Is there a clear and well articulated corporate vision? How does the company intend to create value? Convey a sense of corporate advantage the firm will exploit and be specific enough to guide a firm’s actions.
- Internal consistency: Are the elements of the firm’s corporate strategy aligned with one another? Do they form a coherent whole?
- External consistency: Does the strategy fit with the external environment? Is the strategy sustainable against changing environmental and competitor strategies?
- Feasibility: Is the organization being asked to do too much in too short a time? Is the strategy too risky?
- Corporate Advantage: (a) Does ownership of the business create benefits elsewhere in the corporation? (b) Are these benefits greater than the costs of overhead? (c) Does it create more value than any other possible corporate parent or alternative governance structure?