**7. Corporate Level Strategy**

When a firm decides to expand its operations beyond a single industry and to operate businesses in several industries, it is pursuing a corporate level strategy of diversification.

Corporate level strategy is different from business level strategy.

Corporate level strategy is adapting to conditions in the external environment, while business level strategy is adapting to conditions in the internal environment. Therefore a firm can have two levels of strategy: business level strategy and corporate level strategy.

Corporate level strategy addresses two fundamental issues:

1. What businesses should a firm/corporation compete in?
2. How can these businesses be managed so they create ‘synergy’?

When a company starts to move into other product lines or other markets in order to maintain its competitive position, it is said to ‘diversify its business’. The strategy that is used to diversify a business is the ‘corporate level strategy’. A corporate level strategy is an action plan developed by top people in the organisation to gain competitive advantage through the selection and management of a mix of businesses competing in several industries or product markets.

Reasons for firms to diversify their businesses

1. Opportunities for growth in the present business are declining e.g. current markets are getting smaller or getting saturated.
2. The firms have the technological expertise, core competencies and resource strength and therefore they are able to do more than the current state of operation.
3. To reduce risk especially in a competitive marketplace.
4. To acquire new technologies.
5. To acquire market share.
6. To increase or improve growth.
7. To stabilize or improve earnings.
8. To achieve synergy or economies of scale.
9. Government incentives encourage competition but discourage merger or monopolies

10. Managers have their interests to do so.

Three ways firms develop corporate strategy:

1. Single business/concentration strategy

Most firms begin their corporate strategy with a single or a small group of products and services and a single market. This is known as *concentration corporate level strategy* e.g. McDonald’s engaging only in one line of business and wherever it goes it does the same business and uses the same strategy.

|  |  |
| --- | --- |
| Advantages | Disadvantages |
| 1. Can master the business and its environment2. All resources can be directed to one thing to  gain sustainable competitive advantage.3. Prevent proliferating of management levels  and staff function.4. Able to invest profits back into the business. | 1. One product or market susceptible to environmental changes.2. Obsolescence of product.3. Uneven cash flow and profitability.4. Not challenging enough. |

Circumstances may arise that will soon compel a business organisation with concentration strategy to diversify its business to other product line or markets in order to remain competitive.

It may move from concentration strategy to some form of vertical integration or diversification of products, markets or resource conversion process.

1. Vertical Integration Strategy

It describes the extent to which a firm is involved in several stages of the industry supply chain.

 Raw Primary Final

 material manufacturing product Wholesaling Retailing

 extraction manufacturing

It begins with the extraction of raw materials such as timber, ore and crude oil. In primary manufacturing, these raw materials are converted into commodities such as wood pulp and iron. Sometimes, it involves the creation of components that are used to assemble final products, such as the engine, transmission and brake systems used in automobiles.

Final product manufacturing involves the creation of a product that is in its final form prior to consumption such as the final assembly of an automobile.

Wholesaling involves channeling final products to retail outlets and retailing consists of selling these products to the ultimate consumer. In some cases, the products bypass the wholesaling and/or retailing stages due to direct sale by the manufacturer to customers. Some industries, such as steel and wood products, contain firms that are predominantly vertically integrated. In other industries, such as apparel, vertical integration is limited and most organisations are only involved in one or a few stages.

Reasons for using Vertical Integration

1. To increase control over the quality of supplies.
2. To control the way a product is marketed.
3. To obtain better or more complex information about supplies or markets.
4. To have greater opportunity for product differentiation through coordinated effort.
5. Believe that profits can be enhanced through assuming one of the functions that was previously performed by another company. This is more due to the reason of transaction cost economies i.e. it is more economical to produce a good or service in-house than to buy it from the open market.

Research has found that vertical integration does not achieve highly profitable strategy than other corporate level strategies. Other recent research study has suggested that vertical integration may bring about reduced administrative, selling and R & D costs but incur higher production costs.

It is found that vertical integration often requires substantially different skills than those currently possessed by the firm. In this situation, vertical integration is similar to unrelated diversification. A firm that can manage one stage of the industry supply chain will not necessary excel at other stages. For this reason, many firms avoid vertical integration and move directly into some form of diversification.

|  |  |
| --- | --- |
| Advantages | Disadvantage |
| 1. Bring about reduced administrative, selling  and R & D costs.2. More economical to produce a good or service  in-house than to buy it from the open market. | 1. Require different skills than those currently  possessed.2. Able to manage one stage of the industry supply  chain will not necessary excel at other stages.3. Incur higher production costs. |

3. Diversification Strategy

A firm can diversify its business into related or unrelated businesses.

1. If the firm diversified into the same business (in the same industry) then it is ***related diversification.***
2. If the firm diversified into different types of business (in different industries) than what it is involved, then it is ***unrelated diversification***.

**Justification for diversification**:

1. Industry attractiveness test – when the return is attractive enough.
2. Cost of entry test – when the investment cost is not too high.
3. The better-off test – the new business offers potential improvement of performance for both the parent business and the new business.

Theory of Diversification

Firms diversify when they have excess resources, capabilities and core competencies that have ‘multiple’ uses. E.g. large firms compete against each other in several markets i.e. there is rivalry in multi-point competition.

Fundamentally diversification is an approach to gain competitive advantage through the *creation of value* *either by increasing revenues or reducing costs* while implementing the business level strategies.

The other reasons are: a) *to gain market power* and b) *financial economies*.

In diversification the firm is looking for synergy in order to achieve sustainable competitive advantage.

**Related Diversification**

Here an organisation enters an industry that is related to what it is doing or already knows.

Relatedness comes in two main types:

a. Tangible Relatedness - the firm can share the same physical resources with the other related business units. E.g. the same plant can manufacture two similar products instead of being done in two separate places. This enables the optimal volume capacity to be achieved and where the cost of production is the lowest. This is ‘*economies of scale’*. This leads to ‘*operational synergy’* through resource sharing.

Other examples of synergy resulting from tangible relatedness:

* Using the same marketing or distribution channels for mult6iple related products.
* Buying similar raw materials for related products through a centralized purchasing office to gain purchasing economies.
* Providing corporate training programmes to employees from different divisions that are all engaged in the same type of work.
* Advertising multiple products simultaneously.

b. Intangible Relatedness - where the capabilities (knowledge, skills and expertise) developed in one area are used in another area. When the use of capabilities is done properly, intangible relatedness can lead to ‘*managerial synergy’*. E.g. Campbell Soup has applied skills in manufacturing and packaging soup to a variety of other products.

Synergy based on intangible resources, such as brand name or management skills and knowledge, may be more conducive to the creation of a sustainable competitive advantage, since intangible resources are hared to imitate and are never used up.

Creation of Market Power in Related Diversification

* By blocking competitors through multi-point competition (i.e. compete in many markets) to achieve market power

It means that the firm is able to sell its products above the existing competitive level or reduce the costs of its primary and support activities below the competitive level or both. This is done by having similar businesses working together or the affiliation of a business with a strong parent to attain a strong bargaining position in relation to suppliers and customers as well as to enhance its position against its competitors. This is also referred to as ‘*pooled negotiating power’*.

* Vertical integration which can be backward (source of raw materials) or forward (toward ultimate customers) integration to achieve market power.

This occurs when a firm incorporate more processes toward the original source of raw materials (backward integration) or toward the ultimate consumer (forward integration).

Benefits of vertical integration:

* Secure sources of raw materials or distribution channels.
* Access to new business opportunities.
* Simplified procurement and administrative procedures.
* Protection of and control own valuable assets.

Risks of vertical integration:

* Cost and expenses associated with increased overhead and capital expenditures.
* Loss of flexibility (too large investment).
* additional administration costs associated with managing a more complex set of activities.
* Successful execution of strategies of vertical integration can be very difficult.

**Unrelated Diversification**

There is no similarity in their respective value chains to enable the transfer of skill or capability or technology from one business to another or to combine similar activities to reduce cost or to produce competitively valuable benefits from operating under a common corporate umbrella. It is therefore not possible to look for strategic fits here to enhance shareholder value.

However, it involves the use of financial resources and executive skills to acquire financially attractive business opportunities to build shareholder value. This result is to enhance shareholder value above the 1 + 1 = 2 effect i.e. to create synergy.

Therefore, when unrelated diversification is used appropriately, it can create value to the firm through ‘*financial economies’*. They are cost savings achieved through proper allocations of financial resources inside and outside the firm.

Examples

1. The parent firm allocates resources to its portfolio of businesses to optimize profitability, cash flow and growth. This is known as ‘*efficient internal capital allocation’*.
2. It can also enhance value by setting appropriate human resources practices and financial controls for each of its business units i.e. have people who are able to supervise the subsidiaries to obtain high level of performance. This is known as ‘*corporate parenting’*.
3. Restructuring - the firm can purchase other firms and restructure their assets and then sell them to make profits. The firm normally acquires the other firms at low prices, improve on them and sell them at high prices to make good profits out of them.

Another approach is to improve on the acquired firm and continue on the business.

Pros and Cons of Unrelated Diversification Strategy

|  |  |
| --- | --- |
| Pros | Cons |
| 1. Business/financial risk is scattered .2. Invest in industries with best profit prospects.3. Company’s profitability may be more stable  when one industry is down, its loss is offset by  the profits of others.4. Shareholder value is enhanced when a company  with big profit potential is acquired. | 1. Difficult to manage many different businesses competently.2. Absence of added source of cross-business  strategic fits to gain competitiveness.3. The potential for greater sales-prrofit stability  may fall short of the mark over the course of  the business cycle. |

Combination of Related and Unrelated Diversification Strategies

In reality, companies have both related and unrelated diversification strategies.

**Possible means to achieve diversification**:

***1. Acquisition***

The most popular method of diversification to another industry.

Reasons:

* The quicker way and an efficient way to acquire technological know-how, experience and other competitive advantages.
* Overcome entry barriers.
* Overcome uncertain cost of new product development.
* Increase speed to market.
* Lower risk compared to developing new products because outcomes (of an acquisition) can be estimated more easily and accurately.
* Easier to develop and introduce new products in markets already served currently by the acquired firm.
* Helps to reshape the firm’s competitive scope through product diversification.

Note:

* Acquisition is the best way to get access to the needed technology, resources and

 capabilities compared to joint-venture and strategic alliance.

* It allows the acquiring firm to have control of the management and operation of the

 acquired business.

Risks/Problems in acquisition

* Integration difficulties due to different cultures, financial and control systems.
* Inadequate evaluation of acquired firms.
* Large or extraordinary debt of the acquired firm.
* Inability to achieve synergy.
* Too much focused on acquisition.
* Too large result in control problems.

*2****. Internal Start-Up***

An existing company creates the same business using the same strategy in other places or countries. E.g. McDonald’s, KFC.

This strategy is only implemented when:

1. There is plenty of time to launch the new business from group-up.
2. Incumbent firms are slow or ineffective to responds to a new entrant to the market.
3. Internal entry has lower cost than entry through acquisition.
4. The existing company has most or all the skills it needs to compete effectively.
5. The targeted industry is populated with many relatively small firms and no powerful rivals.

Advantages:

* Can master the business and its environment.
* All resources can be directed to one thing to gain sustainable competitive advantage.
* Prevent proliferating of management levels and staff function.
* Able to invest profits back into the business.

Disadvantages

* One product or market susceptible to environmental change.
* Obsolescence of product.
* Uneven cash flows and profitability.
* Not challenging enough.

***3. Joint Ventures and Strategic Alliances***

***Joint Venture*** is forming a *new* company by two or more partners.

E.g.

* Owners of two separate companies agree to form a new company (the joint-venture company).
* The shares of the new company are owned by the owners of the two separate companies and whatever portion of share holds by each partner depends on what they have agreed.
* Each partner is required to contribute either funds or technical know-how for the JV company.

***Strategic Alliances*** *(Strategic Partnerships)*

* SA is more favoured today than JV because it is more flexible and adaptable to rapidly changing technologies and market conditions.
* Firms get together to share their resources and capabilities to undertake a big project.
* They do not hold any shares in any of the partner firms.
* Each contributes what it is best in its business.
* They the profits.

JV and SA can be a useful way to gain access to a new business in 3 types of situation:

1. When an opportunity is too complex, uneconomical or risky for a single organisation to pursue.
2. When opportunities in a new industry require a broader range of competencies and know-how than any one organisation can provide.
3. JV is the only way to gain entry into the foreign market because of government restriction in the foreign country.

The reason for cooperation among firms:

* Cooperative activity between firms enable them to cope successfully with a *dynamic environment* characterized by high uncertainty and turbulence.
* *Dynamic environment* refers to changing markets, technologies, economics and where large investment funds are required to provide new products with shortening life cycle. A single firm cannot cope with all these changes in the environment.

General features of cooperative strategy are:

* A genuine trust among the partners.
* Partners have good reputation.
* The superiority being difficult to imitate.
* Can develop new joint ventures for new projects.

Problems:

* Stealing of the partner’s secret.
* No trusting relationship.
* One partner tries to dominate other partners.
* Existence of suspicion.
* Lacking of cooperation.
* Uneven contribution of resources, know-how or capabilities.

**What are the strategic options for companies already diversified?**

A company that has been diversified may face some problem when one or more of its

business units suffered financial losses and the performance of the diversified company

is badly affected and therefore its survival is threatened.

Five possible strategies that the diversified company can take to restore it to good health:

1. Restructuring strategy

 It involves divesting some businesses and acquiring new businesses in order to put a new face on the company’s makeup. Weak business units or up-down performers in unattractive industries or no longer fit a company’s revised diversification strategy are sold off or split into several independent companies. (Examples: Westinghouse, British Imperial Chemical & Hanson PLC)

2. Turnaround Strategy

 It involves restoring a diversified company’s money losing businesses to

 profitability, instead of selling them off (i.e. divesting them).

 Possible ways:

 (i) Selling or closing down a portion of its operation.

 (ii) Shifting to a different business-level strategy.

 (iii) Launching new initiatives to boost the business revenues.

 (iv) Pursuing cost reduction.

 (v) Using a combination of these efforts.

3. Strategies to broaden a diversified company’s business base.

 Make new acquisitions and/or enter into additional strategic partnerships in order

 to build positions in new related or unrelated industries or to strengthen the

 position of business units in industries where the firm already has a stake.

4. Divestiture strategies aimed at retrenching to a narrower diversification base.

 Those companies that are too small to make a sizable contribution to earnings or

 have little or no strategic fit with the businesses are taken out from the business

 portfolio. This will free resources to be used for paying debts, support expansion

 of the remaining businesses or to make acquisition of assets to strengthen the

 company’s competitive position of one or more of the remaining core businesses.

5. Multinational Diversification Strategies.

 Enter into new businesses and extend operation of existing businesses into foreign

 markets. The diversified company can become a multinational, multi-industry

 enterprise.

**Six possible ways to attain competitive advantage:**

1. Full capture of economies of scale and experience curve effects.
2. Opportunities to capitalise on cross-business economies of scope (strategic fit).
3. Opportunities to transfer competitively valuable resources from one business to another and from one country to another.
4. Ability to leverage (make) use of a well-known and competitively powerful brand name.
5. Ability to capitalize on opportunities for cross-business and cross-country collaborations and strategic coordination (such as R & D).
6. Opportunities to use cross-business or cross-country subsidization to compete rivals – such as using financial and organisation resources from operations in different countries or other lines of business to cross subsidize a competitive assault on the market position of rivals.

**Possible problems with diversification:**

1. Over diversification and over stretching of resources.
2. Poor governance mechanism to control the manager’s performance.

Assignment

1. What are the 2 types of diversification firms can take advantage of?
2. What kind of competitive advantage can a firm achieve in relation to related diversification? Unrelated diversification?
3. Do firms go for both types of diversification? Why?
4. What are the possible ways firms diversify their businesses? Their advantages and disadvantages for each of them?
5. What options do diversified firms have to improve their strategies?
6. List 6 ways for firms to achieve competitive advantage.