Corporate Strategy and Growth Strategies

Corporate strategy

The decisions over the scope of the firm's activities.

- Product scope: How specialized should the firm be in terms of the range of products it supplies?
- Geographical scope: What is the optimal geographical spread of activities for the firm?
- Vertical scope: What range of vertically linked activities should the firm encompass.

Distinction between business and corporate strategy

- Corporate strategy is concerned with where a firm competes;
- Business strategy is concerned with how a firm competes with a particular area of business.

Dimensions of scope

- Vertical scope (vertical integration),
- Geographical scope (multinationality) and
- Product scope (diversification)

The key underlying concepts for analyzing these different dimensions

- Economies of scope in resources and capabilities,
- Transaction costs, and
- Costs of corporate complexity

Transaction Costs and the Scope of the Firm

Firms, Markets, and Transaction Costs

- Two forms of economic organization

1. **The market mechanism**: individuals and firms, guided by market prices, make independent decisions to buy and sell goods and services.

Adam Smith termed it as the "invisible hand" because its coordinating role does not require conscious planning.

2. Administrative mechanism of firms:

- Decisions concerning production and resource allocation are made by managers and imposed through hierarchies.

Alfred Chandler has referred it as the “visible hand” because coordination involves active planning.

- Firms and markets may be viewed as alternative institutions for organizing production.

- Firms and markets coexist, but their relative roles vary.

Mainframe computer industry & personal computer industry,

- The administrative mechanisms of firms predominate in the former, markets are more important in the latter
- Thus, in mainframes, the dominant supplier, IBM, remains highly vertically integrated. It produces many of its own components (such as microprocessors), develops its own operating and applications software, and undertakes distribution, marketing, and customer support.

Personal computers

Involve a network of firms linked by market contracts:

- Design and marketing is undertaken by firms such as HP, Acer and Lenovo.
- Components are produced by firms such as Intel, Seagate, and Samsung.
- Assembly is outsourced to contract manufactures such as Asustek and Quanta Computer.
- Customer support is also outsourced to specialist suppliers—often located in India or Eastern Europe.

What determines which particular activity is undertaken within a firm and which through the market?

- Ronald Coase’s answer was relative cost.
- Markets are not costless.
- Transaction costs.
- If the transaction costs associated with organizing across markets are greater than the administrative costs of organizing within firms, we can expect the coordination of productive activity will be internalized within firms.

Factors that have greatly increased the efficiency of firms

- Technology
- Management techniques

So the market economy had been replaced by a corporate economy

J. K. Galbraith predicted that

‘the inherent advantages of firms over markets in planning and resource allocation would result in increasing dominance of capitalist economies by a small number of giant corporations’

“Downsizing” and “Refocusing,”

- Large industrial companies reduced both their product scope through focusing on their core businesses, and their vertical scope through outsourcing.

Why?

- Turbulence of the business environment
- Developments of information and communications technology (ICT)

Corporate scope: vertical integration

- Is it better to be vertically integrated or vertically specialized?
- The simple question for the firm is: to make, or to buy?

The Costs and Benefits of Vertical Integration

- It allowed superior coordination and reduced risk

Change of opinion:

- **Outsourcing**, enhances flexibility and allows firms to concentrate on those activities where they possess superior capabilities
- Coordination benefits associated with vertical integration can be achieved through collaboration between vertically-related companies.

- A company that undergoes vertical integration acquires a company operating in the production process of the same industry.
- Reasons: strengthening its supply chain, reducing production costs, capturing upstream or downstream profits, or accessing new distribution channels.
- E.g. Ikea and Forests in Romania, Netflix produces its own content

Vertical Integration

- Firm's ownership of vertically related activities.
- The greater a firm's ownership extends over successive stages of the value chain for its product, the greater its degree of vertical integration.
- The extent of vertical integration: the ratio of a firm's value added to its sales revenue
- The more a firm makes rather than buys, the lower are its bought-in goods and services relative to its sales revenue.

Vertical integration can be either

- **Backward,** where the firm takes over ownership and control of producing its own components or other inputs, or
- **Forward**, where the firm takes over ownership and control of activities previously undertaken by its customers.
- Vertical integration may also be full or partial.

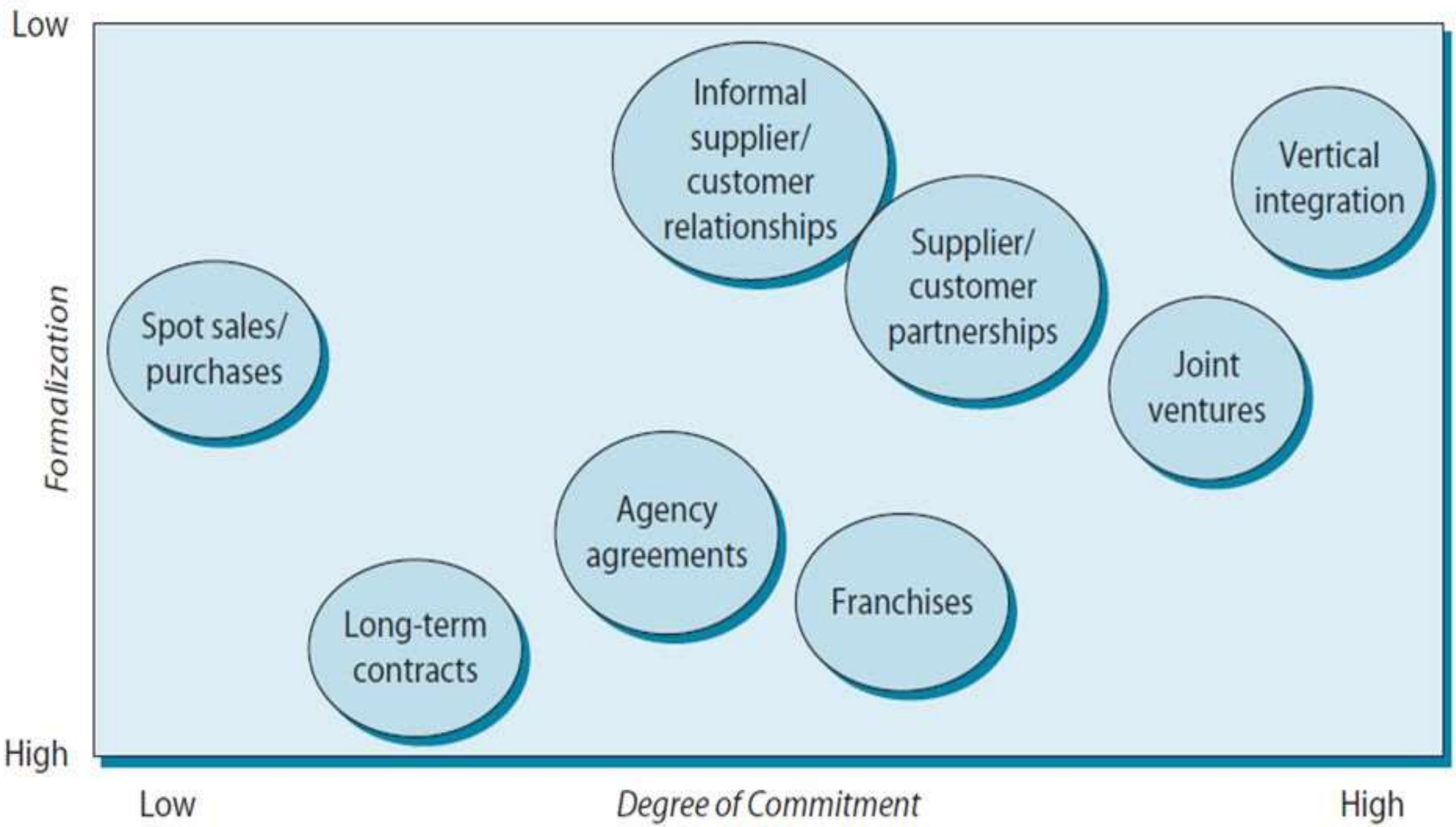
Technical Economies from the Physical Integration of Processes

- The benefits of vertical integration has emphasized the technical economies of vertical integration: cost savings that arise from the physical integration of processes.
- The need for the co-location of plants, not common ownership is necessary.

Horizontal Integration

- When a company wishes to grow through horizontal integration, its primary goal is to acquire a similar company in the same industry.
- Other goals: increasing in size, creating economies of scale, increasing market power over distributors and suppliers, increasing product or service differentiation, expanding the company's market or entering a new market, and reducing competition.
- E.g. Marriott and Starwood Hotels, The Walt Disney Company and 21st Century Fox

Different Types of Vertical Relationship



1. Long-term contracts

- Market transactions can be either spot or
- Long-term contracts that involve a series of transactions over a period of time and specify the terms of sales and the responsibilities of each party.
- A longer term contract can help avoid opportunism and provide the security needed to make the necessary investment.

2. Vendor partnerships

- Vertical relationships based on trust and mutual understanding
- Provide the security needed for transaction-specific investments, the flexibility to meet changing circumstances, and the incentives to avoid opportunism.
- Entirely relational contracts with no written contract.
- E.g. Japanese automakers

3. Franchising

- It is a contractual agreement between the owner of a business system and trademark (the franchiser) that permits the franchisee to produce and market the franchiser’s product or service in a specified area.
- Franchising brings together the brand, marketing capabilities, and business systems of the large corporation with the entrepreneurship and local knowledge of small firms.
- E.g. McDonald’s