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Business Strategy

Lecture 1 What is strategy & Why is it important

Strategy: the art of creating superior performance.

- Strategy is future oriented, you should not focus on what your competitors are doing right now, but on the direction in which they are going and the changes the industry might experience.
- It's not the knowledge, because what we perceive as knowledge is questionable. It's very "ify", it's about outcomes. Sometimes tied to high performance.
- There is no given definition of strategy, some take it from a planning point of view, others from a performance point of view.
- The issue of strategy is that there are a lot of things to say, but it's very difficult to apply. What we know about strategy is based on an outlier (small number of people that have either succeeded or failed). Strategy books never focus on the average company.
- There are no clear steps that one can follow to fail or succeed, it is about many factors. Thus, it is difficult to determine ***dominant business strategy.***

Strategy aims to answer the questions:

- Why do firms outperform others?
- What can we say to firms that will help them outperform others?

How do we assess strategy?

It's difficult because we do not have a simple way to measure performance unlike measuring temperature for instance.

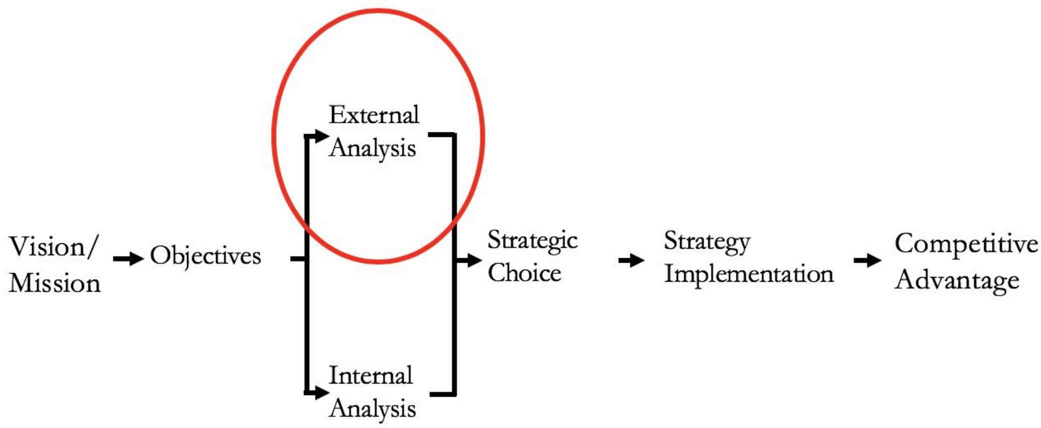
We can't just say that a company is doing 'well' because that depends on how you look at it, profit for example is not a good indicator.

- e.g. Amazon does not make any profit but is not failing and has a valid strategy.

Exam: she wants us to be critical of dominant business strategies.

Strategy Process towards Sustained Competitive Advantage

Nb ignore red ring



Sustained/Sustainable Competitive Advantage

Sustainable/sustained competitive advantage: A long-term competitive advantage that is not easily duplicable or surpassable by the competitors.

An SCA is built by creating/improving/exploting core competencies that can turn into distinctive competencies.

Capability/Capability: a set of assets or resources to used perform a business process (which is composed of individual activities).

- E.g. Distribution, manufacturing, leadership

All firms have capabilities, however a firm will usually focus on certain capabilities consistent with its strategy.

Types of Competencies

Core Competence: A competence that is central, not peripheral, to a company's strategy, competitiveness, and profitability.
Distinctive Competence: A core competence performed better than rivals.

- E.gs:
    - adapting to marked trends faster than your competitors.
    - Toyota: low cost, high quality manufacturing
    - Starbucks: innovative coffee drinks and store ambience

Our **aim as a company** is to create distinctive competences to create sustained competitive advantage.

Lecture 2 Porter: Generic Strategies & 5 Forces

Porter wanted to understand why in some markets profits are high whilst in others profits are low.

- Airlines: sometimes make a loss and need government subsidiaries.
- Soft-drinks: high profits

He acknowledged that industries differ amongst them but also overtime:

- Profits
- Supply chain
- Needs & Wants
- Revenues
- Stage of cycle
- Market share

He identified that low industry profits were associated to:

- Strong suppliers
- Strong customers
- Low barriers of Entry
- Many opportunities for substitutes

- Intense rivalry

He found that these forces can act on the industry reducing its profits. Thus, he developed a framework that aims to look at the competitive nature of an industry at a point in time to assess its profitability. It can be used by a company looking to analyse an entry to a new market or release of a new product.

Porter's 5 Forces

Porter's 5 forces: a framework for analysing the nature of the competition in an industry.
- It assesses the attractiveness of a market when wanting to launch a new product or into a new market.

He established that the main forces that acted on an industry where:
1. Barriers of Entry
2. Supplier Bargaining Power
3. Consumer Bargaining Power
4. Threat of Substitutes
5. Rivalry between existing competitors

Examples of companies doing well for exam purposes:
- *Hollister's reputation amongst teens allows them to charge a premium.*
- *Powerade (coca-cola) beats Gatorade in sales 4:1 as it is able to differentiate itself and there are few other major players.*

1. Barriers of Entry

If it's easy to enter an industry, aggregate profits are reduced because the industry is more competitive.

- The share of industry profits of each firm is reduced
- Threat of a new company entering the market and gain market share will intensify rivalry.

High barriers of entry make the industry look less attractive to potential new entrants. It does not have much effect on existing rivals.

Factors that affect barriers of entry:

- **Capital Requirements -** how expensive is it to join the market/industry.
  - Hair salons have low capital requirements, thus we see many of them.
  - Industries with high fixed costs have larger barriers of entry.
- **Customer/Supplier switching costs**
- **Patents**
- **Brand Equity/Loyalty -** high brand loyalty will mean it is difficult to convince consumers to switch brand.

- **Expected Retaliation -** how prepared are companies to combat new entrants.
    - If you have **excess capacity** your competitors know that if you enter the market and lower the price, they might be able to lower it even more thus trumping your strategy. You will probably not be able to survive in that situation (also depends on the type of product).
- **Government policy:** a government may state that only *x* number of licenses for a specific type of store should be allowed in *x* kilometers like Pharmacies in Spain.
- **Supplier/Consumer switching costs -** how difficult is it to convince customers or suppliers to switch to buying/supplying from you.
- **Economies of Scale/learning:** companies with high economies of scale/learning may have a large cost-advantage over new entrants.

Low barrier of entry markets:

- Dog walking: low-skill everyone can do it, no need for much infrastructure.
- Personal tutor: everyone knows basic reading, maths, science skills.
- Hair salons: simple setup, not very niche skill

High barrier of entry markets:

- Soft-drinks - coca-cola: large economies of scale, high brand awareness and loyalty thus less desire for substitutes.
- Pharmaceuticals: large R&D expenditure, long product design and testing, approval of drug.

2. Bargaining Power of Consumers/Customers

If customers have strong bargaining power then they are able to put pressure on the companies to lower prices.

Factors that define customer bargaining power:

- **Customers are concentrated:** they behave in the same way thus you must please them or they will leave.
- **Purchase a significant fraction of supplier's sales:** if someone purchases a large amount of what you offer they have they can negotiate (especially you can't sell to anyone else).
- **Products are undifferentiated:** consumers can easily switch to another product.
- **Buyer has full information:** knows about competitor's offerings and their prices.
- **Buyer presents credible threat of backward integration (B2B)**: you want them to keep ordering form you.
    - **Backward Integration:** if you are a seller and buy your providers that is an example of backwards integration. E.g. Heinz Tomato

Example of consumers with high bargaining power:

- The supermarket industry is sometimes dominated by a small number of large retail chains which means they can exert great bargaining power on suppliers.

3. Bargaining Power of Suppliers

If suppliers have strong bargaining power then they are able to put pressure on the companies to charge higher prices.

Factors that affect supplier bargaining power:

- **Amount of suppliers**: if there aren't many, they have a high bargaining power.
- **Costly to switch supplier**
- **Suppliers' products have few substitutes**
- **Suppliers' product is an important input to buyers' product:** if a supplier supplies oranges and you just put them in a package and sell them, they have a lot of power.
- **Suppliers' products are differentiated:** if you buy from a specific supplier because of a certain feature.
- **Threat of forward integration:** you don't want them to stop supplying you and you don't want a new competitor.
    - **Forward Integration:** if you are a supplier and you buy/create the outlet that sells your product, that is forward integration. E.g.IKEA, De Beers (largest diamond seller in the world).

4. Threat of Substitute Products

Substitute: performs a similar function to the core product, but are not in the same industry.

Factors that affect the rate of substitution:

- **Performance of the substitute**
- **Pain to switch:** for example if you have already peripherals for an iphone you might not want to purchase those for another phone.

Example of substitutable supplier:

- If you are a newspaper agency and you have a paper supplier, the supplier may not have much power because newspapers are mainly read online now.

5. Rivalry Among Existing Firms

Markets which have a high rivalry are not desirable.

Determinants of intensity:

- **Number of competitors:** more competitors implies less customers/firm thus more competition.
- **Nature of the industry:** in declining or slow-growing markets competition is much more fierce.

Modes of rivalry:

- Price competition
    - generally leaves the entire industry worse off (price wars only benefit consumers)
- Advertising battles
- Improved service / warranties
- New product introduction

Market intensity and rivalry also depends on market share of firms and industry structure:

- **Perfect Competition**: large number of firms, no product differentiation, price taking behaviour
- **Niche Markets**: product differentiation, localized competition
- **Oligopoly**: few firms, strategic interdependence, profitability based on behaviour
- **Dominant Firm**: one/few large firms, more small firms, price leadership
- **Monopoly**: single firm

Possible exam questions:
- What are the things that discourage new entrants?
- What can organizations do in order to raise barriers to entry? (stopping others from coming in)
    - A: Excess capacity (being able to produce more if needed so you can lower the price)
- What are the conditions that combat high buyer power?
- What can organizations do in order to overcome powerful buyers?
- What are the conditions that combat threat of substitutes?
    - A: Differentiation or cost (don't be stuck in the middle)
- What can organizations do in order to overcome threats associated with substitute products
- How many organisation does michael porter assume can gain competitive advantages?
- Under the 5 forces how many organisation can have sustained competitive advantage?
    - **A:** 1 company, he says that sustainable competitive advantage can only occur in monopolistic markets.

Applying Porter's 5 Forces

- Technological change has lowered entries of barrier in many industries.
- Takeovers increase customers and suppliers bargaining power.

Porter's 5 Forces
+ It is prescriptive: tells us if a market is good to enter or not.
+ It is useful to understand which markets we may prioritise if entering a new market or creating a new product.
- Stipulates that only one firm can have sustained competitive advantage.
- Assumes that resources are homogenous.
- Does not take into account non-industry factors (company culture, company change, government taxes)
- Defining an industry is difficult
- Pace of change is quick and this offers a snapshot in time only.

Porter's Generic Strategies

Porter suggested 2 overall strategies that would lead to sustained competitive advantage:
- Low cost strategy
- Differentiation strategy

Under this context porter defines sustained competitive advantage as: advantage over competitors gained by offering consumers greater value either by:
- Low prices (supported by low costs) or
- Greater benefits & services that justify higher prices (highly differentiated).
    - E.g. Apple

Low Cost Strategy

Aim: become the lowest-cost operator.

Key features of low-cost operators:
- **High levels of productivity and efficiency**

- **Bargaining power to negotiate with suppliers**
- **Typically involves production on large scale** (economies of scale).
- **Lean production methods** (minimise waste and optimise production time/resources).

If you are the lowest-cost operator and:

+ Selling prices are similar across the industry, your lower cost will allow you to enjoy better profit/unit.
+ You adopt a strategy to offer the lowest price, you will gain some market share (depends on elasticity of demand).

The best products for a low cost strategy are those which do not require personalisation or differentiation.

Examples of companies that follow a low-cost strategy:

- Low cost airlines: Ryanair - cheap short haul flights
- Xiaomi - low cost tablets and smartphones
- Poundland/Aldi/Walmart

Differentiation Strategy

Aim: to offer higher value by adding benefits, features or quality to your product.

How to achieve it:

- **Superior product quality:** durability, features, benefits
- **Branding:** customer recognition and desire
- **Wide distribution:** it is essential that your product is stocked by retailers
- **Sustained promotion**: continue to inform customers about your superior benefits

Examples of companies with successful differentiation strategies:

- Apple: superior differentiation through brand loyalty/image.
- Dyon: differentiation through product innovation
- All luxury brands sell more than just a product, they sell an experience, a brand or a social status.

Porter argued that if you are not able to have a differentiated or low cost strategy then you will fall in the middle. You will then face competitors which have chosen one of these two superior strategies.

Companies stuck in the middle are those which do not transmit what the company stands for to the consumers, if they are low cost operators or differentiated. Examples:

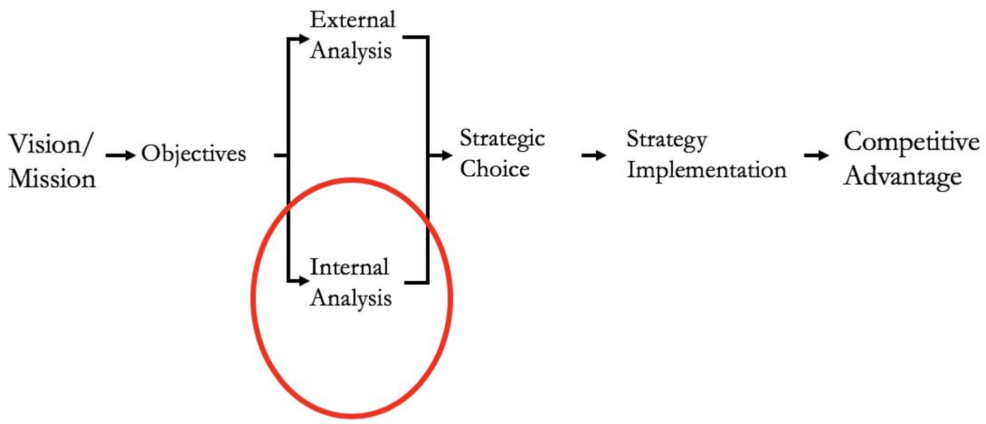
- WHS
- Morrisons
- McDonalds
- Sony

Nowadays, industries have advanced an in some cases it is possible to have firms taht have both a low-cost strategy and a differentation strategy at the same time.

- E.g. IKEA
    - Achieves low cost thanks to cost leadership (cost)
    - Provide good quality and reliable furniture (diff)

   - Can adapt their product range to the country they are operating in (diff)

Lecture 3 Resource and Knowledge Based Views of the Firm



Jay Barney's Resource-Based View

Resource-Based View (RBV): a framework that aims to determine the resources with the potential to deliver competitive advantage.

Note that this is an internal analysis of the company to establish sustained competitive advantage as opposed to Porter's outside look.

The resources a firm may have can be of many kinds:
- **Assets**: factories, stock, offices, patents
- **Capabilities**: judgement, intelligence, learning, problem-solving
- **Firm attributes**: Culture, formal reporting structures, control systems
- **Information**: formal information, networks
- **Knowledge**: Human and social capital: tacit information, experience, personal relationships, etc.

We must look into these to see if we have resources that meet certain criteria and thus provide sustained competitive advantage.

Resources that build sustained competitive advantage (VRIN)

Valuable: resources that allow us to to exploit opportunities or neutralise threats in external environment.
- In practise: does it increase revenue or reduce cost?
- These resources are necessary to form a **core competence**:
   - e.g. Customer service agents and telephones are resources forming the core competence for a call centre

Rare: the resource is not available to many competitors.
- If the resource is not rare enough it may lead to perfect competition.

- E.g. Intangibles such as organizational culture.

Inimitable: resources which are difficult or costly to imitate.
What prevents imitation?
- Unique market conditions
- Causal ambiguity: a firm understands the use of a resource better than others.
- Social complexity – a resource that depends on social factors like trust, teamwork, informal relationships that cannot be duplicated or take time.

Non-substitutable: no equivalent/similar resource an be used to implement the same strategy.
- E.g. a bank employee can offer much better customer service than an ATM. A company has very good brand loyalty vs a good marketing strategy.

Examples of VRIN resources:
- The team that changes tyres at F1: high skill, high level of understanding, discipline and synergy.
- Someone who has been operating (surgery) for a long time
- Leadership in the military: everyone protects each other, they call themselves **brothers** not colleagues.

*parity = the state or condition of being equal, especially as regards status or pay.

James Barney categorised sustained competitive advantage:

Valuable?	*Rare?*	*Costly to Imitate?*	*Non-substitutable?*	*Competitive Implications*	*Economic Performance*
No	--	--	--	Competitive Disadvantage	Below Normal
Yes	No	--	--	Competitive Parity	Normal
Yes	Yes	No	--	Temporary Competitive Advantage	Above Normal (temporary)
Yes	Yes	Yes	No	Temporary Competitive Advantage	Above Normal (temporary)
Yes	Yes	Yes	Yes	Sustained Competitive Advantage 😁	Above Normal

Criticism of RBV

- It is difficult to measure VRIN of a resource, no established way to do so

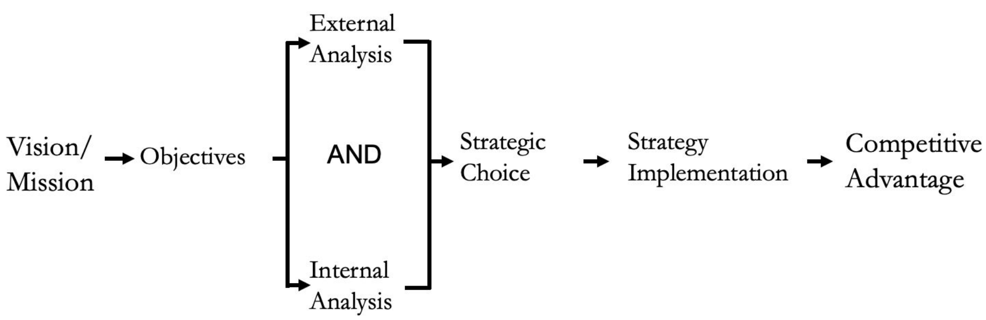
    - could be an opinion
- How do we distinguish between different VRIN resources
- Lacks operationalization, it is difficult to test
- Descriptive, not prescriptive: we have been told how to identify VRIN resources but it does not tell us how to make a resource VRIN. It tells us how to assess them but not how to transform them

Porter vs Barney

	Industrial Organization (IO) [Michael Porter**]**	**Resource Based View (RBV) [**Jay Barney**]**
Focus	External—describes environmental conditions favoring high levels of industry performance	Internal— performance as a function of firm's internal characteristics and resources
Assumptions	Firms within an industry have identical strategic resources. Resources are highly mobile (easily bought and sold) and therefore homogeneous.	Firms have idiosyncratic, not identical strategic resources. Resources are not perfectly mobile and therefore heterogeneous.
Unit of analysis	Industry	Resources

RBV	5-forces
Purpose: To gain superior performance	Purpose: To gain superior performance
How do we gain superior performance? Through sustained competitive advantage	How do we gain superior performance? Through sustained competitive advantage
Sources of SCA: Resources that are: VRIN	Sources of SCA: Monopoly
Resources must be: Inimitable Non-substitutable Heterogeneous	Competitive positioning must be: Cost leadership Differentiation
Unit of analysis: Employs a more stable strategic parameter (ie. Resources)	Unit of analysis: I/O uses quite an unstable parameter, governed by many factors (i.e. the industry)
More realistic Ricardian rents Product heterogeneity Sees strategy as path dependent	Less realistic Monopolistic rents “Homogenous” products Strategy is a series of static equilibria
Usefulness to managers Not prescriptive	Usefulness to managers Provides a good framework, prescriptive
SW (Strengths & Weaknesses)	OT (Opportunities & Threats)

Ricardian rents: any money above what you invest in your resources
5 forces is more useful since it tells managers what to do.



Exam: expects for us to say that neither strategy is useful on its own rather they are complimentary, one looks at the strengths & weakness and the other at Opportunities & Threats

---- Not common in exam -----

Knowledge Based View

Others look at knowledge as a unit of analysis. It is a very important and particular resource because:

- Unlike other resources, knowledge does not depreciate
- It can generate increasing returns over time
- Human productivity is knowledge dependent – most other resources are simply embodiments of knowledge

What is it comprised of?:

- Rules and directives (plans, forecasts, policies, procedures, etc.)
- Common training and routines
- Group problem solving and decision making
- Common organizational culture and language
- Shared meanings

Unique characteristics of Knowledge:

Transferability ("knowing about" vs. "knowing how")

- Knowing about – explicit information that can be communicated
  - Easy to transfer from one firm to another
- Knowing how – tacit (something that cannot be written down and understood), revealed through application and practice
  - Transfer is slow, costly, uncertain

Capacity for aggregation

- Depends on "absorptive capacity" of recipient
- Explicit knowledge can be aggregated, tacit is much more difficult

Appropriability of knowledge

- A public good – can be consumed without exhausting it
- A non-rivalrous good – can be resold without losing it

Distinct Competitive Advantage through Knowledge

Tacit Knowledge: Knowledge about something that cannot be documented

- Tacit knowledge is Valuable
  - *"I don't know it's just gut feeling"*
  - leads to core and even distinctive competence

- Tacit knowledge is Rare
  - "bundle of knowledge" not available to any firm in the industry

- Tacit Knowledge is Inimitable
  - cannot be possessed by any other firm
  - based on unique history of organization
  - lack of understanding of causal links
  - strongly influenced by organizational culture and social ties

- Tacit Knowledge is Non-substitutable
  - no equivalent resource to routines and experience of employees.
  - Exception: patents/copyrights

---- Not common in exam -----

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Lecture 4 Blue Ocean Strategy

Authored by W. Chan Kim and Renee Mauborgne in 2005. Is a strategy based on a study of 150 strategic moves spanning more than 100 years and 30 industries.

Blue Ocean Strategy: is a strategy developed not to **not to outperform the competition in the existing industry, but to create new market space** or a blue ocean, thereby **making the competition irrelevant**.

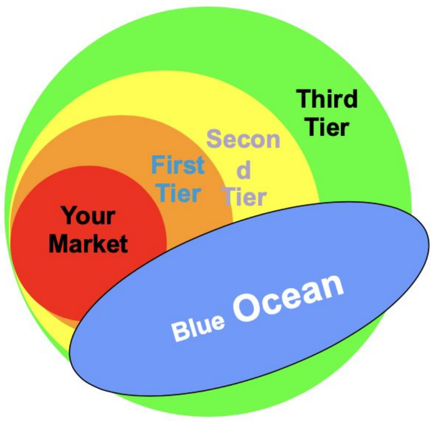
- BOS is the simultaneous pursuit of differentiation and low cost.
  - Involves breaking the value-cost trade-off to create new market space
  - not centered on technological advances, rather, on taking existing concepts and applying them in new ways and in new combinations.
- BOS offers systematic and reproducible methodologies and processes in pursuit of innovation by both new and existing firms.
- BOS frameworks and tools are designed to be visual in order to not only effectively build the collective wisdom of the company but also to effectively execute through easy communication.

Blue Ocean strategies are based on ‘Critical Success Factors’ (CSFs)
- Factors that customers find particularly valuable
- Factors that provide a significant cost advantage

Blue Oceans: are new market spaces where competition is minimized – think wide, empty seas
They contrast with **Red Oceans**: intense rivalry in well-defined industries – think ‘big fish eating little fish’

Red Ocean Strategy	Blue Ocean Strategy
Compete in existing market space	Create uncontested market space
Beat the competition	Make the competition irrelevant
Exploit existing demand	Create & capture new demand
Make the value-cost trade off	Break the value- cost trade off
Align strategy choice of differentiation <u>or</u> low cost	Simultaneous pursuit strategy of differentiation <u>and</u> low cost

“The ocean is a very bloody space with RBV and Porter’s instead blue ocean is where that blood is not existent”

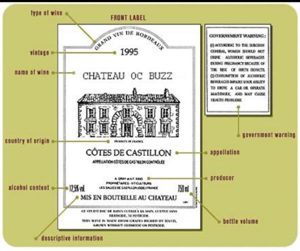


Reach Beyond Existing Demand

- First Tier: “Soon-to-be” non-customers who are on the edge of your market, waiting to jump ship
- Second Tier: “Refusing non-customers who consciously choose against your market.
- Third Tier: “Unexplored” non customers who are in markets distant from yours.

Blue Ocean – Go for the Largest Catchment of Non-Customers

Reach Beyond Existing Demand
Example – [yellow tail]



Traditional Wine :

- An elite, refined image in packaging with heavy use of wine terminology.
- Aging quality.
- Prestige of a vineyard and its legacy.
- Complexity and sophistication of a wine's taste, such as tannins and oak.
- A diverse range of wines to cover all varieties of grapes & consumer preferences

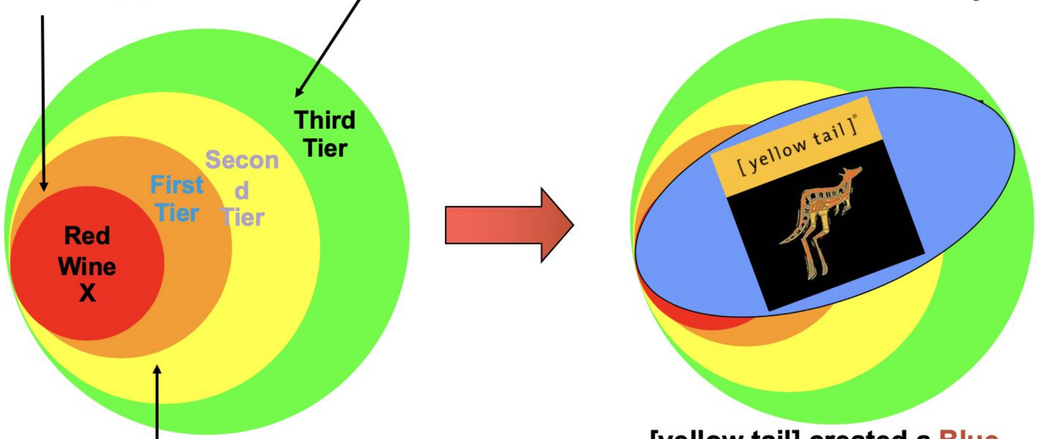
[yellow tail] :

- No jargon. Simple and nontraditional label.
- Aging is not important.
- Vibrant and fun.
- Sweeter and easier to drink.
- Only one Red (Shiraz) and one White (Chardonnay).

Tier 1 – Wine drinker market

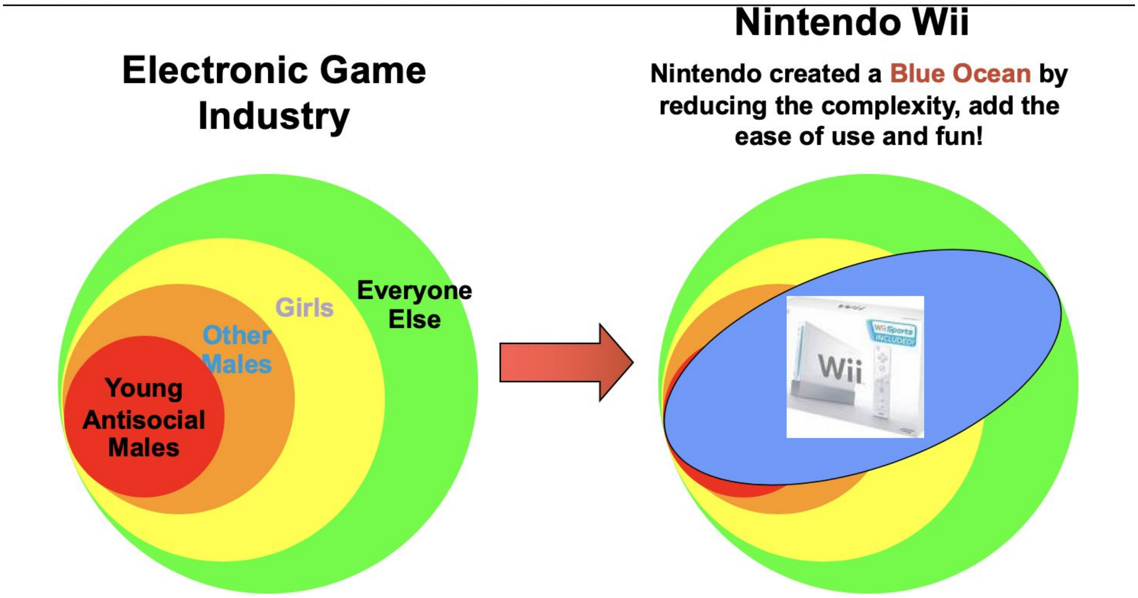
Tier 3 – Anyone that drinks water

[yellow tail] did not focus on the wine market only



Tier 2 – "Easier to drink" market, eg., beer, cocktails, soft-drink

[yellow tail] created a Blue Ocean by making its wine more appealing to the bigger population



Analysis BOS:

+ High profit margin in new industry.
+ Possibility to create long lasting brand equity.
- Eventually becomes a red ocean if it doesn't fail.
- Arriving too early: customers may not understand what you are trying to sell.
- Change in company culture to adapt to new strategy may be difficult (people are resistant to change)
- Some blue oceans are free of predators but also of fish (you may not know until you go).
- No benchmarks to assess risks. Maybe there's a reason why companies are not in that space
- There are no analytic frameworks to aid creation and implementation
- They may become red oceans if they are very attractive and have no barriers to entry

Examples of companies using Blue Ocean Strategy

- Cirque Du Soleil: Lowered costs by not using animals. Raised value by telling a story. Now has very good brand equity that enables it to charge a premium.

Lecture 5 Corporate Strategy

Resource homogeneity (assumption of 5 forces): it is difficult to find an industry in which every competitor that wants to compete in the market has equal access to every kind of resource necessary to compete. Homogenous resources are difficult to pin down as in real industry it is hard to define. Example where everyone has the same amount of resources: refugee camp.

Does this mean Red Ocean theories should be discarded?

- Knowing about red oceans and how to compete in them is crucial given that a majority of markets are red oceans.

Why do firms exist?

According to Adam Smith, there are 2 components to improve economic well-being:

- Division of Labour and Specialization
- Capacity to trade, truck, barter, exchange

If this is the case, then we should be an economy of individual specialists, with the "invisible hand" dictating demand/supply

Transaction Cost Theory

The main reason why companies exist is to lower transaction costs.

- **Search & information costs** – the time it takes for us to find a product and to which product is the best quality, lowest price, etc. (even with "satisficing") adds to the transaction cost.
- **Bargaining costs -** costs of reaching an agreement on a transaction with the other party adds to the transaction cost. Perhaps at a certain price the person who owns the asset is not willing to give it away. Imagine *every time you walked into a supermarket you had to bargain the price of each item.*
- **Policing and enforcement costs** – ensuring the other party adheres to the terms of the contract is part of a transaction cost. *If something goes wrong with the product, there are quality standards that come with establishing companies. If quality standards are not set in stone, then your sales affect your reputation.*

Make vs Buy decision -> If these costs are too high, the entrepreneur will start involving himself in produce the product himself.

Company: a "nexus of contracts", between the owners and suppliers, creditors, employees, clients, the government, and other actors. People are going to work for this firm at this price, the items sold are going to be at this price etc...

Development of Corporations

Stages of Development (Berle and Means, 1938)

1. The firm starts off as a small business fully owned by the founder
2. As firm grows, the founder requires more capital, and raises it by issuing stock
3. Over time, the founder owns a smaller and smaller percentage of the company
4. The founder will eventually fully divest himself from the company, leaving it in the hands of professional managers.

In essence overtime, the owners give up control. But why is this a problem?

Principal agent problem: where the owner and manager disagree. Usually what occurs is that there is a compromise between both what managers what to do and what owners want to do.

Agency Theory

These are the ways in which the principal agent problem manifests itself. The assumption is that both principals and agents act according to their own interest. This is compounded by two issues

1. **Information Asymmetry**: managers have more access to firm information that people outside.
    a. Information asymmetry produces a situation in which parties start to bargain about the price.
2. **The moral hazard problem:** Managers are more risk-seeking given that they are generally protected from losses… Or are they?

So we need a way to minimize:
1. The three transaction costs in the operating environment (with suppliers, distributers, etc.)
    a. Search/Information, Bargaining, Policing/Enforcement costs
2. The three agency costs within the organization.
    a. Divergence, Incentive and Monitoring costs

Corporate Governance Approaches

Corporate Governance: the way in which you govern, manage your company.

There are two theories:
Stockholder Theory (Friedman): focus on the stockholders/shareholders: The business of business is making a profit and building shareholder value is the prime purpose.
Primary group: Employees, suppliers and customers matter in building value

Stakeholder Theory (R. Edward Freeman): argues that the quickest way to destroy shareholder value is to ignore these stakeholders. Instead we must identify the other diverse stakeholder groups in a corporation that need to be engaged – the secondary groups

There are some ways in which they can be compatible. Ie Ben & Jerrys acquired by Unilever and now Happy Milks provide milk for them. Makes the stakeholder and stockholder happy.

Formal definitions of corporate governance

Definition 1: “[a] combination of mechanisms which ensure that the management (the agents) runs the firm for the benefit of one or several stakeholders (principals). Such stakeholders may cover shareholders, creditors, suppliers, clients, employees and other parties with whom the firm conducts its business”

Definition 2: The companies most successful at outperforming their competitors over time are those that aim towards goals other than maximizing shareholder value. Employees and customers often know more about and have more of a long-term commitment to a company than shareholders do. Tradition, ethics and professional standards often do more to constrain behavior than incentives do.

How is corporate governance associated with superior performance

Financial Benefits

Efficiency:
- Streamlining business process
- Improves operating performance
- Lowers costs and capital expenditures

Return on Equity

- Improving ROE
- Increase profitability
- Improves the chances that SHs will receive sustainable dividends

Higher share price

- Profitability improves share price performance
- Firms gets better recognition as a good performing stock
- Attracts investor confidence, and new capital

There is no direct link but when you do things well, ie you treat employees well, you treat consumers well, then you develop a reputation and this has its benefits.

Good CG practices improves reputation quickly
People's willingness to buy, recommend, work for, and invest in a company is driven 60% by their perceptions of the company, and only 40% by their perceptions of the products

Long-Term strategic CG has similar effects
Firms that are successful in emerging economies typically invest in the local communities where their plants are located, providing education and social services

Conclusions

Corporate strategy involves a creating strong corporate governance practices. Corporate governance is about creating the necessary infrastructure (incentives and monitoring) to ensure agents work in the interest of multiple principals

Given externalities and internal evolutions, corporate strategy has to adapt over time to better "fit" changing circumstances.

An effective corporate strategy reduces agency and transaction costs, and ensures the long-term stability of an organization.

Lecture 7 Strategic Capability

Strategic capability: is the adequacy and suitability of the **resources** and **competences** of an organization for it to survive and prosper.

Resources: assets that companies have.
Competences: ways that resources are deployed effectively.

The resources are what we have and the competences are what we do

Resources: What we have		Competences: what we do well
Machines, buildings, raw materials, products. Patents, databases, computer systems	Physical	Ways of achieving utilisation of plant, efficiency, productivity, flexibility, marketing
Balance sheet, cash flow, suppliers of funds	Financial	Ability to raise funds and manage cash flows, debtors, creditors etc.
Managers, employees, partners, suppliers, customers	Human	How people gain and use experience, skills, knowledge, build relationships, motivate, innovate

We make use of these to ensure long term survival and competitive advantage.

Ie NASA has a lot of space, a lot of finance and human resources which can use their skills and make use of the machinery to deliver a product.

How can strategic capabilities contribute to long-term success?

- **Dynamic capabilities:** an organization's ability to renew and recreate its strategic capabilities to meet the needs of changing environments (opposite is ordinary capabilities)
    - NETFLIX has gone from distributing movies to making them
    - Apple went into the music industry and became a music distributor with itunes and the acquisition of DR Dre.

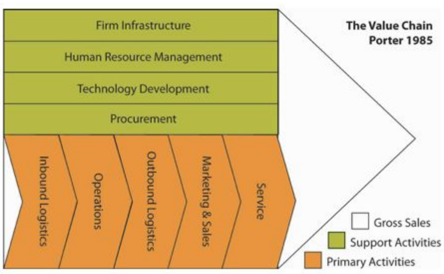
- **Distinctive capabilities:** Capabilities that customers value or competitors can't imitate. (opposite to threshold capabilities: those that help survival but not gain sustained competitive advantage).
    - Customer service

"Knowing what your capabilities are is just as important as having strategic capabilities"

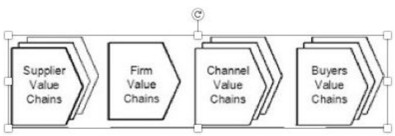
How do we diagnose strategic capabilities?

- VRIO look at what you offer and determine if its: **Valuable**, **Rare**, difficult to **Imitate**, supported by **Organization**?
- Benchmarking: comparing to industries average or comparing to the best
- Value Chain: how to produce your project and Value System: relationships, activities and everything that happens around it.

VALUE CHAIN

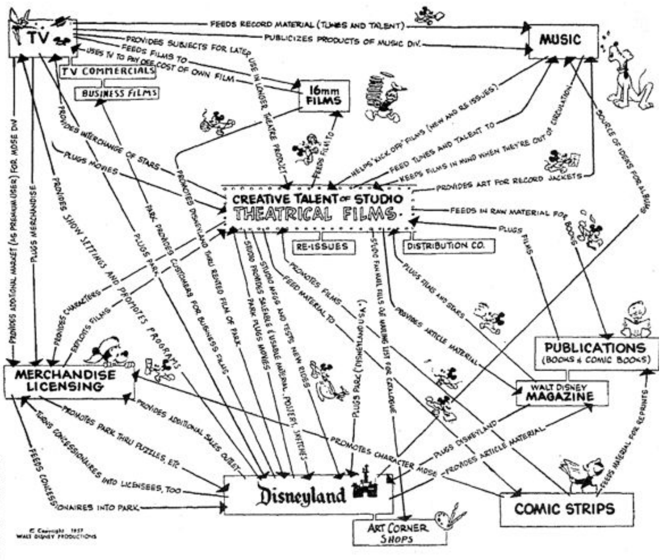


VALUE SYSTEM



Porter believed that if you found what you do well and nurtured that you would do well in the long run.

- Activity Mapping: you map the activities taking place in your organisation and map those to others with which they are assocaited.



- SWOT (Strengths, Weaknesses, Opportunities and Threats)
  z

Managing strategic capability

Once we find which our strategic capabilities are we must take care of these.

- **Internal capability development:** look for ways in which we can nurture these strategic capabilities within the organisation.
- **External capability development:** look for ways in which we can nurture these strategic capabilities form outside the organisation.
- **Ceasing activities:** if you feel that they are not doing much, they are not contributing much, you stop them.
- **Monitoring outputs and benefits:** close monitoring to understand the benefits they provide.
- **Building awareness:** telling people in the organisation what they are so that they are present.

Lecture 8 The Strategic Change Process: Diversification and Internationalization

Why change strategies?

- **Changes in environment**: customers may have new buying patterns.
- **Economic downturn:** people spend less, luxury goods are bought less.
- **Strategic drift**: tendency for companies to develop incrementally on the basis of historical and cultural influences, but fail to keep pace with a changing environment. *Ie The way we do things is now changing. We can't just have brick and mortar stores we must have a digital store too.*

Over 50% of major change initiatives fail to deliver the planned benefit. Many organisations want to avoid change but sometimes CEOs come in and want to change things. They want to be the guy that was able to change things.

Change vs Something new

Doing something new: in line with the core capabilities of an organisation.
- Google going into the driverless car industry. Google makes AI and google already uses AI.

Undergoing change: associated with having to adapt new capabilities.
- Netflix learning to create movies rather than just streaming them.

Types of change

- Extent of change: **Realignment vs transformation**
- Nature of change (speed): **'Big Bang" vs Incremental**

- **Incremental:** slow changes
- **Big bang:** some idea that has been brought unnaturally, a new CEO just comes in. All of a sudden.

Nature of change \ **Extent of change**	Realignment	Transformation
Incremental	Adaptation	Evolution
Big Bang	Reconstruction	Revolution

- **Adaptation**: Most common form, occurs incrementally and doesn't require changing the org's culture.
- **Reconstruction:** May be rapid and involve a lot of upheaval, but doesn't require major changes to the culture. Turnarounds often fall in this category
- **Revolution**: Requires rapid and major strategic change as well as cultural change. Particularly common in cases of 'strategic drift'. *This is the most problematic and extreme form of change. This is the area where we see change.*
- **Evolution**: Requires culture change, but not urgent. Can be most difficult to manage because people won't see the need for change.

How do we manage change successfully?

Managing strategic change successfully builds on these key premises:

- **Context matters**: No 'one right way' of managing change
- **Inertia and resistance:** people tend to be risk averse and hold on to existing ways of doing things. *"But this is how we've been doing it"*
  - Be aware of consultants within your company
- **Leadership matters:** but leadership may not be just from the top.

The Change Kaleidoscope

Different aspects to consider when we undergo change.

Diversity can be somewhat controversial as diversity training is something that is ticked off as done when someone comes up to you and talks to you about diversity for 45 minutes. Instead things like learning other cultures or other languages is a better approach.

Why does strategic change fail

- **Competency traps:** organisations can get stuck in doing things they do well, core capabilities become core rigidities. The more highly developed the capabilities, the more difficult to develop new routines
- **Social & political structures**: when change disrupts established social patterns and threatens the power of those in positions of authority, organizations tend to resist change.
  - China blocking the patents Apple use.
- **Conformity:** organizations fall into common structures and strategies, often due to risk aversion rather than any external pressure.
- **Death by planning:** taking too much time planning that change takes long.

  - Brexit
- **Limited search:** companies prefer exploitation over exploration.
- **Bounded rationality:** there is too much information to take in to make a perfect decision. Companies may spend too much time finding too much information and not making trade-offs. Rather we should focus on taking rational decisions as we are rational beings.
- **Reinterpretation**
- **Too tight a fit between strategy, structure, & systems:** we cannot make any change happen because everything fits in just perfectly.
- **Behavioral compliance**: complying with the letter of the law but not the spirit.

Diversification

Diversification: involves increasing the range of products and markets served by an organization.
Related diversification: Diversifying into products or services with relationships to the existing business.
Unrelated diversification: Diversifying into products or services with no relationships to the existing business.

More risky:
  - Might not know about the market/industry. Joint ventures may fix this.
  - Large transaction cost in going to a new market

- Unrelated diversification can be key for a company as it is makes your strategy valuable, rare, immitrable. However, there are pressures from the market not to do that.

Diversification Benefits - value creating drivers

- Economies of scope
- Stretching corporate management competences ("dominant logics")
- Exploiting superior internal processes: might have the ability to tap onto a joint venture's experience and work.
- Increasing market power: more sources of revenue. Ie AWS

Diversification creates value if there are **synergies**.
Synergy: the benefit gained where activities or assets complement each other by creating benefits which are larger when combined than the the sum of the parts.

Diversification should be done in the cases where there is very clear synergies.

Reasons for Diversifying

- Environment becomes unattractive (regulations, market boundaries etc): GDPR with user data monetization.
- Industry's competitive environment becomes unprofitable
- Strategic intent of organization covers more than one business
- Surplus capabilities: we know a lot about a market/industry but we are not using this to its full ability.
- Capability gaps
- Managerial goals: a CEO may want to change the goals so that they are under their expertise.

Value Destroying Drivers

- Responding to market decline
- Spreading risk
- Managerial ambition

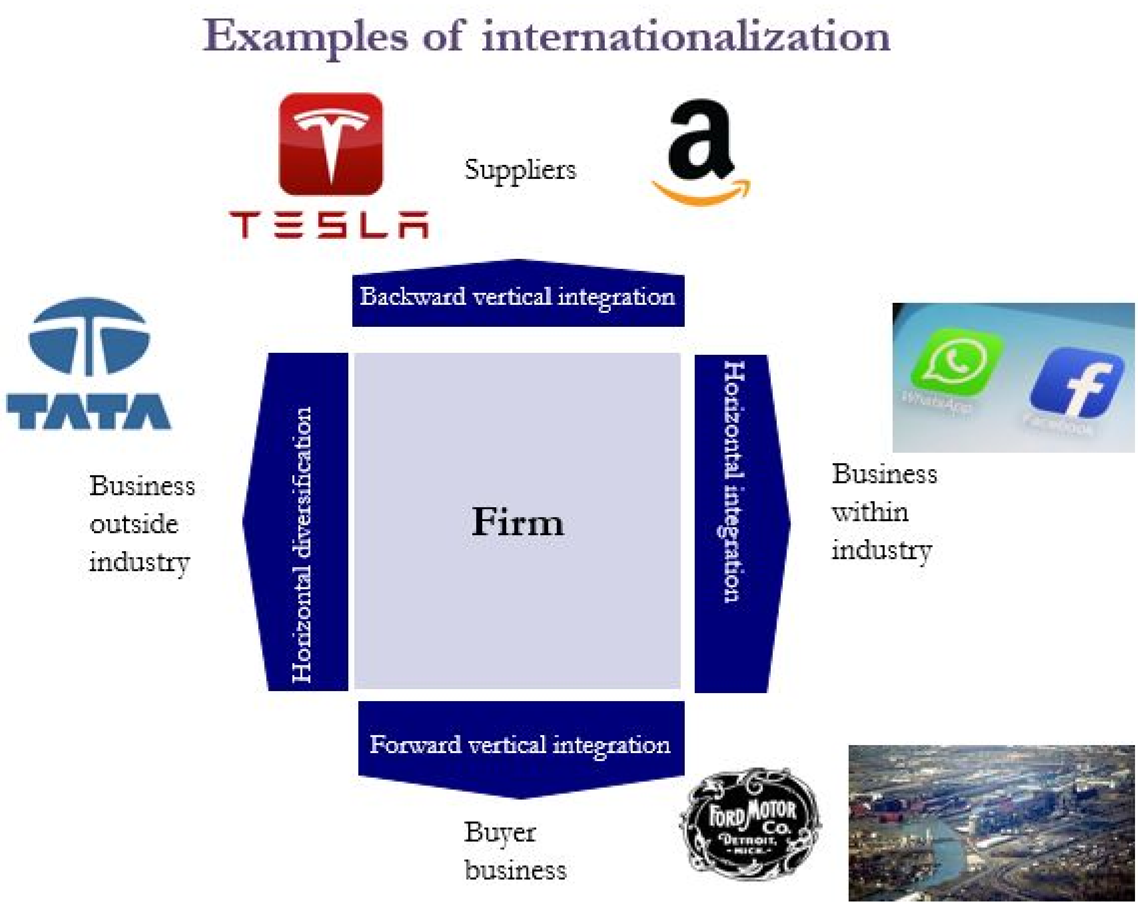
Strategic Directions

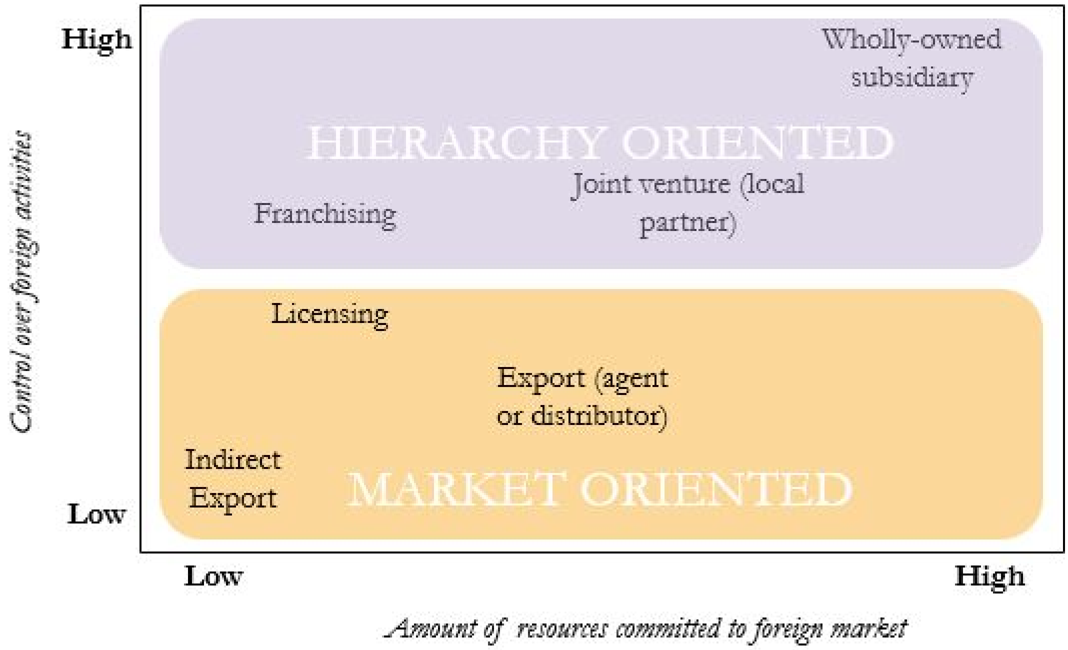
Increasing risk

Market \ Product	Existing products	New products
Existing markets	Market penetration	Product development
New markets	Market development	Diversification

Increasing risk

Internationalization





Alliances and partnerships

Many companies work in conjunction with others to build a product. For instance a boing does not make its own engines rather they are delivered by Rolls Royce or GE. As with other many other parts from other distributors.

These rely on relationships and networks that the company have and the people in the company have.

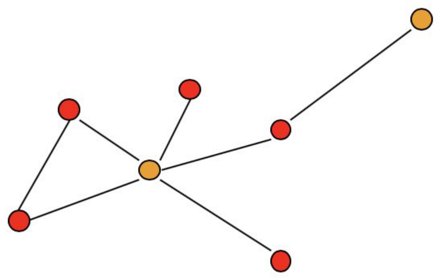
Link between networks and competitive advantage

Competitive advantage rests on:

- **Physical Capital**: resources and capabilities that are VRIN (RBV view)
- **Human Capital**: competencies and resources that employees possess (education, experience etc)
- **Social Capital**: The way in which connections to other firms facilitates goal achievement (who you know)

Networks and Competitive Advantage

- **Network:** A set of ties among a set of actors (or "nodes")



- **Actors:** People, organizations, business-units, countries …
- **Ties:** Any instance of 'connection of interest' between the actors (can be positive or negative)

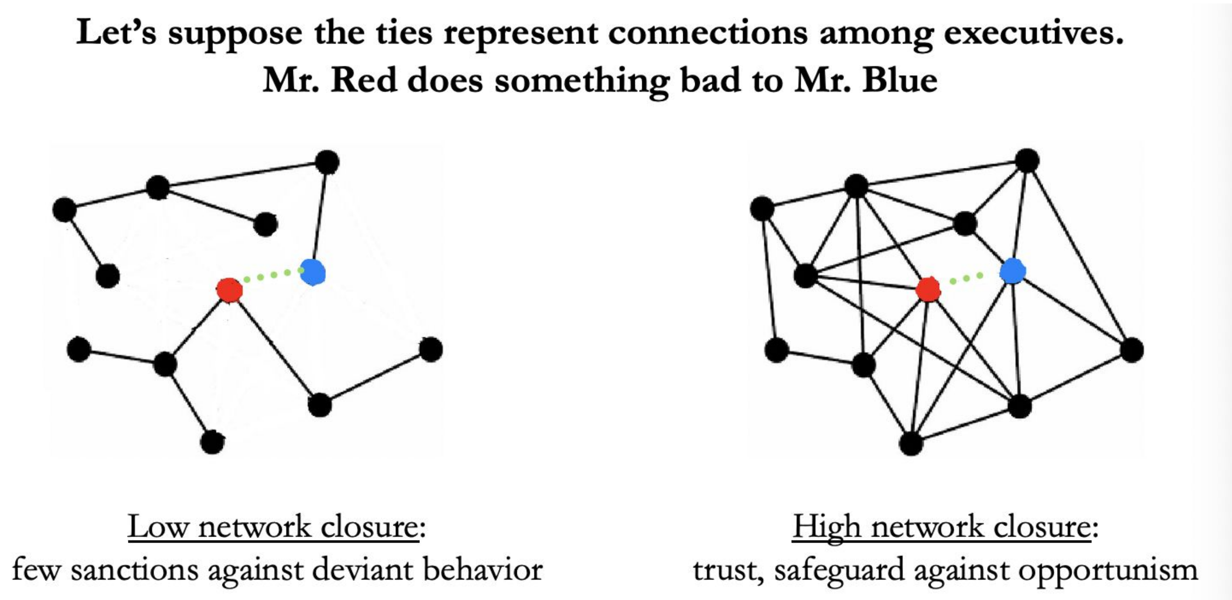
Networks in an organizational context

If a firm is a node, then a tie can be

- A buying, selling relationship
- Ownership
- A joint venture or alliance
- Competition

Different types of networks

If the red does something bad to the blue. Which network is more damaging to the Red?



The one with the highest network closure as it relies on trust.

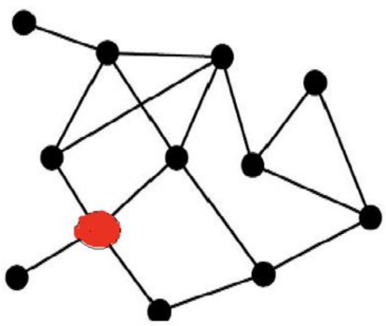
Think of it as if you were a team and someone does something bad to a team member, would you favor or despise him.

Why do ties matter?

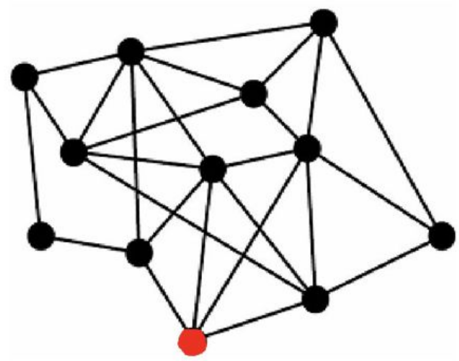
Many successful job placements come from indirect connections ("weak ties"). If you are in a closed network it is likely that those people also have access to the same resources. Someone from a weak tie is more likely to bring more information that you do not have access to in your own environment.

Granovetter's conjecture: strong ties are more likely to contain information you already know

Network closure reduces Network Diversity (for a given company)



High Diversity:
brokerage benefits, diverse resources, innovative ideas



Low Diversity:
Redundant ties, shared resources, group-think

Access to information for example is best in High Diversity networks, since there is less redundant ties.

Lecture 9 Reputation and Sustainability as Sources of Competitive Advantage

Reputation is an important intangible asset for firms.

- Reputations are **for something, with someone** having a good/bad reputation is no monolithic rather it is varied depending on from which perspective we are looking.
    - This is why it is important to consider which reputation to invest on to create competitive advantage.
    - Many stakeholders have interests in the firm's performance and this sometimes comes into conflict with having a good reputation.

Company reputation: "a perceptual representation of a company's past action and future prospects that describe the firm's appeal compared to other leading rivals (Fombrun, 1996)

- Reputation can be built doing activies like:
  - Advertising
  - Sponsorship
  - Philanthropy
- It can depend on the stakeholder. It can be good towards one stakeholder but bad towards another.

Good reputation plays an important role in value creation and is difficult to replicate due to its intangible nature.

Note that stakeholders come in many varieties some may have an interest in creating the biggest profit but some may have an interest in creating the biggest wellfare.

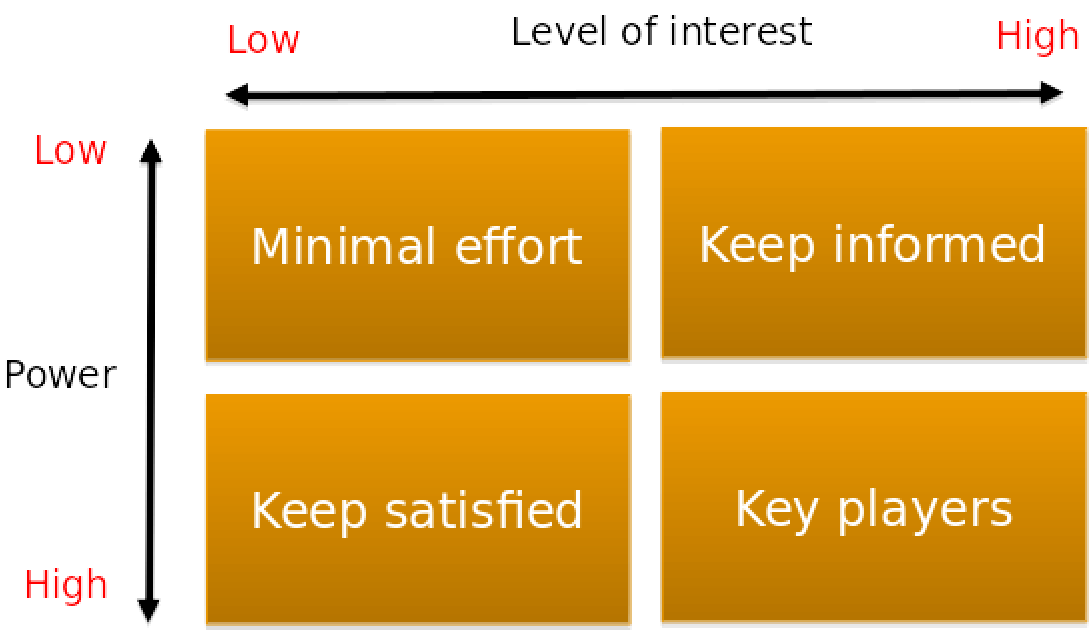
- Employees (wage and salaries)
- Landlords (rent)
- Governments (taxes)
- Citizens (clean environment)
- Customers (safe products)
- Lenders (interests)

STAKEHOLDERS

- Owners (profits)

SHAREHOLDERS

We can map stakeholders in terms of the impact they have on the firm's activity or how likely they to back or oppose to a strategy and do they have the power to do so.



Corporate Social Responsibility (CSR) is important for those stakeholders which are not legally bound to the company.

- CSR is important to stakeholders like local communities and pressure groups unlike contractual stakeholders like suppliers, employees consumers.

CSR initiatives are for example:
- Changing methods of production to reduce environmental impacts
- Making infrastructure investments in local communities
- Developing philanthropy initiatives

Philanthropy: the desire to promote the welfare of others, expressed especially by the generous donation of money to good causes.

There are also other reasons firms engage in CSR:
- **Attract and retain talented employees:** if the labor market is competitive on the firms' side, it's harder to get access to skilled or talented workforce. CSR can be a potential competitive advantage to attract employees, as it improves the perception of the firm if these values are aligned with those of the employees
- **Brand differentiation:** through CSR the company can offer a significantly different product. CSR adds value to the product and makes it original, the product then stands out of competition. CSR can create customer loyalty because of shared ethical values. E.g, Patagonia, The Body Shop (the brand is the CSR)

For example CSR in a car company may be climate change. Investing in a way to reduce emissions is CSR.

Sustainable Development/Sustainability

Said she is not keen on this and won't ask many questions about this

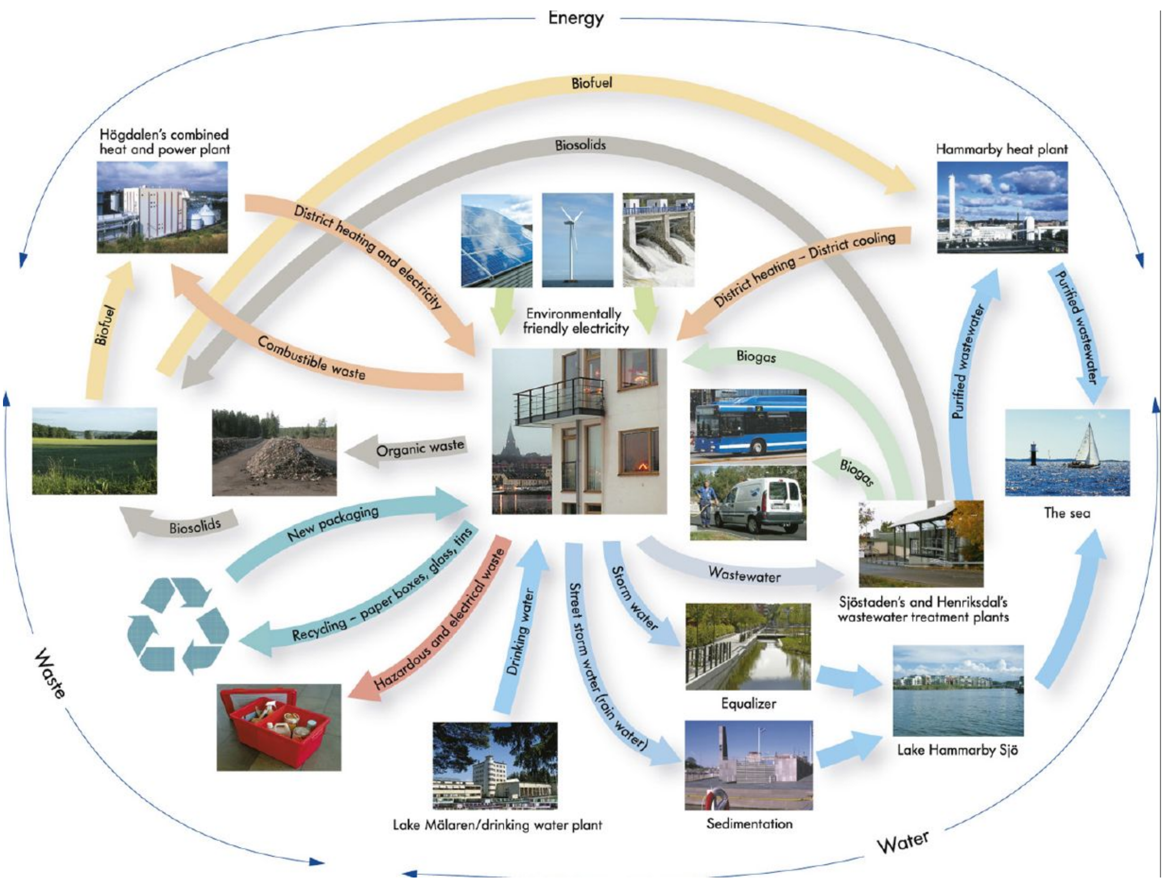
Definitions of sustainability have change a lot and it is very difficult to measure.

Defined in class as: **the social, environmental and economic that make up sustainable development.** The three P's people, planet, profit.

There are two systems in which sustainable development can happen.

Closed-loop systems

Closed-loop systems: confine a space in which everything that happens in that space is sustainable. Waste is reused in other parts of the system.
- Example: an area of Stockholm which is self-sustainable and produces no waste.



Sustainability as an end state

Sustainability as an end-state: is the outcome you produce sustainable. For example lower emissions. Waste is produced aimed to be minimised.

- **Sustainable development**: a process/pathway of growth
- **Sustainability:** desired end-state or outcome

The most recent way that people have been talking about sustainability is about **resilience.**

Resilience states that mistakes will be made but you don't die as a result of them. For instance, Nokia, they are able to re-emerge although they are not the number one in disruptive technology as they used to be. Some companies may not be good for the world but they are able to be sustainable in of themselves and can live for long periods of time.

Thus, for businesses we can say that:

Sustainable Business Practice: address competitive landscapes increasingly shaped by climate change, resource scarcity, regulatory uncertainty and economic volatility.

Examples of ecologically sustainable practice

Lecturer is a bit devious about these practises herself. "Do not feel obliged to memorise them"

1. Total Quality Environmental Management (TQEM)
    a. Efficiency - elimination of emissions, effluents and accidents e.g. Life cycle Analysis (LCA), closed loop systems

2. Ecological sustainable Competitive Strategies
    a. Sustainable least-cost, Sustainable differentiation, Sustainable niche strategy
3. Technology-for-nature swaps
    a. Companies purchase national debt or transfer environmental technology in exchange for "sustainability rights"
4. Reduction of the impact that populations have on ecosystems
    a. Establishment of infrastructure in developing countries
    b. Higher levels of education & healthcare reduced birthrates

An example of a sustainable organisation is IKEA that aims to increase the use of renewable materials in products, incentivises consumers to bring their own bags, they carry out the process themselves and have a model in which they do not want to depend on others.

Conclusion

- Sustainability is no longer just about integrating environmental, social and economic issues. It is a strategic choice.
- It is a long-term risk management tool: A response to globalization, to climate change, to risk & uncertainty (crises and disasters)
- It can't be accomplished by one group (state/business/NGOs); it has to be an aggregate effort among stakeholders