**MGT 3664: Corporate Strategy**

**Instructors**: Peter Thompson, Alex Oettl, Marco Ceccagnoli

**Scope of the Course**

This course examines topics concerned with the creation and maintenance of value by multi-business enterprises. Corporate strategy is concerned in part with issues such as the appropriate mix of business units, make-or-buy decisions, the acquisition or development of new business units, and the disposal of existing business units; these questions are often not relevant to strategy studied at the level of the individual business unit.

**Learning outcomes**

1. Expose you to corporate strategy problems faced by companies regarding scope decisions of where to compete in the horizontal and vertical scope dimensions
2. Equip you with the conceptual frameworks and tools for solving corporate strategy decisions

This course may be useful for those who seek careers in consulting, general management, and investment banking where multi-business firms play an especially critical role.

**Readings and Other Materials**

Case study material and some readings are available in a course packet from HBS.

**A Note on Case Discussions**

Case discussions are intended to present dilemmas as they are encountered by managers, so it is important to deal with the cases as you find them (i.e., no “Monday morning quarterbacking” based on knowledge of what happened after the time frame of the case). In case discussions, the present tense should be interpreted as referring to the time frame of the case or its end. Please do not prepare for the class discussion by seeking out additional or more recent data on the firms or industries in the case.

**Course Requirements and Grading**

**Individual**

**1.** Three Mid-Term Exams.

**2**. Class Participation. The usual expectations apply here – that you come to class prepared to answer questions when called up, and prepared to offer answers when not called upon. There will be cold-calling.

**Group**

**3.** Project.A significant group project, described below, will involve an extensive report, and a presentation at the end of the semester. Groups should consist of three or four people.

**Overall Grade**

The course grade is determined by the weighted average of:

**1.** The three exams (50%).

**2.** Class participation (20%)

**3**. Group project (30%)

**Class participation**

Things that have an impact on the class participation grade include:

* Is the participant a good listener?
* Is the participant willing to interact with other class members?
* Are the points made relevant to the discussion? Are they linked to the comments of others?
* Do the comments add to our understanding of the situation?
* Does the participant distinguish among different kinds of data (i.e., facts, opinions, beliefs, concepts)?
* Is there a willingness to test new ideas, or are all comments "safe" (e.g., repetition of facts without analysis and conclusions)?

You may have to take pop quizzes in class. The scores from these pop quizzes will be part of your class participation grade.

This is not an easy course, as it provides an in-depth introduction to an extraordinarily complex subject. Missing class greatly detracts not only from your own ability to learn, but more importantly of that of your peers. As one is unable to participate when not in attendance, missed classes will negatively affect your class participation mark. The Institute’s attendance policy can be accessed at: [http://www.catalog.gatech.edu/rules/4/#](http://www.catalog.gatech.edu/rules/4/).

**Group Project**

You will be asked to form a group of no more than three people during the first week of class. Please have one of the members email me with the names of group members, a name for the group, and the name and preferred email of the corresponding member of the group (the corresponding member will be in charge of emailing submissions to me, and of communicating messages between me and the rest of the group; this is simply a coordination role, not a chairing role) no later than **January 21**.

Your group runs the acquisitions department at a major corporation, which is charged with identifying existing firms that might profitably be acquired. In this project, you are to choose which corporation your group represents and identify a target firm for acquisition. You will then prepare a report for your Board of Directors that (i) explains why the firm is likely to be worth more to your firm than as a stand-alone company; (ii) develops an estimate of the value of synergies to your company, and a corresponding bid price; and (iii) carries out a comparative analysis of strategies alternative to acquisition that could accomplish similar goals for your firm. **Note**: You may choose an acquisition that has already taken place, although you write your report as though it has yet to occur.

## **ACADEMIC INTEGRITY:**

The course process will follow all relevant and appropriate Georgia Institute of Technology academic regulations ([http://www.honor.gatech.edu](http://www.honor.gatech.edu/)) including those about academic integrity. All students are expected to maintain traditional standards of academic integrity by giving proper credit for all work. All suspected cases of academic dishonesty will be aggressively pursued. A student shall be guilty of a violation of academic integrity if he or she represents the work of others as his or her own or aid another's misrepresentation. **Any violation associated with a homework, assignment, examination or quiz will result in a zero for the assignment and a failing grade for the course.** Such violations will be reported to the Office of Student Integrity, which may impose penalties beyond those by the instructor. Students are encouraged to read the ACM Code of Ethics (<http://www.acm.org/constitution/code.html>), particularly sections 1.3, 1.5, 1.6, 2.2 and 2.4.

## **STUDENTS WITH DISABILITIES:**

Students requesting academic accommodations based on a documented disability are required to register with the Office of Disability Services. Please obtain a form from their office and turn it in to me at the beginning of the semester. The Office of Disability Services is located in the Smithgall Student Services Building, Suite 123. The phone number is 404-894 2563.

<http://disabilityservices.gatech.edu/content/4/contact-us>

**COURSE CALENDAR AND CONTENT**

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| **Week 1** | |
| **Day 1** | **Day 1** |
| **Introduction**  **Mini Case: Apple Maps** | **Scale and Scope**  **A.** Static economies of scale and scope.  **B.** Learning by doing, and dynamic scale economies.  **C.** Learning spillovers and scope. |
| **Readings**  Israel, Shel (2012): “Why Apple Had To Release Its Terrible Maps App Now.” *Forbes*. 29 September.  Besanko, David, David Dranove, Mark Shanley, and Scott Shaefer (2010): “Economies of Scale and Scope *“. Chapter 2 in Economics of Strategy*. | |

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| **Week 2**  **Horizontal Scope 1: Motives for Diversification** | |
| **Day 1** | **Day 2** |
| **Case**  **Saatchi & Saatchi** | **Lecture**  **A.** Economic motives for diversification in the absence of economies of scope: ***I****nternal capital markets; market power; resource availability.*  **B**. Managerial motives for diversification.  **C.** Evidence on diversification and performance. |
| Case 792-056: *Saatchi & Saatchi Co. PLC: Corporate Strategy* | |
| **Saatchi & Saatchi,** *founded in 1970, became the world's largest advertising agency in 1986. It then diversified into consulting and other managerial areas before crashing in 1989. Under a new CEO, the company restructured and refocused on its advertising agencies.*  **1**. What were the economic motivations that led the firm to diversify?  **2**. How sound were these motivations? How much of the failure of the diversification strategy could have been foreseen?  **3**. What do you think of Louis-Dreyfus’ actions? Would you have chosen a different clean-up strategy? | |
| **Readings**  Porter, Michael E. (1987): “From competitive advantage to corporate strategy.” *Harvard Business Review*, **65**(3):43-59 | |

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| **Week 3**  **Horizontal Scope 2: Entry into New Markets** | |
| **Day 1** | **Day 2** |
| **Case**  **Polaroid-Kodak** | **Lecture**  **A.** The economics of entry and entry deterrence. |
| Case 9-376-266: *Polaroid-Kodak.* | |
| * + **Polaroid-Kodak:** *Describes Kodak's long-awaited challenge to Polaroid in the field of instant photography. Provides technological and company background of both Polaroid and Eastman-Kodak and their respective product lines. Discusses Polaroid's claim that Kodak infringed on 10 Polaroid patents.*   1. What do you think are Kodak’s goals in potentially entering the instant photography market?  2. Is there anything that Polaroid could have done in the late 1960s or early 1970s to discourage Kodak from entering?  3. Once it is clear the Kodak is entering, what strategy should Polaroid take?  4. How does the fact that Kodak is a supplier to Polaroid affect Polaroid’s and Kodak’s incentives?  5. How would you expect competition between the two firms to play out? | |
| **Readings**  Besanko, David, David Dranove, Mark Shanley, and Scott Shaefer (2010): “Entry and Exit *“. Chapter 11 in Economics of Strategy*. | |

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| **Week 4**  **Horizontal Scope 3: Evaluating Synergies and Investments** | |
| **Day 1** | **Day 2** |
| **Case**  **Cadbury Schweppes** | **Lecture**  **A.** Bidding under uncertainty.  **B.** NPV analysis, the weighted cost of capital, and real options. |
| Case 9-708-453: *Cadbury Schweppes: Capturing Confectionary (A)*  Case 9-708-454: *Cadbury Schweppes: Capturing Confectionary (B)* | |
| **Cadbury-Schweppes:** *Global confectionery and beverage maker Cadbury Schweppes needs to decide whether or not to make an acquisition bid for Adams, an underperforming gum company which has been put up for sale by pharmaceutical giant Pfizer. The (A) case provides brief histories of the two companies; traces the global confectionery industry, focusing especially on chocolate and gum; and details the analysis of the merger decision. The (B) case explores the specific identified synergies in-depth and provides an opportunity to judge their viability.*  **1.** What strategic factors might support doing the deal or caution against it? What might be its impact on Cadbury Schweppes’ overall market position/portfolio? How will rivals respond?  **2.** The case study identifies many different potential synergies. To what extent are the proposed synergies with Cadbury Schweppes’ existing business units plausible. Which are implausible? | |
| **Readings**  Eccles, Robert G., Kersten L. Lanes, and Thomas C. Wilson (1999): “Are you paying too much for that acquisition?” *Harvard Business Review*  Dixit, A. and R. Pindyck (1995): “The options approach to capital investment.” *Harvard Business Review,* **73**:105-115. | |

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| **Week 5**  **Horizontal Scope 4: Understanding and managing value creation and value destruction** | |
| **Day 1** | **Day 2** |
| **Case**  **Microsoft’s acquisition of Sendit** | **Lecture**  **A.** key dimensions of the post-acquisition problem.  **B.** Analyze key decisions in structuring the integration process. |
| *Microsoft’s acquisition of Sendit INSEAD, 2003* | |
| **Microsoft’s acquisition of Sendit:** *The case describes Microsoft's first significant acquisition in Europe and its first in the telecom equipment (software) market. SendIt is a publicly listed Swedish start-up, which offers the only Windows based solutions to the IP-based mobile phone services market. The acquisition starts in high tone, loses momentum and is finally integrated with some degree of success..*  1. How attractive is Sendit for Microsoft? How should the opportunity be assessed?  2. What would be the most suitable governance solution for a possible combination between Microsoft and Sendit?  3. If you were Mark Ledsome, how would you present the Sendit opportunity to Bob Muglia, VP of Microsoft’s .net initiative (your boss)? Please come to class with a summary slide of your recommendation and the rationale. | |
| **Readings**  -“Managing acquisitions”, 1991 by P. Haspeslagh & D. Jemison, Ch. 6-9, pp 105-166  - “Making the Deal Real: How GE Capital Integrates Acquisitions”, R. Ashkenas, L. DeMonaco & S. Francis, Harvard Business Review, Jan-Feb1998, pp 165-178 | |

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| **Week 6**  **Horizontal Scope 4: Exits and Break-Up** | |
| **Day 1** | **Day 2** |
| **Case**  **Humana** | **Lecture**  **A.** The analytics of the exit decision: the loss of real options.  **B.** Preparing a business unit for disposal. |
| Case 9-294-062: *Humana Inc.: Managing in a Changing Industry.* | |
| **Humana:** *Intensifying competition and change in the U.S. health care industry force a large integrated health-care provider to reassess its strategy of operating both hospitals and health insurance plans (HMOs). In an attempt to increase its stock price and operating performance, the company considers a number of alternative restructuring strategies for separating the two businesses, including a corporate spinoff.*  **1.** Why did increased competition lead Human to decide that its hospitals and health insurance plans should be separated?  **2.** The assumption in the case is that at one time it made sense for Humana to diversify into insurance? Is this assumption reasonable?  **3.**  Which of the restructuring alternatives do you favor, and why? | |
| **Readings**  Mankins, Michael C., David Harding, and Rolf-Magnus Weddigen (2008): “How the best divest.” *Harvard Business Review*.  [Mair](http://cb.hbsp.harvard.edu/cb/web/search_results.seam?conversationId=20172&N=4294957378), Johanna, and [Caterina Moschieri](http://cb.hbsp.harvard.edu/cb/web/search_results.seam?conversationId=20172&N=4294804364) (2011): “Successful divestitures need proper cultivation.” *IESI Insight Magazine*, June 15. | |

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| **Week 7/8**  **Horizontal Scope 5: Multipoint Competition** | | |
| **Day 1** | **Day 2** | **Day 3** |
| **Mid-Term I** | **Case**  **Nutrasweet** | **Lecture**  **A.** The economics of multimarket competition. |
| Case 9-794-079: *Holland Sweetener v. NutraSweet* | | |
| **Holland Sweetener v. NutraSweet:** *The NutraSweet Co. has very successfully marketed aspartame, a low-calorie, high-intensity sweetener, around the world. NutraSweet's position was protected by patents until 1987 in Europe, Canada, and Japan, and until the end of 1992 in the United States. The case series describes the competition that ensued between NutraSweet and the Holland Sweetener Co. (HSC) following HSC's entry into the aspartame market in 1987.*  1. How important is Holland Sweetener’s cost advantage that is conveyed by its new process?  2. How should Holland Sweetener expect NutraSweet to respond to its entry into Europe and Canada?  3. What actions has Holland Sweetener taken, or should it take, to affect NutraSweet’s behavior?  4. What value does Holland Sweetener bring to the game? How should Holland Sweetener attempt to capture this value? | | |
| **Readings**  Jayachandran, Satish, Javier Gimeno and P. Rajan Varadarajan (1999): “The theory of multimarket competition: A synthesis and implications for marketing strategy.” Journal of Marketing, 63(3):49-66. | | |

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| **Week 9/10**  **Vertical Integration 1: Technical Efficiency versus Agency Efficiency** | | |
| **Day 1** | **Day 2** | **Day 3** |
| **Case**  **Celulosa Arauco** | **Lecture**  **1.** Double marginalization  **2.** Upstream and downstream moral hazard | **Mid-Term 2** |
| Case 709-462: *Arauco: Forward Integration or Horizontal Expansion?* | | |
| **Celulosa Arauco**, *a major Chilean producer of market pulp and wood products, owns over 1.2 million hectares of forest in South America and is one world's largest producers. Arauco is considering a $1.2 billion expansion project, which would include the company's sixth market pulp plant. Arauco’s CEO is debating whether the company and its shareholders would be better served by a forward integration into the paper business instead of increasing the company's capacity in market pulp.*  **1.** Should Arauco build the Nueva Aldea project?  **2.** Should Arauco own both forests and pulp production facilities? Does the Alto Parana project help you answer this question?  **3.** Do you think there is a better alternative to investing in a pulp plant? | | |
| **Readings**  Narayanan, V.G., and Ananth Raman (2000): “Aligning Incentives for Supply Chain Efficiency. HBS Note, 9-600-110.  Gertner, Robert, Marc Knez, (1999): “Vertical Integration: Make or Buy Decisions.” *Financial Times Mastering Strategy Series*. | | |

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| **Week 11**  **Vertical Integration 2: Asset Specificity and Hold-up** | |
| **Day 1** | **Day 2** |
| **Case**  **PepsiCo in China** | **Lecture**  **1.** The analytics of hold-up  **2.** Contract terms and asset specificity. *Evidence from coal-fired power stations.* |
| Case HKU693: *Pepsi Grows Potatoes in China*. | |
| **PepsiCo** *introduced Lay's potato chips to China in 1997. As its chips business grew in China, it faced increasing difficulties in securing a reliable supply of quality potatoes. In the North American market, Pepsi relied on external suppliers for its potatoes, but in China, it ran into problems both in sourcing locally and in getting its US supplier to grow potatoes on its behalf. The matter was further complicated by the fact that the Chinese government had banned the import of potatoes.*  **1.**Faced with numerous obstacles in sourcing potatoes in China, how should Pepsi go about securing this critical input? Should it rely on external suppliers given China's immature agribusiness industry, or should it integrate backwards to grow its own potatoes? | |
| **Readings**  Schwarz, Michael and Yuri Takhteyev (2009): "Half a century of public software institutions. Open source as a solution to the hold-up problem." NBER working paper 14916. | |

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| **Week 12**  **Vertical Integration 3: Alternatives to Vertical Integration** | |
| **Day 1** | **Day 2** |
| **Case**  **Millennium Pharmaceuticals** | **Lecture**  **1.** Alternatives to vertical integration. A*lliances and joint ventures*. *Tapered integration; franchises; implicit contracts and long-term relationships;* |
| Case 600-038 *Millennium Pharmaceuticals (A)* | |
| **Millennium** **Pharmaceuticals** *is a fast-growing biotechnology firm in Cambridge, MA, which has made heavy use of strategic alliances to finance the development of technology platforms based on the latest breakthroughs in genomics. As the firm considers developing pharmaceutical drugs itself, its faces a number of challenges: 1) Can they revolutionize drug development by making it more predictable, faster, and less costly? 2) How should they select their alliances such that they move closer to becoming a pharmaceutical firm and still attract the funding needed for their strategy? 3) How can they continue to grow rapidly and attract and retain some of the best minds in the pharmaceutical industry?*  **1.** Why do biotechnology firms exist? Why aren’t biotechnology activities organized as subsidiaries of pharmaceutical companies?  **2.** Why do biotechnology firms seem to fare so poorly in their collaborations with pharmaceutical companies, and why is Millennium more successful than average?  **3.** What are the advantages for large pharmaceutical or agribusiness firms to engage in alliances with, but not to acquire, biotech firms?  **4.** Since this case was written in 2001, the biotechnology industry has changed considerably and, especially in the last few years, numerous biotech firms have been acquired by pharmaceutical firms. What has changed since 2001 to encourage acquisition rather than collaboration? | |
| **Readings**  Doz, Yves and Gary Hamel, “Discovering Value in Alliances,” chapter 2 in *Alliance Advantage*, Boston: Harvard Business School Press, 1998, pp. 33-56.  Dyer, Jeffrey H., “Collaborative Advantage and the Extended Enterprise,” Introduction in *Collaborative Advantage*, Oxford: Oxford University Press, 2000, pp. 3-22. | |

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| **Week 13**  **International Diversification** | |
| **Day 1** | **Day 2** |
| **Case**  **Lincoln Electric** | **Lecture**  **A.** The economics of currency risk.  **B.** Incorporating currency and sovereign risk into investment evaluations. |
| Case 9-398-095: *Lincoln Electric: Venturing Abroad* | |
| **Lincoln Electric**, *a 100-year-old manufacturer of welding equipment based in Cleveland, Ohio, motivates its U.S. employees through a culture of cooperation and an unusual compensation system.Lincoln remained focused on manufacturing in the United States until 1988, when it began to expand manufacturing through acquisitions and greenfields, eventually in 11 new countries. However, Lincoln was unable to replicate its highly productive system abroad, leading to a major restructuring in the early 1990s. In 1996, Lincoln set about expanding the company's manufacturing base through a new strategy. The case concludes in Asia, where Lincoln is trying to decide whether and how to establish a manufacturing presence in Indonesia, and in particular whether to try (again) to transfer Lincoln's unique incentive-driven management system.*  **1.** How was Lincoln able to grow and prosper for so long in such a difficulty industry that forced out other giants such as GE, Westinghouse, and BOC? What has accounted for Lincoln’s outstanding and enduring success in US?  **2.** Given the great success, why did the internationalization thrust of the late 1980s and early 1990s fail?  **3.** What do you think of Lincoln’s emerging international strategy by the mid-1990s? Does this company have a competitive advantage that can be transferred to the global environment?  **4.** What advice would you give to Mike Gillespie with regard to his Asian expansion strategy, and particularly, his plans to expand operations in Indonesia? | |
| **Readings**  HBS Note 9-295-100:  [Froot](http://cb.hbsp.harvard.edu/cb/web/search_results.seam?conversationId=829664&N=4294962742), Kenneth A, and [W. Carl Kester](http://cb.hbsp.harvard.edu/cb/web/search_results.seam?conversationId=829664&N=4294962948) (1997): *Cross-Border Valuation.*  *Provides a review of valuation techniques used to assess cross-border investments. Discusses the discounting of free cash flows with a weighted average cost of capital and the use of adjusted present value. Special concerns such as foreign-exchange risk, country risks, and international diversification are also discussed.* | |

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| **Week 14**  **Corporate Governance: Incentives Pay in Corporations** | |
| **Day 1** | **Day 2** |
| **Case**  **Safelite** | **Lecture**  **A.** The analytics of simple incentive pay schemes.  **B.** Other forms of incentives.*Efficiency wages and unemployment; promotion tournaments; deferred compensation.* |
| Case 800-291: *Performance Pay at Safelite Auto Glass.* | |
| **Safelite Auto Glass** *was in 1993 the largest nationwide automobile glass company in the US, with about 500 stores across the country and more than 3,000 employees, including 1,000 windshield installers.**This case describes the company's plans to change its compensation and incentive plan for employees. In particular, it details plans to change from hourly pay to piece rate pay for windshield installers*.  **1.** What good and bad things do you expect to happen if Safelite introduces the pay for performance scheme?  **2.** Should Safelite implement the scheme? Do you think the potential benefits outweigh the risks? | |
| **Supplementary Readings**  Milgrom, P., and J. Roberts (1992): “Principles of Incentive pay.” *Economics, Organization and Management*, pp. 214-235. | |

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| **Weeks 15 and 16**  **Mid-Term III**  **Group Presentations** |