From competitive advantage to corporate strategy

Business, Management

A diversified company has 2 levels of strategy:

1. Business unit (competitive): how to create competitive advantage in each business?

2. Corporate (companywide): concerns two different questions: what businesses the corporation should be in and how the corporate office should manage the array of business units?

Most corporate strategies have dissipated instead of created shareholder value. Now we have to rethink to corporate strategy according to past diversification strategies failed and large takeover possibilities over every firm.

In order to study the diversification program of a firm we have to analyze it over the long run. Porter found that on average corporation divested more than half their acquisitions in new industries and more than 60% of their acquisitions in entirely new fields. He calculated for each company he could compare with its divestment rate the total shareholder returns. Shareholder returns are not a good measure of diversification success! This measure could work only if you compare the shareholder value that is with the shareholder value without diversification.

Premises to corporate strategy.

1. Competition occurs at the business unit level 2. Diversification inevitability adds costs and constraints to business units 3. Shareholders can readily diversify themselves trough portfolio diversifications without paying acquisition premium. The corporate strategy cannot succeed unless it truly adds value! Under which conditions diversification can create shareholder

value? 1. The attractiveness test for the industry in which diversify Diversification cannot create shareholder value unless new industries have favorable structures that support returns exceeding the coc. If this isn't the case the company must have the capability to restructure the industry or to have a competitive advantage. An industry need to be attractive before entering.

A company might benefit from entering before the industry shows its full potential. The diversification can then transform the industry's structure. Another common reason for ignoring this test is a low entry cost 2. The cost of entry test: diversification cannot build shareholder value if the cost of entry into a new business eats up it expected returns. Strong market forces however are working to do that. Remember that the more attractive is an industry the more expensive is to get into. 3. The better-off test (the new unit must gain competitive advantage from its link with the corporation). A corporation must bring some significant competitive advantage to the new unit or the new unit must offer potential for the corporation. Diversifying corporate risk doesn't imply create shareholder value in and of itself. Doing something that shareholders can do by themselves is not a basis for corporate strategy. Diversification of risk should only be a by-product of corporate strategy and not a prime motivator. Four different concepts of Corporate Strategy according to different way to create shareholder value and organizing the diversified company.

1. Portfolio management The concept of strategy most in use in portfolio management is based primary on diversification trough acquisition. In portfolio strategy, the corporation seeks shareholder value in a number of

ways. It uses its expertise and analytical resources to spot attractive acquisition candidates that the individual shareholder could not. The company provides capital on favorable terms. It introduces professional management skills and discipline. Finally it provides high quality review and coaching. The assumption of portfolio management vary according to the test we want to pass: to pass the attractiveness and cost of entry we will look for undervalued company on the other hand if we want to pass the better-off we must have a significant competitive advantage. Today portfolio management works only in developing countries where large companies are few, capital markets are undeveloped and professional management is scarce.

2. Restructuring The new businesses are not necessarily related to existing units. All that is necessary is an unrealized potential. The restructuring strategy seeks out undeveloped, sick, or threatened organizations or industries on the threshold of significant change. The result must be a strengthened company or a transformed industry. To work this strategy requires a corporate management team with the insight to spot undervalued companies or positions in industries ripe for transformation. There is a high risk in this strategy and usually limit the time in which the company can succeed at the strategy.

3. Transferring skills The first 2 concepts of strategy have the purpose of creating value trough a company’s relationship with each autonomous unit. The last 2 exploit the interrelationship between businesses. We are talking about synergies! To understand the role of relatedness in corporate strategy we must give a new meaning referring to the activities of the value chain

(value activities) that we can group in primary and support activities. The value chain defines the 2 types of interrelationships that may create synergy. The first is the company's ability to transfer skills and expertise and the second is the ability to share activities. Transferring skills leads to competitive advantage only if similarities among businesses meet 3 conditions:

1. Similar activities: sharing expertise makes sense 2. The transfer of skills involves activities important to competitive advantage. 3. The skills transferred represent a significant source of competitive advantage. This process can be one time or on-going and must be guided by the company, it's not accidentally or by osmosis. 4. Sharing activities in value chains trough businesses Is a potent basis for Corporate Strategy because sharing often enhances competitive advantage by lowering cost or raising differentiation. But not all sharing leads to competitive advantage!

A cost-benefit analysis of prospective sharing opportunities can determine whether synergy is possible. Sharing can lower costs if it achieves economies of scale, boosts the efficiency, helps a company move more rapidly down the learning curve or enhancing potential for differentiation. Sharing activities involves costs that the benefits must outweigh. Every company have to consider well if has economies of scale from merging activities otherwise the coordination costs kill the coordination benefits. Opportunities to take advantage from sharing activities especially because of developments in technology, deregulation and competition.