BUS 472

Corporate Strategy

Spring 2014

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Class meets: Tuesdays Thursdays, 4:00-5:15pm,

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.

Readings and Other Materials

Case study material and some readings are available in a course packet from HBS. The link for the course packet is

https://cb.hbsp.harvard.edu/cbmp/access/23257130

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%)

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.

Your group report is due on **April 15**. A presentation of your analysis and findings will take place on either **April 17, 22** or **24**. There are also some intermediate deliverables for this project, listed in the following section.

Notable Dates (see also calendar view on next page)

1. There are no classes on March 11 and 13 (Spring Break).

2. There are three mid-terms: February 18, March 6, and April 15.

2. Intermediate and final deliveries for the group project are due on the following dates. Due **5pm.** *Please note that these are final deadlines: you are welcome and encouraged to submit prior to these deadlines.*

- **5.1** Memo 1, identifying corporation and target firm, with bullet-point list outlining tentative reasons for choice. Due **5pm, Tuesday March 18.**
- **5.2** Memo 2, summarizing the case you intend to make to justify acquisition. Due **5pm, Tuesday, March 25**
- **5.3** Memo 3, summarizing the reasoning for bid you intend to make. Due **5pm, Tuesday April 1**
- **5.4** Memo 4, summarizing alternatives to acquisition. Due **5pm, Tuesday April 8**
- **5.4** Final report. Due **Tuesday 5pm, April 15**.

Format for Submissions

1.The corresponding member of each group is responsible for ensuring timely submission of deliverables.

2. All deliverables are should be sent via email by 5pm on the due date.

3. Each deliverable should contain a single pdf file. Do not include additional files, such as spreadsheets.

4. Receipt by me of a pdf file from the corresponding member of the group is taken to imply that each member of the group has seen and approved submission of the deliverable.

<table>
<tr><th colspan="2">Week 1
January 14 and 16</th></tr>
<tr><th>Tuesday</th><th>Thursday</th></tr>
<tr><td>Introduction

Mini Case: Apple Maps</td><td>Scale and Scope
A. Static economies of scale and scope.
B. Learning by doing, and dynamic scale economies.
C. Learning spillovers and scope.</td></tr>
<tr><td colspan="2">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.</td></tr>
</table>

Week 2
January 21 and 23
Horizontal Scope 1: Motives for Diversification

Tuesday	Thursday
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

<table>
<tr><th colspan="2">Week 3
January 28 and 30
Horizontal Scope 2: Entry into New Markets</th></tr>
<tr><td>Tuesday</td><td>Thursday</td></tr>
<tr><td>Case
Polaroid-Kodak</td><td>Lecture
A. The economics of entry and entry deterrence.</td></tr>
<tr><td colspan="2">Case 9-376-266: Polaroid-Kodak.</td></tr>
<tr><td colspan="2">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?</td></tr>
<tr><td colspan="2">Readings
Besanko, David, David Dranove, Mark Shanley, and Scott Shaefer (2010): “Entry and Exit “. Chapter 11 in Economics of Strategy.</td></tr>
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Week 4
February 4 and 6
Horizontal Scope 3: Evaluating Synergies and Investments

Tuesday	Thursday
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.

Week 5 February 11 and 13 Horizontal Scope 4: Exits and Break-Up	
Tuesday	**Thursday**
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, Johanna, and Caterina Moschieri (2011): “Successful divestitures need proper cultivation.” *IESI Insight Magazine*, June 15.

Week 6/7 February 18, 20, and 25 Horizontal Scope 5: Multipoint Competition		
Tuesday (18th)	**Thursday (20th)**	**Tuesday (25th)**
Mid-Term I	**Case** **Nutrasweet**	**Lecture** **A.** The economics of multi-market 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.

<table>
<tr><th colspan="3">Week 7/8
February 27, March 4 and 6
Vertical Integration 1: Technical Efficiency versus Agency Efficiency</th></tr>
<tr><td>Thursday (27th)</td><td>Tuesday</td><td>Thursday (6th)</td></tr>
<tr><td>Case
Celulosa Arauco</td><td>Lecture
1. Double marginalization
2. Upstream and downstream moral hazard</td><td>Mid-Term 2</td></tr>
<tr><td colspan="3">Case 709-462: Arauco: Forward Integration or Horizontal Expansion?</td></tr>
<tr><td colspan="3">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?</td></tr>
<tr><td colspan="3">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.</td></tr>
</table>

Week 9 **March 18 and 20** **Vertical Integration 2: Asset Specificity and Hold-up**	
Tuesday	**Thursday**
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.

Week 10 **March 25 and 27** **Vertical Integration 3: Alternatives to Vertical Integration**	
Tuesday	**Thursday**
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.

<table>
<tr><th colspan="2">Week 11
April 1 and 3, 2013
International Diversification</th></tr>
<tr><td>Monday</td><td>Wednesday</td></tr>
<tr><td>Case
Lincoln Electric</td><td>Lecture
A. The economics of currency risk.
B. Incorporating currency and sovereign risk into investment evaluations.</td></tr>
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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, Kenneth A, and W. Carl Kester (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.

Week 12
April 8 and 10, 2013
Corporate Governance: Incentives Pay in Corporations

Monday	Wednesday
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.

Weeks 13 and 14
April 15: Mid-Term III
April 17, 22, and 24: Group Presentations