Chapter 8: Selecting Corporate-Level Strategies

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Learning Objectives

After reading this chapter, you should be able to understand and articulate answers to the following questions:

1. What is corporate-level strategy and how does it differ from business-level strategy?
2. What is vertical integration and what benefits can it provide?
3. What are the three types of diversification and when should they be used?
4. What are four methods that a firm can use to implement its corporate strategy?
5. Why and how might a firm retrench or restructure?
6. What is portfolio planning and why is it useful?

8.1 Introduction

The preceding chapters focused on generic business-level, also referred to as generic competitive strategy: how firms compete head-to-head on products and services they offer. The intent is to develop strategies that provide a competitive advantage, so that buyers will purchase what a business has to offer instead of purchasing from a competitor. However, there are three types of strategy: business-level, corporate-level, and international strategy.

In this chapter, the focus is on corporate-level strategy. Corporate-level strategy is a paradigm shift from business-level strategy. It asks: what businesses should the firm be in, and how can being in those businesses

create synergy and improve performance? Diversification is the key in corporate strategy. There are several ways that a corporate diversification strategy can be implemented that will be examined here. The third and final type of strategy following business-level and corporate-level strategies is international strategy, which will be discussed in the next chapter.

8.2 Corporate-Level Strategy Defined

What's the Big Picture at Disney?

Figure 8.1: Walt Disney remains a worldwide icon five decades after his death.

Disney's *Avengers: Endgame* movie, released in 2019, was Disney's highest grossing movie of all time. With revenues of over $2 billion, it is one of seven Disney movies to gross over $1 billion. *Frozen II* was the highest grossing animated movie at $1.37 billion (Clark, 2020).

Although Walt Disney was a visionary, even he would have struggled to imagine such enormous numbers when his company was created. In 1923, Disney Brothers Cartoon Studio was started by Walt and his brother Roy in their uncle's garage. The fledgling company gained momentum in 1928 when a character was invented that still plays a central role for Disney today—Mickey Mouse. Disney expanded beyond short cartoons to make its first feature film, *Snow White and the Seven Dwarves*, in 1937.

Following a string of legendary films such as *Pinocchio* (1940), *Fantasia* (1940), *Bambi* (1942), and *Cinderella* (1950), Walt Disney began to diversify his empire. His company developed a television series for the American Broadcasting Company (ABC) in 1954 and opened the Disneyland theme park in 1955. Shortly before its opening, the theme park was featured on the television show to expose the American public to Walt's innovative ideas. One of the hosts of that episode was Ronald Reagan, who twenty-five years later became president of the United States. A larger theme park, Walt Disney World, was opened in Orlando in 1971. Roy Disney died just two months after Disney World opened; his brother Walt had passed in 1966 while planning the creation of the Orlando facility.

The Walt Disney Company began a series of acquisitions in 1993 with the purchase of movie studio Miramax Pictures. ABC was acquired in 1996, along with its very successful sports broadcasting company, ESPN. Two other important acquisitions were made during the following decade. Pixar Studios was purchased in 2006 for $7.4 billion (Stewart, 2011). This strategic move brought a very creative and successful animation company

under Disney's control. Three years later, Marvel Entertainment was acquired for $4.24 billion. Marvel was attractive because of its vast roster of popular characters, including Iron Man, the X-Men, the Incredible Hulk, the Fantastic Four, and Captain America. In addition to featuring these characters in movies, Disney could build attractions around them within its theme parks.

With annual revenues in excess of $38 billion, The Walt Disney Company was the largest media conglomerate in the world by 2010. It was active in four key industries. Disney's theme parks included not only its American locations but also joint ventures in France and Hong Kong. A park in Shanghai, China opened in 2016. The theme park business accounted for 28% of Disney's revenues.

Disney's presence in the television industry, including ABC, ESPN, Disney Channel, and ten television stations, accounted for 45% of revenues. Disney's original business, filmed entertainment, accounted for 18% of revenue. Merchandise licensing was responsible for 7% of revenue. This segment of the business included children's books, video games, and 350 stores spread across North American, Europe, and Japan. The remaining 2% of revenues were derived from interactive online technologies. Much of this revenue was derived from Playdom, an online gaming company that Disney acquired in 2010.

Disney continued with more acquisitions, buying Lucasfilm in 2012, Maker Studios in 2015, BAMTech in 2017, and 21st Century Fox in 2019. With the exception of 2017, when there was a slight revenue decline, Disney's revenues have shown consistent, strong growth (Macrotrends, n.d.). Can Disney maintain this trend? Is Disney getting too large to manage effectively? With the COVID-19 pandemic of 2020 shutting down many of Disney's business lines temporarily, should Disney diversify into other industries, and not be so dependent on the entertainment industry for its future success?

Business-level strategy deals directly with how a firm competes in the marketplace. How does the firm get buyers to purchase their products and services as opposed to those of their competitors? Corporate-level strategy considers issues at a broader level of analysis. The word "corporate" does not refer to the legal entity of a corporation, but to the level of strategy higher than direct head-to-head competition. Any size firm can develop corporate-level strategy. The owner of a McDonald's franchise can pursue a corporate strategy, as can the owner of a local plumbing company.

Figure 8.2: Will John Lassiter, Pixar's chief creative officer, be prevented from making more quirky films like Up! by parent company Disney?

Corporate Strategy –Specifies actions taken by the firm to gain a competitive advantage by selecting and managing a group of different businesses in several industries and/or product markets.

In corporate-level strategy, executives seek to answer two basic questions, and then three more detailed questions.

A. What business(es) should we be in?

B. How should we manage the portfolio to achieve synergy/create value?

With respect to the first question A above, what business(es) should we be in, firms must ask:

1. In what stage of the industry value chain should we participate?
2. What range of products and services should we offer?
3. Where geographically should we compete?

All three of these questions should be answered within the context of question B above, how can synergy be achieved?

Synergy in the business context means the cooperation or interaction of two or more business units so that they perform more effectively together than they would if independent. For example, if a larger company acquires a similar smaller company, some of the administrative overhead expenses such as accounting or human resources can be combined and operate more efficiently. Another synergy produced is overall reduced marketing expenses since they can market their products together.

The foundational issue in corporate-level strategy is diversification: how can the organization diversify, and in doing so, create synergy? Diversification can address geographic questions, such as how Disney established theme parks in France, Japan, and China. Also, moving a firm into other industries, outside the home industry, is another way to diversify. Warren Buffet's company Berkshire Hathaway owns businesses as diverse as real estate, insurance, and a railroad. Additionally, a firm may expand into business areas within its value chain, by acquiring suppliers upstream in the supply chain or distributors or retailers downstream. For example, when Disney launched its streaming service Disney+, it diversified downstream in its value chain to control and provide an outlet for the movie content it produced.

The executives in charge of a firm such as The Walt Disney Company must decide whether to remain within their present domains or venture into new ones. In Disney's case, the firm has expanded from its original business (films) and into television, theme parks, cruise lines, and several others. In contrast, many firms never expand beyond their initial choice of industry. Disney executives could consider further diversifying geographically, diversifying into additional industries, and diversifying deeper into its value chain, for example, by acquiring some of its suppliers. In all these considerations, Disney needs to evaluate if and how synergy can be produced.

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Image Credits

Figure 8.1: Unknown author. "Walt Disney introduces each of the Seven Dwarfs in a scene from the original 1937 Snow White theatrical trailer." Public Domain. Retrieved from https://en.wikipedia.org/wiki/File:Walt_Disney_Snow_white_1937_trailer_screenshot_(13).jpg.

Figure 8.2: Genin, Nicolas. "John Lasseter for Up at the 66th Mostra." CC BY-SA 2.0. Retrieved from https://commons.wikimedia.org/wiki/File:John_Lasseter-Up-66th_Mostra.jpg.

8.3 Diversification

There are a variety of reasons a company may consider diversification. Diversification strategies can help mitigate the risk of a company operating in only one industry. If an industry experiences issues or slows down, being in other industries can help soften the impact. Companies can also diversify within their own industry. There are three types of diversification:

1. **Related Diversification** –Diversifying into business lines in the same industry; Volkswagen acquiring Audi is an example.
2. **Unrelated Diversification** –Diversifying into new industries, such as Amazon entering the grocery store business with its purchase of Whole Foods.
3. **Geographic Diversification** –Operating in various geographic markets, which is the corporate strategy of Starbucks, Target, and KFC.

In all three diversification strategies, the goal is to achieve synergy. How can the firm operate more efficiently and effectively through its diversification efforts?

Three Tests for Diversification

A proposed diversification move must first answer three questions to determine if it should be accepted or rejected (Porter, 1987).

1. How attractive is the industry that a firm is considering entering? Unless the industry has strong profit potential,

entering it may be very risky. Porter's Five Forces Analysis can help with this assessment.

2. How much will it cost to enter the industry? Executives need to be sure that their firm can recoup the expenses that it absorbs in diversifying. When Philip Morris bought 7Up, it paid four times what 7Up was actually worth. Making up these costs proved to be impossible and 7Up was sold less than 10 years later.
3. Will the new unit and the firm be better off? Unless at least one side gains a competitive advantage, diversification should be avoided. In the case of Philip Morris and 7Up, for example, neither side benefited significantly from joining together.

Related Diversification

Related diversification occurs when a firm moves into a new industry that has important similarities with the firm's existing industry or industries (Figure 8.1). Because films and television are both aspects of entertainment, Disney's purchase of ABC is an example of related diversification. Some firms that engage in related diversification aim to develop and exploit a core competency to become more successful. A **core competency** is a skill set that is difficult for competitors to imitate, can be leveraged in different businesses, and contributes to the benefits enjoyed by customers within each business (Prahalad & Hamel, 1990). For example, Newell Rubbermaid is skilled at identifying under-performing brands and integrating them into their three business groups: (1) home and family, (2) office products, and (3) tools, hardware, and commercial products.

Estee Lauder was a pioneer in the cosmetics industry. Estee Lauder summarized her zest for business by noting, "I have never worked a day in my life without selling. If I believe in something, I sell it, and I sell it hard." The company that bears her name has used related diversification and other growth strategies to create over two dozen brands of cosmetics, perfume, skin care, and hair care products. Below we illustrate some of the products that make up the Lauder empire.

Prescriptives offers customizable cosmetics that provide an exact match to the customer's skin tone.

The Lauder empire includes a number of license agreements such as with Donna Karan's **DKNY** Be Delicious perfume.

Smashbox, acquired in 2010, is the cosmetics line of a premier photo studio founded by the great-grandsons of Hollywood cosmetics legend Max Factor.

Estee Lauder's **Sensuous** is one of the perfumes marketed under the Lauder name.

Bumble and bumble provides salon-quality shampoo, conditioner, and other hair care products.

Clinique was the first high-end, allergy-tested, dermatologist-recommended cosmetics brand.

Bobbi Brown (namesake of the celebrated makeup artist) focuses on teaching women to be their own makeup artists.

M.A.C. (Makeup Art Cosmetics) products were originally designed for professional makeup artists but are now available to consumers worldwide.

Aveda's line of high-end botanical spa products was acquired in 1997.

Figure 8.3: Estee Lauder exemplifies related diversification with their ventures into skincare, makeup, and hair care products.

Honda Motor Company provides a good example of leveraging a core competency through related diversification. Although Honda is best known for its cars and trucks, the company actually started out in the motorcycle business. Through competing in this business, Honda developed a unique ability to build small and reliable engines. When executives decided to diversify into the automobile industry, Honda was successful in part because it leveraged this ability within its new business. Honda also applied its engine-building skills in the all-terrain vehicle, lawn mower, and boat motor industries.

Figure 8.4: Honda's related diversification strategy has taken the firm into several businesses, including boat motors.

Sometimes the benefits of related diversification that executives hope to enjoy are never achieved. Both soft drinks and cigarettes are products that consumers do not need. Companies must convince consumers to buy these products through marketing activities such as branding and advertising. Thus, on the surface, the acquisition of 7Up by Philip Morris seemed to offer the potential for Philip Morris to take its existing marketing skills and apply them within a new industry. Unfortunately, the possible benefits to 7Up never materialized.

Unrelated Diversification

"Don't put all your eggs in one basket" is often a good motto for individual investors. By building a portfolio of stocks, an investor can minimize the chances of suffering a huge loss. Some executives take a similar approach. Rather than trying to develop synergy across businesses, they seek greater financial stability for their firms by owning an array of companies. Warren Buffett's Berkshire Hathaway has long enjoyed strong performance by purchasing companies and improving how they are run. Below we illustrate some of the different groups in their very diversified portfolio of firms.

Table 8.1 Unrelated Diversification at Berkshire Hathaway

Berkshire's insurance group includes firms such as General Reinsurance Corporation and GEICO. They maintain capital strength at exceptionally high levels, which gives them an advantage even a caveman could understand.	Berkshire's financial health is also fueled by utilities and energy companies that are part of the MidAmerican Energy Holdings Company.	Their apparel businesses include well-known names such as Fruit of the Loom and Justin Brands.
Building companies include Acme Building Brands, makers of the famous brick, as well as paint company Benjamin Moore & Co.	FlightSafety International Inc. is a Berkshire firm that engages in high-tech training for aircraft and ship operators.	Retail holdings include a number of furniture businesses such as R.C. Willey Home Furnishings, Star Furniture Company, and Jordan's Furniture, Inc.
Hungry for more businesses to manage, Berkshire acquired The Pampered Chef, Ltd.—the largest direct kitchen tools seller—in 2002.	Buffett had a sweet tooth for See's Candies, whom he purchased from the See's family in 1972.	Shareholders were all on board for the purchase of the Burlington Northern Santa Fe Corporation railroad in 2009.

Why would a soft-drink company buy a movie studio? It's hard to imagine the logic behind such a move, but Coca-Cola did just this when it purchased Columbia Pictures for $750 million. This is a good example of unrelated diversification, which occurs when a firm enters an industry that lacks any important similarities with the firm's existing industry or industries (Table 8.1). Luckily for Coca-Cola, its investment paid off—Columbia was sold to Sony for $3.4 billion just seven years later.

Most unrelated diversification efforts, however, do not have happy endings. Harley-Davidson, for example, once tried to sell Harley-branded bottled water. Starbucks tried to diversify into offering Starbucks-branded furniture. Both efforts were disasters. Although Harley-Davidson and Starbucks both enjoy iconic brands, these strategic resources simply did not transfer effectively to the bottled water and furniture businesses.

A different example, lighter firm Zippo tried to avoid this scenario. According to CEO Geoffrey Booth, the Zippo lighter is viewed by consumers as a "rugged, durable, made in America, iconic" brand (Associated Press, 2011). This brand has fueled ninety years of success for the firm. But the future of the lighter business is bleak. This downward trend is likely to continue as smoking becomes less and less attractive in many countries. To save their company, Zippo executives want to diversify.

In particular, Zippo wants to follow a path blazed by Eddie Bauer and Victorinox Swiss Army Brands Inc. The rugged outdoors image of Eddie Bauer's clothing brand has been used effectively to sell sport utility vehicles made by Ford. The high-quality image of Swiss Army knives has been used to sell Swiss Army–branded luggage and watches. As of 2020, Zippo has diversified into pocket knives, money clips, pocket flashlights, key holders, writing instruments, and tape measures. Trying to figure out which of these diversification options would be winners, such as the Eddie Bauer-edition Ford Explorer, and which would be losers, such as Harley-branded bottled water, was a key challenge facing Zippo executives.

Figure 8.5: The durability of Zippo's products is illustrated by this lighter, which still works despite being made in 1968.

Geographic Diversification

Firms may also diversify through expanding geographically. Big box stores such as Target and Best Buy use this strategy. Starbucks and KFC have found success with international expansion as well as domestic expansion. Synergy is developed in several ways. Many of the administrative functions such as logistics, procurement, human resources, and legal can be consolidated at the corporate level, so they do not need to be duplicated at each location. New store development is also made easier. Having already developed new stores, the firm can establish a process that it has learned from previously establishing stores, and can implement this best practice to efficiently build out, equip, and supply new stores.

Horizontal Integration: Mergers and Acquisitions

Horizontal integration refers to pursuing a diversification strategy by acquiring or merging with a rival. The term merger is generally used when two similarly sized firms are integrated into a single entity. In an acquisition, a larger firm purchases and absorbs a smaller firm. Examples of each are illustrated below..

Table 8.2 Horizontal Integration

Horizontal Integration Examples
ExxonMobil is a direct descendant of John D. Rockefeller's Standard Oil Company. It was formed by the 1999 merger of Exxon and Mobil. As in many mergers, the new company name combines the old company names.
Starbucks acquired competitor Seattle's Best Coffee—which had a presence in Borders Bookstores and Subway Restaurants—in order to target a more working-class audience without diluting the Starbucks brand.
Bill Hewlett and Dave Packard formed Hewlett-Packard in a garage after graduating from Stanford in 1935. HP has pursued horizontal integration through a merger with Compaq computers and the acquisition of Palm, a digital personal assistant. Both failed miserably.
DaimlerChrysler was formed in 1998 when Chrysler entered into what was billed as a "merger of equals" with Germany's Daimler-Benz AG. The marriage failed, with billions of dollars in losses, and Chrysler is currently owned by Italian automaker Fiat.
There tend to be many of mergers in the banking industry. Recently, BB&T merged with SunTrust Banks and adopted the new name Truist Financial Corp.
The merger of wireless carriers Sprint and T-Mobile combined the number three and four companies in the market. The new company name dropped Sprint and operates under the name T-Mobile.

Rather than rely on their own efforts, some firms try to expand their presence in an industry by acquiring or merging with one of their rivals. This strategic move is known as **horizontal integration** (Table 8.2). An acquisition takes place when one company purchases another company. Generally, the acquired company is smaller than the firm that purchases it. A merger joins two companies into one. Mergers typically involve similarly sized companies. Disney was much bigger than Miramax and Pixar when it joined with these firms, thus these two horizontal integration moves are considered to be acquisitions.

Horizontal integration can be attractive for several reasons. In many cases, horizontal integration is aimed at lowering costs by achieving greater economies of scale. This was the reasoning behind several mergers of large

oil companies, including BP and Amoco in 1998, Exxon and Mobil in 1999, and Chevron and Texaco in 2001. Oil exploration and refining is expensive. Executives in charge of each of these six corporations believed that greater efficiency could be achieved by combining forces with a former rival. Considering horizontal integration alongside Porter's Five Forces model highlights that such moves also reduce the intensity of rivalry in an industry and thereby make the industry more profitable.

Some purchased firms are attractive because they own strategic resources such as valuable brand names. Acquiring Tasty Baking was appealing to Flowers Foods, for example, because the name Tastykake is well known for quality in heavily populated areas of the northeastern United States. Some purchased firms have market share that is attractive. Part of the motivation behind Southwest Airlines' purchase of AirTran was that AirTran had a significant share of the airline business in cities—especially Atlanta, home of the world's busiest airport—that Southwest had not yet entered. Rather than build a presence from nothing in Atlanta, Southwest executives believed that buying a position was prudent.

Figure 8.6: The combination of UFC and Strikeforce into one company may accelerate the growing popularity of mixed martial arts.

Horizontal integration can also provide access to new distribution channels. Some observers were puzzled when Zuffa, the parent company of the Ultimate Fighting Championship (UFC), purchased rival mixed martial arts (MMA) promotion Strikeforce. UFC had such a dominant position within MMA that Strikeforce seemed to add very little for Zuffa. Unlike UFC, Strikeforce had gained exposure on network television through broadcasts on CBS and its partner Showtime. Thus, acquiring Strikeforce might help Zuffa gain mainstream exposure of its product (Wagenheim, 2011).

Despite the potential benefits of mergers and acquisitions, their financial results often are very disappointing. One study found that more than 60% of mergers and acquisitions erode shareholder wealth while fewer than one in six increases shareholder wealth (Henry, 2002). Some of these moves struggle because the cultures of the two companies cannot be meshed. Other acquisitions fail because the buyer pays more for a target company than that company is worth and the buyer never earns back the premium it paid.

In the end, between 70% to 90% of mergers fail, according to a Harvard Business Review study, often at huge losses (Lakelet Capital, 2009). For example, Mattel purchased The Learning Company in 1999 for $3.6 billion and sold it a year later for $430 million—12% of the original purchase price. Similarly, Daimler-Benz bought Chrysler in 1998 for $37 billion. When the acquisition was undone in 2007, Daimler recouped only $1.5 billion worth of value—a mere 4% of what it paid. Thus, executives need to be cautious when considering using horizontal integration.

Vertical Integration Strategies

When pursuing a **vertical integration** strategy, a firm gets involved in new portions of the value chain (Table 8.3). This approach can be very attractive when a firm's suppliers or buyers have too much power over the firm and are becoming increasingly profitable at the firm's expense. By entering the domain of a supplier or a buyer, executives can reduce or eliminate the leverage that the supplier or buyer has over the firm. Considering vertical integration alongside Porter's five forces model highlights that such moves can create greater profit potential. Firms can pursue vertical integration on their own, such as when Apple opened stores bearing its brand, or through a merger or acquisition, such as when eBay purchased PayPal.

In the late 1800s, Carnegie Steel Company was a pioneer in the use of vertical integration. The firm controlled the iron mines that provided the key ingredient in steel, the coal mines that provided the fuel for steel making, the railroads that transported raw material to steel mills, and the steel mills themselves. Having control over all elements of the production process ensured the stability and quality of key inputs. By using vertical integration, Carnegie Steel achieved levels of efficiency never before seen in the steel industry.

When using vertical integration, firms get involved in different elements of the value chain. This concept gets top billing at American Apparel, a firm that describes its business model as "vertically integrated manufacturing." The elements of their integrated process for designing, manufacturing, wholesaling, and selling basic T-shirts, underwear, leggings, dresses, and other clothing and accessories for men, women, children, and dogs is illustrated below.

Table 8.3 Vertical Integration at American Apparel

American Apparel Vertical Integration
Backward Vertical Integration – entering a supplier's business—is evident as all clothing design is done in-house—often using employees as models.
Manufacturing is conducted in an 800,000 square foot factory in downtown Los Angeles.
Ironically, it was a Canadian named Dov Charney who founded American Apparel in 1989.
The vertical integration process allows the company to keep pace with the fast-moving world of fashion. It takes just a couple of weeks to go from idea to retail floor.
Forward Vertical Integration – American Apparel uses forward vertical integration—entering a buyer's business—by operating 250 plus company-owned stores worldwide.

Today, oil companies are among the most vertically integrated firms. Firms such as ExxonMobil and ConocoPhillips can be involved in all stages of the value chain, including crude oil exploration, drilling for oil, shipping oil to refineries, refining crude oil into products such as gasoline, distributing fuel to gas stations, and operating gas stations.

The risk of not being vertically integrated is illustrated by the 2010 Deepwater Horizon oil spill in the Gulf of Mexico. Although the US government held BP responsible for the disaster, BP cast at least some of the blame on drilling rig owner Transocean and two other suppliers: Halliburton Energy Services (which created the cement casing for the rig on the ocean floor) and Cameron International Corporation (which had sold Transocean

blowout prevention equipment that failed to prevent the disaster). In April 2011, BP sued these three firms for what it viewed as their roles in the oil spill.

Figure 8.7: The 2010 explosion of the Deepwater Horizon oil rig cost eleven lives and released nearly five million barrels of crude oil into the Gulf of Mexico.

Vertical integration also creates risks. Venturing into new portions of the value chain can take a firm into very different businesses. A lumberyard that started building houses, for example, would find that the skills it developed in the lumber business have very limited value to home construction. Such a firm would be better off selling lumber to contractors.

Vertical integration can also create complacency. Consider, for example, a situation in which an aluminum company is purchased by a can company. People within the aluminum company may believe that they do not need to worry about doing a good job because the can company is guaranteed to use their products. Some companies try to avoid this problem by forcing their subsidiary to compete with outside suppliers, but this undermines the reason for purchasing the subsidiary in the first place.

Backward Vertical Integration

A **backward vertical integration** strategy involves a firm moving back along the value chain and entering a supplier's business. Some firms use this strategy when executives are concerned that a supplier has too much power over their firms. In the early days of the automobile business, Ford Motor Company created subsidiaries that provided key inputs to vehicles such as rubber, glass, and metal. This approach ensured that Ford would not be hurt by suppliers holding out for higher prices or providing materials of inferior quality.

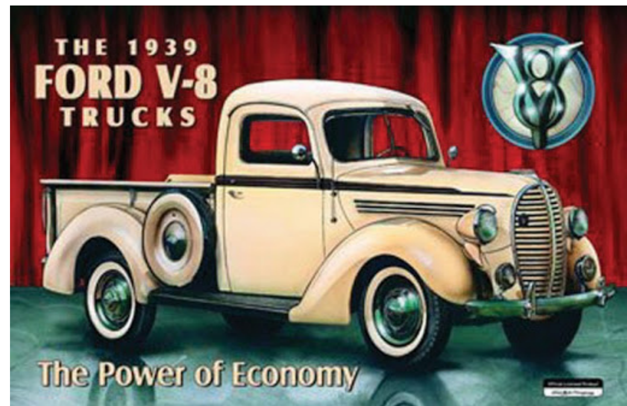

Figure 8.8: To ensure high quality, Ford relied heavily on backward vertical integration in the early days of the automobile industry.

Although backward vertical integration is usually discussed within the context of manufacturing businesses, such as steel making and the auto industry, this strategy is also available to firms such as Disney that compete within the entertainment sector. ESPN is a key element of Disney's operations within the television business. Rather than depend on outside production companies to provide talk shows and movies centered on sports, ESPN created its own production company. ESPN Films is a subsidiary of ESPN that was created in 2001. ESPN Films has created many of ESPN's

best-known programs, including *Around the Horn* and *The Dance* documentary. By owning its own production company, ESPN can ensure that it has a steady flow of programs that meet its needs.

Forward Vertical Integration

A **forward vertical integration** strategy involves a firm moving further down the value chain to enter a buyer's business. Disney has pursued forward vertical integration by operating more than three hundred retail stores that sell merchandise based on Disney's characters and movies. This allows Disney to capture profits that would otherwise be enjoyed by another store. Each time a *Frozen* book bag is sold through a Disney store, the firm makes a little more profit than it would if the same book bag were sold by a retailer such as Target.

Forward vertical integration also can be useful for neutralizing the effect of powerful buyers. Rental car agencies are able to insist on low prices for the vehicles they buy from automakers because they purchase thousands of cars. If one automaker stubbornly tries to charge high prices, a rental car agency can simply buy cars from a more accommodating automaker. It is perhaps not surprising that Ford purchased Hertz Corporation, the world's biggest rental car agency, in 1994. This ensured that Hertz would not drive too hard of a bargain when buying Ford vehicles. By 2005, selling vehicles to rental car companies had become less important to Ford and Ford was struggling financially. The firm then reversed its forward vertical integration strategy by selling Hertz.

Figure 8.9: The massive number of cars purchased by rental car agencies makes forward vertical integration a tempting strategy for automakers.

eBay's purchase of PayPal and Apple's creation of Apple Stores are two examples of forward vertical integration. Despite its enormous success, one concern for eBay is that many individuals avoid eBay because they are nervous about buying and selling goods online with strangers. PayPal addressed this problem by serving, in exchange for a fee, as an intermediary between online buyers and sellers. eBay's acquisition of PayPal signaled to potential customers that their online transactions were completely safe—eBay was now not only the place where business took place but eBay also protected buyers and sellers from being ripped off.

Apple's ownership of its own branded stores set the firm apart from computer makers such as Hewlett-Packard, Dell, and Lenovo that only distribute their products through retailers like Best Buy and Office Depot. Employees at Best Buy and Office Depot are likely to know only a little bit about each of the various brands their store carries. In contrast, Apple's stores are popular in part because store employees are experts about Apple products. They can therefore provide customers with accurate and insightful advice about purchases and repairs. This is an important advantage that has been created through forward vertical integration.

Key Takeaways

- Diversification strategies involve a firm stepping beyond its existing industries and entering a new value chain. Generally, related diversification (entering a new industry that has important similarities with a firm's existing industries) is wiser than unrelated diversification (entering a new industry that lacks such similarities). Geographic diversification is another strategy to drive synergy.
- A horizontal diversification strategy involves trying to compete successfully within a single industry.
- Mergers and acquisitions are popular moves for executing a concentration strategy, but executives need to be cautious about horizontal integration because the results are often poor.
- Vertical integration occurs when a firm gets involved in new portions of the value chain. By entering the domain of a supplier (backward vertical integration) or a buyer (forward vertical integration), executives can reduce or eliminate the leverage that the supplier or buyer has over the firm.

Exercises

1. Studies have shown that executives' pay increases when their firms get larger. What role, if any, do you think executive pay plays in diversification decisions? Is this an ethical issue?
2. Identify a firm that has recently engaged in diversification. Search the firm's website to identify executives' rationale for diversifying. Do you find the reasoning to be convincing? Why or why not?
3. Suppose the president of your college or university decided to merge with or acquire another school. What schools would be good candidates for this horizontal integration move? Would the move be a success?
4. Given that so many mergers and acquisitions fail, why do you think that executives keep making horizontal integration moves?
5. Identify a well-known company that does not use backward or forward vertical integration. Why do you believe that the firm's executives have avoided these strategies?
6. Some universities have used vertical integration by creating their own publishing companies. The Harvard Business Press is perhaps the best-known example. Are there other ways that a university might vertically integrate? If so, what benefits might this create?

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8.4 Implementing Corporate Strategy

Once a firm decides which corporate strategy to pursue, it must implement that strategy successfully. As noted earlier, many attempts to diversify end in failure. Executing a good implementation plan successfully is key.

There are various ways that a firm can implement their corporate diversification strategy. These are:

- Internal Development
- Strategic Alliance
- Joint Venture
- Merger and Acquisition

Internal Development

When deciding what business to be in, sometimes an organization chooses **internal development**. Internal development means the company develops and launches the new business themselves. To do this, the firm should have a strong entrepreneurial orientation, as this implementation method is the same process as starting a new business. A firm may select this method if they have sufficient resources and capabilities within the firm or can hire the expertise and knowledge to develop this new business unit and achieve the marketing and sales required to be successful. Internal development has been the implementation method of choice for Apple's corporate strategy. Apple has used internal development to enter new markets. Apple moved from the computer industry to the music industry with iPod and Apple music and then into the smartphone industry by developing internal capabilities and resources. This is a very costly and time-intensive strategy, but as is evident with Apple, it can be extremely lucrative and create many competitive benefits.

Strategic Alliance

A firm might implement their corporate strategy by working with another firm, even if that firm is a competitor. A **strategic alliance** is a mutually beneficial relationship between two organizations, usually governed through a contractual agreement. The firms may agree to share expertise or knowledge, resources, supply chain activities, distribution channels, research and development, etc.. Often money changes hands as one company provides what the other company needs. T-Mobile and Nokia entered into a strategic alliance in 2018, where for a fee, Nokia helped T-Mobile develop its 5G network. Barnes & Noble and Starbucks have a strategic alliance whereby

Starbucks puts their coffee shops inside of the Barnes & Noble bookstores. In all these examples, an alliance was beneficial for both companies.

Joint Venture

Similar to a strategic alliance, two or more companies form a **joint venture** when they "birth" a third company, and the joint venture partners are shared owners of the new firm. With a joint venture, a new company is always formed. The ownership arrangement can vary as to how much each partner owns and how much each partner has control. Typically, profits of the new company are shared according to the ownership percentages. Joint ventures can work well, even among competitors, when each partner brings something of value to the venture that the other partner could use. US airplane manufacturer Boeing created a joint venture with the Brazilian aircraft manufacturer of smaller commercial jets Embraer to start a third company that will get Boeing into the smaller passenger planes market. Boeing owns 80% of the company, and Embraer 20% (AP News, 2019).

Mergers and Acquisitions

A common method for firms to diversify is through mergers and acquisitions. A **merger** is between two companies of similar size and are less common. **Acquisitions** occur when one company buys another. Typically, a larger company acquires a smaller one. Mergers and acquisitions (M & A) may occur between competitors, which reduces the competition in the market. In this situation, the M & A is an example of related diversification and horizontal integration. T-Mobile's merger with Sprint is an example. Firms might acquire other companies in their value chain to give them more control within the industry. Moving into their suppliers' industry is backward integration, and buying companies in industries they sell to is forward integration. Forward integration is illustrated by Apple establishing Apple Stores and having direct involvement in the retail market. One way to diversify by acquisitions is through unrelated diversification. Unrelated diversification occurs when one company purchases another company that is located in an industry the first company is not involved in. An example of this strategy is Berkshire Hathaway owning companies in industries as diverse as insurance and railroads.

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8.5 Strategies for Getting Smaller

“In what industry or industries should our firm compete?” is the central question addressed by corporate-level strategy. In some cases, the answer that executives arrive at involves exiting one or more industries.

Retrenchment

In the early twentieth century, many military battles were fought in a series of parallel trenches. If an attacking army advanced enough to force a defending army to abandon a trench, the defenders would move back to the next trench and try to refortify their position. This small retreat was preferable to losing the battle entirely. Trench warfare inspired the business term retrenchment. Firms following a retrenchment strategy shrink one or more of their business units. Much like an army under attack, firms using this strategy hope to make just a small retreat rather than losing a battle for survival. It is also commonly referred to as “downsizing” or “right-sizing.”

Figure 8.10: The term retrenchment has its origins in trench warfare, which is shown in this World War I photo taken in France.

Retrenchment is often accomplished through laying off employees. For example, South African grocery store chain Pick n Pay announced plans to release more than 3,000 of its estimated 36,000 workers. Just over a month earlier, South African officials had approved Walmart’s acquisition of a leading local retailer called Massmart. Rivalry in the South African grocery business seemed likely to become more fierce, and Pick n Pay executives needed to cut costs for their firm to remain competitive.

A Pick n Pay executive explained the layoffs by noting that “the decision was not taken lightly but was required to ensure the viability of the retail business and its employees into the future” (Chilwane, 2011). This is a common rationale for retrenchment—by shrinking the size of a firm, executives hope that the firm can survive as a profitable enterprise. Without becoming smaller and more cost effective, Pick n Pay and other firms that use retrenchment can risk total failure. This strategy was particularly evident during the COVID-19 pandemic of 2020. Many organizations shrank temporarily with hopes of surviving until the economy opened up again. Some did survive, and unfortunately, some did not.

Restructuring

Spin-offs occur when businesses create a new firm from a piece of their operations. Because some diversified firms are too complex for investors to understand, breaking them up can create wealth by resulting in greater stock market valuations. Spinning off a company also reduces management layers, which can lower costs and speed up decision making. Below we describe a variety of firms that were created as spin-offs.

Table 8.4 Spin Offs

Examples of Spin Offs
There are 17 billion of Freescale Semiconductor's chips in use around the world. The firm was spun-off from Motorola.
Toyota started in the car business, right? Wrong. The firm was spun-off in the 1930s from Toyoda Automatic Loom Works—a company that produced commercial weaving looms.
Delphi Automotive—an automotive parts company headquartered in Troy, Michigan—is a spin-off from General Motors.
Guidant Corporation—a spin-off from Eli Lilly—designs and manufacturers artificial pacemakers, defibrillators, stents, and other heart-helpful medical products.

Executives sometimes decide that bolder moves than retrenchment are needed for their firms to be successful in the future. Divestment refers to selling off part of a firm's operations. In some cases, divestment reverses a forward vertical integration strategy, such as when Ford sold Hertz. Divestment can also be used to reverse backward vertical integration. General Motors (GM), for example, turned a parts supplier called Delphi Automotive Systems Corporation from a GM subsidiary into an independent firm. This was done via a spin-off, which involves creating a new company whose stock is owned by investors (Table 8.4). GM stockholders received 0.69893 shares of Delphi for every share of stock they owned in GM. A stockholder who owned 100 shares of GM received 69 shares of the new company plus a small cash payment in lieu of a fractional share.

Divestment also serves as a means to undo diversification strategies. Divestment can be especially appealing to executives in charge of firms that have engaged in unrelated diversification. Investors often struggle to understand the complexity of diversified firms, and this can result in relatively poor performance by the stocks of such firms. This is known as a **diversification discount.** Executives sometimes attempt to unlock hidden shareholder value by breaking up diversified companies.

Figure 8.11: Fortune Brands hopes to unlock hidden shareholder value by divesting unrelated brands such as Masterlock.

Sometimes diversified companies find themselves in a situation where, instead of synergy, they are experiencing increased inefficiency and increased costs. In this case, the value of the individual businesses are worth more separately than when part of the conglomerate. This can happen when an organization grows too large, with too many layers of management,

and too top heavy. This situation is called a diversification discount. General Electric is a good example of this phenomenon. GE made everything from light bulbs, to washing machines, to jet engines, to CAT, scanners, to large power systems, and had engaged in operating a financial institution, GE Capital, that provided loans to companies. When the recession of 2008-2009 hit, GE Capital was left holding a lot of unpaid debt, and drove the GE stock price down. GE began to get out of the financing business, along with a number of its other business lines. It trimmed down to a much smaller organization that was not so complicated to manage in order to survive.

Fortune Brands provides another good example. Surprisingly, this company does not own Fortune magazine, but it has been involved in a diverse set of industries. The firm consisted of three businesses: spirits (including Jim Beam and Maker's Mark), household goods (including Masterlock and Moen Faucets), and golf equipment (including Titleist clubs and balls as well as FootJoy shoes). Fortune Brand's CEO announced a plan to separate the three businesses to "maximize long-term value for our shareholders and to create exciting opportunities within our businesses" (Dalal, et. al., 2011). Fortune Brands took the first step toward overcoming the diversification discount when it reached an agreement to sell its golf business to Fila. Later plans to spin off the home products business were announced.

Executives are sometimes forced to admit that the operations that they want to abandon have no value. If selling off part of a business is not possible, the best option may be liquidation. This involves simply shutting down portions of a firm's operations, often at a tremendous financial loss. GM has done this by scrapping its Geo, Saturn, Oldsmobile, and Pontiac brands. Ford followed this approach by shutting down its Mercury brand. Such moves are painful because massive investments are written off, but becoming "leaner and meaner" may save a company from total ruin.

Key Takeaway

- Executives sometimes need to reduce the size of their firms to maximize the chances of success. This can involve fairly modest steps such as retrenchment or more profound restructuring strategies.

Exercises

1. Should Disney consider using retrenchment or restructuring? Why or why not?
2. Given how much information is readily available about companies, why do you think investors still struggle to analyze diversified companies?

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Figure 8.11: Thegreenj. "A Master Lock brand padlock." CC BY-SA 3.0. Cropped. Retrieved from https://commons.wikimedia.org/wiki/File:Masterpadlock.jpg.

8.6 Portfolio Planning and Corporate-Level Strategy

Executives in charge of firms involved in many different businesses must figure out how to manage such portfolios. General Electric (GE), for example, competed in a very wide variety of industries, including financial services, insurance, television, theme parks, electricity generation, lightbulbs, robotics, medical equipment, railroad locomotives, and aircraft jet engines. When leading a company such as GE, executives must decide which units to grow, which ones to shrink, and which ones to abandon.

Portfolio planning can be a useful tool. Portfolio planning is a process that helps executives assess their firms' prospects for success within each of its industries, offers suggestions about what to do within each industry, and provides ideas for how to allocate resources across industries. Portfolio planning first gained widespread attention in the 1970s, and it remains a popular tool among executives today.

The Boston Consulting Group Matrix

The Boston Consulting Group (BCG) Matrix is the best-known approach to portfolio planning (Table 8.5). Using the matrix requires a firm's businesses to be categorized as high or low along two dimensions: its share of the market and the growth rate of its industry. The BCG Matrix has four quadrants or categories:

- Cash Cows: High market share units within slow-growing industries are called cash cows. Because their industries have bleak prospects, profits from cash cows should not be invested back into cash cows but rather diverted to more promising businesses.
- Dogs: Low market share units within slow-growing industries are called dogs. These units are good candidates for divestment.
- Stars: High market share units within fast-growing industries are called stars. These units have bright prospects and thus are good candidates for growth.
- Question Marks: Finally, low-market-share units within fast-growing industries are called question marks. Executives must decide whether to build these units into stars, hold them, or to divest them.

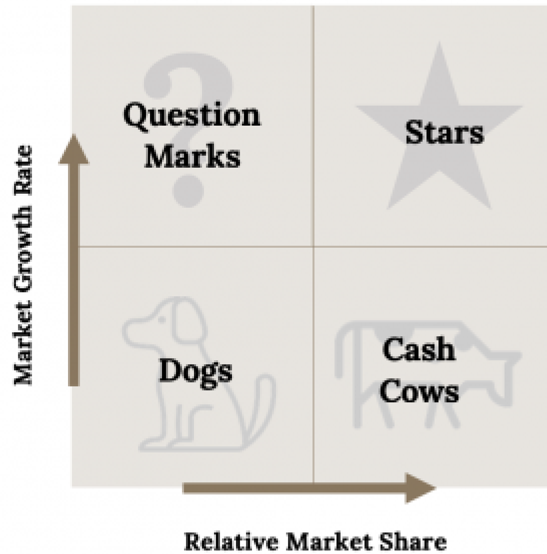

Figure 8.12: BCG Matrix

Figure 8.12 shows how the BCG Matrix is laid out. The various business units that a company has are plotted on the matrix. Once plotted, decisions can be made about the portfolio of businesses the company operates, such as where more investment would be beneficial, and which units may be candidates to divest.

The Boston Consulting Group matrix is the best-known approach to portfolio planning—assessing a firm's prospects for success within the industries in which it competes. The matrix categorizes businesses as high or low along two dimensions—the firm's market share in each industry and the growth rate of each industry. Suggestions are then offered about how to approach each industry.

Table 8.5 The Boston Consulting Group Matrix

	Low Relative Market Share	High Relative Market Share
High Industry Growth Rate	Question marks should be resolved by executives by deciding whether to foster or sell these units.	Stars should be funded and encouraged to grow.
Low Industry Growth Rate	It sounds mean, but dogs should be sold if possible and abandoned if necessary.	Cash cows should be "milked" to supply funds to more promising businesses.

To use the BCG Matrix, the company needs to know the market share for each of its business lines and the relative growth rate. It is important to set the scales on both axes so that the midpoints are roughly in the middle of the range of the market share and growth rates of the business units. Once the axes are set, the business units are plotted on the matrix relative to each other. Figure 8.14 shows a BCG Matrix for the Coca-Cola company and its various products. Notice that sometimes the market share axis is reversed, as it is in Figure 8.12.

Figure 8.13: Owning a puppy is fun, but companies may want to avoid owning units that are considered to be dogs.

Sometimes a third dimension is plotted on the BCG Matrix, using the size of the circle. The circle sizes might represent the business units' proportion of total company revenues or proportion of total company profit generated. This added dimension can assist in decision making regarding the business units. For example, if a business unit in the Dog quadrant also represents 40% of the company's revenue and 35% of its profit, divesting it would mean a significant downsizing of the company with implications for many other support functions.

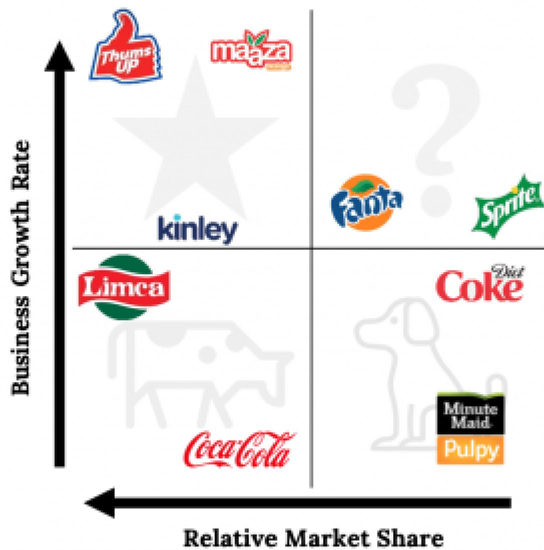

Figure 8.14: BCG Matrix of Coca-Cola

Once plotted, company leadership can evaluate its portfolio and make decisions on how to optimize its company. For example, in Figure 8.13, the two products in the Cash Cow quadrant have little opportunity for growth, given the socio-cultural force toward more healthy foods. Since they already have a high market share, it may be best to use their profits to invest in other business lines with more growth and market share potential. The products in the Question Marks and Dogs categories also are impacted by the trend toward healthy eating, so investment there is questionable. Usually, if investment in Question Marks can result in greater market share, it can be a wise move. Dogs are sometimes considered for divestment, however, Diet Coke has such high revenues and profit margins, divesting it would have a negative impact on the company. Investing in the Stars, where Kinley water products leverage the trend toward healthy beverages, and Thumbs Up is booming in India, would be a good decision.

Limitations to Portfolio Planning

Although portfolio planning is a useful tool, this tool has important limitations. First, portfolio planning oversimplifies the reality of competition by focusing on just two dimensions when analyzing a company's operations within an industry. Many dimensions are important to consider when making strategic decisions, not just two. Second, portfolio planning can create motivational problems among employees. For example, if

workers know that their firm's executives believe in the BCG Matrix and that their subsidiary is classified as a dog, then they may give up any hope for the future. Similarly, workers within cash cow units could become dismayed once they realize that the profits that they help create will be diverted to boost other areas of the firm. Third, portfolio planning does not help identify new opportunities. Because this tool only deals with existing businesses, it cannot reveal what new industries a firm should consider entering.

Key Takeaway

- Portfolio planning is a useful tool for analyzing a firm's various business units, but this tool has limitations. The BCG matrix is one of the most widely used approaches to portfolio planning.

Exercises

1. Is market share a good dimension to use when analyzing the prospects of a business? Why or why not?
2. What might executives do to keep employees within dog units motivated and focused on their jobs?

Image Credits

Figure 8.12: Kindred Grey (2020). "The BCG Matrix." CC BY-SA 4.0. Retrieved from: https://commons.wikimedia.org/wiki/File:The_BCG_Matrix.png.

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8.7 Conclusion

This chapter explains corporate-level strategy. Executives grappling with corporate-level strategy must decide in what industry or industries their firms will compete. Many of the possible answers to this question involve diversification, which can be related, unrelated, or geographic. Integration involves expanding into new stages of the value chain. Backward integration occurs when a firm enters a supplier's business while forward vertical integration occurs when a firm enters a customer's business. Firms implement their corporate diversification strategies through internal development, strategic alliances, joint ventures, mergers and acquisitions. Sometimes being smart about corporate-level strategy requires shrinking the firm through retrenchment or restructuring. Finally, portfolio planning using the BCG Matrix can be useful for analyzing firms that participate in a wide variety of industries or business lines.

Exercises

1. Divide your class into four or eight groups, depending on the size of the class. Each group should create a new portfolio planning technique by selecting two dimensions along which companies can be analyzed. Allow each group three to five minutes to present its approach to the class. Discuss which portfolio planning technique seems to offer the best insights.