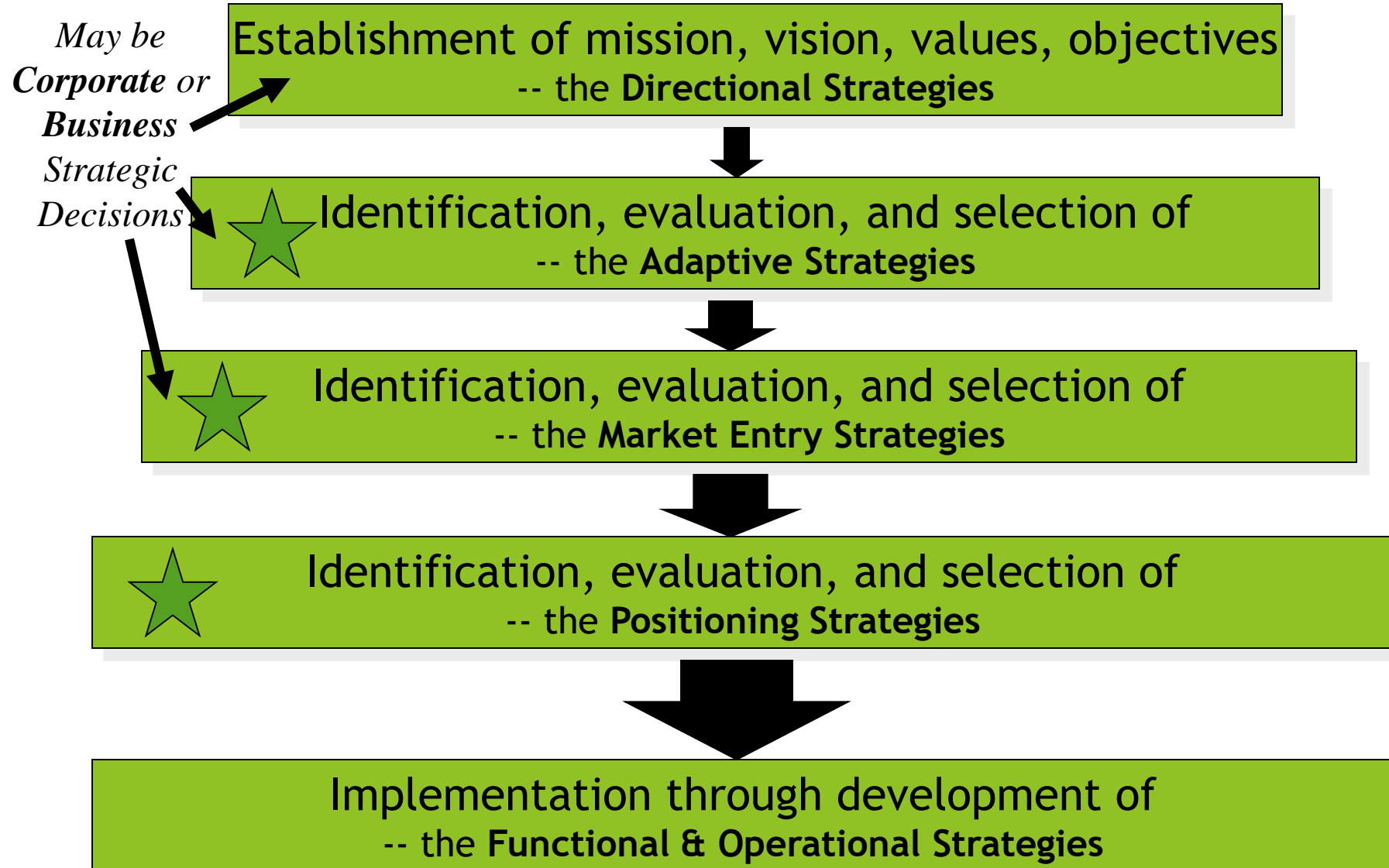


Course title: Digital Strategy and Action

Crafting an acquisition strategy

Dr. Shakhlo Ergasheva

The Decision Logic of Strategy Formulation



Adaptive Strategies

- ▶ Delineate how the organization will adapt to changes in the environment or competitive landscape:

Expansion

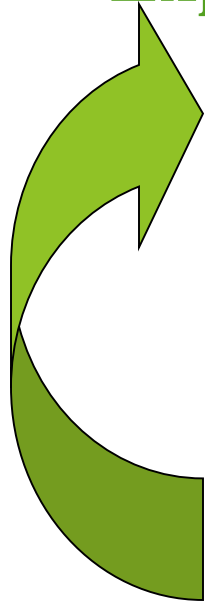
- **Diversification**
- **Vertical Integration**
- Market Development
- Product Development
- Penetration

Contraction

- Divestiture
- Liquidation
- Harvesting
- Retrenchment
- Outsourcing

Stabilization

- Enhancement
- Status Quo



Corporate Strategy Decisions Only

Adaptive: Expansion-Diversification

- ▶ When markets outside the organizations **core** business offer potential for substantial growth.
- ▶ Considered **risky**, because entering an unfamiliar market or offering a product/service that is different.
 - ▶ **Related Diversification** is when the organization chooses a market to enter that is similar to its present operations.
 - ▶ Clothing manufacture entering into the shoe market.
 - ▶ **Unrelated Diversification** is when the market chosen to enter is dissimilar, sometimes intended to create a portfolio of separate products/service.
 - ▶ Clothing manufacturer entering into the electronics market.

Advantages and Risks of Single Businesses

▶ Advantages:

- ▶ Less ambiguity about “who we are”
- ▶ Energies of firm can be directed down one business path and keeping strategy responsive to industry change
- ▶ Less chance resources will be stretched too thinly
- ▶ Resources can be focused on building competencies and capabilities
- ▶ Higher probability innovative ideas will emerge
- ▶ Top executives can maintain hands-on contact with core business
- ▶ Important competencies more likely to emerge
- ▶ Ability to parlay experience and reputation into
 - ▶ Sustainable competitive advantage
 - ▶ Prominent leadership position

▶ Risks:

- ▶ Putting all the “eggs” in one industry basket
- ▶ If market becomes unattractive, a firm’s prospects can quickly dim
- ▶ Unforeseen changes can undermine a single business firm’s prospects
 - ▶ Changing customer needs
 - ▶ Technological innovation
 - ▶ New substitutes

Motives for Diversification

GROWTH

- The desire to escape stagnant or declining industries a powerful motives for diversification (e.g. tobacco, oil, newspapers).
- *But*, growth satisfies managers not *shareholders*.
- Growth strategies (esp. by acquisition), tend to **destroy** shareholder value.

RISK SPREADING

- Diversification reduces variance of profit flows
- *But*, **doesn't create value for shareholders**—they can hold diversified portfolios of securities.
- Capital Asset Pricing Model shows that diversification lowers *unsystematic risk* not *systematic risk*.

PROFIT

- For diversification to create shareholder value, then bringing together of different businesses under common ownership and must somehow increase profitability.

Competitive Advantage from Diversification

MARKET POWER

- Predatory pricing
- Reciprocal buying
- Mutual forbearance

Evidence of these is sparse

ECONOMIES OF SCOPE

- Sharing tangible resources (research labs, distribution systems) across multiple businesses
- Sharing intangible resources (brands, technology) across multiple businesses
- Transferring functional capabilities (marketing, product development) across businesses
- Applying general management capabilities to multiple businesses

ECONOMIES FROM INTERNALIZING TRANSACTIONS

- Economies of scope not a sufficient basis for diversification—must be supported by transaction costs
- Diversification firm can avoid transaction costs by operating internal capital and labor markets
- Key advantage of diversified firm over external markets--- superior access to information

When to Diversify

Competitive Position

Strong

Weak

Market Growth

Rapid

Strong competitive position, rapid market growth -- **Not** a good time to diversify

Weak competitive position, rapid market growth -- **Not** a good time to diversify

Slow

Strong competitive position, slow market growth -- Diversification is **top priority** consideration

Weak competitive position, slow market growth -- Diversification merits **consideration**

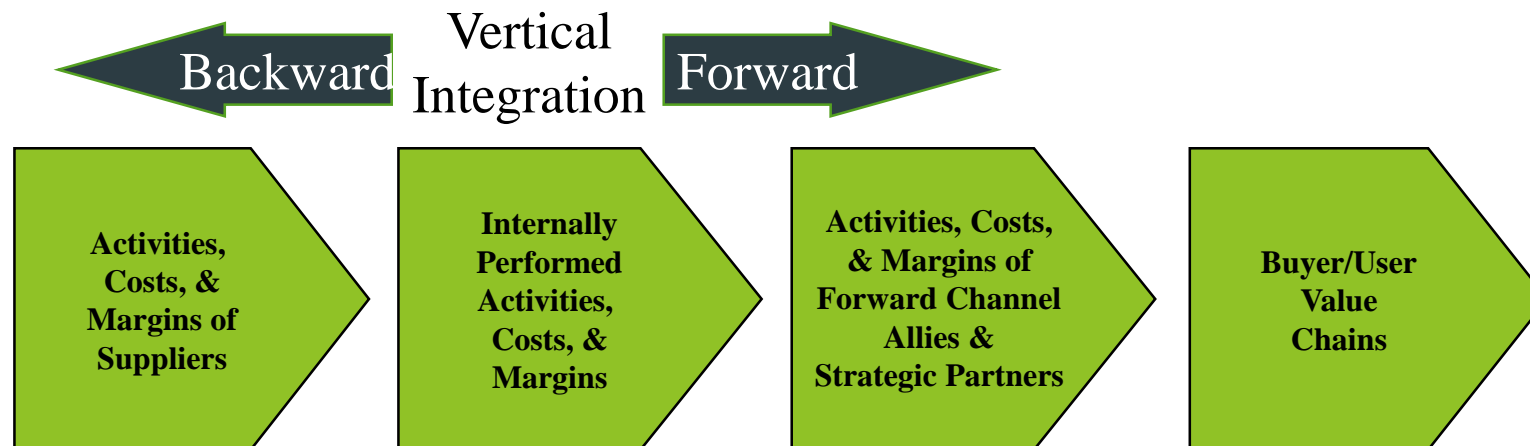
Related Diversification

- ▶ **Competitive advantage** can result from related diversification if opportunities exist to:
 - ▶ *Transfer* expertise/capabilities/technology
 - ▶ *Combine* related activities into a single operation and *reduce costs*
 - ▶ *Leverage* use of firm's *brand name reputation*
 - ▶ Conduct related value chain activities in a *collaborative fashion* to create valuable *competitive capabilities*
- ▶ **Approaches:**
 - ▶ *Sharing* of sales force, advertising, or distribution activities
 - ▶ Exploiting closely related technologies
 - ▶ Transferring know-how / *expertise* from one business to another
 - ▶ Transferring *brand name and reputation* to a new product/service
 - ▶ Acquiring new businesses to uniquely help firm's position in existing businesses

Adaptive: Expansion-Vertical Integration

- Vertical integration extends a firm's competitive scope within *same industry*
 - *Backward (upstream)* into sources of supply
 - *Forward (downstream)* toward end-users of final product/service
- Can aim at either *full* or *partial* integration

Plastics Producer / Medical Device Device Marketer or Retail Store (e.g.,
Machinery Provider Manufacturer Distributor Walgreens)



Benefits and Cost of VI

Benefits

- ▶ Technical economies from integrating processes e.g. iron and steel production
- ▶ Superior coordination
- ▶ Avoids transactions costs of market contracts in situations where there are:
 - small numbers of firms
 - transaction-specific investments
 - opportunism and strategic misrepresentation
 - taxes and regulations on market transactions

Costs

- ▶ Differences in optimal scale of operation between different stages prevents balanced VI
- ▶ Strategic differences between different vertical stages creates management difficulties
- ▶ Inhibits development and exploitation of core competencies
- ▶ Limits flexibility
 - in responding to demand cycles
 - in responding to changes in technology, customer preferences, etc.

Unrelated Diversification

- ▶ Involves diversifying into businesses with:
 - ▶ **No** strategic fit
 - ▶ **No** meaningful value chain relationships
 - ▶ **No** unifying strategic theme
- ▶ Approach is to venture into “any business in which we think we can make a profit”
- ▶ Firms pursuing unrelated diversification are often referred to as **conglomerates**
- ▶ Attractive Targets:
 - ▶ Companies with undervalued assets
 - ▶ Capital gains may be realized
 - ▶ Companies in financial distress
 - ▶ May be purchased at bargain prices and turned around
 - ▶ Companies with bright prospects but limited capital

Any company that can be acquired on **good** financial terms and offers good prospects for profitability is a good business to diversify into!

GE: Unrelated Diversification



- ▶ Aircraft Engines
- ▶ Commercial Finance
- ▶ Consumer Finance
- ▶ Consumer Products
- ▶ Equipment Management
- ▶ Industrial Systems
- ▶ Insurance



We bring good things to life.



- ▶ Medical Systems
- ▶ NBC
- ▶ Plastics
- ▶ Power System
- ▶ Specialty Material
- ▶ Transportation Systems

Levels and Types of Diversification

Low

Single Business

> 95% of business from a single business unit

Dominant Business

Between 70 and 95% of business from a single business unit

Related Constrained

<70% of revenues from dominant business; all businesses share product, technological and distribution linkages

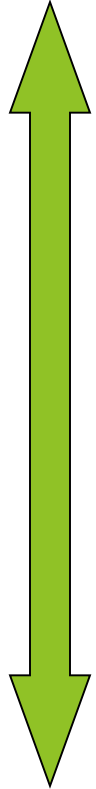
Related Linked (Mixed Related and Unrelated)

< 70% of revenues from dominant business and only limited links exist

Very High

Unrelated

< 70% of revenue comes from the dominant business, and there are **no common links** between businesses



Cooperative Form of Multidivisional Structure: Related-Constrained Strategy

- ▶ Structural integration devices create tight links among all divisions
- ▶ Corporate office emphasizes centralized strategic planning, human resources, and marketing to foster cooperation between divisions
- ▶ R&D is likely to be centralized
- ▶ Rewards are subjective and tend to emphasize overall corporate performance, in addition to divisional performance
- ▶ Culture emphasizes cooperative sharing

Strategy and Structure Growth Pattern: Multidivisional Structure

Simple Structure

Efficient implementation of formulated strategy

Sales Growth-Coordination and Control Problems

Functional Structure

Efficient implementation of formulated strategy

* Multidivisional structure is used to handle coordination problems caused by diversification.

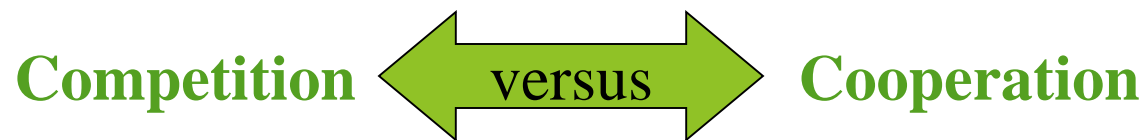
Multidivisional Structure

Sales Growth-Coordination and Control Problems

Diversification and Multidivisional Structure

Three major benefits:

1. More accurate monitoring of the performance of each business, simplifying problems of control.
2. Facilitate comparisons between divisions, improving resource allocation decision process.
3. Stimulate managers of poorly performing divisions to look for ways of improving performance.



- Managers try to strike a balance between:

Competing among divisions for scarce capital resources

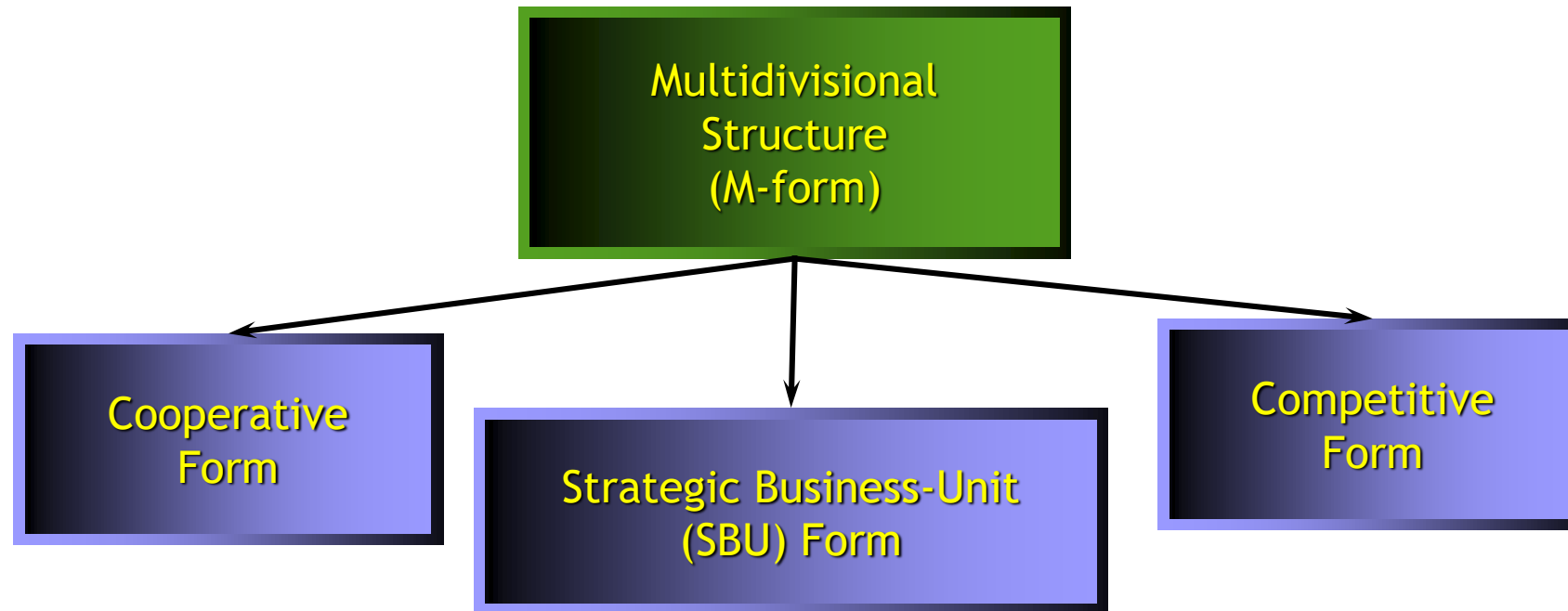
And

Creating opportunities for cooperation to develop synergies

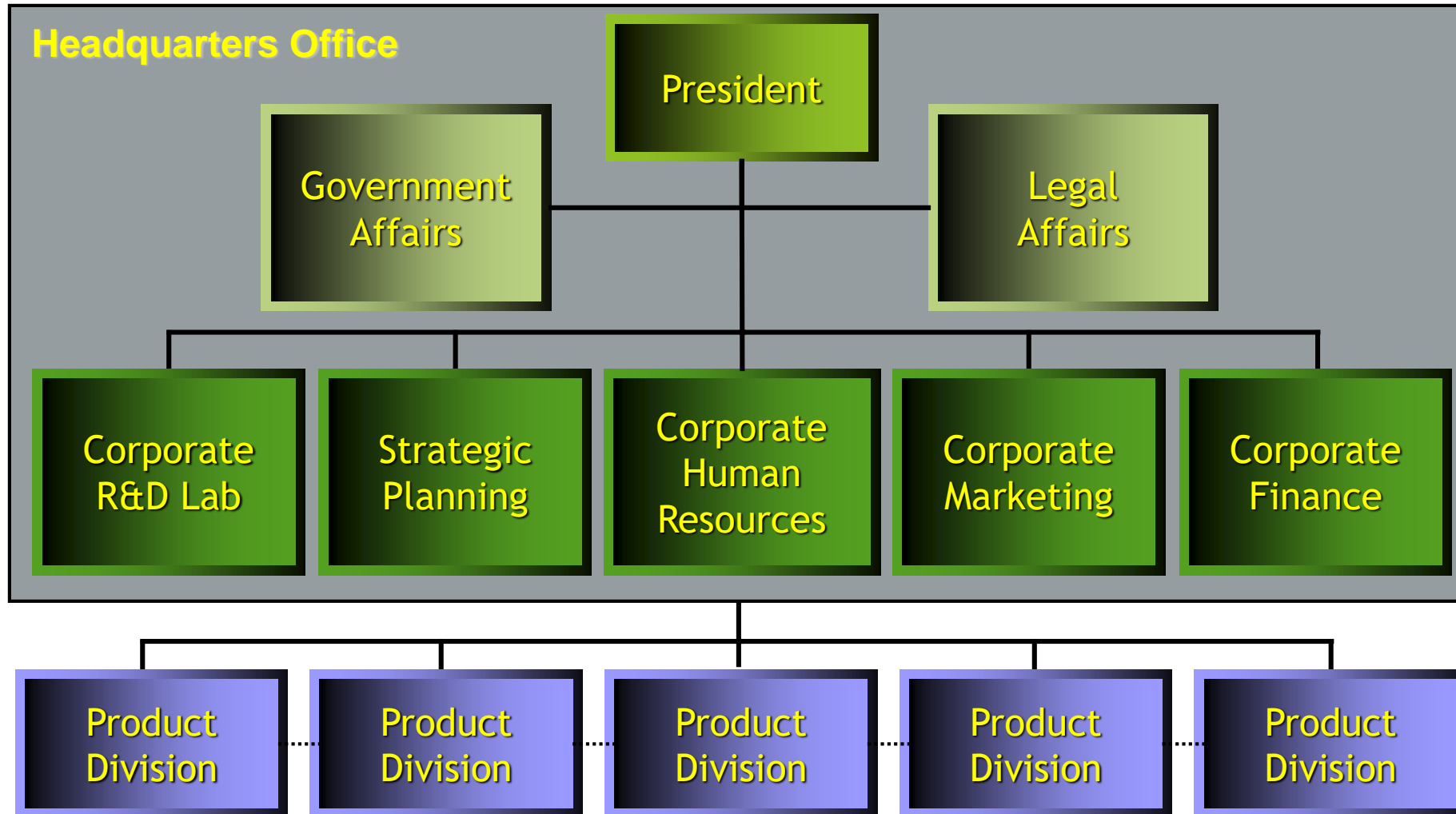
Variations of the Multidivisional Structure

Structure will evolve over time with:

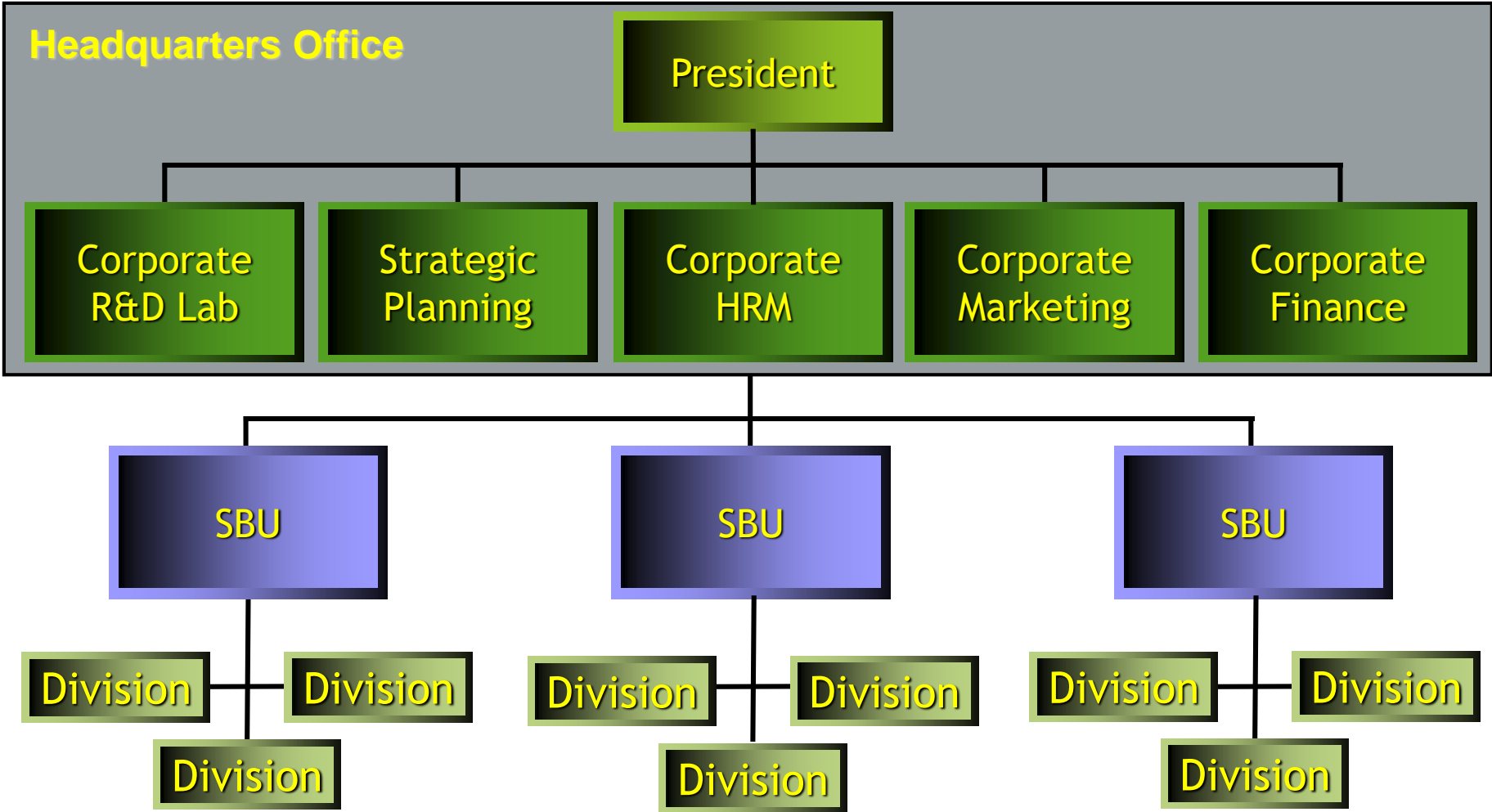
1. Changes in strategy
2. Degree of diversification
3. Geographic scope
4. Nature of competition



Cooperative Form of Multidivisional Structure: Related-Constrained Strategy



SBU Form of Multidivisional Structure: Related-Linked Strategy



SBU Form of Multidivisional Structure: Related-Linked Strategy

- ▶ Structural integration among divisions within SBUS, but independents across SBUs
- ▶ Strategic planning may be the most prominent function in headquarters for managing the strategic planning approval process of SBUs for the president.
- ▶ Each SBU may have its own budget for staff to foster integration.
- ▶ Corporate headquarters staff serve as consultants to SBUs and divisions, rather than having direct input to product strategy, as in the cooperative form.

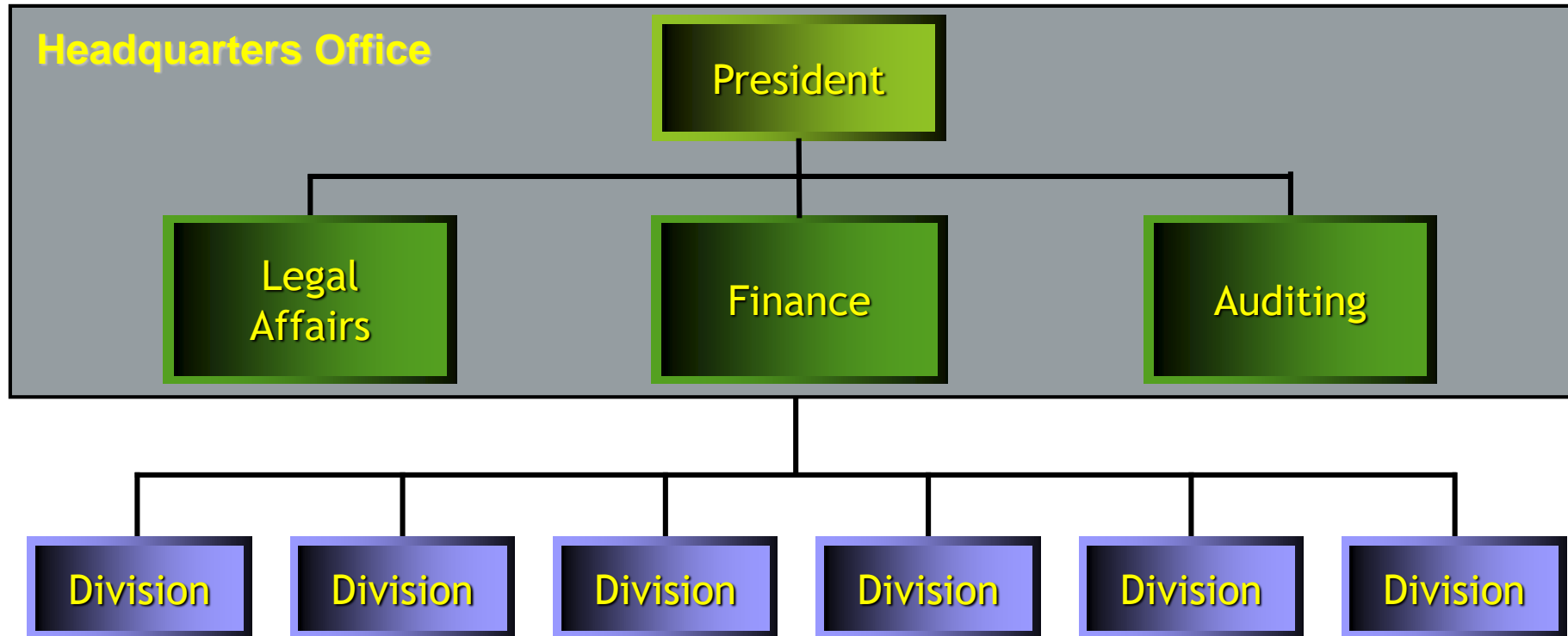
Diversification and Market Power

- ▶ Multipoint competition: Two or more diversified firms simultaneously compete in the same product areas or geographic markets.

For example:

- ▶ HP acquired Compaq to compete more equally and on more fronts with other large companies such as IBM.
- ▶ Vertical integration: Company produces its own inputs (backward integration) or owns its own source of distribution of outputs (forward integration)

Competitive Form of Multidivisional Structure: Unrelated Diversification Strategy



Competitive Form of Multidivisional Structure: Unrelated Diversification Strategy

- ▶ Corporate headquarters has a small staff
- ▶ Finance and auditing are the most prominent functions in the headquarters to manage cash flow and ensure the accuracy of performance data coming from divisions
- ▶ The legal affairs function becomes important when the firm acquires or divests assets
- ▶ Divisions are independent and separate for financial evaluation purposes
- ▶ Divisions retain strategic control, but cash is managed by the corporate office
- ▶ Divisions compete for corporate resources

Appeal / Drawbacks of Unrelated Diversification

▶ Appeal:

- ▶ Business **risk scattered** over different industries
- ▶ Capital resources can be directed to those industries offering best profit prospects
- ▶ **Stability of profits** -- Hard times in one industry may be offset by good times in another industry
- ▶ If bargain-priced firms with big profit potential are bought, shareholder wealth can be enhanced

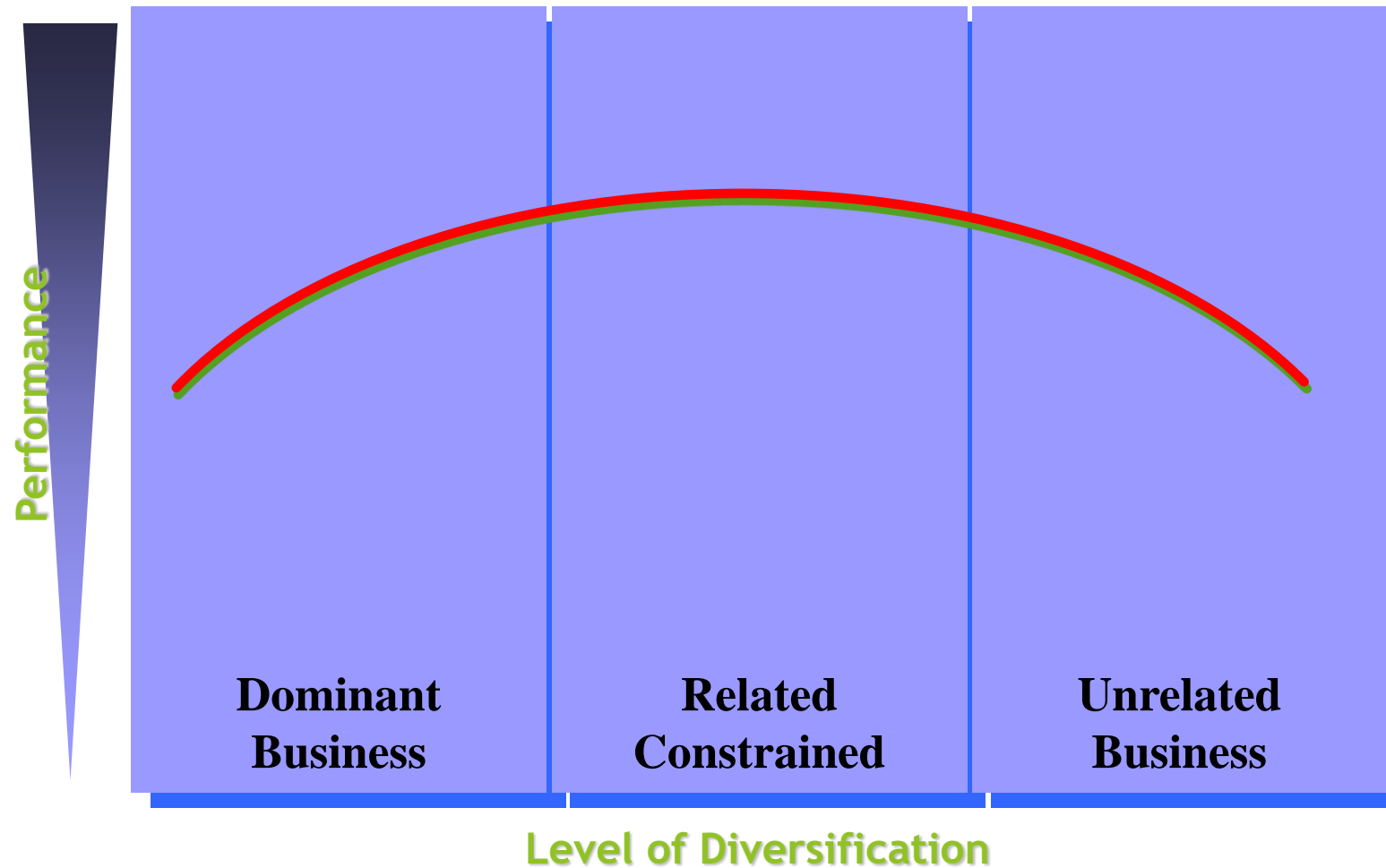
▶ Drawbacks:

- ▶ Difficulties of competently managing many diverse businesses
- ▶ There are typically **no strategic fits** which can be leveraged into competitive advantage
 - ▶ Consolidated performance of unrelated businesses tends to be no better than sum of individual businesses on their own (and it may be worse)
 - ▶ Promise of greater sales-profit stability over business cycles seldom realized

Characteristics of Structural Forms

Structural Characteristics	Cooperative M-Form	SBU M-Form	Competitive M-Form
Type of Strategy	Related-Constrained	Related-Linked	Unrelated Diversification
Degree of Centralization	Centralized at Corporate HQ	Partially Centralized in SBUs	Decentralized to Divisions
Use of Integrating Mechanisms	Extensive	Moderate	Nonexistent
Divisional Performance Appraisal	Subjective Strategic Criteria	Strategic & Financial Criteria	Objective Financial Criteria
Divisional Incentive Compensation	Linked to Corporate Performance	Linked to SBU & Division Performance	Linked to Divisional Performance

Relationship Between Diversification and Performance



How Firms Enter New Industries

Entering New Industries

▶ Acquisition (or Mergers) -

Most popular approach to diversification

▶ **Advantages:**

- ▶ **Quicker** entry into target market
- ▶ Easier to hurdle certain entry barriers
- ▶ Technological inexperience
- ▶ Gaining **access** to reliable suppliers
- ▶ **Size** to match rivals in terms of efficiency and costs
- ▶ Getting adequate distribution access

▶ New Internal Business

More attractive when:

- ▶ Ample **time** exists to create new business from ground up
- ▶ **Incumbents slow** in responding to new entry
- ▶ **Less expensive** than acquiring an existing firm
- ▶ Company already has most of needed skills
- ▶ Additional capacity will not adversely impact supply-demand balance in industry
- ▶ New start-up does not have to go head-to-head against powerful rivals

▶ Joint Venture

Good way to diversify when:

- ▶ Uneconomical or **risky** to go it alone
- ▶ **Pooling** competencies of two partners provides more competitive strength
- ▶ **Foreign** partners are needed to surmount
 - ▶ Import quotas
 - ▶ Tariffs
 - ▶ Nationalistic political interests
 - ▶ Cultural roadblocks

Mergers, Acquisitions and Takeovers

- ▶ **Merger:** a strategy through which two firms agree to integrate their operations on a *relatively* co-equal basis.
- ▶ **Acquisition:** a strategy through which one firm buys a controlling interest in another firm with the intent of making the acquired firm a subsidiary business within its own portfolio
- ▶ **(Hostile) Takeover:** a special type of an acquisition strategy wherein the target firm did *not* solicit the acquiring firm's bid.

Reasons for Making Acquisitions



Reasons for Making Acquisitions

Increased Market Power

- ▶ Factors increasing market power
 - ▶ when a firm is able to sell its goods or services above competitive levels or
 - ▶ when the costs of its primary or support activities are below those of its competitors
 - ▶ usually is derived from the size of the firm and its resources and capabilities to compete
- ▶ Market power is increased by
 - ▶ horizontal acquisitions
 - ▶ vertical acquisitions
 - ▶ related acquisitions

Reasons for Making Acquisitions

Overcome Barriers to Entry

- ▶ Barriers to entry include
 - ▶ Economies of scale in established competitors
 - ▶ Differentiated products by competitors
 - ▶ Enduring relationships with customers that create product loyalties with competitors
- ▶ Acquisition of an established company
 - ▶ May be more effective than entering the market as a competitor offering an unfamiliar good or service that is unfamiliar to current buyers
 - ▶ Includes cross-border acquisitions

Reasons for Making Acquisitions

Cost of New Product Development and Increased Speed to Market

- ▶ Significant investments of a firm's resources are required to
 - ▶ develop new products internally
 - ▶ introduce new products into the marketplace
- ▶ Acquisition of a competitor may result in
 - ▶ lower risk compared to developing new products
 - ▶ increased diversification
 - ▶ reshaping the firm's competitive scope
 - ▶ learning and developing new capabilities
 - ▶ faster market entry
 - ▶ rapid access to new capabilities

Reasons for Making Acquisitions

Lower Risk Compared to Developing New Products

- ▶ An acquisition's outcomes can be estimated more easily and accurately compared to the outcomes of an internal product development process.

Increased Diversification

- It may be easier to develop and introduce new products in markets currently served by the firm.
- It may be difficult to develop new products for markets in which a firm lacks experience; acquisitions are the quickest and easiest way to diversify a firm and change its portfolio of businesses

Reasons for Making Acquisitions

Reshaping the Firms' Competitive Scope

- ▶ Firms may use acquisitions to reduce their dependence on one or more products or markets
- ▶ Reducing a company's dependence on specific markets alters the firm's competitive scope

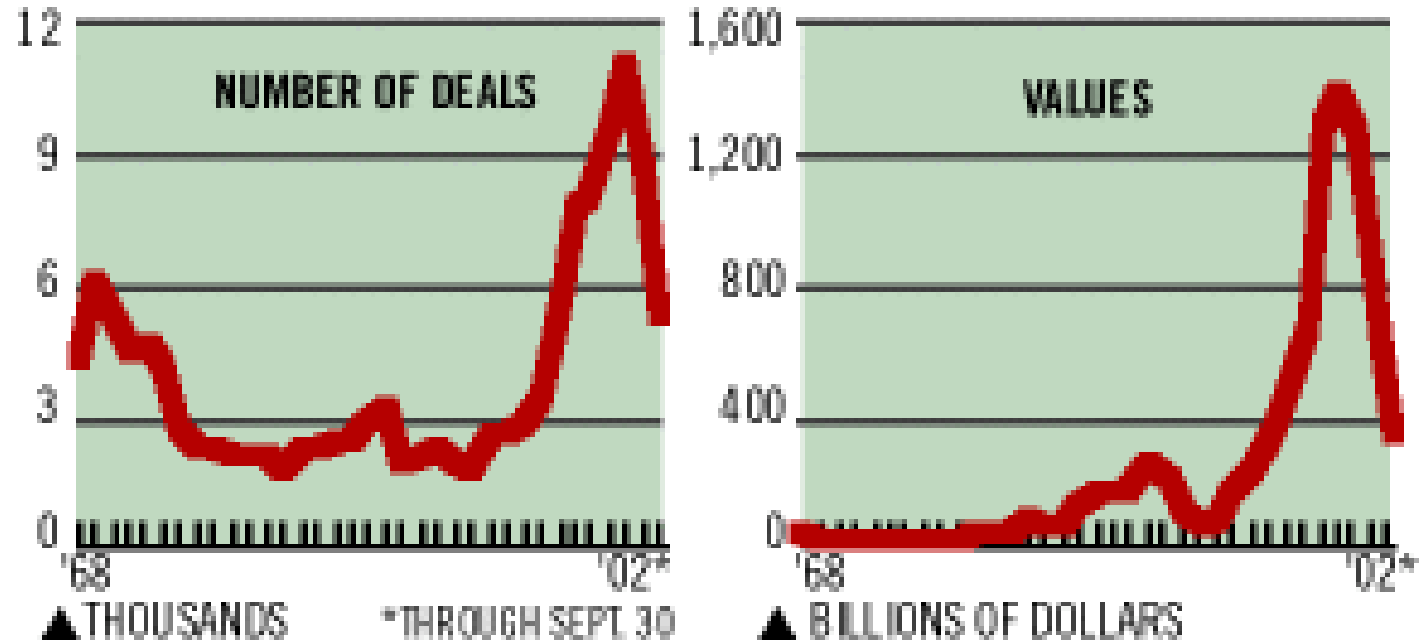
Learning and Developing New

Capabilities • Acquisitions may gain capabilities that the firm does not possess.

- Acquisitions may be used to:
 - acquire a special technological capability
 - broaden a firm's knowledge base
 - reduce inertia

MERGER BOOM

Nearly \$4 trillion worth of mergers were done from 1998 through 2000—more than in the preceding 30 years



Data: Mergerstat

Diversification and Corporate Performance: A Disappointing History

Attaining the intended payoffs from diversification efforts is hard:

- The diversification records of 33 large, prestigious U.S. companies over the 1950-1986 period showed that most of them have divested many more acquisitions than they had kept. The corporate strategies of most companies had dissipated rather than enhanced shareholder value—by taking over companies and breaking them up, corporate raiders had thrived on failed corporate strategies.
- Another study evaluated the stock market reaction to 600 acquisitions over a period between 1975 and 1991. The results indicate that acquiring firms suffered an average 4 percent drop in market value (after adjusting for market movements) in the three months following the acquisition announcement.
- A study analyzed 150 acquisitions worth more than \$500 million that took place between July 1990 and July 1995. Based on total stock returns from 3 months before the announcement and up to 3 years after the announcement:
 - **30 percent** substantially eroded shareholder returns.
 - **20 percent** eroded some returns.
 - **33 percent** created only marginal returns.
 - **17 percent** created substantial returns.
- A study since 1997 in deals for \$15 billion or more, showed the stocks of the acquiring firms have, on average, under-performed the S&P stock index by 14 percentage points and under-performed their peer group by four percentage points after the deals were announced.

Business Week 2002 Merger

Maniacs

BIG DEALS

Megamergers have done little for buyers' share prices. A year later, many lagged their peers or just kept pace

BUYER	INDUSTRY	TARGET	DATE	VALUE* (BILLIONS)	PREMIUM**	RETURNS***		
						SELLER INITIAL	BUYER INITIAL	BUYER 1 YEAR
AMERICA ONLINE	INTERNET SOFTWARE	TIME WARNER	1/00	\$165.9	55.8%	11%	1%	17%
PFIZER	PHARMACEUTICALS	WARNER-LAMBERT	11/99	93.9	29.7	20	-12	1
EXXON	OIL & GAS	MOBIL	12/98	77.2	34.7	18	1	-5
TRAVELERS GROUP (1)	INSURANCE	CITICORP	4/98	70.0	10.4	8	6	2
SBC COMMUNICATIONS	TELECOM SVCS.	AMERITECH	5/98	61.4	23.1	3	-8	-19
NATIONSBANK (2)	BANKS	BANKAMERICA	4/98	59.3	48.4	2	4	4
AT&T	TELECOM SVCS.	MEDIAONE GROUP	4/99	55.8	24.3	18	-6	-4
BELL ATLANTIC (3)	TELECOM SVCS.	GTE	7/98	52.8	3.8	-1	5	6
VIACOM	MEDIA	CBS	9/99	40.4	4.0	5	6	32
QWEST COMMUNICATIONS	TELECOM SVCS.	U S WEST	6/99	40.3	27.5	4	-23	21
DAIMLER-BENZ	AUTOMOBILES	CHRYSLER	5/98	38.6	54.3	16	-6	-30
JDS UNIPHASE	COMMUNICATIONS EQUIP.	SDL	7/00	38.1	59.7	24	-19	-14
CHASE MANHATTAN (4)	FINANCIAL	J.P. MORGAN	9/00	36.3	28.9	1	-16	-10
CHEVRON	OIL & GAS	TEXACO	10/00	35.8	24.8	12	-3	10
NORWEST (5)	BANKS	WELLS FARGO	6/98	33.9	0.9	-3	-11	10

*Value of offer when announced **Difference between the offer price and the seller's market price one week before the announcement ***Percentage-point difference between company returns and indexes of S&P 500 peers from one week before announcement to one week (initial) and one year after Current name: (1) Citigroup (2) Bank of America (3) Verizon (4) J.P. Morgan Chase (5) Wells Fargo

Data: Standard & Poor's, Mergerstat, Boston Consulting Group, Inc. Thomson Financial

More M&A Activity

Mergers: A Bit of Mania for 2005 “The value of announced deals for 2004 was \$767 billion as of Dec. 15, up 40% from 2003's \$544 billion, according to Thomson Financial Services. That's a big increase, but it restores M&A volume only to a level below where it stood in 1997, when it hit \$887 billion.” –BusinessWeek, 12/27/2004

Shake, Rattle, And Merge “Remember the urge to merge? Quelled since 2000, it's coming back. In the last quarter of 2004, deals for U.S. companies came at a trillion-dollar-a-year pace -- and more are in store.” – BusinessWeek, 1/12/2005

Merger Machine Keeps Churning Out Deals “A strong first quarter for mergers continued in the second quarter, as deals rolled in from seemingly every sector: banks, stock exchanges, oil companies, real-estate firms and consumer-products companies. It was one of history's largest and most diverse corporate-buying sprees, with nearly \$1 trillion in deals around the world.” WSJ, 7/3/2006



Problems With Acquisitions



Problems With Acquisitions

Integration Difficulties

- ▶ Integration challenges include
 - ▶ melding two disparate corporate cultures
 - ▶ linking different financial and control systems
 - ▶ building effective working relationships (particularly when management styles differ)
 - ▶ resolving problems regarding the status of the newly acquired firm's executives
 - ▶ loss of key personnel weakens the acquired firm's capabilities and reduces its value

Problems With Acquisitions

Inadequate Evaluation of Target

- ▶ Evaluation requires that hundreds of issues be closely examined, including
 - ▶ financing for the intended transaction
 - ▶ differences in cultures between the acquiring and target firm
 - ▶ tax consequences of the transaction
 - ▶ actions that would be necessary to successfully meld the two workforces
- ▶ Ineffective due-diligence process may
 - ▶ result in paying excessive premium for the target company

Problems With Acquisitions

Large or Extraordinary Debt

- ▶ Firm may take on significant debt to acquire a company
- ▶ High debt can
 - ▶ increase the likelihood of bankruptcy
 - ▶ lead to a downgrade in the firm's credit rating
 - ▶ preclude needed investment in activities that contribute to the firm's long-term success

Problems With Acquisitions

Inability to Achieve Synergy

- ▶ Synergy exists when assets are worth more when used in conjunction with each other than when they are used separately
- ▶ Firms experience transaction costs (e.g., legal fees) when they use acquisition strategies to create synergy
- ▶ Firms tend to underestimate indirect costs of integration when evaluating a potential acquisition

Problems With Acquisitions

Too Much Diversification

- ▶ Diversified firms must process more information of greater diversity
- ▶ Scope created by diversification may cause managers to rely too much on financial rather than strategic controls to evaluate business units' performances
- ▶ Acquisitions may become substitutes for innovation

Problems With Acquisitions

Managers Overly Focused on Acquisitions

- ▶ Managers in target firms may operate in a state of virtual suspended animation during an acquisition
- ▶ Executives may become hesitant to make decisions with long-term consequences until negotiations have been completed
- ▶ Acquisition process can create a short-term perspective and a greater aversion to risk among top-level executives in a target firm

Problems With Acquisitions

Too Large

- ▶ Additional costs may exceed the benefits of the economies of scale and additional market power
- ▶ Larger size may lead to more bureaucratic controls
- ▶ Formalized controls often lead to relatively rigid and standardized managerial behavior
- ▶ Firm may produce less innovation

Attributes of Effective Acquisitions

Attributes	Results
Complementary Assets or Resources	Buying firms with assets that meet current needs to build competitiveness
Friendly Acquisitions	Make integration go more smoothly
Careful Selection Process	More likely to lead to easy integration and building synergies
Maintain Financial Slack / Relatively Low Debt Levels	Maintain financial flexibility. Provide enough financial resources so that profitable projects would not be foregone
Sustain Emphasis on Innovation	Continue to invest in R&D as part of the firm's overall strategy
Flexibility	Has experience at managing change and is flexible and adaptable

Adaptive: Contraction Strategies

Exit Strategies

- ▶ **Divestiture** - operating strategic unit (or entire business) is sold as a result of a decision to permanently and completely leave the market.
- ▶ **Liquidation** - selling the assets of an organization, which cannot be sold as a viable and operational organization (assets still have value, but not the business).
- ▶ **Harvesting** - reaping maximum short-term benefits riding a long-term decline in the market.

Adaptive: Other Contraction or Restructuring Strategies

- ▶ **Downsizing** - Wholesale reduction of employees
- ▶ **Outsourcing** - Involves *not* performing certain value chain activities internally and relying on outside vendors to perform needed activities and services.
- ▶ **Downscoping**- Selectively divesting or closing non-core businesses and reducing scope of operations. Leads to greater focus on primary operations.
- ▶ **Retrenchment** - response to declining profitability usually brought about by increasing costs - needs redefinition of target market, selective cost elimination, and asset reduction. (Much like Downscoping).
- ▶ **Leveraged Buyout (LBO)** - A party buys a firm's entire assets in order to take the firm private.

Exhibit 6–11: ♦ Rationales and Relative Risks of Contraction of Scope Strategic Alternatives

Strategy	Relative Risk	Rationale
<i>Divestiture</i>	Low	<ul style="list-style-type: none"> ▪ Industry in long-term decline ▪ Cash needed to enter new, higher-growth area ▪ Lack of expected <i>synergy</i> with core operation ▪ Required investment in new technology seen as too high ▪ Too much regulation ▪ Unbundling
<i>Liquidation</i>	Low	<ul style="list-style-type: none"> ▪ Organization can no longer operate ▪ Bankruptcy ▪ Trim/reduce assets ▪ Superseded by new technology
<i>Harvesting</i>	Low	<ul style="list-style-type: none"> ▪ Late maturity/decline of the product life cycle ▪ Consider divestiture or downsizing ▪ Short-term cash needed
<i>Retrenchment</i> (<i>personnel, markets,</i> <i>products, assets</i>)	Moderate	<ul style="list-style-type: none"> ▪ Market has become too diverse ▪ Market is too geographically spread out ▪ Personnel costs are too high ▪ Too many products or services ▪ Marginal or nonproductive facilities

Decision Tool 1: Evaluating Competitive Strength Different Business Units

Objectives:

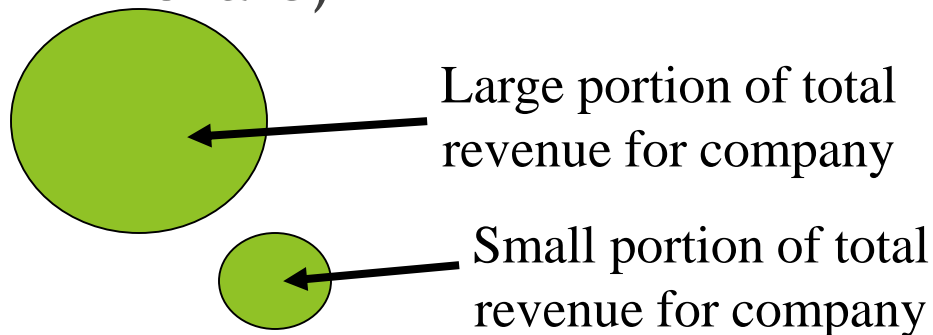
- ▶ Determine how well each business is positioned in its industry relative to rivals
- ▶ Evaluate whether it is or can be competitively strong enough to contend for market leadership

Competitive Strength Factors:

- ▶ Relative market share
- ▶ Ability to compete on cost
- ▶ Ability to match rivals on quality and/or service
- ▶ Ability to exercise bargaining leverage with suppliers or customers
- ▶ Technology and innovation capabilities
- ▶ How well business unit's competitive assets and competencies match industry KSFs
- ▶ Brand name recognition and reputation
- ▶ Profitability relative to competitors

Constructing an Attractiveness / Strength Matrix

- ▶ Use **quantitative** measures of industry attractiveness and business strength (remember the weighted vs. unweighted attractiveness matrices?) to plot location of each business in matrix
- ▶ Each **business unit** appears as a **circle**:
 - ▶ **Area of circle** is proportional to size of business as a percent of company revenues
(**Or** area of circle can represent relative size of industry with pie slice showing the company's market share)



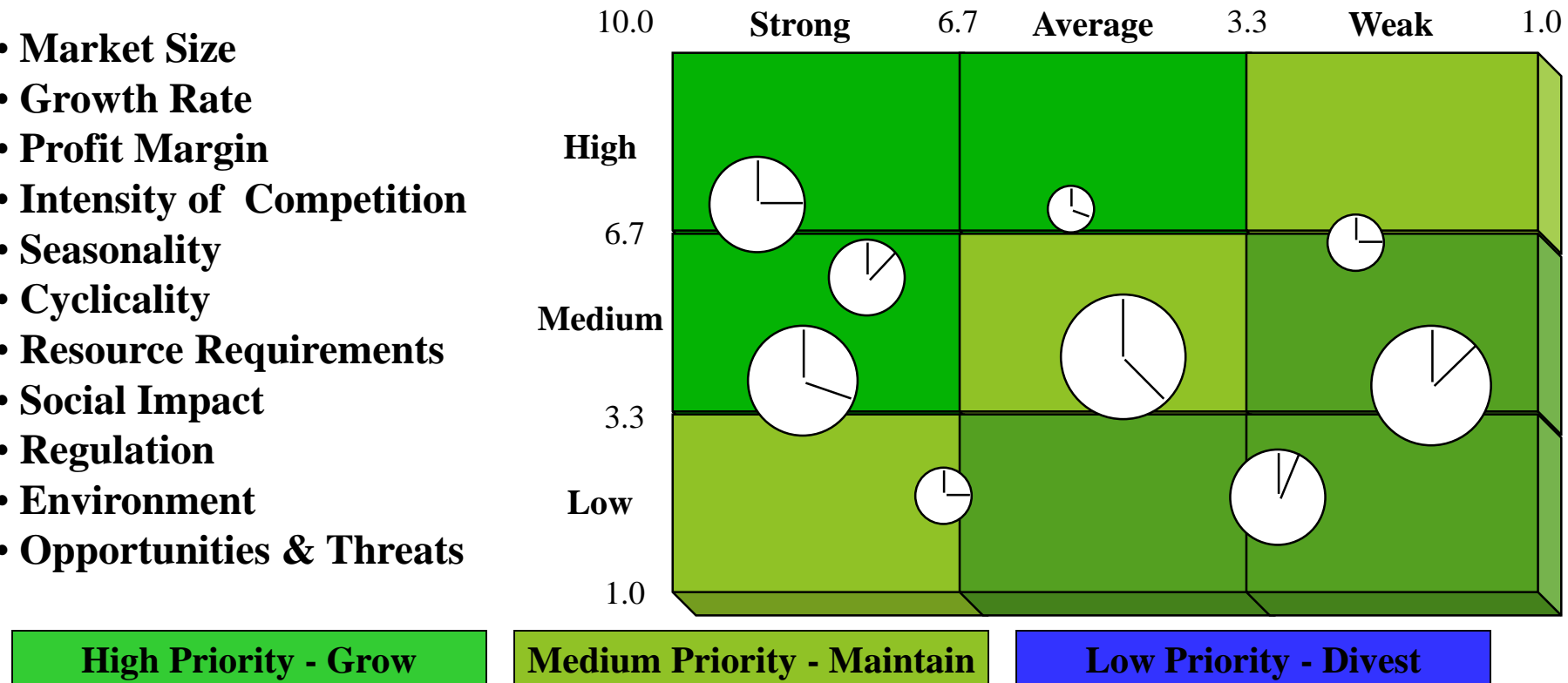
Representative Nine-Cell Industry Attractiveness-Business Strength Matrix

Industry Attractiveness

- Market Size
- Growth Rate
- Profit Margin
- Intensity of Competition
- Seasonality
- Cyclical
- Resource Requirements
- Social Impact
- Regulation
- Environment
- Opportunities & Threats

Business Strength

- Relative Market Share
- Reputation/ Image
- Bargaining Leverage
- Ability to Match Quality/Service
- Relative Costs
- Profit Margins
- Fit with KSFs



High Priority - Grow

Medium Priority - Maintain

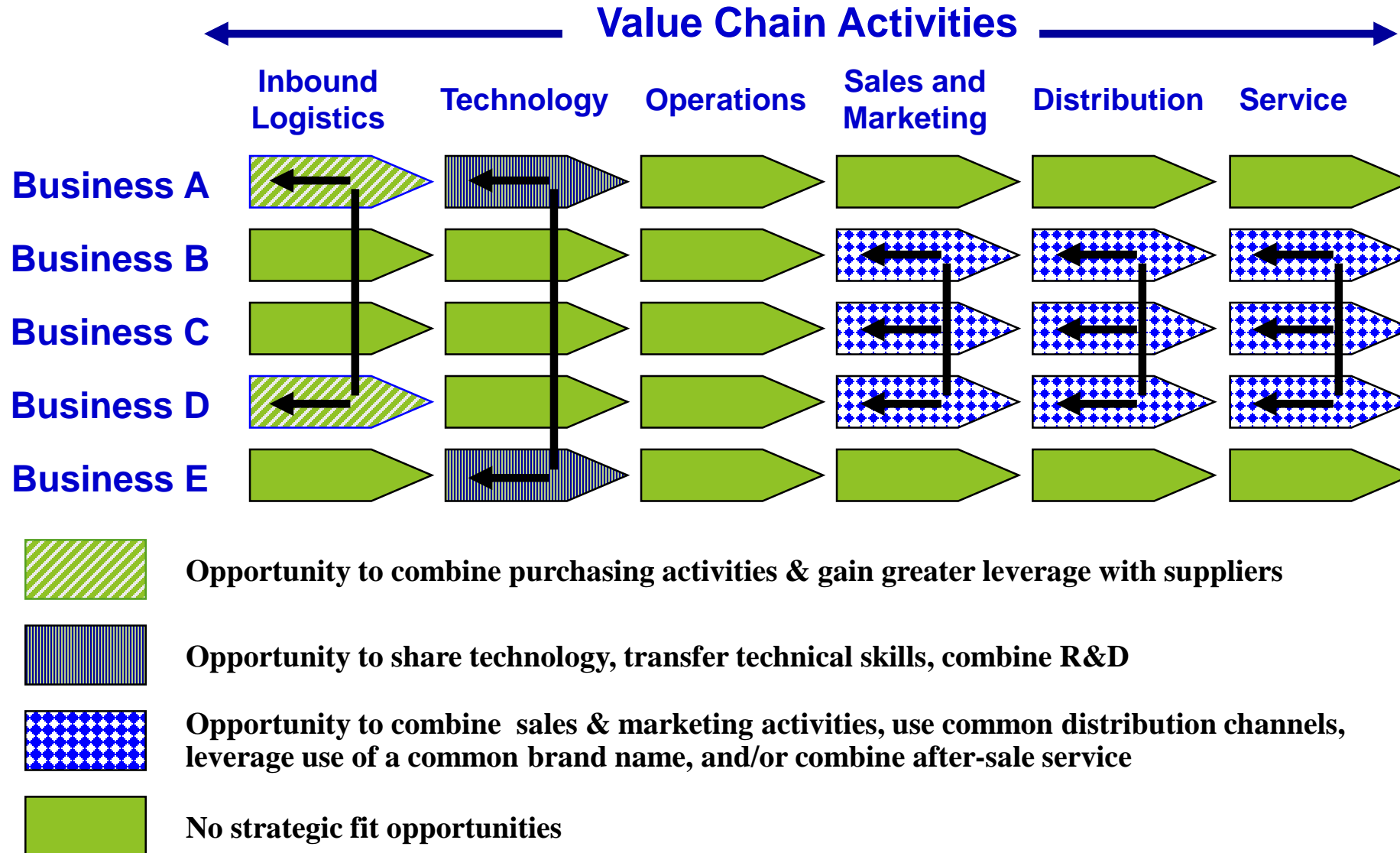
Low Priority - Divest

Decision Tool 2: Assessing Strategic Fit

▶ Objective

- ▶ Determine competitive advantage potential of value chain relationships and strategic fits among current businesses
- ▶ **Examine fit needs from two angles:**
 - ▶ Whether one or more businesses have valuable strategic fit with other businesses in portfolio
 - ▶ Whether each business meshes well with firm's long-term strategic direction

Identifying Strategic Fits Among a Diversified Firm's Business Units



Decision Tool 3: Assessing Resources

Objective:

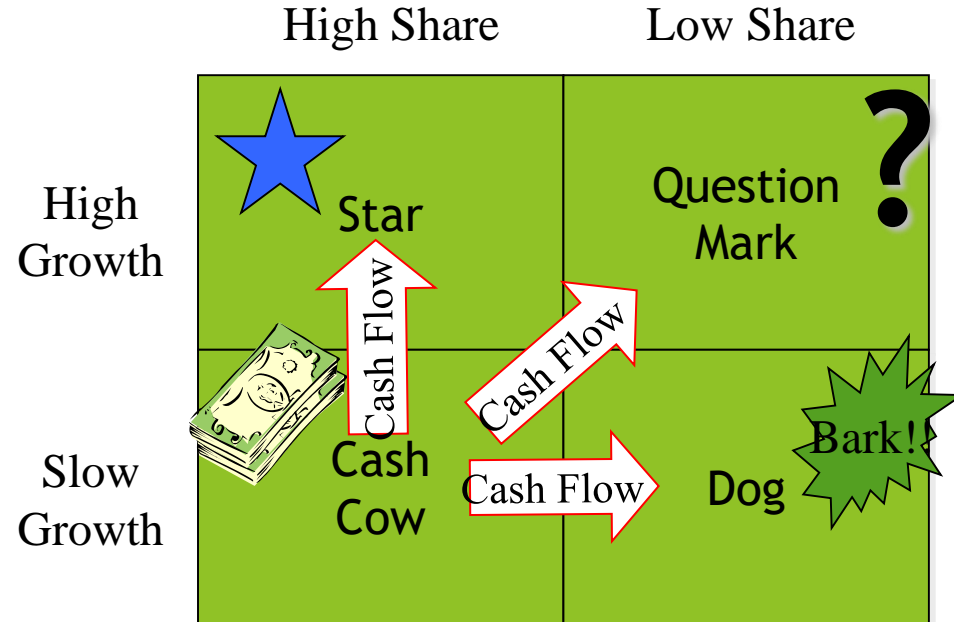
- ▶ Determine how well firm's resources *match* business unit requirements
- ▶ Good resource fit exists when:
 - ▶ Businesses *add* to a firm's resource strengths, either financially or strategically
 - ▶ Firm has (financial) resources to adequately *support* requirements of its businesses as a group

Dogs to Hogs: Assessing Cash Flow between Businesses

- Determine cash flow and investment requirements of the business units - Are they **cash hogs** or **cash cows**?

A business is a *cash hog* when its internal cash flows are inadequate to fully fund its need for working capital and new capital investment *the parent company has to continually pump in capital to “feed the hog”*

- Strategic options:
 - 📄 Aggressively invest in *attractive* cash hogs (question marks or stars)
 - 📄 Divest cash hogs (dogs, maybe question marks) lacking long-term potential



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