Chapter 8: Corporate-Level Strategy

CHAPTER SUMMARY

This chapter focuses on the use of corporate-level strategies to define the arenas in which organizations will participate. Diversification strategy is the primary vehicle used at the corporate level to create value for a portfolio of businesses that exceeds the value potential of the individual businesses under different ownership. Diversification is examined at various levels of connectedness amongst the individual businesses within a corporation.

Value-creating reasons for firms to use corporate-level strategies are explored, with a look at vertical integration as a means to gain power over competitors.

Value-neutral and value-reducing reasons for diversifying are also presented, along with the design of organizational structure that facilitates implementation for each type of corporate-level strategy discussed.

CHAPTER OUTLINE

Levels of Diversification
  - Low Levels of Diversification
  - Moderate and High Levels of Diversification
Reasons for Diversification
Diversification and the Multidivisional Structure
  - Operational Relatedness: Sharing Activities
  - Corporate Relatedness: Transferring of Core Competencies
Related Diversification
  - Using the Cooperative Form of the Multidivisional Structure to Implement the Related Constrained Strategy
  - Using the Strategic Business-Unit Form of the Multidivisional Structure to Implement the Related Linked Strategy
  - Market Power through Multimarket Competition and Vertical Integration
  - Simultaneous Operational Relatedness and Corporate Relatedness
Unrelated Diversification
  - Efficient Internal Capital Market Allocation
  - Restructuring
  - Using the Competitive Form of the Multidivisional Structure to Implement the Unrelated Diversification Strategy
Value-Neutral Diversification: Incentives and Resources
  - Incentives to Diversify
  - Resources and Diversification
Value-Reducing Diversification: Managerial Motives to Diversify
Summary

KNOWLEDGE OBJECTIVES

1. Define corporate-level strategy and discuss its importance to the diversified firm.
2. Describe the advantages and disadvantages of single and dominant business strategies.
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3. Explain three primary reasons why firms move from single and dominant business strategies to more diversified strategies to enhance value creation.
4. Describe the multidivisional structure (M-form) and controls and discuss the difference between strategic controls and financial controls.
5. Describe how related diversified firms create value by sharing or transferring core competencies.
6. Explain the two ways value can be created with an unrelated diversification strategy.
7. Explain the use of the three versions of the multidivisional structure (M-form) to implement different diversification strategies.
8. Discuss the incentives and resources that encourage diversification.
9. Describe motives that can be incentives for managers to overdiversify a firm.

**LECTURE NOTES**

<table>
<thead>
<tr>
<th>See slides 1-3.</th>
<th><strong>Key Terms</strong></th>
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<tbody>
<tr>
<td></td>
<td><strong>Corporate-Level Strategy</strong> - specifies actions a firm takes to gain a competitive advantage by selecting and managing a portfolio of businesses that compete in different product markets or industries.</td>
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<table>
<thead>
<tr>
<th>See slide 4.</th>
<th>1. Describe product diversification.</th>
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<tr>
<td></td>
<td>a. It is the primary form of corporate-level strategy.</td>
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<td>b. It is concerned with the scope of the industries and markets in which the firm competes.</td>
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<td>c. It defines how managers buy, create, and sell different businesses to match skills and strengths with opportunities.</td>
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<td>d. It is expected to reduce variability in the firm’s profitability, generating earnings from several different business units.</td>
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<tr>
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<td>e. There is a cost to developing and monitoring a diversification strategy, which must be balanced with benefits to establish an ideal portfolio of businesses.</td>
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**Levels of Diversification** - This section introduces the different levels of diversification that vary according to the connections between and among businesses with a corporation.
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2. What are the five categories of diversification?
   a. Low levels of diversification
      i. Single business
      ii. Dominant business
   b. Moderate to high levels of diversification
      i. Related constrained
      ii. Related linked
   c. Very high levels of diversification
      i. Unrelated

Low Levels of Diversification - This section discusses two types of strategies used by firms pursuing low levels of diversification.

See slide 6.

See Additional Notes Below.

Key Terms
- Single Business Strategy - corporate-level strategy in which the firm generates 95% or more of its sales revenue from its core business area.
- Dominant Business Diversification Strategy - corporate-level strategy in which the firm generates between 70% and 95% of its total sales revenue within a single business area.

Additional Discussion Notes for Low Levels of Diversification - These notes include additional materials that cover the strategies for firms with low levels of diversification.

Low Levels of Diversification
A single business diversification strategy generates 95% or more of a firm’s sales revenue from its core business area. Take the chewing gum market, for example. Wm. Wrigley Jr. Company uses a single business strategy while operating in relatively few product markets. Wrigley’s brands include Spearmint, Doublemint, and Juicy Fruit, and in the 1990s the company added sugar-free gums Hubba Bubba, Orbit, and Ice White. Collaboration with Procter & Gamble (P&G) to produce a dental chewing gum—marketed under P&G’s Crest brand—causes Wrigley to become slightly more diversified than it has been historically.

A dominant business diversification strategy generates between 70% and 95% of a firm’s total revenue within a single business area. Smithfield Foods uses the dominant business diversification strategy; the majority of its sales are generated from raising and butchering hogs. Recently, however, Smithfield diversified into beef packing by acquiring a smaller beef processor. Smithfield also attempted to acquire IBP, the largest beef packer, but was outbid by Tyson Foods. Although it still uses the dominant business diversification strategy, Smithfield’s addition of beef packing operations suggests that its portfolio of businesses is becoming more diversified.
### Key Terms

- **Related Diversification Strategy** - corporate-level strategy in which the firm generates more than 30% of its sales revenue outside a dominant business and whose businesses are related to each other in some manner.
- **Related Constrained Diversification Strategy** - related diversification strategy characterized by direct links between the firm’s businesses.
- **Related Linked Diversification Strategy** - related diversification strategy characterized by linked firms that share fewer resources and assets among their businesses, concentrating on the transfer of knowledge and competencies among the businesses.
- **Unrelated Diversification Strategy** - corporate-level strategy for highly diversified firms in which there are no well-defined relationships between its businesses.

### Additional Discussion Notes for Moderate and High Levels of Diversification

These notes include additional materials that cover the strategies for firms with moderate and high levels of diversification.

**Moderate and High Levels of Diversification**

A firm generating more than 30% of its sales revenue outside a dominant business and whose businesses are related to each other in some manner uses a *related diversification corporate-level strategy*. When the links between the diversified firm’s businesses are rather direct, a *related constrained diversification strategy* is being used. A related, constrained firm shares a number of resources and activities among its businesses (Campbell Soup, Procter & Gamble, Xerox, and Merck & Company).

A highly diversified firm (no relationships between its businesses) follows an *unrelated diversification strategy*. United Technologies, Textron, and Samsung are examples of firms using this type of corporate-level strategy. In Latin America, China, Korea, and India, conglomerates (firms following the unrelated diversification...
strategy) continue to dominate the private sector (~30% of GNP). The largest business groups in India, Brazil, Mexico, Argentina, and Colombia are family-owned, diversified enterprises. However, the viability of these large diversified business groups is now questioned.

| Reasons for Diversification | 4. Discuss the reasons that firms use diversification strategies.  
|                           | a. To increase the firm’s value by improving its overall performance (value-creating diversification).  
|                           | b. To gain market power relative to competitors, often through multimarket competition (introduced in Chapter 6) or vertical integration (defined later in the chapter).  
|                           | c. To allocate capital more efficiently to those businesses with the greatest potential for high performance or as a part of a business restructuring plan.  
|                           | d. In response to government-induced stimuli (such as antitrust regulation and tax laws)  
|                           | e. In response to concerns about a firm’s low performance, uncertainty of future cash flows, or other types of risk.  
|                           | f. To take advantage of tangible or intangible resources the firm possesses that would facilitate diversification.  
|                           | g. To match and thereby neutralize a competitor’s market power (such as to neutralize another firm’s advantage by acquiring a distribution outlet similar to its rival).  
|                           | h. To expand a firm’s portfolio of businesses and reduce managerial employment risk (if one of the businesses in a diversified firm fails, the top executive of the firm has an opportunity to remain employed).  
|                           | 5. What are two ways diversification strategies can create value?  
|                           | a. Operational relatedness - sharing activities  
|                           | b. Corporate relatedness - transferring knowledge  

| Diversification and the Multidivisional Structure | This section discusses the type of organizational structure needed to support implementation of multi-business strategies.  

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Key Terms

- **Multidivisional structure (M-form)** - organizational structure which ties together several operating divisions, each representing a separate business or profit center to which responsibility for daily operations and business-unit strategy is delegated.

- **Organizational Controls** - guide the use of strategy, indicate how to compare actual results with expected results, and suggest corrective actions to take when the difference between actual and expected results is unacceptable.

- **Strategic Controls** - subjective criteria intended to verify that the firm is using appropriate strategies for the conditions in the external environment and the company’s competitive advantages. (Used for “sharing” strategies.)

- **Finance Controls** - objective criteria used to measure firm performance against previously established quantitative standards. (Used for unrelated diversification.)

6. As initially designed, what were the three major benefits of the M-form?
   a. It enabled corporate officers to more accurately monitor the performance of each business, which simplified the problem of control.
   b. It facilitated comparisons between divisions, which improved the resource allocation process.
   c. It stimulated managers of poorly performing divisions to look for ways to improve performance.

7. What are three variations of the M-form?
   a. Cooperative
   b. Strategic business-unit (SBU)
   c. Competitive

**Related Diversification** - This section describes the strategy intended to develop and exploit economies of scope between business units to build upon or extend its resources, capabilities, or core competencies and create value. Operational and corporate relatedness determine how resources are used to create economies of scope.

Key Terms

- **Economies of Scope** - cost savings that the firm creates by successfully transferring some of its capabilities and competencies that were developed in one of its businesses to another of its businesses.

- **Synergy** - conditions that exist when the value created by business units working together exceeds the value those same
Additional Discussion Notes for Related Diversification - These notes include additional materials that cover and illustrate related diversification strategy concepts.

**Related Diversification**

*Economies of scope* are cost savings that the firm creates by successfully transferring some of its capabilities and competencies that were developed in one of its businesses to another of its businesses. As shown in Figure 7.2 in the text, firms seek to create value from *economies of scope* through two operational economies: *sharing activities* (operational relatedness) and *transferring skills or core competencies* (corporate relatedness).

Ford Motor Co. diversified into many related business units, from rubber plantations to auto body manufacturing plants to upholstery material factories. This allowed Ford to become a nearly fully integrated firm. In doing so, Ford was able to produce an automobile that was process and assembly line manufactured. Owning the value chain allowed Ford to control the quality, specifications of manufacture, timing of manufacturing, and delivery of parts that went into its automobiles. Ford could then produce a car that was affordable. Selling a large number of its products allowed Ford to realize high profits. As an added bonus, the autos were easily repaired as there was no longer the need for replacement parts to be machined-to-fit. Replacement parts could be purchased off-the-shelf and installed. This also created an aftermarket of auto parts.

### Operational Relatedness: Sharing Activities - This section presents how and why firms create operational relatedness and discusses issues which affect the degree to which activity sharing creates positive outcomes.

<table>
<thead>
<tr>
<th>8. How can firms create operational relatedness?</th>
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<tbody>
<tr>
<td>a. By sharing primary activities</td>
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<td>b. By sharing support activities</td>
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<tr>
<th>9. What issues affect the degree to which activity sharing creates positive outcomes (value and increased returns)?</th>
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<tbody>
<tr>
<td>a. Activity sharing requires sharing strategic control over business units.</td>
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<td>b. Pursuing appropriate coordination mechanisms can lead to successful creation of economies of scope.</td>
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<tr>
<td>c. Activity sharing can be risky because business-unit ties create links between outcomes and can cause organizational difficulties that interfere with success.</td>
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<tr>
<td>d. More attractive results are obtained through activity</td>
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See Additional Notes
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Additional Discussion Notes for Operational Relatedness - These notes include additional materials that cover and illustrate the key characteristics and assumptions of sharing activities to execute a related diversification strategy.

Operational Relatedness
Firms can create operational relatedness by sharing either a primary activity such as inventory delivery systems or a support activity such as purchasing practices. Procter & Gamble’s paper towel business and baby diaper business both use paper products as an input to the manufacturing process. The joint paper production plant that produces inputs for the two divisions is an example of a shared activity. In addition, because these two businesses produce consumer products, they both share distribution channels and sales networks.

PepsiCo has done well in the recent past, but sales growth in carbonated beverages may have reached market saturation or could even decline due to evidence linking soft drink consumption to childhood obesity. PepsiCo reaction? In 2001 PepsiCo purchased Quaker Oats—the maker of the sports drink Gatorade—for $12 billion. PepsiCo believes that it has found a reliable growth driver as Gatorade is the market leader in sports drinks and experienced a 13% annual growth rate in sales revenue between 1998 and 2001. To increase Gatorade’s market share PepsiCo has been integrating Gatorade into its distribution channels. Thus, Pepsi soft drinks, such as Pepsi Cola and Mountain Dew, and Gatorade are sharing the firm’s outbound logistics activity. Similarly, the same distribution channels could be used to distribute Quaker Oats’ healthy snacks and Frito-Lay’s salty snacks.

Using the Cooperative Form of the Multidivisional Structure to Implement the Related Constrained Strategy - This section discusses the formation of divisions around products or markets to develop an organizational structure for implementing a related constrained diversification strategy.

See slide 21.

Key Terms
- Cooperative Form - organizational structure using horizontal integration is to bring about interdivisional cooperation.

See Figure 8.4: Cooperative Form of the Multidivisional Structure for Implementation of a Related Constrained Strategy (slide 22).

10. Describe how the cooperative multidivisional form of structure can be formed around products or markets to support a related constrained diversification strategy.
   a. All of the divisions share one or more corporate strengths.
   b. Interdivisional sharing depends on cooperation.
   c. Links resulting from effective integration mechanisms
support sharing of both tangible and intangible resources.

d. Centralization is one integrating mechanism that can be used to link activities among divisions, allowing firms to exploit common strengths and share competencies.

e. Success is influenced by how well information is processed among divisions.

f. Success can be influenced by managerial commitment levels and the response to some lost managerial autonomy.

**Additional Discussion Notes for Related Constrained Strategy**

These notes include additional materials that illustrate use of the related constrained diversification strategy.

**Related Constrained Strategy**

Procter & Gamble, a related constrained firm, is supported by a cooperative structure of five global business product units (baby, feminine and family care, fabric and home care, food and beverage, and health and beauty care) and seven market development organizations (MDOs) formed around a global region. Using the five global product units to create strong brand through ongoing innovation, P&G interfaces with customers to ensure that a division’s marketing plans fully capitalize on local opportunities. Information is shared between the product-oriented and the marketing-oriented efforts to enhance the corporation’s performance. Indeed, some corporate staff members are responsible for focusing on making certain that knowledge is meaningfully categorized and then rapidly transferred throughout P&G’s businesses. Production competencies, marketing competencies, or channel dominance are examples of strengths that P&G’s divisions might share.

**Corporate Relatedness: Transferring of Core Competencies**

This section presents the sharing of intangible assets that are the foundation of core competencies across divisions to create value in multidivision firms.

**Key Terms**

- Corporate-Level Core Competencies - complex sets of resources and capabilities that link different businesses, primarily through managerial and technological knowledge, experience, and expertise.

11. In what ways does transferring competencies across businesses create value?

   a. The expense of developing a competence is incurred in one unit, eliminating the need for the second unit to allocate resources to develop the competence.
See Additional Notes Below.

<table>
<thead>
<tr>
<th>b. Intangible resources are difficult for competitors to understand and imitate; therefore, the unit receiving a transferred competence often gains an immediate competitive advantage over its rivals.</th>
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<tbody>
<tr>
<td><strong>Additional Discussion Notes for Corporate Relatedness</strong> - These notes include additional materials that cover and illustrate the key characteristics and assumptions of transferring core competencies to execute a related diversification strategy.</td>
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</table>
| **Corporate Relatedness**  
A firm’s intangible resources, such as its know-how, can become its core competencies, resources and capabilities that link businesses through managerial and technological knowledge, experience, and expertise.  
For example, McDonalds is creating value by transferring an intangible resource among its businesses: Chipotle Mexican Grill (a small Colorado chain of Mexican food restaurants), Donato’s Pizza (a pizza restaurant chain), Boston Market (a chain specializing in home-style cooking), and Prêt à Manger (a London chain with an eclectic food offering, such as sushi and salmon sandwiches). McDonalds’ goal is to transfer knowledge about all phases of the fast-food industry to its newly acquired restaurants. McDonalds believes that the knowledge the company has gained from operating its core business can also create value in its other food venues—venues attracting customers who do not frequent McDonald’s units. Interestingly, McDonalds’ stock price declined in early 2002, with questions surfacing about the firm’s ability to maintain its historic growth and performance rates. Although all of these acquired businesses are small, McDonalds believes that each can profitably grow by applying its knowledge in what are unique food concepts. Estimates are that the new units could add 2% to McDonalds’ growth rate within a few years. |

**Using the Strategic Business-Unit Form of the Multidivisional Structure to Implement the Related Linked Strategy** - This section discusses the formation of strategic business units (SBUs) to develop an organizational structure for implementing a related linked diversification strategy and the complexities of this form of structure.

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<th><strong>Key Terms</strong></th>
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<td></td>
<td><strong>Strategic Business-Unit Form</strong> - form of multidivisional organization structure with three levels used to support the implementation of a diversification strategy.</td>
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8–10
12. Describe how the SBU form of structure can be formed to support a related linked diversification strategy.
   a. Divisions within each SBU are related in terms of shared products and/or markets.
   b. Divisions of one SBU have little in common with divisions of other SBUs.
   c. Divisions within each SBU share product or market competencies to develop economies of scope.
   d. Integrations used in cooperative form are equally effective for the SBU form.
   e. Each SBU is a profit center.
   f. Financial controls are more vital for evaluating performance.

Additional Discussion Notes for the SBU Form of Multidivisional Structure - These notes include additional materials that illustrate the complexity and use of the strategic business-unit form of multidivisional structure to implement a related linked diversification strategy.

Using the SBU Form of the Multidivisional Structure for Implementation of a Related Linked Diversification Strategy

Complexity is reflected by the organization’s size and product and market diversity. Related linked firm GE, for example, has 28 strategic business units (SBUs), each with multiple divisions. GE Aircraft Engines, Appliances, Power Systems, NBC, and GE Capital are a few of the firm’s SBUs.

The scale of GE’s business units is striking. GE Aircraft Engines is the world’s leading manufacturer of jet engines. With almost 30 divisions, GE Capital is a diversified financial services company creating comprehensive solutions to increase client productivity and efficiency. The GE Power Systems business unit has 21 divisions including GE Energy Rentals, GE Distributed Power, and GE Water Technologies.

GE SBUs are making efforts to form competencies in services and technology as a source of competitive advantage. Recently, technology was identified as an advantage for the GE Medical Systems SBU, as that unit’s divisions share technological competencies to produce equipment, including computed tomography (CT) scanners, MRI systems, nuclear medicine cameras, and ultrasound systems. Once a competence is developed in one of GE Medical Systems’ divisions, it is quickly transferred to the other divisions in that SBU so that the competence can be leveraged to increase the unit’s overall performance.

Market Power through Multimarket Competition and Vertical Integration - This section describes the use of related diversification strategies to gain market power.
### Key Terms

- **Market Power** - exists when firm is able to sell its products above the existing competitive level or to reduce costs of primary and support activities below the competitive level or both.
- **Multimarket (or Multipoint) Competition** - exists when two or more diversified firms simultaneously compete in the same product or geographic markets.
- **Vertical Integration** - exists when a company produces its own inputs or owns its own source of distribution of outputs.
- **Taper Integration** - exists when a firm sources inputs externally from independent suppliers as well as internally within the boundaries of the firm, or disposes of its outputs through independent outlets in addition to company-owned distribution channels.

### Questions

13. What are two avenues for increasing market power through diversification?
   - a. Multimarket Competition
   - b. Vertical Integration

14. How is vertical integration used to gain market power over rivals?
   - a. Reduced operational costs
   - b. Reduced market costs
   - c. Improved product quality
   - d. Protected technology (from imitation)

15. What are some limitations to vertical integration?
   - a. Outside supplier may produce inputs at a lower cost.
   - b. Bureaucratic costs may occur.
   - c. Substantial investments may be required.
   - d. Changes in demand can create a capacity imbalance and coordination problems.

### Additional Discussion Notes for Market Power

These notes include additional materials that cover and illustrate the concepts of multipoint competition and vertical integration.

#### Multipoint Competition

Multipoint competition exists when two or more diversified firms simultaneously compete in the same product areas or geographic markets (discussed on p. 217). For example, the actions taken by Hewlett-Packard (HP) in its merger with Compaq demonstrate multipoint competition. This merger allows the new HP to compete with the likes of IBM and Sun Microsystems. For example, HP and Compaq are now coordinating their efforts in PCs, servers, and services. The combined revenues of the two...
companies almost equal those of IBM.

As a competitive action, HP and Compaq’s decision to integrate their operations is a strategic action to improve the new HP’s market positions and strategic response to IBM’s success in servers and services. Counterattacks are not common in multipoint competition because the threat of a counterattack may prevent strategic actions from being taken, or, more likely, firms may retract their strategic actions when faced with the threat of counterattack. Using a matching strategy (taking the same strategic action as the attacker) is a strategic response. It signals a commitment to defend the status quo without escalating rivalry.

Vertical Integration
Smithfield Foods is a vertically integrated hog processing business. It is vertically integrated backward by raising the hogs that it processes in its plants. While packaging plants excel when the price of meat is low and suffer when it is high, Smithfield can control its costs because it owns the facilities that provide the raw materials required for its core processing operations. This control gives Smithfield market power over its rivals. It typically produces products at below industry production cost. Recent acquisitions of ten U.S. and a few international meat-packaging companies are intended to support Smithfield’s vertical integration to yield attractive options to consumers.

Many manufacturing firms no longer pursue vertical integration. In fact, deintegration is the focus of most manufacturing firms, such as Intel and Dell, and even among large automobile companies, such as Ford and GM, as they develop independent supplier networks. Contract manufacturers, such as Solectron Corp., often manage their customers’ entire product lines and offer services ranging from inventory management to delivery and after-sales service. Conducting business through e-commerce makes vertical integration into “virtual integration.” Thus, efficient relationships are possible with suppliers and customers via virtual integration allowing cost reductions of processing transactions while improving supply-chain management control of inventories.

Simultaneous Operational Relatedness and Corporate Relatedness - This section discusses the difficulties firms may face when simultaneously seeking operational and corporate forms of economies of scope through shared activities and competencies.

See slide 34.

Key Terms
- **Matrix Organization** - organizational structure in which a dual structure combines both functional specialization and business product or project specialization.
16. What are the implications of this dual strategy?
   a. Managing two sources of information is very difficult.
   b. More process mechanisms to facilitate integration and coordination may be required.
   c. Success is likely to produce a sustainable competitive advantage as imitation becomes difficult.

Additional Discussion Notes for Simultaneous Operational and Corporate Relatedness - These notes include additional materials that cover and illustrate a dual approach for executing a related diversification strategy.

Simultaneous Operational Relatedness and Corporate Relatedness
Some firms simultaneously seek operational and corporate forms of economies of scope. Although it has not developed distribution capabilities, Disney has been successful in using both operational relatedness and corporate relatedness. It made $3 billion on the 150 products that were marketed with its movie, The Lion King. Sony’s Men in Black was a clear hit at the box office and earned $600 million, but box office and video revenues were practically the entire success story. Disney succeeded by sharing activities regarding the Lion King theme within its movie, theme parks, music, and retail products divisions, while at the same time transferring knowledge into these same divisions, creating a music CD, Rhythm of the Pride Lands, and a video, Simba’s Pride. In addition, there were Lion King themes at Disney resorts and Animal Kingdom parks.

However, it is difficult for analysts from outside the firm to fully assess the value-creating potential of the firm pursuing both operational relatedness and corporate relatedness. As such, Disney’s assets have been discounted somewhat because “the biggest lingering question is whether multiple revenue streams will outpace multiple-platform overhead.”

Unrelated Diversification - This section introduces a comprehensive discussion of the use of a corporate-level unrelated diversification strategy to create value.

Key Terms

- **Financial Economies** - cost savings realized through improved allocations of financial resources based on investments inside or outside the firm.

17. What types of financial economies can create value with an unrelated diversification strategy?
   a. Efficient internal capital allocation
   b. Asset restructuring of purchased corporations
### Efficient Internal Capital Market Allocation

This section highlights the advantages of firms with internal capital markets to fund investments and operations.

#### See slides 38–40.

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<th>18. What are the major advantages for firms with internal capital markets?</th>
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<tr>
<td>a. Information provided to capital markets through annual reports and other sources may not include negative information, instead emphasizing positive prospects and outcomes. External sources of capital have limited ability to understand the dynamics inside large organizations. Even external shareholders who have access to information have no guarantee of full and complete disclosure.</td>
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<td>b. Although a firm must disseminate information, that information also becomes simultaneously available to the company’s current and potential competitors. With insights gained by studying such information, competitors may find it easier to attempt to duplicate a firm’s competitive advantage. Thus, an ability to efficiently allocate capital through an internal market may help the firm protect its competitive advantages.</td>
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<td>c. Capital can be allocated according to more specific criteria than is possible through external market allocations.</td>
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<td>d. External market may fail to allocate resources adequately to high-potential investments.</td>
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<th>19. What is the downside to internal capital markets?</th>
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<td>a. Firms sometimes substitute acquisitions for innovations, allocating more to analyze and complete acquisitions than nurturing internal innovation.</td>
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<td>b. Conglomerates in developed economies have a fairly short life cycle as financial economies are more easily duplicated than the gains from operational and corporate relatedness.</td>
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### Restructuring

This section discusses how firms create financial economies by buying, restructuring, and selling other companies’ assets in the external market.

#### See slide 42.

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<tr>
<th>20. What are some of the considerations in successfully implementing a restructuring strategy?</th>
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<tr>
<td>a. Success usually calls for a focus on mature, low-technology businesses with more certain demand and less reliance on valuable human resources.</td>
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| b. Service businesses oriented toward clients are difficult to buy/sell because of their sales orientation and the
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Using the Competitive Form of the Multidivisional Structure to Implement the Unrelated Diversification Strategy - This section discusses the formation of independent divisions to develop an organizational structure for implementing an unrelated diversification strategy.

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<tr>
<th>See slide 43.</th>
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<td></td>
<td>- Competitive Form - organizational structure in which the firm’s divisions are completely independent.</td>
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| See Figure 8.6: Competitive Form of the Multidivisional Structure for Implementation of an Unrelated Strategy (slide 44). | 21. Describe how the competitive form of structure can be formed to support an unrelated diversification strategy. |
| See Additional Notes Below. | a. Divisions do not share common corporate strengths. |
| See slides 45-46. | b. Integration devices are not developed to coordinate activities across divisions. |
| See slide 47. | c. Efficient capital markets in unrelated strategies require organizational arrangements that emphasize divisional competition rather than cooperation. |
| | d. Specific performance expectations and accountability for independent divisions stimulate internal competition for future resources. |
| | e. Headquarters maintains a distant relationship to avoid intervention in divisional affairs. |
| | f. Strategic controls are used to monitor performance relative to targeted returns. |
| | g. Headquarters remains responsible for cash flow allocation, performance appraisal, resource allocation, and the legal aspects related to acquisitions. |

| 22. What are three benefits expected from internal competition among divisions? | Additional Discussion Notes for the Competitive Form of Multidivisional Structure - These notes include additional materials that illustrate the use of the competitive form of multidivisional structure to implement an unrelated diversification strategy. |
| | a. Internal competition creates flexibility. |
| | b. Internal competition challenges the status quo and inertia. |
| | c. Internal competition motivates effort. |

Using the Competitive Form of the Multidivisional Structure for Implementation of an Unrelated Diversification Strategy

Started as a small textile company in 1923, Textron Inc. is an industrial conglomerate using the unrelated diversification strategy. It has grown...
through volume, geography, vertical or horizontal integration, and diversification. Its growth started when the firm vertically integrated in 1943 to gain control of declining revenues and underutilized production capacity. Facing another revenue decline in 1952, the company diversified by acquiring businesses in unrelated industries. Today, Textron has five divisions: aircraft, automotive, industrial products, fastening systems, and finance. Return on invested capital is the financial control Textron uses as the primary measure of divisional performance. According to the firm, “return on invested capital serves as both a compass to guide every investment decision and a measurement of Textron’s success.”

Value-Neutral Diversification: Incentives and Resources - This section introduces a discussion of diversification strategy that is not designed with value-creating objectives in mind.

Incentives to Diversify - This section outlines value-neutral incentives, both internal and external, that encourage organizations and managers to diversify.

23. Describe the external and internal factors that influence managerial decisions to diversify.
   a. Antitrust regulations - recent trend toward increased scrutiny.
   b. Tax laws affecting corporate and individual tax rates.
   c. Low performance - manager look for ways to improve returns.
   d. Uncertain future cash flows - defensive strategy sometimes needed in mature industries concerned with long-term survival.
   e. Synergy - sought to reduce risk.

Additional Discussion Notes for the Relationship between Firm Performance and Diversification - These notes include additional materials that demonstrate strategic reactions to uncertain future cash flows and risk to the firm.

Uncertain Future Cash Flows
Historically, independent sales agents sold Tupperware products (Tupperware Parties), but as more women reenter the workforce, the firm’s traditional customer base—women in their homes—has eroded. Tupperware wanted to diversify its distribution due to uncertainty about demand for its products. For example, in July 2001, Target started to display Tupperware products in SuperTarget stores and on Target’s Web site. To prevent problems with the traditional sales channel, Tupperware’s independent sales agents staff the displays of the firm’s
### Resources and Diversification

- This section notes the importance of resources and capabilities required by the firm to successfully use a corporate-level diversification strategy.

### Value-Reducing Diversification: Managerial Motives to Diversify

- This section discusses the motivations behind some managers’ decisions to engage in diversification strategies that do not benefit the organization.

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| 24. What are some non-value-adding reasons that managers seek to diversify? | a. Desire for increased compensation for handling the complexities and difficulties of managing larger firms  
   b. Desire for reduced managerial and employment risks |
| 25. What mechanisms contribute to protecting shareholder interests from self-interested managerial tendencies to overdiversify? | a. Corporate governance  
   b. External market for corporate control  
   c. External market for managerial talent (concern for their reputations) |
| 26. Discuss how the interaction of value-related goals and the adoption of particular diversification strategies affect firm performance. | a. The greater the incentives and the more flexible the resources, the higher the level of expected |

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products in SuperTarget stores. Company officials estimated that 40% of sales would come from this and similar ventures such as television and mall ventures within five years. Thus, Tupperware is diversifying its distribution channels in order to reduce the uncertainty of its future cash flows.

**Firm Risk Reduction**

StarTek Inc. historically has generated its revenues from a small number of large customers: packaging and shipping software for Microsoft, providing tech support to AOL Time Warner and AT&T, and maintaining communications systems for AT&T. To reduce its dependence risk, StarTek chose to diversify. It spent $12.4 million to acquire a 20% interest in Gifts.com, an online retailer selling gifts, home furnishings, and other merchandise. Unfortunately, Gifts.com is losing money. StarTek also invested in a mortgage-financing firm that has since been accused of defrauding investors, forcing StarTek to take a $3 million charge in 2001. Clearly, firms seeking to reduce risk by diversifying should fully understand the nature of the businesses they are entering through their diversification efforts.
Ethical Questions - Recognizing the need for firms to effectively interact with stakeholders during the strategic management process, all strategic management topics have an ethical dimension. A list of ethical questions appears after the Summary section of each chapter in the textbook. The topic of ethics is best covered throughout the course to emphasize its prevalence and importance. We recommend posing at least one of these questions during your class time to stimulate discussion of ethical issues relevant to the chapter material that you are covering. (See slides 52-57.)