Lecture 1 – Fundamentals of SM

Strategic management

- Process of maintaining a dynamic fit between the environment & internal resource capabilities for a sustainable competitive advantage

What is strategy?

- **Strategy as a plan**
  - Theorists presume better planning systems have competitive advantages due to a solid basis for resource allocation and coordination. (Strategy as efficient)
  - **Assumptions:**
    - Strategy is a conscious, purposeful and rational course of action
    - Based on a clear mission and objectives agreed on
    - Data and analytical power is required
    - Clearly formulated with distinct phases of implementation

- **Strategy as a pattern**
  - Theorists believe good planning and sufficient pursuit of emergent ideas create competitive advantages. This allows for resource allocation, coordination and creative actions.
  - Not too much planning needed to avoid being too rigid and to account for unrealized strategies. (intended, unrealized, emergent, realized strategies)
  - **Assumptions**
    - Strategy is party conscious and purposeful and partly serendipitous (luck)
    - Mission and objectives are flexible and adaptable
    - Deviations from plan occur from the interaction between the firm and its environment
    - Formulation and implementation may not be linear (can be spontaneous)

- **Strategy as a position**
  - Theorists believe competitive advantages come from positioning because it determines above-average or average returns.
  - Refers to generic strategy, value proposition, customer targets, etc.
  - **Assumptions**
    - Strategy is basically a selection of a niche and defending that niche

- **Strategy as a perspective**
  - Theorists believe competitive advantage depends on how outsiders identify with the firm because this identification provides resources needed to thrive.
  - **Assumptions**
    - Company's identity affects the way of learning
    - Company's identity is seen by all identically
    - Company's identity can be managed in response to changes in context
      - Changing how the firm learns due to changes in the environment is difficult, as it is tied to their identity.

Population ecology approach

- Assumes strategic management doesn't matter and the environment determines the survival of the firm.
- **However,** strategic management is valuable to adapt to disruptive change in the environment

Value chain activities

- **Primary activities**
    - **Inbound logistics**
        - Activities used to receive, store and disseminate inputs to a product
        - Eg. Materials handling, warehousing, inventory control, etc.
    - **Operations**
        - Activities necessary to convert inputs (given by inbound logistics) to outputs
        - Eg. Machining, packaging, maintenance, etc.
    - **Outbound logistics**
        - Activities involved in collecting, storing and distributing final products to customers
        - Eg. Finished goods warehousing, order processing, etc.
    - **Marketing and sales**
    - **Service**
        - Activities to enhance/maintain a product's value
        - Eg. Installation, repair, training
- **Support activities**
    - **Procurement**
        - Designed to purchase inputs to produce (for inbound logistics)
        - Eg. Raw materials, supplies, assets, etc.
    - **Technological development**
        - Activities to improve the product and improve manufacturing processes
    - **Human resource management**
    - **Firm infrastructure**

Lecture 2 – Positioning vs. RSB view

Company environment

- IT and globalization have made continuous and discontinuous changes lasting
- Strategies must therefore be formulated while considering rules are temporary.

Environmental layers

- **Micro level**
    - Customers, debtors, creditors, suppliers, partners, etc.
    - Changes in this layer will only affect the focal firm
- **Industry level**
    - Competitors, regulators, analysts, ranges of products, technologies, etc.
    - Changes in this layer will affect the focal firm and its peers
- **Macro level**
    - Social, economic, political and technological dynamics
    - Changes in this layer affect many industries
- <u>All three environmental layers are interconnected.</u> Therefore, firms must develop a strategy that considers micro, industry and macro levels in current and future states.

Positioning literature

- Developing a strategy consists of deciding in which industry to compete in a how using Porter's 5 forces. After, the firm chooses a generic strategy.
    - **Porter's 6th force – Complements**
        - Products that are compatible and complementary to one another
        - They offer more value to the consumer together than alone
- **Generic strategies:**

Target/Market Scope	Advantage: Low Cost	Advantage: Product/Service Uniqueness
Broad (Industry Wide)	Cost Leadership Strategy	Differentiation Strategy
Narrow (Market Segment)	Focus Strategy (low cost)	Focus Strategy (differentiation)

Strategic groups

- A cluster of firms that have similar product-market strategies (in terms of technology, pricing, distribution or customer segment)
- Different strategic groups have different profitability rates in the same industry
- **Mobility barriers** make it difficult for firms to switch to different strategic groups. Therefore, they explain intra-industry variation in performance
- <u>The closer the strategic groups in terms of strategy, the lower the average industry profits.</u>

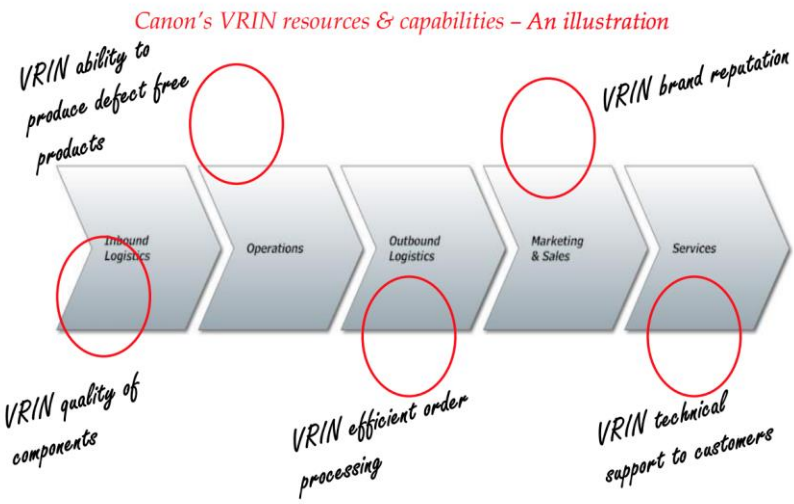
Downsides of creating strategy through positioning literature

- Information provided is only valid for a short time-span (not dynamic)
  - The analysis only describes firm performance and competitor analysis at a single point in time
  - Therefore, doesn't lead to sustainable competitive advantage (SCA) in the future
  - Too much focus on the present may have a negative impact on creativity and entrepreneurial envisioning (not looking to the future)
- This leads people to believe the RBV is better for strategy creation

Resource-based view (RBV) literature

- Developing strategy should be about identifying and leveraging the resources and capabilities that can provide competitive advantages
- Resources that provide CA
  - **Valuable** – must contribute to value creation
  - **Rare** – So others cannot use them
  - **Inimitable** – So others cannot copy
  - **Non-substitutable** – So others cannot create the same value with other resources

VRIN example



Lecture 3 – CA in global markets

- No SCA can be obtained in local markets due to globalization making strategy-making more difficult.

Globalization, IT opportunities and disaggregation of the value chain

- Very useful to grow and expand - Higher accessibility of knowledge and institutions removing trade barriers
- Any company can disaggregate (separate) the value chain in different locations all over the world (eg. Manufacturing in China, marketing done elsewhere, etc.)

Opportunity exploitation requires a mastery of competitor analysis

- Helps firms identify niches in the market that haven't yet been exploited.
- This avoids direct competition and less intense response from competitors
- Competitor analysis to <u>understand and predict</u> competitive responses is utmost important
- **Competitor analysis** – when a firm analyzes a competitor's:
    - **Market commonality**
    - **Resources similarity**

The local-global rivalry and competitive dynamics

- Number of competitors and intensity of competition have risen with globalization
- Example: multimarket competition
    - However, multimarket competition = less likely competitive responses

Identifying rivals

- All players need to be monitored using *time factor* and *substitution potential*
    - Other firms can become a competitor overtime

Internationalization

- Provides firms with access to <u>new markets</u> and access to <u>new factor markets</u> (these markets can provide cheaper/better quality raw materials)

Factors driving competitive responses

- **Market commonality**
    - The number of markets in which organizations compete and the importance of the individual markets to each
    - Low market commonality = likely attack from competitors
        - Multimarket competition reduces the likelihood of an attack, however they're <u>likely to respond aggressively</u> when attacked
        - Due to the consequences being bigger
- **Resources similarity**
    - The similarity of tangible and intangible resources in type and amount.
    - Firms with similar resources likely have similar strengths/weaknesses/strategies

Drivers of competitive actions

- **Awareness** – where competitors are able to recognize the degree of *market commonality* and *resource similarity*
- **Motivation** – Relates to perceived gains and losses
- **Ability**

Diamond model

- The **Diamond model** is used to understand the source of competitor's CA
    - **Firm strategy, structure and rivalry**
        - Eg. If companies in a sector are very innovative, then it will force companies to innovate even more to differentiate themselves
    - **Demand conditions**
    - **Factor conditions**
        - Land/labor/capital aspects
        - In India, there are many software developers/electrical engineers (labor). Therefore, there are more electronic companies in India
    - **Related and supported industries**
- With the goal of ***internationalizing*** and ***seeking resources***, focus on:
    - Factor conditions and related/supported industries
- With the goal of ***internationalizing*** and ***seeking markets***, focus on:
    - Firm strategy, structure and rivalry and demand conditions

International modes of entry strategies

- **Exporting** (high cost, low control)
    - **Direct exporting** – Exporting using the company (production remains at home)
    - **Indirect exporting** – Exporting through foreign sales representatives (intermediaries)
- **Contracting**
    - **Franchising** – To sell the right to use its business model
    - **Licensing** – When a firm purchases the right to manufacture another firm's products. This has low cost, low risk, little control, low returns
- **Foreign Direct Investments (FDI)**
    - **Joint venture –** An alliance between multiple firms where an independent entity is created
    - **Wholly owned subsidiary** – Set up through a **greenfield investment** (building the WOS from the ground up giving the firm full controllability)

Weighing alternative 'how to go' options

- Firms need to balance risk and reward while controlling resource deployment.
- Therefore, companies usually start with indirect exporting for the lowest risk and slowly increase their foreign presence and risk.

How to proceed to internationalize

- **Multi-domestic strategy**
    - Decentralized decision-making
    - Less knowledge sharing across BU
    - A company adapts its products according to customer needs in the local market.
    - Markets segmented by region/country
- **Global strategy**
    - Centralized decision-making
    - Greater integration across BU
    - Standardized products
    - Low responsiveness to local markets
- **Transnational strategy**
    - Being efficient globally and highly responsive to local markets.
    - Flexible coordination (shared vision and individual commitment)
    - Shared identity is very important

Lecture 4 – Corporate strategy and diversification

Business-level strategies

- To gain a CA detailing *<u>how to compete</u>* *within* product markets based on core competencies
    - Cost leadership
    - Differentiation
    - Focused cost leadership
    - Focused differentiation

Corporate-level strategies

- Actions to gain a CA based on managing groups of businesses *across* product markets. They detail in *<u>which product market</u>* to compete.

Walt Disney: diversification case

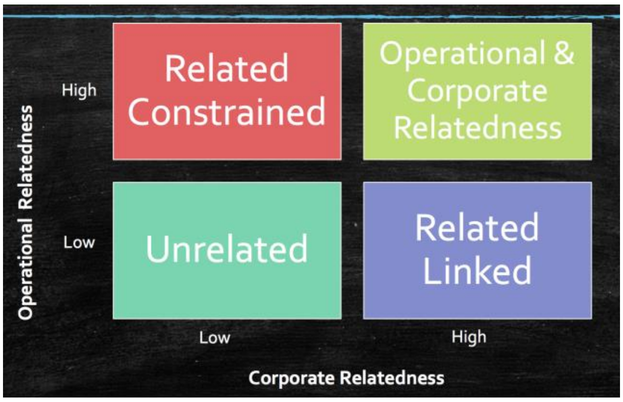
- **Synergy** was needed geographically, horizontally and vertically. Achieved through:
    - **Horizontal diversification** – Cruise ships, educational retreats
    - **Vertical diversification** – Internet, TV, merger with Touchstone

Reasons to diversify

- To create shareholder value, based on:
    - **Industry attractiveness test**
        - Determining an industry's growth in profitability
    - **Cost-of-entry test**
        - Identifying the entry barriers
    - **Synergy test**
        - Synergy occurs when all subsidiaries perform better together than they would separately outside of the 'corporate umbrella'
- Limited growth opportunities in existing sectors
- Spreading the risk
- Leverage on a powerful brand name
- Save costs
- Find new uses of core competencies and capabilities
- **Value-neutral reasons**
    - Desire to match and thereby neutralize a competitor's market power

Types of diversification

- **Related diversification** – Value is created from <u>economies of scope</u> and <u>market power</u> by sharing the business's activities/core-competencies. The types of diversification are <u>identified by their level of operational and corporate relatedness.</u>
    - **Operational relatedness**
        - Sharing operational activities between businesses
        - This creates economies of scope from tangible resources (plant, equipment, other assets, etc. are shared)
    - **Corporate relatedness**
        - Sharing core competencies between businesses
        - This creates economies of scope from intangible resources (knowledge, core-competencies, experience, etc. are shared)
- **Levels of diversification** (moderate to high levels of diversification)
    - **Related constrained** (only operational relatedness)
    - **Operational & corporate relatedness** (both operational & corporate relatedness)
    - **Related linked** (only corporate relatedness)



- **Unrelated diversification** (highest level of diversification)
    - Diversifying into businesses with:
        - No strategic fit
        - No meaningful value chain relationships
        - No unifying strategic theme
    - Firms pursuing this strategy are called **conglomerates**
        - These firms venture into any business that seems profitable
    - Creates value through **financial economies** – cost savings realized on improved allocation of financial resources by investing inside/outside the firm
- **Strategic fit**
    - Strategic fit exists when the value chains of different businesses present opportunities for **cross-business unit transfer, lower costs** by combining the performance of related value chain activities or resource sharing.
    - All to build stronger competitive capabilities

Lecture 5 – External growth strategies: M&A

M&A

- When two companies agree to integrate operations co-equal basis and *form a new* company
- Upon agreement with shareholders, they exchange their shares for new shares
- **Vertical M&A** – Merger between firms at different levels of the supply chain in an industry
- **Horizontal M&A** – Merger between firms at the same level in an industry

Acquisition

- Implies a company wants to control 100% in another company, with the intention of turning it into a subsidiary of its own.
- The acquiring company makes an offer for the common stock of the other company at a fixed price per share

Reasons for M&A

- **To acquire resources/capabilities that are:**
    - Non-transferrable
    - Not easily replicated
    - Based on tacit knowledge
    - Difficult/less efficient to develop internally
    - Eg. Disney and Pixar acquisition
- **To generate cost economies and market power**
    - Eg. Exxon and Mobil merged to avoid monopolization to remain market leaders
- **Increased diversification**
    - Forward/backward integrate or gain access to new markets
    - Eg. Disney and ABC channel: for Disney to forward integrate to TV distribution
- **Geographically expansion**
    - Eg. Heineken expanding their product line globally

Downsides of M&A

NOTE: Acquisitions usually benefit the shareholders of the *acquired* firm the most. Downside are:

- Expensive
- Asymmetric information issue
- Post-merger integration is challenging
- Over-diversification (acquisitions have become a substitute to a firm's innovation)
- Culture clashes

Strategic alliances

- **Strategic alliance -** A formal agreement between two or more companies to co-operatively work towards a common objective.
- **Joint venture** – A strategic alliance in which the partners set up a third independent corporate entity that they own and control jointly, sharing revenues and expenses

What makes alliances strategic

- Creating/sustaining a core competence or competitive advantage
- Blocking a competitive threat
- Increasing bargaining power of alliance members over suppliers or buyers
- Creating new market opportunities

Why companies form alliances

- To access, rather than acquire capabilities
- To share risk
- Lower costs (resource pooling as costs are shared)
- More flexible organizational structure that are adaptive to change
- **NOTE:** forming alliances instead of merging/acquiring with companies allows both firms to ***maintain their corporate*** identity as they're only tapping into one another's capabilities.

Market type: reasons for strategic alliances

- **Slow-cycle**
    - Gain access to a restricted market
    - Establish franchise in a new market
    - Maintain market stability
- **Fast-cycle**
    - Unstable/unpredictable **hypercompetitive** markets
    - Speed up market entry and maintain market leadership
    - Alliances help overcome uncertainty
- **Standard-cycle**
    - Alliances are more likely to be made by firms with complementary resources and/or capabilities.
    - Reduce costs (economies of scale)
    - Learn new business techniques

Strategic alliance cooperative strategies

- **Business-level –** Firms use business level strategies to develop CA contributing to desired positions in the market and performance in individual product markets.
    - **Vertical/horizontal complementary alliances**
        - Sharing resources from the same/different stage in the value chain
        - This is the most successful form of strategic alliance as they're long-term (SCA), while strategic alliances usually offer short-term CA.
        - Used in *standard-cycle markets*
    - **Competition response**
    - **Uncertainty-reduction**
        - To hedge against risk, especially in *fast-cycle markets*
    - **Competition-reducing: Explicit and tacit collusion**
        - Explicit/tacit collusion (illegal)
        - Least chance of creating an SCA

- **Corporate-level –** To diversify in terms of products offered and/or in markets served
    - **Diversifying alliances**
        - When firms share resources/capabilities to diversify into new product/market areas.
    - **Synergistic**
        - Firms share resources/capabilities to create economies of scope
    - **Franchising**
    - **Cross-border**
        - When firms in different countries combine resources/capabilities to create a CA

International alliances:

- Gain local knowledge
- Political connections
- Access to different distribution channels

Strategic alliance pitfalls

- Culture clashes
- Integration issues
- Expected gains may not materialize
- Becoming too dependent on new partner
- <u>Loss of control over proprietary knowledge, technologies, other secrets, etc.</u>

Lecture 6 – **Entrepreneurial strategies**

Entrepreneurial strategy
- The process by which individuals pursue opportunities without regard to the resources they currently control

Schumpeterian approach - Opportunity creation
- Radically disrupting the market to create a new product through **'creative destruction'** and the recombination of resources, resulting in pushing new products/services to the market
    - The entrepreneur is an innovator aiming to initiate change
    - Disrupting the market equilibrium
    - For change to take place, there needs to be an economic, political, social or technological breakthrough
    - Breakthroughs require new innovative and rare information

Kirznerian approach – Opportunity discovery
- The entrepreneur is <u>alert</u> and creates entrepreneurial profits by *discovering information and knowledge gaps* among people in the market. They exploit opportunities by acting as an arbitrageur (price adjuster), **<u>based on information asymmetries</u>.**
    - These opportunities can be seen by anyone, so observe them first (be alert)
    - <u>Opportunity is seen as a result of differential access to information</u>

Entrepreneur characteristics
- Risk-taking
- <u>Locus of control</u>
    - Attribute what happens to yourself (internal LoC) or to external forces (external LoC)
- <u>Counterfactual thinking</u>
    - Thinking about events that didn't happen and how to react to them
- Need for achievement
- Regulatory focus
- **Most important factor: perseverance**

Founder types
- **Sunbirds**
    - Transport solutions that work in one area and apply them in another.
    - Re-apply ideas to other places
- **Architects**
    - Spot problems and design new products/services to satisfy unfulfilled needs
    - Find a problem and build it from the ground up
- **Integrators**
    - Combining existing elements to shape new outcomes
    - Eg. Chipotle (combining fast food and casual restaurants)

Charisma
- Rooted in values and feelings. Charisma consists of:
    - **Logos** – Powerful and reasoned rhetoric
    - **Ethos** – Have personal and moral credibility
    - **Pathos** – Rouse follower's emotions and passions
- Charismatic leaders tend to:
    - Show integrity, authority and passion
    - Rely on nonverbal behaviour: animated voice, facial expressions and gestures

Entrepreneurial reasoning

- **Pattern-recognition and experience**
  - Process through which individuals identify meaningful patterns in complex arrays of events or trends.
  - The ability to recognize opportunities for new ventures due to perceived connections between apparently independent events
- **Analogies**
  - Relies on analogical reasoning in unfamiliar environments
  - Applying a solution from a past original context to a current unfamiliar context
  - **Surface analogs**
    - Working concepts that can be ‘plugged in’ to a different setting

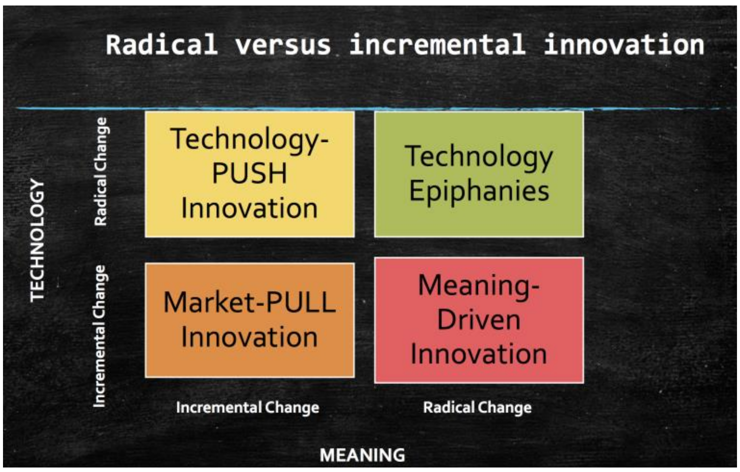
Creation of new industries and markets characteristics

- There is an availability of qualified people
- Forced innovation
- Number of failures extremely high

Note: When creating new industries/markets, *resources* (talented, smart people) are more valuable than *projects* (clients, etc.) as it will lead to success.

Entrepreneurial strategies

- **Technology-push innovation**
  - Introducing a completely new product to the market created from significant innovation.
- **Market-pull innovation**
  - Companies build on existing but unfulfilled customer needs for technology that doesn’t exist yet
    - Technology has to ‘catch up’, hence the need for a ‘pull’ in the market
    - Eg. Mobile phone developed due to customer need for a portable device
  - Assumes innovation should begin by getting close to users and observing activities
  - Eg. Creating hybrid cars response to an increased demand for sustainable products
- **Meaning-driven innovation**
  - When a product already exists, but companies change its meaning and role in society.
  - Involves radical rebranding of a product through heavy advertising
  - Eg. Swatch achieved this by changing brand of watches from expensive to cheap
- **Technology epiphanies innovation**
  - Combining technological and meaning change. When the technology already exists, but are transformed to change its meaning.
  - Eg. Wii changed technology of video games (gesture recognition) and also changed its role (competitive to gaming for fun)



Design-driven innovation
- *Technology push* and *market pull*

Business-model innovation
- Rethinking business and reshaping resources around a new customer need.

Intrapreneurship
- When people *within* the business act ‘entrepreneurial’
- Encouraging employees to think and create new ideas

Corporate venturing
- Large organizations developing or investing in other start-ups to develop innovating products

Lecture 7 – Organizational structure and strategic design

Organizational structure

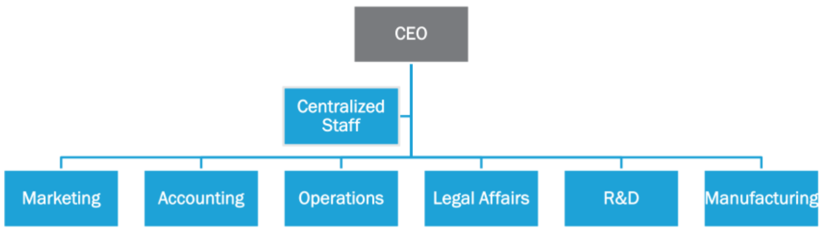
- How a firm is organized determines its capacity for action

Types of structures and diversification strategies:

- **Functional** – Cost leadership (business-level strategy/single corporate strategy)
    - Lowest level of diversification
- **Divisional** – Unrelated diversification
- **Divisional SBU –** Related linked diversification
- **Matrix** – Related constrained diversification
- **Hybrid -** Transnational

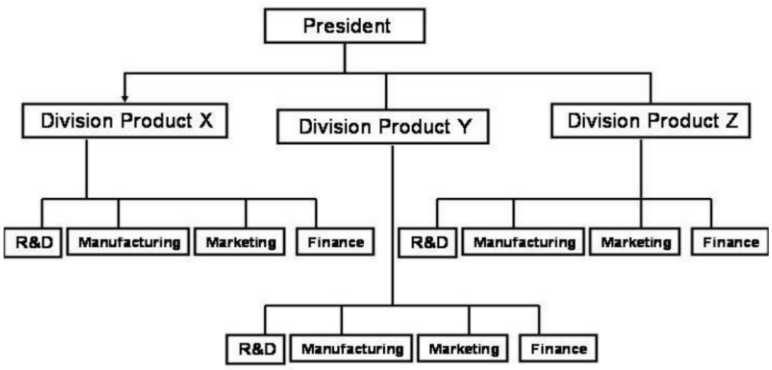
Functional structure

- Pursues efficiency and low-cost strategies (good for stability and standardized products)
- Innovation is not facilitated as departments don't share information
- <u>High centralization</u>
- **Key features:**
    - Functional specialization and economies of scale
    - High knowledge exchange *within* functions
    - Little cross-function communication/knowledge sharing *across* functions
    - Suitable for business-level strategy or single corporate strategy (lowest level of diversification)



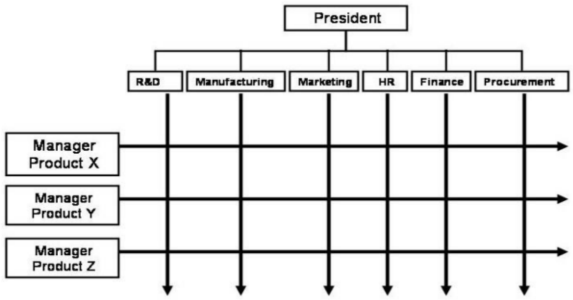
Divisional structure

- Most effective for growth, innovation and customer focus strategies
- Can support multiple product lines and eases diversification
- Usually pursues **unrelated diversification** strategies due to no synergies
- **Key features:**
    - Divisions organized along *market, customer, product* or *geographic lines*
    - Divisions are independent profit centers
    - <u>Enhances top managements control over the corporation</u>
    - Low need of integration among products or markets within the processes
    - <u>Highly autonomous market</u>
    - Can inhibit cross-business synergies



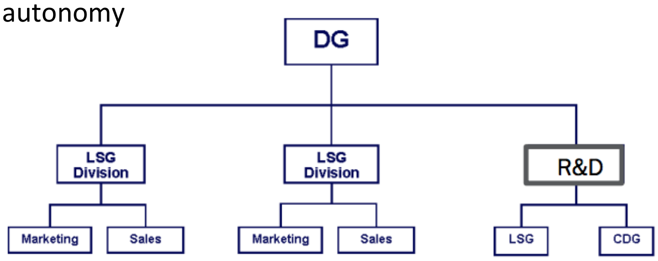
Matrix structure

- Most suitable to pursue growth, innovation, customer focus and cost saving strategies
- Significant information flow and frequent conflicts. (double layer of reporting)
    - Employees have two bosses = conflict and long decision-making
- **Key features:**
    - Based on multiple dimensions at once
    - Involved multiple reporting relationships (dual reporting from two bosses)
    - Economies of scope
    - Disadvantage: adds an additional layer of management, which is expensive and slows decision making



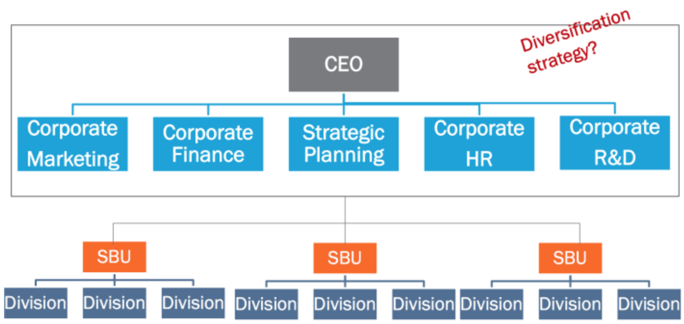
Hybrid structure

- Combines divisional and functional structure (1&2 are divisions but 3 is a function)
- Most effective for growth, innovation, customer focus and cost savings strategies
- **Key features:**
    - Excludes the R&D process, no synergies
    - Low need of integration among products or markets within the processes
    - Best solution is a product/market organization with a centralized unit governing R&D for all products and markets
    - High autonomy



Divisional structure (SBU form)

- With a SBU form, there are some weak synergies by functions and between units
- This structure supports linked diversification strategies
- Low need of integration among products or markets within the processes



Comparative table

Structure	**Synergies**	**Interdependences (across functions)**	**Strategy**	**Product specificities**
Functional	*High*	*Low*	*Efficiency, cost, defender*	*Low*
Divisional	*Low*	*High*	*Growth, innovation, customer focus*	*High*
Hybrid	*Some*	*High*	*Growth, innovation, customer focus, cost savings*	*High*
Matrix	*High/medium*	*High*	*Growth, innovation, customer focus, cost savings*	*High*

How to choose a structure

- **Primary factors to consider**
  - Synergies, economies, strategy, strategy, product life cycle
  - Interdependence across functions *within* products/markets
- **Secondary factors to consider**
  - Size, cultural constraints, accountability
  - Interdependencies across functions *across* products/markets

Synergy examples

- Two products share the same customer (marketing)
- Two products use the same technology (manufacturing)
- Two products use the same materials/components (purchasing)
- Two products use the same bulk or base tech (R&D)

No correct structure

- There is no one right structure. The task is to select the form that is <u>best for the problem at hand.</u>

Lecture 8 – Strategic Renewal

Strategic renewal

- The organization needs to maintain a fit between environment and internal processes, structure, processes, resources, etc.
  - The fit needs to be dynamic to accommodate to continuous change in the environment
  - Done to alter its **path dependence** (future coming from past actions)

Adaptation view

- Organizations can 'catch up' to external environment (focus on **continuous renewal**)
  - **Dynamic capabilities theory**
    - The dynamics of resource deployments within organizations overtime
    - Extension to resource-based view, except much more adaptable
    - Firm continuously seeks new opportunities/resources to match/create market change
  - **Organizational learning theory**
    - How organizational members notice, interpret and use information to change the firm's fit to their environment
    - **Absorptive capacity** – Ability to value, understand and utilize new external knowledge
  - **Behavioural theory**
    - Bounded rationality
      - Decision makers also strive to maintain firm performance within industry averages and seek stability
      - Therefore, they constantly try to adapt to stay performing

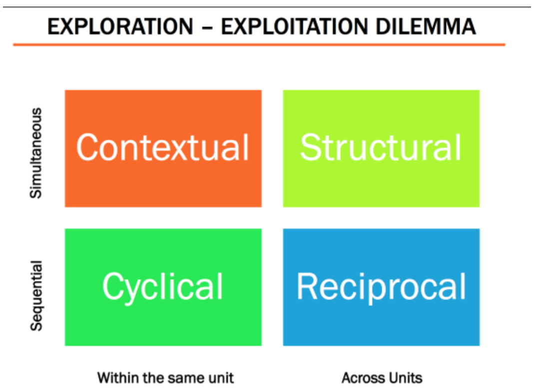
Selection view

- Organizations cannot 'catch up' to external environment (deterministic approach)
  - **Population ecology theory**
    - Survival of firms is determined by the environment
      - <u>*Structural inertia*</u>
        - Organizations that survive the 'selection' build structural inertia **–** structures and procedures that accumulate overtime which constrain adaptability to environmental change.
      - <u>*Fitness*</u>
        - The capacity to learn and change behaviour/capabilities to fit new circumstances in the environment
  - **Resource-based-view theory**
    - VRIN model creates 'stickiness' difficult to change in the short-term
    - <u>Core competencies can turn into 'core rigidities'</u>
  - **Evolution theory**
    - **Routines** (predictive behaviour patterns) develop overtime and create competitive advantages.
    - However, as routines develop, radical change is difficult
    - Routines only change if they haven't been used in a while or through *evolutionary modification*
  - **Institutional theory**
    - When firms begin to resemble each other in strategy and structure
    - Coercive, normative, mimetic isomorphism

Organizational learning in strategic renewal

- **Exploratory learning**
  - Long-term renewal and adds new attributes to current competencies/activities (building on an *organization's future*)
  - Variance-increasing activities and trial and error
  - Search, discovery, autonomy and innovation
  - **Renewal trap**
    - Over-exploration and excessive search destroys value of current resources
  - **Important in:**
    - Turbulent environments
    - High velocity of change processes
    - Increased competitiveness
    - When sufficient resources are available
- **Exploitative learning**
  - Short-term renewal by building on existing competencies and activities (building on an *organization's past*)
  - Variance-decreasing activities and disciplined problem solving
  - Efficiency, control, certainty and variance reduction
  - **Competence trap**
    - Over-exploitation in existing resources threatening survival with environmental changes
- **Ambidextrous**
  - For long-term survival, an organization should engage in *both exploratory learning and exploitive learning* to become ambidextrous

How ambidexterity is pursued



- **Simultaneous**
  - Firms have *separate* units that are strictly involved in exploitation or exploration activities. These are tied together through
    - Common strategic objectives
    - Common values
    - Linking mechanisms – leveraging assets

- **Contextual ambidexterity**
  - When a firm tries to achieve both exploitation and exploration simultaneously *within the same unit*
  - This is done by creating an organizational context that stimulates people to do both by focusing on **culture** to constantly create new ideas and innovate

- **Structural ambidexterity**
    - Highly differentiated organizational form by pursuing exploitation and exploration simultaneously *across units*.
- **Cyclical ambidexterity**
    - Sequential pursuit of exploitation and exploration within the *same unit*.
    - Long periods of exploitation and short bursts of exploration
- **Reciprocal ambidexterity**
    - Sequential pursuit of exploitation and exploration *across business units*
    - Eg. Exploring upstream or downstream

Steps to achieve ambidexterity (USA Today newspaper case)
- **Change leadership**
    - Change leaders who prefers integration
    - Replace staff with better team players
    - Fire senior-level executives who don't support the integrated strategy
- **Modify incentives**
    - Create a **common bonus** program
    - Change HR policies
    - Promotion/compensation should be tied into employee willingness to share content across units
- **Modify coordination patterns**
    - Emphasize common mission

Lecture 9 – Strategic decision-making

Strategic decision-making biases

- **Framing bias**
  - The way information is framed impacts decision-making
  - Eg. Get back $400 of the $1200 vs. lose $800 out of the $1200
    - Information can be framed as either a win or a loss
- **Misconceptions of chance**
  - Probability is always the same for all options
  - Eg. Flipping a coin 6 times: probability of HTHTHT, TTTHHH or HHHHHH is the same
- **Anchoring bias**
  - Relying too heavily on the first information offered
  - Eg. 'Last year 88% failed' being a representation for this exam
- **Availability bias**
  - The easier the information is available, the more likely it is true
  - Eg. More words with R _ _ _ *or* _ _ R _? we can easily think of more words starting with R than the second
- **Error in odds**

Behavioural strategy

- **Rational decision-making**
- **Bounded rationality**
- People rely on heuristics (cognitive shortcuts) to speed decision-making, which creates bias

Pattern-recognition biases

- Process to which individuals identify meaningful patterns in complex arrays or trends, even when there are none.
  - **Confirmation bias -** Overweighting evidence of belief and not enough evidence to reject belief
  - **Power of storytelling -** The tendency to remember and believe information presented in a story
  - **Management by example -** Generalizing based on examples that recently occurred or are memorable
  - **Champion bias -** The tendency of believing a plan based on the person presenting it (trustworthiness) instead of looking at the facts
  - **False analogies -** Relying on comparisons in cases that are not directly comparable
- **How to *minimize* negative impact**
  - Change angle of vision (test alternatives/other cases)
  - Add similar cases for a comparative analysis
  - Reframe problems (provide alternative explanations)

Stability biases

- Create a tendency towards inertia in uncertain circumstances
  - **Anchoring** – Rooting to a single value
  - **Sunk-cost fallacy** – Taking sunk costs into account in decision-making
  - **Loss aversion** – Trying to minimize losses (risk aversion)
  - **Status quo bias** – preference to the status quo
- **How to *minimize* negative impact**
  - Create stretch-goals, which are hard to achieve to do 'business as normal'. This makes people strive for newer things rather than being 'stable'

Social biases

- Arise from the preference of social harmony over conflict
    - **Groupthink –** Striving for consensus of the group at the cost of better alternatives
    - **Sunflower management** – Tendency for groups to align their views to their leader's view
- **How to *minimize* negative impact**
    - Create a climate of trust where decisions are de-personalized

Action-oriented biases

- Taking action without giving much thought about negative outcomes
    - **Excessive optimism** – overestimating success, underestimating failure
    - **Overconfidence**
    - **Competitor neglect** – Planning without taking competitive responses into account
- **How to *minimize* negative impact**
    - Apply a **pre-mortem** strategy – thinking of all ways of how a plan can fail and how to solve these issues.
    - Create a clear division between meetings where uncertainty and dissenting voices (about variance) are encouraged, where executives take the lead.

Interest biases

- Occurs when there are conflicting incentives (monetary or emotional incentives)
    - **Misaligned individual incentives** – Individuals striving to benefit themselves/their BU at the expense of the whole company
    - **Inappropriate attachments** – emotional attachments to elements in the business which misaligns interests
    - **Misaligned perception of organizational goals** – Disagreement about the objectives
- **How to *minimize* negative impact**
    - Create a balance sheet

Issues of Kodak

- **Cognitive inertia**
    - When a firm gets locked into its traditional way of thinking
    - Difficult to adapt its theories, beliefs and assumptions
- **Action inertia**
    - Some strategic options have more resistance than others
- **Sticky culture**
    - When managers see events as threats rather than opportunities

Lecture 10 – Corporate governance, organizational learning & performance

CEO effectiveness depends on

- Cognitive ability
- Ambition
- Exercise of power

Transactional leaders

- Set goals and the method to achieve these goals (eg. Bill Gates)
- Evaluate performance with:
  - **Rewards** (bonus payments, etc.)
  - **Sanctions** (demotion, verbal, etc.)
- Interested in followers as a mean to achieve a certain an organizational goal
- Transactional leadership is best for exploitation and for short-term

Transformational leaders

- Provide a *charismatic vision* but do not specify *how* the vision is to be achieved
- Interested in developing momentum to pursue vision (Eg. Ghandi)
  - **Idealized attributes** – Building relations based on trust and respect
  - **Idealized behaviours** – Leaders set the example and model the way
  - **Intellectual stimulation** – Leaders encourage training and development of new ideas
  - **Inspirational motivation** – Leaders motivate employees to explore
  - **Individual consideration** – Leaders enable others to act through coaching and support
- Transformational leadership is best for exploration and for long-term

Leadership balance between exploitation and exploration

- The two compete for limited monetary resources
- The two require different mindsets
- Exploration riskier than exploitation
  - The returns for exploration only materialize with lag (long-term)
  - However, when firms exploit more, it endangers their well-being in case of a discontinuous change

Corporate governance

- A set of mechanisms to ensure corporate leaders make decisions to satisfy all parties
- Eg. Interests aligned to stakeholders and managers (establish harmony between parties)
- Mechanisms include **ownership concentration** *(internal)*, **board of directors** *(internal)*, **executive compensation** *(internal)*, **and market for corporate control** *(external mechanism)*

- **Ownership concentration**
  - Ownership concentration is the number of large-block shareholders (own >5% of shares). Many large-block shareholders = more shareholder power
  - High degrees of ownership concentration influences strategies taken to maximize shareholder value.
  - **However,** large-block shareholders may influence strategy to expropriate wealth from minority shareholders
  - **Diffused ownership**
    - A firm with many shareholders with small percentages of shares with only very little large-block shareholders
    - This produces weak monitoring of manager's decision

- **Board of Directions (BoD)**
    - A group of *elected* individuals (elected by shareholders) who act in the firm's interests by monitoring and controlling the corporation's top-level managers.
    - BoD is created from CEO & individuals elected by shareholders *(insiders, related outsiders, and outsiders)*
        - **Insiders**
            - Active top-level managers (CEO and others) elected because they are a source of information about day-to-day activities
        - **Related outsiders**
            - Some relationship with the firm. These are not involved in day-to-day activities
        - **Outsiders**
            - Are independent of the firm's day-to-day operations and other relationships
    - **Functions of BoD**
        - **Monitoring function**
            - Selection of CEO
            - Set executive compensation
            - Review CEO performance
            - Approve annual budget
        - **Resource-provision function**
            - Provide expertise
            - Ease access to external networks
            - Decide strategic direction
    - **Features of a weak BoD**
        - CEO is chairman
        - Too many insiders and related outsiders
        - BoD is homogenous (no diversity in expertise)
    - **Features of a strong BoD**
        - There is a varied set of directors *(diversity in expertise)*
        - There are independent outsiders
        - Minorities are represented *(different ethnic backgrounds, genders, etc.)*

BoD - One-tier vs. two-tier board

- **One-tier board**
    - Only one BoD focused on *shareholder maximization* with both insiders and outsiders
    - CEO chairman, but not in the UK
    - Shareholders elect executive and non-executive directors
    - **Pro** – More responsive – quicker decision-making because the CEO has more power
    - **Con** – Relatively weaker check on CEO
- **Two-tier board**
    - Formal separation of insiders and outsiders who operate in separate boards
        - <u>Insiders responsible for day-to-day operations</u>
        - <u>(related) outsiders responsible for supervising, advising and counselling top-level managers</u>
    - Focused on *stakeholder maximization*
    - **Pro** – Better monitoring
    - **Con** – Slow decision-making process

One tier vs two tier BoD

- One-tier boards are better for *exploration strategies*
- Two-tier boards are better for *exploitation strategies*

Executive compensation for corporate governance

- Interest alignment through salaries, bonuses and long-term incentives (stock options)
  - Linking managerial wealth to the wealth of common shareholders

Market mechanism for corporate control (external mechanism)

- The possibility for outsiders to take over underperforming firms, thus disciplining managers
- Becomes active when a firm’s internal controls fail. This is only used when internal governance mechanisms are relatively weak and proven ineffective

Overview of Lecture Cases:

Diversification

- **Walt Disney diversification strategy**
  - *Operational & corporate relatedness*
    - Sharing activities along the value chain but also sharing core competencies among their businesses
  - **Synergy** was needed geographically, horizontally and vertically. Achieved through:
    - **Horizontal diversification** – Cruise ships, educational retreats
    - **Vertical diversification** – Internet, TV, merger with Touchstone

Mergers and acquisitions:

- **Merger between Disney and Pixar**
  - **Motives**
    - To access resources/capabilities which are: *non-transferable, not easily replicated, based on tacit knowledge, etc.*
    - Personal and professional respect between employees between Disney and Pixar (already a close relationship between the two firms)
    - Clear organizational structure map of roles that either: remains unchanged or is integrated into Disney's practices
    - Protection of Pixar's creative culture

- **Merger between Exxon and Mobil (horizontal merger)**
  - **Motives**
    - To generate cost economies and market power
    - Massive restructuring needed to avoid monopolization
    - ExxonMobil remain the strongest leader in the oil market

- **Merger between Disney and ABC channel**
  - **Motives**
    - Diversification
    - It was undervalued (ABC channel was $14 billion in debt)
    - Key to reach out to a larger audience
    - Disney required forward integration into TV to avoid risks of being unable to distribute their movies

- **Problems with merger between Daimler Benz and Chrysler**
  - **Post-merger integration issues**
    - Businesses kept separate (no synergies)
      - No overlapping products
      - Eg. Mercedes = high-end cars and Chrysler = affordable cars
      - **No synergies**
    - Entering a period of slow market growth
    - Very different cultures

Radical vs. Incremental innovation

- **Technology-push** – Eg. Kindle
- **Market-pull –** Eg. Recycling bins and hybrid cars
- **Meaning-driven** – Eg. Swatch, Kodak camera or Kitchen Ware
- **Technological epiphanies** – Eg. Nintendo Wii

P&G - Organizational structure

- **In 1955 - P&G – Divisional structure**
  - Focused on **Product differentiation** (and brands were managed individually)
  - Focus is both on functions and brand: brand managers in the same division compete for market space, yet share divisional functions
    - **Divisional structure**
    - Geographical based structure
  - **Why not functional?**
    - Not interested in low costs, but rather on gaining market share and brand recognition
  - P&G invented brand management
- **Present day – P&G – Global matrix structure**
  - Europe's country functions consolidated into continental ones
  - Powerful and independent global functions ensure knowledge, resource pooling and transfer of best practices
- **Overall, P&G switched from a divisional structure to a matrix structure**
  - Started to manage categories of products, not only their brand
  - Eventually their matrix structure changed into a global matrix

Strategic renewal

- **USA today – from paper to digital to network**
  - Despite stabilized profits, they encountered increasing competition from online
  - Therefore, USAToday.com was created
    - Set up as an entirely different unit
    - Brought experts outside the traditional newspaper group to manage online division (hired outsiders that aren't accustomed to traditional processes)
    - Fostered an entrepreneurial and collaborative culture
    - However, there was very slow growth, so they had to become ambidextrous
  - **USA today steps to ambidexterity**
    - **Change leadership**
      - Appoint new leader in favor of integration between online and newspaper division (internal hire)
      - Hire someone externally to manage TV operations (external hire)
      - Replace staff with better team players
      - Fire senior officers who don't support integration
    - **Modify incentives**
      - Replace unit-specific goals with a common bonus program (bonus based on performance of all three units and not separately)
      - Change HR policies to promote transfer of personnel across the three units
      - Promote and compensate employees based on willingness to share content across platforms (paper, digital, network)
    - **Modify coordination patterns**
      - Emphasize common mission
      - Hold biweekly meetings with each unit's heads
      - Cross-attendance at staff meetings
      - Increased investment in online

Strategic decision making

- **Kodak case (camera)**
  - **Status quo bias** – Didn't want to change
  - **New CEO in 1933**
    - Divested all business that were not linked to the core business
    - Started focusing on building core capabilities including:
      - Imaging technologies
      - Color science
  - However, efforts failed as **managers simply didn't understand the digital world**
  - **Issue of Kodak**
    - **Cognitive inertia**
      - Hard to adapt theories, assumptions from traditional beliefs
    - **Action inertia**
      - Some strategic options have more resistance than others, even if they may be more attractive
    - **Sticky culture**
      - Seeing events as threats rather than them as opportunities