

## Chapter 2

# Corporate Strategy Decisions and Their Marketing Implications

**I. “Ryanair: Low Prices, High Profits—But Increasing Competition”** discusses Ryanair’s use of a straightforward low-cost/low-price corporate strategy and its growth into one of Europe’s largest and most profitable airlines.

### II. Strategic Challenges Addressed in Chapter 2

- In view of the interactions and interdependences between corporate-level strategy decisions and strategic marketing programs for individual product-market entries, this chapter examines the components of a well-defined corporate strategy in more detail:
  - The overall scope and mission of the organization
  - Company goals and objectives
  - A source of competitive advantage
  - A development strategy for future growth
  - The allocation of corporate resources across the firm’s various businesses
  - The search for synergy via the sharing of corporate resources, competencies, or programs across businesses or product lines

#### A. Implications for Marketers and their Marketing Plans

- All six components of corporate strategy together define the general strategic direction, objectives, and resource constraints within which marketing plans must operate.

### III. Corporate Scope – Defining the Firm’s Mission

- A well-thought-out mission statement guides an organization’s managers as to which market opportunities to pursue and which fall outside the firm’s strategic domain.
- To provide a useful sense of direction, a corporate mission statement should clearly define the organization’s strategic scope. It should answer such fundamental questions as:
  - What is our business?
  - Who are our customers?

- What kinds of value can we provide to these customers?
- What should our business be in the future

### **A. Market Influences on the Corporate Mission**

- An organization's mission should fit both its internal characteristics and the opportunities and threats in its external environment.
  - It should also focus the firm's efforts on markets where the resources and competencies will generate value for customers, an advantage over competitors, and synergy across products.

### **B. Criteria for Defining the Corporate Mission**

- Many firms specify the domain in *physical* terms, focusing on *products* or *services* or *technology* used
  - The problem is that such statements can lead to slow reactions to technological or customer-demand changes.
- Theodore Levitt argues that it is better to define a firm's mission as *what customer needs are to be satisfied and the functions the firm must perform to satisfy them*.
- One problem with Levitt's advice, though, is that a mission statement focusing only on basic customer needs can be too broad to provide clear guidance and can fail to take into account the firm's specific competencies.
- The most useful mission statements focus on the customer need to be satisfied and the functions that must be performed to satisfy that need, and they are *specific* as to the customer groups and the products or technologies on which to concentrate.

### **C. Social Values and Ethical Principles**

- An increasing number of organizations are developing mission statements that also attempt to define the social and ethical boundaries of their strategic domain.
- Some firms are pursuing social programs they believe to be intertwined with their economic objectives, while others simply manage their businesses according to the principles of *sustainability*—meeting humanity's needs without harming future generations.
- Crafting mission statements that specify explicit social values, goals, and programs—with inputs from employees, customers, social interest groups, and other stakeholders—is becoming a more important part of corporate strategic planning.

- **Ethics** is concerned with the development of moral standards by which actions and situations can be judged. It focuses on actions that may result in actual or potential harm of some kind (e.g., economic, mental, physical) to an individual, group, or organization.
  - Particular actions may be legal but not ethical.
  - Ethics is more proactive than the law. Ethical standards attempt to anticipate and avoid social problems, whereas most laws and regulations emerge only after the negative consequences of an action become apparent.

#### **D. Why are ethics important? The Marketing Implications of Ethical Standards**

- Unethical practices can damage the trust between a firm and its suppliers or customers, thereby disrupting the development of long-term exchange relationships and resulting in the likely loss of sales and profit over-time.
- Marketers sometimes feel pressure to engage in actions that are inconsistent with what they believe to be right, such as paying bribes to win a sale from a potential customer or to ensure needed resources or services from suppliers and government agencies.
  - Such dilemmas are particularly likely to arise as a company moves into global markets involving different cultures and levels of economic development where economic exigencies and ethical standards may be quite different.

#### **E. Getting Caught Can Be Costly**

- Such inconsistencies in expectations and demands across countries and markets can lead to uncertainty among a firm's employees, and consequently to unethical—and possibly illegal—behavior.
- When employees are caught engaging in unlawful behavior—particularly bribery—by government regulators, fines and penalties can increase the costs dramatically.
- Even when the fines imposed are not large, the negative publicity surrounding the exposure- of unethical practices can raise doubts about future sales revenues and cash flows, thereby making investors more reluctant to commit funds and reducing the firm's market capitalization.
- A company can reduce such problems by spelling out formal social policies and ethical standards in its corporate mission statement and communicating and enforcing those standards.

- It is not always easy to decide what a firm's ethical policies and standards should be.
  - There are multiple philosophical traditions or frameworks that managers might use to evaluate the ethics of a given action.

#### **IV. Corporate Objectives**

- To be useful as decision criteria and evaluative benchmarks, corporate objectives must be specific and measurable. Therefore, each objective contains four components:
  - A *performance dimension* or attribute sought.
  - A *measure or index* for evaluating progress.
  - A *target or hurdle* level to be achieved.
  - A *time frame* within which the target is to be accomplished.
- Exhibit 2.4 lists some common performance dimensions and measures used in specifying corporate as well as business-unit and marketing objectives.
- When specifying short-term business-level and marketing objectives, however, two additional dimensions become important:
  - Their relevance to higher-level strategies and goals
  - Their attainability
- Thus, corporates find it useful to follow the SMART acronym when specifying objectives at all levels:
  - **S**pecific,
  - **M**easurable
  - **A**ttainable
  - **R**elevant
  - **T**ime-bound

##### **A. Enhancing Shareholder Value: The Ultimate Objective**

- In recent years, a growing number of executives of publicly held corporations have concluded that an organization's ultimate objective should be to increase its shareholders' economic returns as measured by dividends plus appreciation in the company's stock price.
  - To do so management must balance the interests of various corporate constituencies, including employees, customers, suppliers, debt holders, and stockholders.

- A going concern must strive to enhance its ability to generate cash from the operation of its businesses and obtain any additional funds needed from debt or equity financing.
- Management's primary objective should be to pursue capital investments, acquisitions, and business strategies that produce sufficient future cash flows to return positive value to shareholders.
- Many firms set explicit objective targeted at increasing shareholder value:
  - These are usually stated in terms of a target return on shareholder equity, increase in the stock price, or earnings per share.
  - Recently, though, some executives have begun expressing such corporate objectives in terms of *economic value added* or *market value added (MVA)*. A firm's MVA is calculated by combining its debt and the market value of its stock and then subtracting the capital that has been invested in the company. The result, if positive, shows how much wealth the company has created.
- Broad shareholder-value objectives do not always provide guidance for a firm's lower-level managers or benchmarks for evaluating performance.

## B. The Marketing Implications of Corporate Objectives

- Trying to achieve many objectives at once leads to conflicts and trade-offs.
- Managers can reconcile conflicting goals by prioritizing them.
- Another approach is to state one of the conflicting goals as a constraint or **hurdle**. Thus, a firm may attempt to maximize growth subject to meeting some minimum ROI hurdle.
- In firms with multiple business units or product lines, however, the most common way to pursue a set of conflicting objectives is to first break them down into subobjectives and then assign different subobjectives to different business units or products.
- As firms emphasize developing and maintaining long-term customer relationships, *customer-focused objectives*—such as satisfaction, retention, and loyalty—are being given greater importance. Such market-oriented objectives are more likely to be consistently pursued across business units and product offerings.

### C. Gaining a Competitive Advantage

- A *sustainable* competitive advantage at the corporate level is based on company resources, resources that other firms do not have, that take a long time to develop, and that are hard to acquire.
- The trick is to develop a competitive strategy for each division within the firm, and a strategic marketing program for each of its product-market entries, that convert the company's unique resources into something of value to customers.
- Strategies are built—at least in part—on a firm's marketing-related resources and competencies.

### V. Corporate Growth Strategies

- Often, there is a gap between what the firm expects to become if it continues on its present course and what it would like to become.
- To determine where future growth is coming from, management must decide on a strategy to guide corporate development.
- Essentially, a firm can go in two major directions in seeking future growth:
  - **Expansion** of its current businesses and activities
  - **Diversification** into new businesses, either through internal business development or acquisition

#### A. Expansion by Increasing Penetration of Current Product-Markets

- One way for a company to expand is by increasing its share of existing markets. This typically requires actions such as making product or service improvements, cutting costs and prices, or outspending competitors on advertising or promotions.
- Even when a firm holds a commanding share of an existing product-market, additional growth may be possible by encouraging current customers to become more loyal and concentrate their purchases, use more of the product or service, use it more often, or use it in new ways.

#### B. Expansion by Developing New Products for Current Customers

- A second avenue to future growth is through a product-development strategy emphasizing the introduction of product-line extensions or new product or service offerings aimed at existing customers.

### C. Expansion by Selling Existing Products to New Segments or Countries

- Perhaps the growth strategy with the greatest potential for many companies is the development of new markets for their existing goods or services.
  - This may involve the creation of marketing programs aimed at nonuser or occasional-user segments of existing markets.
- Expansion into new geographic markets, particularly new countries, is also a primary growth strategy for many firms.

### D. Expansion by Diversifying

- Diversifying operations is typically riskier than the various expansion strategies because it involves learning new operations and dealing with unfamiliar customer groups.
- **Vertical integration** is one way for companies to diversify.
  - **Forward vertical integration** occurs when a firm moves downstream in terms of product flow, as when a manufacturer integrates by acquiring or launching a wholesale distributor or retail outlet
  - **Backward integration** occurs when a firm moves upstream by acquiring a supplier.
- Integration can give a firm access to scarce or volatile sources of supply or tighter control over marketing, distribution, or servicing of its products.
- **Related (or concentric) diversification** occurs when a firm internally develops or acquires another business that does not have products or customers in common with its current businesses but that might contribute to internal synergy through the sharing of production facilities, brand names, R&D know-how, or marketing and distribution skills.
- The motivations of **unrelated (or conglomerate) diversification** are primarily financial rather than operational. By definition, an unrelated diversification involves two businesses that have no commonalities in products, customers, production facilities, or functional areas of expertise.
  - Such diversification mostly occurs when a disproportionate number of a firm's current business face decline because of decreasing demand, increased competition, or product obsolescence.
  - Unrelated diversification tends to be the riskiest growth strategy in terms of financial outcomes.

### **E. Expansion by Diversifying through Organizational Relationships or Networks**

- Recently, firms have attempted to gain some benefits of market expansion or diversification while simultaneously focusing more intensely on a few core competencies.
- They try to accomplish this feat by forming relationships or organizational networks with other firms instead of acquiring ownership.

## **VI. Allocating Corporate Resources**

- To exploit the advantages of diversification, corporate managers must make intelligent decisions about how to allocate financial and human resources across the firm's various businesses and product-markets.
- Three sets of analytical tools have proven useful in such decisions:
  - **Portfolio models**
  - **Value-based planning**
  - **Models that measure customer equity** to estimate the value of alternative marketing actions

### **A. Portfolio Models**

- These models enable managers to classify and review their current and prospective businesses by viewing them as portfolios of investment opportunities and then evaluating each business's competitive strength and the attractiveness of the markets it serves.
- ***The Boston Consulting Group's (BCG) growth-share matrix***
  - It analyzes impact of investing resources in different businesses on the corporation's future earnings and cash flows.
  - Each business is positioned within a matrix, as shown in Exhibit 2.6.
  - The vertical axis indicates the industry's growth rate, and the horizontal axis shows the business's relative market share.
  - The **market growth rate** on the vertical axis is a proxy measure for the maturity and attractiveness of an industry.
  - A business's **relative market share** is a proxy for its competitive strength within its industry.
  - In the exhibit, the size of the circle representing each business is proportional to that unit's sales volume.



- ***Resource Allocation and Strategy Implications***
  - Each of the four cells in the growth-share matrix represents a different type of business with different strategy and resource requirements. The implications of each are discussed below:
    - *Question marks*: Businesses in high-growth industries with low relative market shares are called *question marks* or *problem children*. Such businesses require large amounts of cash, not only for expansion to keep up with the rapidly growing market, but also for marketing activities to build market share and catch industry leader. If management can successfully increase the share of a question mark business, it becomes a star. But if managers fail, it eventually turns into a dog as the industry matures and the market growth rate slows.
    - *Stars*: A *star* is the market leader in a high-growth industry. As their industries mature, they become cash cows. They often are net users rather than suppliers of cash in the short run.
    - *Cash cows*: Businesses with a high relative share of low-growth markets are called *cash cows* because they are the primary generators of profits and cash in a corporation. Such businesses do not require much additional capital investment.
    - *Dogs*: Low-share businesses in low-growth markets are called *dogs* because although they may throw off some cash, they typically generate low profits, or losses. Divestiture is one option for such businesses, although it can be difficult to find an interested buyer. Another common strategy is to harvest dog businesses.
- ***Limitations of the Growth-Share Matrix***
  - *Market growth rate is an inadequate descriptor of overall industry attractiveness*. Market growth is not always directly related to profitability or cash flow.
  - *Relative market share is inadequate as a description of overall competitive strength*. Market share is more properly viewed as an outcome of past efforts to formulate and implement effective strategies.
  - *The outcomes of a growth-share analysis are highly sensitive to variations in how growth and share are measured*. Defining the relevant industry and served market (i.e., the target-market segments being pursued) also can present problems.
  - *While the matrix specifies appropriate investment strategies for each business, it provides little guidance on how best to implement those strategies*.

- *The model implicitly assumes that all business units are independent of one another except for the flow of cash.* If this assumption is inaccurate, the model can suggest some inappropriate resource allocation decisions.
- **Alternative Portfolio Models**
  - In view of the preceding limitations, a number of firms have attempted to improve the basic portfolio model. Such improvements have focused on developing more detailed, multifactor measures of industry attractiveness and a business's competitive strength and on making the analysis more future-oriented.
  - Multifactor models are more detailed than the simple growth-share model and provide more strategic guidance concerning the appropriate allocation of resources across businesses. However, the multifactor measures in these models can be subjective and ambiguous, especially when managers must evaluate different industries on the same set of factors.

## B. Value-Based Planning

- **Value-based planning** is a resource allocation tool that assesses the shareholder value a given strategy is likely to create.
- Value-based planning provides a basis for comparing the economic returns to be gained from investing in different businesses pursuing different strategies or from alternative strategies that might be adopted by a given business unit.
- A number of value-based planning methods are currently in use, but all share three basic features:
  - They assess the economic value a strategy is likely to produce by examining the cash flows it will generate, rather than relying on distorted accounting measures, such as return on investment.
  - They estimate the shareholder value that a strategy will produce by discounting its forecasted cash flows by the business's risk-adjusted cost of capital.
  - They evaluate strategies based on likelihood that the investments required by a strategy will deliver returns greater than the cost of capital. The amount of return a strategy or operating program generates in excess of the cost of capital is commonly referred to as its **economic value added**, or EVA.

- ***Discounted Cash Flow Model***
  - In this model, shareholder value created by a strategy is determined by the cash flow it generates, the business's cost of capital (which is used to discount future cash flows back to their present value), and the market value of the debt assigned to the business.
  - The future cash flows generated by the strategy are affected by six “value drivers”
    - The rate of sales growth the strategy will produce
    - The operating profit margin
    - The income tax rate
    - Investment in working capital
    - Fixed capital investment required by the strategy
    - The duration of value growth
- ***Some Limitations of Value-Based planning***
  - Value-based planning is not a substitute for strategic planning; it is only one tool for evaluating strategy alternatives identified and developed through managers' judgments. It does so by relying on forecasts of many kinds to put a financial value on the hopes, fears, and expectations managers associate with each alternative.
  - While good forecasts are notoriously difficult to make, they are critical to the validity of value-based planning. Once someone attaches numbers to judgments about what is likely to happen, people tend to endow those numbers with the concreteness of hard facts.
    - Therefore, the numbers derived from value-based planning can sometimes take on a life of their own, and managers can lose sight of the assumptions underlying them.
  - Inaccurate forecasts can create problems in implementing value-based planning.
    - There are natural human tendencies to overvalue or undervalue financial projections associated with each strategy alternatives and undervalue others.
    - Another kind of problem involved in implementing value-based planning occurs when management fails to consider all the appropriate strategy alternatives.

### **C. Using Customer Equity to Estimate the Value of Alternative Marketing Actions**

- This approach calculates the economic return for a prospective marketing initiative based on its likely impact on the firm's customer equity, which is the sum of lifetime values of its current and future customers.
- Each customer's lifetime value is estimated from data about the frequency of their purchases in a category, the average quantity purchased, and historical brand-switching patterns, combined with the firm's contribution margin.
- The impact of a firm's or business unit's past marketing actions on customer equity can be statistically estimated from historical data. This enables managers to identify the financial impact of alternative marketing "value drivers" of customer equity, such as brand advertising, quality or service improvements, etc.

## **VII. Sources of Synergy**

### **A. Knowledge-Based Synergies**

- The performance of one business can be enhanced by the transfer of competencies, knowledge, or customer-related intangibles—such as brand-name recognition and reputation—from other units within the firm.
- In part, such knowledge-based synergies are a function of the corporation's scope and mission.
- The firm's organizational structure and allocation of resource also may enhance knowledge-based synergy.

### **B. Corporate Identity and the Corporate Brand as a Source of Synergy**

- Corporate identity—together with a strong corporate brand that embodies that identity—can help a firm stand out from its competitors and give it a sustainable advantage in the market. *Corporate identity* flows from the communications, impressions, and personality projected by an organization.
- One rationale for corporate identity programs is that they can generate synergies that enhance the effectiveness and efficiency of the firm's marketing efforts for its individual product offerings.

### **C. Corporate Branding Strategy—When Does a Strong Corporate Brand Make Sense?**

- The corporate brand will not add much value to the firm's offerings unless the company has a strong and favorable image and reputation among potential customers in most of its target markets.
- A strong corporate brand also makes most sense when company-level competencies or resources are primarily responsible for generating the benefits and values customers receive from its individual offerings.
- An exploratory study based on interviews with managers in 11 Fortune 500 companies suggest that a firm is more likely to emphasize a strong corporate brand when its various product offerings are closely interrelated, either in terms of having similar positionings in the market or cross-product elasticities that might be leveraged to encourage customers to buy multiple products from the firm.

#### **D. Synergy from Shared Resources**

- A second potential source of corporate synergy is inherent in sharing operational resources, facilities, and functions across business units.
- When such sharing helps increase economies of scale or experience-curve effects, it can improve the efficiency of each business involved.
- However, the sharing of operational facilities and functions may not produce positive synergies for all business units. Such sharing can limit a business's flexibility and reduce its ability to adapt quickly to changing market conditions and opportunities.

#### **End of Chapter Discussion Questions and Answers**

1. **The Kelly Bottling Company, located in a large metropolitan area of some 5 million people, produced and marketed a line of carbonated beverages consisting mainly of flavored soft drinks (not including colas), soda water, and tonics. They were sold in different types of packages and sizes to a wide variety of retail accounts. How might such a company expand its revenues by pursuing each of the different expansion strategies discussed in Exhibit 2.5?**

**Answer:**

Student answers may vary. Answers should include elements such as:

- Penetration (Current Markets/Current Products):  
Kelly should use penetration strategies that involve increasing the frequency of use and the quantity used. It should also seek new applications of the soft drinks which

might include new recipes for alcoholic and non-alcoholic mixes. Probably it will have to increase promotional expenses significantly.

- **Product development (Current Markets/New Products):**  
Kelly will have to introduce new products. They can be product line extensions or completely new products.  
Probably the company will introduce new soft drinks but it might also introduce products like sports drinks or bottled water.
- **Market development (New Markets/Current Products):**  
Kelly will need to seek new markets by targeting new segments or expanding into new geographic areas. New segments might include older adults. Expanding outside of the metropolitan area would also be a reasonable action.
- **Diversification (New Products/New Markets):**  
The company may use vertical integration—perhaps buying a wholesaler (assuming it makes its own products as a manufacturer). It might diversify into related businesses like food processing. One possibility is to diversify outside of its industry to a totally unrelated line of business.

**2. Which diversification strategy is illustrated by each of the following acquisitions? What synergies or benefits might each purchase produce?**

- a. A packaged food company's acquisition of a fast-food company that features hamburgers and french fries.
- b. A large retailer's purchase of an interest in a company producing small appliances.
- c. A tobacco company's acquisition of a beer company.
- d. An oil company's acquisition of an insurance company.

**Answer:**

Student answers may vary. Answers should include elements such as:

- a. A packaged food company's acquisition of a fast-food company that features hamburgers and French fries.  
Diversification into related businesses (concentric diversification): The benefits include knowledge of products and customers related to the company's original area. Also, distribution may be similar. There may be promotional synergies as well.
- b. A large retailer's purchase of an interest in a company producing small appliances.  
Backward integration: The benefits would include influence over the pricing and quality of a source of product.

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- c. A tobacco company's acquisition of a beer company.  
Concentric diversification: Both are discretionary products taxed by government.  
Distribution is not identical but may be similar, providing some efficiency.
- d. An oil company's acquisition of an insurance company.  
Conglomerate diversification: The different industries have unrelated business cycles so that a downturn in one should not mirror a downturn in the other. Motivation is primarily financial.
3. **Critics argue that the BCG portfolio model sometimes provides misleading advice concerning how resources should be allocated across SBUs or product markets. What are some of the possible limitations of the model? What might a manager do to reap the benefits of portfolio analysis while avoiding at least some shortcomings you have identified?**

**Answer:**

Student answers may vary. Answers should include elements such as:

The BCG model has the following limitations:

- Market growth rate is an inadequate descriptor of overall industry attractiveness.
- Relative market share is inadequate as a description of overall competitive strength.
- The outcomes of a growth-share analysis are highly sensitive to variations in how growth and share is measured.

While the matrix specifies appropriate investment strategies for each business:

- it provides little guidance on how best to implement those strategies.
- it implicitly assumes that all business units are independent of one another except for cash flow.

Managers can use the portfolio concept to understand the relative strengths of their products and their industries and identify which products to support with investments, which to stop supporting and the source of resources for support.