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HANDOUTS

FUNDAMENTALS OF MANAGEMENT

-SECOND PARTIAL-

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It is a useful tool for studying the subject, but does not guarantee preparation as exhaustive and complete as the material recommended by the University.

STRATEGIC MANAGEMENT

ECONOMIES OF SCALE AND DIVERSIFICATION (ses. 14)

- **strategy**:
  - 1. What your long-term (financial) goals are and how to meet them
  - 2. How to convince customers to give you money rather than your competitors

- Five most important concepts of strategic management
  1. **Value proposition**: what you are doing (providing value) that makes people give you money —> something that solves them a problem/saves them time
     - Something that solves a customer's problem or satisfies a customer's need. —> It also be a better or cheaper version of an existing product
     - Essentially: why people give you money
  2. **Key activities** —> The most important operations a company must perform in order to make its business work. Steps a company make in order to actually produce and sell the product.
     - Key activities are required to fulfill a value proposition, maintain customer relationships, and earn revenues.
  3. **Core competencies**: unique strength that allow a company to perform its key activities better than its competitors (why you are better than your competitors) —> It can be based on superior technology, smarter employees, more efficient processes (eg. You have cheaper price) or a stronger brand (eg. Mc Donald's name)
  4. **Resource constraint** —> companies can only take strategic actions given the amount of money, time, natural resources, and technical skills they currently possess, since no person, nor company has unlimited money and time.
  5. **Principal - Agent Issues**: make sure that the manager has the same goals as the owners. Who is really in charge? Is a strategic decision being made for the short-term interest of the company, or the long- term?

ECONOMIES OF SCALE

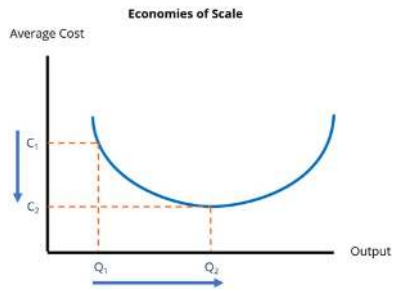
- **Economies of scale**: when the average cost of each unit that you produce is declining because the fixed cost are spread —> The more of a product you make, the cheaper each unit additional costs to produce.

- **Total costs**: TC that a firm accumulates during a year ($TC = VC * Q + FC$)
  - The total cost function represents the total costs a firm would acquire for a given level of production
  - variable costs (Costs that fluctuate with the quantity of products that are manufactured) + fixed costs (Costs that do not fluctuate with quantity) (indivisible)
- **Average costs** function describes the firm's per unit cost (AC= TC/Q)
  - It depends on the number of units produced

- Fixed costs & **Indivisibilities:**
  - Fixed costs are the most common source of economies of scale. •

- Fixed costs arise when there are *indivisibilities* in the production process. —>Indivisibility is an input that cannot be scaled down below a certain minimum size – even when the level of output is small.
- Examples of indivisible fixed costs: Factory Buildings, Factory Machines, Delivery Vehicles

- **Product specific fixed costs**:
  - When the manufacturing and sale of a specific product requires unique, non-variable cost.
    - majority in the R&D (research and development —> needed to build the product —> you need to research to know how the product will work and to actually build it)
    - Other examples: Software development costs, Employee training costs —> employee's labour and websites



- **Production constraints**: Average costs will continue to decrease until capacity constraints are met (there is a maximum capacity the firm has) —> the graph is not perfectly U shaped as in the slide (actually: little bump in the graph as you need new fixed costs to actually meet the growing demand (eg: a new factory)) —> Specifically for Product, Plant, and Equipment fixed costs as opposed to R&D fixed costs.

- **Cost Intensive industries**:
  - **Capital intensive**: When a significant percentage of total costs are fixed costs then production is considered to be *capital intensive* (eg. Really expensive R&D, telecommunications, airline, oil and gas, mining, logistics, car industry)
    - These industries require larger initial investments and are harder for new companies to enter.
    - Economies of scale are more powerful in capital intensive industries!
  - **Materials or Labor Intensive**: When most production costs go to variable raw materials or labor then the production is considered to be *materials* or *labor intensive*. (eg. Consulting firms where the labour is expensive)
    - Development labor (scientists or coders) is considered fixed costs, not variable.

- **Special sources of Economies of Scale**
  - **Economies of Density**: Cost savings that arise due to a greater geographic density of customers (eg, New York City —> it costs more to build a shop there, but you will have more customers)
  - **Purchasing Power**: Buying in bulk leads to discounts in both product cost and shipping.
  - **Advertising & Branding**: Lower costs of advertising per potential customer (the more your brand is well known the more powerful is your advertising and less you have to advertise) (eg.

Mc Donald's) + when a company sells more product (you just advertise the logo and not all the single products (eg. Nike, adidas)

- **The learning curve**: Advantages that flow from accumulating experience and know-how (the more experience you have the faster you get) —> it helps you get more revenues (key difference between economies of scale that has more to do with costs)
  - Benefits Include:
    - Better understanding of customer preferences.
    - Ways to make product higher quality.
    - Ways to reduce damage during shipping.
  - Differences with Economies of Scale:
    - 1) The learning curve is more prevalent in labor-intensive industries where people can actually learn. Less important in capital-intensive industries.
    - 2) Economies of scale are solely focused on cost, learning curve can also increase sales.

- Why are economies of scale **important**?
  - Companies need to understand the potential market of customers before making large capital investments (understand the breakeven point)
  - If you are good at economies of scale, you will be really good at competition (Firms operating efficiently at economies of scale are less likely to have competitors enter their market)
  - Lowering average unit cost increases profit => making you rich!

- **Scaling**: getting really big really quick (different from economies of scale) —> you are not necessarily becoming profitable as for economies of scale
  - Simply growing a company's operations.
  - Achieved by maximizing output and reaching new customers.
  - When companies are growing rapidly, they are considered to be "Scaling".
  - Differences with economies of scale: Economies of scale is achieved by lowering the average cost per unit. —> It can be achieved by increasing output or decreasing variable costs.

- **Diseconomies of Scale**: when a company becomes too big it also becomes less manageable (in today's world is not necessary true —> a little more limited today as we have many technology tools that have helped a lot the "manageability" of firms)
  - The larger a firm becomes, the harder it is to make change: Can only make incremental changes to products. + Leaves firms vulnerable to large industry changes.

- **Forecasting**: understanding what your potential customers' base is —> Firms need to know how large the potential customer base is before investing in fixed assets!
  - Firms need to perform a break-even analysis to ensure that the fixed asset is worth investing in!
  - If you miss forecast and you overbuild: you build too many fixed costs

  - Eg: It build a factory that can produce 100,000 widgets per year, but the maximum potential customers are 50,000 widgets per year – you will not achieve economies of scale (Your ability to scale will be limited by the market demand).
- If you underestimate forecast: also bad

- **Agency problems correlated to Scaling**:
  - For Scaling you need more money (achieving economies of scale is expensive): you can either bring in outside investors (you get extra capital, but you are reducing your power into the company) or you go to banks (they give you a loan —> problem: less ability to make strategic decisions because of bank regulations)
  - Typically, outside investors are required to achieve scale: Banks, Venture capital firms, public shareholders
  - Venture capital companies: they invest in startups by purchasing a percentage of these firms
    - Private equity firms: focus more on inefficient companies and they think they can drive them in an efficient point

- **Real life measurement & Evaluation**:
  - **Income statement**:
    - COGS (=cost of goods sold) /Revenue: A decline in COGS as a percentage of revenue over time can suggest that the company is achieving economies of scale in per-unit costs.
    - SG&A (=Selling general and administrative expenses)/ Revenue: A decline in SG&A expenses as a percentage of revenue over time suggests that managers and salespeople are becoming more efficient.
    - Operating Margin: Increasing operating margins indicate overhead costs are distributed over more sales
  - **Balance Sheet**:
    - Asset Turnover Ratio (Revenue / Assets): Increases in asset turnover ratio can indicate that the company is utilizing its assets more efficiently as it scales.
    - Inventory / Revenue: As companies grow, inventory costs should reduce (due to cheaper supplies); A decreasing inventory–to–revenue ration suggests economies of scale in production.
    - Operating Leverage (Contribution Margin / Profit): Helps determine how well a company uses its fixed-cost items to generate profit. Operating leverage should decrease as firms utilize economies of scale.

- Examples of economies of scale:
  - Ford Motor Company
  - Narayna Health Hospital (watch the video! —> slide 29): For-Profit Pediatric Hospital Group in India —> cheaper operations thanks to Economies of Scale

ECONOMIES OF SCOPE

- Economies of scope:

- **Horizontal Boundaries** of the Firm: Both the quantity and the variety of products that a firm produces.
- **Product Diversification**: Expanding the number of different products that a firm sells
- **Achieved by**:
  - Introduction of a new product.
  - Acquiring (buying) an existing company. —> Only achieved if they purchase a company that has at least one key competence that overlaps (it makes more efficient the processes)

- **Economies of scope**:
  - Economies of scope exist if the firm achieves cost savings as it increases the variety of goods and services it produces.
  - Economies of scope are only achieved if a firm leverages its *core competencies* when manufacturing or selling the new product.
    - A business activity is a core competency if it: Provides superior value to the customer. + Is difficult for a competitor to replicate. + Rare.

- **Financial stability**
  - Firms that are in industries with seasonal or inconsistent sales periods may look for ways to generate revenue during other seasons.
  - Firms in declining industries may want to invest in an industry relevant to the future. (Eg. Kodak disposable cameras to Polaroid)
  - Firms that are losing sales to a competitor may want to move to a new industry

- **Scope Economies**
  - Economies of scope are most effective when they are complimentary to existing products.
    - This is known as *strategic fit*. (Eg: PepsiCo —> Pepsi + chips as Doritos and Lays + fast food (kfc + pizza hut + taco bell) + Gatorade + breakfast food)
  - Economies of scope are effective if they can utilize existing economies of scale —> different products with the same factory (sharing production lines) and more or less same raw materials, they can share same supply chains and delivery+ joint advertising and branding

- **Strategic Relevance** of Economies of Scope (it mostly benefits revenues—> difference with economies of scale that only really benefits costs)
  - **Revenue/sales Benefits**:
    - Simply having more things to sell!
    - Encourage customers to buy more products through bundling (discounts on more products owned by the company together)
    - Maintain brand loyalty.
    - More bargaining power with customers (not directly with individual customers but with resellers as supermarkets —> they could pull more products off the shop so they have more bargaining power, they can charge higher prices)
  - **Cost Benefits:**

  - Shared fixed and development costs. (Eg: video games —> they use the same R&D making different video games that have same features)
  - More bargaining power with suppliers.
  - Similar benefits as economies of scale!

- **Unrelated diversification**: When a firm horizontally expands without utilizing economies of scope —> rarely effective (only in same rare cases)
  - Examples: Hyundai, Tata
  - Why do firms do this?
    - Allows the firm to be less dependent on a single industry.
    - Give the firm more power – with customers, suppliers, and even governments (as Tata in India they have a lot of power in general in the market)

- When should a company **not diversify**?
  - When they lack economies of scope! —> Firms struggle when they lack core competencies in an industry.
  - When they lack the financial and attention resources necessary to expand into a new product line —> Takes away resources from core products
  - When managers lack the ability to manage different business units in different industries —> Loss of focus can draw attention away from core products

- **Consequences of Misunderstanding/Neglect**
  - Financial losses from investment to enter a new market.
    - Firms have to make a decision to invest in their new product or to continue investing in a successful product.
  - Brand damage can occur if the new products are failing to meet the quality standards or do not align with the brand's other products.

  - Eg: Apple (video) —> idea of building a car for the overlapping of the hardware business (as iPhones)
    - Core competencies: hardware development, software development, Branding
    - Why was the apple car project a bad fit for apple? For the majority: timing issue, they underestimate the size of the project (it ended up taking them a lot more money and people that where needed)
    - Why did apple end its car project? Resources in that project were needed to develop generative AI (competitors could potentially damage its core business)

- **Real life measurement & Evaluation**:
  - **Income statement**:
    - Revenue growth relative to expense growth:

- Economies of scope should lead to revenue growth that outplaces the increases in expenses.
- Expenses such as SG&A, and advertising should increase at a slower rate than revenue.

- Gross Margin (=Revenue - COGS) for each product should improve
  - Economies of scope should lead Gross Margin to increase for all of a brand's products.
  - If gross margin increases for the core product, then management is struggling with diversification.

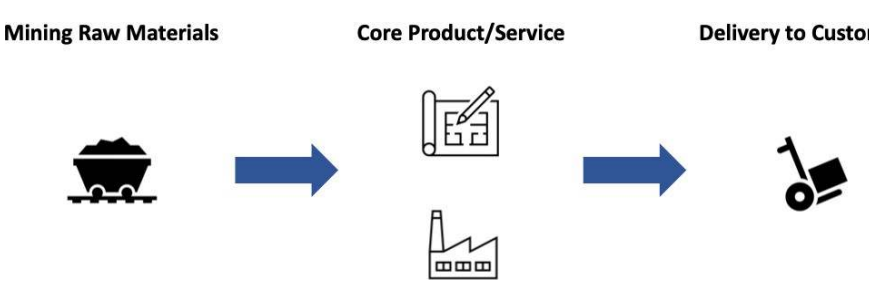
- **Balance Sheet**:
  - Asset Turnover Ratio (revenue/assets):
    - Increases in asset turnover ratio can indicate that the company is utilizing its assets more efficiently as it scales.
    - Economies of scope mean that a company can utilize its fixed assets across multiple product lines.
  - Revenue Growth relative to R&D expenses and Intellectual Property Investments:
    - Economies of scope mean that companies are utilizing patents and research discoveries for multiple product lines.

- Example: Sony Corporations
- Billy's Backpack—> exercise on excel file

VERTICAL INTEGRATION & THE MAKE OR BUY DECISION (ses. 15)

- **Vertical Integration definition**: When a company expands its operations into different stages of production within the same industry – rather than contracting with external suppliers, service providers, or sellers
- **Make or Buy decision**: When a company has to decide between performing an activity itself (i.e., making component parts) or purchasing it from an independent firm.

- Different types of vertical Integration
  - **Backwards** integration: Producing component parts and sourcing raw materials for your product.
  - **Forward** Integration: Selling and distributing the product to consumers.



- Eg. Apple that owns stores distributing its products

- **Make or Buy decision**: Unavoidable choice
  - All stages of production must be performed. —>The make-or-buy decision is about deciding which company performs each stage of production.
  - Consumers choose between products based on price and quality of a good —> Therefore, companies evaluate the make- or-buy decision based the resulting impacts to product costs and quality.

- Consumer Goods are more and more complex today
  - Eg: a car has over 30,000 unique parts inside of them —> a car firm obviously does not produce all of these parts on their own, maybe some of them but not ALL
  - Eg. Apple with their iPhones—> the camera is coming from Sony, Display from Samsung LG

- **Strategic Relevance**:
  - **Making**:
    - **Benefits** of making something on your own —> it reduces uncertainty, you know exactly how is made and the quality and more importantly you know exactly the supply chain (when you are going to get the component to adjust your all production scheduled otherwise deleted if a component is not arriving on time)
      - Reduces uncertainty: Gives companies more control over quality and delivery times.
      - Allows the company to use internal fixed assets to leverage economies of scale.
      - Easier to meet sustainability goals.
    - **Cost** of making:
      - Allocation of investment money away from key activities.
      - Forces management to oversee more activities – less focus on key activities.

  - **Buying:**
    - **Benefits** of Buying:
      - Market firms tend to have either lower costs or higher quality.
        - Produce products for multiple buyers – better economies of scale.
        - Market firms are more susceptible to competition.
      - Gives the buying firm more time to focus on key activities.
    - **Cost** of buying:
      - Coordinating supply chain lines is complex.
      - Firms are often required to share patents with producers —>Leading to possible data leaks (legitimate problem that companies see)
      - Losing control of your production increases risk. (opposite of the benefits of making)

- Managers have to evaluate and re-evaluate the make-or-buy decision for every component part!

- Opportunity cost of making:
  - Companies have a limited amount of available capital to make investments each year —> Every dollar spent on one activity cannot be used on another activity.
  - When companies invest money in performing R&D, engineering, and producing component parts for a final product, they are forgoing other potential diversification products or sales related investments. —> For example, reducing potential advertising budget.

- **Complications of Buying**:
  - **Transaction Costs**: Buying large quantities of supplies and coordinating with distribution partners is a very complicated and time-consuming process.
    - Pricing and delivery terms need to be negotiated.
    - Contracts need to be written (typically between 50-100 pages long). —> they are incredibly expansive (the attorneys are expensive) —> that's why a firm may violate the contract because they know the other firm doesn't have the money to pay a lawsuit
    - Contracts need to be enforced by firms – often through lawsuits. (Even if you have signed the contract you need to enforce them)

  - **Relationship Specific Assets**:
    - Definition: A fixed asset that specifically supports a particular "Buy" transaction between two companies.
    - The asset cannot be easily redeployed to other transactions without additional costs.
      - As a result, it is more difficult for at least one of the two businesses to break the contract. Furthermore, it may reduce the opportunities to buy or sell the product to other firms.
    - Why do companies want this? If the contract is set up fairly and there is high levels of trust between buyer and seller, it can create stability for both companies.
    - *REVIEW* (15.5) relationship specific assets —> the asset has to be very specific for one customer —> it cannot be resold/applied to another customer
    - **Types** of relationship Specific Assets:
      - Site Specificity:
        - When a supplier builds a fixed asset next to a buyer's production facility.
        - Example: Airbus builds a supply warehouse next to a major airport.
      - Physical Asset Specificity:
        - When the physical or engineering properties of a supplier's fixed asset are specifically tuned for a specific customer.
        - Example: Intel designing specific computer chips for Apple computers.
      - Human Asset Specificity:

    - When a supplier's employees learn the norms, routines, and standard operating procedures.
    - Can also be applied to technical aspects of the business.
    - Example: Auditors at Big Four Accounting Firms (Deloitte, EY, KPMG, PwC)

- **Technical Specificity**: As a component part becomes more specialized towards a single buyer, it becomes more expensive.
    - Specialized assets to manufacture the component part.
    - Fewer buyers to purchase the specialized component part. (Reduces Economies of Scale!)
    - As a result, more firms will decide to "Make" highly specific and unique component parts.

- **Rents and Quasi-Rents**:
    - Economic Return – Profit or value generated above and beyond the basic costs of production.
    - Rent: Long-term economic return generated from owning a unique asset.
    - Quasi-Rent: Economic returns generated from temporary or situational factors.
        - If a buyer is willing to pay *extra* for a specific/custom component part that could only be sold at a discount to another customer in an open market. —> Quasi-rent is the *extra* profit that you make by selling to the specific customer rather than selling to the general market.
        - Example: The bright shirt (slide 17-18)

- The **Holdup Problem**:
    - If an asset is not relationship specific: Quasi-Rent = 0
    - The larger the Quasi-Rent number is, the more power the buyer has over the supplier after the investment is made.
    - *REVIEW* (15.7) the holdup problem —> the customer of the relationship specific asset has more bargaining power on the company that produces it because they have invested money in it and they cannot resell the specific asset to another customer

    - The Holdup Problem occurs when the party with more power uses that power to renegotiate contract terms in their favor. This occurs because contracts can be difficult to enforce!
    - The holdup problem can encourage firms to vertically integrate that particular component.
    - It can also prevent suppliers from taking on specialized projects.
    - Example: Netflix (slide 20)

- When should companies **buy** a component product or service?
    - If the manufacturing of a component part is outside of the firm's core competences.
        - Eg: Ikea is a very vertically integrated company (they have their own forests for example) but for their food court they buy the products (it's outside of their core competencies)
    - If the firm cannot utilize economies of scale when manufacturing a component part.
        - Example: Requiring new factories or requiring new R&D costs.

- If an external firm can sell the same component part for less than the focal firm can produce it.
- If an external firm can produce a higher quality component part than the focal firm is capable of producing. —> Possibly due to the external firm holding a more valuable patent.

- When should companies **make** a component product?
  - If it is a new or complicated product that no external firms can/will produce.
  - When a product involves a trade secret. (Eg: coca cola and the secret formula —> the production process is all in house)
  - When there is sufficient overlap with existing core competencies and fixed assets – allowing for economies of scale. (Eg: Amazon)
  - Poor Relationships with Suppliers – The Holdup Problem

- What happens when firms misevaluate the make- or-buy decision?
  - They can end up over-allocating resources (money & time) to a specific aspect of production. —> Loss of flexibility and missed strategic opportunities
  - Reputational Risks. (Reductions in quality + Supply chain stoppages)

  - Eg of vertical integration disaster: AT&T disaster they bought media companies with debt (their leverage was completely gone) + they overestimated the revenues they would have had from this acquisition —> they lost billions of dollars on the transaction (slide 31)

- Vertical integration is very uncommon —> very common 100 years ago, today most vertical integration is done by technology companies – combining hardware and software.
- The decline of Vertical Integration:
  - 100 years ago, supply chains were much slower and communication was far more limited. Therefore, companies would just build factories next to the resource.
  - Much easier for management to oversee all levels of production
    - Management, engineers, assembly line workers and miners all worked in the same place.
- Main reasons for which vertical integration is less common today:
  - Globalization
    - Developing countries with lower labor costs made it cheaper to manufacturer goods further from the end-customer.
    - Decrease in global shipping costs has made it easier to ship raw materials and component parts all over the world.
    - Managing global supply chains is much more challenging than only managing local supply chains – forcing companies to outsource upstream production.
  - Better communication technologies:
    - The internet has made it easier for companies to communicate with external suppliers. This has led to better coordination.
    - The “transaction costs” with an external supplier have been reduced.

- Research & Design of Products.
- Software for Products
- Content for products- movies, music, & games
- Apple Stores
- Branding

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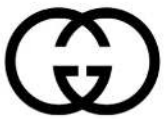


- Design
- Owns merino wool farms to source fabric.
- Manufactures clothes in Italy
- Retail Stores
- Branding

- Extracts oil and natural gas from the ground.
- Refines oil in petroleum at refineries.
- Operates some electricity factories in Italy.
- Direct sales to customers
- Branding

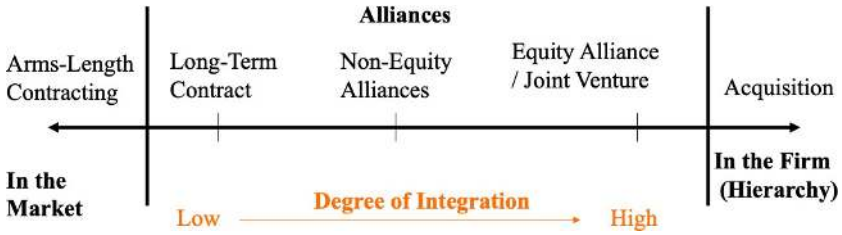
- Examples:

- What does vertical integration look like today?
  - Most large corporations perform 3 key activities in-house:
    - Research and Development/Engineering
    - High Level Marketing/Branding
    - Product Assembly
    - eg: Bayer —> the majority of pharmaceutical firms do not produce in house but in-house R&D, external production and in-house supply chain and marketing name
  - The rest of the production and sales activities are outsourced to suppliers and distributors.

- Covid-19 Pandemic and Supply chain disruptions: —> Factory slowdowns in China during the Covid-19 pandemic disrupted production facilities all over the world.
  - Buyers were unable to receive the component parts needed for their assembly line from suppliers – shutting down the Buyer's assembly process. —> This has led some firms to encourage their suppliers to move closer to the home country.

ALLIANCES (ses. 16)

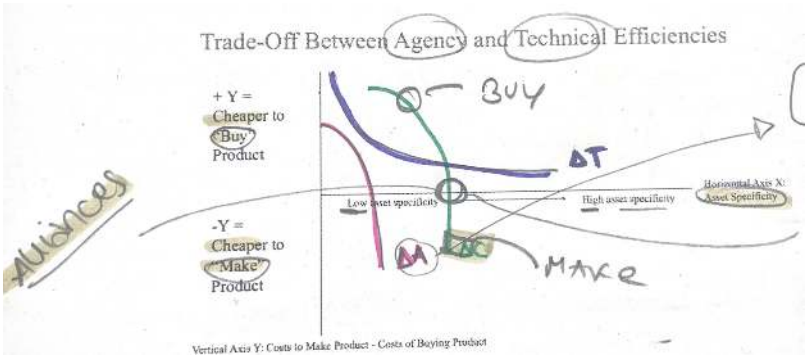
- Integrating in a Vertical Production Line —> the make-or-buy decision is not a true binary process, there is spectrum of integration levels within a vertical production line.
  - we are going to talk about *how* these companies actually execute the make-or-buy decisions through the use of alliances, acquisitions, and contracting with other firms.
  - Spectrum of integration



- What does it mean to be integrated?
  - **High level of integration**: more control over how supplier produces a component product or how salespeople sell a final product.
    - Having more control over production and production assets (relationship specific assets) and controlling who can use it
    - More alliance on management to resolve production disputes
  - **Low level of integration**: less control over how a component product is produced or a final product is sold
    - No ownership of a supplier's production assets
    - More reliance on courts to resolve production disputes—> more likely to have a lawsuit

- How do firms decide on their level of integration? For a specific transaction
  - Optimal vertical organization minimizes the sum of technical and agency inefficiencies (i.e., minimize the sum of production and transaction costs).
  - **Technical efficiency** (ΔT) —> how much does it cost to produce the item
    - Cost efficiency in the physical production of the good or service.
    - Efficient firms are utilizing economies of scale.
    - Measured: ΔT = Minimum Cost of Production to "Make" – Minimum Cost of Production to "Buy"
  - **Agency efficiency** (ΔA) —> transaction costs
    - Cost efficiency in reducing transaction costs.
    - Transaction costs are incurred in negotiation, writing, and enforcing contracts.

- Measured: ΔA = Minimum Transaction Cost to "Buy" – Minimum Transaction Cost to "Make"



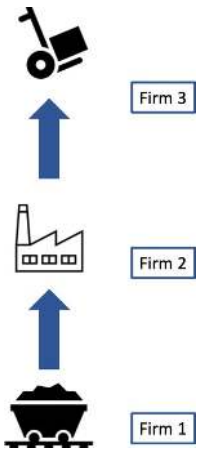
- +Y:
- The fewer suppliers
- The more specific an asset becomes it increases the transaction cost
- Situations where alliances occur —> the point where is difficult to make decision because on the line horizontal axis

- look at the graphs on slides 8-9-10-11

Acquisitions

- **Mergers and Acquisitions** (M&A) —> when two companies become one company
  - Mergers and Acquisitions (**M&A**) is an overarching term used to describe a transaction that combines two businesses into a single company.
  - **Merger**: two companies mutually agree to become one together —> mutual decisions (no mergers against the willing of one of the companies): only friendly
  - **Acquisition**: a larger company purchases a smaller company —> it can occur against the will of the smaller company (the large company can just purchase the shares of a smaller company): friendly or unfriendly
  - M&As are typically associated with economies of scope / diversification.
    - Company purchasing a competitor.
    - Company moving into a new industry via an acquisition.

- types of vertical acquisitions:
  - **Forward integration**:
    - Firm 2 purchases Firm 3.
    - Gives firm 2 greater access over sales and distribution.
  - **Backward Integration**
    - Firm 2 purchases Firm 1
    - Gives Firm 2 greater control over production quality and supply chain efficiency.
  - **Vertical Integration** is desirable when one firm's investment in relationship-specific assets has a significantly greater impact on the value created in the vertical chain than does the other firm's investment.



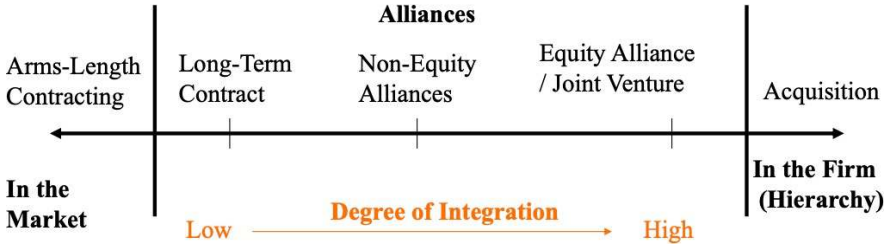
- Vertical acquisitions example: The concert Industry example: Band —> Concert Promoters (tour organization (= renting venue, tour staff, venue staff, transportation) + concert promotion) —> Ticketing Service (=ticket sales)
  - "Live nation"- "Ticketmaster": Merger—> they created a vertical integrated monopoly —> they can really squeeze their competitors
    - Opposing attorneys to the merger because preoccupations it would be anti-competitive and violate anti-trust
    - Consent decrese
    - Promotion
      - Competitors: 25%
      - Live Nation: 25% —> better pricing to convince artists to book with them instead of competitors: 20%
        - Low margin business —> difficult to break even because they have a lot of variable costs
    - Ticketing
      - Competitors: 5%
      - Ticketmaster: 5% —> 10% (they higher it of 5% that was the 5% they lost on Live Nation as they are the same company due to the merger)
        - Extremely high margin business —> basically no variable costs (only website, servers…other FCs)

Alliances

- strategic alliance: an arrangement between two independent companies to fulfill complex business transactions together.
  - Alliances help assign ownership and control of relationship specific assets while simultaneously —> (it depends on the degree of integration of the alliance, if on the right side of slide 20 graph more shared and the relationship specific asset is shared too, while if on the right side less of the relationship specific asset is shared)
  - Goal: business arrangement that is mutually beneficial to both parties in situations where contracts are too difficult to write or enforce.
  - Complex transactions, not routine, usually uncertainty form the future

- Why do alliances exist?
  - Some buyer-supplier tasks require too much uncertainty to write a complete contract.
    - Specifically, transactions that are complex and not routine.
    - Transactions that span a long period of time bringing in uncertainty from the future.
  - If the transaction involves the building of a relationship-specific asset.
  - If one party lacks expertise in completing a transaction on their own.
  - Government Regulation
    - In situations where governments prevent foreign firms from operating independently.
    - Alliances between local firms and foreign firms can help them gain access to a market.

- how so firms decide on a level of integration?
  - Level of cooperation required between the two companies.
  - The number of relationship-specific assets that need to be built.
  - Strictness of Government Regulations.



- **1. long term contract** (**low** integration contract between a buyer and supplier)
  - Formal contracts where a buyer and a supplier come to fulfill a transactional agreement over an extended period of time.
  - These contracts will involve relatively few (if any) relationship-specific assets, and the partners maintain a high degree of independence.
  - Extended work experience between a buyer and supplier can create both efficiency and stability for either side.
  - Very common in the manufacturing industry.

- **2. Non-equity alliance** (**medium** integration)
  - Collaborative agreements where firms share: Resources, knowledge, or technology.
    - Contracts will state who has to supply what resource, and how the alliance outputs will be shared.
  - Non-Equity Alliances are mutually beneficial. —> Both firms benefit but they may have slightly different goals/benefits from the alliance.
  - Trust and alignment of strategic objectives are critical.

  - Eg1: airline alliances
    - Most countries in the world: strict regulations: an airline can only fly flights that either begin or and in their country of registration (look at the slide 24) —> two problems
    - Very first airline alliances: Star Alliance (US and Europe airlines) in the 90's and it expanded in the years
    - Risks of these alliances:
      - Gates usually leased long term or owned by an airline
      - Same thing for the bag: the first airline has to coordinate the bag from the first flight to a second flight even if the second flight is not of the first airline

    - Revenue benefits? Guarantee for customers, more recognition worldwide, more market demand, additional revenue via your alliance partner (because you are getting partial revenues from operating partially a route you couldn't operate before)

- Eg 2: research alliance
    - pharmaceutical companies pay for research in a university because the researchers are highly specialized there but universities often don't have enough money to carry on some researches (eg: covid vaccines)
    - Science professors at Universities have highly specialized knowledge in their given fields. However, they are often lacking enough money to fund all of their research projects. Therefore, they will collaborate with large corporations that may financially benefit from the results of the research project.

- **3. Joint venture** (**high** integration)
    - Two or more firms that create a new, jointly-owned company to pursue a specific objective. Both firms are co-owners of the new joint venture.
    - Very high levels of integration between the two companies:
        - Both companies will have to provide resources: money, raw materials, or human expertise.
        - Relationship-specific assets will be owned by the joint venture.
    - Extremely high levels of coordination and commitment.
        - At risk of integration issues if the two companies do not work well together.
        - Difficult to end relationship if unsuccessful.
    - Often used to help coordinate extremely expensive relationship-specific assets.
    - it takes years and years of coordination
    - Extremely expensive —> only worthy if the revenue is billions of dollars
    - They are rare but when they occur is for very very expensive assets

    - Eg: in the 70's the Chinese government decided that western auto makers that wanted to enter the chinese market had to have a 50% joint venture with a local Chinese manufacturer (as SAIC) and produce the cars in china in order to be sold there
        - Very risky for western automakers but they agreed to enter the Chinese market because it's huge
        - Why was this a risky strategy? Really costly relationship specific assets

Alternative Integration Options

- **Tapered integration** —> a company doing both a vertical integration on the make side and on the buy side
    - Def: A mixture of vertical integration and market exchange
    - The manufacturer produces some quantity of a product itself and purchases the remainder from independent firms.
    - Can lead to additional coordination problems for a firm and quality differences.
    - Why do companies do that?

  - It helps a firm expand its output more quickly than if it was producing or selling the product solely on its own.
  - Can help firms alleviate the holdup problem – reduces power of suppliers.

- Very common in the hotel industry: in the 90's, they started franchising: they were no longer building and running their own hotels (eg)
  - It can also be not a franchising (that was just an example)

- **Franchising** —> an independent business that licenses its branding
  - Def: A franchise is an independent business that licenses its branding, products, and business knowledge from a "Franchisor" business.
  - A franchise business will build the store/restaurant, hire the staff directly, and paying a licensing fee to the franchisor.
  - Why do companies do it?
    - For the Franchisees:
      - "Buying" a brand image allows them to attract customers much faster.
      - Easier to access small business loans when opening a franchise.
    - For the franchisor: To Scale up faster
      - Faster growth due to less up-front capital by the Franchisor firm.
      - Less risk: Lack of investment in fixed costs reduces the amount of debt on the balance sheet

  - Types of Franchising Models:
    - MC Donald: Franchisees own the fixed asset (MCD requires a minimum investment of 1,000,000 dollars) —> the revenues are 96% of the franchisee
      - Not in charge of the relationship specific asset
    - Chick-fil-A: Only a 10,000$ charged as a franchise fee and they pay for everything but you share 50% of the revenues
      - In charge of the relationship specific asset

- **Business Groups**

CASE STUDY - (ses. 17)

- NO SPECIFIC QUESTIONS ABOUT THE CASE IN THE EXAM
  - It might ask questions similar to this case study in the exam

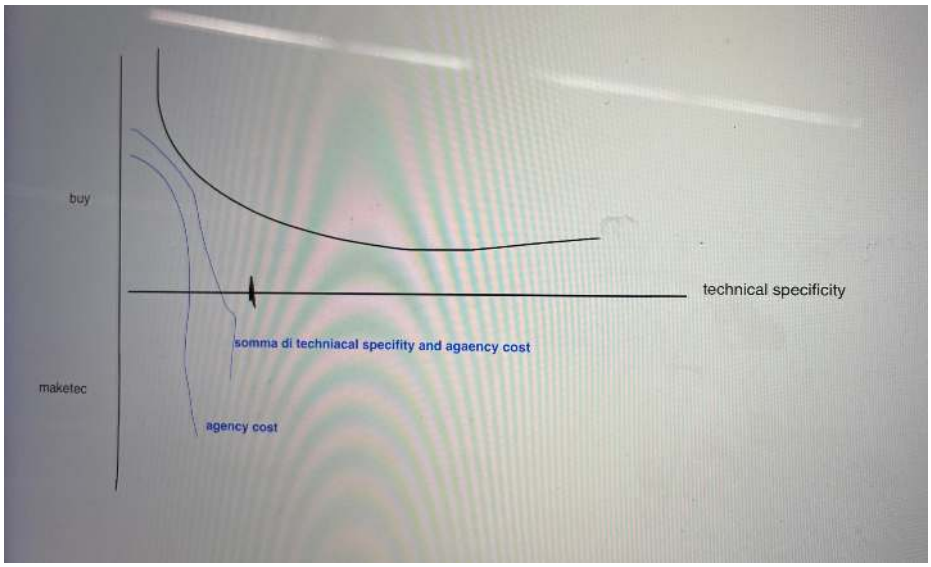
Queal Case study

- Owners: a psychologist and a businessman
- They learned how to make the product from the American company open sources
- How can Queal achieve economies of scale?
  - They have to sell a lot of products

- At then start in-house production, in a school laboratory. Fixed cost: only the rent (the did not have any labour costs, not hired people at the start)

- What is the main problem Queal encounters in the case?
  - Very rapid growth —> decision of outsource production (they were ready to scale up and they decided to outsource production to do so)
  - They picked the wrong supplier
  - They did not have a formal contract with Rotterdam Food —> as a result they did not have ways to mention suppliers to the degree they needed to

- Why did they choose to outsource production?
  - Technical specificity —> they underestimated it
    - The more technical specific a product is the more likely you buy it from suppliers than make



it yourself

- The more technical specificity the more expensive to make so less suppliers available and more towards the making in-house instead of buying
  - The More agency (when relying on outside producers) because necessity of difficult contract and enforcement of the contract that are costs

- What reasons did the founders have for not wanting to make their product on their own? They would have needed to bring in an outside investor and they didn't want to lose control (they struggled to handing over some level of control to another person)
  - Also, they were taking less responsibility by outsourcing production as they were not directly reliable for the product
- They managed badly the relationship with Rotterdam food: no contract, only by emails, they did not clarify the quality of the ingredients or where they had to get them from, they had problems with supplier's packaging supplier (third parties supplier issues became them, usually does not happen if there is a proper contract) —> they did not invest in stipulating a proper contract with their supplier

  - the issue was not just the contract but also the enforcement (they did not have ways to control the issues that were coming up)

- Outsourcing production
  - What are some of the main advantages of outsourcing productions?
    - Less work to handle
    - They maintain 100% ownership
    - Owning relationship specific asset (if there are any, none in this case)
    - Can focus on what they (managers) do best
  - What are some of the main disadvantages of outsourcing productions?
    - Losing control of the ingredients of the product as all
    - Trust issues
    - Bargaining issues (negotiation - holdup problem)
    - Coordination and communication problems between sales and production
      - Customer relation issues
    - Profit margins possibly lower

- what were the main contributors to the failure of Queal-Rotterdam foods outsourcing deal? Lack of experience, lack of monitoring
- Should queal continue outsourcing the production with another supplier? They chose to make the product at the end (main reason: 21% profit margin more) also their two main competitors produce in-house —> one supplier producing for the tree competitors would achieve better economies of scale
- How did they benefit from this? Now they have more experience
- Disadvantages of having to go through the make or buy decision again at this stage? They may have lost customers to competitors because they could not satisfy customers' demand in that period
  - They gave recipes to suppliers — > recipes are hard to patent (usually technological innovations)
  - Competitors making new flavors

- five pillars of Queal:
  - 1. Value proposition: food substitute product itself (affordable and easy) + customer service + unique flavors
  - 2. Key activities: sourcing ingredients + making the product + R&D + advertising + customer services
  - 3. Core competencies: exceptional customer relationship + Advertising +
  - 4. Resource constraints: investment money + lack of human capital + lack of R&D knowledge in the key industry + lack of Production knowledge
  - 5. Principle Agent: entrepreneurs wanted to maintain 100% control + investors might not show the same vision + maintain CEOs' spot (the more share they gave up in the company they could be replaced as CEOs)

COMPETITORS AND COMPETITION - (ses. 18)

Types of Markets and Competitors

- What is a market?
  - A market is a group of buyers and sellers that exchanging payment for goods or services.
    - Value is created for both the buyer (satisfying a need) and the seller (earning revenue).
  - Customers within a market have common needs/problems that can be satisfied by a particular product or service.
  - The size and scope of a market is determined by the number of customers that have a need/problem, and the frequency that need/problem occurs.

- Market segmentation: specific needs and problems of individuals can be subdivided into geographical, demographic and psychographic factors (to break down what your competitors better are):
  - Geographic location
    - Local, national, and international markets.
    - Needs and problems may vary between (or be specific to) geographic locations.
  - Demographic
    - Age, gender, income level, and education.
    - Different people will encounter different needs and problems at different stages of their life
  - Psychographic
    - Individual values and interest will drive consumers the problems they encounter and the needs/wants they have. (by different values or interests)

  - Eg. Market segmentation in the auto industry: big difference between US cars and Europe cars —> there are more overlaps than differences from the demographic and psychographic point off view but geographically they differ a lot.
    - Demographic: automakers develop cars for different gender demographics, age demographics, income demographics

- How do you identify a competitive market?
  - Needs-Based Market Identification
    - What problems does my product solve, what value provides and look into competitors that solve the same problem, provide the same similar thing
    - Rather than looking at similarities between products, look at how consumers are currently solving a problem.
    - If there are multiple companies solving the same problem or fulfilling the same need, then they are competitors – no matter how different their products may look on paper.

- How does the government identify a competitive market?

- Antitrust regulators (government agencies in charge of creating fair and open marketplaces) identify competitors and a competitive market based off of pricing criteria.
  - European Commission (EC) and U.S. Department of Justice (DOJ)
- A market is well defined if a merger between two competitors would lead to a *small but significant nontransitory increase in price* (*SSNIP*).
  - If two firms merge and consumers have fewer choices within a market, then they must have been competitors.

- Eg1: Facebook and Instagram —> Facebook acquired Instagram in 2012 as a way to grow its number of mobile phone users. The government allowed the merger because the combined company would lack dominant market share in the "personal social networking" market. As iMessage, Twitter, Snapchat, LinkedIn, and YouTube were all considered to be in the same market.
- Eg 2: Direct TV and DISH network (2002) (two home-satellite television providers. People who live in remote and rural areas rely on them to provide television where cables are too impractical.) —> no merger was allowed because the government believed it would create a monopoly for rural consumers who had no other options.
  - Direct TV and DISH (2024) —> they tried to merge again and this time the government allowed it because these companies are now competing with online video streaming services so they would no longer create a television monopoly for rural consumers.
- Eg 3: Siemens and Alstom (2019) (Siemens and Alsom are Europe's two largest rail manufacturers.)—> Siemens and Alstom argued that they had a small global market share and needed to merge to remain competitive against Chinese and Japanese competitors. But the government did not allowed it. The EU Commission focused on Siemen and Alstoms share in Europe, and cited that competition concerns from foreign competitors was unlikely in Europe.
- Eg 4: Six Flags and Cedar Fair (2023). The US's two largest regional amusement park chains. Owned amusement parks in different cities across America. They did not compete in the same city. The government allowed it. Regulators considered the market for family entertainment, rather than the market for regional amusement parks. Also noted that Disney and Universal Studios had more annual customers.

- How can companies identify competitors?
  - Competitors are firms whose strategic choices impact one another —> e.g., if company A reduces its price it will hurt company B
  - Product Performance Characteristics —> (What does my product do for consumers? Are there similarly performing products to mine?)
  - Product's Occasions for Use —> (When, where, and how is my product used?)
  - Geographic Market —> (Are there other similar products being sold in the same location? Is it difficult for consumers to purchase a competitor's product from another location?)

- Two types of competitions
  - **Direct competition**:
    - Direct competitors operate within the same industry and offer similar products or services.

- These products are easily substitutable. —> This means that it is easy to switch from one firm's products to a competitor's products.
- Product Performance Characteristics:—> Both products perform similarly and solve the same problem/need.
- Occasions for Use:—> Both products will be used at similar times and in similar situations.
- Geographic Market: —> Both products are easily accessible for consumers in a single geographic location.
- Eg: Uber- Lyft- Freenow
  - Product Performance Characteristics: Ride-hailing services where customers request a driver and pays on a mobile app.
  - Occasions for Use: Anytime a customer needs a driver to take them somewhere.
  - Geographic Market: Three apps have different geographic reach: Uber competes directly against Lyft in the US; Uber competes directly with FreeNow in Europe; Lyft & FreeNow don't compete directly against each other.

- **Indirect competition**:
  - Indirect competitors are products or services that are a fundamentally different product – but satisfy or fulfill a similar need. (Less specific products and less specific needs in comparison to direct competition)
  - These products are less substitutable than direct competitors but still compete for time money and attention.
  - Product Performance Characteristics: products look different and solve the same problem in different ways. Problems tend to be less specific and more general issues.
  - Occasions for Use: Indirect competitors may only be competitors under certain situations.
  - Geographic Market: Products may not be sold in the same stores or locations.
  - Eg: the entertainment market; drink market (orange juice, water, beer between each other in the scenario one person is thirsty but if you want a beer directly than orange juice not a competitor. Orange juice is not beer. A person who wanted a beer but received orange juice would be disappointed. **—>** Under these circumstances, orange juice is not a competitor for a beer brand!)
    - Eg 2: Armani and H&M both sell clothes and both in Milan
  - Context and framing of competitors are important! —>Products may only be substitutable at certain times of the day and under certain situation.

- Identifying competitors
  - Diversion Analysis:
    - One-way firms can identify their most direct competitors is by asking their customers to identify their "second choice".

- Pro: Can help you retain customers by understanding which competitor they would leave you for.
- Cons: Does not help you identify customers that you are already losing to indirect competitors.
- Eg: This analysis tells BMW's marketing team that the Audi Q5 is the most direct competitor, and that the Porsche Macan is a more indirect competitor. But it does not tell them that Tesla is a strong indirect competitor.

Textbook Example: Competitors to BMW X3	
Audi Q5	40
Lexus RX	20
BMW X5	19
Land Rover Discovery	15
Porsche Macan	12
Other Luxury SUVs	28
Other cars and SUVs	17
Total Responses	150

- Geographic Analysis:
  - Catchment Areas are the locations where a firm receives most of its customers from.
    - Where your customers live, work, or spend time.
    - Firms should survey to other residents in their catchment area to understand why they are choosing competitors 'products.
  - Are Conad and Carrefour competitors in Milan? That depends on your street address.

Degrees of competition in a market

- Market structure and Competition:
  - Market structure is the number of individual firms and the distribution of firms in a market.
  - Distribution refers to the market share of each firm. —>A market may have 5 total competitors, but one large firm may control 80% of the market.

- Herfindahl Index
  - Equation: $HI = \sum_i (s_i)^2$
  - Used to assess the level of competition (or monopolistic concentration) in a market.
  - A lower Herfindahl Index indicates more perfect competition

Example 1:
Firm A: 40%
Firm B: 30%
Firm C: 20%
Firm D: 10%

$HI = (.4)^2 + (.3)^2 + (.2)^2 + (.1)^2 = 0.30$

- **Perfect Competition**
  - Perfect competition occurs when there are many producers selling easily substitutable products.
  - The firms need to have relatively similar market power. (Herfindahl score < 0.2)

  - Necessary condition for perfect competition:
    - Many sellers: many sellers will encourage price competition.
    - Consumers Perceive the Products to Be Homogenous
      - When products are very similar, consumers tend to be less loyal to one brand over another.
      - When products are perfectly homogenous they will always choose the cheapest product.
    - There is Excess Capacity:

  - Firms with excess capacity can increase their economies of scale through additional production.
  - Firms that need to build new fixed assets are less likely to compete against firms with excess capacity.
- Eg: agriculture:
  - There are thousands of farmers that produce corn, wheat, and soybeans.
  - There are also hundreds of corporate buyers (food processers, exporters, and feed producers).
  - Homogenous products: Little differentiation between the corn grown by one farmer and another.
  - Individual farmers have no control over market prices. —>They take price established by buyers.

- **Monopolistic Competition**
  - Monopolistic Competition is a market with many sellers and many buyers – no single firm can control or influence the market.
  - However, the products or services being offered are differentiated enough to make the consumers perceive them as different.
  - With monopolistic competition, firms compete on marketing, advertising, and product features rather than solely focusing on price.
  - Herfindahl score < 0.2
  - More reflective of real life than perfect competition!
  - Eg: water bottles, televisions (How different are these products? They are the same size and have the same resolution. Have the same Apps.)

- **Monopoly**
  - Monopoly power is "the ability to act in an unconstrained way" such as increasing price or reducing quality.
  - That is because competing firms introduce price and quality constraints.
  - Monopolists face downward sloping demand curves. As it raises prices it will reduce demand.
  - As a result, monopolists will set prices at a point that maximizes its own profit. —> Monopolies cannot price discriminate – must charge same price to all customers. —> in reality they can but in the models they don't discriminate because only on one product in the model
  - This means that monopolistic markets have higher prices and lower available supply for consumers. —> Produce the quantity where Marginal Revenue = Marginal Cost.
  - Herfindahl score > 0.6

  - Eg: De Beers —> De Beers controls 85% of the world's diamond mines. De Beers purposefully limits the supply of diamonds to maximize its profits. Diamond mining has incredibly high barriers to enter - all diamond mines are already owned. Lab grown diamonds are finally cutting into De Beers market share – but they are still the exclusive suppliers of "real diamonds".

- **Oligopoly**
  - Most large corporations participate in oligopolies.
  - Markets with only a few sellers.
    - Limited competition, but not a monopoly.
    - Tend to form in markets with high fixed costs (capital intensive).
  - Firms are highly aware of each other's actions – and respond to each other's actions.
  - Herfindahl score: $0.2 < \text{Oligopoly} < 0.6$
  - An oligopoly's profits are greater than perfect or monopolistic competition, but lower than a monopoly.
  - Eg: Telecommunications industry
    - Telecommunication firms benefit from high capitalization costs – keeping competitors out. Building cell phone towers and laying internet cables is expensive!
    - Work with the government to limit new companies entering a market.
    - Limited differentiation between brands.
    - Pricing between firms is very similar.

- **Cournout Quantity Competition**:
  - A model simulating a duopoly (oligopoly with only 2 firms) selling homogenous products. —> Products are perfectly substitutable.
  - A Cournot-Nash Equilibrium occurs when each firm's output decision (quantity) is the best response to the other firm's output.
  - The revenue destruction Effect:
    - The combined output of both firms will subsequently determine the price both firms can charge.
    - This model shows that a firm's output decisions (quantity) affect the market price and profits for themselves and their competitor.
  - Eg: Global oil production (US - OPEC-Russia)
    - Oil is a homogenous product – not much differentiation between different producers.
    - OPEC (led by Saudi Arabia) is a coalition of countries with oil reserves – excluding Russia & US.
    - Saudi Arabia has the largest accessible oil reserves in the world, and it is a significant part of their GDP – want stable profits.
    - OPEC members work together to maintain a consistent high price for oil by coordinating on their yearly production.
    - The US is currently the largest producer of oil, but it is also the largest consumer. Therefore, it prefers low prices for oil.
    - When OPEC reduces production, the US increases production & vice-versa.
    - Both groups increase and decrease production to achieve their optimal price.

- **Bertrand Price Competition**

- Another duopoly model with perfectly substitutable products – this time firms compete on price.
- In the Bertrand Model:
  - Price drives quantity.
  - Consumers will always select the cheaper price.
  - If the price is the same companies will split demand 50/50
- According to the Bertrand Model:
  - The firm that lowers the price will capture 100% of the market.
  - Firms will keep lowering price until Price = Marginal Cost.
- Bertrand Model is representative of Perfect Competition – and is the reason why firms choose to differentiate through monopolistic competition.

- **Differences** Bertrand and Cournout (lo chiede all'esame sicuro!!!—> non chiede quale dei due model da applicare guardando uno scenario perchè è un esercizio troppo theorethical, chiede le caretteristihce):
  - Cournout Quantity Model:
    - Firms choose a capacity and then compete by increasing capacity and subsequently lowering price.
    - Firms are capacity constrained – and may not be able to produce enough supply to capture whole market.
    - Two firms can be profitable
  - Bertarand Price Competition:
    - Firms choose a price and then subsequently allocate demand
      - Either 50% if price the same.
      - Or 100% and 0% if price is different.
    - Firms are not capacity constrained, they can service entire market.
    - Firms cannot be profitable.
      - Each firm has an incentive to reduce price by $1 until Price = Marginal Cost.
    - Neither firm can be profitable and the price always going down to equal the marginal cost

- Evidence on Market Structure and Performance
  - Firms can avoid Bertrand Price competition by diversifying their products horizontally.
    - If products are differentiated – changes in price will not lead to 100% of consumers changing.
  - Economists have found that for undifferentiated products, an increase in the number of firms leads to lower prices and a higher number of units being sold.
  - A reduction in the number of firms operating leads to price increases.

ENTRY AND EXIT - (ses. 19)

Industry life cycles

- the birth of an industry —> radical innovations (solve a problem that has never been solved before or something so revolutionary)
  - Some entrepreneurial ideas are so revolutionary that they create their own market.
    - Maybe the technology solves a unique problem that has never been solved before.
    - Maybe the technology is so advanced it immediately renders all other technologies obsolete.
  - These *Radical Innovations* give birth to new industries.
    - Eg: airplane —> revolutionized transports

  - Lifecycle
    - Industries are born, grow, mature, and decline just like living beings – this is called the *Industry Life Cycle*.
    - Industry life cycles are categorized based off of the number of customers in a market.
    - different stages
      - startup—> they have an idea but still trying to figure it out
      - Growth
      - Maturity
      - Decline
    - The stage of a lifecycle in which the industry is in will have an impact on:
      - The type of innovation in the industry.
      - The type of investors/investment in the industry.
      - The number of competitors in the industry.

  - Definition of innovation: “Innovation is the multi-stage process whereby organizations transform ideas into new/improved products, service, or processes, in order to advance, compete and differentiate themselves in their marketplace” (Baregheh, Rowley, & Sambrook, 2009).
    - Innovations drives differentiation —> very important concept
    - Product innovations can also increase the quality (attracting new customers) or introduce new features for customers or decrease production cost

- types of **innovations** (measured on level of technological innovativeness and Level of Market change):
  - 1. Radical innovations (eg: airplane) —> A fundamentally new technology or process, leading to the creation of entirely new markets.
  - 2. Disruptive Innovations (eg: dvd displayer —> disruptive, before film tapes) —> Innovations that disrupt an existing market with a radically better product: more affordable, better quality…

- 3. Architectural innovation —> an existing technology is used to create a new market (eg: smartphone —> similar operating system of the computer just smaller) —> Reconfiguring existing technology and components in new ways to create new markets or applications.
- 4. Incremental Innovation —> least revolutionary; continuously occur over a product lifecycle and have to continuously adjust a product to make it more competitive. It is the most common type of innovation.

- Types of **investors**
  - Angel investor: very first person that gives a company money
    - Angel investors are wealthy individuals who invest in very early stage, small startups. These are extremely risky investments.
    - They invest in the startups phase
    - They know most of their investments are not gonna be winners, but when they invest in a winner their return is gonna be huge
    - Around ≈20% of the company
  - Venture Capital Funds:
    - Venture Capital Funds are risk investment funds that invest in the most promising startups with "growth potential". High risk. (They invest in what they consider the most promising startups in the world, millions of dollars, very sizable investment to allow the company to scale)
    - In the growth phase more commonly (at least two years olds, usually)
    - 20/30% of the company
  - Hedge Funds:
    - Low risk investors (that is the main difference with venture capital —> risky investment) —> hedge funds only invest in already established companies
    - Hedge Funds are large investment portfolios that invest large, established companies. Looking for stable, low risk investments.
    - In the end of the growth phase/ Maturity phase
    - Not more of 10% of the company
  - Private Equity Funds (collection of wealthy people money given to them to be invested)
    - Private Equity Funds purchase firms in mature and declining industries. They focus on making mature companies more profitable.
    - Declining phase
    - More than 51% of the company (they buy control of the company)

- **Startup Stage**
  - Very few customers —> people don't really understand the technology yet
  - An industry is born with the introduction of a new product or technology.
  - Technology is relatively new and few people fully understand how to commercialize it.
    - Uncertainty keeps potential competitors out.

    - Few customers – early adopters. (Less concerned about competitors but just to get customers)
  - Focus on product innovation and refinement.
  - Innovation types: Radical & Architectural
  - Investors types: Angel Investors & Venture Capital.
  - Competition Level: Low
- **Growth stage**
  - Customers become interested in the product and the market size increases significantly.
  - Companies focus on scaling (selling to more customers) and gaining market share.
  - Attracts the attention of new competitors.
  - Innovation Types: Disruptive & Incremental
  - Investors Types: Venture Capital & Hedge Funds.
  - Competition Level: High
  - Eg: Netflix has the greatest market share in the media streaming market because they didi it first in this stage
- **Maturity Stage**
  - The market size reaches its maximum point all potential customers have been reached. —> Most profitable industry stage (companies they are gonna be able to coordinate with each other better)
  - The top firms in the industry become established. Smaller firms begin to exit.
  - Companies focus on reducing costs through economies of scale.
  - Most profitable industry stage!
  - Innovation Types: Disruptive & Incremental
  - Investors Types: Hedge Funds.
  - Competition Level: Medium
- **Decline Stage**
  - Changing customer preferences leads to a decline in the market size. (Maybe people are bored of your products, or there are new innovations on your market)
  - Some firms may try to exit the market through diversification.
  - Companies may begin to eliminate the most unprofitable parts of their business. Cutting everything that cost them money
  - Innovation Types: Disruptive & Incremental
  - Investors Types: Private Equity Firms
  - Competition Level: Medium to Low
  - Eg; real life example: shopping malls
    - They have declined in popularity, especially because of the online shopping market
    - Stage in lifecycle: maturity/ decline stage
      - Fewer customers into the mall
      - Less retailer that pays them rent

    - There are still popular malls in specific locations
  - Three real estate companies have many shopping malls in the US (2 out of 3 have already gone out of business)
  - What types of innovation are shopping malls undertaking? Giving them thing they can do in the mall but not on the internet (as restaurants…)
  - What could shopping malls become? How could they use their space? Open spaces, warehouses (magazzini), schools, parking spaces, amusement parks, hospitals, data centers of big companies (like google cloud)

Entry and Exit decision

- New firms enter a market if they see long-term profit potential in it (not in market in a maturity or decline phase usually); Firms tend to enter industries in the startup and growth phases.
- Contestable Markets
  - Contestable markets are industries/markets with low barriers to entry.
  - Contestable markets either have unmet customer demand, which makes it easy for an entrant to gain market share.
  - Or current industry players are charging monopolistic prices.
  - example: Airline routes
    - In the airline industry, individual city pairings (Paris – Rome) are considered individual markets.
    - It is very easy for established airlines to open a new route if they believe:
      - A route is underserved (too little quantity)
      - If a competitor is price-gouging customers
      - This is how low-cost carriers in Europe have gained so much market share.

- How do firms enter markets?
  - **Internal developments**:
    - A company invests in R&D to create a new product for a specific product.
    - Time consuming to design, build, and then distribute a product from scratch.
    - Risky, because R&D does not always lead to a better innovation.
    - Most effective in the startup phase and early in the growth phase.
  - **Mergers and Acquisitions**
    - probably the easiest way to enter a market—> buy a company already in the market
    - could be really profitable for companies, they save time skipping the R&D phase;
    - If the acquirer and acquirees 'markets are similar, acquirer can leverage existing economies of scale to create economies of scope
    - Still a risky proposition for companies – need to make sure they do not overpay for a company.
      - Firms with good brand recognition are expensive.

    - Best value can be found when firms with existing brand names in other industries acquire firms with low brand recognition in the target market.
  - Eg: Google acquired DeepMind (In 2014, Google wanted to become a more significant player in the new AI and machine learning industry (startup phase))
    - DeepMind didn't have yet a recognizable brand name but very on the market
    - In 2014, Google wanted to become a more significant player in the new AI and machine learning industry (startup phase).
    - Google purchased DeepMind for $500 million and all of its researchers became Google employees. This instantly made Google a leader in the AI industry.
    - Google has used DeepMind's technology in: Google's Gemini AI Chatbot. Google Search. Google Translate
  - Eg; Google acquisition of YouTube —> they paid it a lot of cause YouTube is a recognizable brand name.
    - Google created "Google Video" in 2005 to enter this market.
    - Google focused on content from media companies, and less on private individuals.
    - YouTube, also founded in 2005 became far more popular than Google Video.
    - Google wanted to stay in the online video market and decided that acquiring YouTube for $1.6 billion was better than continuing to compete against them. (Google felt this was a better strategy than competing with YouTube)

- **Strategic Alliances**
  - If unsure about a risky entry into a new market, it can form an alliance with another firm to enter in a low-risk, low-cost way.
  - Joint-Ventures
    - Example: Sony Ericsson cell phone. Joint venture between personal electronics company and telecommunications company.
  - Franchises
    - Example: Global expansion of fast-food restaurants.
  - Brand Licensing:
    - Allows a firm to license its brand to another firm in the focal market – typically a firm with a good product but low brand recognition – as a way to gain some revenue from the market without making any financial investment.
    - Example: Disney branded toys made by Mattel.

- Why do firms exit a market?
  - Declining profitability
    - Caused by a declining market overall.
    - Or a superior competitor lowering prices below a firm's marginal cost.
  - Financial constraints/liquidity problems
    - Large with limited financial resources or debt problems may have to decide between keeping profitable business units and selling or exiting less profitable markets.

- How do firms exit a market?
  - **Bankruptcy** (the most obvious, when a company's profit is unable to pay off their monthly debt expenses) —> Company exits the market by no longer existing.
  - **Shutting down a business unit**
    - Company just stops producing a product and stops performing research in the area.
    - Many employees end up losing their job.
    - Eg: Apple not in the automobile sector
  - **Spin off**:
    - A corporation split itself into smaller multiple companies (pieces)
    - One piece will keep the original management team, stock ticker, and branding.
    - The other piece will become a completely new company that will subsequently be sold on the stock market.
    - Example: Fiat spins off Ferrari
  - **Selling a business unit to a competitor**
    - A business unit is a part of a company that operates in a specific market – Geographic Market or a specific product market.
    - Eg: General motors (GM) exits Europe and Australia's market
      - Government regulations are requiring companies to transition to electric vehicles.
      - This has become very costly for automakers who need to simultaneously invest in battery R&D and build new production factories.
      - This has led many car companies sell or close business units to their competitors in order to raise the necessary financial capital.

  - Barriers to exit: sometimes a company wants to live a market but they are unable to do it
    - Exit barriers refer to situations where firms want to leave a market but are contractually or financial forced to stay.
    - Situational Examples:
      - If a firm is unable to sell its fixed assets in the undesirable market, or the sales price wouldn't pay off the debt.
      - If the firm needs to fulfill a long-term contract.
      - Management might be fired for entering a market and then leaving!

Entry Deterring Strategies

- **Incumbent Asymmetry**
  - Incumbent firms (firms already in the market) have a natural advantage by already existing in a marketplace.
  - These advantages arise out of already establishing relationships with customers and maintaining customer loyalty.

- Incumbent firms also have better industry knowledge that will allow them to react better to challenges within an industry.
- The incumbent already possesses the relevant/necessary fixed costs.

- **Barriers to entry**:
  - Barriers to entry are external and internal factors that increase the decrease the likelihood of a new firm entering a market.
  - Structural barriers: When a firm has a natural cost advantage (usually from established fixed costs) or government regulation.
  - Strategic barriers: When a firm makes strategic pricing moves to discourage entry. o Firms use these strategies when they lack structural barriers.
- **Barriers to entry and the industry life cycle**:
  - Barriers to entry are at its lowest in the Startup phase. Instead, the risk often times keeps players out. Barriers to entry are also low during growth phase while companies are scaling up and few companies have brand recognition. Barriers to entry are at its highest point in the maturity phase.
  - In the decline stage: very few companies wanna enter into declining industries so barriers are low
- **Control of Essential Resources**
  - The most effective entry barrier is to maintain significant control over essential resources in your production process through vertical integration.
  - This level of vertical integration is very difficult to manage, and government regulators tend to frown on vertical monopolies like this.
  - However, firms can achieve this in some industries through technological patents.
    - Patents give their inventors 20 years of exclusive rights over an invention.
    - New entrants can try and “invent around” a patent, but this is difficult to do.
    - Patents: essential resources, can help a company develop a product that other companies cannot make
      - Eg: pharmaceutical companies (billions of dollars in R&D —> they prevent other companies to copy them with a patent —> block competitors out)
        - Sometimes though pharmaceutical companies have monopolistic power
- **Economies of Scale and Scope**
  - Economies of scale allow firms to produce a large quantity of products at the lowest per unit cost possible.
  - Firms successfully implementing economies of scale can intimidate new entrants by: Requiring high levels of investment in fixed costs in order to compete.
  - If both firms end up operating at economies of scale it could introduce a Cournot quantity problem creating an oversupply of the product and destroying profitability. This potential negative outcome will also discourage new entrants.
- **Marketing Advantages of Incumbency**
  - Firms with strong brand recognition are protected from entries from startups and firms with low brand recognition.

- It will take a new firm significantly more advertising spends in order to achieve similar levels of brand recognition.

- However, firms with strong brand recognition in other similar industries that can still enter.
  - If the entrant effectively uses economies of scope to leverage its brand in the new industry, then this barrier is not very effective.
  - Eg: coca cola

- **Government regulation**
  - Governments may require new firms to obtain specific licenses or permits. Often times the licensing and permitting rules are influenced by incumbent firms.
  - Government regulations may require additional companies to meet additional safety or environmental standards driving up production costs and making an industry appear less profitable.
    - Especially true in high technology sectors
  - Zoning Laws
    - Some local governments have laws about what types of building can be built on a specific piece of land (residential, business, industrial).
    - Incumbent businesses may influence local governments to limit additional business zoning to keep out competitors

  - Example: Bocconi Groceries just moved in the town of Smithville:
    - What structural barriers should Bocconi Groceries enact in order to protect their market from competitors? Special contracts with suppliers (limiting competitors to enter in the market), predatory pricing, additional licenses and permits for firms entering the market, try to change zoning laws, lobbying the government, invest a lot in fixed cost so that they have the largest store that sells everything, brand marketing, loyalty programs so that people go there instead of their competitors, buy available land

- **Strategic barriers to enter:**
  - Limit pricing: firms that have monopoly can do it (setting the price so low that other companies cannot compete with it, but just for a short period of time) —> temporary solution.
    - When an incumbent firm charges a low price to discourage new firms from entering. This is particularly effective for firms that would have to invest in new fixed costs to compete.
    - However, this prevents the incumbent firm from charging monopoly pricing, and as a result the threat of a new entrant is beneficial for consumers.
    - It is also unlikely that firms will choose a limit pricing strategy for an extended period of time. Investors will eventually want to see higher levels of profitability from the firm.
  - Predatory pricing —> after another competitor has entered the market —> the incumbent firm completely sets a low price to drive smaller rivals from the market.
    - Predatory pricing occurs when a large incumbent sets a low price to drive smaller rivals from the market.
      - This is more effective than limit pricing and will send a stronger message to other potential entrants.
      - Gives the incumbent firm a “Reputation for toughness”.

  - Wars of Attrition
    - A price war hurts all firms in the market – regardless of who started the fight.
    - Firms with greater financial resources have an advantage and can sustain price wars for longer periods of time.
    - Firms with significant amounts of debt will be at a disadvantage.
  - Just when the opposing company is a small company (if it's a multinational they have more money and it won't work cause they can lower the price more and for more time)
- Strategic Bundling
  - Companies can try and bundle products together as a means of discouraging competition.
  - New firms entering a market would also have to produce and sell a similar bundle – reducing their profitability.
  - Can also happen increase product synergies and increase switching costs for customers.
  - Eg: Microsoft Windows Operating System and Microsoft Office

- How do new Entrants beat incumbents?
  - Disruptive innovation
    - Innovating new products to reduce the cost of production.
    - Innovating new marketing and distribution methods.
    - Sometimes large incumbents have a hard time adapting to disruptive innovation.
  - Strategic Positioning and Competitive Advantage

INDUSTRY ANALYSIS - (ses. 20)

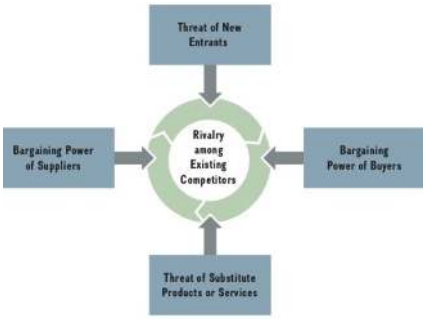
- Strategy concepts we've studied:
  - Horizontal boundaries - ses 14
  - Supply chain - ses 15&16
  - Competitor identification and degrees off competition - ses 18
  - Firm entry and exit - ses 19

Ci sono delle slides di recp delle sessioni precedenti perchè il prossimo argomento le collega tutte

Porter's Five Forces Model

- Porter's Five Forces Model —> the referencial model used the most
  - How internal and external forces can influence an industry's profitability
  - how competitive an industry can be but also an industry's profit potential
  - Who holds the power within the industry (bargaining power) —> who has the most profit

- Porter's Five Forces demonstrates how internal and external forces can influence an industry's profitability.
- The model helps businesses and investors understand:
  - How competitive an industry is.
  - Who holds the most power within industry.
  - An industry's profit potential.



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- <u>Ses. 18 - recap</u>
  - What is a market?
    - A market is a group of buyers and sellers that exchange payment for goods or services.
    - Customers within a market have common needs/problems.
  - Market segmentation
  - Four types of market competition

  - strategicallly positioning of firms:
    - low cost,
    - high quality/luxurious,
    - niche market —> smaller customer group with more specific needs (eg. Vegetarian, vegan—> small percentage of the overall consumer base)

  - strategic groups —> set of companies that pursue the same strategy/positioning within a market —> Despite being in the same industry, the impact of the five forces may affect each strategic group differently.

- **1**. why is **interval rivalry** one of the five forces?
  - Prices for goods are lower when there are more sellers in the market.
  - Firms have to spend money on product differentiation to attract and retain customers.
    - Spending money on advertising or unique product features.
    - Continuous investment in R&D.
  - The stronger the interval rivalry is, the lower the profit of the firm

- <u>Ses. 19-recap</u>
  - A company enter a market because they see profit in it
    - Contestable markets
  - Barriers to prevent entering in a market (structural - strategic)

- **2**. why is **threat of new entry** one of the five forces?

- New competitors increase the level of competition —> leading to lower profits
- Implementing the strategic and structural barriers is expensive —> it requires incumbents investements in fixed costs

- **3**. why is **threat of substitutes** one of the five forces?
  - Review indirect competition from ses. 18 if you don't remember because important for this
  - Substitute products can steal customers away and erode the size of a market.
  - Changing consumer preferences can lead them out of the focal industry to a substitutable industry.

- Ses. 16
  - the higher the technical specificity —> the greater the bargaining power of the supplier
  - Forwards and Backwards Integration —> the more the company is integrated the more bargaining power (the holdup problem - ses.15)

- **4**. why is **bargaining power of suppliers** one of the five forces?
  - Suppliers hold power if there are more firms purchasing a component part than suppliers producing it.
  - High switching costs between suppliers also give power to suppliers – allowing them to slowly increase prices on customers without fear of losing them.
  - If a supplier could credibly threaten to forward-integrate into the industry and become a competitor, then they have strong bargaining power.

- **5**. why is **bargaining power of buyers** one of the five forces?
  - Eg. Leonardo —> the government as one of the many few buyers so the government has a lot of bargaining power
  - In industries where the number of suppliers outnumber the number of buyers, the buyer has far greater control. (If a buyer has low switching costs, they have more power)
  - If the buyer requires the supplier to build and operate relationship specific assets.
  - If the buyer could credibly backwards integrate into an industry, they have significant power.
  - If a buyer has low switching costs, they have more power.

- **key takeaways from porter's five forces**
  - Broad definition of competition (be cautious of indirect competition and new entrants)
    - Other forces such as buyers and suppliers are also trying to maximize profits and extract the most value within a supply chain.
    - Firms need to look beyond direct competitors and be cautious of indirect competition and new entrants.

  - Profit potential
    - An increase in one of the five forces will decrease the industry's profit potential.

- Firms should try to eliminate strong forces and maximize opportunities created by weak forces.

- The most profitable
  - technical field —> most difficult to imitate (fewer substitutes)
  - Finance industry
  - Resell stores
  - Oil industry/ mining industry —> strong internal rivalry and very high fixed costs
  - Distribution services —> low profitability —> high internal rivalry and high costs

- Firms can take strategic action to reduce internal and external forces
- How can firms (we answered to the following questions in class)
  - decrease the level of internal industry competition? M&A
  - Increase barriers to entry?
  - Reduce the threat of substitutable products? Increase economies of scope, start competing in an industry with potential substitutes
  - Reduce the bargaining power of buyers? Integrate
    - Eg: airline: alliances, fidelity programs - loyalty points
  - Reduce the bargaining power of suppliers?

Five forces example

- Eg: movie theater industry—> all the 5 forces are taking away power from the movie theaters company
  - Theatrical window is becoming way smaller overtime, but they survived the pandemic
  - 1. Internal rivalry:
    - Oligopoly with relatively little product differentiation —> Internal rivalry is very strong
      - Limited number of competitors but high homogeneity
  - 2. Threat of new entry:
    - Very few companies want to enter this market —> they see low profit in it
      - The prices that movie theaters are charging are at their lowest (limit pricing)
      - They are expensive to build (high fixed costs)
  - 3. Threat of substitutes:
    - The most important substitute: streaming platforms —> they are a huge threat to movie theaters
    - Other substitutes: video games, social media, YouTube (other activities that people can engage in their free time and take their money away)
  - 4. Bargaining power of suppliers:
    - Movie theaters totally rely on suppliers (big studio chain to give them movies) but at the same time they have some sort of leverage and negotiation as there are different studio chain that can supply them movies

    - suppliers are unable to vertical integrate (for law, they could not buy movie theaters)
    - Lots of suppliers but still movie theaters have low bargaining powers with bigger studio chains
  - 5. bargaining power of buyers:
    - We're the buyers —> we have bargaining power because we can wait for movies to come out on streaming platforms
      - Buyers have low switching cost (there is no real difference between movie theaters so I will choose the least expensive one)
      - Easily substitutable
    - Bigger bargaining power that a movie theatre may have over the buyers are:
      - going to the movie theatre is an event (may be exclusive)
      - better quality of reproducing the movie
      - Popcorn better at the cinema than at home
      - Date night

DELTA CASE STUDY - (ses. 21)

- **Five forces of the US Airline Industry**
  - Internal Rivalry:
    - Demographic: different seats (economy, business, first class...)
    - Psychographic: sustainability
    - Branding: customer service
    - Time: punctuality, layovers, frequency
    - Route network
    - Is there a lot of internal rivalry? Yes, a lot of companies flying the same routes, same times
  - bargaining power of customers:
    - Is the product homogenous? It depends on the customer (someone may just look for the cheapest, someone may just care about customer service and experience)
    - How easy is to compare pricing between airplanes? really easy
    - Are there any switching costs for customers? Depends on the type of customers: low for tourists, high for business flyers (1st degree PD micro)
  - Bargaining power of suppliers
  - Threat of substitutes: basically none
  - Threat of New entrants
    - Airport landing slots: lobbying control —> significantly decrease the number of new entrants

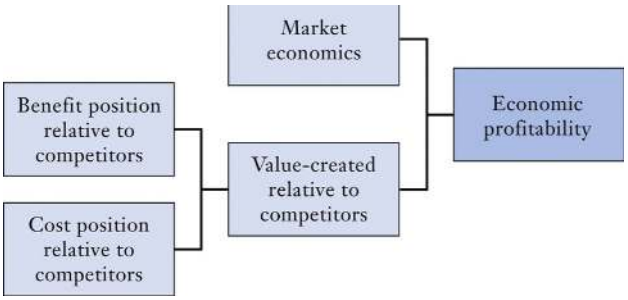
- **Delta's responses to the Five Forces**

- **Session 22: non c'eri ma hanno fatto esercizi in blackboard (cecilia)**

STRATEGIC POSITIONING - (ses. 23)

Competitive Advantage

- Competitive advantage:
  - Def: When a firm ears a higher rate of economic profit than the average rate of economic profit in its market.
  - How firms achieve the competitive advantage?
    - Creating and delivering more economic value than their rivals, and... (creating more advantage and at a lower price than their competitors)
    - Capturing a portion of this value in the form of profits.
  - Framework for competitive advantage:
    - Ability to create value depends on attractiveness of the market (gauged through P-5 analysis), and a firm's cost / benefit position relative to its competitors.

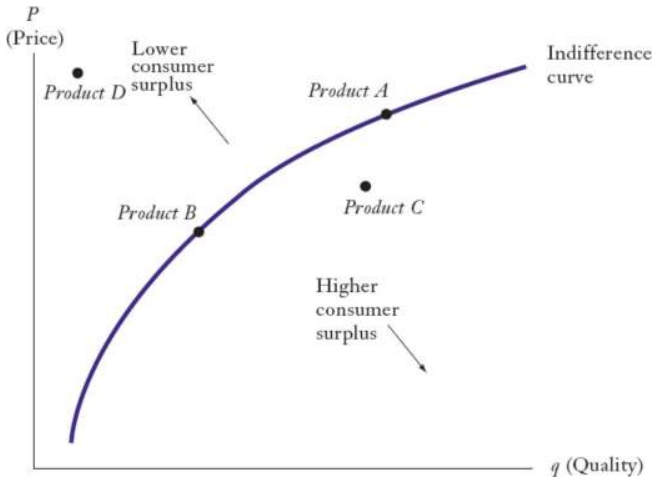


  - Maximum willingness-to-pay:
    - Def: The most amount of money that a particular consumer is willing to pay for a product.
    - A particular consumer may have a different willingness-to-pay for two very similar products.
    - Willingness-to-pay will differ between consumers as well.
      - Different customers will have different tastes, values, preferences and needs.
      - As a result, different customers may be willing to pay different prices for the same good.
    - Eg: Ferrari (400,000$) - Fiat (37,000$): two very similar products (to a degree) can be perceived as extremely different benefits from the consumer point of view and as a result have two very different prices —> because of the different willingness to pay

  - Consumer Surplus:
    - Def: the amount of value that a consumer receives if a product is priced below their willingness to pay.
    - Consumers will purchase the product that gives them the highest consumer surplus —> consumers will never purchase a product that has a negative consumer surplus.
    - Eg: Toyota Camry - Tesla —> the willingness to pay depends on the consumer preferences:

- If the consumer values more the quality and reliability —> he will purchase the Toyota
- While if the consumer values more the environmentally conscious choice —> he will purchase the Tesla

- Value Map:
  - Indifference Curve:
    - Yields price-quality combinations that yield the same consumer surplus.
    - Points above the indifference curve lower lower consumer surplus.
    - Points below the indifference curve offer higher consumer surplus
  - Consumer Surplus Parity:
    - When two firms offer the same consumer surplus
    - Consumers see no reason to switch between firms on the indifference curve.



- **Consumer Surplus**
  - B = Benefit a Consumer Expects to Derive from a Product (Maximum Willingness-to-Pay)
  - P = Product's Monetary Price
  - *Consumer Surplus* = $B - P$
- **Producer Surplus**
  - P = Product's Monetary Price
  - C = Cost to to Produce
  - *Producer Surplus* = $P - C$
- **Value-Created = Consumer Surplus + Producer Surplus**
  - *Value-Created* = $(B - P) + (P - C) = (B - C)$

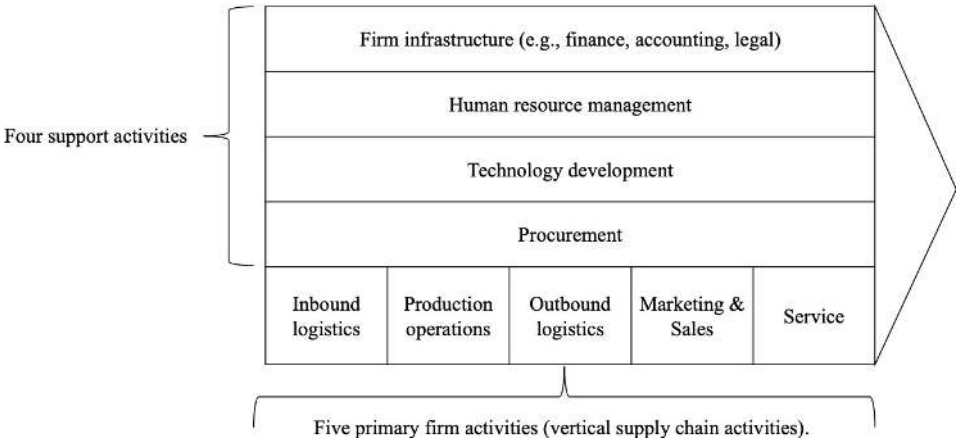
- Value Creation: MATH

- Value Creation and Competitive Advantage
  - The seller whose product characteristics and price provide the customer the greatest amount of consumer surplus will win. —> For example, customers will choose Firm 1 if: $B_1 - P_1 > B_2 - P_2$
  - The most aggressive consumer surplus that a seller would be willing to offer is at the point where $P = C$.
    - At this point, the consumer receives all of the value created.

- Customers will then choose Firm 1 if B1- C1> B2 - C2 —> Consumers are selecting the product that creates the most value.
- If the products are homogenous, $B_1=B_2$ and Bertrand price competition ensues.

- The Value Chain:
  - Understanding where and how value is created is really difficult to measure
  - In order to understand how firms create value, we must study their vertical supply chain. —>When discussing value, this is called the value chain.
  - Each step in the vertical or value chain is an opportunity for a firm to add both benefits and costs to the final product.

  - Porter's Value chain:
    - Primary activities —> directly contribute to the production, sale, and support of the product or service —> the vertical supplied chain activities
    - Four support activities: activities provide the necessary infrastructure to support the primary activities —> that the company has that managers can actually implement creating value
    - The better the support activities, the more efficiently a company can perform primary activities.
    - The purpose of the value chain is to help firm's identify operational strengths and weaknesses and help them better understand which differentiation strategy to take.
    - Essentially: It just shows how value can be on bothg the support side and the primary side —> if you want to reduce costs on one (primary activities) you have to reduce costs also on the others (support activities) and viceversa



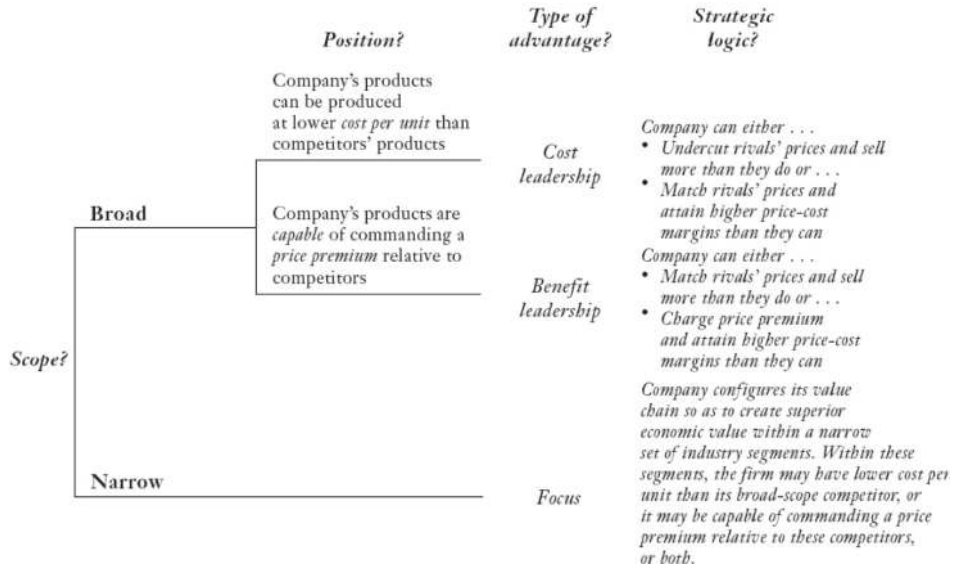
    - Southwest Airlines Example (slide 19)

  - Value Creation, Resources and Capabilities:
    - Two ways for firms to generate more value than competitors:
      - 1. Unique value chain configuration.

- 2. Performing value chain activities more efficiently than competitors.
- Creating superior economic value requires brands to possess resources and capabilities that competitors lack.

- Resources:
  - Firm specific assets
  - Examples: Patents and trademarks; Brand name and reputation; Employee expertise; Organizational Culture
- Capabilities:
  - Broad range of skills and abilities that a company develops to utilize its resources effectively.
  - These can include processes, routines, or specific technologies that a firm can utilize.
  - Firms with superior capabilities can gain an advantage over its competition.
  - Core competencies are unique and rare capabilities. —> core competencies are the best capabilities, and they would end up generating the most value over the other capabilities.

Strategic Positioning



- A firm's generic strategy describes how it positions itself:
- Broad strategies target large groups of customers.
- Narrow focus strategies target niche customer groups. (Think of it as a niche market, targeting specific needs)

- Cost Leadership Strategy:
  - A company's products are produced at a lower *cost per unit* than competitors 'products.
  - Three Different Types of Cost Leadership:
    - 1.Benefit Parity —> Product has the same benefits or quality (*B*) as competitors but sold at a lower price (*P*).

- Eg: Walmart: they offer all the products at a lower price than their competitors because of economies of scale and all in the same building (reduction of cost for them and extreme bargaining power with its suppliers)

- 2. Benefit Proximity —>Product has slightly fewer benefits or less quality (*B*) than competitors but significantly lower (*P*).
  - Eg: Ryanair: they don't offer you basic things but they are way cheaper
- 3. Qualitatively Different —>Significantly changing a product's features or appearance to achieve similar benefits (*B*) but significantly lower prices (*P*)
  - Eg: Ikea —>Ikea offers affordable, stylish home furnishings but you build the things yourself so less expensive and qualitatively different because other companies sell things already put together

- Benefit Leadership Strategy:
  - A company's products offer more *B* to the customers than its rivals.
  - Two Different Types of Benefit Leadership:
    - 1. Benefit Parity: Product has superior benefits or quality (*B*) as competitors but sold at the same price (*P*).
    - 2. Benefit Proximity: Product has significantly higher benefits or quality (*B*) than competitors but at a slightly higher price (*P*).

  - Benefit Drivers (<u>What types of benefits can help firms differentiate themselves</u>?):
    - 1. Physical characteristics of the product itself. —> Superior performance, quality, or ease of use.
      - Eg: Dyson's cordless vacuum was a major improvement on its competitors in both fan power and battery life.
    - 2. Characteristics of the services or complementary goods the firm offers for sale. —> Bundles that the seller includes with the product, such as a product warranty or guaranteed maintenance.
      - Eg: Microsoft Office 365 – Includes cloud storage, video conferencing software, and regular software updates. This is intended to encourage users to switch from the old, single-purchase versions of Microsoft Office.
    - 3. Characteristics associated with the sale or delivery of the good. —> Specific benefit drivers include speed and timeliness of delivery. Non-pushy salespeople
      - Eg: Gorillas specializes in ultra-fast delivery. Other companies specialize in luxurious, "white glove" delivery options.
    - 4. Characteristics that shape consumer's perceptions or expectations of the product's performance. —> Product's reputation for superior performance – from advertising or other consumer's experiences.
      - Eg: Patagonia
    - 5. The subjective image of the product. —> Brand image of a product, driven by advertising and prestige.
      - Eg: Patek Philippe Geneve (watches)

- Comparing Cost and Benefit Advantages:
  - Cost Advantage:
    - Better when the nature of the product limits opportunities for enhancing its perceived benefits.
    - Consumers are relatively price sensitive.
    - Consumer can only inspect visible features before purchasing.
    - Eg: shopping on amazon: you don't see the quality of the products from just two images, you are only gonna choose the cheapest one
  - Benefit Advantage:
    - Better strategy when consumers will pay a significant price premium for attributes enhancing perceived benefits.
    - If other firms have already achieved low costs through economies of scale.
    - When the product is going to be used over a long period of time and reliability is important to consumers.

- Extracting Profits with **Low** Product Differentiation:
  - Cost Advantage:
    - Modest price cuts gain lots of market share.
    - Low profit margin – must maximize market share.
    - Optimal Strategy: Firms should underprice competitors to gain market share.
  - Benefit Advantage (really difficult here):
    - Modest price hikes lose lots of market share.
    - Low profit margin – must maximize market share
    - Optimal Strategy: Firms should maintain price parity with competitors and let benefits drive market share increases.

- Extracting Profits with **High** Product Differentiation:
  - Cost Advantage:
    - Big price cuts gain little market share.
    - Optimal Strategy: Maintain price parity with competitors, and let lower costs drive higher profits.
  - Benefit Advantage:
    - Big price increases lose little market share because of the product differentiation.
    - Optimal Strategy: Charge a price premium relative to competitors.

- "Stuck in the Middle": Firms attempting to simultaneously perform a low-cost strategy and a benefit-leadership strategy run the risk of doing neither well
  - Furthermore, pursuing both strategies simultaneously can confuse customers about the quality of the product.
  - Firms can avoid being "stuck in the middle" by:

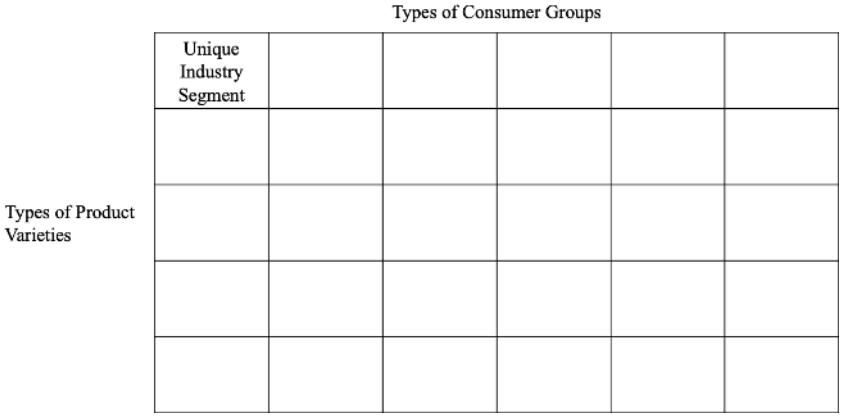
- Becoming a benefit-leader first (establishing a reputation for selling high-quality products) and then lowering costs through economies of scale as market share grows.
- Increasing a product's initial quality and then saving money on customer service and product recalls later on.

- Eg: Kmart (a reseller that Walmart ended up killing)
  - Kmart wasn't performing well support activities: inefficient with their supply chain operations —> unable to charge lower prices as Walmart had started
  - At first: Walmart and Kmart had different target customers
    - Then maturity phase: high rivalry —> stealing customers
  - Problem:
    - Low Cost Leader - Walmart
    - Benefit Cost Leader - Target
    - Kmart was none of these, all they did is that they had stores in a lot of places first (they gained the market share first but they weren't able to maintain this market share) but when these two other competitors raised in the market, Kmart had no point to exist anymore (it was neither Low Cost leader or Benefit Cost leader) —> Kmart was "Stuck in the Middle"

Broad Coverage vs. Focused Strategies

- Segmenting an Industry:
  - Differentiating between cost leadership and benefit leadership describes *how* firms will create economic value.
  - Industry segments determine *where* the firm will create value —> When firms look at a particular portion of customers and they say these are gonna be our target customers (and choose if cost or benefit driver)
- Industry Segments:
  - An industry can be represented in two dimensions:
    - Product Groups —> Differentiated products within the same product category or industry.
    - Customer Groups —> Geographic, demographic, and ideological differences between people.
  - Segments occur at the intersection of a particular product group with a particular customer group.
  - Structural attractiveness of segments varies due to:
    - Buyer economics
    - Segment Size

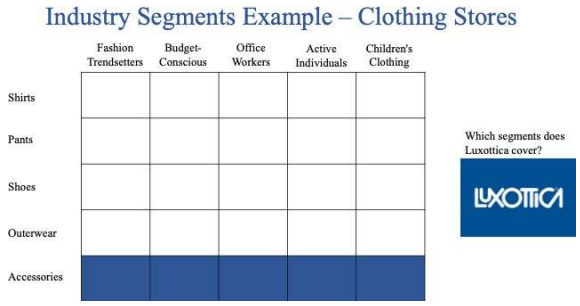
- Buyers segment tastes, in each have similar needs, and marketing responses

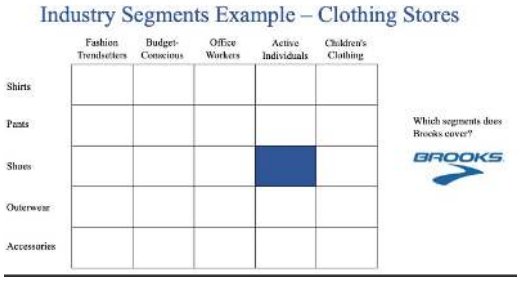


- Broad Coverage Strategies: A broad coverage strategy seeks to serve all customer groups in the market by offering a full line of related products.
  - Characterized by:
    - Wide product range
    - Multiple customer segments
    - Sold in a variety of different markets
    - Mass marketing strategy
  - Eg: Volkswagen Group: they have different brands

- Focus Strategies:
  - When a firm offers a narrow set of product varieties, serves a narrow set of customers, or both.
  - 1. *Customer specialization*: when a firm offers an array of related products to a limited class of customers.
  - 2. *Product specialization*: when a firm produces relatively limited product varieties for a potentially wide set of customer groups.
  - 3. *Geographic specialization*: When a firm offers its products in a specific geographic location – can be either broad coverage in a single geographic market or customer/product specialized.

- Eg: OVS covers a lot of segments —> kind of a broad strategy:





- Exercise in class: see the slides, answer written on them!

APPLE CASE STUDY - (ses. 24)

PC industry:

1. *internal rivalry*: High, significant differences in profitability
2. *threat of new entrants*: medium because it's easy to build a computer the difficult part is actually gain the trust of a base of customers and to impose itself in the market
3. *threat of substitutes:* There are several products that can substitute many tasks of the computer: smartphones, tablets, game devices, tv and media devices.
4. *bargaining power buyers*: medium
   - Corporate companies: high bargaining power.
   - Home buyers: low-medium bargaining power.
   - Education and Government customers: high bargaining power.
   - small-medium sized companies: medium bargaining power.
5. *bargaining power suppliers:* medium-high power in the pc industry in general

Smartphone:

1. *internal rivalry:* medium
2. *threat of new entrants:* high
3. *threat of substitutes*: low
4. *bargaining power buyers:* low- medium
5. *bargaining power suppliers:* medium-high

Apple:

1. *Competitive advantages:*
    1. seamless ecosystem (mac, iphone, ipad, airpods...)
    2. easiness to use
    3. strong brand
    4. bundling service
    5. privacy
    6. quality reliability and longevity
2. *Home kit:* the ecosystem, bundling, ease of use, privacy
3. *Vision Pro:* branding, quality reliability, ecosystem
4. *Apple Pay:* easy to use, privacy, branding
5. *Apple TV+:* branding, bundling, ease of use, quality

STRATEGY & STRUCTURE - (ses. 25)

EXERCISE - MAKE OR BUY (it will be on the exam for sure!!) —> session 25 practice problem —> **read <u>the slides,</u> exercise!! To know what he will ask for**

- Producer and consumer surplus —> calculate them on a per unit basis
    - How do you calculate average costs?
    - Consumer surplus= willingness to pay - price
    - Producer surplus= price - average cost/unit = EBIT/ units sold
    - Value Created= willingness to pay - average cost/unit = consumer's surplus + producer's surplus

    - Probably negative numbers in the exam (he likes to be tricky)
    - This should be the as much accounting he will ask us to do - no ratios, just the make or buy exercises and the necessary computing things to be able to answer

Introduction to Structure

- Organizational structure describes the arrangements by which a firm:
    - Divides up its critical tasks
    - Specifies how decisions are to be made among managers and employees
    - Establishes routines and information flows to support operations

    - These can be both formal and informal arrangements —> there is for sure a formal organizational structure very company has an organizational chart)

- Agency problem
    - Owners/shareholders do not manage the day-to-day company operations.
    - Instead, they hire a professional manager to run the company on their behalf.
    - Contracts need to be written so that managers will work hard and generate as much value for the shareholders as possible.

- Why is structure important?
  - Efficiency relies on it (iff you have too many employees) and the agency problem
  - A firm's structure is important for two key reasons
    - 1. Helps align employee goals with that of management and owners – reducing the agency problem.
    - 2. Can help a firm maximize its profit by making employees more efficient.
    - Better structure–>FewerEmployees –> Higher Profits

- The innovator's dilemma (When new technologies cause great firms to fail)—> reading suggestion (not on the exam but interesting)

Strategy that follows Structure

- Departmentalization: deciding of employees in small departments —> Departmentalization represents the choices managers make regarding the appropriate division of labor within the firm.
- Firms can be partitioned by:
  - Tasks (functions)
  - Inputs
  - Outputs
  - Geography
  - Time of Work

- Coordination and control
  - Coordination —> Organizational structure will dictate how easily information flows throughout the company.
  - Control —> Organizational structure will determine who gets to make specific decisions.
  - If decision making authority is delegated properly, and employees are properly incentivized, a firm can ensure all of its divisions will be working in the same direction.

- Approaches to Coordination
  - Self-contained departments
    - Autonomous work units where managers control operating decisions and provide summary financial and accounting data to headquarters.
      - Sometimes these work units are referred to as "Profit Centers".
    - If an autonomous group focus on support activities such as human resources or accounting, they are called "responsibility centers".
  - Lateral relations
    - When economies of scale or scope require close coordination among work groups.
    - Individual employees may work for/report to different work groups.

- Evolution of Firm structure

- One hundred years ago, firms used a U-Shaped organizational structure to reduce the number of managers and maximize economies of scale.
  - When firms began to diversify into new products and markets, the U-form became cumbersome, and the M-form emerged as a better alternative.
- The M-form lead to duplication of activities when firms expanded globally and created "international divisions".
  - As firms try to balance local responsiveness with global economies, a mix of matrix form and network form help create flexible organizations

- Strategy Environment Coherence
  - The organizational structure that a firm pick needs to logically fit the strategy the firm chooses to pursue.
    - If a firm wants to be a benefit-leader, they should pick a strategy that increases contact among researchers and engineers.
    - If a firm wants to be a cost-leader, they should eliminate as many coordinating costs as possible and streamline the firm's hierarchy.
    - If a firm plans on participating in several geographic markets, they need to give more autonomy to their geographic divisions.

- Technology and Organizational Structure
  - Technology (def): The scientific knowledge that a firm possesses, as well as the firm's application of scientific to the products and services the firm sells.
  - Firms researching and developing products with a new technology will want to increase coordination through a decentralized approach.
  - Firms working with an older or established technology will prefer a more hierarchical structure that reduces managerial overhead.
  - Low- technology situation company: you don't want connections in the departments (to cost-cutting, you don't need those)

- Task independence and structure:
  - *Task independence* (def): The extent to which two or more positions in an organization depend on each other to do their work.
  - *Sequential Interdependence* (def): When one group depends on the other group's outcome, but not vice versa.
    - Example – Movie editor requires cinematographer to finish filming.
  - *Pooled Interdependence* (def): When two or more groups are not directly dependent on one another, but the financial success or failure of one group will impact the other group.
    - Example – The Disney Company's ESPN (un canale) & PIXAR divisions.

- Structure Follows Strategy
  - A firm that relies on personal relationships between sales personnel and clients may benefit from a decentralized structure.

- The same firm may enjoy substantial scope economies, which favor centralization or even a matrix structure.
- When facing conflicting environmental factors, the firm should focus on those factors that are critical to its strategic success.
  - If a firm is dependent on maintaining benefit leadership based on close relationships to customers, then it should favor decentralization.
  - If the firm is pursuing cost leadership based on scale economies, then centralization is preferred.
- You can't simultaneously build a structure that is both cost efficient and customer-benefit (le due differenziazioni della ses. 23)

Subunit Structure

- Subunit Structure: Organizational structure refers to the linkages between the firm's smaller organizational subunits —> Large corporations may have hundreds of subunits.
- These small subunits are used to complete simple tasks and can be constructed in several ways:

  - 1. Individually —> Individual subunits
    - When each individual is given their own set of tasks and does not interact with other employees.
    - The individual is rewarded (paid) based on his/her output.
    - In the real word: finance and commodity traders
      - Traders are given individual portfolios of companies are expected to generate a positive return with minimal oversight.
      - Each trader analyzes market data, identifies opportunities, and executes trades independently within broadly set corporate guidelines.
      - Compensation is often tied directly to the trader's individual performance.

  - 2. Self-Managed Teams
    - A collection of individuals working together to set and pursue common objectives.
    - Team performance determines team rewards.
    - Very common in research and product-development focused firms.

  - 3. Hierarchy of Authority —> there's a boss in charge of an individual or a team
    - When one member of the group is in charge of coordinating and monitoring the actions of others.
    - This becomes necessary as firms become more complex.
      - Some employees must handle routine day-to-day tasks.
      - More experienced employees must focus on coordination and problem solving.
  - Need for a hierarchy
    - Independent work groups should be able to operate independently and perform routine tasks without supervision.

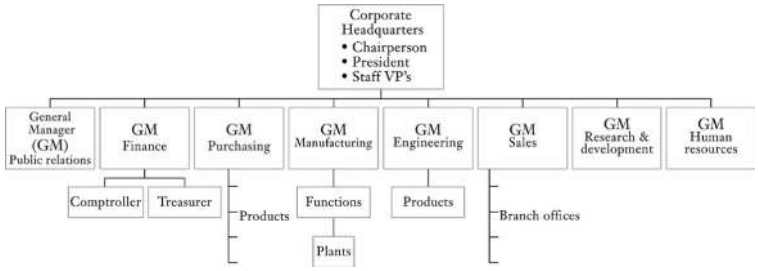
- Administrative hierarchy develops to handle "exceptions" – situations requiring decisions that cannot be easily resolved using standard routines.
- As a result, decisions made at the top of the hierarchy should be the most difficult and least routine of all.

- Complex hierarchy —> def: An organizational structure involving multiple groups and multiple levels of grouping
  - Complex hierarchies become necessary as firms expand vertically and horizontally.
    - Firms need to *departmentalize* their employees into task or product specific subgroups.
    - Managers must *coordinate* between subgroups to achieve the firm's objectives.

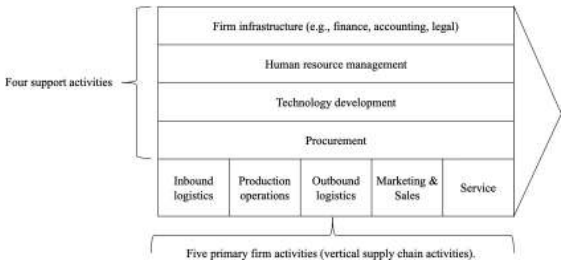
Types of Organizational Structure

- **Functional Structure (U-form)**
  - Each *department* in the firm is responsible for a particular functional area such as finance or marketing.
  - The unitary functional structure is suitable for stable conditions when operating efficiency is the prime consideration.

- Good for cost-leaders company



  - Each step in the value chain of the primary activities and the support activities would be their own department. All of the departments would report to a single managerial office who would centralize strategic decision making.

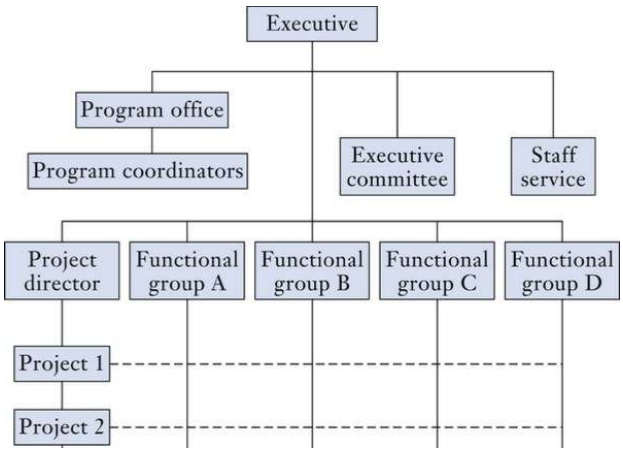


- Essentially: It just shows how value can be on bothg the support side and the primary side —> if you want to reduce costs on one (primary activities) you have to reduce costs also on the others (support activities) and viceversa
- Example on slide 41: Logitech —> all Logitech brands have the same core products with only slight variations.

- **Multidivisional Structure (M-form)**
  - The multidivisional firm is organized along such dimensions as product line, geography or type of customers.
  - Divisional managers will be responsible for operating decisions and the top management will handle strategic decisions.

- Measuring divisional performance is easier under M-form.
- Why M-form structure?
  - The M-Form makes sense when companies have a diversified portfolio of products (economies of scope) or a diversity of geographic markets.
  - As a result, more operational and strategic decision making is delegated from headquarters to the managers of the divisions.
  - Consider it as several U-Shape organizations operating under a single umbrella.
- Example (slide 44): Unilever (dutch-company) —> they act as a bank —> they invest on the most significant projects
  - Unilever has 5 vastly different product types
  - Decision making is relegated to the division heads
  - Central management works to enable economies of scale whenever possible
- Example: Apple - video on YouTube

- **Matrix Structure**
  - Organized along two (or more) dimensions - for example, product line and geography.
  - In a two-dimensional matrix, an employee belongs to two hierarchies and has two bosses
  - Allows a firm to economize on scarce human resources
  - Why matrix structre?
    - The matrix structure can increase the flow of information across the company because employees are giving feedback to multiple division heads.
    - However, when a single employee has multiple bosses, coordination can become a problem.
    - Matrix form is most suitable when a single task performed by an employee can benefit two divisions. —> Task interdependence! (Will be defined in a few slides…).



- Eg: Ford
- Employees report to both functional managers & project managers.
- Functional departments include engineering, marketing, and finance.
- Projects include the specific vehicle products.
- Ford uses cross-functional collaboration when developing a vehicle.

- **Network Structure**
  - Workers or worker groups contribute to multiple organizational tasks.
  - Work groups are reconfigured into new teams when the tasks change.
  - Coordination costs will be a major concern.
  - Example: consulting companies —> they work on different projects with people that have skills for that project for a specific period of time (it is not necessary any consistency)

REVIEW SESSION - (ses. 26)

- consumer and producer surplus on a per unnit basis to calculate in the exam if asked (he said he should specify it)

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