

FINA 7A97

**Corporate Strategy—Equity Fund
Management**

C.T. Bauer College of Business

University of Houston

Fall 2017

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Office Hours: Wednesday 4:30-5:30

I. Course Objective

This course focuses on the following precise question: How does the competitive environment of firms affect their ability to sustain **value-creation**; that is, earn superior economic returns or rents? This issue is fundamental for **stock valuation** since stock prices reflect discounted expected cash flows: superior stock performance must then depend on the firm's ability to sustain superior economic performance. While the focus of the course will be on non-financial firms, the fundamental analytic framework will also apply to financial firms.

The basic framework involves three key concepts: **competitive advantage**, **industry structure**, and **firm strategy**. A sustainable **competitive advantage** is necessary for a firm to earn long run abnormal/superior equity returns. To be of economic value, competitive advantage must be sustainable; i.e., not easily imitated or superseded by rivals or new entrants. Industry structure refers to those fundamental aspects of the firm's competitive environment that facilitate or constrain its ability to create a sustainable competitive advantage. Strategy is the firm's long-term pro-active policy that recognizes the industry structure and then develops sustainable competitive advantage through the firm's product positioning, cost efficiency, organizational structure and culture, and so forth.

II. Course Materials

The course material will consist of (1) lecture notes and other reading material relating to the analytical frameworks used in the course and case studies of "real-life" decision-making situations that invite students to bring together their knowledge and apply it to situations that challenge top-management. The case studies (and Excel Spreadsheets) will be downloaded from Harvard Business School Publishing website with the link (use control + click or please copy on your browser):

<http://cb.hbsp.harvard.edu/cbmp/access/70694652>

The lecture notes will be posted on Blackboard.

III. Class Content and Attendance

Class time will be divided between lectures on the analytic material and discussion of cases that highlight the practical management issues raised by the theoretical frameworks. The cases are carefully chosen to do much more than simply illustrating the concepts covered in the lectures. The cases will often point to ambiguities in the concepts or invite attention to subtle issues that do not usually come through in the study of the text-book. The assignment of cases and the focus questions to help in the preparation or analysis of these cases are clearly spelt out in the syllabus below, and the case discussions are a very important part of the course. **Class attendance is very important and strongly encouraged. Ten percent of the grade is based on class participation (see the description of the class participation grade below).**

IV. Reading Assignments

Reading assignments are shown in the accompanying course outline. For each session, you should complete the reading assignment prior to the class. I will presume that a rigorous attempt has been made to answer the case assignment questions, and generally start by “cold-calling” on students to start the discussion by providing their answers to the assigned questions.

V. Course Requirements

Students will be required to present both written work and oral analysis of the cases. The written work will involve **three** case reports. Two of these are group reports (preferably based on your CIF teams), and one is an individual report. The

case report assignments and their due dates are clearly spelt out below. I also describe in detail the form and content for these reports, and the grading criteria.

Oral analysis will be presented in case discussions. I expect students to have read the cases and prepared the assignment questions prior to the class session. Inadequate preparation not only means losing grading points but also lowers the entire class standard.

VI. Grading

The grading weights of the course-work are as under:

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|------------------------|------------|--------------|
| 1. Case Report 1 | 30 percent | (Group) |
| 2. Case Report 2 | 35 percent | (Individual) |
| 3. Case Report 3 | 25 percent | (Group) |
| 4. Class Participation | 10 percent | (Individual) |

Class participation reflects the standard of contribution to class discussions, especially in the cases. In terms of grading criteria for case discussions, I will look for whether the student (1) has thoroughly prepared the case, (2) is a good listener, i.e., can link his or her arguments to the comments of others, and (3) is willing to be “creative” in offering new ideas. For someone with perfect attendance record, the lowest participation grade shall be---in general---no lower than a B+. **However, one unexcused class absence will automatically force the class participation grade to be a B, two unexcused absences will force the grade to be a C. (More than two unexcused class abstentions will result in a participation grade of F).**

Written Work Schedule

Due Date

Case 1 **November 7**

Case 2 **November 28**

Case 3 **5 p.m., Dec. 11**

Case Reports

Case Report #1

Due November 7

Select any two companies: one whose stock you would recommend to purchase and one whose stock you would currently pass on. **For each company:**

- Do a “five-force” type industry structure analysis;
- Precisely specify the company’s competitive advantage and the strategy the company has adopted to develop and sustain the advantage;
- Briefly summarize the principal competitive threats;
- Give an assessment of the strategy in place to deal with these threats. If a satisfactory strategy is not in place, in your opinion, articulate a strategy you would develop if you are the CEO of the company.

For *each company*, the executive summary should be a single paragraph of *no more than 250* words. The actual analysis should be no more than 8 double-spaced pages (4 pages maximum per firm). Please attempt to use only a minimal number of attachments.

Case Report #2

Due November 28

The second report is to be based on the case:

Bed Bath & Beyond (BBBY)

Assignment

The assignment is to evaluate whether share valuation of BBBY as of 8/8/94 (see exhibit 3) is reasonable, or undervalued, or somewhat overvalued, from the viewpoint of:

- Its current strategy and recent performance
- Potential problems with sustaining this strategy and competitive

advantage To do this, you may consider the following “backwards recursion” approach:

1. Use a quick (and dirty) valuation methodology, such as the growth perpetuity formula, and information given in the case to “back out” investors’ expectations on earnings and book equity value growth.
2. Then evaluate how reasonable are these expectations? To do so, consider the following:
 - a. Assess BBBY’s current performance, especially in relation to its competitors. What are its competitive advantages that drive its superior ROE to date?
 - b. Are the business, operating, and expansion strategies consistent with each other? How sustainable are BBBY’s ROE and growth rate?

3. Next, analyze the effectiveness of BBY's plans to finance its expansion? What potential problems are likely to be encountered as BBY implements its expansion plans? How does the current (August 1994) equity valuation relate to the financing of BBY's expansion plans?

The paper should have an executive summary of no more than 250 words and should not exceed 6 pages in length double-spaced. You can give appendices, but please do so judiciously.

Case Report #3

Due 5 p.m. December 11

The third report is to be based on the case:

“Bitter Competition: The Holland Sweetner Company vs. NutraSweet”

Assignment

NutraSweet's position is protected by patents up to 1987 in Europe, Canada and Japan and till 1992 in the U.S. Given the pending expiration of patents, Holland Sweetner Company (HSC) is positioning to enter these markets. The current timeframe is 1986.

The assignment is to analyze the basic industry structure and NutraSweet to guide Mr. Vermijs in evaluating NutraSweet's response. In particular, you should focus on the relative likelihood of the two scenarios that Vermijs has in mind: price war and normal competition. Given this analysis, you then need to forward the best entry positioning and post-entry operational policies for HSC. To analyze NutraSweet, you will need to look at:

- Its past policies;
- Entry barriers it has created;

- Its current and prospective financial position---this is crucial in gauging NutraSweet's ability to financially survive a price war.

Note that the issue of NutraSweet's response is absolutely crucial to HSC even though HSC has sunk the construction costs of the 500-tonne plant. All of HSC's future decisions: expand/contract/enter U.S. market/exit will depend on NutraSweet's response. In turn, **NutraSweet's response will be conditioned by the investment and commitment that HSC demonstrates prior to entry.**

Entry and Post-entry issues:

- Pricing?
- Product differentiation (branding) or a dependable follower?
- Scale?
- Do you foresee an expansion?

The report should have two components. The first is an *executive summary of no more than 250 words*. In this section, you will summarize your specific recommendations (based on the assignment in the report). You need not backup your recommendations at this point. In the second part of the paper you should provide a full analysis of the case situation, and justify your recommendations. This part should not *exceed 6 doublespaced pages*. Only a minimal number of attachments should be used.

Detailed Syllabus

Tuesday

October 17

Setting Basic Themes

Reading Assignment

1. Lecture Note on Value Creation
 2. Note on the Structural Analysis of Industries (HBS)
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**Tuesday
October 24**

Industry Analysis

Reading Assignment

1. Lecture Note on Industry Analysis
2. Lecture Note on Price Competition

Case to Prepare

Crown Cork & Seal in 1989

Questions to Prepare

1. If we were to analyze the industry structure of CCS, what is the appropriate industry to consider?
2. How attractive has the metal container industry been over the years?

3. How well did CCS do under John Connelly? What was the key to their success?
4. What significant changes are taking place in the industry? How should the new CEO, John Avery, respond? Should CCS change Connelly's strategy?

**Tuesday
October 31**

Price Competition (continued)

Cases to Prepare

- A. Cola Wars Continue: Coke and Pepsi in 2010
- B. GE versus Westinghouse in Large Turbine Generators

Questions to Prepare (Coke vs Pepsi)

1. Why, historically, has the soft-drinks industry been so profitable?
2. Compare the economics of the concentrate business to the bottling business. Why is the profitability so different?
3. How has the competition between Coke and Pepsi affected the industry's profits?
4. Can Coke and Pepsi maintain their profitability in the wake of flattening demand and the growing popularity of non-carbonated drinks

Questions to Prepare (GE vs Westinghouse)

1. What are the structural attributes of the nuclear turbines industry?
2. Why is the price competition so intense between GE and Westinghouse?

3. Why cannot GE and Westinghouse choose long run strategies to assuage price competition and “divide” the market? What are the impediments to appropriate capacity planning and product differentiation strategies to deal with the competitive situation?
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**Tuesday
November 7**

Competitive Advantage I: Cost Advantage

Case Report #1 Due

Reading Assignment

1. Creating Competitive Advantage (HBS)
 2. Lecture Notes on Creating & Sustaining Competitive Advantage
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**Tuesday
November 14**

Reading Assignment

1. Competitive Advantage I: Cost Advantage
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Case to Prepare

Airborne Express

Questions to Prepare

1. How and why has the express mail industry evolved in recent years? How have these changes affected the smaller competitors?
2. How has Airborne survived and recently prospered in this industry?

3. Identify and quantify Airborne's competitive advantage?
 4. What should Airborne do to strengthen its position?
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**Tuesday
November 21**

**Competitive Advantage II: Product Differentiation & Niche
Positioning**

Reading Assignment

1. Lecture Note on Product Differentiation Advantage & Niche Positioning

Case to Prepare

Husky Injection Molding

Questions to Prepare

1. Why has Husky's strategy? Why has the company been so successful before the recent problems?
 2. Are Husky's injection moldings worth the premium price?
 3. What has caused Husky's current difficulties? How should the company respond?
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**Tuesday
November 28**

Case Report #2 Due

Reading Assignment

1. Lecture Note on Strategy
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Case to Prepare

Trader Joe's

Questions to Prepare (Trader Joe's)

1. How do firms make profits in the supermarket industry?
 2. Using financial ratio analysis in Exhibit 2, what can we infer about the strategies of the different companies? What does the analysis say about value creation in this industry?
 3. What are the key sources of Trader Joe's competitive advantages? What are the main threats? Is their competitive advantage sustainable?
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Tuesday December 5

Reading Assignment

1. Lecture Notes on Game Theory
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Case to Prepare

The Holland Sweetner Company vs. NutraSweet

1. How would you “model” the HSC entry and strategy decision as a dynamic game?

2. What factors should HSC consider in formulating its entry strategy?
 3. What factors will determine Nutrasweet's response to HSC's entry?
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