GEMBA IX – Theme 8A
Strategy Formulation

26 September 2013 – 30 September 2013, Shanghai Jiao Tong University, Shanghai
Professors Arvind Bhambri (Strategy) and Julia Plotts (Finance)

All assigned readings and cases for all the week's sessions need to be read and studied before the first session at SJTU. Focus on reading and being prepared to discuss.

In different ways, you have been discussing strategy and strategic decisions in all themes of GEMBA. In themes 8A and 8B, we will integrate prior concepts and introduce some new concepts of strategic decision-making. In particular, we will discuss the advantages and limitations of the various strategy frameworks and practice their application to major strategic decisions and cross-border transactions (merger, acquisition, divestiture) to evaluate whether the transaction creates shareholder value.

Thursday, September 26, 2013

8:30-9:45 Strategic Thinking Professor Bhambri

Required review:

Review your notes from Theme 4 strategy with Professor Blumenthal focusing specially on the Wal-Mart and Apple cases. These are two of the most popular cases in business education today and we will use the cases to re-visit and refresh core strategy concepts.

Questions:

1. What is the core of effective strategic thinking?
2. From the various frameworks and cases that you have studied, which frameworks do you think have the most potential impact? Why?
3. Which frameworks do you think would be easy to apply? Why?
4. Which frameworks would be very difficult to apply? Why?

9:45-10:00 Break

10:00 – 11:15 Competitive Dynamics I Professor Bhambri

We will start theme 8 with a discussion of competitive dynamics, namely, how companies anticipate and counter expected competitive actions. Strategy is not developed or executed in a vacuum. The results of any strategy depend to a significant extent on how competitors retaliate. By the same token, companies attempt to signal, pre-empt, and otherwise influence the responses of its competitors. We will look at one of the most intensely competitive industries, the airline industry, and we will see what we can learn about competitive dynamics from the experience of a “start-up” in this industry. We will continue our study of competitive dynamics through tomorrow.

Topics:

Competitive Dynamics
First Mover and Second Mover Advantages
Competitive Moves and Signals
Competitor Analysis and Profiling
Anticipating Competitor Actions

Case Dogfight over Europe: Ryanair (A) #9 700 015

This case, set in 1986, is a business school classic. It describes Ryanair's initial launch strategy. Ryanair must compete with established companies like Aer Lingus and British Airways that will likely retaliate against Ryanair. This case gives us a chance to explore Ryanair's strategy, positioning, and sustainability through a series of cases that we will discuss over two days.

Discussion Questions

1. What is your assessment of Ryanair's launch strategy?
2. How do you expect Aer Lingus and British Airways to respond? Why?
3. How costly would it be for Aer Lingus and British Airways to retaliate against Ryanair's launch rather than to accommodate it?
4. Can the Ryan brothers make money at the fare they propose?

Readings:

Dogfight Over Europe: Ryanair (A) (9-700-015)
MacMillan & McGrath, Global Gamesmanship (HBR 3260)

11:15 – 11:30 Break

11:30 – 12:45 Competitive Dynamics and Interaction (continued)

12:45-1:45 Lunch

1:45-2:00 Theme 8 FInance Introduction

Required review:

Review your Ross Westerfield Jaffe text (Corporate Finance) textbook from Themes 2-3 finance with Professors Campbell and Callahan. Theme 8 assumes a basic foundation or understanding of the following concepts:

Accounting:

- Review the financial statements and how they inter-relate, financial ratios, calculation of free cash flow (understand working capital, depreciation, capital expenditures).

Finance:

- Time Value of Money: present value, future value, annuities, perpetuities
- Capital Budgeting: Net Present Value (NPV), Internal Rate of Return (IRR) payback

- Other: stock and bond valuation, risk and reward, CAPM model, Weighted Average Cost of Capital (WACC)

This session will provide an overview of the finance content covered in Theme 8. We will discuss the importance of fundamental analysis in evaluating firms and their ability to create value for shareholders. In Themes 2-3 Finance we have discussed the firm's objective to maximize returns for shareholders by increasing the intrinsic value of the business. Maximizing shareholder value involves managing firm performance in the short term and also long-term health.

The financial strategy sessions will involve applying tools of financial analysis and valuation methodologies to evaluate a company's strategic and competitive positioning, financial performance, and strategic alternatives. Discounted Cash Flow (DCF) analysis is a key building block for valuation. During our financial strategy sessions we will review time value of money fundamentals from financial management and will discuss enterprise (firm) valuation. An important aspect of the sessions will be to bridge financial theory and practice with valuation, capital structure analysis, and corporate strategy in the context of real world implications.

Learning Objectives:

- Utilizing and interpreting financial data and applying valuation techniques to make decisions about courses of action for a firm. Valuing companies using various valuation models and assessing a firm's business and competitive strategy and whether it is creating value for shareholders.
- Discuss valuation in practice, corporate control and governance.
- Discuss strategies for value creation including mergers and acquisitions.
- Discuss valuation considerations for private companies.

2:00-3:00 Foundations of Value Professor Plotts

Required Reading:

1. KGW Chapters 1-5 The Foundations of Value
2. Interco HBS Case # 291033 (Theme 2 Finance material)

In this session we will revisit the Interco case discussed in Theme 2 with Professor Tim Campbell. We will assess a third party valuation and will discuss value creation and valuation frameworks. We will also discuss the role of activist investors and proxy fights and will revisit the topic of agency problems. Interco is a company that owned several highly visible branded products, including Converse shoes, London Fog and Ethan Allen furniture. The management of Interco received an unsolicited offer to buy the company from an investor group led by the Rales brothers. The offer involved a substantial premium over the market value of the company, but the management chose to resist the hostile acquisition. As a part of their effort they hired the prestigious investment-banking firm Wasserstein Perella to perform a valuation of the company. The valuation and the methodology are described in the case study.

Learning Objectives:

- How do we determine intrinsic value for an asset or a firm?
- Discuss market deviations from intrinsic value
- Review a third-party valuation and sniff out the M.S.U. (Interco case)
- Discuss "Sum of the Parts" valuation approach.

- Review a third party valuation and introduce the concept of "agency problems."
- Understand the role of third party valuation service providers.
- Introduce private equity and discuss leveraged and management buyouts.

Discussion Questions:

1. What is your view of poison pills? Does this anti-takeover defense make strategic sense for the companies that adopt them? Are they beneficial to shareholders?
2. (Interco) Consider the summary of the takeover offer in exhibit 9. In your opinion was this a fair offer?
3. (Interco) Critique the valuation presented to Interco Board of Directors on August 8, 1988 by advisor Wasserstein, Perella & Co. (exhibits 9-13). In your opinion, were Wasserstein's assumptions reasonable? Hint: were they engaging in M.S.U.?
4. (Interco) Evaluate the management policies of Interco and assess whether you think the company would be more valuable under current management or under management by the Rales brothers.

3:00 – 3:15 Break

3:15 – 4:30 Foundations of Value **Professor Plotts**

4:30 – 4:45 Break

4:45 – 6:30 Performance Measurement **Professor Plotts**

Required Reading:

1. KGW Chapter 7-8
2. Review Themes 2-3 Ross Westerfield Jaffe Chapters 2-3 (Financial Statements and Cash Flow and Financial Statement Analysis)

A critical component of valuation is the analysis of a company's historical performance and benchmarking performance relative to peers. We will discuss key drivers of value creation including return on invested capital (ROIC), revenue growth and financial health.

We will analyze financial performance and how this will impact valuation and a firm's strategic alternatives (including mergers and acquisitions). In this session we will review financial statement analysis techniques and will discuss how to apply the analysis for firm valuation and forecasting performance.

Discussion questions:

1. Consider the methods for measuring financial performance and assess your Theme 8 project company on value creation and financial health. Calculate and analyze metrics such as return on assets, return on equity and return on invested capital. Consider the company's capital structure, liquidity, leverage, efficiency, solvency, and other performance metrics.
2. Review the Home Depot and Lowes examples in Chapter 7 for calculating invested capital, NOPLAT, Free Cash Flow, and Return on Invested Capital. Optional Practice Problems: Review Questions #1-3 on page 163.

Friday, September 27, 2013

8:30-9:45 Building Capabilities I Bhambri

The question, "Is this a sustainable advantage?" has come up time and again during the program. But how do companies build advantage? What is the process? Is there a pattern? These are the questions that we will explore as we discuss how Ryan Air went from the verge of bankruptcy to a profitable, growing, sustainable enterprise.

Key Topics:

Incumbency Advantages and Disadvantages
Strategy Innovation and capability building
Evolution of industry structure
Competitor dynamics

Case: RyanAir (C) (will be distributed in class)

Discussion Questions:

1. How did Ryan Air go from the verge of bankruptcy to become a profitable enterprise?
2. What are the biggest threats facing the company?
3. What recommendations would you make at the end of the case?

9:45-10.00 Break

10:00 – 11:15 Competitive Dynamics (III) Professor Bhambri

Now that you know the airline industry well, we will use your knowledge to probe the nature of competitive dynamics more deeply.

Case: The Battle for Logan Airport: American Airlines (AA) versus Jetblue (JB)
Reading: Competitor Analysis: Anticipating Competitive Actions #9 701 120

Discussion Questions:

1. What should Joe Smith do? Should American Airlines (AA) respond to Jetblue's (JB) entry into Logan airport? Why or why not?
2. If AA responds, what considerations should be taken into account? Specifically, what should its response look like?
3. In anticipating AA's potential reaction, how should JB prepare?
4. In light of the AA-JB rivalry, what should the other airlines do? (Students with last names that begin with A through D, should take Delta/Song's viewpoint; E-H should take United; I-L should take US Airways; M-P take Southwest; Q-U take AirTran; and V-Z take Virgin Atlantic.

11:15 – 11:30 Break

11:30 – 12:45 Competitive Dynamics (continued) Professor Bhambri

12:45-1:45 Lunch

1:45-3:00 Value-Based Management/Performance Measurement Professor Plotts

Required Reading:

1. Online article “Creating value: An interactive tutorial” November 2010[i]

http://www.mckinsey.com/insights/corporate_finance/creating_value_an_interactive_tutorial

In this video presentation, McKinsey partner Tim Koller explores the four guiding principles of corporate finance that all executives can use to focus on value creation during strategic decisions.

Discussion Questions:

1. In the Koller video about the core-of-value principle, he mentions that a typical large company in the U.S. and Europe is valued at 15-16x Price/Earnings, what characteristics justify either a higher or lower valuation?
2. Look up two comparable publicly traded companies on the Internet to gain familiarity with their valuation multiples such as P/E. If you don’t have an industry or company that interests you, please analyze Target and Wal-Mart’s financial metrics and compare to the data discussed by Koller. You might also wish to analyze Home Depot and Lowes from Chapter 7.

3:00 – 3:15 Break

3:15-4:30 Value-Based Management/Performance Measurement Professor Plotts

4:30-4:45 Break

4:45- G9 & G10 Joint Session – Guest Speaker
TBD

[i]Students may be asked to complete a brief, free registration to access the McKinsey & Company Insights and Publications.

Saturday, September 28, 2012

7:00-8:00 Breakfast

8:30-9:45 Frameworks for Valuation **Professor Plotts**

Required Reading:
1. KGW Chapter 6
2. KGW Chapter 9-14 (skim)

Discussion questions:

- Review the frameworks for DCF-Based Valuation and the Enterprise DCF valuation for Home Depot in Chapter 6.
- Which key assumptions have the most impact on firm valuation: free cash flow forecast, continuing value (terminal value), discount rate (WACC)? What, if anything, might be done to mitigate the risk or uncertainty in enterprise valuation?

9:45-10.00 Break

10:00 – 11:15 Application of Valuation Frameworks **Professor Plotts**

Required Reading:
1. HBS Case Study Spyder Active Sports – 2004 (9-206-027)
2. Valuing High Growth Companies: KGW Chapter 34 (skim)

Please note that excel spreadsheets with financial data from the Spyder exhibits will be provided via e-mail.

The Spyder case allows us to assess an expansion/high-growth phase company's strategic alternatives and an owner's consideration of timing of "exit" options. We will discuss valuation issues of a privately owned company and aspects of entrepreneurial finance.

David Jacobs founded a high-end ski apparel company in 1978. He successfully built and grew the company, establishing a major international brand that appealed to ski racers and other active skiers. In 1995, he sought external financing to support further growth of the company and structured a financial deal with CHB Capital Partners, a private equity firm in Denver. By 2004, Jacobs was ready to consider alternative types of equity transactions that would provide a source of liquidity to him and his family, including sale of Spyder to another apparel company and sale of a large block of stock to a private equity firm.

Discussion questions:
- Identify the different "exit" options that are feasible for Spyder in 2004, and analyze the benefits and costs of each alternative. Is this a good time to sell the business? Consider the interests and needs of the owner(s), the current state and future prospects of the company, and the current state of the financial markets.
- Together we will perform a DCF valuation analysis of Spyder utilizing its forecast in exhibit 5 of the case. We will also discuss alternatives for the appropriate discount rate and terminal (continuing) value. At what point will Spyder reach the end of its high-growth period?

- Spyder is not publicly traded; but we can still apply the market approach (price multiples) to estimate the company's implied value. Evaluate the financial data provided for Spyder and also the comparable publicly-traded company price multiples (Exhibit 11) and comparable past merger and acquisition price multiples (Exhibit 9) to determine an estimated value for the company in 2004. Note that the implied value of Spyder via the market approach will be impacted by the type of buyer (strategic or financial) and type of sale (majority/controlling stake vs. minority interest/non-controlling stake).
- Compare the alternative transactions described on the last page of the case. Which one would you choose if you were David Jacobs? Which one would you choose if you were a general partner in CHB Capital Partners? Who else is affected by this choice and how?

11:15 – 11:30 Break

11:30 – 12:45 Application of Valuation Frameworks continued Professor Plotts

12:45-1:45 Lunch

1:45-3:00 Project Workshop Bhambri/Plotts

Required Readings: Theme 8 Project Assignment

Review the sample GEMBA project presentation materials. In your opinion, what does the report do well? In your opinion, what are the report's weaknesses?

Discussion Questions:

- All M&A transactions begin with the spark of an idea. Translating that idea into a concrete proposal takes hard work. Doing so teaches a lot about the drivers of M&A success, and the elements of deal design. Designing a transaction requires skills of analysis and negotiation. During the Theme 8 project your team will survey a number of analytical tools and will complete strategic frameworks in your analysis of a current or proposed cross-border M&A transaction. The work in this project will teach you a great deal about the design process, and the important leadership skills called for. We will survey some strategic frameworks useful in M&A, and the steps necessary to translate a concept into a solid proposal. Form an initial opinion about your Theme 8 project deal. The key aim is to develop your ability to think critically and to form a "view" of events and circumstances.

3:00 – 3:15 Break

3:15-4:30 Project Workshop Bhambri/Plotts

4:30 – 5:30 Social Pub Session

Sunday, September 29, 2013

7:00-8:00 Breakfast

8:30-9:45 Competing with Business Models & Platforms Professor Bhambri

Required Reading:

1. ASUSTeK and the Google Nexus 7 Tablet HBSP 9 613 056
2. How Companies Become Platform Leaders, A. Gawer and M. Cusumano, SMR 268

This case illustrates platform competition in the tablet computer industry and highlights the challenges of modularity and specialization in complex technology settings.

Discussion Questions:

1. If ASUSTek and Google want to design a tablet to compete with the Apple iPad, what challenges do they face?

2. Jerry talks about design, what is he trying to do?

3. How successful do you think Google will be in its vertical specialization model in competing with Apple? If you were Google, what would you do next?

4. How does a company like ASUSTek differentiate itself? What advice would you give Jerry?

9:45-10:00 Break

10.00 – 11.15 Competing with Business Models and Platforms (continued)

11:15 – 11:30 Break

11:30 – 12:45 Joint Finance/Strategy Session Bhambri/Plotts

Required Reading:

1. Investindustrial Exits Ducati #113058

In early 2012, Investindustrial, a European private equity group, publicly announced their intention to sell their 76.7% stake in Ducati Motor Holding S.p.A., an iconic Italian producer of sport performance motorcycles. The decision followed a six-year turnaround during which Ducati returned to profitability and significantly expanded its product line. Investindustrial's team had the following exit alternatives: 1) a trade sale to an automotive buyer; 2) a secondary buyout, partial or complete, by a financial investor; 3) a relisting in Hong Kong. Each option had its pros and cons, but all required a careful valuation of Ducati to maximize the investors' return on their flagship investment.

Discussion Questions:

1. What option should Investindustrial choose to exit Ducati? (i) A public listing in Hong Kong? (ii) A trade sale to a car or motorcycle manufacturer? (iii) A sale to another financial investor?
2. What is your assessment of Ducati's performance during the 2006-2011 period?

3. What is the value of Ducati? Based on your answer to question (1), how much would you expect Investindustrial to sell Ducati for?
4. How would you incorporate Ducati's brand into the firm's valuation?

12:45-1:45 Lunch

1:45-3:00 Joint Finance/Strategy Session Bhambri/Plotts

3:00 – 3:15 Break

3:15-4:30 Joint Finance/Strategy Session Bhambri/Plotts

Monday, October 1, 2012

7:30-8:30 Breakfast

8:30-9:00 Theme 8A Finance Quiz

9:00-9:45 Creating Value Through Mergers & Acquisitions Professor Plotts

Required Reading:

1. KGW Chapter 21

Many corporate acquisitions fail to increase shareholder value. We know that the two main reasons for failed acquisitions are that 1) buyers overpay and 2) merger companies sometimes suffer from culture clash, or poor post acquisition integration and they fail to achieve expected synergies. During this session we will discuss mergers and acquisitions as a financial strategy. We will also discuss how companies consider the potential for synergies (revenue enhancement and cost advantages) in their analysis of strategic takeovers. We will also discuss potential value creation from divestitures. We will identify M&A issues worth attention and develop an instinct for the problems and opportunities in an M&A situation.

Discussion Questions:

- What are the specific factors that differentiate deals that are successful?
- What are the deal characteristics that don't matter (have no impact on either value creation or destruction)?

9:45-10:00 Break

10:00 – 10:45 Role of Private Equity, M&A/Cross Border Deals Professor Plotts

Discussion Questions:

- What are the current trends in Asian cross-border M&A? What are the current hot sectors? With the increasing presence of Asia-based private equity funds, how significant will private equity's role be in intra-Asian M&A? How will the growing number of RMB denominated private equity funds affect M&A in China? Will private equity play a major role in South East Asia going forward?
- What challenges does M&A face in Asia? Have segments of the market become overvalued as a result of rising competition?

10:45 – 11:15 Q&A, Summary **Professor Plotts**

11:15 – 11:30 Break

11:30 – 12:45 Strategy Development & Execution **Professor Bhambri**

Required Readings:

1. Haier: Taking A Chinese Company Global in 2011 HBSP 712 408
2. Why the Lean StartUp Changes Everything Steven Blank HBR R1305C

Discussion Questions:

- What were the key decisions that led to Haier's success?
- Try to distill an underlying logic and pattern to the types of decisions and the sequence in which they were made.
- What do you see as the most significant challenges facing Haier at the end of the case?

12:45-1:45 Lunch

1:45-3:00 Strategy Development & Execution **Professor Bhambri**

Question:

As you reflect on what you have learned about strategy, how would you assess your own organization's strategy? What are the key issues that need to be addressed? What seems to stand in the way?

3:00 – 3:15 Break

3:15-4:30 Q&A, Summary & Evaluations **Professor Bhambri**