

**FINA 7397**

**Competitive Strategy and Firm Value**

**Course Syllabus**

**C.T. Bauer College of Business**

**University of Houston**

**Fall 2013**

**Professor Praveen Kumar**

**220\_H Melcher Hall**

**[pkumar@uh.edu](mailto:pkumar@uh.edu)/713-743-4770**

**Office Hours: Monday 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 two key concepts: *industry structure* and *firm strategy*. Industry structure refers to those fundamental aspects of the firm's competitive environment that facilitate or constrain its ability to earn superior economic returns on its investment. Strategy is the firm's long-term pro-active policy that recognizes the industry structure and then develops a sustainable *competitive advantage*; namely, the aspect of firm's product positioning and cost structure and organization that allows it to earn above-average returns. To be of economic value, competitive advantage must be *sustainable*; i.e., not easily imitated or superseded by rivals or new entrants. Competitive advantage analysis is central to excess stock returns (i.e., returns in excess of the risk-adjusted required rate of return).

But stock (or equity valuation) depends crucially in understanding the role of growth or real options in firm value. Indeed, superior valuation analysis skills reside in understanding the sustainability of cash flows from assets-in-place, identifying the growth options, and evaluating whether the firm has a strategic and financial plan to nurture and harvest these options. We will, therefore, also briefly (given the half-semester time-frame) examine the methodologies for valuing real options.

## 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 (please copy on your browser):

<https://cb.hbsp.harvard.edu/cbmp/access/22271945>

The lecture notes will be posted on Blackboard as the course progresses.

### 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. Fifteen 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 that should be worked on and handed in as a group effort, preferably based on your CIF teams. 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       | 25 percent |
| 2. Case Report 2       | 35 percent |
| 3. Case Report 3       | 25 percent |
| 4. Class Participation | 15 percent |

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

	<b>Due Date</b>
<b>Case 1</b>	<b>November 18</b>
<b>Case 2</b>	<b>December 2</b>
<b>Case 3</b>	<b>Dec. 14</b>

# Case Reports

## General Information

The main requirement in terms of the content of the reports is that the logical foundations of your analysis be clearly documented. More precise criteria employed in the grading of the report are given below.

### Grading Criteria for the Case Reports

The grade on the report will be based on the extent to which the report:

1. Grounds the narrative on analytical concepts;
2. Explicitly states the assumptions in the analysis;
3. Isolates the fundamental problems or issues for the situation, and remains focused on these;
4. States criteria for choosing among alternative action plans or valuation scenarios;
5. Integrates the action plans with the analysis;
6. Reads well as a coherent narrative.

Overall, the logical consistency, precision and analytic structure of the paper will be emphasized in the grading of the report. A useful writing model is the way good lead stories are written in newspapers: the first paragraph is written so that any one who only wishes to read the first paragraph comes away with the main points of the story, the second paragraph introduces the next subtle or detailed layer of information etc.

### Case Report #1

#### Due November 18

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.

The executive summary should be in two paragraphs of no more than 200 words each. You should attempt to summarize your perspective on the firm in one paragraph. The actual analysis should be no more than six double-spaced pages (4 pages maximum per firm). Attempt to use only a minimal number of attachments

## **Case Report #2 Due December 2**

**The second report is to be based on the case:  
E.I. Dupont de Nemours & Company: Titanium Dioxide  
(Course Website)**

### **Setting**

Dupont is considering expanding substantially its production capacity for titanium dioxide (TD). Since the expansion requires an investment of about \$500 million, the decision requires careful competitive and financial analysis. In particular, the size of the investment implies that the decision will only be value-creating if it generates economic profits over a long horizon, which requires Dupont building a sustainable competitive advantage in the TD market.

### **Assignment**

You are required to provide both a financial and a strategic analysis to develop a recommendation for the CFO and CEO of Dupont regarding the TD capacity expansion decision. To do this you will need **to at least** answer/do the following for each category:

- What are Dupont's competitive advantages in the TD market in 1972? What must it do to maintain and even enhance these advantages?
- Build a financial model to forecast **incremental** cash flows for the project for 1973-1985 under both strategies (maintain capacity vs. growth); you need to justify that your model truly identifies cash flows incremental to the project
- Make a judgment call on the appropriate terminal value in 1985. What rate of growth will you choose thereafter? Why?
- What are the risks associated with each strategy?
- How might competitors respond to each of the strategies? What other factors should Dupont consider?
- Which strategy should Dupont pursue?

The paper should have an executive summary of no more than 350 words and should not exceed 8 pages in length double-spaced. You can give as many appendices as you want.

## **Case Report #3**

### **Due 5 p.m. December 14**

**The third report is to be based on the case:  
Bitter Competition: The Holland Sweetner Company vs. NutraSweet”  
(Course Website)**

### **Setting**

NutraSweet’s position is protected by patents till 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 time-frame is 1986 and Mr. Vermijs of HSC has put together a crack team of internal analysts and outside consultants to study the market, consider NutraSweet’s likely response, and devise HSC’s optimal entry policy. *You* are that crack team. Your analysis will lay the foundation for HSC’s basic strategy and operational policies to maximize the chances for a successful entry.

### **Assignment**

The basic assignment is to analyze the basic industry structure and NutraSweet to guide 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 polices;
- 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 350 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 double-spaced pages*. Only a minimal number of attachments should be used.



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**Monday  
October 21**

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**Reading Assignment**

1. Lecture Notes on Value Creation
  2. Lecture Notes on Market Efficiency\*
  3. Lecture Notes DCF\*
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**Monday  
October 28**

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**Reading Assignment**

1. Note on the Structural Analysis of Industries (HBS)
2. Lecture Notes on Industry Analysis

**Cases to Prepare**

Cola Wars Continue: Coke and Pepsi in the Twenty-First Century

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**Questions to Prepare**

1. Why is the soft-drinks industry 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

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**Monday  
November 4**

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**Reading Assignment**

1. Lecture Notes on Creating & Sustaining Competitive Advantage

**Cases to Prepare**

GE versus Westinghouse in Large Turbine Generators

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**Questions to Prepare**

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?
  4. In particular, what are the impediments to appropriate capacity planning and product differentiation strategies to deal with the competitive situation?
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**Monday  
November 11**

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**Reading Assignment**

1. Creating Competitive Advantage (HBS)

**Cases to Prepare**

Samsung

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### **Questions to Prepare**

1. What were the sources of Samsung's cost advantage in DRAMs in 2003?
  2. What were the sources of Samsung's price premium in DRAMs in 2003?
  3. What recommendations will you make to Chairman Lee regarding the threat of large-scale Chinese entry?
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**Monday  
November 18**

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### **Case I Due**

#### **Reading Assignment**

1. Lecture Note on Strategies for Value Creation

#### **Cases to Prepare**

Methanex

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### **Questions to Prepare**

1. Commodity industries are often characterized as being "strategically unattractive." Does this apply to methanol?
2. Identify the major threats to the methanol industry now and the foreseeable future. Which of these apply to Methanex?
3. Describe and analyze Methanex's competitive strategy. Does it generate and sustain competitive advantage and create value? If so, how?
4. What are the risks with Methanex's strategy? List the most significant risks. Are there any mitigation strategies?
5. Methane has followed a relatively focused (non-diversified) strategy. Is this an advantage or a disadvantage?

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**Monday  
November 25**

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**Reading Assignment**

1. Strategy as a Portfolio of Real Options (HBR)
2. Lecture Note on Valuation of Growth Options

**Cases to Prepare**

**MW Petroleum (A)**

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**Questions to Prepare**

1. What do you think motivated the sale of MW properties? Are the properties likely to be worth more to Apache than to Amoco?
  2. Consider the cash flow projections. Who made the projections? Are they true expected cash flows? How does the nature of the cash flow forecasts affect the discount rate that you use?
  3. Do you think the 13% discount rate is excessive? How would you calculate the discount rate given the information in the case?
  4. Which MW assets should be regarded as options? Provide a strategy for valuing these options and make some rough estimates.
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**Monday  
December 2**

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**Case II Due**

**Reading Assignment**

1. Lecture Notes on Game Theory
2. Option Games (HBR)

**Cases to Prepare**

Bitter Competition: The Holland Sweetener Company vs. Nutra Sweet (A)

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### **Questions to Prepare**

1. How should Vermijs expect Nutrasweet to respond to Holland Sweetner Company's entry into the European and Canadian aspartame markets?
2. How should Vermijs assess the relative likelihood of the two scenarios he has in mind: price war and normal competition.