

On Corporate Strategy and Financial Strategy

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This article by Ashok Korwar makes an attempt to systematically develop the link between corporate strategy and financial strategy.

Drawing on concepts from both strategic management and financial theory, the paper develops propositions which may act as guidelines for top managers in formulating financial strategies, given the corporate strategies their companies are pursuing. A select number of corporate strategy types is considered, and the implications for capital structure, dividend policy, and capital budgeting policy of each corporate strategy type are discussed.

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What do terms like 'financial strategy' and 'strategic finance' really mean? In what way do they differ from the standard value-maximization policies corporate finance discusses in detail? What is the link to corporate strategy? These are issues of fundamental concern to top managers of companies as well as top finance managers who would like to have a broader perspective on their companies than a merely functional one.

At a very basic level, it is generally agreed that corporate financial decisions directly affect the market value of its shares and bonds, which means top managers should be concerned about them. Every textbook worth the name makes this point quite well.

At another level, Brealey and Myers (1991, Chapter 36) observe that strategic planning can be considered to be really just an extended form of capital budgeting. This is certainly a useful observation. This assertion could be taken to be suggesting an alternative way to do strategic planning: begin with capital budgeting and proceed to understand at a very deep level what drives the assumptions behind the numbers. However, this is not likely to be a very easy or fruitful way to undertake strategic planning.

In a similar vein, Barwise, Marsh, and Wensley (1989) note that the use of rigorous discounted cash flow (DCF) analysis forces top managers to ask the right questions of their marketing and operations people, which presumably would lead to the right strategic decision. This observation is also a useful one, but again it does little more than reaffirm the importance of thinking through in great detail the implications of any marketing or strategic decision. Any attempt to quantify business plans necessarily throws up weaknesses in the assumptions underlying them and can certainly help rethink these assumptions.

When it comes to specifics, one of the few worthwhile contributions is by Myers (1977, 1984). Myers was the first to point out that there is a link between the firm's growth strategies and its debt policy (we shall explain

the link in the relevant sections below). However, Myers does not develop in a systematic fashion the link between corporate strategy and financial strategy except for this one special case. In some sense, this paper is an attempt to build on such insights.

In general, the literature suffers from two gaps, which this paper attempts to fill:

- * On the one hand, the literature does not really have much to say on firm-specific issues such as: how does dividend policy depend on the firm's corporate strategy? Or, what kind of capital budgeting systems makes sense for different kinds of firms?
- * On the other hand, the connection is rarely made between the literature on corporate strategy and the literature on finance.

In this paper, we shall adopt the procedure of developing propositions linking corporate strategy with financial strategy. These propositions would be such that top managers of corporations (corporate strategists) would find them directly useful. This approach would address both the gaps described above.

We have made no attempt to test any of the propositions developed herein—that is a larger work which may be undertaken subsequently. This paper confines itself to laying out the propositions which appear to make sense.

Financial Strategy and Corporate Strategy

Financial Strategy

By financial strategy decisions, we mean the broad corporate finance decisions which are made at the level of the corporation's management committee or above — at the level of the board. These are not specific decisions such as whether to undertake a project or not, or what rate of interest to borrow at. We shall be talking about policy decisions which are clearly finance-related and so qualify as a 'financial strategy.'

We shall focus in particular on three kinds of policies, all well-known in the finance literature: capital structure policy, dividend policy, and capital budgeting policy.

Capital structure policy would be concerned about the following kinds of issues:

- * By what proportion of debt and equity should the company finance its operations?
- * Beyond that, to what extent should the debt be long-term versus short-term? If equity finance is to be raised, should it be through rights issues or through a primary issue?

- * To what extent should internal funds be used to finance the company, versus external funds?

Dividend policy concerns itself with the following kinds of issues:

- * What proportion of earnings should be paid out as dividends to shareholders?
- * Should the level of dividends remain stable from year to year or should it be changed?

Capital budgeting policy would be the policy guidelines specifying in general terms the financial parameters by which operations, requests for funding, and projects in general, will be evaluated. While the specification and implementation of these techniques is not a top management concern, only top management (including the top finance manager) can specify what the decision process should be.

Corporate Strategy

By corporate strategy, we mean the entire set of coordinated functional and management policies, coupled with the central vision which drives the corporation, which together define how the corporation chooses to compete in its business (see, for instance, Jauch and Glueck, 1988, for various similar definitions).

Our first proposition follows directly from this definition. Since corporate strategy, by definition, includes the 'entire set', it also follows that it includes 'financial strategy' as one of its strands. Corporate strategy, then, is logically prior to financial strategy, as it is to marketing strategy, product strategy, or any other functional strategy. This is entirely in line with the literature on corporate strategy, such as Ansoff (1985).

Proposition 0

Corporate strategy defines financial strategy

This basic proposition assumes that corporate strategy is made in some rational fashion, that the overall needs of the corporation are first examined, and only then are the various strands of finance, marketing, product development, R&D, HRD, etc. brought in to weave the fabric of corporate strategy. Even if the corporate strategy making process is intuitive and perhaps irrational, it is likely to start from the big picture and only then worry about how to finance the big picture. Even the academic proponents of intuitive models of strategy formulation (for instance, Isaack, 1978) or the proponents of political models (such as Freeman, 1984) would agree that the big picture comes first irrespective of how that big picture is arrived at.

The issue then is what does a given corporate strategy imply for financial strategy? We shall examine

this question systematically, for a wide variety of major corporate strategy types.

Types of Corporate Strategy and their Implications for Financial Strategy

Different firms, often in the same industry, may be seen to be pursuing different kinds of corporate strategies. Generally speaking, a given firm would not employ more than one kind of strategy at a time, since the functional and operational implications of each strategy type are quite different.

Before we begin, a caveat may be in order. Any attempt to classify a corporation's strategy must necessarily be an oversimplification. Thus, while we must assert that a firm cannot and should not be pursuing two different kinds of strategies at the same time, it is undoubtedly true that many firms, in fact, do just that. In such cases, we shall assume that there is a dominant strategy and a subsidiary strategy. We shall be discussing the dominant strategy.

Although any classification of strategies is necessarily a simplification, it is, nevertheless, a useful simplification, for it helps us identify the one or two critical success factors the firm must master.

Again, the propositions derived below are meant to be taken in the spirit of *ceteris paribus*—other things being equal. When we affirm, for instance, that firms of a certain kind should constantly update their capital structures in search of the lowest cost of financing overall, we do not mean that other kinds of firms should not. The search for a minimum cost of capital is a worthwhile search for any company to undertake. We are merely affirming that firms pursuing a certain kind of strategy should pay special attention to such problems. Given that top management can focus only on a small number of critical parameters, updating their capital structure regularly may be a critical issue for certain kinds of firms, perhaps not so critical for others.

We begin with the typology of corporate strategies suggested by Porter (1980)—differentiation, cost leadership, and focus. Exhibit 1 provides a brief working definition.

The Porter 'generic strategies' scheme is not the only possible one, of course. Jauch and Glueck (1988), for instance, provide several competing schemes of classification. In this paper, it is not our intention to discuss the merits and demerits of such various classification schemes. Nor can we hope to discuss the implications of each and every strategy type mentioned in the literature. Instead, we shall concentrate on a small number of 'strategy types,' which are generally popular

in the management literature and which appear to have the potential to capture the essence of what we can observe corporations in the world actually doing.

The list in Exhibit 1, though exhaustive enough in a way, does not sufficiently capture the essence and spirit of several interesting corporate strategies. To incorporate these, we shall add to this list the following small number of 'strategy types':

1. Competing on speed
2. First-mover strategies

More recent concepts like 'core competence' (Prahalad and Hamel, 1990) and 'competing on capabilities' (Stalk *et al.*, 1992) are not discussed here, in the interest of brevity.

This expanded list should suit our purpose as defined above. Exhibit 2 presents a brief working definition of these additional strategy types.

Exhibit 3 lists the various strategy types we are going to consider, combining those in Exhibit 2 with those in Exhibit 1. We shall consider each of these in turn, and derive propositions on financial strategy for each.

Exhibit 1: Types of Corporate Strategy (following Porter, 1980)

- * Cost Leadership: Gaining competitive advantage over other firms by sustaining a lower overall cost of doing business. Prices charged to the customer may or may not be the lowest.
- * Differentiation: Gaining competitive advantage over other firms by offering a superior product and/or service, "often, but not always, built around superior brands and brand image.
- * Focus: Gaining competitive advantage over other firms by building special relationships, special understanding, special products, and special features of product, service and delivery, which enable the firm to 'own' some niche of the market.

Exhibit 2: Other Corporate Strategy Types

- * Speed: Gaining competitive advantage over other firms by being able to respond faster to changes in market trends, customer preference, technology changes, etc.
- * First-mover: Gaining competitive advantage over other firms by virtue of being the first to enter a given business or industry.

Exhibit 3: Comprehensive List of Corporate Strategy Types

- * Differentiation
- * Cost Leadership
- * Focus
- * Speed
- * First-mover

Corporate Strategy: Differentiation

Differentiation as a strategy hinges on creating 'something different' about the company and its products — distinguishing the company from its competitors by way of better products, better service, or simply a better image. Quality, service, reliability, ability to deliver to far-off places, reach, brand image, product innovation, all these are examples of competing through differentiation.

To sustain differentiation based on better products, the company must usually invest heavily in R&D. To sustain differentiation through image-building, heavy advertising must usually be resorted to.

Financial Strategy for Differentiation

Capital Structure

Companies pursuing a differentiation strategy would tend to have a very large part of their value in the form of intangibles, some part of which may be viewed as options on future business opportunities. For instance, the market value of a company like ITC or Hindustan Lever greatly exceeds not only the value of their assets but also the present value of all their existing businesses. This excess, whether ascribed to 'brand equity' or 'good name/' can also be described as the market's valuation of the company's future businesses, yet unknown and unknowable, which the company may get into at some point of time in the future. These future moves by the company may be viewed as options on future business opportunities—options because the company does not have to get into them, it merely has the option of doing so.

Such companies would be wise to borrow as little as they can. To summarize the arguments advanced by Myers (1977), if such companies were to acquire fixed liabilities such as debt repayments, their managers may end up making poor decisions in the future —poor from the point of view of the firm as a whole.

The easiest way to understand this is in a two-period model. During the first period, the company makes investments which are basically 'buying options'

on future businesses—it may buy an equity stake in another company, invest in R&D, test market a product, and so on. None of these actions commits the firm to anything—they are merely preparatory moves. At this stage, the project or business is not fully defined or understood—and computation of future cash flows is a meaningless exercise.

In the second period, the project becomes well-defined. Cash flows can be estimated. The firm now has the option of making a further larger investment and taking the project or letting it go. Now, at this stage, consider what would happen in a company which has a large amount of debt to be paid off at the end of the period. Unless there is a significant likelihood of the project earning enough to pay off the debt and still has something substantial left over for the shareholders, managers may not be interested in taking the project. This despite the fact that the project is a 'good' project in the sense that its Net Present Value (NPV) is positive. Managers behave this way because they act primarily in the interest of shareholders, not debt-holders. (This is quite a plausible supposition, at least in India.)

Since such future investment decisions are not optimal, the value of the firm would be lower if it had a high level of debt than if it did not. This is because, if the firm had no debt at all, for instance, its managers would presumably be free to evaluate future investment opportunities (which are yet unknown) strictly on their merits.

Thus, we conclude that firms with high 'R&D equity' or 'brand equity' should avoid debt. A differentiation strategy calls for largely equity financing.

Proposition 1

Differentiation as a corporate strategy calls for low debt levels relative to equity.

Dividend Policy

Since the firm is made up largely of intangibles, it is difficult for an outsider (investor in the share market) to gauge the value of the firm. How can someone not privy to the internal affairs of the firm really know all the future options the company has, let alone attach a value to them? Intangibles can be accurately valued only by managers inside the company. To communicate the value of such business prospects to the outside world, the company would be well advised to employ 'signalling' mechanisms of some kind. Communicating the message is important because the firm's share price should reflect all these intangibles accurately if shareholders are to be adequately rewarded.

Increases in dividends are known in the finance literature to have significant 'signalling' value (see, for

instance, Ross, 1977; Woolridge, 1983). Investors appear to regard increases in dividends as a sign of confidence on the part of insiders or managers. Firms which can successfully transmit such signals to the market would see their share prices rising.

Thus, we may conclude that a corporate strategy based on differentiation would call for a dividend payout rate which is both high and frequently increasing, the increases being timed to correspond to major new initiatives like new product launches or major advertising campaigns.

Proposition 2

Differentiation as a corporate strategy calls for high and frequently increasing dividend payout.

One implication of Propositions 1 and 2, read together, is that such a company must keep raising fresh equity capital, since it would be otherwise difficult to maintain high payout and low debt at the same time. Alternatively, the company must have a high level of international cash generation through operations¹.

Financial Parameters for Evaluation

The value of companies in this strategic segment is composed mainly of intangibles, primarily embodied in people. The scarce resource in such companies is more often good people than money. For instance, the major scarce resource to be invested in a major product design effort would be the time and talents of R&D engineers and product designers. The opportunity costs of committing such resources to a given project are quite high. Similarly, if a major advertising campaign is to be launched, the genius of talented marketing people may turn out to be the scarce resource to be rationed carefully. In such situations, therefore, human capital is the constraint, more than financial capital.

Capital budgeting techniques like NPV do not adequately reflect the required rate of return on human capital.

One way to adjust for this human capital effect is to raise the required rate of return by some arbitrary amount for projects requiring scarce and expensive human capital. However, the managerial implications of such adjustments are often unpleasant, for they give rise to the suspicion that top management is 'manipulating' the decision rule to favour some people and punish others. While top management may have no such intention, it is difficult to maintain the transparency which is so crucial to building trust and team spirit in the organization.

1. I am indebted to an anonymous referee for this observation.

A major effort is required to determine some appropriate measure of 'required rate on people. Such an exercise, though difficult, is not impossible. While this is not the place to go into it in depth, we would suggest that a historical analysis of the rate of return such scarce human resources have been able to earn in the past may provide some sort of measure which can be used to construct a required rate of return on human capital².

Proposition 3

Differentiation as a corporate strategy calls for modification of capital budgeting procedures to reflect a higher cost of human capital.

Further, there are more sophisticated ways to evaluate projects than simply NPV. If the investment project is an option, surely option pricing techniques ought to be used to evaluate them. This may sound highly fanciful, but there are a small number of companies which actually do use sophisticated simulation models and explicitly apply option pricing methodologies to assign values to R&D projects. CEOs should invest the effort and money required to develop such models which would be meaningful for their company.

Generally speaking, to use option pricing models for project evaluation, we would need to collect historical data on the volatility of returns to similar projects. For instance, a good proxy for the volatility of returns to biotechnology projects might be the returns for typical biotechnology stocks. The time over which the option can be exercised becomes another critical parameter. The capital investment to be made in the future if the project is to be continued becomes the exercise price of the option. In this manner, the value of the initial project, which is an option on the future project, can be determined by applying the Black Scholes Option Pricing Model (Black and Scholes, 1973). Nichols (1994) provides some excellent examples of how this might be done using the case of Merck.

Proposition 4

Differentiation as a corporate strategy calls for the use of option pricing models and simulation techniques to evaluate projects.

Corporate Strategy: Cost Leadership

The essence of cost leadership as a corporate strategy is to achieve and sustain a lower per unit cost of production and delivery than any of the firm's competitors.

2. The author has conducted one such exercise for a company he worked for, where human capital was a critical scarce resource. The results were reasonably satisfactory.

There are two major approaches to achieving cost leadership: economies of scale and minimization of overheads and administrative costs. We shall examine the implications of each of these routes separately for the financial strategy of the firm.

Financial Strategy for Cost Leadership

Economies of Scale

Economies of scale are usually achieved through heavy investment in large-scale plant and equipment capable of handling large-scale operations. In doing this, the firm will acquire significant 'tangible' assets like plant and machinery. This strategy is generally adopted in stable industries, else the investments involved would place the company at great risk.

Capital Structure

So long as the firm has tangible assets like plant and equipment, it should find it easy to borrow money. Access to debt markets and bank loans is much easier for such companies.

Because of the tax subsidy provided by the government to debt financing (interest payments are tax-deductible to the firm whereas dividend payments are not), there is a distinct cost advantage to debt financing (Modigliani and Miller, 1958).

Were it not for certain mitigating factors, the optimal capital structure might well be 100 per cent debt. Major factors which dissuade a firm from borrowing too heavily would be—bankruptcy costs, loss of value in the event of bankruptcy (because of loss of customers, loss of 'good name,' loss of credibility), loss of flexibility due to restrictive debt covenants, and so on. While all these factors are real enough for any company, we would argue that, other things being equal, firms which are pursuing cost leadership through economies of scale are less affected by these costs than other firms might be. Bankruptcy costs are small because of the tangible assets backing the debt, and loss of value due to loss of good name and so on would be more applicable to firms pursuing a differentiation strategy than firms seeking a cost leadership position. Thus, we can conclude that firms in this category should borrow more than the average firm does.

Proposition 5

Cost leadership as a corporate strategy, achieved through economies of scale, calls for high debt levels relative to equity.

Dividend Policy

Other things being equal, dividends have relatively little signalling role to play when the firm is seeking

competitive advantages purely through economies of scale. Since the industry is relatively stable, the financial markets may be presumed to have enough information to evaluate the firm's projects correctly, without any special effort on the firm's part beyond its usual corporate communications efforts. At the same time, since a high debt level (see Proposition 5 above) would necessarily involve a high fixed cash outflow, firms in this strategic segment may be well advised to minimize the cash outflow from dividends.

Proposition 6

Cost leadership as a corporate strategy, achieved through economies of scale, calls for a low dividend payout.

financial Parameters for Evaluation

Where the industry is stable, standard capital budgeting techniques like NPV and Internal Rate of Return (IRR) are likely to work well. The estimation of future cash flows and of the cost of capital is not fraught with the conceptual and practical difficulties we encounter in other strategy types such as differentiation.

Because heavy up-front investments are required to be made, the use of such DCF techniques is also extremely important. Firms in this segment should promulgate a strict policy requiring all project proposals to be evaluated using a detailed DCF analysis.

Proposition 7

Cost leadership as a corporate strategy, achieved through economies of scale, calls for consistent use of NPV and IRR techniques.

Overhead Cost Minimization

An alternative route to achieving cost leadership is to focus intensively on cost reduction in every possible activity and department of the corporation. Top management attention is focused on constantly searching for ways to reduce costs and increase productivity (see, for instance, Woo and Cooper, 1982).

Capital Structure

Cost of finance is usually a very significant cost of doing business. It would make sense for companies, who are constantly looking for ways to reduce their overheads, to pay close attention to their cost of capital.

The firm should explicitly identify the cost of its various sources of financing, and should continually adjust its capital structure to keep it at that optimal level which would minimize its overall weighted average cost of capital. Great attention must be paid to estimating the costs and benefits of debt and equity and the balance between the two must be reviewed frequently. This

balance changes from day to day, because it is driven by factors like the interest rates in the market, the mood and conditions in the share markets, tax laws (which affect the company's operating tax shields), and the rate of growth of the company itself.

Proposition 8

Cost leadership as a corporate strategy, achieved through overhead cost minimization, calls for constant adjustment of the firm's debt to equity ratio.

Having decided an optimal mix of debt and equity, the firm should keep searching for cheaper alternatives even among these. Equity can be raised via rights issues or via primary issues, debt can be sold in public offerings or it can be privately placed with institutions.

Smith (1977) points out that rights issues as a source of equity capital can be substantially cheaper than primary issues to the public at large. Similarly, private placements of debt are cheaper than public issues.

There are, of course, considerations such as publicity, image and so on, which would tempt the company to go in for public issues, but it should firmly opt for the low cost route in the face of all such temptations.

Proposition 9

Cost leadership as a corporate strategy, achieved through overhead cost minimization, calls for greater use of rights issues relative to primary public issues of equity, and greater use of private placements of debt relative to public issues.

Dividend Policy

Dividend policy probably has only a minor role to play here. However, to the extent that the firm's single focus is cost minimization, it should seriously consider whether it is worthwhile to incur the costs of paying out dividends with one hand while gathering in funds with the other. Internal earnings are the cheapest source of funds, since they require no special effort to raise, and the company should be reluctant to squander them in paying dividends. Other things being equal, considerations such as 'signalling' which we encountered in the case of firms pursuing a differentiation strategy, should not be important here.

Proposition 10

Cost leadership as a corporate strategy, achieved through overhead cost minimization, calls for a low dividend payout rate.

Financial Parameters for Evaluation

Since the target debt/equity ratio assumes prime importance in the quest for minimum cost of capital, the

firm must develop highly sophisticated and accurate models to calculate, several times a year, its cost of debt and cost of equity. Such models are not costly to develop, but the firm must inculcate the discipline of taking such calculations seriously and sensitize operating as well as financial managers to the importance of such numbers.

The firm must also be able to forecast accurately a number of related future cash flows, such as its depreciation tax shields, since the calculation of optimal capital structure requires tradeoffs between debt and non-debt tax shields in the coming years.

Proposition 11

Cost leadership as a corporate strategy, achieved through overhead cost minimization, calls for the use of sophisticated models for calculation of cost of capital and optimal capital structure.

Before we leave the subject of cost leadership as a corporate strategy, it may be worthwhile to note that cost of finance is probably not the most important or significant cost the company is managing. For instance, a concerted value engineering programme or initiatives which strive to eliminate waste (such as JIT, Kaizen, etc.) are probably much more critical to achieving cost leadership. What we have done here, as with all other strategy types, is to take an 'other things being equal' approach, and have focused only on financial strategy implications.

Corporate Strategy: Focus

A focus strategy necessarily calls for the building of special relationships with customers. Long-term contracts, special deals and discounts, and special 'try-out' clauses for new features, are the norm here.

Financial Strategy for Focus

As most companies in the power sector, for instance, have discovered to their dismay, all these 'special relationships' typically lead to very high receivables outstanding, since it is very difficult to pressure a customer to pay up quickly if the company is seeking repeat orders, long-term contracts, and so on. It is our experience that such firms end up with severe working capital shortages. Working capital management must become the focus of attention.

Capital Structure

Accounts receivable being current assets, the firm should match the duration of its liabilities accordingly. If the terms of its assets and liabilities get out of balance, it could find itself in severe difficulties if there is a liquidity crunch or if the term structure of interest rates changes drastically. The firm should rely extensively on short-

term rather than long-term financing. Short-term financing nearly always means short-term debt.

Proposition 12

Focus as a corporate strategy calls for the heavy use of short-term debt.

Dividend Policy

Implications for dividend policy are not particularly clear here.

Financial Parameters for Evaluation

Since accounts receivable will be large, the firm should explicitly build in incentives for its managers to manage them better. ABB, for instance, charges its profit centres interest on receivables outstanding, in a bid to encourage them to collect faster. Service companies, who are particularly prone to this problem, should explicitly build in collections efficiency into their systems for evaluating, motivating, and rewarding managers. At the same time, capital budgeting procedures should pay great attention to the working capital requirements of any project.

Proposition 13

Focus as a corporate strategy calls for explicit consideration of working capital requirements and costs.

Corporate Strategy: Speed

Stalk (1988) was the first to develop this concept. Going beyond Porter (1980) to consider a new dimension — time — he points out that speed of response can itself be a new and innovative way to compete. If a company can respond faster to changing customer demands, if it can be more flexible than its competitors in dealing with special needs of special customers, it will be able to beat its competitors. The oft-cited case of Benetton (see Jarillo and Martinez, 1988) is a good illustration of how such a strategy works. Benetton is in the fast-changing world of fashion garments, yet it is very much a mass-producer. It has been able to change its line of products several times during a season lasting as short as four months, by pursuing de-integration and flexibility in every sphere of its operations, from design to retail outlets.

To implement such strategies, companies must build in a great deal of flexibility into their operations. They must be able to change their scale and product mix at a moment's notice, get information quickly, and be able to act without the slightest delay. The watchword will be 'keeping options open.' Constraints on operations are to be eschewed wherever they may arise.

Financial Strategy for Speed

We propose that flexibility requires large reserves of cash and perhaps even of inventory. A company which has large cash reserves handy can move quickly to tie up resources, build new plants, buy new retail outlets, and so on. Similarly, Benetton works very hard to force its retail shops to keep as low an inventory as possible, so that trends in customers' tastes can be picked up as soon as possible. The company itself supplies all its shops directly from a central warehouse in Italy, where it ends up holding quite a large inventory itself.

Proposition 14

Speed as a corporate strategy calls for a large investment in cash and inventories.

Capital Structure

At the same time, constraints on operations such as liquidity requirements, strict limits on financial ratios etc., should be avoided, since they potentially limit the firm's ability to make large investments swiftly, or exit business areas quickly. Such firms would do best to avoid debt, since debt usually comes with precisely such restrictive covenants which proscribe freedom of action.

Again, rather like the firms which pursue a differentiation strategy, firms which face rapidly changing market conditions and rely on speedy response to survive, must also ensure that their future investment options are kept as open as possible. This would be another reason to avoid debt.

Proposition 15

Speed as a corporate strategy calls for low debt levels.

A related concern is that the firm must avoid being locked in to technology or equipment of any specific kind, especially if the technology is changing very rapidly. The very fact that the company has invested a large amount in equipment may act as an impediment to speedy changeover to a different kind of equipment. Such companies may find it worthwhile to lease rather than purchase equipment wherever the option is available.

Proposition 16

Speed as a corporate strategy calls for leasing rather than purchasing equipment.

Dividend Policy

A commitment to pay out a set percentage of earnings as dividends imposes its own constraints. Such constraints should be avoided at all costs.

At the same time, internal funds should be retained as much as possible, in order to build up the needed cash reserves.

Proposition 17

Speed as a corporate strategy calls for a low dividend payout.

Financial Parameters for Evaluation

One of the implications of operating in fast changing markets, where speed is of the essence, is that it makes little sense to plan investment projects over very long periods of time. Thus, companies in this strategic segment may well find it more useful to focus on measures such as payback period rather than the standard NPV and IRR to evaluate its projects.

Proposition 18

Speed as a corporate strategy calls for use of payback period rather than NPV and IRR in project evaluation.

Corporate Strategy: First-mover

Closely related to the concept of speed as a strategy is the concept of 'first-mover' strategies. The two are not identical, however. 'First-movers' concentrate on being the first to enter any new emerging business area. The idea here is to grow rapidly and create entry barriers for any potential entrants who may subsequently think of following in your wake. Creation of entry barriers may include seizing a large market share as swiftly as possible, tying up critical suppliers, creating a strong brand name, and so on.

Financial Strategy for First-mover

Capital Structure

In a competitive world, he who would move first must move silently.

If the firm were to finance its projects with a large equity issue, or a large convertible debenture issue to the public, it would be forced to reveal significant information about the project's prospects and its own implementation plans to the public. Since the public includes the firm's competitors, both current and potential, this kind of disclosure must be avoided at all costs. As SEBI increasingly turns its attention to protecting investors' interests, as the SEC in the US has done for a long time, such disclosure requirements will become more and more stringent in India.

The firm must therefore rely either on internal funds or on private placements of debt, where inside information can be doled out very discreetly.

Proposition 19

A corporate strategy of being the first-mover calls for avoidance of public issues of equity and convertible debentures and greater use of internal funds and private placements.

Dividend Policy

Reasoning along the same lines, if use of internal funds is to be maximized, the firm must conserve its cash rather than pay out dividends. There is little sense in 'signalling' since a major consideration is to avoid giving out information to its competitors.

Proposition 20

A corporate strategy of being the first-mover calls for a low dividend payout.

Financial Parameters for Evaluation

We have observed above that one of the aims of the first-mover is to build entry barriers to deter potential competitors from entering the industry. One effective way to build entry barriers is to tie up suppliers and dealers through financing schemes which bind them to the company. Good credit appraisal and rating systems become a must for the company to be able to do this effectively.

Proposition 21

A corporate strategy of being the first-mover calls for extensive use of financing schemes, backed by strong credit appraisal systems.

Summary and Conclusions

Table 1 summarizes the propositions derived in this paper.

In general, it is probably fair to say that the propositions relating to dividends are a little less strong than the other propositions. In two instances, the implications for dividend policy are not particularly clear. All the propositions are empirically testable.

The disciplines of finance and strategic management have evolved along separate lines, but both are of concern to top managers at the level of CEO, MD, and Chairman of corporations. At this level, it is not particularly useful to merely tell financial managers that, in the final analysis, corporate strategy rules supreme, or to exhort strategic planners to pay more attention to the numbers. What is needed is a clear articulation of what a specific corporate strategy means for financial strategy, and vice versa.

This paper has made a modest beginning in this direction. By thinking through the implications of various types of corporate strategy, we have been able to

formulate a number of propositions which could provide specific guidance to top managers of corporations in formulating their financial strategies. While we have not provided any empirical evidence to support or reject any of these propositions, the propositions do appear to be testable. Future empirical work could attempt to test them.

We have certainly not been able to think of all the possible implications of corporate strategy for financial strategy, nor have we been able to come up with an exhaustive list of strategies of either kind. What we have done is to demonstrate that a link clearly exists between corporate strategy and financial strategy, and have given some examples of what such links might be.

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Table 1: Summary of Propositions
Proposition 0: Corporate Strategy Defines Financial Strategy

Corporate Strategy	Capital Structure	Dividend Policy	Financial Parameters	Other
Differentiation	Low debt (1)	High payout, frequent increases (2)	High rate for human capital (3) Option pricing models, simulation (4)	
Cost leadership (scale)	High debt (5)	Low payout (6)	Consistent use of NPV, IRR (7)	
Cost leadership (overheads)	Constant adjustment (8) Use rights offers, private placements (9)	Low payout (10)	Sophisticated models for cost of capital, optimal capital structure (11)	
Focus	High Short-term debt (12)	Not clear	Attention to working capital costs and investments (13)	
Speed	Low debt (15) Use leases (16)	Low payout (17)	Use payback period (18)	High cash, inventory (14)
First - mover	Internal funds, private placements (19)	Low dividend payout (20)	Credit appraisal techniques (21)	

Note : Numbers in parantheses refer to the proposition number in the text.

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