Advanced Diploma
in
Business Administration

Study Manual

CORPORATE STRATEGY

The Association of Business Executives

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Contents

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Corporate Strategy

Syllabus

Aims

1. Structure complex strategic problems and propose logical solutions.
2. Apply the full range of techniques and concepts available to the contemporary corporate planner.
3. Analyse, assess, and choose between strategic alternatives.
4. Understand the financial, human, and organisational issues which affect the successful development and implementation of corporate strategies and plans.
5. Incorporate contemporary issues and developments affecting organisations into corporate plans.
6. Assess the impact and implications of international and global issues on the corporate strategic planning process.

Programme Content and Learning Objectives:

After completing the programme the student should be able to:

1. The nature, scope and need for corporate strategy. Some key concepts in corporate strategic planning:

The nature and importance of corporate strategic planning in today's organisation. The various definitions and models of corporate strategy and planning and the characteristics of corporate strategic decisions compared to other levels of strategic planning and decision-making in the organisation. The various elements involved in the development of corporate strategy and some of the key concepts and vocabulary used by today's corporate strategists.

2. Corporate strategy in practice:

The application of corporate strategy in various types of organisational settings and how corporate strategies develop in different organisations. Strategy development for: small businesses, manufacturing and service organisations, public sector organisations, voluntary and not-for-profit organisations, professional service organisations, innovatory organisations and multinational corporations. Different patterns of strategy development, including intended versus realised strategies, pre-planned versus emergent strategies and imposed strategy development. Factors affecting strategy development in the organisation and challenges for strategy development including uncertainty and the notion of strategic drift.

3. Analysis for corporate planning:

Types of analyses required for corporate planning decisions. Environmental analysis including, for example, PEST and the identification of key environmental drivers. The steps and stages in environmental analysis, together with techniques for auditing and forecasting the environment. In addition, the competitor environmental analysis is included, encompassing strategic group analysis, the analysis of competitive market structure, and competitor based strategies including strategies for market leaders, market followers and market challengers. Finally, in this part of the syllabus, internal analysis is considered, including the assessment of strengths and weaknesses, value chain analysis, comparative analysis and benchmarking, financial analyses and identifying core competences and critical success factors.

4. **Identifying strategic options:**

   The range of strategic options and decisions which the corporate planner must assess. First, the identification and selection of alternative mission statements and key objectives for the organisation. The nature of mission statements and the importance of business definition together with the range of possible objectives and goals which the corporate planner may select between. Factors affecting the selection of objectives including the role and influence of stakeholders and shareholders. Options for strategic direction from consolidation to exit strategies, including Ansoff's Product Market Matrix. Methods of strategic development including internal development, mergers and acquisitions, and joint developments and strategic alliances are introduced. Finally this part of the syllabus will also consider the bases of strategies, competitive advantage ranging from cost and price based strategies, added value strategies, differentiation strategies, through to focus and hybrid strategies.

5. **Strategy evaluation and selection:**

   The range of concepts and techniques in evaluating and selecting between strategic options. The criteria of suitability, acceptability and feasibility in strategy evaluation and selection. Included in the techniques of strategy evaluation and selection are: decision tree analysis, strategy screening, risk analysis and techniques of financial analysis. Key concepts of strategy evaluation and selection include the concepts of strategic fit and synergy. Finally, the different processes for selecting strategies are considered, encompassing how strategic choice and selection of strategies can be undertaken within organisations.

6. **Implementing and controlling strategies:**

   Factors affecting the implementation and control of corporate strategies. The determination of policies, procedures and budgets, together with the design of different organisational structures which may be used to implement strategies including those for multinational/global organisations. Resource configuration and resource allocation and control, including the use of information as a control.

7. **Tools and techniques for the corporate strategist:**

   The range of contemporary techniques and tools available to the corporate strategist together with their limitations. The variety of tools which have specifically been developed to aid the corporate strategist in the identification, selection and evaluation of strategies. The following are considered to be examples of important tools and techniques for today's corporate strategist: BCG's Growth Share Matrix, Directional Policy Matrices including the General Electric (GE) and Shell Matrices, Porter's Industry/Market Evolution Matrix, A D Little's Competitive Position/Industry Maturity Matrix, the Parenting Matrix, PIMS Technique, the Experience Curve Concept, and GAP Analysis.

8. **Further and future issues in corporate strategy:**

   In this part of the syllabus, a number of contemporary and possible future developments important to the corporate strategist are considered. In particular the importance of Information Technology and Information Systems for the Corporate Strategist, international and global aspects of corporate strategic planning are also introduced. Finally, issues in the management of strategic change are considered together with the increasing emphasis and importance given to the social/ethical, and environmental considerations for today's corporate planner.

Method of Assessment:

By written examination. The pass mark is 40%. Time allowed 3 hours.

The question paper will contain:

Eight questions of which **four** must be answered. All questions carry 25 marks.

Further Reading

The ABE is keen to encourage students to read around their subjects although your study manual provides complete coverage of the syllabus for the examination. If you have time available once you have worked through the manual, you may wish to consult one or more relevant books from the ABE's suggested reading list which can be found in each subject syllabus. Advanced Diploma students especially should supplement their study of the manual with wide reading of relevant journals, quality newspapers and contemporary media sources.

Recommended Reading

- G Johnson and K Scholes, *Exploring Corporate Strategy*; 5th edition, 1998 (Prentice Hall)

Additional Reading

- J L Thompson, *Strategic Management: Awareness and Change*; 3rd edition, 1997 (Thomas Business Press)
- H Mintzberg and J Quinn, *The Strategy Process: Concepts, Contexts and Cases*; 3rd Edition, 1996 (Prentice Hall)
- J D Hunger and T L Wheeler, *Strategic Management*; 6th edition, 1998 (Longman)

Supplementary Journals

- Harvard Business Review
- Long Range Planning
- Strategic Management Journal

Study Unit 1

An Introduction to Corporate Strategy

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INTRODUCTION

All organisations need to be able to manage strategies.

In this Unit we shall consider the role and importance of corporate strategy and strategic management in modern organisations.

An outline of the key elements in the process of corporate strategic planning will be given, and the major patterns and drivers of the development of strategy within organisations will be explained.

We will also discuss the application and development of corporate strategy in different types of organisation.

Objectives

After studying this unit, students should be able to:

- explain the role of corporate strategy and strategic management in modern organisations and assess its importance;
- outline the key elements in the process of corporate strategic planning;
- explain the major patterns and drivers of strategy development within organisations;
- discuss the application and development of corporate strategy in different types of organisation.

A. WHAT IS STRATEGY?

Dictionary definitions of strategy tend to emphasise it in terms of a military context, such as "the science of forming and carrying our projects of military operations, generalship", but also add "finesse in carrying out **any** project".

In management terms, to paraphrase Koontz and O'Donnell, they describe it as "a decision about how to use available resources to secure a major objective in the face of possible obstructions……such as competitors, public opinion, legal status, taboos and similar forces".

Strategy implies action as well as decision-making and involves consideration of the environment in which it operates.

The term 'corporate strategy' relates to strategy applied by organisations of all types, both private and public, and of all sizes both large and small.

The Need for Strategic Planning

Management of an organisation may be described as achieving given objectives through the efforts of other people, and so strategic management is concerned with the establishment of a medium- to long-term strategy by top management within an organisation.

Corporate strategy is that which is undertaken on behalf of a corporation, as opposed to that of an individual; although we all adopt strategies on our own behalf as we pursue what Blackadder's assistant Baldrick would refer to as 'a cunning plan'.

In order to achieve corporate objectives a strategic plan has to be established. This identifies each major element so that provision can be made for it within the overall plan. Without this planning those who are responsible for the activities which must be carried out in order to achieve the objectives, i.e. the operational or tactical managers, are unable to select the necessary tactics.

Provided there is a strategic plan set up by top management there is no need for tactical managers to be fully informed of its detail; all they have to do is develop trust in senior managers so that they follow out their instructions.

Managers at all levels in an organisation have some responsibility for involvement beyond the task they currently have in hand. The more senior the manager, the broader this responsibility is and the further forward in time it extends.

Thus, for example, a senior manager in a large corporation such as BT is planning for 20 years ahead in telecommunications, whereas a first line manager is planning the best way to replace or repair a customer's phone line.

Strategic Management

Strategic planning has been recognised in the last 40 years or so as a necessary topic for managers to study.

This movement was largely due to Hofer and Schendel who showed how the strategic management approach evolved from the policy formulation and the 'initial-strategy' approach of the 1960s.

The **policy formulation approach** established the need for managers to create rules which set the parameters within which a functional area exists, and define what the functional area can and cannot do.

The **initial-strategy approach** was defined by Chandler (1962) as being the determination of long-term goals and objectives for an organisation, and the setting up of the necessary courses of action too achieve these, together with the allocation of resources necessary for this.

Strategy as a Process

Ansoff, Andrews et al started with Chandler's approach and refined it to introduce the idea of strategy being a process.

This work has been further extended by Mintzberg and Walters, and they have defined strategy as being a "pattern in a stream of decisions".

Objectives, Policy and Strategy

Hofer and Schendel created a composite definition of strategy which suggests that a strategic management approach can only be based on the idea that attainment of objectives is added to policy and strategy.

Thus:

- specific objectives are set;
- a policy is formulated to establish rules;
- routine strategic planning sets out where we want to be and how we can get there;
- tactical planning details the necessary actions to be taken in order that strategies are achieved;
- a control function is put in place in order to monitor progress towards achieving objectives.

Strategic Planning

There is a need for all managers to be involved in strategic planning in order to establish tactical plans within their area. Senior managers establish policy for more junior ones within the corporate policy so that strategies and tactics at all lower levels comply with those set at corporate level.

Advantages and Limitations of Corporate Strategic Planning

Corporate Strategic Planning is essential if an organisation is to survive, let alone expand. No organisation can remain on a plateau; if it is not going up then it is going down, since all other organisations in the same sector will always be trying to increase their own market share to the detriment of its competitors.

Successful strategic planning involves looking ahead and making decisions based upon future likely conditions. In some cases this will lead to decisions to diversify into other markets, and where these, or other, decisions fail then the organisation can be left in real trouble.

Such an example of a failure to diversify was seen a few years ago when many finance suppliers, such as Building Societies, decided to enter the estate agency sector at a time when house selling was buoyant and then had to withdraw, losing a lot of money, when the market was flooded with competition.

There are limits to what corporate strategic planning can achieve, since pressures can be brought by groups of stakeholders, i.e. shareholders, management, workforce, suppliers, etc., who feel threatened by such decisions.

A recent example of a large company having to bow to such pressure is provided by Marks and Spencer. A decision to close its European stores, in an attempt to reduce company losses, met with great opposition from employees likely to be affected by such a decision. Those employed in Paris were especially vocal in their opposition, together with the unions representing Marks and Spencer's employees, and the management has been forced to back down and to review its position.

B. LEVELS OF STRATEGY

There are three levels of strategy which we can consider.

- **Corporate Strategy** involves the overall scope of the organisation, its operation in structural or financial terms, and the allocation of its resources throughout its various business or divisions.

  This level involves senior management in determining the key activities of the company in terms of the nature and extent of the product markets in which it will operate.

  At this level the strategic planner has to look ahead and decide which businesses the company will be involved in for the future.

  For example, at the corporate level a transport company will need to decide which markets it will operate in:

  - Will they consider only road transport and, if so, will it be in the public or commercial areas?
  - Will they also want to be involved in rail transport and, if so, will they want to be innovative and consider light rail or monorail methods of travel?
  - They may also need to consider diversification and integration with other operators.

  Strategic decisions with regard to finance will concern the overall financial structure of the company, including the nature and number of Strategic Business Units (SBUs) which will be established.

  Finally, strategic planning at the corporate level has to take account of the expectations of the company's shareholders and others who have an interest in it such as financial houses, employees, etc. These are the company's stakeholders.

- **Business Strategy** deals with the competitive position of the specific SBUs or divisions with respect to those products or services which should be developed and the markets towards which they should be aimed. Decisions taken at this level include deciding between cost leadership, differentiation, and focus.

  Having decided upon the core competitive strategy, decisions then have to be made as to whether the particular strategy selected will be pursued alone or, for example, in partnership within a strategic alliance.

- **Operational Strategy** - this third level of strategy is concerned with specific functions within the organisation, such as marketing or finance, and the contribution which these make to the other strategic levels.

  For example, operational strategies for marketing would include strategies for segmentation and targeting and strategic decisions for each of the elements of the marketing mix i.e. product, price, place and promotion.

There is considerable overlap between the three different levels of strategies, although they are effectively a hierarchy. Corporate strategies first help to delineate and then to constrain business unit strategies, which in their turn help to delineate operational strategies, so they all need to be consistent with one another.

Operational strategies must be relied upon to deliver the corporate and business level strategies.

This vital integration between the three strategy levels is dependent upon effective communication between management at the different levels within the organisation.

Establishing Strategic Intent

An organisation's strategy needs to result in the correct action being taken, using the necessary resources for it to achieve its objectives.

In order to achieve this the objectives must be clearly defined at the planning stage.

The corporate plan provides the parameters for the planning activity, which include the following:

Mission Statement

A mission statement is concerned with the reason the organisation exists. It tells the stakeholders what it is doing and why. It must be capable of determining the organisation's strategic intent.

These days most organisations, both commercial and public, have a mission statement. Mission statements normally include the following:

- A visionary statement which represents a general long-term plan. For example, for a National football team to win the World Cup.
- A statement of the organisation's main reason for existing. For example, "in order to provide the best possible banking services for its customers" would be a suitable statement on behalf of a bank.
- The organisation's main activities and its overall aim, such as Tesco's intention "to be the UK's number one food retailer".
- The organisation's key values - these are its corporate objectives.

  In Tesco's case these are:

  (i) offering customers best value and most competitive prices;

  (ii) providing progressive returns for shareholders;

  (iii) developing its employees and rewarding them fairly. With equal opportunities for all;

  (iv) working with suppliers to achieve a long-term business relationship based on strict quality and price criteria;

  (v) supporting the local community and protecting the environment.
- The organisation must be capable of the necessary action to fulfil its strategic intent.

Goals, Objectives and Strategies

Goals are a general statement of the way the organisation is moving, which is in line with its mission statement, and are qualitative in nature. For example, "to increase profit".

Corporate objectives are quantitative in nature. For example, "to increase profit before tax by 12% in the next financial year".

Strategies are objective statements which lay down a set of actions in order to achieve or maintain a particular position.

C. THE STRATEGIC MANAGEMENT PROCESS

Managers in general have certain roles to perform. Mintzberg identified three major ones.

- **Interpersonal** - where the manager is:
  - (i) a figurehead for the organisation;
  - (ii) a leader, responsible for their own actions and those of their subordinates;
  - (iii) a liaison officer working with everyone, both inside and outside of the organisation.
- **Informational** - receiving and communicating information as:
  - (i) a monitor looking for useful information, booth within and outside the organisation;
  - (ii) a disseminator distributing the information subordinates need in order to fulfil their functions;
  - (iii) a spokesperson giving information to other than their own workteam, and on occasions representing their own unit or the organisation as a whole.
- **Decision-making** - as:
  - (i) an entrepreneur dedicated to improving their unit, often by initiating change;
  - (ii) disturbance handler, producing solutions to difficult problems and following them through, even though they might be unpopular;
  - (iii) resource-allocator, trying to balance fairly the distribution of limited resources in accordance with needs and goals;
  - (iv) negotiator, both within and outside the organisation.

Above all, Mintzberg sees managers as being pragmatic and active individuals.

These roles represent the operational aspects of a manager's job, but strategic management goes beyond such activities as dealing with finance, production and human resources. The operational activities implement strategic policy but do not constitute strategic management, which includes not only strategic decision-making but also the action which puts these decisions into force.

Bowman and Asch defined strategic management as "the process of making and implementing strategic decisions", and to be "about the process of strategic change".

Johnson and Scholes consider this to be an insufficient definition, since it fails to account for a number of the points which are important in managing an organisation. Instead, Johnson and Scholes consider that the management process consists of the following elements:

- The analysis of strategy - an understanding of the changes going on in the environment in which the organisation exists and how these affect the organisation and its activities, its strength of resources, and the expectations of its stakeholders.
- The choice of strategy - which is concerned with all the possible courses of action which may be taken.
- An evaluation of each of the courses of action identified and the selection of those which the organisation should attempt to follow.
- The implementation of the selected planned strategy into an effective course of action.

Strategy-making

Mintzberg and Waters suggest that the strategy pursued by an organisation can be placed on a continuum. At one end is strategy which has been **planned**, i.e. where those whose role it is to be strategy-makers have clearly formulated their intentions, which are then translated into the relevant actions. At the other end is **emergent strategy**, such as consensus strategies which come about via a process based on the results of a number of individual actions that create a consistent pattern.

In between these two extremes are other types of strategy, including that which is **entrepreneurial**.

Mintzberg identified three modes of strategy-making:

- **Planned -** strategy which is created ahead of events, which may be formally documented or just clearly thought through, may be specific or general, but involves some sort of consciously intended course of action.
- **Entrepreneurial -** strategy which involves vision and concept attainment, which is intuitive and non-analytical, thrives on uncertainty and is geared to seeking out opportunities. It is often based on the personal vision of the chief executive and may not be made explicit.
- **Adaptive -** where strategy formulation and implementation proceed concurrently, i.e. strategy is adapted to changing conditions.

It is accepted that there is no 'best way' to formulate a strategy and that the process of doing so which is appropriate for one particular organisation carrying out a particular type of task in a particular environment may well be unsuitable for another organisation operating in a different setting.

Mintzberg and Waters thus take a contingency approach to the subject, i.e. the right strategy to follow depends on the total situation within which it is to be used.

A Strategic Model

In making strategic decisions there are three major factors which managers have to take into account:

- the expectations and objectives of shareholders;
- the total resources which are available to the organisation in order to achieve its objectives; and
- the total environment within which the organisation operates.

In each case there is a high degree of uncertainty.

Strategic Analysis

Consideration of each of the above three factors is referred to as strategic analysis, the aim of which is to understand the strategic position of the organisation.

Expectations and Objectives of Shareholders

All organisations have to be as clear as possible about what their long-term objectives are; otherwise they cannot expect to achieve them. However, one difficulty which can arise in setting long-term objectives is that the expectations of different groups associated with the organisation do not always coincide. For example, within a commercial organisation you may find that shareholders are looking for a good return on their investments via high dividends, whereas the corporate management is seeking to achieve market growth by reinvesting profits and the workforce is looking for long-term employment prospects, and these objectives may be mutually exclusive. Also, over a period of time, objectives may change due to the effect of outside influences, such as changes in currency values, over which the organisation has no control. Part of the management of strategy involves trying to reconcile these different expectations in order to set the organisation's objectives.

Total Resources Available to the Organisation

Which strategy an organisation can pursue is dependent on the current strengths and weaknesses of its resources, both human and finance, and these can change in accordance with the prevailing environment in which the organisation operates. For example:

- The skill which employees possess may have been suitable in the past but might not be transferable to new methods of working.
- The financial strength of the organisation can also vary with time, and this will have an effect on its ability to raise funding from either shareholders or financial institutions. This will influence the choice of future strategy.

The Total Environment within which the Organisation Operates

This is also a powerful influence on what strategy can be pursued. The major difficulty for managers is in forecasting what the future has in store. Global factors such as terrorist attacks, especially of the magnitude of the recent one on the finance centre in New York, can have an overnight effect on world financial markets, for example, which no-one could anticipate. Whatever type of organisation we consider the future of its environment is uncertain. When you consider the difficulties of forecasting tomorrow's weather conditions, despite all the high-tech equipment available, what chance has a manager in trying to predict likely changes to an organisation's environment over the next five years or so?

An additional complication to this model is that these factors seldom act in unison; in fact they usually seem to pull in different directions at the same time.

Strategic management requires managers to cope with extremely complex issues which are of a non-routine nature and are often ambiguous. Although there is no straightforward system for ensuring success, the use of a model such as that described can help to reduce the chances of failure.

D. PATTERNS OF STRATEGIC DEVELOPMENT

As we saw earlier, when considering the different levels of strategy, the operational level of an organisation is the one where decisions and activities are carried out and which determines the success or otherwise of the organisation's strategy.

Strategies are often developed by managers in an intended planned pattern and are acted upon, or realised. But a strategy can also be arrived at in other ways. For instance, in the case of strategies which are due to the effect of day-to-day decision-making at the operational level, which are referred to as emergent strategies, and which come about, i.e. are realised, without the specific intention of managers. There may also be strategies which have been planned by managers but which for some reason or other do not get acted upon, and these are referred to as unrealised strategies.

It can happen that there may be a difference between the strategy which managers consider they are following and that which is in fact being pursued by the organisation over a period of time.

Also, it does not follow that, because an organisation's intended or planned strategy is not being fulfilled, it does not have a strategy at all.

If strategy is concerned with the direction in which an organisation is moving over a long period of time, then, although it may occur in steps, or punctuated, it can be thought of as an emergent process.

In describing different modes of strategy Mintzberg used the term 'deliberate' to describe a strategy in which "intentions existed and were then realised", i.e. what was planned was in fact put into effect. He used the term 'emergent' to refer to a strategy where "patterns developed in the absence of intentions, or despite them", which went unrealised.

He further suggested that in most cases strategies include both deliberate and emergent characteristics.

Thompson and Strickland were also of the opinion that aspects of a strategy, however objective in its design, could be affected by the subjective actions of managers. They used the phrase ‘crafting a strategy’ in order to achieve performance objectives, and said of it, “crafting a strategy is rarely so dominated by objective analysis as to eliminate any room for the subjective imprint of managers”.

The Development of Strategy

We have already seen that an organisation’s strategy is based on what its managers intend to be the direction in which the organisation should proceed, although subsequent actions at the operational level can cause the overall strategy to be changed. Other factors which can have an effect on the way in which the strategy develops may come from either within or outside the organisation.

External influences may include:

- political pressures, such as monopoly restrictions, taxation policies, employment legislation, foreign trade regulations, environmental protection legislation imposed by government or by the efforts of pressure groups;
- cultural changes, due to changes in lifestyles, consumer demands, and people’s attitudes towards a ‘greener’ environment.

Internal influences can include:

- the availability of resources within the organisation
- changing expectations of stakeholders
- the position of the organisation in the marketplace.

An example of the political environment affecting an organisation’s strategy is provided by Pirelli, who have recently decided to move away from tyres and into the telecommunications sector.

They have achieved this by combining with Benetton in order to take over Olivetti and thus to acquire a controlling interest in Telecom Italia.

In doing so Pirelli have ignored conventional wisdom by exchanging precious cash for debt and a stake in a company offering no clear synergies. They even paid an 80% premium to the prevailing share price. Pirelli investors saw this as a poor strategic decision, particularly at a time when the telecommunications industry is suffering badly, and responded immediately to send its share value plummeting.

The decision by Pirelli has been described by market commentators as a political rather than an economic one, and as marking a return in Italy to old-style family capitalism and the enhancement of dynasties.

Uncertainty and Strategic Drift

Within any organisation management is concerned to apply itself to answering three major questions:

- How uncertain is the environment in which the organisation exists?
- What are the sources of this uncertainty?
- How should this uncertainty be dealt with?

In order to answer these questions it is necessary to consider both opportunities and threats which are present in the environment.

The most helpful way of arriving at this information is by carrying out a management audit which gives a ‘snap shot’ picture of the organisation at a particular moment in time.

Audits allow corporate planning to be carried out against a background of a detailed and objective understanding of organisational capability and the opportunities and threats. The information provided by an audit assists management, not only to see where the organisation is at the particular moment in time, but also where it is perceived to be and how it is regarded by others.

We shall consider external audits of an organisation by means of Porter's Five Forces Model, or PEST, in detail in Study Unit 2.

An organisation's strategy is a way of aiming to achieve its stated objectives but over a period of time there sometimes emerges a difference between what it was hoped would be achieved and what was likely to be achieved if the original plans were continued. As the environment changes gradually the organisation's strategy needs to develop incrementally in line with it. If the organisation's strategy fails to do this then a strategic drift occurs.

New strategies must then be chosen in order to narrow, if not close completely, the gap between what is being aimed at and what is likely to be achieved.

Johnson and Scholes have pointed out that this drift is not easily detected because, although changes to strategy are being made, managers tend to pursue the familiar ways of the past, so these methods often achieve short term success which gives them the appearance of being effective even though they are moving away from the forces working in the environment. Eventually the drift becomes apparent because of its size, or the change in environment increases. Either way, performance is adversely affected and a state of flux then occurs when strategy development has no clear direction.

At this point either more transformational change takes place, which brings the organisation back on track with respect to its strategy, or the organisation fails.

E. STRATEGIC MANAGEMENT AND BUSINESS PLANNING

Every organisation needs to have a business plan which is regularly reviewed in order to keep it up-to-date.

The plan is articulated by corporate leaders, who give the organisation direction and save it from change via strategic drift. They create a vision of a possible future that allows both themselves and others to see more clearly the direction to take, building upon the organisation's current capacities and strengths.

Stoner and Freeman define a business plan thus:

> "a formal document containing a mission statement, description of the firm's goods or services, a market analysis, final projections, and a description of management strategies for attaining goals".

- A **mission statement** is a way of expressing the overall philosophy of the organisation, which is in line with the values and expectations of its stakeholders, in those groups or individuals who have a stake in, or expectations of, the organisation's performance. They include employees, managers, shareholders, suppliers, customers or clients, and the community in which the organisation operates.

  For example, Pilkington, one of the world's largest manufacturers of glass and glazing products for the building and automotive markets, says:

  > "Our mission is to be a dynamic, market driven, global provider of glass products, judged best in class by our customers, our people and our shareholders. We believe our strategies to increase our efficiency, together with our growth initiatives, make us the most competitive glassmaker in the world".

- **Description of goods and services -** this is a description of what the organisation has to offer. BT describes itself as "one of Europe's leading providers of communications services". It says:

  > "We aim to help our customers make the most of the opportunities that communications technology brings. As well as voice services, we are concentrating on newer areas where we have established already a strong position, such as mobile, internet and -business

services and solutions. As the next stage in the transformation of BT, we plan to create two strong and separately quoted businesses, BT Wireless and Future BT."

- **Market analysis -** as part of its plan, an organisation needs to consider the state of its market place.

  Walker Greenbank is a multi-faceted company operating in the printed fabric, home décor and furniture market. It states, in an overview of its markets, that:

  > "Market conditions in the six months to 31 July 2001 continued to be difficult. Therefore, despite a significant reduction in the cost base at the end of last year, this proved insufficient to return the group to profitability and further actions including additional redundancies have had to be taken. The continued slowdown in the market place in the first half combined with customers destocking has particularly affected the group's manufacturing businesses. The slowdown has resulted in sales being 10% lower than the same period last year in the core brands. However, total sales for the group are broadly in line with last year due to the inclusion of a full six months of the acquisitions made in March 2000. The pre-exceptional operating loss in the period is £1,495,000 compared to a pre-exceptional operating loss of £14,000 last year".

- **Final projections** are statements of the organisation's plans for where it is expecting to be in the future. It may be expressed in terms of increased market share, financial turnover or profit.

  Centrica, the conglomerate which includes the supply of gas and electricity, telecommunications, home heating services, road services such as breakdown recovery, and financial services, have a whole range of projections across the board.

  In general they quote their vision to be:

  > "a leading supplier of essential services in our chosen markets. Our strategy is to retain and attract customers in our core businesses with continual improvements in service and value, while at the same time developing new opportunities in Britain and internationally".

  In detail they say they plan to:

  > "offer even more value for money services to our customers in Britain and elsewhere. Specifically we will extend our financial and telecommunications services. We aim to supply a million telecommunications services to customers by the end of 2001, including mobiles and web access as well as a fixed-line service. We will continue to develop the AA.com as the premier source of motoring information. We will also bring in a new type of AA roadside recovery vehicle to give our members an even better service. This year you will be able to check your bill online, make payment and access a range of information pages on the gas.co.uk site".

- **Management strategies for attaining goals -** there is a link between business planning and strategic management.

  mmO_2 plc is a company, set up by means of a demerger with BT, specifically to supply mobile communications services in Europe. Its stated strategy is as follows:

  > "Our goal is to create shareholder value through above sector average growth in revenue and EBITDA (earnings before interest, tax, depreciation and amortisation). They key elements of our strategy to achieve this goal are to:
  >
  > (i) emphasise operational performance and execution
  >
  > (ii) achieve greater integration by managing our business cohesively, and
  >
  > (iii) lead in new data services through GPRS (General packet radio service, allowing customers to remain connected to the network between calls for the receipt and transmission of data) and UMTS (Universal mobile telecommunications system, an international standard of third generation mobile phones)".

What you will notice from the above quotes is that, although businesses may differ from one another in many ways, such as market share, products or services, size, financial strength, etc. what they have in common is a plan for the future, however unclear the future may be.

In respect of planning, Fayol made the following points:

- Plans have objectives and are guided by policies.
- Planning is a process made up of closely linked stages.
- There are methods and techniques to be used in planning.
- Short-range planning is easier than long-range planning.

Goals and Objectives

The following descriptions of goals and objectives are those which are generally accepted in terms of strategic management:

- **Goals** (or aims) are a general statement of the direction in which the organisation is planning to go, and which is in agreement with its mission statement. Goals are normally qualitative, i.e. general, in nature, such as mmO_2 plc aiming to "create shareholder value".
- **Corporate objectives** (or quantified objectives) are more likely to be quantified, or at least to be a precise statement in line with stated goals. For example, Centrica's stated aim to "supply a million telecommunications services to customers by the end of 2001".

The important point to note is the difference between qualitative statements which describe an attribute or a degree of excellence, and quantitative statements which are measurable and include a number or an amount.

Policies, Strategies, Tactics and Control

- **Policies** refer to the basic objectives of the organisation and define the long-term purpose. As a consequence policies are broad rather than precise in nature, and will exist for every part of the operation, serving as a broad restraint which will give guidance to managers. For example, 'to achieve a return on investment (ROI) of 10%'. In this case there is no fixed time constraint given, which is acceptable in policy-setting provided a time element is implied. In this example the ROI objective is continuous. If the policy was to increase ROI, then the policy statement would have to be written so as to reflect this, for example, 'to increase ROI by 10% by the end of this year (2002) and then to maintain it at that level'.
- **Strategies** are objective statements that identify the actions by means of which a particular position is to be achieved or maintained. A long-term plan will include strategic statements which will have been derived from the established policies.
- **Tactics** follow from the strategies which have been selected, and which in turn have been derived from the organisation's policies. Tactical objectives are of a short-term nature and are designed to achieve short-term aims. If the organisation is operating effectively as a functional system, then it follows that, if all tactical objectives are achieved, strategies and therefore overall policies are also achieved.
- **Control** is necessary in order to monitor the effectiveness of the action which is being taken, i.e. to determine the extent to which it is achieving the set objectives and goals.

Summary

The three stages of:

planning,

acting, and

evaluating,

underpin all management action, at whatever level within an organisation.

The stages of management action are:

- establishment of policy
- generation of strategy
- specification of tactics
- provision of control measures.

Figure 1.1 illustrates the hierarchy of plans and planning relationships between the different levels of management within an organisation.

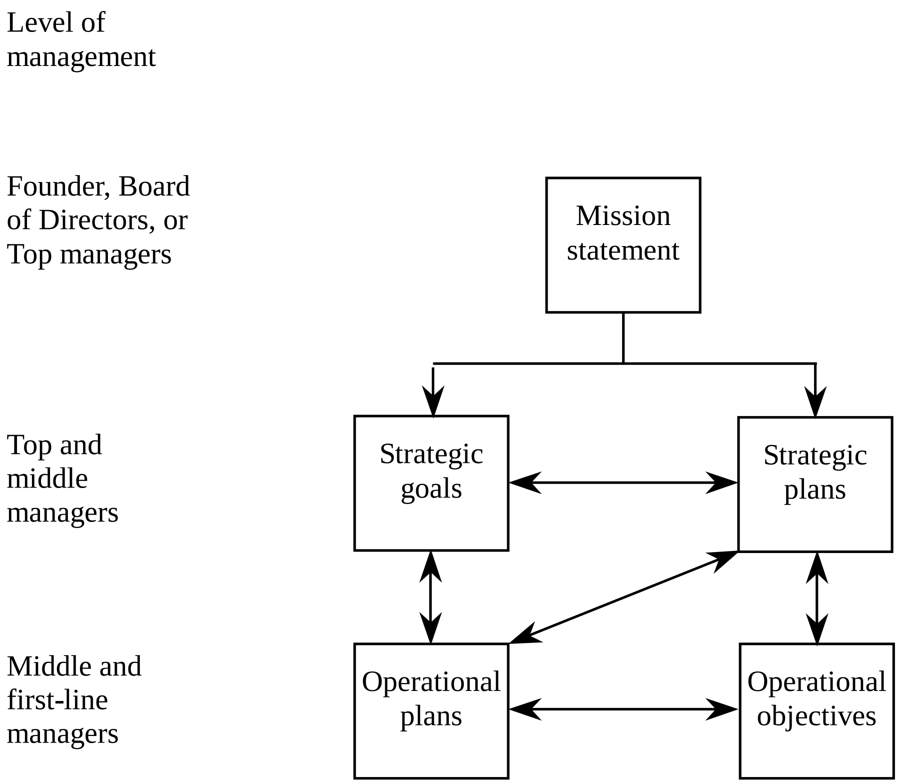


Figure 1.1: Hierarchy of Plans

(After Stoner and Freeman)

F. STRATEGIC MANAGEMENT IN DIFFERENT CONTEXTS

Although all businesses share common fundamental principles, they can also differ in many ways. For example:

- private companies have objectives such as making a profit or increasing their market share;
- public sector organisations may exist to provide a service;
- a not-for-profit organisation, such as a club, exists to provide facilities and entertainment for its members.

Likewise, there are differences between organisations in terms of their strategies.

Small Businesses

These are likely to have a limited range in terms both of their markets, and their range of products or services. This will tend to limit their strategic issues, with a major consideration being that of competitiveness and of trying to expand.

Since most small businesses are private companies, their methods of raising any necessary finance for expansion will also be limited and will be a key strategic issue. The most likely result of this is that they will become dependent on a bank, or other similar financial institution, and will need to maintain a good relationship with them.

Multinational Companies

By their nature these are very complex organisations and, unlike small businesses, their strategies will be linked to the control of a range of businesses or divisions spread across a number of different countries, thus adding complications due to financial and language differences, as well as differences of culture.

Strategic management in these circumstances will be the concern of a large number of managers, whose day-to-day decisions must be within the overall strategy of the company. The control of a wide range of business centres which are widely-spread geographically means that the necessary control systems, whether centralised or decentralised, must be very sophisticated.

Manufacturing and Service Organisations

These have important differences based on their objectives.

- In the case of the **manufacturer**, it is the quality of the product which creates the company's competitiveness and, therefore, its strategy will be closely linked to the product.
- In the case of **service provision**, the competitiveness of one organisation with respect to its rivals will depend on less obvious aspects, such as the public's perception of the company, based on publicity and image marketing strategies as, for instance, in getting the strength of a particular insurance company around you.

Thus it is more likely that those at the sharp end of the service provider will be more in control of company strategy, whereas it is those at senior levels in manufacturing companies who will have the greater influence.

Voluntary and Not-for-Profit Organisations

This class includes charities, foundations, clubs, learned societies, trade associations, professional bodies, etc.

Although they do not exist to make a profit, many of these organisations end the year with a surplus of income over expenditure from their trading activities.

They will also have income from membership fees, donations and bequests.

Where they differ financially from Commercial organisations is that they apply their income and surpluses to furthering the purpose of the club, society or charity and not to paying dividends to shareholders.

- Because of their dependence on funding from sponsors rather than clients, it is easy for the efforts of **not-for-profit organisations** to be concentrated on lobbying for resources, which makes it difficult for them to have a clear strategic plan.
- In the case of **voluntary organisations**, their basis for existence is deeply rooted in particular shared values and these have an important influence on the development of strategy.

Innovatory Organisations

Companies such as Hewlett-Packard have a strategy which encourages employees to develop new ideas in order to keep their business at the cutting edge of the computer sector in which they operate. Hewlett-Packard's way of doing this is to set aside work-time each day specifically for the purpose of allowing their employees to pursue such activities.

This is not a new concept in business, since the General Electric Company (GEC) were concerned with the same strategy 30 years ago. GEC used the ability of the company to meet customer needs at minimum costs for developing, manufacturing and marketing new products. The company - or an integrated segment of it - exploited new scientific and technical knowledge, in manufacturing and marketing as well as engineering, to lead competition in aggressively applying such knowledge in the creation and marketing of new products. To do this they took account, not only of innovation, but also of the ability to capitalise on new ideas at the right time and at a cost, and the quality required, that would appeal to the customer and make the new product successful.

Professional Service Organisations

Services such as medical, accountancy and the law still see traditionally-based values as an important part of their enterprises. Often these exist in the form of partnerships, which consist of two or more persons carrying on a business together.

This form of organisation appeals to professional people, since they can retain a large amount of individual freedom of action and maintain their personal relationship with clients, whilst gaining the advantages of larger amounts of capital and of expertise. In terms of strategic management in such an arrangement, the main difficulties arise where differences of opinion have to be resolved in order to pursue an agreed policy. In view of recent changes for medical partnerships, with the advent of budget holders and the development of large medical centres, professional service organisations in future are likely to find themselves becoming more competitive and having to adopt strategies similar to those of profit-making organisations.

Study Unit 2

Strategic Analysis 1: (The External Environment)

Contents *Page*

INTRODUCTION

In this Unit we are going to consider the importance and the scope of analysis in corporate planning.

In particular we are going to look at the external influences on corporate strategy and the key environmental drivers.

We will discuss the importance of analysing the state of competition and of the marketplace.

Finally we will consider the appropriate tools for use in analysing the external environment.

Objectives

After studying this unit, students should be able to:

- explain the importance and scope of analysis in corporate planning;
- discuss the range and influence of external factors in corporate strategy, and identify key environmental drivers;
- discuss the importance of competitor and market analysis;
- explain and use appropriate tools in the analysis of the external environment.

A. CORPORATE PLANNING

Fayol made the following points in regard to planning:

- Plans have objectives and are guided by policies.
- Planning is a process made up of closely linked stages.
- There are methods and techniques which can be used in planning.
- Short-range planning is easier than long-range.

Corporate planning is concerned with every aspect of an organisation and is developed at the highest management level.

In some cases this will involve activities spread throughout a number of different countries and the work of thousands of people.

By its nature, then, a corporate plan will be wide-reaching and not too detailed. It will be longer-term than operational plans and also it will need to be more flexible in order to allow for changes in the organisation's environment over time.

It is important, therefore, to carry out careful analysis of the factors which make up the external environment. These could include:

- analysis of the current market size and its rate of change, in order to assess its future movement;
- market research of existing and potential clients in order to determine current and future expectations;
- an investigation of current and emerging competitors, an assessment of potential competitors, in each case with respect to their strengths and weaknesses;
- an analysis of the stability of own market share and likely trends;
- consideration of the effectiveness of the distribution system;
- a review of supplier network, in particular a detailed analysis of major suppliers, and of patterns of selling;

- an analysis of any agencies which the organisation uses, looking at trends in agency practice and cost-effectiveness in particular. With regard to agencies of major importance this needs to be very detailed, as with the analysis of competitors.

An example of the value of analysing market size and adjusting future business to cater for an expanding niche is shown by Torex, a computer software company which appears to be bucking the trends in the computing sector.

Whereas many commercial customers are currently cancelling or postponing IT spending, Torex's customers, who are mainly healthcare providers such as the NHS, are expanding their systems. In particular, healthcare providers are very enthusiastic with regard to the electronic storage and transmission of information and are making funds available for systems development.

Torex is currently only a small company compared with others in the market but, with plenty of room to grow, it is already producing rapidly rising profits and a matching market reputation.

A company which has reviewed its market sector and made a strategy shift is the engineering firm Weir, who have recently chosen to concentrate their efforts on the manufacture of pumps and valves.

This may be rather mundane work but it is an area which offers a wide client base from such applications as paper mills to oil refineries in a growing market. It also opens up possibilities of follow-up services.

As a consequence of this change of strategy the company has greatly improved its position.

Unilever provides us with an example of coping with the problems of dealing with unreliable agencies. They have put up for sale their relatively new home cleaning business, known as Myhome, because they have failed to find a reliable supply of cleaning staff.

As a spokesperson for Unilever has said, "finding good Mrs Mops is a hard job".

Myhome was intended to be used as a way of promoting Unilever household cleaning products. However, with only a few thousand customers, the trial, which was intended to run for at least another year before a decision about its future was taken, has been brought to a premature end.

B. ENVIRONMENTAL ANALYSIS

Managers responsible for the success of an organisation are concerned about the effect that factors in the external environment have upon it.

They cannot control the external environment but they need to identify, evaluate and react to those forces outside the organisation which may affect them.

The way in which managers attempt to achieve this is by means of a qualitative assessment of signals they receive which are relative to outside influences. There is therefore a need to carry out an analysis of these forces by means of the kind of methods we have just explored. In other words, to use external environmental analysis.

There are a number of models available for carrying out external environmental analysis and we shall explore some of these in detail later.

Types of Environment

To decide on the focus which environmental analysis should take it is important to consider the nature of an organisation's environment in terms of its uncertainty.

A **simple/static environment** is the easiest to analyse. In this case, a detailed, systematic, historical analysis is probably sufficient in order to understand it.

In a **dynamic environment**, all aspects of the environment are subject to change. When changes are rapid and/or sudden, such environments are referred to as turbulent. Frequently, change in one element of the environment leads to changes in other elements; thus change feeds upon itself.

In these conditions managers must look to the future, not just to the past. A useful model for achieving this is known as 'scenario building', in which an attempt is made to construct a view of the future based not just on hunches but by building consistent views of possible developments around key factors - (see later details).

Complex environments are becoming more and more common in modern times.

Technology, markets, politics, etc. are becoming more intricate and more involved. The globalisation of organisations in the form of multinational firms and multinational political structures, such as the European Union, have greatly increased environmental complexity leading to conditions of the greatest uncertainty. Analysis of such environments is often focused on helping to sensitise managers to signals in their environment, and encouraging them to be flexible and intuitive in their responses to such signals. Both dynamism and complexity serve to increase uncertainty. As a consequence, uncertainty sets limits on the ability to predict accurately the future state of the environment.

Tom Peters argues that organisations must cope with this increasing uncertainty in their environment and he emphasises the need for flexibility as organisations set out to cope with their environments.

Environmental Drivers

Certain forces in the environment act as long-term drivers of change. These forces include rapid changes in technology, leading in turn to shorter life spans of such technology and the need for increased efficiency, often achieved by economies of scale.

In addition, globalisation of markets has led to world-wide searches by companies to obtain skilled labour, raw materials, total market share, etc.

Nestlé, for example, the world's biggest food company, has improved sales growth by over 5% in the first half of 2001.

The way in which this has been achieved is by means of what they term their "Globe" project. This is aimed at increasing business efficiency, and by increased spending in launching new products, i.e. by putting more money into the market.

They also have plans to acquire other companies in the food sector. In particular, they are targeting mineral water and nutrition businesses.

Auditing and Forecasting the Environment

We have already mentioned in Unit 1 the use of audits in corporate planning and their relationship to the opportunities and threats present in the environment.

Such audits must consider the needs of the whole organisation, as only then will they enable functional strategies to be determined.

An audit produces a wealth of information which will help management to decide on both short- and mid-term planning.

Action may be required in the short term in order to have a firm base from which to move forward. It is essential that a corporate identity is established and for both internal and external audiences to agree on what it is.

Mid-term planning can only be successful if it is based on a firm foundation and the audit process is designed to give management the information it requires to enable such a foundation to be identified and/or established.

Forecasting trends and developments is the act of giving advance warning in time for beneficial action to be taken.

Level and Period of Forecasts

Forecasting takes place at different levels - internationally, nationally, by industry, by segments, etc. Eventually a specific forecast for a specific product will be required.

In making individual forecasts managers must be aware of the larger environmental factors.

Short-, medium- and long-term forecasting is in value-loaded terms, i.e. what is short-term to one organisation may be regarded as medium-term to another.

For many organisations, long-term forecasting means up to about 10 years. In capital intensive industries such as energy provision, however, it can be for up to 50 years.

The Purpose of Forecasting

The major purpose of forecasting is as a basis for long-term planning.

All forecasting is fraught with the danger of being wrong, at least in detail, since there are so many extraneous factors which cannot be taken into account. Take weather forecasts, for example, how often does the forecaster come back the next day to explain how wind speeds or changes of direction were responsible for yesterday's forecast being less than accurate? With forecasting, however, no matter how inaccurate it is, there is no direction, no basis for action and nothing for control to work on. The alternative to a forecast is a guess, and we cannot allocate a value of probability to a guess.

The major reason for forecasting is to reduce uncertainty, and management must use the best available information and techniques, supplemented by good judgment, in order to achieve the best possible forecast.

C. COMPETITOR ENVIRONMENTAL ANALYSIS

In order to establish where an organisation is placed in its environment with respect to its competitive position, it is necessary to examine the relative strengths and weaknesses of its competitors. To achieve this comparison the organisation needs to scan the environment continuously and to monitor key indicators.

It is also important to consider the strategies used by competitors. Are they, for instance, committed to offering products at budget prices, as with companies like Superdrug, or do they rely on a reputation for high quality, as with Boots? This type of knowledge is useful when looking at how competitors have dealt with the forces within their environment in the past. It also gives an indication of how they are likely to act in the competitive environment in the future.

Analysis of Competitive Market Structure

In any market there is a huge number of competing companies and they cover a large range of geographical locations.

In addition, many companies who formerly enjoyed some form of protection from competition through the operation of monopolies now have to compete openly for their business.

An example of this in the UK is encouragement by the government for free competition between suppliers of gas and electricity.

Trade barriers in many areas are also less stringently applied than they used to be, particularly within the European Community. All of this results in the need for companies to better understand their own position by examining it against its competitors, whether this means competitors in the marketplace or, as in the public sector, competitors for resources.

This is the basis for what Porter calls '**competitor analysis**', which broadly means looking at who the competition is, and how they perform, i.e. what strategies they use and how successful they are in doing so. It also needs to include an assessment of potential competitors as well as existing ones.

When considering who the competition is it is necessary to take a very broad view. For example, a company offering package holidays abroad is not only in competition with other companies offering similar holidays but also with holiday offers in this country as well. In other words, the competition is in the holiday industry as a whole and not just that segment of it offering package holidays abroad, i.e. competition is with all those companies who are offering the same or similar customer benefits.

Porter has extended the idea of competitor analysis to include the analysis of the competitive industry structure, as we shall see later when we consider Porter's Five Forces Model and strategic group analysis.

How do we Carry out Competitor Analysis?

Having decided who our competitors are we then need to consider how they operate, i.e. what their strategies are.

For this we need to know:

- What are their objectives?
  - Are they seeking growth and, if so, is it profit growth, revenue growth or market share growth?
  - Are they competing in terms of price, quality, customer service or some other factor?
- Which marketing targets are their strategies aimed at?
- How successful are our competitors?
  - Financial analysis of performance trends will be helpful here (refer to Study Unit 3).
- What are our competitors' strengths and weaknesses?
- What is the current strategy of our competitors?
  - How are they likely to change in the future?
  - Do they show a consistent approach to strategy development, for example, by a tendency towards differentiation, or product development?

Discovering the answers to questions of this kind assists a company to understand the strategies which their competitors currently pursue and how they are likely to deal with them in the future.

How may Competitor Analysis be used?

By discovering the strengths and weaknesses of its competitors a company can compare these to its own strengths and weaknesses, enabling them to make a relative assessment. Based on such an assessment they can develop strategies in order to achieve a competitive advantage.

An important point to make here is that the comparison of strengths and weaknesses between a company and its competitors yields a relative assessment. For example, a company's particular strength may be the ability to be very cost-effective in terms of production. However, in order to be an advantage in the marketplace, it must be better than its competitors, i.e. it is no use being good at something if your competitors are even better.

Having carried out the strengths and weakness comparison with competitors the results can be used to decide future strategy in order to achieve company objectives. Analysis of the competitive industry structure provides information on which strategic decisions can be made about suitable markets and customer groups for targeting. This then contributes to the company finding a suitable position to take up vis-à-vis its competitors. Competitor analysis helps to identify those strategies which are likely to result in achieving a superior competitive performance. It also enables a company to consider its relative performance over time in an objective rather than s subjective way.

The foregoing has shown how important competitor analysis is to a company in terms of its strategic planning.

Systematic procedures for comparing the relative strengths and weaknesses of the competition can produce a vital input to a company's strategic planning.

Competitor-based Strategies

There is a large number of factors, both external and internal, which can have an influence on strategy formulation.

These include the following:

External Factors

- The nature of the competition and the products which are available in the marketplace.
- Political, economic, social and technological pressures.
- What it is that buyers need.
- The environment in which the organisation operates, whether it is stable or turbulent.

Internal Factors

- Corporate objectives.
- The size and power of the organisation.
- The resources available.
- The way the organisation is operated, i.e. its procedures and practices.
- Stakeholders' expectations.
- The organisation's position in the marketplace.
- Whether the organisation is a leader or follower.
- Whether the management is aggressive or not.

Any aspect of the internal or external environment can have an influence on the organisation's strategy.

An organisation can be classified as any one of the following:

A leader - one which is innovative in nature and is regularly the first to bring new products into the marketplace.

This type of company is likely to be a powerful one with a large share in the market and having high resources. It will gain a competitive advantage from being first into the market as, for example, was Thermos with the first vacuum flask, but has to invest heavily in product development and has to accept a subsequent high level of risk.

Leaders have to have the necessary strategies to:

- protect their current market share;
- encourage existing customers to increase their demand;
- attract and retain new customers;
- update the product design/service for its customers;
- introduce new products to new markets.

In order to carry out these strategies, the company needs to adopt a policy of:

- **innovation -** by always being ahead of its competitors;
- **fortification -** by pursuing activities which are aimed at keeping the competition down;

- **confrontation -** by using such tactics as price wars in order to reduce competitors' profits, and by aggressive promotional campaigns to increase sales;
- **harassment -** through maintaining a high level of pressure on distributors and criticising the competition.

A follower - one which tends to copy what leaders do. These companies do not invest heavily in research and development themselves but try to take advantage of the work done by others. They will never get the initial major market share but they do not spend money on development, nor in creating an awareness of a new product, as this will already have been done by the leaders. They can take advantage of any errors which leaders may make.

For example, if a technical problem is found in a new product followers may be able to put this right before launching their own version. Or they may be able to take advantage of a leader creating a greater demand for their new product than they can themselves satisfy, leaving scope for a follower to fill the gap.

In either of these situations it is possible for followers to find buyers turning from the leader's product to their own, with the leader losing its market share.

Followers can amend a leader's product by changing its price, quality, etc. and, since amendment is cheaper than development, will enjoy lower costs.

Because they do not create original ideas but cling to the tails of leaders, followers are often referred to as "me-too" marketers.

A challenger - one which, as with followers, tries to overtake the market leaders. The methods adopted by the companies include price-cutting incentives offered to distributors, improved levels of service to customers, sharing costs with others, etc. Currently, much of the competition between supermarkets is based on who can provide the most reliable service of home delivery based on ordering via the internet.

A niche marketer - an organisation which offers some kind of specialised product or service, often referred to as a 'unique service proposition' (USP).

Market leaders do not usually bother too much about niche marketers, since they are likely to be catering for only a small market segment. Despite this low market share, niche markets can be very profitable to those who operate in them.

Over time, of course, both the circumstances of an organisation and the environment in which it is operating change, so the stance adopted by the organisation will also change. This may lead to a given organisation attacking a market leader or defending itself against a preditating follower. These changes may be based upon organisation looking for extra growth or profits, or even trying to survive. They may also be due to a change of top management, leading to a change in the organisation's culture.

Strategies used by Marketers

These may be classified as attack strategies or defence strategies.

Attack Strategies

- **Direct challenge (differential advantage)**

  This is a high risk strategy with a potentially high pay-off. Because market leaders are in a very strong position a large financial investment as well as great determination, is required to pursue this strategy.

  A recent example of this strategy was seen by Tesco's successful bid to take market share away from Sainsbury and become the new market leader.

- **Direct attack (distinctive competence)**

  This strategy involves removing the leader's competitive advantage by means of a new innovative product. It is a very effective method, provided the advantages are valued by the target market.

- **Direct attack (market share)**

  This is the process of taking over smaller firms in the marketplace in order to build up market share. The clever part with this strategy is the retention of customers from those businesses taken over.

- **Flank attack**

  In this strategy it is necessary to find a slot in the market which is not currently filled. The niche is identified by segmentation analysis. Having discovered the gap it is essential to determine whether or not it is untenable. If it is not untenable then it can be used as a base from which to attack in order to build market presence and share.

- **Encirclement**

  This is an attempt to overwhelm a competitor on every front. It is very expensive to mount, but also very expensive to resist. Japanese companies in the electronics market often pursued this strategy successfully by producing a constant stream of ever-better, ever-cheaper products until they achieved dominance.

- **By-pass**

  This is a method of indirect attack by broadening a resource base until the attacker is strategically prepared before actual confrontation.

- **Guerrilla**

  Small competitors who are unable to attack a big competitor on a broad front can hit them aggressively in areas where they know they will be slow to respond. Although this strategy is unlikely to defeat a market leader, it can enable the smaller firm to take a substantial profit from the market.

Defence Strategies

- **Position defence**

  This consists of flexible consolidation. No company can remain static, since others will be trying to increase their own market share. Product innovation is necessary in order to remain tenable and maintain market position, even with well established products. An entrenched market leader will need to pursue promotional innovation to keep its product in front of the eyes of its customers. This is likely to give the leader massive cost advantages and help it to defend even a sustained attack.

- **Pre-emtive defence**

  Attack is often the best means of defence, and an attack on a potential challenger can distract them through their need to defend themselves. It might be described as 'getting your retaliation in first', and is a strategy successfully pursued by a number of well-known companies.

- **Counter-offensive**

  This involves carrying out an aggressive response to an attack in order to protect market share.

- **Mobile defence**

  This involves a company keeping on the move through innovation, market expansion and diversification into new marketplaces. This type of entrepreneurial strategy is pursued even when there is no apparent attacker in sight.

Richard Branson's expansion of Virgin from records to air travel to trains, etc. is a good example of this type of strategy.

- **Flanking defence**

  In this strategy companies which are under attack may try to match the products of an attacking competitor. However, this can misfire, as the American motor companies found when they tried to compete against imports of smaller foreign cars by producing similar sized ones of their own. The strategy failed because the foreign designs were proven, whereas the Americans were working in an area unknown to them, hence their designs were not as good.

- **Contracting defence**

  If this means pulling back to a position of strength from which to mount a counter-attack this can be a successful strategy. However, if it means continually falling back, then, rather like a football team's defence which retreats as the opposition advances until their strikers can shoot at goal, a company can reach a point where it has to contract.

  Insignia, the new name of the former Post Office, has been retreating currently as competition hots up, particularly through electronic forms of communication. It now faces a huge loss of business and a large deficit on its trading.

Any organisation, in choosing its strategy has a complex decision to make. Sometimes mistakes are made which result in huge losses. Often influences outside the control of managers are responsible for these errors.

Strategic Group Analysis

Competitor analysis can be developed into strategic group analysis in order to determine more specifically who represents the most direct competition, and what form this competition will take.

The purpose of this form of analysis is to enable an organisation to home in on others with the same strategic characteristics who are thus competing on the same basics.

Porter has argued that these groups can be identified by considering just two or three sets of key characteristics.

Some of the characteristics which Porter suggests are as follows:

- diversity of product/service offered
- quality of product/service
- technological leadership (a leader or follower)
- pricing policy
- organisation's size, etc.

With respect to technical leadership, a number of drugs companies have criticised Boots in the past for producing their own brands based on the research and development carried out at high cost by others.

This type of analysis may be used:

- to see how rival companies compete within their strategic groups;
- to look at the mobility of an organisation in moving from one group to another;
- to predict changes within a market.

Competitive Advantage

Organisations have two main strategy levels:

- Company-wide - which is carried out at the corporate level

- Competitive - which is the concern of individual business units.

In the case of competitive strategy, the object of the exercise is to increase the business's client base at the expense of its competitors.

Competitive strategy is concerned with gaining a competitive advantage in each of an organisation's individual business units.

According to Michael Porter, this may be achieved by a:

- **cost leadership strategy** - to become the lowest cost producer;
- **differentiation strategy** - to be unique in its market with respect to potential competitors;
- **focus strategy** - concentrating on satisfying a small section within its target population.

Cost Leadership

This is difficult to sustain because competitors often copy them and the advantage is therefore only short term.

A possible alternative to being the individual lowest cost supplier is to join a co-operative with others in the same market and take part in a collective purchasing scheme in order to obtain economies of scale. Such a policy has helped many small general stores when they have joined the Spar co-operative.

Differentiation

Some organisations are able to offer something to their customers which enables them to charge more for their products/services, i.e. some added value. This is often associated with brand names that customers feel (not always correctly) are superior.

I recently had a conversation with a sales assistant in Harrods store who told me they could sell almost anything at a higher than normal price if it had 'Harrods' written on it - and especially if it was supplied in a Harrods carrier.

Focus

This strategy involves selling what is considered a better quality product at a higher price than other similar ones.

In car manufacturing there are a number of small companies still building cars by traditional (hand) methods rather than by mass production, such as Marcos and Morgan.

Whichever strategy is followed, it is always vulnerable to changes in the environment which cannot be forecast and over which the organisation has no control.

Who could have expected the farming industry in the UK to recover from the major effects of BSE only to then suffer from Foot and Mouth disease?

In the end, Porter suggests that these are the only three main strategies that can be followed and that a business not following one or other of them is "stuck in the middle".

The model is referred to as Porter's Generic Strategy Model, and is illustrated in Figure 2.1.

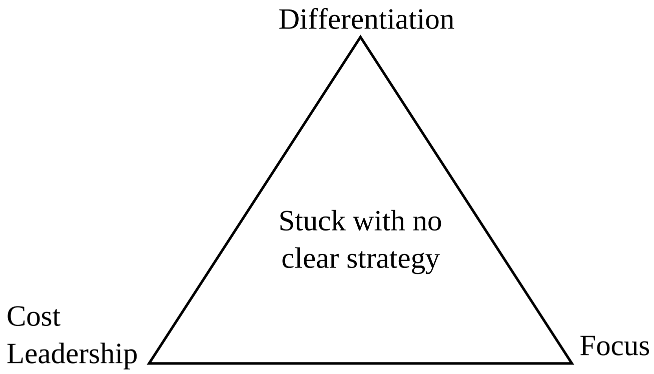


Figure 2.1: Porter's Generic Strategy Model

D. INTERPRETING ENVIRONMENTAL ANALYSIS

In order to interpret the environment there are four major question which the managers of an organisation have to consider:

- How can we minimise the threats from the environment?
- How can we take maximum advantage of the opportunities which may exist?
- What advantages do we have over our competitors?
- What are our limitations?

Every organisation's environment changes over a period of time. Sometimes this change acts in favour of the organisation; sometimes the opposite happens and the organisation has to take steps to avoid being blown off course, i.e. away from its strategy.

When changes in the environment can be seen to be happening in the distance, i.e. a long way off in terms of time, it is possible for strategy changes to be made in order to counteract their effect, if they are likely to pose a threat, or to take full advantage of them if they are likely to offer an advantage.

If changes in the environment happen suddenly, then it is the organisation(s) which can best handle change which is/are more likely to survive.

PEST Analysis

We have already seen that an organisation does not exist in a vacuum but in an environment, and that it interacts with the environment in which it operates.

This interaction is not a one-way but a two-way process, with the organisation being influenced by factors outside of it over which it has no control. In turn, the organisation can influence its environment, through such activities as advertising and marketing. Thus an organisation can exert influence over its customers, both existing and potential ones, by making a product or service available and thus establishing a demand for it which did not exist previously. This sometimes results in a leading organisation creating a market larger than it alone can satisfy, thus creating business for following organisations.

In order to understand the functioning of an organisation as it interacts with its environment, four key elements have been identified which, taken together, make up the total environment. These are political, economic, social and technological elements, hence the acronym PEST. In reality these elements may overlap, and some experts would add two others, those of legal and environment, but at this stage we will consider the four basic elements.

Political

Organisations are influenced by government policies such as taxation policies, political orientations, legislative structures, trade union power and so on, and they may attempt to influence government thinking in these and other relevant areas to their own advantage by lobbying, providing party funds, etc.

Economic

Organisations have to operate in conditions of boom and bust (recession) at times. Interest rates change, tax rates change, the money supply can alter, investment levels go up and down, as people try to guess likely future market movements, etc. In the global economy, exchange rates have an effect and stock markets throughout the world are linked to one another. These affect the ability of firms to compete with overseas markets. As has often been said, 'when America sneezes, Europe catches a cold'.

Energy costs can also play a significant part in business activity.

On the other hand the pricing and pay policies of large organisations can affect the wider economy.

Social

The culture of an organisation is affected by the culture of the society in which it operates. Changes in lifestyles affect the market and thus the running of an organisation. Social mobility, demography, family size, etc. can all contribute an effect on the human resources inputs and the market(s) in which an organisation operates.

Technological

The level and focus of both government and industrial research and development expenditure have an effect on technological changes in the environment. The nature of such changes and the speed of technology transfer will have an impact on an organisation's own technology. Product life cycles, which seem to get shorter and shorter, particularly in the electronics industry, also play an important role in this area.

Example of a PEST Analysis

This was carried out on behalf of an organisation which retails to the agricultural/horticultural sector.

Element	Trend	Importance (1→10)	Comments
Political	Agriculture	10	Industry declining
	Euro	1	Legislation
	Election	3	Unlikely to pose a threat
	Legislation	10	
	Hunting ban	7	Loss of income equestrian/pet/clothing
Economic	More money	8	More disposable income
	Cash flow	10	Cost of merger
	Low inflation	6	More disposable income
	Interest rates low	6	More disposable income

Element	Trend	Importance (1→10)	Comments
Social	Leisure industry	10	More leisure time Growth in industry
	Healthy life	8	Walking
	Shopping later/longer	10	Changes in shopping trends
	Quality products	8	Last longer, but improve image
Technological	Internet	9	Threat of selling products over internet by competitor
	E-mail	10	Benefits to company include contact with suppliers
	Computer	10	Oscar system developed to suit our needs
	Database	6	Enlarging from open evening etc. Targeting customers
	Customer Account card	8	A winner - if properly controlled

Entering and Exiting a Market Environment

With respect to the likely competitive issues, it is necessary to consider how those within a market might respond to a new entry challenging their market share.

There are a number of barriers which can affect both the entry and exit of companies to and from a particular market.

Barriers to entering include:

- the capital cost involved;
- the market costs involved in competition with other already well established companies once entry has been made;
- the technology owned by existing companies;
- access to distribution channels - marketing may be difficult because competing manufacturing companies own their own retail outlets;
- a 'fight back' from existing members, which could raise the cost of entry;
- brand-switching costs, where existing members have agreements with their customers;
- legislation and/or government action, where licences may have to be obtained.

These barriers will depend on the sector the organisation is trying to enter, so they will need to research the specific barriers and how effective they are.

The major barrier to exiting a market is the level of capital investment an organisation has invested in it. Even where profit margins are low, this can lead to a company carrying on and hoping for things to improve.

Scenario Planning

By basing their judgment on objective techniques and adding a little imagination by means of their own intuition, researchers are often able to create a series of alternative future scenarios. Each of these alternatives needs to be consistent and to have some probability of occurring. The purpose of such forecasting is to stimulate creative thinking and opportunities for managers to look ahead.

Marketers carrying out research into the sale of low alcohol fizzy drinks have shown that consumers are influenced in their judgment of the alcoholic content of the drink by the colour of the can in which it is presented.

Within the scheme of scenario planning we also have:

- **cross-impact analysis -** which identifies a set of key trends and asks the question "if A occurs, what impact with this event have on other trends?"

and

- **demand/hazard forecasting -** which sets out to identify major events which would have an impact on the organisation. Each event is rated for its convergence with other major events taking place in society and its appeal to the public:
  - the greater the event's convergence and appeal the more likely it is to happen;
  - the higher-rated events are the ones which management takes more account of.

Subjective forecasting helps managers to make strategic judgments about future events, to identify the best strategic route to take, and then to make contingency plans to deal with them.

Those events which are closer in time will be given more accurate levels of probability of their occurring. Eventually, all events will have occurred and can then provide databases from which objective forecasting can be made for future events.

E. TOOLS FOR COMPETITOR AND MARKET ANALYSIS

Porter's Five Forces Model

Porter's summary of the forces which govern industrial competition provides us with a rationale that underpins the 'mechanical' aspect of a management audit - see Figure 2.2.

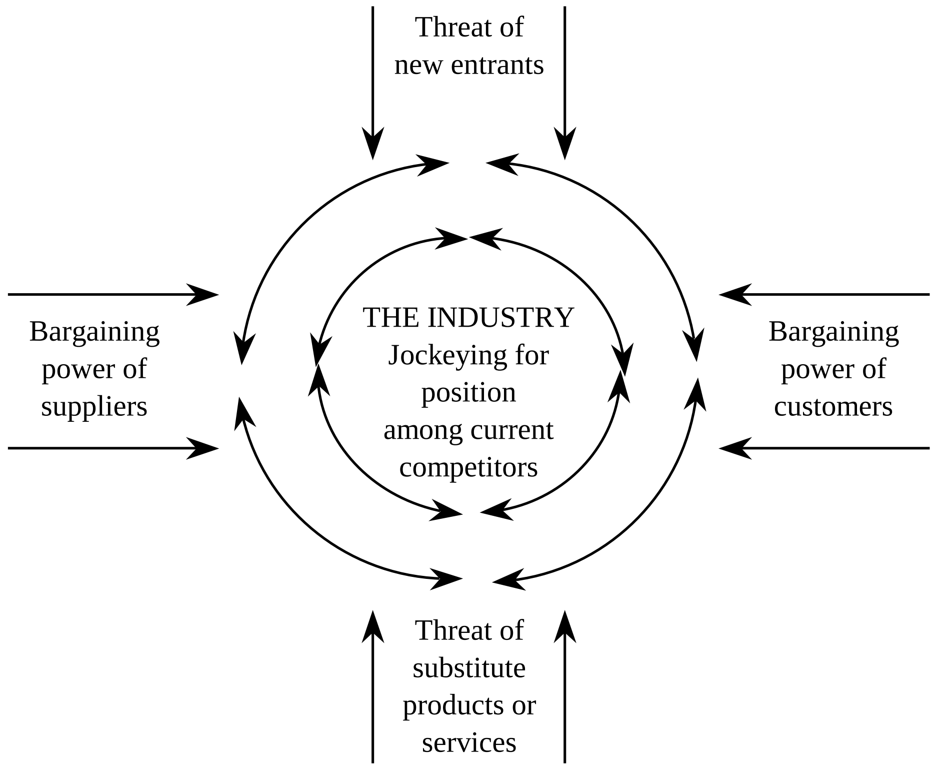


Figure 2.2: Five Environmental Forces (Porter)

Porter has suggested that it is the "collective strength of these forces which determines the ultimate profit potential of an industry".

The aim of a corporate strategist is to find a position in the industry where the organisation can defend itself against these forces or can influence them in its favour.

Strategic Group Analysis

The mapping of strategic groups in a particular industry can provide information about the competitive structure of the industry and the opportunities and constraints with respect to development which exist within it.

The maps are produced by plotting the geographic coverage o a company against marketing intensity in terms of marketing costs as a % of sales (see Figure 2.3).

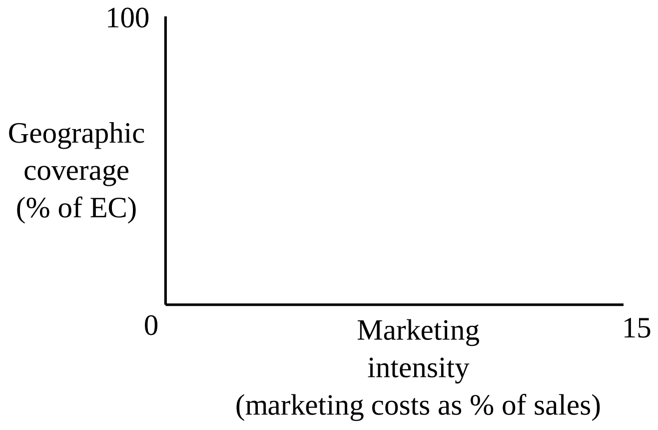


Figure 2.3: Strategic Group Map

The purposes to which such mapping may be applied include:

- the prediction of market changes
- the identification of strategic opportunities.

Product Life Cycle (PLC) Analysis

The benefits of using PLC theory come from working with the concept rather than using it as a quantified predictive device. Once it is understood, it is possible to use it in a 'predictive hindsight' manner.

With hindsight, it is possible to plot the progress of a product, for example in terms of volume against time. Life Cycle theory holds that a typical 'S shape' curve will be obtained (see Figure 2.4). Given that this shape curve is expected, a manager can say, "when I look back, at which point on the curve will I discover we have been at this time?"

During this life cycle a continuous process of external change takes place, from the entry of competitors to consumer attitudes. Understanding this enables a marketer to anticipate these changes and to plan accordingly.

Any marketing change can affect the curve, not just a change in the product. Thus PLC is a variable, not a determinant.

The following arguments can be used against the PLC concept:

- Biological metaphors are misleading.
- Attempts to match empirical sales data to PLC curves have proved difficult.
- The curve depends upon the management of the product over time; it is not independent.
- It is not equally valid for product class, product form and for brands.
- Its stages are difficult to define.
- Identification of stage position is difficult to determine.
- The scope for its use as a planning tool is limited.
- Experience has shown that, where PLC has been used as a planning tool, opportunities have been missed and costly mistakes have been made.

Whilst there is considerable truth in these arguments, PLC as a shorthand form of description is and will remain of fundamental importance to the understanding of product policy.

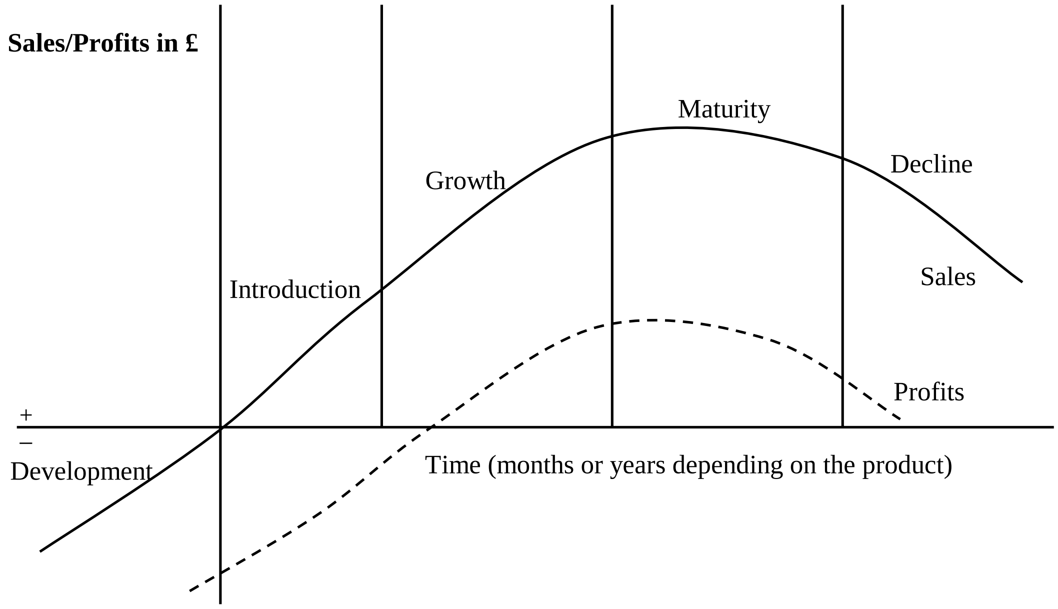


Figure 2.4: Product Life Cycle

Market Segmentation and Customer Value Analysis

The position of an organisation in the market place in relation to its competitors is very important, so assessing market with respect to customers is very valuable in forming strategy. Not all customers are the same, so it is useful to consider markets in terms of segments. For example, that segment of the market which caters for buyers with unlimited resources will differ from that where buyers have a limited budget. Those who cannot afford a Rolls Royce can still be customers of other car manufacturers. This analysis can be quantified by measuring the size of market segments and of competitors' market share by segments. It can also be considered in a qualitative way.

In either case the market segments need to be considered in terms of their growth and of their size in order to establish their individual competitiveness.

Directional Policy Matrices

There are a number of models which look at directional policy. We will consider three of them:

- **The GE Matrix**

  This model takes account the nature of the market and the capability of the companies within it and assess businesses units in terms of the 'attractiveness of the industry' and the 'business strength' of the company.

  Planners take account of factors such as the following in order to assess a company as 'high', 'medium' or 'low' with a view to placing them on a grid. Often these factors are 'weighted' by the planner.

Industry attractiveness	Business strength
Market size (numbers/value)	Differential advantages
Market diversity	Share (number/value)
Growth rate (total/segment)	Sales (volume/growth)
Profitability (total/unit)	Breadth of product line
Competitors	Mix effectiveness
Social/legal environment	Innovativeness

On the grid the circles represent overall market sales.

The share held by the company is then shown as a proportion of the circle (see Figure 2.5).

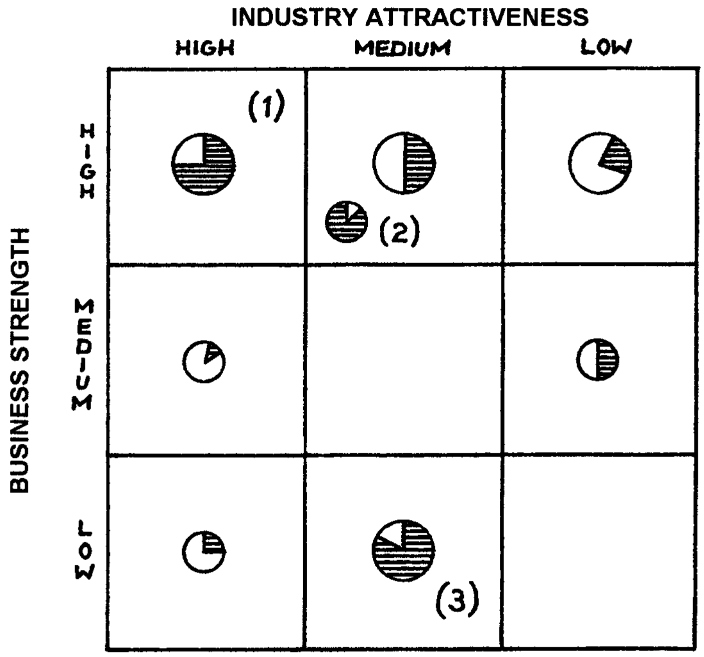


Figure 2.5: General Electric Business Matrix

Figure 2.5 shows the characteristics of products in a company's portfolio. The company has major shares in three markets:

(1) Highly attractive market with large overall potential revenue. The company has high business strengths.

(2) Market is mid-value but again the company has high business strengths. Overall market income is not high but there is future potential.

(3) Market not highly attractive and company strength is low. High share of market may be because competitors have withdrawn. This market may be potentially lucrative in earnings but small in size. Planners may decide therefore to stay and keep out competitors.

Strategic Options

Strategic options for companies on the GE matrix cover three types of management activity. Each strategy covers three of the nine cells (see Figure 2.6).

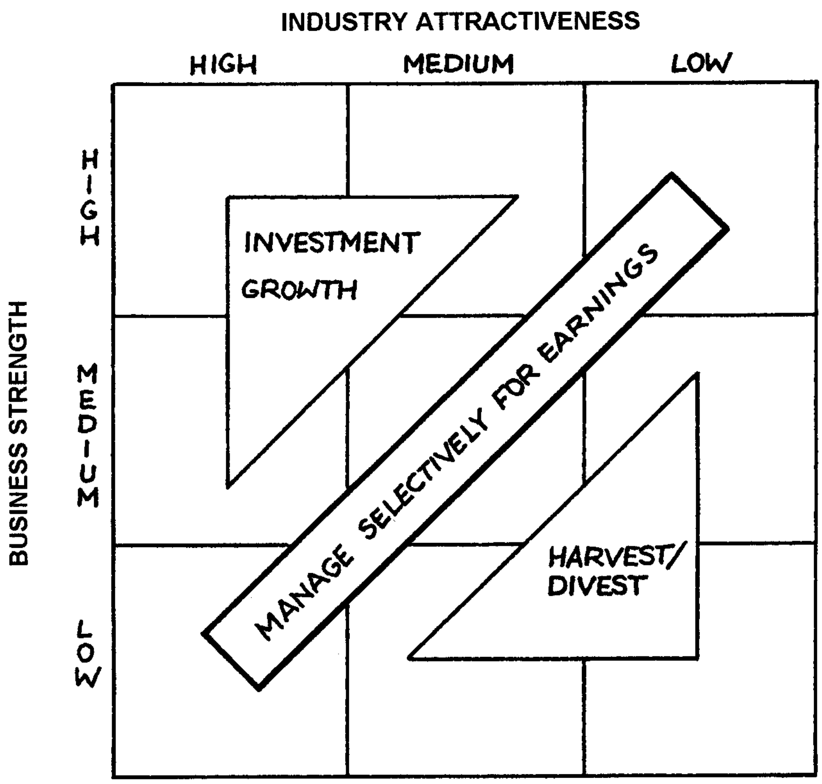


Figure 2.6: General Electric Matrix Strategies

Investment for Growth

– Used with strong products in markets with high or medium attractiveness where company has high or medium strength. Full resources of advertising, distribution, good price margins, etc. would be used and profitability expectations would be high.

Manage Selectivity for Earnings

– Strong position in weak market. Company uses marketing to retain loyalty.

– Moderate position in moderate market. Company identifies underserved segment(s) and invests selectively.

– Weak position in attractive market. Company must decide whether to increase investment, concentrate on niche(s), acquire another business or trim off activities.

Harvest/Divest

– May decide to minimise marketing activities and concentrate on selected products only.

– Divest products and close down any non-productive business unit.

Profits are 'harvested' because investments are minimal.

- **The Shell Directional Policy Matrix**

  This is similar to the GE matrix but the variables are 'competitive capabilities of the company' and 'potential profitability of the market sector'.

ENTERPRISES COMPETITIVE CAPABILITIES	PROSPECTS FOR SECTOR PROFITABILITY: UNATTRACTIVE	AVERAGE	ATTRACTIVE
WEAK	DISINVEST	PHASED WITHDRAWAL	DOUBLE OR QUIT
AVERAGE	PHASED WITHDRAWAL	CUSTODIAL GROWTH	TRY HARDER
STRONG	CASH GENERATION	GROWTH LEADER	LEADER

Figure 2.7: Shell Directional Policy Matrix

- **Arthur D Little Strategic Condition Matrix**

  This is a more detailed model, having twenty cells to identify various business units. The variables used with this model are ‘competitive position’, which denotes the nature of the position held by the company in the market (and whether or not it can maintain it), and the ‘stage of industry maturity’, which is similar to describing the life cycle of the industry.

STAGE OF INDUSTRY MATURITY

COMPETITIVE POSITION	Embryonic	Growth	Mature	Ageing
Dominant	Grow fast. Build barriers. Act offensively.	Grow fast. Aim for cost leadership. Defend position. Act offensively	Defend position. Increase the importance of cost. Act offensively.	Defend position. Focus Consider withdrawal.
Strong	Grow fast. Differentiate.	Lower cost. Differentiate. Attack small firms.	Lower costs. Differentiate. Focus.	Harvest.
Favourable	Grow fast. Differentiate.	Focus. Differentiate. Defend.	Focus. Differentiate. Hit smaller firms.	Harvest.
Tenable	Grow with the industry. Focus.	Hold-on or withdraw. Niche. Aim for growth.	Hold-on or withdraw. Niche.	Withdraw.
Weak	Search for a niche. Attempt to catch others.	Niche or withdraw.	Withdraw.	Withdraw.

Figure 2.8: Arthur D Little Strategic Condition Matrix

What is not shown in this model is the ‘non-variable’ position, when the company’s capabilities are really limited and the market offers no indication of improvement.

It might then have to be accepted that the business should withdraw from the market in a way that minimises the cost and does minimal disruption to the company’s overall portfolio.

Study Unit 3

Strategic Analysis 2: (The Internal Environment)

Contents ***Page***

INTRODUCTION

In Unit 3 we will examine the scope, nature and importance of analysing the internal environment in corporate planning.

We will explain appropriate tools for carrying out this analysis, and for conducting an internal appraisal, together with the techniques of their use.

Objectives

After studying this unit, students should be able to:

- explain the role and importance of the concepts of resources, competences and strategic capability, and discuss their interrelationship;
- explain and use appropriate tools and techniques for conducting an internal appraisal.

A. RESOURCES, COMPETENCIES AND STRATEGIC CAPABILITY

Resources

Some years ago the resources a company had to call on to carry out its business operations were generally referred to as three M's - materials, machines and men (sometimes with the addition of a fourth M, money). The capability of an organisation to compete effectively with others in its market depends to a large extent on the resources from which it can draw, together with the balancing of these resources and the mix of activities which they allow the organisation to perform.

Nowadays, we would describe the key resource areas as including machines, buildings, etc., and people (not just men), together with an assessment of both the quantity and quality of each. In addition, of course, the financial resources available to the organisation are also vital to its success.

An important concept to be considered together with these resources when considering the strategic capability of an organisation is the linkages between them, which will affect its ability to compete with others.

Competencies

These are the strengths which lie at the core of an organisation and which give it its competitive edge, together with its areas of weakness which it has to avoid.

When considering the competencies of an organisation, it is also very useful to compare it with those of its competitors.

For example, in the fashion industry, a key competence would be that of design. The company with the best design team is likely to be the most successful.

The competence of design, however, belongs to the individual designer rather than to the organisation for which he or she is working at a particular time. Consequently, a designer moving from one organisation to another can cause a change in its competitive position.

When George Davis was working for Next, they developed a good reputation for their clothes design. When he left to go to Asda, there was a related fall in Next's competitive position in the clothes market and an increase in that of Asda's. It appears that he is currently considering a move from Asda to Marks and Spencer, and it will be interesting to see if this is the boost which they need in their clothesware section.

Strategic Capability

The strategic capability of an organisation may be regarded as its core competencies with respect to those of its competitors.

In order to assess the strategic capability of an organisation, a major factor to consider is its financial position.

The difficulty here lies in deciding which financial aspect to measure, since a company's financial situation represents different things to different people. For example:

- **Shareholders** in the company are mainly interested in the returns they receive for the money they have invested in terms of dividends paid and increases in share values.
- On the other hand, **financiers**, who have provided funds through loans to the company, are more interested in the risks which these represent as shown by its gearing ratio of debt/equity.
- Those who are **suppliers of goods, services or materials** to the company are mostly concerned about its liquidity and its ability to pay for such items in the short-term.
- The company's **employees** are also interested in its liquidity, as this affects its ability to pay salaries.

In addition to these stakeholders, two other groups are interested in the financial status of a company. One of these is the community in which it exists, who are involved in such things as potential donations the company may make to local charities. The other is those who are concerned about its long-term effect on the environment.

B. THE PROCESS OF INTERNAL APPRAISAL

Resource Audit

A resource audit is a suitable starting point for considering the importance of an organisation's internal environment.

The audit itself is a highly skilled task and needs to be carried out by an experienced team of researchers.

Before the audit, managers within the organisation have a role to play, which is to provide:

- **the desire** - to have the information provided by a full audit in order to aid performance improvement
- **the resources -** which will have to be provided for within the corporate plan
- **the briefing -** which must be meticulous and comprehensive, yet call for no more than is absolutely necessary.

Without these provisions any audit will be a waste of time and resources. It may in fact do actual damage to the organisation's morale and even could, in the extreme, impair its ability to survive. The aim of the audit is to discover both the nature and the quantity of the resources available to the organisation.

Johnson and Scholes suggest that these can be typically grouped under the headings of physical resources, human resources, financial resources and what they call 'intangibles'.

- **Physical resources**

  These include machines and the production capacity of the business, and embrace the age, condition, capability and location of machinery.

- **Human resources**

  This refers to the number and types of skills available within the business, not merely the number of people employed.

- **Financial resources**

  How capital may be obtained, the management of cash within the business, the control of debtors and creditors, and relationships with money suppliers such as shareholders, finance houses, etc.

- **Intangible resources**

  The stuff of which the ‘good will’ of the business is made up, which could be a major asset, and may be a result of useful contacts, brand names, the company image, etc.

Analysis of Competencies

When we were considering competencies earlier in the unit we looked at the effect on an organisation of the movement of a holder of competence, in this case the designer George Davis, in going from one company to a competitor and taking his competence with him. Similar events occur in the finance industry when fund managers move between unit trust operators. In analysing the competence of an organisation the question of who owns the competence, i.e. whether it is the organisation or an individual, is an important one to answer.

Other factors which need to be considered when analysing competencies include:

- whether a competitor can acquire the competence by buying it, or by copying it.
- How long-lasting it is, which is linked to product life cycles.

In the case of purchase, or imitation, supermarkets often compete with higher priced branded goods by marketing their own in-house brand. Since they do not actually manufacture the product there is often speculation about the suppliers of such goods. Some consumers insist on sticking to the original brand, on the grounds that it has a reputation to maintain, whereas others make their choice based on price. Kellogg’s have gone so far as to declare they do not supply their cornflakes to any other company and that they market the original product; all others being an (inferior) imitation.

Analysing Costs

Cost efficiency in an organisation can be achieved in a variety of ways:

- **Economies of scale** are available through bulk purchasing, as in the case of co-operatives such as the Spar chain of grocery stores.
- **Supply costs**, which can be kept low by strict management of input costs, an example of which is shown by the Marks and Spencer strict control over their suppliers by insisting on being the sole purchaser.
- **Efficient production** methods, such as mass production as in the motor industry.
- **Experience curves**, which illustrate the rule that over a period of time the costs of production will decrease in relation to the number of units produced as experience increases in processes, material purchasing etc. (see Figure 3.1).

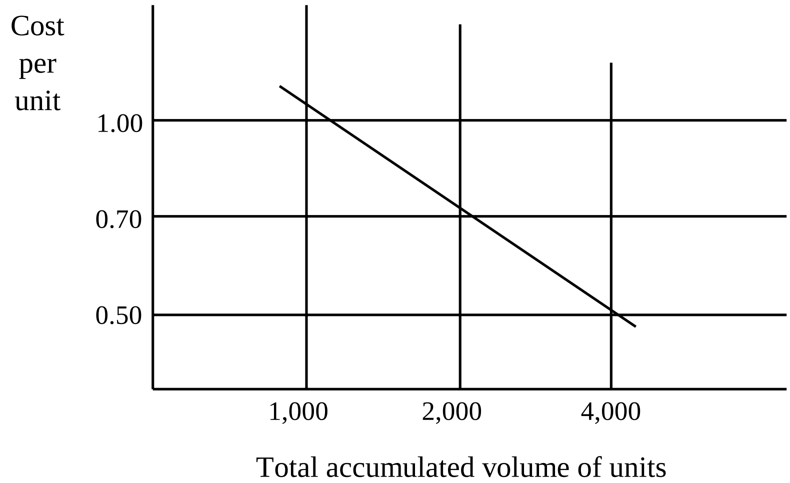


Figure 3.1: Experience Curve

In analysing costs it is important to assess how each of these factors relates to the organisation sustaining its competitive position.

Comparative Analysis

This is used to see how the value system of an organisation has changed over a period of time. It is carried out mainly by considering the history of the company itself or by comparing its performance with the norms of the industry within which it operates.

By looking at financial ratios such as sales/capital and sales/employees and comparing current values with those of recent years, it is possible to identify trends.

Comparing the company's position in terms of these factors with the norms for the industry, helps to identify its relative position with respect to its competitors.

Assessment of Organisational Performance

In order to develop strategic plans for future performance a company needs to analyse both its current and past performance. This is an integral part of assessing the company's strengths and weaknesses, from which to decide on its strategic capability. Organisational performance is an essential consideration, since the company must pursue strategies which it is capable of sustaining.

Three ways of approaching the analysis of a company's current and past performance are:

- by historical analysis of performance;
- by a comparison with the relative performance of organisations in the same industry, i.e. with industry norms; or
- by benchmarking, i.e. a comparison against the best performers.
- **Historical analysis**

  The analysis consists of looking back at how the company has performed in the past and by comparing its current performance with previous years in order to find out whether there have been any significant changes.

  This form of analysis usually considers those areas of a company's performance which can be readily quantified, such as total sales, market share, financial ratios, profitability, etc.

  The down side of this type of analysis is that, although it can identify changes of performance or trends in activities, it does not provide any reasons for them.

It also has the weakness that it does not take account of relevant changes in the external environment within which the company operates, such as slumps in worldwide trade of the magnitude of those currently being experienced, partly due to the terrorist attacks on America during September 2000.

Historical analyses can also provide too rosy a picture of a company's performance, since it may be doing well relative to its own past performances whilst at the same time not doing very well relative to the current performances of its competitors.

Because historical analysis is by its nature an insular method, it can lead to complacency within a company over its performance and strategic capability which is not justified if its competitors are in fact increasing their performance.

- **Comparison with industry norms**

  In order to avoid the potential problems of complacency creeping into a company's vision of its current performance, as can happen with historical analysis, it is important for a comparison to be made between the company and other competitors in its industry and with the standards of performance which are accepted as being the industry norms.

  The problem with this type of analysis is based on the difficulty of comparing different companies with their differences in resources, objectives and so on. As a consequence of these differences, what may be regarded as a competent performance for one company may be regarded as a poor one for another company with access to greater resources of finance, skilled personnel, etc. Comparison with industry norms does have the advantage over historical analysis, however, since it is not as insular.

  One difficulty in carrying out comparisons between organisations is that of deciding on suitable performance indicators. As with historical analysis, the temptation is to use quantifiable measures, such as sales, profits etc., but these are not always relevant when considering not-for-profit organisations, for example, so there are times when qualitative measures have to be used.

  Industry norms are increasingly being used in the public sector, leading to the controversial 'league tables' currently favoured by the government, particularly in the health service and education, but hated by a number of workers within those areas.

  A major complaint is that these comparisons do not take place "on a level playing field" because resources are not equally distributed and the different client groups for different hospitals, schools, etc. are not comparable. Despite these reservations, it is true that industry norm analysis is a powerful addition to the historical analysis approach.

- **Benchmarking**

  This method goes beyond the industry norms comparisons by assessing the competence of an organisation against that of the best performers in the sector.

  Benchmarks are useful because they can be set for separate activities, which then makes them transferable from one industry to another. For example, standards of hygiene set for hospitals can become transferable to hotels, and catering standards for hotels may be transferred to hospitals.

  Benchmarking may be used to compare a particular aspect of an organisation's activities against the best in the class, or it may look at the organisation's overall performance against the best performers. So, for example, benchmarking may be used to compare an organisation's total quality management, or its system of distribution of goods or services, with those organisations which are the best performers in these areas.

  Benchmarking may also be based on the formation of a partnership between organisations across industries, with one company using a company which is accepted to be the best in a given activity to help it to improve its own performance. Difficulties can obviously arise where companies are close competitors, but even here it is possible to use benchmarking through collaboration.

Benchmarking is particularly useful in the service and not-for-profit sectors as a way of assessing performance, with the objective of future improvement, where quantitative measures such as financial performance, are either more difficult to apply, or are inappropriate.

Financial Analysis

Because of its nature this area is often left to accountants, but markets must also be able to understand financial statements in order to be capable of monitoring the company's progress, calculate budgets or carry out forecasting, and this is also true for other executives.

The following three main financial statements which are used in financial analysis:

- The **Balance Sheet**, which shows the current financial position of the company by showing how it is funded and by identifying precisely where the monetary value is located.
- The **Profit and Loss Account**, which gives the details of the amount of profit, or loss, which has been made at various levels within the company.
- The **Operating Costs Statement**, which provides a detailed breakdown of the costs incurred in any activity. Knowing how much cost is incurred enables managers to calculate the percentage of profit (or loss) that each department, or function, is making.

Balancing the Business

An important concept in the process of the internal appraisal of an organisation is that of the balancing of its resources.

This can be analysed by considering the following aspects:

- The mix of activities which collectively make up the organisation's overall portfolio, and how well these complement one another.
- The balance of skills and personalities of those employed in the organisation and the ways in which they are linked together in order to create a competitive advantage.
- The flexibility of the organisation's resources and how well they are able to adapt to a changing environment.

C. TECHNIQUES FOR CONDUCTING AN INTERNAL APPRAISAL

Value Chain Analysis

A value chain may be defined as:

> An organisation's co-ordinated set of activities to satisfy customer needs, starting with relationships with suppliers and procurement, through production, selling and marketing, and delivery to the customer. Each stage of the chain is linked with the next stage and looks forward to the customer's needs and backwards from the customer as well. Each link in the value chain must seek competitive advantage, either by being cheaper than the corresponding link in competitor's chains, or by means of added value through superior quality or differentiated features.

The value chain concept was developed by Michael Porter with particular reference to working teams functioning as service units. He uses the term 'value activities' to describe the different identifiable activities of which any business is a collection, e.g. marketing, production, etc.

He suggests it is at this level that the unit achieves a competitive advantage, rather than at company level.

Porter classified these activities as being either primary or secondary (support).

Primary activities are:

- inbound logistics - receiving, storing and distributing inputs;
- operators - which turn these inputs into the final product or service;
- outbound logistics - storage and distribution to consumers;
- marketing and sales - which make consumers aware of the products or services available;
- service - installation and after-sales servicing.

Secondary activities provide the infrastructure which enables the primary activities to take place and are:

- infrastructure - systems vital to the organisation's strategic capability, which usually support the whole chain, e.g. planning, finance, quality management;
- human resource management - recruitment, training, development, etc.
- resource and technology - product or process development, etc.
- procurement - acquisition of the necessary resource inputs to the primary activities.

In addition, Porter added the idea of 'margin'. The goal of any generic strategy is to create value which is greater than the cost of its creation, the difference between the two being margin. The function of the value chain is to display 'total value', which includes value activities and margin.

Figure 3.2 illustrates Porter's overall concept, the generic value chain.

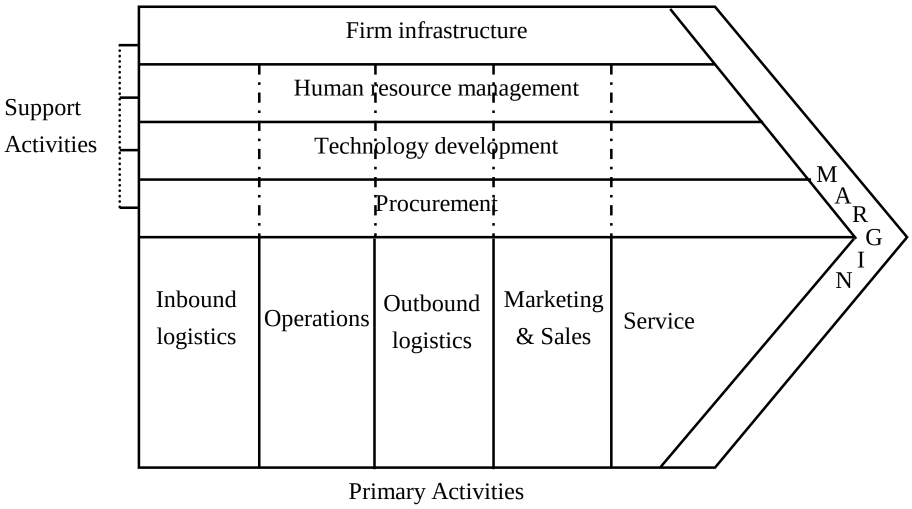


Figure 3.2: The Generic Value Chain

(After Porter)

Value chain relationships consist of:

(i) the company's ability to transfer skills and/or expertise between similar chains; and

(ii) the ability of different units to share activities.

In (i) the skills considered must be of advanced level to assist the company to develop a competitive edge. For example, the expertise of an advertising executive, who could use the skills of marketing developed in one section of a company to improve sales in another section.

In (ii) units might share a common distribution system in order to take advantage of lower fuel costs by producing economies of scale, or of reducing capital investment by sharing warehouse storage facilities.

Value chain analysis can lead in this way to create positive synergy between those units involved, i.e. the whole becoming greater than the sum of the parts.

Figure 3.3 shows an organisation drawing in resources and converting them into goods and services, and, in doing so, adding value.

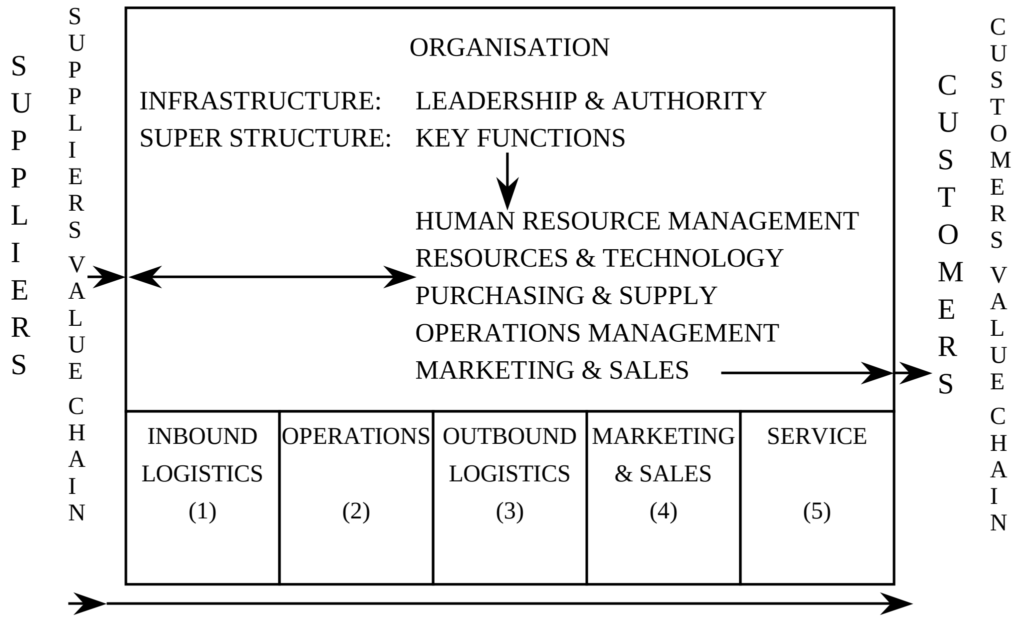


Figure 3.3: Value creation

Steps in the process are value enhanced:

(1) if the organisation can procure the right resources at the right price at the right time (storage and control of stock is crucial);

(2) by total quality management and continuous quality improvement techniques;

(3) by the proper transportation and distribution of goods and services;

(4) when customers are informed of goods and/or services which are available and when they are assisted to make wise choices in their purchases;

(5) when high quality after-sales service is provided.

The value chain of the organisation links to:

- the value chains of its suppliers, who will have value chains of their own;
- the value chains of its customers, when customer choice is assisted by customer education, e.g. leaflets, informative labelling, helpful store layout, etc. For example, B and Q, the do-it-yourself store, provide information leaflets within their stores which show customers how to carry out activities such as wall tiling, etc. and many garden centres supply information leaflets on the care of plants.

In these ways any given organisation is part of the wider value system which creates a product or a service.

Using the nine activities identified by Porter, a strategic planner can analyse each in turn in order to discover which of them gives rise to actual or potential customer value, and where the company is strategically distinct from its competitors. Thus it can be established where a competitive advantage can be achieved.

For example, in the primary activity of service to customers, Dell computers set out to provide a faster, more efficient technical service to their users than their competitors could provide and this yielded them a competitive advantage, particularly in the business rather than the personal computer segment. The advantage arose despite the price of their packages being greater than that of competitors, because they identified that the more important consideration for a company user was that their system was very rapidly put right again if it went down.

The company had used the idea of value chain analysis by examining its own key strengths and weaknesses and comparing them to customer needs and to their competitors' resource profiles in order to develop a competitive advantage.

This example is a simple one as it illustrates only one aspect of the complex analysis of the value chain.

In practice, competitive advantage is often derived from the links between activities in the chain, since these are more difficult for competitors to copy.

In addition, the analysis should go beyond the value chain of the company itself and consider the value chains of both suppliers to the company and to its distributors.

Also, the needs and expectations of customers have to be taken into account, since a competitive advantage is only to be gained if it meets these. For example, if a company can only offer through its value chain activities a better quality product which its customers do not particularly want, and at a higher price which they are not prepared to pay, then it will not create a competitive advantage. Value chain analysis provides a valuable means of carrying out a resource audit for a company through a systematic analysis of its value activities with a view to create a competitive advantage over its competitors.

Portfolio Analysis

Investors try to maintain a balanced portfolio so that if one company or sector is doing badly it can be offset by others which are doing well at the same time.

Similarly, companies try to achieve a balanced portfolio in which the activities of the company are complementary, rather than trying to pursue a single product or a single market.

One of the first methods for classifying business units in terms of market growth rate compared with market share was proposed by the Boston Consulting Group (BCG).

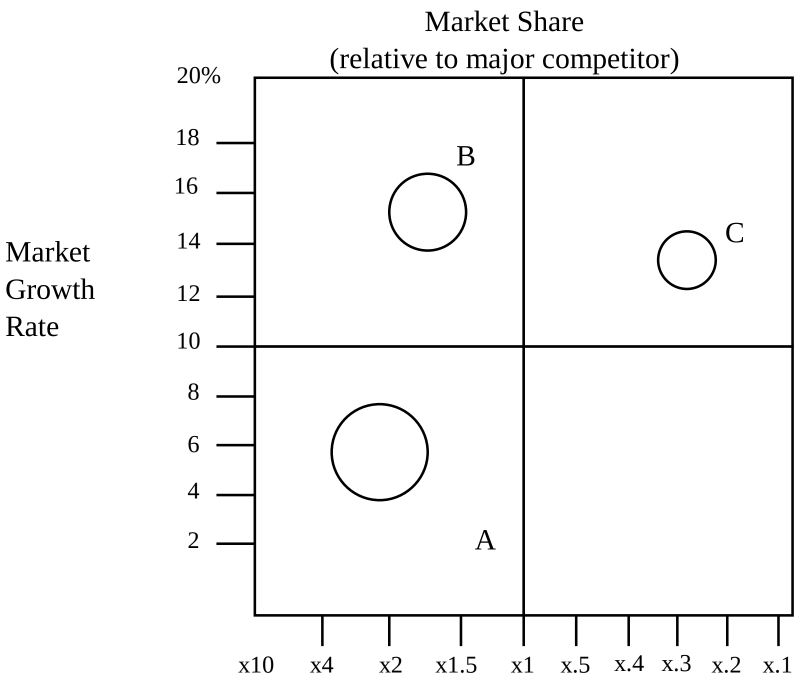
The BCG growth-share matrix has developed into one that allows a comparison to be made on a relative market share basis (see Figure 3.4).

Relative market share is calculated by taking the ratio of your own sales to those of your major competitors.

For example:

Our Sales	**Sales of the Top 3 Companies**			**Relative Market Share**
£m	£m	£m	£m	£m
2.5	5.22	4.72	3.77	0.48
4.0	4.0	4.0	2.84	1.00
6.7	6.7	4.9	4.5	1.37

The results are then plotted using log scaling and with circles that are sized in proportion to the volume of business.



Circles indicate size of SBU/product
Centre of circle indicates position in matrix

Figure 3.4: Boston Consulting Group Growth-Share Matrix

Notes:

(i) Whilst the matrix provides some degree of quantification, it is primarily a perceptive tool.

(ii) Circles are notoriously unreliable to see exactly where the centre falls without a complex and confusing set of grid lines being added to the model.

(iii) The model is criticised because it assumes high market growth, such as the levels available in the early 1970s, when the model was first introduced, and which are rarely found today.

The model must thus be used with care. However, it is computer-friendly and can be dynamic. It provides the basis for more sophisticated techniques of portfolio analysis and is a comfortable route into modern techniques.

Using the BCG model enables planners to classify their products/strategic business units (SBUs) into four categories according to their position on the matrix. This classification can also help in understanding the nature of the products/SBUs, i.e. whether they are ‘cash providers’ or ‘cash users’ (see Figure 3.5).

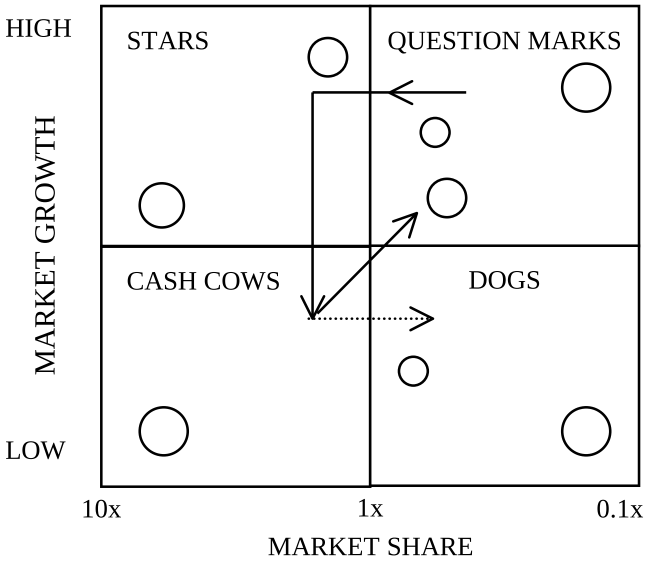


Figure 3.5: Boston Consultancy Group Matrix

This matrix may be used as a guide to product strategy. The names are:

- **Stars**, where high market share but high market growth forces the supplier to reinvest profits into promotion to maintain market share. These are often products in the growth stage of the life cycle and are not particularly profitable.
- **Cash cows**, where high market share and low market growth minimises promotional expenditure. They are often products in the maturity, saturation or decline stage of the life cycle. High market share guarantees good profitability (except during the saturation stage).
- **Question marks** (sometimes referred to as problem children), where low market share but high market growth forces the supplier to invest heavily in promotion without earning enough profit from sales to cover expenditure. They are often products in the growth stage of the life cycle, but the low market share makes them highly unprofitable.
- **Dogs** may be products that have failed to establish themselves in a mature, saturated or declining market, in which case they are likely to be unprofitable (although promotional costs are small, there are no economies of scale and earnings may not be sufficient to cover costs). Alternatively, they may be products which have established a particular niche in the market. Such products can command a premium price and can be highly profitable. An example would be Morgan sports cars, which have a low market share of the total car market but earn a very satisfactory profit.

The Boston Group suggested that investment should principally be channelled into stars and those which could be promoted to star status. Investment in cash cows should be at the level necessary to maintain market share. The profitability of dogs should be carefully monitored and the organisation should withdraw from unprofitable dogs. It should also withdraw from question marks which are without star potential.

Referring to Figure 3.5, the company has two **star products**, one which has the leading share in its market and one which has only slightly more share than its leading competitor. Efforts should be made to increase the share of the second product in order to secure its future profitability, particularly as the market has a very high growth rate. This could be where future earnings lie.

The company has only one **cash cow** so it is vulnerable. A loss in market share could mean trouble, even more so if there is no star to come in and take its place. In this situation the company would have to pump in finance to support its cash cow, instead of supporting other categories. If it supported other categories instead of its cash cow, this would eventually become a dog.

The company has three **question marks**. Planners may decide to concentrate all its efforts on one of them in order to make it successful, and leave the others just ticking along until they have secured the position of the most favourable. The product which is producing a greater proportion of revenue (the one with the largest circle) may be chosen for extra effort as it obviously has a good earning potential.

The company also has two **dogs**. Given that they consume cash, they are often dropped by companies but it is not always wise to do so immediately as they may still be making money. The competition must be considered, as well as the effect on customers. Dropping a product from a range can upset buyers who then look for other suppliers.

If you have developed a preference for a particular food product, say a salad dressing, originally stocked by your usual supermarket, and they cease to stock it for some reason, you look to other stores instead. Having found your dressing in a rival supermarket, the chances are you will buy other things there as well, and might even transfer all your food shopping to the new store.

Thus a company retaining a dog may sell other products with a high profit margin to customers who visit the company mainly to purchase the dog item.

Growth-Gain Matrix

In order to measure how well each Strategic Business Unit (SBU) is keeping pace with market growth, market growth rate can be plotted against product growth rate and used, together with the growth-share matrix shown in Figure 3.5. This matrix, shown in Figure 3.6, shows share losers as those which appear above the diagonal broken line, and share gainers below the line.

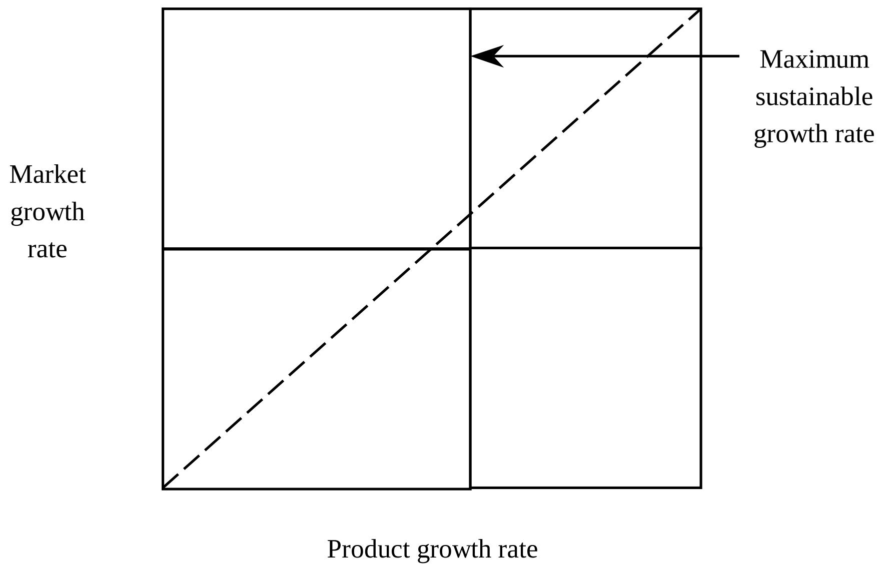


Figure 3.6: BCG Growth-Gain Matrix

In this matrix the maximum sustainable growth rate is plotted as a solid vertical line and the weighted average growth rate of the products within the portfolio cannot be greater than this maximum.

Where the weighted average growth rate, sometimes referred to as the ‘centre of gravity’, lies to the left of the line, there is scope for further growth. The significance of this is that it shows that changes of strategy may be necessary in order that resources are directed to this area so that this potential growth is realised.

Multifactor Portfolio Matrix

Because they were aware of the limitations of the BCG matrix, General Electric and McKinsey combined together to develop a more sophisticated model called the multifactor matrix.

This uses nine cells and makes a serious attempt at quantifying the situation.

In this model market attractiveness is measured against competitive position and both axes are quantified as in Figure 3.7. In this example, the base axis is marked from 5.0 to 1.0, rather than from 1.0 to 5.0 as is conventional practice in constructing graphs, but it allows the matrix to work.

The circles in the diagram each represent a market, with the shaded areas representing the share of the market which is held by the company.

The arrows indicate the direction of market movement, and the model is highly dynamic.

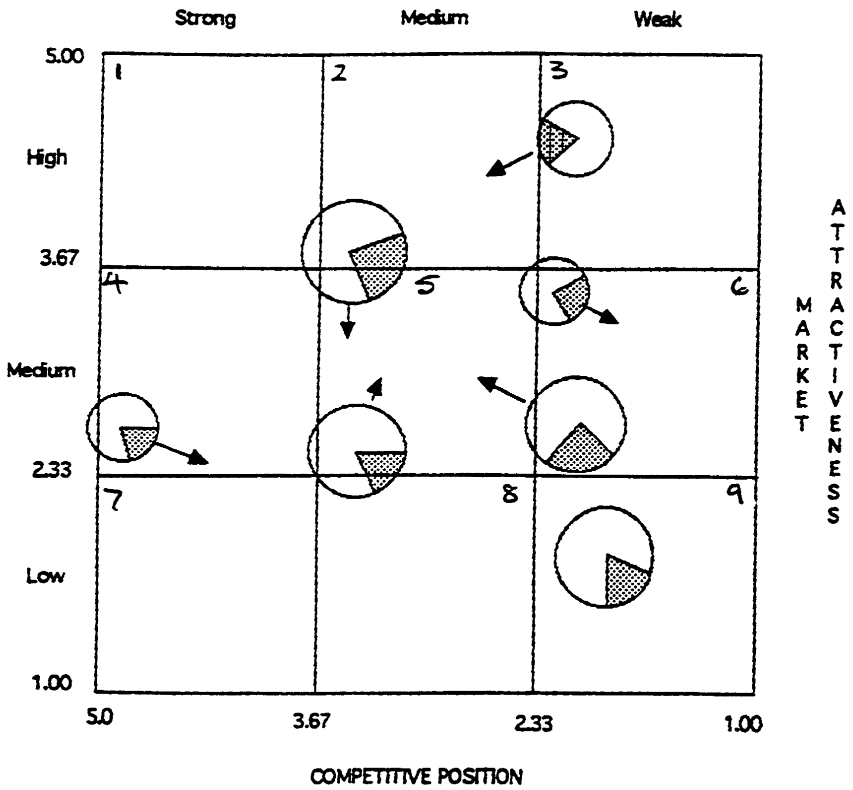


Figure 3.7: Multifactor Portfolio Matrix

The cells in the diagram are numbered only in order to be able to identify them in the following discussion.

The general strategic principles illustrated are:

Cells 1,2 and 4	–	invest
Cells 3, 5 and 7	–	manage selectively for earnings
Cells 6., 8 and 9	–	either harvest or divest

Criteria that may be used to establish market attractiveness and competitive position are unique to each organisation and they must be established with considerable care over a period of time. A weighting figure is assigned to each factor and the total weighted score determines the position on the matrix.

The following criteria are used:

- **To measure market attractiveness**
  - market size
  - the size of key segments of the market
  - growth rate
  - diversity
  - seasonal demand
  - price sensitivity
  - marketing opportunities
  - competitive structure
  - entry and exit barriers
  - technology
  - availability of necessary workforce
  - environmental issues
  - political and legal issues, etc.
- **For competitive position (business strength)**
  - market share
  - organisation (or SBU) growth rate
  - sales force effectiveness
  - depth of product line
  - distribution
  - financial resources
  - marketing effectiveness
  - price
  - experience curve (see below)
  - quality/reliability
  - investment utilisation etc.

Experience Curves

It is often said that, whilst one person may have ten years' work experience, another may have just one year's experience repeated ten times over.

Considerable research has been carried out to determine the effect of experience rather than time in carrying out manufacturing tasks. The Boston Consulting Group (BCG) have established that important relationships exist between the cumulative experience gained by an organisation and its unit costs, which is referred to as the experience curve, i.e. they found that experience is a key source of cost advantage.

Over a period of time the costs of production will decrease in relation to the number of units produced as experience increases in terms of processes, material purchasing and so on. This was shown previously in Figure 3.1.

D. INTERPRETING INTERNAL ANALYSIS

SWOT Analysis

Any organisation's corporate plan must take into account the following:

- its **S**trengths
- its **W**eaknesses
- the **O**pportunities available to it
- the **T**hreats it faces.

Hence the acronym SWOT.

The process of analysing these factors in relation to the organisation's environment is known as SWOT analysis.

SWOT provides a guide to management action. It provides an excellent framework to enable the evaluation of complex information to be carried out. From a well constructed SWOT framework areas for action can be identified - although it is not a suitable tool for quantification.

The basic framework consists of four segments that share relationships (see Figure 3.8).

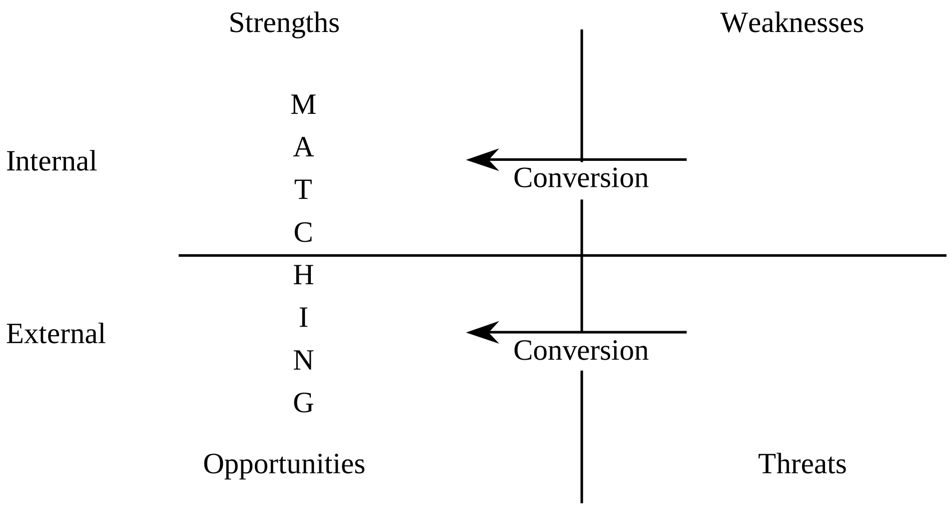


Figure 3.8: SWOT Framework

- Strengths and weaknesses refer to the internal aspects of the organisation.
- Opportunities and threats exist externally.

Wherever possible, the intention is to convert weaknesses to strengths and threats to opportunities, bearing in mind that what is seen as a threat to one person is regarded as an opportunity by another.

It is sometimes necessary to place a factor between two segments in the framework. For example, if a weakness is being worked on but is not yet converted to a strength it may be useful to place it 60/40 between strengths and weaknesses. There is also often a difficulty in assigning a factor to a segment - is it a strength or a weakness? Sometimes, a closer look will show it to be both at the same time.

- An organisation's **strengths** may include:
  - the skills and expertise of its management and staff;
  - organisational factors, such as its responsiveness to change;

- access to resources, e.g. availability of cheap capital (perhaps due to government relocation programmes);
- its market position.

Strengths must be considered relative to the organisation's competitors. A bank, for instance, may consider itself as having good international banking skills but this opinion is only valid if the skills are better than other financial institutions also involved in the international capital markets.

- **Weaknesses** are, in general, the opposite of strengths and similar factors need to be taken into account. There is, however, a significant difference in that weaknesses can be absolute. Weaknesses should not be considered only in relation to the organisation's competitors, but also with respect to the standards of the industry as a whole. For example, organisations have invested heavily in information technology (IT) in recent times and as a consequence made large cost savings. An overall decline in IT skills throughout industry would result in all companies losing these cost savings and would push up all their costs, resulting in no loss of competitive advantage for any particular company.
- **Opportunities** arise as a result of environmental factors and environmental changes. Changes in the economic environment, such as a new Finance Act, might create opportunities for the introduction of new savings products, such as ISAs.
- **Threats** are also the result of changes in the environment. Increases in interest rates (which may have to come sooner rather than later) and a downturn in the economy force banks to make increased provision for bad debts, threatening profitability and capital adequacy.

An example of an organisation turning a potential threat into an opportunity is provided by Bradford and Bingley's chief Chris Rodrigues.

When the management of the Bradford and Bingley Building Society reluctantly bowed to members' pressure and demutualised, they became a small fish in a very big pond. Bradford and Bingley as a bank lacks the scale to compete with others such as Halifax and Nationwide in the core UK mortgage market but Rodrigues saw this as an opportunity to diversify rather than a threat to their independent survival. So, although mortgages and savings accounts are still currently a key generator of profits for Band B, he has reinvented the company as a provider of financial services, i.e. a distributor of other people's financial products.

As part of a longer-term strategy he has set up two new business units. One, known as the Market Place, is the distributor of financial products, together with a team of independent financial advisers. The other, known as Market Express, operates in the sector of buying-to-rent.

This strategy has been well received by the financial and stock markets, and shares in B and B are showing about 50% premiums on their launch price.

Strategic Fit and SWOT Analysis

The importance of SWOT analysis is derived essentially from the notion of 'strategic fit'. This is based on the idea that a company must match its key skills and resources to the opportunities presented to it by changes in the environment in which it operates. This in turn implies that strategy and plans must be based on a careful matching of internal company resources and abilities to external environmental trends and changes.

The environment gives rise to major organisational opportunities and threats. Therefore, the first requirement of an effective SWOT analysis is the establishment of an intelligence system capable of monitoring and forecasting changes in the environment.

The technique of SWOT analysis is very much a case of assessing a company's strategic fit, or lack of it. This involves considering the company's individual profile of strengths and weaknesses and the opportunities and threats presented by changes and trends in the environment.

A full SWOT analysis should be carried out whenever considering future corporate objectives and strategies in order that these should reflect the results of such an analysis. A full audit taking account of the SWOT factors should be made at least annually in the planning cycle.

Some companies prefer to employ outside consultants, rather than their own staff, to conduct their SWOT analysis so as to get a potentially more objective view, particularly of the company's strengths and weaknesses.

Carried out regularly, an objective SWOT analysis is a key step in the process of achieving a strategic fit between a company's resources and abilities and its external environment.

Critical Success Factors (CSFs)

These are the factors on which the success of a strategic change depends. For example, the need to reduce response time to customers' requests.

A resource plan should ensure all critical factors are identified and their number kept to a minimum. Establishing standards provides the basis for measuring performance and, especially in complex operations, certain points are chosen for particularly close monitoring, since it is impossible to observe everything. The points chosen must be critical ones, either by being limiting factors in the operation or ones which are better at showing that things are going according to plan.

Examples of standards which may be used are:

- the measurement of business income by considering profit (before and after tax), or by profit as a percentage of sales, or by return on investment (ROI);
- the measurement of the financial state of an organisation by inventory levels, cash availability, working capital, or assets/liabilities ratio, etc.

A critical success factor is anything which must be successful if the organisation is to meet its overall objectives, and will normally have an adverse effect across a large part of the organisation if failure occurs in this particular area.

If the organisation is divided up into smaller units, then critical success factors can be identified for each of these various areas of the business. If each unit or area achieves its own CSFs, then the business should achieve its overall targets.

When setting objectives, it is important to define the CSFs which will indicate when these have been achieved. Where objectives have been quantified this is easy, but where they are related to task achievement it is even more necessary to spell out the factors that will contribute to successful performance and the standards to be met.

CSFs can be important in relation to organisational structure. Ideally, a company should be internally organised in relation to the particular requirements of its business, and not by reference to any historic considerations. Also, any organisational structure may be appropriate for the current phase of development but inappropriate for the following phase, where the CSFs may be significantly different.

Study Unit 4

Strategy Development and the Bases of Strategic Choice

Contents ***Page***

INTRODUCTION

This is the first of two units which will be discussing strategic choice. It will provide you with an outline of the process of developing strategies (covering basis, direction and methods) and examines in detail the first of these, i.e. the basis of choice. We will also be looking at appropriate techniques for strategy development.

Objectives

After studying this unit, students should be able to:

- identify the nature and scope of strategy development;
- explain the three bases of strategic choice;
- explain and use appropriate techniques to elucidate strategic options within each of the three bases.

A. STRATEGIC DEVELOPMENT OPTIONS

Nature and Scope of Options

Before it can develop strategic options an organisation needs to look at itself very thoroughly. A business needs to recognise its strengths and weaknesses. It needs to know what kind of company it is, and to do this it should ask itself questions such as, are we:

- a single product/service company, such as shoes or furniture?
- a process company, such as electronics?
- an end-user, such as communications?

In addition to taking into consideration products, markets and technology, the company also has to consider the values, aspirations and prejudices of those top managers who control it.

The company must then ask itself questions about the opportunities which exist in its market(s), and whether it can deal with its own weaknesses, perhaps by buying in expertise or by acquiring other companies, etc.

Koontz and O'Donnell describe effective strategy as knowing and capitalising on one's strengths, whilst avoiding one's weaknesses, and then attempting to match these appropriately with opportunities.

The options available to an organisation are best considered within the overall generic strategy it is pursuing.

Decisions with regard to generic strategy, direction and method are not independent. As Johnson and Scholes point out, an organisation which is following a generic strategy of providing a product or service which differs from that of its competitors, i.e. a strategy of differentiation, can also be following a strategic direction of product or service development and still have further choice as to the method which is to be used to achieve new development, such as:

- by means of its own efforts;
- by combining with others in a joint venture; or
- by acquiring another company.

A Model of Strategic Choice

Development strategies contain a number of elements, which can be considered by asking the questions:

(i) What is the basis of the strategy?

(ii) Which direction is it going to take?

(iii) How will it be carried out?

The basis of generic strategies

As we saw in Unit 2 Michael Porter argues that there are three fundamental ways in which companies can achieve sustainable competitive advantage, i.e. can increase its market share at the expense of its competitors. These are:

- A **cost leadership strategy -** where the company sets out to be the lowest cost producer in its industry by selling a standard, no-frills product. For example, a low cost air flight which provides no in-flight meals, in aircraft with less leg room than usual, etc.
- A **differentiation strategy -** where the company offers a unique product or service. For example, the marketing of Walt Disney films on video.
- A **focus strategy -** where the company concentrates on catering for a small section of the market, as in the case of Stella Artois lager which is sold to those who are prepared to pay for something which is advertised as "reassuringly expensive".

The direction of the strategy

This can take several different forms:

- **Withdrawal** from the market, either full or partial, can be the correct direction to take. For instance, withdrawal from the market of those parts of a business which are underachieving will release resources which may then be used more effectively elsewhere.
- **Consolidation** within a growing market is supported by the results shown in the experience curve (Unit 2). In a mature market, consolidation can mean putting more money into the market, as Nestlé have decided to do. In declining markets it can be productive to take over the assets of competitors who are leaving the market as a means of consolidating the business.
- **Market penetration** means taking advantage of opportunities to increase market share. The ease with which this can be done will depend, as with consolidation, on the current state of the market. If it is a growing market then penetration may be relatively easy, if the market is static it will be much more difficult due to the activities of larger market shareholders. In declining markets the scope for penetration will depend to a large extent on whether or not others are leaving it.
- **Product development** is often carried out by companies in order to cater for changes in consumer demands. For example, over the last few years the UK public's taste in foods has changed greatly, mainly as a consequence of more available travel to foreign countries. This has led to food suppliers having to stock what might have been regarded as quite exotic foods just a short while ago. The other main reason for a company involving itself in product development is where the product has a very short life cycle. The most obvious examples of this are seen in the electronics industry, with rapid developments in television, DVD's etc., and in telecommunications with the continuous changes in mobile telephones.
- **Market development** is often carried out by companies developing new markets whilst trying to maintain their position in their current market(s). One of the ways market development can be achieved is by companies starting to export their goods.

- **Diversification** is another direction which companies can take into other products and/or markets, by means of internal or external development.

  When a company develops beyond its present product and market whilst remaining in the same area, this is described as **related diversification**. For example, a newspaper expanding by taking over a radio station remains within the media sector. It has built on its present strengths by using its expertise to develop new interests in the same sector.

  This form of diversification can occur by:

  – **backward diversification**, when activities related to inputs in the business are developed, i.e. further back in the value chain, as with a jam manufacturer investing in a fruit farm;

  – **forward diversification**, when activities are further forward in the value chain, such as a small brewery purchasing a public house;

  – **vertical diversification**, when the company develops interests complementary to its current activities, for example Walter Greenbank are a group of vertically integrated companies which design, manufacture, market and distribute wall coverings and furnishing fabrics.

  The term **unrelated diversification** is used to describe a company moving beyond its present interests into unrelated markets or products. For example, Centrica, whose core business is in the gas industry, moved into financial services by launching the 'Goldfish' credit card.

Diversification can bring a number of advantages to a company.

Related diversification can:

- control supplies, leading to continuity, improved quality, etc.;
- control of markets, by guaranteeing sales and distribution through tied outlets;
- take advantage of existing expertise and knowledge in the company when expanding into new activities;
- provide better risk control, through no longer being reliant on a single product or market.

Unrelated diversification can:

- exploit under-utilised resources;
- provide movement away from declining activities;
- spread risks by avoiding having 'all the eggs in one basket';
- reduce seasonal peaks and troughs;
- create greater positive synergy.

Diversification, however, does not always improve a company's business. For example, high street banks who decided they could operate successfully in the property market by buying up estate agencies found themselves having to dispose of the businesses at a loss when the market collapsed.

Alternative methods for carrying out the strategy

- **Internal development**

  By developing products internally rather than using outside agencies, the company can have the advantage of using skills and knowledge acquired during the development in order to market the product more effectively.

  Similarly, developing new markets through the use of internal staff helps the salesforce to better understand the market.

- **Acquisition**

  One of the advantages of acquisition as a method of carrying out a strategy is that it enables the company to obtain new products or markets very quickly.

  In order to test the effectiveness of acquisition Drucker has suggested five simple rules:

  (i) The acquiring business must consider what value it can add to the acquired business. This may include management, technology, distribution, etc. Finance is necessary but unlikely to be sufficient on its own.

  (ii) A common core of unity must exist between the businesses in terms of markets, products, technology, etc. This helps to create a common culture or at least sympathy between the two separate ones.

  (iii) The acquiring company's management must understand the business being acquired.

  (iv) The acquiring company must put a quality management team quickly into the acquired business.

  (v) The acquiring business must be able to retain the best management from both businesses.

  As managers will see the acquisition both as a risk, and may therefore leave, and as an opportunity, and will stay, a clear promotion and management development strategy must be in place at the time of the take-over.

  Porter suggested that the rate of acquisition failures (between 60% and 74%), where there is a mismatch between the core competencies or experience of the acquirer and acquired business. The greater the mismatch, the greater the risk of failure.

- **Joint development/alliances**

  One of the ways that businesses develop is through franchises, where the franchiser is responsible for setting up an outlet such as 'Spud-u-like' or 'Qwik Print' and for marketing, training, etc., and the franchise holder undertakes specific activities such as selling.

  Joint ventures are arrangements between organisations which remain independent but have an equal share in the new organisation. In these arrangements the assets are jointly managed but can be separated.

B. BASIS OF STRATEGIC CHOICE 1

Corporate Purposes and Aspirations

Any organisation should be able to answer the question:

> "What is the aim or purpose of this organisation?"

All companies limited under the Companies Act have their aims written down in what is usually referred to as the 'object's clause' in their memorandum of association. This clause is a legal requirement and is usually written in such a manner that the company can do almost anything it wants.

The purpose of an organisation is often expressed through a mission statement (see later), or more specific objectives, and aspiration it would ultimately hope to achieve.

For example, a football club playing in Division Three of the English Football League this season may set itself objectives of promotion to Division Two within the next 2 or 3 seasons, but aspire ultimately to obtain membership of the Premier League.

Over a period of time the corporate objectives of an organisation, i.e. those objectives which apply to the organisation as a whole, can change and so the legal objectives established when a company first comes into being may bear little resemblance to the objectives it has today. Strategy is the means of achieving corporate objectives, but objectives can change as strategies develop.

Objectives for an organisation are usually set by the most dominant stakeholder(s), which are often the managers of the organisation, but sometimes they are set by a single individual, particularly in the case of an entrepreneur such as Richard Branson at Virgin.

Ownership Structures

Sole Proprietor (also known as the sole trader)

This is the oldest and simplest structure. The proprietor provides the financial resources and makes the decisions. There may be employees in the firm, and some decision-making may be delegated to them, but the ownership rests with the proprietor, who provides the funds and takes responsibility for profit or losses.

Partnerships

In the UK the Partnership Act (1890) limits the number of partners in a business to twenty. In 1967 the Companies Act removed this limit on qualified and practising accountants and solicitors and the business members of a recognised stock exchange.

The Limited Partnership Act (1907) provides for a business to have general partners, who have unlimited liability but carry on all the running of the firm, as with sole proprietors, and also limited, or "sleeping" partners who contribute capital but take no part in managing the business. Limited partners receive a fixed rate of interest on their capital and have the protection that there is a limit on their liability, which is the amount of their capital subscription.

Private and Public Limited Companies

The Companies Act (1985) differentiated between private limited companies, which must have "Ltd" in their names, and public limited companies, which must include "Plc" in their name. Both types are owned by their shareholders who hold the "equity" in the company, which is why ordinary shares are called "equities". The liability of the shareholders is limited to the value of their shareholding, i.e. the maximum they can lose is what they paid for their shares.

- Shares in private companies can only be traded with the agreement of the shareholders; they cannot be offered to the general public, as can shares in public companies.
- A private company must have at least two shareholders, whereas a public company must have at least seven.
- A private company must have at least one director (two if the company secretary is a director); a public company must have at least two directors.

Companies are controlled by their owners, the ordinary shareholders, who can vote at the Annual General Meeting to appoint or remove the Directors who manage the business.

Shareholders expect a return on their investment in the company through dividends, which are based on the size of the profits, and increases in the value of their shares.

Co-operatives

Their structure includes:

- open membership;
- democratic control through a system o one member one vote (regardless of the number of shares held);
- distribution of any surpluses in proportion to purchases - the dividend;
- promotion of education;

- religious and political neutrality.

Co-operative movements exist in over 70 countries with over 500 million members worldwide. In the UK there are 8 million members and the annual turnover is £6 billion.

Mutual Societies

These are owned by their members, who are also the shareholders.

- A building society's members are those who put money into a share account which pays interest or dividends.
- Many insurance companies are also mutual societies with their policy holders being the members.

All mutual societies are managed by an elected board of directors who appoint the senior management of the society.

Public Corporations

These are effectively companies set up by Act of Parliament, such as the BBC. They have no shareholders. Their capital is held by the Treasury and the relevant Minister appoints the board which manages the corporation. The Minister and the Treasury agree on borrowing limits. The corporation is a legal entity, but the Minister is responsible to Parliament for the running of the industry.

Mission and Strategic Intent

As we saw in Unit 1, a mission statement is concerned with the reason an organisation exists, and tells its stakeholders what it is doing, and why it is doing so.

Once an organisation has been set up, it begins the process of planning, to make sure that it remains in business for years to come.

Smaller companies may plan on a small scale but larger companies such as multinationals, must have a formal planning system whereby they set their mission, goals, objectives and strategy. This planning is vital if the organisation is to remain successful, profitable and in business. As part of this process a company must spell out its short- and long-term objectives to show:

- Where it wants to go.
- Which markets it may want to enter.
- Which companies it may want to acquire or merge with.
- Whether it wants to innovate or diversify.
- Whether it wants to downsize and divert some of the its business interests.

These are just some of the day-to-day decisions made during business operations.

However, an organisation cannot effectively make such decisions without first analysing where it is now, where it wants to be and whether it has the resources, financial, physical and human, to enable it to achieve its targets.

This involves the systematic formulation of mission, goals, objectives and strategy.

Defining the Business

We have already said that businesses need to know where they are going, what markets they wish to take part in, how diverse they wish to be and how they propose to remain in business. The need to compete has widened from town to county, to region, to state, to country, to continent, to the world and so we see the development of the **global firm**. This is one which can secure major benefits in all areas of operation, with the ability to site production plants and distribution network in whichever region or whichever country offers the best advantages.

A global organisation is one which has reached the stage where it plans worldwide manufacturing facilities, marketing policies, financial flows and logistical systems.

Thus, for example, components and supplies are bought where they can be obtained cost-effectively. This means reduction in transport costs of raw materials, and the use of labour where it is cheaper and more readily available. One result of this is in job losses at traditional production sites in the UK, with companies such as the shoe manufacturer, Clarks, moving their factories from Somerset to the Far East.

Different global areas have concentrated on different aspects of business in the past. So, for instance, European companies have good engineering and technical skills, and the Japanese produce good value for money through their concentration on quality design and their production. A global company can take advantage of these differences by using ‘horses for courses’, thereby improving overall quality.

In the past some firms have made blunders by trying to trade on a world basis from their own country. General Foods, for example, failed badly when they tried to launch packaged cake mixes in Japan. This was due to the fact that the Japanese have no tradition of baking and so no ovens. You cannot bake cakes without ovens!

In order to avoid such errors, companies need to be more aware of their customers’ needs by moving from narrow ethnocentric thinking, where they view things from their own culture, to polycentric thinking, where they work from the view of the culture in which they are marketing.

Polycentric orientation requires autonomy for operating managers in each country, yet global policy, especially of branding, requires a central control. Too much central control and individuality is lost; too little and the global strategic power is weakened. Those companies who can best deal with this dichotomy will gain as a reward improved competitive leverage in the global market.

C. BASIS OF STRATEGIC CHOICE 2

Bases of SBU Competitive Advantage

In Unit 2 we saw how organisations operate on two main strategy levels:

- at corporate level; and
- at competitive level.

It is the competitive level which is the concern of the individual strategic business units (SBUs), i.e. the units within the corporate entity which have external markets for its goods or services which distinguishes it from any other of the organisation’s SBUs.

Porter proposed his generic value chain (see Unit 3) as a tool to identify areas of possible added value which give an organisation a real competitive advantage. Johnson and Scholes, however, point out that, in order to achieve competitive advantage, it is not sufficient to develop a cost leadership strategy based on being the lowest cost; it is necessary also to supply a product or service which the user sees as having an advantage over the competition.

They also argue that his views on differentiation are flawed in that consumers are not necessarily just looking for low prices but are also willing to pay more to acquire what they consider to be a better quality product or service. Thus companies can reduce prices in order to reinvest in their organisation to offer unique benefits to their customers and in this way to pursue a strategy of differentiation.

Tesco stores seem to have followed this kind of differentiation very successfully. They offer a range of products at widely differing price ranges, starting at the lowest end with their ‘economy’ products, which are often very basic commodities such as washing-up liquid, through branded products in the middle price range, and up to their top of the range products marketed under their ‘Tesco finest’ silver labels.

SBUs, then, have a number of ways in which they can achieve a competitive advantage in their markets by means of these various strategies.

Bowman's Strategy Clock

In Study Unit 2 we considered Porter's Generic Strategy Model (see Figure 2.1), in which he identified the two generic strategies of competing either through lower costs and prices, or through differentiating the company's products and services to offer customers a higher perceived added value.

This is still a useful model in this area but, since his original work, other, more refined, models have been developed which have added to the range of generic strategies based on the two competitive dimensions of price and added value.

One of these models is that proposed by Bowman and known as his 'strategy clock'.

In this model Bowman has taken Porter's original idea of generic strategies and has refined them and extended them to give a total of eight possible alternative strategies based on different permutations of price and perceived value to customers.

The 'clock' is based around these eight different permutations, which are as follows:

Strategy	Basis/characteristic
1	'No frills' (low price/low added value)
2	'Low price'
3	'Hybrid' (low cost base all owing low price and differentiation)
4	'Differentiation' (with or without price premium)
5	'Focused differentiation'
6	'Increased price/standard value'
7	'Increased price/low value'
8	'Low value/standard price'

These are shown in the diagram below, Figure 4.1.

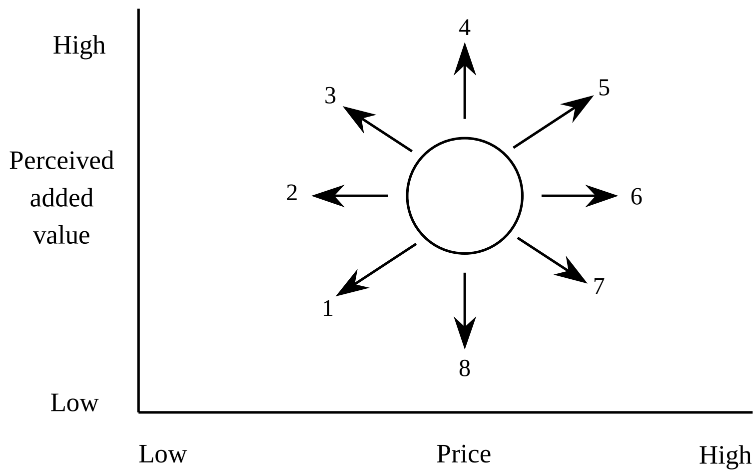


Figure 4.1: Bowman's Strategy Clock

Strategy 1 - 'No frills'

As the term implies, this strategy is based on products or offerings which have no additional features, design elements, service back up and so on. They represent the most basic of products and therefore the lowest perceived added value. However, this strategy also allows the lowest prices to be charged. This can be a very effective strategy for market segments who are unwilling, or unable, to afford anything but the most basic product or service.

An example of this strategy was that employed by the KwikSave food stores who sold products directly out of their boxes in a 'pile it high and sell it cheap' campaign.

Strategy 2 - 'Low price'

Some companies seek to obtain a competitive advantage by reducing prices while, at the same time, attempting to maintain the quality offered by others. The major disadvantage of this strategy is that it is easily copied by competitors and can result in price wars, such as those recently seen between the food supermarket chains and the petrol retailing sector. A company needs to be the cost leader, in order to successfully pursue this strategy.

Strategy 3 - 'Hybrid'

As the term suggests this is a strategy based on relatively high perceived value but low price. Obviously, this combines two strategies which are likely to give a company a competitive advantage, and is therefore potentially very attractive to customers. However, it is normally a strategy which can only be supported for a short time as margins and profits are too low in the long run for it to be sustainable. A company may follow this strategy with the intention of gaining market share quickly and driving competitors away.

It is a strategy often chosen by sellers of 'flat pack' furniture, such as IKEA. In this system costs are lowered by leaving the customer to assemble the product for themselves, which then allows it to be of good quality at a low price.

Strategy 4 - 'Differentiation'

These strategies are an attempt to offer perceived added value over competitors at a similar, or even higher price, thus giving the company better margins whilst remaining competitive through differentiated products. The key to success fore this strategy is that the basis for differentiating the product or service must be of value to the customer and must also be based on sustainable competences which are difficult for competitors to copy or match. In the food sector, a company pursuing this strategy is Waitrose, who convince their customers that paying more means getting better quality. Even frozen chickens are nowadays branded, and some customers claim to be able to tell the difference between competitive brands.

Strategy 5 - 'Focused differentiation'

This is similar to strategy 4, the difference being that the differentiated product or service is offered to a particular group of customers or segment of the market. This enables a company to concentrate on those customers who will value the differentiation being offered and also has the advantage of being potentially easier to protect from would-be competitors. An expanding area which lends itself to this type of differentiation is that of the health and leisure industry.

Those who can afford it prefer to pay for additional luxury, which they also see as raising their own image above those of others. Thus a swimming pool in a luxury health club can be perceived as being a better one in which to swim rather than the local baths.

Strategy 6 - 'Increased price/standard value'

At face value this would appear to be a seemingly attractive alternative for a company. In fact, it often leads to ultimate failure. In the short run this strategy can be used where, for example, the customer cannot buy from somewhere else or where they are unaware of a more competitive alternative offer. However, for most companies in the long run this is not a viable strategy, because customers will eventually 'see through it'.

Strategy 7 - 'Increased price/low value'

This is a variation on strategy 6. It takes increased price and low value to the next level. Needless to say, this strategy is only really feasible for an organisation which has a monopoly, and there are fewer and fewer of these today.

Strategy 8 - 'Low value/standard price'

Although in this strategy prices are lower than in the two previous strategies (6 and 7), so also is the value. Again, this is not a viable strategy in the long term. As an example, many would argue that this is the strategy which has led to the demise of the British car industry.

Bowman's strategy clock provides a useful way of identifying alternative strategies based on 'perceived added value' versus 'price'. However, whereas the first five of the strategies are likely to be successful, the others seem to be destined for failure.

Price-based Strategies

D. Low price/added value

This is a strategy which can be followed by those who imitate their competitors' products. For example, a number of look-alike, or should it be smell-alike, perfumes are available on the market. Those who buy them know they are not the real thing but, if they cannot afford highly-priced products, they do not have that choice.

E. Low price

Some companies seek a competitive advantage by reducing prices but, at the same time, attempting to maintain the quality offered by others. This strategy often leads to price wars, such as have been seen in the petrol retailing sector.

F. Hybrid strategies

These are an attempt to keep prices low but offer added value. These strategies are often pursued by sellers of 'flat pack' furniture, such as IMF pioneered. In this system costs are lowered by leaving the customer to assemble the product, which can then be of good quality, and at the same time advertising the advantage that you can collect the item yourself and not have to wait for it to be delivered.

G. Differentiation strategies

These are an attempt to offer perceived added value over competitors at a similar, or even slightly higher price. 'Better' products or services are offered in an attempt to secure a larger market share and volume. In the food sector, a company pursuing this strategy is Waitrose, who convince their customers that paying more means getting better quality. Even frozen chickens are nowadays branded, and some customers claim to be able to tell the difference between competitive brands.

H. Focused differentiation strategies

Here, organisations offer a better quality product or service at a higher price. In these cases the organisation is usually focusing on a particular segment of the market.

An expanding area which lends itself to this type of differentiation is the health and leisure industry.

Those who can afford it prefer to pay for additional luxury, which they also see as raising their own image above that of others. Thus a swimming pool in a luxury health centre can be perceived as being a better one in which to swim than the local baths.

D. BASIS OF STRATEGIC CHOICE 3

Enhancing SBU Strategy

We saw earlier that SBUs are separate entities of an organisation, but at the same time they are a part of the total corporate structure.

When we considered the BCG growth-share matrix in Unit 3, we said that an organisation needed to have a balanced portfolio of units, all of which are complementary.

Although SBUs have autonomy, it is important that there is a central control operating on behalf of the parent company which is looking to enhance its individual units. For example, by looking after units which are currently 'dogs' it may be possible to retain an important population of customers and also remain in a market which will ultimately recover. The organisation also needs to consider the case of products which have just been launched, where the market has not really taken off. Such products can be classed as 'dogs' but, given more investment, the market might be stimulated into a faster growth rate and the 'dog' could actually gain more share. Sometimes the faith of one manager in a unit can turn a company's portfolio around completely.

Portfolio Management

We have seen that the various types of SBU each have different characteristics as far as revenue generated and money for investment are concerned. Figure 4.2 indicates the likely cash position placed on a BCG matrix.

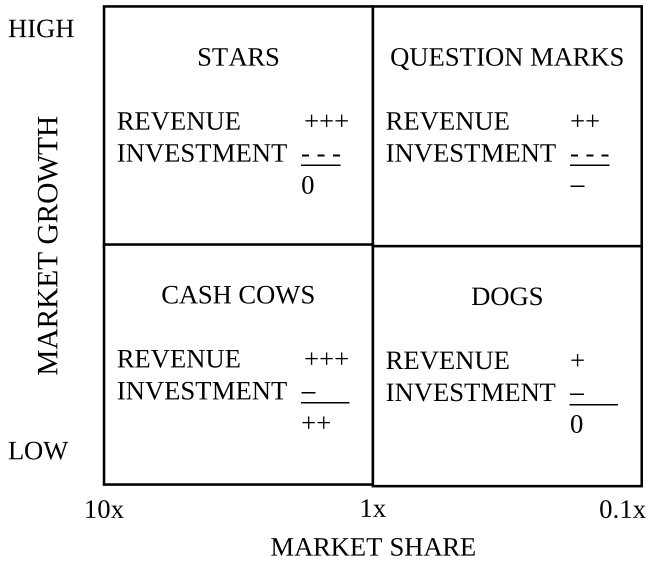


Figure 4.2: Boston Consultancy Group Matrix

After positioning its SBUs on the BCG matrix, the company must decide whether its portfolio is balanced, i.e. there are not too many of any one type. It must then allocate objectives, strategies, etc. to each of the SBUs.

Strategies suggested by the matrix are:

- Build for 'question marks' to increase share, even if it means giving up short-term profits.
- Hold for 'cash cows' which are strong, to preserve share.

- Harvest — for weak 'cash cows', where the future is poor, or for 'question marks' and 'dogs' to increase short-term cash flow regardless of long-term effects.
- Divest — to sell off, liquidate or delete an SBU which is a 'dog' or 'question mark' draining resources.

Changes in SBU position

Figure 3.5 showed the life of an SBU which moves from 'question marks' to 'stars' to 'cash cows' to 'dogs'. The solid arrow shows the ideal route as far as the company is concerned; the dotted line shows the possible route a 'cash cow' can take.

Because the BCG plots the current position of an SBU, it can be used periodically to assess any changes in position. It can also be used to project future positions, either likely or preferred.

Using our original example of the BCG matrix, Figure 4.3 shows how the positions can change for four of them.

Two are shown as 'planned' and two as 'forecast'. For 'planned' positions, strategists will be taking the initiative, whereas for 'forecast' positions, defensive or remedial action may be necessary.

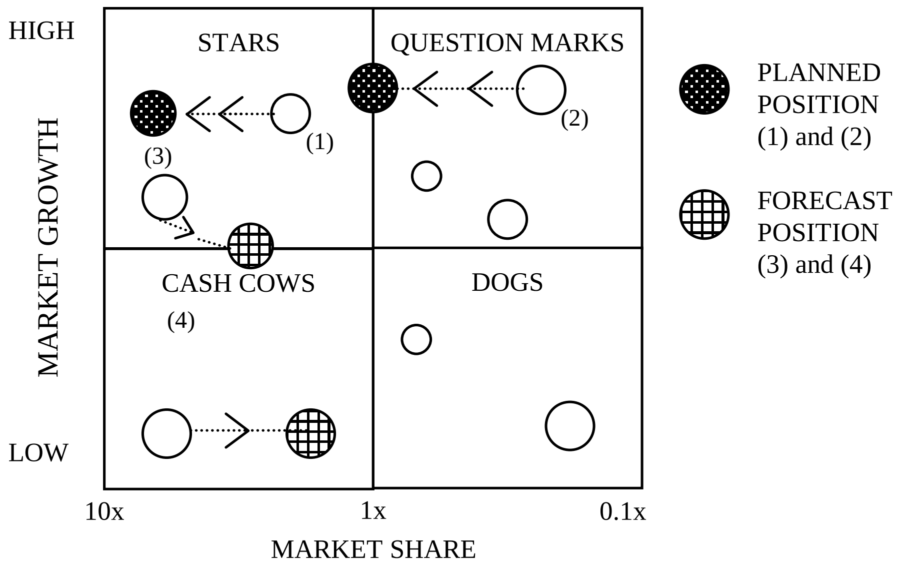


Figure 4.3: Boston Consultancy Group Matrix

The BCG model considers both share and competitive positioning and is easy to understand because of its visual nature. Its main problems are as follows:

- There may be difficulty in plotting information accurately because, unless done by computer modelling, the size of the circles can only be an estimate.
- It is not fair to expect all SBUs to have the same rate of return, market share, etc. Since the point is to assess the position of an SBU and different markets have different growth rates, it is better to plot only one SBU on a BCG matrix.
- If it is used to predict cash usage, valuable SBUs may be allowed to stagnate and die due to lack of investment.
- The model only uses market share and market growth as variables (but companies with a small market share can be highly profitable, e.g. Morgan cars).
- The model ignores environmental factors, which may have an impact on performance.

- Positioning can encourage planners to develop bad habits, e.g. not allowing ‘cash cows’ sufficient funds so that they grow weak, or leaving them too many funds at the expense of others.

Financial Strategy

The financing of SBUs is related to their positions in terms of their market share.

Star SBUs are the ‘providers of tomorrow’ and, as such, can justify financial investment, which can be a cash drain on the organisation. Even stars with high market share may involve investment in promotion or distribution, etc. if the competition is attacking.

Stars can therefore both produce revenue and absorb financial resources - which can sometimes mean they break even.

Investment decisions must be based on the future potential of the SBU, with regard to both its product(s) and its market(s).

Question marks - although they are generating funds, they have not yet reached a dominant position in the market, and still need a lot of investment for development. The parent company must therefore decide whether they want to continue investing in them. Referring back to Figure 3.5, we see that there are three ‘question marks’. The company may decide to concentrate financial efforts on one SBU in order to retain its success. In this case the SBU producing the greater revenue may well be chosen to receive extra finance due to its good earning potential.

Cash cows produce good revenue, do not need high investment and often involve economies of scale. The money earned from ‘cash cows’ should be used to invest in other SBUs which are placed in other classifications in the BCG matrix. It is likely, then, that a company would invest in its current ‘cash cows’ in order to retain market share.

Dogs usually produce low profits and often incur actual losses. They will always consume cash, even if it is just due to the cost of the time it takes to manage them. Financial decisions have to be made, therefore, as to whether they should be dropped and the resources re-allocated to other SBUs, or whether the market in which they work could be improved and enhanced by a greater cash injection.

The Role of the Parent Company

We have already seen that SBUs have a degree of autonomy, although they are run under the umbrella of the parent company and have to take account of its corporate strategy.

Within the parent company, then, the SBUs retain their own identity and sometimes also their own individual structures.

The SBUs often operate best if left alone, particularly in a volatile environment. They have the advantage of being a part of the parent company in terms of offsetting profits against any losses incurred by other SBUs in the group, and in terms of getting cheaper finance for their individual development from the parent.

The parent company has the advantage of spreading risk across a number of diverse businesses in a ‘swings and roundabouts’ sort of manner.

The disadvantage of this arrangement is the risk of a lack of internal strategic consolidation and the duplication of effort by the various SBUs.

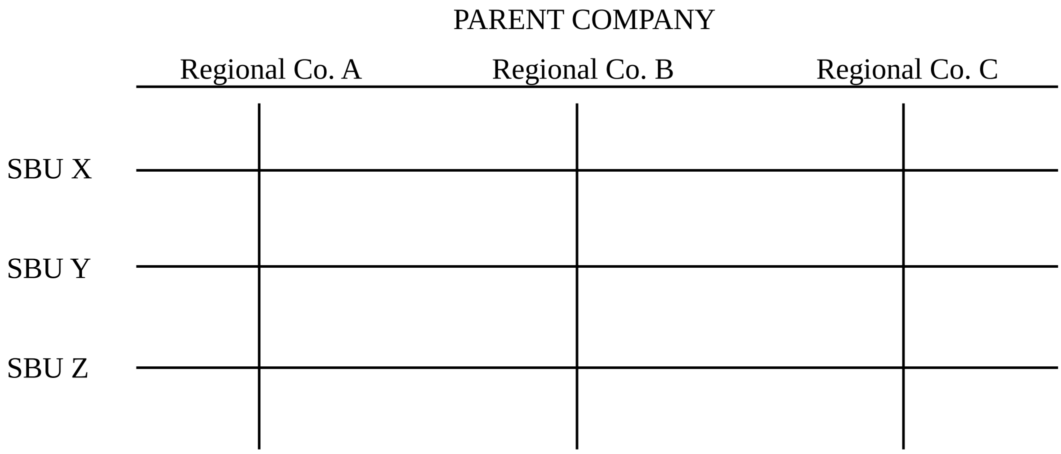


Figure 4.4: Parenting Matrix

Figure 4.4 illustrates a parenting matrix such as that of a multinational organisation, where the parent company operates in a number of different regions.

Study Unit 5

Strategic Direction and Methods of Development

Contents *Page*

INTRODUCTION

Following on from the previous Unit, we conclude the discussion of strategic options. Unit 5 examines alternative directions for strategic development and alternative methods of strategy development. Appropriate techniques for strategy development will also be covered.

Objectives

After studying this unit, students should be able to:

- identify and explain the range of possibilities for strategic direction;
- identify and explain the range of methods available for strategy development;
- explain and use appropriate techniques to elucidate potential strategic directions.

A. ALTERNATIVE STRATEGIC DIRECTIONS

Growth Strategies - Ansoff's Product/Market Matrix

Ansoff's model helps to identify which strategy is appropriate at any given time and in various sets of circumstances in order to develop a company.

He claims that only products and markets need to be considered, and that these can only be either old or existing, and new, or potential.

From this basis there are four possible combinations:

- Existing products selling to existing markets.
- Existing products which can be sold to new markets.
- New products being sold in existing markets.
- New products which can be sold to new markets.

Using these different combinations, Ansoff points to four possible basic strategies, as shown in Figure 5.1, the Ansoff Matrix.

Ansoff's four strategies are as follows:

(1) Market Penetration

This refers to selling an existing product in an existing market.

This strategy is suitable in a growing market which is as yet not saturated.

Penetration of the market can be achieved by:

- attracting new customers for the product;
- increasing the usage, or purchasing rate, of existing customers.

It is often achieved by increasing activity through more intensive distribution, aggressive promotion, pricing, etc.

		PRODUCT	
		EXISTING	NEW
MARKET	EXISTING	MARKET PENETRATION	PRODUCT DEVELOPMENT
	NEW	MARKET DEVELOPMENT	DIVERSIFICATION

Figure 5.1: Ansoff Matrix

(2) Market Development

Here the existing product is offered in a new market. This strategy is used when a regional business wants to expand, or when new markets are opening up, or when a new use is found for the existing product.

It means appealing to sectors of the market or to geographical regions not already catered for. To do so may mean repositioning of products and also the use of new distribution methods or channels.

(3) Product Development

This involves a development of new products to sell in existing markets. Sometimes it merely involves new packaging, perfume, colour, etc.

It is usually employed with branded goods so that the qualities of the 'new' product are linked to the customer's confidence in the established brand. It builds on customer loyalty.

(4) Diversification

This has the advantage of preventing a company from relying too much on its existing SBUs. It can be a means of growth and expansion of power, and can also act as insurance against potential disasters - a 'life raft' in case of large environmental changes.

It involves the introduction of new, i.e. innovative, products into market sectors which are new to the company, or it may be that the product is new to the company but has been already available in the market.

Each of the strategic directions need detailed and careful analysis in order to determine their viability in the short-, medium- and long-term, before a strategic choice is made.

It is on the basis of such quantitative analysis that decisions will be taken: Ansoff is not in itself a decision-making tool.

There are different levels of risk associated with the different Ansoff product/market quadrants. In general, these are as follows:

	Risk factor
Existing product/existing market	1
Existing product/new market	2
New product/existing market	4
New product/new market	16

Examples of these different strategies can be seen in the following:

(1) McDonald's are moving more towards younger children by using packaging which is attractive to them and by making toy gifts available with 'junior' meals.

(2) Nestlé are developing a new sectors of the coffee drinking market by introducing decaffeinated Nescafé for those who in the past have avoided drinking caffeine.

(3) Nescafé are also introducing new brands of their product. They currently offer nine different varieties in instant coffee:

    Original instant

    Original instant decaffeinated

    Gold blend - "smooth and rich"

    Gold blend decaffeinated

    Black gold - Colombian coffee offering a "magical mystery" for "nose and palate".

    Alta Rica - "full bodied".

    Expresso - "short, dark and intense".

    Camp Colombie - "smooth and aromatic".

    Kenjara - "fine and delicate".

These should cater for most tastes and preferences, don't you think?

(4) Scottish Power has shown it is on its way back through its first quarter profit figures. It had adopted a strategy of diversification by going into such areas as financial services, telecoms, and water, but is now developing a more coherent strategy around being a US and UK generator and supplier of energy, having discovered that diversification is not always a successful move.

Protect and Build Strategies

Withdrawal

There are times when a company's best strategic option is to withdraw either partially or fully from some part of its market, or to sell a particular SBU in order to raise funds to be used with another.

This strategy can help a company to maintain a balanced portfolio and form part of a consolidation or growth strategy for the overall corporation, in order to protect its total position.

Withdrawal can also be due to an SBUs position becoming so bad that liquidation, either voluntary or forced, is the only option.

Recently, Granada, the media company, sold its motorway services outlets to Moto, as it is currently having trouble with income from TV advertising.

Similarly, Boots, the drug company, have closed their Japanese outlets, having failed to entice shoppers to buy their medicines and health and beauty products. They also quit their Dutch loss-making division last August, but insist they still intend to operate an international division, initially through small store-in-store formats in Taiwan and Thailand.

Consolidation

Consolidation implies changes in the way an organisation operates, whilst still retaining the same range of products and markets.

They way by which this is achieved will depend on the state of the market.

In a growing market the organisation has to try to grow with the market in order to maintain its share.

Growth in demand in the health services, for example, tends to create great difficulties of funding. One of the ways this is being tackled is by bringing in private funding to what is a public service in the form of the NHS. One of the ways of achieving this is to have private companies build hospitals which they then rent back to the NHS, in this way providing capital funds which will then be regained over a long period of time.

In a mature market an organisation will try to defend itself by offering better quality than its competitors or by increasing its market activity. In declining markets it may be possible to find distributors who are looking for new sources of supply.

At times, when a mature market is moving towards becoming a declining market, many organisations adopt a 'harvesting' strategy. For example, they may take advantage of physical assets such as under-utilised storage accommodation, and lease it out to others. This is especially useful if the decline in the market is short-term, or if it is thought it will eventually recover.

Market Penetration

- If a market is expanding, it may be relatively easy for an organisation to expand, sometimes because a competitor creates a bigger demand than it can satisfy itself.
- In mature markets, penetration is more difficult, because the market leaders have a distinct cost structure advantage.
- In declining markets there is little opportunity for a company to build its market share unless others withdraw from the market.

It may be that a company has to hang in there until others are forced to go - never a very comfortable situation.

Development Strategies

Innovation and Product Updates

Creating new products and updating existing ones are strategies which may be used in order to consolidate.

Creating new products is inevitably a high risk strategy since it is a costly process to bring a new product to market. These costs include the time and effort involved in designing the new product, the setting up of a production line and the advertising and marketing needed to create a market for it, in addition to the normal costs of production, distribution, etc. Only a small proportion of innovative products are ever successfully brought to market, but the rewards are very great, so some companies regard it as a worthwhile investment.

Companies who try to market new products usually stick to what they basically know, that is, they use the skills and knowledge inside the organisation, as we saw in the example of the Hewlett Packard method of allocating work time to encourage new designs.

Updating existing products is much less risky than trying to create new ones, particularly in a company which has a good research and development (R and D) section. Here again, the most likely successes are when building on the core competencies and skills within the company.

Profit Impact on Market Strategy (PIMS)

PIMS is a programme which stems from a research project between the Marketing Science Institute and Harvard Business School to determine how profit impacted on market strategy, and vice versa.

The PIMS project, which is still in progress, has four main areas of strategic planning under investigation.

- **Forecasting Profits -** often these are just projections of local experience, but, when market conditions are likely to change, or when a new strategy is envisaged, how reliable is past history as a predictive guide?
- **Allocating Resources -** requests for capital from different divisions usually exceed the size of the pot. The question then is “which products and markets are likely to give the best returns?” Estimates from divisional representatives can be doubtful, since they have a vested interest.
- **Measuring Management Performance -** corporate management would welcome a way of determining what level of return on investment (ROI) is reasonable or normal for different SBUs under given circumstances.
- **Appraising New Business Proposals -** when considering a new development or acquisition corporate management would appreciate some method of estimating ROI.

The common thread running through these strategic planning situations is the need to estimate ROI in a given business, under given market conditions, following a given strategy, and to have the means of doing so.

PIMS aims to identify the most significant determinants of profitability and to provide guidelines for strategic management.

It has a database of about 3,000 SBUs from several hundred firms, including both successful and loss-making examples. Company and market backgrounds are recorded, as well as the strategies which were adopted, together with the results achieved.

The main findings of the PIMS programme have been that profitability is influenced by:

● Competitive position	–	relative market share
	–	relative profitability
	–	product quality
● Capital structure	–	intensity of investment
● Production structure	–	vertical integration
● Company characteristics	–	corporate size
	–	corporate diversity
● Market environment	–	customer concentration
	–	stage in life cycle.

The commercial side of the programme is administered by US Strategic Planning Unit, but is also available in other countries.

The main purpose of the model, or programme, is to get companies to look at the outcomes of strategies pursued by others when faced with similar situations/conditions.

Information is available, for a price, in reports in one of four formats:

- PAR - average ROI and cash flow based on market technology, cost structure and competition.
- Look-alikes - strategies (and outcomes) used by similar companies.
- Strategy analysis - which shows the likely effect of strategy changes on ROI/cash flow, both short- and long-term.

- Optimum strategy - suggests strategies which will maximise results.

PIMS reports are extremely specific, e.g. "the average ROI for businesses with less than 10% market share was about 9%………on average a difference of 10% in market share is accompanied by a difference of about 5% in pre-tax ROI".

Criticisms of PIMS include:

- lack of trust in the accuracy of the data supplied, and/or the processing of it;
- an insufficient depth of academic discipline;
- the derivation of apparently reliable figures for a specific business obtained by means of a generalist technique or model.

It is important when using any model to realise that these are intended to aid management not to replace it.

Product Life Cycle Concept

This was first discussed in Unit 2, when we saw it as a tool which can be used in order to analyse both a company's competitors and its market (Figure 2.4).

In considering the growth of a product, we can use the life cycle curve, since its shape will depend on the rate at which customers adopt, or take up, the product and the satisfaction which the product gives them.

For example, a poor product, which has been well advertised, will grow rapidly as customers try it out, and then decline just as rapidly as dissatisfaction grows and is described to other potential customers. Most marketers accept that one dissatisfied customer will tell ten others. Conversely, a product can appear on the market before the consuming public are ready to take to it.

Rogers' adopter categories are the definitive model of the adoption process, as shown in Figure 5.2.

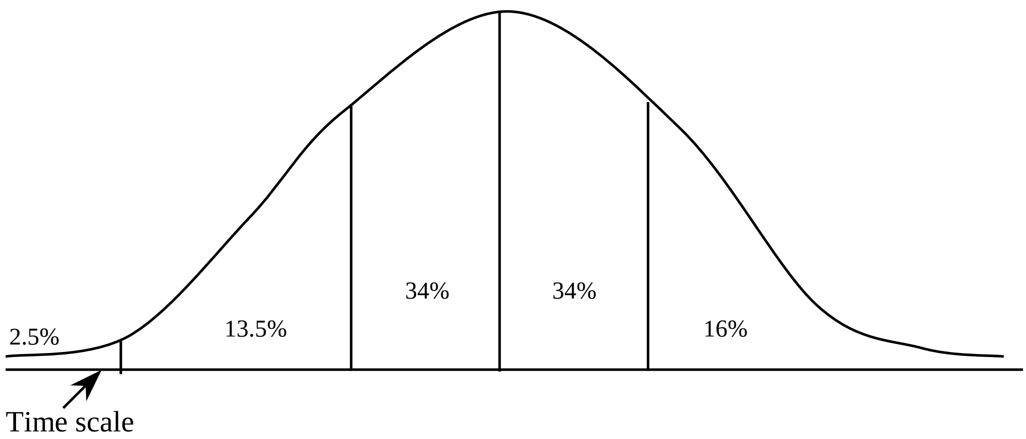


Figure 5.2: Adopter Categories Based on Relative Time of Adoption of Innovation

Rogers' categories are as follows:

- Innovators - 2.5% - those who get satisfaction from being ahead of fashion.
- Early adopters - 13.5% - opinion leaders; those keen to try new things.
- Early majority - 34% - those willing to try new things, but are not 'pioneers'.
- Later majority - 34% - the followers of fashion, who perhaps wait for the product to become a perceived necessity; certainly not prepared to take risks with a new idea.
- Laggards - 16% - the latecomers.

Rogers' theory neatly forms a normal distribution curve.

In practical terms, it is for each marketer to forecast the pattern of adoption for individual products. This will have the strongest implications for forecasting the duration of the introductory and growth stages of the product.

A product opening up a market will be distinctive, i.e. innovative. But with success comes competition in the form of copying, perhaps from products with distinct advantages of their own. As time passes the 'innovative' product loses this distinction and then has to be updated in order to sell it on differential terms, i.e. it is different, not distinct.

(a) Consumer attitudes

When consumers purchase a product it is in part 'brought to life' by what they bring to it based on their own attitudes, that is, from the consumers' psychological and sociological frames of reference. This can be illustrated by the fact that some people will still stick to their 'old fashioned' systems of record players despite the development of cassette recorders, CD players, etc.

Demand for a product tends initially to be **primary**, i.e. the basic function of the product. For example, a standard mobile phone.

Later, usually with competitors in the market, the demand can become **secondary**, with the functional aspect being taken for granted. In the mobile phone sector this has led to fancier cases and more 'modern' shapes, and now to visual screens.

Later, as less and less distinctiveness is seen and the functional aspects are taken for granted products tend to be bought more on psychological grounds.

In practice all three systems of demand,

- primary
- secondary, and
- psychological,

operate all the time with varying degrees of strength, and it is the mixture of relative strengths which the marketer has to be aware of, and match.

(b) Vectoring

A product must be defined in terms which are meaningful to the marketing process.

For example, it is quite possible for a product to be making good progress in terms of its life cycle in a technological sense while at the same time be approaching saturation in terms of either market or segment penetration. These two levels of performance are by no means coincident.

The term 'vector', when used in marketing, means that the market segment is satisfied by a particular product. The segment being considered may be capable of being satisfied by two or more products from the same organisation, as in the case of the different coffee products offered by Nestlé.

As each product-segment unit of activity is a vector having its own dynamics, then each has a vector life cycle. Consequently, separate marketing decisions will be required for the market, each segment and each vector segment.

An example of this kind of market approach can be illustrated by an antibiotic which may effectively treat a range of infections. A quick glance through your own medicine cabinet may well throw up a particular example of this. For instance, paracetamol is marketed in a number of different products aimed at particular areas of the market, 'Calpol' is a suspension of paracetamol suitable for young children, paracetamol tablets are marketed for general pain relief, and co-codamol tablets of paracetamol and codeine are recommended for extra-strong pain relief. A company can therefore be in the business of selling several different ‘products’ all based on the same product.

Most products can either be put to more than one use in their current form, or can be easily adapted to make this possible. Therefore, it is necessary to identify the different market opportunities and to take separate decisions on the viability of each of them.

Planning should be carried out on the basis of a separate life cycle for each market opportunity. We have to consider where we can gain synergy (see later notes for a fuller explanation of synergy) by a generalised marketing approach, and where we have to be specifically responding to the needs of a particular defined segment.

An example of this type of marketing is provided by the manufacture of sports shoes, or ‘trainers’. In this case we first of all need to identify what our potential customers regard as ‘trainers’ and what it is they want from them.

Through carrying out this marketing research we may come up with the following:

- There are serious athletes who want them for different uses such as for court play, tennis, badminton or squash. Others may want them for track training or for cross-country or road running.
- Some people may see trainers as a fashion item, but this will form a sub-set of each of our identified vectors.
- Non-players will also buy our shoes, some because they want to be regarded as players, others who just like them as comfortable shoes.

Given this information, we could find we have not just one, but 30 niche markets available, as shown in Figure 5.3.

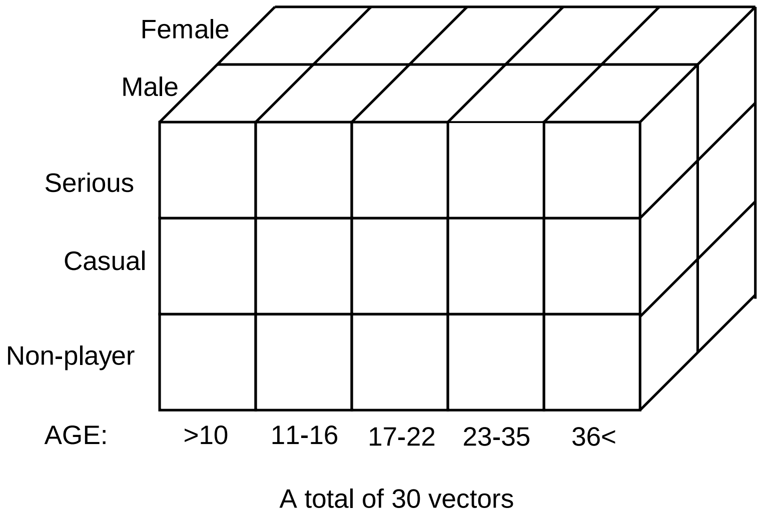


Figure 5.3: ‘Trainers’ Potential Vector Matrix

Market Development Strategies

New Segments

Not all consumers of products are the same. They can differ in terms of their characteristics such as age, sex, income, race, location, lifestyle, etc., and in terms of their needs, such as preferences of price and of brand, quality expectations, etc. Consequently, markets are best thought of in terms of their different segments, rather than the total market as a whole.

Different segments of the market cater for different, definable, groups of consumers. It is possible, therefore, for a company to operate successfully by having a foothold in a number of different segments in its market, without actually being dominant in any one segment.

A company can develop by entering a ‘new’ segment, i.e. one it was not marketing in previously. It may even be possible to identify a segment which has not been identified previously, and so be the first to enter.

New Territories

Another source of market development is in entering new territories, for example, new geographical territories.

In the past, Marks and Spencer’s attempt to enter the American market through Brookes Brothers, and Boots’ retreat from Holland and Japan.

On the other hand, in the drinks sector, both Budweiser from the US and Foster’s from Australia have successfully entered the UK market for lager, despite European companies having been there much longer.

New Uses

New uses can often be found for existing products and so be a means of market development. For example, prior to the invention of the internal combustion engine, petroleum’s main use was as a liniment for horses!

Heavier/More Frequent Usage

It may be possible for a company to expand by convincing its customers to use its product more frequently.

Examples of this type of market expansion can be seen in the cosmetics sector, where shampoo manufacturers advocate the frequent use of their products. For instance, anti-dandruff shampoos, which are to be used every time hair is washed in order to keep it free of dandruff.

Diversification Strategies

Related and Unrelated Diversification

One of the ways in which a company can expand its activities is by diversifying into other products and/or markets.

As we saw in Unit 4, diversification may be **related**, i.e. the company remains in the same area of operation whilst developing beyond its present product and market; or it may be **unrelated**, in which its new activities take it beyond its present interests into new unrelated markets or products.

The Concept of Synergy

It is often said, particularly in problem solving, that two heads are better than one. In other words, there is an advantage to having more than one person’s view when making a decision.

This is the concept of synergy, where a system as a whole is greater than the sum of its parts. This is often illustrated thus:

$$2 + 2 = 5$$

In terms of developing an organisation, this is most readily observed when an expansion or a merger occurs, for example, when an organisation responsible for the production of an item, such as computer hardware, merges with an organisation that markets the product, such as a retail sales outlet. For an effective holistic system to result from such a merger, all of its parts need to be contributing synergistically.

In this example the synergy created is described as being positive, but it should also be noted that synergy can sometimes produce a negative result, when

$$2 + 2 = 3$$

Mergers which occur voluntarily are usually based on the hope of providing positive synergistic benefits, such as greater cost-effectiveness, often through combining similar departments and thus reducing the staff payroll.

But Porter points out that not all synergy is real; much of it can be imagined and does not materialise. He also points out that bringing SBUs together can cause a negative effect if they compete with one another rather than co-operating; hence negative synergy is the result.

In studying the results of a large number of major corporations' acquisitions, Porter discovered that, in many cases, these did not produce the positive synergy that had been envisaged and that where this was the case, they were divested rather than retained. Synergy arises through strengths in a business, but it cannot cure weaknesses.

The Process of Synergy

A simple way of illustrating the process of synergy is to ask a group of people to produce independently a list of, say, names of British birds, and then to ask them to read out their individual lists to the other group members in order to obtain a combined list.

The result will almost invariably show a greater variety in the combined list than that produced by any one individual member.

A more practical example can be illustrated by the use of 'brainstorming' in order to obtain solutions to a problem. This is a technique which was developed by Alex Osborn for generating a large number of ideas on a selected topic. Like all techniques which are based on creative thinking it is dependent for its success on the complete separation of the creative and the critical processes. it has no set discipline but aims to encourage the free interchange of ideas between members of a group - say 5 to 15 people - and the generation of new ideas by a chain reaction between them.

The basic rules are:

- **Suspend judgment -** no criticism of suggestions, however, unlikely they may seem (each is recorded)
- **Free wheel -** give all imagination a free rein, with ideas from anywhere, even wild ones accepted
- **Quantity -** the more ideas the better
- **Cross fertilise -** combine and build on the ideas already expressed.

After an agreed period of time the list of ideas is evaluated. This is best carried out by:

(a) classifying them by type;

(b) sifting out the useful ideas;

(c) selecting those which are suitable to be followed up.

The technique cannot guarantee to cover the whole field comprehensively, nor is it applicable where you are searching for the one correct answer. But it is useful when trying to make a start, to break new ground, particularly in non-specialist fields where experience from a wide range of people can be helpful.

The method illustrates the advantages of positive synergy, with one person's idea, even if it is 'way out', providing the seed for someone else's inspiration, which often then leads to a much more workable solution.

Synergy and Strategy

- **Synergy and value chain analysis**

  In Study Unit 3 we considered value chain analysis as a technique for conducting an internal appraisal, and mentioned how positive synergy can be created through the ability to transfer skills and/or expertise between similar chains, and the sharing of activities between different units.

  In this context synergy is related to the assessment of how much extra value can be gained by the provision of linkages between activities in the value system which have previously not been connected to one another, or where connections between them have been of a different type.

  Strategies of market development, such as the sharing of advertising costs or the use of a well known brand name, can create synergy, as can product development through the pooling of expertise and knowledge.

  Porter has suggested that the way to determine whether or not sharing opportunities are likely to lead to positive synergy is by carrying out a cost-benefit analysis. He states that sharing must involve not just any old activity but those activities which are themselves significant to providing competitive advantage.

  Thus assessing the likely benefits which synergy can provide may be used as a method of evaluating a strategy.

- **Synergy and diversification**

  We mentioned earlier the hopes that in diversification through acquisitions or mergers an organisation would obtain positive synergy.

  Porter has argued that, in this respect, those organisations which diversify by building on their core business, that is, by related diversification, which may be

  - **backwards** into activities related to inputs into the current business, i.e. those further back in the value system, such as the provision of basic raw materials,
  - **forwards** into activities concerned with the outputs of the business, i.e. further forward in the value system, such as transport or servicing, etc. or
  - **horizontal** into activities which are competitive with, or directly complementary to, the organisation's current activities, as in the case of a travel agency becoming involved in the provision of transport for clients to a local airport,

  do better than those which diversify in an unrelated way, i.e. into products or markets or the creation of new products which bear no obvious relationship to the organisation's current markets or products.

However, synergy **can** be involved in unrelated diversification. In this case the synergistic benefits are usually based either on financial gains, where cash flow originating from one business is used to develop another, or on the use of managerial skills associated with one successful business to improve another less dynamic one.

Younger has also made the point that, although the aim of diversification is usually to increase earnings, the risks of doing so by acquisition are reduced if there is some kind of relationship to the existing business so that one company can add something to the other, or where, in the case of the acquisition going wrong, the management have the ability to step in and put things right.

Areas in which Synergy can Arise

- Sales and marketing
- Operations
- Investment

- Personnel
- Financial

(a) **Sales and marketing synergy** can arise through the combination of linkages in the value chain, as we have just seen. For example, where production and distribution channels are combined, or where a company uses its well-established brand names or corporate identity to gain extra benefits in new markets.

(b) **Operating synergy** can be obtained by increasing the use of existing facilities and personnel, by spreading overhead costs and by large-scale purchasing, which enables a company to secure good discounts.

(c) **Investment synergy** often involves the transfer of skills, such as research and development knowledge, or by the sharing of plant and machinery.

(d) **Personnel synergy** is, as it sounds, related to the skills of the people employed by a company or organisation. Thus highly competent strategic planners, through increased performance, can acquire other companies by means of diversification, in order to give rise to positive synergy.

(e) **Financial synergy**

All the areas of synergy we have been considering so far can have an effect on financial performance. In addition, there can also be opportunities for synergy in the financial area itself. For example, the acquisition of another company by one which has cash to spend may bring a financial gain in the form of extra profits from what would otherwise be cash which was lying idle.

In assessing the likely results to be obtained by means of acquisitions or mergers, or in the planning of product market expansion, the likely effects of synergy arising need to be taken into account.

There are, however, two potential problems which need to be considered:

- the fact that synergy can be negative as well as positive;
- the difficulty of actually measuring synergy.

In the first case, we have already seen how negative synergy can be the outcome if the combining SBUs compete rather than co-operate with one another.

In the case of measuring synergy in order to evaluate its effect in a quantifiable way, increased sales, reduced costs, etc. can be measured and used to determine synergistic outcomes. But to forecast these results in advance of diversifications is very difficult, leading as Porter has said to much of the advantages proving to be over-optimistic.

Synergy is an important consideration for corporate planners to take account of, in particular with respect to potential acquisitions and diversifications. They must try to evaluate and quantify possible areas of synergy, both positive and negative, when planning the combination of resources.

B. ALTERNATIVE METHODS OF STRATEGY DEVELOPMENT

Internal Development

Many companies use internal development as their primary method of strategy development. They prefer to expand by adding to the list of products or services they are offering, rather than trying to expand the territory in which they operate.

Their strategy is based on the assumption that, by offering customers a wide range of products, there is more likelihood that they will buy your products rather than go to a competitor.

It is similar to the ‘loss leader’ strategy used by many supermarkets, where they encourage customers into their stores with special offers which appear to be better than their competitors and then hope to recoup any losses by selling other products. Few supermarket shoppers find the time to visit a number of stores in order to buy the loss leaders in each of the different outlets - although a store near where I live has found it necessary to limit the number of bottles of ‘an offer’ wine that the local senior citizens are allowed per visit!

Examples of internal development are often found in the food industry, especially in confectionery, where new chocolate products arrive with regularity, and in frozen food companies, where new frozen meals in particular are being introduced.

The advantages of this method of development include:

- the ease with which new products can be added to companies’ lists;
- the fact that the existing salesforce can just add the new line to their product list;
- no special distribution facilities need to be set up;
- there is no need for different paperwork;
- the chance of success should be high, since the company knows the market.

However, there are also some disadvantages to note in the form of:

- high development costs - even for a new bar of chocolate;
- high set-up costs, particularly if extra plan and machinery is required;
- the cost of advertising and sales promotion.

At the end of the day, there is no guarantee that the product will be successful and, in fact, it is thought that about 80% of new products are abandoned soon after they have been brought to the market, and a lot of them do not even get that far.

Mergers and Acquisitions

When two companies merge, positive synergy is likely to be achieved. For example, the combined research function is likely to product far better results than the independent units.

Mergers can result in negative synergy, however, where a new activity is gained by purchasing it rather than by developing it internally.

- Some years ago the merger of British car firms to form British Leyland created a negative synergy.
- In recent times, Sainsbury, the supermarket chain has withdrawn from its Taste TV joint venture with Carlton Communications, as it does not seem to have worked out as expected.

Acquiring another company is attractive to those thinking of developing by entering a new market, since it makes the time taken to enter much shorter than it would be by internal development. It is also a good way for a company to acquire expertise.

A recent example of this strategy is the acquisition by William Mercer, the consultancy, of SCA consulting, a company which has expertise in advising on performance-related remuneration packages. The acquisition will increase Mercer’s performance measurement practice and increase the range of advice they can offer to companies.

One of the reasons that a company acquires others is to ‘asset strip’, that is, to achieve a short-term financial gain by buying up a company which is for some reason undervalued and then to sell off parts of it in order to make a quick profit. It is this form of behaviour which has given company acquisitions a bad press.

The main difference between companies developing by acquiring others or by merging with them is that mergers are more likely to come about voluntarily, because each is trying to increase synergy.

Acquiring another company already engaged in the activity a company is trying to enter in order to achieve its aim is quicker but more expensive than internal growth.

The major difficulty with acquisition is in the integration of the new company with the activities of the old.

Joint Developments and Strategic Alliances

Joint developments are arrangements between organisations where they set up a newly created organisation which they jointly own whilst still retaining their individual independence.

Porter is of the opinion that companies with the best acquisition records tend to make heavier-than-average use of **joint ventures**; but thinks that they are just as risky as acquisitions.

There is a whole range of ways in which joint developments and strategic alliances are set up, with a spectrum of inter-organisational relationships, with very formalised arrangements at one end down to very loose at the other.

Johnson and Scholes suggest three factors which influence the form of the alliance, namely:

- asset management - the extent to which assets need to be managed jointly;
- asset separability - the extent to which the assets may be separated between the organisations;
- asset appropriability - the extent to which one of the parties involved might appropriate the other assets.

Besides **joint ventures** other forms of co-operation can include the setting up of a **consortium** in order to focus on a particular activity or project. In this arrangement the relationship is likely to be very formalised. Projects such as the joint venture between British Aerospace and Aero Spatiale of France which, resulted in the supersonic aircraft, Concorde, and the more recent co-operation between European companies which has produced the Airbus are examples of successful formal arrangements.

These joint ventures are typified by the need to jointly manage assets, although they can be separated from the parent company without adversely affecting it.

Alternatively, other **alliances** can be set up in order to work on a particular project without there being a formalised arrangement. Such ventures are more like market relationships and come about in circumstances where there is no need to have joint management, where assets cannot easily be separated from their parent company, or where there might be the risk of one member of the partnership making off with another’s assets.

Other types of joint ventures include **franchising**, where a business is set up by a major player and is then operated by a franchise holder under the umbrella of the franchiser.

Finally, there are **licensing** partnerships, where one company allows another to produce or market its product under licence, by paying a fee, and **subcontracting**, where an organisation gets another to carry out duties on its behalf. Subcontracting is becoming quite widely-used in the public services where, for example, an authority pays a company to undertake its duties of street cleaning or waste removal.

Study Unit 6

Strategy Evaluation and Selection

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INTRODUCTION

In this Unit we will be examining the three criteria used for evaluating appropriate strategies. These are suitability, acceptability and feasibility. We will also consider how the process of choice and the selection of appropriate strategies may be carried out.

Techniques appropriate for the evaluation of strategies will also be covered.

Objectives

After studying this unit, students should be able to:

- discuss the key criteria in evaluating strategies;
- explain and use appropriate techniques in evaluating alternative strategies;
- identify and explain approaches to the process of selection.

A. EVALUATION CRITERIA

Suitability

The best strategy to adopt for an organisation is that which is most suited to its current strengths and its position. In other words, it is the extent to which a proposed strategy fits the situation as identified by a strategic analysis, and how well it would sustain, or improve, the organisation's competitive advantage.

It is not enough simply to identify an attractive opportunity. If the strategy is to be successful, it must also be an opportunity for which the organisation is suited, i.e. has the relevant business strengths. This is why strategy evaluation must also consider criteria by which the likely competitive position of the business can be assessed, i.e. it represents the criteria which determine how 'easy' it would be to exploit the opportunity - the customer's likelihood of buying what it is you want to offer.

This would involve considering such things as:

- price
- product quality
- distribution
- after sales service
- reputation
- availability.

By adding a weighting to these factors it is possible to take account of the customer's priorities for these criteria in order to establish the critical success factors.

Acceptability

As Johnson and Scholes ask, "acceptable to whom?". In addition to the customers finding the product or service acceptable, it is also necessary to consider the opinions of the organisation's stakeholders. For example, in the case of a company, what the shareholders expect is an important consideration, and in any organisation it is necessary to keep the workforce 'onboard' as it is they who can most easily make it difficult for a strategy to succeed if they are opposed to it.

Currently, the government is trying to introduce a policy of involving private companies to take over activities in the public sector, for example, by involving them in the education service. The unions which represent current workers in the public service sector are opposing this in the interests of their members, and if the government is unable to gain their co-operation it is unlikely that the strategy will be successful.

Another important dimension in getting a strategy accepted is with respect to the environment. One of the problems being experienced by the mobile phone company Orange is the resistance by members of the public to having masts erected near their homes, due to fears about the potential effects on health.

Feasibility

The third factor which needs to be considered is whether it is possible to implement the strategy successfully. It must be asked “have we the necessary resources to put this strategy into effect?”

Resources in this context means more than just financial capability, although this, of course, is fundamental. It also requires that the quality of performance is satisfactory, which means that the necessary skills are available within the workforce. Other necessary resources may include:

- technological ‘know how’;
- availability of materials and machines; and
- other necessary back up services.

B. STRATEGIC FIT AND SYNERGY

It is not only important that a strategy works towards achieving the objectives which an organisation has stated, but also that it does not have an adverse effect on any other of the organisation’s activities. A particular strategy must fit in with and relate to all other strategies within the organisation.

This applies at every level, and to every area, but is particularly important at the operational level, where interdepartmental co-operation and liaison is so vital. Strategic options also need to be considered in terms of their cultural fit, i.e. how easily they can be assimilated by the organisation.

In these areas, if there is a difference in fit, then it is the culture of the organisation which should be adjusted to fit the strategy, rather than changing the strategic option to fit the current culture.

We have already described synergy as being achieved where two or more activities combine together in such a way that the combined whole is greater than the sum of the parts. Synergy can arise through a shared strategic logic between SBUs. Thus, if two or more SBUs have compatibility with a decentralised contract, and there is an opportunity for each of them to improve by sharing then, as Campbell suggests, strategies based on the exploitation of synergy may be regarded as suitable.

C. ASSESSING SUITABILITY

Establishing Rationale

- **Product life cycle analysis**

  We first studied this in Unit 2, where we saw that a continuous process of external change takes place during a product’s life cycle, ranging from the entry of competitors into the market to changes in consumer attitudes.

  Sooner or later, every product loses its appeal and customers stop buying it.

  The reasons for this decline can include:

  - customer's changes in taste;
  - the emergence of new designs;
  - cheaper (or better) alternatives, etc.

The product life cycle supplies an important concept in assessing the strengths and weaknesses of an organisation's strategy. In an ideal situation, a company's products would be at different stages in the life cycle, some just entering, some growing, some at their peak and some declining. This would provide for continuity of the company, and so a strategy which secured this situation would be a preferred option.

- **Positioning**

  Recent research into the effect of the change of status of an organisation from the public sector to the private sector, or vice versa, in order to improve its performance does not necessarily have a great effect.

  There are a number of examples, such as the privatisation of the railways in the UK, which suggest that performance may in fact decrease.

  The overall conclusion from investigations in the USA into the results of changes in privatisation and also the deregulation of industries is that the establishment of a clear positioning strategy is the most important single issue for organisations as the basis for a sustainable strategy.

- **Value chain analysis**

  Again, referring back to Unit 3, we see that Porter's generic strategy has as its goal the creation of value which is greater than the cost of acquiring it. The difference between the added value and its cost is what Porter describes as 'margin'.

  The function of the value chain is to display 'total value', which includes value activities and margin. The success of such a strategy in providing this, or not as the case may be, is the means of assessing its suitability for an organisation.

- **Portfolio analysis**

  When we first introduced the BCG matrix in Unit 3 we saw how they arrived at the conclusion that investment should be channelled into 'stars' and those products which could be promoted to star status. An alternate strategy, outlined in Figure 3.5, would be to move 'question marks' through 'stars' and then on to 'cash cows'.

  What we need to ask is:

  - whether this strategy would move the company into a dominant market position.
  - Have we sufficient financial resources, made through our 'cash cows' to be able to make such an investment?

  We have already said that, as a private investor in the stock market seeks to have a balanced portfolio of shares, so an organisation needs to have a balance of activities, in order to allow for 'swings' in one area to be offset against the 'roundabouts' in another.

  A comparison of business strength against industry attractiveness, as shown in Figure 2.6, may be used to give development priorities to the different SBUs by employing a strategy of greater resources being allocated to those SBUs with higher attractiveness that can achieve a strong competitive position.

- **Business profile analysis**

  The nature of the position held by a company in the market, its competitive position, and whether or not it can hold on to that position within the market, can be compared with the stage of maturity of the industry in order to suggest the effectiveness of different strategic options.

  Such a model is provided by the Arthur D Little strategic condition matrix, illustrated in Figure 6.1. This is in some ways similar to describing a life cycle for an industry.

  What it does not show is the position which occurs when the company's capabilities are very limited and the market does not show any signs of likely opportunities for improvement.

In this situation it may be that the only strategic option to take is to cease activities and withdraw from the market in such a way as to minimise both the cost of withdrawal and the disruption to the company's overall portfolio.

COMPETITIVE POSITION	STAGE OF INDUSTRY MATURITY: Embryonic	Growth	Mature	Ageing
Dominant	Grow fast. Build barriers. Act offensively.	Grow fast. Aim for cost leadership. Defend position. Act offensively.	Defend position. Increase the importance of cost. Act offensively.	Defend position. Focus. Consider withdrawal.
Strong	Grow fast. Differentiate.	Lower cost. Differentiate. Attack small firms.	Lower costs. Differentiate. Focus.	Harvest.
Favourable	Grow fast. Differentiate.	Focus. Differentiate. Defend.	Focus. Differentiate. Hit smaller firms.	Harvest.
Tenable	Grow with the industry. Focus.	Hold-on or withdraw. Niche. Aim for growth.	Hold-on or withdraw. Niche.	Withdraw.
Weak	Search for a niche. Attempt to catch others.	Niche or withdraw.	Withdraw.	Withdraw.

Figure 6.1: Arthur D Little Strategic Condition Matrix

- **Gap analysis**

  This is a useful tool, both in helping to set realistic objectives and as a basis for identifying the extent to which existing strategies will fail to meet performance objectives in the future.

  In a visual form it combines the "where are we now?", (and the "where would we be with no further action?"), with the "where do we want to be?". The gap between these two gives a clear picture to management of what must be achieved - a challenge to become more proactive. When planning at strategic level, it is possible to first throw forward a forecast of desired revenue/profits, and also those which are expected to be obtained from existing products and markets. Often this leaves a shortfall between what is desired and what is believed to be possible.

  It is then possible to consider how this gap may be bridged, by pursuing strategic options such as:

  - internal growth
  - diversification, etc.

  Figure 6.2 illustrates the concept of the planning gap.

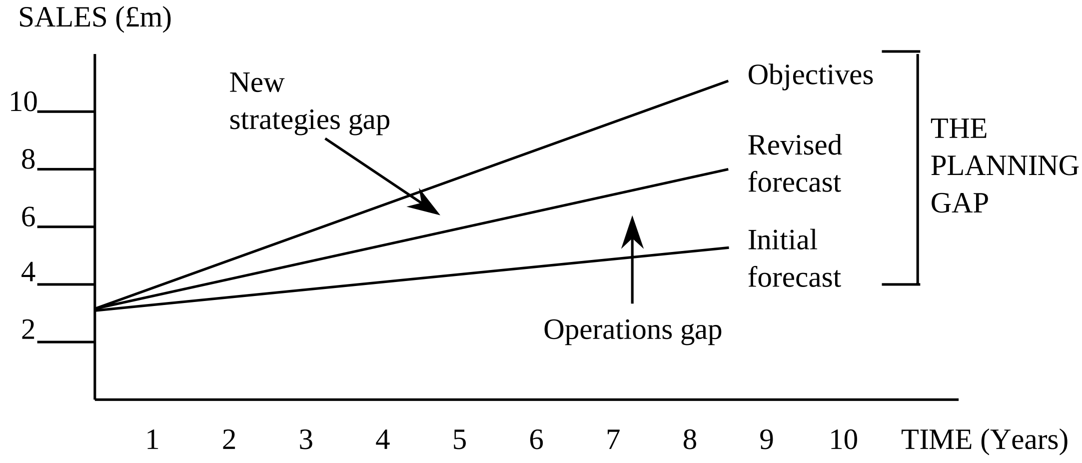

Figure 6.2: Strategic Planning Gap

Most planning operations are commenced from the perspective of the market place and so the salesforce are the starting point for decisions about the most effective strategy to pursue. Some information has to be put into the planning system as a starting point for strategic planning in order to produce a first-draft plan, firstly for a function or an SBU and ultimately for the organisation as a whole. If, however, a particular function represents the limiting factor in the planning process then the initial forecast will be produced there and other functions/SBUs will have to fall in line.

- **Advantages of gap analysis**

  There are a number of advantages from using gap analysis:

  - It forces management to be forward thinking.
  - It encourages an analysis to be made of the forces which may either help or hinder the achievement of future objectives.
  - It can be used as a dampening device to reduce either over-optimistic, or over-pessimistic objectives to more realistic ones.
  - It encourages management to think about the strategies they can use in order to close gaps; which is probably the most important advantage from a strategic planning point of view.

- **Methods of closing the gap**

  When a gap is forecast, for example, in the company's profit level, management needs to look for strategies which are likely to close it. These strategies will be related to the reasons for the gap, which might be:

  - a decline in sales due to obsolete products;
  - an increase in production costs due to ageing machinery, or increasing labour costs, or both;
  - a change in the needs or demands of the market target.

  Once the gaps and the causes of them have been identified then suitable strategies for closing them can be considered. These might include:

  - the development of new products;
  - reducing costs, by improved efficiency or the replacement of old machinery;

- diversification into new products or markets.

Often it is necessary for a company to use, not just one strategy to close the gap, but a combination of strategies introduced over time and phased in as and when they can be delivered.

Different types of strategy take different times to become effective and have different levels of risk associated with them.

In general, the following can be used as a guide:

Strategy	**Speed**	**Risk**
Market penetration	Quick	Lower risk
Market development	↕	↕
Product development		
Diversification	Slow	Higher risk

Figure 6.3 illustrates the need to improve a company's profit level over time.

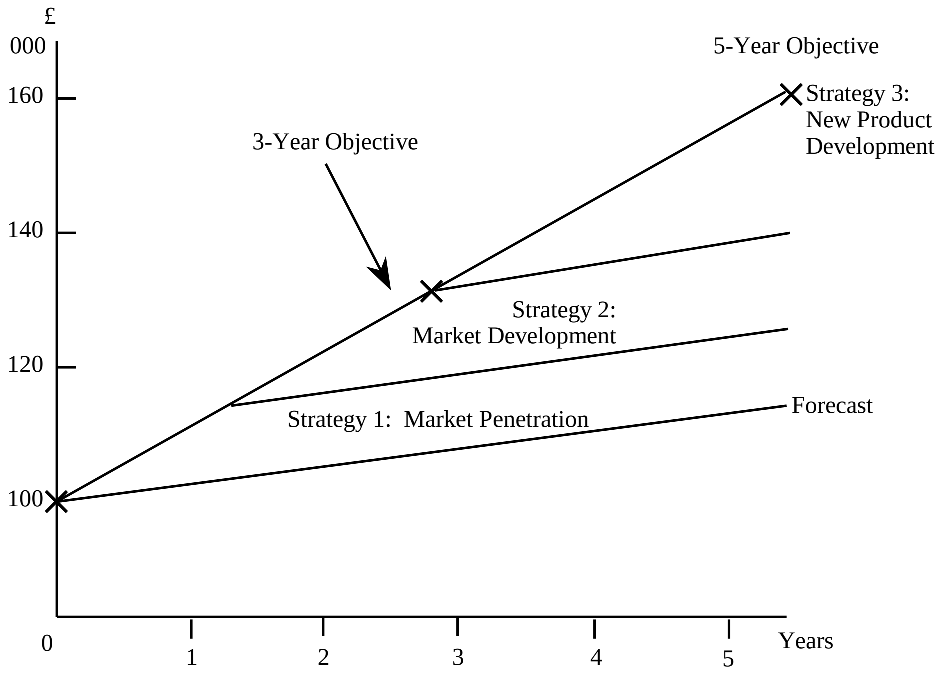

Figure 6.3: Alternative Strategies for Closing the Planning Gap

As you can see, gap analysis presentation can be used to help managers think about both the scale of what must be achieved and also the timing of when strategies may start to have an impact on results.

- **Limitations of gap analysis**

  Although gap analysis is a very useful tool for planning future strategies it does have a number of limitations:

  - Gap analysis does not of itself show which are the most appropriate ways of closing gaps.
  - Gaps are complex to predict.

- Gap analysis cannot allow for sudden and unexpected changes in a company's environment.

Despite these limitations, however, gap analysis has an important part to play in corporate strategic planning. This is due in the main to it forcing management to look to the future and to accept that gaps may occur.

In this way it contributes to improving the process of strategic planning within an organisation.

- **Gap analysis in the public sector**

  Thus far we have been considering gap analysis as a planning tool in the commercial sector. It can also be used, in a slightly different way, in the public sector.

  In this context the strategic problem is often concerned with whether future demands on a public service are likely to change to such an extent that the current provision of resources will be unable to cope.

  This is a particularly important consideration with respect to the statutory obligations of public services, such as the provision of schools, hospitals and the social services.

  In order to assess the gaps likely to exist in the future for such provision, information regarding births and deaths statistics, together with likely movements of areas of employment is very important.

Screening Techniques

- **Ranking** is a method of placing an organisation in a 'league table', based on a set of factors which are linked to its strategic situation.

  The way in which the key factors are arrived at is an important influence on the positions allocated in the league. Whether they are simple, quantitative measures, such as market share, or are weighted according to the opinion that they are more important than other factors provides opportunities for disagreement about the position a particular organisation fills. The system does have the benefit, however, of drawing attention to mismatches between a ranking position and the different strategic options an organisation can adopt.

  Recently, much controversy has been raised with respect to the league tables produced by Offsted for schools, in particular in the secondary sector. Arguments about the unfairness of basing the list on examination results without regard for the environment of the school and its catchment area abound, and many would argue that the factors used in the assessment are inadequate.

- **Decision trees** can be of help to managers when they are faced with tactical decisions on such matters as spending money on researching an opportunity. Such a model helps the manager to review the options objectively and to decide the cost/benefit of more research, or to compare the alternative strategies in terms of their risk and potential losses.

  The key point is to identify the ways forward and assign a quantitative value to each option to indicate the likelihood of it occurring.

  The decision tree is a pictorial method for displaying information and is a tool used as a basis of probability theory. Using a decision tree it is possible to predict the effect of different strategies, and enables eventualities to be identified and consequences forecast, before quantification is applied.

  For example, we can show the sequence of events involved in an investment decision.

  An organisation is trying to assess the costs and benefits likely from investing in a new major computing program (see Figure 6.4).

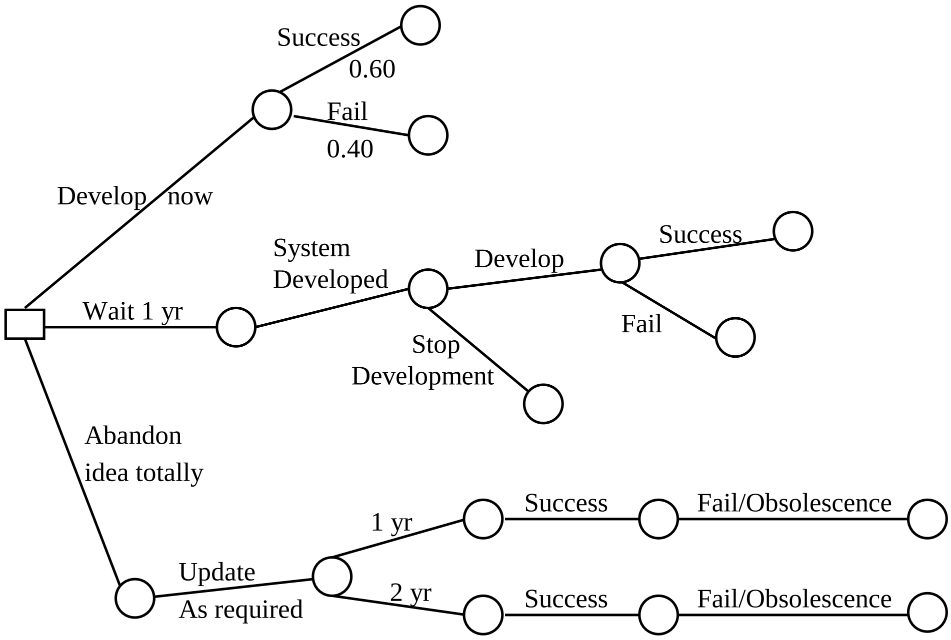

Figure 6.4: Decision Tree

Each activity on the tree is assigned a mathematical probability of its occurring. In our example, the cost of developing a new program from base now is £100,000. We assess the likelihood of success in developing the program as 0.6, therefore the cost will be £100,000 multiplied by 0.6, or £60,000. If the development fails, the cost will be £100,000 × 0.4 or £40,000.

Decision trees are widely used in operational decision-making, but they can equally be used in formulating strategies.

They help by ensuring that the problem is approached in a structured way and by forcing the decision-makers to look at all the possible outcomes.

Decision trees do not improve the quality of guesses and estimates, but they encourage logical thinking with respect to strategic option selection.

- **Scenario building -** by drawing on objective techniques, and adding a little creative imagination in terms of the choice and weighting of the variables, a researcher can create a series of alternative futures. Each of the alternatives can then be used to screen different strategic options by matching them to these possible future scenarios.

  This method differs from the ranking and decision tree ways in that it does not provide a prioritised list of options but instead gives a series of contingency plans which will identify the preferred option for each of the possible scenarios.

  Future scenarios of an organisation's environment in, say, 5+ years' time, can be drawn up by means of PEST analysis (see Unit 2). These scenarios can then be used to evaluate possible future strategies by matching them to one another.

  Because this method provides a series of suitable contingency plans, rather than just a number of different options, it is particularly useful in times of greatest uncertainty.

  Each possible future scenario can then have associated with it a number of plans, so that, whichever scenario ultimately becomes closest to the actual environment at some future point in time, the most suitable strategy can be used.

D. ASSESSING ACCEPTABILITY

Analysing Return

In order to decide upon which strategy to employ, we need to know what sort of return we are likely to get from each of them.

Ways of assessing returns include:

- profitability analysis
- cost/benefit analysis
- shareholder value analysis.

Profitability analysis - precisely how to measure profitability is open to debate. However, the three levels of profit, i.e.

trading (or operating) profit,

pre-tax profit,

and profit after tax

can all be used as the 'output'.

For investment, the usual terms are either total assets, net worth, equity capital, the number of shares or the market value of the company. The most suitable financial objective, according to most people is 'return on investment' (ROI), or 'return on capital employed' (ROCE), or 'return on equity' (ROE).

In the UK, company accounts are most likely to show 'earnings per share', and often some other measure of profitability such as 'payback period', which is found by finding the time at which the cumulative net cash flow is zero, i.e. when cash flow into the company is equal to that put in to start a new process or venture.

Cost/benefit analysis attempts to go beyond just a measurement of financial profit to include other returns, both tangible and intangible, both to the organisation making the strategic choice and to others who may benefit from it. So, for example, a local authority may invest money in the building of a by-pass road, which will reduce expensive repair work to, say, an ancient bridge, and so create a financial gain for the authority, whilst also benefiting those whose quality of life is improved by the removal of a large amount of traffic through their neighbourhood.

The actual cost value of these intangible advantages is always difficult to measure but, despite this problem, cost/benefit analysis is useful, since it encourages decision-makers to consider all the factors which should be taken into account when making a strategic choice.

Shareholder value analysis - the major responsibility for the directors of a public company is to provide financial rewards for its shareholders.

In order to achieve this end it is important that the key cash generators of the company are identified, which are the value- and cost-drivers which sustain the competitive position of the company.

Analysing Risk

Risk describes a situation in which there are a number of different possible strategies involved and a number of possible outcomes which may result from a particular strategic choice. The likely return from a particular choice is a measure of its acceptability. But there is a risk involved in following a particular strategy and this must be assessed as part of the evaluation of that strategy. Going ahead without considering the probable effects of a choice is a gamble, and management should not be engaged in gambling. Instead they should be involved in risk containment.

Two of the best known product/market opportunities matrices which give a probable risk ranking are:

- Ward's 16-cell matrix (Figure 6.5) and

- Shell's direction policy matrix (Figure 6.6).

NEWNESS OF MARKET	NEWNESS OF PRODUCT: Same Product	Extended Model	Modified or improved design	New Product
Same market	1	2	4	8
Better market coverage	2	4	8	16
New coverage but in related areas	4	8	16	32
Totally new market	8	16	32	64

Figure 6.5: War's 16-cell Matrix

In this matrix the numbers in the cell indicate the degree of risk associated with each alternative.

COMPANY COMPETITIVE CAPABILITIES / BUSINESS SECTOR PROSPECTS	Unattractive	Average	Attractive
Weak	DISINVEST	PHASED WITHDRAWAL	DOUBLE OR QUIT
Average	PHASED WITHDRAWAL	CUSTODIAL GROWTH	TRY HARDER
Strong	CASH GENERATION	GROWTH LEADER	LEADER

Figure 6.6: Shell Directional Policy Matrix

Sensitivity analysis is a technique for assessing risk which is used in modelling to determine which outcomes are sensitive, i.e. subject to change, in response to particular inputs. It is widely used now because of the availability of computer spreadsheet packages which are suited to this kind of analysis.

In practice, it needs the intervention of a manager to identify a particular input and amend it in a pre-planned way, at the same time trying to maintain the levels of all the other variables.

Allowance does have to be made for changes in the other variables and for their effect on the result. The basic questions which have to be satisfied are:

- How was the result achieved affected by the planned input change?
- How was it affected by the uncontrolled variable changes?

An example of the usefulness of this type of analysis is provided by Filmsales UK Ltd, the largest UK supplier of acetate film. They were able to reduce their trade advertising from full-page colour to quarter-page black and white over a period of two years, and in so doing greatly reduced their costs, without sales losses. They achieved this by carrying out a carefully controlled series of experiments, moving gradually step by step and monitoring each change carefully before moving on.

Stakeholder Reactions

A valuable aid to assessing how stakeholders are likely to react to particular strategic choices is that of stakeholder 'mapping'. This can be carried out by assessing:

- how likely a particular group is to force the company to realise its expectations;
- how much power a group wields;
- the likely impact they might have on future strategies.

We have already noted that the workforce in an organisation can respond powerfully through its unions when the members feel their jobs or conditions of work are threatened, as with the public sector workers taking issue with the government over the introduction of the private sector into the health service and to education in particular.

The fall of Marconi is an example of the power of shareholders in a public company. About a year ago Marconi shares were worth £12.50. The chairman, Lord Simpson, then made a strategic decision to move the company away from the defence industry, by selling its defence contracts to BAC, and into the telecommunications sector. In the short-term this appears to have been a disastrous decision, since the telecoms sector is currently in such a poor state. Shareholders reacted angrily to the news and the share price plummeted to 30p. It remains to be seen whether this was a long-term strategy, but in the meantime it is anticipated the company will sell its white goods, automation and data systems divisions in an attempt to get rid of non-core business and save and estimated £500 million. The chairman, Lord Simpson, and his Chef Executive will not be around to see the results of these decisions as they have now been forced to resign.

E. ASSESSING FEASIBILITY

Funds Flow Analysis

In order to assess the feasibility of a particular strategic option, it is essential to find out whether the necessary resources are available to support it.

This can be done by assessing the cost of implementing the option and then the likely sources of the funding required.

The implementation costs are made up of any capital investment necessary, plus any necessary increases in working capital, such as increases in stock, which are associated with the new strategy. Other payments which will have to be made in respect of the new operation, such as tax liability and payment of dividends to shareholders, also need to be estimated.

The future expected profits to be made from the operation are then estimated. After deductions due to the writing down of capital assets, etc. are made, the expected flow of funds into the company over the period considered will be established. Any shortfall between the anticipated costs of introducing the strategy and the profits to be made from so doing will then have to be covered. This requires looking to sources such as bank overdraft or trade credit for short-term finance and to line of credit, such as medium-term loans or industrial hire purchase, for buying necessary plant or machinery. Extra finance may also be raised by issuing new shares.

Breakeven Analysis

This may be used to discover at what level of sales revenue all costs of production have been met - the breakeven point - after which all future sales contribute to profit.

In forecasting profit, the amount by which revenue is expected to exceed breakeven is termed the 'margin of safety', i.e. the forecast can be wrong by that amount without the operation showing a loss.

Breakeven is reached when revenue is equal to variable + fixed costs.

$$\text{B/E volume} = \frac{\text{fixed costs}}{(\text{revenue} - \text{variable costs})/\text{units sold}}$$

Thus, if a company has fixed costs of £10,000, variable costs of £15,000 and sells 5,000 units for £30,000, the B/E volume (in unit terms) is:

$$\frac{10{,}000}{(30{,}000 - 15{,}000)/5{,}000} = 3{,}333 \text{ units}$$

Once the fixed and variable costs are known, a sales price fixed and a sales forecast made, a breakeven chart can be plotted, as in Figure 6.7.

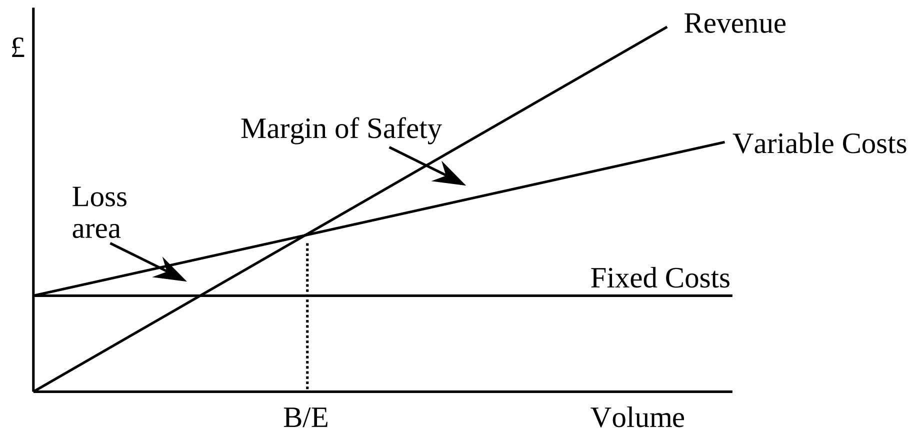

Figure 6.7: Breakeven Chart - Fixed Costs Plotted First

Figure 6.7 shows fixed costs as a horizontal, with variable costs, in strict relationship to sales volume, as a curve above. Breakeven (B/E) is shown by the meeting of the revenue and total cost curves. Revenue is the number of units sold at the price determined.

Figure 6.8 shows the same information, but variable cost has been plotted first. It is this form of the graph which is most widely accepted.

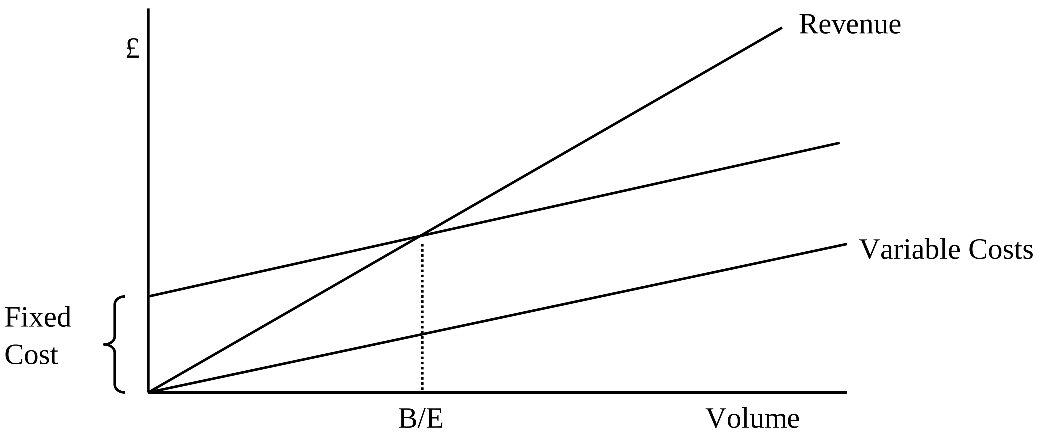

Figure 6.8: Breakeven Chart - Variable Costs Plotted First

Breakeven analysis has a wide application and can be used to determine:

- whether sufficient market penetration can be achieved to reach viability;
- whether costs and quality assumed are achievable;
- whether sufficient funding is available to meet necessary costs.

Resource Deployment Analysis

This is a method for considering **all** the resources needed to put a particular option into being, rather than just a consideration of necessary financial resources. It is carried out by tabling resources, such as machines, personnel, finance and any other relevant necessary input, for a number of different options in order to assess the most likely option to be successful.

The strength of such an analysis lies in identifying necessary changes in resources needed for any particular option and deciding whether such a change is feasible.

Return on Capital Employed (ROCE)

A frequently used method for evaluating alternative strategies is that of comparing forecast profit levels with the investment required for the implementation of each strategy and expressing this as a percentage return on capital employed. This method allows us to rank alternative strategies in an objective way with respect to profitability.

In order to carry out this analysis we need to be able to identify both the costs and the revenues associated with each individual strategy. This is sometimes difficult because of interaction with other parts of the business. It can also be difficult to accurately forecast future costs, and particularly future revenues over the lifetime of a strategy.

In general, planners tend to underestimate costs, a habit which seems particularly true in civil engineering activities, where the final cost of a roadworks or a public building is often several times the original estimate, and revenues seem to be underestimated.

For this reason it is useful to prepare a range of anticipated ROCE calculations, from ‘optimist’ through to ‘pessimistic’.

By plotting a graph of % ROCE against time, it is possible to forecast the return on capital employed at a specific time after a new strategy is implemented (see Figure 6.9).

In this example, the new strategy will result in a return on capital of 15% by 2005

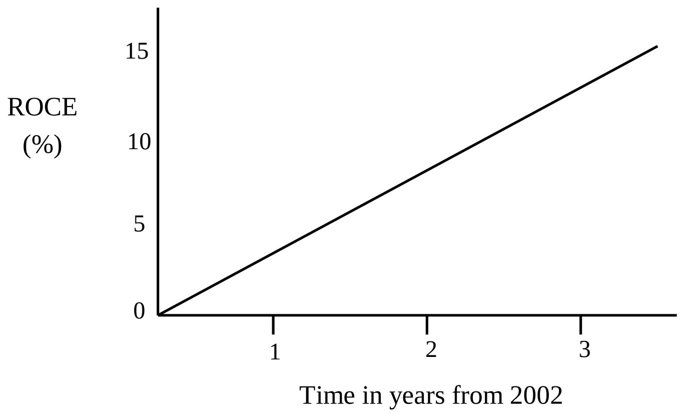

Figure 6.9: Return on Capital Employed

Payback Period

Although ROCE gives us a direct way of comparing the overall profitability of different strategies, it does not allow for some strategies taking longer than others to recover the initial investment. One way of calculating this is by estimating how long it will take to recover the initial investment by means of a particular strategy.

The payback period is calculated by finding the time at which the cumulative net cash flow becomes zero (see Figure 6.10). In this example, the payback period would be 3½ years. If a company is considering whether to use one strategy as opposed to another, then the one with the shortest payback time is likely to appear more attractive.

However, this is only one factor in a complex number of different ones and would only be the deciding factor if the evidence showed that the payback was earlier when the original investment in either strategy was the same and the actual return over the lifetime of each of the strategies was also equal. In practice, the choice is seldom that simple, so payback period cannot be used as an indicator of profitability on its own.

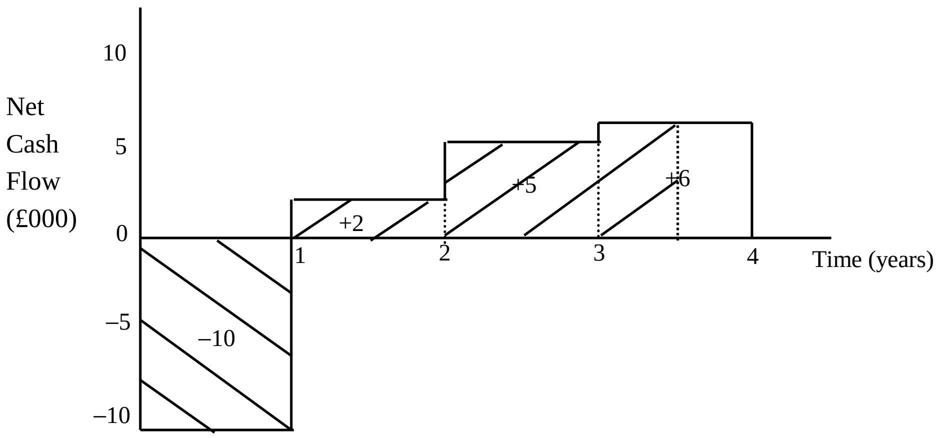

Figure 6.10: Payback Period

Discounted Cash Flow Analysis (DCF Analysis)

This is an extension of the payback period analysis, but, unlike payback, the DCF analysis takes account of income received in the future.

DCF is probably the most widely used investment appraisal technique, since it indicates the likely profitability of an investment over its lifetime. It takes into account that income received in the future is, in real terms, not worth as much as income received today, i.e. funds generated early in the life of a strategy are of greater value than those generated later.

Once the net cash flows have been assessed for each of the preceding years, they are discounted progressively to allow for the later income becoming worth progressively less. Normally, the discounting rate is based on the current value placed on money invested in the strategy, and this factor is applied to future annual cash flow forecasts over the lifetime of the strategy. The cash flow is thus discounted progressively and is then totalled in order to obtain the net present value (NPV) of the project.

Most computer spreadsheet packages now include NPV and also the internal rate of return (IRR), and these functions make it possible to carry out DCF calculations.

Cost/benefit Analysis

There are occasions when measuring profitability for a particular strategy does not take account of all the implications of a particular selection.

For example, important strategic decisions, such as where to site a new London airport, or whether or not to construct an out-of-town shopping mall, can have a considerable effect on a community's environment, or on existing businesses, and these cannot be measured just in terms of financial evaluation.

Cost/benefit analysis involves placing a financial value on all the costs and benefits of alternative strategies, including the effects on people's lives of increased traffic congestion and noise pollution.

Its advantage is that it forces planners to look beyond the obvious costs and benefits of a particular strategy and to consider the wider implications.

Unfortunately, many of these wider implications cannot be assessed objectively by means of the kinds of financial analysis we have been considering, and thus the decisions become subjective.

Despite this weakness, cost/benefit analysis provides an extra tool for evaluating the effect of strategic planning.

F. SELECTION OF STRATEGIES

Planned Strategy

Mintzberg describes a planned strategy as one where the leaders at the centre of authority draw up a plan, having described their intentions as precisely as possible, and then work hard in order that the planned strategy is implemented with as little change as possible.

Since the plan is of no use unless it can be carried out in the organisation's environment, a planned strategy is found only in an environment which, if not benign or controllable, is at least predictable.

Galbraith says some organisations, which he describes as the "new industrial states", are sufficiently powerful to impose their plans on their environment. Others are able to predict their environments with sufficient accuracy as to be able to follow planned strategies.

Enforced Selection

To a rapidly increasing extent, strategies are being forced on organisations by groups outside the organisation, such as government, trade unions, etc. Whether this enforcement is in the form of direct regulation, or the competition of government-supported businesses, or the various conditions for accepting government aid or contracts, the result is that many aspects of strategy are imposed. Strong unions, through collective bargaining, are also able to impose decisions on management, together with various pressure groups who can force changes to policies and strategies. Recent examples of these types of enforcement include:

- **Government aid** linked to development areas, which encourage companies to set up factories in areas of unemployment.
- **Pressure groups** demanding reduction in the tax on petrol, who have nearly brought the UK to a halt by picketing storage depots.

Learning from Experience

Where there are considerable uncertainties about the future, many organisations try to 'sit on the fence' when the selection of a strategic option has to be made. In some sectors, such as manufacturing industries, it is difficult to delay choosing a preferred option, so companies have to make a decision one way or the other.

In others sectors, such as service organisations, it is easier to make deferred choices and to leave a final choice until later. This gives the organisation the opportunity to learn by experience in order to make a more informed final choice at a later date.

Some retailing companies adopt a policy of trying out new strategies, fashions, methods of distribution, improved shopping facilities, etc. by putting them into flagship stores in the first instance in order to assess their impact, and then introducing them into all their stores if the strategy works out.

Command

Fayol was one of the first persons to sit down and work out what the role of management is. In his ‘elements’ of management he listed ‘command’. What he intended it to mean was the way in which management makes sure that things get done, i.e. that the operations of the organisation are carried out. In order to be in command it is necessary to have power, and in organisations this can be based on a number of factors.

For example, in an operation heavily dependent on computers, those who can repair the machines or put right the software programs when the computers are ‘down’ can wield a large amount of power.

In selecting a strategy, power is also an important factor and the ultimate power is to be able to command that a certain selection of strategy is made.

The situations where this is possible are limited in general to sole proprietors and to very charismatic leaders, such as Sir Richard Branson.

G. SELECTION OF MISSION STATEMENTS AND KEY OBJECTIVES

Mission Statements

We first considered an organisation’s mission statement in Study Unit 1, when we saw that it represents the overall reasons why the organisation exists.

In strategic planning and decision-making, the role of the strategic mission includes stating the scope and boundaries of the organisation. It is important that members of the organisation fully support its mission; if they do not, real problems can arise in respect of the strategic direction the organisation is trying to pursue.

The mission statement of any organisation needs to take account of the following points:

- It should be **general in its content** so that it covers the organisation’s reasons for existence.
- It should be **visionary**, and likely to last for a long time, so that strategies which are developed in order to fulfil it are capable of being changed over time, as necessary.
- It should describe the **position the organisation hopes to attain** in its sector.
- It should **state the key values of the organisation**, taking account of the expectations and values of its stakeholders.
- It should be such that the organisation has both the **intention and the capability of living up to it**.

The importance of the organisation’s mission statement is that it gives out information to its stakeholders about its intentions and what it is hoping to achieve.

In terms of strategic planning and thinking, the mission statement helps to direct planners towards specific organisational objectives, policies and strategies.

Organisations can use their mission statement to explain what they are all about, in terms of their products/services, customer needs, geographical scope, etc., and in this way to determine their strategic direction.

Strategic Vision

Strategic vision is an important addition to a strategic mission in that it looks to the future state of the organisation.

A clear strategic vision enables an organisation to remain focused over a period of time and protects it from strategic drift (refer to Study Unit 1).

Having a challenging strategic vision, such as becoming a market leader in a particular dimension, helps to keep a company on course and therefore successful.

Strategic vision acts as a motivating factor for employees and also as a means of strategy selection.

Key Objectives

Key corporate objectives represent a precise statement of an organisation's goals and are formulated by senior management.

They are often, though not always, expressed in financial terms, such as profit levels, sales target figures or share values, i.e. they tend to be **quantified**. They are an expression of how the organisation proposes to meet its stakeholders' expectations.

Objectives can be of two types:

- **Closed objectives**, which are capable of being achieved at some time in the future.

  For example, "we aim to supply a million telecommunications services to customers by the end of 2001" [Centrica Plc]

- **Open objectives**, which can never be finally achieved, since they will always persist.

  For example "….to build a strong future out of our opportunities" [Scottish Power]

Johnson and Scholes argue that, contrary to some other opinions, both closed and open objectives can be useful.

Mission, they say, should be a very important influence on strategy because it:

- may concentrate employees' perception of their operation on the needs of their customers and the utility of the service; and also
- set the boundaries within which they see the business developing.

Thus, **mission statements** are related to focusing strategy rather than deciding when it has been achieved.

Closed objectives have a particular part to play in some scenarios, such as when a business hits a crisis. If a turnaround situation develops, where the choice is between the business either going under or surviving, then specific objectives are essential.

Closed objectives are also helpful for planning purposes, since the objective in this case becomes a target to be achieved. For example, financial objectives such as profitability are useful for judging the success, or otherwise, of a new SBU.

The Role and Influence of Stakeholders

The expectations of stakeholders, both individuals and groups, influence the purposes of an organisation. We have already seen how these affect the organisation's mission statement and, through this, its objectives.

Objectives tend to emerge as the wishes of the most dominant stakeholder group, which is usually composed of the organisation's managers. In pursuing these objectives, however, the members of the dominant group act in accordance with their interpretation of the political situation, and will often abandon some of their expectations in order to improve their chances of achieving others.

Few individuals have the power to determine the strategy of an organisation on their own. In general, it is usually a group of like-minded people, who share the same aims and ideals, who come together to influence the organisation's strategy. These groups can arise both within departments, at different levels of the hierarchy, and in different geographical locations. The groups are not necessarily constant in nature but often arise as a result of a particular events occurring.

Both internal and external stakeholders can have an effect on the development of an organisation's strategy, and understanding them and how they can influence strategy is a very important part of strategic analysis.

Conflicting Interests of Stakeholders

It is often the case that different stakeholders have different expectations of a company. For example, shareholders, who are the providers of the company's capital and the ultimate risk-takers, are mostly concerned with the company attaining maximum profitability in order to obtain the best return of shareholder capital over time.

However, this may seem to reduce the position of other stakeholders in the company, such as employees, customers, suppliers etc. to that of second best.

In addition to these **direct stakeholders**, i.e. those with an ongoing relationship with the day-to-day business of the company, there are other **indirect stakeholders**, such as the local community in which the company is based, and the government, etc. who also have an interest in its activities.

It is easy to see how conflict can arise between the interests of such diverse groups. Higher profits for shareholders, for example, are likely to lead to lower pay for employees, higher prices for customers, and detrimental effects on the local community through a reduced concern for environmental factors.

Maximising profitability through the efficient and effective use of scarce resources would seem to be the obvious target for a commercial business, since anything less would lead to higher costs and thence to a reduced competitive edge, which would act against the interests of stakeholders in general, with lower job security and fewer new products for customers.

The role of management, then, is to balance these conflicting interests by developing a partnership with various stakeholders. The road to success is to offer something to each of them.

This is best achieved through long-run profitability, i.e. by maximising profits over time, which may mean seeking a partnership with suppliers and distributors in the value chain. The result of such a partnership can lead to:

- the effective development of new products;
- total quality control; and
- excellent customer services.

This type of strategy is also consistent with objectives such as growth and market share, which leads to a surplus that, in turn, can help to satisfy all stakeholders, since:

- employees are paid more, and have better working conditions;
- customers get better products are lower prices; and
- shareholders received maximum returns.

Thus the conflicting interest of different stakeholder groups can all be met.

Study Unit 7

Implementation and Control 1 - Organisation

Contents *Page*

INTRODUCTION

In this, the first of two units considering the implementation of strategies, we will be looking at the importance of organisational design and structure. We will identify the impact of alternative organisational structures on strategy implementation, and discuss both the advantages and the limitations of centralised or decentralised structure in respect of strategic planning and control.

Objectives

After studying this unit, students should be able to:

- discuss the importance of organisational design and structure in strategy implementation;
- identify the impact of alternative organisational structures on strategy implementation;
- discuss the advantages and limitations of centralised or decentralised structures in respect of strategic planning and control.

A. THE CONCEPTS OF STRATEGIC ARCHITECTURE AND CONTROL

When considering how best to implement a chosen strategy there are a number of factors which have to be taken into account which are concerned with the design and structure of the organisation. We have already seen that the environment in which the organisation exists has a major influence both on what it can do, and how it can do it. How stable the environment is will have an effect on strategic implementation. In turbulent times Drucker has said, although by definition there is irregular, erratic activity, nevertheless there are strategies which can use rapid change as opportunities, which can convert the threat of change into opportunities for productive and profitable action, and these are the ones which have to be used. In a more stable environment different strategies will be more appropriate, and so we need to take account of the state of the environment when implementing a chosen strategic option.

The diversity of an organisation is also relevant to strategy implementation. There are big differences between, for example, the needs of a large multinational corporation and those of a small local business.

The extent to which modern technology is employed is also an important factor. Decisions about exporting products will be different for a local pottery to make, than for a mass production company. Accountability of the management of an organisation also plays a part in the strategic design. Whether they are acceptable to shareholder or to rate or tax payers will influence how the structure is designed.

Strategic control aims to be a balance between strategic planning and financial control. In the decentralisation of power from the 'head office' type of control to its investment in the SBUs of an organisation, complete independence is rarely obtained. The changes which occur usually move away from tight control at the centre towards strategic control, where the centre acts as a shaper of strategy.

B. THE IMPORTANCE OF ORGANISATIONAL DESIGN AND STRUCTURE IN STRATEGY IMPLEMENTATION

When considering this relationship the work of Goold and Campbell is very relevant.

They studied the styles of relationship between the centre of an organisation and its SBUs and placed them in the following categories:

- strategic planning
- financial control
- strategic control

By looking at the planning influence and the control influence of the centre and the SBUs, they cam up with the following:

- planning influence is related to the centre's efforts to shape strategies as they emerge and before decisions are taken
- control influence refers to the way in which the centre reacts to the results achieved.

Strategic Planning Style

This is when the centre acts as master planner, accepting inputs from SBUs but setting the broad strategy. SBUs are regarded by the centre as just providing operational delivery of the master plan. It arises due to a lack of confidence in SBUs' managers and results in control and co-ordination by the centre being at a high level. It provides good integration across SBUs, which is useful if resources are shared, and, by allowing the use of unskilled labour, it reduces costs.

This is a bureaucratic design which, since decisions are taken at top management levels, does not rely on short-term views.

Problems with this system can arise due to:

- slow communications
- resistance by SBU managers, who see their role as entirely tactical and can spend a lot of time 'nit-picking'
- fewer low-risk strategies than if the strategy came from the SBU operating managers
- resistance to the closing-down of poorly-performing units (because the strategies came from the centre).

This type of arrangement tends to lead to concentration in a few core areas where it is possible to have a degree of expertise.

Goold and Campbell gave BOC, Cadbury and Lex as examples of this type.

Financial Control Style

This is the extreme opposite of strategic planning. In this case the centre acts as a shareholder or banker for the SBUs. The SBU managers lead the strategy within a budgetary control framework.

The centre

- sets financial targets
- appraises divisions' performances
- appraises capital bids from divisions.

Low-risk strategies are pursued, but profitability ratios are higher.

SBUs are able to diversify by deciding on entry to new markets or in developing new products. They may even be allowed to use funding from outside the parent group so as to support new developments. Growth is mainly via acquisitions rather than by internal development.

Companies of this type appear to be:

- quicker to replace managers
- fiercer in applying pressure via monitoring
- better at recognising and rewarding good performance

as compared with those who adopt the styles of strategic planning or strategic control.

Goold and Campbell quote BTR, Hanson Trust and Tarmac as examples.

Strategic Control Style

As we saw earlier, this style aims to be a balance between the other two styles. Where the strategic control style operates the centre's control is concerned with:

- the organisation's overall strategy
- the balance of activities and the role of each division
- the organisation's policies on such matters as employment, etc.

The formulation of strategy begins with the SBUs but requires to be tested and agreed by corporate management, i.e. it is a bottom-up process within central guidelines.

Power lies where there is the expertise.

Budgets and decisions cannot be over-controlled by the centre as this would produce delays and confusion, but it remains responsible for assessing the performance of divisions against their own business plans, within which the annual budget has an important role.

Relationships between the centre and its divisions, as suggested by Goold and Campbell, are as shown in Figure 7.1.

	Strategic Planning	**Financial Control**	**Strategic Control**
Description - key features	Centre acts as 'masterplanner' Top-down Highly prescribed Detailed controls	Centre acts as 'shareholder/banker' Bottom-up Financial targets Control of investment	Centre acts as 'strategic shaper' Bottom-up Strategic and financial targets Less detailed controls
Advantages	Co-ordination	Responsiveness	Centre/divisions complementary Ability to co-ordinate Motivation
Potential problems	Centre out of touch Divisions tactical	Loss of direction Centre does not add value	Too much bargaining Culture change needed New bureaucracies
Examples	BOC Cadbury Lex STC Public sector pre-1990s	BTR Hanson Tarmac	ICI Courtaulds Public sector post-1990s

Figure 7.1: Centre-Division Relationships (Goold & Campbell)

Strategic control demands that the organisation has a clear understanding of how responsibility for strategy is divided between the centre and the divisions.

The centre has responsibility for:

- defining key policies
- allocating resources to divisions
- assessing the performance of divisions

All other activities may be devolved to the divisions themselves.

Goold and Campbell identified ICI and Courtaulds as being in this group.

C. ALTERNATIVE ORGANISATIONAL STRUCTURES

The structure of an organisation is the framework within which all the activities of management, i.e. planning, operating, controlling and motivating, take place. The actual organisational set-up is laid out in an organisation chart which shows:

- who reports to whom, and
- who is responsible for what.

Functional Structures

This structure allocates key functional areas to managers, while a director co-ordinates their activities (see Figure 7.2).

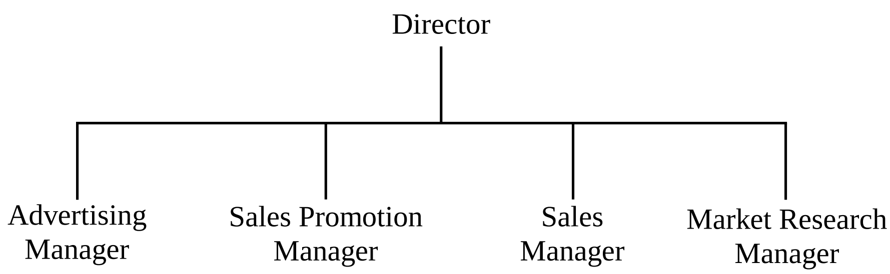

Figure 7.2: A Functional Structure

The functional structure is typically found in smaller companies or those with a small range of products. It is based on the primary tasks which the company has to carry out.

Divisional Structure

The subdivisions within a divisional structure can be formed on the basis of such units as

- types of product
- different services
- geographical areas, etc.

The structure is used where there is more diversity within the organisation than can be adequately covered within a functional structure, although the divisions themselves are likely to be split into functional management areas.

Functional structures allow greater operational control at senior levels in an organisation but, when the organisation is large, or its product/service base is diverse, this can overburden senior managers with operational issues rather than allowing them the necessary time to take a strategic view.

With a divisional structure this problem can be overcome, with each division able to concentrate on its own business environment, as in Figure 7.3.

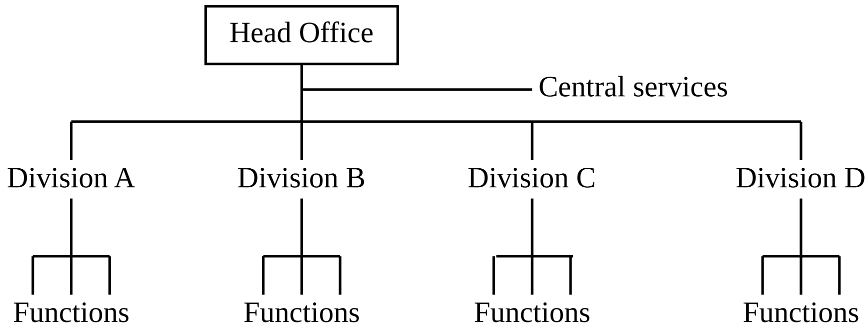

Figure 7.3: A Divisional Structure

Holding Company Structure

Ultimately an organisation may grow so large that the only effective way it can be managed is by making separate companies out of existing divisions. This can be achieved so that the only relationship between each operating company and the top of the organisation is the legal one of ownership, the divisions becoming 'wholly-owned subsidiaries'.

The connections become mainly concerned with the movement of finance and the transfer of profits, with the parent company only interfering if adequate profits are not being made.

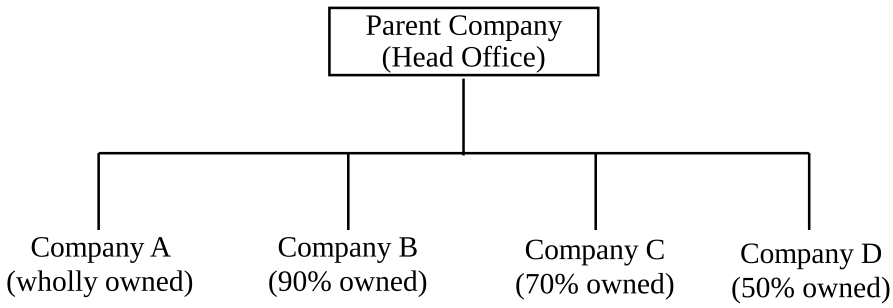

Figure 7.4: A Holding Company Structure

The Matrix Structure

This is a combination of structures which appears as in Figure 7.5.

In this example each marketing manager would have a co-ordinating responsibility for a particular product, including its production, distribution, storage, promotion and sale.

With companies engaged in project work, such as advertising agencies, a project manager would be appointed to ensure its success.

The project manager would have a number of experts making reports for as long as the project lasted, when all those concerned would move on to other work.

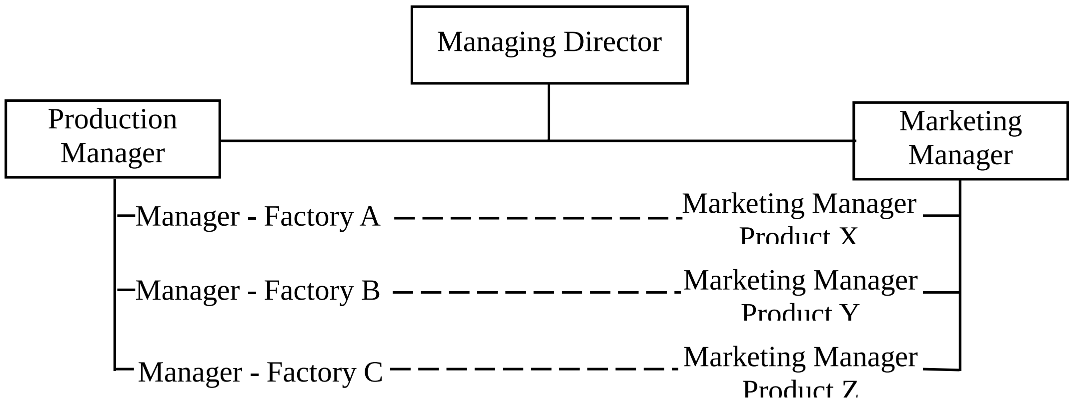

Figure 7.5: A Matrix Structure

The matrix structure is intended to avoid the weaknesses of the functional and divisional structures. The essence of a matrix is that the functional relationships within the business still stand.

In Figure 7.5 there is still a production manager with three factory managers reporting to him/her. However, each factory manager would have a direct relationship with their counterpart on the marketing side, rather than an informal indirect contact.

Intermediate Structures

The structures already discussed are not always adopted in their straightforward design.

Often companies find it necessary to move away from one type of structure towards another as circumstances dictate.

So, a company with a satisfactory functional structure may find itself moving towards a divisional structure as the business expands and diversifies.

In some cases new divisions have to be set up in order to co-ordinate the activities of the others. For example, centralised planning departments may be used.

Networks/Virtual Organisations

None of the structures described so are is really suitable for innovative organisations such as the aerospace industry or consulting companies.

This type of enterprise needs a structure that can bring together a team of experts with diverse skills and interests and mould them into a creative team.

Mintzberg suggested ‘adhocracy’ as the means by which this could be achieved, being an organic structure relying for its co-ordination on the mutual adjustment of its members to support a common cause.

Networking has many similarities with the adhocracy, with the major difference being the use of the network as the key co-ordinating factor, together with relational contracts.

The result is a very dynamic organisation, consisting often of young professionals, who have support staff to control and maintain the operation in terms of contracts with clients, the organisation of contracts and financial services and the maintenance of buildings, etc.

Multinational Structures

These can take a number of different forms, with the simplest being that in which there is a structure for the home-based parent company with the management of ‘overseas’ subsidiary companies being controlled through a direct contact between the manager in charge of the subsidiary and the chief executive of the parent company. Recent advances in telecommunications, such as teleconferencing, make the type of person-to-person contact which the multinational company needs available through video contact to global conferences on split sites.

Some multinationals retain their home-based structures and set up international divisions to deal with overseas trade. Many, however, have moved out from this narrow ethnocentric thinking, where things are viewed from the point of view of the home-based culture, to polycentric thinking, where they work from the view of the subsidiary's culture.

International companies are moving towards total globalisation, where they adopt worldwide manufacturing facilities, marketing policies, financial flows and logistical systems. Components and supplies are obtained where they are cheapest and global operating units report to the chief executive or executive committee rather than to the head of an international division.

Recently organisation structures have been set up which combine the advantages of the international subsidiary, with its local responsiveness, with those of the global structure, thus setting up an integrated network of resources and capabilities. These have been termed by Bartlett and Ghoshal as 'transnational companies'. They have suggested a form of the different types of structure for multinational companies as illustrated in Figure 7.6.

This illustrates the extent to which local independence and responsiveness should take precedence over global co-ordination.

As Johnson and Scholes point out, this balance will vary with circumstances and over a period of time.

		Global co-ordination	
		Low	High
Local independence and responsiveness	Low	International divisions	Global product companies
	High	International subsidiaries	Transnational companies

Figure 7.6: Structural Types in Multinational Companies (after Bartlett and Ghoshal)

D. INFLUENCES ON ORGANISATIONAL DESIGN

Strategy

It is important to match the design of an organisation with the type of strategy it intends to pursue, since the two are interrelated.

In a mechanistic system control is by directive; authority and communication conform to the hierarchical type of structure producing a vertical interaction. Loyalty and obedience are insisted upon and working behaviour and operations are controlled by management.

This type of organisation is best suited to pursue a strategy of strict control of costs and efficiency.

On the other hand, in an organic type of organisation, where the approach encourages lateral and vertical communication and authority, commitment to the task is considered to be more important than loyalty and obedience. A complex network of communication and control is considered necessary to foster adaptability and rapid change and individual effort is recognised through self-direction.

In this type of organisation the specialist goes where needed, authority is placed with whoever can deal with the problem and a cosmopolitan atmosphere is encouraged. This allows a strategy of differentiation to be followed which requires a high degree of creativity.

Policies

The way in which an organisation's policies are arrived at will similarly depend upon the way it is structured.

If a multi-stage process is adopted, where someone well down in terms of the organisation structure has an idea which is discussed with others and then passed up the line as a proposal until it reaches the decision-making level, this is likely to be an organic design.

Such is the system in innovative companies such as Hewlett-Packard.

Alternatively, the process of policy-making may be just a two-stage process, involving, for instance, a proposal from the managing director followed by approval from the board, as is likely in a mechanistic structure.

Processes and Technology

The type of work which forms the basis of a company will have an important effect on the type of organisational design.

For example, if the company is involved in the mass production of items such as washing machines, refrigerators, cars, etc. there is little room for creativity among the workforce. What is required in this design is strict control and often a tendency towards centralisation.

Recently Honda announced a huge investment in car production at Swindon. At a time when UK car manufacturers are cutting back, Honda are planning to produce a quarter of a million cars per year in this country, many of them for export back to Japan. When a recent TV programme showed some of their current car production I was interested in how few humans were involved in the process, and thought what a pile up would occur if one of the machines went wrong.

In this sort of scenario, strict control is vital for the business to proceed.

Due to the huge amount of technology involved, the most important members of the workforce will be those who can control the technology and they wield a large amount of power. Thus the organisation moves towards an adhocracy, with the involvement of project teams, etc.

More sophisticated technology allows for greater centralisation of organisations, with information flowing in from a number of outlets back to a head office where the decision-making is carried out.

The retailer Next was an early entrant into this type of centralisation. Using electronic scanning in their stores they are able at the end of a trading day to see the whole picture of business sales at a central office from which information is then relayed back to store managers as necessary.

Accountability

Accountability is an aspect of responsibility and this is another factor which will affect the design of an organisation.

The term is often used when considering the public purse. In general, members of the public like to be able to identify the person, or persons, who are responsible for the decision-making with respect to the taxes they pay and the services they receive. Movement in these areas towards greater accountability usually involves centralisation of decision-making, with an easily identifiable team or individual at the very centre.

Currently, moves are being made in a number of UK cities to appoint a professional, elected Lord Mayor, as in the case of Ken Livingstone in London, so that accountability becomes easier to identify.

Environment

The environment in which an organisation exists has a powerful influence on the way in which it can operate and thus affects its design.

Mintzberg has suggested that there are five conditions within the environment which need to be considered in the context of design:

– "*the more dynamic the environment then the more organic the structure*".

  Where the environment is stable, future conditions can be forecast with a reasonable degree of accuracy and so the organisation can easily standardise. When conditions are turbulent, the organisation must remain flexible, and must have an organic structure.

– "*the more complex the environment, the more decentralised the structure".*

  The main reason for the decentralisation of an organisation is that decision-making becomes too complex for a central individual.

– "*the more diversified the organisation's markets, the greater the propensity to split it into market-based units, or divisions, given favourable economies of scale*".

  An organisation that can identify distinct divisions based, for example, on geographical locations is likely to operate in that form, provided it will produce economies of scale in doing so.

– "*extreme hostility in its environment drives any organisation to centralise its structure temporarily*".

  In these circumstances organisations tend to centralise power in order to be able to give a rapid response. An extreme example of this would be a military campaign. Under battle conditions you do not want a number of different decisions being made at the same time.

– "*disparities in the environment encourage the organisation to decentralise selectively to differentiated work constellations*".

  When the environment is mixed, i.e. really a number of different environments, it requires the organisation to approach them in different ways, so there is a tendency to create different work areas to cope with each type.

Reinforcing Cycles

In the same way that strategy has an impact on organisation design, so also the converse is true, that design has an effect on strategy. Thus there are mutually reinforcing activities, with each affecting the other. The likely result of this is that there will be a change in the way that things are done by the organisation.

E. ISSUES IN ORGANISATIONAL DESIGN

Mintzberg's Model of Organisational Configuration

Mintzberg has suggested a framework for an organisation in which he originally identified five different components, namely:

- the strategic apex
- the middle line
- the operating core
- technostructure, and
- support staff.

He first introduced this in 1983 and later added a sixth component, ideology, in 1989.

The **strategic apex** involves top management who formulate the organisation's mission, goals, objectives and strategy. They shape the organisation's strategic direction and the visionary concept of where the organisation is headed within a specified time.

The **middle line** involves middle managers implementing the objectives and strategy which have been formulated at the top. They are the managers of corporate functions, or SBUs, and are responsible for the operating core but report to senior managers.

The **operating core** involves employees who are responsible for processing and converting inputs into outputs. They also include production staff.

The **technostructure** involves the application of expertise to the organisation's business activities. This includes the standardisation of activities such as planning and scheduling work, planning for the demand and supply of human resources, etc. The staff who make up the technostructure do not directly supervise the work of others.

Support staff provide services to the operating core even though they operate independently of it. This includes services such as canteen provision, administration, etc.

The **ideology** is a kind of halo effect of beliefs and traditions that surrounds the whole organisation.

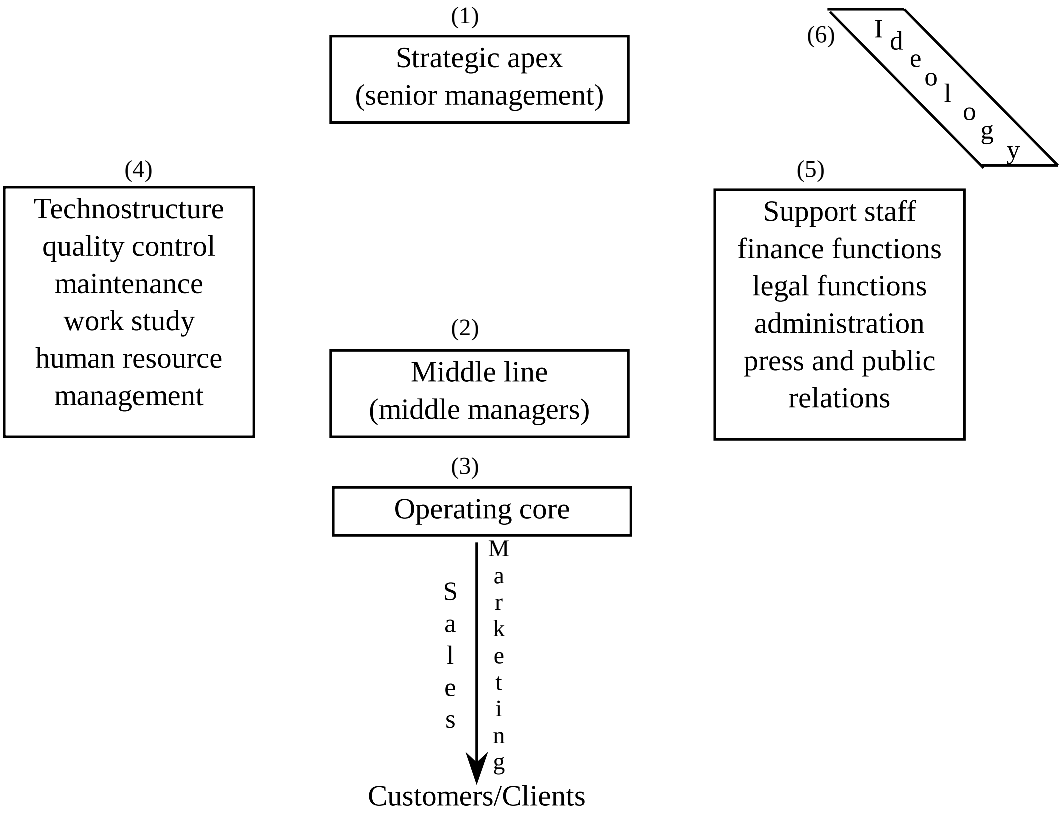

Figure 7.7: Mintzberg's Structural Model (+ link to customers/clients)

Alternative Organisational Configurations

The most suitable structure for an organisation will depend on a given set of circumstances or situations when implementing strategies.

Accordingly Mintzberg has identified six different configurations which he suggests are the most suitable to be adopted in particular cases. These are:

- the simple structure configuration;
- the machine bureaucracy configuration;
- the professional bureaucracy configuration;
- the divisionalised configuration;
- the adhocracy configuration; and
- the missionary configuration.

In addition to these six, a further organisational configuration is increasingly found in practice, and this is:

- the network configuration.
- **The simple structure configuration**

  Mintzberg suggests that this type of structure is perhaps not a structure at all, since relatively few activities in the organisation are formalised and planned.

  - The hierarchy is flat, with the strategic apex being the key part of the organisation, dominated by the chief executive, who may often be the owner.
  - Division of work is flexible and responsibilities are often not precisely specified.
  - This type of structure or configuration is very flexible and therefore well-suited to small, young, entrepreneurial organisations operating in a dynamic, hostile environment where market change is very rapid.
- **The machine bureaucracy configuration**

  This configuration is dominated by a large staff function, which focuses on routine systems that standardise work processes and procedures in the organisation. In other words, the key part of the organisation is the technostructure. Responsibilities and lines of authority are well defined and members of the organisation 'know their place'.

  - This type of configuration is best for old, large organisations which have regulated tasks and are under technocratic control.
  - It is best suited to simple environments which are static, i.e. where rates of change are relatively slow, and where cost efficiency is what leads to competitive advantage.
- **The professional bureaucracy configuration**

  Efficiency and effectiveness are achieved in this configuration through the professional competence and skills of the organisation's employees. The key part of the organisation is its core; and its design parameters are the core and the standardisation of work. A high degree of interaction between the group members takes place, with emphasis being placed on training, learning and professional knowledge.

  - The systems employed are simple ones and adherence to these is through professional commitment and control.
  - The environment in which this type of configuration operates best is one which is complex and static, such as hospitals.

- **The divisionalised configuration**

  The key part in this type of configuration is the middle line. The type of company operating in such a configuration is that which produces a number of different products and operates within an environment which is simple and static but diverse. Typically, such companies are old-established, very large and controlled by the middle line.

  - One of the key issues encountered is that of the relationship between the corporate head office and the divisions, or SBUs, particularly with respect to who is responsible for what.
  - A key co-ordinating mechanism is the standardisation of outputs.
  - This is a configuration well suited to organisations where success in different markets requires different skills and strategies.

- **The adhocracy configuration**

  This configuration is best for organisations which rely on innovation and change for achieving competitive success. The company is normally young, involved in complex tasks and under expert control. The key part of the organisation lies in both its operating core and its support staff. The systems employed have to be such that creativity is encouraged and communication between the different parts of the organisation must be open. Co-ordination is achieved through mutual adjustment by means of a supportive and open style.

  - The environment in which such a configuration is appropriate is one which is complex and dynamic.
  - The type of company which is best suited to the adhocracy configuration is one where product life cycles are short, such as high technology industries.

- **The missionary configuration**

  This is typical of voluntary organisations, where the members share the same visions and ideals. The key part of the organisation is thus ideology. Often there is little formalised structure, although this is not always the case in the uniformed voluntary organisations.

  - The key co-ordinating mechanism for this type of configuration is the standardisation of norms.
  - The environment in which it is likely to operate will be one which is simple, and static.
  - Internally, the organisation is usually middle-aged, often composed of enclaves, and operating by means of simple systems.

- **The network configuration**

  A seventh configuration is that associated with network organisations, as described by Miles and Snow.

  This configuration is in many ways similar to that of the adhocracy, but with a major difference in the use of networking as its key co-ordinating mechanism, together with relational contracts.

  - The key part of the organisation is the strategic apex or support staff.
  - The type of organisation likely to utilise the network configuration is often young and professionally controlled.
  - The environment in which the network organisation operates is a dynamic one.

These seven different configurations are the major alternatives which can be used to support and implement an organisation's strategies.

Although very few organisations are likely to fit exactly into any one of these stereotypes, the configurations can be used to think through some important issues with respect to the structure/strategy fit in an organisation. Because no one configuration is best, it is necessary to match a configuration to the prevailing strategic situation and circumstances facing the organisation.

Co-ordination and Control

Mintzberg suggests that there are six mechanisms by means of which organisations co-ordinate their activities.

These are by

- "mutual adjustment"
- "direct supervision"
- "standardisation of work processes"
- "standardisation of outputs"
- "standardisation of skills" and
- "standardisation of norms".

Mintzberg described the first two as "ad hoc" and the others as "various forms of standardisation".

– **Mutual adjustment**, he suggested, comes about as a consequence of informal communication, which leads to co-ordination of work between a number of people.

– **Direct supervision** is, as it appears, the co-ordination of the work of a team by means of one person being in charge. It is required when the number of people working together becomes too large for mutual adjustment to be possible.

– **Standardisation of work processes** means having a plan for the procedures to be carried out so that everyone works in the same way. It's rather like having the assembly instructions for a flat pack kitchen unit supplied by Schreiber (or any one of a number of similar companies).

– **Standardisation of outputs** refers to the results of work. So it is important that, in assembly work, one person's part of the job has to be suitable for the next person to add their stage.

– **Standardisation of skills** occurs where a person receives training in a particular activity, say in driving a vehicle, which is the same as that received by others, so that driving is standardised and at least we all drive on the same side of the road (most of the time). The same kind of standardisation would apply in surgeons learning to carry out a prescribed operation.

– **Standardisation of norms** results in the members of an organisation sharing a common set of beliefs, and in so doing achieve co-ordination of effort.

Centralisation and Decentralisation

In entrepreneurial structures, Handy identified a structure which places emphasis on centralisation and central power which suits smaller organisations. In these cases the power comes from the core of the business and the figurehead is seen as a powerful and influential individual, with the authority to allocate and control resources based on their position giving them complete freedom to do what they want. Handy refers to this structure as the **power culture**.

In larger organisations, where there is a bureaucratic structure, some authority and power is decentralised or devolved. This enables decisions to be made and instructions given to workforce personnel without reference to a higher authority. In any organisation which employs 10,000 people or more, on different sites and perhaps also in different countries, it is not possible for all decisions to be referred back to head office, so routine decision-making is delegated to regional or divisional level.

There are, it can be argued, advantages and disadvantages to both centralisation and decentralisation, in terms of both relationships and responsibilities.

Advantages of centralisation include:

- decision-making is easier, quicker and simpler
- the figurehead/chief can keep control of operations
- the structure can be flatter, i.e. fewer levels of management, and so less costly
- resources are more easily allocated and controlled
- there is less need for complicated rules and procedures since these can be developed, co-ordinated and implemented from the centre.

Disadvantages of centralisation include:

- it can only truly work in small companies
- little authority or power is delegated, reducing the managers' role
- routine decision-making is slow when managers have to consult the chief for approval.

Advantages of decentralisation include:

- managers are able to make routine decisions themselves
- empowerment of middle and junior managers acts as a motivator to them
- information technology enables communications between regions and head office to be good.

Disadvantages of decentralisation include:

- possible distortion of communications as they pass through a number of filters
- communication needs appropriate control and co-ordination to avoid difficulties
- greater co-ordination and control needed between the five original components of Mintzberg's organisational configuration
- possible difficulties in keeping large numbers of employees, dispersed over a number of different locations, committed to the organisation's mission, goals, objectives and strategy
- there will need to be a sufficiently large pool of suitably qualified and experienced managers to deal with the responsibilities.

Mintzberg, in using the terms centralisation and decentralisation to refer to the sharing of decision-making power, described:

- a **centralised structure** as one where all the power rests at a single point in the organisation; and
- a **decentralised structure** as one where the power is dispersed among many individuals.

He does not restrict the terms decentralised to the dispersion of formal power only, and distinguishes between:

- **vertical decentralisation**, where formal power is delegated down the hierarchy to line managers; and
- **horizontal decentralisation**, where formal or informal power is dispersed out of the line hierarchy to non-managers, such as operators or support staff.

He also speaks about:

- **selective decentralisation**, as being the dispersal of power over one or a few kinds of decision to the same place in the organisation; and of
- **parallel decentralisation**, where power for many kinds of decision is dispersed to the same place.

Mintzberg sees the advantage of centralisation as being the keeping of all the power in one place, thus ensuring the tightest form of co-ordination, with all decisions being made in one head and then carried out through the process of direct supervision.

"Why then decentralise?" he asks, and answers this himself by pointing out that one brain is often inadequate since it cannot know everything. In addition, he adds that decentralisation means that an organisation can respond more quickly to changes in local conditions, and also presents more scope for flexibility for capable individuals, which acts as a motivating factor.

Mintzberg suggests that there are six basic types of decentralisation, each linked to one of the six co-ordinating mechanisms described above. These are:

Type I	-	centralisation - direct supervision
Type II	-	limited horizontal decentralisation (selective) - standardisation of work processes
Type III	-	limited vertical decentralisation (parallel) - standardisation of work outputs
Type IV	-	horizontal decentralisation (parallel) - standardisation of skills
Type V	-	selective horizontal and vertical decentralisation - mutual adjustment
Type VI	-	decentralisation - standardisation of norms

- **Type I - centralisation**

  Here direct supervision from the strategic apex means that each line manager controls those below in the hierarchy, so that all the power rises to the top to stay in the hands of the chief executive.

- **Type II - limited horizontal decentralisation**

  Where the standardisation of work processes is the method of co-ordination, workers at the lower levels in the hierarchy lose power both to those higher up the hierarchy and also to those in the technostructure, who are responsible for designing the control systems. This results in vertical centralisation to the strategic apex and limited horizontal decentralisation (selective) to the technostructure.

- **Type III - limited vertical decentralisation**

  Where work outputs are standardised, power to make decisions is delegated to a limited number of divisional managers, thus giving us limited vertical decentralisation, which is parallel because power is also at the strategic apex. There is also a selective degree of decentralisation to the analysts in the technostructure, since they control only the design of the standardisation of outputs.

- **Type IV - horizontal decentralisation**

  In this type it is the standardisation of skills which provides co-ordination. The work is carried out by large units of professionals, who can operate with little control from line managers and be responsible for their own decision-making. This gives us a form of horizontal decentralisation (parallel) with power located in the operating core.

- **Type V - selective horizontal and vertical decentralisation**

  Here the professionals work in small groups, co-ordinated by mutual adjustment, and are able to exert a lot of power. This gives us a combination of selective vertical decentralisation, with delegation to groups at different hierarchical levels, together with selective horizontal decentralisation of power within each group of both managers and non-managers, with control resting in the hands of those with the necessary expertise.

- **Type VI - decentralisation**

  This is exhibited where co-ordination is affected by the standardisation of norms of behaviour between people who share the same beliefs and ideals.

  Power is shared equally throughout the organisation, resulting in the most democratic form of structure.

The debate about whether centralisation or decentralisation of decision-making is the one to be preferred, both in the private- and the public-sector, is ongoing. The term used for ‘decentralisation’ in this debate is often that of ‘devolution’, meaning the extent to which the centre of the organisation allows the control of decision-making to pass lower down the hierarchy.

This, suggests Johnson and Scholes, raises the question of “control over what?”

Goold and Campbell considered this in their work on management styles in diversified organisations and provided stereotypes of possible relationships between the centre and the parts of an organisation, and how responsibilities for decision-making may be divided between them.

The three stereotypes which they suggested are:

- strategic planning
- financial control and
- strategic control

We considered these stereotypes in some detail earlier in this study unit.

Study Unit 8

Implementation and Control 2 - Resources

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INTRODUCTION

This second unit dealing with implementation and control of strategy will concentrate on the allocation of resources, as a key aspect. We will look at the issues of resource configuration, planning and control as well as specifically discussing the role of information and information systems as a resource for improving strategic development and implementation.

Objectives

After studying this unit, students should be able to:

- analyse the ways in which resource allocation is central to strategic implementation;
- discuss the role of resource plans in implementation and control, and explain the processes involved;
- identify the value to the organisation of information as a resource, and assess the potential role of information systems in improving strategic development and implementation.

A. THE ROLE, SCOPE AND IMPORTANCE OF RESOURCES IN STRATEGIC IMPLEMENTATION AND CONTROL

Larry Alexander carried out a research project which included interviewing the chief executive officers (CEOs) of 21 different private sector firms in order to find out which implementation problems they faced most frequently in attempting to put strategic decisions into effect.

As part of this study they raised the point that the provision of sufficient resources was an important factor.

They identified at least four different kinds of resources:

- **Money** was an obvious choice. It was regarded as a bottom line requirement, and they accepted that a failure to provide adequate funding may lead to limited success in implementing a strategy, or to absolute failure to do so.
- **Human resources** were also identified as having either a positive or negative effect on implementation.
- **Technical expertise**, as related to the new strategic decision was also mentioned. Companies which did not have this expert knowledge in-house accepted the need to hire it in order to implement strategic decisions related to new activities.
- **Sufficient time to implement the decision**. Both adequate time and attention by top management and sufficient time for those affected by the strategic decision to implement it.

  So often it is not the difficulty of carrying out a new project which causes stress in people, but the time pressure and constraints under which they are expected to achieve it.

Successfully implementing a new strategy will have an effect on the overall distribution of resources within an organisation and so planning the use of the necessary resources for this operation is very important. In any organisation resources are limited, so part of the reason for resource planning is to make sure the organisation gets the best out of them.

Resource planning is carried out at two levels,

- the corporate level
- the operating level

At the corporate level the resources are allocated between the different parts of the organisation, i.e. between the different businesses.

At the operating level resources are allocated to the different departments.

A resource which the CEOs did not mention to Alexander, but which we will be considering in detail later in this unit, is that of information. Without information at the right level of detail, and in time for it to be acted upon, it becomes impossible for an organisation to operate effectively.

Resource planning is linked to the evaluation of a strategy since, without the necessary resources to implement the strategy there is no sense in trying to put it into operation.

Often, particular strategies have to be abandoned because they lack the resources to carry them through to completion.

B. RESOURCE CONFIGURATION

Resource Deployment and Co-ordination

- At the **corporate level**, strategy is essentially about resource allocation across businesses (SBUs), business functions (marketing, production, etc.), divisions or geographical locations (in multinational companies), or service department (in public services). In most companies, however, formal strategy planning and capital investment appraisal are two separate things.

  Alexander's investigations showed that companies engaged in process portfolio planning try to correct this contradiction by tying the capital investment process closely to strategic planning. Few companies allocate resources primarily on the basis of strategies, (he found that only 14% tend to do so), but at least the business plan is regarded as an element in the evaluation process for investment projects.

  Very few companies tackle the allocation of strategic expenses, such as research and development or marketing in the same way. In organisations where it is considered at the strategic decision level that the deployment of resources does not require much change over time, there is a tendency to use a formula in order to fix allocations.

  For example, in a College, the allocation of funding to a particular department is often based, per capita, on the number of students in that department, with may be some scope for 'horse trading' between the departments themselves.

  At a time of development in an organisation which leads to increased funds overall, then the allocation of additional funds can be made available to selected areas, to enable them to purchase extra resources.

  In the case of decline in growth, then resources may need to be reallocated to support certain areas or to help with new developments. This is sometimes reflected by a change in strategy with respect to appointments of staff, where, instead of it being assumed that if a member of one team is lost they are replaced in the same team, each vacancy, however arrived at, must be considered carefully before being replaced, and each new appointment has to be justified beyond the principle of maintaining existing team numbers.

  A particular problem of resource allocation arises where activities of different units overlap. For example, where services such as information technology are shared.

- **At the business level**, resource allocation has to be take account of need to add value to the organisation's activities in order to achieve an advantage over competitors. Resource planning at the business level is necessarily much more detailed than at the corporate level. Johnson and Scholes recommend, nevertheless, that resource planning must be put into a strategic framework, and that this can be achieved by considering:

  resource identification

fit with existing resources

fit between resources

- **Resource identification** is concerned with knowing exactly what resources will be necessary to effectively pursue a particular strategy successfully and how these should be configured.
- **Fit with existing resources** considers the extent to which the resources build on what is already available, and how the organisation will adjust its current resources to meet the requirements of the new strategies.
- **Fit between resources** looks at how the new resources fit together, whether they are consistent in the way the various value activities are planned to support the strategy and a consideration of the new linkages which must be put in place.

Business Process Re-engineering (BPR)

Business process re-engineering (BPR) is a method used to improve the effectiveness and efficiency of business processes, including the way in which resources are deployed.

BRP has two important features:

- Instead of assuming that the processes currently carried out by a business need to be improved, it looks at which processes are actually essential to meet business objectives, and aims to redesign them from first principles in order to improve cost, quality, speed and service.
- It regards information technology (IT) as an integral part of the business process, rather than a way to automate existing processes.

BPR aims to 'reinvent' from first principles the way that companies carry out their business, by throwing away the view that they should be organised in functions and departments in order to perform tasks and concentrating instead on processes.

A process is regarded as a set of activities which, in total, produce a result which is of value to a customer, such as the development of a new product.

Adopting BPR means asking questions, such as:

- Why do we do this at all?
- How does it help to meet customer needs?
- Could we eliminate the task or process if we changed something else?
- How can we get away from specialisation, so that several jobs are combined into one, i.e. a more effective use of human resources?

There are a number of approaches to BPR, one of which involves the steps shown in Figure 8.1.

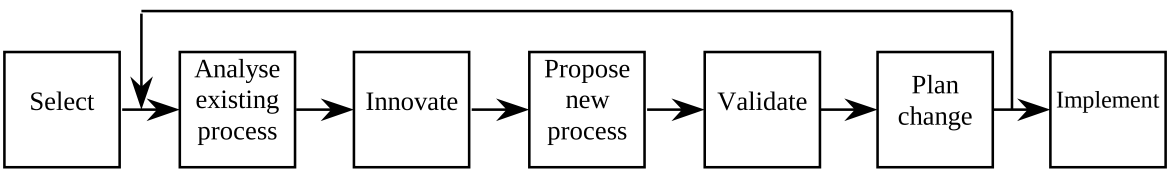

Figure 8.1

Select involves identifying which processes should be subject to BPR and defining their scope.

One feature of BPR is that it is often most effective when applied to processes for which automation has not been successful, including processes which involve a lot of customer contact. To improve processes of this type requires changes to working practices, as well as the introduction of IT.

Analyse involves describing the current processes using techniques such as process mapping and organisation diagramming. Process mapping is similar to data flow diagramming. Organisation diagrams show the reporting relationships between the SBUs in the organisation.

Innovate involves devising new processes which achieve the business objective and is the most difficult and creative part of the process. Some techniques start with a blank sheet of paper, ignoring current organisation and processes. Methods which can be used include brainstorming or looking at how different business sectors handle similar problems.

Propose involves documenting exactly what is being proposed and drawing up a cost/benefit analysis and schedule for the changes.

Validate means ensuring the proposed changes will achieve the objectives sought. It will involve consultation with the staff affected as well as the assessment of the proposals against the organisation's strategies and the available technological resources.

Plan involves planning the implementation of the proposed changes.

It requires a combination of change management and project management skills. There are technological approaches which combine these disciplines, such as ETHICS (Effective Technical and Human Implementation of Computer Systems).

Implement is where changes are made to working practices/organisation structure and the IT component.

Techniques such as value chain analysis can also be used, in order to think up new processes.

The advantage of this approach is that it also considers support activities and the way in which value claims interact, see Figure 8.2.

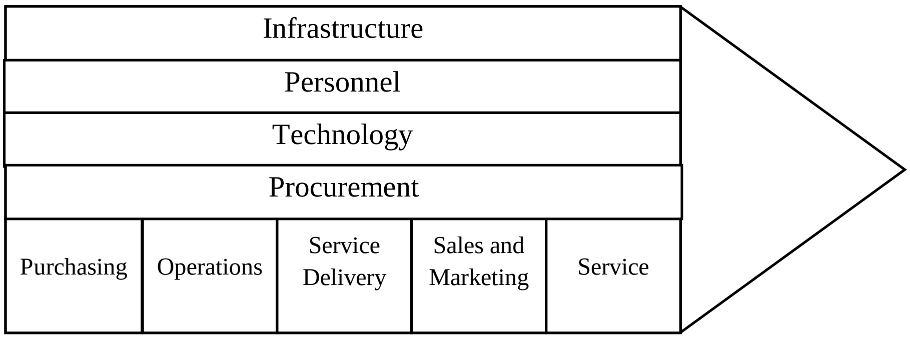

Figure 8.2

Another alternative way of finding new processes is one which starts by looking at the existing ones in order to identify bottlenecks and waste. This is based on a technique known as ;value engineering', which is used in the engineering industry and which looks at every component of a machine to see how it could be produced at a lower cost. A similar approach can be used for business processes.

The main benefits of BPR are

- Customers can deal with a single point of contact.
- Several jobs can be combined, so that the primary need to satisfy the customer does not get lost in organisational complexity.
- Workers make decisions, which reduce the need for supervisors, resulting in fewer delays, lower overhead costs, better customer response times, and greater staff motivation.

- The steps in the process are carried out in a sensible order, and removing specialisation allows more jobs to be done in parallel.
- Processes can easily be adapted to cope with work of greater or lesser complexity, instead of making everything go through the same lengthy steps.
- Checks and controls can be reduced without a loss of quality.

In other words, BPR uses resources effectively, so BPR has resulted in considerable cost reduction in many companies.

For example, IBM credit used to take seven days to process applications for credit by people wishing to buy computers. Before BPR was applied, there were five separate specialist stages through which an application was progressed.

- logging the credit request
- credit checking
- modifying the standard loan covenant
- pricing the loan, and
- compiling a quote letter

Experiments then showed that the actual work involved took only 90 minutes; the real delay was caused by having different departments which did the work in stages and then had to pass it on to each other.

By replacing the specialists with generalists, called ‘deal structurers’, who handled all the steps in the process, the average turnaround time was reduced from seven days to four hours, and productivity was increased 100 times.

Experience and Competences

In Unit 3 we said that the competences of an organisation are the strengths which it has, and which give it its competitive edge.

We saw also in that unit that experience curves can be used to show how costs of production decrease over time as experience is gained by those involved in producing units.

These two attributes then, competence and experience, represent extremely important resources within an organisation.

In recent years there has been a tendency amongst a number of companies to encourage older employees to leave, via voluntary redundancy or early retirement schemes. In so doing a lot of important resources have been lost to the company. B and Q, the do-it-yourself store, have acknowledged this situation and encouraged older workers to return to their outlets. As a result of this they have found themselves a very good source of both competence and experience which has helped their company to develop a competitive edge.

Competitive Advantage

In defining the term “value chain”, Michael Porter describes every SBU as being a collection of different activities, ranging from sales to accounting, that enable it to compete with other SBUs. He refers to these as value activities and says that it is at this level, rather than at the corporate level, that the unit achieves competitive advantage.

Value chain analysis shows that an organisation is not made up just of a collection of different resources, such as machines, money and personnel, but that it is the way in which these resources are deployed through the organisation’s systems of operation that the products or services are valued by the customer or client.

It is through the value activities and the linkages between them that competitive advantage is gained by an organisation.

Porter categorises the value activities as,

- **Primary -** which create the productor service, deliver it and market it, and provide after-sales support, and
- **Support -** which are the support activities which provide the input and infrastructure which allow the primary activities to take place, i.e. company infrastructure, human resource management, technology development and procurement.

In each of the categories it is the way that resources are deployed which leads to the creation of value, and thus to competitive advantage.

Johnson and Scholes suggest that resource utilisation can be achieved in three stages:

(i) by identifying value activities - assigning costs and added value, and identifying which are the critical activities

(ii) by identifying cost or value drivers - those factors which determine cost or value of each activity

(iii) by identifying linkages - which either reduce cost or add value, and which discourage imitation.

Management's role is to examine the costs and performance in each value-creating activity and to look for ways to improve, preferably ones which will add positive synergy to the whole.

Competitors' costs and activities should also be looked at and their performance used as a benchmark for performance appraisal.

It is essential to look for competitive advantage beyond the organisation's own value chain, by considering those of its suppliers and the members of its distribution channel, since these also have a part to play in the consumers' perception of quality.

Resources of finance, personnel, production capacity, etc. all have to be allocated to achieve competitive advantage. One of the difficulties of resource allocation at the corporate level, especially, in large organisations, is the extent to which overlap, sharing or duplication of resources occurs between various parts of the organisation. This can apply across the board, from relatively minor considerations such as the sharing of photocopying services between departments, to major considerations such as two divisions sharing their transport and distribution services. It is issues such as these which affect the centralisation or decentralisation of control over resource allocation.

Central control over resource allocation is required where the strategies involved are dependent upon high levels of co-ordination or co-operation between different departments and/or divisions. Where divisions or SBUs are to a large extent independent, then control by the centre is less important.

Boston Consulting Group Competitive Advantage Matrix

BCG, in a development of their matrix approach to strategic portfolio planning, which we considered in Study Unit 4, produced a competitive advantage matrix (see Figure 8.3). In this they plotted the number of possible approaches by means of which an industry could achieve a competitive advantage against the size of the advantage which could be gained.

Number of Approaches to Achieve Advantage		Small	Large
	Many	Fragmented	Specialised
	Few	Stalemated	Volume

Size of the Advantage

Figure 8.3: BCG Competitive Advantage Matrix

BCG identified four industry types:

(i) Volume industry

In these industries, there are only a few advantages which companies may gain, but these are relatively large.

For example, in the construction industry, there is possible differentiation in criteria such as low cost, speed, specialisation, etc. Profitability is correlated with company size and market share.

(ii) Stalemated industry

In these industries too there are only a few potential advantages and disadvantages, and each is small.

The steel-making industry is an example, where there is little scope for differentiating the product or its manufacturing cost.

Profits here are unrelated to company size.

(iii) Fragmented industry

In these industries there exist many opportunities for differentiation, but again each is only small.

A restaurant can differentiate in many different ways but can only achieve a low market share.

Once again, profitability is not related to company size.

(iv) Specialised industry

Here many opportunities exist for differentiation, each of which can yield a high pay-off.

For example, specialised equipment makers can target very tightly, and small companies can be as profitable as large ones.

BCG plotted each of these four industry types on their matrix, as you can see in Figure 8.3. Most value-added opportunities can be copied by competitors and they are therefore relatively short-lived.

For instance, the credit card company Visa was the first to introduce a plastic card with a hologram attached as a security measure, only to find that a week after they had publicly launched it a technique to add holograms to plastic cards was announced. The only real response to such competition is that adopted by some computer companies, who are committed to working in the future, producing new ideas as their competitors try to catch up.

Competitive Differentiation

Four areas may be identified for creating competitive differentiation:

- product differentiation
- services differentiation
- personnel differentiation
- image differentiation

(i) Product differentiation

In order to create a product which differs from those of competitors the following points can be considered:

- **features** of the product, which characterise it and supplement its basic function;
- **performance**, which is the level at which the product's primary characteristics operate;
- **conformance**, which describes how nearly the product's design and operational characteristics match its target standard;
- **durability**, being the product's operating life-time;
- **reliability**, which describes the likely guarantee of useful operation;
- **repairability**, which is the measure of how easy it would be to get the product fixed if it did go wrong; and
- **style**, which refers to how the product is seen by the customer, i.e. how attractive it is. (This is taken to such lengths by some manufacturers that you can buy different coloured covers for your mobile phone (which in no way enhances its performance).)

All of these are parameters which designers can work within and they serve to illustrate what a large scope exists.

(ii) Services differentiation

The services which are offered in support of a product create a number of opportunities for differentiation:

- **Delivery** of the product **-** This may apply to accuracy, care and flexibility. For example, the availability of further attempts to deliver packages to customers unable to receive them at the first attempt.
- **Installation -** This includes checking that the product performs satisfactorily after it has been installed. Some companies deliver 'white cabinet' items, such as freezers and cookers, and leave the customer to unpack them and get rid of the packaging materials, whereas more enlightened companies carry out these tasks on behalf of their customers.
- **Customer training -** This involves making sure the equipment supplied can be properly operated by the customer.
- **Consultancy -** This can be made available to assist customers to be able to use equipment more efficiently, for example, in the case of commercial computer installations, which then leads to greater profitability for the purchasing company.
- **Repair** of faulty equipment. This involves getting the customer back into action quickly, by swift removal and replacement.

(iii) Personnel differentiation

Competitive advantage can be gained by recruiting better quality staff and then offering them good training facilities and incentive schemes.

The John Lewis Partnership are a good example of such policies, and many customers at their stores vouch for the difference it makes.

(iv) Image differentiation

Since there is often little to choose between alternative branded products, it is necessary for companies to look for image differentiation in ways such as:

- creative marketing through snappy slogans or attractive packaging;
- something which appeals to customers' emotions, such as the current "British Farm Standard" which appears on a number of meat products in particular, and which also includes an easily identifiable picture of a tractor.

The Competitive Advantage of Nations

Michael Porter has identified four interlocking elements which give us a means of considering the attributes of advantage with respect to the geographical location of a company.

These elements form a network of location-based conditions which can be used to analyse the position of a company relative to its location.

- **Factor conditions -** those necessary inputs of resources which the company needs in order to support its activities (in particular those which are due to natural resources). These include climate, an appropriate labour force and the relevant skills and knowledge which have been developed over time, for example in a location with a long history of engineering production.
- **Home market demand conditions -** the demands of independent purchasers of the company's products which make it necessary for it to continually innovate and improve them.
- **Other related local industries -** which support and collaborate with the company, thus enhancing its competitive potential.
- **Local rivalry -** this develops strong competitive characteristics which are needed to tackle the home market, and can then be applied to worldwide markets.

In addition to these four major elements, Porter also identifies others, which include:

- **Governmental behaviour**, in the form of intervention to encourage growth and the creation of jobs in areas of high unemployment, for example, by granting subsidies and investment in development areas, or even by non-intervention.
- **The element of chance**, which applies to companies as much as to individuals, i.e. being in the right place at the right time.

C. RESOURCE PLANS

A resource plan sets out to show how the resources within an organisation can be best used in order to pursue its agreed strategies.

Financial Planning

The allocation of resources of any kind will have implications in terms of finance, and this is achieved through **budgets** operated by managers.

Budgets have a number of different uses. For example, as we shall see later, they form an important part of management control. Here, however, we will consider them as part of the planning process.

A well-planned and constructed budget, based on a credible sales forecast and an acceptable level of profit, is a tremendous help to managers in assisting them to achieve company objectives. A good budget is a **summary** in numerical form of what a business does, and a well-constructed financial summary can act as a 'window' through which the plans and activities of managers can be observed.

In practice, however, budget figures are arrived at as a result of planning and forecasts of expected performance. They only have meaning when backed up with actionable plans. The end point of each plan is a goal towards which actions are aimed.

For example, the marketing department of a certain international glass manufacturing company has set as its goal the achievement of an increase of 10% in sales over the previous year's results (up to £1.4 billion). To achieve this goal, programmes must be developed for:

- marketing research;
- developing sales promotions with certain characteristics, by a fixed time;
- launching advertising programmes with certain features during a given period of time; and
- preparing and deploying the salesforce.

In each of these areas at sub-unit level, there should be related plans and objectives to contribute towards the achievement of the various programmes.

Also, the marketing area plans and objectives will need to be supported by co-ordinating programmes in areas such as new product development, purchasing, production, warehousing, transport, costing, pricing, etc. Without such a workable network of plans and objectives budget figures alone will be just hopes, or guesswork.

A budget, then, is effectively a model of the resources required to achieve objectives. It can be tested and adjusted in order to accommodate changes in expectations, or to check the progress that might be achieved in a project.

Of the budget headings which we will consider later, the one which is concerned with planning is that of the capital budget.

- **Capital budgeting** is concerned with resource capacity and the flow of funding for a particular project or decision. One of its limitations is that, as a consequence, it can fail to take account of the impact on overall organisational performance.

Other types of budget which may be used in financial resource planning include:

- **annual revenue budgets**, which can provide detailed financial resource plans, and may then be used to monitor performance against the plan; and
- **projected profit and loss accounts**, which are used to forecast the possible effects of decisions on the overall performance of the organisation over an extended period of time.

One of the main difficulties in budgeting is that of reallocating funds when strategies change in the future. Because the power base of the organisation generally remains the same, those who made decisions on the original allocation of funds are reluctant to concede any reallocations.

This is particularly true in the public sector, where the decisions are made on a political rather than an economic basis.

As we enter 2002, for example, most of Europe is embracing the new euro monetary system. Wim Duisberg, the president of the European Central Bank, announced that "the euro is more than just a currency; it is a symbol of integration in every sense of the word".

Personnel Planning

Personnel planning is carried out in order to ensure the organisation has the right quantity and quality of staff doing the right things in the right place at the right time.

Strategic changes always have a significant impact on the people within the organisation, so these changes need to be anticipated whenever possible.

In carrying out personnel planning, Johnson and Scholes suggest there are three important issues which need to be taken into account:

- personnel configuration
- recruitment and selection
- training and development
- **Personnel configuration**

  This is carried out by means of demand forecasting, which is a detailed analysis of the staffing requirements necessary for the organisation to succeed in following a particular strategy, including the number of staff needed and the skills they must possess. Where new strategies are to be introduced, it will be necessary to plan for changes in the new personnel requirements. This may lead to redeployment or the transfer of some staff to other parts of the organisation, or it may require the setting up of a redundancy programme. Each of these situations will have an effect on a resource plan.

- **Recruitment and selection**

  The emphasis placed on the recruitment and selection of staff must be related to the organisation's strategic aims, and must take account of any likely changes in direction. Existing recruitment policies are likely to be effective for the type of work demands of the past, but may not be suitable when a new strategy is implemented.

  It may be possible to meet the new skill requirements by retraining existing staff but, if the magnitude of the change is large, it is likely that new staff who already have these skills will have to be appointed from outside the organisation.

  An example of this kind of recruitment is provided by recent appointments of school headmasters or college principals from outside the teaching profession, because the skills of running a business organisation are very different from those of teaching and are more likely to be found in candidates selected from a business background.

- **Training and development**

  The amount of staff training needed in order to carry out a new strategy will be related to the degree of change involved. The greater the change, the more training will be necessary. In the case of existing staff being trained, this is more likely to be on-the-job coaching and practice. The content will be designed to suit the learning objectives of the staff in training, within the context of the organisation.

Critical Success Factors (CSFs)

We mentioned earlier, in unit 3, that a critical success factor is anything on which the success of a strategic change depends, and that a resource plan should make sure that all CSFs are identified, and also that the number of them should be kept to a minimum.

An example of a critical success factor might be the reduction of customer response time.

Another example would be a company which distributes to retailers products which have a short shelf-life.

The critical success factor for distribution may be to minimise delay in delivery to the retailers, so that the maximum shelf-life is available during the period on sale in the shop. This will minimise the level of out-of-date returns by customers, and also increase customer satisfaction levels. This non-financial objective should be measured in terms of days elapsed between the stock being released to the distribution department and received by the retailer, or as an overall percentage of the total shelf-life of the product which must still be available when the product is received by the retailer.

At IBM, the definition of CSFs is part of the strategic planning programme using a consensus approach with groups of senior managers. This takes place in the following stages:

1. **Understand the mission**

   The team collectively agrees a mission statement, in no more than three or four short sentences, which clear defines the circumstances in which the mission will have been successfully accomplished.

2. **Identify issues which will impact on the mission**

   The team focuses on the mission and identifies dominant issues by listing one-word descriptions of whatever they think will impact on the mission's achievement, by means of a brainstorming activity, in which everyone contributes, nothing is ruled out, no judgments are allowed, and the facilitator writes down everything so that all team members can see it.

3. **Identify the CSFs**

   By referring to the list of things they believe will impact on the mission, the team identifies the CSFs.

   CSF statements:

   - Define what the team believes needs to be done to accomplish the mission.
   - Are not only necessary to the mission, but also, together with the other CSFs are sufficient to achieve the mission.

   The list of CSFs

   - should not exceed eight
   - should include a mix of strategic and tactical factors.

   Absolute consensus must be obtained for those CSFs listed.

4. **Identify and define actions necessary to meet the CSF requirements**

   - Identify and list what has to be done to meet the CSFs.
   - Define the business processes needed to meet CSF requirements.

5. **List CSFs and processes**

   A matrix is produced which lists the CSFs and the processes relevant to each.

6. **Ensure that CSFs and processes will achieve the desired results**

   The team reviews each CSF to ensure it has the necessary processes which are sufficient to achieve the required results.

7. **Implement the action plan**

   The team confirms the action plan associated with the processes and set up the implementation programme. Monitoring and follow-up arrangements are also put in place.

Planning and Control

Having selected the CSFs, there is no particular collection of controls available to all managers because of the wide range of products and services offered by different organisations, and the number of policies and plans.

There is, however, a large number of standards which can be used to measure certain types of performance.

For example

- The contents of a product and its dimensions can be written down and used to control its quality.

The rate of production can be quantified as number of products per day, shift, etc.

- Costs can be measured in terms of components per unit.
- Business income can be recorded as profit.
- Financial stability can be checked via cash available, working capital, depreciation, etc.

The ability to select critical control points is an important part of management, since sound control depends upon them.

Good managers know, however, that control is an integral part of the planning process, which is not an exact science, but that reviewing actual outcomes against anticipated ones will help to improve performance.

There are three basic elements associated with the control process.

- Setting the objectives or specific standards.
- Evaluating performance and measuring actual progress.
- Providing feedback for management to enable them to take corrective decisions and modify plans.

The role of control is shown in Figure 8.4, by considering the strategic planning and control cycle.

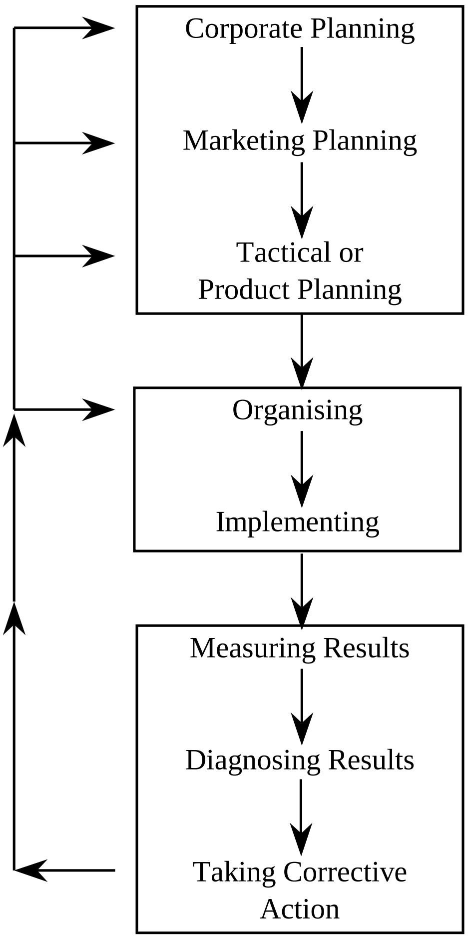

Figure 8.4: The Strategic Planning and Control Cycle

For the planning process to work effectively, there must be a willingness to change plans if necessary. Flexibility is essential, as also is a communication system which allows progress, developments or changes to be highlighted to management within the timeframe when effective action can be taken.

Control needs to take place at the three levels of planning:

corporate

marketing

tactical/product.

Managers need to be clear about how they will evaluate the effectiveness of their plans, so that where necessary feedback systems can be developed, and resources can be switched in order to achieve new objectives.

Control Mechanisms

Most control systems are concerned with costs, or quality or safety.

Budgets

Planning is carried out in order to ensure the organisation gets the best out of its limited resources.

A strategic plan is essentially made up of inputs to achieve a desired output.

The inputs are the resources - personnel, materials, machines, buildings, etc. and the budget is a simple financial statement of the resources necessary in order to carry out the plan. It is also a quantitative plan of activities designed to control the allocation, flow and use of resources over a given period of time. Management control will consist of a number of budgets and forecasts. This consolidated budget will reflect corporate mission, objectives and strategies.

Part of this consolidated management budget is the marketing budgets which we will consider here in a little detail. The marketing budgets include:

- sales volumes, values and incomes
- selling expenses
- distribution and warehousing costs
- advertising and public relations expenses
- market research costs
- marketing salaries, commission, expenses
- customer services
- marketing administration costs.

These costs are usually considered under five budget headings:

(i) **The Cash Budget -** liquidity, opening and closing balances, inflow and outflow of cash (share issues to bring cash into the company, dividends to shareholders which pay it out).

(ii) **Budgeted Profit and Loss Account -** matching income received with costs incurred over a set period of time (in order to measure profitability).

(iii) **Budgeted Balance Sheet -** which looks at the total assets of a SBU and its liabilities, such as repayment of loans (to the corporate body).

(iv) **Budgeted Funds Statement -** the sources of funding and how they are linked to corporate objectives.

(v) **Capital Budget -** which concerns resource capacity and the budgets for alternative strategic choices.

The basis on which a budget is set is referred to as ‘appreciation’, and this can be:

- % of past or projected future sales
- % increase (decrease) on previous budget

- in order to match the competition
- what is considered to be needed for the task.

Quality Control

Those areas which need to be considered for quality control include:

- personnel
- materials, and
- products.

– **Controlling the quality of personnel** involves the recruitment of the right staff in the first place, training and developing staff once they are employed, and carrying out regular appraisal in order to identify any areas which require further training and development.

– **Controlling the quality of materials** requires control over suppliers by means of selection of the right suppliers in awarding contracts and checking that quality standards of the suppliers are maintained.

– **Production control systems** need to be put in place in order to maintain the quality of the product which meets customer's expectations.

In addition, the maintenance of machinery and buildings is also an important part of quality control.

Safety

Anything which is concerned with safety of personnel, customers, plant, etc. is always a priority use of resources.

D. INFORMATION AS A RESOURCE

Information and Control

The role of a manager involves decision-making and controlling.

In order to make a decision, check the outcome and either confirm, or modify, that it requires a control process. This process has five stages:

(i) Establish a plan.

(ii) Record the plan.

(iii) Implement the plan.

(iv) Compare actual performance with what was planned.

(v) Evaluate and decide on further action.

In order to carry out this process information is needed for stages (I) and (iv), so there is a constant flow of information during the control process.

Without complete and up-to-date information, correct decisions and proper planning would be impossible. Incomplete or delayed information can be damaging to management control.

An important question to ask here is 'how much detail is needed?'

The answer to this is the person who is receiving the information. For example at the operation level of management, routine information is required, which contains the facts of what has been done in order to provide a history of actions carried out. A shop manager may need to know the daily sales totals, whereas area office may need only weekly totals and head office only require monthly returns. Information should only be provided at the level and amount which is actually required.

Too much information is not necessarily useful, i.e. 'the more detail the better' is not necessary true. For instance, if head office was provided with daily totals by each store, the information would simply be a mass of data requiring processing in order to be useful. Therefore, although a mass of data is needed from which to draw information, the details passed to managers should be no more than they require.

A finance company with which I worked some years ago decided to control the use of their in-house telephones because they thought too many private calls were being made. In order to do this they installed a machine which recorded on paper every call which was made out of the offices. The result was so much information that the person they employed to check it was overwhelmed, and the system had to be abandoned. When it was pointed out how much was being spent on the monitoring the company wisely decided it was cheaper, and better motivation, to allow staff to make a limited number of private calls.

Information must also be relevant to the purpose for which it is being used. Users should receive the minimum of information for their needs.

Information should also be:

- timely, and
- accurate.
  - **Timeliness** depends on the receiver. At the operational level it might need to be instantly available. For example, on a production line the spoilage rate needs to be readily available in order to check any deficiencies as soon as they happen. At a higher managerial level the need for immediate information is reduced because more time is available for making decisions. Timely information is that which is available at the time it is required.
  - **Accuracy** of information is related to its cost. Very accurate information is expensive, and often slightly less accurate but sufficient information, which is less costly, is all that is required.

    There is a difference between accuracy and precision. Sales figures could be computed to the nearest penny, pound or thousand pounds, i.e. to different levels of precision. But if the data used is incorrect, or the calculations made are wrong, then the result will be inaccurate.

The quality of information supplied is also very information for control purposes. Quality information needs to be:

- relevant - pertinent to the receiver, who will then operate more effectively with it than without it
- reliable - being timely, accurate and verifiable
- robust - meaning that it will stand the test of time and of failures of handling.

Managing Feedback

In order to prevent too much information being supplied to managers which can result in them suffering from overload, the managers must decide what information and feedback they require and build provision for that into the planning process.

Exception Reporting

This is a useful tool to help managers to receive only the information required. The system allows managers to set parameters in terms of costs and revenue, enquiries or sales, etc.

- The manager is alerted only to products or outlets whose actual performance is falling more than x% outside that budgeted for.

- Managers have to decide how much variance they can allow without being alerted to it, i.e. how big should x be?

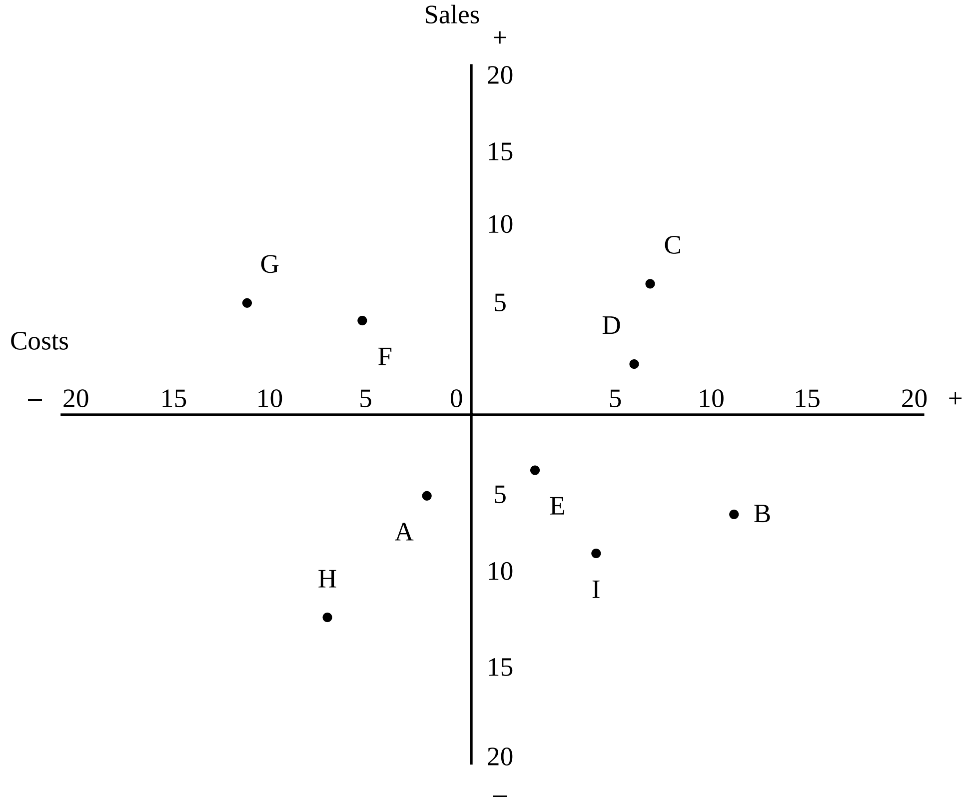

Figure 8.5

The grid in Figure 8.5 plots all the products of a company, indicating for each product, A to I, their performance against budget; + or – costs, and sales levels.

By incorporating lines which allow for the tolerance limits set by the manager, only those products which need immediate attention are highlighted - in Figure 8.6, those products that fall outside 5% (i.e. x has been chosen as being equal to 5).

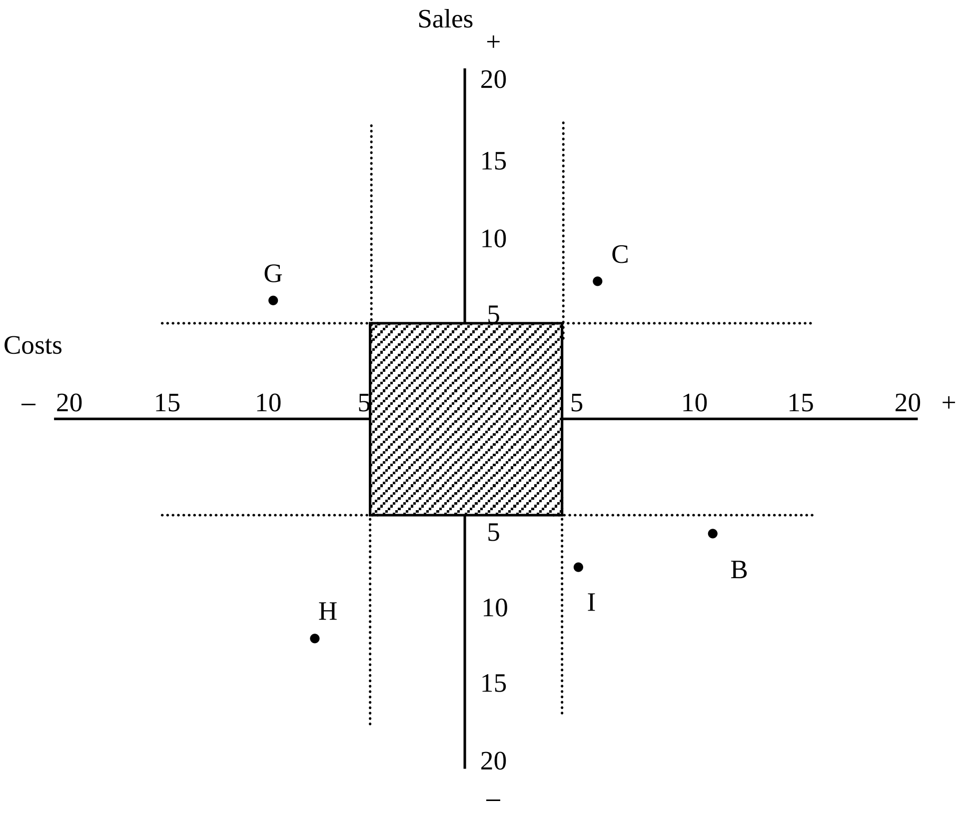

Figure 8.6

The products requiring attention because their performance is outside the 5% limit are:

B, where sales are down and costs are up

C, where sales are up and costs are up

G, where sales are up and costs are down

H, where sales are down and costs are down

I, where sales are down and costs are up.

Continued Development of Information Systems (IS)

Information systems have become an important concept in management because of the need for improved communications within an organisation.

IS and their supporting technology were originally used to improve the supply of information to managers, for example, by means of visual display units (VDUs), so that it was more quickly available. Its main purpose was seen as improving systems which were carried out manually by clerical staff. The main advantages of these new systems were seen as:

- reducing clerical costs by improving efficiency, and
- improving the effectiveness of managers by providing them with better quality and more up-to-date information.

However, the sources of information remained the same as before and so its quality was not improved. But most organisations now realise that investing in IS can lead to greater exploitation of information resources and that this is an important part of their business strategy.

The attitude of management to IS investment is influenced by their understanding of the potential benefits it can bring, and also by the reality of the benefits obtained previously.

During the recession of the late 1980s in the UK the commonly held view was that any investment in IS had to be financially justified. As a consequence of this many systems were developed piecemeal and this has meant they tend to suffer from being 'integrated' more by accident than design.

At BAC systems, for example, I recall many different personal computers (PCs) were purchased independently by different sections, depending to a large extent on personal preferences. A situation was reached where many of these systems were incompatible, and then a central control was set up to ensure that in future this would not be the case.

In order to use IS successfully in the future the main opportunities for improving business effectiveness lie in the efficient integration of systems, both internally and externally.

To this end IS strategy is concerned with how the organisation will satisfy its needs for new computer systems to support its business.

One technique which is used for systems development is that of 'affinity analysis' or 'grouping', in which processes are grouped together according to the data they affect, and this is used to identify the best sequence for developing systems.

Systems development also has to take account of market and product strategies. There is no point in developing sophisticated systems to support markets or products from which the organisation intends to withdraw.

Cost/benefit analysis and investment appraisal techniques will be used to assess the case for systems development.

The business may also impose an absolute limit on investment in IS to ensure expenditure does not get out of line with income growth (see Figure 8.7).

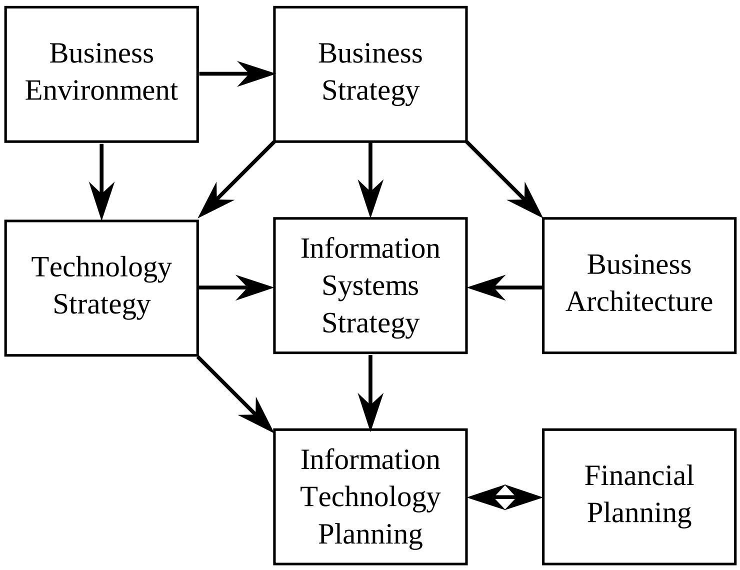

Figure 8.7

Information technology planning is used to schedule and allocate resources to projects in order to meet technology or information systems objectives.

As more advanced technology becomes available for IS, organisations who wish to use it as a means of gaining competitive advantage will have to invest more in order to develop their systems.

Study Unit 9

Managing Strategic Change

Contents ***Page***

INTRODUCTION

In this unit we will be examining the processes by means of which organisational change may be managed in pursuing strategic goals.

We will review the types of change arising from strategic decisions.

We shall also identify the key levers in the change process, and discuss the issues which need to be managed in order to achieve effective change.

We will consider the role of change agents and of both internal and external stakeholders in implementing change.

Objectives

After studying this unit, students should be able to:

- review the types of change arising from strategic decisions;
- identify the key levers in the change process;
- discuss the issues which need to be managed in achieving effective change;
- analyse the importance of change agents and explain the role of internal and external stakeholders in implementing change.

A. WHAT CONSTITUTES CHANGE AND THE ORGANISATIONAL PROCESSES INVOLVED

The term ‘change’ refers to any situation where conditions differ from one time to another.

Development is planned change implemented in order to achieve objectives.

The changes which can be experienced by organisations and those who work in them are both extensive and wide-ranging. The rate of change in the modern world is rapid, and accelerating. The pace of change catches many organisations by surprise. This is due to many factors, not only in the technological field, but also in the way people see others, in their value systems, and in the demands they make concerning the quality of their life. But technology and competitive pressures are formidable forces amongst the many factors causing change.

Management in all fields has a duty to respond to developments in the external environment. An organisation must constantly be changing its objectives, and hence its organisational structure, working procedures and systems, and its management methods. Staff have to face up to changing their skills and their place of employment, even if they remain in the same organisation.

In the 1980s, a Pepsi Cola executive, flushed with success as a consequence of gaining a competitive advantage over their arch rival Coca Cola, wrote a book called “The Other Guy Blinked”. Unfortunately for him, either he or his colleagues must also have blinked because Coca Cola retaliated and recaptured the market share.

The changing environment affects both management and the workforce at all levels. For example, the production of a letter for a company has, over recent years, been changed at leave five times in terms of the output method, with more changes probably still to come.

- In the 1960s, it is likely the firm would have provided manual typewriters.
- In the late 1960s these were quickly replaced by electric typewriters.
- In the early 1970s along came more sophisticated models. Electric typewriters, such as the IBM Golfball, which enabled the operator to change the typeface.

- During the late 1970s word processors were introduced - large dedicated installations, with three or four workstations operating through a central processor and output device. They required a fair amount of space and were very cumbersome, but offered the advantage of being able to correct, format, amend and tailor documents for the user.
- At the same time, electric typewriter manufacturers were developing even more sophisticated models, such as typewriters with memories and the capability of utilising simple software packages.
- In the 1980s most firms quickly grasped the opportunity to use the revolutionary new personal computer, which took up little more space than a typewriter and had greater capability than any previous technology.
- The personal computer has miniaturised to a lap-top model, to a hand-held model, and looks as though it might itself become obsolete as the improvements in technology continue to move relentlessly onward ad infinitum.

The technology has undoubtedly made the production process easier, but a typical or average operator would have had to take each new innovation on board, not knowing how quickly change would come about or the amount of training they would need in order to achieve the standard of work required of them.

Some organisations are very responsible to change and have the culture and structure needed to support it. These are the organic type of organisation, which we described in Unit 7, which are proactive when it comes to change, and, rather than react to it in a crisis situation, when it is too late, they plan for change and make contingency arrangements to buffer any changes that may affect them. In organic organisations, change is linked to overall corporate strategy and therefore planned for accordingly.

Mechanistic organisations, on the other hand, are inherently bureaucratic in nature and, according to Burns and Stalker, do not respond well to change. This is not to say that they do not change, they just do not change as quickly as organic organisations. Because of this they tend to wait until the organisation is at crisis point before changes are made. This is adopting a reactive stance. As a consequence, change is not usually linked to overall corporate strategy.

Change is inevitable and we all have to learn to deal with it. As Charles Darwin said, “It is not the strongest species that survive, nor the most intelligent, but the ones most responsive to change.”

The Organisational Processes Involved in Change

As we have just seen, change can take place in different ways depending on the organisation involved. In general, change is best effected incrementally, i.e. in small steps over a period of time, since this allows it to use the skills and values of members of the organisation, allowing a smooth transition from one situation to another.

Transformational change occurs in large movements of strategy and comes about most often with bureaucratic organisations, such as the armed forces, when change has often been put off until a crisis point is reached due to strategic drift.

Organisational change is a complicated activity and its implementation is often met with resistance from several different angles:

- from middle managers who fear that delayering programmes will adversely affect them
- from managers who fear a reduction in their authority and power
- from employees who fear that change will affect the status quo, and separate them from friends and colleagues with whom they currently work.

Schein recognised the problems that organisations face when planning and implementing change, and developed a model to use in order to pre-empt any potential resistance.

Schein's model is known as the unfreeze-change-refreeze model, and takes place in a number of steps:

- Step 1: **Unfreeze -** this involves the organisation "unfreezing" existing attitudes any behaviour. Individuals go through a process of "unlearning" old habits, old perceptions and old ideas about how change will affect them.
- Step 2: **Change -** which involves a "change" in behaviour. Individuals modify their old ways and adopt new ways of thinking about change - how it should be implemented, and how it can be positive rather than negative.
- Step 3: **Refreeze -** the final stage involves "refreezing" the newly-adopted behaviours and attitudes. The organisation may need to offer positive reinforcements, such as incentives, to encourage individuals to accept the changes.

In this 3-step model of change, the process as a whole is achieved through leadership, communication, education and training. Effective training can be used to create a major change in the attitude of employees, which must then be made permanent by creating the necessary structures, procedures and incentives to support the new culture.

A major task for management is to produce the initiatives necessary to achieve the freezing step. Some of the ways in which this can be done are by:

- setting up employee suggestion schemes;
- giving staff a greater input into the decision-making process;
- implementing schemes which reward good effort, such as 'staff of the month';
- creating good team spirit through company identification schemes, such as logos, advertising, T-shirts etc.;
- producing company newsletters;
- making managers more visible, for example by 'open door' policies or 'managing by walking about' (MBWA) schemes.

This model can be used when individuals are opposing change, or when management wants to gain acceptance for a change that directly affects employees, such as a change in working conditions.

Another model for helping the implementation of change is **Lewins' Force Field Analysis model**. In this model Lewins identified 'driving forces' for change and 'restraining forces' against change. Lewins believed that driving forces try to push change through, whilst restraining forces try to resist change and maintain the status quo. It uses the concept of apparent immobility in a social situation representing a state of "dynamic tension", between the needs, drives, aspirations, fears and other feelings of the people involved.

The identification of the driving forces and the restraining forces, their strength and how they can be modified is the 'force field analysis'.

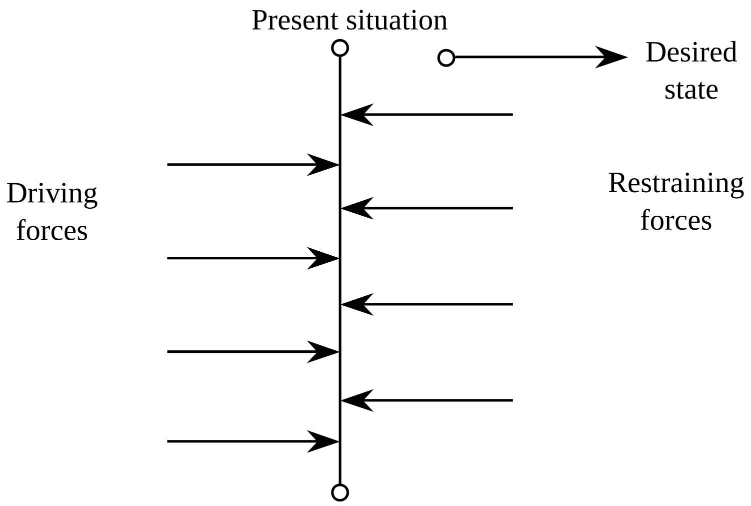

Figure 9.1: Lewins' Force Field Analysis Model

Lewins suggested two ways of dealing with change:

- Strengthen the driving forces by encouraging those associated with the change and driving the change, to educate and convince those who oppose it that it is for the organisational good.
- Weaken the opposing forces by:
  - persuading someone to act as a change agent in order to win over opposers
  - offering concessions to opposers in order to buy them off
  - involving individuals by means of employee participation principles such as quality circles, joint consultative committees, etc.
  - using a manager, with positional and personal power, to coerce opposers into accepting change.

Movement in the desired direction can most readily be achieved by reducing or removing restraining forces. Increasing driving forces before reducing restraining forces often increases the restraining forces in reaction.

B. TYPES OF STRATEGIC CHANGE

Managed and Unmanaged Change

According to Helsey et al, change can be implemented in two ways, participative change and directive change.

- **Participative change** is based upon a participative management style that utilises employee participation methods. Senior management can encourage employees lower down the hierarchy to be part of the change programme, and, as a result, accept the changes by:

  (i) identifying a change agent who can gently coerce resistors to accept the change. Influential people, such as leaders of informal groups who wield personal power are ideal, because other group members do not see them as part of the 'establishment'.

  (ii) circulating information about the change - the group can then give their comments on the change and management have a forum in which to listen to views, and perhaps amend the programme.

This type of participative approach may turn initial resistance to acceptance, and allow the change to be managed effectively. It has the disadvantage however of being a lengthy process and may not be feasible if the change has to be implemented quickly.

- **Directive change** is the opposite of participative. Employees are notified at short notice that changes will be made. They do not have a chance to express their opinions and end up feeling change has been forced on them. As this is the case, attitudes and behaviour tend to become negative rather than proactive and this leads to resistance to the change. There is an advantage to this method of change, however, in that the programme can be implemented quickly. The drawback is that the resistance to it is more prolonged and greater, because employees feel they were not consulted about the change.

Both of these methods of implementation can be used when the change involved is being managed, or controlled, by the organisation.

Unmanaged change is that which is not being controlled, but is due to pressures outside the organisation which force change upon it. Factors such as reductions in customer demand for a product can force change on an organisation. Nevertheless change has always been with us, as Gaius Petronus said in 66 BC, "We trained hard, but it seemed that every time we were beginning to form up into teams we would be reorganised. I was to learn later in life that we tend to meet any new situation by reorganising, and a wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency and demoralisation."

So, the good manager plans for change and is able to manage it incrementally. Poorer managers have to cope with change anyway, and it tends to manage them.

Imposed Change

Some change is imposed on organisations by factors beyond their control. A PEST analysis shows us that political, economic, social and technological factors can all have an effect on an organisation from outside.

For example, government policies can dictate change. Currently there is much discussion in the UK about the introduction of the Euro and the effect this would have on businesses. Whether it is introduced will be a political decision and, although the business community will be able to voice its opinion, if it is introduced it will cause massive changes to be imposed, as indeed they were when the decision to decimalise currency was made.

Economic factors beyond the control of businesses can also cause changes to be made. In a time of recession, for instance, businesses have to become leaner, and restructuring is often forced on them. In the aftermath of the terrorist attack on New York, many airline companies have been forced to make big changes in their operations.

Changes in lifestyles also force changes on organisations.

Finally, the rate at which technology is changing is constantly reducing product life cycles and imposing change, particularly in the electronics industry.

C. DIAGNOSING CHANGE NEEDS

Strategic Drift

We first mentioned strategic drift in Unit 1 when we were considering the way an organisation's strategy often opens up a gap between what was anticipated to be achieved and what was achieved in reality.

Strategic drift can arise when changes are attempted to be introduced within the existing frame of reference, or paradigm, of the organisation. This indicates a need for change, which is best satisfied incrementally. If this is not done, however, the drift away from what is necessary becomes increasingly obvious, or environmental change increases, both of which lead to a deterioration of performance. A transformational change may then be needed to get the organisation's strategic development back on track.

Gap Analysis

We referred to gap analysis in Unit 6 and showed, in Figure 6.2, how a gap can exist between what is desired and what is believed to be possible.

Where such a gap exists it is necessary to adopt a strategy, or a series of strategies phased in over time. Whether a single strategy may be used will depend on the resource requirements necessary and their availability at that time. It may be that the required resources are not immediately available, and consequently a combination of strategies may have to be introduced and phased in as and when they can be delivered, so that necessary change is made.

Barriers/Facilitators

A number of barriers to change are related to an unwillingness to move away from the way things have been done in the past, despite the fact they are no longer possible.

Well-established routines and procedures have a strong influence in attempting to maintain the status quo, along with control systems, and symbols. Relationships based on power or dependency are also powerful in persuading people to conform to 'what they know' rather than entering into new, as yet untried, ones. Facilitators in overcoming these barriers to the diagnosis of change needs include the participation of the staff concerned. This encourages people to identify themselves with the change process required and to be able to see the positive effects which can be achieved.

Structures and Control Systems

For most organisations, achievement of their critical success factors will require a constant review of their organisational capabilities, and the necessary incremental changes to ensure that they are compatible with the business strategy.

The problem for many organisations is not that they need to change, but that they do not see the need for change. This is especially true for organisations which have been successful in the past and cannot see why they should change what they see as a winning formula which everyone feels safe and comfortable with.

John Gardner describes it thus:

> "Most organisations have developed a functional blindness to their own defects. They are not suffering because they cannot sold their problems but because they cannot see their problems."

And John Galbraith comments:

> "Faced with the choice between changing one's mind and proving that there is no need to do so, everybody gets busy on the proof."

An example of the need to change systems is provided by considering the problems of growth from a small to a medium or large size organisation. When an organisation grows it is usually as a result of being successful, and there is often a tendency to believe that everything is easy once success is obtained. It may be argued that the attitudes and behaviour which have led to success will lead to further success. However, it is often found that the contrary is true, and that growth brings new problems which may be difficult to overcome.

These may include:

- A tendency to become a confused organisation structure. As new people are brought into the organisation to provide the expertise needed in various fields, insufficient thought may be given to their precise place and responsibilities within the organisation. Growth must be planned and systematic and proper thought given to co-ordinating the activities of the staff.

- Necessity for a change of attitude. People cling to the old and the familiar. In a small firm people know each other well and use first names, but in a larger company the personal touch is no substitute for performance.
- The larger a company becomes the greater its need for long-term planning, and more time will have to be devoted to setting objectives and establishing realistic and relevant tasks and targets.
- As organisations grow larger, there tends to be a remoteness between top management and the lower levels. Each additional level of management is a potential obstacle to good communications.

When I joined the staff of a local technical college, back in 1960, we had just a half dozen lecturers plus a Principal and his secretary (who was the total administrative staff). At that time communication between us took place on a daily basis, often over the dinner table. As the college grew rapidly, and more staff were appointed, communications became more difficult, but the problem was that systems of all kinds lagged behind development and confusion increased. This is often a problem with expanding organisations. By the time I left the college we had hundreds of staff working on a number of different sites, and with a well organised system of communication and control, without which it would not have been possible to operate.

Failing to react to the environment is also a potential danger for an organisation. As environmental threats build up it is imperative to change or the organisation will die. Sooner or later the organisation has to react to changes in its business environment and this will almost always necessitate changes to administrative systems, structures and procedures.

Structure invariably follows strategy. Organisation structure involves:

- grouping of jobs - do we want specialisation or flexibility or a service orientation?
- integration - do we want co-operation or the benefits of differentiation?
- centralisation - do we want to control, or to give autonomy?

Organisational Practices

Different organisations react in different ways to change and to some extent this depends on their ways of operating.

For example, if a company is facing tight competition on pricing in the marketplace and as a consequence sees the need to streamline costs, it might decided to:

- downsize, i.e. reduce the number of jobs
- delayer, i.e. reduce the number of layers in the hierarchy
- widen the span of control, i.e. the number of people reporting to any one manager.

These actions would be primarily intended to reduce costs, but they would also have an immediate effect on communications and information systems, the flexibility of staff and the training required to achieve this, and on the style of management.

The organisation's practice of a 'command and control' style of management would have to change to an 'empowering', i.e. more delegative, style. In another example, suppose a company experiences wide local variations in consumer tastes and in the markets for its goods. If it practised a centralised functional structure and tightly controlled management style this would not be appropriate under the circumstances. Changing its structure to one of decentralised SBUs and giving a high degree of autonomy to local mangers would be more likely to achieve the speed of reaction and local flexibility demanded by the current business environment, and so a change in its organisation practices would be needed to achieve success.

D. THE FOUR AREAS OF DESIGNED CHANGE

A **designed** change is one which has been planned by the organisation, rather than one that has been imposed upon it by external factors.

It can take place in four areas, by means of modifying:

- the task
- the technology
- the structure
- the people

Modifying the Task

It may be that the required change can be achieved by modifying a task rather than a whole system or set of procedures. This represents the simplest type of change because its impact will be restricted to a small part of the organisation rather than the whole. It will require only a minimum change to operational procedures and a relatively small amount of retraining.

In order to modify the task we need to carry out the following steps:

- **Identify the task** (and confirm that a change is necessary).

  The need for modification would probably have shown up over a period of time. For example, it may be that a publishing house has been used to receiving manuscripts from writers via the post, which leaves it open to the vagaries of the postal system. It may be possible in future to avoid these problems by the use of a fax facility to receive manuscripts over a telephone link, printing them out as they arrive. The only procedural change would be to instal a fax machine, and the only training required would be to train an operator to use it. This would therefore involve just a simple change to a task.

- **Consider the implication of modifying the task.**

  Any change will impact on other areas, so it is necessary to consider all the implications of modifying the task. This includes considering any effect on existing procedures. In our example, this would include checking whether there is a large stock of postage stamps or pre-stamped envelopes. We also need to consider what effect there might be on staff in the post room, including any possible redundancy costs. All of these have to be included in the cost of the modification as well as the cost of the fax machine, and may mean the simple modification could be too costly.

- **Analyse the modification.**

  An analysis of the effect of carrying out the modification must include considering the effect it will have on systems or procedures outside the immediate area.

  Consultation will have to be carried out with the users of the system, who may see possible problems that an experienced analyst might miss.

  For instance, will all the writers working for the publisher be able to receive fax messages as well as send them? It is possible for those who do not have a fax machine of their own to use a commercially owned one, but they will still have to receive post in response. This means there may have to be a parallel system in operation, using both fax and post.

- **Propose and agree the modification.**

  Once it is agreed to introduce the modification, the change must be documented. This has to include:

  – details of the change;

- a business case for implementing it;
- the cost and any savings anticipated; and
- details of implementing the change.

This must be agreed with all those involved.

- **Implement the modification.**

  After fully testing the task and ensuring that everyone is satisfied it will work, a date for implementing it must be set. Users of the system must be fully trained to use it. On the date of implementation the analyst will need to supervise the operation to make sure it is carried out correctly, and have recovery procedures and back-ups available to return to the old system if the new one fails.

- **Sign the task off.**

  Once the change is running smoothly and has been accepted by the users, management can ‘sign off’ the modification, i.e. agree that the change has worked and is doing the job required of it.

Modifying the Technology

Office and computer technology is always being improved and it is an important, and difficult, task to keep up with all the changes taking place. A company must always keep on the move; since competitors will never allow you to stand still, you are either moving upwards or falling downwards in order to maintain company image and stay in the game. Also, new advances in technology make the job easier to do, more efficiently and in less time.

- **New technology.**

  Using the typing of letters as an example, we have moved through a huge range of diversity from the ‘old fashioned’ typewriter, often of a portable kind, used by writers (and others). If mistakes in the typing were made they could be erased and typed over.

  Technology advanced and an electric typewriter with its own memory was marketed, which meant that errors could be amended before the machine actually typed the character.

  The next stage brought word processors, which meant that a script could be corrected, using a VDU, before it was printed.

  As the printer technology improved it became possible to produce letter-quality prints. The original printers proved too noisy, so insulated hoods were placed over them.

  As technology advanced yet further it seemed that spelling deteriorated, so the next step was the introduction of word spellers into the package (but beware those who use ‘American English!!). These allow the computer to highlight any spelling errors so that the operator could correct them.

  Finally cam the laser printer, which gives good quality printing at low cost, and quietly - Finally? -

  This example serves to illustrate how technology responds to a need and provides affordable and efficient solutions.

  It is the responsibility of the organisation to move with the technology. Some companies are still at the typewriter stage, and some writers still use pen and paper (Jilly Cooper claims to be one of them), not because they cannot afford to move with the technology but because they are content with their existing system.

  There is not necessarily anything wrong with this attitude, but it does mean that staff may still be carrying out laborious tasks that technology could do for them.

- **Market analysis.**

  Before adopting any new technology, the market must be well researched. A checklist should be drawn up listing all of the benefits required from the technology.

  Advice can be obtained from manufacturers and suppliers but it is necessary to check that it fits in with your particular company and its objectives.

  Any technology installed must be compatible with other existing systems and equipment and not result in your being restricted to just one supplier for future development.

  You also need to check whether any equipment or software could be upgraded to deal with future advances, and not become quickly redundant. This is especially important in the field of computers.

- **Impact upon the company.**

  New technology can have a big impact on a company; for example, by increasing its efficiency and by providing a modern image to both customers and competitors.

  More important, however, is the impact on your staff using it, both during the disruption when it is being installed and the noise associated with that and its operation.

  Staff will also require comprehensive training in order to use the new equipment so as to become both able and confident. Even an experienced operator will have to become familiar with a new piece of equipment or keyboard, and often will spend time pressing all the wrong keys or buttons before becoming fully efficient.

Modifying the Structure

Change may not necessarily affect tasks or technology. It may be that changing circumstances, or the company's environment may indicate that a change of its structure, or system, is needed.

This is in some ways an easier change because it may not be expensive in terms of research into procedures and technology. On the other hand, it can be very difficult to change structures because they involve people's responsibilities and lives, so you are likely to meet with resistance and a demotivated workforce.

- **The need to modify a structure.**

  Change is necessary. In fact, it is essential to the health of an organisation. Even though the organisation may not wish to change, its customers or suppliers may oblige it to do so. This can involve considering changing even the entire structure of the organisation due to advances in technology.

- **Problems associated with changing the structure.**

  The existing structure must be analysed very closely to determine which areas are in need of change and will benefit from it.

  Problems which can arise from changing an organisational structure include:

  - **Imposition upon existing responsibilities.**

    Any change to job responsibilities or boundaries is likely to meet with resistance from people losing responsibilities, or even those gaining them. In order to make such changes, therefore, it is important to consult with the individuals concerned and to clearly define the areas of responsibility. To encourage a positive attitude to such changes, senior management must be committed to the successful introduction of the revised structure, and must be seen to be so.

  - **Problems of additional responsibility.**

    Additional responsibility, which is imposed on an individual due to a changed structure, can result in a number of outcomes, both positive and negative.

Where the person is capable of handling the new responsibility, this is a positive and beneficial aspect. In fact, some individuals thrive on being given extra tasks and added responsibility.

If the people are not capable of handling these extra tasks, then it must be accepted that, if they were previously capable, it is the change imposed on them which has resulted in their no longer being capable of being fully efficient.

When considering restructuring, therefore, it is important to realise that not only the tasks but also the personnel must be taken into account. Those who were working efficiently on the old task but seem unable to cope with the restructured task may need to be redeployed.

– **Boundary definitions.**

  In changing organisational structures, great controversy can be caused by adding to or reducing existing boundaries and responsibilities. There are few people who will happily accept that, as a result of boundary changes, their responsibilities are to be reduced. Agreement must be reached through senior management decisions.

– **Organisational problems.**

  Changing the structure of an organisation can be complex. Lines of communication need to be considered and, if necessary, revised to reflect the new structure. Communication with customer's organisations may also need to be revised, and they may not appreciate the fact that your structural changes may cause complications with their current lines of communication with you.

  In this kind of situation a large amount of tact and diplomacy is needed, with the emphasis being placed on the positive aspects of the restructuring for both companies.

Modifying the Attitudes of the People Concerned

This is possibly the most difficult aspect of change. Our attitudes are an enduring set of beliefs which cause us to perceive things and to behave in given ways, and which exert a directive influence on the way we behave.

It is very difficult to change a person's attitude; it is easier to change their behaviour. However, if you can change the way people behave, their attitudes, eventually, will come into line.

People are essential to the survival of an organisation, and it is important they feel they are contributing to its well-being and to that of their colleagues.

Motivated individuals undertake their duties pleasantly, efficiently and profitably.

When dealing with other organisations, the individual represents the company and its image. No matter at what level the contact takes place, it is still company to company at the respective level.

- **Training.**

  Training explains the unknown to the unaware. It inspires confidence, and confidence spells satisfaction and productivity. When people are subjected to a change in their working environment then training, to create both confidence and motivation, should be high on the change schedule.

  Although training will involve two measurable costs, i.e. the cost of the course itself and the loss of the employee's production capacity during the training (the opportunity cost), gains, which are not as easily measured, will be made by the employee being able to carry out the new functions of the system a lot faster and with greater confidence.

- **Consultation.**

  It is the users who have to make the new system work, so they are the most important people in the system. Experienced analysts realise this and spend a large portion of the design time consulting with users and seeking their opinions on potential changes to the system.

  Cost savings will be made if users are happy with the new system. If they are not, they will do everything they can to discredit it.

- **Resistance to change.**

  Once a new task is learned, and experience has been gained in carrying it out, the individual gains in confidence and security. Changes threaten this security, so users often openly resist any changes to an existing system. Although consultation will help to overcome such resistance, it remains a difficult problem for managers to solve.

E. MANAGING CHANGE PROCESS

Management Styles

There are a number of management styles which have been identified over the years, but they tend to lead back to Douglas McGregor's Theory X and Theory Y, which he proposed in his book "The Human Side of Enterprise".

McGregor suggested that the way managers tried to control their staff assumed that they were in general lazy and shirked responsibility, with little ambition and a built-in dislike of work. Consequently, they needed to be strictly controlled and told what to do. An organisation run on such lines tends to exhibit an authoritarian nature, with power invested in the managers to enforce obedience.

Under such a system it is not surprising if the workforce become passive and resistant to change. This is Theory X.

On the other hand, McGregor suggested that people were naturally inclined to use their energy in both mental and physical effort and that they will exercise self-direction and self-control in pursuing objectives to which they are committed - this he called Theory Y.

The Theory Y type of organisation is participative, rather than directive, and in introducing change seeks to bring its staff 'on board'.

Group participation is a useful technique for obtaining support in a situation of change. It is not a trick to make people think that they came up with the management's idea. In true participation, the manager first analyses the problem alone and tries to arrive at the best solution. Then he/she calls subordinates together to discuss the situation, and generally the outcome is that a better solution is agreed.

There is a big difference between:

(i) informing staff of the decision to introduce change, which provokes maximum resistance

(ii) consulting staff and then deciding, which gets less resistance

(iii) involving staff in the decision-making, which results in the least resistance.

In practice, of course, decisions on change sometimes have to be made without much consultation, and in these cases the role for participation is reduced. However, participation by staff in the introduction of a change, the need for which has been explained to them, is often the best way forward.

The participative management style then is more appropriate in managing change.

Structures and Control Systems

The more flexible a structure, the easier it is to adopt change. The more rigid the structure, the more difficult it is.

Burns and Stalker carried out a significant piece of research in which they contrasted two completely different systems of organisation:

- mechanistic
- organismic

The mechanistic system is characterised as:

- hierarchical structure of control, communication and authority
- differentiation of functional tasks
- emphasis on technicalities of the function rather than the needs they serve
- precise definition of duties, authority, methods and processes attached to each function
- operations and behaviour tend to be governed by instructions and decisions from superiors
- communications tend to be vertical and via precise channels
- greater importance attached to internal rather than cosmopolitan knowledge
- insistence on implicit obedience to superiors.

The organismic system is characterised as:

- continual adjustment and re-definition of tasks through interaction
- encouragement of contribution of specialised knowledge and experience to the task
- commitment to the organisation is wide and not limited to a technical field
- omniscience no longer attributed to the head of the business. Knowledge can be located anywhere in the network
- lateral rather than vertical communication
- communications consist of information and advice rather than instructions
- mutual confidence, rather than authority, is the main force
- wide participation in decision-making
- individual's conduct and behaviour is governed by community of interest rather than contractual relationship with superior
- manager is agent for maintaining intergroup communication rather than agent of higher authority
- members of the organisation are encouraged to grow to greater responsibility, rather than be controlled
- the primary, i.e. face-to-face, group is the basic unit of organisation.

The mechanistic system is more appropriate to a stable environment where little change is anticipated.

The organismic system is much more appropriate to a changing environment, such as the electronics industry, where constant research is being carried out and new products consistently being introduced.

In the dynamic system, although positions are not hierarchical, they are stratified and defined according to expertise. The lead or authority is taken by whoever is most informed or capable, as in a matrix structure. The mechanistic system tends to be more comfortable for many as it is more easily understood and operated, whereas organic systems impose a greater strain and possible anxiety, but changes are much more readily and easily carried out.

Organisational Practices

When we considered this area in the previous section we saw how the way an organisation operates, i.e. the way it carries out its functions, will affect how it can put a change into operation.

Those organisations which have strict rules for operating their business find it more difficult to introduce change.

Examples of such organisations are easily found in the public service areas, where services are provided which have to interlink with other services.

In these areas a change of organisation or behaviour in one sector can have a knock-on effect on others and the tendency is to stick to the status quo on the grounds that it works. In other words, "If it ain't bust don't mend it."

For instance, over the last few years there has been increasing pressure on schools to reorganise both their daily hours and their term times. As more flexibility has been put into the workplace, more parents are looking for greater scope to book their annual holidays, etc. One of the big obstacles to rearranging term times, in particular in the secondary and tertiary sectors, is the timing of examinations, which are geared to higher education. Whilst colleges and universities insist on sticking to their current enrolment dates, there is little room for the schools to move their annual holiday dates. In order to make significant progress in this direction, all those institutions who are involved will have to come to a joint agreement to change, and this requires a change in many well-established practices.

Power and Influence

Pfeffer has suggested that power (and therefore influence as well) is stable in most organisations most of the time. Thus stability, not change, is descriptive of the power distributions in most organisations as well.

There are three main factors which promote stability in an organisation,

- commitment to decisions and strategies previously adopted
- the institutionalisation of organisational cultures, and
- the self-perpetuation of power, where those who have power are able to acquire the resources which in turn help the maintenance of power.

These areas act as powerful factors which promote organisational stability and discourage change, which then becomes both infrequent and also difficult to carry out at all.

Where it does not require a fundamental change in the power distribution of an organisation then change itself is easier to accomplish. However, where it does necessitate a shift in the distribution of influence, change is a rare event. It is then brought about mainly by a major change in the organisation's environment which creates problems which are too large to be ignored or where there are constraints which are too pervasive to be disregarded.

For example, Matalan, the discount retailer, lost their chief executive Angus Monro recently, when he quit after a boardroom row with the company's chairman over the group's strategy. This followed a fall in sales growth which brought about a 33% collapse in the company's share price. This fall was explained by the company's financial director as due to "growing too far, too fast" and a change of strategy to look for "consistent growth".

Culture

We have just observed that one of the factors which encourage stability in an organisation is that of commitment and a second is to the institutionalisation of organisational culture.

These two together tend to prevent change from occurring and so in order to carry out a change they have to be overcome.

For a change to have meaning for members of an organisation it must be shown in terms of their daily experience.

People like to be associated with success and part of the culture of an organisation is based on this.

At one time British Aerospace had a large notice hung in their workshops, and printed on pay advice slips, which said "British workmanship at its best." This became a part of the company's culture, that they were at the forefront of good practice.

In these situations, a necessary change, for example, in procedures or systems, can be introduced into the culture by reassuring staff that the change is in order to maintain the overall success of the organisation, that where a problem has been identified something positive is being done about it, so that commitment to the company is enhanced rather than reduced.

Communication

How soon people are informed about a proposed change, and how well they are kept informed about its progress is an important factor in carrying it out. How this communication process is carried out will depend to an extent on the size of the organisation. To be effective it needs to be personal, i.e. a face-to-face encounter rather than a printed message.

In a small organisation this can be easy to carry out by means of a meeting of all employees. In larger organisations, where this is not possible, it is often carried out by a series of small group briefings. In either case there needs to be the opportunity for discussion, rather than a monologue, and in the case of briefings it is important that:

- the information given out is the same for all, and
- the results of any discussion is made available to all.

Tactics

Inevitably, when faced with change, people ask "what's in it for me?"

Part of any process for managing change is to give an answer to this question.

Management strategies for change at work tend to fall into two tactical groups:

- Hard sell
- Soft sell.

Figure 9.2 illustrates some of these which may be used in trying to introduce greater flexibility of work processes.

In the hard sell tactics there is little room for showing advantages to the workforce. In the soft sell methods there is much more scope.

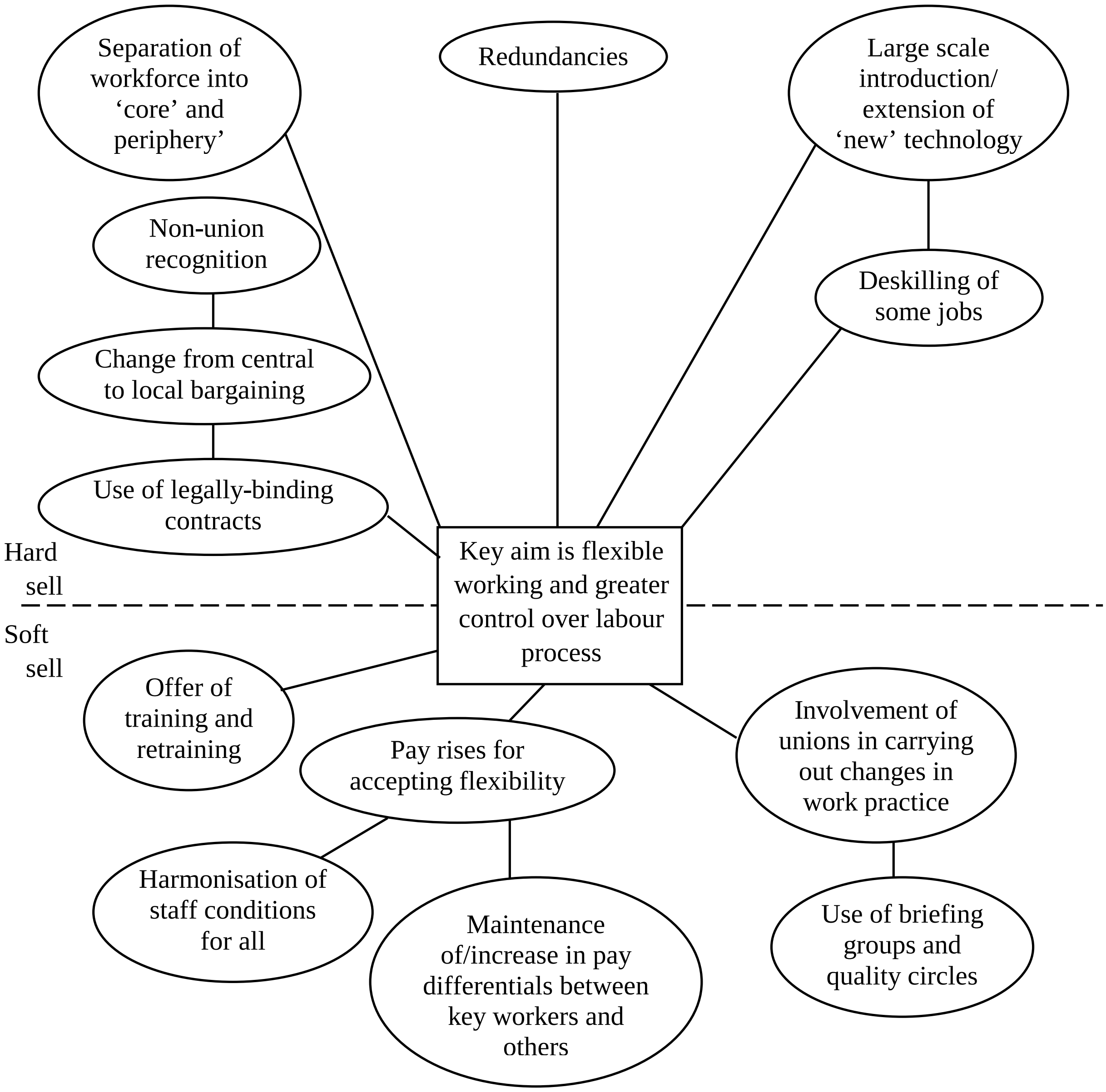

Figure 9.2: Management Tactics for Change in Working Practices

Currently the Post Office is facing another battle with unions after announcing that it is to cut 2,100 managerial and administrative jobs. The manager's union said it was shocked that Consignia, the holding company, was seeking to impose compulsory redundancies in order to streamline its operation in the face of greater competition. The job cuts will be part of a restructuring which will cost 9,400 jobs in total. Consignia say that most of those involved will be retrained to work in other parts of the company, but are not confident they can avoid compulsory redundancies. A spokesman for the union has said "this is very unsettling for our members. It is likely to make them feel less flexible and responsive to change".

At the same time, the Communication Workers Union, which represents the delivery staff, is angry over suggestions that mail could be delivered by supermarkets, milkmen and other distribution firms.

Consignia says that the workforce has been aware for some time that some of its staff would have to go. "We hope we won't have to make compulsory redundancies at all", said a spokesman.

Perhaps a softer, more participative, tactical approach would have lessened tension and been easier to achieve.

Further Management Styles for Managing Change

Thus far we have considered the following styles managing a change situation:

- through participation and collaboration with those affected by the changes; and
- by educating the staff involved and communicating to them the reasons for, and the main effects of the proposed changes.

Here we will look at two further management styles which may be adopted, both of which are based on the principle that the manager's role is to manage. These are by:

- direction, and
- coercion.
- **Direction** involves the use of managerial authority to specify and introduce change. It is a top-down style of management based on the hierarchical organisational structure. It relies on the notion that strategic change is the responsibility of top managers, so such decisions are taken at the top of the hierarchy and those lower down are expected to co-operate in their successful implementation.

  As with any management style, there are both advantages and disadvantages to operating in this way.

  The main advantage of a directional management is that it acts quickly and, in a situation where change needs to be carried out rapidly, it is very successful.

  Its success will depend to a large extent, however, on how good the top management is in having a clear direction and vision.

  Disadvantages which may arise are mainly due to resentment by those who feel they should have had an input into the decision-making process, and this can lead to problems of lack of acceptance, ill-feeling and a lack of trust by those affected by the changes.

  This style is most often found in the entrepreneurial type of organisation.
- **Coercion** is basically the most extreme form of the direction style. Here, managers essentially force people to accept a change by means of either implicit or explicit threats; for example, with a loss of promotional prospects or job security, by transferring staff to other parts of the organisation, or even sacking them.

  Coercion takes the form of issuing edicts of the required changes and time limits as to when they are to be affected.

  It is a risky process because, as with the direction style, people inevitably feel strong resentment to change which is imposed on them.

  Nevertheless, in situations where speed is essential, where, for example, the company is facing a crisis situation, and where the proposed changes will not be popular however they are introduced, it may be that coercion is the manager's only option.

  The coercive style is usually found in very structured organisations, such as the police force and armed forces.

One final style which we can consider for introducing change is that of 'intervention', by means of the use of 'change agents. We shall consider this, and the role played by change agents, in the next section of this study unit.

The following are some common mistakes made by managers in introducing change:

- Trying to use only one style, or a limited set of styles, regardless of the situation. Types of managers who make this mistake include:
  - the '**hard man**', who tries always to coerce staff;
  - the '**people-friendly**' type, who always wants to involve the team;
  - the intellectual manager , who relies on educating and communicating with staff involved (his is the commonest mistake).
- Trying a piecemeal approach to a change situation in an incremental manner, rather than one which is part of a clearly considered strategy.

F. ROLES IN CHANGE PROCESSES

Change Agents

In chemistry, the speed of a chemical reaction can be increased by the use of a catalyst, or change agent. Such a catalyst increases the rate of a reaction but is not involved in the reaction itself and so is not used up. It can be used over and over again to speed up the conversion of reactants to products. Different reactions require different catalysts to be used.

In a similar way, organisations can speed up and facilitate the process of change by using a change agent. Often the change agent role is performed by someone from outside the organisation, who has not absorbed the culture and values it possesses, although it is not essential than an outsider is used.

The change agent role may be played by an outside consultant, a specialist within the organisation, a new manager, or an enlightened manager who is able to look beyond traditional approaches.

Schein describes the role of change agent as follows:

> "….to help the organisation to solve its own problems by making it aware of organisational processes, of the consequences of these processes, and of the mechanisms by which they may be changed. The ultimate concern……is for the organisation's capacity to do for itself what he/she has done for it."

The role, then, is not to solve problems but to teach the organisation how to solve them itself. The change agent is there to set in motion the collection of information and the building of models of the organisation, prior to indicating where intervention may be of use. The agent is there also to decide which techniques are the right ones to use in a particular situation, and to guide their use.

The change agent is also a powerful intervention tool, using him/herself as a trigger for action. Much of their influence springs from the way they relate to the client. Therefore, they must live the values they are trying to inculcate.

Managers

Denis Pym carried out detailed research studies into how people at all levels in an organisation respond to change, and identified a number of characteristics which led to managers being more or less successful in introducing change. These are summarised in the table shown, Figure 9.3.

Less Successful	Managerial Characteristic	More Successful
Boss is 'expert' on subordinate's job	View of technical skills	Boss no longer expects to be, nor is regarded as, the 'expert'
Efficiency and human relations are separate features of behaviour	View of dimensions of leadership	Efficiency and human relations are merged
Directive and authoritative	Relations with subordinates	Equality in relations with others, authority according to contribution
Submissive	Relations	
Decisions are of a serial kind, i.e. based upon assumptions that previously successful solutions can be applied to new problems	Decision-making	Less dependence on experience and more on evaluation of the evidence

Figure 9.3

Managers who hold mechanistic views and have rigid personalities tend to react to change in one of two ways. They either cling to old habits/procedures more strongly, promoting like-minded people and closing ranks to make innovations fail, or they grasp any innovation as a magic answer, rather like a drowning man clutching at straws.

Managers have a vital role to play in introducing strategic change and if they are not totally committed to it themselves then they are unlikely to be successful. What Pym has shown is that the personal characteristics of a manager play a big part in controlling their ability to successfully implement change.

Workers

It is the workers at the 'coal face' who are ultimately those who have to make a strategic change successful. Without their co-operation management cannot make it happen.

Tom Lupton pointed out that an individual is not only an instrument to be organised, but also a decision-maker. He sees the individual partly as someone who submits to organisational demands, partly as someone who reacts emotionally to them and other social stimuli, and partly as a rational being who decides about things.

With respect to change being introduced by a top-down strategy, Lupton suggested that, since top management is responsible for what happens to an organisation, it is part of their role to impose change.

However, the top-down management style is inadequate and denies the organisation the total skills of those closest to the job. Lupton suggested a way forward to release these skills by means of the consultative process.

Support for the view that change can be implemented from the bottom-up as well as the top-down is supplied by Pugh, who argues that managers who are themselves prepared to change are likely to consider ideas initiated at the shopfloor level.

Carrying out a survey of subordinates' ideas for improvement has often surprised managers, because of the quality of the proposals made. One of the rules Pugh suggests as a means of successfully implementing change is to initiate it through informal discussion, in order to obtain feedback and encourage participation. Thus the workers' role in the change process goes beyond merely putting other people's ideas into effect to being a part of the decision-making process.

Stakeholders

Who are the stakeholders in an organisation?

They include:

- shareholders
- managers
- employees
- customers, and
- the wider community whose lives are affected by the organisation.

What role do these play in the change process?

Well, we have considered already the role of managers and employees, so we now need to look at shareholders and the community. Both of these groups can impose a lot of pressure on an organisation with respect to change.

– **Shareholders** have control of strategic resources and can remove or increase the supply of money to the organisation. If changes which the organisation plans do not receive the support of the shareholders, they can bring pressure to bear through:

  - their voting power at annual general meetings, both with respect to resolutions about change and the re-appointment of directors
  - their financial power by disposing of their shareholdings and precipitating reductions in share prices.

  In these ways they act as a controlling influence on what the business is able to do.

The members of the community have a political role to play. If the organisation is a public service organisation, for example, they can vote against proposals on spending, etc. Where they are particularly incensed they can prevent even government's plans being changed; remember the Poll Tax rebellion. Where communities feel the environment is threatened, they can also bring a lot of pressure to bear: think of objections to road schemes.

Study Unit 10

Issues and Developments in Modern Corporate Strategy

Contents *Page*

INTRODUCTION

In this final unit we are moving away from a concern with the processes of strategy development and implementation in order to examine a range of major issues affecting corporate strategy in modern organisations.

These include international trade and globalisation, social responsibility, business ethics and the environment.

Objectives

After studying this unit, students should be able to:

- discuss the implications of international trade and globalisation for strategic planning and implementation, with particular reference to management, developing plans and organisational structures;
- identify the key issues raised by the concepts of social responsibility and business ethics, and discuss their impact on corporate strategy;
- assess the impact of environmental concerns on strategic planning and implementation.

A. THE GROWTH OF INTERNATIONAL TRADE, CONCEPT OF GLOBALISATION

Market expansion is concerned with extending the area in which a business operates, so that more potential customers are aware of the products or services you are providing.

Very often organisations cannot operate at full efficiency unless they are covering a whole region or country. It is not very effective to advertise your product on television if half your audience cannot buy it.

The need to compete has continued to grow, so that, having covered a country, the next step is to move over a continent, and then finally to sell your products/services worldwide.

Most capital goods companies have moved into overseas markets as their home markets become saturated. As more and more companies become multinational corporations, so more and more service organisations, such as insurance companies, have been forced to follow because these multinationals are their clients.

Exporting is a method of market expansion and is usually the first step towards international trading. This is often followed by the business setting up locations in other countries, where its products are manufactured as well as marketed, in order to take advantage of the local availability of raw materials, or of cheap labour, thus reducing transport costs.

Trade has expanded worldwide, so that we have now reached the stage of global industries. These have been defined by Porter as those in which

> "the strategic positions of competitors in major geographic or national markets are fundamentally affected by their overall global positions".

A global firm is one that can secure major benefits in all areas of operation, with the ability to site production plants and distribution networks in whichever region of whichever country offers the best advantages.

This has led to nation states actively competing to attract foreign investment, and global corporations are acquiring an economic power to rival many nation states.

Strategic alliances are being set up globally, such as Toyota and General Motors. We have also seen extension by acquisition, with the Swiss owned Nestlé acquiring such companies as Findus, Libby, Carnation, Crosse & Blackwell, and Rowntree. In 1992 they adopted a policy of carrying the Nestlé brand identification on all products.

Domestic firms operating in global industries now have little time to determine strategy as the pace of globalisation is rapid and the windows of opportunity are closing. In Kotler's view the opportunities will soon become available in global niche marketing.

European companies seem to be less able than the Americans or the Japanese in conceiving global strategies. These two countries have dominated world markets in cars and electronics, for example. On the other hand, European companies are good at finding niche markets. Goldthorp has said that, "they understand this country, this block, this marketplace, and they tend to do very well in that".

It will be very interesting, in the light of Kotler's and Goldthorp's views, to see what impact the European companies have on global niche marketing.

Firms trading out of their own country have often made mistakes in the past. In Unit 4 we mentioned the case of General Foods failing to sell cake mixes in Japan. Other notable examples include:

- Many Western products and promotions failing in the Far East through a lack of appreciation of the importance of colour. For example, red is considered lucky by the Chinese, whereas white is the colour of death.
- Many American products have failed in Europe because companies considered that the UK was a good test market for Europe.

These and other catalogued failures are the results of assumptions that:

- the rest of the world is like us (whoever "we" are)
- our way is best.

The key, as always, is to study the customers and consumers in the target markets and adapt a package to meet their needs. This does not compromise global branding, because the contents of, for example, a Nescafé jar, will be different from country to country. But the assurance that it will be good quality instant coffee remains, and the recognition is universal.

The Potential Benefits of Globalisation

There are many benefits which may be gained by pursuing global strategies.

- **The advantages of cost reduction**

  Costs may be reduced through the economies of scale which arise due to the sheer volume of trade available on a worldwide scale.

  Sourcing and/or operating from lower-cost countries also allows costs to be reduced, as does a reduction in the duplication of development, production and marketing costs.

  Greater flexibility to exploit differences in factor costs between countries, or in exchange rats, is also available to global companies.

- **Improvements in quality**

  Exposure to a global market and the competition within it often has the effect of making a company improve its systems and procedures, and also the quality of its products, in order to compete.

  This can be achieved through concentrating materials and personnel resources so as to satisfy the higher level demands often found in new markets and with international customers, as opposed to domestic markets and consumers, who have a much greater choice of suppliers.

- **Meeting customer demands**

  Marketing on a global scale leads ultimately to having brand names which are themselves recognised worldwide. This, in turn, added to the improved quality which accrues as above, creates an enhanced company image.

  Success in the global marketplace, as in so many other areas, creates its own success. A company which has embarked upon a global strategy is able to use the same market mix in different countries. This then results in greater global recognition by customers, backed up by greater availability of both products and services, provided the company identifies 'horses for courses' and does not fall into the culture traps which we described earlier.

  Increased competitive leverage

  Global strategies enable a company to enter new markets by means of low cost advantage, due to economies of scale, etc. as we have just seen. They also allow a company to compete in those markets which have the greatest potential for increased sales and profits, as, for example in opening up new markets in countries such as China.

  Having a greater number of markets in which to operate increases a company's opportunities to attack its competitors, and also provides the option of moving out of a market which is saturated or is suffering from a depression and transferring attention to other markets which are currently more buoyant. In other words, it allows the company to have a portfolio of opportunity where a balance can be struck between different markets, rather as an investor in the stock market seeks to have a balanced portfolio of stocks and shares, so that falls in one company can be offset against rises in another.

  Pursuing global strategies has a number of advantages for a company which go beyond mere economies of scale, although this is itself an important factor.

A Global Approach to Strategic Planning

The recent growth in the global company and a global approach to strategic planning has been due to a number of driving forces which have affected the structure of the global market and made it what it is today.

We have already discussed the potential cost advantages of operating on a global basis, and these act as a driving force, prompting more global approaches.

Other important driving forces include:

- the convergence of markets
- government policies
- global competition
- **The Convergence of Markets**

  As markets have converged on an international scale, the global customer has developed as an important feature. This has been partly due to the shrinking of the world through quicker and cheaper long-distance travel, which has resulted in customers being made aware of the variety of food, clothes, entertainment, sporting activities and lifestyles available in general across the globe. As a consequence the needs and tastes of people in widely different geographical locations have converged. Witness the spread of fast food from McDonalds to countries such as Russia for example.

  This convergence has been further encouraged by changes in shopping methods, with the Internet and the World Wide Web enabling people to shop easily on a worldwide basis.

  The introduction of the euro monetary system in Europe is another factor which will encourage this convergence to continue.

All of these factors combined have resulted in the need for companies to develop a global approach to strategic planning.

- **Government Policies**

  Both governmental and trade policies have also acted as driving forces for global change. The idea of free trade and free markets has been put forward as being to the advantage of all countries. Movement has been achieved on a limited scale and has resulted in a number of trade barriers being lowered, but there is still a long way to go before prices of goods are equalised, even throughout members of the European Union (EU), although this is based on the principle of free trade between the member states. A number of countries, including France and the USA, still fiercely defend their own interests by imposing trade embargoes when they feel these are necessary.

- **Global Competition**

  Because of these driving forces already described, more and more companies are developing global strategic planning and operations. This, then, acts as a pressure on other companies who are still operating on a domestic basis to come into line, since they find themselves faced with competition from virtually every part of the world, whether they like it or not. As more companies become international in their development, the interaction between competitors on a global scale is bound to increase.

  All of the factors we have described have been responsible, along with others, for the development of a global organisation of companies which, over the last decade, has been a very significant factor of the world economy.

  "No country is an economic island".

B. STAGES IN THE DEVELOPMENT OF INTERNATIONAL ORGANISATIONS

Exporting

As we have just seen, exporting is a method of market development and is the first step from being a national to an international organisation. In export marketing an organisation is firmly based in a home market and sets up trading arrangements with other countries.

Overseas Investment/Divisions

The next stage in development towards global trading is for the organisation to locate some of its manufacturing, distribution or marketing operations overseas. This may be achieved either by investing in other companies or by setting up an international division. In this arrangement the home-based structure may be kept in the beginning, whether it is functional or divisional, with the overseas interests being managed separately through a dedicated international division.

The reasons companies move in this direction are sometimes related to tariff barriers or due to import controls being imposed on exported goods.

They may also stand to gain through reductions in the cost of labour, materials or distribution.

International Operations

An international business applies marketing operations across national frontiers and will usually have subsidiaries established in its major markets. It may even export from these subsidiaries.

According to Robert Maxwell, the first distinction between export and international marketing lies in the location of employees - both a resource and a commitment. He sees the real key as being the addition of a resource, and suggests that a great many companies have strong commitments to foreign markets but do not themselves commit their own resources overseas.

Companies which have no direct control will never achieve such a strong market position as those who actually manage their own resources. Those who wish to attain a strong market position but find their overseas markets do not contribute much to their revenue should therefore take a harder look at the methods they are using.

From simple beginnings, progression via greater commitment of resources can lead to the point where a company has a complete marketing and production operation through a subsidiary company.

Not every country will allow this arrangement. Some prefer joint ventures, in which they stipulate a percentage of national ownership. Others, particularly the ‘developing countries’ prefer to import whole production facilities and hire the expertise to manage them for a while.

Multinational Operations

Multinational companies operate in a large number of different countries. They differ mainly from international companies in terms of scale and of attitude. National identities almost disappear and managers see the world as a whole, although having local differences.

Multinational companies are not associated with any particular home market. As a consequence of their non-nationalism they often come into conflict with governments. For example, the British government has been known to claw back money from multinational companies on the grounds that they have made “excessive” profits. One company to suffer from this in the past is La Roche, the Swiss pharmaceutical company. In order to develop into a multinational company, then, it is necessary to be able to act uniformly on a worldwide basis, where differentiation between both products and markets is not very pronounced.

The Global Company

A global company has passed on to the stage where it plans worldwide manufacturing facilities, marketing policies, financial flows and logistical systems. Components and supplies are bought where they can be obtained cost-effectively and global operating units report to the Chief Executive or executive committee rather than to the head of an international division. Staff are recruited from many companies and managers are trained in worldwide operations, not just domestically or internationally.

For instance, Nestlé brought the MD of their Australian operation to run the UK one for 18 months, whilst the UK Production Director went to Australia to gain experience before coming back to take over in the UK. Both of these relocations were made with only a few days notice, despite the seniority of the individuals concerned.

Domestic market operations are no longer viable for the serious organisations. The technology exists to operate globally and the results prove this to be a very effective strategy. There are problems within the global environment, but they have to be faced up to if the organisation is to survive, let alone prosper.

The international product life cycle suggests that comparative advantage in many industries is moving from high-cost to low-cost countries, and companies cannot stay domestic and expect to retain their markets.

The first step is to understand the international marketing environment, particularly the international trade system. A full management and marketing audit must be carried through on each and every market, and the concepts of ‘export’ and ‘international’ must be got rid of. A global strategic plan is identical in process to a domestic plan, but the operating area is much larger and the fluctuations, for example foreign exchange rates, much more volatile, thus adding to risk. However, as Porter has said “Global companies win out”, so that makes it worthwhile.

Expanding into International Markets

We have just considered how a company can develop from operating in a domestic market to taking a place in the world market.

Before such a move is made, however, there are a number of considerations and decisions which have to be taken.

- **Analysis and Evaluation**

  The first step which must be taken is to determine whether the financial resources which will be needed to develop an overseas market are to hand. This can be carried out by means of an investigation of the company's strengths and weaknesses, i.e. by means of a **SWOT analysis** as we described in Study Unit 3. This will also show whether other necessary capabilities, such as personnel, marketing, production, etc. are available.

  This analysis needs to be interpreted from an international standpoint, i.e.

  – Are our staff capable of operating within a different culture?

  – Do they have the ability to use foreign languages?

  – Do they understand other national characteristics?

  Armed with this information, it should be possible to decide whether the company could pursue its overall corporate objectives whilst operating on the international stage.

  From the SWOT analysis the opportunities and threats associated with expanding internationally will also be shown up, and this knowledge can be used to assess the possible outcome of a decision not to expand in this way in terms of competitive ability.

  Opportunities and threats are related to the external environment in which the company is operating, or in this case considering operating.

  In Study Unit 2 we saw how a PEST analysis considered the following aspects of the external environment:

  - political factors
  - economic factors
  - social/cultural factors
  - technological factors.

  To this list we could add

  - demographic factors (births, deaths), etc.) and
  - competitor factors

  All these factors need to be included in the international perspective, even though their analysis is more difficult when applied to markets which are different to those with which the analysts are familiar.

  In order for an excursion into the international marketplace to be successful it is important that:

  - market selection and
  - market entry

  are correctly chosen.

  To achieve this it is necessary to evaluate the markets under consideration by means of the following criteria:

  - assessment of market potential
  - accessibility of the market

- suitable method(s) of entry
- analysis of competitors' products or services

From this evaluation the company's competitive advantage vis-à-vis other competitors in the chosen international market must be measured.

- **Market Entry**

The next step is to consider how the chosen market should be entered. In Study Unit 2 we considered some of the barriers which may have to be overcome in entering new markets. We have just seen that the simplest way to move from being a domestic to an international player is via overseas exporting of goods, then developing by means of overseas investment and the setting up of an international division.

Shared ownership schemes or joint ventures with foreign companies are another way into international trading.

The attraction of these schemes include:

- the cost advantages (as already described);
- the perception of being a local rather than a foreign company; and
- possible positive synergy gained through the distinct competencies which each company can bring to the partnership.

Other ways which companies may use in order to expand internationally include licensing agreements, whereby the right is granted to another company to manufacture the parent company's products.

An example of this is provided by the glass manufacturer Pilkington, who, in the late 1950s, developed an extremely advanced process for making plate glass. This process enabled the company to cut their manufacturing costs to such a degree that they could have gained an unassailable competitive advantage over other glass manufacturers. They decided that, instead of keeping the process to themselves, they would make it available under licence to the rest of the industry. They later said that the decision was made partly because it seemed the correct moral thing to do, and partly in return for royalty income.

Strategic decisions about which markets a company should trade in, whether they are domestic or international, ought to be based on research into both the company's internal capabilities and its external environment.

In terms of international expansion, these decisions should be based on the current international market and on the company's ability to compete on an international scale.

C. STRATEGIC ISSUES

Researchers have carried out studies into how national culture affects such factors as employee motivation, management style and organisation structure. They have discovered identifiable differences in these areas between different countries.

For example, British culture has a higher level of tolerance of uncertainty than have many others, including France, Germany and Spain. French managers are highly risk-conscious and tend to react to uncertainty by referring situations upwards to a higher authority, ultimately to the government.

Management

Differences in culture have implications for managers in multinational companies when they are deciding how best to implement strategic decisions across their different divisions.

Two extreme examples of how national characteristics and culture affect strategic considerations are where the strategies are likely to be planned, or where an adaptive approach is likely to be more successful.

Planned strategies are most appropriate where uncertainty is dealt with by reducing it, and where the emphasis is placed on the hierarchy, the individual and the work tasks. Organisations which follow this pathway are seen to be proactive and in control.

A good example of this type of culture is the USA. Here society is seen as championing individual rights and being tolerant of racial and religious differences. The Americans have strict job descriptions and set out to hire people who fit them. But despite this emphasis on individualism, and particularly on personal development, American companies seem to strive also for homogeneity, dressing in the 'company style' for example. Americans generally adapt very readily to working in teams and can quickly establish rapport with one another when brought together for a joint project. (They are often issues a team shirt, to help build this spirit.)

An **adaptive strategy** is likely to be found in cultures which accept uncertainty more readily. In this case the organisation has less control and is reactive rather than proactive, and the tendency is to look towards the group rather than the individual.

The Japanese provide a good example of this type of culture with their emphasis on teamwork. Japanese managers are well known for their ability to motivate their employees and create harmony, intense involvement and a deep commitment to the company's goals.

Europeans, like Americans, are tolerant of racial and religious differences in general, and even more tolerant of individual differences. European employees tend to be less willing than Americans to conform, and tend also to show a lack of respect for authority. It may be argued that this natural dislike of authority can produce advantages for an organisation, with managers delegating decision-making downwards. This encourages staff at lower levels to be creative, and this in turn increases their confidence in their ability to change things which 'matter'. When appointing staff, European managers are less rigid than Americans and are more likely to 'adjust' the job description to fit it to the individual hired.

European companies have a looser concept of corporate culture than exists in the USA, and particularly in Japan. Dress codes are also much less controlled. European managers are trying to learn from the Japanese how to encourage and improve teamwork with their staff. One of the factors making this difficult is that of the culture and education system which encourages people to compete against one another in order to achieve success.

Finally, Drucker has even suggested that management is itself a 'culture', rather than a discipline, and as such as its own set of values, beliefs, tools and language. The real challenge for management, then, lies not in coping with the different cultures of the Germans, Japanese, etc. but in overcoming the limitations of its own culture. The problem is not a simple one and so, therefore neither is the solution to it. It lies not in tackling problems in a piecemeal unco-ordinated way, using techniques such as quality circles, team-building programmes etc., but in creating an overall fit of all the managerial parts.

Developing Plans

We considered in Unit 7 the different structures which multinational organisations adopt. Starting from the simplest, where overseas subsidiary companies are controlled by direct contact between the manager in charge of the subsidiary and the chief executive of the parent company, towards the setting up of international divisions dealing with overseas trade, there is movement from centralised planning at 'home', towards a devolved responsibility so that planning can take place within the overseas culture.

Transnational company structures, as suggested by Bartlett and Ghoshal, move further towards planning being developed at a local basis, taking precedence over a centralised 'head office' structure. Where authority and power is decentralised, planning will also be decentralised.

Johnson and Scholes see the issues of structure and control at the corporate level and relationships between businesses and the corporate centre as being a major strategic problem for multinational firms. This is due to the firm being involved in a range of businesses of different types in the form of subsidiary companies in a holding company structure or divisions within a multidivisional structure.

The issue of centralised planning and decision-making versus decentralised has never been resolved. On the one hand it seems that those on the ground at the sharp end of the business, i.e. those based locally, are best placed to do so. On the other hand, an activity in one part of the world must be consistent with corporate policy and so the autonomy of companies established within nation states is subject to the overriding policies of corporate management. As the role of the corporate decision-maker has grown it has also become more distant, and key decisions about plans and strategies, although formulated at 'local' levels in overseas divisions, often have to be referred to a central office.

Structure

Many organisations adopt an organisation structure which reflects geography to some extent.

This may apply both,

- domestically - where branches are grouped by area and region, and
- internationally - where branches and divisions are grouped by country or by groups of countries.

Grouping by country within an international network makes sense for a number of reasons. The organisation may have to report to local regulatory and tax authorities, which requires a 'country head office' to consolidate the information required.

Organisations increasingly attempt to align their internal structure with the markets they serve, so that customers will find themselves dealing with staff who are aware of the particular requirements of that market. In the multinational organisation this is usually best served through a divisional structure.

An example of a highly successful company which has always been at the leading edge of innovative organisational structure is the Matsushita Electric Company, which is amongst the fifty largest corporations in the world, and markets its products under such well-established brand names as National, Panasonic, Quasar and Technics.

In the 1930s the founder of the company, Konosuke Matsushita, organised it in terms of divisions, in order to keep the company small and entrepreneurial, and to provide clarity and control. Each division was set up on its own, at a time when the company was involved in manufacturing radios and other small consumer appliances.

Matsushita himself was attracted to the divisional structure because he saw the behavioural advantages, with each division led by a manager motivated to keep a sharp eye on the marketplace, rather like the captain of a ship keeping a look out on weather conditions.

Matsushita was motivated in this decision by four factors:

(i) A desire to have independent divisional managers whose performance could be clearly measured.

(ii) Due to their self-sufficiency, managers would be driven to establish a strong consumer orientation.

(iii) This would gain the advantages of small companies, in particular their flexibility.

(iv) Specialisation of divisions would train managers much more quickly, thus providing a pool which would be needed as the company expanded.

He balanced this move towards decentralisation by centralising the key functions of:

- a comprehensive accounting system

- a company 'bank' into which profits from the divisions were paid, and from which they could apply for funding for capital improvements
- centralised personnel function
- centralised training.

Over the years the company has been flexible in terms of centralisation and decentralisation as the founder deemed necessary in the prevailing environmental conditions, but throughout the centralisation of the four key functions has remained.

D. SOCIAL RESPONSIBILITY

What do you understand social responsibility to mean?

Koontz and O'Donnell see it as a personal responsibility. They define it as "the personal obligation of everyone, as he acts in his own interests, to assure the rights and legitimate interests of all others are not impinged".

They see it as a social obligation owed by individuals and not by organisations.

Marks and Spencer, on the other hand, see it as an obligation of organisations in respect to their relationship with the community in which they operate. In their annual review for 2001 they are pleased to report that in MORI's annual study they remain in the ten most respected major companies in terms of social responsibility. They point out that, over a number of years, they have invested 1% of their pre-tax profits in the form of cash, employee time and gifts in kind for charitable causes. They also are willing to support the efforts of their own staff who are involved in charitable causes. In respect of this, they quote the case of their regional manager's secondment from the Croydon Branch to work alongside the National Neighbourhood Watch Association to produce a Guide to Citizenship for Young People.

In this way perhaps Marks and Spencer have found a way in which the social responsibility of their organisation can help the individual's contribution to social responsibility.

From the point of view of organisations, the term applied commonly is **corporate social responsibility** (CSR), and this is becoming increasingly important as stakeholders themselves become more aware of the issues involved.

Many British companies are interested in and put efforts into CSR but all too often these are informal and unpublicised. By advertising what they are doing, those companies involved can be very helpful in encouraging others to follow their lead.

The government regards CSR as a serious issue and has recently appointed a minister for it. The post, which has been given to Dr K Howells, has two main aspects to it:

- making the business case for CSR, and
- co-ordinating government activity across Whitehall to promote CSR.

Dr Howells is quoted* as saying, "Businesses can make a vital contribution to addressing social problems. Business investment in communities is a powerful force for tackling deprivation and promoting a fairer, inclusive society, both at home and abroad. It can also provide communities with new skills, staff resources and access to a wider range of contacts."

He also points out that there are advantages to be gained by businesses in supporting CSR, through working closely with communities, in terms of new marketing opportunities.

> "The most important single asset that companies have outside is their reputation. CSR is a way of embellishing and sustaining that reputation, which is just as important as needing to have the best product and the most competitive prices" said Dr Howells.

If we accept that this is true, then CSR is a means of adding value to a company and improving its competitive edge.

So, what does CSR actually do, in addition to making cash donation to charities?

Organisations can donate their skills, experience and time. For example, business people can volunteer their skills to work on specific projects in the field of the arts through schemes such as the Arthur Andersen Skills Bank. The thrust of these schemes is to give the arts an injection of professional advice, and the volunteers benefit themselves from working in a stimulating new environment.

The NatWest Bank similarly helps the arts, in their case by providing skilled trained members of the boards of art institutions and museums.

In an entirely different area of work, Business Action on Homelessness works with companies in order to put homelessness issues on the corporate agenda. Help can be provided at all levels in this work from assisting those living on the streets to resettlement programmes.

Overall, companies can, and do, provide help through the donation of cash and/or equipment through staff fund-raising events such as sponsored runs, to employee secondment.

The questions faced by organisations in respect of CSR are mainly these:

- How far is CSR legitimate in terms of the money spent on it?
- Will the organisation gain from investing in CSR?
- What is the response of the stakeholders to CSR?

- If you are an employee of Marks and Spencer, do you think the money the company spends on community projects could better be spent on your welfare provision, or improvements to your working conditions?
- If you are a shareholder of Lloyds TSB, do you think the £30 million or so per year they hand out to CSR should be at least partly returned through dividends? Do you think the community at large has more respect for a company such as Tesco Stores for involving itself in community projects?

These are the kind of questions that corporations need to address when making decisions about CSR. Whatever they decide it is here to stay, and many believe that public pressure will cause it to become a necessity. It is already seen not as a constraint but as an aim in itself.

*Note, quotations from Dr Howells first appeared in ‘Director’ for October 2000.

E. BUSINESS ETHICS

Recently the subject of corporate social responsibility has widened into what is generally referred to as business ethics.

First of all, let us define what we mean by ‘ethics’. A dictionary definition describes ethics as ‘a moral philosophy which teaches people their duty, and the reasons for it.

Therefore, we might say that ethics are principles concerned with interpersonal behaviour.

If they are principles, then:

- They should be universally applicable.
- They should provide the standards by means of which the conduct of people can be compared.
- They can be taught, and thus help to establish generally acceptable standards of conduct.

Many business and professional groups, for example in the legal and medical fields, have adopted codes of conduct for their membership which help to establish a standard of acceptable behaviour, and these in turn help to further ethical practices.

The way in which organisations perform their activities within society has an effect both on society in general and on individuals and their values. This raises questions about the role of managers in the area of strategic management in terms of ethical practices, and the way they treat people.

Johnson and Scholes suggest that the ethical issues which concern both businesses and public sector organisations operate at three different levels:

- **The macro level**, which concerns their role at the national and international level of the organisation of society.
- **The corporate level**, which focuses on the ethical issues concerning individual corporate entities, both in the private and the public sector, when selecting and implementing strategies.
- **The individual level**, which concerns the behaviour of individuals within organisations.

In considering the position taken up by organisations in terms of ethical conduct there are four categories which can be discerned.

In category 1, the role of the business is seen to be focused on its business performance in terms of making a profit. As Milton Friedman put it, “the business of business is business”, and “the only social responsibility of business is to increase its profit”.

This type of business regards social issues (for which we can read ethical issues) as none of their concern, and that these are best left to society to decide for itself by legislation what is acceptable and what is not.

In the second category comes those organisations which look beyond the business of making a profit for shareholders to consideration of the wider group of stakeholders.

Here a limited amount of sponsorship or involvement in ‘worthy causes’ is seen as being of economic value in improving the public image of the organisation.

The third category embraces the interests of stakeholders to a greater extent and sees its role as going beyond just the obvious business targets of employing people and providing profits, to ‘looking after their people’. Companies such as the chocolate manufacturer J S Fry, saw their role as providing decent working conditions and improving the environment as well as creating profit. Their principle of providing a ‘factory in a garden’ at Keynsham, near Bristol, was an example of their philosophy.

The final category, which includes many charitable organisations, contains organisations whose raison d’être is to provide the means of meeting society’s needs. For these organisations finance is less important than the provision of an acceptable level of service. Unfortunately, without some source of income, whether by sponsorship or taxation, they cannot exist and so they face the problem of trying to reconcile these two.

There are a number of examples where the ethical face of business can be, or has been seen some years ago, during the public outrage in the UK at the apartheid policy in South Africa, Barclays Bank was accused of supporting the regime and, as a consequence, a boycott of the bank was called for by the National Union of Students, which had a considerable negative impact on its business.

Recently, there has been a move amongst some companies to claim their business practices are ethical, and so their shares are referred to as ethical shares, which gives them an appeal to some investors.

There has also been an expansion in ‘fair trade’ products. For instance, Clipper Fairtrade teas are marketing with a mark which says ‘Clipper - the ethical tea company’, and claims that the Fairtrade Foundation is committed to maintaining strict controls covering the education, healthcare, housing, fair pay, safe working conditions and other welfare matters of those who produce the tea.

Perhaps the best known example of an ethical company is that of the Body Shop, set up by Anita Roddick and her husband Gordon and based on what she refers to as its DNA - its very strong social, ethical and environmental stance. She says she would like "to be judged by our actions in the larger world, by the positive difference we make". Unfortunately, it seemed that not all her customers shared her view that the "business of business should not be about making money, but about responsibility. It should be about public good", when in 1998 the company almost went under. At that time, with lots of other companies setting up copy-cat products, the Body Shop ethical sourcing policy did not seem to count for much. Maybe the business world, and society in general, is still seeking an acceptable way of combining ethics with business so that good policies can also make profits.

From the above we may summarise the following four alternative ethical positions which a company may adopt:

short-term shareholder interests

longer-term shareholder interests

multiple stakeholder obligations

'shaper of society'

- **Short-term shareholder interests.**

  This is the "business is business" stance as described by Milton Friedman, in which the primary objective is to satisfy the short-term interests of shareholders through the strategies and policies which the company pursues. This type of company concentrates on short-term profit which will increase shareholder value and returns.

  Other, wider, ethical issues with respect to other stakeholder groups, or to the community in general, are regarded as not their responsibility.

- **Longer-term shareholder interests.**

  This position is also largely concerned with shareholder interests but takes account of the premise that the longer-term interests of shareholders may well benefit from developing good relationships with other stakeholders.

  Thus it is felt that being concerned with the wider issues will, in the long term, result in higher profits and returns for the company's shareholders.

- **Multiple stakeholder obligations.**

  Here the interests of the wider group of stakeholder are taken into account. These include employees, customers, suppliers, distributors and the community at large.

  Unlike those companies which meet only the minimum statutory obligations, as with short and longer-term shareholder interests, these companies go beyond minimum requirements in order to achieve a balance between the interests and expectations of their shareholders and those of other groups of stakeholders.

  Problems can arise for companies in this category in terms of conflict between social responsibility and company survival, or between social responsibility and shareholder expectations.

  Many public sector organisations fit into this category.

- **Shaper of society.**

  This category contains those organisations whose raison d'être is primarily to effect changes in society in accordance with the needs of the community. Financial and shareholder interests are regarded as being of only secondary importance.

  The dilemma faced by such organisations is how commercial they are prepared to be in order to carry out their social role. The answer will depend to some extent on circumstances, and also on the structure of the organisation. For example, a company without shareholders, such as a private family company, or a public service organisation, would find it easier to adopt this stance.

The larger charities, such as Oxfam, are in a similar position, where they are accused by some of being too commercial and of spending too high a proportion of their income in internal administration.

In considering these alternative ethical positions it is important to remember that they will have a major impact on the organisation's operations, including its strategies.

F. ENVIRONMENTAL ISSUES

I think we could have titled this 'environment matters', because it does, to all of us.

Some of those areas causing concern today include:

- deforestation
- global warning
- the decline in fossil fuel supplies
- the 'fishing out' of the oceans, etc.

How do these affect strategic planning?

- **Deforestation -** with many people showing concern for the disappearance of forests, these companies which use wood and wood products in their business have had to look either to alternative materials or to sustainable sources in order to maintain their client/customer base.

  One of the ways this can be achieved is by recycling wood and paper products. The pen I am using to write these original draft notes has its carcass made from recycled paper, and was supplied by Friends of the Earth, for example.

- **Global warning -** something about which there is still some debate, but it is generally accepted that we need to reduce carbon dioxide emissions worldwide, and this has an impact on a number of businesses including the car industry and those factory sites which give off carbon dioxide. This has resulted in a number of strategic decisions having to be made such as the use of catalytic converters, and gas filtration systems.

- The **decline in world stocks of fossil fuels** has led to such changes as legislation in the UK on engine size for cars, with reductions in road fund licences for smaller sizes, and to investigations into other forms of sustainable energy sources.

  In Somerset, for example, plans are well in place to install a number of 'wind farms', to use wind power for the production of electricity.

- The **disappearance of fish stocks** has resulted in fishing quotas being cut for European fishermen, resulting in a large decrease in the English fishing fleets operating out of Devon and Cornwall. At the same time it has encouraged the setting up of fish farms, particularly for salmon in Scotland.

Another factor becoming increasingly important is known as '**Green Chemistry**'. Introduced in the early 1990s this is defined as the design of chemical products and processes that reduce or eliminate the use and generation of hazardous substances.

The hazards in this definition include:

toxicity

physical hazards, such as explosion or fire

global climate change, and

resource depletion.

The criteria used in the selection of materials used as inputs into processes are of the following kind:

- Methods used to obtain starting materials, by mining etc. should have a minimum impact on the natural environment.
- Material inputs should be of low, or no, toxicity.
- Starting materials should be renewable.
- Where possible, starting materials should be waste products from other processes.

Often the best and least expensive options for reducing environmental deterioration are the re-use of products, or, where this cannot be done, by recycling products.

Much is already being achieved through household recycling programmes where the waste products collected can be re-used either to make the same product again, such as glass bottles, or in the manufacture of a different product such as the use of aluminium cans, as a source of aluminium for the manufacture of any appropriate product.