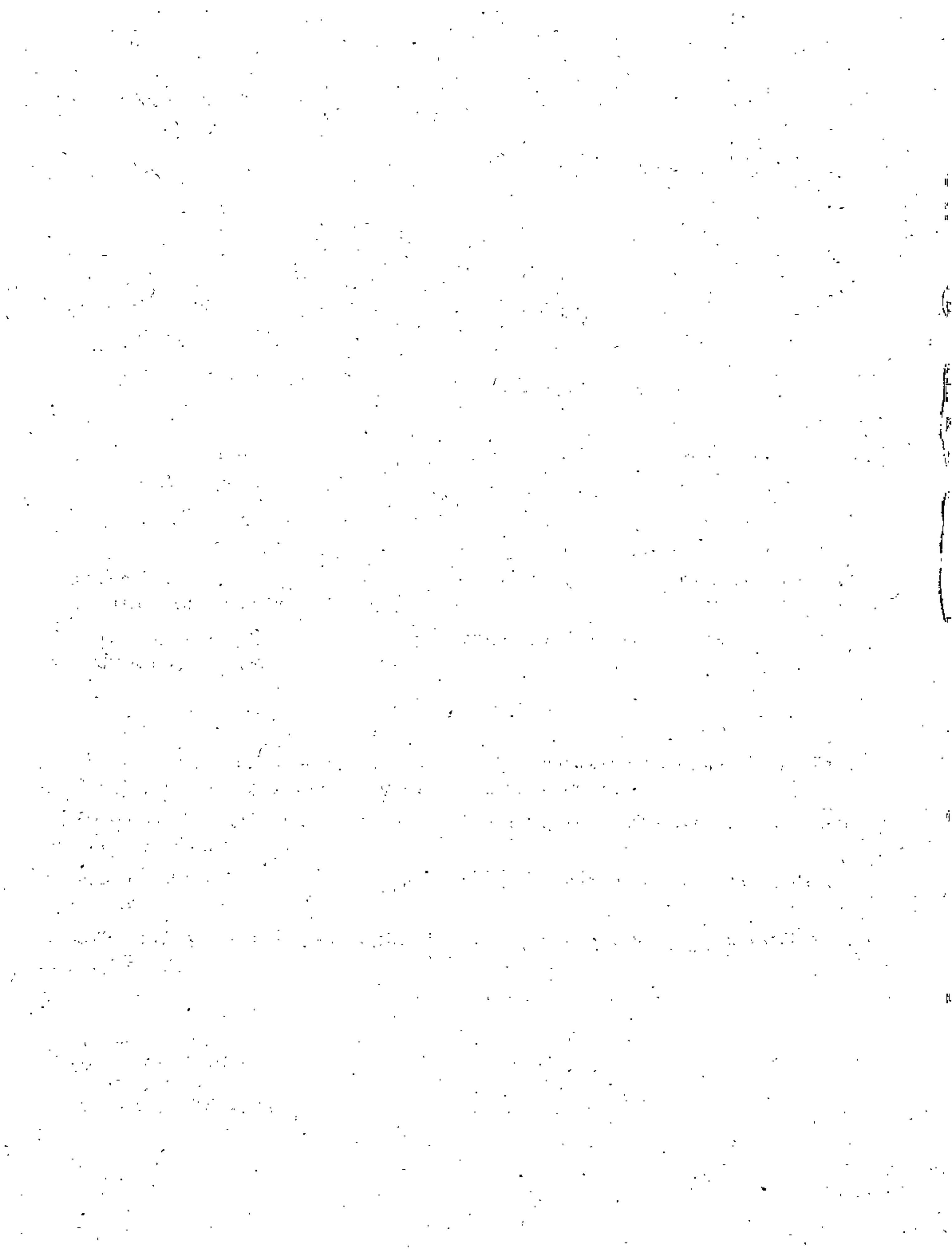
CONTENTS

Units	Page No.
1. Introducing the Strategic Management	1-49
2. Environmental Scanning and Corporate Analysis	50-93
3. An Introduction to Strategy Creation	94-147
4. Strategy Implementation	148-189



SYLLABUS

STRATEGIC MANAGEMENT

M-235

UNIT I

Introduction, Strategic Management, Business Policy, Corporate Strategy, Basic Concept of Strategic Management, Mission, Vision, Objectives, Impact of globalization, Basic Model of Strategic Management, Strategic Decision Making, Impact of Internet and E-Commerce, Role of Strategic Management in Marketing, Finance, HR and Global Competitiveness.

UNIT II

Environment Scanning, Industry Analysis, Competitive Intelligence ETOP Study, OCP, SAP Scanning, Corporate Analysis, Resource based approach, Value-Chain Approach, Scanning Functional Resources, Strategic Budget and Audit.

UNIT III

SWOT Analysis, TOWS Matrix, Various Corporate *Strategies: Growth/ Expansion,* Diversification, Stability, Retrenchment and Combination Strategy. Process of *Strategic Planning, Stages of corporate* development, Corporate Restructuring, Mergers and Acquisition, Strategic Alliances, Portfolio Analysis, Corporate Parenting, Functional Strategy, BCG Model, GE 9 Cell, Porters Model: 5 Force and Porters Diamond Model, Strategic Choice.

UNIT IV

Strategy Implementation through structure, through Human Resource Management: through *values and ethics. Mc Kinsey's 7S Model, Organisation Life Cycle,* Management and Control, Activity based Costing, Strategic Information Systems, Case Study related to the Entire Syllabus.

UNIT 1 INTRODUCING THE STRATEGIC MANAGEMENT

NOTES

★ STRUCTURE ★

1.0 Learning Objectives
1.1 Introduction
1.2 Basic Concept of Strategic Management
1.3 Business Policy
1.4 Mission, Vision and Objectives of Strategic Management
1.5 Impact of Globalization
1.6 Basic Model of Strategic Management
1.7 Strategic Decision Making
1.8 Finance and Global Competitiveness
1.9 Role of Strategic Management in Marketing
1.10 Strategic Human Resource Management
- *Summary*
- *Review Questions*
- *Further Readings*

1.0 LEARNING OBJECTIVES

After going through this unit you will be able to:

- define strategic management
- explain about business policy
- explain basic concepts of strategic management.
- describe impact of globalization.
- explain about strategic decision making.
- define finance and global competitiveness.

NOTES

1.1 INTRODUCTION

Strategies are means to ends. All organizations, large and small, profit-seeking and not-for profit, private and public sector, have a purpose, which may or may not be articulated in the form of a mission and/or vision statement. Strategies relate to the pursuit of this purpose.

Strategies must be created and implemented, and it is these issues which are addressed by our study of strategic management. This opening chapter begins by outlining how successful organizations manage their strategies, and what they achieve, before exploring the meaning of strategy in greater detail. It then continues with an explanation of the strategic management process in the context of the framework upon which this book is structured before explaining the different ways in which strategies are created. Next it describes how the subject of strategic management has developed in the last 30 years, before concluding with a brief consideration of the similarities and differences in strategic management in various types of organization.

There are a number of aspects to strategic management. First, the *strategy* itself. This is concerned with the establishment of a clear direction for the organization and for every business, product and service, and a means for getting there which requires the creation of strong competitive positions. The second requirement is excellence in the *implementation* of strategies in order to yield effective performance. Third, *creativity and innovation* are needed to ensure that the organization is responsive to pressures for change and that strategies are improved and renewed.

Fourth is the ability to manage *strategic change*, both continuous, gradual, incremental changes and more dramatic, discontinuous changes. Innovation and change concern the strategy process in an organization.

Sound implementation and innovation should enable an organization to thrive and prosper in a dynamic, global environment, but in turn they depend on competencies in strategic awareness and learning. Organizations must understand the strategic value of the resources that they employ and deploy, and how they can be used to satisfy the needs and expectations of customers and other stakeholders while outperforming competitors.

Strategy is about actions, not plans – specifically the commitment of resources to achieving strategic ends ... concrete steps that immediately affect people's lives, not abstract intentions. Andrew S Grove, CEO, Intel

The Low-price, No-frills Airlines, which showed that:

- newcomers can change an industry – by being creative, innovative and different
- new competitors can, and will, find ways of breaking down apparent barriers to entry

- companies need to find some clear and distinct competitive advantage, something which is both attractive to customers and profitable
- this advantage will come from what organizations do: their distinctive competencies and capabilities
- charismatic and visible strategic leaders often have a major impact on the choice and implementation of key strategies
- people are critically important if strategies are to be implemented effectively
- the Internet is becoming increasingly important; and
- business can be fun!

NOTES

It is, however, also important to realize that *in many* organizations certain parts may be 'world class' and highly profitable while other businesses are not. Good practices in the strong businesses can be discerned, transferred and learned, but this may not be enough. Some industries and competitive environments are simply less friendly and premium profits are unlikely. The real danger occurs if the weaker businesses threaten to bring down the strong ones that are forced to subsidize them. It is an irony that companies in real difficulty, possibly through strategic weaknesses, need to turn in an excellent performance if they are to survive. Finally, it must be realized that past and current success is no guarantee of success in the future. Companies are not guaranteed, or entitled to, continued prosperity. They must adapt and change in a dynamic environment. Many fail to do this, for all sorts of reasons, and disappear. Some close down; others are acquired. McDonald's, *at the end of this chapter. In summary, it is* no longer adequate for organizations to have strong, professional management – they also need good change management. What works effectively today may not be appropriate tomorrow. Organizations need new visions for the future and the capability to deliver them. They require open communications and a team approach, a willingness to listen and respond to customers, the delegation of real **power**, the ability to share learning across the organization and the ability to use culture to convey aims and values. Change is seen as an opportunity, not a threat. This sometimes implies, an entrepreneurial **strategic leader**. It invariably requires flexibility and innovation, which implies intrapreneurial managers who accept responsibility for driving the change initiatives. Typically such managers will exhibit the following skills and attributes:

- A tolerance of calculated risks
- A combination of leadership, general management and financial skills

NOTES

- Planning, time and project management skills
- Receptiveness to innovation
- A commitment to continuous learning
- A willingness to delegate
- Motivated by factors other than financial gain
- Self-confident, resilient and persevering
- Good communication skills.

1.2 BASIC CONCEPT OF STRATEGIC MANAGEMENT

More than anyone else, Henry Mintzberg has been responsible for drawing attention to alternative views and perspectives on strategy, all of them legitimate. Mintzberg *et al.* (1998) provide an excellent summary of his work on this topic. The top oval in Figure 1.1 suggests that strategies can be seen in a **visionary** context. Here it is implied that strategy can be considered as a clear strategic purpose, intent and direction for the organization, but without the detail worked out. In a dynamic **environment,** managers would then determine more detailed and specific strategies in 'real time' rather than exclusively in advance. However, they would always have a framework of direction to guide their decision-making and help them to determine what is appropriate.

In addition, some strategies come from a visionary input from an entrepreneurial manager, or strategic leader, who spots an opportunity and is minded to act on it. This contrasts with some people's thinking that strategy and *planning* are synonymous. Certainly, as we shall see later in this chapter, **strategic planning** has a crucial role in **strategy creation,** but it does not fully explain how strategies are changed. Both the visionary and planning perspective are concerned with thinking ahead as far as it might be sensible to think and **plan**. While the *tactical* view is also about the future, it is really about the immediate future. The assumption being made here is that competitors in a dynamic market will constantly adopt new ploys in an attempt to steal a short-term gain or advantage. Their **tactics** may be easily copied, but there can be some temporary advantage when rivals are caught by surprise and need time to react.

Metaphorically, we can relate these ideas to a game of competitive football. There will be a broad purpose concerned with finishing at a certain level in a league or winning a cup competition, and this will influence the fundamental approach to every game. Sometimes a win would be seen as essential; on other occasions a 'clean sheet' would be more desirable or a draw could be perfectly satisfactory. From this, more detailed game plans will be devised for every match. But, inevitably, 'the best laid

NOTES

schemes o' mice and men gang aft a gley'. Early goals by the opposition can imply a setback and demand that plans are quickly revised and tactics changed. This is always possible at half-time, but during the match the team will have to rely on shouted instructions from the touchline and leadership from the team captain as play continues. Individual players will always be allowed some freedom of movement and the opportunity to show off their particular skills. New tactics will emerge as players regroup and adapt to the circumstances, but quite often games will be turned around by the individual vision, inspiration and brilliance of key players.

These three views all concern the future and imply change; the notion of *position* is akin to the idea of freezing time momentarily. It relates to strategic fit and the organization's competitive position at the present time. It is, in effect, a statement of what is happening; and it can be vital for 'taking stock', realizing and clarifying a situation so that future changes are based on clear knowledge rather than assumption.

Of course, organizations come to their present position as a result of decisions taken previously; plans have been implemented and tactics adjusted as events have unfolded. It is again crucial to analyse and understand this evolving *pattern*, appreciating just what has happened, why and how. This can be a valuable foundation for future decisions, plans and actions but, although history can be a guide to the future, rarely in strategy are events repeated without some amendment. The importance of clarifying the pattern from the various decisions and changes also explains why strategy has irreverently been described as a 'series of, mindless, random events, rationalized in retrospect'!

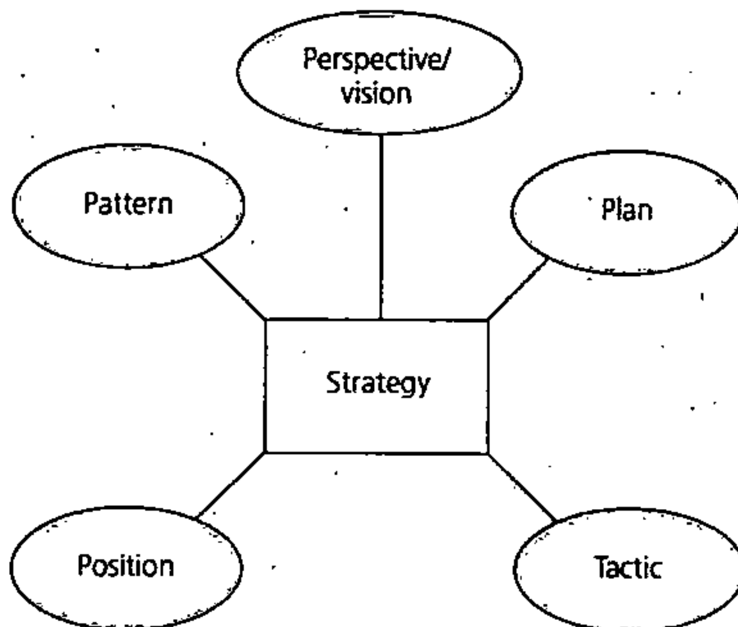


Figure 1.1 Five views of strategy

Our understanding of these alternative perspectives will be strengthened when we look at how strategies are created and changed.

NOTES

1.3 BUSINESS POLICY

When we argue that an organization needs a sound, or a winning, business model we mean that there is a need for a very clear picture concerning what the organization is – and what it isn't – and who will buy its products and services and why. The business model thus embraces three key themes: the product (or service); the market; the 'compelling reason to buy'.

It is important to remember here that strategy always involves choices. Organizations have to make decisions about what they intend to do – at the same time ruling out things it is less appropriate or desirable for them to do. Maybe it is because competition is too intense; or perhaps they do not possess the required competencies and capabilities. This picture then needs to be communicated and understood throughout the organization. Moreover, the model – and the strategies which underpin it – need to be reviewed constantly.

The picture should embrace the business as it is now, and how it will be in the future – where and how it will change and grow. One interesting example of choice and timing is the high technology start-up which offered its Internet systems to BT, whose engineers were truly enthusiastic about the prospects. However, in BT it was the marketing and sales people who bought new systems and they felt the product was too far ahead of its time, and, as a consequence, they would be unable to sell it to BT customers. As a result it took 18 months for the market to catch up with the technology.

For the low-cost, no-frills airline. This model may have been pioneered by Southwest Air but it has been copied extensively by others, including easyJet and Ryanair. It is important to realize that the business models for these two competitors, whilst similar, are different. Ryanair looks to be low cost in every activity whilst easyJet chooses to incur some higher costs to offer a slightly different service. In particular easyJet opts for main airports in the cities it flies to, whilst Ryanair invariably chooses the cheapest available in the vicinity.

Passengers are likely to have to travel further to catch their flights. In addition, easyJet broke ranks with the basic model when it decided to use more than one plane, adding Airbuses to its Boeing fleet.

The fundamental underpinning to the model is a low-cost culture with a constant search for savings to allow ever-lower prices, but without reducing passenger safety. This demands that only those aspects of the

service that are seen as essential or important are included; others that are offered by the traditional full-service airlines are dropped. The market is anyone – business, holiday or general passengers – who wants low prices and will trade off certain aspects of service to get them. The model then has to be *delivered and implemented;* and this is where we come down to the operational details that support the model. The choice of a single type of aircraft and the selection of fringe airports are typical actions that make up the strategy to deliver the model.

By contrast, Manchester United is far more than a successful football club. It is a collection of diversified but related activities that can be *associated with* a distinctive brand – a brand which signifies success, such that association with it automatically implies being part of something that is successful. It reflects high **quality** – and consequently customers expect to have to pay premium prices to buy this association. The 'core market' might be the 60,000 plus fans who turn up at Old Trafford for Premier League matches, but there are many more people all round the world who are interested in having some part of this success story. In Porter terminology, Manchester United is very clearly differentiated – and very profitable. Drawing upon this introduction to the business model we can restate strategy as a set of four visions or articulated pictures – for:

- The businesses and industries the organization should be in – its corporate strategy
- How it will compete in each one in its search for advantage – which takes in its targeted customers
- How every activity which supports these strategies can be linked effectively to create synergy and avoid fragmentation
- How and when to change strategies.

It will be appreciated that all of these support the essential purpose of the organization.

Functional, competitive and corporate strategies

Figure 1.2 reflects that there are three distinct perspectives of strategic analysis:

1. The strategic environment
2. The competing organization
3. The individual strategist.

The diagram summarizes three distinct, but interrelated *and interdependent,*

levels of strategy: corporate (the whole organization), competitive (the distinct strategy for each constituent business, product or service in the organization) and functional (the activities which underpin the competitive strategies).

NOTES

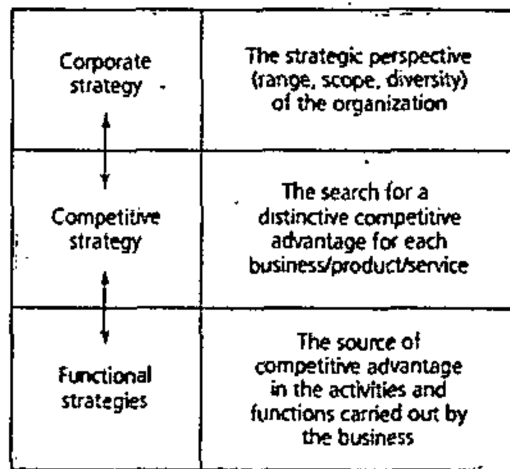


Figure 1.2 Levels of strategy

Simply, most organizations choose to produce one or more related or unrelated products or services for one or more markets or market segments. Consequently, the organization should be structured to encompass this range of product markets or service markets. As the number and diversity of products increases the structure is likely to be centred on divisions which are sometimes referred to as **strategic business units** (SBUs). Such SBUs are responsible individually for developing, manufacturing and marketing their own product or group of products. Each SBU will therefore have a strategy, which Porter (1980) calls a **competitive strategy**. Competitive strategy is concerned with 'creating and maintaining a competitive advantage in each and every area of business (Porter, 1980). It can be achieved through any one function, although it is likely to be achieved through a unique and distinctive combination of functional activities. For each functional area of the business, such as production, marketing and human resources, the company will have a functional strategy. It is important that **functional strategies** are designed and managed in a co-ordinated way so that they interrelate with each other and at the same time collectively allow the competitive strategy to be implemented properly.

Successful competitive and functional strategies add value in ways which are perceived to be important by the company's stakeholders, especially its customers, and which help to distinguish the company from its competitors. Adding value is explained and discussed further in the supplement to Part One. Mathur and Kenyon (1998) reinforce these points. They contend that **competitive advantage** is fundamentally about the positioning and fit of an organization in its industry or market, and that success is based on distinct differences and sound cost management.

Corporate strategy, essentially and simply, is deciding what businesses

the organization should be in and how the overall group of activities should be structured and managed. It has been described by Porter as 'the overall plan for a diversified business', although it is perfectly acceptable for a business to elect to stay focused on only one product or service range. This does happen in many companies, especially small businesses.

In this case the corporate and competitive strategies are synonymous. Corporate strategy for a multibusiness group is concerned with maintaining or improving overall growth and **profit** performance through **acquisition**, organic investment (internally funded growth), **divestment** and closure. The term strategic perspective is often used to describe the range and diversity of business activities, in other words the corporate strategy.

Each business activity then has a competitive position or strategy. The management of corporate strategy concerns the creation and safeguarding of *synergies* from the portfolio of businesses and activities.

Synergy and change

Synergy is a critical aspect of both corporate and competitive strategies. It is important that the functions and businesses within an organization work collectively and support each other to improve effectiveness and outcomes. At all times, companies should carry out efficiently those activities which are essential for creating a distinctive or differentiated competitive position, and avoid incurring unnecessary costs by providing non-essential values. This implies that they clearly understand their markets, their customers and the **key success factors** that they must meet, *i.e.*, their defined competitive strategy. Moreover, they should constantly seek improvement by driving their operating efficiencies. These **activities** will be encapsulated in the organization's functional strategies, as illustrated in Figure 1.3.

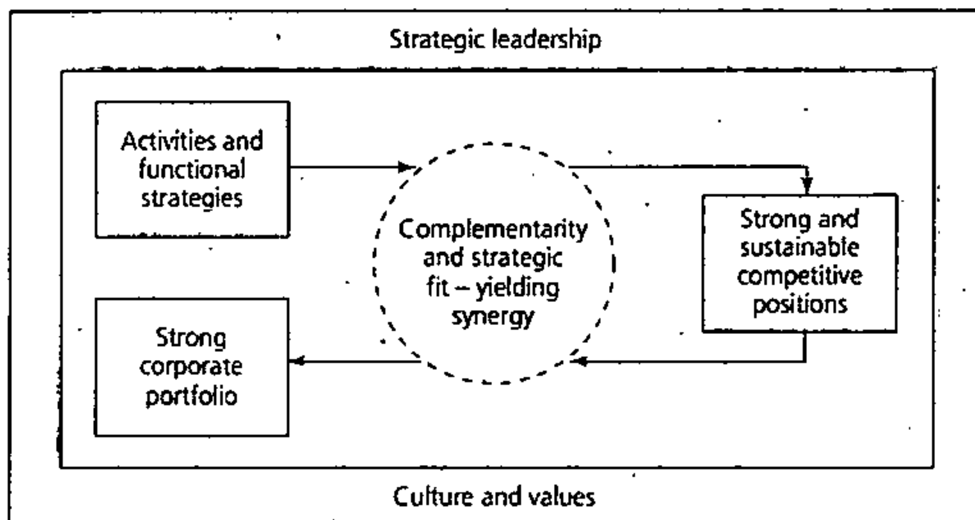


Figure 1.3 Strategic success through complementary activities

NOTES

Figure 1.3 highlights that these functional strategies must fit a defined, clear competitive strategic position and complement each other to achieve internal synergy. Where they fail to complement each other the company's competitive position will inevitably be weakened. The outcome will be a strong competitive position which can only be sustained by innovation and improvement, and sometimes by the move to a new competitive **paradigm**. Managing these changes effectively is very dependent upon the style and approach of the strategic leader and the culture and values of the organization. Michael Porter (1996) has argued along similar lines.

It is important to remember, though, that people are often naturally competitive and their competitive energy should be directed against external rivals rather than members of their own organization. Carefully managed, internal competition for scarce resources can, of course, sharpen managerial skills.

1.4 MISSION, VISION AND OBJECTIVES OF STRATEGIC MANAGEMENT

All newly appointed chief executives should ask five key questions:

- *What are the basic goals of the company?*
- *What is the strategy for achieving these goals?*
- *What are the fundamental issues facing the company?*
- *What is its culture?*
- *And is the company organized in a way to support the goals, issues and culture?*

Bob Bauman, ex-chief executive of SmithKline Beecham

When Sir Ian MacGregor took over the ailing British Steel Corporation he met each senior executive face-to-face and asked him to justify the existence of his part of the organization. Each one was given a maximum of ten minutes.

Traditionally, courses in strategic management have been built around three important elements:

- strategic *analysis*
- strategy *creation and choice*
- strategy *implementation.*

These three elements are shown in Figure 1.4, together with the key aspects of strategy that relate to them. In this book, however, we typically use the term 'strategic awareness' to embrace the analysis of the current situation and an assessment of the routes forward that are available,

and 'strategic change' to reflect the selection of the route to follow and its implementation.

NOTES

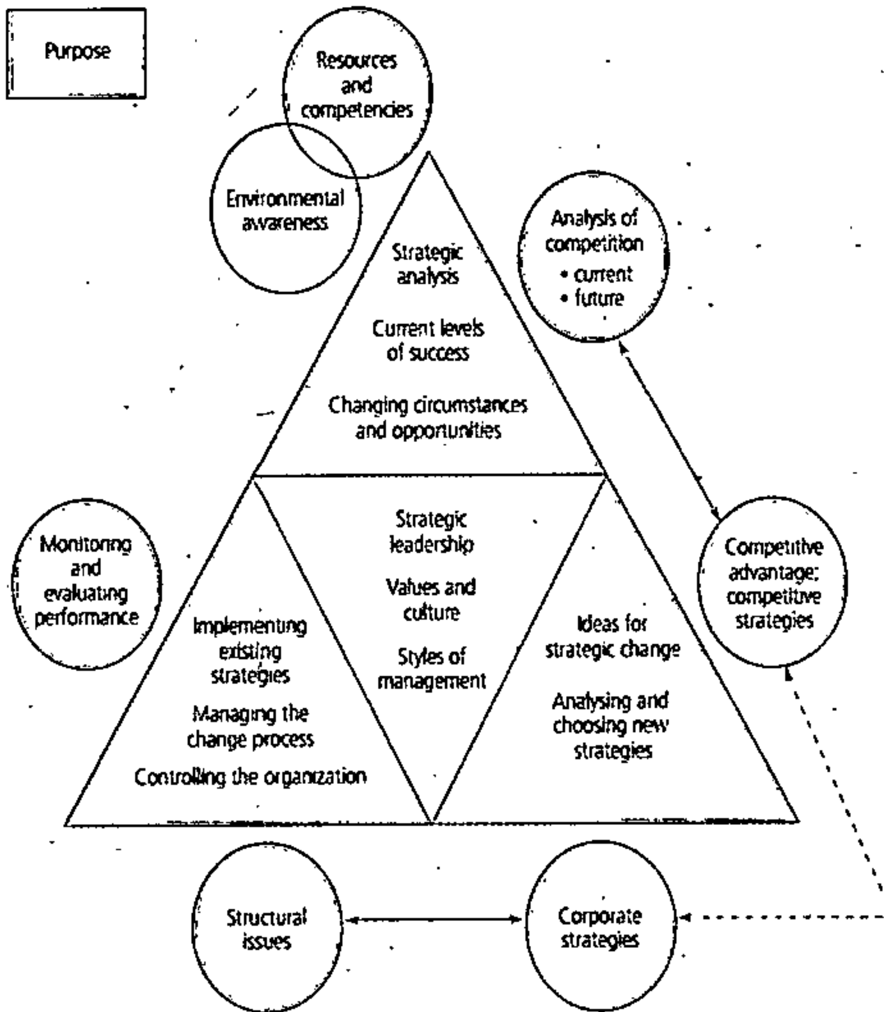


Figure 1.4 Strategic management

All within the overall purpose of the organization. Strategic management, then, involves awareness of how successful and strong the organization and its strategies are, and of how circumstances are changing. At any time, previously sound products, services and strategies are likely to be in decline, or threatened by competition. As this happens, new 'windows of opportunity' are opening for the vigilant and proactive companies.

New strategies, which may be changes to the corporate portfolio or changes at the competitive level, must be created. Sometimes these strategic ideas will emerge from formal planning processes; at other times, and particularly in the case of functional and competitive strategies, changes will emerge as managers throughout the organization try out new ideas. The actual strategies being pursued at any time reflect the organization's strategy content, and the important issues are:

NOTES

- the ability of the organization to add value in meaningful ways, which exploit organizational resources to achieve synergy, and at the same time
- satisfy the needs of the organization's major stakeholders, particularly its shareholders and customers.

The selection of new strategies must take account of these criteria. Existing and new strategies must be implemented. A strategy is only useful when it has been implemented, and hence the organization must have an appropriate structure, clear and contributory functional strategies and systems which ensure that the organization behaves in a cohesive rather than a fragmented way. The larger or more diverse the organization becomes, the more likely it is that this becomes a problem. In multiproduct, **multinational** organizations with considerable interdependence between the products or services and between subsidiaries, for example, divisions may become competitive with each other and not pull together. The processes involved in designing and carrying through any changes must be managed, monitored and controlled.

These process themes can be captured in relevant frameworks for studying strategy, such as the one featured in Figure 1.5 (a), which all tend to follow a pattern:

- appraisal of the current situation and current strategies, invariably using a SWOT (strengths, weaknesses, opportunities and threats) analysis, which itself is likely to be informed by a number of other external and internal analysis frameworks
- determination of desirable changes to objectives and/or strategies – at all levels, corporate, competitive, functional
- a search for, and choice of, suitable courses of action
- implementation of the changes
- monitoring progress; ongoing appraisal.

Historically this process model has been seen as a deterministic framework for strategy creation and strategic management. However, whilst this framework certainly helps us to understand strategy, this is not the same as implying that effective strategies can always be created by systematically following the steps in a model such as this. Such

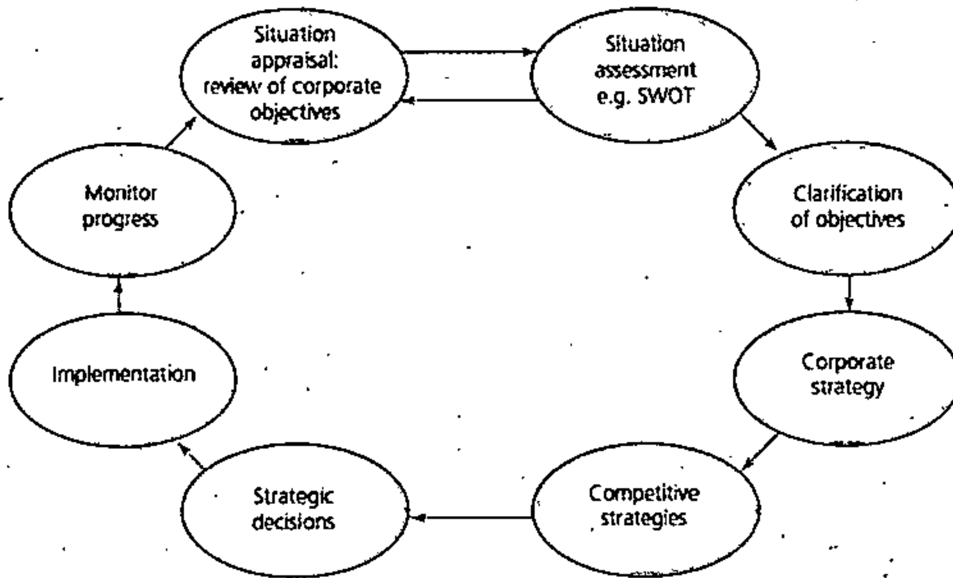


Figure 1.5(a) Strategic management: awareness and change

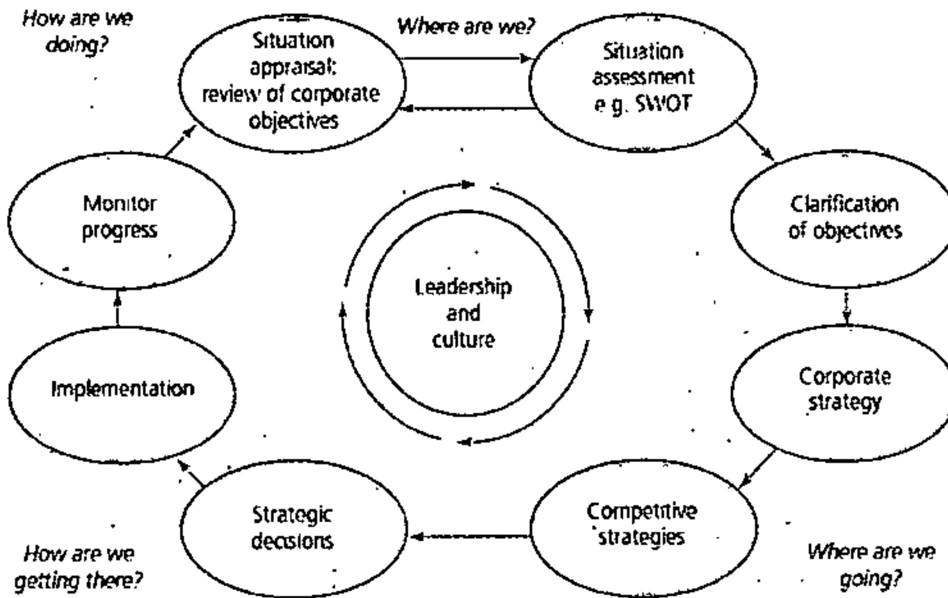


Figure 1.5(b) Strategic management: awareness and change

NOTES

an approach would imply that strategy is top-down and leader-driven, that creating routes forward is relatively straightforward and that the majority of problems are likely to be found at the implementation stage. This is not altogether realistic; and, in fact, many strategic leaders have confirmed it does not reflect the reality of strategic decisionmaking in practice. Figure 1.5 (a) therefore shows the process as an unbroken circle rather than a sequential analysis. Figure 1.5 (b) goes a stage further and annotates this basic process model by, first, adding a number of key questions which, realistically, organizations, and managers at

NOTES

various levels in the hierarchy, not just the most senior layer, should be addressing *all the time*. These are not issues which only need to be considered once a year as part of a planning cycle; in dynamic environments circumstances are changing all the time and organizations must continuously search for new opportunities as well as appreciating the reactive changes to strategies and tactics that are required in order to remain effective. Leadership and culture have also been placed in the centre of the diagram, illustrating their critical impact on strategic decision making and strategic performance.

Arguably, strategy and strategic change in organizations cannot be understood without some understanding of the contribution of the strategic leader and the way in which the culture acts either as stimulus or constraint on the necessary changes. The way that an organization is structured into divisions and/or functions, and the amount of authority delegated to individual managers must inevitably influence day-today decision-making. These 'coal-face' decisions determine the actual strategies pursued and the levels of success. The objectives that an organization is pursuing in reality therefore stem from **strategy implementation**. In order to properly appreciate just how well an organization is doing relative to both its objectives and its competitors, to explore opportunities and threats, to appraise strengths and weaknesses, to evaluate alternative courses of action and so on, it is vital to have an effective information system. How an organization gathers and uses information is therefore another important aspect of strategic management.

1.5 IMPACT OF GLOBALIZATION

Here the emphasis is very much on corporate strategy: diversity, geographical scope and co-ordinating the countries where products are made with the countries where they are sold. Using low-cost labour factories in Eastern Europe and the Far East can prove controversial while still being an economic necessity. In addition, these are often very powerful companies whose annual turnover exceeds the gross national product (GNP) of many of the world's smaller countries. Nevertheless, issues of competitiveness and competitive advantage are as relevant as they are for a small business. One key complication can be currency fluctuations when component supplies and finished goods are moved around the world.

The major dilemma for many global companies concerns their need to achieve global-scale economies from concentrating production in large plants whilst not sacrificing their local identity and relevance in the various markets. To accomplish this they must stay close to their customers and markets, whose specific tastes and preferences may differ markedly, even though they are buying essentially the same product.

The *organizational structure* can be, *and often is, just* as important as the strategy. This, in turn, raises a number of important people issues. People may be switched from business to business and from country to country as part of their personal progression. This movement also helps the whole organization to transfer skills and knowledge and to learn good practices from different parts of the business.

Global corporations also need to develop expertise in financial management. Attractive development grants and packages will be available in certain countries and influence strategic developments. Interest rates are not the same around the world, and consequently loans can be more attractive in certain countries and not in others.

Moreover, tax rates vary and it can be very beneficial to be seen to be earning profits in low-tax countries instead of high-tax ones.

Not-for-profit organizations

Organizations such as churches and charities clearly fit into this sector very well, but certain other profit-generating businesses, such as museums, zoos and local theatres, are relatively closely aligned. In the case of the latter examples, the profit objective is often designed to create a 'war chest' for future investment rather than to reward an owner or a group of investors. For this reason there are many common characteristics. Money may be perceived differently in not-for-profit organizations than in profit-seeking businesses, but there is still a need to create a positive cash flow. A charity, for example, can only spend on good causes if it can generate funds. For this reason, churches and charities can legitimately appear very commercial in their outlook, and this must be accepted alongside the cause that they are targeting.

These not-for-profit organizations need social entrepreneurs or strategic leaders who, in many ways, will be similar to those found in the profit-seeking sector. They will possess similar **entrepreneurial** and leadership qualities, but they will be driven by a cause, which attracts them to the particular organization and sector. This, in turn, guides the mission, purpose and *culture. In addition, there is likely to be a greater reliance* on voluntary helpers and possibly managers and others who readily accept salaries and wages below those that they might earn in the profit sector.

There are likely to be variations on the modes of strategy creation discussed herein. There is likely to be some committee structure, involving both salaried employees and unpaid volunteers, the latter often in senior roles. Decision-making can be slow and political in nature, although clearly it does not have to be this way. However, strong and dominant leaders (either paid or unpaid) quite often emerge and are at the

heart of strategy-making. Because there is a need for accountability for the funds raised, planning systems are likely to be prominent.

Public sector organizations

NOTES

In many countries around the world the composition of this sector has changed over recent years. Typically essential service industries, such as telecommunications, gas, electricity, water, and air, bus and rail transport, have been privatized, often resulting in the creation of a number of complementary or even competing businesses. The outcome in each industry has been one or more private companies, some of which have since merged or been acquired, sometimes by overseas parents. In the case of the UK this privatization programme has also included individual companies such as British Airports Authority (BAA), which manages several airports but is largely a retail organization.

Outside direct government control, BAA has expanded overseas and now manages a number of other airports around the world. In every case there is some form of regulation and government influence, as distinct from the direct government control of the past. The trend towards privatization has gathered momentum for many reasons, one factor in Europe being the stronger stance on government subsidies to individual industries by the European Commission. The key appears to lie in the effectiveness of the regulation, which must attempt to balance the needs of all key stakeholders: customers, employees and investors. As a result, we now tend to think of local authorities and public health and emergency services as the archetypal public sector organizations. Clearly these are service businesses, and ones which will always have to choose and prioritize between different needs and stakeholders. In general, they will always be able to achieve more outcomes if they can acquire more resources. However, they remain largely dependent on central government for their resources and are therefore influenced by the political agenda of the day.

Increasingly, some have greater involvement with the private sector than was the case in the past. The British National Health Service works alongside the private health-care sector and, although their roles and remits differ, the same consultants operate in both sectors. Many services in local communities were subjected to compulsory competitive tendering (CCT) during the early and mid-1990s and, as a result, were outsourced to providers in the private, profit-seeking sector. CCT has now been replaced by the need to find and deliver 'best value'.

Decision-making and style features some element of bureaucracy, in part because of the role of governing bodies, be they elected (local councillors) or appointed (*e.g.*, NHS Trust Boards). As accountability has become increasingly public in recent years, analysis and planning will also be very prominent. Again, however, strong leaders can, and will, make an impact; and, as the

public sector environment is no more stable than the one affecting commercial businesses, emergent strategy is also very important.

1.6 BASIC MODEL OF STRATEGIC MANAGEMENT

NOTES

The business model provides an explanation of an organization's 'recipe for success', and it contains those factors that essentially define the business. It is, in many respects, the vehicle for delivering the purpose or mission. It encapsulates both 'big picture' and 'little picture' elements and it can be applied to both the present and the future. Over time the model, and the strategies it encapsulates, are likely to change, even if the basic purpose remains constant. Put simply, the business model should clearly show how the business is going to make money. Many dot.com business essentially failed because they did not address the issue of how they were going to make money. They offered technology to deliver a product that customers simply were not prepared to pay for – they failed to blend business and technology innovation.

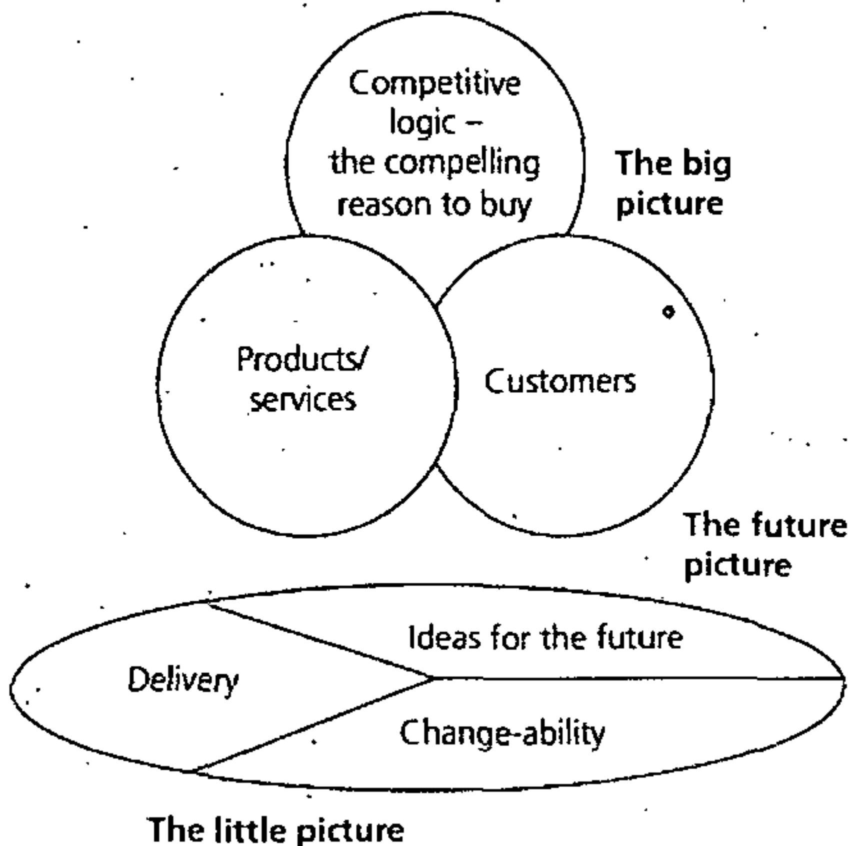


Figure 1.6 The business model

Every organization is practicing *a model, even though it may not have* thought it through in any depth. Where this is the case, any success

NOTES

could well be short-lived as it implies there is a reliance on good fortune rather than analytical insight. One might argue that if the model can't be articulated or written down, then the organization's managers don't know what the model is.

The business model is outlined in Figure 1.6 and the elements of this diagram are discussed below. The three fundamental elements of the model itself are shown at the top, metaphorically mounted on an important base.

The basic themes of the business model are products (or services), customers and competitive logic – the compelling reason for people to buy the products and services. It is, of course, important to recognize that good ideas and a plausible outline model are relatively easy to imagine and define ... the secret lies in delivering the model and implementing the strategies. In military terms, tactics can be trickier than the grand strategy – even though we clearly need both.

Products and services constitute *what* the organization produces or markets. The range can be broad or narrow, focused or diversified. The choice, like the selection of target customers and competitive strategies, implies a decision concerning what to do and what not to do. There needs to be a clear strategic logic for what is in the range. Every one should be able to make a contribution to the business; none of them should be in a position where they bring harm to any of the others because, perhaps, they are underperforming and demanding cash subsidies.

Customers make up markets – they are the *who* in the model. Again the coverage can be narrow or broad. The scope of the business can be localized, national or international. And these can vary between the various products. The link between products and customers represents the organization's strategic or competitive position. If it is a strong, or a winning, position, then there is a good reason for this. When we add the third element, *competitive logic*, we have our *why,* our compelling reason to buy. These three together constitute the organizational 'big picture'. The competitive logic can be based on price; equally it can be based on difference. There are four basic approaches to the positioning element of the model:

- A narrow product (or service) range for a broad range of customers – the basics of the business model for Starbucks and the low-cost airlines
- A broad product range for a defined segment of the market – Harrods provides a vast choice of items for those people who are willing to pay premium prices and who enjoy being seen out with a Harrods bag
- A narrow range for a targeted niche – hand-made Morgan cars

appeal to a limited number of people who want a sports car with an essentially pre-war style and who are willing to join a waiting list of some four years duration

NOTES

- A broad range for a wide market – Amazon.com has added a diverse range of products to its original books and it sells to anyone who is interested in buying online.

The *delivery* section of the base is an essential adjunct, even though it may not strictly be part of the outline model. Without a clear strategy for implementing and delivering the model the organization will be compromising on **efficiency** and effectiveness. This then is the *how* element and it includes the structure of the organization and the operations and activities carried out by people within the structure. Cost management and synergy are key themes. Unnecessary costs should be avoided; equally it can be a mistake to 'penny-pinch' on things that really matter to customers. At the same time it can be helpful if the activities complement and support each other. This is the 'little picture' behind the 'big picture'.

What works successfully today cannot be guaranteed to work for ever. Business models and strategies have life cycles and therefore organizations must address *when* they might need to make changes. They need an appreciation of a 'future picture', concerning changes to *what, how and for whom.* This is the *future model.*

Essentially the right model changes with circumstances. Therefore developing and adapting the business model is the key to business success. Getting it right is essentially the main test for the top management of any business. When *they get the business model wrong profits suffer.* In 2003, out of town retailer Matalan had ceased to get it right. Chief Executive John King is quoted as saying: 'I've come to the conclusion the value wasn't good enough, we have not been aggressive enough on price and we went on promotion too late.' As a result, Matalan was forced to cut prices by 50 per cent before Christmas and 75 per cent in the New Year.

We can use Matalan to reprise the main elements of an effective business model. The business model must clearly show and prove how you are going to make money. It must address and answer the following questions.

- What is different about our value proposition?
- Who are our customers?
- What do customers value today?
- What will customers value tomorrow?

NOTES

The questions asked of customers should also be addressed of investors. The capital markets need to be convinced that a business understands the needs of investors. If not they will not buy into the business model.

Ensuring the future model can also be delivered when it is needed means that the organization needs *change-ability*, which in turn will be very dependent upon its strategic leadership. Hamel (2000) argues that new business models are emerging all the time as fresh opportunities are found. Amongst the examples he cites are:

1. Consolidation in the small and medium-sized enterprises (SME) sector as large organizations grow bigger by systematically absorbing a series of small (and sometimes local) businesses. Examples include funeral services and Hanson, the UK-based aggregates business which operates mainly in the US and UK
2. Throwaway varieties of such products as watches and cameras
3. Individual customizing. Collector's editions of the ubiquitous Barbie doll appeal to certain enthusiasts and command a premium price. Apple's iPod allows people to download music of their own choosing to compile a CD of their favourites.

William Morrison The William Morrison supermarket group, strongest in the north of England and still a family company in many respects, competes successfully with Tesco, Sainsbury and ASDA. Founded in Bradford and led by the septuagenarian entrepreneur Sir Ken Morrison, and prior to its acquisition of Safeway, Morrisons had approaching a 20 per cent share of the food retailing market in Yorkshire, although across the country as a whole it was nearer 4 per cent. The market leader, Tesco, now has 18 per cent of the UK market.

Fundamentally the large supermarket chains offer broadly the same product ranges, although there will be some clear differences. Across a wide range of goods there are the leading brands and own-label alternatives, which normally are cheaper. Morrisons' customers are not going to be markedly different from those who pick Tesco or ASDA. They all emphasize competitive prices. Location, of course, and convenience will influence customer choice. Sainsbury is somewhat different as their prices overall are slightly higher. Waitrose (owned by John Lewis) and Marks and Spencer, with a focus on premium products and higher prices, have a different market appeal. So where is the Morrisons 'compelling reason to buy'? The Morrison strategy is not identical to those of its rivals. Morrison focuses on a composite package of 'everyday low prices' (which itself isn't unique – both ASDA and Tesco claim the same), multi-buys and special offers. It is this combination that makes it distinctive. Unusually

it also manufactures a substantial proportion of its own food products, even owning its own abattoirs. It packages most of its own fresh food and displays these in-store as they would feature in a traditional open street market. This is very deliberate and it reflects Morrisons' origins as market traders. In addition, every store looks the same. Bananas are hung up to keep them fresh, when normally they will be laid out in trays. Again unusually, it owns its own delivery fleet rather than relying on specialist logistics companies. In a Morrisons store you will see fishmongers and butchers in white hats and striped aprons – which is pretty ubiquitous – but they will be found in a section of the store which is designed to feel like an open street market. The focus is on *food; Morrisons is less interested than its main rivals in clothing and* other nonfood products. There are no online sales and no loyalty cards.

In this respect we can see Morrisons' northern roots being strongly reflected in its ambience and culture. Some would argue that these northern roots are also reflected in Morrisons taking more trade credit days from its suppliers than any of its leading rivals.

Dell It has been said that Michael Dell, founder and CEO of Dell Computer, is fast becoming the Henry Ford of the information age – as a mass producer of standardized products. Dell assembles and sells PCs and laptops and, more recently, servers and storage hardware. The company began when Dell was a university student some 20 years ago. In the early days Dell sold only to the business market, and, although this remains his dominant market, home consumers are a growth area. The business model is simple and powerful – and unusual for the industry.

Dell buys in standardized components in order to minimize the need for any expensive R&D. Sales are direct to customers, typically over the Internet. Together with a telephone helpline, this alleviates the need for middlemen and the consequential distributor margins. Dell builds to order and carries very little inventory of finished products.

This cannot happen effectively without strict attention to detail and constant process re-engineering. As a result Dell has relatively low costs. *It then adopts a very aggressive pricing policy in order to seize* market share from any competitor who has taken its eye off the ball and let its costs increase. The assumption is that this business model can be used for other consumer electrical products such as digital music players and flat screen televisions.

Some critics argue that the model has to be limited as a substantial proportion of consumers would be unwilling to buy without being able to inspect a model in a store. But the logic of this argument becomes thinner as more and more of us know people who have bought a Dell – we can inspect theirs.

NOTES

Avon Like Dell, Avon's business model is also built around direct selling. Avon was 117 years old in 2003, having started life as the California Perfume Company. Most of us would recognize the brand from the 'army' of Avon ladies who deliver catalogues to their customers every few weeks, take their orders and later deliver their choices.

Customers pay their local agent. The products themselves are manufactured in various countries around the world. Although the direct selling remains constant, other elements of the model are constantly changing. Existing product ranges are likely to change at any time; and new products are added, often replacing poor-selling items. Packaging often changes to freshen the appearance of products. No two catalogues are identical, although some products do appear regularly; and there are always special offers. More recently 'well-ness' products for health- and fitness-conscious customers have been included. These range from vitamin supplements to yoga mats. Avon 'Cosmeceuticals', brands endorsed by dermatologists, fit somewhere between medications and cosmetics.

Avon has also diversified to widen its overall customer appeal. It became prominent as a convenient supplier to middle class mothers who were short of time for personal shopping, but this is no longer adequate. Although the average age of Avon's customers is around 39, this average is falling slowly. In part this is affected by the wider product choices; it is also enhanced by the choice of younger role models to promote the products.

Model Yasmin le Bon and tennis stars, Serena and Venus Williams are included here. In addition, in the US, Avon has developed its new Mark range for 16–24 year old customers. Like Ikea, Avon has seen the benefit of moving into China and Russia, two huge consumer markets. However, direct selling is illegal in China and so Avon trades through specialist boutiques.

London Zoo In the case of London Zoo we see evidence of difficult decisions concerning 'products' and customers. Without at least some retailing activities London Zoo would be out of business. A part of the Zoological Society of London, the zoo has a key scientific purpose related to conservation and the preservation of endangered species. However, those animals that are particularly attractive to most paying visitors are often not the most endangered. Moreover, there is a duty to educate as a large proportion of the visitors are children. Many national animal collections around the world are much more heavily subsidized, but in recent years London Zoo has not been allowed to become grant-dependent. It has had to establish a revenue generating business model without losing sight of its origins and fundamental purpose – within the constraint of its location in a Royal Park which seriously affects any possibility of expansion. London Zoo has therefore had to build a model which balances conservation, education and entertainment.

NOTES

The Opera *Globally, opera can only survive if it is subsidized, so* again the business model must embrace this. The subsidy can be from government – in the UK The Arts Council, which, for example, accounts for 30 per cent of the budget at The Royal Opera House – or corporate and private donors.

Customers are willing to pay very high prices for the best seats as long as the quality performance merits it. And many operagoers are discerning. In part opera is expensive because it demands a large number of singers and musicians. In the UK, prices for the Royal Opera House Covent Garden rise to £160.00 – although the cheapest restricted view seats can sometimes be bought for £3.00. The Metropolitan in New York is more expensive, with top prices of US$280.00. But opera houses have to be maintained through the year and orchestras retained. They are not going to be full of customers every night of the year. The market is too limited for that.

Opera has long enjoyed an elitist image; operagoers are so-called aficionados. And yet the reality has changed in recent years. The opera 'product' now extends well beyond the! world's leading opera houses. The change began when *Nessun Dorma* was used as the theme music for the 1990 football World Cup and, on the back of this, the concert by 'The Three Tenors' was broadcast to the world on television and the accompanying CD became the best-selling classical album of all time. More recently more populist singers like Lesley Garrett and Russell Watson have brought operatic arias to an everwider audience. And who will ever forget Julia Roberts being introduced to the opera in the film *Pretty Woman* and being so moved she almost 'peed in her pants'! In other words, the opera 'product' now encapsulates CD and popular television as well as actual performances for a growing and changing market. The leading singers have been very carefully 'packaged' and marketed to give them a wider appeal.

Invensys Invensys began life as BTR and was later absorbed by another engineering conglomerate, Siebe. When Sir Owen Green stepped down as strategic leader in 1993 BTR had enjoyed some thirty years of acquisition, diversification and growth. It was the seventh largest company in the UK. Ten years later Invensys was relegated from the FTSE 100, the share price had collapsed and the debt was regarded as 'junk'. Things began to go downhill when the once successful business model was no longer appropriate.

Interestingly Hanson, a very similar business to BTR in many respects, was deliberately split into five separate businesses. BTR *did not* opt for such radical change and has paid a penalty. The BTR business model relied on control through cash. Companies, typically anything involving engineering of some form, were bought if they were undervalued

NOTES

and capable of some rejuvenation. Overheads were reduced and parts might be sold on as the company was split up. Prices were increased because many customers are captive in the short term. Strategic leaders of business units were rewarded for profit success – but there was a penalty for failure! Cash was repatriated from the individual businesses to BTR's head office and invested selectively in those businesses that could provide the highest returns. Synergy and linkages between the businesses was not high on the agenda.

However, as the productivity reforms of the Thatcher government took hold the number of undervalued businesses declined. They were driven out of business altogether. When the economy stagnated, the ability to generate cash as BTR had been able to do in the past was also reduced. This led to less investment in the businesses, which became less competitive as a result. BTR was now in a downward spiral. A new business model was based on divestment and selective acquisition to build a different empire of related businesses – but the company has never been able to restore its cash-generating successes of the 1980s and early 1990s. Invensys now has its fifth strategic leader in ten years.

1.7 STRATEGIC DECISION MAKING

Figure 1.7 shows the relationships between these terms, highlighting their key constituents.

The word 'values' is important in both the mission and vision statement, but with a different emphasis. It is important that a mission statement captures how an organization will create and add value for its customers; the vision relates to the corporate values that should be held by employees and visible to the outside world. The expression *aims* is sometimes used as an alternative to mission. The term *goals* is seen as synonymous with objectives; and in this book the terms are used interchangeably.

Specifically, where other works are being referred to and those authors have used the term goal as opposed to objective, their terminology is retained. It is also important to distinguish between long-term and short-term objectives or goals. Thompson and Strickland (1980) provide a useful distinction. They argue that objectives overall define the specific kinds of performance and results that the organization seeks to produce through its activities. The *long-term objectives* relate to the desired performance and results on an ongoing basis; *short-term objectives* are concerned with the near-term performance targets that the organization desires to reach in progressing towards its long-term objectives. Making use of such techniques as management by objectives, these performance targets can be agreed with individual managers, who are then given responsibility for their attainment and held accountable.

NOTES

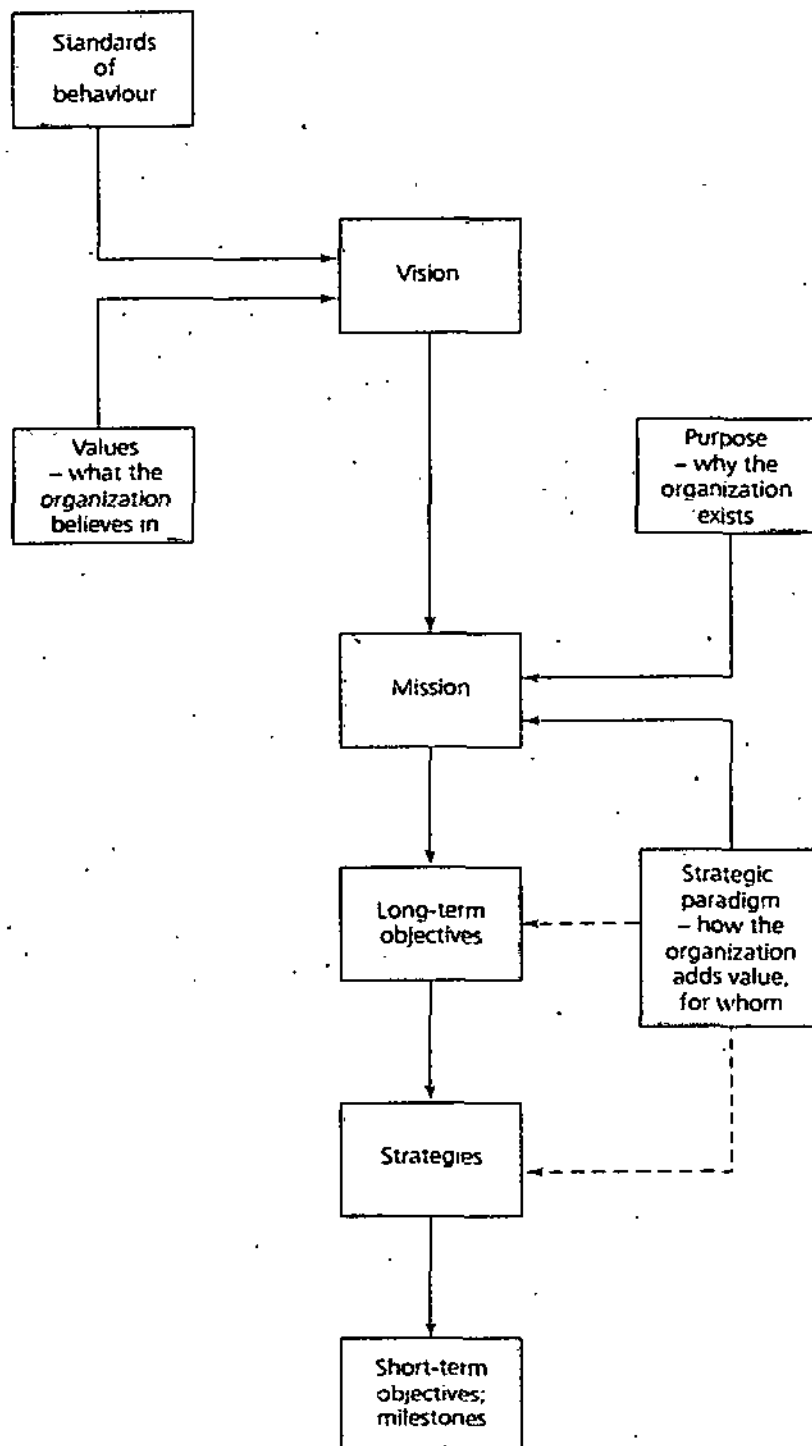


***Figure 1.7** Vision and mission statements and objectives*

Vision statements

While mission statements have become increasingly popular for organizations, vision *statements* are less prevalent. The lack of a published statement, of course, is not necessarily an indication of a lack of vision. Where they exist they reflect the company's vision of some future

state, which ideally the organization will achieve. Terminology and themes such as a world-class manufacturer, a quality organization, a provider of legendary service and a stimulating, rewarding place to work might well appear. The essential elements focus on those values to which the organization is committed and appropriate standards of behaviour for all employees. Possible improvement paths, employee development programmes and measures or indicators of progress should be established for each element of the vision.

Strategy development is like driving around a roundabout. The signposts are only useful if you know where you want to go. Some exits lead uphill, some downhill – most are one-way streets and some have very heavy traffic indeed. The trick is in picking the journey's end before you set out – otherwise you go around in circles or pick the wrong road.
Gerry M Murphy, when Chief Executive Officer, Greencore plc, Ireland

Arne Ness said, when he climbed Everest: I had a dream. I reached it. I lost the dream and I miss it. When we reached our dream we didn't have another long-term objective. So people started to produce their own new objectives, not a common objective, but different objectives depending on where they were in the organization. I learned that before you reach an objective you must be ready with a new one, and you must start to communicate it to the organization. But it is not the goal itself that is important ... it is the fight to get there.

Jan Carlzon, when Chairman and Chief Executive Officer, Scandinavian Airlines System

Mission statements

The corporate mission is the overriding *raison d'être* for the business. Ackoff (1986), however, claimed that many corporate mission statements prove worthless, one reason being that they consist of loose expressions such as 'maximize growth potential' or 'provide products of the highest quality'. How, he queries, can a company determine whether it has attained its maximum growth potential or highest quality? His points are still valid today. Primarily, the mission statement should not address what an organization must do in order to survive, but what it has chosen to do in order to thrive. It should be positive, visionary and motivating.

Ackoff suggests that a good mission statement has five characteristics. It will contain a formulation of objectives that enables progress towards them to be measured.

- It differentiates the company from its competitors.
- It defines the business(es) that the company wants to be in, not necessarily is in.

- It is relevant to all stakeholders in the firm, not just shareholders and managers.
- It is exciting and inspiring.

Campbell (1989) argues that to be valuable mission statements must reflect corporate values, and the strategic leader and the organization as a whole should be visibly pursuing the mission. He takes a wider perspective than Ackoff by including aspects of the corporate vision and arguing that there are four key issues involved in developing a useful mission. First, it is important to clarify the purpose of the organization – why it exists. Hanson plc, for example, which is referred to at various stages in this book, was led by Lord James Hanson for some 25 years and he stated:

NOTES

It is the central tenet of my faith that the shareholder is king. My aim is to advance the shareholder's interest by increasing earnings per share.

By contrast, and at the same time, Lex Service Group published an alternative view:

We will exercise responsibility in our dealings with all our stakeholders and, in the case of conflict, balance the interest of the employees and shareholders on an equal basis over time.

The implications of these contrasting perspectives are discussed in the next section of this chapter.

Second, the mission statement should describe the business and its activities, and the position that it wants to achieve in its field. Third, the organization's values should be stated. How does the company intend to treat its employees, customers and suppliers, for example? Finally, it is important to ensure that the organization behaves in the way that it promises it will. This is important because it can inspire trust in employees and others who significantly influence the organization.

It is generally accepted that in successful companies middle and junior managers know where the strategic leaders are taking the company and why. In less successful organizations there is often confusion about this. Mission statements, like vision statements, can all too easily just 'state the obvious' and as a result have little real value. The secret lies in clarifying what makes a company different and a more effective competitor, rather than simply restating those requirements that are essential for meeting key success factors. A mission (or vision) statement which could easily be used by another business, whether in the same industry or not – as many can be – is, simply, of no great value. Companies that succeed long term are those which create competitive advantages and sustain their strong positions with flexibility and improvement. The vision and mission should support this.

NOTES

The principal purpose of these statements is communication, both externally and internally and, arguably, a major benefit for organizations is the thinking they are forced to do in order to establish sound statements. Nevertheless, many are still worded poorly. In addition, it is essential that the mission (or vision) is more than a plaque in a foyer; employees have to make the words mean something through their actions. For this to happen, employees must feel that the organization actually means what it is saying in the mission and vision statements. There must be an element of trust, for without it the desired outcomes will not be achieved.

The mission clearly corresponds closely to the basic philosophy or vision underlying the business, and if there is a sound philosophy, strategies that generate success will be derived from it. Sock Shop was founded in 1983, with a simple vision. One newspaper has summarized it as, 'shopping in big stores for basic items like stockings is a fag, but nipping into an attractive kiosk at an Underground station, British Rail concourse or busy high street is quick, convenient and can be fun'. From this have emerged six key marketing features or strategies, which have become the foundations of the company's success and rapid growth:

- shops located within areas of heavy pedestrian traffic
- easily accessible products
- friendly and efficient service
- a wide range of quality products designed to meet the needs of customers
- attractive presentations
- competitive selling prices.

In 1989, after a number of years of growth and success, Sock Shop began to lose money. The hot summer weather and the London Underground strikes were blamed for falling sales. Increasing interest rates caused additional financial problems. Moreover, Sock Shop expanded into the US and this had proved costly. However, in February 1990 Sock Shop founder, Sophie Mirman, commented: 'We provide everyday necessities in a fashionable manner ... our concept remains sound. Our merchandise continues to be not to be wary of each other and prices are held back to some extent for fear of losing market share. Suppliers are interdependent and fear that a price decrease will be met by competitors (thus reducing profits) and price increases will not (hence market share will be threatened). There are two types of oligopoly, depending on whether opportunities exist for significant differentiation. In all of these models competition is a major determinant of profit potential and therefore objectives must be set with competitors in mind.

In a monopoly (again somewhat theoretical in a pure sense) excess profits could be made if government did not act as a restraint. In the UK,

although such **public sector organizations** as British Gas and British Telecom have been privatized, their actions in terms of supply and pricing are monitored and regulated.

Stakeholder theory

NOTES

The influence of external stakeholders looks at the business environment, but it is important to introduce the topic at this stage. A further assumption of profit-maximizing theory is that shareholders in the business should be given first priority and be the major consideration in decision-making, and this arose because early economic theorists saw owners and managers as being synonymous.

This assumption no longer holds, however. A study of market models demonstrates the important role played by competitors and by government as a restraining force, and it was also suggested that organizations must pay some regard to their suppliers and distributors. In addition, managers and employees must be considered. The decisions taken by managers which create incremental change will be influenced by the objectives and values that they believe are important. Managers are paid employees, and whilst concerned about profits, they will also regard growth and security as important.

These are all *stakeholders*. Freeman (1984) defines stakeholders as any group or individual who can affect, or is affected by, the performance of the organization. Newbould and Luffman (1979) argue that current and future strategies are affected by:

- external pressures from the marketplace, including competitors, buyers and suppliers; shareholders; pressure groups; and government
- internal pressures from existing commitments, managers, employees and their trade unions
- the personal ethical and moral perspectives of senior managers.

Stakeholder theory, then, postulates that the objectives of an organization will take account of the various needs of these different interested parties who will represent some type of informal coalition. Their relative power will be a key variable, and the organization will on occasions 'trade off' one against the other, establishing a hierarchy of relative importance. Stakeholders see different things as being important and receive benefits or rewards in a variety of ways, as featured in Table 1.2. Stakeholder interests are not always consistent. For example, investment in new technology might improve product quality and as a result lead to increased profits. While customers who are shareholders might perceptively benefit, if the investment implies lost jobs then employees, possibly managers, and their trade unions may be dissatisfied.

NOTES

Table 1.1 Structural characteristics of four market models

Market	Number of firms	Type of product	Control over price by supplier	Entry conditions	Non-price competition	Examples
Pure competition	Large	Standardized Identical or almost identical	None	Free	None	Agricultural products; some chemicals; printing, laundry services
Monopolistic competition	Large	Differentiated	Some	Relatively easy	Yes	Clothing; furniture; soft drinks; plumbers restaurants
Oligopoly	Few or a few dominant	Standardized or differentiated	Limited by mutual interdependence Considerable if collusion takes place	Difficult	Yes	Standardized: cement; sugar; fertilizers Differentiated: margarine, soaps; detergents
Pure monopoly	One	Unique	Considerable	Blocked	Yes	British Gas (domestic consumers); water companies in their regions; local bus companies in certain towns

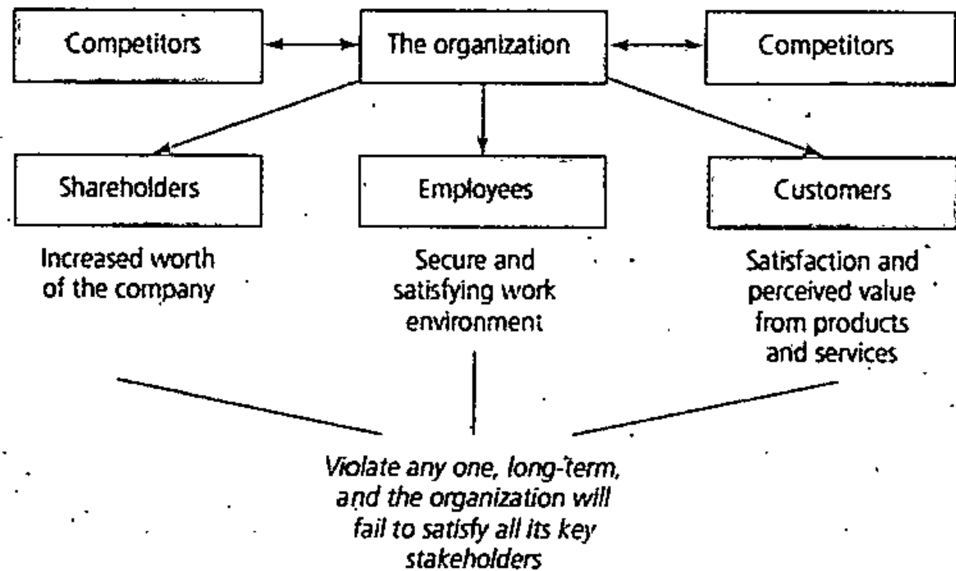
If the scale of redundancy is large and results in militant resistance, the government may become involved. The various stakeholders are not affected in the same way by every strategic decision and, consequently, their relative influence will vary from decision to decision. In 1995 Shell, one of Europe's most successful and respected companies, was forced to change an important strategic decision following a high-profile campaign by a leading pressure group. Shell wanted to sink its redundant Brent Spar oil platform in deep seas some 150 miles west of Scotland. It had reached an agreement with the UK government that, scientifically, this was the most appropriate means of disposal for the platform.

Table 1.2 Examples of stakeholder interests

Shareholders	Annual dividends; increasing the value of their investment in the company as the share price increases. Both are affected by growth and profits, Institutional shareholders may balance high-risk investments and their anticipated high returns with more stable investments in their portfolio
Managers	Salaries and bonuses; perks; status from working for a well-known and successful organization; responsibility; challenge; security
Employees	Wages; holidays; conditions and job satisfaction; security – influenced by trade union involvement
Consumers	Desirable and quality products; competitive prices – very much in relation to competition; new products at appropriate times
Distributors	On time and reliable deliveries
Suppliers	Consistent orders; payment on time
Financiers	Interest payments and loan repayments; like payment for supplies, affected by cash flow
Government	Payment of taxes and provision of employment; contribution to the nation's exports
Society in general	Socially responsible actions – sometimes reflected in pressure groups

Greenpeace objected and protesters boarded the platform, claiming that it still contained 5000 tonnes of oil which would eventually be released to pollute the sea. The ensuing and professionally orchestrated publicity fuelled public opinion, and there were protests in a number of European countries, including attacks on petrol stations in Germany. Shell backed down and agreed to investigate other possibilities for disposal. The UK government expressed both anger and disappointment with this decision. Independent inspectors later proved that Greenpeace's claims were gross exaggerations - the residual oil was much, much less than 5000 tonnes. The press concluded: 'Shell went wrong in spending too much time convincing government of the case for sea-bed dumping, but not attaching enough importance to consulting other stakeholder groups.' Shell had been made to appear socially irresponsible, yet the ethics of the Greenpeace campaign are questionable; these issues are explored further at the end of this chapter. Waterman (1994) contends that successful companies do not automatically make shareholders their first priority. Instead, they pay primary attention to employees and customers and, as a result, they perform more effectively than their rivals. The outcome is superior profits and wealth creation for the shareholders. Simon (1964) argues that one of the main reasons for an organization's collapse is a failure to incorporate the important motivational concerns of key stakeholders. Small businesses, for example, are generally weak in relation to their suppliers, especially if these are larger well-established concerns; and if they neglect managing their cash flow and fail to pay their accounts on time they will find their deliveries stopped. For any organization, if new products or services fail to provide consumers with what they are looking for, however well produced or low priced they might be, they will not sell. A 1999 survey by Deloitte Consulting confirmed that 'customer-centric' manufacturing companies worldwide are 60 per cent more profitable than those that are less committed to customers. In addition, they enjoy lower operating costs. Customer-centricity is seen as a 'systematic process which sets objectives for customer loyalty and retention and then tracks performance towards those goals'. It should facilitate the development of higher added value, premium-price products.

NOTES



Without committed employees the company cannot produce quality products and services.

Without quality products and services the company will fail to satisfy its customers.

Without customers the company's revenue will fall and it will fail to increase its worth for its shareholders.

It is now in a spiral of decline.

If the company's financial performance is deteriorating it will be perceived as an insecure place to work; employees will be increasingly dissatisfied and their work quality may deteriorate further.

Employees may leave for other jobs; as a result, customer service will be affected...

Figure 1.8 Satisfying stakeholders

Figure 1.8 shows that shareholders, employees and customers are the three key stakeholders that the organization must satisfy, but invariably in a competitive environment: if they fail with any group long term they will place the organization in jeopardy through a spiral of decline. Figure 1.9 is an alternative presentation of the same points. On the left is a virtuous circle of growth and prosperity. Satisfied, perhaps even delighted, customers enable high financial returns, which can be used in part to reward employees. A perception of fairness here can be instrumental for motivating employees to keep customers satisfied and thus sustain the circle. The right-hand side clarifies that the needs of customers can sometimes conflict with the demands of some shareholders, especially

those who are willing to tade off long-term achievement for short-term financial returns. Competitors are always trying to persuade customers to switch allegiance and thus impact on an organization's success.

NOTES

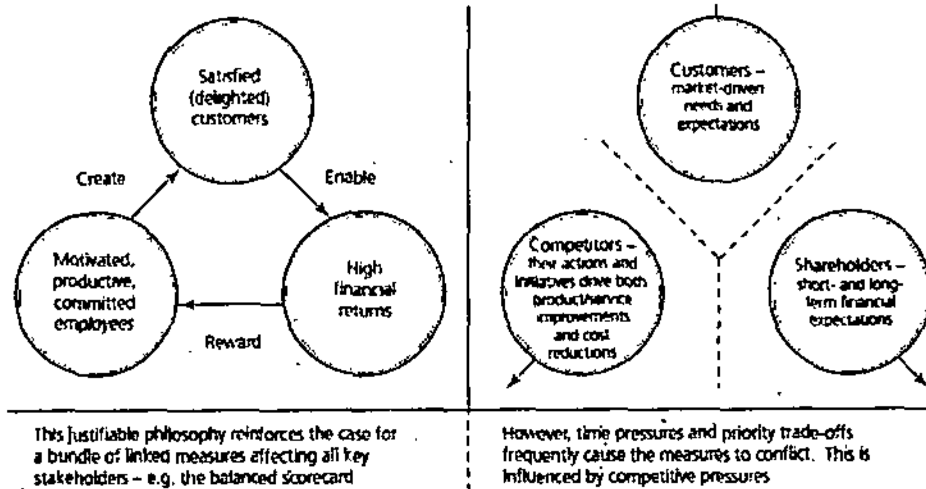


Figure 1.9 Complementary or conflicting measures

While these arguments are, in themselves, convincing, many organizations still fail to satisfy their stakeholders long term. The following theories provide some insight into this reality.

The investor and the employee are in the same position, but sometimes the employee is more important, because he will be there a long time, whereas an investor will often get in and out on a whim in order to make a profit. The worker's mission is to contribute to the company's welfare, and his own, every day. All of his working life he is really needed.

Akio Morita, Joint Founder, Sony

Cyert and March's behavioural theory

Stakeholder theory is closely related to the ideas in Cyert and March's *A Behavioural Theory of the Firm* (1963). Cyert and March argue that the goals of an organization are a *compromise* between members of a coalition comprising the parties affecting an organization. The word compromise is used as the actual choice is linked to relative power and there are *inevitably conflicts of interest*. Cyert and March argue that there are essentially five directional pulls to consider:

- production-related, and encapsulating stable employment, ease of control and scheduling
- inventory-related – customers and sales staff push for high stocks and wide choice, management accountants complain about the cost of too much stock
- sales-related – obtaining and satisfying orders

- market share, which yields power relative to competitors
- profit, which concerns shareholders, senior management and the providers of loan capital.

NOTES

This theory stresses the perceived importance of the short term, as opposed to the long term, because issues are more tangible and because decisions have to be taken as situations change. Organizations adapt over time and it is likely that changes will be limited unless it is necessary to change things more radically. In other words, once a compromise situation is reached there is a tendency to seek to retain it rather than change it, and the goals will change as the values and relative importance of coalition members change. As a result, organizational slack develops. This is 'payments to members of the coalition in excess of what is required to keep them in the coalition'. It is difficult, for example, to determine the minimum acceptable reward for employees; assets are generally underexploited since it is difficult to know the maximum productivity of a person or machine; and uncertainties mean that less than optimal price, product and promotional policies will be pursued. The existence of slack does allow for extra effort in times of emergency.

This theory can be usefully considered alongside Herbert Simon's (1964) theory of satisficing. Here he contends that managers seek courses of action which are acceptable in the light of known objectives. These actions may not be optimal but they are chosen because of internal and external constraints such as time pressure, a lack of information and the vested interests of certain powerful stakeholders.

Objectives and constraints

Simon (1964) also makes an important distinction between objectives and constraints. Some of the ends that strategies are designed to achieve are not freely set objectives but constraints imposed on the organization by powerful stakeholders or agencies. Simply, organizational freedom – to set objectives – is constrained. For example, an animal food company might wish to offer low priced feeds for livestock but be constrained by dietary requirements which, by determining ingredients, influence costs and hence prices. In recent years, many of the world's leading drug companies have changed their strategies as a result of external constraints. Governments have been increasingly reluctant to fund expensive drugs and treatments. Some companies have closed plants, while others have relocated for lower costs. There has been an increased research focus on treatments that are most likely to receive funding, arguably at the expense of potential breakthroughs in other areas. Priorities and strategies in the UK National Health Service (NHS) are affected by the government's

waiting-list targets. Network Rail (which manages and maintains the UK railway infrastructure for the government) has an independent regulator who imposes specific requirements and targets for safety which inevitably affect costs and borrowing needs.

NOTES

A number of other authors have offered theories in an attempt to explain the behaviour of organizations and the objectives they seek.

Baumol's theory of sales maximization

Baumol (1959) argues that firms seek to maximize sales rather than profits, but within the constraint of a minimum acceptable profit level. It can be demonstrated that profit maximizing is achieved at a level of output below that which would maximize sales revenue and that, as sales and revenue increase beyond profit maximizing, profits are sacrificed. Firms will increase sales and revenue as long as they are making profits in excess of what they regard as an acceptable minimum. Businessmen, Baumol argues, attach great importance to sales as salaries are often linked to the scale of operations. 'Whenever executives are asked "How's business?", the typical reply is that sales have been increasing or decreasing.'

Williamson's model of managerial discretion

Williamson (1964) argues that managers can set their own objectives, that these will be different from those of shareholders and that managerial satisfaction is the key. Satisfaction increases if a manager has a large staff reporting to him or her, if there are lavish perks and if profits exceed the level required for the essential development of the business and the necessary replacement of equipment. This extra profit can be used for pet projects or the pursuit of non-profit objectives. The manner in which managers reward themselves for success is discretionary.

Marris's theory of managerial capitalism

Marris (1964) again postulates growth as a key concern, as managers derive utility from growth in the form of enhanced salaries, power and status. The constraint is one of security. If, as a result of growth strategies pursued by the firm, profits are held down, say because of interest charges, the market value of the firm's shares may fall relative to the book value of the assets. In such a case the firm may become increasingly vulnerable to takeover, and managers wish to avoid this situation.

Penrose's theory of growth

Penrose (1959) has offered another growth theory, arguing that an organization will seek to achieve the full potential from all its resources.

NOTES

Firms grow as long as there are unused resources, diversifying when they can no longer grow with existing products, services and markets. Growth continues until it is halted. A major limit, for example, could be production facilities either in terms of total output or because of a bottleneck in one part of the operation. Changes can free the limit, and growth continues until the next limiting factor appears. Another limit is the capacity of managers to plan and implement growth strategies. If managers are stretched, extra people can be employed, but the remedy is not immediate. New people have to be trained and integrated, and this takes up some of the time of existing managers. Penrose refers to this issue as the 'receding managerial limit' because again the limiting factor decreases over a period of time.

In a climate of reasonably constant growth and change managers learn how to cope with the dynamics of change; and properly managed, given that overambition is constrained and that market opportunities exist, firms can enjoy steady and continuous growth.

Galbraith's views on technocracy

Finally, Galbraith (1969) highlighted the particular role of large corporations, whose pursuit of size requires very large investments associated with long-term commitments. Because of these financial commitments the corporations seek to control their environment as far as they possibly can, influencing both government and consumer, and they in turn are controlled by what Galbraith calls 'technocrats' – teams of powerful experts and specialists. Their purposes are, first, to protect as well as control the organization, and hence they seek financial security and profit, and, second, to 'affirm' the organization through growth, expansion and market share. As is typical of oligopolists, price competition is not seen to be in their interests, and hence aggressive marketing and nonprice competition are stressed. In addition, such firms will seek to influence or even control (by acquisition) suppliers and distributors, and they may well see the world, rather than just the UK, as their market. These issues are all explored later in the book.

Galbraith (1963) also identified the growth of 'countervailing power' to limit this technocracy. The growth of trade unions in the past is an example of this, but, as seen in recent years, the technocrats have fought back successfully. The increasing size and power of grocery retailers such as Sainsbury and Tesco, and their success with own-label brands, has put pressure on all product manufacturers, especially those whose products are not the brand leader. As a consequence the owners of the strongest brands have invested heavily to promote their brands and ensure that they are selected, even though there may be cheaper alternatives. Moreover, there have been mergers within retailing in an attempt to

strengthen power bases. Tesco has expanded from the UK into Europe, while Wal-Mart has acquired ASDA. Simply, over time there are swings in relative power and, as a result, the potential for consumer exploitation is checked and available profits are shared more widely.

NOTES

Profit as an objective

Whether profit is the ultimate objective of profit-seeking business organizations or whether it is merely a means to other ends, which themselves constitute the real objectives. Not-for-profit organizations are considered separately later in this chapter.

Ackoff (1986) argues that both profit and growth are means to other ends rather than objectives in themselves. He argues that profit is necessary for the survival of a business enterprise, but is neither the reason for which the business is formed nor the reason why it stays in existence. Instead, Ackoff contends,

Those who manage organizations do so primarily to provide themselves with the quality of work life and standard of living they desire ... their behaviour can be better understood by assuming this than by assuming that their objective is to maximize profit or growth.

However, it is also important to consider the quality of life of investors (shareholders), customers, suppliers and distributors, as well as other employees of the firm who are not involved in decision-making. Developing earlier points, it can be argued that employees are the major stakeholders, because if the firm goes out of business they incur the greatest losses.

In many respects it does not matter whether profit is seen as an objective or as a means of providing service and satisfaction to stakeholders, as long as both are considered and not seen as mutually exclusive. However, the 'feel' and culture of an organization will be affected. In simple terms an organization will succeed if it survives and meets the expectations of its stakeholders. If its objectives relate to the stakeholders, it is successful if it attains its objectives.

The purpose of industry is to serve the public by creating services to meet their needs. It is not to make profits for shareholders, nor to create salaries and wages for the industrial community. These are necessary conditions for success, but not its purpose.

Dr George Carey, retired Archbishop of Canterbury

The responsibility of business is not to create profits but to create live, vibrant, honourable organizations with a real commitment to the community. Anita Roddick, founder, The Body Shop

NOTES

The influence of shareholders

Some commentators hold the view that too many companies are still encouraged to seek short-term profits in order to please their major institutional shareholders, and that it is only by considering the long term and the interests of all stakeholders that companies will become more effective competitors in world markets. In the UK, for example, Constable (1980) stated: 'Britain's steady relative industrial decline over the past 30 years is related to an insistence on setting purely financial objectives which have been operated in relatively short time scales.' Institutions such as pension funds effectively control the UK's largest companies through the sizeable blocks of shares that they own; in contested takeovers, for example, individual pension fund managers will be instrumental in determining the outcome. These managers have a remit to earn the best returns that they can obtain for their members. Since the mid-1990s there has been a drive to increase the transparency of these large shareholder blocks, and companies have been required to publish more information.

The issue of short-termism is complex, however, and investigates the debate. Companies, obviously, cannot disregard powerful institutional shareholders. What is crucial is to ensure that there is dialogue and mutual understanding and agreement concerning the best interests of the company, its shareholders and other stakeholders. In his debate on the short- and long-term perspective, Constable (Table 1.3), contrasts two sets of objectives, ranked in order of priority. He contends that company B is likely to grow at the expense of company A, and that these objective sets, A and B, are essentially those adopted by large UK and Japanese companies, respectively, for much of the period since the Second World War. To suggest that Japanese success rests solely on a particular set of objectives is oversimplifying reality, but it has certainly contributed.

Table 1.3 Contrasting company objectives

Company A	Company B
1. Return on net assets, 1–3 year time horizon	1. Maintenance and growth of market share
2. Cash flow	2. Maintenance and growth of employment
3. Maintenance and growth of market share	3. Cash flow
4. Maintenance and growth of employment	4. Return on net assets

NOTES

Table 1.4 Perceptions of stakeholder importance

Stakeholder	*Prioritization by industry strategic leaders*	*Prioritization by analysts with institutional investors*
Existing customers	1	1
Existing employees	2	3
Potential customers	3	2
Institutional investors	4	4
Suppliers	5	7
Potential employees	6	6
City analysts	7	5
Private (individual) shareholders	8	10
Business media	9	9
General media	10	11
Local communities	11	12
Members of Parliament/Local Authorities	12	8

In Japan and Germany, however, shareholders do not exert pressure in the same way as they do in the UK. Cross-shareholding between companies in Japan means that only 25 per cent of shares in Japanese businesses are for trading and speculation, and this generates greater stability. In Germany the companies hold a higher proportion of their own shares, and banks act as proxy voters for private investors. Banks thereby control some 60 per cent of the tradeable shares, again generating stability. German companies also adopt a two-tier board structure. A supervisory board has overall control and reports to shareholders and employee unions; reporting to this board is a management board, elected for up to five years.

Table 1.4 pulls together a number of the points discussed here by showing how organizational strategic leaders and institutional investors do not share completely the same perspective on stakeholder priorities, although there are clear similarities with the most important stakeholders. *Interestingly, suppliers, key partners in the* ***supply chain****, receive a* higher priority from strategic leaders, while the institutions rate politicians more highly than do organizational leaders. It is both significant and realistic, that small, individual shareholders are not particularly powerful, because they are generally too disparate to become organized. Individually, they may be able to embarrass an organization with difficult questions at its Annual General Meeting, but this is far from an expression of ongoing power.

NOTES

The importance of the strategic leader

To conclude this section it is useful to emphasize the key role of the strategic leader, and his or her values, in establishing the main objectives and the direction in which they take the organization. Personal ambitions to build a large conglomerate or a multinational company may fuel growth; a determination to be socially responsible may restrain certain activities that other organizations would undertake; a commitment to high quality will influence the design, cost and marketing approach for products. A strong orientation towards employee welfare, will again influence objectives quite markedly.

The objectives and values of the strategic leader are a particularly important consideration in the case of small firms. While it is possible for small firms to enjoy competitive advantage, say by providing products or services with values added to appeal to local customers in a limited geographical area, many are not distinctive in any marked way. Where this is the case, and where competition is strong, small firms will be price takers, and their profits and growth will be influenced substantially by external forces. Some small firm owners will be entrepreneurial, willing to take risks and determined to build a bigger business, whereas others will be content to stay small. Some small businesses are started by people who essentially want to work for themselves rather than for a larger corporation, and their objectives could well be concerned with survival and the establishment of a sound business which can be passed on to the next generation of their family.

Each of the ideas and theories discussed in this section provides food for thought, but individually none of them explains fully what happens, or what should happen, in organizations.

In the authors' experience certain organizations are highly growth orientated, willing to diversify and take risks, while others, constrained by the difficulties of coping with rapid growth and implementing diversification strategies, are less ambitious in this respect. Each can be appropriate in certain circumstances and lead to high performance, but in different circumstances they may be the wrong strategy.

Stakeholder theory is extremely relevant conceptually, but organizations are affected by the stakeholders in a variety of ways. Priorities must be decided for companies on an individual basis. Moreover, the strategic leader, and in turn the organization, will seek to satisfy particular stakeholders rather than others because of their personal backgrounds and values. There is no right or wrong list of priorities. However, while priorities can and will be established, all stakeholders must be satisfied to some minimum level. In the final analysis the essential requirement is congruence among environment, values and resources.

So far this chapter has concentrated on profit-seeking organizations and considered just how important the profit motive might be. Not-for-profit organizations may be growth conscious, quality conscious or committed to employee welfare in the same way as profit seekers, but there are certain differences which require that they are considered separately.

1.8 FINANCE AND GLOBAL COMPETITIVENESS

Causes generate effects. Actions lead to outcomes. On occasions companies may attempt to seize the competitive initiative and introduce an innovatory change. An action by one competitor which affects the relative success *of rivals provokes responses.*

One action can therefore provoke several reactions, depending on the *extent of the impact and the general nature of* competition. Each reaction in turn further affects the other rival competitors in the industry. New responses will again follow. What we have in many markets and industries is a form of *competitive chaos*. Figure 1.10 shows a competitive business environment which is permanently fluid and unpredictable. For example, British Telecom (BT) continues to face competition from cheap phone call and Internet service providers as well as demands that it provides free access to its network.

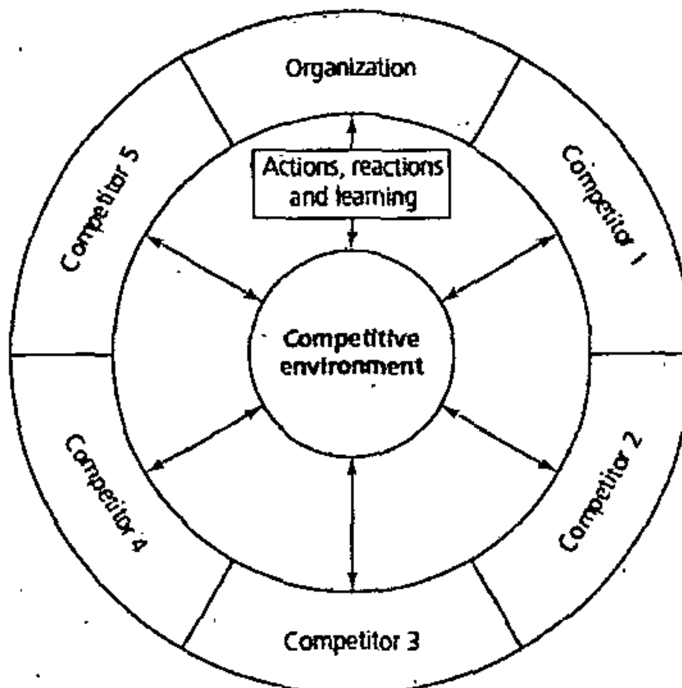


Figure 1.10. Dynamic competition

This is considered a restrictive act and has slowed down the development of both the Internet in the UK and of broadband services. BT must

NOTES

adapt and respond to defend its place in the market, or eventually the government will force regulatory change on them. It is important to differentiate between two sets of similar, but nevertheless different, decisions. First, some actions are innovatory and represent one competitor acting upon a perceived opportunity ahead of its rivals; other actions constitute reactions to these competitive initiatives. Second, some decisions imply incremental strategic change to existing, intended strategies; on different occasions companies are adapting their strategies (**adaptive strategic change**) as they see new opportunities which they can seize early, or possible future threats which they are seeking to avoid. The process is about *learning and flexibility*. Often they involve an *intrapreneur*, an internal entrepreneur. The skills required by organizations are:

- the ability to discern patterns in this dynamic environment and competitive chaos, and spot opportunities ahead of their rivals
- the ability to anticipate competitor actions and reactions
- the ability to use this intelligence and insight to lead customer opinion and outperform competitors.

Ocean Spray has been cited by Rosabeth Moss Kanter (1990) as another US company which spotted a potentially lucrative competitive opportunity missed by its rivals. Small 'paper bottles' for soft drinks were being used in Europe, but the leading US manufacturers did not see them taking off in America and were not enthusiastic. Ocean Spray, which manufactures a range of products, including drinks, from cranberries (sometimes mixed with other fruits) had empowered a middle manager from engineering to look for new ideas for the company – an aspect of their planned strategy – and he saw the potential.

The result was an 18-month exclusive rights agreement. The packaging concept proved attractive and the final outcome was a substantial increase in the popularity of cranberry juice drinks. Simply, children liked the package and came to love the drink. Ocean Spray products are now much more evident around the world. The Ocean Spray example illustrates how competition can come from unexpected sources. It is dangerous for any organization to assume that future competitive threats will only come from rivals, products and services that they already know and understand; in reality, it can be the unrecognized, unexpected newcomers which pose the real threat because, in an attempt to break into an established market, they may introduce some new way of adding value and 'rewrite the rules of competition'.

NOTES

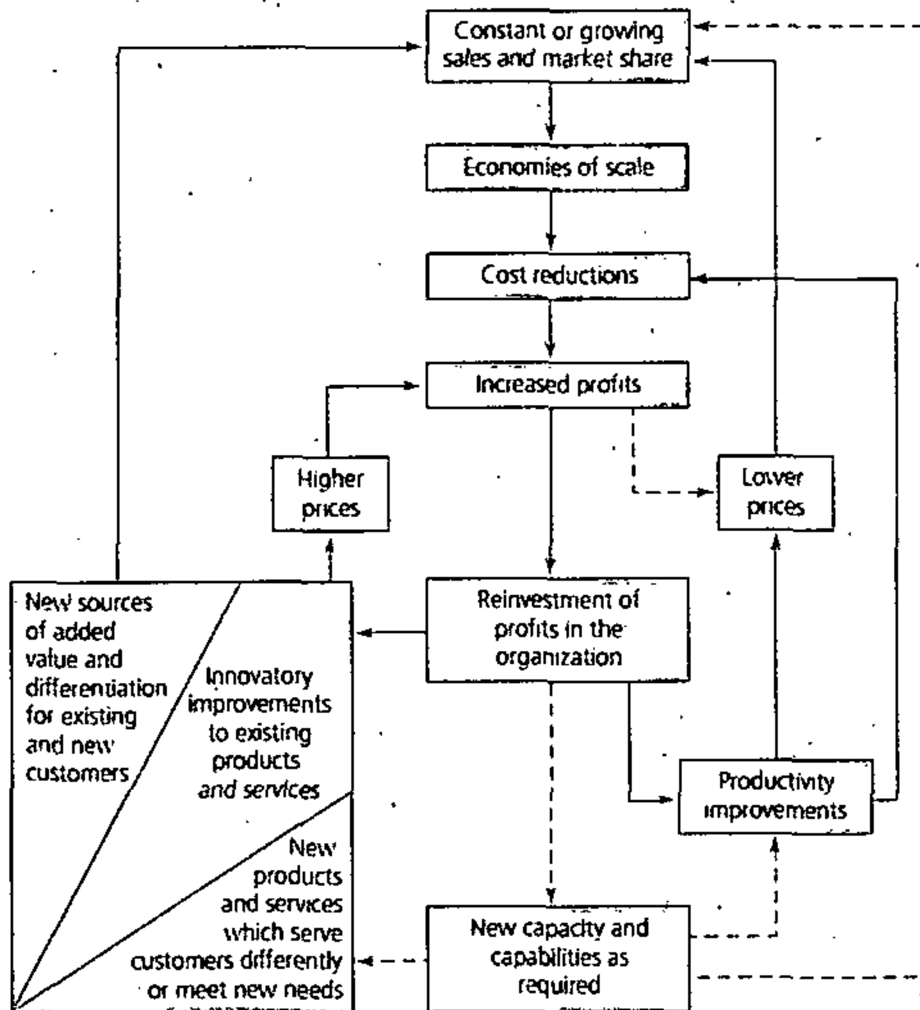


Figure 1.11 The competitive cycle

Bill Gates' view of the future, based on personal computers on every desk, was radically different from that of long-time industry leader, IBM, and it enabled Microsoft to enter and dominate the computer industry. British Airways was surprised by the entry and success of Virgin Atlantic Airways on profitable transatlantic routes, as it perceived its main competition to come from the leading US carriers. Virgin was adding new values, offering high and differentiated levels of service at very competitive prices. The success of Direct Line, with telephone insurance services at very competitive prices, has provoked a response from existing companies; telephone banking is having a similar effect. In both cases the nature of the service has been changed dramatically, and improved for many customers. Figure 1.11 shows how organizational resources need to be used to drive the competitive cycle. Constant, or ideally growing, sales and market share can lead to economies of scale and learning and, in turn, cost reductions and improved profits. The

NOTES

profits could, in a particularly competitive situation, be passed back to customers in the form of lower prices, but more normally they will be reinvested in the organization. This can generate productivity improvements, sometimes with new capacity and, then, lower prices and/or further cost reductions. The investment can also bring about new sources of added value and differentiation, possibly allowing higher prices and further profit growth. The improved competitiveness should also increase sales and market share and drive the cycle round again. These changes might take the form of gradual, continuous improvements or radical changes to establish new rules of competition.

In this regard the market for DVD players has shown both dramatic growth and massive price reductions. When first introduced, a DVD player was a premium item. Now they are being sold in supermarkets for a fraction of the initial entry price.

1.9 ROLE OF STRATEGIC MANAGEMENT IN MARKETING

A large number of the rapid growth firms present written business plans1 for strategy implementation. The written plans enable CEOs to manage more critical business functions, grow faster and achieve a higher proportion of revenue from new products and services than those whose plans are unwritten. Additionally, written business plan helps growing firms to increase their revenues faster over their competitors than those without a written plan. The major advantages and issues associated with strategic marketing planning are as under:

- Strategy is a major focus for higher revenues and profits- and to hatch new products, expand existing business, and create new markets.
- Business strategy is the single most important management issue and will remain so for the next five years.
- Democratize the strategy process by handing it over to teams of line and staff managers from different disciplines.
- Create networks of relationships with customers, suppliers, and rivals to gain greater competitive advantage.

A company may use strategic marketing planning to identify long-term opportunities and manage day-to-day operations. Strategic marketing planning is an essential instrument to grow present markets, spot growth markets, recognize new product innovation, and stay alert to new opportunities. The Figure 1.12 exhibits the key areas of strategic management and the process thereof.

Situation Analysis

Marketing plan process begins with a *situation analysis* of a specific product or market. Whereas the strategies plans look ahead three to five years, the situation analysis requires that you look back three to five years to obtain a historical perspective of business. The situation analysis is divided into three parts: marketing mix analysis, market background, and competitor analysis. For *marketing mix analysis,* objectively and factually write sales and unit volume by product, analyze pricing and access promotion and distribution. *Market background* deals with the nature of audience, human factor, the image you convey, what customers think of product, and the frequency of its use. The examination of the background permits you to think extensively about marketplace and customers. The third part also permits you to *analyze competitors* in detail.

Marketing Opportunities

After you have analyzed the situation, the next step is to evaluate opportunities. Surprisingly, managers often neglect this part of the process. This planning step is exceedingly important, since the whole purpose of conducting the situational analysis is to expose opportunities. Opportunities are voids or gaps in a product, a market, or a service that can be filled to satisfy customer needs and wants. This stage of marketing plan is best achieved by incorporating the input of various functional managers from manufacturing, R&D, product development, finance and sales. Brainstorming is a useful technique for identifying opportunities. For example, consider the features and benefits of product. Study the situation analysis, including competitive intelligence, and allow the ideas to flow. Do not attempt to judge them- just record them as they emerge. The probability is that you will record 90% to 95% of them, form a new product, or render a new service.

Marketing Objectives

Third step in the marketing plan is to work out primary and functional marketing objective. First, develop *primary quantitative objective*, such as sales in dollars and units, market shares, gross margins, return on investment,. return on assets, and any other quantitative information required by the organization. Second, develop *functional objectives* as they pertain to product, packaging, services, pricing, promotion, and distribution. These functional areas are commonly referred to as the *marketing mix* . It should be evident that the marketing mix is a key part of the marketing plan in that it represents the controllable factors you can employ to achieve the primary financial and volume objectives. The marketing mix also helps you identify sources of competitive problems and,. in turn, suggests possible solutions or strategies.

NOTES

Strategies and Action Plans

On the basis of marketing objectives, you can now develop the strategies and action plans that translate those objectives into action. Unless you can support objectives with firm action plans, they are useless. They are no more than good intentions until you develop the strategies and tactics that will make them happen. Thus, for each objective, develop a strategy and a tactic action plan. Further, each strategy should include details about what is going to happen, when it is going to happen, and who is responsible for carrying out the action.

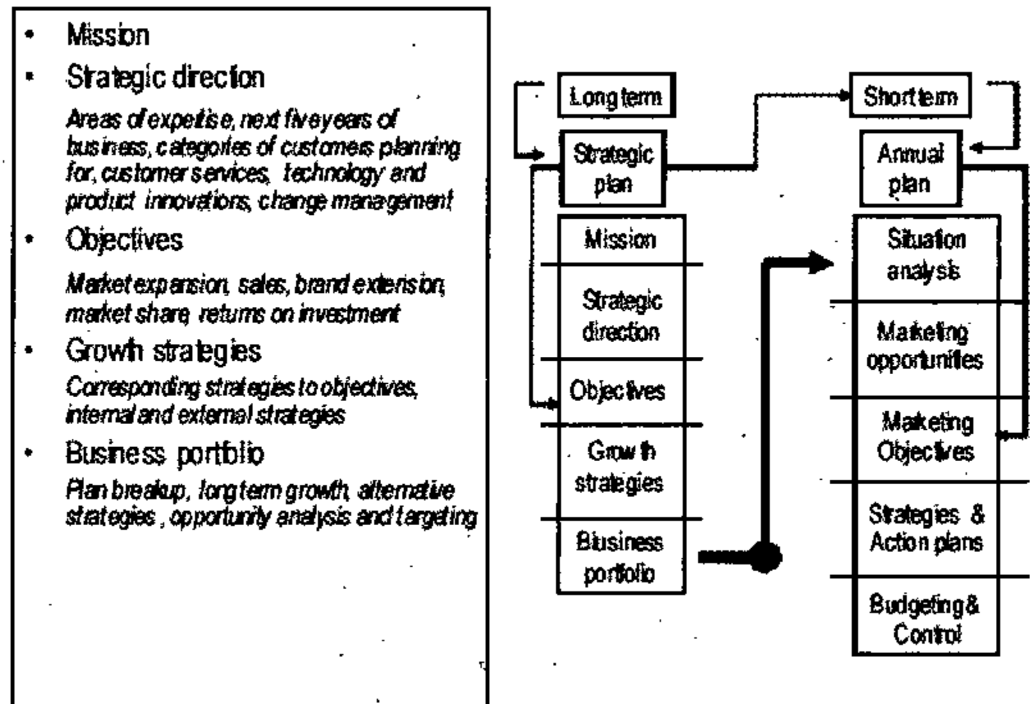


Figure 1.12 Paradigm of strategic marketing management

Financial Controls and Budgets

This step in financial plan involves the financial controls, budgets, and variance reports that translate into numbers for the actions that you have stated in the previous steps.

Combinations of the long-term strategic and annual marketing plans form a total strategic marketing plan for any level of an organization, from corporate management down to product line manager. Further, for every major product and market described in the business portfolio, you should develop a specific annual tactical marketing plan. Thus, you combine a long-term strategic viewpoint with a one-year tactical framework to create action- something that the strategic plan by itself could not accomplish and for which the marketing plan alone is too narrow a perspective for today's competitive environment.

1.10 STRATEGIC HUMAN RESOURCE MANAGEMENT

NOTES

The human resource management that aims to improve the productive contribution of individuals while simultaneously attempting to attain other societal and individual employee objectives has undergone drastic change with the passing of years.

We all know that HRM is concerned with the "people" & keeping the fact in mind that HRM helps in acquiring, developing, stimulating & retaining the outstanding employees as it gives both effectiveness & efficiency to the working of the organization, it has been started being used strategically & is now termed as Strategic human resource management.

The changing role of HRM:

The role of human resource management is changing & is changing very fast, to help companies achieve their goals. HRM has gone through many phases – from hiring & firing to relationship building, from there to legislation role, & now its role is shifting from protector & screener to strategic partner & as a change agent.

Defining SHRM

1. Organizational use of employees to gain or keep a competitive advantage against competitors.
2. *Involves aligning initiatives* involving how people are managed with organizational mission and objectives.

In today's flattened, downsized & high-performing organizations, highly trained & committed *employees* – not machines – are often the firm's competitive key. Perhaps the most drastic change in HR's role today is its growing involvement in developing & implementing the company's strategy. In order to understand the modern aspect of HR *i.e.,* SHRM, lets discuss the terms which would help us in understanding the concept:

- *Core Competency* can be defined as - A unique capability in the organization that creates high value and that differentiates the organization from its competition.
- *Mission* Statement explains purpose and reason for existence; it is usually very broad, but not more than a couple of sentences & it serves as foundation for everything organization does.
- Strategy: the company's plan of how it will balance its internal strengths & weaknesses with external opportunities & threats

in order to maintain a competitive advantage, earlier this role was performed by the line managers, but now it is carried by the HR manager.

NOTES

Strategies increasingly depend on strengthening organizational competitiveness & on building committed work teams, & these put HR in a central role. In the fast changing, globally competitive & quality oriented industrial environment, it's often the firm's employees – its human resources – who provide the competitive key. And so now it is a demand of the time to involve HR in the earlier stages of development & implementing the firm's strategic plan, rather than to let HR react to it. That means now the role of HR is not just to implement the things out but also to plan out in such a manner that the employees can be strategically used to get edge over the competitors, keeping in mind the fact that this is the only resource (HUMANS), which cannot be duplicated by the competitors.

Benefits of a Strategic Approach to HR:

- Facilitates development of high-quality workforce through focus on types of people and skills needed
- Facilitates cost-effective utilization of labor, particularly in service industries where labor is generally greatest cost
- Facilitates planning and assessment of environmental uncertainty, and adaptation of organization to external forces
- Successful SHRM efforts begin with identification of strategic needs
- Employee participation is critical to linking strategy and HR practices
- Strategic HR depends on systematic and analytical mindset

Corporate HR departments can have impact on organization's efforts to launch strategic initiatives

SUMMARY

- All organizations, large and small, profit-seeking and not-for profit, private and public sector, have a purpose, which may or may not be articulated in the form of a mission and/or vision statement. Strategies relate to the pursuit of this purpose.
- Strategic Management is concerned with the establishment of a clear direction for the organization.
- Strategy is about actions, not plans – specifically the commitment of resources to achieving strategic ends ... concrete steps that immediately affect people's lives, not abstract intentions.

- Strategy can be considered as a clear strategic purpose, intent and direction for the organization, but without the detail worked out.
- **Corporate strategy**, essentially and simply, is deciding what businesses the organization should be in and how the overall group of activities should be structured and managed.
- Freeman (1984) defines stakeholders as any group or individual who can affect, or is affected by, the performance of the organization.
- Strategic marketing planning is an essential instrument to grow present markets, spot growth markets, recognize new product innovation, and stay alert to new opportunities.
- The human resource management that aims to improve the productive contribution of individuals while simultaneously attempting to attain other societal and individual employee objectives has undergone drastic change with the passing of years.

REVIEW QUESTIONS

1. What exactly is a strategy? What have you learned about different perspectives, levels and ways in which they are changed?
2. What are the key elements in the strategic management process?
3. How have Marks and Spencer sought to attain and maintain competitive advantage? What do you think their objectives might have been?
4. Draw and discuss the business model for an organization.
5. Draw and discuss the local and global competition.
6. Discuss role of strategic management in marketing.
7. Discuss strategic human resource management.

FURTHER READINGS

1. **Strategic Management:** A.C. Mittal and B.S. Sharma, Vista International Pub., 2006.
2. **Strategic Management:** Garth Saloner, Andrea Shepard, Joel Podolny, Wiley.
3. **Strategic Management: Concepts and Cases:** Milind T. Phadtare, PHI Learning.
4. **Strategic Management: Current Trends and Issues:** Edited by P. Mohana Rao and Trilok Kumar Jain, Deep and Deep.

UNIT 2 ENVIRONMENTAL SCANNING AND CORPORATE ANALYSIS

NOTES

★ STRUCTURE ★

2.0 Learning Objectives
2.1 Introduction
2.2 Environmental Scanning
2.3 Industry Analysis
2.4 Resource-Led Strategy
2.5 Strategic Budget and Audit
2.6 Scanning Functional Resources
2.7 Impact of E-Commerce
2.8 Approach to Managing Strategy
2.9 Balanced Scorecard Strategic Advantage Profile (SAP)
2.10 Environmental Threat and Opportunity Profile (ETOP)
2.11 Organizational Capability Profile (OCP)
• *Summary*
• *Review Questions*
• *Further Reading*

2.0 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- define environmental scanning.
- explain what is industry analysis.
- describe about strategic budget and audit.
- explain about scanning functional resources.
- explain the impacts of E-commerce on an organisation.
- understand various value chain processes.
- know about various techniques like SAP, ETOP, OCP etc.

NOTES

2.1 INTRODUCTION

Good ideas for the future can either start inside the organization or be obtained from external contacts, and the ability to synthesize and exploit the information that is available to develop new products, new services and new strategic positions is a reflection of the organization's *strategic thinking* capabilities.

At one level, matching, exploiting and changing the linkages between resource competency and environmental opportunity is an expression of organizational competitiveness, and the presence (or absence) of competitive advantage. It was shown earlier how it is essential for organizations to seek competitive advantage for every product, service and business in their portfolios. Competitiveness comes from functions and activities, and the effectiveness of the links between them. This is one aspect of *synergy*. The second aspect of synergy is the relatedness and interdependency of the different products, services and businesses and their ability to support each other in some way.

2.2 ENVIRONMENTAL SCANNING

Figure 2.1 illustrates the organization in the context of its external environment. Its suppliers and customers, upon whom it depends, and its competitors – both existing and new-in-the-future – are shown as having an immediate impact. Wider environmental forces bear on all the 'players' in the industry, and these are shown in the outer circle as political, economic, social and technological (PEST) forces.

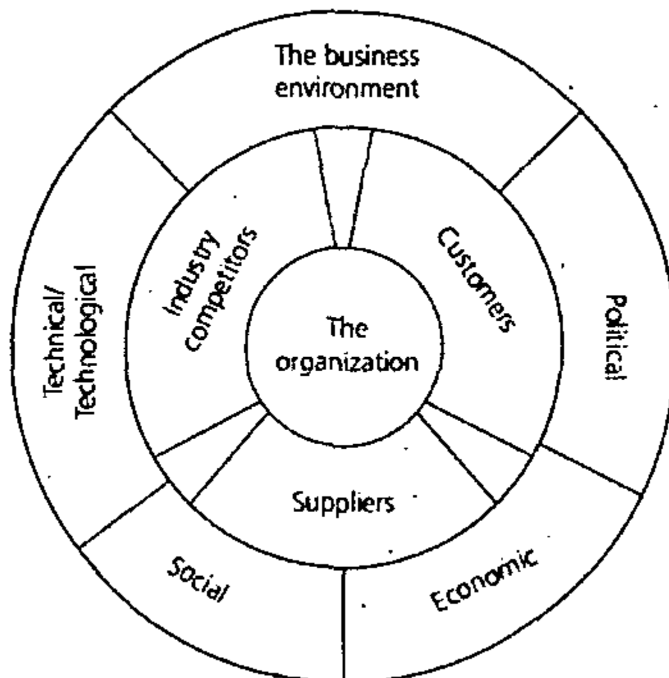


Figure 2.1 The business environment

NOTES

The forces and influences have been deliberately shown in concentric circles. It is quite typical for us to think of the organization as a group of activities (and/or functions) and then to place everything and everyone else, including suppliers and customers, in a so-called external business environment. Increasingly, it makes considerable sense for the organization to see itself working in partnership with its suppliers, distributors and customers. When this perspective is adopted, then only competitors from the middle ring would be placed in the external environment, together with the general forces which impact upon the whole industry.

Figure 2.2 extends this point, and shows the various concepts and techniques discussed in this part of the book in diagrammatic form.

2.3 INDUSTRY ANALYSIS

Strategic thinking embraces the past, present and future. Understanding patterns and lessons from the past will certainly inform the future – but given the dynamic, turbulent and uncertain business environments that affect many industries and organizations, it would be dangerous to assume that the future will reflect the past and be a continuation of either past or existing trends.

Figure 2.3 shows (bottom triangle) how strategies which link competencies with a strategic vision for the future embrace learning from the past, an awareness of existing competencies and some insight into likely future trends. The top part of the figure highlights that *organizational learning* is required to build the future and that it encompasses:

- a reflection on how present strategies have emerged over time
- an understanding of current competencies and the strategic value of particular resources and the linkages between them
- knowledge of existing competitors and what they are doing at the moment – and preparing to do in the future
- an appreciation of possible new sources of competition
- an awareness of wider environmental opportunities and threats
- an ability to share information with, and thus learn from, external partners and contacts, including suppliers, distributors and customers.

The effective organization will synthesize this learning into insightful strategies for dealing with future uncertainties. Campbell and Alexander (1997) offer a different, but clearly related, approach to strategic thinking. They delineate three elements. First, insight into operating issues: with **benchmarking** other organizations (searching for good practices), process re-engineering and total quality management organizations should look

for opportunities to improve continuously the way they do things. Second, *future-gazing: exponents of chaos theory warn of the need always to* be ready for the unexpected and unpredictable; and so here the emphasis is on discontinuous change, and the idea of reinventing and thus controlling developments in the industry. Put another way, establishing new rules of competition and seizing the high ground ahead of any rivals. Scenario building plays an important role. The third element is behaviour and culture. *Without a clear and communicated vision and direction*, and with an absence of employees who are willing to engage the future and look for change opportunities, strategic thinking will be very limited and unimaginative. Simply, the organization must become more entrepreneurial in a dynamic environment.

Courtney *et al*. (1997) distinguish four alternative future patterns and three broad approaches, which have different degrees of relevance for different situations. The four futures are:

- a clear and definable future, which implies a continuation of present trends
- a limited and definable number of discrete alternatives which can be evaluated and judged
- a known range of possibilities, which can be defined only in more general terms
- real uncertainty, and with the possibility of major disruption and change.

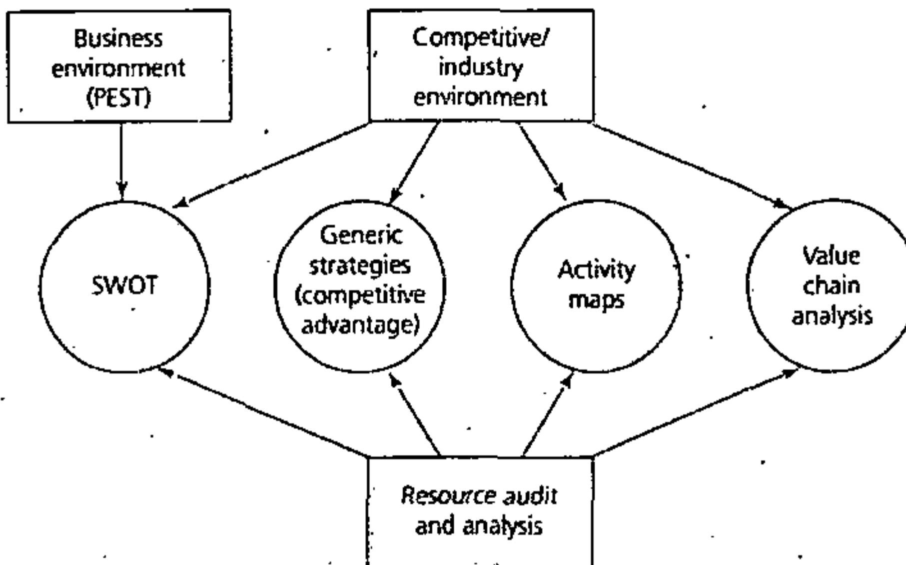


Figure 2.2 Competitive strategy: A summary of techniques

The three broad approaches, which should not be seen as mutually exclusive, for utilizing organizational learning to deal with the relevant future pattern are:

NOTES

- being relatively clear, or confident, about the direction, attempting to have an important influence and shape events
- accepting that there will be some uncertainty, staying vigilant and in close touch with events and happenings, and adapting to retain a strong position
- monitoring events and waiting for an appropriate opportunity to intervene in some way.

Figure 2.4 completes this section and summarizes the purposes and broad elements of strategic thinking. Throughout this section on strategic thinking, the emphasis has been on the ability to take a holistic view and synthesize information. We need to synthesize information from the past and present and combine it with a view of the future. This embraces information which originates inside the organization and information that can be obtained from external partners and contacts. Synergy, which is discussed next, explains the importance of linkages and synthesis.

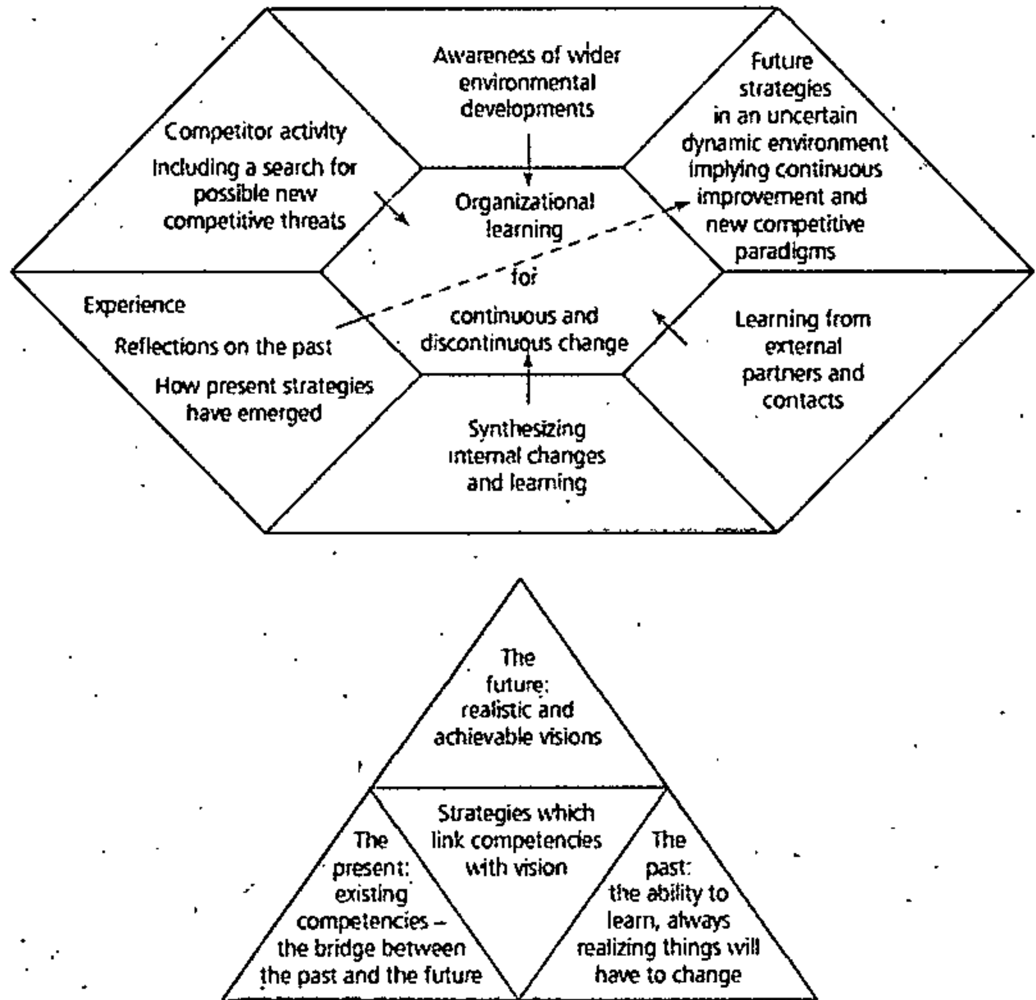


Figure 2.3 Organizational learning

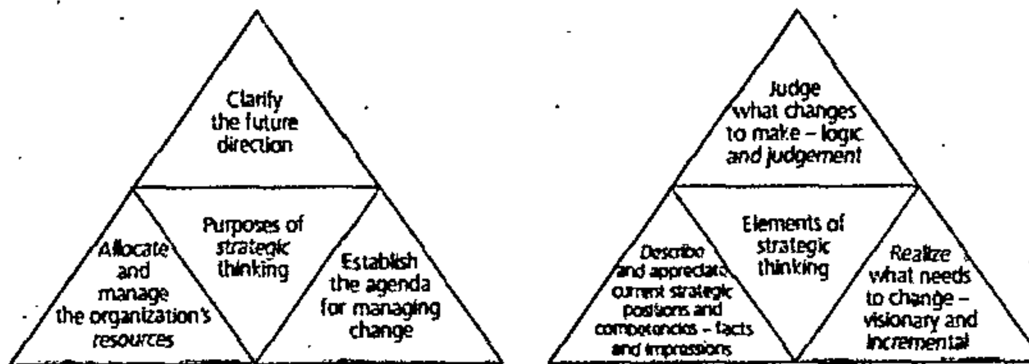


Figure 2.4 Strategic thinking – purposes and elements

2.4 RESOURCE-LED STRATEGY

The *resource*-based view of strategy gradually emerged during the 1980s and 1990s with a series of important contributions, in particular work on core competency from Prahalad and Hamel (1990) and on added value by Kay (1993). This view helps to explain why some organizations succeed in creating competitive advantage and earning superior profits, while others do not. Consequently, it looks at strategies which can be identified with an individual company as distinct from those that are available to all competitors through an understanding of industries and markets. In other words, market opportunities have to be identified and then satisfied *in an individual and distinctive way*. Supporters of the resource-based view put forward a number of arguments. As long as there are opportunities which can be identified, it will normally be easier and less risky for organizations to exploit their existing resources in new ways than to seek to acquire and learn new skills and competencies. Innovation matters and new ways of exploiting resources must be found to sustain any competitive advantage.

Relative differences which separate a company from its rivals are critical: just having a resource is not enough. For this reason, it can be useful if particular strengths are not easily learned and imitated by rivals. The opening case on Dyson shows how innovation and new ways of creating and adding value through design can markedly change an industry. In this particular case, innovation allowed a newcomer to *establish a position of market dominance and force a reaction from* established manufacturers. This chapter looks first and briefly at the idea of a resource audit before considering resource linkages and synergy through architecture and the notion of the value chain. The chapter concludes with a section on reputation and branding, key intangible assets.

People feel the best about their work when they do a high-quality job!

Getting a job done quickly is satisfying. Getting a job done at low cost is rewarding. But getting a job done quickly, at low cost and with high quality is exciting!

Robert C Stempel, when Chairman, General Motors Corporation

NOTES

2.5 STRATEGIC BUDGET AND AUDIT

Environments spring surprises on organizations from time to time. Sometimes the surprises constitute opportunities; at other times, threats. The most vigilant and aware organizations will be better placed to respond. Success lies in seeing opportunities 'ahead of the game' and responding in some individual way, ideally one that is genuinely different, appreciated by customers and not easily copied by rivals. The ability to do this comes down to individual, specific to the organization competencies and capabilities, which in turn emanate from the organization's resources. Resources, therefore, make the difference. In this chapter this argument is explored in greater depth and frameworks are provided which can help us to audit and evaluate strategic resources.

It does not follow that every resource an organization possesses is strategically significant. Sometimes it is tempting to list every positive resource as a strength, but this may be illusory. When we evaluate the resources of an organization in terms of their strategic significance, five factors matter:

1. Competitive superiority. The relative value when compared to rival organizations. A resource is not really a competitive strength if it is possessed by every competitor.
2. Barriers to replication. It is useful if rivals can be stopped from imitating or replicating any valuable resources.
3. Durability. Basically a time advantage relating to 1 and 2.
4. Substitutability. Can competitors neutralize the value of a resource by substituting an alternative?
5. Appropriability. Kay (1993) contends that it is essential that the organization possessing the resource benefits from it, rather than the real benefit accruing to someone else, such as a supplier or distributor.

The relationship between environmental forces and internal resources is at the heart of Figure 2.5, which has been adapted from the Harvard Business School approach to strategy (Kelly and Kelly, 1987). Here, selected products, services and markets are seen as environment driven and the competitive environment and stakeholders are shown with resources and values as four key strategic elements linked to corporate objectives.

These elements can be changed, but in many cases not readily and not quickly, and consequently at any point in time they are reasonably fixed. Six operating elements are also incorporated. *Marketing* relates to how the various products and services are positioned in relation to competitors, and how they are priced, advertised and distributed. *Manufacturing* involves the types of production process, location issues and technology utilization. *Finance* incorporates both performance targets and sources of funding. *Research and development* considers how much to spend on research and development and whether the perspective is short or long term. *Human resources* relates to the types of people utilized and how they are rewarded. The *organization structure* encompasses how these functions are co-ordinated and controlled.

These operating elements determine whether or not the corporate objectives are achieved. The different functions in the organization are affected to varying degrees by different stakeholders, and certain stakeholders who have a significant impact on certain functions may have little direct importance for others. Equally, the specific stakeholders may influence individual functions in quite different ways. Their impact upon the whole organization is therefore affected by the organization structure and relative power and influence within the firm. The figure also highlights the strategic value of functional managers taking a more holistic view of the organization and their role and contribution.

How, then, might we audit and evaluate these operating elements or strategic resources? An internal analysis should be a three-stage process:

1. an evaluation of the profile of the principal skills and resources of an organization
2. a comparison of this resource base with the requirements for competitive success in the industry
3. a comparison with competitors to determine the relative strengths and weaknesses and any significant comparative advantage.

Where *internal managers carry out this analysis*, it is inevitable that there will be some subjective judgement and it will be affected by their position in the organization. In a SWOT (strengths, weaknesses, opportunities and threats) analysis, then, the strengths and weaknesses of resources must be considered in relative and not absolute terms. It is important to consider whether they are being managed effectively as well as efficiently. Resources, therefore, are not strong or weak purely because they exist or do not exist. Rather, their value depends on how they are being managed, controlled and used.

In auditing resources we consider the functional areas of the business, as this is where the human, financial and physical resources are deployed. These areas might include finance, production, marketing, research

NOTES

and development, procurement, personnel and administration. However, it is also important to consider how they are related together in the organization's structure and control systems. A brilliant and successful marketing manager, for example, might seem to represent a strength; however, if there is no adequate cover for him and he leaves or falls ill, it is arguable that the firm has a marketing weakness.

Control systems, such as production and **financial control**, and the ways in which managers co-operate within the organization influence how well resources are managed for efficiency and effectiveness. Table 2.1, which is not meant to be fully comprehensive, provides a sample of key resource considerations. In completing such an audit the various resources should be evaluated: their existence, the ways in which they are deployed and utilized, and the control systems that are used to manage them. Efficiency measures of the salesforce might include sales per person or sales per region, but the effectiveness of the salesforce relates to their ability to sell the most profitable products or those products or services that the organization is keen to promote at a particular time, perhaps to reduce a high level of stocks. The efficiency of individual distribution outlets can be measured by sales revenue in a similar way. However, the effectiveness of the distribution activity relates to exactly which products are being sold and to whom, whether they are available where customers expect them, and how much investment in stock is required to maintain the outlets. The efficiency of plant and equipment is linked to percentage utilization. The effectiveness involves an assessment of which products are being manufactured in relation to orders and delivery requirements, to what quality and with what rejection levels.

It is also important to assess the relative strengths and weaknesses in relation to competition. Managers must be aware of and must address strategic issues if the resources are to be used for creating and sustaining competitive advantage. *Marketing* can be looked at from the point of view of managing the activities which comprise the marketing function. Product design and pricing, advertising, selling and distribution would be included here. However, if an organization is marketing orientated there is an implication that employees throughout the organization are aware of consumers and customers, their needs, and how they might be satisfied effectively while enabling the organization to achieve its objectives. Consumer concern becomes part of the culture and values.

Consumers and customers are mentioned separately because for many organizations, particularly the manufacturers of products for consumer markets, their customers are distributors and their ultimate consumers are customers of the retailers that they supply. Innovation and quality can be seen as aspects of production or *operations management*. Again, it is helpful if these factors become part of the culture. An innovatory

organization is ready for change, and looking to make positive changes, in order to get ahead and stay ahead of competition. A concern for quality in all activities will affect both costs and consumer satisfaction. In *human resources management* values are communicated and spread throughout the organization.

Financial management includes the control of costs so that profit is achieved and value is added to products and services primarily in areas that matter to consumers. This should provide differentiation and competitive advantage. Lower costs and differentiation are important themes in competitive strategy. They relate to both an awareness of consumer needs and the management of resources to satisfy these needs effectively and, where relevant, profitably. Marketing orientation and the effective management of production and operations, people and finance are all essential aspects of the creation and maintenance of competitive strength and advantage. Functional and competitive strategies are important for an understanding of strategic management in all types of organization, and they are especially important for a large proportion of small businesses and many not-for-profit organizations.

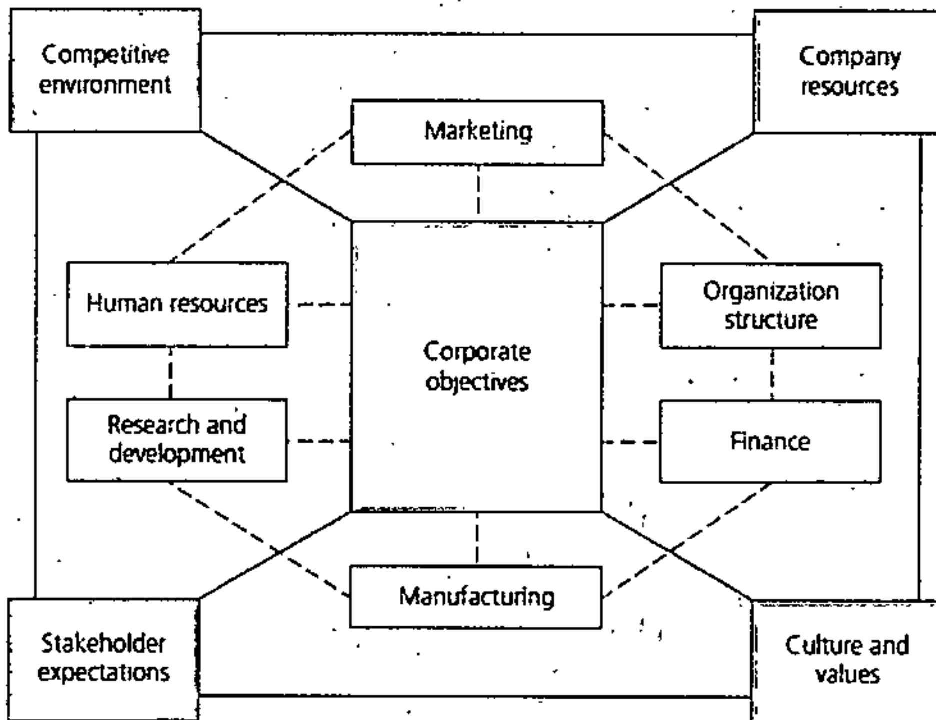


Figure 2.5 Matching the organization and the environment.

Corporate strategic changes such as major diversification and acquisition, divestment of business units which are underperforming or international expansion may not be relevant for small firms with a limited range of products or services and a primarily local market, or for not-for-profit organizations with very specific missions. However, these organizations

must compete effectively, operate efficiently and provide their customers and clients with products and services that satisfy their needs. Competitive and functional strategies are therefore the relevant issue.

NOTES

Table 2.1 Aspects of the resource audit

Resource/function	*Key considerations*
Marketing	Products and services: range, brand names and stage in life cycle
	Patents
	Strength of sales force
	Distribution channels
	Market information
Operations	Location and plant
	Capital equipment
	Capacity
	Processes
	Planning and manufacturing systems
	Quality control
	Supplies
Research and development	Annual budget
	Technology support
	Quality of researchers
	Record of success and reputation
	Spending in relation to industry norm
Information	Organizational knowledge and extent of sharing
	Information systems
	Problem-solving capabilities and procedures
Finance	Capital structure
	Working capital
	Cash flow
	Costing systems and variances
	Nature of shareholders
	Relations with bankers
Human resources	Numbers and qualifications
	Skills and experience
	Age profile
	Labour turnover and absenteeism
	Flexibility
	Development and training record and policies
	Motivation and culture
	Managerial competencies and capacity

As the Internet becomes more pervasive in our lives some organizations and industries are being presented with wonderful opportunities and, at the same time, real threats. Book retailing has changed with the growth of Amazon.com and the opening of online bookshops by the leading book retailers. Similarly, domestic banking has been changed with the growth of ATMs (automated teller machines or 'holes in the wall'), telephone call centres and Internet accounts. Competitors have had to develop new skills, competencies and capabilities in order to survive, let alone thrive. The challenge, though, did not stop here. It has also been necessary

NOTES

to clarify the key success factors for those customers who opted to avoid the Internet and stick with a personal service. What exactly are their needs and preferences? How can they be satisfied 'wonderfully well'? How can costs be trimmed in the process?

Sometimes the value and constituency of these networks and partnerships can be hard to quantify or even explain. They owe a lot to people and to their history. They are relationships which emerge and strengthen over many years and are dependent upon personal relations and interactions. This often serves to make them even more powerful as they are automatically difficult to replicate. Consequently, architecture can be a vital element of competitive advantage.

As more and more organizations opt to focus on core strengths, activities and competencies, and divest those that are peripheral, the significance of architecture is reinforced and increased. When companies outsource important services such as information technology (IT) or payroll management, or choose to buy-in key components they once made for themselves, they need to be able to rely upon, and trust, their new suppliers. Managing relationships, therefore, becomes an important new capability. Some organizations, of course, have chosen to **outsource** their manufacturing. Dyson has switched its manufacturing to Malaysia to reduce costs. Royal Doulton (china) now focuses on design and marketing and outsources production from Indonesia. Dr Martens boots and shoes are made in China. Hornby, manufacturer of model electric trains and Scalextrix car racing systems, also manufactures in China. However, this move was not directed at reducing costs, per se. Hornby found it could devote two labour hours for every one used in the UK and thus produce models with much higher quality and detail at the same total cost. Without changing its prices, Hornby has seen its sales grow rapidly because of the greater authenticity.

At the same time the company has been innovatory with new products. For example, both Eurostar and the Hogwarts Express from the Harry Potter stories provided new sales opportunities. Buckingham and Coffman (1999) also draw attention to the importance of architecture in their delineation of four levels of customer service. Level 1 is accuracy and level 2, availability. These, they argue, have to be seen as the relatively easy levels, and are generally taken for granted. In other words, without them, a company cannot hope to win repeated business. Levels 3 and 4 are working partnerships and the provision of advice and support. These relate to strategic architecture.

Porter also made a contribution to strategic architecture by providing a value chain framework for helping to identify valuable differences and manage cost drivers. Before we look in depth at the value chain,

however, we next consider two critically important strategic resources: people and information. We are concentrating on these as they are key drivers of change as well as being crucially important in the implementation of chosen strategies.

NOTES

2.6 SCANNING FUNCTIONAL RESOURCES

The 'people contribution'

Successful organizations meet the needs and expectations of their customers more effectively than their competitors; at the same time, they generate acceptable financial returns. Achieving these outcomes requires competent and committed people. People, then, are critically important strategic resources. Successful companies will be able to attract, motivate, develop, reward and keep skilled and competent managers and other employees. They will be able to create and implement strategic changes in a supportive culture. People need to be used and stretched to get the best out of them but, correspondingly, they need to be looked after and rewarded. However, even successful companies have lean periods, and when these occur, they will again be able to retain their most important people. There is no one best way of achieving this.

Everything that an organization does, in the end, depends on people. Although technology and IT can make a major strategic impact, it is people who exploit their potential. Managers and employees are needed to implement strategies and to this end they must understand and share the values of the organization. They must be committed to the organization and they must work together well. At the same time, where an organization is decentralized and operating in a turbulent environment, the strategic leader will rely on people to spot opportunities and threats, to adapt and create new strategies.

Consequently, it is people who ultimately determine whether or not competitive advantage is created and sustained. Adding new values with innovation, they can be an opportunity and a source of competitive advantage; equally, unenthusiastic, uncommitted, untrained employees can act as a constraint. People's capabilities are infinite and resourceful in the appropriate organizational climate. The basic test of their value concerns how much they – and their contribution – would be missed if they left or, possibly worse, left and joined a competitor. They could take customers with them and not be easily replaced.

Achieving the highest level of outcomes that people are capable of producing will therefore depend upon the human resource practices adopted by the organization. While the issues are clear and straightforward – they

involve selection, training, rewards and work organization – there is no single best approach to the challenge. A relatively formal, 'hard' approach can prove very successful in certain circumstances; other organizations will derive significant benefits from a 'softer', more empowered style. One issue here is whether the business is being driven by a small number of identifiable, key decision- makers or by the employees collectively.

It is worth considering whether either of the market-driven (the E in E–V–R Congruence) and resource-based (R) views of strategy truly explain what has happened as Semco. Arguably the real driving force behind the changes has been values. Semler, in effect, deregulated Semco, allowing people the freedom to choose how they would work. Certain policies regarding competitiveness guided appropriate behaviour.

To bring out the best in people, they have to be managed well, and this requires leadership. A useful metaphor is that of an orchestra. Every member (manager/employee) is a specialist, with some making a unique contribution which, on occasions, can take the form of a solo performance. Nevertheless, all the contributions must be synthesized to create harmony (synergy), which is the role of the conductor (strategic leader). A single musician (weak link) can destroy a performance; a chain is only as strong as its weakest link. A successful organization, therefore, needs people with appropriate skills and competencies who can work together effectively. People must be:

- committed (commitment can be improved)
- competent (competencies can be developed, and can bring improved product quality and productivity)
- cost-effective (ideally costs should be low and performance high, although this does not imply low rewards for success)
- in sympathy with the aims of the organization (are the values and expectations of all parties in agreement?)

Where people grow, profits grow.

Dr Alex Krauer, when Chairman and Managing Director, Ciba-Geigy

2.7 IMPACT OF E-COMMERCE

The strategic value of information

People make decisions, but information is the fuel they use in decision-making; it can also be an important source of competitive advantage in certain circumstances. It must be stressed that IT, per se, is rarely

NOTES

a source of advantage, but information management can be. So, what exactly do we mean by 'informa-ion' and how might it be exploited?

Information has been defined as 'some tangible or intangible entity that reduces uncertainty about a state or event' (Lucas, 1976), which is a way of saying that information increases knowledge in a particular situation. When information is received, some degree of order can be imposed on a previously less well-ordered situation. Information is needed for, and used in, decision-making. Information, information systems and information technology are all aids to decision-making. The more information managers and other employees have about what is happening in the organization, and in its environment, the more strategically aware they are likely to be. Information about other functional areas and business units can be particularly helpful in this respect.

Ackoff (1967), however, suggested that management information systems can easily be based on three erroneous assumptions:

- Managers are short of information. In many cases managers have too much irrelevant information.
- Managers know the information they require for a decision. However, when asked what information they might need, managers play safe and ask for everything which might be relevant, and thereby contribute to the overabundance of irrelevant information.
- If a manager is provided with the information required for a decision he or she will have no further problem in using it effectively. How information is used depends on perceptions of the issues involved. Moreover, if any additional quantitative analysis or interpretation is required, many managers are weak in these skills.

Nevertheless, decisions and decision-making do involve both facts and people. While the right information available at the right time can be extremely useful, the real value of information relates to how it is used by decision-makers, particularly for generating and evaluating alternative possible courses of action. In designing and introducing IT and management information systems into organizations it is necessary to consider the likely reaction of people as well as the potential benefits that can accrue from having more up to date and accurate information available. Information gathering should never become an end in itself, for the expertise and experience in people's heads can be more useful than facts on paper.

Moreover, it is important to evaluate who actually needs the information, rather than who might find it useful for increasing awareness, and to ensure that those people receive it. Although information technology and information systems can be expensive to introduce, those organizations that receive information, analyse and distribute it to the appropriate decision-makers more quickly than their competitors can achieve a competitive edge, particularly in a turbulent environment. Hence, the structure and

culture of the organization should ensure that managers who need information receive it, and at the right time. However, while information can lead to more effective decision- making, it remains a manifestation of power within the organization, and this aspect needs monitoring. If information that could prove useful is withheld from decisionmakers, negligently or deliberately by political managers pursuing personal objectives, the effectiveness of decision-making is reduced.

Information is used through a filter of experience and judgement in decision-making, and its relative value varies between one decision-maker and another. In certain instances the available information will be accurate, reliable and up to date. In other circumstances the information provided may already be biased because it is the result of the interpretation of a situation by someone who may have introduced subjectivity. Some managers, perhaps those who are less experienced, will rely more heavily on specific information than others, for whom experience, general awareness and insight into the situation are more important.

To complicate matters further, Day (1996) argues that organizations do not know what they know. In other words, they are awash with data that do not get translated into valuable information and hence real organizational knowledge. Linked to this, it is clear that quite frequently they also fail to realize the value of some of the information that some people in the organization possess. This can be taken even further. If organizations do not know what they know, it must follow they do not know what they do not know. They remain unaware of certain opportunities that others will seize and that they would have found valuable if they knew of their existence. Correspondingly, they do not find out about certain threats until it is too late to act.

Decision-making and the interpretation of information

Spear (1980) argues that when information systems and the provision of information for managers are being considered it is important to bear in mind how people make decisions, interpret data and information, and give meaning to them. In decision-making managers sometimes behave in a stereotyped way and follow past courses of action; sometimes they are relatively unconcerned with the particular decision and may behave inconsistently. In each case they may ignore information which is available and which if used objectively would lead to a different conclusion and decision. At other times information is used selectively and ignored if it conflicts with strongly held beliefs or views about certain things. In other words, information may be either misused or not used effectively.

Moreover, when considering a problem situation managers have to interpret the events that they are able to observe and draw certain conclusions about what they believe is happening. The question is: do

NOTES

managers perceive reality? Is there even such a thing as reality, or are there simply the meanings that we give to events? The following example will explain the point. Worker directors, popular in some other European countries, have always been a controversial issue among managers and trade union officials in the UK, with some of them supportive and others, in reality a majority, strongly opposed to their introduction. Managers who oppose them argue that they will reduce managerial power to run an organization; union opponents argue they would increase managerial power because the directors would be carefully selected or co-opted to include mainly those who were antagonistic to many of the aims of the union. These views represent meaning systems. The idea of worker directors, and what they are, is definite and agreed; their meaning and the implications of using them are subjective and interpretative.

A parallel situation would concern the interpretation of economic data. If, say, interest rates are rising, share prices are falling or the value of the pound is strengthening, do economic analysts agree or disagree on their meaning?

The strategic information challenge

Why do some organizations, which are currently enjoying success and high profits, fail to realize when products, services or strategies are about to lose customer support? Why do they fail to anticipate competitor initiatives? Why are others able to be more proactive? Being close to customers, and in touch with new developments in a dynamic and possibly chaotic marketplace, requires information, intelligence and learning. Successful organizations monitor the activities of their customers, suppliers and competitors; they ask questions and test out new ideas. They express a willingness to learn and to change both their perspective on competition – their mindset concerning which factors determine competitive success – and the things they actually do. Sophisticated analyses and models of past and current results and behaviour patterns make an important contribution but, as Day (1996) argues, it is also necessary to think through how a market might respond to actions designed to retain existing customers and win new business, while outflanking and outperforming competitors. One of the reasons for Canon's continued success has been its ability to spot new market opportunities for its advanced technologies and exploit them early. Canon is also adept at reducing its dependency on product s/ markets as competition intensifies and demand plateaus. In the 1970s, for example, Canon successfully and systematically switched emphasis away from cameras (while remaining active and innovatory in the market) to photocopiers, and then to computer printers and facsimile machines, always adopting the same focus principles. Canon now has a range of digital cameras and accessories.

In order to become and remain strategically successful, organizations must create and sustain competitive advantage. They must continue to enjoy E–V–R congruence, frequently in a dynamic and turbulent environment. To achieve this, information must be gathered and shared, but this is not merely a question of designing a new information system.

Day (1996) contends that many organizations 'do not know what they know' either because data and signals are misinterpreted or because the flows are inadequate. Decision-makers do not receive the information that they need, or they fail to learn about things that might prove useful. *Organizations that prioritize vertical channels and ignore horizontal* flows are the ones most likely to fail to learn. The important elements for strategic success are:

- tracking events in the market and the environment, choosing responses (both proactively and reactively) and monitoring the outcomes of the actions which follow. Competitor initiatives must be dealt with; benchmarking best practices and general awareness can suggest new ideas
- making sure that important information from the questioning and learning from these emergent changes is disseminated effectively
- reflecting upon outcomes in the context of E–V–R congruence to ensure that the organization can sustain an effective match with its environment
- where appropriate, adapting policies and procedures to better guide future decisions.

The implication is a constant willingness to be flexible and to change as necessary. Companies must work from the twin perspectives of opportunity and threat. First, a willingness to learn and grow and, second, a realization that without appropriate and timely change a company is likely to face a crisis. Gilbert (1995) further argues that strategically successful organizations leverage their innovative competitive ideas with speed and act quickly.

They obtain market feedback continuously and rapidly and adapt to the feedback ahead of their rivals. They exploit the potential of strategic as well as competitive and operating information systems.

The value chain

Supply-chain partnerships

In this section we develop the significance of internal and external architecture introduced earlier in the chapter and explain an important analytical framework. Developing his earlier work on industry structure (Porter 1980), where he highlights the significance of the relative power

NOTES

of buyers and suppliers, Porter (1985) argues that in the search for competitive advantage a firm must be considered as part of a wider system:

suppliers > firm > distributors > consumers.

As well as seeking improvements in its own activities, a firm should assess the opportunities and potential benefits from improving its links with other organizations. A firm is linked to the marketing and selling activities of its suppliers, and to the purchasing and materials handling activities of its distributors or customers.

The supply chain, then, is a process, and managing it is a key *strategic capability*. Cost savings and service differentiation can be achieved. Organizations can create synergy, and enjoy the appropriate benefits, if they can successfully link their value chain with those of their suppliers and distributors. Just in time (JIT) deliveries integrate a supplier's outbound logistics with the organization's inbound logistics. Stock and costs can be reduced for the manufacturer, whose delivery lead time and reliability should also be improved. Set up properly, a JIT system can enable suppliers to plan their work more effectively and reduce their uncertainty. This requires an open exchange of reliable, up-to-date information and medium- to long-term supply arrangements. When Nissan was developing the supply chain for its UK manufacturing plant in Sunderland, it deliberately forged links with its suppliers' suppliers in its search to control costs without sacrificing quality and service. A retail bookseller, taking orders for non-stock items, needs to be sure of the delivery lead time from his publishers or wholesaler before quoting a date to the customer. This again demands accurate information, supported by reliable supply.

Carphone Warehouse, a leading retailer of mobile phones, has retailed telephones at prices ranging from 50p to over £300. Where the phone is sold as part of a package which involves a monthly line rental, the phone will typically have been provided free to the Carphone Warehouse by one of the major networks, such as BT, Orange or Vodafone, who in turn will have a supply arrangement with a manufacturer, perhaps Nokia or Motorola. The retailer will later receive a share of the future call revenues, normally between 3 per cent and 5 per cent. The ultimate value to Carphone Warehouse of the sale will average £300, regardless of the apparent selling price. In the case of phones used for prepaid calls without any monthly line rental, a typical sale will yield £200.

Organizations looking to launch a new product need to ensure that their supply and distribution networks are properly in place; given this, all interested parties can benefit. Retailers will need to be convinced of a new product's viability and potential before they agree to stock it, normally at the expense of taking something else off their shelves.

Manufacturers must be sure that stocks are available where customers expect to find them before they proceed with launch advertising. The

key lies in an integrated network, where all members of the supply chain see themselves as mutual beneficiaries from an effective total system; however, this does not always happen. Supply-chain management issues become increasingly important where organizations seek to reduce the number of their suppliers, *buying as many items as possible from* each selected supplier. It is quite feasible that these major suppliers will have to buy-in products that they do not make themselves in order to create the 'basket' of items demanded by their customer. This strategy has been adopted by the leading oil companies and car manufacturers. In 1994 Ford in the USA included components from 700 US suppliers in its Tempo model; in 1995 the company's equivalent Mercury Mystique was using 227 suppliers worldwide. One supplier, for example, was now required to provide a fully assembled dashboard, ready for immediate installation; it is likely that the electronic instrumentation will be bought-in by the relevant supplier. In 1999 Ford of Brazil went further. For the first time a supplier was given responsibility for part of the production line in a Ford assembly plant. Simply, the workers are employed by the supplier but work inside a plant owned by Ford.

NOTES

Preece *et al.* (1995) use the value chain to explain how Levi Strauss, producer of the internationally successful Levi's jeans, has created value and used its value-creating activities carefully to establish a distinctive corporate reputation, which is a form of competitive advantage. Key aspects include:

- established links with suppliers from around the world
- team manufacturing (underpinned by training and empowerment) and linked to high-technology equipment and sophisticated information support
- global advertising and branding
- alliances with retailers who concentrate on Levi's jeans and do not stock competitor products
- a programme of 'marketing revitalization' designed to reduce lead times and improve the availability of the products.

Strengthening the processes involved in managing the supply chain relates to the level of service that companies are able to offer their customers and to total quality management.

Corporate restructuring to improve international competitiveness is a vital priority for British and European businesses in the 1990s. However, such restructuring must be a continual process of change and revitalization if we are to consistently satisfy the consumer's need for the highest quality products and services at the most competitive cost. The leadership of this process is the primary role of management in the modern company.

NOTES

Ian G McAllister, when Chairman and Managing Director, Ford Motor Company Limited, UK When ICI had an Explosives division, which manufactured a range of explosive products, managers also developed expertise in detonating explosions. Quarry managers, who buy the products, really want stones and rocks on a quarry floor rather than the explosives. As a consequence ICI offered to produce a three-dimensional map of a quarry for their customers, indicating where the charges need to be placed, and then, when suitable holes have been drilled in the quarry face (by the quarry owners), carry out controlled explosions. In this way they add value for their customers and link the two value chains.

The organization's value chain

While strategic success depends upon the way in which the organization as a whole behaves, and the ways in which managers and functions are integrated, competitive advantage stems from the individual and discrete activities that a firm performs. A cost advantage can arise from low-cost distribution, efficient production or an excellent sales force that succeeds in winning the most appropriate orders. Differentiation can be the result of having an excellent design team or being able to source high-quality materials or high-quality production. Value-chain analysis is a systematic way of studying the direct and support activities undertaken by a firm. From this analysis should arise greater awareness concerning costs and the potential for lower costs and for differentiation. Quite simply, argues Porter (1985), competitive advantage is created and sustained when a firm performs the most critical functions either more cheaply or better than its competitors. But what are the most critical factors? Why? How and where might costs be reduced? How and where might differentiation be created?

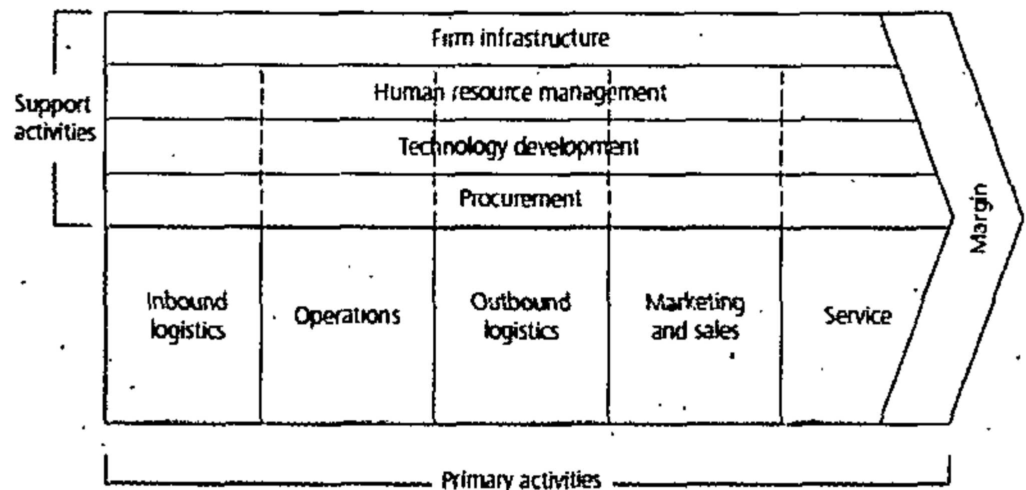


Figure 2.6 The value chain

Activities in the value chain

The value chain developed by Michael Porter is illustrated in Figure 2.6. There are five primary activities, namely inbound logistics, operations, outbound logistics, marketing and sales, and service. In the diagram they are illustrated as a chain moving from left to right, and they represent activities of physically creating the product or service and transferring it to the buyer, together with any necessary after-sale service. They are linked to four support activities: procurement, technology development, human resource management, and the firm's infrastructure. The support activities are drawn laterally as they can affect any one or more of the primary activities, although the firm's infrastructure generally supports the whole value chain. Every one of the primary and support activities incurs costs and should add value to the product or service in excess of these costs. It is important always to look for ways of reducing costs sensibly; cost reductions should not be at the expense of lost quality in areas that matter to customers and consumers. Equally, costs can be added justifiably if they add qualities that the customer values and is willing to pay for. The difference between the total costs and the selling price is the margin. The margin is increased by widening the gap between costs and price. The activities are described in greater depth below.

Primary activities

- *Inbound logistics* are activities relating to receiving, storing and distributing internally the inputs to the product or service. They include warehousing, stock control and internal transportation systems.
- *Operations* are activities relating to the transformation of inputs into finished products and services. Operations includes machining, assembly and packaging.
- *Outbound logistics* are activities relating to the distribution of finished goods and services to customers.
- *Marketing and sales* includes such activities as advertising and promotion, pricing and sales force activity.
- *Service* relates to the provision of any necessary service with a product, such as installation, repair, extended warranty or training in how to use the product. Each of these might be crucial for competitive advantage. The nature of the industry will determine which factors are the most significant.

Support activities

- *Procurement* refers to the function or process of purchasing any inputs used in the value chain, as distinct from issues of their

NOTES

application. Procurement may take place within defined policies or procedures, and it might be evidenced within a number of functional areas. Production managers and engineers, for example, are very important in many purchasing decisions to ensure that the specification and quality are appropriate.

- *Technology development*: technology is defined here in its broadest sense to include know-how, research and development, product design and process improvement and information technology.
- *Human resource management* involves all activities relating to recruiting, training, developing and rewarding people throughout the organization
- *The firm's infrastructure* includes the structure of the organization, planning, financial controls and quality management designed to support the whole of the value chain. Again, each of these support activities can be very important in creating and sustaining competitive advantage.

Subactivities Porter argues that it can often be valuable to subdivide the primary and support activities into their component parts when analysing costs and opportunities for differentiation. For example, it is less meaningful to argue that an organization provides good service than to explain it in terms of installation, repair or training. The competitive advantage is likely to result from a specific subactivity. Similarly, the marketing mix comprises a set of linked activities which should be managed to complement each other. However, competitive advantage can arise from just one activity in the mix, possibly the product design, its price or advertising, technical support literature, or from the skills and activities of the sales force.

Linkages within the value chain

Although competitive advantage arises from one or more subactivities within the primary and support activities comprising the value chain, it is important not to think of the chain merely as a set of independent activities. Rather, it is a system of interdependent activities. Linkages in the value chain, which are relationships between the activities, are very important. Behaviour in one part of the organization can affect the costs and performance of other business units and functions, and this quite frequently involves trade-off decisions. For example, more expensive materials and more stringent inspection will increase costs in the inbound logistics and operations activities, but the savings in service costs resulting

from these strategies may be greater. The choice of functional strategies and where to concentrate efforts will relate to the organization's competitive and corporate strategies concerning competitive advantage.

Similarly, several activities and subactivities depend on each other. The extent to which operations, outbound *logistics* and *installation* are co-ordinated can be a source of competitive advantage through lower costs (reduced stockholding) or differentiation (high quality, customer-orientated service). This last example uses linkages between primary activities, but there are also clear linkages between primary and support activities.

Product design affects manufacturing costs, purchasing policies affect operations and production costs, and so on. Having introduced and discussed the concept of the value chain, it is now important to consider how it might be applied in the evaluation of costs and differentiation opportunities.

The value chain and competitive advantage

Cost leadership and differentiation strategies

In the next section we discuss how differentiation and cost management are two key themes in competition and also introduce Porter's generic strategies built around cost leadership and differentiation (Porter, 1985). Here, though, we look at how these themes relate to the value chain framework.

Cost leadership The argument of Porter (1985) that the lowest cost producer in either a broad or narrow competitive scope (the broad market or specialist segments):

- delivers acceptable quality but produces the product or service with lower costs than competitors
- sustains this cost gap
- achieves above-average profits from industry-average prices.

This cost advantage will be achieved by the effective management of the key determinants of costs.

The differentiation strategy Similarly, Porter argues that the successful application of a differentiation strategy involves:

NOTES

Table 2.2 Indicative cost breakdown of a manufacturing and a service business

	Manufacturing firm (% of total)	Professional firm of accountants (% of total)	
Primary activities			
Inbound logistics	4	8	(data collection for audits)
Operations	64	26	(actual auditing)
Outbound logistics	1	5	(report writing and presentations)
Marketing and sales	7	21	(getting new business)
Service	1	3	(general client liaison)
	77	63	
Support activities			
Procurement	1	1	
Technology development	10	8	(IT development)
Human resources management	2	16	
Firm's infrastructure	10	12	
	100	100	

These figures are only indicative, and should not be seen as targets for any particular firm.

- the selection of one or more key characteristics which are widely valued by buyers (there are any number of opportunities relating to different needs and market segments)
- adding costs selectively in the areas perceived to be important to buyers, and charging a premium price in excess of the added costs.

The success of this strategy lies in finding opportunities for differentiation which cannot be matched easily by competitors, and being clear about the costs involved and the price potential. Costs in areas not perceived to be significant to buyers must be controlled, and in line with competitor costs, for otherwise above-average profits will not be achieved.

The successful implementation of both of these strategies therefore requires an understanding of where costs are incurred throughout the organization. Understanding costs and the search for appropriate cost reductions involves an appreciation of how costs should be attributed to the various discrete activities which comprise the value chain. Table 2.2 compares a possible cost breakdown for a manufacturing firm with that for a firm of professional accountants. If an analysis of the value chain is to be meaningful, it is important that the costs are genuinely attributed to the activities that generate them, and not simply apportioned in some convenient way, however difficult this might prove in practice. Given the figures in Table 2.2 one might question whether the manufacturing firm is spending enough on human resources management and marketing, and the accountancy practice too much.

Cost drivers

It is important to appreciate which cost drivers are the most significant. The following cost drivers can all influence the value chain.

- Economies of scale and potential experience and learning curve benefits.
- Capacity utilization, linked to production control and the existence of bottlenecks.
- Linkages -- Time spent liaising with other departments can incur costs, but at the same time create savings and differentiation through interrelationships and shared activities.
- Interrelationships and shared activities – Shared activities, possibly a shared sales force, shared advertising or shared plant, can generate savings. Close links between activities or departments can increase quality and ensure that the needs of customers are matched more effectively.
- Integration – This incorporates the extent to which the organization is vertically integrated, say manufacturing its own component parts instead of assembling bought-in components, or even designing and manufacturing its own machinery. This again can influence costs and differentiation, and is an important element of the strategy of YKK, which is featured as an example later in this chapter.
- Timing – Buying and selling at the appropriate time. It is important to invest in stocks to ensure deliveries when customers want them, but at the same time stockholding costs must be monitored and controlled.
- Policies – Policy standards for procurement or production may be wrong. If they are set too low, quality may be lost and prove detrimental. If they are too high in relation to the actual needs of the market, costs are incurred unnecessarily.
- Location issues – This includes wage costs, which can vary between different regions, and the costs of supporting a particular organization structure.
- Institutional factors – Specific regulations concerning materials content or usage would be an example.

Porter argues that sustained competitive advantage requires effective control of the cost drivers, and that scale economies, learning, linkages, interrelationships and timing provide the key opportunities for creating advantage. In the case of a cost leadership strategy, the cost advantage is relative to the costs of competitors, and over time these could change if competitors concentrate on their cost drivers. Consequently, it is

useful to attempt to monitor and predict how competitor costs might change in the future linked to any changes in their competitive and functional strategies.

NOTES

Common probiems in cost control through the value chain

It was mentioned above that it can prove difficult to assign costs to activities properly, and this is one of the difficulties likely to be encountered in using value-chain analysis as a basis for more effective cost management. Porter contends that there are several common pitfalls in managing costs for competitive advantage:

- misunderstanding of actual costs and misperceptions of the key cost drivers
- concentrating on manufacturing when cost savings are required. Often it is not the area to cut if quality is to be maintained, especially once a certain level of manufacturing efficiency has been achieved
- failing to take advantage of the potential gains from linkages
- ignoring competitor behaviour
- relying on small incremental cost savings when needs arise rather than introducing a long-term, permanently installed cost-management programme.

Differentiation opportunities

It has been mentioned on a number of occasions that competitive advantage through differentiation can arise from any and every area of the business. In relation to the component parts of the value chain, the following are examples of where differentiation might originate.

Primary activities

- *Inbound logistics* – careful and thoughtful handling to ensure that incoming materials are not damaged and are easily accessed when necessary, and the linking of purchases to production requirements, especially important in the case of JIT manufacturing systems.
- *Operations* – high quality; high-output levels and few rejections; delivery on time.
- *Outbound logistics* – rapid delivery when and where customers need the product or service.
- *Marketing and sales* – advertising closely tied to defined market

segments; a welltrained, knowledgeable and motivated sales force; and good technical literature, especially for industrial products.

- *Service* – rapid installation; speedy after-sales service and repair; and immediate availability of spare parts.

Support activities

- *Procurement* – purchasing high-quality materials (to assist operations); regional warehousing of finished products (to enable speedy delivery to customers).
- *Technology development* – the development of unique features, and new products and services; the use of IT to manage inbound and outbound logistics most effectively; and sophisticated market analyses to enable segmentation, targeting and positioning for differentiation.
- *Human resources management* – high-quality training and development; recruitment of the right people; and appropriate reward systems which help to motivate people.
- *Firm's infrastructure* – support from senior executives in customer relations; investment in suitable physical facilities to improve working conditions; and investment in carefully designed IT systems.

In searching for the most appropriate means of differentiating for competitive advantage it is important to look at which activities are the most essential as far as consumers and customers are concerned, and to isolate the key success factors. It is a search for opportunities to be different from competitors in ways which matter, and through this the creation of a superior competitive position. The Japanese zip manufacturer YKK, the world market leader, grew to enjoy a superior competitive position, and the company's strategy is analysed against the value chain in the next section.

An application of the value chain

YKK has arguably succeeded in creating both cost leadership and substantial differentiation with its corporate, competitive and functional strategies, and these have resulted in effective barriers to entry into the industry and close relationships with customers. The idea might be illustrated in Figure 2.7.

The essential components of the strategy, summarized below, are illustrated in Figure 2.8, which places them in the context of the value chain and highlights the linkages. YKK is structured as a multiplant multinational company with both wholly owned subsidiary companies and joint ventures

NOTES

throughout the world. The latter organizations are primarily the result of local politics, particularly in low labour cost countries in the Far East. While the subsidiaries are decentralized and enjoy some local autonomy, they are invariably managed at the top by Japanese executives on a period of secondment.

Consequently, there is substantial influence from the Japanese parent. YKK invests a significant percentage of after-tax profits back in the business, and as a result is heavily automated and able to enjoy the benefits of the experience/learning curve. Moreover, YKK prices its finished products very competitively both to generate customer satisfaction and to create barriers to entry. The company is vertically integrated, designing and manufacturing its own production machinery, and this gives it a unique competitive edge. It is also particularly innovative as far as both machinery and finished products are concerned.

Coils of semi-finished zips are produced in the Far East, particularly Japan, and exported to such countries as the UK, where they are cut to size and finished in response to customer orders. This results in both cost advantages and speedy deliveries from semi-finished stocks. A wide range of colours and sizes is kept ready for finishing. In the UK the key garment manufacturers and the retail outlets that they serve are targeted by YKK and are given special service.

The 'Cycle of Goodness' philosophy has not been exported in its complete form, but employee relations are an important aspect of the human resources strategy. Participation and involvement are essential features, and total quality management is a key feature. Conceptually, the value chain is a useful way of analysing resources and functions within the organization in the context of how they might individually contribute to competitive advantage. At the same time the linkages between them should be assessed, because it is from these interrelationships and linkages that synergy in the form of additional cost savings or differentiation is created.

To apply the value chain properly it is important also to allocate costs to activities, and to evaluate whether costs could be saved in various areas or whether additional spending on certain activities might yield additional benefits by adding value in ways which are important to consumers. In practice it can be difficult to assign costs accurately. In this respect the actual application, rather than the concept, of the value chain is more applicable for managers than for students of this subject. In the authors' experience, applications of the value chain pose difficulties for managers, primarily because the management accounting systems in many organizations do not readily provide the data in the form required. Developing this theme, Johnson and Kaplan (1987) contend that certain costs are extremely difficult to allocate to certain individual products, but they are the costs of activities which are very significant in relation to total

quality and in turn competitive advantage. Machine failures are one example, and they affect a number of products and can mean that deliveries are late and possibly priorities are changed. But how should the costs be allocated? As production systems become increasingly sophisticated, overheads, as a proportion of total costs, increase relative to the direct costs of labour and materials. Genuinely allocating these production overheads is difficult.

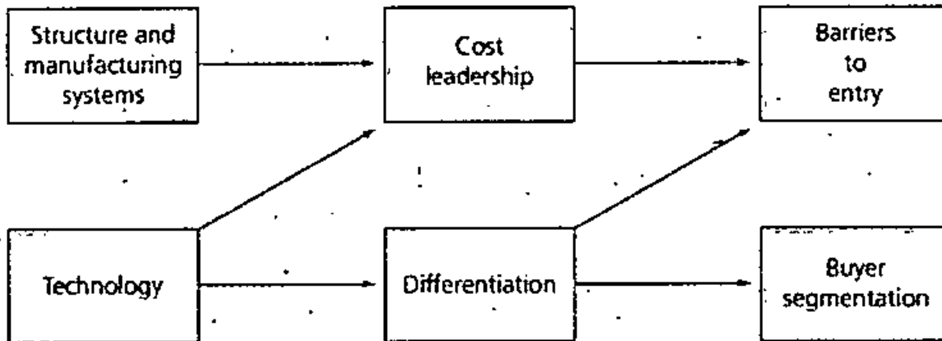


Figure 2.7 YKK's competitive advantage

Nevertheless, the value chain can provide an extremely useful framework for considering the activities involved in producing products and services and considering their significance for customers.

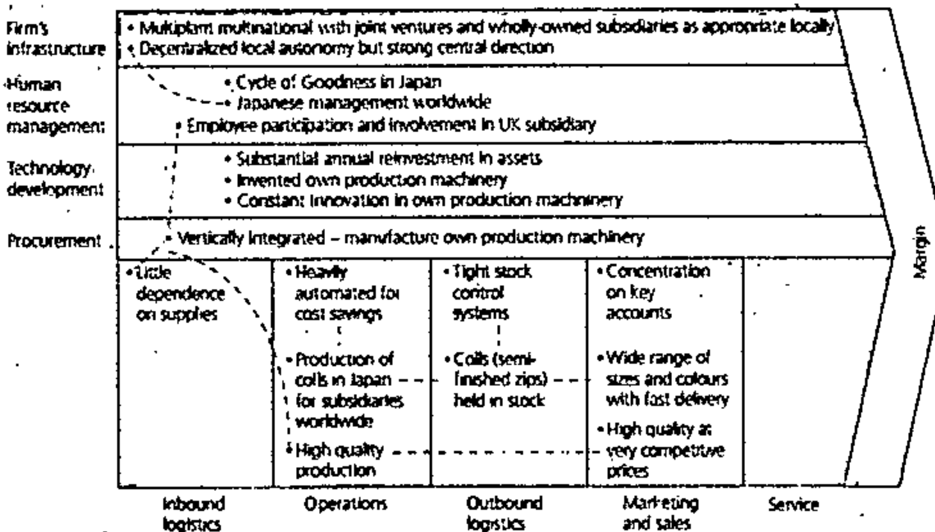


Figure 2.8 YKK's competitive advantage and the value chain

We are students of Japan here in General Electric. We think they're marvellous, marvellous industrialists. We like their new product development, we like their speed, we like their quality focus. I put them at the pinnacle, and we're working every day to learn everything we can from them

John F Welch, ex-Chairman and CEO, General Electric

We continue this chapter by returning to Kay's (1993) framework and looking at reputation, but before we do this it is important to cross

NOTES

reference activity mapping. In a 1996 *Harvard Business Review* article, Michael Porter developed activity maps as an adjunct to the value chain. The challenge is to produce a framework of the critically important activities, together with those that support them, and show how they all link together.

The impact of the Internet

The emergence and rapid growth of the Internet and the World Wide Web during the 1990s spawned a number of new and very entrepreneurial businesses. It is easy to be seduced by Internet possibilities and, supported by venture capital, many new Internet companies have grown rapidly. Few, however, have turned growing revenues into profits. At the same time, it has also demanded that every organization develop a strategy for harnessing its potential: it will not go away and, for some, will completely transform their ways of operating and doing business. This section briefly explores some of these issues.

The Internet provides information – which can make decision-making much easier, but is potentially in quantities so great that it is hard to assimilate

- allows a company to advertise and promote itself and its products and services
- speeds up communication by replacing printed memos and telephone calls
- enables electronic trading. This again can take several forms. For consumer sales, information on a product (such as a book) can very readily be provided, along withreviews; moreover, in the case of a compact disc, sample tracks can be played. Virtual reality can be employed to move people around either a shopping mall or a supermarket.

Many case shows how certain organizations have been able to secure very large amounts of capital to pursue an apparent good idea for an e-commerce business. However, it also shows how volatile the traded shares of these businesses can be as they grow in size but fail to post any profits. The fundamental principle behind many new *e-commerce businesses* is trading without either manufacture or long-term inventory. E-commerce cuts out the retail store element. New organizations dedicated to e-commerce are similar in principle yet distinctly different from the situation where established organizations (for example, Tesco and Waterstone's) sell via the web as well as through their own high-street outlets.

The large retailers are increasingly moving in this direction because of the impact of the specialist e-commerce companies on customer buying

habits. While the new businesses may own warehouses for collecting stock for onward transmission and holding limited numbers of fast-moving items, there will rarely be any need for them to employ either sales or production staff, and this element can be outsourced to specialists in logistics, leaving the e-commerce company to focus on creating and maintaining a successful web site once the supply chain is set up. Simply, they are a virtual company. The transaction begins when a potential customer uses a home computer to check out the web site of the e-commerce business, selects an item and places an order electronically. Typically, credit-card information will be requested, and an instant credit check will be carried out by contacting the computer system of the relevant credit-card company. Once the payment details have been confirmed, an order is transmitted to the manufacturer of the product in question. If the e-commerce company is holding the product in stock, this would be replaced by an order to the company's own warehouse, who will later reorder from the manufacturer. Delivery to the customer can be direct from the manufacturer or via the e-commerce business who will receive bulk supplies and post out individual parcels.

Their fundamental advantage is their ability to reach a wide customer audience at low cost, as long as they can be attracted in the first place and then retained as a regular customer. Relatively specialist items can thus be made available to people who find it difficult to visit the shops that sell them directly. One key disadvantage is that the goods cannot be touched and inspected, which matters more for some customers and products than it does for others. The main infrastructure requirements for a successful e-commerce business are appropriate managerial and technical skills, venture capital to set up a sophisticated supply chain and secure payment systems. They also need customers who can and do access their site, recognize the convenience and benefits being offered, and believe that the payment systems are private and secure.

Every business needs an Internet strategy; it has to decide upon the extent to which it intends to use the Internet for promotion and for commercial transactions. For many organizations, it is far more important for business-to-business transactions than it is for direct sales to customers.

The ultimate popularity of Internet trading for consumer products remains difficult to predict for a number of reasons. More and more households are on-line but the penetration is uneven. While all age groups are involved, younger people are more likely to use the Internet than older generations. Men seem more comfortable with the technology than women in many cases, and there is a greater incidence when people have enjoyed higher education and have above-average earnings. The geographical coverage in the UK is biased to the southern counties. But this is now. Various predictions for future take-up have been offered

and they are not all in accord. Some customers are keen to use the Internet for information gathering but stop short of buying electronically. This is partly linked to a reluctance to input credit-card details into a personal computer.

NOTES

However, the potential of the Internet to link business with business is enormous and it offers both cost savings and service improvements. The term *e-markets* is normally used for this linkage. E-markets:

- link computers and databases
- constitute virtual and private networks where companies and their suppliers can share vital information
- allow easy and fast transfer of up-to-date information on current orders, contracts, prices, inventory, deliveries and so on – access can be controlled through passwords
- monitor and analyse activities
- have a facility for transactions
- enable cost reductions together with better information and a faster response time
- allow suppliers to auction any surplus stock, and
- allow buyers to ask for bidders against a special or an emergency need.

2.8 APPROACH TO MANAGING STRATEGY

Strategy guru Michael Porter describes the foundation of strategy as the "activities" in which an organization elects to excel.

"Ultimately, all differences between companies in cost and price derive from the hundreds of activities required to create, produce, sell, and deliver their products or services ...differentiation arises from both the choice of activities and how they are performed." If the foundation of strategy is, as Porter maintains, the "selection and execution of hundreds of activities,"

Then strategy cannot be limited to a few people at the top of an organization. Strategy must be understood and executed by everyone. The organization must be *aligned* around its strategy. "performance management systems" are designed to create organization alignment. Herein lies one of the major causes of poor strategic management.

"Most performance management systems are designed around the annual budget and operating plan. They promote short-term, incremental, tactical behavior."

In their survey of 200 major companies, the consulting firm Renaissance

Worldwide and CFO Magazine found that several barriers are built into the typical performance management system.

- *Visions Are Not Actionable.* Vision is not translated into operational terms that provide useful guides to action. Only 40% of middle management and less than 5% of line employees clearly understand the vision of their organizations.
- *Goals and Rewards Are Not Linked to Strategy.* Goals and incentives are linked to annual financial performance rather than long-term strategy. Only 50% of executives, 20% of middle management, and less than 10% of line employees have goals and compensation linked to strategy.
- *Resource Allocation Is Not Linked to Strategy.* Capital allocation and discretionary program funding are based on short-term budgets and financial criteria, not long-term strategy. Only 43% of organizations have a strong linkage between their long-range strategy and their annual budget.
- *Feedback Is Tactical, Not Strategic.* The feedback and review process concentrates on the control of short-term operating performance instead of long-term strategic performance. Forty-five percent of management teams spend *no* time at their monthly management meetings making strategic decisions. Eighty-five percent of management teams spend less than one hour per month.

Performance management programs are used to align an organization with its strategic goals and tactical objectives. At the center of any performance management program is a framework on which the various alignment programs (measurement, goal setting, compensation, and investments) are focused.. Historically, financial frameworks such as ROI or the annual budget have dominated. More recently, new performance management frameworks have evolved around quality, shareholder value, customer satisfaction, business processes, and core competencies. While each of these perspectives is important to the success of a business, each represents only a small part of a broader picture. To manage only one of these perspectives is to invite sub-optimization. The only logical focus for a performance management program is *strategy*. The concepts of the

- Balanced Scorecard Strategic advantage profile (SAP)
- Environmental Threat and Opportunity Profile (ETOP)
- Organizational Capability Profile(OCP)

Enterprise Management processes put strategy at the center to create strategic focus and strategic alignment and to enable organizations to translate strategy into action.

2.9 BALANCED SCORECARD STRATEGIC ADVANTAGE PROFILE (SAP)

NOTES

The Balanced Scorecard approach begins with the promise that financial measures are not sufficient to manage an organization. Financial measures tell the story of past events. They are not helpful to guide the creation of future value through investments in customers, suppliers, employees, technology, or innovation. The Balanced Scorecard complements measures of past performance (lagging indicators) with measures of the drivers of future performance (leading indicators). The objectives and measures of the scorecard are derived from an organization's vision and strategy. These objectives and measures provide a view of an organization's performance from four perspectives.

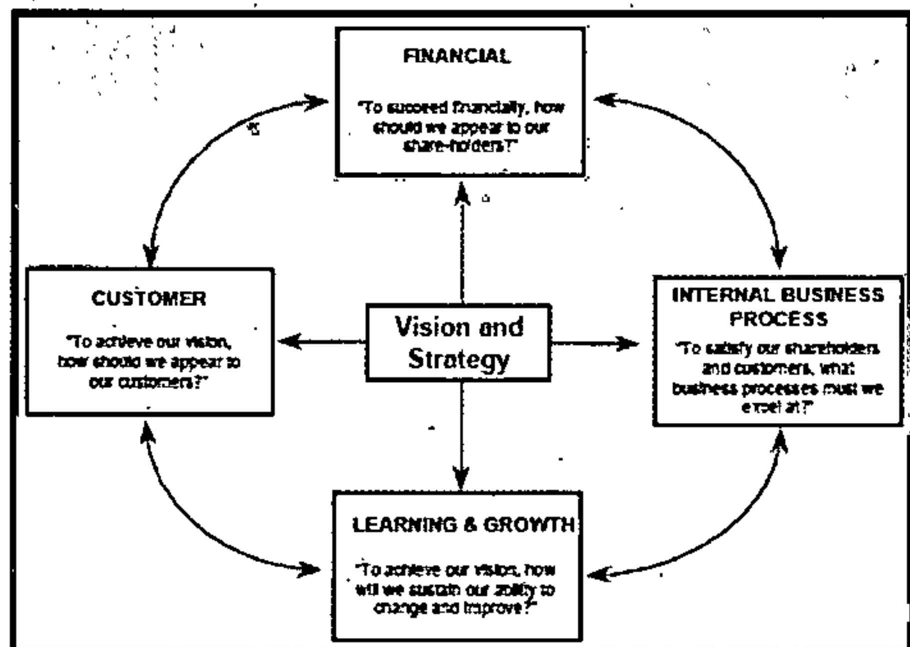


Figure 2.9 : The Balanced Scorecard: Four Perspectives

1. *Financial* – the strategy for growth, profitability, and risk viewed from the perspective of the shareholder.
2. *Customer* – the strategy for creating value and differentiation from the perspective of the customer.
3. *Internal Business Processes* – the strategic priorities for various business processes, which create customer and shareholder satisfaction.
4. *Learning and Growth* – the priorities to create a climate that supports organization change, innovation, and growth.

Using the Balanced Scorecard, corporate executives can now measure how their business units create value for current and future customers. They can also learn what investments in people, systems, and procedures

are necessary to improve future performance. While retaining an interest in financial performance, the Balanced Scorecard clearly reveals the drivers of superior, long-term value and competitive performance. The Balanced Scorecard tells the story of the strategy.

Information technology that is capable of supporting an effective Str tegic Enterprise Management system must be able to develop, maintain, communicate, and operationalize the Balanced Scorecard. This requires the ability to:

- Enable smooth communication across the entire organization during the collaborative development and maintenance of corporate, business unit, and personal Balanced Scorecards.
- Leverage industry-specific best practice through ready-to-use key performance indicator (KPI) catalogs and cause-and-effect templates.
- Integrate BSCs fully into the Strategic Enterprise Management process to support BSC-based business planning and simulation, performance monitoring, and stakeholder communication.
- Link the Balanced Scorecard with the business execution system to speed up translation of strategy into action.

It supports the development and maintenance process of a Balanced Scorecard through the following functionality:

- Definition of strategic objectives and initiatives by the four perspectives of the Balanced Scorecard.
- Definition of an influence diagram (cause-and-effect linkage) to visualize dependencies among strategic objectives on a Balanced Scorecard.

Once the scorecard has been designed, it must be linked to the management process to create action and results. Companies that successfully implemented Balanced Scorecards did so by reinventing every part of their management system to focus on strategy. From their experiences, we begin to see the criteria for a new management process, tailored to the needs of the new economy. We refer to this process as Strategic Enterprise Management (SEM). The SEM process is built on four principles:

1. *Strategy: A Continuous Process.* During times of transition, the future is highly uncertain. New approaches are being introduced to deal with a new economy. Strategy is a "hypothesis" about what the future will look like and how to get there. As you begin to execute a strategy, the picture of the destination will evolve and change. The SEM process must put this strategic hypothesis at the center of the organization, test it continuously,

NOTES

and change course as required. Strategy must be a continuous process, not an annual event.

2. *Strategy: Everyone's Job*. It is estimated that approximately 50% of all work performed in industrialized countries today is knowledge work. This percentage increases each year. Workforce knowledge represents an asset that we are just beginning to use effectively. In this structure, strategic information and decision-making can no longer be left to senior managers. Salesmen or customer service representatives, for example, can change a company's strategy from "low cost provider" to "solution provider" by changing the role that they play with the customer. Knowledge workers make strategic choices every day. Strategy may be formulated at the top but executed and refined at the bottom. The SEM process must ensure that everyone in the organization understands the strategy, is aligned with it, and is capable of executing it.
3. *Strategic Knowledge Networks*. Knowledge is everywhere in the organization. Truck drivers and telephone operators frequently know more about customer preferences than marketing executives or product designers. Traditional organization structures, designed around vertical, functional silos, lock this knowledge up in compartments, making it almost impossible to share. New approaches like "virtual organizations," "networks," and "self-governing teams" have created breakthroughs that allow cross-disciplinary groups to come together and share their knowledge for a common goal. The SEM process must support the work of such strategic knowledge networks, providing the infrastructure for accountability and governance.
4. *Strategic Leadership*. John Kotter, in his landmark work on leadership, stresses the distinction between leadership and management. Managers use a set of processes such as planning, budgeting, organizing, staffing, controlling, and problem-solving to keep an organization running smoothly. If practiced well, good management has the potential to "produce a degree of predictability and to consistently produce shortterm results." Leadership, on the other hand, is a set of processes that defines what the future should look like, aligns people with that vision, and inspires them to make it happen despite the obstacles. If practiced well, good leadership has the potential to produce dramatic change that help make a firm more competitive. While good management is important, executing the dramatic changes implied by strategy requires good leadership. The SEM process must be based on active participation and ownership by those responsible for strategic leadership: the executive team.

These four principles translate into the management process summarized in Figure 2.10. The following pages describe the highlights of this process, as well as lessons learned from successful leading-edge companies, and provide an overview of the functionality of SAP Strategic Enterprise Management to support this process.

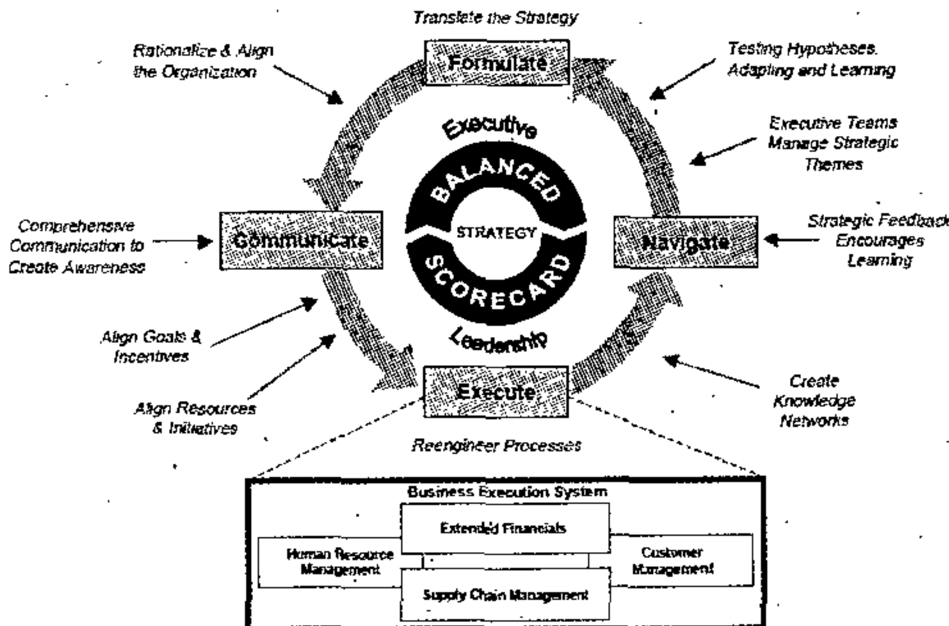


Figure 2.10 : The Ingredients of Highly Successful Balanced Scorecard Programs

2.10 ENVIRONMENTAL THREAT AND OPPORTUNITY PROFILE (ETOP)

Environmental, Threat, Opportunity Profile (ETOP) is also an important technique for the organizations. Every organisation must know threat and opportunity before they enter in the business. If an organization is able to analyse its threats and opportunities it can enjoy favourable results. An opportunity is a favourable condition in the organisation's *environment which enables it to consolidate* and strengthen its position. A threat is a unfavourable condition in the organisation's environment which creates a risk for or causes damage to the organization.

The preparation of ETOP provides a clear picture to the strategists of which sectors, and the different factors in each sector, have a favourable impact on the organization. By mean of an ETOP, the organization knows where it stands with respect to its environment. Obviously, such an understanding can be of a great help to an organization in formulating appropriate strategies to take advantage of the opportunities and counter the threats in its environment.

Help also can be taken from the external consultant/experts while preparing ETOP for the business. It is essential on the part of strategists to exploit the opportunity as early as possible because it will not wait for you, and try to deal with the threats with the available resources of the organizations. 50% organizations have claimed that they have prepared ETOP analysis whereas 50% have shown negative response (Table 2.3 and 2.4). In the absence of ETOP analysis, these organizations can't show the favourable results.

Table 2.3 : Status of ETOP in Indian Textile Companies

Status		Organisation
(A)	Used	10
(B)	Not-Used	10
	Total	10

Table 2.4 : ETOP analysis of six selected textile companies out of 20

Threats	Opportunities
- High Prices of Cotton, Electricity Fuel and water - Increasing wages - Worldwide market depression	- Consumer's taste towards cotton - Reputation and goodwill of company
Threats - Low price of yarn - Low requirement of market - High cost of production due to increased cost of power, fuel labour, logistics etc.	**Opportunities** - Product Development - Develop new market - Better cotton selection
Threats - Open competition - Excess supplies	**Opportunities** - Quota free period after 2004 - Increase in population would need more clothing
Threats - Poor infrastructure in the country - Less friendly labour - Laws/Revenue laws	**Opportunities** - Larger consumer base - Abundance of skilled workers - Huge international markets - Good availability of raw materials
Threats - Price competition from other fibres - General low economy worldwide - Unhealthy textile industry in India	**Opportunities** - Promotion of dyed fibres - Application development
Threats - Low productivity - Poor labour laws	**Opportunities** - Art of technology

To conclude it could be said that environmental appraisal played a very important role in the corporate houses and organizations must monitor it through the proper environmental scanning techniques like, customer dialogues, basis statistical forecasting, scenario writing, decision tree analysis, trend analysis etc. Strategists must give due response to the quick environmental scanning technique for environmental scanning in the complex, volatile and turbulent environment. All the companies must examine the ETOP analysis and reduce the degree of threats on the

basis of their *competency* and *capability*. This is the only way out to compete with China in future.

2.11 ORGANIZATIONAL CAPABILITY PROFILE (OCP)

Profiling of individuals within organisations has reflected traditional management principles, that is jobs and components of jobs have been seen as functionally specific. Jobs therefore have been described in terms of the functions or tasks they fill without reference to the cultural or communications environment of the organisation.

While treating jobs as cogs in the machine does produce structural efficiencies, it does not recognise the truly productive aspects of individuals, that is the ability to adapt to changing circumstances and the individual ability to innovate and find solutions to problems. Having individuals fit into clearly defined roles reduces capabilities for performance and inhibits innovation.

Existing business profiling provides an identification of the skills gap in performing current jobs within the organisation. Skills based needs analysis have identified functional expectations of positions. These are most successful where specific functional positions composed from job activities within processes that achieved defined process outcomes. A skill based profiling of jobs has been limited in identifying knowledge components of jobs. Psychological testing of knowledge of non-skills components of jobs has been limited to general traits of existing office holders and those performing in current positions and not in an individual's capability or capacity to perform.

Traits have been measured to determine behavioural compatibly between individuals and job roles, these have been retrospective judgements in terms of individual traits that in the past have been seen to cause performance in particular jobs. The identification and delivery of knowledge components of jobs at least at the management level has been provided through educational streams, universities have provided functional job related vocational education through postgraduate study. Management competencies have at least indirectly been identified in relation to general educational qualifications. Capability inventories are a dynamic business tool; it is the embodiment of the competencies, cognitive factors and experience required to achieve competitiveness; and the basis for framing training and development, career development and organisational development.

Within the organisation, individual and organisational performance must be aligned to ensure that energy and effort are not wasted. As

NOTES

has been identified one problem associated with using capabilities rather than functionally specific job roles is that efficiency is sacrificed for effectiveness or a focus on outcomes. The key to the process is the ability to develop a 'shared vision' or 'shared frame of reference' that can drive activity within groups or within the organisation to provide a focus for individual efforts. The table below identifies the alignment that needs to take place between organisational and individual capability management.

Table 2.5 : Capabilities and the Three Levels of Enterprise Application

Performance variables	Organisational level	Process level	Individual level
Strategic - Mission/ Goals	Does the organisation mission/ gaols fit the reality of the economic, political. and cultural forces?	Do the process goals enable the enterprise to meet the corporate and individual mission/ goals	Are the professional and personal mission/ goals of individuals' consistent with the enterprise?
Cognitive	Does the enterprise system provide structure, policy and creative frameworks supporting innovation and performance?	Are processes designed to permit individuals' and groups to modify systems to ensure they meet anticipated contingencies?	Does the individual contribute to performance systems and creative processes?
Expertise	Does the enterprise establish and maintain selection and training policies and resources?	Does the process of developing expertise assist responsiveness of systems to changes?	Does the individual have the applied competencies to achieve required performance?
Future Capacity	Does the enterprise have the leadership, capital, and infrastructure to achieve its mission/ goals?	Does the process have the capacity to perform to current and future customer requirements?	Does the individual want to perform and to learn?
Cultural Awareness	Do the policies, culture and reward systems support and encourage diversity while developing convergence towards desired performance?	Does the process provide the information and human factors required for individuals and groups to maintain it?	Does the individual want to work towards agreed outcomes while respecting divergent views and attitudes?

The figure below depicts how a capability inventory is an integral component of an enterprise's strategic system. The shaded boxes indicate the strategic level activities (crossfunctional and collective), and the non-shaded boxes indicate more process or operationally based activities. Building a capability inventory to serve such a function is not easy. It presupposes management acknowledges learning as a strategic activity, and the contribution of learning can be measured in 'terms of current and future enterprise competitiveness (capacity).

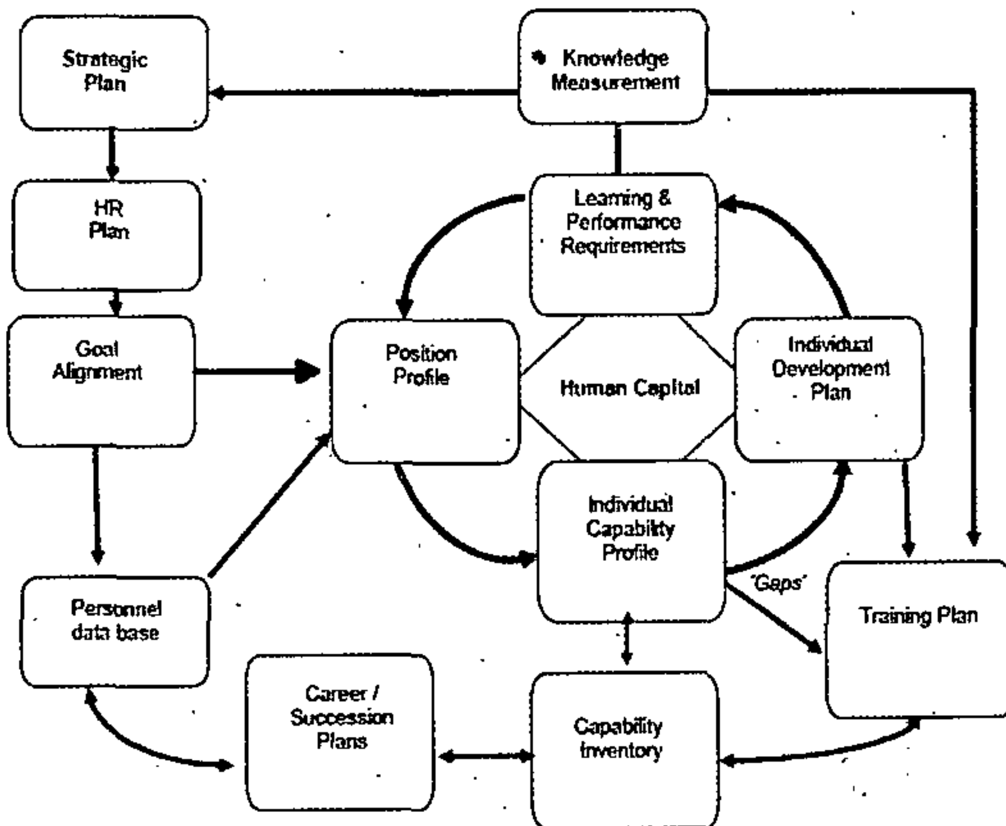


Figure 2.11: Positioning a capability inventory within an organisation's *knowledge and learning systems*

SUMMARY

- Good ideas for the future can either start inside the organization or be obtained from external contacts, and the ability to synthesize and exploit the information that is available to develop new products, new services and new strategic positions is a reflection of the organization's *strategic thinking* capabilities.
- *People feel the best about their work when they do a high-quality job! Getting a job done quickly is satisfying. Getting a job done at low cost is rewarding. But getting a job done quickly, at low cost and with high quality is exciting!*
- Success lies in seeing opportunities 'ahead of the game' and responding in some individual way, ideally one that is genuinely different, appreciated by customers and not easily copied by rivals.
- In a SWOT (strengths, weaknesses, opportunities and threats) analysis, then, the strengths and weaknesses of resources must be considered in relative and not absolute terms.

NOTES

- Successful organizations meet the needs and expectations of their customers more effectively than their competitors; at the same time, they generate acceptable financial returns.
- Information has been defined as 'some tangible or intangible entity that reduces uncertainty about a state or event'
- Value-chain analysis is a systematic way of studying the direct and support activities undertaken by a firm.
- The emergence and rapid growth of the Internet and the World Wide Web during the 1990s spawned a number of new and very entrepreneurial businesses.
- The Balanced Scorecard approach begins with the promise that financial measures are not sufficient to manage an organization.
- The SEM process must ensure that everyone in the organization understands the strategy, is aligned with it, and is capable of executing it.
- Every organisation must know threat and opportunity before they enter in the business.

REVIEW QUESTIONS

1. What do you understand by Strategic thinking?
2. What are the opportunity-driven and resourcebased views of strategy? Where and why are they different? Why is it important for organizations to embrace both views simultaneously?
3. Think about your own buying habits and choices. Where do you specifically choose high-profile branded items, and where are you less concerned? Why? What do you think this behaviour is saying about you?
4. Consider how strategic changes in one retail sector, from an emphasis on hardware stores that specialize in personal service and expert advice to customers from all employees, to a predominance of do-it-yourself supermarkets and warehouses, might have affected issues of staff motivation, personal development needs and appropriate reward systems.
5. Albeit by rule of thumb, take a team of people with whom you associate closely and evaluate their behaviour characteristics Where is the team strong? Where is the team weak? Do you believe it is balanced? If not, what might be done to change things?
6. Consider how the increasing utilization of information technology

in retailing has affected you as a customer. Do you feel that the major retail organizations who have introduced and benefited from the greater utilization of IT have attempted to ensure that the customer has also benefited and not suffered?

7. Consider why it is argued that the increasing utilization of IT by organizations is a cultural issue. How might managers be encouraged to make greater use of the technology which is available?
8. How do you personally use the Internet? Do you feel you are exploiting its potential?
9. Explain Balanced Scorecard Strategic advantage profile (SAP).
10. Explain Environmental Threat and Opportunity Profile (ETOP).
11. Explain Organizational Capability Profile (OCP).

FURTHER READINGS

1. **Strategic Management:** A.C. Mittal and B.S. Sharma, Vista International Pub., 2006.
2. **Strategic Management:** Garth Saloner, Andrea Shepard, Joel Podolny, Wiley.
3. **Strategic Management: Concepts and Cases:** Milind T. Phadtare, PHI Learning.
4. **Strategic Management: Current Trends and Issues:** Edited by P. Mohana Rao and Trilok Kumar Jain, Deep and Deep.

UNIT 3 AN INTRODUCTION TO STRATEGY CREATION

NOTES

★ STRUCTURE ★

3.0 Learning Objectives
3.1 Introduction
3.2 Planning and Strategy Creation
3.3 Changing Strategies
3.4 Strategic Thinking and Strategic Planning
3.5 Planning and Planning Systems
3.6 The Planning Gap
3.7 A Contemporary Approach to Strategic Planning
3.8 Strategic Planning Issues
3.9 Strategic Planning Techniques
3.10 A Model For Industry Analysis
3.11 Dynamic Nature of Industry Rivalry
3.12 Generic Strategies to Counter the Five Forces
3.13 Strategic Growth
3.14 Strategic Alliances—An Introduction
- *Summary*
- *Review Questions*
- *Further Readings*

3.0 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- understand strategy creation
- know about SWOT Analysis
- know about TOWS matrix
- explain various corporate strategies
- describe the process of strategic planning

- know about various stages of corporate development, restructuring, mergers and acquisitions
- know about BCG Model, GE 9 cell and porters Model.

NOTES

3.1 INTRODUCTION

Football, or really any professional sport, provides a useful metaphor for understanding strategy creation. Teams – or, in the case of sports such as tennis, individuals – will begin all important matches with a game plan. They will have studied their opponents, assessed their relative strengths and weaknesses, thought about their natural game and about how they might approach this particular match, and worked out how they might be beaten. Led by the manager, coaches will have helped the players with the analysis and the tactics. Normally, the objective will be about winning. In some instances it can be about not losing (a subtle difference) or winning might be qualified by adding a 'means' objective related to approach and style. These game plans will undoubtedly *inform* the players, but it may be impossible to carry them out to the letter. Unexpected tactics from their opponents will ensure that this is the case.

Once the game is underway, the intended plans and strategies will be adjusted – there will be incremental changes. Broadly, however, they may well be implemented, certainly as long as the game is being won and not lost. At the same time, new, unexpected opportunities will be presented during the game, and good teams will be able to adapt. Of course, 'the best laid plans o' mice and men gang aft a gley'. The opponents may prove stronger and more disciplined than predicted. They may take the lead in the first minute and seize control of the game. In this case, there will be a need to adapt to the threats and change the tactics. When this happens, the ability to remain cohesive and disciplined as a team is essential. In football pundit terminology this is usually described as 'keeping your shape'.

At any time there is always the opportunity for individuals to show initiative and to shine. A strong, experienced and maybe visionary team manager (the strategic leader in this example) can act as a master tactician and an inspiration both beforehand and from the sidelines during the game. Talented players, with individual goals, spectacular saves or important tackles at key moments, will often make important contributions and, by doing so, encourage their colleagues also to make the extra effort that tips the balance.

As they always say, a game is not lost until the final whistle: teams often do go one or two goals down before recovering to win. It is useful

NOTES

to contrast this metaphor with others. American football resembles rugby in some ways, but it remains a very distinctive game. At any one time a team will be attacking or defending in a series of moves, designed to advance a fixed number of yards – or stop the opposing team advancing. The player pool will contain both attackers and defenders, and players will enter and exit the fray depending on the state of the game.

Specialist kickers will only be on the field when a kick needs taking. Coaches can call time-outs and provide tactical advice between plays as players come on and off the field. Tactics and planning clearly have a different role. Warfare is also a competition in its own way. There are clearly objectives for the conflict. There are plans and tactics. There are visionary leaders and historically there has been considerable emergence, with a reliance on the bravery of men in the field. In the past warfare has often involved a serious degree of slaughter in the attempt to defeat the enemy systematically over a period of time. More recently the strategic intent has been based on demoralization. Combatants will endeavour to make a very powerful early strike of such enormity it destroys the enemy's belief that they can win. This implies an emphasis on vision (the way to achieve this), planning (the tactics) and speedy execution. There is, then, less reliance on emergence.

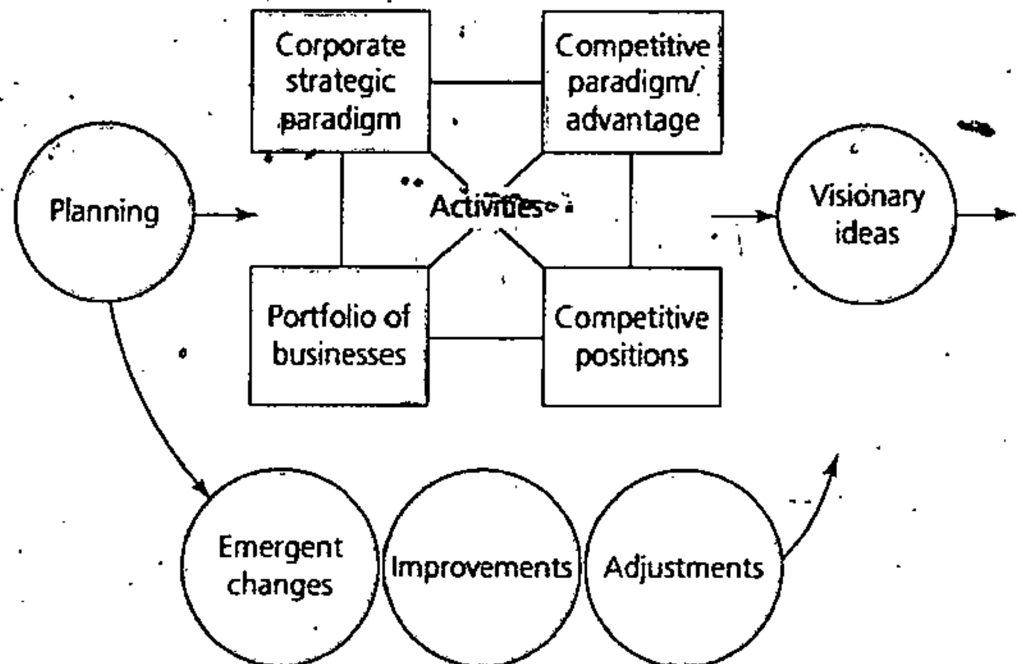


Figure 3.1 Strategy creation

Figure 3.1 reiterates that strategy and strategic management embrace the corporate portfolio of businesses and the search for competitiveness and competitive advantage with each business, product and service, and that this competitiveness arises from the functional activities that an organization undertakes. Visionary ideas *pull* the organization forward.

Where these result in significant changes, they will often be associated with the strategic leader. Planning *pushes* everything forward. Emergent changes, improvements and adjustments – intrapreneurial changes initiated and implemented by individual managers throughout the organization – *support* and complete the process.

If all strategies were planned formally, then organizations would be able to look back and review the decisions that they had made over a period of time. At some stage in the past there would have been a clear recorded statement of intent which matched these events closely. In reality, stated plans and actual events are unlikely to match closely. In addition to strategies that have emerged and been introduced entrepreneurially, there are likely to have been expectations and planned possible strategies that have not proved to be viable. However, broad directions can be established and planned and then detailed strategies allowed to emerge as part of an ongoing learning experience within the organization.

3.2 PLANNING AND STRATEGY CREATION

Mintzberg (1989) contends that the strategic leader should be the chief architect, in conjunction with planners, of corporate plans; the process should be explicit, conscious and controlled; and issues of implementation should be incorporated. Essentially, analysis leads to choice, which leads on to implementation. The process is sequential:

Analysis → Choice → Implementation

Certain organizations might claim that detailed long-term planning is essential for them. An airline, for example, must plan capacity several years ahead because of the long delivery lead times for new aeroplanes and the related need to manage cash flow and funding. In addition, resources must be co-ordinated on an international scale. While planes are utilized on most days and fly as many hours in the day as possible, crews work only limited hours, and typically finish a flight or series of flights in a location which is different from their starting point.

However, Mintzberg argues that this is planning the implications and consequences of the strategic perspective, not necessarily the perspective itself. Detailed planning of this type should not inhibit creativity concerning the perspective. Planning of some form will always be required in large organizations. It forces thinking and enables and supports resource allocation and budgeting. However, the extent and nature of the overall planning contribution will relate to the industry and the environment and be affected by both leadership and culture.

NOTES

The visionary mode

A visionary strategic leader who formulates strategic change in his or her mind may only be semiconscious of the process involved. He or she will clearly understand the current and desired strategic perspective, and ideally the culture of the organization will be one in which other managers are receptive of the changes in perspective. The personality and charisma of the leader, and the ability to sell his or her ideas, will be crucial issues, and as speed of action, timing and commitment are typical features the strategy can prove highly successful.

The visionary or entrepreneurial approach suggests that the strategic leader is very aware of the strengths, weaknesses and capabilities of the organization; the current matching with the environment; a wide range of possibly diverse opportunities for change; and the likely reaction of managers to certain changes. Similar to the 'bird approach' the selection is made somewhat arbitrarily without careful and detailed planning, and therefore an element of risk is involved. This informality in the process is important to allow for creativity and flair. The strategic leader then sells the idea to other managers, and the strategy is implemented and changed incrementally as experience is gained and learning takes place. In other words, the vision acts as an umbrella and within it specific decisions can be taken which lead to the emergence of more detailed strategies.

Chris Gorman, the new co-owner of the Gadget Shop chain, operates very much within the entrepreneur strategic leader role. Immediately prior to the Gadget Shop, Gorman had the very interesting title of 'Chief Entrepreneur' within Great Universal Stores. GUS had bought the Reality Group from Gorman and after the acquisition Gorman had this new role. However, Gorman did not stay long within GUS because 'it was not my skill set... I am not someone who is comfortable as a manager working through the layers that make up a large PLC.'

Analysis (in the form of ongoing awareness) and choice Implementation Dangers

The success of this mode in the long term depends on the continued strategic awareness and insight of the strategic leader, particularly if the organization revolves around a visionary leader and becomes heavily dependent upon him or her. People may be visionary for only a certain length of time, and then they become blinkered by the success of current strategies and adopt tunnel vision, or they somehow lose the ability to spot good new opportunities.. It might also be argued that, if luck is involved, their luck runs out. The problems occur if the strategic leader has failed to develop a strong organization with other visionaries who can take over.

On a current basis the strategy requires management as well as leadership. In other words, managers within the organization must be able to capitalize on the new opportunities and develop successful competitive positions within the revised strategic perspective. This might involve an element of planning; equally it might rely more on the adaptive approach described below.

The adaptive and incremental modes

Under the adaptive and incremental modes strategies are formed and evolve as managers throughout the organization learn from their experiences and adapt to changing circumstances. They perceive how tasks might be performed, and products and services managed, more effectively, and they make changes. They also respond to pressures and new strategic issues. There will again be elements of semiconsciousness and informality in the process. Some changes will be gradual, others spontaneous, and they will act collectively to alter and improve competitive positions. *As individual decisions will often involve only* limited change, little risk and possibly the opportunity to change back, this is essentially the 'squirrel approach'. Managers learn whether their choice is successful or unsuccessful through implementation.

Hence this mode implies limited analysis preceding choice and implementation, which are intertwined and difficult to separate. A proper analysis follows in the form of an evaluation of the relative success:

Analysis → Choice and (limited) implementation → Analysis

Adaptive strategic change requires decentralization and clear support from the *strategic* leader, *who also seeks to stay aware of progress* and link the changes into an integrated pattern. It is often based on setting challenges for managers: challenging them to hit targets, improve competitiveness and stretch or exploit internal systems and policies to obtain the best possible returns. The greater the challenge, the more care needs to go into establishing a suitable reward system. When the structure enables effective adaptive change, then intrapreneurship can be fostered throughout the organization and individual managers can be allowed the necessary freedom. However, if adaptive changes are taking place in a highly centralized organization, and despite rigid policies, there is a problem which should be investigated. The major potential drawbacks concern the ability of the organization and the strategic leader to synthesize all the changes into a coherent pattern, and the willingness and ability of individual managers to take an organization-wide perspective. Information technology provides opportunities for collecting and coordinating information and should be harnessed to support decentralization. In addition, team briefing

NOTES

can prove useful. Here, a strategic leader would regularly brief his or her senior executives, discussing progress and any proposed changes to the corporate strategy and policies.

On a cascading basis managers would quickly and systematically communicate this information downwards and throughout the organization by meeting teams of people responsible to them. The secret lies in also using team briefing meetings to communicate information upwards by reporting on new strategic issues and how they are being handled.

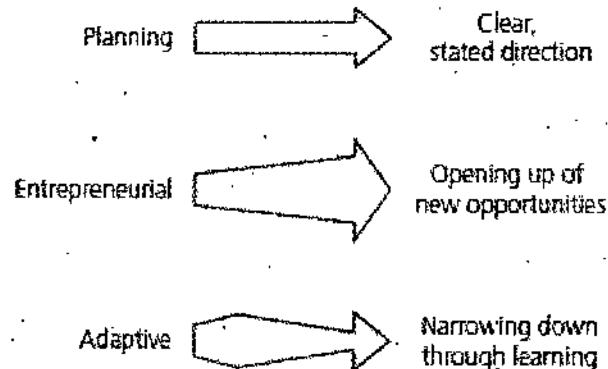


Figure 3.2 Strategy creation processes

Figure 3.2 provides a short summary of the processes. Planning is shown at the top as a 'closed funnel' activity. The entrepreneurial, visionary style is more one of diverging and opening things up, widening the scope of the ideas considered. Adaptive strategy (responding to new opportunities) is, conversely, illustrated as a convergent process.

Here, learning and synthesis are required to form cohesive patterns which bind the emerging strategies. In the entrepreneurial mode, planning is required during implementation; and in the adaptive mode, individual managers are doing their own planning, sometimes informally, sometimes more formally.

3.3 CHANGING STRATEGIES

Two important strategic pressures can leave the unprepared organization weakened: competitive and other environmental pressures, and focusing too much on controls at the expense of flexibility.

Hurst (1995) has shown how management and control becomes increasingly necessary as organizations grow and become more complex, but that this development contains the seeds of potential failure. Figure 3.3 shows that organizations often start life with an entrepreneurial vision but that the significance of this vision soon gives way to learning and emergence as the entrepreneur and the organization learns to cope with the pressures

of a dynamic and competitive environment. This flexibility maintains the momentum and the organization grows and prospers. To ensure that the organization is managed efficiently, planning and control systems run by specialist professional managers become increasingly prominent, but this often reduces the flexibility which has proved so valuable. If the flexibility is lost, if the organization fails to address what it is doing wrong while it is still succeeding, some of the momentum for innovation is lost.

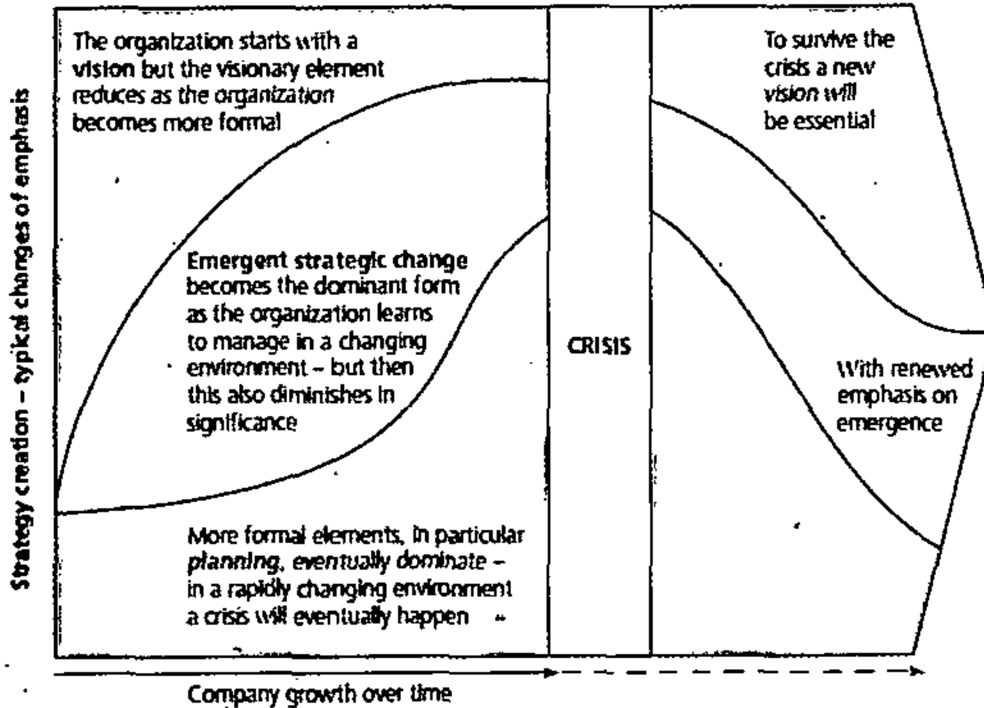


Figure 3.3. Strategic change

Unless the entrepreneur and the organization foresee the impending problem and find a major new initiative, a crisis is likely to happen. If the organization is to survive the crisis it will need a substantial new opportunity, together with a renewed reliance on innovation and learning Businesses hit these crisis points when they run short of money, usually because they have failed to remain competitive and to attract sufficient resource contributions from customers and other important resource suppliers. Sometimes turnaround is possible, frequently accompanied by a change of strategic leader to input the new vision and inspiration. On other occasions the intervention is too late, and the organization either collapses or is taken over as a means of providing the necessary new leadership and resourcing.

Businesses in trouble, then, may be realistically irrecoverable, recoverable but only to a level of survival, or capable of genuine renewal. The immediate need is to stop any financial haemorrhaging before new opportunities are sought and pursued. The first step does not need

someone with entrepreneurial talent and temperament – it is largely based on technique, backed by a willingness to take tough decisions – but the second stage does.

Hurst further argues that on occasions it can be valuable to engineer an internal crisis and upset in order to drive through major changes in an organization that has lost its dynamism and become too resistant to change. A controlled crisis is better than one resulting from external events as it can be used for positive change rather than constitute a more desperate reaction.

Stasis is less likely to happen if the company employs and encourages creative people who drive innovation and intrapreneurship. But if momentum is lost, the company may need more than creative people: it may need a 'maverick', perhaps someone who is normally ill-at-ease in a typical organization or a new strategic leader who will come in for just a short period. The maverick manager is unorthodox, individualistic and outspoken, someone who will challenge mediocrity and existing ways of doing things and someone who is not afraid to upset others in the drive for change.

Another way of presenting these arguments is the following four-stage model of organizational progression and development.

- The first step is a *creative* one, when new ideas are put forward.
- *Reflection and nurturing* follow as the idea is crafted into a winning opportunity. The person who has the original idea may not be the person who takes it forward in the most opportune way.

3.4 STRATEGIC THINKING AND STRATEGIC PLANNING

The opening case story on FedEx shows two key elements of strategy creation in action and working together – visionary ideas and planning. The planning focuses on the project management and the implementation of a visionary idea. Without sound planning the venture could not possibly have worked. But when we talk about 'strategic planning' this is not exactly what we mean. Planning can also be used to identify future strategies, although it is only one way of identifying future opportunities. This chapter looks at planning's contribution to strategy making.

Robinson (1986) argues that the role of the planner should be not to plan but to enable good managers to plan. It is not the task of the planner to state the objectives; rather he or she should elicit and clarify them. Planning should concentrate on understanding the future, which is uncertain and unpredictable, and helping managers to make decisions about strategic changes. Thus, the aim of planning should be to force people to think and examine, not to produce a rigid plan. It is worth reinforcing here that the real value of planning is not the plan which emerges, and which

might be produced as a summary document which is worth little more than the paper it is printed on! Rather, the value lies in the thinking that the act and process of planning forces people to do.

NOTES

Undoubtedly, planning techniques, used carefully, can help to provide a valuable description and analysis of where the organization is 'now'. But for managing the future and its inherent uncertainties, vision and flexibility will also be essential, alongside a clear direction and purpose. New thinking is essential for reaching the new competitive high ground first. Strategic planning systems, popular and dominant in the 1960s and 1970s, became less fashionable in the 1980s and 1990s, but they still have an important contribution to make. In most companies planning had not contributed to strategic thinking and, because strategic thinking is essential, a new role has had to be found for strategic planning.

Strategic planning became fashionable for two basic reasons. First, it provided a means for allocating resources and managing budgets in complex multiproduct organizations and, second, it helped to pull together the disparate activities and businesses in organizations. These needs remain.

The outcome for many organizations was formal planning systems, heavily reliant on financial data, and supported by thick planning manuals. This was the downside. On the positive side, planning can encourage managers to think about the need and opportunities for change, and to communicate strategy to those who must implement it. This was particularly important in the 1960s and early 1970s when there was an abundance of investment opportunities and a dearth of capital and key priorities needed to be established. In complex multiactivity organizations, decisions have to be made concerning where to concentrate investment capital in relation to future earnings potential, and this has generated a number of portfolio analysis techniques, some of which are studied later in this chapter. Rather than use these techniques for gaining greater awareness and insight, for which they are well suited, managers sought to use them prescriptively to determine future plans.

Formal strategic planning had become unfashionable by the 1980s for a number of reasons:

- Planning was often carried out by planners, rather than the managers who would be affected by the resultant plans.
- As a result, the outcome of planning was often a plan which in reality had little impact on actual management decisions, and therefore was not implemented.
- The planning techniques used were criticized primarily because of the way in which they were used.

- The important elements of culture and total quality management were usually left out.

However, many industries continue to experience turbulent environments caused by such factors as slower economic growth, globalization and technological change, and consequently strategic thinking is extremely important. The following questions must be addressed:

NOTES

- What is the future direction of competition?
- What are the future needs of customers?
- How are competitors likely to behave?
- How might competitive advantage be gained and sustained?

Organizations must ensure that these questions are constantly addressed rather than addressed occasionally as part of an annual cycle. Line managers who implement plans must be involved throughout the process. Every executive needs to understand how to think strategically. Rigorous frameworks and planning manuals are not necessary as long as the proper thinking takes place.

There should be a strategic plan for each business unit in a complex organization, *i.e.,* clear competitive strategies built around an understanding of the nature of the industry in which the business competes, and sources of competitive advantage. Chosen strategies must have action plans for implementing them, including an assessment of the needs for finance and for staff training and development. This is generally less difficult than formulating a corporate strategy for the whole organization.

3.5 PLANNING AND PLANNING SYSTEMS

What do we mean by planning?

All managers plan. They plan how they might achieve objectives. However, a clear distinction needs to be made between the cerebral activity of informal planning and formalized planning systems.

A visionary strategic leader, aware of strategic opportunities and convinced that they can be capitalized upon, may decide independently where the organization should go and how the strategies are to be implemented. Very little needs to be recorded formally. Conversations between managers may result in plans which again exist only in individual managers' heads or in the form of scribbled notes. Equally, time, money and other resources may be invested by the organization in the production of elaborate and formally documented plans.

In all cases planning is part of an ongoing continuous activity which addresses where the organization as a whole, or individual parts of it, should be going. At one level a plan may simply describe the activities

and tasks that must be carried out in the next day or week in order to meet specific targets. At a much higher level the plan may seek to define the mission and objectives, and establish guidelines, strategies and policies that will enable the organization to adapt to, and to shape and exploit, its environment over a period of years. In both cases, if events turn out to be different from those which were forecast, the plans will need to be changed.

The value of strategic planning

When managers and organizations plan strategies they are seeking to:

- be clearer about the business(es) that the organization is in, *and should be in*
- increase awareness about strengths and weaknesses
- be able to recognize and capitalize on opportunities, and to defend against threats
- be more effective in the allocation and use of resources.

Irrespective of the quality or format of the actual plans, engaging in the planning process can be valuable. It helps individual managers to establish priorities and address problems; it can bring managers together so that they can share their problems and perspectives. Ideally, the result will be improved communication, co-ordination and commitment. Hence there *can be real benefit from planning or thinking* about the future. What form should the thinking and planning take? Should it be part of a formalized system making use of strategic planning techniques?

Corporate and functional plans

Corporate and strategic plans concern the number and variety of product markets and service markets in which the organization will compete, together with the development of the necessary resources (people, capacity, finance, research and so on) required to support the competitive strategies. Strategic plans, therefore, relate to the whole organization, cover several years and are generally not highly detailed. They are concerned with future needs and how to obtain and develop the desired businesses, products, services and resources. The actual timescale involved will be affected by the nature of the industry and the number of years ahead that investments must be planned *if growth and change are to* be brought about.

Functional plans are derived from corporate strategy and strategic plans, and they relate to the implementation of functional strategies. They cover specific areas of the business; there can be plans relating to product development, production control and cash budgeting, for example. Functional plans will usually have shorter time horizons than is the case for strategic plans, and invariably they will incorporate greater detail.

NOTES

However, they will be reviewed and updated, and they may very well become ongoing rolling plans. While strategic plans are used to direct the whole organization, functional plans are used for the short-term management of parts of the organization. It is easy to imagine how this would apply to Federal Express.

Competitive strategies and functional strategies and plans are essential if products and services are to be managed effectively, but they should be flexible and capable of being changed if managers responsible for their implementation feel it necessary. Ohmae (1982) emphasizes that individual products must be seen as part of wider systems or product groups/business units, and that although short-term plans must be drawn up for the effective management of individual products, it is important to ensure that thinking about the future is done at the appropriate level. As an example, a particular brand or type of shampoo targeted at a specific market segment would constitute a product market. The company's range of shampoos should be produced and marketed in a co-ordinated way, and consequently they might constitute a strategic planning unit. The relevant strategic business unit might incorporate all of the company's cosmetics products and there should be a competitive strategy to ensure that the various products are co-ordinated and support each other. In terms of strategic thinking, Ohmae suggests that it is more important to consider listening devices as a whole than radios specifically, and that this type of thinking resulted in the Sony Walkman and similar products. In the same way, the Japanese realized a new opportunity for black and white television receivers in the form of small portable sets, when other manufacturers had switched all of their attention to the development of colour sets. If the level of thinking is appropriate, resources are likely to be allocated more effectively.

Alternative approaches to planning

Taylor and Hussey (1982) feature seven different approaches to planning which are detailed briefly below.

- *Informal planning* takes place in someone's head, and the decisions reached may not be written down in any extensive form. It is often practised by managers with real entrepreneurial flair, and it can be highly successful. It is less likely to be effective if used by managers who lack flair and creativity.
- *Extended budgeting* is rarely used as it is only feasible if the environment is stable and predictable. Extended budgeting is primarily financial planning based on the extrapolation of past trends.
- *Top-down planning* relates to decisions taken at the top of the organization and passed down to other managers for implementation. These managers will have had little or no input into the planning

process. Major change decisions reached informally may be incorporated here, and then a great deal depends upon the strength and personality of the strategic leader in persuading other managers to accept the changes. At the other extreme, top-down plans may emanate from professional planners using planning techniques extensively and reporting directly to the strategic leader. These are the type of plans that may not be implemented.

- *Strategic analysis/policy options* again uses planning techniques, and involves the creation and analytical evaluation of alternative options. Where future possible scenarios are explored for their implications, and possible courses of action are tested for sensitivity, this form of planning can be valuable for strategic thinking. It is an appropriate use of planning techniques, but it is important to consider the potential impact on people.
- *Bottom-up planning* involves managers throughout the organization, and therefore ensures that people who will be involved in implementing plans are consulted. Specifically, functional and business unit managers are charged with evaluating the future potential for their areas of responsibility and are invited to make a case for future resources. All of the detail is analysed and the future allocation of resources is decided. In an extreme form thick planning manuals will be involved, and the process may be slow and rigid. Necessary changes may be inhibited if managerial freedom to act outside the plan is constrained. A formal system of this nature is likely to involve an annual planning cycle.
- *Behavioural approaches* can take several forms, but essentially the behavioural approach requires that managers spend time discussing the future opportunities and threats and areas in which the organization might develop. The idea is that if managers are encouraged to discuss their problems and objectives for the business freely, and if they are able to reach agreement concerning future priorities and developments, then they will be committed to implementing the changes. However, it is quite likely that not all of the conflicts concerning resource allocation and priorities will be resolved. Clearly, scenario planning can be very useful here.
- The term *strategic review* was coined to take the best features of the other six approaches and blend them together into a systematic and comprehensive planning system.

All of these approaches have individual advantages and disadvantages, and they are not mutually exclusive. The approach adopted will depend on the style and preferences of the strategic leader, who must:

NOTES

- clarify the mission and corporate objectives and establish the extent and nature of changes to the corporate perspective
- approve competitive and functional strategies and plans for each part of the business, however they might be created, and
- establish appropriate control mechanisms, which may or may not involve substantial decentralization.

It has been established that planning may be either informal or formal. Informal planning, as such, cannot be taught; but formal planning systems can. These are the subject of the next sections.

3.6 THE PLANNING GAP

Such authors as Argenti (1980), Hussey (1976), Cohen and Cyert (1973) and Glueck and Jauch (1984) have developed a number of essentially similar models of systematic planning.

All of these models use the concept of gap analysis, which is extremely useful for strategic thinking purposes. It addresses the following questions:

- Where do we want to go?
- Where can we go realistically?

When considering where and how an organization might develop in the future, both the desired and realistic objectives are essential considerations. Desired objectives relate to where the strategic leader and other decision-makers would like to take the organization if it is possible to do so. Realistic objectives incorporate the influence of the various stakeholders in the business, and their expectations; the existence of suitable opportunities; and the availability of the necessary resources. The issue of the risk involved in the alternative courses of action that might be considered is crucial. The discussion of the planning gap draws attention to the increasing risk typically associated with certain strategic alternatives, in particular diversification, which is often implemented through acquisition. However, diversification may be the only feasible route to the achievement of high growth targets or the maintenance of present rates of growth in profits and sales revenues. The strategic leader, perhaps under significant pressure from City investors, shareholders and analysts who expect growth rates to be at least maintained, may be forced to pursue high-risk strategies. Table 3.1 looks at how three organizations, specifically Virgin, Royal Bank of Scotland, and Sony, have pursued several different strategies over a period of years. While undue risk should be avoided wherever possible, it is always important to accept a certain level of risk and set stretching targets for managers and businesses.

Table 3.1 Applications of the simple growth vector

	Virgin	Royal Bank of Scotland	Sony
Market penetration	Publicity, self-publicity and exploitation of Virgin name, e.g. Branson's balloon challenges	Sponsorship of major sporting activities. Not closing branches when other banks were closing their branches	Sony as a brand
Market development	Before divesting the businesses, opening Virgin Megastores around the world and a music business in the US	Building the credit card business to No. 2 in the UK in partnership with multinationals such as Shell	The Sony Walkman and associated derivatives: existing products repackaged
Product development	Music retailing led to music production and publishing and later music videos	Building scale through UK bank acquisitions e.g. National Westminster	Tape recorders to videos; televisions; compact discs (some limited diversification involved)
Related diversification	Films, computer games	Insurance. Direct Line; US banking acquisitions	Computers, Sony Playstation (related technologies e.g. PDAs)
Unrelated diversification	Virgin Atlantic Airways, Virgin Holidays, Virgin Cola, Virgin Financial Services		CBS Records, Columbia Pictures (vertical integration that some would argue is related diversification for Sony

NOTES

The Planning Gap

The planning gap should be seen as an idea which can be adapted to suit particular circumstances, although gap analysis could be regarded as a planning technique. An example of the planning gap is illustrated in Figure 3.4. The horizontal axis represents the planning time horizon, stretching forward from the present day; either sales volume or revenue, or profits, could be used on the vertical axis as a measure of anticipated performance. The lowest solid line on the graph indicates expected sales or profits if the organization continues with present corporate, competitive and functional strategies; it does not have to slope downwards. The top dashed line represents ideal objectives, which imply growth and which may or may not ultimately be realized. The difference between these two lines is the gap. The gap is the difference between the results that the organization can expect to achieve from present strategies continued forward and the results that the strategic leader would like to attain.

The example illustrated in Figure 3.4 shows the gap filled in by a series of alternative courses of strategic action ordered in an ascending hierarchy of risk. Risk is constituted by the extent to which future products and markets are related to existing ones; and this idea of increased risk and strategic alternatives is developed further in Figures 3.5 and 3.6.

NOTES

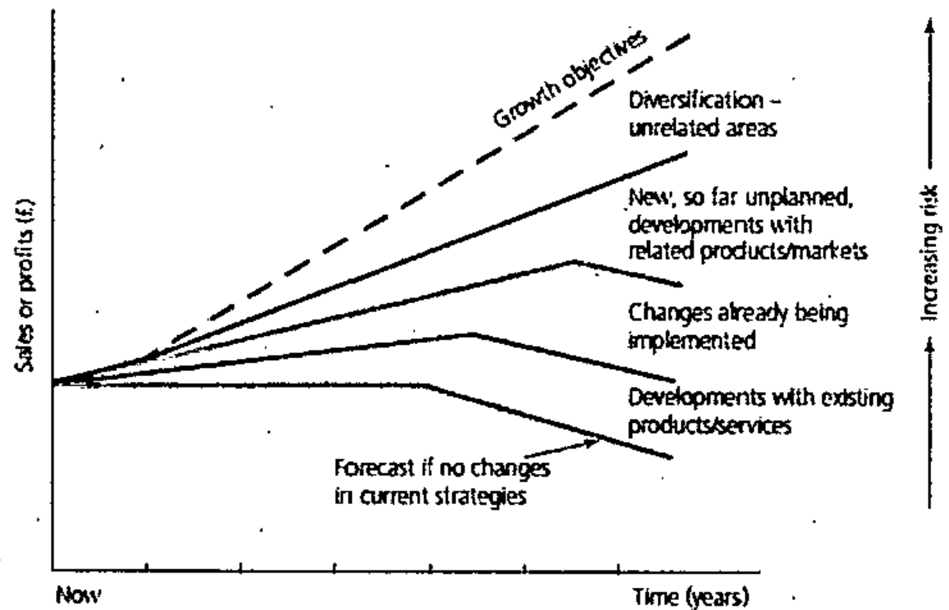


Figure 3.4 An example of the planning gap

The lowest risk alternative is to seek to manage present products and services more effectively, aiming to sell more of them and to reduce their costs in order to generate increased sales and profits. This is termed market penetration in the simple growth vector developed by H Igor Ansoff and illustrated in Figure 3.5. It can be extended to strategies of market and product development, which imply, respectively:

- new customers or even new market segments for existing products, which might be modified in some way to provide increased differentiation; and
- new products, ideally using related technology and skills, for sale to existing markets.

(In this context 'new' implies new to the firm rather than something that is necessarily completely new and innovative, although it could well be this.) Figure 3.4 distinguishes between market and product development strategies that are already under way and those that have yet to be started.

The highest risk alternative is diversification because this involves both new products and new markets. Figure 3.6 develops these simple themes further and distinguishes between the following:

- replacement products and product line extensions based on existing technologies and skills, which represent improved products for existing customers

- new products based on new or unrelated technologies and skills, which constitute concentric diversification (these may be sold to either existing or new customers)
- completely new and unrelated products for sale to new customers. This is known as conglomerate diversification and is regarded as a high-risk strategic alternative.

Market \ Product	Present	New
Present	Market penetration	Product development
New	Market development	Diversification

Figure 3.5 Ansoff's growth vector

Using the planning gap

Thinking about the extent of the initial gap between present strategies and ideal objectives enables managers to consider how much change and how much risk would be involved in closing the gap and achieving the target objectives. Some of the strategies considered might be neither feasible nor desirable, and consequently the gap might be too wide to close. Similarly, the degree of risk, especially if a number of changes is involved, might be greater than the strategic leader is willing to accept. In these cases it will be necessary to revise the desired objectives downwards so that they finally represent realistic targets which should be achieved by strategic changes that are acceptable and achievable.

This type of thinking is related to specific objectives concerning growth and profitability. It does not follow that either growth or profit maximization will be the major priority of the organization, or that the personal objectives of individual managers will not be an issue.

NOTES

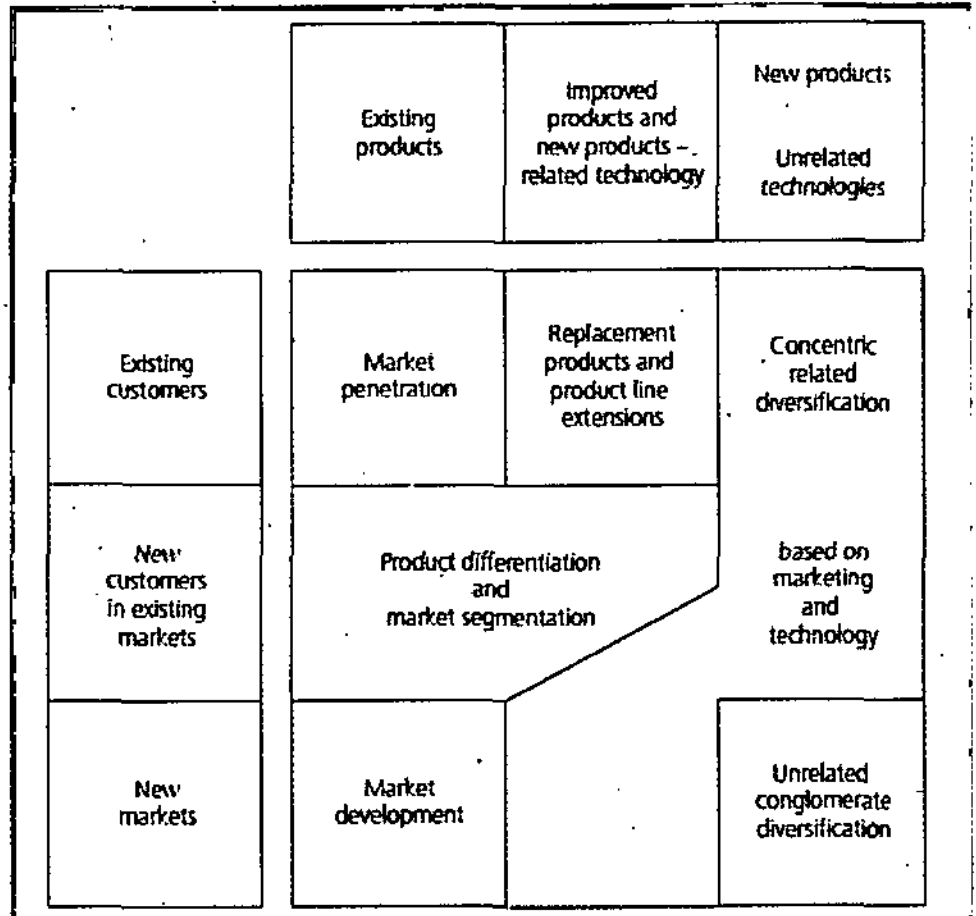


Figure 3.6 An extended growth vector

3.7 A CONTEMPORARY APPROACH TO STRATEGIC PLANNING

In order to ensure that planning does not become an end in itself, and that planners facilitate management thinking, many large companies have evolved personalized contemporary planning systems along the lines of the one illustrated in Figure 3.7.

The organization's culture and the expectations of the strategic leader and the key stakeholders influence the whole process of analysis and decision-making. The thinking starts with an assessment of the current position of the organization, its skills and resources, and an evaluation of whether there is a clear understanding of the mission, the broad objectives and directions for the future.

Then the business environment is analysed thoroughly, concentrating on the industries in which the organization currently competes and those in which it might apply its skills and resources. Feeding into this analysis are three other analyses:

- broad scenario planning – conceptualizing a range of different futures with which the organization might have to deal, to ensure that the less likely possibilities, threats and opportunities are not overlooked, and to encourage a high level of flair and creativity in strategic thinking
- product portfolio analyses, which are discussed in greater detail in the next section; contingency and possible crisis planning considerations can be incorporated in this
- industry analyses, following the Porter criteria for judging attractiveness and opportunities for competitive advantage

This *environmental* analysis should focus on any *strategic issues* – current or forthcoming developments, inside or outside the organization, which will impact upon the ability of the organization to pursue its mission and meet its objectives. Ideally, these would be opportunities related to organizational strengths. Wherever possible any unwelcome, but significant, potential threats should be turned into competitive opportunities. The band across the bottom of Figure 3.7 shows how this contemporary approach blends planning techniques with an intellectual input and later action plans for implementing strategic choices.

It will be seen that the identification of strategic issues is the transition point from analysis to decisions regarding future strategy: it is where techniques give way to more intuition and intellectual inputs before implementation issues are explored. From these analyses competitive strategy decisions must be reached concerning:

- the reinforcement or establishment of a superior competitive position, or competitive advantage, for each business within the existing portfolio of products and services
- product markets and service markets *for future development*, and the appropriate functional strategies for establishing a superior competitive position.

Amalgamated, *these functional and* competitive strategies constitute the corporate strategy for the future, which in turn needs to be broken down into resource development plans and any decisions relating to changes in the structure of the organization – *i.e.*, decisions that reflect where the organization is going and how the inherent changes are to be managed.

Simply, planning techniques and analyses are used to clarify the key strategic issues. Discerning the issues and deciding what should be done to address them requires creativity (the search for something different) and hence a more intellectual input. Once broad strategic directions are clarified, detailed implementation planning will follow.

NOTES

Like the strategies, these detailed implementation plans should not be seen as inflexible. It is important that new strategic issues are spotted and dealt with continuously, and the organization structure must enable this to happen, either by decentralization and empowerment or by effective communications.

The Channel Tunnel between England and France was named the greatest construction achievement of the twentieth century. Passenger and freight shuttles began operating in 1994; Eurostar passenger services began a short while later, but growth was constrained until the fast access route between London and Folkestone began opening (in stages) in 2003. Freight trains also use the tunnel. The tunnel operator, Eurotunnel, has made operating profits since 1997 but other charges have meant net losses. In 2003 Eurotunnel identified the following strategic issues:

- the expensive infrastructure was underutilized
- operator access charges were too high
- there were conflicts between the various stakeholders, many of them caused by the financial losses

Eurotunnel decided to reduce access charges to stimulate demand. There was a belief that demand was sufficiently price-elastic for this to improve profitability. Debts would have to be restructured – and not for the first time. There would be fresh investment in the Folkestone freight terminal to allow it to handle Continental gauge trains for the first time. And the terminal areas of Kent and the region around Calais would be promoted to stimulate tourism.

Commentary A systematic approach to corporate planning may well succeed in the essential task of co-ordinating the plans for all the divisions and businesses in a large organization, enabling the strategic leader to exercise control over a conglomerate – and this is good. However, the system should not prohibit vision and learning within the corporation, which is important as these are the two modes of strategy creation most likely to take the organization forward in a competitive and uncertain environment.

Unfortunately, the vision and learning may be concentrated within individual divisions when ideally, it will permeate the whole organization. Typically, strategic planning systems grew to be very formal. All ideas from the individual businesses had to be supported by comprehensive, documented analyses. Now it is frequently accepted that many proposals cannot be fully justified quantitatively; instead, the assumptions and justifications will be probed and challenged by divisional boards. Care must also be taken to ensure that the evaluation and resource allocation processes do not create too high a level of internal competition. Divisions and businesses

should have to justify their intentions and proposals, and it is inevitable they will be competing for scarce resources. Nevertheless, the real enemy is external competitors, not other parts of the organization, and this must never be forgotten.

NOTES

In addition, some organizations still tend to use the performance targets as the primary means of control, which sometimes results in short-term thinking. Once a business drops below its target it is put under considerable pressure to reduce costs, and this may restrict its ability to be creative and innovative. Many strategic planning systems could be improved if the head office corporate planners had more contact and involvement with the businesses; they sometimes tend to be remote and detached. In summary, formalized planning systems may be imperfect, but a system of some form remains essential for control and co-ordination. Alone it cannot enable the company to deal with competitive uncertainties and pressures – vision and learning are essential, but planning must not be abandoned.

This section has considered the important role and contribution of strategic planning in large, and possibly diverse, organizations. The *next section considers strategic planning in small businesses.*

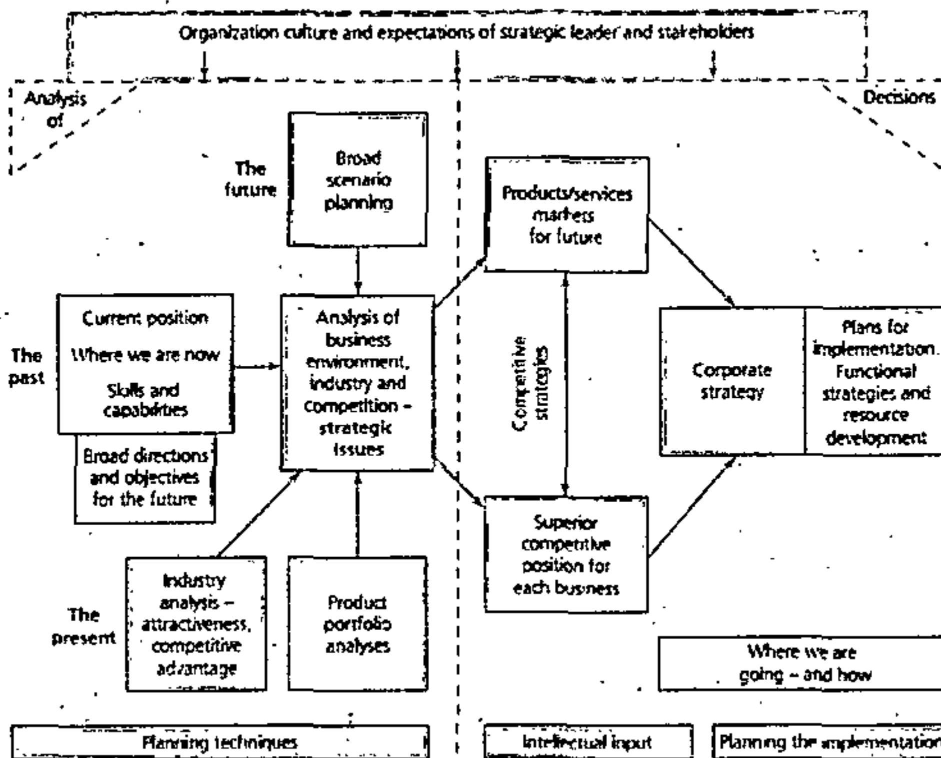


Figure 3.7 A contemporary approach to strategic planning.

NOTES

Strategic planning and small businesses

Many small companies stay focused and do not diversify or acquire another business. Their corporate perspective stays the same, but they still need to create some form of competitive advantage and develop and integrate functional plans. In this respect, small business planning is similar to that for an individual business inside a conglomerate. Unfortunately, many small owner–managers misguidedly believe that:

- strategic planning is too expensive and only belongs in large organizations
- formalized processes, requiring expert planners, are essential
- the benefits are too long term and there are no immediate pay-offs.

As a result they adopt a more seat-of-the-pants reactive approach. Both vision and flexibility are important features of most successful small businesses, but these can be built on to provide greater strength and stability. Simply, and reinforcing points made earlier in the chapter, small companies can benefit in the same way as large ones from discerning the important *strategic issues* and from involving managers from the various functions in deciding how they might best be tackled. Small companies should involve all relevant managers in discussions about priorities, opportunities, problems and preferences. They should look ahead and not just consider immediate problems and crises. Objective information and analyses (albeit limited in scope) are required to underpin the process, which must be actively and visibly supported by the owner–manager or strategic leader, who, in turn, must be willing to accept ideas from other managers. Adequate time must also be found, and sound financial systems should be in place to support the implementation of new strategies and plans.

It is, of course, important to remember that small companies which needed to raise finance from the banking system or elsewhere would have had to draw up a business plan to support their request. All too often these plans are then put in a drawer and largely forgotten rather than being used as a framework for budgeting and monitoring performance. Some small company managers never really develop a discipline of planning.

3.8 STRATEGIC PLANNING ISSUES

Who should plan?

Among the various authors on corporate planning who have been referred to earlier in this chapter, there is a consensus of opinion that strategic planning should not be undertaken by the chief executive alone, planning

specialists divorced from operating managers, marketing executives or finance departments. An individual or specialist department may be biased and fail to produce a balanced plan. Instead, it is important to involve, in some way, all managers who will be affected by the plan, and who will be charged with implementing it. However, all of these managers together cannot constitute an effective working team, and therefore a small team representing the whole organization should be constituted, and other managers consulted. This will require a schedule for the planning activities and a formalized system for carrying out the tasks.

NOTES

As discussed above, it is important that planning systems do not inhibit ongoing strategic thinking by managers throughout the organization. Threats must still be spotted early and potential opportunities must not be lost.

Planning traps Ringbakk (1971) and Steiner (1972) have documented several reasons why formal planning might fail and have discussed the potential traps to avoid. Among their conclusions are the following:

- Planning should not be left exclusively to planners who might see their job as being the production of a plan and who might also concentrate on procedures and detail at the expense of wide strategic thinking.
- Planning should be seen as a support activity in strategic decision-making and not a once-a-year ritual.
- There must be a commitment and an allocation of time from the strategic leader. Without this managers lower down the organization might not feel that planning matters within the firm.
- Planning is not likely to prove effective unless the broad directional objectives for the firm are agreed and communicated widely.
- Implementers must be involved, both in drawing up the plan (or essential information might be missed) and afterwards. The plan should be communicated throughout the organization, and efforts should be made to ensure that managers appreciate what is expected of them.
- Targets, once established, should be used as a measure of performance and variances should be analysed properly. However, there can be a danger in overconcentrating on targets and financial data at the expense of more creative strategic thinking.
- The organizational climate must be appropriate for the planning system adopted, and consequently structural and cultural issues have an important role to play.
- Inflexibility in drawing up and using the plan can be a trap. Inflexibility in drawing up the plan might be reflected in tunnel vision, a lack of flair and creativity, and in assuming that past trends can be extrapolated forwards.

- If planning is seen as an exercise rather than a support to strategy creation, it is quite possible that the plan will be ignored and not implemented.

The impact of planning on managers

Unless the above traps are avoided and the human aspects of planning are considered, the planning activity is unlikely to prove effective. Abell and Hammond (1979) and Mills (1985) highlight the following important people considerations:

- Ensure the support of senior executives.
- Ensure that every manager who is involved understands what is expected of them and that any required training in planning techniques is provided.
- Use specialist planners carefully.
- Keep planning simple, and ensure that techniques never become a doctrine.
- Particularly where detailed planning is involved, ensure that the time horizon is appropriate. It is harder to forecast and plan detail the further into the future one looks.
- Never plan for the sake of planning.
- Link managerial rewards and sanctions to any targets for achievement which are established.
- Allow managers of business units and functions some freedom to develop their own planning systems rather than impose rigid ones, especially if they produce the desired results.

In summary, planning activities can take a number of forms, and organizations should seek to develop systems that provide the results they want. Ideally, these should encapsulate both strategic thinking and the establishment of realistic objectives and expectations and the strategies to achieve them. Planning techniques can be used supportively, and their potential contribution is evaluated in the next section. Systematic corporate planning, though, should not be seen as the only way in which strategic changes are formulated.

The role of planning and planners

In the light of the comments above on strategy formulation, this section concludes by considering further the role of planning and planners. Planning and strategy creation are different in the sense that planners may or may not be strategists but strategists might be found anywhere in the organization. Mintzberg (1989) suggests that planning activities are likely to involve a series of different and very useful analyses, but it does not follow that these must be synthesized into a systematic planning system.

Planners can make a valuable contribution to the organization and to strategic thinking by:

- programming strategies into finite detail to enable effective implementation (this will involve budgeting and ensuring that strategies are communicated properly, plus the establishment of monitoring and control processes)
- formalizing ongoing strategic awareness – carrying out SWOT analyses and establishing what strategic changes are emerging at any time
- using scenarios and planning techniques to stimulate and encourage thinking
- searching for new competitive opportunities and strategic alternatives, and scrutinizing and evaluating them.

In other words, all of the activities incorporated in the planning systems discussed earlier in the chapter are seen to be making an important contribution, but they need not be component parts of a systematic model. Rather, they are contributors towards strategic thinking, awareness and insight.

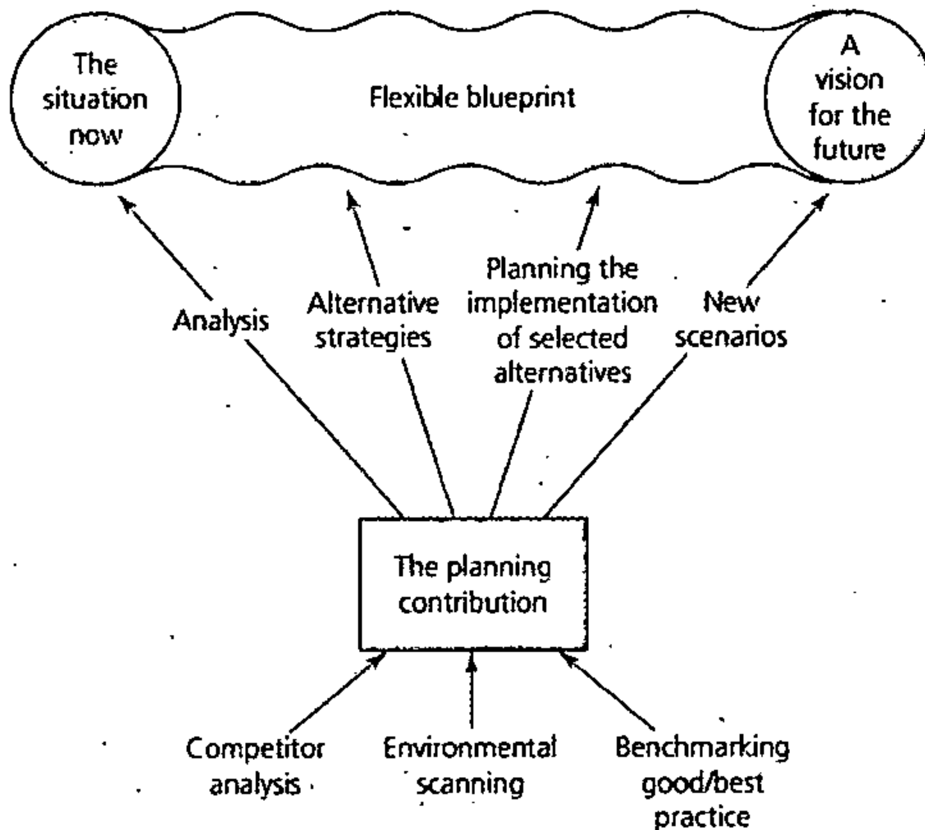


Figure 3.8 The planning contribution. Systematic planning (in isolation) will not create a vision – but you can plan your own way towards a vision. Ideas generated through planning may well change the vision

NOTES

Johnson (1992) further points out that on occasions plans are documented in detail only because particular stakeholders, say institutional shareholders or bankers, expect to see them as justification for proposals. There is never any real intention that they should be implemented in full..

Figure 3.8 draws together a number of these themes and illustrates the various contributions that planning and planners can make. In conjunction with this, the next section considers the relative value and contribution of selected planning techniques.

The key macro and micro variables of our business are so dynamic that poker becomes more predictable than planning and reactivity more profitable than rumination.

Dr John White, ex-Managing Director, BBA

I have a saying: 'Every plan is an opportunity lost' ... because I feel that if you try to plan the way your business will go, down to the last detail, you are no longer able to seize any opportunity that may arise unexpectedly.

Debbie Moore, Founder Chairman, Pineapple (dance studios) Ltd

3.9 STRATEGIC PLANNING TECHNIQUES

It has already been explained that different strategists and authors of strategy texts adopt different stances on the significance of vision, culture and strategic planning techniques in effective strategic planning. In this book the view is held that the role of the strategic leader, styles of corporate decision-making and organization culture are key driving forces in strategy creation and implementation. However, strategic planning techniques, which rely heavily on the collection and analysis of quantitative data, do have an important contribution to make. They help to increase awareness, and thereby reduce the risk involved in certain decisions. They can indicate the incidence of potential threats and limitations which might reduce the future value and contribution of individual products and services. They can help in establishing priorities in large complex multiproduct multinational organizations. They can provide appropriate frameworks for evaluating the relative importance of very different businesses in a portfolio.

However, their value is dependent on the validity and reliability of the information fed into them. Where comparisons with competitors are involved, the data for other companies may well involve 'guesstimation'.

Judgement is required for assessing the significance of events and competitor strategies; vision is essential in discontinuous change management. In the author's opinion strategic planning techniques should be used to

help and facilitate decision-makers. They should not be used to make decisions without any necessary qualifications to the data and assumptions.

Portfolio analysis The Boston Consulting Group growth-share matrix can be very useful for positioning products in relation to their stage in the product life cycle as long as one is both careful and honest in the use of data. It can provide insight into the likely cash needs and the *potential for earnings generation*. However, while a particular matrix position indicates potential needs and prospects, it should not be seen as prescriptive for future strategy. In certain respects, all competitive positions are unique, and it is very important to consider the actual industry involved and the nature and behaviour of competitors. Business unit and product managers are likely to be able to do this with greater insight than specialist planners as they are in a better position to appreciate the peculiarities of the market.

The product portfolio suggests the following strategies for products or business units falling into certain categories:

- cash cow – milk and redeploy the cash flow
- dog – liquidate or divest and redeploy the freed resources or proceeds
- star – strengthen competitive position in growth industry
- question – invest as appropriate to secure and improve competitive position.

The Boston Consulting Group (BCG) Growth-share Matrix

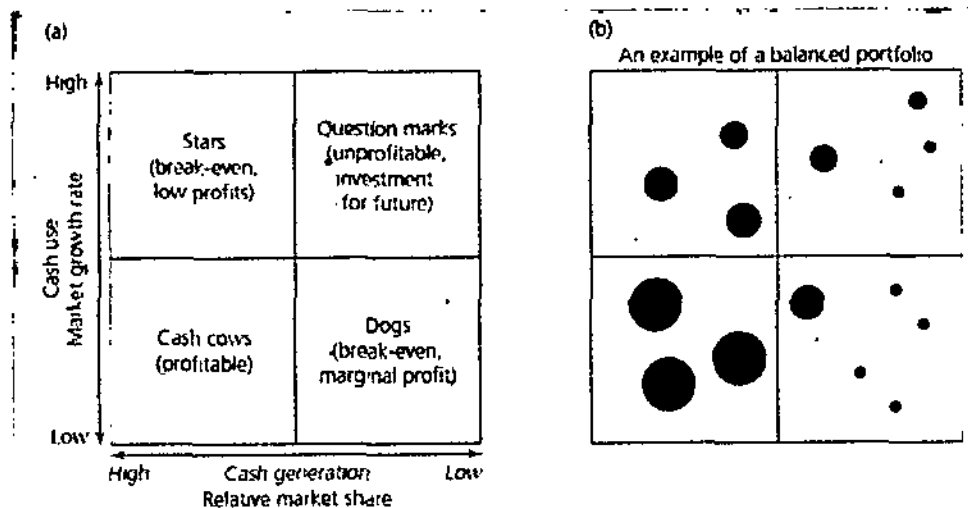


Figure 3.9 The Boston Consulting Group growth-share matrix

NOTES

Basic premises

Bruce Henderson (1970) of BCG has suggested first that the margins earned by a product, and the cash generated by it, are a function of market share. The higher the market share, relative to competitors, the greater the earnings potential; high margins and market share are correlated. A second premise is that sales and revenue growth requires investment. Sales of a product will only increase if there is appropriate expenditure on advertising, distribution and development; and the rate of market growth determines the required investment. Third, high market share must be earned or bought, which requires additional investment. Finally, no business can grow indefinitely. As a result, products will at times not be profitable because the amount of money being spent to develop them exceeds their earnings potential; at other times, and particularly where the company has a high relative market share, earnings exceed expenditure and products are profitable.

Profitability is therefore affected by market growth, market share, and the stage in the product life cycle. A company with a number of products might expect to have some that are profitable and some that are not. In general, mature products, where growth has slowed down and the required investment has decreased, are the most profitable, and the profits they earn should not be reinvested in them but used instead to finance growth products that offer future earnings potential.

The matrix

The matrix is illustrated in Figure 3.9. Chart (a) shows the composition of the axes and the names given to products or business units which fall in each of the four quadrants; chart (b) features 15 products or business units in a hypothetical company portfolio. The sterling-volume size of each product or business is proportional to the areas of the circles, and the positioning of each one is determined by its market growth rate and relative market share.

The market growth rate on the vertical axis is the annual growth rate of the market in which the company competes, and really any range starting with zero could be used. The problem is where to draw the horizontal dividing line which separates high-growth from low-growth markets. The relative market share on the horizontal axis indicates market share in relation to the largest competitor in the market. A relative market share of 0.25 would indicate a market share one-quarter of that

of the market leader; a figure of 2.5 would represent a market leader with a market share that is 2.5 times as big as that of the nearest rival. The vertical dividing line is normally 1.0, so that market leadership is found to the left-hand side of the divider. It is important to consider market segmentation when deciding upon the market share figure to use, rather than using the share of the total market. The growth-share matrix is thus divided into four cells or quadrants, each representing a particular type of business.

- Question marks are products or businesses which compete in high-growth markets but where market share is relatively low. A new product launched into a high-growth market and with an existing market leader would normally constitute a question mark. High expenditure is required to develop and launch the product, and consequently it is unlikely to be profitable and may instead require subsidy from more profitable products. Once the product is established, further investment will be required if the company attempts to claim market leadership.
- Successful question marks become stars, market leaders in growth markets. However, investment is still required to maintain the rate of growth and to defend the leadership position. Stars are marginally profitable only, but as they reach a more mature market position as growth slows down they will become increasingly profitable.
- Cash cows are therefore mature products which are well-established market leaders. As market growth slows down there is less need for high investment, and hence they are the most profitable products in the portfolio. This is boosted by any economies of scale resulting from the position of market leadership. Cash cows are used to fund the businesses in the other three quadrants.
- Dogs describe businesses that have low market shares in slower growthmarkets. They may well be previous cash cows, which still enjoy some loyal market support although they have been replaced as market leader by a newer rival. They should be marginally profitable, and should be withdrawn when they become loss makers, if not before. The opportunity cost of the resources that they tie up is an important issue in this decision.

Boston Consulting Group http://www.bcg.com

NOTES

Given that a dog represents a product or service in a relatively low-growth industry sector, and one which does not enjoy market segment leadership, it follows that many companies will have a number of dogs in their portfolios. **Liquidation** or divestment will not always be justified. Products which have a strong market position, even though they are not the market leader, and which have a distinctive competitive advantage can have a healthy cash flow and profitability. Such products are sometimes referred to as cash dogs. Divestment is most appropriate when the market position is weak and when there is no real opportunity to create sustainable competitive advantage, as long as a buyer can be found.

According to Hamermesch (1986) many businesses that are classified as cash cows should be managed for innovation and growth, especially if the industry is dynamic or volatile, or can be made so. In other words, strategies that succeed in extending the product life cycle can move it from a state of maturity into further growth. One example quoted is coffee. This market experienced renewed growth when the success of automatic coffee makers increased demand for new varieties of fresh ground coffee. The success of Starbucks shows how a single organization which spots and seizes an opportunity can change an industry and provide an impetus for growth. When 'milking' products care also has to be taken not to reduce capacity if there is a chance that demand and growth opportunities might return as a result of scarcities or changes in taste. When restrictions on the import of Scotch whisky into Japan were eased in the late 1980s, the product enjoyed star status, even though it was seen as a cash cow in the UK.

Strategic decisions based on portfolio positions may also ignore crucial issues of interdependence and synergy. Business units may be treated as separate independent businesses for the purposes of planning, and this can increase the likelihood of the more qualitative contributions to other business units, and to the organization as a whole, being overlooked when decisions are made about possible liquidation or divestment.

Directional policy matrices

The best-known directional policy matrices were developed in the 1970s by Shell and General Electric and the management consultants McKinsey. They are broadly similar and aim to assist large complex multiactivity enterprises with decisions concerning investment and divestment priorities. A version of the Shell matrix is illustrated in Figure 3.10; a fuller explanation can be found in Robinson *et al.* (1978). In using such a matrix there is an

assumption that resources are scarce, and that there never will be, or should be, enough financial and other resources for the implementation of all the project ideas and opportunities which can be conceived in a successful, creative and innovative organization. Choices will always have to be made about investment priorities. The development of an effective corporate strategy therefore involves an evaluation of the potential for existing businesses together with new possibilities in order to determine the priorities.

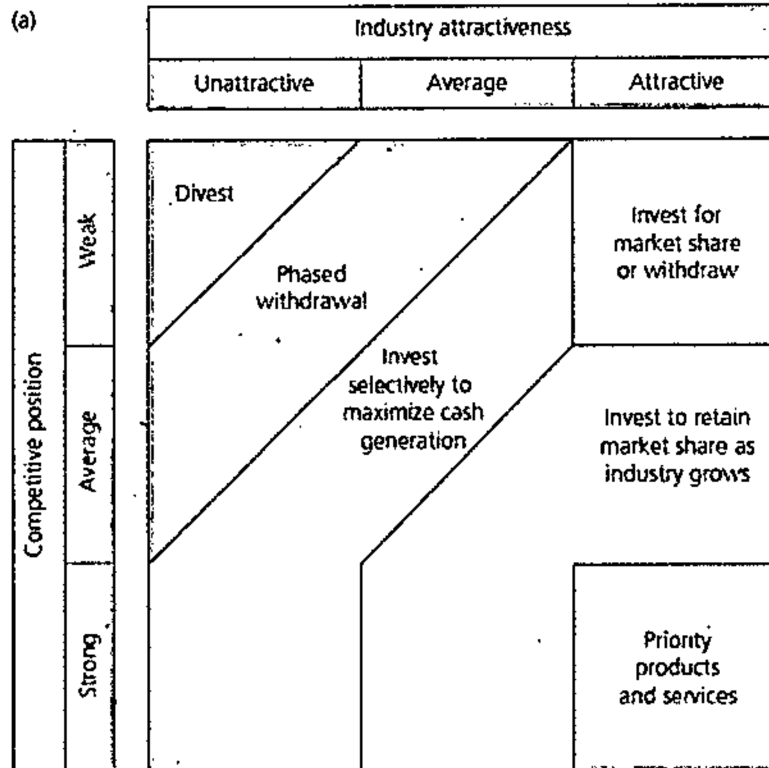
Table 3.2 Factors in the directional policy matrix

Industry attractiveness	Market growth Market quality, or the ability for new products to achieve higher or more stable profitability than other sectors Supplier pressure Customer pressure Substitute products Government action Entry barriers Competitive pressure
Competitive position and relative strength	Competition Relative market shares Competitive postures and opportunities Production capability Research and development record and strengths Success rate to date, measured in terms of market share and financial success (earnings in excess of the cost of capital)

The matrix is constructed within two axes: the horizontal axis represents industry attractiveness, or the prospects for profitable operation in the sector concerned; the vertical axis indicates the company's existing competitive position in relation to other companies in the industry. New possibilities can be evaluated initially along the vertical axis by considering their likely prospects for establishing competitive advantage. It will be appreciated that Michael Porter's work links closely to this. In placing individual products in the matrix the factors shown in Table 3.2 are typical of those that might be used.

NOTES

(a)



(b)

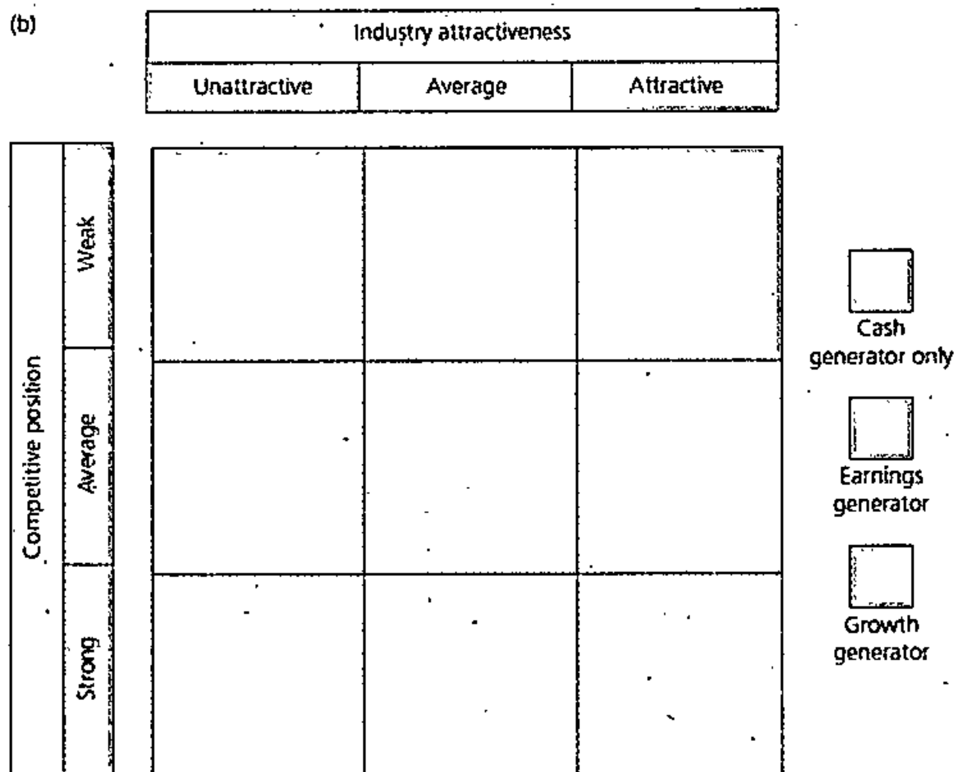


Figure 3.10 The directional policy matrix developed by Shell – two presentations

GE / McKinsey Matrix

In consulting engagements with General Electric in the 1970's, McKinsey & Company developed a nine-cell portfolio matrix as a tool for screening GE's large portfolio of strategic business units (SBU). This business screen became known as the **GE/McKinsey Matrix** and is shown below:

		Business Unit Strength		
		High	Medium	Low
Industry Attractiveness	High			
	Medium			
	Low			

Figure 3.11: GE / McKinsey Matrix

The GE / McKinsey matrix is similar to the BCG growth-share matrix in that it maps strategic business units on a grid of the industry and the SBU's position in the industry. The GE matrix however, attempts to improve upon the BCG matrix in the following two ways:

The GE matrix generalizes the axes as "Industry Attractiveness" and "Business Unit Strength" whereas the BCG matrix uses the market growth rate as a proxy for industry attractiveness and relative market share as a proxy for the strength of the business unit. The GE matrix has nine cells vs. four cells in the BCG matrix. Industry attractiveness and business unit strength are calculated by first identifying criteria for each, determining the value of each parameter in the criteria, and multiplying that value by a weighting factor. The result is a quantitative measure of industry attractiveness and the business unit's relative performance in that industry.

3.10 A MODEL FOR INDUSTRY ANALYSIS

Porter's Five Forces

The model of pure competition implies that risk-adjusted rates of return should be constant across firms and industries. However, numerous economic studies have affirmed that different industries can sustain different levels of profitability; part of this difference is explained by industry structure.

NOTES

Michael Porter provided a framework that models an industry as being influenced by five forces. The strategic business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm operates.

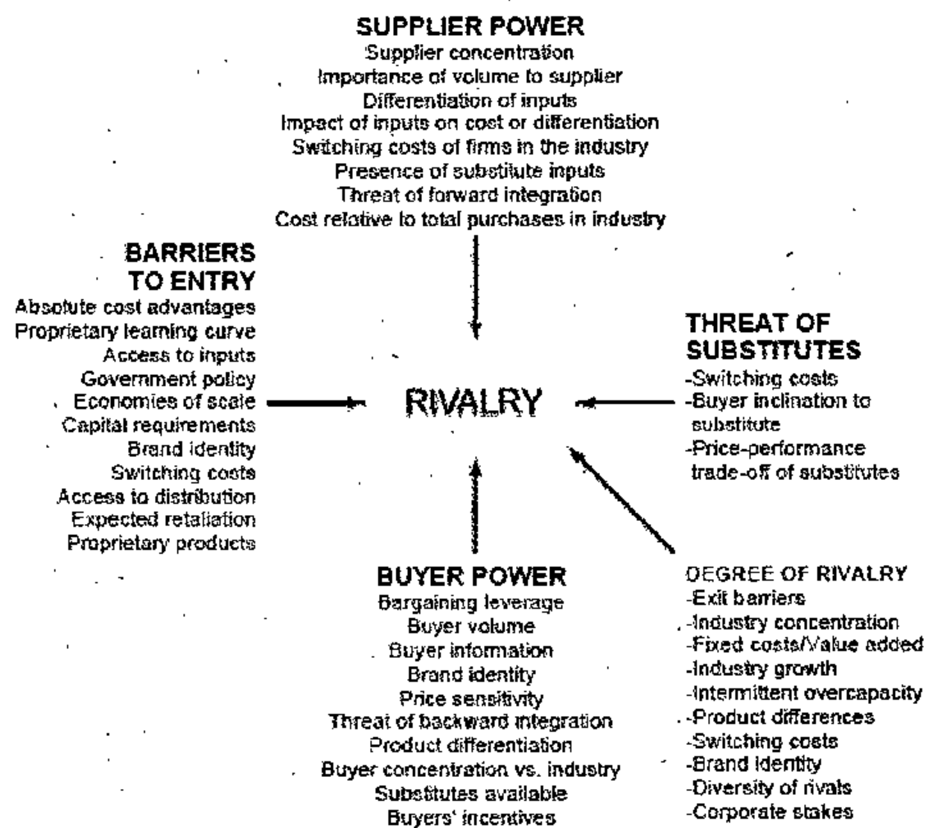


Figure 3.12 : Diagram of Porter's 5 Forces

I. Rivalry

In the traditional economic model, competition among rival firms drives profits to zero. But competition is not perfect and firms are not unsophisticated passive price takers. Rather, firms strive for a competitive advantage over their rivals. The intensity of rivalry among firms varies across industries, and strategic analysts are interested in these differences. Economists measure rivalry by indicators of industry concentration. The Concentration Ratio (CR) is one such measure. The Bureau of Census periodically reports the CR for major Standard Industrial Classifications (SIC's). The CR indicates the percent of market share held by the four largest firms (CR's for the largest 8, 25, and 50 firms in an industry also are available). A high concentration ratio indicates that a high concentration of market share is held by the largest firms - the industry is concentrated. With only a few firms holding a large market share, the competitive landscape is less competitive (closer to a monopoly). A low concentration ratio

indicates that the industry is characterized by *many rivals, none of* which has a significant market share. These *fragmented* markets are said to be competitive. The concentration ratio is not the only available measure; the trend is to define industries in terms that convey more information than distribution of market share. If rivalry among firms in an industry is low, the industry is considered to be disciplined. This discipline may result from the industry's history of competition, the role of a leading firm, or informal compliance with a generally understood code of conduct. Explicit *collusion* generally is illegal and not an option; in low-rivalry industries competitive moves must be constrained informally. However, a maverick firm seeking a competitive advantage can displace the otherwise *disciplined market*. When a rival acts in a way that elicits a counter-response by other firms, rivalry intensifies. The intensity of rivalry commonly is referred to as being cutthroat, intense, moderate, or weak, based on the firms' aggressiveness in attempting to gain an advantage.

In pursuing an advantage over its rivals, a firm can choose from several competitive moves:

- Changing prices - raising or lowering prices to gain a temporary advantage. Improving product differentiation - improving features, implementing innovations in the manufacturing process and in the product itself.
- Creatively using channels of distribution - using *vertical integration* or using a distribution channel that is novel to the industry. For example, with high-end jewelry stores reluctant to carry its watches, Timex moved into drugstores and other non-traditional outlets and cornered the low to mid-price watch market.
- Exploiting relationships with suppliers - for example, from the 1950's to the 1970's Sears, Roebuck and Co. dominated the retail household appliance market. Sears set high quality standards and required suppliers to meet its demands for product specifications and price.

The intensity of rivalry is influenced by the following industry characteristics:

1. **A larger number of firms** increases rivalry because more firms must compete for the same customers and resources. The rivalry intensifies if the firms have similar market share, leading to a struggle for market leadership.
2. **Slow market growth** causes firms to fight for market share. In a growing market, firms are able to improve revenues simply because of the expanding market.
3. ***High fixed costs*** *result in an economy of* scale effect that increases rivalry. When total costs are mostly fixed costs, the firm must

NOTES

produce near capacity to attain the lowest unit costs. Since the firm must sell this large quantity of product, high levels of production lead to a fight for market share and results in increased rivalry.

4. **High storage costs or highly perishable products** cause a producer to sell goods as soon as possible. If other producers are attempting to unload at the same time, competition for customers intensifies.
5. **Low switching costs** increases rivalry. When a customer can freely switch from one product to another there is a greater struggle to capture customers.
6. **Low levels of product differentiation** is associated with higher levels of rivalry. Brand identification, on the other hand, tends to constrain rivalry.
7. **Strategic stakes are high** when a firm is losing market position or has potential for great gains. This intensifies rivalry.
8. **High exit barriers** place a high cost on abandoning the product. The firm must compete. High exit barriers cause a firm to remain in an industry, even when the venture is not profitable. A common exit barrier is asset specificity. When the plant and equipment required for manufacturing a product is highly specialized, these assets cannot easily be sold to other buyers in another industry. Litton Industries' acquisition of Ingalls Shipbuilding facilities illustrates this concept. Litton was successful in the 1960's with its contracts to build Navy ships. But when the Vietnam war ended, defense spending declined and Litton saw a sudden decline in its earnings. As the firm restructured, divesting from the shipbuilding plant was not feasible since such a large and highly specialized investment could not be sold easily, and Litton was forced to stay in a declining shipbuilding market.
9. **A diversity of rivals** with different cultures, histories, and philosophies make an industry unstable. There is greater possibility for mavericks and for misjudging rival's moves. Rivalry is volatile and can be intense. The hospital industry, for example, is populated by hospitals that historically are community or charitable institutions, by hospitals that are associated with religious organizations or universities, and by hospitals that are for-profit enterprises. This mix of philosophies about mission has lead occasionally to fierce local struggles by hospitals over who will get expensive diagnostic and therapeutic services. At other times, local hospitals are highly cooperative with one another on issues such as community disaster planning.
10. **Industry Shakeout.** A growing market and the potential for high profits induces new firms to enter a market and incumbent firms to increase production. A point is reached where the industry becomes crowded with competitors, and demand cannot support the new entrants and the resulting increased supply. The industry

may become crowded if its growth rate slows and the market becomes saturated, creating a situation of excess capacity with too many goods chasing too few buyers. A shakeout ensues, with intense competition, price wars, and company failures.

NOTES

BCG founder Bruce Henderson generalized this observation as the Rule of Three and Four: a stable market will not have more than three significant competitors, and the largest competitor will have no more than four times the market share of the smallest. If this rule is true, it implies that: If there is a larger number of competitors, a shakeout is inevitable Surviving rivals will have to grow faster than the market Eventual losers will have a negative cash flow if they attempt to grow All except the two largest rivals will be losers The definition of what constitutes the "market" is strategically important. Whatever the merits of this rule for stable markets, it is clear that market stability and changes in supply and demand affect rivalry. Cyclical demand tends to create cutthroat competition. This is true in the disposable diaper industry in which demand fluctuates with birth rates, and in the greeting card industry in which there are more predictable business cycles.

II. Threat Of Substitutes

In Porter's model, substitute products refer to products in other industries. To the economist, a threat of substitutes exists when a product's demand is affected by the price change of a substitute product. A product's price elasticity is affected by substitute products - as more substitutes become available, the demand becomes more elastic since customers have more alternatives. A close substitute product constrains the ability of firms in an industry to raise prices.

The competition engendered by a Threat of Substitute comes from products outside the industry. The price of aluminum beverage cans is constrained by the price of glass bottles, steel cans, and plastic containers. These containers are substitutes, yet they are not rivals in the aluminum can industry. To the manufacturer of automobile tires, tire retreads are a substitute. Today, new tires are not so expensive that car owners give much consideration to retreading old tires. But in the trucking industry new tires are expensive and tires must be replaced often. In the truck tire market, retreading remains a viable substitute industry. In the disposable diaper industry, cloth diapers are a substitute and their prices constrain the price of disposables.

While the threat of substitutes typically impacts an industry through price competition, there can be other concerns in assessing the threat of substitutes. Consider the substitutability of different types of TV transmission: local station transmission to home TV antennas via the airways versus transmission via cable, satellite, and telephone lines. The new technologies available and the changing structure of the

NOTES

entertainment media are contributing to competition among these substitute means of connecting the home to entertainment. Except in remote areas it is unlikely that cable TV could compete with free TV from an aerial without the greater diversity of entertainment that it affords the customer.

III. Buyer Power

The power of buyers is the impact that customers have on a producing industry. In general, when buyer power is strong, the relationship to the producing industry is near to what an economist terms a **monopsony** - a market in which there are many suppliers and one buyer. Under such market conditions, the buyer sets the price. In reality few pure monopsonies exist, but frequently there is some asymmetry between a producing industry and buyers. The following tables outline some factors that determine buyer power.

Buyers are Powerful if:	Example
Buyers are concentrated - there are a few buyers with significant market share	DOD purchases from defense contractors
Buyers purchase a significant proportion of output - distribution of purchases or if the product is standardized	Circuit City and Sears' large retail market provides power over appliance manufacturers
Buyers possess a credible backward integration threat - can threaten to buy producing firm or rival	Large auto manufacturers' purchases of tires
Buyers are Weak if:	**Example**
Producers threaten forward integration - producer can take over own distribution/retailing	Movie-producing companies have integrated forward to acquire theaters
Significant buyer switching costs - products not standardized and buyer cannot easily switch to another product	IBM's 360 system strategy in the 1960's
Buyers are fragmented (many, different) - no buyer has any particular influence on product or price	Most consumer products
Producers supply critical portions of buyers' input - distribution of purchases	Intel's relationship with PC manufacturers

IV. Supplier Power

A producing industry requires raw materials - labor, components, and other supplies. This requirement leads to buyer-supplier relationships between the industry and the firms that provide it the raw materials used to create products. Suppliers, if powerful, can exert an influence on the producing industry, such as selling raw materials at a high price to capture some of the industry's profits. The following tables outline some factors that determine supplier power.

NOTES

Suppliers are Powerful if:	**Example**
Credible forward integration threat by suppliers	Baxter International, manufacturer of hospital supplies, acquired American Hospital Supply, a distributor
Suppliers concentrated	Drug industry's relationship to hospitals
Significant cost to switch suppliers	Microsoft's relationship with PC manufacturers
Customers Powerful	Boycott of grocery stores selling non-union picked grapes
Suppliers are Weak if:	**Example**
Many competitive suppliers - product is standardized	Tire industry relationship to automobile manufacturers
Purchase commodity products	Grocery store brand label products
Credible backward integration threat by purchasers	Timber producers relationship to paper companies
Concentrated purchasers	Garment industry relationship to major department stores
Customers Weak	Travel agents' relationship to airlines

V. Barriers to Entry / Threat of Entry

It is not only incumbent rivals that pose a threat to firms in an industry; the possibility that new firms may enter the industry also affects competition. In theory, any firm should be able to enter and exit a market, and if free entry and exit exists, then profits always should be nominal. In reality, however, industries possess characteristics that protect the high profit levels of firms in the market and inhibit additional rivals from entering the market. These are ***barriers to entry***.

Barriers to entry are more than the normal equilibrium adjustments that markets typically make. For example, when industry profits increase, we would expect additional firms to enter the market to take advantage of the high profit levels, over time driving down profits for all firms in the industry. When profits decrease, we would expect some firms to exit the market thus restoring a market equilibrium. Falling prices, or the expectation that future prices will fall, deters rivals from entering a market. Firms also may be reluctant to enter markets that are extremely uncertain, especially if entering involves expensive start-up costs. These are normal accommodations to market conditions. But if firms individually (collective action would be illegal collusion) keep prices artificially low as a strategy to prevent potential entrants from entering the market, such ***entry-deterring pricing*** establishes a barrier.

Barriers to entry are unique industry characteristics that define the industry. Barriers reduce the rate of entry of new firms, thus maintaining a level of profits for those already in the industry. From a strategic

perspective, barriers can be created or exploited to enhance a firm's competitive advantage. Barriers to entry arise from several sources:

NOTES

1. **Government creates barriers.** Although the principal role of the government in a market is to preserve competition through anti-trust actions, government also restricts competition through the granting of monopolies and through regulation. Industries such as utilities are considered natural monopolies because it has been more efficient to have one electric company provide power to a locality than to permit many electric companies to compete in a local market. To restrain utilities from exploiting this advantage, government permits a monopoly, but regulates the industry. Illustrative of this kind of barrier to entry is the local cable company. The franchise to a cable provider may be granted by competitive bidding, but once the franchise is awarded by a community a monopoly is created. Local governments were not effective in monitoring price gouging by cable operators, so the federal government has enacted legislation to review and restrict prices. The regulatory authority of the government in restricting competition is historically evident in the banking industry. Until the 1970's, the markets that banks could enter were limited by state governments. As a result, most banks were local commercial and retail banking facilities. Banks competed through strategies that emphasized simple marketing devices such as awarding toasters to new customers for opening a checking account. When banks were deregulated, banks were permitted to cross state boundaries and expand their markets. Deregulation of banks intensified rivalry and created uncertainty for banks as they attempted to maintain market share. In the late 1970's, the strategy of banks shifted from simple marketing tactics to mergers and geographic expansion as rivals attempted to expand markets.

2. **Patents and proprietary knowledge serve to restrict entry into an industry.** Ideas and knowledge that provide competitive advantages are treated as private property when patented, preventing others from using the knowledge and thus creating a barrier to entry. Edwin Land introduced the Polaroid camera in 1947 and held a monopoly in the instant photography industry. In 1975, Kodak attempted to enter the instant camera market and sold a comparable camera. Polaroid sued for patent infringement and won, keeping Kodak out of the instant camera industry.

3. **Asset specificity inhibits entry into an industry.** Asset specificity is the extent to which the firm's assets can be utilized to produce a different product. When an industry requires highly specialized technology or plants and equipment, potential entrants are reluctant to commit to acquiring specialized assets that cannot be sold or converted into other uses if the venture fails. Asset specificity provides a barrier to entry for two reasons: First, when firms

already hold specialized assets they fiercely resist efforts by others from taking their market share. New entrants can anticipate aggressive rivalry. For example, Kodak had much capital invested in its photographic equipment business and aggressively resisted efforts by Fuji to intrude in its market. These assets are both large and industry specific. The second reason is that potential entrants are reluctant to make investments in highly specialized assets.

4. **Organizational (Internal) Economies of Scale.** The most cost efficient level of production is termed **Minimum Efficient Scale** (MES). This is the point at which unit costs for production are at minimum - i.e., the most cost efficient level of production. If MES for firms in an industry is known, then we can determine the amount of market share necessary for low cost entry or cost parity with rivals. For example, in long distance communications roughly 10% of the market is necessary for MES. If sales for a long distance operator fail to reach 10% of the market, the firm is not competitive.

The existence of such an economy of scale creates a barrier to entry. The greater the difference between industry MES and entry unit costs, the greater the barrier to entry. So industries with high MES deter entry of small, start-up businesses. To operate at less than MES there must be a consideration that permits the firm to sell at a premium price - such as product differentiation or local monopoly.

Barriers to exit work similarly to barriers to entry. Exit barriers limit the ability of a firm to leave the market and can exacerbate rivalry - unable to leave the industry, a firm must compete. Some of an industry's entry and exit barriers can be summarized as follows:

Easy to Enter if there is:	**Difficult to Enter if there is:**
• Common technology	• *Patented or proprietary know-how*
• Little brand franchise	• Difficulty in brand switching
• Access to distribution channels	• Restricted distribution channels
• Low scale threshold	• High scale threshold
Easy to Exit if there are:	**Difficult to Exit if there are:**
• Salable assets	• Specialized assets
• Low exit costs	• High exit costs
• Independent businesses	• Interrelated businesses

3.11 DYNAMIC NATURE OF INDUSTRY RIVALRY

NOTES

Our descriptive and analytic models of industry tend to examine the industry at a given state. The nature and fascination of business is that it is not static. While we are prone to generalize, for example, list GM, Ford, and Chrysler as the "Big 3" and assume their dominance, we also have seen the automobile industry change.

Currently, the entertainment and communications industries are in flux. Phone companies, computer firms, and entertainment are merging and forming strategic alliances that re-map the information terrain. Schumpeter and, more recently, Porter have attempted to move the understanding of industry competition from a static economic or industry organization model to an emphasis on the interdependence of forces as dynamic, or *punctuated equilibrium*, as Porter terms It.

3.12 GENERIC STRATEGIES TO COUNTER THE FIVE FORCES

Strategy can be formulated on three levels:

- corporate level
- business unit level
- functional or departmental level.

The business unit level is the primary context of industry rivalry. Michael Porter identified three generic strategies (*cost leadership*, *differentiation*, and *focus*) that can be implemented at the business unit level to create a competitive advantage. The proper generic strategy will position the firm to leverage its strengths and defend against the adverse effects of the five forces.

Porter's Diamond of National Advantage

Classical theories of international trade propose that comparative advantage resides in the factor endowments that a country may be fortunate enough to inherit. Factor endowments include land, natural resources, labor, and the size of the local population.

Michael E. Porter argued that a nation can create new advanced factor endowments such as skilled labor, a strong technology and knowledge base, government support, and culture. Porter used a diamond shaped diagram as the basis of a framework to illustrate the determinants of national advantage. This diamond represents the national playing field that countries establish for their industries.

The individual points on the diamond and the diamond as a whole affect four ingredients that lead to a national comparative advantage. These ingredients are:

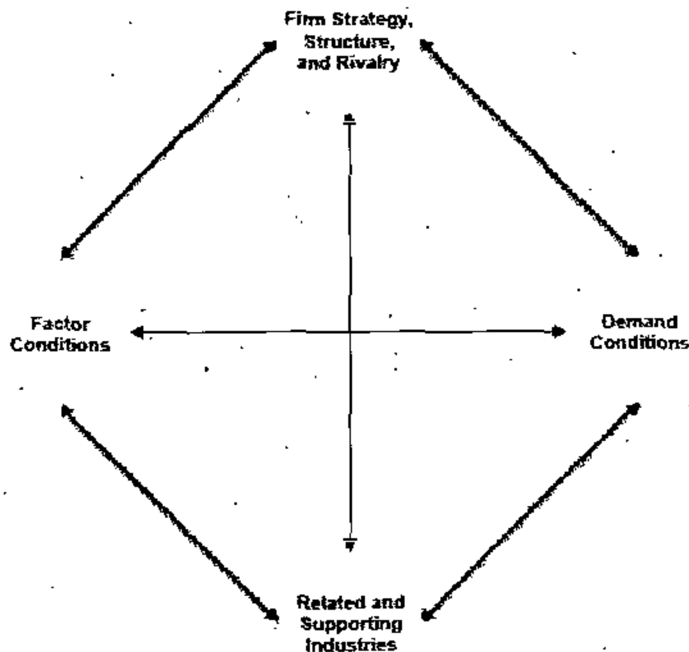


Figure 3.13: Porter's Diamond of National Advantage

1. the availability of resources and skills,
2. information that firms use to decide which opportunities to pursue with those resources and skills,
3. the goals of individuals in companies,
4. the pressure on companies to innovate and invest.

The points of the diamond are described as follows.

I. Factor Conditions

A country creates its own important factors such as skilled resources and technological base.

- The stock of factors at a given time is less important than the extent that they are upgraded and deployed.
- Local disadvantages in factors of production force innovation. Adverse conditions such as labor shortages or scarce raw materials force firms to develop new methods, and this innovation often leads to a national comparative advantage.

II. Demand Conditions

When the market for a particular product is larger locally than in foreign markets, the local firms devote more attention to that product

NOTES

than do foreign firms, leading to a competitive advantage when the local firms begin exporting the product.

- A more demanding local market leads to national advantage.
- A strong, trend-setting local market helps local firms anticipate global trends.

NOTES

III. Related and Supporting Industries

- When local supporting industries are competitive, firms enjoy more cost effective and innovative inputs.
- This effect is strengthened when the suppliers themselves are strong global competitors.

IV. Firm Strategy, Structure, and Rivalry

- Local conditions affect firm strategy. For example, German companies tend to be hierarchical. Italian companies tend to be smaller and are run more like extended families. Such strategy and structure helps to determine in which types of industries a nation's firms will excel.
- In Porter's Five Forces model, low rivalry made an industry attractive. While at a single point in time a firm prefers less rivalry, over the long run more local rivalry is better since it puts pressure on firms to innovate and improve. In fact, high local rivalry results in less global rivalry.
- Local rivalry forces firms to move beyond basic advantages that the home country may enjoy, such as low factor costs.

The Diamond as a System

The effect of one point depends on the others. For example, factor disadvantages will not lead firms to innovate unless there is sufficient rivalry.

- The diamond also is a self-reinforcing system. For example, a high level of rivalry often leads to the formation of unique specialized factors.

Government's Role

The role of government in the model is to:

- Encourage companies to raise their performance, for example by enforcing strict product standards.
- Stimulate early demand for advanced products.

- Focus on specialized factor creation. Stimulate local rivalry by limiting direct cooperation and enforcing antitrust regulations.

Application to the Japanese Fax Machine Industry

The Japanese facsimile industry illustrates the diamond of national advantage. Japanese firms achieved dominance is this industry for the following reasons:

- Japanese factor conditions: Japan has a relatively high number of electrical engineers per capita.
- Japanese demand conditions: The Japanese market was very demanding because of the written language.
- Large number of related and supporting industries with good technology, for example, good miniaturized components since there is less space in Japan.
- Domestic rivalry in the Japanese fax machine industry pushed innovation and resulted in rapid cost reductions.
- Government support - NTT (the state-owned telecom company) changed its cumbersome approval requirements for each installation to a more general type approval.

3.13 STRATEGIC GROWTH

Organizations can opt to grow organically, by investing their own resources to develop new competencies and capabilities and open up new market opportunities, but this is always going to take time. There is also an implicit assumption that the necessary competencies can actually be developed. It could be that aspects of the intellectual property involved are elusive. Equally, potential customers have to be persuaded to buy from a new and possibly unproven provider. Again this may prove elusive. Acquisitions, joint ventures or strategic alliances have the advantage of linkages with a proven supplier who has already developed the appropriate competencies and the necessary customers. They will also typically be faster – but they are often going to imply higher risk because they involve partnerships that have to be worked out. The successful implementation of an acquisition can easily take longer than anticipated. Because many organizations continue to prefer 'external' means to the internal, organic option, diversification (a route) and acquisition (a means) often go hand-in-hand. They both imply some uncertatinty and risk, risks that roll together.

As a result of the diversification, merger and acquisition activity the UK (for one) has developed a number of large companies with sizeable

NOTES

asset bases and domestic market shares, but few which are dominant in their industries or sectors at a world or even a European level – points that were also discussed earlier in the book. Constable (1986) argues that the high level of strategic energy devoted to these strategies created an illusion of real growth, with an emphasis on the shorter-term financial aspects of strategic expertise as opposed to the operational and market-based aspects which, long term, are of great significance. Arguably, too much top management time and effort has been spent on seeking and implementing acquisitions, and avoiding being acquired.

Although the nature of investment funding and stock market expectations have been significant influences behind the diversification and acquisition activity in the UK, there are other explanations. If a company has growth objectives and there are finite limits to the potential in existing markets, as well as barriers to becoming more international in order to penetrate related markets abroad, diversification may be an attractive option.

However, there may already be intense competition in domestic markets which the company considers entering, especially if the industries involved are attractive and profitable. The competition may be both UK producers and imported products and services and may be compounded by active rivalry for share and dominance. In such circumstances, direct entry may seem less appropriate than acquisition of an existing competitor. As acquisitions and mergers increase industrial concentration and the power of certain large organizations, government policy on competition may act as a restraint on particular lines of development for certain companies. Large firms may be encouraged to diversify into unrelated businesses where there is little apparent threat to the interests of consumers, rather than attempting horizontal integration which might be prevented by the intervention of the Competition Commission. Joint ventures offer another way round this constraint. A contrasting argument suggests that a company which has grown large, successful and profitable in a particular industry is likely to seek diversification while it is strong and has the resources to move into new business areas effectively. The benefits of such a move are likely to seem more realizable by the acquisition of an existing organization than by the slower build-up of new internal activities. This type of growth requires finance, which generally has been available for successful companies.

When companies are acquired then both sales and absolute profits increase quickly, and sometimes markedly. But does profitability also increase? Are assets being utilized more effectively in the combined organization? Is synergy really being obtained? Or are the increased sales and profits merely an illusion of growth?

Finally, Constable offers two further arguments to explain the strategic activity in the UK. First, strategic leaders of large organizations are typically aggressive in nature, and acquisition is an expression of aggression.

Second, there is a commonly held belief that the larger a company becomes the less likely it is to be a victim of a takeover bid. Hence, while diversification is essentially offensive and designed to bring about expansion and growth, it could be argued that on occasions it is a defensive strategy.

In choosing whether to diversify or not, Markides (1997) recommends that organizations should address five key questions:

1. What can we do better than our competitors? This, of course, is the area around which to focus and build.
2. What strategic resources are required in the possible new areas? What are the implications of this?
3. Can we beat the competition and become a strong player?
4. Is there a downside risk? In particular, might existing businesses be affected in any detrimental way?
5. What learning potential is there? Can the new business enhance synergy and improve our existing businesses and the organization as a whole? This assumes, of course, that the organization is able to exploit the learning potential.

Reasons for diversification and acquisition

There are, then, a number of sound and logical reasons why a firm might seek to diversify through acquisition. Some of these have been mentioned above; others are discussed below. Most are economic. The fact that diversification and acquisition strategies often prove less successful than the expectations for them is more likely to result from the choice of company to acquire and from issues and problems of implementation than the fact that the idea of diversification was misguided.

Diversification may be chosen because the existing business is seen as being vulnerable in some way: growth potential may be limited; further investment in internal growth may not be justified; the business may be threatened by new technology. Some businesses are undervalued by the stock market, making them vulnerable to take-over if they do not diversify. Some products and businesses may currently be valuable cash generators, but with little prospect of future growth. In other words, they may be cash cows generating funds that need to be reinvested elsewhere to build a future for the company. Leading on from this, the company may have growth objectives that stretch beyond the potential of existing businesses.

Diversification may occur because a company has developed a particular strength or expertise and feels that it could benefit from transferring this asset into other, possibly unrelated, businesses. The strength might be financial (high cash reserves or borrowing capacity), marketing,

technical or managerial. If genuine synergy potential exists, both the existing and newly acquired businesses can benefit from a merger or acquisition.

A company which has become stale or sleepy, or which has succession problems at the strategic leader level, may see an acquisition as a way of obtaining fresh ideas and new management, and this may seem more important than the extent to which the businesses are related.

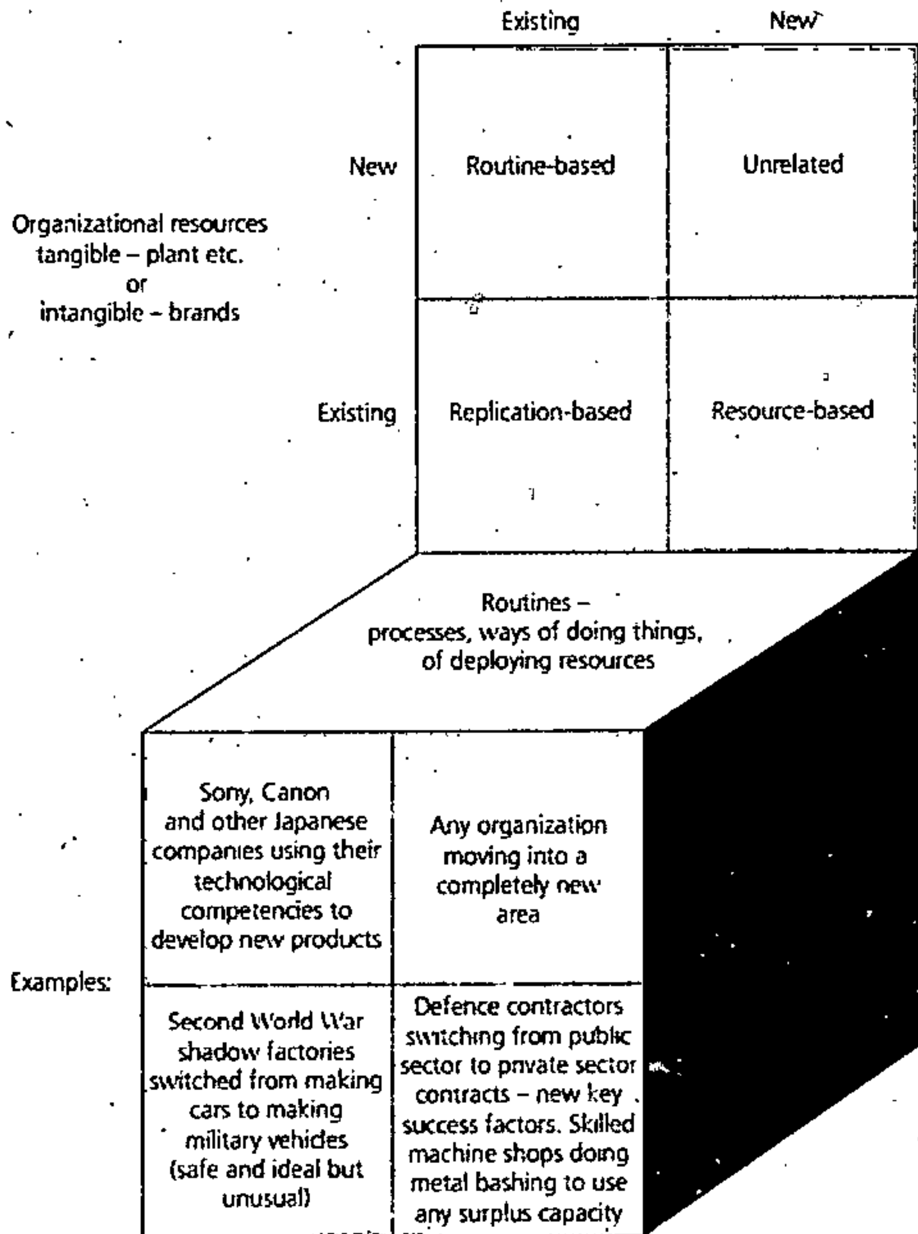


Figure 3.14: Diversification alternatives

Some diversification and acquisition decisions are concerned with reducing risk and establishing or restoring an acceptable balance of yesterday's, today's and tomorrow's products in a complex portfolio. This will be

especially attractive where a company is relying currently on yesterday's products.

Some strategic changes in this category will result from the ego or the ambitions of the strategic leader, who may feel that he or she can run any type of business successfully, regardless of the degree of unrelatedness. Some may be very keen to grow quickly, possibly to avoid takeover, and acquisitions may happen because a company is available for purchase rather than as the outcome of a careful and detailed analysis. It will be suggested later that the major beneficiaries of an acquisition are often the existing shareholders of the company being acquired. Consequently, it is sometimes argued that the self-interest of the City and large institutional shareholders might be behind certain mergers and acquisitions.

NOTES

Figure 3.14 provides a useful summary of related and unrelated diversification opportunities. The top part of the diagram suggests that the degree of unrelatedness increases when:

- the **tangible resources** involved, both plant and equipment and intangible brands are different rather than similar, and
- the processes – the ways in which these resources are deployed and utilized – also changes.

The bottom part provides examples of each situation. It will be appreciated that the strategic risk increases as the extent of the newness and learning increases.

3.14 STRATEGIC ALLIANCES – AN INTRODUCTION

While some form of partnership can be one of the quickest and cheapest ways to grow or develop a new and maybe global strategy, it is also one of the toughest and most risky. Many alliances fail. The needs of both partners must be met, and consequently three important questions must be answered satisfactorily:

1. *Why* use an alliance?
2. *Who* to select as a partner?
3. *How* to implement the agreement?

Garrette and Dussauge (1999) argue that many European companies have tended to think about alliances from a defensive perspective rather than as a proactive growth opportunity. All too often they are a fall-back when the competition authorities stand in the way of a merger or acquisition. Many of the examples referred to throughout this chapter

NOTES

indicate that several successful American and Japanese companies have adopted a different perspective. In the late 1990s, for example, research into the largest 1000 American companies revealed that 20 per cent of their revenues came directly from alliances.

There is evidence of some disagreement amongst strategy authors concerning the meaning of the terms 'joint venture' and 'strategic alliance'. Here, *strategic alliance* is used to encapsulate all forms of agreement between partners, and *joint venture* for those agreements which involve either the establishment of a new, independent company owned jointly by the partners, or the minority ownership of the other party by one or both partners. The term 'consortium' is also used in this context. One instance would be where companies in an industry generally collaborate or share, maybe through a trade association. The Japanese *keiretsu* (or family of businesses) is another, but quite different, example. Here companies, often in a geographical cluster, own stakes in each other and share and collaborate wherever possible. This might take the form of intertrading; it might equally be by seconding staff to help with a particular problem or difficulty. An alliance (or joint venture) could involve:

1. direct competitors, maybe sharing common skills, and with the objective of increased market share
2. less direct competitors with complementary skills – where the intention is more likely to be benchmarking and learning for mutual benefit, and the possible development of new ideas
3. related companies sharing different skills and competencies. Here organizations might well be linked in the same added-value chain (e.g. a manufacturer and either a supplier or a distributor). Such an alliance should generate synergy through cooperation, innovation and lower costs while allowing each partner to concentrate on its core competencies.

The intention will invariably be to increase competitive advantage without either merger or acquisition. As we move from an alliance to a joint venture and from 1 to 3 in the above hierarchy, the significance increases for the partners involved. Some companies will be involved in several alliances with different companies at the same time – this is not a one-off strategy for them. As an example, Toshiba (Japanese manufacturer of heavy electrical apparatus, electronic devices, information systems and consumer products such as televisions, videos, kitchen appliances and white goods) has created a global network of allies for different products and technologies, including Alstom, Siemens, Ericsson, General Electric, Motorola, Time Warner and Apple. Toshiba sees this 'circle of friends' as an opportunity for sharing ideas to obtain the latest technology and to

gain competitive advantage through learning. Here, the ability to manage a network of partners is a core strategic capability and source of competitive advantage.

NOTES

Reasons for joint ventures and strategic alliances

- The *cost of acquisition may be too high.*
- Legislation may prevent acquisition, but the larger size is required for critical mass.
- Political or cultural differences could mean that an alliance is more likely to facilitate integration than would a merger or acquisition.
- The increasing significance of a total customer service package suggests linkages through the added value chain – to secure supplies, customize distribution and control costs. At the same time individual organizations may prefer to specialize in those areas where they are most competent. An alliance provides a solution to this dilemma.
- The threat from Japanese competition has driven many competitors into closer collaboration, but they may not wish to merge. For example, American and European car manufacturers have taken stakes in Japanese businesses, where outright acquisition is unlikely.
- Covert protectionism in certain markets necessitates a joint venture with a local company. This has been particularly true in China, one of the world's fastest growing economies.

The likely outcomes

- In simple terms, increased competency, synergy and a stronger global presence are the potential outcomes targeted most frequently by alliance and joint venture partners.
- Greater innovation could well accrue from the pooling and sharing of ideas and competencies, which in turn enables greater focus (by each partner) combined with resource leverage.

SUMMARY

- The personality and charisma of the leader, and the ability to sell his or her ideas, will be crucial issues, and as speed of action, timing and commitment are typical features the strategy can prove highly successful.

NOTES

- Two important strategic pressures can leave the unprepared organization weakened: competitive and other environmental pressures, and focusing too much on controls at the expense of flexibility.
- The opening case story on FedEx shows two key elements of strategy creation in action and working together – visionary ideas and planning.
- In all cases planning is part of an ongoing continuous activity which addresses where the organization as a whole, or individual parts of it, should be going.
- *Top-down planning* relates to decisions taken at the top of the organization and passed down to other managers for implementation.
- The planning gap should be seen as an idea which can be adapted to suit particular circumstances, although gap analysis could be regarded as a planning technique.
- The market growth rate on the vertical axis is the annual growth rate of the market in which the company competes, and really any range starting with zero could be used.
- diversification is essentially offensive and designed to bring about expansion and growth, it could be argued that on occasions it is a defensive strategy.

REVIEW QUESTIONS

1. What do you understand by strategy creation?
2. Explain Changing strategies in detail.
3. Explain strategic thinking and strategic planning.
4. Differentiate Corporate and functional plans.
5. What do you understand by planning gap?
6. Discuss Strategic planning in small businesses.
7. Discuss Boston Consulting Group (BCG) Growth-share Matrix.
8. Discuss GE / McKinsey Matrix.
9. Explain Porter's Five Forces.
10. Explain organizations growth.
11. What are different reasons for diversification and acquisition?
12. Discuss effective acquisition strategies.
13. Discuss reasons for joint ventures and strategic alliances.

FURTHER READINGS

1. **Strategic Management:** A.C. Mittal and B.S. Sharma, Vista International Pub., 2006.
2. **Strategic Management:** Garth Saloner, Andrea Shepard, Joel Podolny, Wiley.
3. **Strategic Management: Concepts and Cases:** Milind T. Phadtare, PHI Learning.
4. **Strategic Management: Current Trends and Issues:** Edited by P. Mohana Rao and Trilok Kumar Jain, Deep and Deep.

UNIT 4 STRATEGY IMPLEMENTATION

NOTES

★ STRUCTURE ★

4.0 Learning Objectives
4.1 Introduction
4.2 Strategy Implementation through Structure
4.3 Implementation and Change
4.4 Problems of Successful Implementation
4.5 Successful Implementation
4.6 Centralization and Decentralization
4.7 Management and Control
4.8 Activity Based Costing
4.9 Managing the Corporate Portfolio
4.10 Strategic resource Management
4.11 Policies, Budgets and Control
4.12 Corporate Culture
4.13 Ethics and Values
4.14 Strategic Information System
- *Summary*
- *Review Questions*
- *Further Readings*

4.0 LEARNING OBJECTIVES

After going through this unit you will be able to:

- define strategy implementation
- know about Mc Kinsey's 7S Model
- describe organisation life cycle.
- explain management and control
- understand activity based costing
- know about strategic information system.

NOTES

4.1 INTRODUCTION

In this unit, the creation of strategy by different ways is explained. Which policies support the strategies are mentioned here.

The changing aspects of implementation are explained by considering strategic leadership and elements of strategy. In designing the structure and making it operational it is important to consider the key aspects of empowerment.

4.2 STRATEGY IMPLEMENTATION THROUGH STRUCTURE

The structure of an organization is designed to break down the work to be carried out – the tasks – into discrete components, which might comprise individual businesses, divisions and functional departments. People work within these divisions and functions, and their actions take place within a defined framework of objectives, plans and policies which are designed *to* direct and *control their efforts. In designing the* structure and making it operational it is important to consider the key aspects of empowerment, employee motivation and reward. Information and communication systems within the organization should ensure that efforts are co-ordinated to the appropriate and desired extent and that the strategic leader and other senior managers are aware of progress and results.

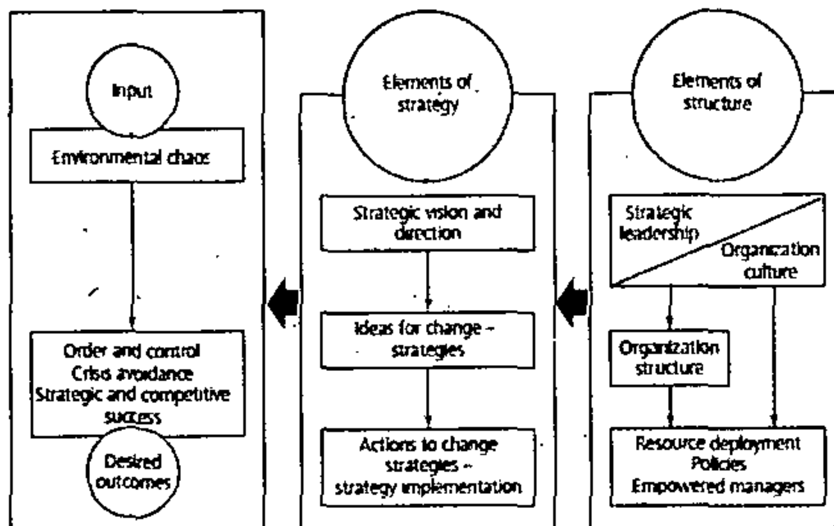


Figure 4.1 Strategy implementation.

It has already been established that in a competitively chaotic environment one essential contribution of the strategic leader is to provide and share a clear vision, direction and purpose for the organization (see Figure 4.1). From this, and taking into account the various ways in which strategies might be created (incorporating the themes of vision,

NOTES

planning and emergence), actions and action plans need to be formalized – the middle column in the figure. These strategies and proposals for change cannot be divorced from the implementation implications, which are shown in the right-hand column. Is the structure capable of implementing the ideas? Are resources deployed effectively? Are managers suitably empowered? Do organizational policies support the strategies? If the answers to these questions contain negatives, then either the strategic ideas themselves, the structure, organizational policies or aspects of resource management will need to be reviewed and rethought. The final decisions will either be determined or strongly influenced by the strategic leader, and affected by the culture of the organization.

If appropriate, feasible and desirable strategies that *are* capable of effective implementation are selected and pursued, the organization should be able to establish some order and control in the environmental chaos and avoid major crises – the left-hand column of Figure 4.1. This still requires that strategies, products and services are managed efficiently and effectively at the operational level. Responsibility for operations will normally be delegated, and consequently, to ensure that performance and outcomes are satisfactory, sound monitoring and control systems are essential.

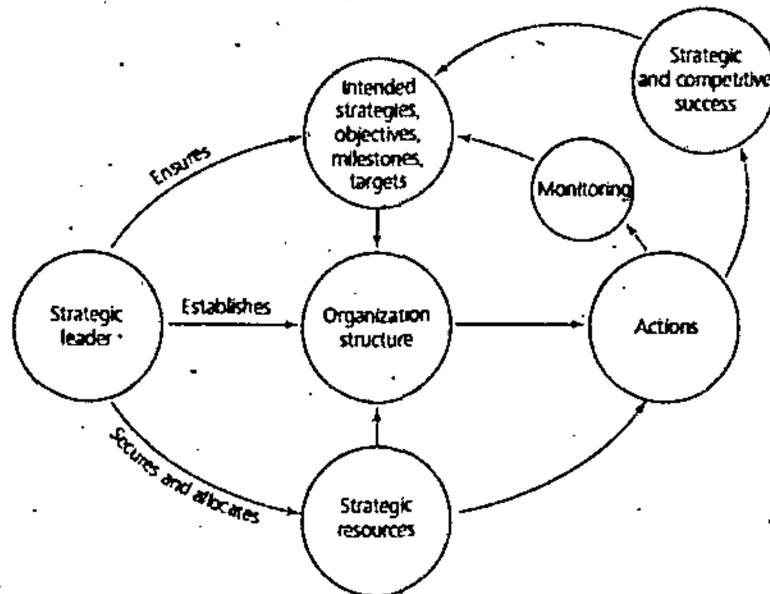
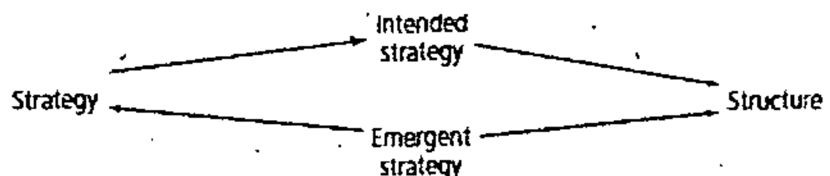


Figure 4.2 Intended strategy implementation.

It is important to appreciate that while structures are designed initially – and probably changed later at various times – to ensure that *determined* or *intended* strategies can be implemented, it is the day-to-day decisions, actions and behaviours of people within the structure which lead to important *emergent* strategies. There is, therefore, a continual circular process in operation:



NOTES

Consequently, while issues of structure and implementation are being considered at the end of this book, they should not be thought of as the end point in the strategy process. They may be the source of strategic change.

Figure 4.2 explains the implementation of intended strategies in more detail. The strategic leader is charged with ensuring that there are *appropriate targets* and milestones, establishing a suitable organization structure and securing and allocating the relevant strategic resources, such as people and money. People then use the other strategic resources, working within the structure, to carry out the tasks that they have been allocated, and their actions should be monitored and evaluated to check that the targets and objectives are being achieved.

Figure 4.3 summarizes the emergent strategy process which, clearly, is less prescriptive. This time the strategic leader provides a broad strategic direction. Empowered managers work within a decentralized structure, but they are constrained by any relevant rules, policies and *procedures. The strategies that emerge are affected* by the constraints, the extent to which managers accept empowerment and the accumulation, sharing and exploitation of organizational knowledge. The outcome of the strategies is related to the extent to which they deal with the competitive and environmental pressures with which the organization must deal.

To summarize the outcome, in terms of strategic management and organizational success, is dependent upon:

- the direction provided by the strategic leader
- the culture of the organization
- the extent to which managers throughout the organization understand, support and *own* the mission and corporate strategy, and appreciate the significance of their individual contribution
- the willingness and ability of suitably empowered managers to be innovative, add value and take measured risks to deal with environmental opportunities and competitive surprises
- the effectiveness of the information sharing, monitoring and control systems.

4.3 IMPLEMENTATION AND CHANGE

Implementation incorporates a number of aspects, some of which can be changed directly and some of which *can only be changed indirectly.* The latter aspects are more difficult for the strategic leadership to control and change. The success of the strategic leader in managing both the direct and indirect aspects influences the effectiveness of:

NOTES

- the implementation of strategies and strategic changes which are determined through the planning and visionary modes of strategy creation, and
- the ability of the organization, and its managers, to respond to changes in the environment and adapt in line with perceived opportunities and threats.

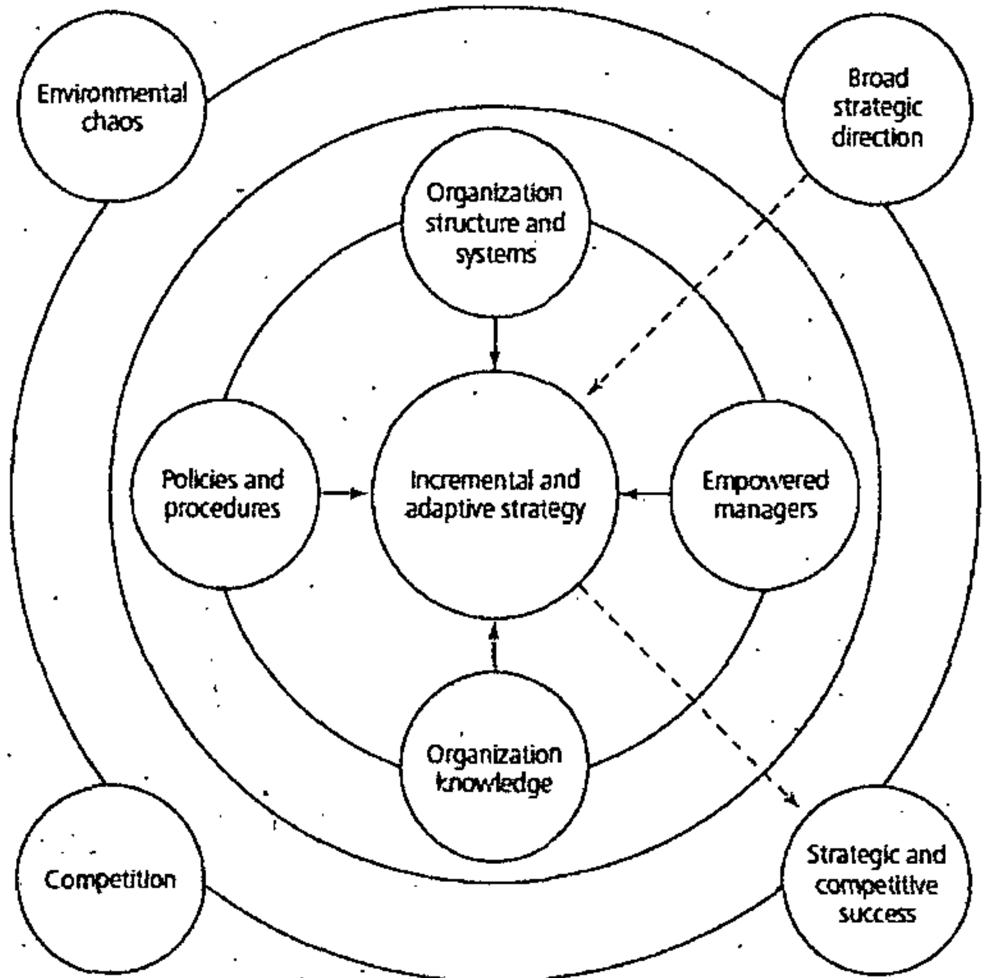


Figure 4.3 Emergent strategy.

4.3.1 Aspects of implementation that can be changed directly

- The organization structure (the actual, defined structure, not necessarily the way in which people behave within the structure)
- management systems
- policies and procedures
- action plans and short-term budgets
- management information systems.

4.3.2 Aspects of implementation that are changed indirectly

NOTES

Communication systems While the management information system can affect formal information flows, the network of informal communications truly determines awareness. Such communications are affected by, and influence, the degree and spirit of co-operation between managers, functions and divisions.

Managing and developing quality and excellence Attention to detail, production on time and to the appropriate quality, and the personal development of managers and other employees are all factors in this. As well as developing managers' skills and capabilities generally, it is important to consider the quality of management in particular areas and the cover for managers who leave or who are absent. The organization structure should provide opportunities for managers to grow and be promoted.

Manifested values and the organization culture This involves the way in which things are done: standards and attitudes which are held and practised.

The fostering of innovation The willingness of people to search for improvements and better ways of doing things. Their encouragement and reward is very much influenced by the strategic leader, with leadership by example often proving significant. Those aspects that can be changed directly generally imply physical changes in the way in which resources are allocated. Behavioural aspects, which imply changes in beliefs and attitudes, can only be modified indirectly. Both are considered in the forthcoming chapters.

4.4 PROBLEMS OF SUCCESSFUL IMPLEMENTATION

Owen (1982) contends that in practice there are four problem areas associated with the successful implementation of strategies.

1. At any time strategy and structure need to be matched and supportive of each other. Products and services need to be managed independently, or in linked groups or business units, if they are to be matched closely and effectively with their environments. There may be good reasons for having a structure that does not separate the products, services and business units in this way. The strategic leader might prefer a centralized structure without delegated responsibilities, for example. The organization might possess certain key skills and enjoy a reputation for strength in

NOTES

a particular area, and this might be influential in the design of the structure. Equally, certain skills might be absent and have to be compensated for. Related to this might be the willingness or reluctance of managers to change jobs or location within the structure. Structures cannot be created and activated independently of the people involved; their individual skills may provide either opportunities or constraints. Changing attitudes and developing new skills is accomplished indirectly, as pointed out above, and takes time. It is also possible that related products may be produced in various plants nationally or internationally, when a geography-orientated structure, which keeps the plants separate, is favoured for other sound reasons. In addition, it may not prove feasible to change the structure markedly every time there is a change in corporate strategy and, instead, acceptable modifications to the existing structure are preferred to more significant changes.

2. The information and communications systems are inadequate for reporting back and evaluating the adaptive changes that are taking place, and hence the strategic leader is not fully aware of what is happening. Hence the performance of the existing structure is not monitored properly, and as a result control mechanisms may be ineffective.

3. Implementing strategy involves change, which in turn involves uncertainty and risk. New skills may have to be developed, for example. While managers may agree in meetings to make changes, they may be more reluctant in practice to implement them. Motivating managers to make changes is therefore a key determinant.

4. Management systems, such as compensation schemes, management development and communications systems, which operate within the structural framework will have been developed to meet the needs of past strategies. They may not be ideal for the changes that are taking place currently, and again it is difficult to modify them continually.

Alexander (1985) argues that additional factors are also significant, especially:

- The failure to predict the time and problems that implementation will involve, such as the time required for a new business or venture to take off, which is invariably underestimated. This may not seem critical, but it can be. In the early months of a new business, more cash is typically spent than revenue is earned. The accumulating debt is a so-called 'valley of death' that the business must come through and out of before it can start earning real money and (eventually and hopefully) enter the land of plenty.

- Other activities and commitments that distract attention and possibly cause resources to be diverted. Paradoxically, one way of coping with the likelihood of disruptive and distracting events is to ensure that the organization has spare resources in readiness for such emergencies; but slack of this sort can appear to imply inefficiency and underutilized resources, and it can be expensive.
- The bases on which the strategy was formulated changed, or were forecast poorly, and insufficient flexibility to deal with the change pressures has been built in. All of these problems presuppose that the formulated strategic change is sound and logical. A poorly thought-out strategy will create its own implementation problems.

4.5 SUCCESSFUL IMPLEMENTATION

To counter these problems Owen (1982) suggests the following:

- Clear responsibility for the successful outcome of planned strategic change should be allocated.
- The number of strategies and changes being pursued at any time should be limited. The ability of the necessary resources to cope with the changes should be seen as a key determinant of strategy and should not be overlooked.
- Necessary actions to implement strategies should be identified and planned, and again responsibility should be allocated.
- Milestones, or progress measurement points, should be established.
- Measures of performance should be established, as well as appropriate monitoring and control mechanisms.

These, Owen argues, can all be achieved without necessarily changing the structural framework but rather by changing the way in which people operate within it. In addition, Alexander contends that the involvement and support of people who will be affected by the changes in strategy must be considered, and that the implications of the new strategies and changes should be communicated widely, awareness created and commitment and involvement sought. Incentives and reward systems underpin this. In the same way that no single evaluation technique can select a best strategy, there is no best way of implementing strategic change. There are no right answers, as such. A number of lessons, considerations and arguments, however, can be incorporated into the thinking and planning. Three final points need to be mentioned to conclude this introduction. First, although there are no right answers to either strategy formulation or strategy implementation, the two

NOTES

must be consistent if the organization is to be effective. Arguably, how the organization does things, and manages both strategy and change, is more important than the actual strategy or change proposed.

Second, the style of strategic leadership will be very influential. We also argue that the preference of the strategic leader affects the desirability of particular strategic alternatives. The structure of the organization, the delegation of responsibilities, the freedom of managers to act, their willingness to exercise initiative, and the incentive and reward systems will all be determined and influenced by the strategic leader. These in turn determine the effectiveness of implementation. The strategic leader's choices and freedom to act, however, may be constrained by any resource limitations and certain environmental forces. Third, the timing of when to act and make changes will also be important. In this context, for example, Mitchell (1988) points out that timing is particularly crucial in the implementation decisions and actions that follow acquisitions. Employees anticipate changes in the organization, especially at senior management level, and inaction, say beyond three months, causes uncertainty and fear. As a result, there is greater hostility to change when it does occur. The dangers of hasty action, such as destroying strengths before appreciating that they are strengths, are offset. Mitchell concludes that it is more important to be decisive than to be right, and then learn and adapt incrementally.

4.6 CENTRALIZATION AND DECENTRALIZATION

Centralization and decentralization relate to the degree to which the authority, power and responsibility for decision-making are devolved through the organization. There are several options, including the following:

- All major strategic decisions are taken centrally, at head office, by the strategic leader or a group of senior strategists. The size of any team will depend upon the preference of the overall strategic leader together with the size, complexity and diversity of the organization. Strictly enforced policies and procedures will constrain the freedom of other managers responsible for business units, products, services and functional areas to change competitive and functional strategies. This is centralization.
- Changes in the strategic perspective are decided centrally, but then the organization is structured to enable managers to change competitive and functional strategies in line with perceived opportunities and threats.
- The organization is truly decentralized such that independent business units have general managers who are free to change their respective

strategic perspectives. In effect they run a series of independent businesses with some co-ordination from the parent headquarters.

NOTES

The extent to which true decentralization exists may be visible from the organization's charted structure. It is always useful to examine the membership of the group and divisional/business unit boards, regardless of the number and delineation of divisions. The organization is likely to tend towards decentralization where there is a main board and a series of subsidiary boards, each chaired by a member of the main board. The chief executive/strategic leader, who is responsible for the performance of each subsidiary, will not necessarily have a seat on the main board. The organization will tend towards greater centralization where the main board comprises the chairperson/chief executives of certain subsidiaries, generally the largest ones, together with staff *specialists. Hence decentralization and divisionalization are not synonymous* terms.

The ten main determinants

- the size of the organization
- geographical locations, together with the
  - homogeneity/heterogeneity of the products and services
  - technology of the tasks involved
  - interdependencies
- the relative importance and stability of the external environment, and the possible need to react quickly
- generally, how quickly decisions need to be made
- the workload of decision-makers
- issues of motivation via delegation, together with the abilities and willingness of managers to make decisions and accept responsibility
- the location of competence and expertise in the organization. Are the managerial strengths in the divisions or at headquarters?
- the costs involved in making any changes
- the significance and impact of competitive and functional decisions and changes
- the status of the firm's planning, control and information systems.

Advantages and disadvantages

There are no right or wrong answers concerning the appropriate amount of centralization/decentralization. It is a question of balancing the potential advantages and disadvantages of each as they affect particular firms.

It has been suggested that companies which achieve and maintain high growth tend to be more decentralized, and those which are more

NOTES

and decentralization (which influences the nature and role of strategic planning in the organization) and the nature of key reporting systems (the extent to which they are loose and flexible or tight and financial). Goold and Campbell use three terms – financial control, strategic planning and strategic control – to categorize large UK companies against these criteria.

4.8.1 Financial control companies

Financial control is seen as an ideal approach for a holding company where the businesses are independent and unrelated. Hanson and BTR were excellent examples and advocates of this style, which for many years under the leadership of Lord (Arnold) Weinstock was also preferred by the more focused GEC.

- Strategy creation is heavily decentralized to business unit managers. Within their agreed financial targets they are free to develop and change their competitive and functional strategies.
- Budgets and targets – and their achievement – are critically important control mechanisms.
- The small head office monitors financial returns closely and regularly, intervening when targets are missed – head office is a 'controller'.
- Head office also acts as a corporate investment banker for investment capital.
- Achievement is rewarded, and units are encouraged to put forward and chase ambitious targets. Underperforming managers are likely to be removed.
- The head office adds value by acquiring and improving underperforming businesses; if additional value cannot be added it may well sell off businesses.
- There will, typically, be few interdependencies and links between the businesses.
- Growth is more likely to be by acquisition than organic investment, with many financial control companies taking a short-term view of each business and being reluctant to invest in speculative research and the development of longer-term strategies.

Owen Green, chief executive and architect of BTR, had the following philosophy:

1. Never pursue extra sales at the expense of profit margins.
2. Raise prices whenever there is an opportunity.
3. Investment should never exceed the amount written off in depreciation.

The result was high profit margins but a lack of capital investment; growth was mainly by acquisition rather than by investing in the existing businesses. Herein lay the ultimate limitations.

NOTES

4.8.2 Strategic planning companies

Strategic planning tends to be adopted in organizations which focus on only a few, an preferably related, core businesses. Examples include Cadbury Schweppes, United Biscuits and BP. Historically it has been the favoured approach for most public-sector organizations.

- Strategic plans are developed jointly by head office and the business units, with head office retaining the final say. Strategic planning is centralized.
- Day-to-day operations only are wholly decentralized.
- Head office sets priorities and co-ordinates strategies throughout the organization, possibly initiating cross-business strategies, and thereby acts as an orchestrator.
- A long-term perspective is realistic, and the search for opportunities for linkages and sharing resources and best practice can be prioritized. This normally requires central control. Individually the businesses would tend to operate more independently; organization-wide synergies may involve sacrifices by individual businesses.
- Goold and Campbell conclude that there are co-ordination problems if this approach is used in truly diversified organizations.
- Budgets are again used for measuring performance.
- The tight central control can become bureaucratic and demotivate managers, who may not feel *ownership* of their strategies.

Other dangers are that thinking may become too focused at the centre, with the potential contributions of divisional managers underutilized; and that the organization may be slow to change in response to competitive pressures. Value can be added successfully if corporate managers stay aware and expert in the core businesses and if the competitive environment allows this style to work.

4.8.3 Strategic control companies

Financial control and strategic planning are appropriate for particular types of organization, but both styles, while having very positive advantages, also feature drawbacks. The strategic control style is an attempt to obtain the major benefits of the other two styles for organizations that are clearly diversified but with linkages and interdependencies. Value is added by balancing strategic and financial controls.

NOTES

- Strategy creation involves decentralization to the business units, although head office still controls the overall *corporate* strategy.
- The role of head office is to review divisional and business plans, and approve strategic objectives and financial targets, accepting that they may need to be changed in a competitive environment. Performing a coaching role, head office encourages businesses to achieve their potential by active involvement and by fostering the spreading of learning and good practice through the organization.
- Strategy creation and budgetary control can be separated, allowing for more creative performance measurement. Sometimes competitive pressures and misjudgements mean strategies have to be changed, and hoped-for financial targets may be missed. A strategic control style can recognize this and deal with the implications.
- Head office does, however, monitor and control financial performance and success against strategic milestones and objectives.

Although decentralization is a feature, head office still requires considerable detail about the various businesses if it is to ensure that the synergy potential is achieved and very short-term thinking is avoided. Political activity will be prevalent as individual businesses compete with each other for scarce corporate resources.

It was mentioned earlier that GEC, under Lord Weinstock – who was in charge for 32 years – adopted a financial control style. When he retired (in 1996) and was replaced by Lord George Simpson the style was quickly changed to strategic control.

Simpson inherited a GEC that was diversified and financially sound, but it was risk averse and experiencing relatively low growth. It was also in possession of a legendary cash mountain of £2.5 billion. Simpson created a new agenda for growth. With divestments and acquisitions the portfolio was changed. The style also changed. There was to be more focus on customers and people and less on cost control. There was greater decentralization, accompanied by robust reporting systems. It is not unusual to see changes of strategy, structure and style accompanying a change of leadership, especially if a company is in difficulty or the predecessor has been in place for a long time.

Two leading organizations that utilized the strategic control style – ICI and Courtaulds – both concluded that they were overdiversified. This belief was strongly reinforced by institutional investor pressure. The attitude of the stock market and their shareholders meant that their share prices were underperforming against the index, the average of the UK's largest companies. There were numerous businesses in each organization, although some were clearly interlinked. At the same time these clusters

had little in common and featured different strategic needs and cultures. Because of these differences, and the inevitable complexity, corporate headquarters could not add value with a single entity. Both companies split into two distinct parts to enable a stronger focus on core competencies and strategic capabilities. Courtaulds was split into Courtaulds Chemicals (subsequently acquired by Akzo Nobel of Germany) and Courtaulds Textiles (sold to Sara Lee of the US). ICI separated its chemicals and pharmaceuticals businesses. The former remain as ICI, but many of the activities have been divested and replaced by more consumer-focused businesses. ICI continues to struggle. The others were renamed Zeneca, which soon merged into Astra Zeneca.

4.8.4 Levels of success

Goold and Campbell (1988) studied 16 large UK companies, including those given as examples above, and concluded that each style has both advantages and disadvantages and that no one style is outstandingly the most successful.

Strategic planning companies proved to be consistently profitable during the 1980s, mainly through organic growth. Head office corporate staff tended to be a quite large group and differences of opinion with general managers sometimes caused frustration within the divisions and business units. *Financial control companies* exhibited the best financial performance. In a number of cases, particularly BTR and Hanson, this resulted from acquisition and divestment rather than organic growth. Short-term financial targets were felt to reduce the willingness of general managers to take risks. There were few trade-offs whereby short-term financial targets were sacrificed for long-term growth. A general manager, for example, might consider a programme of variety reduction and product rationalization with a view to developing a more consistent and effective portfolio. In the short term this would result in reduced revenue and profits before new orders and products improved overall profitability. This temporary fall might be unacceptable in the face of short-term financial targets. *Strategic control companies* also performed satisfactorily but experienced difficulties in establishing the appropriate mix of strategic and financial targets for general managers. Financial targets, being the more specific and measurable ones, were generally given priority. Goold and Campbell concluded that while the style of management adopted within the structure determines the strategic changes that take place, the overall corporate strategy of the company very much influences the choice of style. Large diverse organizations, for example, will find it difficult to adopt a strategic planning approach. Equally, where the environment is turbulent and competitive, increasing the need for adaptive strategic change, the financial planning approach is

NOTES

less appropriate. Not unexpectedly, Hanson's main acquisitions were of companies in mature, slow-growth sectors.

While companies may appreciate that there is a mismatch between their corporate strategy and style, changing the style can be difficult. Moreover, many organizations will not be able to implement a new style as effectively as the one that they are used to. Goold *et al*. (1993) revisited the organizations and their research five years later, partly stimulated by the change in fortunes in some of the companies involved. This review reinforced the conclusion that financial control is ideally suited to a group of autonomous businesses in a conglomerate, but it is less suitable for a portfolio of core businesses or ones seeking to compete globally. In 1988 Goold and Campbell had argued that the adoption of a hands-off, financial control style by GEC and other electronics companies in the UK had hindered their development as globally competitive businesses. Global development demands synergy between a number of national businesses.

BTR and Hanson had already begun to focus more on selected core businesses, and their relative performance was deteriorating. Strategic planning continued to add value as long as corporate managers had close knowledge and experience of their core businesses. Where their portfolio was arguably too diverse – although not so diverse that they could be classified as diversified conglomerates – strategic control companies were experiencing difficulties. The researchers poured scorn on the idea that a decentralized structure, supported by a modern budgeting and planning system, would enable a competent management team to add value to almost any new business. Strategic control can only work with an effective mix of tight financial control and devolved authority to instigate emergent strategic changes; to achieve this successfully, head offices again need to appreciate the detail of competitive strategies in the subsidiaries.

Appreciating the specific problems and opportunities faced by subsidiary businesses is particularly important for establishing fair reward systems. Reward systems are likely to be based on specific performance targets, but these could relate to growth in revenue, absolute profits or profitability ratios. Stonich (1982) has suggested that business units might be categorized as having high, medium or low growth potential. Four factors could be used in evaluating their relative performances: return on assets; cash flow; strategic development programmes and increases in market share. The relative weighting attributed to each of these four factors would be changed to reflect their specific objectives and whether they were of high, medium or low-growth potential. Return on assets and cash flow would be critical for low growth business units, and market share and strategic development programmes most important for those with high growth potential. The factors would be weighted equally for medium growth. This approach would be particularly relevant where general

managers were changed around to reflect their particular styles of management and the current requirements of the business unit.

One question left unanswered concerns the extent to which the conclusions of Goold and Campbell are a result of British management strengths, weaknesses and preferences. Certain Japanese companies appear to grow organically at impressive rates while maintaining strict financial controls and directing corporate strategic change from the centre. This tendency, however, is affected by legislation which restricts the ability *of Japanese companies to grow by acquisition* and *merger*. Without this control Japanese firms may have followed different strategies. The next section endeavours to pull together the lessons from this and other research and the cases quoted herein.

4.9 MANAGING THE CORPORATE PORTFOLIO

Porter (1987) argues that corporate strategy is that which makes the corporate whole add up to more than the sum of its parts, but further contends that the corporate strategies of too many companies dissipate rather than create shareholder value. He comments:

Moving from competitive strategy to corporate strategy is the business equivalent of passing through the Bermuda Triangle. The failure of corporate strategy reflects the fact that most diversified companies have failed to think in terms of how they really add value.

Porter's arguments are as follows. Corporate strategy involves two key questions or issues. First, what businesses should the company choose to compete in; second, how strategically distinct businesses should be managed at the corporate level?

When the debate on corporate strategy opened in Part Four *of this* book, synergy was held out as the justification for strategic changes, especially if they involved diversification. The ideas behind synergy are defensible, but synergy *potential* alone cannot justify change. Implementation matters and, being realistic, synergy is frequently based on intangibles and possibilities rather than definites. When we look back on acquisitions that fail to deliver the promised synergies, we can never be sure how much the problem was the strategic logic and how much was implementation.

4.9.1 Portfolio management

The basic premise of portfolio management is that competition occurs at the business level and this is where competitive advantages are developed. Businesses should compete for centralized corporate investment resources, and they should be divested if there are no further opportunities

NOTES

for developing new values. To facilitate this, a costeffective organization structure should enable cross-fertilization between the businesses while maintaining overall control. The role of the corporate headquarters was to seek and acquire attractive (potentially highly profitable) businesses, fit them in to the organization, assess their requirements and allocate strategic resources according to their position in the relevant matrix. Of course, in reality, many low-performing businesses were retained, diluting the earnings potential and, as a consequence, shareholders sometimes became sceptical. Their belief was that they could diversify their own portfolio of investments as a hedge against risk – they did not need the businesses to do this on their behalf. In addition:

- undervalued companies were not always easily acquired – they were simply not available
- all too often excessive premiums were paid when businesses were acquired
- professional management and capital resources alone do not build value and yield competitive advantage
- businesses are often interdependent for all sorts of reasons and therefore strategies cannot be ring-fenced and set in isolation
- some businesses (and their managers) are defeated by the complexity and diversity of the portfolio.

However, one variant of portfolio management, restructuring, does have its logic and attraction.

4.9.2 Restructuring

Restructuring requires the identification of industries and companies with the potential for restructuring and transformation with new technologies, new people and/or consolidation. There is no need for them to be related to the existing businesses in the portfolio. The new parent intervenes to turn around the business: first, by cost-cutting and increased efficiency, and second, by adding new values to build a stronger competitive base and position. Once there are no further opportunities to add value the business should be sold to raise money for further acquisitions. Restructuring is not about hoarding businesses to build an empire and never divesting anything which, clearly, some strategic leaders have been prone to do.

Clear elements of restructuring can be seen in the Hanson approach. Certainly, efficiencies were increased as businesses were slimmed down, and businesses were always for sale at the right price. However, Hanson did not invest substantially to build new competitive advantages.

Restructuring works well when the strategic leadership can spot and acquire undervalued companies and then turn them around with sound

management skills, even though they might be in unfamiliar industries. In a sense, there is an underlying belief that good managers can manage anything, and to a degree there is some truth in this assertion. The issue is whether they *manage the renewal as well as the consolidation.*

NOTES

The appropriate structure and style of corporate management are clearly critical. Naturally, if suitable undervalued businesses cannot be found – *which is typically the case* when a country's economy has been tightened and weak competitors have already disappeared as closures or acquisitions – restructuring has no basis.

4.9.3 Sharing activities and transferring skills

He argues that they are most likely to be met where there is some interrelationship between the existing and new businesses. The basis for this might be tangible or intangible, and therefore it is easy to be deluded into thinking that there are similarities when in reality there are differences. Interrelationships are defined as 'connections among distinct businesses that lead *to competitive advantage from being in* both'. Hanson found a connection in low-cost capital and astute tax-avoidance strategies, but it would be more typical to see them in marketing or technology. The search for these synergies begins with an analysis of the value chains and the objective is to find opportunities for lowering costs and creating or enhancing differentiation. Activities, know-how, customers, distributors and competitors can all be shared. The benefits must outweigh the costs involved, for while there are always opportunities to share they may not lead to any competitive advantage. The outcome of sharing can be clearly tangible (such as better capacity utilization) or more *intangible where it comes through learning and intelligence.* There is invariably a difficult balancing act involved. A shared sales force is often a possibility, for example. Where this happens, higher calibre people can sometimes be recruited as there are more promotion prospects, buyers can be more easily accessed as more products are being sold at any one time, and less time is spent travelling between calls. However, different selling skills may be required for different products – some are sold on price, others on performance differences – and the attention given to certain ones may be inadequate.

The greatest returns should normally be found where activities are actually shared, but where *this is not feasible, transferring skills can* also be beneficial. The thinking here begins with a clear appreciation of strategic capabilities and the search for related industries in which these skills and capabilities could be usefully applied – again for savings or differentiation. The businesses must be sufficiently similar that sharing expertise is meaningful, and the potential advantage will always be greater if the capabilities involved are fresh to the new industry.

NOTES

Where activities are to be shared and/or skills transferred, the corporate structure must be one that encourages it to happen and actively encourages managers to search out for opportunities. Many are actually structured in ways that erect barriers to sharing. Finally, one key challenge in organizations that are heavily diversified and decentralized is to ensure that there is a shared corporate identity, which goes beyond the structural framework and comes down to the style of leadership and management. Porter concludes that diversification, decentralization and sharing can be complementary, although they may appear contradictory. They simply demand a sophisticated approach to the management of diversity.

4.10 STRATEGIC RESOURCE MANAGEMENT

Figure 4.6 recapitulates how the corporate mission and purpose provide the basis from which corporate and competitive strategies are derived. The corporate portfolio provides a number of ways for the organization to pursue its mission – but each business in the portfolio will require different levels of attention and resourcing. These decisions relate to priorities linked to the potential of, and desired outcomes from, each business.

The achievement of competitive advantage and success comes down, in the end, to individual contributions, and to guide and manage these, objectives, targets and milestones will be set.

Once intended strategies have been determined, either in broad outline or in greater detail, the organization must plan their implementation. This means, first, that the resources required for implementation – including capital equipment, people and finance – are available where and when they are needed. Resources need to be *allocated* to different managers, functions and businesses, and then *co-ordinated* to generate synergy. Second, the managers responsible for implementation must understand what is expected of them and be empowered and motivated to take the necessary decisions and actions. In addition, *monitoring and control* systems are required.

At the corporate strategy level, organizations might establish priorities for different divisions and businesses using portfolio analysis, and evaluate the strategic and financial implications of alternative investments. Decisions may be taken within the constraints of existing capital, financial and human resources; if they demand new resources, then these must be obtained in an appropriate timescale. Proposed acquisitions may require an organization to raise funding externally; organic development of new products may require new skills and competencies. Resources can be switched from one part of a business to another.

At the functional level, *policies* and procedures can guide managers and other employees in the utilization of these corporate resources to add value, create competitive advantage and achieve the desired objectives. These policies can be tightly defined to maintain strong, central control, or very loose and flexible to enable people to use their initiative and be flexible. The ongoing management of the resources will then use action plans and budgets.

Action plans relate to the detailed strategies and plans for the various key functions, the activities which must be carried out if competitive and corporate strategies are to be implemented successfully; *budgets* add a crucial financial dimension to these plans. Together they attempt to integrate sales, supply potential, production activities and cash flow to ensure that resources are available to produce goods and services where and when they are required. The organization would like to avoid a situation where it has requests that it would like to take, or worse, it has booked orders, but it does not have the resources to enable production or supply. The potential danger here is one of overtrading and overcommitment. Both its bank and its customers can easily end up disappointed. It would also wish to avoid situations where it has idle capacity and no orders, or instances where it is producing for stock rather than for customers. This dilemma is one faced all the time by many small businesses, and in it we can see an endeavour to balance the resource-based perspective of strategy with the opportunity-driven approach.

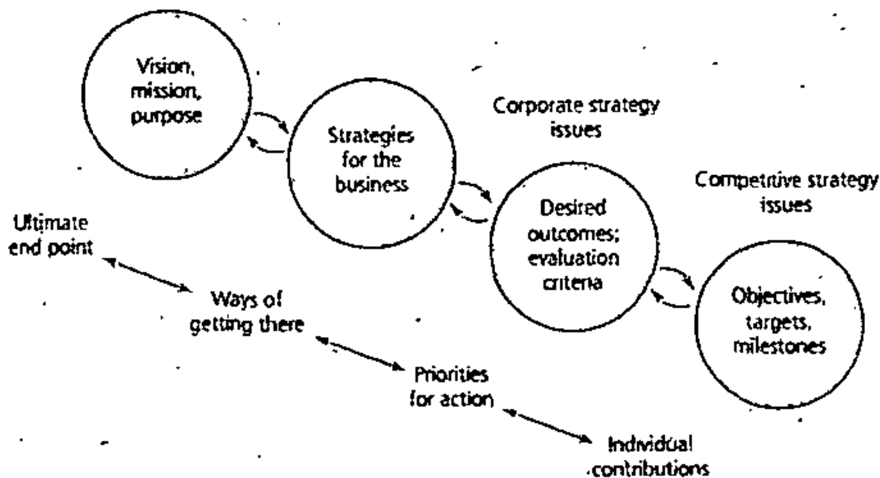


Figure 4.6 Strategy implementation and resource management.

This planning process then provides a useful check that the corporate and competitive strategies that have been formulated are both appropriate and feasible in the sense that they can be implemented. At the same time, this planning and budgeting must not be so rigid that the organization is unable to be responsive. Forecasts and judgements will never be completely accurate; when intended strategies are implemented there

NOTES

will need to be incremental changes and revisions to plans. To respond to new environmental opportunities and competitor initiatives, the organization will need to be adaptive.

Emergent strategic change of this nature demands resource flexibility, at both the corporate and functional levels. The plans should incorporate clear milestones – target levels of achievement against a timescale. By constant monitoring the organization can check whether it is booking sufficient business, whether it is producing the necessary quality on time, whether it is underproducing or overproducing, whether its costs and prices are different from those that it forecast, and whether it is managing the movement of cash in and out of the business to the budgeted targets.

A review of progress can highlight potential deficiencies to either resource requirements or likely outcomes. If orders are exceeding expectations, then additional resources may be required if the organization is to properly satisfy the new level of demand. If these cannot be found, schedules will need to be changed and maybe future supplies rationed. If orders are below expectations, then either new business opportunities will need targeting at short notice, possibly implying very competitive prices and low margins, or end-of-year targets revised downwards. Vigilance and pragmatism here can help to ensure that the organization does not face unexpected crises. Effective communications and management information systems are essential for planning, monitoring and control.

The allocation of resources at a corporate level is closely tied in to the planning system through which priorities must be established. Portfolio analyses such as the directional policy matrix may well be used to help to determine which products and business units should receive priority for investment\funding; and any new developments that are proposed will require resources. An acquisition, for example, will need to be financed, but the integration of the new business after the purchase may also involve the transfer of managers and other resources.

4.11 POLICIES, BUDGETS AND CONTROL

4.11.1 Policies

Policies are designed to guide the behaviour of managers in relation to the pursuit and achievement of strategies and objectives. They can guide either thoughts or actions, or both, by indicating what is expected in certain decision areas. Over time they establish the way in which certain tasks should normally be carried out, and place constraints upon the decision-making freedom that managers have. In this respect they imply that the implementation of strategies formulated by strategic leaders is a planned activity, and recognize that managers may at times wish to

NOTES

make changes and pursue objectives which are personally important to them. Policies, therefore, should be related to stated objectives and strategies and assist in their implementation; at the same time they should not restrict managers to the extent that they are unable to make incremental and adaptive changes when these are appropriate or necessary. Managers should be offered sufficient inducements to comply with organizational policies, and sanctioned when they fail to comply without justification.

Policies need not be written down or even formulated consciously. They may emerge as certain behaviour patterns become established in the organization and are regarded as a facet of values and culture. A policy can exist simply because it is the perceived way that something has always been done. Policies are particularly significant in the case of recurring problems or decisions as they establish a routine and consistent approach.

Policies can be either advisory, leaving decision-makers with some flexibility, or mandatory, whereby managers have no discretion. Koontz and O'Donnell (1968) suggest that mandatory policies should be regarded as rules rather than policies. They argue that mandatory policies tend to stop managers and other employees thinking about the most efficient and effective ways in which to carry out tasks and searching for improvements. *Policies should guide rather than remove discretion.*

Koontz and O'Donnell further argue that advisory policies should normally be preferred because it is frequently essential to allow managers some flexibility to respond and adapt to changes in both the organization and the environment. Moreover, mandatory policies are unlikely to *motivate managers, while advisory guides can prompt innovation.*

4.11.2 The creation and use of policies

It has already been mentioned that policies may be created both consciously and unconsciously. The main stated policies are those that the managers *of the company draw up in relation to their areas of discretionary* responsibility. Certain key policies will be established by the overall strategic leader and will be filtered down the organization. It is important that when general managers create policies for their divisions and business units, and functional managers for their departments, there is some consistency between them.

Some policies will be forced on the company by external stakeholders. Government legislation upon contracts of employment, redundancy terms and health and safety at work all affect human resource policies, for example. The design of certain products will have to meet strict criteria for safety and pollution. The fabric used for airline seats in the UK must be fire resistant, and there are similar restrictions upon the type

of foams that can be used in furniture. Car engines must be designed to meet certain emission regulations. In some cases financial policies can be dictated by powerful shareholders or bankers.

It is useful, then, if the major functional areas of the business are covered by explicit policies which are known to all employees who will be affected by them. Where they exist in this form they provide a clear framework in which decisions can be made; and they also allow people to understand the behaviour patterns that are expected of them in particular circumstances. However, the policies should not be too rigid and prevent managers making important change decisions. Changes in strategies may require changes of policy if they are to be implemented successfully.

4.11.3 Budgets

Budgets, quite simply, are plans expressed in numerical terms, usually in financial terms. They will indicate how much should be spent, by which departments, when, and for what purpose.

Pearce and Robinson (1985) distinguish between three types of budget. *Capital budgets* concern the allocation of resources for investment in buildings, plant and equipment. These new resources will be used to generate future revenues. *Sales budgets* reflect the anticipated flow of funds into the organization based on forecast sales; and *revenue or expense budgets* concern the operating costs that will be incurred in producing these products and services. Because of such factors as seasonal demand, the need to hold stock, and the fact that the final payment for goods and services is likely to occur after all operating expenses have been paid, the flows of cash in and out of the business need to be controlled through these budgets.

Budgeting the direct costs of producing certain products and services requires an estimate of the raw materials, components, labour and machine hours that are likely to be needed. Standard costing techniques usually form the basis of this, with analyses of any variances being used to measure both performance and the reliability of the standard costs.

People are a crucial strategic resource, and their physical contribution in terms of hours of work can be budgeted. Work study and other techniques will be used to establish the standard times required to complete particular tasks, which can then be costed. While such standards, and the wage rates which are used to determine the payment for these inputs, are likely to be common throughout the organization, and in many cases agreed centrally, the selection and training of the people in question are likely to be decentralized. While the skills and capabilities of staff should be considered when the budgets are quantified, the process of budgeting can be useful for highlighting weaknesses and deficiencies.

NOTES

Developing from this, another expense that needs to be budgeted is training and management development programmes. This involves the utilization of funds which are currently available to improve the long-term contribution and value of people. Training and development should therefore be seen as an investment. However, the anticipated returns will be difficult to quantify, and as a result the investment techniques considered earlier may be of only limited use. Moreover, the contribution of people will also depend upon their commitment to the organization, which in turn will be influenced by the overall reward and incentives packages which are offered and the ability of the organization structure to harness and co-ordinate their various contributions.

4.11.4 The budgeting process

All managers who spend money, and whose departments consume resources, should ideally be given a budget. These budgets should represent agreed targets that relate closely to the manager's objectives, again agreed with his or her superior. In the same way that individual manager objectives contribute towards the objectives for departments, business units, divisions and ultimately the organization as a whole, individual budgets will be part of a master budget. Activities that constrain other activities, because they involve scarce resources for which demand exceeds supply capability, should be budgeted early.

Budgets and objectives are clearly related, and consequently resources should be allocated to those areas and activities in the organization that are seen as priorities. If important objectives are to be achieved, and priority strategies implemented, resources must be provided. Where growth and profits are important organizational objectives, those business units and products that are best able to contribute to their achievement should be funded accordingly. This approach suggests that the strategies being implemented have been formulated to satisfy corporate objectives, and personal objectives have been contained. However, the process of budgeting can facilitate the ability of managers to pursue personal objectives. *Moreover, budgeting can be perceived as a technique for* short-term financial management rather than a key aspect of strategy implementation. These contentions are expanded below.

Where resources are available and new developments are being considered, the previous record and contribution of managers is likely to have an influence. *Rather than select strategies on merit and then allocate the* most appropriate managers to implement them, the strategies championed by successful managers may be preferred. Furthermore, the ability of certain managers to exercise power and influence over resource allocations within the organization, issues discussed in the next chapter, may result in allocations to areas and activities that potentially are not the

most beneficial to the organization as a whole. Bower (1970) points out that where the objectives of the organization are difficult to agree and quantify, as is the case in many not-for-profit organizations, the political ability of managers to defend existing allocations and bid for additional resources grows in importance. Wherever this is evident, the resource allocation process becomes a determinant of the objectives and strategies pursued by organizations.

4.11.5 Flexibility with budgets

The budgeting process will normally take place on an annual basis, but as the targets will be utilized for regular performance reviews there should be scope to adjust budgets either upwards or downwards. While sales and revenue budgets are by nature short term, capital budgets have long-term implications. Investments may be paid for in instalments, and their returns are likely to stretch over several years. The budgets are interrelated. Once capital investment decisions have been taken there are immediate implications for revenue to support them.

The allocation of resources to managers is dependent upon the strategies that the organization has decided to continue and develop, but adaptive changes require flexibility which must be accounted for. Where resources are limited and finite, strategic opportunities may be constrained. New alternatives may only be feasible if other activities are divested. Flexed budgets are designed to allow for changes in the level of activity, which might result from adaptive changes in functional and competitive strategies. Managers would realize that, if they were able to sell in excess of their targets, then resources would be found to facilitate increased production. The assumption would be that more sales equals more profit, which may well be true. However, if the implication is that resources would be diverted from other activities, issues of opportunity cost are again relevant; and the resources should only be diverted from activities which are either less profitable or strategically less important to the organization in the long term.

4.11.6 Zero-base budgeting

Where a traditional approach to budgeting is adopted, once the continued production of a product or service has been assumed or decided, demand prospects are forecast. Against these are set expense budgets based on standard costs. Overhead contributions are most probably adjusted for volume changes and inflation. Previous experiences are therefore carried forward and used as a base. With zero-base budgeting no previous experience is assumed, and every proposed activity must be justified afresh.

It was suggested earlier that many local authorities have, historically, sought to continue with existing service provisions, supplemented by

new and additional services when resources could be found to fund them. Local authorities who make use of zerobase techniques start with the assumption that all services must be justified and priorities established on merit. Existing services might well be replaced rather than continued simply because they already exist, or better ways of providing the services might be found.

Under traditional budgeting methods it is easy to carry forward past inefficiencies which result in overspending. Zero-base budgeting should prevent this and offer opportunities for reducing expenses by searching for improved efficiencies. Moreover, the establishment of priorities on merit can result in greater effectiveness, depending on the assessment criteria selected for evaluation.

Zero-based budgeting is conceptually very attractive as it distinguishes between highand low-priority areas and constrains the pursuit of personal objectives by managers. Its implementation presents a number of difficulties, however, which often result in traditional budgeting being preferred. The most serious problems concern the administration, paperwork and time required to implement it effectively and establish priorities objectively. In large, complex organizations the decision-making burden concerning low-level priorities, which individually may not be very significant, can draw senior management attention away from the overall strategic needs of the organization. Finally, zero-based budgeting implies that any job might be declared redundant at any time, and this causes both uncertainty and increased political activity.

4.11.7 Measurement and control systems

The need to measure and evaluate performance, and to make changes when *necessary, applies at all levels of the organization. Budgets establish* quantitative targets for individual managers, departments, business units and divisions.

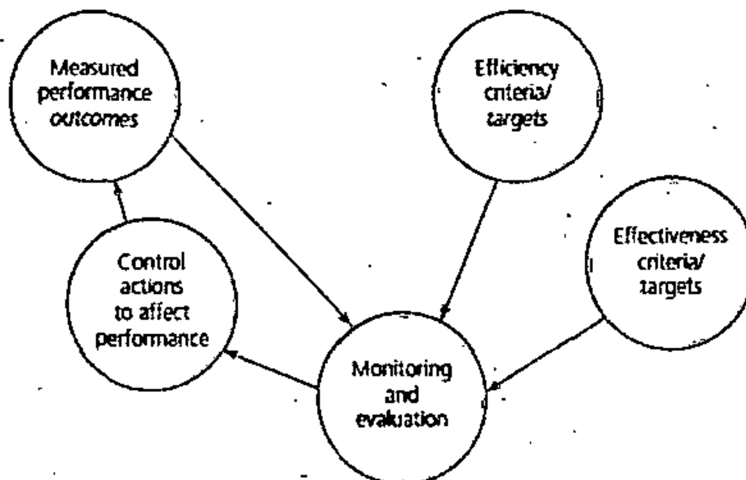


Figure 4.7 Monitoring and control.

NOTES

Progress against these targets can be measured through the information system; and the feedback should be both fast and accurate to enable any corrective actions to take place quickly. The ability of all of these budget holders to achieve their targets will be useful when reviewing their futures.

When establishing budgets and performance targets it is, however, important to ensure that the attention of managers is not focused too narrowly on only their areas of responsibility. Their contributions to other managers and their commitment to the overall interests of the organization are the sources of synergy. While these measures of individual performances are crucial, the effectiveness of all functional, competitive and corporate strategies and their abilities to achieve corporate objectives are the ultimate measures.

The effectiveness of the contribution of such activities as research and development is difficult to assess, but this is no excuse for not trying. Figure 4.7 summarizes these ideas and Figure 4.8 charts a number of possible performance measures – those on the right focus on efficiency and reflect a financial control culture; those on the left are crucial indicators of a commitment to service, quality and excellence. The culture of the organization will dictate which measures are given priority. Establishing such excellence measures requires a real attempt to reconcile the different expectations of the stakeholders. Where there is no common agreement, the objectives and measures selected will reflect the relative power of the various stakeholders. In any case, commercial pressures invariably focus attention on resource management and efficiencies, which are easier to set and monitor. There is then always the danger that because efficiency measures are possible, and often straightforward, they may become elevated in significance and, as a result, begin to be seen as the foundation for the objectives. In other words, measurement potential rather than stakeholder satisfaction dictates objectives.

NOTES

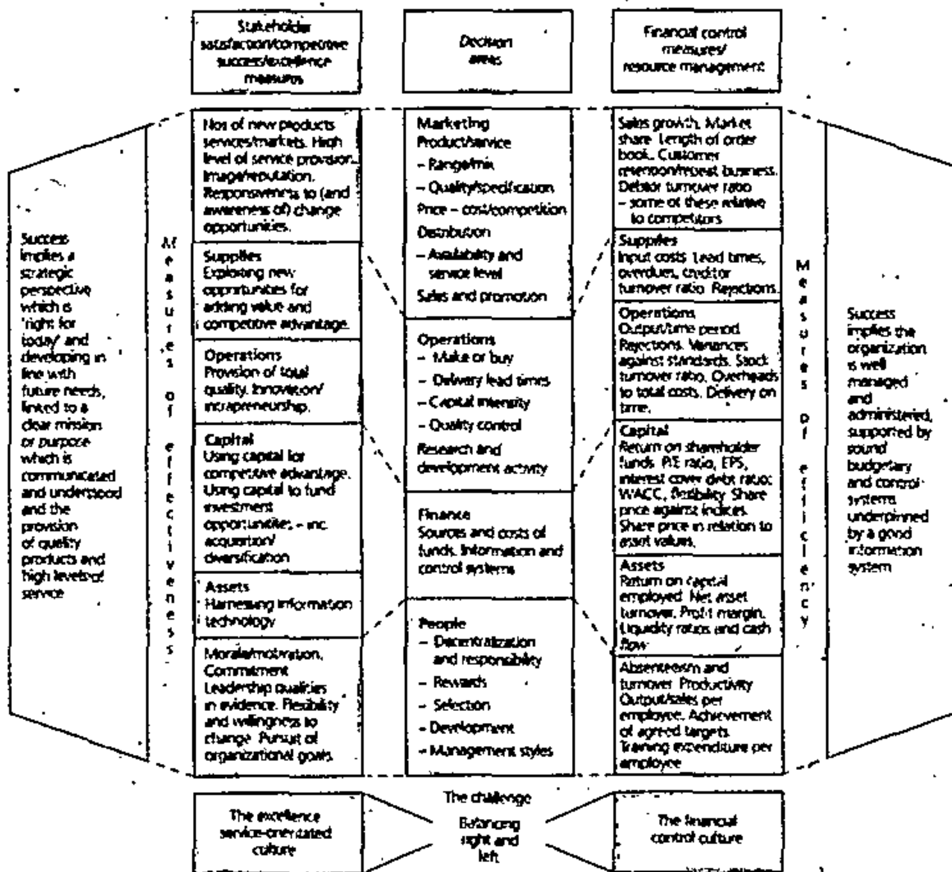


Figure 4.8 Some possible measures of performance.

4.12 CORPORATE CULTURE

Each organization has its own way of dealing with corporate problems and do have their own organizational structure. The culture of the organization very much depends on the behaviour of the employees. If the employees have a strong commitment towards their organizations, the organization is said to have a strong culture and vice versa. For example, Infosys—one of top companies in the area of IT in India—can be said to have a strong organizational culture. This is reflected in its annual results. It is not easy to have a strong culture in the organization. *Lot of it depends on* how the leaders of the organization handle their employees. Looking at this discussion, we can infer that 'corporate culture' is the values and beliefs accepted and practiced by all the employees of the company. To have an appropriate corporate culture, the strategy of the organization should match with it. In this section we would stress more on the role of leaders in shaping the culture of the organization and will discuss the role of leaders in handling the employees. When it comes to handling people, the total personality of a leader comes into play. Managerial effectiveness is the management terminology for leadership. It is well to remember that this truth is

NOTES

applicable at all the levels of management—Junior, Middle and Senior. The 'Katz Model', shown in Figure 4.9 shows the relevant value of management skills at various levels. Although there have been some minor changes in the original design, it clearly shows that Human Relation Skill is consistently the biggest component at all the levels of management.

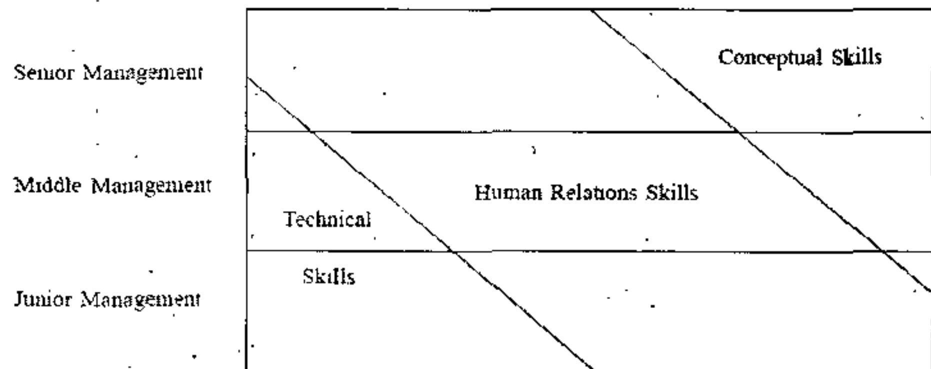


Figure 4.9: Katz Model—Skills of an Effective Manager.

A leader in any organization has to handle people in the following three directions:

- The first—is downwards—his/her own team which he has to build as an effective and cohesive group motivated to achieve the coals of the organization.
- The second—is lateral, which involves winning the support and cooperation of colleagues over whom the leader has no control, but who have an important functional relationship with the group/ organization headed by the leader.
- The third—is a purposeful, constructive and harmonious relation with the higher authority under whom a leader functions—the boss.

4.13 ETHICS AND VALUES

It is not easy to build a strong corporate culture in any organization. A strong culture is based on strong ethics and values. This is very important for the success of the organization in the long-run. It is very easy to adopt short-cut methods to reach the top but the downfall also comes at the same rate. Ethics and values ensure that the organization does not adopt short-cut methods to achieve success; instead it stresses on the concept of sustained success. Every organization has its own code of ethics and standards in a written form. The code of ethics normally contain the following points:

- Honesty

- Fairness in practices of the company—Disclosing the inside information;
- Acquiring and using outside information—Disclosure of outside activities by the employer to the employee;
- Using comapny assets; etc.

The value statements normally include

- *Value of customers*
- Commitment towards the business practices like quality etc.
- duty towards shareholders, suppliers etc.
- following the environmental protection norms etc.

These were the few areas which were covered. There can be more such points, which can be discussed under the head value statements and code of ethics. Each organization has its own set of value statements and code of ethics.

4.14 STRATEGIC INFORMATION SYSTEM

The concept of **Strategic Information Systems** *or* "SIS" was first introduced into the field of information systems in 1982-83 by Dr. Charles Wiseman, President of a newly formed consultancy called "*Competitive Applications,*" (cf. NY State records for consultancies formed in 1982) who gave a series of public lectures on SIS in NYC sponsored by the Datamation Institute, a subsidiary of Datamation Magazine.

In 1984 Wiseman published an article on this subject (co-authored by Prof. Ian MacMillan) in the Journal of Business Strategy (Journal of Business Strategy, fall, 1984) In 1985 he published the first book on SIS called "Strategy and Computers: Information Systems as Competitive Weapons" (Dow-Jones Irwin, 1985; translated into French by Bertrand Kaulek and into Italian by Professor Fabio Corno of Bocconi University). In 1988 an expanded version of this book called "Strategic Information Systems" was published by Richard D. Irwin. This book was translated into Japanese by Professor Shinroki Tsuji and published by Diamond Publishing. Over 50,000 copies have been sold.

The following quotations from the Preface of the first book ("Strategy and Computers: *Information Systems as Competitive Weapons*") establishes the basic idea behind the notion of SIS:

"I began collecting instances of information systems used for strategic purposes five years ago, dubbing them "strategic information systems" (Internal Memo, American Can Company (Headquarters), Greenwich, CT, 1980). But from the start I was puzzled by their occurrence. At

NOTES

least theoretically I was unprepared to admit the existence of a new variety of computer application. The conventional view at the time recognized only management information systems, and management support systems, the former used to automate basic business processes and the latter to satisfy the information needs of decision makers. (Cf. articles by Richard Nolan, Jack Rockart, Michael Scott Morton, et al. at that time)...But as my file of cases grew, I realized that the conventional perspective on information systems was incomplete, unable to account for SIS. The examples belied the theory,and the theory in general blinded believers from seeing SIS. Indeed, some conventional information systems planning methodologies, which act like theories in guiding the systematic search for computer application opportunities, exclude certain SIS possibilities from what might be found. (ibid.)"

"This growing awareness of the inadequacy of the dominant dogma of the day led me to investigate the conceptual foundations, so to speak, of information systems. At first, I believed that the conventional gospel could be enlarged to accommodate SIS. But as my research progressed, I abandoned this position and concluded that to explain SIS and facilitate their discovery, one needed to view uses of computer (information) technology from a radically different perspective."

"I call this the strategic perspective on information systems (technology). The chapters to follow present my conception of it. Written for top executives and line managers, they show how computers (information technology) can be used to support or shape competitive strategy."

Most of the second book, Strategic Information Systems, was exposed from 1985 to 1988 to MBA students at the Columbia University Graduate School of Business and to a large number of practitioners seeking to apply SIS concepts to disparate industry settings. Since that time the concept has stimulated journals on the subject, dissertations, and extensive critical research. (References: search Google Scholar, Clusty, et al. using the terms: Strategic Information Systems, SIS, Charles Wiseman, et al.)

Strategic systems are information systems that are developed in response to corporate business initiative. They are intended to give competitive advantage to the organization. They may deliver a product or service that is at a lower cost, that is differentiated, that focuses on a particular market segment, or is innovative._Some of the key ideas of storefront writers are summarized. These include Michael Porter's Competitive Advantage and the Value Chain, Charles Wiseman's Strategic Perspective View and the Strategic Planning Process, F. Warren McFarlan's Competitive Strategy with examples of Information Service's Roles, and Gregory Parson's Information Technology Management at the industry level, at the firm level, and at the strategy level.

General Definition

NOTES

Strategic information systems are those computer systems that implement business strategies; They are those systems where information services resources are applied to strategic business opportunities in such a way that the computer systems have an impact on the organization's products and business operations. Strategic information systems are always systems that are developed in response to corporate business initiative. The ideas in several well-known cases came from information Services people, but they were directed at specific corporate business thrusts. In other cases, the ideas came from business operational people, and Information Services supplied the technological capabilities to realize profitable results.

Most information systems are looked on as support activities to the business. They mechanize operations for better efficiency, control, and effectiveness, but they do not, in themselves, increase corporate profitability. They are simply used to provide management with sufficient dependable information to keep the business running smoothly, and they are used for analysis to plan new directions. Strategic information systems, on the other hand, become an integral and necessary part of the business, and directly influence market share, earnings, and all other aspects of marketplace profitability. They may even bring in new products, new markets, and new ways of doing business. They directly affect the competitive stance of the organization, giving it an advantage against the competitors. Most literature on strategic information systems emphasizes the dramatic breakthroughs in computer systems, such as American Airlines' Sabre System and American Hospital Supply's terminals in customer offices. These, and many other highly successful approaches are most attractive to think about, and it is always possible that an equivalent success may be attained in your organization.

There are many possibilities for strategic information systems, however, which may not be dramatic breakthroughs, but which will certainly become a part of corporate decision making and will, increase corporate profitability. The development of any strategic information systems always enhances the image of information Services in the organization, and leads to information management having a more participatory role in the operation of the organization.

The three general types of information systems that are developed and in general use are financial systems, operational systems, and strategic systems. These categories are not mutually exclusive and, in fact, they always overlap to some. Well-directed financial systems and operational systems may well become the strategic systems for a particular organization.

NOTES

Financial systems are the basic computerization of the accounting, budgeting, and finance operations of an organization. These are similar and ubiquitous in all organizations because the computer has proven to be ideal for the mechanization and control or financial systems; these include the personnel systems because the headcount control and payroll of a company is of prime financial concern. Financial systems should be one of the bases of all other systems because they give a common, controlled measurement of all operations and projects, and can supply trusted numbers for indicating departmental or project success. Organizational planning must be tied to financial analysis. There is always a greater opportunity to develop strategic systems when the financial systems are in place, and required figures can be readily retrieved from them.

Operational systems, or services systems, help control the details of the business. Such systems will vary with each type of enterprise. They are the computer systems that operational managers need to help run the business on a routing basis. They may be useful but mundane systems that simply keep track of inventory, for example, and print out reorder points and cost allocations. On the other hand, they may have a strategic perspective built into them, and may handle inventory in a way that dramatically impacts profitability. A prime example of this is the American Hospital Supply inventory control system installed on customer premises. Where the great majority of inventory control systems simply smooth the operations and give adequate cost control, this well-know hospital system broke through with a new version of the use of an operational system for competitive advantage. The great majority of operational systems for which many large and small computer systems have been purchased, however, simply help to manage and automate the business. They are important and necessary, but can only be put into the "strategic" category it they have a pronounced impact on the profitability of the business.

All businesses should have both long-range and short-range planning of operational systems to ensure that the possibilities of computer usefulness will be seized in a reasonable time. Such planning will project analysis and costing, system development life cycle considerations, and specific technology planning, such as for computers, databases, and communications. There must be computer capacity planning, technology forecasting, and personnel performance planning. It is more likely that those in the organization with entrepreneurial vision will conceive of strategic plans when such basic operational capabilities are in place and are well managed.

Operational systems, then, are those that keep the organization operating under control and most cost effectively. Any of them may be changed to strategic systems if they are viewed with strategic vision. They are fertile grounds for new business opportunities.

NOTES

Strategic systems are those that link business and computer strategies. They may be systems where a new business thrust has been envisioned and its advantages can be best realized through the use of information technology. They may be systems where new computer technology has been made available on the market, and planners with an entrepreneurial spirit perceive how the new capabilities can quickly gain competitive advantage. They may be systems where operational management people and Information Services people have brainstormed together over business problems, and have realized that a new competitive thrust is possible when computer methods are applied in a new way.

There is a tendency to think that strategic systems are only those that have been conceived at what popular, scientific writing sometimes calls the "achtpunckt." This is simply synthetic German for "the point where you say 'acht!' or 'that's it!'" The classical story of Archimedes discovering the principle of the density of matter by getting into a full bathtub, seeing it overflow, then shouting "Eureka!" or "I have found it!" *is a perfect example of an achtpuncht.* It is most pleasant and profitable if someone is brilliant enough, or lucky enough, to have such an experience. The great majority of people must be content, however, to work step-by-step at the process of trying to get strategic vision, trying to integrate information services thinking with corporate operational thinking, and trying to conceive of new directions to take in systems development. This is not an impossible task, but it is a slow task that requires a great deal of communication and cooperation. If the possibilities of strategic systems are clearly understood by all managers in an enterprise, and they approach the development of ideas and the planning systematically, the chances are good that strategic systems will be result. These may not be as dramatic as American Airline's Sabre, but they can certainly be highly profitable.

There is general agreement that strategic systems are those information systems that may be used gaining competitive advantage. How is competitive advantage gained?. At this point, different writers list different possibilities, but none of them claim that there may not be other openings to move through.

Some of the more common ways of thinking about gaining competitive advantage are:

- Deliver a product or a service at a lower cost. This does not necessarily mean the lowest cost, but simply a cost related to the quality of the product or service that will be both attractive in the marketplace and will yield sufficient return on investment. The cost considered is not simply the data processing cost, but is the overall cost of all corporate activities for the delivery of

NOTES

that product or service. There are many operational computer systems that have given internal cost saving and other internal advantages, but they cannot be thought of as strategic until those savings can be translated to a better competitive position in the market.

- Deliver a product or service that us differentiated. Differentiation means the addition of unique features to a product or service that are competitive attractive in the market. Generally such features will cost something to produce, and so they will be the setting point, rather than the cost itself. Seldom does a lowest cost product also have the best differentiation. A strategic system helps customers to perceive that they are getting some extras for witch they will willingly pat.
- Focus on a specific market segment. The idea is to identify and create market niches that have not been adequately filled. Information technology is frequently able to provide the capabilities of defining, expanding, and filling a particular niche or segment. The application would be quite specific to the industry.
- Innovation. Develop products or services through the use of computers that are new and appreciably from other available offerings. Examples of this are automatic credit card handing at service stations, and automatic teller machines at banks. Such innovative approaches not only give new opportunities to attract customers, but also open up entirely new fields of business so that their use has very elastic demand.

Almost any data processing system may be called "strategic" if it aligns the computer strategies with the business strategies of the organization, and there is close cooperation in its development between the information Services people and operational business managers. There should be an explicit connection between the organization's business plan and its systems plan to provide better support of the organization's goals and objectives, and closer management control of the critical information systems.

Many organizations that have done substantial work with computers since the 1950's have long used the term "strategic planning" for any computer developments that are going to directly affect the conduct of their business. Not included are budget, or annual planning and the planning of developing Information Services facilities and the many "housekeeping" tasks that are required in any corporation. Definitely included in strategic planning are any information systems that will be used by operational management to conduct the business more profitably. A simple test would be to ask whether the president of the corporation, or some senior vice presidents, would be interested in the immediate.

outcome of the systems development because they felt it would affect their profitability. If the answer is affirmative, then the system is strategic.

Strategic system, thus, attempt to match Information Services resources to strategic business opportunities where the computer systems will have an impact on the products and the business operations. Planning for strategic systems is not defined by calendar cycles or routine reporting. It is defined by the effort required to impact the competitive environment and the *strategy of a firm at the point in time that management* wants to move on the idea.

Effective strategic systems can only be accomplished, of course, if the capabilities are in place for the routine basic work of gathering data, evaluating possible equipment and software, and managing the routine reporting of project status. The calendarized planning and operational work is absolutely necessary as a base from which a strategic system can be planned and developed when a priority situation arises. When a new strategic need becomes apparent, Information Services should have laid the groundwork to be able *to accept the task of meeting that need.*

Strategic systems that are dramatic innovations will always be the ones that are *written about in the literature. Consultants in strategic* systems must have clearly innovative and successful examples to attract the attention of senior management. It should be clear, however, that most Information Services personnel will have to leverage the advertised successes to again funding for their own systems. These systems may not have an Olympic effect on an organization, but they will have a good chance of being clearly profitable. That will be sufficient for most operational management, and will draw out the necessary funding and support. It helps to talk about the possibilities of great breakthroughs, *if it is always kept in mind that there are many strategic systems* developed and installed that are successful enough to be highly praised within the organization and offer a competitive advantage, but will not be written up in the Harvard Business Review.

Another way of characterizing strategic information systems is to point out some of the key ideas of the foremost apostles of such systems.

SUMMARY

- The structure of an organization is designed to break down the work to be carried out – the tasks – into discrete components, which might comprise individual businesses, divisions and functional departments.
- Implementation incorporates a number of aspects, some of which

NOTES

can be changed directly and some of which can only be changed indirectly. The latter aspects are more difficult for the strategic leadership to control and change.

- Centralization and decentralization relate to the degree to which the authority, power and responsibility for decision-making are devolved through the organization.
- Financial control is seen as an ideal approach for a holding company where the businesses are independent and unrelated.
- Strategic planning tends to be adopted in organizations which focus on only a few, an preferably related, core businesses.
- The basic premise of portfolio management is that competition occurs at the business level and this is where competitive advantages are developed.
- Restructuring requires the identification of industries and companies with the potential for restructuring and transformation with new technologies, new people and/or consolidation.
- Policies are designed to guide the behaviour of managers in relation to the pursuit and achievement of strategies and objectives.
- Budgets, quite simply, are plans expressed in numerical terms, usually in financial terms.
- Each organization has its own way of dealing with corporate problems and do have their own organizational structure.
- Ethics and values ensure that the organization does not adopt short-cut methods to achieve success; instead it stresses on the concept of sustained success.
- Strategic information systems are those computer systems that implement business strategies;

REVIEW QUESTIONS

1. What are different steps of Strategy Implementation?
2. Explain centralization and decentralization.
3. Discuss the role of leadership in
   (a) Strategic Management
   (b) Improving Productivity
4. Discuss the different functions of leadership.
5. Should a leader change his/her style or continue with his/her style, which is in consonance with his/her basic personality? Discuss.