Advanced Diploma in Business Management

CORPORATE STRATEGY AND PLANNING

The Association of Business Executives
5th Floor, CI Tower • St Georges Square • High Street • New Malden
Surrey KT3 4TE • United Kingdom
Tel: + 44(0)20 8329 2930 • Fax: + 44(0)20 8329 2945
E-mail: info@abeuk.com • www.abeuk.com
## Advanced Diploma in Business Management

### CORPORATE STRATEGY AND PLANNING

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INTRODUCTION

All organisations need to be able to manage strategies.

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

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

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

Objectives

After studying this unit, students should be able to:

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

A. WHAT IS STRATEGY?

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

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

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

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

The Need for Strategic Planning

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

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

In order to achieve corporate objectives a strategic plan has to be established. This identifies each major element so that provision can be made for it within the overall plan. Without this planning those who are responsible for the activities which must be carried out in order to achieve the objectives, i.e. the operational or tactical managers, are unable to select the necessary tactics.
Provided there is a strategic plan set up by top management there is no need for tactical managers to be fully informed of its detail; all they have to do is develop trust in senior managers so that they follow out their instructions.

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

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

**Approaches to Strategy**

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

**Strategic Management**

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

- The **policy formulation approach** established the need for managers to create rules which set the parameters within which a functional area exists, and define what the functional area can and cannot do.
- The **initial-strategy approach** was defined by Chandler (1962) as being the determination of long-term goals and objectives for an organisation, and the setting up of the necessary courses of action too achieve these, together with the allocation of resources necessary for this.

**Strategy as a Process**

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

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

**Objectives, Policy and Strategy**

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

Thus:

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

**Strategic Planning**

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

**Advantages and Limitations of Formal Corporate Strategic Planning**

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

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

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

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

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

Many of the models of how strategies are developed in organisations are based on the notion that strategies can and should be systematically and formally planned following a set of relatively rigid steps and procedures. Johnson and Scholes refer to this notion of strategy development as a “design” view of strategy. Conventionally most textbooks and courses on strategic management and planning have promoted and adopted this design view of strategy and, as a result, many companies have formalised strategic planning systems often carried out by a formal corporate planning department.

There are a number of suggested advantages of having formalised strategic planning systems, some of the main ones being as follows:

**Advantages of Formalised Planning Systems**

(a) Formalised strategic planning provides what many would term a logical but certainly a structured means of analysis and thinking about complex issues and problems. There is no doubt that strategy development is complex, and formal planning systems attempt to help resolve and deal with this complexity by suggesting a series of distinct steps and stages which the manager can follow in the development of strategic plans.

(b) It is argued that formal and structured planning systems force managers to take a longer-term view of strategic options and directions than they would otherwise. So, for example, the stages of environmental and competitor analysis which form a key part of most formalised corporate planning systems encompass planning horizons of three years at the minimum, and in some cases up to 20 years.

(c) Formalised and structured planning systems, it is suggested, enable effective control and evaluation. So, for example, because objectives in formal planning systems are usually precisely specified, and because strategic direction is determined in advance, the measurement of strategic performance is facilitated.
Co-ordination between different functions and managers throughout the organisation can be increased with highly formalised and structured planning systems. This is because very often a formal planning system will require the different functions/managers to work together towards the achievement of corporate objectives in a manner specified in the corporate plan. Furthermore, formalised strategic plans will normally specify and communicate to managers what they are required to do in the context of the strategic plan.

Related to co-ordination, formalised strategic planning also helps ensure that the required resources to implement strategic plans are understood and made available.

Finally, formalised planning systems can sometimes help to motivate individuals towards the achievement of strategic objectives, particularly where they are involved in the planning process and feel, therefore, that they have some degree of ownership of and commitment to the process.

Disadvantages of Formal Planning Systems

Highly formalised strategic planning systems may not always adequately reflect the people and cultural elements of the organisation.

Individual managers may feel absolved from any strategic planning responsibilities, these being left to the specialist strategic planners. As a result, line managers may not feel they own strategic plans.

Highly formalised strategic plans can be restrictive, particularly where the environment is changing rapidly. This may result in lost opportunities and a gradual loss of strategic fit.

Highly formalised strategic planning can become very cumbersome and over-detailed requiring large amounts of analysis and information, often resulting in information overload.

Strategic planning can become a substitute for action, i.e. it can become an activity in its own right divorced from the actual activities and plans of the organisation.

Decline of Formal Corporate Planning Departments

We can see that highly formalised and structured strategic planning has both advantages and disadvantages. Although the design model of strategy development is still the most prevalent model in textbooks and many organisations, it is increasingly recognised that highly formalised and structured approaches to developing strategic plans are becoming less appropriate and effective especially where this process is carried out in a formal corporate planning department. Many organisations have now begun to move away from having such a department, and instead have more informal planning systems at line manager and strategic business unit level, albeit within an overall corporate framework.

One main reason for this trend is the increasingly volatile and changing nature of the environment which requires much more flexibility and speed of planning. Planning systems now need to be more ideas-based and flexible, with less formalisation and adherence to strict procedures and steps. In addition, and related to this, is the increasing emergence of strategies from various levels of the organisation, rather than the top-down approach to strategic planning which tends to accompany the highly formalised and structured systems. It is increasingly recognised that, in today's environment, probably a more effective approach to developing strategic plans is to have some structure to the planning process whilst remaining flexible and, above all, not allowing the strategic planning process to become an end in itself.
Strategic versus Tactical Decisions

One issue in strategic management surrounds the distinction between strategic decisions and tactical decisions. A problem in making this distinction is that what is "strategic" in one company or context can be "tactical" in another company or context. It is important, nevertheless, to distinguish between strategic and tactical decisions and also the inter-relationships between these two levels of planning. Unless we understand what is strategic as opposed to tactical, our planning processes are likely to be ineffective and ambiguous. Notwithstanding the difficulties in separating strategic from tactical, it is now generally accepted that there are a number of characteristics of strategic decisions which mark them out from their more tactical counterparts. These key characteristics are as follows.

Scope/Detail

Strategic decisions are inevitably less concerned with the details of activities in the organisation. Rather, strategic decisions are broad in scope and will therefore contain little real detail. For example, one of the most important strategic decisions in a company is what business the company is to be in the future. In turn, this decision encompasses the selection of the product markets which the organisation will compete in, in the future. So, for example, it might involve decisions regarding the market segments that a company will operate in, but not detailed decisions regarding the choice of specific customers or how to compete for these customers.

Reflect Environmental and Competitive Factors

Strategic decisions, unlike many tactical ones, need to be based on, and reflect, broader environmental and competitive factors. So, for example, a strategic decision will involve the assessment of major opportunities and threats based on an environmental and competitive analysis. Normally, the major opportunities and threats which confront an organisation derive from trends and changes in an environment. Because of this, strategic decisions must be proactive and outward looking, as compared to tactical decisions.

Implication for Resource Allocations

Strategic decisions normally affect major resource allocations in an organisation. For example, strategic decisions may involve decisions about investing in say, new plant and/or new products. Certainly, some tactical decisions can involve large outlays, but it is strategic decisions which essentially determine an organisation's overall resource allocation.

Planning Horizons

Related to the issue of resource allocations is the fact that strategic decisions are normally characterised by longer planning horizons or timescales than tactical decisions. The resources committed by strategic decisions often extend some years into the future. Normally, tactical decisions will encompass planning horizons of no longer than one year, whereas strategic plans may encompass planning horizons of up to ten years and more ahead.

Complexity/Uncertainty

The large numbers of factors which must be assessed in strategic planning, coupled with the long-term planning horizons already mentioned, mean that strategic decisions are characterised by their complexity compared to tactical ones. Not only must a wide range of factors be taken into account in strategic decisions, but often these factors are complexly interrelated. In addition, strategic decisions often involve more uncertainty as to their potential outcomes.

Need for Integration

Strategic decisions will tend to involve and therefore cut across several functional areas in the organisation: for example, a strategic decision may have implications for production, marketing, finance, and personnel. Tactical decisions, on the other hand, can often be taken
in the context of a particular functional area, although of course some degree of co-ordination may still be required. Strategic decisions therefore need to integrate across functional areas and will often require inputs and expertise from a wide range of managers from different functional areas of the business.

To summarise, although it is sometimes difficult to distinguish between strategic and other more tactical decisions in an organisation, in fact strategic decisions do tend to have a number of characteristics which set them aside from tactical decisions. By understanding these distinguishing characteristics, the manager is better placed to understand and implement strategic decisions.

B. LEVELS OF STRATEGY

There are three levels of strategy which we can consider: corporate strategy, business strategy and operational strategy.

**Corporate Strategy**

This embraces the overall scope of the organisation, its operation in structural or financial terms, and the allocation of its resources throughout its various business or divisions.

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

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

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

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

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

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

**Business Strategy**

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

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

**Operational Strategy**

This third level of strategy is concerned with specific functions within the organisation, such as marketing or finance, and the contribution which these make to the other strategic levels.
For example, operational strategies for marketing would include strategies for segmentation and targeting and strategic decisions for each of the elements of the marketing mix, i.e. product, price, place and promotion.

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

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

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

C. ESTABLISHING STRATEGIC INTENT

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

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

The corporate plan provides the parameters for the planning activity, which include mission statements, goals, objectives and strategies.

**Mission Statement**

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

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

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

In Tesco's case these are:

(a) offering customers best value and most competitive prices;
(b) providing progressive returns for shareholders;
(c) developing its employees and rewarding them fairly. With equal opportunities for all;
(d) working with suppliers to achieve a long-term business relationship based on strict quality and price criteria;
(e) supporting the local community and protecting the environment.

- The organisation must be capable of the necessary action to fulfil its strategic intent.
Goals, Objectives and Strategies

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

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

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

D. THE STRATEGIC MANAGEMENT PROCESS

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

- **Interpersonal** – where the manager is:
  (a) a figurehead for the organisation;
  (b) a leader, responsible for their own actions and those of their subordinates;
  (c) a liaison officer working with everyone, both inside and outside of the organisation.

- **Informational** – receiving and communicating information as:
  (a) a monitor looking for useful information, both within and outside the organisation;
  (b) a disseminator distributing the information subordinates need in order to fulfil their functions;
  (c) a spokesperson giving information to other than their own work team, and on occasions representing their own unit or the organisation as a whole.

- **Decision-making** – as:
  (a) an entrepreneur dedicated to improving their unit, often by initiating change;
  (b) disturbance handler, producing solutions to difficult problems and following them through, even though they might be unpopular;
  (c) resource-allocator, trying to balance fairly the distribution of limited resources in accordance with needs and goals;
  (d) negotiator, both within and outside the organisation.

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

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

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

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

- The analysis of strategy – an understanding of the changes going on in the environment in which the organisation exists and how these affect the organisation and its activities, its strength of resources, and the expectations of its stakeholders.
The choice of strategy – which is concerned with all the possible courses of action which may be taken.

An evaluation of each of the courses of action identified and the selection of those which the organisation should attempt to follow.

The implementation of the selected planned strategy into an effective course of action.

**Patterns of Strategy Development**

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

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

Mintzberg identified three modes of strategy-making:

- **Planned** – strategy which is created ahead of events, which may be formally documented or just clearly thought through, may be specific or general, but involves some sort of consciously intended course of action.

- **Entrepreneurial** – strategy which involves vision and concept attainment, which is intuitive and non-analytical, thrives on uncertainty and is geared to seeking out opportunities. It is often based on the personal vision of the chief executive and may not be made explicit.

- **Adaptive** – where strategy formulation and implementation proceed concurrently, i.e. strategy is adapted to changing conditions.

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

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

**A Strategic Model**

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

- the expectations and objectives of shareholders;

- the total resources which are available to the organisation in order to achieve its objectives; and

- the total environment within which the organisation operates.

Each of these is explained below:

**Expectations and Objectives of Shareholders**

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

**Total Resources Available to the Organisation**

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

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

**Total Environment within which the Organisation Operates**

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

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

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

**Key Steps/Elements in Strategic Planning**

Strategic planning involves three key steps or elements which are closely interrelated: they are strategic analysis, strategic choice, and strategy implementation. Each of these is discussed below.

**Strategic Analysis**

Strategic analysis is the first step in strategic planning. It consists of the planner assessing the current position/performance of the organisation – including its present objectives and strategies – and relating this assessment to an analysis of trends and changes in the organisation’s environment. The overall aim of strategic analysis is to form an assessment of the present and likely future performance of the organisation. Strategic analysis involves an assessment of current organisational results, an evaluation of current resources, and an assessment of environmental trends and changes. A key technique here is SWOT analysis, i.e. the assessment of strengths, weaknesses, opportunities and threats. Equally important, however, is the assessment of the actual values and expectations of different shareholder groups. The outcome of strategic analysis should be an assessment of the extent to which current objectives and strategies require to be changed to meet the needs of the future. This gives rise to the need to exercise strategic choice.
Strategic Choice

This second step in strategic planning contains three sub-steps. The first of these is the generation of strategic options. Usually there are numerous alternative ways to achieve a given objective. For example, the objective of growth can be achieved through acquisition or through internal development. Similarly, a company can compete on the basis of, say, cost leadership, or focus, or differentiation. The first step in strategic choice is to delineate the range of strategic options. The second step in strategic choice is to evaluate these options. The most preferred options are those which build on corporate strengths and minimise company weaknesses whilst, at the same time, taking cognisance of environmental opportunities and threats. Strategies should also be evaluated with respect to feasibility and acceptability. The third step in strategic choice then is the selection of alternative strategies. Although selection should be as objective as possible, it is often affected by the values of managers and other groups with interests in the organisation.

Strategic choice is considered in more detail in Study Units 4 and 5.

Strategy Implementation

The third element in the strategic planning process is implementation. Broad strategic choices need to be translated into specific action programmes. Resources need to be allocated, responsibilities defined, organisational structures designed and, finally, systems of information and control put in place. It is often at the implementation stage that most of the problems of co-ordinating and controlling strategic plans are encountered. Human resource considerations are particularly important in the effective implementation of strategic plans. Care should be taken to exercise effective leadership and motivation.

These then are the three elements of the process or framework of strategic planning and management. Again, it should be emphasised that the elements can be seen as a number of interlinked issues or decisions rather than a series of separate sequential steps.

E. PATTERNS OF STRATEGIC DEVELOPMENT

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

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

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

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

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

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

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

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

The Development of Strategy

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

(a) **External influences** may include:

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

(b) **Internal influences** can include:

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

An example of the political environment affecting an organisation's strategy is provided by Pirelli's decision to move away from tyres and into the telecommunications sector. They achieved this by combining with Benetton in order to take over Olivetti and thus to acquire a controlling interest in Telecom Italia.

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

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

Johnson, Scholes and Whittington develop the idea of different patterns of how strategies are developed, by distinguishing between what they call "intended", "realised" and "emergent" strategies

- **Intended Strategies**

These are those strategies which are deliberately planned and designed by the corporate planner. They come from the top down and they are often based on systematic analysis and deliberate decisions and follow a systematic process using strategic systems. They are literally "strategy as design", and are useful in that they provide a structured and systematic way of thinking about strategic issues and
decisions. These strategies may be planned in formal strategic planning workshops and are usually developed by the corporate planning department, sometimes with the help of corporate strategy consultants. **Strategic leadership** plays a key role in intended strategies with one or a small group of senior managers driving the strategic planning process. Sometimes intended strategies at the individual business level are **externally imposed** by corporate headquarters or, in the case of public-sector organisations, by government or civil servants.

- **Realised Strategies**
  These are the actual strategies that an organisation follows in practice. These are often different from its intended strategies, and are usually a compromise. There are many possible reasons why actual strategies may differ from those intended. For example, **internal organisational politics** may require that intended strategies be modified. In many organisations intended strategies are modified as a result of internal power politics and "bargaining" between different groups and individuals. Another reason for realised strategies being different from planned ones is when the planned strategies turn out to be unworkable, or perhaps the environment has changed since the plans were developed. Finally it may well be that the intended plans are resisted or even rejected by interested parties affected by the plans: such interested parties could be managers, employees, or shareholders, or perhaps suppliers, customers, distributors, or even the local community.

- **Emergent Strategies**
  These are strategies that gradually emerge from the day-to-day decisions and activities of the organisation. In this sense they are also "realised strategies" but are less the result of negotiation and bargaining and more due to what Quinn has termed "**logical incrementalism**". This means that strategies are developed through a process of trial and error, from which the organisation (or rather its managers) gradually learn which strategies are the most effective and practical. There is no doubt that the ability to learn is an important and useful skill in the contemporary organisation, especially with heightened environmental complexity and the quickening pace of change. Emergent strategies, however, give rise to the danger of uncertainty and strategic drift.

**Uncertainty and Strategic Drift**

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

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

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

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

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

We shall consider external audits of an organisation by means of Porter's Five Forces Model, or PEST, in detail in Study Unit 2.
An organisation’s strategy is a way of aiming to achieve its stated objectives but over a period of time there sometimes emerges a difference between what it was hoped would be achieved and what was likely to be achieved if the original plans were continued. As the environment changes gradually the organisation’s strategy needs to develop incrementally in line with it. If the organisation’s strategy fails to do this then a strategic drift occurs.

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

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

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

F. STRATEGIC MANAGEMENT AND BUSINESS PLANNING

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

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

Elements of a Business Plan

Stoner and Freeman define a business plan thus:

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

We shall look at each of these business plan components.

Mission Statement

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

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

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

Description of Goods and Services

This is a description of what the organisation has to offer. BT describes itself as "one of Europe's leading providers of communications services". It says:
"We aim to help our customers make the most of the opportunities that communications technology brings. As well as voice services, we are concentrating on newer areas where we have established already a strong position, such as mobile, internet and -business services and solutions. As the next stage in the transformation of BT, we plan to create two strong and separately quoted businesses, BT Wireless and Future BT."

**Market Analysis**
As part of its plan, an organisation needs to consider the state of its market place.

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

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

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

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

In general they quoted their vision to be:

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

In detail they say they planned to:

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

**Management Strategies for Attaining Goals**
There is a link between business planning and strategic management.

O₂ (formerly mmO₂) was set up, by means of a demerger from BT, specifically to supply mobile communications services in Europe. Its stated strategy was as follows:

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

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

In respect of planning, Fayol made the following points:

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

**Goals and Objectives**

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

- **Goals** (or aims) are a general statement of the direction in which the organisation is planning to go, and which is in agreement with its mission statement. Goals are normally qualitative, i.e. general, in nature, such as O₂ plc aiming to "create shareholder value".

- **Corporate objectives** (or quantified objectives) are more likely to be quantified, or at least to be a precise statement in line with stated goals: for example, Centrica's stated aim to "supply a million telecommunications services to customers by the end of 2001".

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

**Policies, Strategies, Tactics and Control**

- **Policies** refer to the basic objectives of the organisation and define the long-term purpose. As a consequence policies are broad rather than precise in nature, and will exist for every part of the operation, serving as a broad restraint which will give guidance to managers: for example, "to achieve a return on investment (ROI) of 10%". In this case there is no fixed time constraint given, which is acceptable in policy-setting provided a time element is implied. In this example the ROI objective is continuous. If the policy was to increase ROI, then the policy statement would have to be written so as to reflect this, for example, "to increase ROI by 10% by the end of this year (2002) and then to maintain it at that level".

- **Strategies** are objective statements that identify the actions by means of which a particular position is to be achieved or maintained. A long-term plan will include strategic statements which will have been derived from the established policies.

- **Tactics** follow from the strategies which have been selected, and which in turn have been derived from the organisation's policies. As we saw earlier in distinguishing between strategic and tactical decisions tactics are of a short-term nature and are designed to achieve short-term aims. If the organisation is operating effectively as a functional system, then it follows that, if all tactical objectives are achieved, strategies and therefore overall policies are also achieved.
Control is necessary in order to monitor the effectiveness of the action which is being taken, i.e. to determine the extent to which it is achieving the set objectives and goals.

Levels of Management Action

The three stages of planning, acting, and evaluating underpin all management action, at whatever level within an organisation.

The stages of management action are:
- establishment of policy
- generation of strategy
- specification of tactics
- provision of control measures.

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

![Figure 1.1: Hierarchy of Plans (after Stoner and Freeman)](image)

G. STRATEGIC MANAGEMENT IN DIFFERENT CONTEXTS

Although all businesses share common fundamental principles, they can also differ in many ways, such as the following:
- private companies have objectives such as making a profit or increasing their market share;
- public-sector organisations may exist to provide a service;
- a not-for-profit organisation, such as a club, exists to provide facilities and entertainment for its members.

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

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

Obviously small businesses have fewer resources than their larger counterparts. Perhaps somewhat surprisingly this means that, if anything, the importance of applying the basic elements of strategic management effectively is even more important. The small business organisation simply cannot afford to make strategic mistakes. Despite this, however, the smaller business is likely to have fewer specialist managers and particularly will often lack skills and expertise in some of the areas required for effective strategic management. So, for example, the smaller business will often find it difficult to prepare accurate forecasts or to conduct specialist marketing research. Because of this, the smaller business will often need to turn to outside help and consultancies for some of their strategic management skills.

Planning in the smaller business is often less formal than in its larger counterparts, but is often easier to communicate throughout the organisation. Often strategic management will be done by one person, the owner/manager.

A smaller business is limited in the ways it can compete: for example, it would not normally be able to compete on cost leadership. Because of this, the small business is likely to concentrate on using the advantages which accrue from its small size such as personal service, flexibility, etc.

The small business is likely to find it more difficult to raise finance and so growth is sometimes difficult to achieve. For the same reason, the smaller business may find it difficult to pursue growth through new product development.

Finally, in the small business the character, skills and vision of its owners are likely to be much more significant in business success or failure than in larger organisations.

Multinational Companies

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

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

The often widespread geographical coverage of such organisations also heightens the importance of the cultural and political elements of the environment which therefore become especially important in the planning process.

Crucial to such organisations are the issues of centralisation versus decentralisation in structure and planning systems, together with the related issue of global versus local strategies.

Finally, the allocation of resources between different parts of the business is extremely important, but also potentially complex. Great care must be taken in such organisations to balance the business portfolio.

Manufacturing and Service Organisations

These differ in important ways, reflecting their differing objectives.
In the case of the manufacturer, it is the quality of the product which creates the company's competitiveness and, therefore, its strategy will be closely linked to the product.

In the case of service provision, the competitiveness of one organisation with respect to its rivals will depend on less obvious aspects, such as the public's perception of the company, based on publicity and image-marketing strategies as, for instance, in getting the strength of a particular insurance company around you.

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

Service products have a number of characteristics which give rise to special considerations for strategic management in service organisations. Service products are essentially intangible, which means they cannot be touched or stored; and they are "inseparable", in that the service provider is inevitably present when the service is consumed. These characteristics mean that the following are key issues in the strategic management of service providers:

- The difficulty of differentiating service products to gain a strategic competitive advantage.
- The importance of synchronising demand and supply.
- The importance of supplier reputation and hence word-of-mouth in customer choice.

With service products we need to consider an extended marketing mix, with the three additional elements of "process", "physical evidence" and "people".

**Voluntary and Not-For-Profit Organisations**

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

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

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

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

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

**Innovatory Organisations**

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

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

**Professional Service Organisations**

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

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

**Public-Sector Organisations**

It is important to recognise that the public sector comprises a very diverse set of business organisations. In fact, it has a number of sub-sectors, including regulatory bodies, local authorities, social and health services, education providers, some trading companies, advice services, police and defence, and many others. Each of these sub-sectors to some extent has its own special characteristics with regard to strategic management.

However, recognising this, it is possible to point to some of the distinct factors affecting strategic management in the public-sector organisation. Perhaps the most significant is the influence of political considerations in the development of and constraints on strategic plans. Compared to the private sector public-sector organisations are very much more accountable for their decisions to outside parties and, indeed, to the public in general. Decisions by managers in such organisations will often be taken in the context of such political/regulatory requirements: for example, a requirement to buy from domestic suppliers. Many public-sector bodies operate within laws and regulations designed to prevent corruption and favouritism, which entail very formal and bureaucratic structures and procedures which can be resistant to change.
# Study Unit 2

## Strategic Analysis 1: The External Environment

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INTRODUCTION

In this Unit we are going to consider the importance and the scope of analysis in corporate planning.
In particular we are going to look at the external influences on corporate strategy and the key environmental drivers.
We will discuss the importance of analysing the state of competition and of the marketplace.
Finally we will consider the appropriate tools for use in analysing the external environment.

Objectives

After studying this unit, students should be able to:

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

A. CORPORATE PLANNING

Fayol made the following points in regard to planning:

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

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

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

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

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

- analysis of the current market size and its rate of change, in order to assess its future movement;
- market research of existing and potential clients in order to determine current and future expectations;
- an investigation of current and emerging competitors, an assessment of potential competitors, in each case with respect to their strengths and weaknesses;
- an analysis of the stability of own market share and likely trends;
- consideration of the effectiveness of the distribution system;
- a review of supplier network, in particular a detailed analysis of major suppliers, and of patterns of selling;
an analysis of any agencies which the organisation uses, looking at trends in agency practice and cost-effectiveness in particular. With regard to agencies of major importance this needs to be very detailed, as with the analysis of competitors.

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

At a time when many commercial customers were cancelling or postponing IT spending, Torex’s customers, who were mainly healthcare providers such as the NHS, were expanding their systems and making funds available for systems development.

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

A company which reviewed its market sector and made a strategy shift was the engineering firm Weir, who chose to concentrate their efforts on the manufacture of pumps and valves. This rather mundane work offered a wide client base from such applications as paper mills to oil refineries, in a growing market. It also opened up possibilities of follow-up services. As a consequence of this change of strategy the company greatly improved its position.

Unilever provides us with an example of coping with the problems of dealing with unreliable agencies. They put up for sale their relatively new home cleaning business, known as Myhome, because they failed to find a reliable supply of cleaning staff. As a spokesperson for Unilever has said, "finding good Mrs Mops is a hard job". Myhome was intended to be used as a way of promoting Unilever household cleaning products. However, with only a few thousand customers, the trial, which was intended to run for at least another year before a decision about its future was taken, was brought to a premature end.

B. ENVIRONMENTAL ANALYSIS

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

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

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

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

Types of Environment

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

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

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

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

(c) **Complex environments** are becoming more and more common in modern times.

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

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

**Environmental Drivers**

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

In addition, globalisation of markets has led to world-wide searches by companies to obtain skilled labour, raw materials, total market share, etc. Nestlé, for example, the world's biggest food company, improved sales growth by over 5% in the first half of 2001.

This was achieved by means of what they termed their "Globe" project. This was aimed at increasing business efficiency, by increased spending in launching new products, i.e. by putting more money into the market. They also planned to acquire other companies in the food sector: in particular, mineral water and nutrition businesses.

**Auditing and Forecasting the Environment**

We mentioned in Unit 1 the use of audits in corporate planning and their relationship to the opportunities and threats present in the environment. Such audits must consider the needs of the whole organisation, as only then will they enable functional strategies to be determined.

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

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

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

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

(a) **Level and Period of Forecasts**

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

In making individual forecasts managers must be aware of the larger environmental factors.
Short-, medium- and long-term forecasting is in value-loaded terms, i.e. what is short-term to one organisation may be regarded as medium-term to another.

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

(b) The Purpose of Forecasting

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

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

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

C. COMPETITOR ENVIRONMENTAL ANALYSIS

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

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

Analysis of Competitive Market Structure

In any market there is a huge number of competing companies and they cover a large range of geographical locations. In addition, many companies who formerly enjoyed some form of protection from competition through the operation of monopolies now have to compete openly for their business. An example of this in the UK is encouragement by the government for free competition between suppliers of gas and electricity.

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

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

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

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

**How Do We Carry out Competitor Analysis?**

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

For this we need to know:

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

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

**How May Competitor Analysis Be Used?**

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

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

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

The foregoing has shown how important competitor analysis is to a company in terms of its strategic planning.
Systematic procedures for comparing the relative strengths and weaknesses of the competition can produce a vital input to a company's strategic planning.

**Competitor-Based Strategies**

There are many factors, both external and internal, which can influence strategy formulation. These include the following:

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

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

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

In terms of the sort of strategy it follows, an organisation can be classified as a leader, a follower, a challenger or a niche marketer. We shall explain what is meant by these terms.

(a) **Leaders**

These are organisations which are innovative and regularly the first to bring new products into the marketplace. Such a company is likely to be powerful, with a large share in the market and having high resources. It will gain a competitive advantage from being first into the market as, for example, was Thermos with the first vacuum flask; but has to invest heavily in product development and has to accept a subsequent high level of risk.

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

In order to carry out these strategies, the company needs to adopt a policy of:
- innovation – by always being ahead of its competitors;
- fortification – by pursuing activities which are aimed at keeping the competition down;
• confrontation – by using such tactics as price wars in order to reduce competitors’ profits, and by aggressive promotional campaigns to increase sales;
• harassment – through maintaining a high level of pressure on distributors and criticising the competition.

(b) Followers

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

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

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

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

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

(c) Challengers

These seek to overtake the market leaders. Their methods include price-cutting incentives offered to distributors, improved levels of service to customers, sharing costs with others, etc. Currently, much of the competition between supermarkets is based on who can provide the most reliable service of home delivery based on ordering via the internet.

(d) Niche Marketers

These offer some kind of specialised product or service, often referred to as a "unique service proposition" (USP).

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

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

Strategies Used By Marketers

These may be classified as attack strategies or defence strategies.

(a) Attack Strategies

• **Direct challenge (differential advantage)**

  This is a high-risk strategy with a potentially high pay-off. Because market leaders are in a very strong position a large financial investment as well as great determination, is required to pursue this strategy.
One example of this strategy was Tesco's successful bid to take market share away from Sainsbury and become the new market leader.

- **Direct attack (distinctive competence)**
  This strategy involves removing the leader's competitive advantage by means of an innovative product. It is a very effective method, provided the advantages are valued by the target market.

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

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

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

- **Bypass**
  This is a method of indirect attack by broadening a resource base until the attacker is strategically prepared for actual confrontation.

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

### (b) Defence Strategies

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

- **Pre-emptive defence**
  Attack is often the best means of defence, and an attack on a potential challenger can distract them through their need to defend themselves. It might be described as "getting your retaliation in first", and is a strategy successfully pursued by a number of well-known companies.
**Counter-offensive**
This involves carrying out an aggressive response to an attack in order to protect market share.

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

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

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

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

The Post Office has been retreating as competition hots up, particularly through electronic forms of communication. It faces a huge loss of business and a large deficit on its trading.

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

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

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

Porter has argued that these groups can be identified by considering just two or three sets of key characteristics. Some of the characteristics which Porter suggests are as follows:

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

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

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

**Competitive Advantage**

Organisations have two main strategy levels:

- Company-wide – which is carried out at the corporate level
- Competitive – which is the concern of individual business units.

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

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

The range of alternative competitive strategies that companies can choose between, including Porters model of "Generic Competitive Strategies", are considered in Study Unit 4

**D. INTERPRETING ENVIRONMENTAL ANALYSIS**

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

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

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

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

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

**PESTL Analysis**

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

This interaction is not a one-way but a two-way process, with the organisation being influenced by outside factors over which it has no control. In turn, the organisation can influence its environment, through such activities as advertising and marketing. Thus an organisation can exert influence over its customers, both existing and potential ones, by making a product or service available and thus establishing a demand for it which did not exist previously. This sometimes results in a leading organisation creating a market larger than it alone can satisfy, thus creating business for following organisations.
In order to understand the functioning of an organisation as it interacts with its environment, four key elements have been identified which, taken together, make up the total environment. These are political, economic, social, technological and legal/regulatory elements, hence the acronym PESTL. In reality these elements may overlap, but we will consider each in turn.

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

- **Economic**
  Organisations have to operate in conditions of boom and bust (recession) at times. Interest rates change, tax rates change, the money supply can alter, investment levels go up and down, as people try to guess likely future market movements, etc. In the global economy, exchange rates have an effect and stock markets throughout the world are linked to one another. These affect the ability of firms to compete with overseas markets. As has often been said, "when America sneezes, Europe catches a cold". Energy costs can also play a significant part in business activity.
  On the other hand the pricing and pay policies of large organisations can affect the wider economy.

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

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

- **Legal/Regulatory**
  Strategies must reflect and take account of legal/regulatory factors. There are literally hundreds of laws and regulations which may affect strategic plans. So for example it may not be legal to sell to certain overseas customer groups or we may not be able to compete in certain ways or perhaps come to arrangements with competitors, etc.

**Example of a PESTL Analysis**

The analysis opposite was carried out on behalf of an organisation which retails to the agricultural/horticultural sector.
### Figure 2.1: Example of a PESTL Analysis

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<td>Legislation</td>
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<td></td>
</tr>
<tr>
<td>Legislation</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hunting ban</td>
<td>7</td>
<td>Loss of income equestrian/pet/clothing</td>
<td></td>
</tr>
<tr>
<td><strong>Economic</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More money</td>
<td>8</td>
<td>More disposable income</td>
<td></td>
</tr>
<tr>
<td>Cash flow</td>
<td>10</td>
<td>Cost of merger</td>
<td></td>
</tr>
<tr>
<td>Low inflation</td>
<td>6</td>
<td>More disposable income</td>
<td></td>
</tr>
<tr>
<td>Interest rates low</td>
<td>6</td>
<td>More disposable income</td>
<td></td>
</tr>
<tr>
<td><strong>Social</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leisure industry</td>
<td>10</td>
<td>More leisure time Growth in industry</td>
<td></td>
</tr>
<tr>
<td>Healthy life</td>
<td>8</td>
<td>Walking</td>
<td></td>
</tr>
<tr>
<td>Shopping later/longer</td>
<td>10</td>
<td>Changes in shopping trends</td>
<td></td>
</tr>
<tr>
<td>Quality products</td>
<td>8</td>
<td>Last longer, but improve image</td>
<td></td>
</tr>
<tr>
<td><strong>Technological</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internet</td>
<td>9</td>
<td>Threat of selling products over internet by competitor</td>
<td></td>
</tr>
<tr>
<td>E-mail</td>
<td>10</td>
<td>Benefits to company include contact with suppliers</td>
<td></td>
</tr>
<tr>
<td>Computer</td>
<td>10</td>
<td>Oscar system developed to suit our needs</td>
<td></td>
</tr>
<tr>
<td>Database</td>
<td>6</td>
<td>Enlarging from open evening etc. Targeting customers</td>
<td></td>
</tr>
<tr>
<td>Customer Account card</td>
<td>8</td>
<td>A winner – if properly controlled</td>
<td></td>
</tr>
<tr>
<td><strong>Legal/Regulatory</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product safety regulations</td>
<td>10</td>
<td>All products must confirm to safety standards</td>
<td></td>
</tr>
<tr>
<td>Packaging and promotion</td>
<td>8</td>
<td>Product information and labelling</td>
<td></td>
</tr>
<tr>
<td>Pricing</td>
<td>8</td>
<td>Must conform to Office of Fair Trading regulations</td>
<td></td>
</tr>
</tbody>
</table>
**Entering and Exiting a Market Environment**

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

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

Barriers to entering include:

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

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

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

**Scenario Planning**

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

Strategies and strategic planning are inherently concerned with the future. Because of this the strategic planner is often concerned to assess the future as an input to developing corporate strategic plans. This is particularly true in the area of environmental analysis in corporate planning. The corporate planner must attempt to assess how the environment of the organisation might be configured in the future so as to develop corporate plans to take account of these envisaged configurations. A technique which has been widely used in this respect is the technique of using scenarios in developing plans for the future.

Scenarios comprise of detailed and plausible views of how the business environment of an organisation might develop in the future couched in such a way that the corporate planner is able to develop a range of strategic objectives and actions to best deal with the envisaged futures.

It is important to stress that scenarios are not the same as forecasts. Forecasts are made on the basis of assumptions that the future can be predicted whereas scenarios are generated on the assumption that it can't.

Scenarios are especially useful in the following circumstances:

(a) Where it is important to take a long-term view of strategy

(b) Where there are a limited number of key factors influencing strategic options

(c) Where there is a high level of uncertainty about such influences.
Unlike a forecast, which tries to predict precisely what the future will be, scenarios represent simply plausible narratives of how the future might turn out.

So, how are scenarios built and used in the corporate planning process? Using the example of an oil company we can first consider the steps in building scenarios.

(a) The first step in building scenarios is to establish the purpose of the scenario, i.e. what is the scenario to consider and be used for? The purpose may be wide-ranging (such as "what will the energy market look like in the future?"), or more focused, to support key decisions facing the organisation (such as "should we invest in developing solar-powered energy sources?").

(b) The second step is to identify the strategic issues or drivers of change in the environment, i.e. the factors in the environment which may affect the future with respect to the purpose of our scenario and about which we are uncertain... Usually these factors are readily identifiable: continuing our example, key drivers about which we are uncertain might include oil costs, discovery of new reserves; environmental protection legislation, etc. The number of factors identified at this stage of scenario-building should be kept relatively small, since the number of possible scenarios can quickly become unmanageable. Those drivers selected should be those that have the greatest impact on possible future strategies for the organisation and about which we are most uncertain. Clearly the selection of strategic issues or drivers of change is crucial to the development of scenarios and therefore should ideally use the most expert and informed managers inside (or sometimes even outside) of the organisation. Membership of the scenario-building team is a crucial factor.

(c) Having identified the key driving factors in our scenario analysis, the next step is to identify different possible plausible futures by factor. Again continuing our example, the scenario team can assess, say, the likely future possibilities regarding environmental protection legislation.

(d) The fourth step is then to combine to build scenarios of plausible configurations of factors, considering the possible range of permutations and combinations of the driving factors selected so as to build "complete pictures" of a possible future. The planner can then develop plausible configurations of developments of driving factors from the previous stage, developing and fleshing out the narrative of the predicted scenarios and assessing possible likely outcomes for each.

When this has been done then the corporate planner can begin to assess the likely implications of the scenarios developed for corporate strategic plans. This may encompass determining objectives to deal with future scenarios, assessing strategic options for the future, and in particular for developing possible contingency plans.

These, then, are the main steps in developing and using scenarios in the corporate planning process. There are a number of other considerations in the process, such as determining the membership of the scenario-building team; the timescales for scenarios; and the number of scenarios to be developed. All of these affect the nature and effectiveness of scenarios.

Scenarios have proved to be a useful approach to dealing with unpredictable and volatile environments where conventional techniques of forecasting have proved ineffective and inappropriate. Again, it is important for the planner to remember that scenarios are not forecasts but they can be a very creative and useful approach to trying to assess the implications of an uncertain future environment.

Within the scheme of scenario planning we also have:

- **Cross-impact analysis**, which identifies a set of key trends and asks the question "if A occurs, what impact will this event have on other trends?"
• **demand/hazard forecasting**, which sets out to identify major events which would have an impact on the organisation. Each event is rated for its convergence with other major events taking place in society and its appeal to the public:
  (a) the greater the event's convergence and appeal the more likely it is to happen;
  (b) the higher-rated events are the ones which management takes more account of.
• **Subjective forecasting**, which helps managers to make strategic judgments about future events, to identify the best strategic route to take, and then to make contingency plans to deal with them. Those events which are closer in time will be given more accurate levels of probability of their occurring. Eventually, all events will have occurred and can then provide databases from which objective forecasts can be made for future events.

**Dealing with Fast-Changing Environments: Planning "Rules"**

Many organisations increasingly operate in fast-changing markets and environments, where strategic plans have to be flexible and adaptive in order to seize opportunities. Inflexible, pre-planned strategies imposed by senior management are generally inappropriate. However, if plans and strategic decisions are allowed to evolve according to circumstances, there is a danger that such plans will be disjointed and inconsistent, and at worst may lead to organisational chaos. Because of this Johnson and Scholes have suggested a number of simple "rules" or guidelines which will serve to give some consistency and structure to strategic plans whilst allowing flexibility and adaptability. Below we look at the five main types of simple rule which Johnson and Scholes identify: how-to rules, boundary rules, priority rules, timing rules and exit rules.

**How-To Rules**

These delineate how a decision will be made or a process executed. For example, IBM specify that no more than a certain percentage of any bought-in component may be sourced from any one source. Similarly Dell specifies that any customer segment which reaches £1 billion turnover must be treated as a separate Strategic Business Unit.

**Boundary Rules**

These specify which organisational opportunities will be pursued and which will not: for example, Convex Inc pursues opportunities only in the business area of mechanical pump devices. Any potential business opportunities outside this product area are deemed as being outside the scope of the business.

**Priority Rules**

These help in ranking any opportunities identified as being within the boundary rules. They set out the criteria for screening and ranking such opportunities so that managers can decide which should be pursued. Thus Virgin base their rankings of business opportunities around criteria such as market growth, profitability and environmental considerations.

**Timing Rules**

These rules help specify the timing of activities such as new product development, and market launch, and so help different parts of the company to synchronise their efforts where necessary. Sony Corporation sets timing rules for overall product development activities which in turn are broken down into timing activities for the different functional areas of the business.
- **Exit Rules**
  These help guide managers in deciding when to leave a market, delete a product, etc. Exit rules may be based on specified levels of profitability, sales and market share, or on rates of market growth/decline.

## E. TOOLS FOR COMPETITOR AND MARKET ANALYSIS

*Porter's Five Forces Model*

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

*Figure 2.2: Five Environmental Forces (Porter)*

Porter has suggested that it is the "collective strength of these forces which determines the ultimate profit potential of an industry". The aim of a corporate strategist is to find a position in the industry where the organisation can defend itself against these forces or can influence them in its favour.

**Strategic Group Analysis**

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

**Strategic Competitor Groups**

The concept of strategic competitor groups provides a way of classifying competitors on the basis of the strategic characteristics of their organisations. The more similar a group of companies are with respect to these characteristics, the more they are likely to be direct
competitors, and the more they will need to be analysed and understood in the development of corporate strategies and plans.

Some of the characteristics which can be used to assess similarity, and hence identify strategic competitor groups, include the following:

- Degree of product (or service) diversity
- Extent of geographical coverage
- Number of market segments served
- Distribution channels used
- Extent of branding
- Product or service quality
- Ownership structure
- Size
- Cost structure

Clearly, any number of characteristics might conceivably form the basis for judging similarity. Porter suggests that what are the key characteristics will vary from industry to industry, but that normally just two or three characteristics will normally be sufficient to identify strategic competitor groups, for example, geographical coverage, size, and distribution channels. The strategic planner must identify what are the most important characteristics in any given industry or market situation.

**Uses of Strategic Competitor Group Analysis**

(a) It enables the strategic planner to distinguish between close and distant competitors, and therefore who the most direct competitors are and on what basis these companies are competing.

(b) It enables the planner to assess how likely or possible it is for a company to move from one strategic group to another. The assessment of mobility between strategic competitor groups can be useful in assessing potential new competitors, or the extent to which the company itself can move into new competitive arenas.

(c) It can be used to identify possible opportunities and/or strategic problems. The analysis may suggest gaps in the market where there are few existing competitors. On the other hand, the analysis may point to potential future problems where there are too many companies and the market is over-competitive.

Perhaps the major difficulty with strategic competitor group analysis lies in determining what constitute the key strategic characteristics which enable the grouping to take place. As already mentioned, the strategic planner must identify and assess the relevant characteristics based on experience and knowledge of the product market being assessed. Overall though the strategic competitor group concept has proved extremely useful.

**Information on Competitors: Competitor Intelligence**

Given the importance of competitor analysis in strategic planning it is essential to collect information and intelligence on competitors on a regular and systematic basis. Some companies conduct industrial espionage, but this is neither necessary nor desirable. Below we look at some of the most valuable (and legal) sources of information and intelligence on competitors.

- **Commercial Databases**
  
  These have been one of the fastest-growing sources of competitor information in recent years. Dozens of such databases are available, and they provide an easy and
speedy way of obtaining competitor information. Such databases include collections of published articles from newspapers, magazines and trade publications; and also specialist reports, patent filings, biographical and corporate information. Databases are a valuable source of financial and other performance information on competitors, and can be used to assess competitor strengths and weaknesses. Databases are also useful for benchmarking activities (discussed in Study Unit 8). With so many databases available the planner needs to be selective in their use, choosing those which are most appropriate and useful with regard to competitor information.

- **Competitor Promotional and Website Information**

Valuable information on competitors can be gleaned from their promotional material, including advertising, corporate publicity and public relations activities. Competitors’ websites often provide useful information about competitors’ product ranges, new product launches, pricing and other marketing activities. Ideally the planner should establish a library of competitor promotional and website information which should help give clues about competitors’ strategies and plans.

- **Customers**

One of the most important sources of information on competitors is information from customers. Many customers deal with more than one competing company, and so may have information on competitors’ activities. For example, customers can provide valuable information and insights on a competitor’s marketing strategies. The planner can also assess from customers the extent to which they are satisfied or otherwise with the competitive offerings of different companies in the marketplace. This will help identify possible ways of gaining business from competitors. One of the most effective ways of collecting information from customers about competitors is through the sales force.

- **Trade Shows and Exhibitions**

Many companies regularly attend major trade shows and exhibitions in their industry. Although attendance at these is primarily part of the organisation's selling effort, trade shows and exhibitions are also valuable sources of information about competitors. The planner should ensure such events are used to gather available information on competitors' product innovations, price structures, marketing methods, etc.

- **Competitors’ Employees**

Used carefully, competitors’ employees can be a valuable and legal source of information on competitors. Obviously great care has to be taken with regard to the legal aspects: it would not be a good idea to encourage existing employees of a competitor to provide information on their organisation. However, it is perfectly legitimate to obtain information from a competitor's employees through the process of hiring them. In many companies competitor’s employees are deliberately headhunted for the sake of the information which they might bring with them if employed.

**Product Life Cycle (PLC) Analysis**

It is possible to plot the progress of a product in terms of sales volume against time. Life cycle theory holds that a typical S-shape curve will be obtained, as shown in Figure 2.3. Given that this shape curve is expected, a manager can say, "When I look back, at which point on the curve will I discover we have been at this time?"

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

Any marketing change can affect the curve, not just a change in the product. Thus PLC is a variable, not a determinant.
The following arguments can be used against the PLC concept:

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

Whilst there is considerable truth in these arguments, PLC as a shorthand form of description is and will remain of fundamental importance to the understanding of product policy. The benefits of using PLC theory come from working with the concept rather than using it as a quantified predictive device. Once it is understood, it is possible to use it in a “predictive hindsight” manner.

![Figure 2.3: Product Life Cycle](image)

**Market and Customer Analysis**

The position of an organisation in the marketplace in relation to its competitors and customers is very important. Below are some of the key areas of analysis regarding markets and customers.

- **Market Size and Potential**

  Existing and potential size of a market is a key element of market analysis. Size will help to determine whether or not to enter a market, the amount of investment which might be required, the long-run profits which might be earned, and possible strategies for growth.
Key Factors for Success

It is important to understand the key factors which underpin success in a market. These can then be compared to the company’s assets and competences.

Market Segmentation

Not all customers are the same, so it is useful to consider markets in terms of segments. For example, that segment of the market which caters for buyers with unlimited resources will differ from that where buyers have a limited budget. Those who cannot afford a Rolls-Royce can still be customers of other car manufacturers. Strategic plans must take into account whether a market segments and if so on what basis. In addition the planner must assess changes in market segments and, in particular, any new segments emerging which may represent future opportunities.

Cost/Value Structure

This element of market analysis is concerned with the relationship between fixed and variable costs in the market; how costs vary with volume, cumulative experience and the main points of value-added and mark-ups and profit margins.

Why Customers Buy

Here we are concerned with understanding the motives of customers and their needs and wants. It is particularly important to establish what the customer values, so that effective competitive strategies can be developed. For example, if customers in a market are predominantly motivated by low prices, then we might consider adopting a low-cost strategy approach. If, in contrast, customers are looking for something that allows them to express their individuality, and are less concerned with low prices, then a strategy of differentiation might be preferred.

When and Where Customers Buy

Establishing the patterns and timing of when customers buy is important. Some markets are highly seasonal, and knowing this can be useful in smoothing sales over the year and planning production and stocking schedules. It is also useful to understand the sorts of outlet and supplier that customers predominantly buy from, and in what quantities. This information is useful in planning distribution and logistics.

Directional Policy Matrices

There are a number of models which look at directional policy and we shall consider three.

(a) The GE Matrix

This model takes account the nature of the market and the capability of the companies within it, and assesses businesses units in terms of the “attractiveness of the industry” and the “business strength” of the company.

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

<table>
<thead>
<tr>
<th>Industry attractiveness</th>
<th>Business strength</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market size (numbers/value)</td>
<td>Differential advantages</td>
</tr>
<tr>
<td>Market diversity</td>
<td>Share (number/value)</td>
</tr>
<tr>
<td>Growth rate (total/segment)</td>
<td>Sales (volume/growth)</td>
</tr>
<tr>
<td>Profitability (total/unit)</td>
<td>Breadth of product line</td>
</tr>
<tr>
<td>Competitors</td>
<td>Mix effectiveness</td>
</tr>
<tr>
<td>Social/legal environment</td>
<td>Innovativeness</td>
</tr>
</tbody>
</table>
On the grid the circles represent overall market sales, and the share held by the company is then shown as a proportion of the circle – see Figure 2.4 overleaf.

Figure 2.4: General Electric Business Matrix

Figure 2.4 shows the characteristics of products in a company’s portfolio. The company has major shares in three markets:

1. Highly attractive market with large overall potential revenue. The company has high business strengths.
2. Market is mid-value but again the company has high business strengths. Overall market income is not high but there is future potential.
3. Market not highly attractive and company strength is low. High share of market may be because competitors have withdrawn. This market may be potentially lucrative in earnings but small in size. Planners may decide therefore to stay and keep out competitors.

Strategic Options

Strategic options for companies on the GE matrix cover three types of management activity. Each strategy covers three of the nine cells, as shown in Figure 2.5 opposite.
**Investment for Growth**

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

**Manage Selectivity for Earnings**

- Strong position in weak market. Company uses marketing to retain loyalty.
- Moderate position in moderate market. Company identifies underserved segment(s) and invests selectively.
- Weak position in attractive market. Company must decide whether to increase investment, concentrate on niche(s), acquire another business or trim off activities.

**Harvest/Divest**

- May decide to minimise marketing activities and concentrate on selected products only.
- Divest products and close down any non-productive business unit.

Profits are "harvested" because investments are minimal.

(b) **The Shell Directional Policy Matrix**

This is similar to the GE matrix, but the variables are "competitive capabilities of the company" and "potential profitability of the market sector". Figure 2.6 illustrates this approach.


**Figure 2.6: Shell Directional Policy Matrix**

<table>
<thead>
<tr>
<th>Prospects For Sector Profitability</th>
<th>Unattractive</th>
<th>Average</th>
<th>Attractive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weak</td>
<td>Disinvest</td>
<td>Phased withdrawal</td>
<td>Double or quit</td>
</tr>
<tr>
<td>Average</td>
<td>Phased withdrawal</td>
<td>Custodial growth</td>
<td>Try harder</td>
</tr>
<tr>
<td>Strong</td>
<td>Cash generation</td>
<td>Growth leader</td>
<td>Leader</td>
</tr>
</tbody>
</table>

(c) **Arthur D Little Strategic Condition Matrix**

This is a more detailed model, having twenty cells to identify various business units. The variables used with this model are "competitive position", which denotes the nature of the position held by the company in the market (and whether or not it can maintain it), and the "stage of industry maturity", which is similar to describing the life cycle of the industry. It is illustrated in Figure 2.7 opposite.
### Figure 2.7: Arthur D Little Strategic Condition Matrix

#### STAGE OF INDUSTRY MATURITY

<table>
<thead>
<tr>
<th></th>
<th>Embryonic</th>
<th>Growth</th>
<th>Mature</th>
<th>Ageing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Competitive Position</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Build barriers.</td>
<td>Aim for cost leadership.</td>
<td>Increase the importance of cost.</td>
<td>Focus</td>
</tr>
<tr>
<td>Favourable</td>
<td>Grow fast.</td>
<td>Lower cost.</td>
<td>Lower costs.</td>
<td>Harvest.</td>
</tr>
<tr>
<td></td>
<td>Attack small firms.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tenable</td>
<td>Grow with the industry.</td>
<td>Focus.</td>
<td>Focus.</td>
<td>Harvest.</td>
</tr>
<tr>
<td></td>
<td>Focus.</td>
<td>Differentiate.</td>
<td>Differentiate.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Defend.</td>
<td>Hit smaller firms.</td>
<td></td>
</tr>
<tr>
<td>Weak</td>
<td>Search for a niche.</td>
<td>Niche or withdraw.</td>
<td>Withdraw.</td>
<td>Withdraw.</td>
</tr>
<tr>
<td></td>
<td>Attempt to catch others.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

It might then have to be accepted that the business should withdraw from the market in a way that minimises the cost and does minimal disruption to the company's overall portfolio.
Study Unit 3
Strategic Analysis 2: The Internal Environment

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INTRODUCTION

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

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

Objectives

After studying this unit, students should be able to:

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

A. RESOURCES, COMPETENCES AND STRATEGIC CAPABILITY

Resources

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

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

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

There is no doubt that an important aspect in developing corporate strategies is the analysis of an organisation's strategic capabilities. These capabilities form the basis of how (or even whether) a company can develop a competitive advantage. Strategic capabilities derive from an organisation's resources and competences; and it is important to understand what these are, how to analyse and evaluate them and, ultimately, how to use this analysis in developing strategies and plans. Amongst the most important concepts in this area are 'threshold capabilities', 'unique resources' and 'core competences'. But first what is meant by competences in the process of strategic planning?

Competences

These are the strengths which lie at the core of an organisation and which give it its competitive edge. When considering the competences of an organisation, it is useful to compare them with those of its competitors.

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

The competence of design, however, belongs to the individual designer rather than to the organisation for which he or she is working at a particular time. Consequently, a designer moving from one organisation to another can cause a change in its competitive position.
When George Davis was working for Next, they developed a good reputation for their clothes design. When he left to go to Asda, there was a related fall in Next's competitive position in the clothes market and an increase in that of Asda's. When he was subsequently reported as considering a move from Asda to Marks and Spencer, there was interest in the likely effect on the position of the latter's clothesware section.

We shall now look at some key concepts which the corporate planner must understand to make full use of the notion of competences.

**Threshold capabilities**

Threshold capabilities are those capabilities which an organisation must have in order to be able to compete in a market and/or pursue a particular strategy. Threshold capabilities comprise 'threshold resources' and 'threshold competences'.

(a) **Threshold Resources**

The notion of threshold resources is based on the idea that in most cases there is a minimum level of resources which an organisation must possess simply in order to survive in the industry, or to pursue a given competitive strategy within it. For example, in many high technology industries competitors must have at least a minimum level of resource capabilities with regard to research and development skills and patent assets. In the UK retail grocery market major competitors must have a minimum level of warehousing and physical distribution resources. In the world car market component suppliers will not survive these days unless they have strong relationships with their customers and therefore a minimum level of relationship resources.

Threshold resources influence strategy choices: a competitive strategy that would otherwise make sense, such as a low-price strategy in a price-sensitive market, may not be feasible for a particular company because it does not have the necessary financial resources.

(b) **Threshold Competences**

Threshold competences are the skills and expertise necessary to deploy resources effectively in a market. Examples of such competences would include design skills, manufacturing expertise, and marketing skills. Again, unless a company has the necessary level of competences to compete in a market or pursue a particular strategy within it, then it should avoid that market or strategy.

In choosing markets and strategies it is thus essential to have the necessary threshold resources and competences.

Assessing threshold capabilities, both resources and competences, is particularly important where an organisation is considering entering a market or choosing how to compete. The organisation can determine whether or not it has the necessary capabilities to survive in the industry/market and, if not, whether these can be readily developed or acquired.

It is also important to note that sometimes both the nature and level of threshold capabilities required to compete in a market can change over time. At one time in the United Kingdom success in the banking industry required large numbers of branches spread throughout the UK. The movement towards internet banking has meant that such resources are no longer as important a factor. In many industries, however, increasing customer aspirations and more powerful competitors often mean that the level of threshold capabilities required tends to rise over time.

Finally it is important to recognise that sometimes capabilities, in terms of both resources and competences, may lie outside of the organisation. For example, a company which has good sources of credit from its suppliers, although not cash-rich itself, might count this supplier credit in assessing its financial resources. We shall consider this aspect of external resources and competences later in the Unit when we look at the notion of 'value networks'.
Unique Resources and Core Competences

Although threshold capabilities are important in selecting markets and strategies they do not necessarily give rise to a competitive advantage. In developing a competitive advantage the notions of 'unique resources' and 'core competences' are essential.

(a) Unique Resources

These are resources which are distinct to an organisation and which no other organisation possesses. Examples of unique resources might be an innovative product or process, or a customer service facility which no other organisation currently offers. In fact unique resources can exist in any of the categories of resources which a company possesses. Where a company has unique resources it is difficult and sometimes impossible for competitors to match these, and so unique resources are the most powerful basis for a long-term sustainable competitive advantage.

In considering using unique resources as a basis for competitive advantage it is important to ensure that the resources identified are difficult to copy, of value to customers, and can be communicated readily to the market place. Although some unique resources can be protected (e.g. patents), eventually most resources of this kind, if successful in the market, will be acquired and/or copied by competitors. The organisation therefore must be constantly seeking to develop new unique resources.

(b) Core Competences

Core competences are those central and unique skills or activities of the organisation which form the basis of its present and future competitive advantage. These competences are what the company does particularly well compared to its competitors. For example, the core competences of Dyson in the home appliance market are in design and innovation. In the electrical tools market the core competences of Black & Decker centre on skills in developing applications for small electric motors. The implication is that organisations should identify and constantly develop those key competences that make them different from their competitors.

As with unique resources, the planner should seek to identify and develop those competences which are relevant to the needs of customers and which are difficult for competitors to imitate.

Strategic Capability

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

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

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

- **Shareholders** in the company are mainly interested in the returns they receive for the money they have invested in terms of dividends paid and increases in share values.
- On the other hand, **financiers**, who have provided funds through loans to the company, are more interested in the risks which these represent as shown by its gearing ratio of debt/equity.
- Those who are **suppliers of goods, services or materials** to the company are mostly concerned about its liquidity and its ability to pay for such items in the short term.
- The company's **employees** are also interested in its liquidity, as this affects its ability to pay salaries.
In addition to these stakeholders, two other groups are interested in the financial status of a company. One of these is the community in which it exists, who are involved in such things as potential donations the company may make to local charities. The other is those who are concerned about its long-term effect on the environment.

B. THE PROCESS OF INTERNAL APPRAISAL

Resource Audit

A resource audit is a suitable starting point for considering the importance of an organisation's internal environment. The audit itself is a highly skilled task and needs to be carried out by an experienced team of researchers. Before the audit, however, managers within the organisation have a role to play, which is to provide:

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

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

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

- **Physical resources**
  These include machines and the production capacity of the business, and embrace the age, condition, capability and location of physical equipment.

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

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

- **Intangible resources**
  The stuff of which the goodwill of the business is made up, which can be a major asset, and may be the result of useful contacts, brand names, the company image, etc.

Analysis of Competences

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

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

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

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

**Analysing Costs**

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

• **Economies of scale** are available through bulk purchasing, as in the case of voluntary chains such as Spar grocery stores.

• **Supply costs**, which can be kept low by strict management of input costs, an example of which is shown by Marks and Spencer's strict control over their suppliers by insisting on being their sole customer.

• **Efficient production** methods, such as mass production as in the motor industry.

• **Experience curves**, which illustrate the rule that over a period of time the costs of production will decrease in relation to the number of units produced, as experience is gained in processes, material purchasing, etc. (see Figure 3.1).

![Figure 3.1: Experience Curve](image)

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

**Comparative Analysis**

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

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

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

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

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

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

We shall look at each of these.

(a) Historical Analysis

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

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

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

It also has the weakness that it does not take account of relevant changes in the external environment within which the company operates, such as slumps in worldwide trade of the magnitude of those experienced after the terrorist attack on America in September 2001.

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

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

(b) Comparison with Industry Norms

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

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

One difficulty in carrying out comparisons between organisations is that of deciding on suitable performance indicators. As with historical analysis, the temptation is to use quantifiable measures, such as sales, profits etc., but these are not always relevant when considering not-for-profit organisations, for example, so there are times when qualitative measures have to be used.
Industry norms are increasingly being used in the public sector, leading to the controversial 'league tables' currently favoured by the government, particularly in the health service and education, but hated by a number of workers within those areas.

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

(c) **Benchmarking**

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

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

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

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

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

**Financial Analysis**

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

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

- **The Balance Sheet**, which shows the current financial position of the company by identifying how it is funded and where precisely the monetary value is located.

- **The Profit and Loss Account**, which gives the details of the amount of profit, or loss, which has been made at various levels within the company.

- **The Operating Costs Statement**, which provides a detailed breakdown of the costs incurred in any activity. Knowing how much cost is incurred enables managers to calculate the percentage of profit (or loss) that each department, or function, is making.

**Balancing the Business**

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

This can be analysed by considering the following aspects:
Strategic Analysis 2: The Internal Environment

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

C. TECHNIQUES FOR CONDUCTING AN INTERNAL APPRAISAL

Value Chain Analysis

A value chain may be defined as:

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

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

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

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

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

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

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

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

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

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

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

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

Figure 3.3 shows an organisation drawing in resources and converting them into goods and services and, in doing so, adding value.
Steps in the process are value enhanced:

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

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

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

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

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

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

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

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

This example is a simple one as it illustrates only one aspect of the complex analysis of the value chain. In practice, competitive advantage is often derived from the links between activities in the chain, since these are more difficult for competitors to copy.

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

Value Networks Analysis

The value chain of the organisation links to:

- the value chains of its suppliers, who will have value chains of their own.
- the value chains of its distributors. For example, B and Q, the do-it-yourself store, provide information leaflets within their stores which show customers how to carry out activities such as wall tiling, and many garden centres supply information leaflets on the care of plants. These form part of the value chain of suppliers in these situations. Similarly an organisation's distributors may add value through, for example, excellent logistics and service back-up

In these ways any given organisation is part of the wider value system which creates a product or a service. The recognition of the importance of the need to assess the wider value system has given rise to the idea of extending value chain analysis to encompass external sources of value and, in particular, relationships with suppliers, distributors, etc. This is known as 'value networks analysis'.

The concept of 'value networks' recognises that very often many of the value-creating activities are, or could be, carried out by other organisations. The 'value network' then recognizes a wider set or network of inter-organisational activities which should be taken into account in assessing value in the context of strategic capabilities. This means that in conducting value analysis it is not sufficient look only at internal activities: rather it is the full network of inter-organisational activities and links which should be assessed, as discussed below.

(a) Identifying the Key Sources of Cost and Value

As already mentioned, value chain analysis identifies five primary and six secondary activities as potential areas of cost and value. The value network enables the corporate planner to analyse the cost and value of these activities both inside the organisation and with respect to the network and links with other organisations.

(b) Identifying Which Activities Are Strategically Important

Once the full network of activities has been analysed with respect to cost and value the planner is able to assess which activities are strategically important and the management of which is therefore central to competitive success and strategic plans. For example, if it is found that R&D is central to competitive success, then it is important that the organisation make sure that these activities are carefully planned and controlled.

(c) Identifying Key Profit Areas

Often certain parts of the value network will be more profitable than others: thus the retail end of the distribution network is often more profitable than manufacturing. Identifying these key profit areas may suggest focusing on them. However, before doing this the planner must ensure that the company possesses, or can develop or acquire, the necessary assets and competences to succeed in these areas of activity.

(d) Make or Buy Decisions

Often a company must decide whether it will undertake an activity itself or pay to have this carried out by another organisation. Where an activity is a key source of cost or value and/or where it is strategically important and/or where it accounts for a disproportionate part of profits would all suggest undertaking this activity in house.
Where this is not the case or when another organisation could simply do it better, would both suggest paying others to carry out the activities.

(e) Selecting and Working with Others

Analysing the value network enables the planner to select the best other organisations to work with and what the best relationships with them might be. For example, if a company identifies that prompt delivery is crucial to competitive success, but it does not have the necessary competences to perform well in this area (i.e. we need to 'buy' this expertise), then we can use value network analysis to identify the best possible partners to perform this activity and how to develop effective working relationships with them.

Overall then we can see that the extension of Porter's value chain analysis to include value-creating activities and relationships outside of the organisation's value network analysis is an important and useful concept in assessing strategic capabilities and strategic options.

Portfolio Analysis

Investors try to maintain a balanced portfolio of investments so that if one company or sector is doing badly it can be offset by others which are doing well at the same time. Similarly companies try to achieve a balanced portfolio of complementary activities, rather than trying to pursue a single product or a single market.

One of the first methods for classifying business units in terms of market growth rate compared with market share was proposed by the Boston Consulting Group (BCG). The BCG growth-share matrix has developed into one that allows a comparison to be made on a relative market share basis (see Figure 3.4).

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

For example:

<table>
<thead>
<tr>
<th>Our Sales £m</th>
<th>Sales of the Top 3 Companies £m</th>
<th>Relative Market Share £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.5</td>
<td>5.22</td>
<td>0.48</td>
</tr>
<tr>
<td>4.0</td>
<td>4.00</td>
<td>1.00</td>
</tr>
<tr>
<td>6.7</td>
<td>6.70</td>
<td>1.37</td>
</tr>
</tbody>
</table>

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

(a) The circles indicate the size of the SBU/product, and the centre of the circle indicates position in the matrix.

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

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

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

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

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

This matrix may be used as a guide to product strategy. The four categories shown in the matrix are:

- **Stars**, where high market share but high market growth forces the supplier to reinvest profits into promotion to maintain market share. These are often products in the growth stage of the life cycle and are not particularly profitable.

- **Cash cows**, where high market share and low market growth minimises promotional expenditure. They are often products in the maturity, saturation or decline stage of the life cycle. High market share guarantees good profitability (except during the saturation stage).

- **Question marks** (sometimes referred to as problem children), where low market share but high market growth forces the supplier to invest heavily in promotion without earning enough profit from sales to cover expenditure. They are often products in the growth stage of the life cycle, but the low market share makes them highly unprofitable.

- **Dogs** may be products that have failed to establish themselves in a mature, saturated or declining market, in which case they are likely to be unprofitable (although promotional costs are small, there are no economies of scale and earnings may not be sufficient to cover costs). Alternatively, they may be products which have established a particular niche in the market. Such products can command a premium price and can be highly profitable. An example would be Morgan sports cars, which have a low market share of the total car market but earn a very satisfactory profit.

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

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

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

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

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

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

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

**Growth-Gain Matrix**

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

![BCG Growth-Gain Matrix](image)

**Figure 3.6: BCG Growth-Gain Matrix**

In this matrix the maximum sustainable growth rate is plotted as a solid vertical line and the weighted average growth rate of the products within the portfolio cannot be greater than this maximum.
Where the weighted average growth rate, sometimes referred to as the 'centre of gravity', lies to the left of the line, there is scope for further growth. The significance of this is that it shows that changes of strategy may be necessary in order that resources are directed to this area so that this potential growth is realised.

**Multifactor Portfolio Matrix**

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

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

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

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

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

![Multifactor Portfolio Matrix Image](image)

**Figure 3.7: Multifactor Portfolio Matrix**

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

The general strategic principles illustrated are:

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

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

The following criteria are used:

(a) **To measure market attractiveness**
   - market size
   - the size of key segments of the market
   - growth rate
   - diversity
   - seasonal demand
   - price sensitivity
   - marketing opportunities
   - competitive structure
   - entry and exit barriers
   - technology
   - availability of necessary workforce
   - environmental issues
   - political and legal issues, etc.

(b) **For competitive position (business strength)**
   - market share
   - organisation (or SBU) growth rate
   - sales force effectiveness
   - depth of product line
   - distribution
   - financial resources
   - marketing effectiveness
   - price
   - experience curve (see below)
   - quality/reliability
   - investment utilisation etc.

**Experience Curves**

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

Considerable research has been carried out to determine the effect of experience rather than time in carrying out manufacturing tasks. The Boston Consulting Group (BCG) have established that important relationships exist between the cumulative experience gained by an organisation and its unit costs, which is referred to as the experience curve, i.e. they found that experience is a key source of cost advantage.
Over a period of time the costs of production will decrease in relation to the number of units produced as experience increases in terms of processes, material purchasing and so on. This was shown previously in Figure 3.1.

**D. INTERPRETING INTERNAL ANALYSIS**

**SWOT Analysis**

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

- its **Strengths**
- its **Weaknesses**
- the **Opportunities** available to it
- the **Threats** it faces.

Hence the acronym SWOT.

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

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

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

![Figure 3.8: SWOT Framework](image)

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

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

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

- An organisation's strengths may include:
  1. the skills and expertise of its management and staff;
  2. organisational factors, such as its responsiveness to change;
  3. access to resources, e.g. availability of cheap capital (perhaps due to government relocation programmes);
  4. its market position.

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

- Weaknesses are, in general, the opposite of strengths and similar factors need to be taken into account. There is, however, a significant difference in that weaknesses can be absolute. Weaknesses should not be considered only in relation to the organisation's competitors, but also with respect to the standards of the industry as a whole. For example, organisations have invested heavily in information technology (IT) in recent times and as a consequence made large cost savings. An overall decline in IT skills throughout industry would result in all companies losing these cost savings and would push up all their costs, resulting in no loss of competitive advantage for any particular company.

- Opportunities arise as a result of environmental factors and environmental changes. Changes in the economic environment, such as a new Finance Act, might create opportunities for the introduction of new savings products, such as ISAs.

- Threats are also the result of changes in the environment. Increases in interest rates (which may have to come sooner rather than later) and a downturn in the economy force banks to make increased provision for bad debts, threatening profitability and capital adequacy.

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

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

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

This strategy was well received by the financial and stock markets, and shares in B and B showed about 50% premiums on their launch price.

**Strategic Fit and SWOT Analysis**

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

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

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

A full SWOT analysis should be carried out whenever considering future corporate objectives and strategies in order that these should reflect the results of such an analysis. A full audit taking account of the SWOT factors should be made at least annually in the planning cycle. Some companies prefer to employ outside consultants, rather than their own staff, to conduct their SWOT analysis so as to get a potentially more objective view, particularly of the company's strengths and weaknesses.

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

**Critical Success Factors (CSFs)**

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

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

Examples of standards which may be used are:

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

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

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

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

CSFs can be important in relation to organisational structure. Ideally, a company should be internally organised in relation to the particular requirements of its business, and not by reference to any historic considerations. Also, any organisational structure may be appropriate for the current phase of development but inappropriate for the following phase, where the CSFs may be significantly different.
Study Unit 4
Strategy Development and the Bases of Strategic Choice

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INTRODUCTION

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

Objectives

After studying this unit, students should be able to:

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

A. STRATEGIC DEVELOPMENT OPTIONS

Nature and Scope of Options

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

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

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

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

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

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

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

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

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

(i) What is the basis of the strategy?
(ii) Which direction is it going to take?
(iii) How will it be carried out?

The development of strategies inevitably involves choice between alternative strategies and hence the need for analysis and decision-making. Although a company's strategic plans are likely to contain dozens of strategic choices, we can identify three major elements of strategic choice in the development of corporate strategies, namely: "What is to be the basis of the strategy?"; "Which direction is it going to take?"; and "How will it be carried out?" These three key elements of strategic choice are discussed below.

The basis of the strategy: Porter's Generic Strategy Model

Essentially this element of strategic choice involves a company deciding how it will compete. The strategy selected should be one which enables a company to achieve and sustain a competitive advantage. One of the best-known frameworks for distinguishing between strategic alternative bases for competing is that proposed by Michael Porter, based on his notion of "generic strategies", which we introduced in Unit 2. Porter identifies three alternative generic strategies: cost leadership, differentiation, and focus.

- **Cost Leadership**
  
  This strategy is based on being the lowest-cost producer. For example the company may pursue economies of scale; or low-cost supplies; basic product designs, and minimum service levels. Such an advantage is difficult to sustain, because competitors often copy these policies, and the advantage is therefore only short-term.

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

- **Differentiation**
  
  This is where a company offers a unique product or service as the basis of its strategy. Some organisations are able to offer something to their customers which enables them to charge more for their products/services, i.e. some added value. This is often associated with brand names that customers feel (not always correctly) are superior; or it may be, for example unique designs or packaging. Some companies differentiate on quality and levels of service.

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

  In order to be successful it is essential that customers value, or can be "persuaded" to value, that which is being used to differentiate the company's offerings from competitors.

- **Focus**
  
  This third alternative strategy is where a company concentrates on catering for a small section of the market and so competes through being specialised. This allows the company to develop in-depth knowledge in a particular area of the market: by concentrating on a small segment of customers the company is better able to meet
their needs. However this strategy can be risky if a larger competitor enters the market or if the market segment goes into decline.

Porter suggests that these are the only three main strategies available, and that a business not following one or other of them is "stuck in the middle". Nevertheless, whichever strategy is followed, it is always vulnerable to changes in the environment which cannot be forecast and over which the organisation has no control.

![Porter's Generic Strategy Model](image)

**Figure 4.1: Porter’s Generic Strategy Model**

**Direction of the Strategy**

This can take several different forms:

- **Withdrawal** from the market, either full or partial, can be the correct direction to take. For instance, withdrawal from the market of those parts of a business which are underachieving will release resources which may then be used more effectively elsewhere.

- **Consolidation** within a growing market is supported by the results shown in the experience curve (Unit 2). In a mature market, consolidation can mean putting more money into the market, as Nestlé have decided to do. In declining markets it can be productive to take over the assets of competitors who are leaving the market, as a means of consolidating the business.

- **Market penetration** means taking advantage of opportunities to increase market share. The ease with which this can be done will depend, as with consolidation, on the current state of the market. If it is a growing market then penetration may be relatively easy, if the market is static it will be much more difficult due to the activities of larger market shareholders. In declining markets the scope for penetration will depend to a large extent on whether or not others are leaving it.

- **Product development** is often carried out by companies in order to cater for changes in consumer demands. For example, over the last few years the UK public's taste in foods has changed greatly, mainly as a consequence of more available travel to foreign countries. This has led to food suppliers having to stock what might have been regarded as quite exotic foods just a short while ago. The other main reason for a company involving itself in product development is where the product has a very short life cycle. The most obvious examples of this are seen in the electronics industry, with rapid developments in television, DVDs etc., and in telecommunications with the continuous changes in mobile telephones.
Market development is often carried out by companies developing new markets whilst trying to maintain their position in their current market(s). One of the ways market development can be achieved is by companies starting to export their goods.

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

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

This form of diversification can occur by:

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

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

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

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

Diversification can bring a number of advantages to a company.

Related diversification can:

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

Unrelated diversification can:

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

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

- Internal development
  By developing products internally rather than using outside agencies, the company can have the advantage of using skills and knowledge acquired during the development in order to market the product more effectively.
  Similarly, developing new markets through the use of internal staff helps the salesforce to better understand the market.

- Acquisition
  One of the advantages of acquisition as a method of carrying out a strategy is that it enables the company to obtain new products or markets very quickly.
  In order to test the effectiveness of acquisition Drucker has suggested five simple rules:
  (i) The acquiring business must consider what value it can add to the acquired business. This may include management, technology, distribution, etc. Finance is necessary but unlikely to be sufficient on its own.
  (ii) A common core of unity must exist between the businesses in terms of markets, products, technology, etc. This helps to create a common culture or at least sympathy between the two separate ones.
  (iii) The acquiring company’s management must understand the business being acquired.
  (iv) The acquiring company must put a quality management team quickly into the acquired business.
  (v) The acquiring business must be able to retain the best management from both businesses.
  As managers will see the acquisition both as a risk (and may therefore leave) and as an opportunity (and will stay), a clear promotion and management development strategy must be in place at the time of the takeover.
  Porter suggested that the rate of acquisition failures is between 60% and 74%, where there is a mismatch between the core competencies or experience of the acquirer and those of the acquired business. The greater the mismatch, the greater the risk of failure.

- Joint development/alliances
  One of the ways that businesses develop is through franchises, where the franchiser is responsible for setting up an outlet (such as "Spudulike" or "Kwik Print") and for marketing, training, etc., and the franchise holder undertakes specific activities such as selling.
  Joint ventures are arrangements between organisations which remain independent but have an equal share in the new organisation. In these arrangements the assets are jointly managed but can be separated.
  We shall look at acquisition and alliances again later in the Unit when we consider strategies for dealing with excessively competitive markets. They will also be discussed in Unit 5 when we consider alternative strategic directions and methods of development.
B. BASIS OF STRATEGIC CHOICE – CORPORATE PURPOSES AND ASPIRATIONS

Any organisation should be able to answer the question:

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

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

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

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

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

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

Ownership Structures

(a) Sole Proprietor (also known as the sole trader)

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

(b) Partnerships

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

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

(c) Private and Public Limited Companies

The Companies Act (1985) differentiated between private limited companies, which must have "Ltd" in their names, and public limited companies, which must include "Plc" in their name. Both types are owned by their shareholders who hold the "equity" in the company, which is why ordinary shares are called "equities". The liability of the shareholders is limited to the value of their shareholding, i.e. the maximum they can lose is what they paid for their shares.
• Shares in private companies can only be traded with the agreement of the shareholders; they cannot be offered to the general public, as can shares in public companies.

• A private company must have at least two shareholders, whereas a public company must have at least seven.

• A private company must have at least one director (two if the company secretary is a director); a public company must have at least two directors.

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

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

(d) Co-operatives

Their structure includes:

• open membership;

• democratic control through a system of one member one vote (regardless of the number of shares held);

• distribution of any surpluses in proportion to purchases – the dividend;

• promotion of education;

• religious and political neutrality.

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

(e) Mutual Societies

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

• A building society's members are those who put money into a share account which pays interest or dividends, or who take out a mortgage with the society.

• Many insurance companies are also mutual societies with their policy-holders being the members.

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

(f) Public Corporations

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

Mission and Strategic Intent

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

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

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

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

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

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

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

**Defining the Business**

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

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

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

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

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

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

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

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

* at corporate level; and
* at competitive level.

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

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

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

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

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

*Bowman's Strategy Clock*

We have already considered Porter's Generic Strategy Model (see Figure 4.1), in which he identified the three generic strategies of competing either through lower costs and prices, or through differentiating the company's products and services to offer customers a higher perceived added value, or competing through focusing on a smaller part of the market.

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

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

In this model Bowman has taken Porter's original idea of generic strategies and has refined and extended them to give a total of eight possible alternative strategies based on different permutations of price and perceived value to customers. These eight permutations are as follows:
Strategy 1: No frills
As the term implies, this strategy is based on products or offerings which have no additional features, design elements, service back up and so on. They represent the most basic of products and therefore the lowest perceived added value. However, this strategy also allows the lowest prices to be charged. This can be a very effective strategy for market segments who are unwilling, or unable, to afford anything but the most basic product or service.

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

Strategy 2: Low price
Some companies seek to obtain a competitive advantage by reducing prices while, at the same time, attempting to maintain the quality offered by others. The major disadvantage of this strategy is that it is easily copied by competitors and can result in price wars. A company needs to be the cost leader, in order to successfully pursue this strategy.
Strategy Development and the Bases of Strategic Choice

- **Strategy 3: Hybrid**
  As the term suggests this is a strategy based on relatively high perceived value but low price. Obviously, this combines two strategies which are likely to give a company a competitive advantage, and is therefore potentially very attractive to customers. However, it is normally a strategy which can only be supported for a short time as margins and profits are too low in the long run for it to be sustainable. A company may follow this strategy with the intention of gaining market share quickly and driving competitors away.

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

- **Strategy 4: Differentiation**
  These strategies are an attempt to offer perceived added value over competitors at a similar, or even higher price, thus giving the company better margins whilst remaining competitive through differentiated products. The key to success for this strategy is that the basis for differentiating the product or service must be of value to the customer and must also be based on sustainable competences which are difficult for competitors to copy or match. In the food sector, a company pursuing this strategy is Waitrose, who convince their customers that paying more means getting better quality. Even frozen chickens are nowadays branded, and some customers claim to be able to tell the difference between competitive brands.

- **Strategy 5: Focused differentiation**
  This is similar to strategy 4, the difference being that the differentiated product or service is offered to a particular group of customers or segment of the market. This enables a company to concentrate on those customers who will value the differentiation being offered and also has the advantage of being potentially easier to protect from would-be competitors. An expanding area which lends itself to this type of differentiation is that of the health and leisure industry.

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

- **Strategy 6: Increased price/standard value**
  At face value this would appear to be a seemingly attractive alternative for a company. In fact, it often leads to ultimate failure. In the short run this strategy can be used where, for example, the customer cannot buy from somewhere else or where they are unaware of a more competitive alternative offer. However, for most companies in the long run this is not a viable strategy, because customers will eventually "see through it".

- **Strategy 7: Increased price/low value**
  This is a variation on strategy 6. It takes increased price and low value to the next level. Needless to say, this strategy is only really feasible for an organisation which has a monopoly, and there are fewer and fewer of these today.

- **Strategy 8: Low value/standard price**
  Although in this strategy prices are lower than in the two previous strategies (6 and 7), so also is the value. Again, this is not a viable strategy in the long term. Many would argue that this is the strategy which led to the demise of the British car industry.

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

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

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

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

**Strategies for Hypercompetitive Markets; Reducing Competition**

In most markets companies face other organisations trying to capture their customers, increase market share, compete for recognition, launch new products first and so on. This constitutes competitive rivalry. The degree of competitive rivalry experienced by most organisations has increased in recent years, with larger numbers of ever more aggressive competitors. In some markets competition can become so intense that they become dysfunctional, with few companies making any profits at all and with large numbers of bankruptcies and company failures. When competitive rivalry reaches this level it is often referred to as "hypercompetition". Such a situation has several disadvantages, as follows:

(a) Excessive competition usually lowers the overall profits of every company in the market.

(b) Excessive competition increases uncertainty and risk with returns being highly volatile and competitors unpredictable.

(c) Customers tend to be less brand-loyal, instead constantly looking for the "best deal" and switching between suppliers.

Because of these adverse effects organisations often pursue strategies designed to reduce this intense rivalry. Four possible strategies for achieving this are discussed below.

- **Increasing barriers to entry**
  Intense competition often occurs when new competitors enter the market. New entrants are usually attracted by the prospect of high profits and or rapid growth in a market. An organisation already active in the market can try to make it difficult for new competitors to enter the market by creating "barriers to entry". There are various ways by which this can be achieved.

  For example an organisation can increase levels of marketing, and particularly advertising /promotional spend, thereby making it difficult for new, often smaller companies to enter the market. Another barrier to entry is the use of patents and new technology whereby a company that developed a new product or technology can prevent new would-be competitors from acquiring the new technology. Aggressive pricing too can also be used to deter potential new entrants to a market.
• **Agreements/strategic alliances**

A second approach to reducing competitive rivalry in a market is for the organisation to seek agreements with other competitors about limiting competition in some way. For example two or more competitors may agree not to compete directly on price. Alternatively they might "agree" not to target each other's customers. Agreements between competitors may take many forms, ranging from the tacit unspoken "understanding" with no formal arrangements, through to highly formalised and structured agreements between competitors such as those when, as discussed earlier in this Unit, competitors form strategic alliances.

Though this approach is to reducing competitive rivalry is widespread it can be a risky strategy, particularly when agreements are with a view to maintaining prices and profits. Price-fixing agreements, cartels, and so on are looked upon unfavourably by legislators in most countries, and by transnational bodies such as the European Union, and companies can find themselves in serious trouble if they are found to be trying to manipulate competitive market structures in this way.

• **Mergers and Acquisitions**

At least some mergers and acquisitions are prompted by a desire to reduce competition (although this is arguably not the best motive for merging with or acquiring a competitor company). This approach to reducing competitive rivalry has the advantages of immediacy and predictability. However, again the main problem is the potential for attracting the attention of the legislator. In many countries there are strict rules governing mergers and acquisitions which appear to be prompted by, or simply result in, reduced competition.

• **Building brand loyalty**

This fourth approach to reducing competitive rivalry is potentially one of the most powerful and effective. A company which can build brand loyalty effectively insures itself against competition. Brand-loyal customers are less likely to switch to competitors' products and services even when tempted by low prices and special offers.

Brand loyalty can be built in many ways including, for example, superior service, superior quality, strong brand image and so on. Building brand loyalty though is a long-term process and can be costly. It is nevertheless a very positive strategy for reducing some of the worst effects of excessive competitive rivalry.

**D. BASIS OF STRATEGIC CHOICE – ENHANCING SBU STRATEGY**

We saw earlier that SBUs are separate entities within an organisation, but at the same time they are a part of the total corporate structure. When we considered the BCG growth-share matrix in Unit 3, we said that an organisation needed to have a balanced portfolio of units, all of which are complementary.

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

We have seen that the various types of SBU each have different characteristics as far as revenue generated and money for investment are concerned. Figure 4.3 indicates the likely cash position placed on a BCG matrix.

![BCG Matrix Diagram](image)

**Figure 4.3: Boston Consultancy Group Matrix**

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

Strategies suggested by the matrix are:

- **Build** – for "question marks" to increase share, even if it means giving up short-term profits.
- **Hold** – for "cash cows" which are strong, to preserve share.
- **Harvest** – for weak "cash cows", where the future is poor, or for "question marks" and "dogs" to increase short-term cash flow regardless of long-term effects.
- **Divest** – to sell off, liquidate or delete an SBU which is a "dog" or "question mark" draining resources.

**Changes in SBU position**

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

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

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

Two are shown as "planned" and two as "forecast". For "planned" positions, strategists will be taking the initiative, whereas for "forecast" positions, defensive or remedial action may be necessary.
The BCG model considers both share and competitive positioning and is easy to understand because of its visual nature. Its main problems are as follows:

- There may be difficulty in plotting information accurately because, unless done by computer modelling, the size of the circles can only be an estimate.
- It is not fair to expect all SBUs to have the same rate of return, market share, etc. Since the point is to assess the position of an SBU and different markets have different growth rates, it is better to plot only one SBU on a BCG matrix.
- If it is used to predict cash usage, valuable SBUs may be allowed to stagnate and die due to lack of investment.
- The model only uses market share and market growth as variables (but companies with a small market share can be highly profitable, e.g. Morgan cars).
- The model ignores environmental factors, which may have an impact on performance.
- Positioning can encourage planners to develop bad habits, e.g. not allowing “cash cows” sufficient funds so that they grow weak, or leaving them too many funds at the expense of others.

**Financial Strategy**

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

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

Stars can therefore both produce revenue and absorb financial resources – which can sometimes mean they break even.
Investment decisions must be based on the future potential of the SBU, with regard to both its product(s) and its market(s).

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

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

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

**The Role of the Parent Company**

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

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

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

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

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

Figure 4.5 illustrates a parenting matrix, such as that of a multinational organisation, where the parent company operates in a number of different regions.
# Study Unit 5

## Strategic Direction and Methods of Development

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INTRODUCTION

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

Objectives

After studying this unit, students should be able to:

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

A. ALTERNATIVE STRATEGIC DIRECTIONS

Growth Strategies – Ansoff’s Product/Market Matrix

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

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

From this basis there are four possible combinations:

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

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

Ansoff’s four strategies are as follows:

(a) Market Penetration

This strategy applies to selling an existing product in an existing market. It is suitable in a growing market which is as yet not saturated.

Penetration of the market can be achieved by:

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

It is often achieved by increasing activity through more intensive distribution, aggressive promotion, pricing, etc.
(b) **Market Development**

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

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

(c) **Product Development**

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

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

(d) **Diversification**

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

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

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

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

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

Risk factor

<table>
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<th>Risk factor</th>
<th>Probability</th>
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<td>Existing product/existing market</td>
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<td>Existing product/new market</td>
<td>2</td>
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Examples of these different strategies can be seen in the following:

- McDonald's are moving more towards younger children by using packaging which is attractive to them and by making toy gifts available with "junior" meals.
- Nestlé are developing new sectors of the coffee-drinking market by introducing decaffeinated Nescafé for those who in the past have avoided drinking caffeine.
- Nescafé are also introducing new brands of their product. They currently offer nine different varieties in instant coffee:
  - Original instant
  - Original instant decaffeinated
  - Gold blend – "smooth and rich"
  - Gold blend decaffeinated
  - Black gold – Colombian coffee offering a "magical mystery" for "nose and palate".
  - Alta Rica – "full bodied".
  - Expresso – "short, dark and intense".
  - Camp Colombie – "smooth and aromatic".
  - Kenjara – "fine and delicate".

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

- Scottish Power for a time adopted a strategy of diversification by going into such areas as financial services, telecoms, and water. It subsequently developed a more coherent strategy around being a US and UK generator and supplier of energy, having discovered that diversification is not always a successful move.

Protect and Build Strategies

Withdrawal

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

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

Withdrawal can also be due to an SBU's position becoming so bad that liquidation, either voluntary or forced, is the only option. For example, the media company Granada, sold its motorway services outlets to Moto when it was having trouble with income from TV advertising.

Similarly, the drug company Boots closed their Japanese outlets, having failed to entice Japanese shoppers to buy their medicines and health and beauty products. They also quit their Dutch loss-making division, while still, insisting they intended to operate an international division, initially through small store-in-store formats in Taiwan and Thailand.
Consolidation
Consolidation implies changes in the way an organisation operates, whilst still retaining the same range of products and markets. The way this is achieved will depend on the state of the market.

In a growing market the organisation has to try to grow with the market in order to maintain its share. Growth in demand in the health services, for example, tends to create great difficulties of funding. One of the ways this is being tackled is by bringing in private funding to what is a public service: for example, by having private companies build hospitals which they then rent back to the NHS, in this way providing capital funds which will then be regained over a long period of time.

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

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

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

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

Development Strategies
Innovation and Product Updates
Creating new products and updating existing ones are strategies which may be used in order to consolidate.

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

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

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

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

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

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

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

Rogers' categories are as follows:

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

Rogers' theory neatly forms a normal distribution curve.

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

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

(a) Consumer attitudes

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

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

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

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

In practice all three systems of demand, – primary, secondary, and psychological – operate all the time with varying degrees of strength, and it is the mixture of relative strengths which the marketer has to be aware of, and match.

(b) Vectoring

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

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

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

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

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

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

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

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

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

- There are serious athletes who want them for uses such as for court play, tennis, badminton or squash. Others may want them for track training or for cross-country or road running.
Some people may see trainers as a fashion item, but this will form a sub-set of each of our identified vectors.

Non-players will also buy our shoes, some because they want to be regarded as players, others who just like them as comfortable shoes.

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

![Figure 5.3: "Trainers" Potential Vector Matrix](image)

**Market Development Strategies**

**New Segments**

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

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

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

**New Territories**

Another source of market development is in entering new territories, for example, new geographical territories. This may or may not be successful. Past failures include Marks and Spencer's attempt to enter the American market through Brooks Brothers, and Boots' retreat from Holland and Japan. On the other hand, in the drinks sector, both Budweiser from the US and Foster's from Australia have successfully entered the UK market for lager, despite European companies having been there much longer.
New Uses

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

Heavier/More Frequent Usage

It may be possible for a company to expand by convincing its customers to use its product more frequently. This type of market expansion can be seen in the cosmetics sector: for example, shampoo manufacturers advocating the frequent use of their products.

Diversification Strategies

Related and Unrelated Diversification

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

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

B. ALTERNATIVE METHODS OF STRATEGY DEVELOPMENT

Internal Development

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

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

This is similar to the "loss leader" strategy used by many supermarkets, where they encourage custom hope to recoup any losses on such offers by selling other products. Few supermarket shoppers find the time to visit a number of stores in order to buy the loss leaders in each of the different outlets – although a store near where I live has found it necessary to limit the number of bottles of "an offer" wine that the local senior citizens are allowed per visit!

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

The advantages of this method of development include:

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

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

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

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

**Mergers and Acquisitions**

In recent years mergers and acquisitions have become increasingly popular as strategic options for organisations.

Mergers may take place in a number of ways, for example by one company acquiring the other company's assets by paying cash or shares or both. In addition mergers may take many forms, from concentric (between firms in the same market) through to conglomerate (between firms in different markets).

Reasons for mergers are likewise varied, but the main causes of mergers are as follows:

- **A Quick Way to Growth**

  For a variety of reasons high rates of growth are popular with strategic planners. Mergers represent one of the quickest possible ways to achieve this growth. Company sales, market share, and asset value, etc can all be increased via merger activity at a speed which would be virtually impossible using organic growth. In times of economic stagnation or recession in particular mergers may represent the only way to achieve growth. Sony and Ericsson are a good example of this reason for merging.

- **Access to Managerial Skills/Resources**

  Many new companies are initially successful because of the entrepreneurial skills of their founders. However, as they grow beyond this initial stage these companies often find that they lack the managerial skills and/or financial and other resources to grow further. Sometimes the only way forward is to seek a merger with a larger partner who can provide these necessary skills and resources.

  A good example of a company looking to acquire the necessary skills and resources through merger was the coming together of Swatch and Mercedes to produce a small, town-based car.

- **Increased Market Share/Market Power**

  One of the most frequent reasons for mergers is to gain market share and thereby increase market power. Normally horizontal mergers are the route for achieving this. Buying market share in this way may be a much cheaper (and, as we saw earlier, a much quicker) route to increasing market share than by alternative methods. There may be several reasons for wanting to increase market share, but a major one is that greater market share leads to greater market power and hence increased levels of profitability. This motive has underpinned the merger strategies of many of the world's automotive manufacturers in recent years.

- **Economies of Scale**

  Another way mergers can lead to higher profits is by reducing costs. Increased size may give rise to economies of scale in manufacturing, purchasing, and marketing.

  Sometimes, unless a company reaches a certain minimum size or "critical mass", it can never hope to compete effectively in the market place. Pharmaceuticals and airlines are examples of industries where there is potential for economies of scale through merger.
Risk Reduction

One motive for pursuing a conglomerate merger strategy (i.e. merging with companies in unrelated product/market areas) can be to reduce market risks. If a company can build a portfolio of disparate businesses it reduces the risks of overall corporate failure by spreading its interests across several markets/industries. Caterpillar and Coca-Cola are both examples of companies who have pursued mergers for this reason.

Synergy

One of the most frequently quoted reasons for mergers is to achieve the benefits of synergy. Put simply, the notion of synergy is that by combining two parts (or businesses) the sum of this combination will be stronger and more effective than the sum of the previously individual parts (or businesses). Virgin is a company that has achieved synergies through merger activity. Synergy is very important in contemporary strategic planning and is therefore considered in more detail in the next section.

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

An example of this strategy was the acquisition, by the consultancy William Mercer, of SCA Consulting, a company with expertise in advising on performance-related remuneration packages. The acquisition increased Mercer's performance measurement practice and hence the range of advice they could offer to companies.

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

The main difference between mergers and acquisitions is that mergers are more likely to come about voluntarily, because each party is trying to increase synergy.

When a company is aiming to increase its product range or enter new markets, acquiring another company already in the field is quicker but more expensive than internal growth. The major difficulty with acquisition is in the integration of the new company with the activities of the old.

The Concept of Synergy

Objectives of Synergy

It is often said that two heads are better than one. In other words, there is an advantage to having more than one person's view when making a decision. This is the basis of the concept of synergy, where a system as a whole is greater than the sum of its parts. This is often illustrated thus:

\[ 2 + 2 = 5 \]

In terms of developing an organisation, this is most readily observed when two companies merge. As we have seen, achieving synergy is often one of the most common reasons for mergers. For example, when an organisation responsible for the production of an item, such as computer hardware, merges with an organisation that markets the product, such as a retail sales outlet, the two companies will be hoping to become more effective and efficient by combining of skills, resources and activities, thereby becoming more profitable. For an effective holistic system to result from such a merger, however, all of its parts need to be contributing synergistically.
In this example the synergy created is described as being positive, but it should also be noted that synergy can sometimes produce a negative result, when

\[ 2 + 2 = 3 \]

Mergers which occur voluntarily usually hope to achieve positive synergistic benefits, such as greater cost-effectiveness, often through combining similar departments and thus reducing the staff payroll. But Porter points out that not all synergy is real; much of what is hoped for and does not materialise. He also points out that bringing SBUs together can cause a negative effect if they compete with one another rather than co-operating, so that negative synergy results.

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

### Synergy and Strategy

- **Synergy and value chain analysis**

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

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

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

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

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

- **Synergy and diversification**

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

  Porter has argued that, in this respect, those organisations which diversify by building on their core business, that is, by related diversification, do better than those which diversify in an unrelated way, i.e. into new products or markets, which bear no obvious relationship to the organisation's current markets or products.

  Such related diversification may be:

  (i) **Backwards**, into activities related to inputs into the current business, i.e. those further back in the value system, such as the provision of basic raw materials;

  (ii) **Forwards**, into activities concerned with the outputs of the business, i.e. further forward in the value system, such as transport or servicing;

  (iii) **Horizontal**, into activities which are competitive with, or directly complementary to, the organisation's current activities, as in the case of a travel agency becoming involved in the provision of transport for clients to a local airport.
Even so, unrelated diversification can result in synergy. Such synergistic benefits are usually based either on financial gains, where cash flow originating from one business is used to develop another, or on the use of managerial skills associated with one successful business to improve another less dynamic one.

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

Areas In Which Synergy Can Occur

These include sales and marketing, operations, investment, personnel, and finance.

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

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

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

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

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

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

Problems With Synergy

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

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

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

In the case of measuring synergy in order to evaluate its effect in a quantifiable way, increased sales, reduced costs, etc. can be measured and used to determine synergistic outcomes. But to forecast these results in advance of diversifications is very difficult, leading, as Porter has said, to much of the hoped-for advantages not being achieved.

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

Joint developments are arrangements whereby one or more organisations set up a newly business units which they jointly own whilst still retaining their individual independence.

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

There is a whole range of ways in which joint developments and strategic alliances are set up, with a spectrum of inter-organisational relationships ranging from very formalised to very loose.

Johnson and Scholes suggest three factors which influence the form of the alliance, namely:
- asset management – the extent to which assets need to be managed jointly;
- asset separability – the extent to which the assets may be separated between the organisations;
- asset appropriability – the extent to which one of the parties involved might appropriate the other assets.

Besides joint ventures other forms of co-operation can include setting up a consortium in order to focus on a particular activity or project. In this arrangement the relationship is likely to be very formalised. Successful formal arrangements include the joint venture between British Aerospace and Aerospatiale of France which resulted in the supersonic aircraft Concorde, and the more recent co-operation between European companies which produced the Airbus. These joint ventures are typified by the need to jointly manage assets, although they can be separated from the parent company without adversely affecting it.

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

Another form of alliance between organisations is that which is simply based on mutual advantage and trust. These types of loose relationship between organisations are often termed network alliances. Although they are essentially informal, such relationships can be highly advantageous to the organisations involved and hence enduring. An example of a network relationship can be found in the airline industry. Here airline companies agree to allow passengers to switch between different airlines although travelling on a particular airline’s ticket. Another example of networks is in the hotel industry, where often hotel groups will undertake to transfer residents to other competitor hotels when their hotels are full.

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

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

Making Strategic Alliances Succeed

We can identify five of the most important factors making for success in strategic alliances.

(a) Commitment and trust: the partners in strategic alliances need to have commitment and trust. In particular they need to be sensitive to the needs of the other parties, particularly where these relationships cross cultures.
(b) **Clear and agreed responsibilities and activities**: more successful strategic alliances usually have clear and agreed organisational arrangements, particularly with regards to responsibilities and allocated activities.

(c) **A desire to learn from other partner(s)**: strategic alliances work better where each party has a desire to learn from the other rather than simply to use the other partner(s) to substitute for lack of resources or competences.

(d) **Flexibility**: strategic alliances are helped by willingness to be flexible on the part of the partners with regard to how the alliance might evolve and change over time.

(e) **Building interpersonal relationships**: strategic alliances work better where the members of the joint development/strategic alliance build strong interpersonal relationships with each other.
# Study Unit 6

## Strategy Evaluation and Selection

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INTRODUCTION

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

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

Objectives

After studying this unit, students should be able to:

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

A. EVALUATION CRITERIA

Suitability

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

It is not enough simply to identify an attractive opportunity. If the strategy is to be successful, it must also be an opportunity for which the organisation is suited, i.e. has the relevant business strengths. This is why strategy evaluation must also consider criteria by which the likely competitive position of the business can be assessed, i.e. it represents the criteria which determine how "easy" it would be to exploit the opportunity – the customer's likelihood of buying what it is you want to offer.

This would involve considering such things as:

- price
- product quality
- distribution
- after-sales service
- reputation
- availability.

By adding a weighting to these factors it is possible to take account of the customer's priorities for these criteria in order to establish the critical success factors.

Acceptability

As Johnson and Scholes ask, “acceptable to whom?” In addition to the customers finding the product or service acceptable, it is also necessary to consider the opinions of the organisation's stakeholders. For example, in the case of a company, what the shareholders expect is an important consideration, and in any organisation it is necessary to keep the workforce "on board" as it is they who can most easily make it difficult for a strategy to succeed if they are opposed to it.

For example, recent British governments have been trying to get private companies to take over activities in the public sector, for example, by involving them in the education service. The unions which represent current workers in the public service sector have opposed this
in the interests of their members, and if the government is unable to gain their co-operation it is unlikely that the strategy will be successful.

Another important dimension in getting a strategy accepted is with respect to the environment. One of the problems experienced by mobile phone companies is the resistance by members of the public to having masts erected near their homes, due to fears about the potential effects on health.

**Feasibility**

The third factor which needs to be considered is whether it is possible to implement the strategy successfully. It must be asked "have we the necessary resources to put this strategy into effect?"

Resources in this context means more than just financial capability, although this, of course, is fundamental. It also requires that the quality of performance is satisfactory, which means that the necessary skills are available within the workforce. Other necessary resources may include:

- technological "know-how";
- availability of materials and machines; and
- other necessary back-up services.

**B. STRATEGIC FIT AND SYNERGY**

It is not only important that a strategy works towards achieving the objectives which an organisation has stated, but also that it does not have an adverse effect on any other of the organisation's activities. A particular strategy must fit in with and relate to all other strategies within the organisation.

This applies at every level, and to every area, but is particularly important at the operational level, where interdepartmental co-operation and liaison are so vital. Strategic options also need to be considered in terms of their cultural fit, i.e. how easily they can be assimilated by the organisation.

In these areas, if there is a difference in fit, then it is the culture of the organisation which should be adjusted to fit the strategy, rather than changing the strategic option to fit the current culture.

We have already described synergy as being achieved where two or more activities combine in such a way that the combined whole is greater than the sum of the parts. Synergy can arise through a shared strategic logic between SBUs. Thus, if two or more SBUs have compatibility with a decentralised contract, and there is an opportunity for each of them to improve by sharing then, as Campbell suggests, strategies based on the exploitation of synergy may be regarded as suitable.

**C. ASSESSING SUITABILITY**

**Establishing Rationale**

(a) **Product Life-Cycle Analysis**

We first studied this in Unit 2, where we saw that a continuous process of external change takes place during a product's life-cycle, ranging from the entry of competitors into the market to changes in consumer attitudes.
Sooner or later, every product loses its appeal and customers stop buying it. The reasons for this decline can include:

- customers' changes in taste;
- the emergence of new designs;
- cheaper (or better) alternatives.

The product life-cycle supplies an important concept in assessing the strengths and weaknesses of an organisation's strategy. In an ideal situation, a company's products would be at different stages in the life-cycle, some just entering, some growing, some at their peak and some declining. This would provide for continuity in the company, and so a strategy which secured this situation would be a preferred option.

(b) Positioning

Recent research shows that changing the status of an organisation, from the public sector to the private sector or vice versa, does not necessarily have a great effect on its performance. There are a number of examples, such as the privatisation of the railways in the UK, which suggest that performance may in fact decline.

The overall conclusion from investigations in the USA into the results of changes in privatisation and also the deregulation of industries is that the establishment of a clear positioning strategy is the most important single issue for organisations as the basis for a sustainable strategy.

(c) Value Chain and Value Network Analysis

Again, referring back to Unit 3, we see that Porter's generic strategy has as its goal the creation of value which is greater than the cost of acquiring it. The difference between the added value and its cost is what Porter describes as "margin".

The function of value chain and value network analysis is to display "total value", which includes value activities and margin. The success of such a strategy in providing this, or not as the case may be, is the means of assessing its suitability for an organisation.

(d) Portfolio Analysis

When we introduced the BCG matrix in Unit 3 we saw how BCG arrived at the conclusion that investment should be channelled into "stars" and those products which could be promoted to star status. An alternate strategy, outlined in Figure 3.5, would be to move "question marks" through "stars" and then on to "cash cows".

What we need to ask is:

- whether this strategy would move the company into a dominant market position.
- Have we sufficient financial resources, made through our "cash cows" to be able to make such an investment?

We have already said that, as a private investor in the stock market seeks to have a balanced portfolio of shares, so an organisation needs to have a balance of activities, in order to allow for "swings" in one area to be offset against the "roundabouts" in another.

A comparison of business strength against industry attractiveness, as shown in Figure 2.6, may be used to give development priorities to the different SBUs by employing a strategy of greater resources being allocated to those SBUs with higher attractiveness that can achieve a strong competitive position.

(e) Business Profile Analysis

The nature of the position held by a company in the market, its competitive position, and whether or not it can hold on to that position within the market, can be compared
with the stage of maturity of the industry in order to suggest the effectiveness of different strategic options.

Such a model is provided by the Arthur D Little strategic condition matrix, illustrated in Figure 6.1. This is in some ways similar to describing a life-cycle for an industry.

What it does not show is the position which occurs when the company's capabilities are very limited and the market does not show any signs of opportunities for improvement.

In this situation it may be that the only strategic option is to cease activities and withdraw from the market in such a way as to minimise both the cost of withdrawal and the disruption to the company's overall portfolio.

<table>
<thead>
<tr>
<th>COMPETITIVE POSITION</th>
<th>STAGE OF INDUSTRY MATURITY</th>
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<tr>
<td></td>
<td>Embryonic</td>
</tr>
<tr>
<td></td>
<td>Build barriers.</td>
</tr>
<tr>
<td>Strong</td>
<td>Grow fast.</td>
</tr>
<tr>
<td></td>
<td>Differentiate.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Favourable</td>
<td>Grow fast.</td>
</tr>
<tr>
<td></td>
<td>Differentiate.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Tenable</td>
<td>Grow with the industry.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Weak</td>
<td>Search for a niche.</td>
</tr>
<tr>
<td></td>
<td>Attempt to catch others.</td>
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</tbody>
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**Figure 6.1: Arthur D Little Strategic Condition Matrix**

(f) **Gap Analysis**

This is a useful tool, both in helping to set realistic objectives and as a basis for identifying the extent to which existing strategies will fail to meet performance objectives in the future.
In a visual form it combines the "where are we now?", (and the "where would we be with no further action?"), with the "where do we want to be?". The gap between these two gives a clear picture to management of what must be achieved – a challenge to become more proactive. When planning at strategic level, it is possible to first throw forward a forecast of desired revenue/profits, and also those which are expected to be obtained from existing products and markets. Often this leaves a shortfall between what is desired and what is believed to be possible.

It is then possible to consider how this gap may be bridged, by pursuing strategic options such as internal growth and diversification.

Figure 6.2 illustrates the concept of the planning gap.

**Figure 6.2: Strategic Planning Gap**

Most planning operations are commenced from the perspective of the marketplace and so the salesforce are the starting point for decisions about the most effective strategy to pursue. Some information has to be put into the planning system for strategic planning in order to produce a first-draft plan, firstly for a function or an SBU and ultimately for the organisation as a whole. If, however, a particular function represents the limiting factor in the planning process, then the initial forecast will be produced there and other functions/SBUs will have to fall in line.

**Advantages of Gap Analysis**

There are a number of advantages from using gap analysis:

- It forces management to be forward-thinking.
- It encourages an analysis to be made of the forces which may either help or hinder the achievement of future objectives.
- It can be used as a dampening device to convert either over-optimistic or over-pessimistic objectives to more realistic ones.
- It encourages management to think about the strategies they can use in order to close gaps; which is probably the most important advantage from a strategic planning point of view.

**Methods of Closing the Gap**

When a gap is forecast, for example, in the company’s profit level, management needs to look for strategies which are likely to close it. These strategies will be related to the reasons for the gap, which might be:
a decline in sales due to obsolete products;
• an increase in production costs due to ageing machinery, or increasing labour costs, or both;
• a change in the needs or demands of the market target.

Once the gaps and the causes of them have been identified then suitable strategies for closing them can be considered. These might include:

• the development of new products;
• reducing costs, by improved efficiency or the replacement of old machinery;
• diversification into new products or markets.

Often it is necessary for a company to use, not just one strategy to close the gap, but a combination of strategies introduced over time and phased in as and when they can be delivered.

Different types of strategy take different times to become effective and have different levels of risk associated with them.

In general, the following can be used as a guide:

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Speed</th>
<th>Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market penetration</td>
<td>Quick</td>
<td>Lower risk</td>
</tr>
<tr>
<td>Market development</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product development</td>
<td>Slow</td>
<td>Higher risk</td>
</tr>
<tr>
<td>Diversification</td>
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</table>

Figure 6.3 illustrates the need to improve a company’s profit level over time.

![Figure 6.3: Alternative Strategies for Closing the Planning Gap](image)
As you can see, gap analysis presentation can be used to help managers think about both the scale of what must be achieved and also the timing of when strategies may start to have an impact on results.

**Limitations of Gap Analysis**

Although gap analysis is a very useful tool for planning future strategies it does have a number of limitations:

- Gap analysis does not of itself show which are the most appropriate ways of closing gaps.
- Gaps are complex to predict.
- Gap analysis cannot allow for sudden and unexpected changes in a company's environment.

Despite these limitations, however, gap analysis has an important part to play in corporate strategic planning. This is due in the main to it forcing management to look to the future and to accept that gaps may occur.

In this way it contributes to improving the process of strategic planning within an organisation.

**Gap Analysis in the Public Sector**

Thus far we have been considering gap analysis as a planning tool in the commercial sector. It can also be used, in a slightly different way, in the public sector.

In this context the strategic problem is often concerned with whether future demands on a public service are likely to change to such an extent that the current provision of resources will be unable to cope. This is a particularly important consideration with respect to the statutory obligations of public services, such as the provision of schools, hospitals and social services.

In order to assess the gaps likely to exist in the future for such provision, information regarding births and deaths statistics, together with likely movements of areas of employment is very important.

**Screening Techniques**

**(a) Ranking**

This is a method of placing an organisation in a "league table", based on a set of factors which are linked to its strategic situation.

The way in which the key factors are arrived at is an important influence on the positions allocated in the league. Whether they are simple, quantitative measures, such as market share, or are weighted according to the opinion that they are more important than other factors, is a question providing opportunities for disagreement about the position a particular organisation fills. The system does have the benefit, however, of drawing attention to mismatches between a ranking position and the different strategic options an organisation can adopt.

Much controversy has been raised with respect to the league tables produced for schools, in particular in the secondary sector. Arguments about the unfairness of basing the list on examination results without regard for the environment of the school and its catchment area abound, and many would argue that the factors used in the assessment are inadequate.

**(b) Decision Trees**

These can help managers when they are faced with tactical decisions on such matters as spending money on researching an opportunity. Such a model helps the manager
to review the options objectively and to decide the cost/benefit of more research, or to compare the alternative strategies in terms of their risk and potential losses.

The key point is to identify the ways forward and assign a quantitative value to each option to indicate the likelihood of it occurring.

The decision tree is a pictorial method for displaying information and is a tool used as a basis of probability theory. Using a decision tree it is possible to predict the effect of different strategies, and this enables eventualities to be identified and consequences forecast, before quantification is applied.

For example, we can show the sequence of events involved in an investment decision. Figure 6.4 illustrates an organisation trying to assess the likely costs and benefits of investing in a major computing program.

![Decision Tree](image)

**Figure 6.4: Decision Tree**

Each activity on the tree is assigned a mathematical probability of its occurring. In our example, the cost of developing a new program from base now is £100,000. We assess the likelihood of success in developing the program as 0.6. Therefore the cost will be £100,000 multiplied by 0.6, or £60,000. If the development fails, the cost will be £100,000 × 0.4 or £40,000.

Decision trees are widely used in operational decision-making, but they can equally be used in formulating strategies.

They help by ensuring that the problem is approached in a structured way and by forcing the decision-makers to look at all the possible outcomes.

Decision trees do not improve the quality of guesses and estimates, but they encourage logical thinking with respect to strategic option selection.

(c) Scenario Building

Scenario building was discussed in Unit 2. We saw that in assessing and forecasting the environment a researcher can create a series of alternative futures or scenarios; and we assessed this use of scenario analysis in the context of assessing and
forecasting the environment. However scenario analysis can also be used to screen different strategic options by matching them to these possible future scenarios.

This method differs from ranking and decision trees in that it does not provide a prioritised list of options but instead gives a series of contingency plans which will identify the preferred option for each of the possible scenarios.

Future scenarios of an organisation's environment in, say, 5+ years' time, can be drawn up by means of PESTL analysis (see Unit 2). These scenarios can then be used to evaluate possible future strategies by matching them to one another.

Because this method provides a series of suitable contingency plans, rather than just a number of different options, it is particularly useful in times of greatest uncertainty.

Each possible future scenario can then have associated with it a number of plans, so that, whichever scenario ultimately becomes closest to the actual environment at some future point in time, the most suitable strategy can be used.

D. ASSESSING ACCEPTABILITY

Analysing Return

In order to decide upon which strategy to employ, we need to know what sort of return we are likely to get from each.

Ways of assessing returns include the following three methods:

- **Profitability Analysis**

  Precisely how to measure profitability is open to debate. However, the three levels of profit, (i.e. trading (or operating) profit, pre-tax profit, and profit after tax) can all be used as the "output".

  For investment, the usual terms are total assets, net worth, equity capital, the number of shares or the market value of the company. The most suitable financial objective, according to most people is "return on investment" (ROI), or "return on capital employed" (ROCE), or "return on equity" (ROE).

  In the UK, company accounts are most likely to show "earnings per share", and often some other measure of profitability such as "payback period", which is found by finding the time at which the cumulative net cash flow is zero, i.e. when cash flow into the company is equal to that put in to start a new process or venture.

- **Cost/Benefit Analysis**

  This attempts to go beyond just a measurement of financial profit to include other returns, tangible and intangible, both to the organisation making the strategic choice and to others who may benefit from it. For example, a local authority may invest money in the building of a bypass road, which will reduce expensive repair work to, say, an ancient bridge, and so create a financial gain for the authority, whilst also benefiting those whose quality of life is improved by the removal of a large amount of traffic from their neighbourhood.

  The financial value of these intangible advantages is always difficult to measure but, despite this problem, cost/benefit analysis is useful, since it encourages decision-makers to consider all the factors which should be taken into account when making a strategic choice.

- **Shareholder Value Analysis**

  Increasingly it is suggested that perhaps the most relevant way of assessing and evaluating alternative strategies is by analysing shareholder value.
The reasons for this are essentially based on the assumption that, in a market economy, shareholders invest in organisations in order to reap financial returns. Without the investment of shareholders the plc organisation would not exist. In addition, it is argued, the best measure of how effectively an organisation is using economic resources, including shareholder investments, is the return on these resources. In other words, the arguments for using shareholder value as the main measure for the evaluation of strategic options is an economic one based on the view that this represents the best measure of the use of scarce resources in an economy and the principal reason for shareholder investment.

It is the case, of course, that if a company does not satisfy its shareholders' financial expectations, it will in the long run cease to be viable. Therefore an organisation must attempt to enhance its ability to generate returns from the operation of its businesses and to attract additional funds needed by debt or equity financing. Obtaining equity financing in particular depends on the expectations of investors with regard to the firm's ability to generate returns on their investments. Understandably, shareholders willingly invest in a company only when they expect a better return on their funds than they could get from other opportunities with a similar degree of risk. Therefore, it is suggested, a company should pursue business strategies that will produce future returns at least sufficient to satisfy shareholders but preferably to maximise value to such shareholders. A company which does not maximise shareholder value will find that its share price is depressed and it will be unable to attract investment to fund future operations and growth. It also may render the company more vulnerable to takeovers by other companies who promise to give greater value to shareholders. Shareholder value analysis, it is argued, should be the only way of evaluating and selecting between different strategic options. This why many companies now set explicit objectives for enhancing shareholder value.

(a) Measuring Shareholder Value

Amongst the most common ways of expressing and hence measuring shareholder value are the relatively simple ones of:

- return on shareholder equity
- increase in share price
- earnings per share.

These are readily understood by most investors and managers, are widely accepted as measures of shareholder performance, and are relatively easily measured.

(b) Market Value Added (MVA)

Recently some companies have been measuring shareholder value in terms of what is often termed "market value added" or MVA. A company's MVA is calculated by combining its debt and the market value of its shares and then subtracting the capital that has been invested in the company. The result shows how much wealth the company has created. Obviously the greater the positive value of this calculation, the greater the value to the shareholder. MVA represents one of the more recent ways of evaluating different strategic options.

(c) Limitations of Shareholder Value

Whilst there is no doubt that it is important and useful to use shareholder value in evaluating alternative strategic options, there are distinct dangers in using this as the single or even overriding means of evaluating and selecting between strategies.
The first danger relates not so much to the actual use of shareholder value but rather to the dangers of using this as the only way of evaluating and choosing between strategic options. The reason for this is that (as we shall see later in the Unit) most companies pursue not just profit but often several other objectives. So using only shareholder value to evaluate strategies may lead to neglecting other important measures of strategic options, such as those which relate to market share, market leadership, and innovation. Only using shareholder value analysis, then, is a somewhat limited and myopic view of what constitutes strategic success.

Related to this is the fact that, although shareholders are extremely important to a company, there are other parties whose interests must also be considered. It is important to consider other “stakeholders” in an organisation. Managers have responsibilities to several groups who have an interest in and/or are affected by the organisation, including customers, suppliers, distributors, the local community, employees, etc. Concentrating only on shareholder value may lead the planner to neglect strategies which provide value to the wider range of stakeholders in a company.

### Analysing Risk

Risk describes a situation in which there are a number of different possible strategies involved and a number of possible outcomes which may result from a particular strategic choice. The likely return from a particular choice is a measure of its acceptability. However, all strategies involve some degree of risk. It is therefore essential, in assessing and evaluating between a range of strategic options, to assess the risk associated with a particular strategy. This is particularly the case where strategies involve long-term commitments, as they so often do, and/or high levels of investment, and particularly where these conditions are associated with high degrees of uncertainty as in the cases of new products or diversification into new markets. Going ahead without considering the probable effects of a choice is a gamble, and management should not be engaged in gambling. Instead they should be involved in risk containment.

Two of the best known product/market opportunities matrices which give a probable risk ranking are:

- Ward’s 16-cell matrix (Figure 6.5) and
- Shell’s direction policy matrix (Figure 6.6).
<table>
<thead>
<tr>
<th>NEWNESS OF MARKET</th>
<th>NEWNESS OF PRODUCT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Same product</td>
</tr>
<tr>
<td>Same market</td>
<td>1</td>
</tr>
<tr>
<td>Better market coverage</td>
<td>2</td>
</tr>
<tr>
<td>New coverage but in related areas</td>
<td>4</td>
</tr>
<tr>
<td>Totally new market</td>
<td>8</td>
</tr>
</tbody>
</table>

**Figure 6.5: Ward’s 16-cell Matrix**

In this matrix the numbers in the cell indicate the degree of risk associated with each alternative.

<table>
<thead>
<tr>
<th>COMPANY COMPETITIVE CAPABILITY</th>
<th>BUSINESS SECTOR PROSPECTS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unattractive</td>
</tr>
<tr>
<td>Weak</td>
<td>DISINVEST</td>
</tr>
<tr>
<td>Average</td>
<td>PHASED WITHDRAWAL</td>
</tr>
<tr>
<td>Strong</td>
<td>CASH GENERATION</td>
</tr>
</tbody>
</table>

**Figure 6.6: Shell Directional Policy Matrix**

Three further techniques for analysing and assessing the risk associated with strategies are financial ratio projections, sensitivity analysis and simulation modelling.

**Financial Ratio Projections**

Usually strategies affect the capital structure of a company. Financial ratio projections are an attempt to assess the effect of a strategy on the key elements of a company’s financial structure. These projected effects can then be assessed with regard to the degree of risk that they entail for the company. Various aspects of a company’s financial structure can be assessed in such an exercise.
First of all, the strategic planner can make an assessment of the effects of a particular strategy on the overall capital structure of a company. For example, a strategy can be assessed with regard to its effect on the capital gearing of an organisation. This might be particularly important where a strategy has a major impact in this area, such as where the strategy would require an increase in long-term loans which would raise the gearing of the company. Parallel with this assessment of the effect on capital structure, techniques such as breakeven analysis can be used to assess the extent to which the company is likely to generate enough profits to service any increased debt liability.

In addition to examining the overall capital structure of a company, the strategic planner can also look at more specific financial impacts of proposed strategies: for example, another area where it might be useful to assess the financial risks associated with a strategy would be to examine its effect on liquidity. Where a strategy involves the use of substantial cash resources, this may seriously affect the liquidity position of a company, which obviously increases risk. Using financial ratio projections to assess the degree of risk associated with specific strategic options is therefore useful. However, the major difficulty with this approach to analysing risk is that it can be difficult to be sure about future financial projections. Given that strategies involve the future, and that the future itself is uncertain, it can be difficult to obtain accurate financial projections.

(b) Sensitivity Analysis

Sensitivity analysis as an approach to assessing risks involves identifying the important critical assumptions which underpin a strategy and its projected outcomes. These critical assumptions can then be challenged in the form of "what if?" questions. Sensitivity analysis is a technique for assessing risk which is used in modelling to determine which outcomes are sensitive, i.e. subject to change, in response to particular inputs. It is widely used now because of the availability of computer spreadsheet packages which facilitate this kind of analysis.

For example, let us assume that a particular strategy is projected to give a return on capital of 15% per annum over a five-year period, based on the assumption that exchange rates will be stable over this period. The strategic planner can then assess what might happen to these projected returns if this underpinning assumption proved to be incorrect and exchange rates were unstable. A variety of alternative exchange rates could be presumed and the effect on projected rates of return assessed. The planner can then assess the extent to which the initial assumption is likely to be realistic and the extent to which there is a risk of alternative outcomes. In this way the planner can consider the range of possible outcomes associated with pursuing a particular strategy as assumptions change.

In practice, it needs the intervention of a manager to identify a particular input and amend it in a pre-planned way, at the same time trying to maintain the levels of all the other variables.

Allowance does have to be made for changes in the other variables and for their effect on the result. The basic questions which have to be answered are:

- How was the result achieved affected by the planned input change?
- How was it affected by the uncontrolled variable changes?

This approach is useful in helping to focus the mind of the planner on identifying and making explicit any assumptions which are being made. Sensitivity analysis can also be used to prepare contingency plans with regard to alternative strategies should assumptions prove not to be accurate.
The problem with sensitivity analysis is that it can lead to a proliferation of alternative strategies, each based on different assumptions. This in turn can result in information overload for the planner and difficulties in arriving at definitive conclusions on which to base decisions.

(c) Simulation Modelling

Simulation modelling is an approach to assessing risk which attempts to simulate all the future conditions which might affect the outcomes of strategies. A simulation model might attempt to project information and forecasts about the future environment, levels of investment and commitment with regard to particular strategies on the part of the company, as well as competitor reactions. Simulation modelling is an attempt to take into account every possible factor which could affect the outcome of a strategic approach. As such, no truly complete simulation models exist in strategic planning. If nothing else, the amount of information required to build such a model is simply too great. However, partial models of strategy simulation which enable the strategic planner to at least predict some of the outcomes associated with strategies and therefore to begin to evaluate risk do exist. One such is the so-called PIMS model, which we shall look at in some detail.

Profit Impact on Market Strategy (PIMS)

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

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

- **Forecasting profits**: often these are just projections of local experience but, when market conditions are likely to change, or when a new strategy is envisaged, how reliable is past history as a predictive guide?

- **Allocating resources**: requests for capital from different divisions usually exceed the size of the pot. The question then is “which products and markets are likely to give the best returns?” Estimates from divisional representatives can be unreliable, since they have a vested interest.

- **Measuring management performance**: corporate management would welcome a way of determining what level of return on investment (ROI) is reasonable or normal for different SBUs under given circumstances.

- **Appraising new business proposals**: when considering a new development or acquisition corporate management would appreciate some method of estimating ROI.

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

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

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

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

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

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

The main purpose of the model, or programme, is to get companies to look at the outcomes of strategies pursued by others when faced with similar situations/conditions. The essence of PIMS is to use empirical evidence to establish which strategies are associated with higher levels of profitability in an industry and thereby to direct managers in these industries towards better (more profitable) courses of action.

Some of the basic questions that PIMS seeks to answer include:
- What is the typical profit rate for each type of business?
- Given current strategies in a company, what are future operating results likely to be?
- What strategies are likely to help improve future operating results?

The company must subscribe to the PIMS project and provide detailed information about, for example, competitors and markets, finances, and assumptions about future sales, costs, and strategies. This information is then compared with the PIMS database. The following series of reports is then prepared for the subscribing company:

(i) A par report showing the ROI and cash flows that are "normal" for this type of business given its market, competition, technology, and cost structure. Also included is an analysis of strengths and weaknesses that are regarded as explaining high or low par figures compared to other businesses in the database.

(ii) A strategy analysis report which computes the predicted consequences of each of several alternative strategic actions, judged by information on similar businesses making similar moves, from a similar starting point and in a similar business environment.

(iii) A report on lookalikes (ROLA) which examines possible tactics for achieving strategic objectives, such as an increase in market share, by analysing strategically similar businesses more closely.

(iv) An optimum strategy report, which is aimed at predicting the best combination of strategies for that particular company, again based on the experiences of other businesses in "similar" circumstances.

There are many advantages to a business using PIMS. Not only can the management assess the likely outcome of its proposed strategies, but also it can identify those strategies that would yield the highest return on investment.

**Limitations of PIMS**

If this is the case, then why does not every company subscribe to PIMS for its strategic planning? There are a number of reasons why not every company can or will subscribe: The service is expensive, and supplying all the information required is costly and time-consuming. The process itself has its limitations:
- PIMS data is historical and may be misleading in conditions of rapid change.
The underlying assumptions of the PIMS model are not clarified and, therefore, must be taken on trust.

The statistical basis of PIMS can give rise to problems of interpretation and understanding:

PIMS is very useful, but it is important when using any model to realise it these is intended to aid management, not to replace it.

E. ASSESSING FEASIBILITY

Funds Flow Analysis
In order to assess the feasibility of a particular strategic option, it is essential to find out whether the necessary resources are available to support it.

This can be done by assessing the cost of implementing the option and then the likely sources of the funding required.

The implementation costs are made up of any capital investment necessary, plus any necessary increases in working capital, such as increases in stock, which are associated with the new strategy. Other payments which will have to be made in respect of the new operation, such as tax liability and payment of dividends to shareholders, also need to be estimated.

The future expected profits to be made from the operation are then estimated. After deductions due to the writing down of capital assets, etc. are made, the expected flow of funds into the company over the period considered will be established. Any shortfall between the anticipated costs of introducing the strategy and the profits to be made from so doing will then have to be covered. This requires looking to sources such as bank overdraft or trade credit for short-term finance and to lines of credit, such as medium-term loans or industrial hire purchase, for buying necessary plant or machinery. Extra finance may also be raised by issuing new shares.

Breakeven Analysis
This may be used to discover at what level of sales revenue all costs of production have been met – the break-even point, or just breakeven – after which all future sales contribute to profit.

In forecasting profit, the amount by which revenue is expected to exceed breakeven is termed the "margin of safety", i.e. the forecast can be wrong by that amount without the operation showing a loss.

Breakeven is reached when revenue is equal to variable + fixed costs.

\[
\text{B/E volume} = \frac{\text{Fixed costs}}{(\text{Revenue} - \text{Variable costs})/\text{Units sold}}
\]

Thus, if a company has fixed costs of £10,000, variable costs of £15,000 and sells 5,000 units for £30,000, the B/E volume (in unit terms) is:

\[
\frac{10,000}{(30,000 - 15,000)/5,000} = 3,333 \text{ units}
\]

Once the fixed and variable costs are known, a sales price fixed and a sales forecast made, a breakeven chart can be plotted, as in Figure 6.7.
Figure 6.7: Breakeven Chart – Fixed Costs Plotted First

Figure 6.7 shows fixed costs as a horizontal, with variable costs, in strict relationship to sales volume, as a curve above. Breakeven (B/E) is shown by the meeting of the revenue and total cost curves. Revenue is the number of units sold at the price determined.

Figure 6.8 shows the same information, but variable cost has been plotted first. It is this form of the graph which is most widely accepted.

Figure 6.8: Breakeven Chart – Variable Costs Plotted First

Breakeven analysis has a wide application and can be used to determine:

- whether sufficient market penetration can be achieved to reach viability;
- whether costs and quality assumed are achievable;
- whether sufficient funding is available to meet necessary costs.

Resource Deployment Analysis

This is a method for considering all the resources needed to put a particular option into being, rather than just a consideration of necessary financial resources. It is carried out by tabling resources, such as machines, personnel, finance and any other relevant necessary input, for a number of different options in order to assess the most likely option to be successful.
The strength of such an analysis lies in identifying necessary changes in resources needed for any particular option and deciding whether such a change is feasible.

**Return on Capital Employed**

A frequently used method for evaluating alternative strategies is that of comparing forecast profit levels with the investment required for the implementation of each strategy and expressing this as a percentage return on capital employed (or ROCE). This method allows us to rank alternative strategies in an objective way with respect to profitability.

In order to carry out this analysis we need to be able to identify both the costs and the revenues associated with each individual strategy. This is sometimes difficult because of interaction with other parts of the business. It can also be difficult to accurately forecast future costs, and particularly future revenues over the lifetime of a strategy.

In general, planners tend to underestimate costs, a habit which seems particularly true in civil engineering activities, where the final cost of roadworks or a public building is often several times the original estimate.

For this reason it is useful to prepare a range of anticipated ROCE calculations, from optimistic through to pessimistic.

By plotting a graph of % ROCE against time, it is possible to forecast the return on capital employed at a specific time after a new strategy is implemented (see Figure 6.9).

In this example, the new strategy will result in a return on capital of 15% by 2005.

![Figure 6.9: Return on Capital Employed](image)

**Payback Period**

Although ROCE gives us a direct way of comparing the overall profitability of different strategies, it does not allow for some strategies taking longer than others to recover the initial investment. One way of calculating this is by estimating how long it will take to recover the initial investment by means of a particular strategy.

The payback period is calculated by finding the time at which the cumulative net cash flow becomes zero (see Figure 6.10). In this example, the payback period would be 3½ years. If a company is considering whether to use one strategy as opposed to another, then the one with the shortest payback time is likely to appear more attractive.

However, this is only one factor in a complex situation, and would only be the deciding factor if the evidence showed that the payback was earlier when the original investment in any potential strategy was the same and the actual return over the lifetime of each of the
strategies was also equal. In practice, the choice is seldom that simple, so payback period cannot be used as an indicator of profitability on its own.

![Figure 6.10: Payback Period]

**Discounted Cash Flow Analysis**

This is an extension of the payback period analysis, but, unlike payback, discounted cash flow (DCF) analysis takes account of income to be received in the future.

DCF is probably the most widely used investment appraisal technique, since it indicates the likely profitability of an investment over its lifetime. It takes into account that income received in the future is, in real terms, not worth as much as income received today, i.e. funds generated early in the life of a strategy are of greater value than those generated later.

Once the net cash flows have been assessed for each of the preceding years, they are discounted progressively to allow for the later income becoming worth progressively less. Normally, the discounting rate is based on the current value placed on money invested in the strategy, and this factor is applied to future annual cash flow forecasts over the lifetime of the strategy. The cash flow is thus discounted progressively and is then totalled in order to obtain the net present value (NPV) of the project.

Most computer spreadsheet packages now include NPV and also the internal rate of return (IRR), and these functions make it possible to carry out DCF calculations.

**Cost/Benefit Analysis**

There are occasions when measuring profitability for a particular strategy does not take account of all the implications of a particular selection.

For example, important strategic decisions, such as where to site a new London airport, or whether or not to construct an out-of-town shopping mall, can have a considerable effect on a community's environment, or on existing businesses, and these cannot be measured just in terms of financial evaluation. Cost/benefit analysis involves placing a financial value on all the costs and benefits of alternative strategies, including the effects on people's lives of increased traffic congestion and noise pollution.

Its advantage is that it forces planners to look beyond the obvious costs and benefits of a particular strategy and to consider the wider implications.
Unfortunately, many of these wider implications cannot be assessed objectively by means of the kinds of financial analysis we have been considering, and thus the decisions become subjective. Despite this weakness, cost/benefit analysis provides an extra tool for evaluating the effect of strategic planning.

F. SELECTION OF STRATEGIES

**Planned Strategy**

Mintzberg describes a planned strategy as one where the leaders at the centre of authority draw up a plan, having described their intentions as precisely as possible, and then work hard in order that the planned strategy is implemented with as little change as possible. Since the plan is of no use unless it can be carried out in the organisation's environment, a planned strategy is found only in an environment which, if not benign or controllable, is at least predictable.

Galbraith says some organisations, which he describes as the "new industrial states", are sufficiently powerful to impose their plans on their environment. Others are able to predict their environments with sufficient accuracy as to be able to follow planned strategies.

**Enforced Selection**

Strategies may be forced on organisations by groups outside the organisation, such as government, trade unions, etc. Whether this enforcement is in the form of direct regulation, or the competition of government-supported businesses, or the various conditions for accepting government aid or contracts, the result is that many aspects of strategy are imposed. Strong unions, through collective bargaining, may also be able to impose decisions on management, as may various pressure groups who can force changes to policies and strategies. Examples of these types of enforcement include:

- **Government aid** to development areas, which encourage companies to set up factories in areas of unemployment.
- **Pressure groups** demanding reduction in the tax on petrol, who nearly brought the UK to a halt by picketing storage depots.

**Learning from Experience**

Where there are considerable uncertainties about the future, many organisations try to "sit on the fence" when the selection of a strategic option has to be made. In some sectors, such as manufacturing industries, it is difficult to delay choosing a preferred option, so companies have to make a decision one way or the other.

In others sectors, such as service organisations, it is easier to make deferred choices and to leave a final choice until later. This gives the organisation the opportunity to learn by experience in order to make a more informed final choice at a later date.

Some retailing companies adopt a policy of trying out new strategies, fashions, methods of distribution, improved shopping facilities, etc. by putting them into flagship stores in the first instance in order to assess their impact, and then introducing them into all their stores if the strategy works out.

**Command**

Fayol was one of the first persons to sit down and work out what the role of management is. In his "elements" of management he listed "command". What he intended it to mean was the way in which management makes sure that things get done, i.e. that the operations of the
organisation are carried out. In order to be in command it is necessary to have power, and in organisations this can be based on a number of factors.

For example, in an operation heavily dependent on computers, those who can repair the machines or put right the software programs when the computers are "down" can wield a large amount of power.

In selecting a strategy, power is also an important factor and the ultimate power is to be able to command that a certain strategy is selected.

The situations where this is possible are limited in general to sole proprietors and to very charismatic leaders, such as Sir Richard Branson.

**G. SELECTION OF MISSION STATEMENTS AND KEY OBJECTIVES**

*Mission Statements*

We considered an organisation's mission statement in Unit 1, when we saw that it sets out the overall reasons why the organisation exists.

In strategic planning and decision-making, the role of the strategic mission includes stating the scope and boundaries of the organisation. It is important that members of the organisation fully support its mission; if they do not, real problems can arise in respect of the strategic direction the organisation is trying to pursue.

The mission statement of any organisation needs to take account of the following points:

- It should be **general in its content** so that it covers the organisation's reasons for existence.
- It should be **visionary**, and likely to last for a long time, so that strategies which are developed in order to fulfil it are capable of being changed over time, as necessary.
- It should describe the **position the organisation hopes to attain** in its sector.
- It should **state the key values of the organisation**, taking account of the expectations and values of its stakeholders.
- It should be such that the organisation has both the intention and the capability of living up to it.

The importance of the organisation's mission statement is that it gives out information to its stakeholders about its intentions and what it is hoping to achieve.

In terms of strategic planning and thinking, the mission statement helps to direct planners towards specific organisational objectives, policies and strategies.

Organisations can use their mission statement to explain what they are all about, in terms of their products/services, customer needs, geographical scope, etc., and in this way to determine their strategic direction.

Mission statements should encompass the whole of an organisation and its overall purpose. They are influenced by many factors., amongst the most important of which are the following:

- Mission statements are affected by the values of senior management. Thus senior managers who are more socially responsible in their values will reflect this in their company mission statements.
- In addition to management values, mission statements will be affected by stakeholder values including, for example, shareholders, employees, suppliers and so on. Exactly
how and to what extent these stakeholder values are reflected in mission statements will be affected by the relative power of the different stakeholder groups.

- Mission statements are often affected by, and need to reflect, legal and regulatory requirements, for example with regard to dealing with customers.
- Mission statements also need to reflect the ethical values of the society/culture in which the organisation operates.
- Finally, mission statements are affected by corporate governance arrangements. These determine to a large extent whom the organisation is there to serve and how the priorities between different and often conflicting groups should be decided. Corporate governance arrangements are closely related to the stakeholder and legal and regulatory factors previously described, and vary according to the nature of the organisation, e.g. whether profit-making or voluntary.

Mission statements are an important aspect of organisational functioning and particularly of strategic planning in the contemporary organisation. They serve a number of purposes pertaining to the overall direction and purposes of an organisation and, if effectively formulated, serve to resolve issues pertaining to the strategic direction which an organisation takes.

Mission, say Johnson and Scholes, should be a very important influence on strategy because it:

- may concentrate employees' perception of their operation on the needs of their customers and the utility of the service; and also
- set the boundaries within which they see the business developing.

Thus, mission statements are related to focusing strategy rather than deciding when it has been achieved.

**Strategic Vision**

Strategic vision is an important addition to a strategic mission, in that it looks to the future state of the organisation. A clear strategic vision enables an organisation to remain focused over a period of time and protects it from strategic drift (discussed in Unit 1).

Having a challenging strategic vision, such as becoming a market leader in a particular dimension, helps to keep a company on course and therefore successful. Strategic vision acts as a motivating factor for employees and also as a means of strategy selection.

**Key Objectives**

Key corporate objectives represent a precise statement of an organisation's goals and are formulated by senior management. They are often, though not always, expressed in financial terms, such as profit levels, sales target figures or share values, i.e. they tend to be quantified. They are an expression of how the organisation proposes to meet its stakeholders' expectations.

Objectives can be of two types:

- **Closed objectives**, which are capable of being achieved at some time in the future: for example, "we aim to supply a million telecommunications services to customers by the end of 2010".
- **Open objectives**, which can never be finally achieved, since they will always persist: for example, "to build a strong future out of our opportunities".

Johnson and Scholes argue that, contrary to some other opinions, both closed and open objectives can be useful. Closed objectives have a particular part to play in some scenarios,
such as when a business hits a crisis. If a turnaround situation develops, where the choice is between the business either going under or surviving, then specific objectives are essential.

Closed objectives are also helpful for planning purposes, since the objective in this case becomes a target to be achieved. For example, financial objectives such as profitability are useful for judging the success, or otherwise, of a new SBU.

**Profit versus Other Objectives**

All organisations should have clearly stated objectives which are specific, measurable, achievable, realistic, and timed. In many organisations the most important overriding objectives are in some way concerned with profit, expressed as a range of financial targets for the company.

Most economists have long stressed the view that businesses should "maximise" their profits. In practice few firms actually set their objectives in terms of economists' notion of maximised profits; but many companies' objectives are expressed in terms of some measure of profit. This may be, say, a specified rate of return on capital employed, or a required profit figure for the next accounting period.

So what explains this overriding importance of profit objectives in so many companies, and what other performance objectives might the strategic plan include?

**Why Profit is the Dominant Objective**

- A major reason for organisations using profits as the overriding objective is the belief that this gives rise to the most effective overall use of scarce resources. If companies always attempt to maximise profits, it is argued, then factors of production will be used to their best effect. This philosophical legacy of economists, regarding the role and purpose of profits in an economy, still pervades and affects our thinking with regard to the primary role and purpose of organisations.

- A second reason is that quite simply a company that consistently fails to make profits will eventually cease to exist (unless of course it receives funds from some other source such as a government subsidy).

- A third reason is that most companies need to produce enough profit to satisfy the providers of capital whether these are private owners, shareholders, banks or other sources. If profits are not sufficient these providers are likely to withdraw their capital.

- A fourth reason for stressing the primacy of profits is that, unless a company makes adequate profits, then in addition to not satisfying investors and shareholders the company itself may be unable to invest itself in new machinery, new products, and so on. Much investment comes from retained profits.

**Objectives Other Than Profit**

Profits are not the only objective that should be included in strategic plans, which should have regard to other key areas of corporate performance. These might legitimately include objectives relating to one or more of the five areas of performance discussed below.

(a) **Company Growth**

Very often companies set objectives in terms of required rates of company growth. This, of course, may include objectives for growth in profits, but often is couched in terms of say growth in sales/turnover, or even some other measure of company size such as number of employees.

Often company success is judged on the basis of growth rates. Companies who have been very successful in terms of growth include Amazon and Google.
Strategy Evaluation and Selection

(b) Market Share
Gaining a particular market share is often a key objective. This is because market share is one of the best measures of marketing and competitive success. Clearly there is a danger that market share objectives and targets can conflict with profitability objectives.

In the airline market the low-cost operators such as Ryanair and Easyjet have been very successful in increasing their shares.

(c) Corporate Stability or Survival
Particularly when economic conditions are difficult a company may focus as much on surviving as on growing and/or increasing its profits. Clearly too much emphasis on simply surviving can lead to a lack of innovation and entrepreneurship, but sometimes an organisation may have no option but to retrench.

The music industry’s sales have been severely affected by the growth in downloading from the internet, and so record companies have turned from looking for growth to establishing objectives and strategies to survive.

(d) Corporate Image
Many companies have objectives relating to how they wish to be perceived in the market (and often in the wider society). For example, some companies wish to enhance their image as "green" organisations, or as "caring for the community".

Examples of companies who consider performance in this area important include the retailer Body Shop and the oil company BP

(e) Technological/Innovation Leadership
Some companies set themselves the objective of being the technological/innovation leader in a market, though it has to be said that this is very often a subsidiary objective to the profit objective itself, i.e. the idea is that by being technological/innovation leader, higher long-term profits will be achieved.

Role and Influence of Stakeholders
As we have mentioned several times already the expectations of stakeholders, both individuals and groups, influence the purposes of an organisation. We have already seen how these affect the organisation’s mission statement and, through this, its objectives.

Objectives tend to emerge as the wishes of the most dominant stakeholder group, which is usually composed of the organisation's managers. In pursuing these objectives, however, the members of the dominant group act in accordance with their interpretation of the political situation, and will often abandon some of their expectations in order to improve their chances of achieving others.

Few individuals have the power to determine the strategy of an organisation on their own. In general, it is usually a group of like-minded people, who share the same aims and ideals, who come together to influence the organisation's strategy. These groups can arise both within departments, at different levels of the hierarchy, and in different geographical locations. The groups are not necessarily constant in nature but often arise as a result of a particular events occurring.

Both internal and external stakeholders can have an effect on the development of an organisation's strategy, and understanding them and how they can influence strategy is a very important part of strategic analysis.
Conflicting Interests of Stakeholders

We have seen that many argue that the primary purpose or overall objective of an organisation should be the maximisation of profits. A major reason for this is the fact that the funds to set up and run most companies of any size are provided by shareholders. It is the shareholders who ultimately own the company; their investment has been motivated by the hope of profits in return for risk-taking. If a company is not maximising profits, it is argued, shareholders will ultimately take their capital to other more profitable companies and the non-profit-maximising companies will over time simply disappear.

However, the shareholder investment argument for maximising profits seems to ignore the place of other interested parties in the conduct and performance of organisations. It is now increasingly recognised that other parties besides shareholders can have an interest or even what might be considered as an investment in a business.

These other interested parties besides shareholders are what we have often referred to as stakeholders. Stakeholder views of business objectives and performance have begun to radically alter perceptions of business, particularly with regard to profits and the notion of "profit maximisation".

A profit-maximising view of business suggests that the needs of other stakeholders in the organisation are, at best, of secondary concern. But is this the case, and in particular does a profit-maximising view of business inevitably mean that there is bound to be a potential conflict between the profit-making requirements of shareholders and the needs of other stakeholders in a company?

Stakeholders may be classified as either direct or indirect.

- **Direct stakeholders** are those groups with an ongoing role in the day-to-day activities of the business. They include employees, customers, suppliers, distributors, creditors and even competitors.

- **Indirect stakeholders** do not have this day-to-day involvement, but are nonetheless affected by an organisation's activities and have an interest in it. They include the local community, government, the media, employer associations, various pressure groups and so on.

For an organisation seeking to maximise profits a number of potential conflicts are apparent. The aim of generating maximum profits for shareholders might lead at one and the same time to higher prices for customers, lower wages for employees, squeezed margins for business partners and detrimental effects for other indirect stakeholders, through lack of concern for the local community or the wider environment. The interests of shareholders therefore would appear inevitably to conflict with the interests of other stakeholder groups.

It can be argued, however, that in fact there is no such inevitable conflict, and that profit-maximising not only facilitates but necessitates the organisation meeting the interests of all stakeholder groups. Over time, maximising profits may demand that managers seek partnership with their suppliers and distributors, in order to develop new products most effectively, ensure total quality and deliver excellent customer service. Incurring extra cost in socially responsible activities may also bring long-term returns in improved relationships with indirect stakeholders. Increased training and staff development will also be justifiable, with higher earnings more than offset by superior productivity. Long-run profitability is also consistent with other objectives so all stakeholders may benefit. In this way customers enjoy better products at lower prices; employees higher wages and improving conditions; the organisation behaves responsibly and still the shareholders receive maximum profit.

So the pursuit of long-run profitability in an organisation does not necessarily give rise to conflict between shareholders and other stakeholders, and indeed may best serve the interests of all.
Maximising profitability through the efficient and effective use of scarce resources would seem to be the obvious target for a commercial business, since anything less would lead to higher costs and thence to a reduced competitive edge, which would act against the interests of stakeholders in general, with lower job security and fewer new products for customers.

The role of management, then, is to balance potentially conflicting interests by developing a partnership with various stakeholders. The road to success is to offer something to each of them.

This is best achieved through long-run profitability, i.e. by maximising profits over time, which may mean seeking a partnership with suppliers and distributors in the value chain. The result of such a partnership can lead to:

- the effective development of new products;
- total quality control; and
- excellent customer services.

This type of strategy is also consistent with objectives such as increasing growth and market share, which lead to a surplus that, in turn, can help to satisfy all stakeholders, since:

- employees are paid more, and have better working conditions;
- customers get better products are lower prices; and
- shareholders received maximum returns.

Thus the conflicting interest of different stakeholder groups can all be met.

**Stakeholder Reactions: Stakeholder Mapping**

Stakeholder "mapping" is a valuable aid to assessing how stakeholders are likely to react to particular strategic choices. This requires assessing:

- how likely a particular group is to force the company to realise its expectations;
- how much power the group wields;
- the likely impact the group might have on future strategies.

With this information the planner can devise strategies and action plans to ensure that powerful and influential stakeholders are persuaded to support proposed corporate strategies.

An example will serve to illustrate the concept and technique of stakeholder mapping.

Imagine a situation where a chemicals company currently producing colourings for the food industry is proposing to open a new factory alongside one producing toxic weedkiller.

The company operates near a built-up area including a housing estate. It is already a major local employer, and envisages that the new factory will eventually provide work for another 100 local people. Projected financial returns from the new project are high. It is however acknowledged that the new factory will detract from the visual amenity of the area and will give rise to an increase in traffic noise and local road congestion. Local councillors who represent the area where the factory is proposed are divided about the relative merits of the scheme.

The organisation needs to consider the impact on and possible actions of the stakeholder groups affected. We might find some stakeholder groups actively opposing the new factory, others being worried but not doing anything, and yet others actively supporting the proposal.

Thus the interests of the stakeholders are potentially conflicting, and their desire and ability to influence and affect the objectives and plans of the company is extremely variable. The workforce and unions might welcome the idea, and so might local suppliers and distributors.
Shareholders might also welcome a potential increase in profits and returns. Local environmental groups, some local councillors and residents living near the proposed factory may be opposed to it because of possible accidents, pollution, and congestion.

Stakeholder mapping is a framework for assessing the different potential attitudes of different stakeholders, and their possible impact on an organisation's plans. Based on this assessment the corporate planning team can then consider what are the most effective strategies for managing the situation. They will assess (or "map") the organisation's stakeholders with regard to two major factors:

- The degree of **interest** (high or low) of each stakeholder group in affecting the proposed plans of the organisation
- The degree of **power** (high or low) of each stakeholder group to do so.

This gives a matrix of four possible categories of stakeholder, as follows.

**Category 1: "Low power/low interest" stakeholders**

Stakeholders in this category are likely to have little influence on the proposed strategy. They are unlikely to want to either block or support the proposed expansion and in addition do not have the power to do so. This category of stakeholders is of little concern in the context of the proposed strategy and warrants minimal attention or effort on the part of the organisation.

**Category 2: "Low power/high interest" stakeholders**

Stakeholders in this category have for various reasons a high degree of interest in the organisation's plans, but like category 1 stakeholders have little power to affect the proposed strategy. These stakeholders should be kept informed with a view to ensuring that they act as supporters.

**Category 3: "High power/low interest" stakeholders**

Although this category have low interest in the organisation's plans they do have the power to influence them. For example, they may have the power to block or at least slow down a proposed development. These stakeholders need to be kept satisfied. In particular they should be actively discouraged from developing a high interest in the proposed strategy, unless their support can be guaranteed.

**Category 4: "High power/low interest" stakeholders**

Needless to say, these are a key category of stakeholder. Their interest and power makes them most likely to want and be able to influence the proposed strategy either as blockers or facilitators. This means that they should been encouraged to act as supporters. This category of stakeholder is worth investing time, money and effort in to secure their backing.

By mapping stakeholders in this way the organisation can develop plans of action for managing the various stakeholder groups with respect to progressing its plans. There are ethical issues surrounding this notion of mapping and managing stakeholder groups, but stakeholder mapping is becoming an increasingly accepted approach in the development of corporate strategies and plans.
# Study Unit 7

## Implementation and Control 1: Organisation

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INTRODUCTION

In this, the first of two units considering the implementation of strategies, we will be looking at the importance of organisational design and structure. We will identify the impact of alternative organisational structures on strategy implementation, and discuss both the advantages and the limitations of centralised or decentralised structures in respect of strategic planning and control.

Objectives

After studying this unit, students should be able to:

- discuss the importance of organisational design and structure in strategy implementation;
- identify the impact of alternative organisational structures on strategy implementation;
- discuss the advantages and limitations of centralised or decentralised structures in respect of strategic planning and control.

A. STRATEGIC ARCHITECTURE AND CONTROL

When considering how best to implement a chosen strategy there are a number of factors which have to be taken into account which are concerned with the design and structure of the organisation. We have already seen that the environment in which the organisation exists has a major influence both on what it can do, and how it can do it. How stable the environment is will have an effect on strategic implementation. In turbulent times, Drucker has said, although by definition there is irregular, erratic activity, nevertheless there are strategies which can use rapid change as opportunities, and which can convert the threat of change into opportunities for productive and profitable action; and these are the ones which have to be used. In a more stable environment different strategies will be more appropriate, and so we need to take account of the state of the environment when implementing a chosen strategic option.

The diversity of an organisation is also relevant to strategy implementation. There are big differences between, for example, the needs of a large multinational corporation and those of a small local business.

The extent to which modern technology is employed is also an important factor. Decisions about exporting products will be different for a local pottery to make, than for a mass production company. Accountability of the management of an organisation also plays a part in the strategic design. Whether they are acceptable to shareholders or to taxpayers will influence how the structure is designed.

Strategic control aims to be a balance between strategic planning and financial control. In the decentralisation of power from the "head office" type of control to its investment in the operating divisions of an organisation, complete independence is rarely obtained. The changes which occur usually move away from tight control at the centre towards strategic control, where the centre acts as a shaper of strategy and the individual parts of the business develop their own strategies and plans within the framework of overall corporate headquarters objectives. The use of strategic business unit (SBU) structures is relevant here.
Strategic Business Units (SBUs) and Corporate Strategic Planning

The Trend towards Diversification

A significant development since 1945 in many economies has been the growth of the diversified, often large, increasingly multinational company. It is not uncommon, for example, for the same company to be producing and marketing products as diverse as high fashion clothes and agricultural machinery.

Hand in hand with this growth in size and diversity go the problems of effectively planning and managing the resources of such companies so that they are used in the most efficient manner. The concept of strategic business units (SBUs) represents what many feel to be an extremely useful mechanism for dealing with these problems.

Nature and Characteristics of SBUs

The original use of the SBU concept is credited to the General Electric Company who in 1968 identified more than forty SBUs in their organisation. In order to understand the meaning and use of this concept it is useful to start with a definition of a strategic business unit.

A strategic business unit is a distinct operating part of a business with its own external market place for products and services, and for which management can or does determine objectives and execute strategies independent of other business areas in the company.

Thus a SBU is a part of the overall company which could if necessary stand alone. The key characteristics of an SBU are as follows:

- It is a single business or collection of related businesses that can be planned and managed separately from the rest of the company.
- It has its own competitors.
- It has a management team which is responsible for strategic planning and performance in that part of the organisation.
- It has control over all its functional activities.

At first glance then an SBU appears similar to the notion of having autonomous profit centres and/or a divisionalised planning system and structure. However the profit-centre concept emphasises short-term consequences, and the divisionalised structure may not lead to the most effective planning and use of resources. In fact SBUs can, and often do, overlap existing divisions in a company. This does not necessarily mean that divisional boundaries need to be redefined; often a strategic business unit can overlap divisions, and a division can include more than one unit.

Benefits of SBU Approach

The benefits of organising and planning along SBU lines in a company are as follows:

- Business definition becomes more effective at the SBU level.
- Clear strategies and targets can be developed for each SBU, based on customer, competitor and company considerations.
- Above all the SBU concept provides a mechanism for the problems of managing size and diversity referred to earlier. Effectively each SBU is run as an independent company with its own management team, customers, plans, and resources.

This last point, however, raises the question of overall corporate strategy and plans and the need to balance the activities of all the SBUs in a company. In fact the SBU concept, together with portfolio planning techniques, also provides a mechanism for corporate planners to assess the relationships between SBUs and to use this assessment in long-term
strategic planning. For example, using the Boston Consulting Group framework discussed in Unit 4 the corporate planner can determine whether any established SBUs can be used to provide cash flow in order to fund smaller and perhaps currently unprofitable SBUs that have long-term growth potential. In this way the SBU concept provides both a useful way of ensuring effective planning for each distinct part of a diversified business, and also a way of ensuring that the overall business is balanced in such a way as to promote long-run organisational objectives.

Certainly defining strategic business units is not always easy. There are likely to be grey areas which may lead to disputes and problems of application. However even the act of trying to identify strategic business units brings important benefits to a company.

B. IMPORTANCE OF ORGANISATIONAL DESIGN AND STRUCTURE IN STRATEGY IMPLEMENTATION

When considering this relationship the work of Goold and Campbell is very relevant. They studied the styles of relationship between the centre of an organisation and its SBUs and placed them in the following categories:

- strategic planning
- financial control
- strategic control

By looking at the planning influence and the control influence of the centre and the SBUs, they came up with the following:

- planning influence is related to the centre's efforts to shape strategies as they emerge and before decisions are taken
- control influence refers to the way in which the centre reacts to the results achieved.

**Strategic Planning Style**

This is when the centre acts as master planner, accepting inputs from SBUs but setting the broad strategy; SBUs are regarded by the centre as just providing operational delivery of the master plan. Such a style arises from a lack of confidence in SBUs' managers, and results in a high level of control and co-ordination by the centre. It provides good integration across SBUs, which is useful if resources are shared, and, by allowing the use of unskilled labour it reduces costs. This is a bureaucratic approach which, since decisions are taken at top management levels, does not rely on short-term views.

Problems with this system can arise due to:

- slow communications
- resistance by SBU managers, who see their role as entirely tactical and can spend a lot of time "nit-picking"
- fewer low-risk strategies than if the strategy came from the SBU operating managers
- resistance to the closing-down of poorly-performing units (because the strategies came from the centre).

This type of arrangement tends to lead to concentration on a few core areas where it is possible to have a degree of expertise.

Goold and Campbell gave BOC, Cadbury and Lex as examples of this style.
Financial Control Style
This is the extreme opposite of strategic planning. In this case the centre acts as a shareholder or banker for the SBUs. The SBU managers lead the strategy within a budgetary control framework.

The centre
- sets financial targets
- appraises divisions’ performances
- appraises capital bids from divisions.

Low-risk strategies are pursued, but profitability ratios are higher.

SBUs are able to diversify by deciding on entry to new markets or in developing new products. They may even be allowed to use funding from outside the parent group so as to support new developments. Growth is mainly via acquisitions rather than by internal development.

Companies of this type appear to be:
- quicker to replace managers
- fiercer in applying pressure via monitoring
- better at recognising and rewarding good performance

as compared with those who adopt the styles of strategic planning or strategic control.

Goold and Campbell quote BTR, Hanson Trust and Tarmac as examples.

Strategic Control Style
As we saw earlier, this style aims to be a balance between the other two styles. Where the strategic control style operates the centre’s control is concerned with:

- the organisation’s overall strategy
- the balance of activities and the role of each division
- the organisation’s policies on such matters as employment, etc.

The formulation of strategy begins with the SBUs but requires to be tested and agreed by corporate management, i.e. it is a bottom-up process within central guidelines.

Power lies where the expertise is.

Budgets and decisions cannot be over-controlled by the centre as this would produce delays and confusion, but the centre remains responsible for assessing the performance of divisions against their own business plans, within which the annual budget has an important role.

Relationships between the centre and its divisions, as suggested by Goold and Campbell, are as shown in Figure 7.1.
Strategic control demands that the organisation has a clear understanding of how responsibility for strategy is divided between the centre and the divisions. The centre has responsibility for:

- defining key policies
- allocating resources to divisions
- assessing the performance of divisions

All other activities may be devolved to the divisions themselves.

Goold and Campbell identified ICI and Courtaulds as being in this group.

C. ALTERNATIVE ORGANISATIONAL STRUCTURES

The structure of an organisation is the framework within which all the activities of management, i.e. planning, operating, controlling and motivating, take place. The actual organisational set-up is laid out in an organisation chart which shows:

- who reports to whom, and
- who is responsible for what.

Figure 7.1: Centre-Division Relationships (Goold & Campbell)
**Functional Structures**

This structure allocates key functional areas to managers, while a director co-ordinates their activities (see Figure 7.2).

![Figure 7.2: A Functional Structure](image)

The functional structure is typically found in smaller companies or those with a small range of products. It is based on the primary tasks which the company has to carry out.

**Divisional Structure**

The subdivisions within a divisional structure can be formed on the basis of such units as:
- types of product
- different services
- geographical areas.

The structure is used where there is more diversity within the organisation than can be adequately covered within a functional structure, although the divisions themselves are likely to be split into functional management areas.

Functional structures allow greater operational control at senior levels in an organisation but, when the organisation is large, or its product/service base is diverse, this can overburden senior managers with operational issues rather than allowing them the necessary time to take a strategic view.

With a divisional structure this problem can be overcome, with each division able to concentrate on its own business environment, as in Figure 7.3.

![Figure 7.3: A Divisional Structure](image)

**Holding Company Structure**

Ultimately an organisation may grow so large that the only effective way it can be managed is by making separate companies out of existing divisions. This can be achieved so that the...
only relationship between each operating company and the top of the organisation is the legal one of ownership, the divisions becoming “wholly-owned subsidiaries”.

The connections become mainly concerned with the movement of finance and the transfer of profits, with the parent company only interfering if adequate profits are not being made.

![Figure 7.4: A Holding Company Structure](image)

**Matrix Structure**

This is a combination of structures which appears as in Figure 7.5.

In this example each marketing manager would have a co-ordinating responsibility for a particular product, including its production, distribution, storage, promotion and sale.

With companies engaged in project work, such as advertising agencies, a project manager would be appointed to ensure its success.

The project manager would have a number of experts making reports for as long as the project lasted, when all those concerned would move on to other work.

![Figure 7.5: A Matrix Structure](image)

The matrix structure is intended to avoid the weaknesses of the functional and divisional structures. The essence of a matrix is that the functional relationships within the business still stand.

In Figure 7.5 there is still a production manager with three factory managers reporting to him/her. However, each factory manager would have a direct relationship with their counterpart on the marketing side, rather than an informal indirect contact.
**Intermediate Structures**

The structures already discussed are not always adopted in their straightforward design. Often companies find it necessary to move away from one type of structure towards another as circumstances dictate.

So, a company with a satisfactory functional structure may find itself moving towards a divisional structure as the business expands and diversifies.

In some cases new divisions have to be set up in order to co-ordinate the activities of the others. For example, centralised planning departments may be used.

**Networks/Virtual Organisations**

None of the structures described so are is really suitable for innovative organisations such as the aerospace industry or consulting companies.

This type of enterprise needs a structure that can bring together a team of experts with diverse skills and interests and mould them into a creative team.

Mintzberg suggested "adhocracy" as the means by which this could be achieved, being an organic structure relying for its co-ordination on the mutual adjustment of its members to support a common cause.

Networking has many similarities with the adhocracy, with the major difference being the use of the network as the key co-ordinating factor, together with relational contracts.

The result is a very dynamic organisation, consisting often of young professionals, who have support staff to control and maintain the operation in terms of contracts with clients, the organisation of contracts and financial services and the maintenance of buildings, etc.

**Multinational Structures**

These can take a number of different forms, with the simplest being that in which there is a structure for the home-based parent company with the management of "overseas" subsidiary companies being controlled through a direct contact between the manager in charge of the subsidiary and the chief executive of the parent company. Recent advances in telecommunications, such as teleconferencing, make the type of person-to-person contact which the multinational company needs available through video contact to global conferences on split sites.

Some multinationals retain their home-based structures and set up international divisions to deal with overseas trade. Many, however, have moved out from this narrow ethnocentric thinking, where things are viewed from the point of view of the home-based culture, to polycentric thinking, where they work from the view of the subsidiary's culture.

International companies are moving towards total globalisation, where they adopt worldwide manufacturing facilities, marketing policies, financial flows and logistical systems. Components and supplies are obtained where they are cheapest and global operating units report to the chief executive or executive committee rather than to the head of an international division.

Recently organisation structures have been set up which combine the advantages of the international subsidiary, with its local responsiveness, with those of the global structure, thus setting up an integrated network of resources and capabilities. These have been termed by Bartlett and Ghoshal as "transnational companies". They have suggested a form of the different types of structure for multinational companies as illustrated in Figure 7.6.

This illustrates the extent to which local independence and responsiveness should take precedence over global co-ordination. As Johnson and Scholes point out, this balance will vary with circumstances and over a period of time.
D. INFLUENCES ON ORGANISATIONAL DESIGN

Strategy
It is important to match the design of an organisation with the type of strategy it intends to pursue, since the two are interrelated.

In a mechanistic system control is by directive; authority and communication conform to the hierarchical type of structure producing a vertical interaction. Loyalty and obedience are insisted upon and working behaviour and operations are controlled by management.

This type of organisation is best suited to pursue a strategy of strict control of costs and efficiency.

On the other hand, in an organic type of organisation, where the approach encourages lateral and vertical communication and authority, commitment to the task is considered to be more important than loyalty and obedience. A complex network of communication and control is considered necessary to foster adaptability and rapid change and individual effort is recognised through self-direction.

In this type of organisation the specialist goes where needed, authority is placed with whoever can deal with the problem and a cosmopolitan atmosphere is encouraged. This allows a strategy of differentiation to be followed which requires a high degree of creativity.

Policies
The way in which an organisation's policies are arrived at will similarly depend upon the way it is structured.

If a multi-stage process is adopted, where someone well down in terms of the organisation structure has an idea which is discussed with others and then passed up the line as a proposal until it reaches the decision-making level, this is likely to be an organic design.

Such is the system in innovative companies such as Hewlett-Packard.

Alternatively, the process of policy-making may be just a two-stage process, involving, for instance, a proposal from the managing director followed by approval from the board, as is likely in a mechanistic structure.
**Processes and Technology**

The type of work which forms the basis of a company will have an important effect on the organisational design.

For example, if the company is involved in the mass production of items such as washing machines, refrigerators, cars, etc. there is little room for creativity among the workforce. What is required in this design is strict control and often a tendency towards centralisation.

Honda announced a huge investment in car production at Swindon, at a time when UK car manufacturers were cutting back. Honda planned to produce a quarter of a million cars per year in Britain, many of them for export back to Japan. When a TV programme showed some of their current car production I was interested in how few humans were involved in the process, and thought what a pile-up would occur if one of the machines went wrong.

In this sort of scenario, strict control is vital for the business to proceed.

Due to the huge amount of technology involved, the most important members of the workforce will be those who can control the technology and they wield a large amount of power. Thus the organisation moves towards an adhocracy, with the involvement of project teams, etc.

More sophisticated technology allows for greater centralisation of organisations, with information flowing in from a number of outlets back to a head office where the decision-making is carried out.

The retailer Next was an early entrant into this type of centralisation. Using electronic scanning in their stores they are able at the end of a trading day to see the whole picture of business sales at a central office from which information is then relayed back to store managers as necessary.

**Accountability**

Accountability is an aspect of responsibility and this is another factor which will affect the design of an organisation.

The term is often used when considering the public purse. In general, members of the public like to be able to identify the person, or persons, who are responsible for the decision-making with respect to the taxes they pay and the services they receive. Movement in these areas towards greater accountability usually involves centralisation of decision-making, with an easily identifiable team or individual at the very centre.

Local authorities can now have power concentrated in the hands of a directly elected mayor, the idea being that the public have someone who is clearly accountable for what goes on.

**Environment**

The environment in which an organisation exists has a powerful influence on the way in which it can operate and thus affects its design.

Mintzberg has suggested that there are five conditions within the environment which need to be considered in the context of design:

- "the more dynamic the environment then the more organic the structure".

Where the environment is stable, future conditions can be forecast with a reasonable degree of accuracy and so the organisation can easily standardise. When conditions are turbulent, the organisation must remain flexible, and must have an organic structure.
“the more complex the environment, the more decentralised the structure”.
The main reason for the decentralisation of an organisation is that decision-making becomes too complex for a central individual.

“the more diversified the organisation’s markets, the greater the propensity to split it into market-based units, or divisions, given favourable economies of scale”.
An organisation that can identify distinct divisions based, for example, on geographical locations is likely to operate in that form, provided it will produce economies of scale in doing so.

“extreme hostility in its environment drives any organisation to centralise its structure temporarily”.
In these circumstances organisations tend to centralise power in order to be able to give a rapid response. An extreme example of this would be a military campaign. Under battle conditions you do not want a number of different decisions being made at the same time.

“disparities in the environment encourage the organisation to decentralise selectively to differentiated work constellations”.
When the environment is mixed, i.e. really a number of different environments, it requires the organisation to approach them in different ways, so there is a tendency to create different work areas to cope with each type.

Reinforcing Cycles
In the same way that strategy has an impact on organisation design, so also the converse is true, that design has an effect on strategy. Thus there are mutually reinforcing activities, with each affecting the other. The likely result of this is that there will be a change in the way that things are done by the organisation.

E. ISSUES IN ORGANISATIONAL DESIGN

Mintzberg’s Model of Organisational Configuration
Mintzberg has suggested a framework for an organisation in which he originally identified five different components, namely:

- the strategic apex
- the middle line
- the operating core
- technostructure, and
- support staff.

He first introduced this in 1983 and later added a sixth component, ideology, in 1989.

(a) The strategic apex involves top management who formulate the organisation's mission, goals, objectives and strategy. They shape the organisation's strategic direction and the visionary concept of where the organisation is headed within a specified time.

(b) The middle line involves middle managers implementing the objectives and strategy which have been formulated at the top. They are the managers of corporate functions, or SBUs, and are responsible for the operating core, but report to senior managers.
(c) The **operating core** involves employees who are responsible for processing and converting inputs into outputs. They include production staff.

(d) The **technostructure** involves the application of expertise to the organisation's business activities. This includes the standardisation of activities such as planning and scheduling work, planning for the demand and supply of human resources, etc. The staff who make up the technostructure do not directly supervise the work of others.

(e) **Support staff** provide services to the operating core even though they operate independently of it. Such services include canteen provision and administration.

(f) The **ideology** is the set of beliefs and traditions that pervades the whole organisation.

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**Figure 7.7: Mintzberg’s Structural Model (+ link to customers/clients)**

**Alternative Organisational Configurations**

The most suitable structure for an organisation will depend on a given set of circumstances or situations when implementing strategies.

Accordingly Mintzberg has identified six different configurations which he suggests are the most suitable to be adopted in particular cases. These are:

- the simple structure configuration;
- the machine bureaucracy configuration;
- the professional bureaucracy configuration;
- the divisionalised configuration;
- the adhocracy configuration; and
- the missionary configuration.
In addition to these six, a further organisational configuration is increasingly found in practice, and this is:

- the network configuration.

We shall look at each of these configurations.

(a) **Simple Structure Configuration**

Mintzberg suggests that this type of structure is perhaps not a structure at all, since relatively few activities in the organisation are formalised and planned.

- The hierarchy is flat, with the strategic apex being the key part of the organisation, dominated by the chief executive, who may often be the owner.
- Division of work is flexible and responsibilities are often not precisely specified.
- This type of structure or configuration is very flexible and therefore well suited to small, young, entrepreneurial organisations operating in a dynamic, hostile environment where market change is very rapid.

(b) **Machine Bureaucracy Configuration**

This configuration is dominated by a large staff function, which focuses on routine systems that standardise work processes and procedures in the organisation. In other words, the key part of the organisation is the technostructure. Responsibilities and lines of authority are well defined and members of the organisation “know their place”.

- This type of configuration is best for old, large organisations which have regulated tasks and are under technocratic control.
- It is best suited to simple environments which are static, i.e. where rates of change are relatively slow, and where cost efficiency is what leads to competitive advantage.

(c) **Professional Bureaucracy Configuration**

Efficiency and effectiveness are achieved in this configuration through the professional competence and skills of the organisation’s employees. The key part of the organisation is its core; and its design parameters are the core and the standardisation of work. A high degree of interaction between the group members takes place, with emphasis being placed on training, learning and professional knowledge.

- The systems employed are simple ones and adherence to these is through professional commitment and control.
- The environment in which this type of configuration operates best is one which is complex and static, such as hospitals.

(d) **Divisionalised Configuration**

The key part in this type of configuration is the middle line. The type of company operating in such a configuration is that which produces a number of different products and operates within an environment which is simple and static but diverse. Typically, such companies are old-established, very large and controlled by the middle line.

- One of the key issues encountered is that of the relationship between the corporate head office and the divisions, or SBUs, particularly with respect to who is responsible for what.
- A key co-ordinating mechanism is the standardisation of outputs.
- This is a configuration well suited to organisations where success in different markets requires different skills and strategies.
(e) **Adhocracy Configuration**

This configuration is best for organisations which rely on innovation and change for achieving competitive success. The company is normally young, involved in complex tasks and under expert control. The key part of the organisation lies in both its operating core and its support staff. The systems employed have to be such that creativity is encouraged and communication between the different parts of the organisation must be open. Co-ordination is achieved through mutual adjustment by means of a supportive and open style.

- The environment in which such a configuration is appropriate is one which is complex and dynamic.
- The type of company which is best suited to the adhocracy configuration is one where product life cycles are short, such as high-technology industries.

(f) **Missionary Configuration**

This is typical of voluntary organisations, where the members share the same visions and ideals. The key part of the organisation is thus ideology. Often there is little formalised structure, although this is not always the case in the uniformed voluntary organisations.

- The key co-ordinating mechanism for this type of configuration is the standardisation of norms.
- The environment in which it is likely to operate will be one which is simple, and static.
- Internally, the organisation is usually middle-aged, often composed of enclaves, and operating by means of simple systems.

(g) **Network Configuration**

A seventh configuration is that associated with network organisations, as described by Miles and Snow.

This configuration is in many ways similar to that of the adhocracy, but with a major difference in the use of networking as its key co-ordinating mechanism, together with relational contracts.

- The key part of the organisation is the strategic apex or support staff.
- The type of organisation likely to utilise the network configuration is often young and professionally controlled.
- The environment in which the network organisation operates is a dynamic one.

These seven different configurations are the major alternatives which can be used to support and implement an organisation's strategies.

Although very few organisations are likely to fit exactly into any one of these types, the configurations can be used to think through some important issues with respect to the structure/strategy fit in an organisation. Because no one configuration is best, it is necessary to match a configuration to the prevailing strategic situation and circumstances facing the organisation.

**Co-ordination and Control**

Mintzberg suggests that there are six mechanisms by means of which organisations co-ordinate their activities: mutual adjustment, direct supervision, standardisation of work processes, standardisation of outputs, standardisation of skills and standardisation of norms. Mintzberg described the first two as “ad hoc” and the others as “various forms of standardisation”.

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• Mutual adjustment, Mintzberg suggested, comes about as a consequence of informal communication, which leads to co-ordination of work between a number of people.

• Direct supervision is, as it appears, the co-ordination of the work of a team by means of one person being in charge. It is required when the number of people working together becomes too large for mutual adjustment to be possible.

• Standardisation of work processes means having a plan for the procedures to be carried out so that everyone works in the same way. It's rather like having the assembly instructions for a flat pack kitchen unit.

• Standardisation of outputs refers to the results of work. So it is important that, in assembly work, one person's part of the job has to be suitable for the next person to add their stage.

• Standardisation of skills occurs where a person receives training in a particular activity, say in driving a vehicle, which is the same as that received by others, so that driving is standardised and at least we all drive on the same side of the road (most of the time!). The same kind of standardisation would apply to surgeons learning to carry out a prescribed operation.

• Standardisation of norms results in the members of an organisation sharing a common set of beliefs, and in so doing achieve co-ordination of effort.

Centralisation and Decentralisation

Handy identified an entrepreneurial structure which places emphasis on centralisation and central power and which suits smaller organisations. In these cases the power comes from the core of the business, which may be a powerful and influential individual, with the authority to allocate and control resources based on their position giving them complete freedom to do what they want. Handy refers to this structure as the power culture.

In larger organisations, where there is a bureaucratic structure, some authority and power is decentralised or devolved. This enables decisions to be made and instructions given to workforce personnel without reference to a higher authority. In any organisation which employs 10,000 people or more, on different sites and perhaps also in different countries, it is not possible for all decisions to be referred back to head office, so routine decision-making is delegated to regional or divisional level.

There are, it can be argued, advantages and disadvantages to both centralisation and decentralisation, in terms of both relationships and responsibilities. We shall look at centralisation and decentralisation in turn.

Advantages of Centralisation

These include:

• decision-making is easier, quicker and simpler
• the figurehead/chief can keep control of operations
• the structure can be flatter, i.e. fewer levels of management, and so less costly
• resources are more easily allocated and controlled

There is less need for complicated rules and procedures since these can be developed, co-ordinated and implemented from the centre.
Role of the Group Headquarters

There are many ways in which having a group HQ can add value.

(a) **Improving Efficiency/Leverage**

Having a group HQ may enable scale advantages from resource sharing. In particular support services and other overhead items may be much more efficient. In addition, a group HQ may be able to exert more leverage in terms of purchasing power or access to markets.

(b) **Expertise**

Group HQ may be able to provide expertise which would not normally be available or affordable within the divisions. Good examples of this would include areas such as market research, operations research, financial services, estates management and IT infrastructure.

(c) **Investment/Corporate Balance**

A group HQ can allocate and channel investment across the group in a more objective way than might be possible if these decisions were made in the individual parts of the business. This can lead to a more balanced portfolio for the business as a whole.

(d) **Fostering Innovation**

A group HQ is often able to encourage and foster innovation throughout the organisation.

(e) **Balancing Risk**

A group HQ can help balance the risks across the different divisions in the organisation and therefore reduce the risk which smaller units often face. Problems of variety and variability of demand across divisions can often be smoothed out with central control.

(f) **Image/Networks**

Having a group HQ can help to build a stronger external image which may in turn benefit the smaller divisions throughout the organisation. In addition, a group HQ may be able to access external networks better than individual units.

(g) **Collaboration**

A group HQ is often better placed to encourage collaboration and co-ordination of effort across divisions. This can help lessen inter-divisional conflict and may result, for example, in products or services which a single division could not deliver. External linkages and collaborations may also be more readily facilitated by a group HQ.

(h) **Setting Standards/Performance Appraisal**

A group HQ is often in a much stronger position to set overall standards and assess the performance of subsidiaries and divisions.

Disadvantages of Centralisation

These include:

- it can only truly work in small companies
- little authority or power is delegated, reducing the managers’ role
- routine decision-making is slow when managers have to consult the chief for approval.
Advantages of Decentralisation

These include:

- managers are able to make routine decisions themselves
- empowerment acts as a motivator to middle and junior managers
- information technology enables communications between regions and head office to be good.

Disadvantages of Decentralisation

These include:

- possible distortion of communications as they pass through a number of filters
- communication needs appropriate control and co-ordination to avoid difficulties
- greater co-ordination and control needed between the five original components of Mintzberg's organisational configuration
- possible difficulties in keeping large numbers of employees, dispersed over a number of different locations, committed to the organisation's mission, goals, objectives and strategy
- there will need to be a sufficiently large pool of suitably qualified and experienced managers to deal with the responsibilities.

**Mintzberg’s Types of Centralisation and Decentralisation**

Mintzberg, in using the terms centralisation and decentralisation to refer to the sharing of decision-making power, described:

- a **centralised structure** as one where all the power rests at a single point in the organisation; and
- a **decentralised structure** as one where the power is dispersed among many individuals.

He does not restrict the terms decentralised to the dispersion of formal power only, and distinguishes between:

- **vertical decentralisation**, where formal power is delegated down the hierarchy to line managers; and
- **horizontal decentralisation**, where formal or informal power is dispersed out of the line hierarchy to non-managers, such as operators or support staff.

He also speaks about:

- **selective decentralisation**, as being the dispersal of power over one or a few kinds of decision to the same place in the organisation; and
- **parallel decentralisation**, where power for many kinds of decision is dispersed to the same place.

Mintzberg sees the advantage of centralisation as being the keeping of all the power in one place, thus ensuring the tightest form of co-ordination, with all decisions being made in one head and then carried out through the process of direct supervision.

"Why then decentralise?" he asks, and answers this himself by pointing out that one brain is often inadequate since it cannot know everything. He adds that decentralisation means that an organisation can respond more quickly to changes in local conditions, and also presents more scope for flexibility for capable individuals, which acts as a motivating factor.
Mintzberg suggests that there are six basic types of decentralisation, each linked to one of the six co-ordinating mechanisms described above. These are:

Type I – centralisation – direct supervision
Type II – limited horizontal decentralisation (selective) – standardisation of work processes
Type III – limited vertical decentralisation (parallel) – standardisation of work outputs
Type IV – horizontal decentralisation (parallel) – standardisation of skills
Type V – selective horizontal and vertical decentralisation – mutual adjustment
Type VI – decentralisation – standardisation of norms.

(a) **Type I: Centralisation**
Here direct supervision from the strategic apex means that each line manager controls those below in the hierarchy, so that all the power rises to the top to stay in the hands of the chief executive.

(b) **Type II: Limited Horizontal Decentralisation**
Where the standardisation of work processes is the method of co-ordination, workers at the lower levels in the hierarchy lose power both to those higher up the hierarchy and also to those in the technostructure, who are responsible for designing the control systems. This results in vertical centralisation to the strategic apex and limited horizontal decentralisation (selective) to the technostructure.

(c) **Type III: Limited Vertical Decentralisation**
Where work outputs are standardised, power to make decisions is delegated to a limited number of divisional managers, thus giving us limited vertical decentralisation, which is parallel because power is also at the strategic apex. There is also a selective degree of decentralisation to the analysts in the technostructure, since they control only the design of the standardisation of outputs.

(d) **Type IV: Horizontal Decentralisation**
In this type it is the standardisation of skills which provides co-ordination. The work is carried out by large units of professionals, who can operate with little control from line managers and be responsible for their own decision-making. This gives us a form of horizontal decentralisation (parallel) with power located in the operating core.

(e) **Type V: Selective Horizontal and Vertical Decentralisation**
Here the professionals work in small groups, co-ordinated by mutual adjustment, and are able to exert a lot of power. This gives us a combination of selective vertical decentralisation, with delegation to groups at different hierarchical levels, with selective horizontal decentralisation of power within each group of both managers and non-managers, with control resting in the hands of those with the necessary expertise.

(f) **Type VI: Decentralisation**
This is exhibited where co-ordination is affected by the standardisation of norms of behaviour between people who share the same beliefs and ideals.

Power is shared equally throughout the organisation, resulting in the most democratic form of structure.

There is ongoing debate about whether centralisation or decentralisation of decision-making is to be preferred, in both the private and public sectors. The term used for “decentralisation” in this debate is often that of “devolution”, meaning the extent to which the centre of the organisation allows the control of decision-making to pass lower down the hierarchy.

This, suggests Johnson and Scholes, raises the question of “control over what?”
Goold and Campbell considered this in their work on management styles in diversified organisations and provided stereotypes of possible relationships between the centre and the parts of an organisation, and how responsibilities for decision-making may be divided between them.

The three stereotypes they suggested, which we considered in some detail earlier, are:

- strategic planning
- financial control and
- strategic control.
Study Unit 8

Implementation and Control 2: Resources

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INTRODUCTION

This second unit dealing with implementation and control of strategy will concentrate on the allocation of resources, as a key aspect. We will look at the issues of resource configuration, planning and control as well as specifically discussing the role of information and information systems as a resource for improving strategic development and implementation.

Objectives

After studying this unit, students should be able to:

- analyse the ways in which resource allocation is central to strategic implementation;
- discuss the role of resource plans in implementation and control, and explain the processes involved;
- identify the value to the organisation of information as a resource, and assess the potential role of information systems in improving strategic development and implementation.

A. ROLE, SCOPE AND IMPORTANCE OF RESOURCES IN STRATEGIC IMPLEMENTATION AND CONTROL

Larry Alexander carried out a research project which included interviewing the chief executive officers (CEOs) of 21 different private-sector firms in order to find out which implementation problems they faced most frequently in attempting to put strategic decisions into effect.

As part of this study they raised the point that the provision of sufficient resources was an important factor.

They identified at least four different kinds of resource:

- **Money** was an obvious choice. It was regarded as a bottom-line requirement, and the CEOs accepted that a failure to provide adequate funding may lead to limited success in implementing a strategy, or to absolute failure to do so.
- **Human resources** were also identified as having either a positive or negative effect on implementation.
- **Technical expertise**, as related to the new strategic decision, was also mentioned. Companies which did not have this expert knowledge in-house accepted the need to hire it in order to implement strategic decisions related to new activities.
- **Sufficient time to implement the decision**: both adequate time and attention by top management and sufficient time for those affected by the strategic decision to implement it. So often it is not the difficulty of carrying out a new project which causes stress in people, but the time pressure and constraints under which they are expected to achieve it.

Successfully implementing a new strategy will have an effect on the overall distribution of resources within an organisation and so planning the use of the necessary resources for this operation is very important. In any organisation resources are limited, so part of the reason for resource planning is to make sure the organisation gets the best out of them.

Resource planning is carried out at two levels: corporate and operating. At the corporate level the resources are allocated between the different parts of the organisation, i.e. between the different businesses. At the operating level resources are allocated to the different departments.
A resource which the CEOs did not mention to Alexander, but which we will be considering in
detail later in this Unit, is that of information. Without information at the right level of detail,
and in time for it to be acted upon, it becomes impossible for an organisation to operate
effectively.

Resource planning is linked to the evaluation of a strategy since, without the necessary
resources to implement the strategy there is no sense in trying to put it into operation.

Often, particular strategies have to be abandoned because they lack the resources to carry
them through to completion.

**B. RESOURCE CONFIGURATION**

*Resource Deployment and Co-ordination*

**Resource Deployment at Corporate Level**

At the corporate level, strategy is essentially about resource allocation across businesses
(SBUs), business functions (marketing, production, etc.), divisions or geographical locations
(in multinational companies), or service department (in public services). In most companies,
however, formal strategy planning and capital investment appraisal are two separate things.

Alexander’s investigations showed that companies engaged in process portfolio planning try
to correct this contradiction by tying the capital investment process closely to strategic
planning. Few companies allocate resources primarily on the basis of strategies (he found
that only 14% tend to do so), but at least the business plan is regarded as an element in the
evaluation process for investment projects.

Very few companies tackle the allocation of strategic expenses, such as research and
development or marketing in the same way. In organisations where it is considered at the
strategic decision level that the deployment of resources does not require much change over
time, there is a tendency to use a formula in order to fix allocations.

For example, in a college, the allocation of funding to a particular department is often based,
per capita, on the number of students in that department, with maybe some scope for "horse
trading" between the departments themselves.

At a time of development in an organisation which leads to increased funds overall, the
allocation of additional funds can be made available to selected areas, to enable them to
purchase extra resources.

In the case of decline in growth, then resources may need to be reallocated to support
certain areas or to help with new developments. This is sometimes reflected by a change in
strategy with respect to appointments of staff, where, instead of it being assumed that if a
member of one team is lost they are replaced in the same team, each vacancy, however
arrived at, must be considered carefully before being replaced, and each new appointment
has to be justified beyond the principle of maintaining existing team numbers.

A particular problem of resource allocation arises where activities of different units overlap:
for example, where services such as information technology are shared.

**Resource Deployment at the Business Level**

Here resource allocation has to be take account of the need to add value to the
organisation's activities in order to achieve an advantage over competitors. Resource
planning at the business level is necessarily much more detailed than at the corporate level.
Johnson and Scholes recommend, nevertheless, that resource planning must be put into a
strategic framework, and that this can be achieved by considering resource identification, fit
with existing resources, and fit between resources.
*Resource identification* is concerned with knowing exactly what resources will be necessary to effectively pursue a particular strategy successfully and how these should be configured.

*Fit with existing resources* considers the extent to which the resources build on what is already available, and how the organisation will adjust its current resources to meet the requirements of the new strategies.

*Fit between resources* looks at how the new resources fit together, whether they are consistent in the way the various value activities are planned to support the strategy and a consideration of the new linkages which must be put in place.

**Business Process Re-engineering**

Business process re-engineering (BPR) is a method used to improve the effectiveness and efficiency of business processes, including the way in which resources are deployed.

**Principles of BPR**

BPR has two important features:

- Instead of assuming that the processes currently carried out by a business need to be improved, it looks at which processes are actually essential to meet business objectives, and aims to redesign them from first principles in order to improve cost, quality, speed and service.

- It regards information technology (IT) as an integral part of the business process, rather than a way to automate existing processes.

BPR aims to "reinvent" from first principles the way that companies carry out their business, by throwing away the view that they should be organised in functions and departments in order to perform tasks and concentrating instead on processes.

A process is regarded as a set of activities which, in total, produce a result which is of value to a customer, such as the development of a new product.

Adopting BPR means asking questions, such as:

- Why do we do this at all?
- How does it help to meet customer needs?
- Could we eliminate the task or process if we changed something else?
- How can we get away from specialisation, so that several jobs are combined into one, i.e. a more effective use of human resources?

**Approaches to BPR**

There are a number of approaches to BPR, one of which involves the steps shown in Figure 8.1.

**Figure 8.1**

- **Select** involves identifying which processes should be subject to BPR and defining their scope. One feature of BPR is that it is often most effective when applied to processes for which automation has not been successful, including processes which
involve a lot of customer contact. To improve processes of this type requires changes to working practices, as well as the introduction of IT.

- **Analyse** involves describing the current processes using techniques such as process mapping and organisation diagramming. Process mapping is similar to data flow diagramming. Organisation diagrams show the reporting relationships between the SBUs in the organisation.

- **Innovate** involves devising new processes which achieve the business objective, and is the most difficult and creative part of the process. Some techniques start with a blank sheet of paper, ignoring current organisation and processes. Methods which can be used include brainstorming or looking at how different business sectors handle similar problems.

- **Propose** involves documenting exactly what is being proposed and drawing up a cost/benefit analysis and schedule for the changes.

- **Validate** means ensuring the proposed changes will achieve the objectives sought. It will involve consultation with the staff affected as well as the assessment of the proposals against the organisation's strategies and the available technological resources.

- **Plan** involves planning the implementation of the proposed changes. It requires a combination of change management and project management skills. There are technological approaches which combine these disciplines, such as ETHICS (Effective Technical and Human Implementation of Computer Systems).

- **Implement** is where changes are made to working practices/organisation structure and the IT component.

Techniques such as value chain analysis can also be used, in order to think up new processes.

The advantage of this approach is that it also considers support activities and the way in which value chains interact: see Figure 8.2.

![Value Chain Diagram](image-url)

Another way of finding new processes is one which starts by looking at the existing ones in order to identify bottlenecks and waste. This is based on a technique known as "value..."
engineering", which is used in the engineering industry and which looks at every component of a machine to see how it could be produced at a lower cost. A similar approach can be used for business processes.

**Main Benefits of BPR**

- Customers can deal with a single point of contact.
- Several jobs can be combined, so that the primary need to satisfy the customer does not get lost in organisational complexity.
- Workers make decisions, which reduce the need for supervisors, resulting in fewer delays, lower overhead costs, better customer response times, and greater staff motivation.
- The steps in the process are carried out in a sensible order, and removing specialisation allows more jobs to be done in parallel.
- Processes can easily be adapted to cope with work of greater or lesser complexity, instead of making everything go through the same lengthy steps.
- Checks and controls can be reduced without a loss of quality.

In other words, BPR uses resources effectively, so BPR has resulted in considerable cost reduction in many companies. For example, IBM used to take seven days to process applications for credit by people wishing to buy computers. Before BPR was applied, there were five separate specialist stages through which an application was progressed: logging the credit request, credit checking, modifying the standard loan covenant, pricing the loan, and compiling a quote letter. Experiments then showed that the actual work involved took only 90 minutes; the real delay was caused by having different departments which did the work in stages and then had to pass it on to each other. By replacing the specialists with generalists, called "deal structurers", who handled all the steps in the process, the average turnaround time was reduced from seven days to four hours, and productivity was increased 100 times.

**Experience and Competences**

In Unit 3 we said that the competences of an organisation are the strengths which it has, and which give it its competitive edge. We saw also that experience curves can be used to show how costs of production decrease over time as experience is gained by those involved in producing units. These two attributes, competence and experience, represent extremely important resources within an organisation.

In recent years there has been a tendency to encourage older employees to leave, via voluntary redundancy or early retirement schemes. In so doing a lot of important resources have been lost. B and Q, the do-it-yourself store, have acknowledged this situation and encouraged older workers to return to their outlets. As a result of this they have found themselves a very good source of both competence and experience which has helped their company to develop a competitive edge.

**Competitive Advantage**

In defining the term "value chain", Michael Porter describes every SBU as being a collection of different activities, ranging from sales to accounting, that enable it to compete with other SBUs. He refers to these as value activities and says that it is at this level, rather than at the corporate level, that the unit achieves competitive advantage.

**Value Activities and Competitive Advantage**

Value chain analysis shows that an organisation is not made up just of a collection of different resources, such as machines, money and personnel, but that it is the way in which these resources are deployed through the organisation's systems of operation which make
the products or services valued by the customer or client. It is through these value activities and the linkages between them that competitive advantage is gained by an organisation.

Porter categorises the value activities as,

- **Primary**, which create the product or service, deliver it and market it, and provide after-sales support, and
- **Support**, which provide the input and resources which allow the primary activities to take place, i.e. company infrastructure, human resource management, technology development and procurement.

**Using Resources for Competitive Advantage**

In each of the categories it is the way that resources are deployed which leads to the creation of value, and thus to competitive advantage.

Johnson and Scholes suggest that resource utilisation can be achieved in three stages:

- by identifying value activities: assigning costs and added value, and identifying which are the critical activities
- by identifying cost or value drivers: those factors which determine cost or value of each activity
- by identifying linkages: which either reduce cost or add value, and which discourage imitation.

Management's role is to examine the costs and performance in each value-creating activity and to look for ways to improve, preferably ones which will add positive synergy to the whole.

Competitors’ costs and activities should also be looked at and their performance used as a benchmark for performance appraisal.

It is essential to look for competitive advantage beyond the organisation’s own value chain, by considering those of its suppliers and the members of its distribution channel, since these also have a part to play in the consumers’ perception of quality.

Resources of finance, personnel, production capacity, etc. all have to be allocated to achieve competitive advantage. One of the difficulties of resource allocation at the corporate level, especially, in large organisations, is the extent to which overlap, sharing or duplication of resources occurs between various parts of the organisation. This can apply across the board, from relatively minor considerations such as the sharing of photocopying services between departments, to major considerations such as two divisions sharing their transport and distribution services. It is issues such as these which affect the centralisation or decentralisation of control over resource allocation.

Central control over resource allocation is required where the strategies involved are dependent upon high levels of co-ordination or co-operation between different departments and/or divisions. Where divisions or SBUs are to a large extent independent, then control by the centre is less important.

**Boston Consulting Group Competitive Advantage Matrix**

BCG, in a development of their matrix approach to strategic portfolio planning which we considered in Unit 4, produced a competitive advantage matrix (see Figure 8.3). In this they plotted the number of possible approaches, by means of which an industry could achieve a competitive advantage, against the size of the advantage which could be gained.
Figure 8.3: BCG Competitive Advantage Matrix

BCG identified four industry types:

(a) **Volume Industry**
In these industries, there are only a few advantages which companies may gain, but these are relatively large. For example, in the construction industry, there is possible differentiation in criteria such as cost, speed, specialisation, etc. Profitability is correlated with company size and market share.

(b) **Stalemated Industry**
In these industries too there are only a few potential advantages and disadvantages, and each is small. The steelmaking industry is an example, where there is little scope for differentiating the product or its manufacturing cost. Profits here are unrelated to company size.

(c) **Fragmented Industry**
In these industries there exist many opportunities for differentiation, but again each is only small. A restaurant can differentiate in many ways but can only achieve a low market share. Once again, profitability is not related to company size.

(d) **Specialised Industry**
Here many opportunities exist for differentiation, each of which can yield a high pay-off. For example, specialised equipment makers can target very tightly, and small companies can be as profitable as large ones.

BCG plotted each of these four industry types on their matrix, as you can see in Figure 8.3. Most value-added opportunities can be copied by competitors and they are therefore relatively short-lived. For instance, the credit card company Visa was the first to introduce a plastic card with a hologram attached as a security measure, only to find that a week after they had publicly launched it a technique to add holograms to plastic cards was announced. The only real response to such competition is that adopted by some computer companies, who are committed to working in the future, producing new ideas as their competitors try to catch up.

**Competitive Differentiation**

Four areas may be identified for creating competitive differentiation: product, services, personnel and image.

(a) **Product Differentiation**
In order to create a product which differs from those of competitors the following points can be considered:
• **features** of the product, which characterise it and supplement its basic function;
• **performance**, which is the level at which the product's primary characteristics operate;
• **conformance**, which describes how nearly the product's design and operational characteristics match its target standard;
• **durability**, being the product's operating lifetime;
• **reliability**, which describes the likely guarantee of useful operation;
• **repairability**, which is the measure of how easy it would be to get the product fixed if it did go wrong; and
• **style**, which refers to how the product is seen by the customer, i.e. how attractive it is. (This is taken to such lengths by some manufacturers that you can buy different coloured covers for your mobile phone, but which in no way enhance its performance.)

All of these are parameters which designers can work within and they serve to illustrate what a large scope exists.

(b) **Services Differentiation**

The services which are offered in support of a product create a number of opportunities for differentiation:

- **Delivery** of the product. This may apply to accuracy, care and flexibility: for example, the availability of further attempts to deliver packages to customers unable to receive them at the first attempt.
- **Installation**: this includes checking that the product performs satisfactorily after it has been installed. Some companies deliver "white cabinet" items, such as freezers and cookers, and leave the customer to unpack them and get rid of the packaging materials, whereas more enlightened companies carry out these tasks on behalf of their customers.
- **Customer Training**: this involves making sure the equipment supplied can be properly operated by the customer.
- **Consultancy**: this can be made available to assist customers to be able to use equipment more efficiently, for example, in the case of commercial computer installations, which then leads to greater profitability for the purchasing company.
- **Repair** of faulty equipment. This involves getting the customer back into action quickly, by swift removal and replacement.

(c) **Personnel Differentiation**

Competitive advantage can be gained by recruiting better quality staff and then offering them good training facilities and incentive schemes. The John Lewis Partnership provide a good example of such policies, and many customers at their stores vouch for the difference it makes.

(d) **Image Differentiation**

Since there is often little to choose between alternative branded products, it is necessary for companies to look for image differentiation in ways such as:

- creative marketing through snappy slogans or attractive packaging;
- something which appeals to customers' emotions, such as the "British Farm Standard" which appears on a number of meat products in particular, and which also includes an easily identifiable picture of a tractor.
C. RESOURCE PLANS

A resource plan sets out to show how the resources within an organisation can be best used in order to pursue its agreed strategies.

Financial Planning

The allocation of resources of any kind will have implications in terms of finance, and this is achieved through budgets operated by managers.

Budgets have a number of different uses. For example, as we shall see later, they form an important part of management control. Here, however, we will consider them as part of the planning process.

A well-planned and constructed budget, based on a credible sales forecast and an acceptable level of profit, is a tremendous help to managers in assisting them to achieve company objectives. A good budget is a summary in numerical form of what a business does, and a well-constructed financial summary can act as a “window” through which the plans and activities of managers can be observed.

In practice, however, budget figures are arrived at as a result of planning and forecasts of expected performance. They have meaning only when backed up with actionable plans. The end point of each plan is the goal towards which actions are aimed.

For example, the marketing department of a certain international glass manufacturing company has set as its goal the achievement of an increase of 10% in sales over the previous year’s results (up to £1.4 billion). To achieve this goal, programmes must be developed for:

- marketing research;
- developing sales promotions, with certain characteristics, by a fixed time;
- launching advertising programmes, with certain features, during a given period of time; and
- preparing and deploying the salesforce.

At sub-unit level in each of these areas there should be related plans and objectives to contribute towards the achievement of the various programmes.

Also, the marketing area plans and objectives will need to be supported by co-ordinating programmes in activities such as new product development, purchasing, production, warehousing, transport, costing, pricing, etc. Without such a workable network of plans and objectives budget figures alone will be just hopes, or guesswork.

A budget, then, is effectively a model of the resources required to achieve objectives. It can be tested and adjusted in order to accommodate changes in expectations, or to check the progress that might be achieved in a project.

Of the budget headings which we will consider later, the one which is concerned with planning is that of the capital budget.

- Capital budgeting is concerned with resource capacity and the flow of funding for a particular project or decision. One of its limitations is that, as a consequence, it can fail to take account of the impact on overall organisational performance.

Other types of budget which may be used in financial resource planning include:

- annual revenue budgets, which can provide detailed financial resource plans, and may then be used to monitor performance against the plan; and
projected profit and loss accounts, which are used to forecast the possible effects of decisions on the overall performance of the organisation over an extended period of time.

One of the main difficulties in budgeting is that of reallocating funds when strategies change in the future. Because the power base of the organisation generally remains the same, those who made decisions on the original allocation of funds are reluctant to concede any reallocations.

This is particularly true in the public sector, where the decisions are made on a political rather than an economic basis. For example, when the euro was introduced, it was suggested that some states were adopting it for political rather than economic reasons.

**Personnel Planning**

Personnel planning is carried out in order to ensure the organisation has the right quantity and quality of staff doing the right things in the right place at the right time.

Strategic changes always have a significant impact on the people within the organisation, so these changes need to be anticipated whenever possible.

In carrying out personnel planning, Johnson and Scholes suggest there are three important issues which need to be taken into account: personnel configuration, recruitment and selection, and training and development

(a) **Personnel Configuration**

This is carried out by means of demand forecasting, which is a detailed analysis of the staffing requirements necessary for the organisation to succeed in following a particular strategy, including the number of staff needed and the skills they must possess. Where new strategies are to be introduced, it will be necessary to plan for changes in the new personnel requirements. This may lead to redeployment or the transfer of some staff to other parts of the organisation, or it may require the setting up of a redundancy programme. Each of these situations will have an effect on a resource plan.

(b) **Recruitment and Selection**

The emphasis placed on the recruitment and selection of staff must be related to the organisation’s strategic aims, and must take account of any likely changes in direction. Existing recruitment policies are likely to be effective for the type of work required up to now, but may not be suitable when a new strategy is implemented.

It may be possible to meet the new skill requirements by retraining existing staff but, if the magnitude of the change is large, it is likely that new staff who already have these skills will have to be appointed from outside the organisation.

An example of this kind of recruitment is provided by recent appointments of school headmasters or college principals from outside the teaching profession, because the skills of running a business organisation are very different from those of teaching and are more likely to be found in candidates selected from a business background.

(c) **Training and Development**

The amount of staff training needed in order to carry out a new strategy will be related to the degree of change involved. The greater the change, the more training will be necessary. In the case of existing staff being trained, this is more likely to be on-the-job coaching and practice. The content will be designed to suit the learning objectives of the staff in training, within the context of the organisation.
**Critical Success Factors**

We mentioned earlier, in unit 3, that a critical success factor (CSF) is anything on which the success of a strategic change depends, and that a resource plan should make sure that all CSFs are identified, and also that the number of them should be kept to a minimum.

One example of a critical success factor might be the reduction of customer response time; another would be a company which distributes to retailers products which have a short shelf-life.

The critical success factor for distribution may be to minimise delay in delivery to the retailers, so that the maximum shelf-life is available during the period on sale in the shop. This will minimise the level of out-of-date returns by customers, and also increase customer satisfaction levels. This non-financial objective should be measured in terms of days elapsed between the stock being released to the distribution department and received by the retailer, or as an overall percentage of the total shelf-life of the product which must still be available when the product is received by the retailer.

At IBM defining CSFs is part of the strategic planning programme, using a consensus approach with groups of senior managers. This takes place in the following stages:

(a) **Understand the Mission**

   The team collectively agrees a mission statement, in no more than three or four short sentences, which clearly defines the circumstances in which the mission will have been successfully accomplished.

(b) **Identify Issues Which Will Impact on the Mission**

   The team focuses on the mission and identifies dominant issues by listing one-word descriptions of whatever they think will impact on the mission's achievement, by means of a brainstorming activity, in which everyone contributes, nothing is ruled out, no judgments are allowed, and the facilitator writes down everything so that all team members can see it.

(c) **Identify the CSFs**

   By referring to the list of things they believe will impact on the mission, the team identifies the CSFs.

(d) **CSF Statements**

   These define what the team believes needs to be done to accomplish the mission. They are not only necessary to the mission, but also, together with the other CSFs, are sufficient to achieve the mission.

(e) **List of CSFs**

   There should not be more than eight CSFs, and they should include a mix of strategic and tactical factors. Absolute consensus must be obtained for those CSFs listed.

(f) **Identify and Define Actions Necessary to Meet the CSF Requirements**

   - Identify and list what has to be done to meet the CSFs.
   - Define the business processes needed to meet CSF requirements.

(g) **List CSFs and Processes**

   A matrix is produced which lists the CSFs and the processes relevant to each.

(h) **Ensure that CSFs and Processes Will Achieve the Desired Results**

   The team reviews each CSF to ensure it has the necessary processes which are sufficient to achieve the required results.
(i) **Implement the Action Plan**

The team confirms the action plan associated with the processes and sets up the implementation programme. Monitoring and follow-up arrangements are also put in place.

**Planning and Control**

It is not possible to identify a set of controls for implementing strategic plans which is common to all types of organisation, because of the wide range both of products and services offered and of policies and plans. There are many standards, however, which can be used to measure certain types of performance, such as the following:

- The contents of a product and its dimensions can be written down and used to control its quality.
- The rate of production can be quantified as number of products per day, shift, etc.
- Costs can be measured in terms of components per unit.
- Business income can be recorded as profit.
- Financial stability can be checked via cash available, working capital, depreciation, etc.

The ability to select critical control points is an important part of management, since sound control depends upon them. Control is an integral part of the planning process: it is not an exact science, but reviewing actual outcomes against anticipated ones will help to improve performance.

There are three basic elements associated with the control process.

- Setting the objectives or specific standards.
- Evaluating performance and measuring actual progress.
- Providing feedback for management to enable them to take corrective decisions and modify plans.

The role of control is shown in Figure 8.4, by considering the strategic planning and control cycle.
For the planning process to work effectively, there must be a willingness to change plans if necessary. Flexibility is essential, as also is a communication system which allows progress, developments or changes to be highlighted to management within the timeframe when effective action can be taken.

Control needs to take place at the three levels of planning:

- corporate
- marketing
- tactical/product.

Managers need to be clear about how they will evaluate the effectiveness of their plans, so that where necessary feedback systems can be developed and resources can be switched in order to achieve new objectives.

**Control Mechanisms**

Most control systems are concerned with costs, or quality or safety.

**Budgets**

Planning is carried out in order to ensure the organisation gets the best out of its limited resources, and a strategic plan is essentially made up of inputs to achieve a desired output.
The inputs are the resources (personnel, materials, machines, buildings, etc.) and the budget is a simple financial statement of the resources necessary in order to carry out the plan. It is also a quantitative plan of activities designed to control the allocation, flow and use of resources over a given period of time. Management control will consist of a number of budgets and forecasts. This consolidated budget will reflect corporate mission, objectives and strategies.

(a) Marketing Budget

Part of this consolidated management budget is the marketing budget which we will consider here in a little detail. The marketing budgets include:

- sales volumes, values and incomes
- selling expenses
- distribution and warehousing costs
- advertising and public relations expenses
- market research costs
- marketing salaries, commission, expenses
- customer services
- marketing administration costs.

(b) Budget Headings

Costs are usually considered under five budget headings:

- **Cash Budget**: liquidity, opening and closing balances, inflow and outflow of cash (share issues to bring cash into the company, dividends to shareholders which pay it out).
- **Budgeted Profit and Loss Account**: matching income received with costs incurred over a set period of time (in order to measure profitability).
- **Budgeted Balance Sheet**: looking at the total assets of a SBU and its liabilities, such as repayment of loans (to the corporate body).
- **Budgeted Funds Statement**: the sources of funding and how they are linked to corporate objectives.
- **Capital Budget**: concerned with resource capacity and the budgets for alternative strategic choices.

(c) Appreciation

The basis on which a budget is set is referred to as "appreciation", and this can be:

- % of past or projected future sales
- % increase (decrease) on previous budget
- in order to match the competition
- what is considered to be needed for the task.

Quality Control

Those areas which need to be considered for quality control include personnel, materials, and products.

- **Controlling the quality of personnel** involves the recruitment of the right staff in the first place, training and developing staff once they are employed, and carrying out regular appraisal in order to identify any areas which require further training and development.
• **Controlling the quality of materials** requires control over suppliers by means of selection of the right suppliers in awarding contracts and checking that quality standards of the suppliers are maintained.

• **Production control systems** need to be put in place in order to maintain the quality of the product which meets customer's expectations.

The maintenance of machinery and buildings is also an important part of quality control.

**Safety**

Anything which is concerned with safety of personnel, customers, plant, etc. is always a priority use of resources.

**Market Share Measurement**

Many companies use market share as a key control mechanism, for the following main reasons:

• Market share is felt to be one of the best indicators of the overall effectiveness of corporate strategies.

• Market share is very closely related to profitability. Even a small change in market share sometimes has a major impact on profit.

• Loss of market share is often the first sign that strategies are not working or that competitors' strategies are more effective.

• Market share measurement is central to some of the techniques of portfolio analysis and planning, such as the BCG matrix.

For effective market share measurement and control it is essential to define the market accurately. There must also be effective information systems to measure and track market share. In consumer markets many companies use retail audits to continuously track market share.

**Customer Satisfaction Monitoring**

(a) **Value as Control Mechanism**

In addition to market share measurement as a control mechanism many companies track and measure customer satisfaction as a key area in evaluating and controlling corporate strategies.

The advantages of including customer satisfaction as a control mechanism are that so doing:

• helps and encourages a stronger customer focus in a company

• can be used as a potential source of competitive advantage by a company

• helps support and improve product and service quality

• helps to motivate and encourage staff to offer better customer service.

(b) **Signs of Customer Dissatisfaction**

Companies should constantly monitor customer satisfaction through "customer tracking". Signs of problems with customer satisfaction include the following:

• falling sales and market share (see above)

• increased customer complaints

• increased returns/order cancellations

• increased customer turnover.
(c) **Benefits of Customer Satisfaction**

Increased customer satisfaction can give rise to:

- increased sales
- reduced marketing costs
- increased market share
- increased lifetime value of customers
- increased brand loyalty and customer retention
- new customers through recommendation.

**The Balanced Scorecard**

(a) **Purpose of Balanced Scorecard**

This approach to the evaluation of corporate strategic performance was developed in the early 1990s by Robert Kaplan and David Norton. It is an attempt to overcome the problems and limitations of some of the more traditional approaches to the evaluation and control of strategic plans.

The balanced scorecard is based on the notion that the more traditional approaches to the evaluation of strategic performance are too narrow and focus too much on quantitative, easy-to-measure, elements of organisational performance which are then translated into strategic control processes. These more traditional control measures tend to centre on areas such as financial performance (e.g. return on capital employed) or perhaps market performance (e.g. market share or growth). Very often control is based on a few measures of performance, or even just one measure.

Kaplan and Norton suggest that this focus on measurable but often narrow areas performance does not provide a useful way for an organisation to understand and control what needs to be done to make strategies work or, indeed, to evaluate how well the strategies are working. They suggest that traditional measures often concentrate on past rather than future performance and are unbalanced in focusing only on a relatively few areas of strategic activity. The balanced scorecard technique for controlling strategic planning has been developed in order to overcome these problems.

(b) **Nature of the Balanced Scorecard**

The balanced scorecard combines both quantitative and qualitative measures of performance. It also concentrates on evaluating the processes and activities associated with the effective implementation of a particular organisation's strategies. In addition, the balanced scorecard approach acknowledges the different expectations of various stakeholders in measuring and controlling organisational performance.

A key element of the balanced scorecard approach is the recognition that every strategy is unique. So, as mentioned above, the specific control processes which an organisation needs to focus on must be related to and stem from that organisation's strategies. The balanced scorecard approach identifies four key strategy areas that need to appear on every scorecard (though perhaps with differing specific measures of performance). These four areas are as follows, with examples of each.

- **Financial**: return on capital, economic value added, cost reduction, shareholder value, cash flow, and financial ratios.
- **Customer**: customer satisfaction, customer retention, acquisition of new customers, customer service.
Internal: personnel turnover, personnel satisfaction, product quality, output, stock turnover.

Growth/future: innovation performance, training and development, application of new technology, employee empowerment.

By including these four key areas, the balanced scorecard immediately forces a wider perspective on what constitutes effective performance and therefore what constitutes effective control with regard to strategies. It also links control not only to short-term performance and outputs, but also to the way in which processes are managed. This can particularly be seen with regard to the inclusion of the "Growth/future" category in the scorecard.

(c) Value of the Balanced Scorecard

There is no doubt then that this indeed is a much more "balanced" approach to measuring and controlling strategic performance. It also emphasises the interrelationships between different performance areas in an organisation.

But the balanced scorecard approach to control has its problems and limitations. There is still a danger of measuring those activities and areas of performance which are most easy to measure and not necessarily those which are strategically crucial. In addition, the balanced scorecard can lead to problems and conflict with regard to what to include. For example, the marketing personnel of a business may have a very different view on what are important strategic areas of control from, say the accountancy function. Finally the balanced scorecard can lead to excessive measurement and control, potentially detracting from implementing action.

Great care therefore needs to be used in the design, application and interpretation of the balanced scorecard technique. Managers throughout the business should be involved in the process: it is important to secure their agreement with regard to what should be on the scorecard.

Overall, however, the balanced scorecard has much to recommend it. It reflects the inter-dependence of a wide range of different performance factors which together determine strategic success.

D. INFORMATION AS A RESOURCE

Information and Control

The Control Process

The role of a manager involves decision-making and controlling. In order to make a decision, check the outcome and either confirm or modify that decision, these needs to be a control process. This process has five stages:

- Establish a plan.
- Record the plan.
- Implement the plan.
- Compare actual performance with what was planned.
- Evaluate and decide on further action.

In order to carry out this process information is needed for the first and fourth stages, so there is a constant flow of information during the control process. Without complete and up-to-date information, correct decisions and proper planning would be impossible. Incomplete or delayed information can also be damaging to management control.
An important question to ask here is how much detail is needed. The answer to this is the person who is receiving the information. For example at the operation level of management, routine information is required, which contains the facts of what has been done in order to provide a history of actions carried out. A shop manager may need to know the daily sales totals, whereas area office may need only weekly totals and head office only require monthly returns. Information should only be provided at the level and amount which is actually required.

Information Overload

(a) Dangers of Information Overload

Too much information is as much a problem as too little. For instance, if head office was provided with daily totals by each store, the information would simply be a mass of data requiring processing in order to be useful. Therefore, although a mass of data is needed from which to draw information, the details passed to managers should be no more than they require.

A finance company with which I worked some years ago decided to control the use of their in-house telephones because they thought too many private calls were being made. In order to do this they installed a machine which recorded on paper every call which was made out of the offices. The result was so much information that the person they employed to check it was overwhelmed, and the system had to be abandoned. When it was pointed out how much was being spent on the monitoring the company wisely decided it was cheaper, and better motivation, to allow staff to make a limited number of private calls.

It is important to remember that overall purpose of information for strategic planning is to improve the management decision-making process. It can be argued, therefore, that any information which does not add to this improvement is superfluous. In fact, if the manager is inundated with information and/or its collection, this can detract from rather than improve decision-making. For example some managers now spend so much time either reading, producing, or interpreting information that they do not have any time left to take decisions. Similarly, what useful information is available in the management information system is so difficult or time-consuming to get at that the manager simply ignores the information completely and goes back to using "intuition" and "judgement" to make decisions. Additionally, the information which is available to the manager, even if it is concise, may not actually be pertinent to his/her decision-making needs. All information in this category is superfluous.

We should also remember that information: its collection, dissemination, analysis, and interpretation all cost money. This cost must be set against the value of the information, again measured in terms of improved decision-making. Even where information improves decision-making this is not worthwhile if the costs associated with that information are greater than the benefits it bestows on the decision-maker.

(b) Avoiding Information Overload

It is thus possible to suffer from too much information, and this problem can be increased by developments in information technology. This danger can be minimised, however, through careful design of the management information and decision support systems. A well-designed information and decision support system should have the following characteristics.

● The system should be based on a careful appraisal and analysis of the decision-making requirements of managers. This involves establishing, for example, what types of decision are made, what sorts of information are required for these decisions and how this information is to be supplied. This involves consulting the end users of the system before it is designed and implemented.
The system should be designed to be user-friendly. Information is wasted if it cannot be, or is not, used. A major problem in the provision of information to managers is that often the system is designed to suit the information specialist rather than the actual decision-maker.

The system should be designed to be interactive. In other words, the system should allow analysis rather than merely retrieval of information. This means that the system should be model-oriented rather than data-oriented.

The system should be cost-effective. As mentioned earlier, information costs money. An effective system of information supply should be based on a careful evaluation of how the system will contribute to more cost-effective decisions.

Information should also be timely and accurate:

- **Timeliness** depends on who it is used by. At the operational level it might need to be instantly available. For example, on a production line the spoilage rate needs to be readily available in order to check any deficiencies as soon as they happen. At a higher managerial level the need for immediate information is reduced because more time is available for making decisions. Timely information is that which is available at the time it is required.

- **Accuracy** of information is related to its cost. Very accurate information is expensive, and often slightly less accurate but sufficient information, which is less costly, is all that is required. Accuracy in this context is not the same as precision. Sales figures could be expressed to a greater or lesser degree of precision, to the nearest penny or to the nearest thousand pounds. This may not matter; but if the figures used are incorrect, or the calculations made are wrong, then the information will be inaccurate.

(c) **Quality of Information**

The quality of information supplied is also very important for control purposes. Information needs to be:

- **relevant**: pertinent to the receiver, who will then operate more effectively with it than without it

- **reliable**: timely, accurate and verifiable

- **robust**: it will stand the test of time and of failures of handling

Managing Feedback

In order to prevent too much information being supplied to managers, which can result in them suffering from overload, the managers must decide what information and feedback they require and build provision for that into the planning process.

**Exception Reporting**

This is a useful tool to help managers to receive only the information they require. The system allows managers to set parameters, in terms of costs and revenue, enquiries or sales, etc. For example:

- The manager is alerted only to products or outlets whose actual performance is falling more than x% outside that budgeted for.

- Managers have to decide how much variance they can allow without being alerted to it, i.e. how big should x be?
The grid in Figure 8.5 plots all the products of a company, indicating for each product, A to I, their performance against budget; + or – costs, and sales levels.

By incorporating lines which allow for the tolerance limits set by the manager, only those products which need immediate attention are highlighted. In Figure 8.6, these are those products that fall outside 7.5% (i.e. \( \times \) has been chosen as being equal to 7.5).

In Figure 8.6 the products requiring attention because their performance is outside the 7.5% limit are:

B, where sales are down and costs are up
C, where sales are up and costs are up
G, where sales are up and costs are down
H, where sales are down and costs are down
I, where sales are down and costs are up.

**Information Systems**

**Development of Information Systems**

Information systems (or IS) have become an important concept in management because of the need for improved communications within organisations.

IS and their supporting technology were originally used to improve the supply of information to managers, for example, by means of visual display units (VDUs), so that it was more quickly available. Its main purpose was seen as improving systems which were carried out manually by clerical staff. The main advantages of these new systems were seen as:

- reducing clerical costs by improving efficiency, and
- improving the effectiveness of managers by providing them with better quality and more up-to-date information.

However, the sources of information remained the same as before, and so its quality was not improved. But most organisations now realise that investing in IS can lead to greater exploitation of information resources and that this is an important part of their business strategy.

The attitude of management to IS investment is influenced by their understanding of the potential benefits it can bring, and also by the reality of the benefits obtained previously.

During the recession of the late 1980s in the UK the commonly held view was that any investment in IS had to be financially justified. As a consequence of this many systems were developed piecemeal and this meant they tended to suffer from being "integrated" more by accident than design.

At BAC systems, for example, I recall many different personal computers (PCs) were purchased independently by different sections, depending to a large extent on personal preferences. A situation was reached where many of these systems were incompatible, and then a central control was set up to ensure that in future this would not be the case.

In order to use IS successfully today the main opportunities for improving business effectiveness lie in the efficient integration of systems, both internally and externally. To this end IS strategy is concerned with how the organisation will satisfy its needs for new computer systems to support its business.

One technique used in systems development is "affinity analysis" or "grouping", in which processes are grouped together according to the data they affect, and this is used to identify the best sequence for developing systems.

Systems development also has to take account of market and product strategies. There is no point in developing sophisticated systems to support markets or products from which the organisation intends to withdraw.

Cost/benefit analysis and investment appraisal techniques will be used to assess the case for systems development. The business may also impose an absolute limit on investment in IS to ensure expenditure does not get out of line with income growth (see Figure 8.7).
Information technology planning is used to schedule and allocate resources to projects in order to meet technology or information systems objectives.

**Using Information Systems for Competitive Advantage**

As more advanced technology becomes available for IS, organisations can now use it as a means of gaining competitive advantage. Some examples will illustrate how this can be done.

(a) **Lower Costs/Lower Prices**

Information has always been used to help control costs. Now developments in IT, giving better and cheaper access to detailed and timely information, has enabled much more effective cost-cutting. Sometimes this is through improved systems of control but increasingly information technology is actually lowering the costs of many business operations and processes. For example, developments in information technology have enabled companies to operate in areas of the world with lower labour costs, whilst at the same time still having effective control. Many companies now deal with customer enquiries through call centres in the developing parts of the world, and this has substantially lowered their costs for these operations. Lower costs where not passed on to customers necessarily mean higher profits for the organisation, and are particularly important therefore for the company pursuing a cost leadership strategy. Alternatively lower costs can be passed on in the form of lower prices, thereby enabling a company to have a price advantage over competitors, at least in the short run.

(b) **Knowledge of Customers and Their Needs**

Information systems are increasingly allowing companies to develop much better information regarding their customers and their needs. Databases, for example, allow companies to identify specific customer requirements, purchasing patterns, income levels, etc which facilitate product and service offerings which are more nearly tailored to the needs of individual customers. In some cases companies have moved towards what could be termed almost customised marketing, which in the past has not been possible or has been considered too expensive.
(c) **Knowledge of Competitors**

Databases facilitate improved information systems concerning competitors; their strategies, strengths and weaknesses, and likely future actions. The organisation which has good information systems on its competitors is in a much stronger position to develop and sustain successful competitive strategies.

(d) **Easier and Faster Purchasing Processes.**

Information technology has facilitated easier purchasing for customers, as well as for companies purchasing from their suppliers. The development of the Internet, and all the information technologies which accompany it (such as websites, electronic data interchange and the intranet), all make it easier for customers to order products and services and have them delivered. As we all know, an increasing number of customers throughout the world are purchasing through their home computers.

(e) **Improved Product Quality and After-Sales Service**

Information technology (again particularly the use of databases) facilitates quality control both for products and for services. Information systems can be used to analyse complaints and explore issues in product or service reliability. Improved after-sales service can be provided by better information systems. An example would be automatic service reminders generated by the information system and sent out to customers of a car dealership.

These, then, are just some of the ways in which information systems and IT are now serving to potentially improve an organisation's strategic capability and help it compete. Effective organisations now plan their information systems around this notion of using the system as a basis for competitive advantage. There is no doubt that the use of information systems for this purpose will continue to grow as companies seek to exploit information as a way of improving their competitive position.
# Study Unit 9

## Managing Strategic Change

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INTRODUCTION

In this unit we will be examining the processes by means of which organisational change may be managed in pursuing strategic goals.

We will review the types of change arising from strategic decisions.

We shall also identify the key levers in the change process, and discuss the issues which need to be managed in order to achieve effective change.

We will consider the role of change agents and of both internal and external stakeholders in implementing change.

Objectives

After studying this unit, students should be able to:

- review the types of change arising from strategic decisions;
- identify the key levers in the change process;
- discuss the issues which need to be managed in achieving effective change;
- analyse the importance of change agents and explain the role of internal and external stakeholders in implementing change.

A. WHAT CONSTITUTES CHANGE AND THE ORGANISATIONAL PROCESSES INVOLVED

The term "change" refers to any situation where conditions differ from one time to another. Development is planned change implemented in order to achieve objectives.

The Nature of Change

The changes which can be experienced by organisations and those who work in them are both extensive and wide-ranging. The rate of change in the modern world is rapid, and accelerating. The pace of change catches many organisations by surprise. This is due to many factors, not only in the technological field, but also in the way people see others, in their value systems, and in the demands they make concerning the quality of their life. But technology and competitive pressures are formidable forces amongst the many factors causing change.

Management in all fields has a duty to respond to developments in the external environment. An organisation must constantly be changing its objectives, and hence its organisational structure, working procedures and systems, and its management methods. Staff have to face up to changing their skills and their place of employment, even if they remain in the same organisation.

In the 1980s, a Pepsi-Cola executive, flushed with success as a consequence of gaining a competitive advantage over their arch rival Coca-Cola, wrote a book called "The Other Guy Blinked". Unfortunately for him, either he or his colleagues must also have blinked because Coca-Cola retaliated and recaptured the market share.

The changing environment affects both management and the workforce at all levels. For example, the production of a letter for a company has, over recent years, been changed at least five times in terms of the output method, with more changes probably still to come.

- In the 1960s, it is likely the firm would have provided manual typewriters.
- In the late 1960s these were quickly replaced by electric typewriters.
In the early 1970s along came more sophisticated models. Electric typewriters, such as the IBM Golfball, which enabled the operator to change the typeface.

During the late 1970s word processors were introduced – large dedicated installations, with three or four workstations operating through a central processor and output device. They required a fair amount of space and were very cumbersome, but offered the advantage of being able to correct, format, amend and tailor documents for the user.

At the same time, electric typewriter manufacturers were developing even more sophisticated models, such as typewriters with memories and the capability of utilising simple software packages.

In the 1980s most firms quickly grasped the opportunity to use the revolutionary new personal computer, which took up little more space than a typewriter and had greater capability than any previous technology.

The personal computer has miniaturised to a lap-top model, to a hand-held model, and looks as though it might itself become obsolete as the improvements in technology continue to move relentlessly onward ad infinitum.

The technology has undoubtedly made the production process easier, but a typical or average operator would have had to take each new innovation on board, not knowing how quickly change would come about or the amount of training they would need in order to achieve the standard of work required of them.

Some organisations are very responsive to change and have the culture and structure needed to support it. These are the organic type of organisation, which we described in Unit 7. They are proactive when it comes to change, and, rather than react to it in a crisis situation, when it is too late, they plan for change and make contingency arrangements to buffer any changes that may affect them. In organic organisations, change is linked to overall corporate strategy and therefore planned for accordingly.

Mechanistic organisations, on the other hand, are inherently bureaucratic in nature and, according to Burns and Stalker, do not respond well to change. This is not to say that they do not change, they just do not change as quickly as organic organisations. Because of this they tend to wait until the organisation is at crisis point before changes are made. This is adopting a reactive stance. As a consequence, change is not usually linked to overall corporate strategy.

Change is inevitable and we all have to learn to deal with it. As Charles Darwin said, "It is not the strongest species that survive, nor the most intelligent, but the ones most responsive to change."

Organisational Processes Involved in Change

As we have just seen, change can take place in different ways depending on the organisation involved. In general, change is best effected incrementally, i.e. in small steps over a period of time, since this allows it to use the skills and values of members of the organisation, allowing a smooth transition from one situation to another.

Transformational change occurs in large movements of strategy and comes about most often with bureaucratic organisations, such as the armed forces, when change has often been put off until a crisis point is reached due to strategic drift.

Organisational change is a complicated activity and its implementation is often met with resistance from several different angles:

(i) from middle managers who fear that delayering programmes will adversely affect them

(ii) from managers who fear a reduction in their authority and power
Communication and change

In fact there is often substantial resistance to change by individuals in an organisation which in turn can result in at best an indifference to new strategies and at worst outright hostility and defiance. Such resistance to strategic change may be due to many factors including, for example, protection of the status quo, a fear of job loss, uncertainty about what the changes involve, and so on. In some ways resistance to change is a perfectly normal and understandable facet of human behaviour, but if strong enough such resistance can detract in a major way from the effectiveness of proposed new corporate strategies and plans. The manager responsible for the implementation of corporate plans, therefore, must be skilled in the management of change and in particular must seek to try to minimise or, better still, plan to avoid resistance to change. There are a number of factors which the manager can consider in planning to minimise resistance to change, but one of the most important factors is that of effective communication. The following are some of the key ways in which effective communication can help in this respect.

- First of all the reasons for change must be communicated effectively. Often of course the reasons for changes in strategy may be complex. However, it is possible to communicate even complex reasons for changes in strategic direction in ways which have meaning and relevance to those affected by such changes. Any changes in aspects of corporate strategy which necessitate change by individuals in the organisation should be communicated throughout the organisation in a way which indicates their significance and challenge.

- Related to the above is the need to highlight only the priorities of the strategy. Some argue that only the key themes of any new proposed strategic approach should be communicated so as to reduce overall complexity and increase understanding.

- The need for and nature of any changes required as a result of changes in strategy should be communicated as soon as possible and without delay to those affected and involved. Obviously, sometimes this needs to be assessed in the context of factors such as the need for confidentiality regarding, say, proposed new strategic plans in an organisation, but as soon as is practicable any changes should be made known to individuals.

- A key way of ensuring effective communication is the involvement of individuals affected by any changes in strategy, both in the strategy development process and in the planning of change itself. Clearly not everyone can be involved to the same extent, but where a more participative style of management is used throughout the planning process, then it is likely that the communication of any proposed/required changes will be improved and resistance reduced.

- In attempting to communicate change effectively, it is important to focus on the mechanisms and particularly the channels for communicating strategies and any change issues associated with these. A variety of channels can be used, ranging from face-to-face contact on a one-to-one or group basis, through interactive means such as telephone and video conferencing, to written mechanisms such as memos, letters and emails and finally general bulletins including circulars, noticeboards, house magazines, etc. Clearly which media are used and are likely to be most effective varies from situation to situation. In general terms, however, where proposed changes are far-reaching and significant, and particularly where they involve complex issues and changes, then more personal face-to-face channels should be used.

- In addition to the formal channels of communication referred to above, the manager must also understand and utilise the informal systems of communication which exist in all organisations. Such informal channels are often referred to as the "grapevine" and
encompass forms of communication such as rumours, gossip, storytelling and so on. The grapevine will always exist so the manager must ensure that the information being passed through the grapevine is accurate and does not lead to increased resistance to proposed changes.

Finally, an important aspect of communication in the change process is the need to see such communication as being two-way. It is essential to encourage mechanisms for feedback regarding any proposed changes. Moreover such feedback should be treated, and be seen to be treated, as valuable and important. A variety of mechanisms can be used for feedback on any proposed or implemented changes ranging from, say, questionnaires through to interviews and of course group meetings.

Effective communication is thus crucial to the issue of managing strategic change in organisations and in particular in trying to minimise or avoid resistance to any such change.

**Schein's "Unfreeze- Change-Refreeze" model**

Schein recognised the problems that organisations face when planning and implementing change, and developed a model to use in order to pre-empt any potential resistance.

Schein's model is known as the unfreeze-change-refreeze model, and takes place in a number of steps:

- **Step 1: Unfreeze**
  This involves the organisation "unfreezing" existing attitudes and behaviour. Individuals go through a process of "unlearning" old habits, old perceptions and old ideas about how change will affect them.

- **Step 2: Change**
  This involves a "change" in behaviour. Individuals modify their old ways and adopt new ways of thinking about change: how it should be implemented, and how it can be positive rather than negative.

- **Step 3: Refreeze**
  The final stage involves "refreezing" the newly-adopted behaviours and attitudes. The organisation may need to offer positive reinforcements, such as incentives, to encourage individuals to accept the changes.

In this three-step model of change, the process as a whole is achieved through leadership, communication, education and training. Effective training can be used to create a major change in the attitude of employees, which must then be made permanent by creating the necessary structures, procedures and incentives to support the new culture.

A major task for management is to produce the initiatives necessary to achieve the freezing step. Some of the ways in which this can be done are by:

- setting up employee suggestion schemes;
- giving staff a greater input into the decision-making process;
- implementing schemes which reward good effort, such as "staff of the month";
- creating good team spirit through company identification schemes, such as logos, advertising, T-shirts etc.;
- producing company newsletters;
- making managers more visible, for example by "open door" policies or "managing by walking about" (MBWA) schemes.
This model can be used when individuals are opposing change, or when management wants to gain acceptance for a change that directly affects employees, such as a change in working conditions.

**Lewins' "Force Field Analysis" Model**

This is another model for helping the implementation of change. Lewins identified "driving forces" for change and "restraining forces" against change. Lewins believed that driving forces try to push change through, whilst restraining forces try to resist change and maintain the status quo. The model uses the concept of apparent immobility in a social situation representing a state of "dynamic tension", between the needs, drives, aspirations, fears and other feelings of the people involved.

The identification of the driving forces and the restraining forces, their strength and how they can be modified is the "force field analysis".

![Figure 9.1: Lewins' Force Field Analysis Model](image)

Lewins suggested two ways of dealing with change:

- Strengthen the driving forces by encouraging those associated with the change and driving the change, to educate and convince those who oppose it that it is for the organisational good.

- Weaken the opposing forces by:
  - persuading someone to act as a change agent in order to win over opponents
  - offering concessions to opponents in order to buy them off
  - involving individuals by means of employee participation principles such as quality circles, joint consultative committees, etc.
  - using a manager, with positional and personal power, to coerce opponents into accepting change.

Movement in the desired direction can most readily be achieved by reducing or removing restraining forces. Increasing driving forces before reducing restraining forces often increases the restraining forces in reaction.
B. TYPES OF STRATEGIC CHANGE

Managed and Unmanaged Change

According to Helsey et al, change can be implemented in two ways, participative change and directive change.

- **Participative change** is based upon a participative management style that utilises employee participation methods. Senior management can encourage employees lower down the hierarchy to be part of the change programme, and, as a result, accept the changes by:
  1. identifying a change agent who can gently coerce resistors to accept the change. Influential people, such as leaders of informal groups who wield personal power are ideal, because other group members do not see them as part of the "establishment".
  2. circulating information about the change. The group can then give their comments on the change, and management have a forum in which to listen to views, and perhaps amend the programme.

This type of participative approach may turn initial resistance to acceptance, and allow the change to be managed effectively. It has the disadvantage of being a lengthy process and may not be feasible if the change has to be implemented quickly.

- **Directive change** is the opposite of participative. Employees are notified at short notice that changes will be made. They do not have a chance to express their opinions and end up feeling change has been forced on them. As this is the case, attitudes and behaviour tend to become negative rather than proactive and this leads to resistance to the change. There is an advantage to this method of change, however, in that the programme can be implemented quickly. The drawback is that the resistance to it is more prolonged and greater, because employees feel they were not consulted about the change.

Both of these methods of implementation can be used when the change involved is being managed, or controlled, by the organisation.

By contrast, unmanaged change is that which is not being controlled, but is due to pressures outside the organisation which force change upon it. Factors such as reductions in customer demand for a product can force change on an organisation. Nevertheless change has always been with us, as Gaius Petronus said in 66 BC, "We trained hard, but it seemed that every time we were beginning to form up into teams we would be reorganised. I was to learn later in life that we tend to meet any new situation by reorganising, and a wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency and demoralisation."

So, the good manager plans for change and is able to manage it incrementally. Poorer managers have to cope with change anyway, and it tends to manage them.

Imposed Change

Some change is imposed on organisations by factors beyond their control. A PEST analysis shows us that political, economic, social and technological factors can all have an effect on an organisation from outside.

For example, government policies can dictate change. Local authorities and health service bodies have been frequently reorganised in line with changes in central government policy. Were the government to decide Britain should adopt the euro this would cause massive changes for business, as there were when decimal currency was introduced.
Economic factors beyond the control of businesses can also cause changes to be made. In a time of recession: for instance, businesses have to become leaner, and restructuring is often forced on them. In the aftermath of the terrorist attack on New York, many airline companies were forced to make big changes in their operations.

Changes in lifestyles also force changes on organisations. Finally, the rate at which technology is changing is constantly reducing product life cycles and imposing change, particularly in the electronics industry.

C. DIAGNOSING THE NEED FOR CHANGE

Strategic Drift

We first mentioned strategic drift in Unit 1 when we were considering the way an organisation's strategy often opens up a gap between what was anticipated to be achieved and what was achieved in reality.

Strategic drift can arise when changes are attempted to be introduced within the existing frame of reference, or paradigm, of the organisation. This indicates a need for change, which is best satisfied incrementally. If this is not done, however, the drift away from what is necessary becomes increasingly obvious, or environmental change increases, both of which lead to a deterioration of performance. A transformational change may then be needed to get the organisation's strategic development back on track.

Gap Analysis

We referred to gap analysis in Unit 6 and showed, in Figure 6.2, how a gap can exist between what is desired and what is believed to be possible.

Where such a gap exists it is necessary to adopt a strategy, or a series of strategies phased in over time. Whether a single strategy may be used will depend on the resource requirements necessary and their availability at that time. It may be that the required resources are not immediately available, and consequently a combination of strategies may have to be introduced and phased in as and when they can be delivered, so that necessary change is made.

Structures and Control Systems

For most organisations, achievement of their critical success factors will require a constant review of their organisational capabilities, and the necessary incremental changes to ensure that they are compatible with the business strategy.

The problem for many organisations is not that they need to change, but that they do not see the need for change. This is especially true for organisations which have been successful in the past and cannot see why they should change what they see as a winning formula with which everyone feels safe and comfortable.

John Gardner describes it thus:

"Most organisations have developed a functional blindness to their own defects. They are not suffering because they cannot solve their problems but because they cannot see their problems."

And John Galbraith comments:

"Faced with the choice between changing one's mind and proving that there is no need to do so, everybody gets busy on the proof."

An example of the need to change systems is provided by considering the problems of growth from a small to a medium or large organisation. When an organisation grows it is
usually as a result of being successful, and there is often a tendency to believe that everything is easy once success is obtained. It may be argued that the attitudes and behaviour which have led to success will lead to further success. However, it is often found that the contrary is true, and that growth brings new problems which may be difficult to overcome.

These may include:

- A tendency to become a confused organisation structure. As new people are brought into the organisation to provide the expertise needed in various fields, insufficient thought may be given to their precise place and responsibilities within the organisation. Growth must be planned and systematic and proper thought given to co-ordinating the activities of the staff.

- Necessity for a change of attitude. People cling to the old and the familiar. In a small firm people know each other well, but in a larger company the personal touch is no substitute for performance.

- The larger a company becomes the greater its need for long-term planning, and more time will have to be devoted to setting objectives and establishing realistic and relevant tasks and targets.

- As organisations grow larger, there tends to be a distance between top management and the lower levels. Each additional level of management is a potential obstacle to good communications.

When I first joined the staff of a local technical college, we had just a half dozen lecturers plus a principal and his secretary (who was the total administrative staff). At that time communication between us took place on a daily basis, often over the dinner table. As the college grew rapidly, and more staff were appointed, communications became more difficult; the problem was that systems of all kinds lagged behind development and confusion increased. This is often a problem with expanding organisations. By the time I left the college we had hundreds of staff working on a number of different sites, and with a well organised system of communication and control, without which it would not have been possible to operate.

Failing to react to the environment is also a potential danger for an organisation. As environmental threats build up it is imperative to change or the organisation will die. Sooner or later the organisation has to react to changes in its business environment and this will almost always necessitate changes to administrative systems, structures and procedures.

Structure invariably follows strategy. Organisation structure involves:

- grouping of jobs: do we want specialisation or flexibility or a service orientation?
- Integration: do we want co-operation or the benefits of differentiation?
- Centralisation: do we want to control, or to give autonomy?

Organisational Practices

Different organisations react in different ways to change, and to some extent this depends on their ways of operating.

For example, if a company is facing tight competition on pricing in the marketplace and as a consequence sees the need to streamline costs, it might decide to:

- downsize, i.e. reduce the number of jobs
- delayer, i.e. reduce the number of layers in the hierarchy
- widen the span of control, i.e. the number of people reporting to any one manager.
These actions would be primarily intended to reduce costs, but they would also have an immediate effect on communications and information systems, the flexibility of staff and the training required to achieve this, and on the style of management.

The organisation's practice of a "command and control" style of management would have to change to an "empowering", i.e. more delegative, style. In another example, suppose a company experiences wide local variations in consumer tastes and in the markets for its goods. If it practised a centralised functional structure and tightly controlled management style this would not be appropriate under the circumstances. Changing its structure to one of decentralised SBUs and giving a high degree of autonomy to local managers would be more likely to achieve the speed of reaction and local flexibility demanded by the current business environment, and so a change in its organisation practices would be needed to achieve success.

D. THE FOUR AREAS OF DESIGNED CHANGE

A designed change is one which has been planned by the organisation, rather than one that has been imposed upon it by external factors.

It can take place in four areas, by means of modifying the task, the technology, the structure or the people.

Modifying the Task

It may be that the required change can be achieved by modifying a task rather than a whole system or set of procedures. This represents the simplest type of change because its impact will be restricted to a small part of the organisation rather than the whole. It will require only a minimum change to operational procedures and a relatively small amount of retraining.

In order to modify the task we need to carry out the following steps:

(a) Identify the task (and confirm that a change is necessary)

The need for modification would probably have shown up over a period of time. For example, it may be that a publishing house has been used to receiving manuscripts from writers via the post, which leaves it open to the vagaries of the postal system. It is now possible to require all such work to be sent as computer files, which can be received a downloaded by any staff member with a PC. This would require no additional equipment, and minimal training

(b) Consider the implication of modifying the task

Any change will impact on other areas, so it is necessary to consider all the implications of modifying the task. This includes considering any effect on existing procedures. In our example, this would include checking whether there is a large stock of postage stamps or pre-stamped envelopes. We also need to consider what effect there might be on staff in the post room, including any possible redundancy costs. All of these have to be included in the cost of the modification.

(c) Analyse the modification

An analysis of the effect of carrying out the modification must include considering the effect it will have on systems or procedures outside the immediate area.

Consultation will have to be carried out with the users of the system, who may see possible problems that an experienced analyst might miss.

For instance, do all the writers working for the publisher have compatible PCs? If some valued authors are unable or unwilling to work on computers, there may have to be a parallel system in operation, using both email and post.
Propose and agree the modification

Once it is agreed to introduce the modification, the change must be documented. This has to include:
- details of the change;
- a business case for implementing it;
- the cost and any savings anticipated; and
- details of implementing the change.

This must be agreed with all those involved.

Implement the modification

After fully testing the task and ensuring that everyone is satisfied it will work, a date for implementing it must be set. Users of a new system must be fully trained to use it. On the date of implementation the analyst will need to supervise the operation to make sure it is carried out correctly, and have recovery procedures and back-ups available to return to the old system if the new one fails.

Sign the task off

Once the change is running smoothly and has been accepted by the users, management can "sign off" the modification, i.e. agree that the change has worked and is doing the job required of it.

Modifying the Technology

Office and computer technology is always being improved; it is an important, though difficult, task to keep up with all the changes taking place. A company must always keep on the move; since competitors will never allow you to stand still, you are either moving upwards or falling downwards in order to maintain company image and stay in the game. Also, new advances in technology make the job easier to do, more efficiently and in less time.

New technology

We can use the production of letters as an example. At one time these came from manual typewriters, often portable. If mistakes in the typing were made they could be erased and typed over.

Technology advanced and an electric typewriter with its own memory was marketed, which meant that errors could be amended before the machine actually typed the character.

The next stage brought word processors, which meant that a script could be corrected, using a VDU, before it was printed.

As the printer technology improved it became possible to produce letter-quality prints. The original printers proved too noisy, so insulated hoods were placed over them.

As technology advanced yet further it seemed that spelling deteriorated, so the next step was the introduction of word checkers into the package (but beware those who use "US English"!!). These allow the computer to highlight any spelling errors so that the operator could correct them.

Finally came the laser printer, which gives good quality printing at low cost, and quietly. Finally?...

This example serves to illustrate how technology responds to a need and provides affordable and efficient solutions.
It is the responsibility of the organisation to move with the technology. Some companies are still at the typewriter stage, and some writers still use pen and paper (Jilly Cooper claims to be one of them), not because they cannot afford to move with the technology, but because they are content with their existing system.

There is not necessarily anything wrong with this attitude, but it does mean that staff may still be carrying out laborious tasks that technology could do for them.

(b) Market analysis

Before adopting any new technology, the market must be well researched. A checklist should be drawn up listing all of the benefits required from the technology.

Advice can be obtained from manufacturers and suppliers but it is necessary to check that it fits in with your particular company and its objectives.

Any technology installed must be compatible with other existing systems and equipment and not result in your being restricted to just one supplier for future development.

You also need to check whether any equipment or software could be upgraded to deal with future advances, and not become quickly redundant. This is especially important in the field of computers.

(c) Impact upon the company

New technology can have a big impact on a company; for example, by increasing its efficiency and by providing a modern image to both customers and competitors.

More important, however, is the impact on your staff using it, both during the disruption when it is being installed and the noise associated with that and its operation.

Staff will also require comprehensive training in order to use the new equipment so as to become both able and confident. Even an experienced operator will have to become familiar with a new piece of equipment or keyboard, and often will spend time pressing all the wrong keys or buttons before becoming fully efficient.

Modifying the Structure

Change may not necessarily affect tasks or technology. It may be that changing circumstances, or the company’s environment, may indicate that a change of its structure or system is needed.

This is in some ways an easier change because it may not be expensive in terms of research into procedures and technology. On the other hand, it can be very difficult to change structures because they involve people’s responsibilities and lives, so you are likely to meet with resistance and a demotivated workforce.

(a) Need to modify a structure.

Change is necessary. In fact, it is essential to the health of an organisation. Even though the organisation may not wish to change, its customers or suppliers may oblige it to do so. This can involve considering changing even the entire structure of the organisation due to advances in technology.

(b) Problems associated with changing the structure

The existing structure must be analysed very closely to determine which areas are in need of change and will benefit from it.

Problems which can arise from changing an organisational structure include:

- Imposition upon existing responsibilities: Any change to job responsibilities or boundaries is likely to meet with resistance from people losing responsibilities,
or even those gaining them. In order to make such changes, therefore, it is important to consult with the individuals concerned and to clearly define the areas of responsibility. To encourage a positive attitude to such changes, senior management must be committed to the successful introduction of the revised structure, and must be seen to be so.

- **Problems of additional responsibility**: Additional responsibility, which is imposed on an individual due to a changed structure, can result in a number of outcomes, both positive and negative. Where the person is capable of handling the new responsibility, this is a positive and beneficial aspect. In fact, some individuals thrive on being given extra tasks and added responsibility. If the people are not capable of handling these extra tasks, then it must be accepted that, if they were previously capable, it is the change imposed on them which has resulted in their no longer being capable of being fully efficient. When considering restructuring, therefore, it is important to realise that not only the tasks but also the personnel must be taken into account. Those who were working efficiently on the old task but seem unable to cope with the restructured task may need to be redeployed.

- **Boundary definitions**: In changing organisational structures, great controversy can be caused by adding to or reducing existing boundaries and responsibilities. There are few people who will happily accept that, as a result of boundary changes, their responsibilities are to be reduced. Agreement must be reached through senior management decisions.

- **Organisational problems**: Changing the structure of an organisation can be complex. Lines of communication need to be considered and, if necessary, revised to reflect the new structure. Communication with customer's organisations may also need to be revised, and they may not appreciate the fact that your structural changes may cause complications with their current lines of communication with you. In this kind of situation a large amount of tact and diplomacy is needed, with the emphasis being placed on the positive aspects of the restructuring for both companies.

**Modifying the Attitudes of the People Concerned**

This is possibly the most difficult aspect of change. Our attitudes are an enduring set of beliefs which cause us to perceive things and to behave in given ways, and which exert a directive influence on the way we behave. It is very difficult to change a person's attitude; it is easier to change their behaviour. However, if you can change the way people behave, their attitudes, eventually, will come into line.

People are essential to the survival of an organisation, and it is important they feel they are contributing to its well-being and to that of their colleagues. Motivated individuals undertake their duties pleasantly, efficiently and profitably.

(a) **Barriers/Facilitators**

A number of barriers to change are related to the unwillingness of staff to move away from the way things have been done in the past, despite the fact they are no longer possible.

Well-established routines and procedures have a strong influence in attempting to maintain the status quo, along with control systems, and symbols. Relationships based on power or dependency are also powerful in persuading people to conform to “what they know” rather than entering into new, as yet untried, ones.

Facilitators in overcoming these barriers to the diagnosis of change needs include the participation of the staff concerned. This encourages people to identify themselves
with the change process required and to be able to see the positive effects which can be achieved.

(b) \textbf{Training}

Training explains the unknown to the unaware. It inspires confidence, and confidence spells satisfaction and productivity. When people are subjected to a change in their working environment then training, to create both confidence and motivation, should be high on the change schedule.

Although training will involve two measurable costs, i.e. the cost of the course itself and the loss of the employee’s production capacity during the training (the opportunity cost), gains, which are not as easily measured, will be made by the employee being able to carry out the new functions of the system a lot faster and with greater confidence.

(c) \textbf{Consultation}

It is the users who have to make the new system work, so they are the most important people in the system. Experienced analysts realise this and spend a large portion of the design time consulting with users and seeking their opinions on potential changes to the system.

Cost savings will be made if users are happy with the new system. If they are not, they will do everything they can to discredit it.

(d) \textbf{Resistance to Change}

Once a new task is learned, and experience has been gained in carrying it out, the individual gains in confidence and security. Changes threaten this security so, as we have seen, users often openly resist any changes to an existing system. Although consultation will help to overcome such resistance, it remains a difficult problem for managers to solve.

\textbf{E. MANAGING THE CHANGE PROCESS}

\textit{Management Styles}

\textbf{Theory X and Theory Y}

There are a number of management styles which have been identified over the years, but they tend to lead back to Douglas McGregor’s Theory X and Theory Y, which he proposed in his book “The Human Side of Enterprise”.

McGregor suggested that the way managers tried to control their staff assumed that they were in general lazy and shirked responsibility, with little ambition and a built-in dislike of work. Consequently, they needed to be strictly controlled and told what to do. An organisation run on such lines tends to exhibit an authoritarian nature, with power invested in the managers to enforce obedience.

Under such a system it is not surprising if the workforce become passive and resistant to change. This is Theory X.

In contrast McGregor suggested that people were naturally inclined to use their energy in both mental and physical effort and that they will exercise self-direction and self-control in pursuing objectives to which they are committed – this he called Theory Y.

The Theory Y type of organisation is participative, rather than directive, and in introducing change seeks to bring its staff “on board”. This suggests that an effective way of managing the change process might be to use a participative/collaborative management style.
Participative Approach to Managing Change

This approach to managing change entails participation in the change process by those affected by the changes envisaged. This is not just involvement or participation with regard to the implementation of the changes, but also the nature of the changes themselves and the strategic issues which underpin the need for change. By involving people affected by the potential changes in this way, individuals are more likely to feel ownership in the decision-making and change processes. This approach to change involves a combination of top-down and bottom-up planning. There is evidence to show that this approach to change can often improve the quality of decisions but, for it to be successful, those involved in the participation process must have the requisite skills and experience. This approach to change is also time-consuming and is therefore best suited to long-term or incremental changes.

Group participation is a useful technique for obtaining support in a situation of change. It is not a trick to make people think that they came up with the management's idea. In true participation, the manager first analyses the problem alone and tries to arrive at the best solution. Then he or she calls subordinates together to discuss the situation, and generally the outcome is that a better solution is agreed.

There is a big difference between three alternative approaches:

- informing staff of the decision to introduce change, which provokes maximum resistance
- consulting staff and then deciding, which gets less resistance
- involving staff in the decision-making, which results in the least resistance.

In practice, of course, decisions on change sometimes have to be made without much consultation, and in these cases the role for participation is reduced. However, participation by staff in the introduction of a change, the need for which has been explained to them, is often the best way forward.

The participative management style then is more appropriate in managing change.

Mechanistic and Organismic Systems

The more flexible a structure, the easier it is to adopt change. The more rigid the structure, the more difficult it is.

Burns and Stalker carried out a significant piece of research in which they contrasted two completely different systems of organisation: mechanistic and organismic.

Mechanistic Systems

The mechanistic system is characterised by:

- hierarchical structure of control, communication and authority
- differentiation of functional tasks
- emphasis on technicalities of the function rather than the needs they serve
- precise definition of duties, authority, methods and processes attached to each function
- operations and behaviour tend to be governed by instructions and decisions from superiors
- communications tend to be vertical and via precise channels
- greater importance attached to internal rather than cosmopolitan knowledge
- insistence on implicit obedience to superiors.
Organismic Systems

The organismic system is characterised as:
- continual adjustment and re-definition of tasks through interaction
- encouragement of contribution of specialised knowledge and experience to the task
- commitment to the organisation is wide and not limited to a technical field
- omniscience no longer attributed to the head of the business. Knowledge can be located anywhere in the network
- lateral rather than vertical communication
- communications consist of information and advice rather than instructions
- mutual confidence, rather than authority, is the main force
- wide participation in decision-making
- individual's conduct and behaviour is governed by community of interest rather than contractual relationship with superior
- manager is agent for maintaining intergroup communication rather than agent of higher authority
- members of the organisation are encouraged to grow to greater responsibility, rather than be controlled
- the primary, i.e. face-to-face, group is the basic unit of organisation.

The mechanistic system is more appropriate to a stable environment where little change is anticipated.

The organismic system is much more appropriate to a changing environment (such as the electronics industry) where constant research is being carried out and new products continually being introduced.

In the dynamic system, although positions are not hierarchical, they are stratified and defined according to expertise. The lead or authority is taken by whoever is most informed or capable, as in a matrix structure. The mechanistic system tends to be more comfortable for many as it is more easily understood and operated, whereas organic systems impose a greater strain and possible anxiety, but changes are much more readily and easily carried out.

Implications of Organisational Practices

When we considered organisational practices in the previous section we saw how the way an organisation operates, i.e. the way it carries out its functions, will affect how it can put a change into operation.

Those organisations which have strict rules for operating their business find it more difficult to introduce change.

Examples of such organisations are easily found in the public service areas, where services are provided which have to interlink with other services.

In these areas a change of organisation or behaviour in one sector can have a knock-on effect on others and the tendency is to stick to the status quo on the grounds that it works. In other words, "If it ain't bust don't mend it".

For instance, over the last few years there has been increasing pressure on schools to reorganise both their daily hours and their term times. As more flexibility has been put into the workplace, more parents are looking for greater scope to book their annual holidays, etc. One of the big obstacles to rearranging term times, in particular in the secondary and tertiary
sectors, is the timing of examinations, which are geared to higher education. Whilst colleges and universities insist on sticking to their current enrolment dates, there is little room for the schools to move their annual holiday dates. In order to make significant progress in this direction, all those institutions who are involved will have to come to a joint agreement to change, and this requires a change in many well-established practices.

**Power and Influence**

Pfeffer has suggested that power (and therefore influence as well) is stable in most organisations most of the time. Thus stability, not change, is descriptive of the power distributions in most organisations as well.

There are three main factors which promote stability in an organisation:

- commitment to decisions and strategies previously adopted
- the institutionalisation of organisational cultures, and
- the self-perpetuation of power, where those who have power are able to acquire the resources which in turn help the maintenance of power.

These areas act as powerful factors which promote organisational stability and discourage change, which then becomes both infrequent and also difficult to carry out at all.

Where it does not require a fundamental change in the power distribution of an organisation then change itself is easier to accomplish. However, where it does necessitate a shift in the distribution of influence, change is a rare event. It is then brought about mainly by a major change in the organisation's environment which creates problems which are too large to be ignored or where there are constraints which are too pervasive to be disregarded.

For example, when Matalan, the discount retailer, lost their chief executive after a boardroom row over the group's strategy, there followed a fall in sales growth which brought about a 33% collapse in the company's share price. This fall was explained by the company's financial director as due to "growing too far, too fast", and the need for a change of strategy to look for "consistent growth".

**Culture**

We have just observed that one of the factors which encourage stability in an organisation is that of commitment and a second is to the institutionalisation of organisational culture. These two together tend to prevent change from occurring and so in order to carry out a change they have to be overcome.

For a change to have meaning for members of an organisation it must be shown in terms of their daily experience. People like to be associated with success and part of the culture of an organisation is based on this. At one time British Aerospace had a large notice hung in their workshops, and printed on pay advice slips, which said "British workmanship at its best". This became a part of the company's culture, that they were at the forefront of good practice.

In these situations, a necessary change (for example, in procedures or systems) can be introduced into the culture by reassuring staff that the change is in order to maintain the overall success of the organisation, and that where a problem has been identified something positive is being done about it, so that commitment to the company is enhanced rather than reduced.

**Education and Communication**

This approach to managing and implementing change involves explaining the reasons for, and the main effects of, the strategic changes being proposed to the individuals involved in and affected by the changes. This may be done through, say, group briefings, company newsletters, and so on. The emphasis in this approach is on ensuring that everyone affected
by the proposed changes is made aware of what is happening, and why, and that the proposed changes are justified, and hopefully then internalised by the people affected. The advantage of this approach to change is that people feel more involved and perhaps less distrustful regarding the changes. It also helps management overcome the problems of rumours and misinformation which often occur when changes are not communicated effectively. On the other hand, this approach to change can be time-consuming and essentially involves a top-down approach. This approach is best used where there is a basis of mutual trust and respect between managers and employees, and where the changes can be communicated simply and effectively.

Effective communication is essential in managing change. How soon people are informed about a proposed change, and how well they are kept informed about its progress, are important factors in carrying it out. How this communication process is carried out will depend to an extent on the size of the organisation. To be effective it needs to be personal, i.e. a face-to-face encounter rather than a printed message.

In a small organisation this can be easy to achieve, by means of a meeting of all employees. In larger organisations, where this is not possible, it is often carried out by a series of small group briefings. In either case there needs to be the opportunity for discussion, rather than a monologue, and in the case of briefings it is important that:

- the information given out is the same for all, and
- the results of any discussion are made available to all.

**Tactics**

Inevitably, when faced with change, people ask "what's in it for me?"

Part of any process for managing change is to give an answer to this question.

Management strategies for change at work tend to fall into two tactical groups: hard sell and soft sell. Figure 9.2 illustrates some of the tactics within these strategies which may be used in trying to introduce greater flexibility of work processes. In the hard-sell tactics there is little room for showing advantages to the workforce. In the soft-sell methods there is much more scope.
There are frequent reports of tensions in this kind of area, when organisations announce major changes involving job losses and potential redundancies. There are often claims and counter-claims by unions and management as to the need for such losses and whether there has been adequate consultation and prior notice. Sometimes it seems likely that a softer, more participative, tactical approach would have lessened tension and made change easier to achieve.

**Figure 9.2: Management Tactics for Change in Working Practices**
Further Consideration of Management Styles

Thus far we have considered the following styles of managing a change situation:

- through participation and collaboration with those affected by the changes; and
- by educating the staff involved and communicating to them the reasons for, and the main effects of the proposed changes.

Here we will look at two further management styles which may be adopted, both of which are based on the principle that the manager's role is to manage. These are by direction, and by coercion. (A further style for introducing change is "intervention", through the use of "change agents". We shall consider this, and the role played by change agents, in the next section of this Unit.)

Direction

This involves the use of managerial authority to specify and introduce change. It is a top-down style of management based on the hierarchical organisational structure. It relies on the notion that strategic change is the responsibility of top managers, so such decisions are taken at the top of the hierarchy and those lower down are expected to co-operate in their successful implementation.

As with any management style, there are both advantages and disadvantages to operating in this way.

The main advantage of a directional management is that it acts quickly and, in a situation where change needs to be carried out rapidly, it is very successful. Its success will depend to a large extent, however, on how good the top management is in having a clear direction and vision.

Disadvantages which may arise are mainly due to resentment by those who feel they should have had an input into the decision-making process, and this can lead to problems of lack of acceptance, ill feeling and a lack of trust by those affected by the changes.

This style is most often found in the entrepreneurial type of organisation.

Coercion

This is the most extreme form of the direction style. Here, managers force people to accept a change by means of either implicit or explicit threats; for example, with a loss of promotional prospects or job security, by transferring staff to other parts of the organisation, or even sacking them.

Coercion takes the form of issuing edicts of the required changes and time limits as to when they are to be affected.

It is a risky process because, as with the direction style, people inevitably feel strong resentment to change which is imposed on them.

Nevertheless, in situations where speed is essential, where, for example, the company is facing a crisis situation, and where the proposed changes will not be popular however they are introduced, it may be that coercion is the manager's only option.

The coercive style is usually found in very structured organisations, such as the police force and armed forces.

Common Mistakes in Introducing Change

The following are some common mistakes made by managers in introducing change:

- Trying to use only one style, or a limited set of styles, regardless of the situation. Types of manager who make this mistake include:
  - the "hard man", who tries always to coerce staff;
(ii) the "people-friendly" type, who always wants to involve the team;
(iii) the intellectual manager, who relies on educating and communicating with staff involved (this is the commonest mistake).

- Trying a piecemeal approach to a change situation in an incremental manner, rather than one which is part of a clearly considered strategy.

F. ROLES IN CHANGE PROCESSES

Change Agents

In chemistry, the speed of a chemical reaction can be increased by the use of a catalyst, or change agent. Such a catalyst increases the rate of a reaction but is not involved in the reaction itself and so is not used up. It can be used over and over again to speed up the conversion of reactants to products. Different reactions require different catalysts to be used.

In a similar way, organisations can speed up and facilitate the process of change by using a change agent. Often the change agent role is performed by someone from outside the organisation, who has not absorbed the culture and values it possesses (although it is not essential than an outsider is used).

The change agent role may be played by an outside consultant, a specialist within the organisation, a new manager, or an enlightened manager who is able to look beyond traditional approaches.

Schein describes the role of change agent as follows:

"….to help the organisation to solve its own problems by making it aware of organisational processes, of the consequences of these processes, and of the mechanisms by which they may be changed. The ultimate concern……is for the organisation's capacity to do for itself what he/she has done for it."

The role, then, is not to solve problems but to teach the organisation how to solve them itself. The change agent is there to set in motion the collection of information and the building of models of the organisation, prior to indicating where intervention may be of use. The agent is there also to decide which techniques are the right ones to use in a particular situation, and to guide their use.

The change agent is also a powerful intervention tool, using him/herself as a trigger for action. Much of their influence springs from the way they relate to the client. Therefore, they must live the values they are trying to inculcate.

Managers

Denis Pym carried out detailed research studies into how people at all levels in an organisation respond to change, and identified a number of characteristics which led to managers being more or less successful in introducing change. These are summarised in the following table, Figure 9.3.
Managers who hold mechanistic views and have rigid personalities tend to react to change in one of two ways. They either cling to old habits/procedures more strongly, promoting like-minded people and closing ranks to make innovations fail, or they grasp any innovation as a magic answer, rather like a drowning man clutching at straws.

Managers have a vital role to play in introducing strategic change and if they are not totally committed to it themselves then they are unlikely to be successful. What Pym has shown is that the personal characteristics of a manager play a big part in controlling their ability to successfully implement change.

**Workers**

It is the workers at the "coal face" who are ultimately those who have to make a strategic change successful. Without their co-operation management cannot make it happen.

Tom Lupton pointed out that an individual is not only an instrument to be organised, but also a decision-maker. He sees the individual partly as someone who submits to organisational demands, partly as someone who reacts emotionally to them and other social stimuli, and partly as a rational being who decides about things.

With respect to change being introduced by a top-down strategy, Lupton suggested that, since top management is responsible for what happens to an organisation, it is part of their role to impose change.

However, the top-down management style is inadequate and denies the organisation the total skills of those closest to the job. Lupton suggested a way forward to release these skills by means of the consultative process.

Support for the view that change can be implemented from the bottom up as well as the top down is supplied by Pugh, who argues that managers who are themselves prepared to change are likely to consider ideas initiated at the shopfloor level.

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**Table 9.3**

<table>
<thead>
<tr>
<th>Less Successful</th>
<th>Managerial Characteristic</th>
<th>More Successful</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boss is &quot;expert&quot; on subordinate's job</td>
<td>View of technical skills</td>
<td>Boss no longer expects to be, nor is regarded as, the &quot;expert&quot;</td>
</tr>
<tr>
<td>Efficiency and human relations are separate features of behaviour</td>
<td>View of dimensions of leadership</td>
<td>Efficiency and human relations are merged</td>
</tr>
<tr>
<td>Directive and authoritative relations with subordinates</td>
<td>Equality in relations with others, authority according to contribution</td>
<td></td>
</tr>
<tr>
<td>Submissive relations</td>
<td>Decision-making</td>
<td>Less dependence on experience and more on evaluation of the evidence</td>
</tr>
</tbody>
</table>

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Support for the view that change can be implemented from the bottom up as well as the top down is supplied by Pugh, who argues that managers who are themselves prepared to change are likely to consider ideas initiated at the shopfloor level.
Carrying out a survey of subordinates' ideas for improvement has often surprised managers, because of the quality of the proposals made. One of the rules Pugh suggests as a means of successfully implementing change is to initiate it through informal discussion, in order to obtain feedback and encourage participation. Thus the workers' role in the change process goes beyond merely putting other people's ideas into effect to being a part of the decision-making process.

**Stakeholders**

Who are the stakeholders in an organisation? They include:

- shareholders
- managers
- employees
- customers, and
- the wider community whose lives are affected by the organisation.

What role do these play in the change process?

Well, we have considered already the role of managers and employees, so we now need to look at shareholders and the community. Both of these groups can impose a lot of pressure on an organisation with respect to change.

**Shareholders**

Shareholders have control of strategic resources and can remove or increase the supply of money to the organisation. If changes which the organisation plans do not receive the support of the shareholders, they can bring pressure to bear through:

- their voting power at annual general meetings, both with respect to resolutions about change and the re-appointment of directors
- their financial power by disposing of their shareholdings and precipitating reductions in share prices.

In these ways they act as a controlling influence on what the business is able to do.

**Community**

The members of the community have a political role to play. If the organisation is a public service organisation, for example, they can vote against proposals on spending, etc. Where they are particularly incensed they can prevent even government's plans being changed: remember the poll-tax rebellion in the late 1980s. Where communities feel the environment is threatened, they can also bring a lot of pressure to bear – think of objections to road schemes.
Study Unit 10
Issues and Developments in Modern Corporate Strategy

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   Approaches to Ethical Issues
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F. Environmental Issues

G. Planning in the Innovative and Entrepreneurial Organisation
INTRODUCTION

In this final unit we move away from a concern with the processes of strategy development and implementation in order to examine a range of major issues affecting corporate strategy in modern organisations.

These include international trade and globalisation, social responsibility, business ethics and the environment.

Objectives

After studying this unit, students should be able to:

- discuss the implications of international trade and globalisation for strategic planning and implementation, with particular reference to management, developing plans and organisational structures;
- identify the key issues raised by the concepts of social responsibility and business ethics, and discuss their impact on corporate strategy;
- assess the impact of environmental concerns on strategic planning and implementation.

A. INTERNATIONAL TRADE AND GLOBALISATION

Market expansion is concerned with extending the area in which a business operates, so that more potential customers are aware of the products or services you are providing.

Very often organisations cannot operate at full efficiency unless they are covering a whole region or country. It is not very effective to advertise your product on television if half your audience cannot buy it.

The need to compete has continued to grow, so that, having covered a country, the next step is to move over a continent, and then finally to sell your products/services worldwide.

Most capital goods companies have moved into overseas markets as their home markets become saturated. As more and more companies become multinational corporations, so more and more service organisations, such as insurance companies, have been forced to follow because these multinationals are their clients.

Exporting is a method of market expansion and is usually the first step towards international trading. This is often followed by the business setting up locations in other countries, where its products are manufactured as well as marketed, in order to take advantage of the local availability of raw materials, or of cheap labour, thus reducing transport costs.

Trade has expanded worldwide, so that we have now reached the stage of global industries. These have been defined by Porter as those in which

"the strategic positions of competitors in major geographic or national markets are fundamentally affected by their overall global positions".

A global firm is one that can secure major benefits in all areas of operation, with the ability to site production plants and distribution networks in whichever region of whichever country offers the best advantages.

This has led to nation states actively competing to attract foreign investment, and global corporations are acquiring an economic power to rival between Toyota and General Motors. We have also seen extension by acquisition, with the Swiss-owned Nestlé acquiring such companies as Findus, Libby, Carnation, Crosse & Blackwell, and Rowntree. In 1992 they adopted a policy of carrying the Nestlé brand identification on all products.
Domestic firms operating in global industries now have little time to determine strategy as the pace of globalisation is rapid and the windows of opportunity are closing. In Kotler's view the opportunities will soon become available in global niche marketing.

European companies seem to be less able than the Americans or the Japanese in conceiving global strategies. These two countries have dominated world markets in cars and electronics, for example. On the other hand, European companies are good at finding niche markets. Goldthorp has said that, "they understand this country, this block, this marketplace, and they tend to do very well in that".

It will be very interesting, in the light of Kotler’s and Goldthorp's views, to see what impact the European companies have on global niche marketing.

Firms trading out of their own country have often made mistakes in the past. In Unit 4 we mentioned the case of General Foods failing to sell cake mixes in Japan. Other notable examples include:

- Many Western products and promotions failing in the Far East through a lack of appreciation of the importance of colour. For example, red is considered lucky by the Chinese, whereas white is the colour of death.
- Many American products have failed in Europe because companies considered that the UK was a good test market for the rest of Europe.

These and other catalogued failures are the results of assumptions that:

- the rest of the world is like us (whoever "we" are)
- our way is best.

The key, as always, is to study the customers and consumers in the target markets and adapt a package to meet their needs. This does not compromise global branding, because the contents of, for example, a Nescafé jar, will be different from country to country. But the assurance that it will be good quality instant coffee remains, and the recognition is universal.

**The Competitive Advantage of Nations – Porter’s “Diamond”**

Michael Porter studied those factors which are associated with success in international markets. He identified four interlocking elements (referred to as "Porter’s Diamond") which underpinned the success of organisations from a particular country in international markets.

- **Factor conditions**: those necessary inputs of resources which the company needs in order to support its activities (in particular those which are due to natural resources). These include climate, an appropriate labour force and the relevant skills and knowledge which have been developed over time, for example in a location with a long history of engineering production.

- **Home market demand conditions**: the demands of independent purchasers of the company's products which make it necessary for it to continually innovate and improve them.

- **Other related local industries**: which support and collaborate with the company, thus enhancing its competitive potential.

- **Local rivalry**: this develops strong competitive characteristics which are needed to tackle the home market, and can then be applied to worldwide markets.

In addition to these four major elements, Porter also identifies others, which include:

- **Governmental behaviour**, in the form of intervention to encourage growth and the creation of jobs in areas of high unemployment, for example by granting subsidies and investment in development areas, or even by non-intervention.
The element of chance, which applies to companies as much as to individuals, i.e. being in the right place at the right time.

Potential Benefits of Globalisation

There are many benefits which may be gained by pursuing global strategies.

(a) Cost Reduction

Costs may be reduced through the economies of scale which arise due to the sheer volume of trade available on a worldwide scale.

Sourcing and/or operating from lower-cost countries also allow costs to be reduced, as does a reduction in the duplication of development, production and marketing costs.

Greater flexibility to exploit differences in factor costs between countries, or in exchange rates, is also available to global companies.

(b) Improvements in Quality

Exposure to a global market and the competition within it often has the effect of making a company improve its systems and procedures, and also the quality of its products, in order to compete.

This can be achieved through concentrating materials and personnel resources so as to satisfy the higher-level demands often found in new markets and with international customers, as opposed to domestic markets and consumers, who have a much greater choice of suppliers.

(c) Improved Customer Satisfaction and Enhanced Company/Brand Image

Marketing on a global scale leads ultimately to having brand names which are themselves recognised worldwide. This, in turn, added to the improved quality which accrues as above, creates an enhanced company image.

Success in the global marketplace, as in so many other areas, creates its own success. A company which has embarked upon a global strategy is able to use the same market mix in different countries. This then results in greater global recognition by customers, backed up by greater availability of both products and services, provided the company identifies "horses for courses" and does not fall into the culture traps which we described earlier.

(d) Increased Competitive Leverage

Global strategies enable a company to enter new markets by means of low cost advantage, due to economies of scale, etc. as we have just seen. They also allow a company to compete where there is the greatest potential for increased sales and profits, for example in opening up new markets in countries such as China.

Having a greater number of markets in which to operate increases a company's opportunities to attack its competitors, and also provides the option of moving out of a market which is saturated or is suffering from a depression and transferring attention to other markets which are currently more buoyant. In other words, it allows the company to have a portfolio of opportunity where a balance can be struck between different markets, rather as an investor in the stock market seeks to have a balanced portfolio of stocks and shares, so that falls in one company can be offset against rises in another.

Pursuing global strategies has a number of advantages for a company which go beyond mere economies of scale, although this is itself an important factor.
A Global Approach to Strategic Planning

The recent growth in the global company and a global approach to strategic planning has been due to a number of driving forces which have affected the structure of the global market and made it what it is today.

We have already discussed the potential cost advantages of operating on a global basis, and these act as a driving force, prompting more global approaches.

Other important driving forces include the convergence of markets, government policies and global competition.

(a) Convergence of Markets

As markets have converged on an international scale, the global customer has developed as an important feature. This has been partly due to the shrinking of the world through quicker and cheaper long-distance travel, which has resulted in customers being made aware of the variety of food, clothes, entertainment, sporting activities and lifestyles available in general across the globe. As a consequence the needs and tastes of people in widely different geographical locations have converged: for example, Witness the spread of fast food from McDonalds to countries such as Russia.

This convergence has been further encouraged by changes in shopping methods, with the Internet and the World Wide Web enabling people to shop easily on a worldwide basis. The introduction of the European single currency is another factor which encourages this convergence.

All of these factors combined have resulted in the need for companies to develop a global approach to strategic planning.

(b) Government Policies

Both governmental and trade policies have also acted as driving forces for global change. The idea of free trade and free markets has been put forward as being to the advantage of all countries. Movement has been achieved on a limited scale and has resulted in a number of trade barriers being lowered, but there is still a long way to go before prices of goods are equalised, even throughout members of the European Union (EU) despite this being based on the principle of free trade between the member states. A number of countries, including France and the USA, still fiercely defend their own interests by imposing trade embargoes when they feel these are necessary.

(c) Global Competition

Because of these driving forces already described, more and more companies are developing global strategic planning and operations. This, then, acts as a pressure on other companies who are still operating on a domestic basis to come into line, since they find themselves faced with competition from virtually every part of the world, whether they like it or not. As more companies become international in their development, the interaction between competitors on a global scale is bound to increase.

All of the factors we have described have been responsible, along with others, for the development of a global organisation of companies which, over the last decade, has been a very significant factor of the world economy.

"No country is an economic island".
**Implications for Corporate Planners**

The growth of globalisation means it is increasingly necessary for today's manager to develop skills in planning and managing with a global perspective. This has the following implications:

- **First**, both opportunities and threats must increasingly be assessed on a global, not a domestic or even international basis. Corporate planners must widen their focus to include global competitors and customers.

- **Second**, technologies and production methods must be selected from the best available, whatever its source, and the suitability of such technologies will need increasingly to be assessed in the context of global production and manufacturing.

- **Third**, manufacturing and investment must be carried out in those countries which make the most cost-effective and strategic sense.

- **Fourth**, product, marketing, and other strategies must be designed with globalisation in mind. Careful attention needs to be paid to issues such as standardising products and brands for global markets. Ford and McDonalds are examples of companies which have benefited from this approach.

- **Finally**, staffing, organising, and control mechanisms have to become increasingly global in nature. Decisions have to be made regarding domestic versus international management. Control and structures will have to deal with diversity and distance.

**B. STAGES IN THE DEVELOPMENT OF INTERNATIONAL ORGANISATIONS**

**Exporting**

As we have just seen, exporting is a method of market development and is the first step from being a national to an international organisation. In export marketing an organisation is firmly based in a home market and sets up trading arrangements with other countries.

**Overseas Investment/Divisions**

The next stage in development towards global trading is for the organisation to locate some of its manufacturing, distribution or marketing operations overseas. This may be achieved either by investing in other companies or by setting up an international division. In this arrangement the home-based structure may be kept in the beginning, whether it is functional or divisional, with the overseas interests being managed separately through a dedicated international division.

The reasons companies move in this direction are sometimes related to tariff barriers or due to import controls being imposed on exported goods.

They may also stand to gain through reductions in the cost of labour, materials or distribution.

**International Operations**

An international business applies marketing operations across national frontiers and will usually have subsidiaries established in its major markets. It may even export from these subsidiaries.

According to one entrepreneur, the first distinction between export and international marketing lies in the location of employees – both a resource and a commitment. He sees the real key as being the addition of a resource, and suggests that a great many companies have strong commitments to foreign markets but do not themselves commit their own resources overseas.
Companies which have no direct control will never achieve such a strong market position as those who actually manage their own resources. Those who wish to attain a strong market position but find their overseas markets do not contribute much to their revenue should therefore take a harder look at the methods they are using.

From simple beginnings, progression via greater commitment of resources can lead to the point where a company has a complete marketing and production operation through a subsidiary company.

Not every country will allow this arrangement. Some prefer joint ventures, in which they stipulate a percentage of national ownership. Others, particularly the "developing countries" prefer to import whole production facilities and hire the expertise to manage them for a while.

**Multinational Operations**

Multinational companies operate in a large number of different countries. They differ mainly from international companies in terms of scale and of attitude. National identities almost disappear and managers see the world as a whole, although having local differences.

Multinational companies are not associated with any particular home market. As a consequence of their non-nationalism they often come into conflict with governments. For example, the British government has been known to claw back money from multinational companies on the grounds that they have made "excessive" profits. One company to suffer from this in the past is Laroche, the Swiss pharmaceutical company. In order to develop into a multinational company, then, it is necessary to be able to act uniformly on a worldwide basis, where differentiation between both products and markets is not very pronounced.

**Global Companies**

A global company has passed on to the stage where it plans worldwide manufacturing facilities, marketing policies, financial flows and logistical systems. Components and supplies are bought where they can be obtained cost-effectively and global operating units report to the Chief Executive or executive committee rather than to the head of an international division. Staff are recruited from many companies and managers are trained in worldwide operations, not just domestically or internationally.

For instance, Nestlé brought the MD of their Australian operation to run the UK one for 18 months, whilst the UK Production Director went to Australia to gain experience before coming back to take over in the UK. Both of these relocations were made with only a few days notice, despite the seniority of the individuals concerned.

Domestic market operations are no longer viable for the serious organisations. The technology exists to operate globally and the results prove this to be a very effective strategy. There are problems within the global environment, but they have to be faced up to if the organisation is to survive, let alone prosper.

The international product life-cycle suggests that comparative advantage in many industries is moving from high-cost to low-cost countries, and companies cannot stay domestic and expect to retain their markets.

The first step is to understand the international marketing environment, particularly the international trade system. A full management and marketing audit must be carried through on each and every market, and the concepts of "export" and "international" must be got rid of. A global strategic plan is identical in process to a domestic plan, but the operating area is much larger and the fluctuations, for example foreign exchange rates, much more volatile, thus adding to risk. However, as Porter has said "Global companies win out", so that makes it worthwhile.
Expanding into International Markets

We have just considered how a company can develop from operating in a domestic market to taking a place in the world market.

Before such a move is made, however, there are a number of considerations and decisions which have to be taken.

(a) Analysis and Evaluation

The first step which must be taken is to determine whether the financial resources which will be needed to develop an overseas market are to hand. This can be carried out by means of an investigation of the company's strengths and weaknesses, i.e. by means of a SWOT analysis as we described in Unit 3. This will also show whether other necessary capabilities, such as personnel, marketing, production, etc. are available.

This analysis needs to be interpreted from an international standpoint, i.e.

- Are our staff capable of operating within a different culture?
- Do they have the ability to use foreign languages?
- Do they understand other national characteristics?

Armed with this information, it should be possible to decide whether the company could pursue its overall corporate objectives whilst operating on the international stage.

From the SWOT analysis the opportunities and threats associated with expanding internationally will also be shown up, and this knowledge can be used to assess the possible outcome of a decision not to expand in this way in terms of competitive ability.

Opportunities and threats are related to the external environment in which the company is operating, or in this case considering operating.

In Unit 2 we saw how a PEST analysis considered political, economic, social/cultural and technological aspects of the external environment. To these we could add demographic (births, deaths, etc.) and competitor factors. All these factors need to be included in the international perspective, even though their analysis is more difficult when applied to markets which are different to those with which the analysts are familiar.

In order for an excursion into the international marketplace to be successful it is important that market selection and market entry are tackled correctly. To achieve this it is necessary to evaluate the markets under consideration by means of the following criteria:

- assessment of market potential
- accessibility of the market
- suitable method(s) of entry
- analysis of competitors' products or services.

From this evaluation the company's competitive advantage vis-à-vis its rivals in the chosen international market must be measured.

(b) Market Entry

The next step is to consider how the chosen market should be entered. In Unit 2 we considered some of the barriers which may have to be overcome in entering new markets. We have just seen that the simplest way to move from being a domestic to an international player is via overseas exporting of goods, then developing by means of overseas investment and the setting-up of an international division.
Shared ownership schemes or joint ventures with foreign companies are another way into international trading.

The attractions of these schemes include:

- the cost advantages (as already described);
- the perception of being a local rather than a foreign company; and
- possible positive synergy gained through the distinct competencies which each company can bring to the partnership.

Other ways which companies may use in order to expand internationally include licensing agreements, whereby the right is granted to another company to manufacture the parent company's products.

An example of this is provided by the glass manufacturer Pilkington, who, in the late 1950s, developed an extremely advanced process for making plate glass. This process enabled the company to cut their manufacturing costs to such a degree that they could have gained an unassailable competitive advantage over other glass manufacturers. They decided that, instead of keeping the process to themselves, they would make it available under licence to the rest of the industry. They later said that the decision was made partly because it seemed the correct moral thing to do, and partly in return for royalty income.

Strategic decisions about which markets a company should trade in, whether they are domestic or international, ought to be based on research into both the company's internal capabilities and its external environment.

In terms of international expansion, these decisions should be based on the current international market and on the company's ability to compete on an international scale.

C. STRATEGIC ISSUES

Researchers have carried out studies into how national culture affects such factors as employee motivation, management style and organisation structure. They have discovered identifiable differences in these areas between different countries.

For example, British culture has a higher level of tolerance of uncertainty than have many others, including France, Germany and Spain. French managers are highly risk-conscious and tend to react to uncertainty by referring situations upwards to a higher authority, ultimately to the government.

**Management**

Differences in culture have implications for managers in multinational companies when they are deciding how best to implement strategic decisions across their different divisions.

Two strategic considerations likely to be affected by national characteristics and culture are where the strategies are to be planned, and where an adaptive approach may be more successful.

- **Planned strategies** are most appropriate where uncertainty is dealt with by reducing it, and where the emphasis is placed on the hierarchy, the individual and the work tasks. Organisations which follow this pathway are seen to be proactive and in control.

A good example of this type of culture is the USA. Here society is seen as championing individual rights and being tolerant of racial and religious differences. The Americans have strict job descriptions and set out to hire people who fit them. But despite this emphasis on individualism, and particularly on personal development, American companies seem to strive also for homogeneity: dressing in the "company
style" for example. Americans generally adapt very readily to working in teams and can quickly establish rapport with one another when brought together for a joint project. (They are often issued a team shirt, to help build this spirit.)

- An adaptive strategy is likely to be found in cultures which accept uncertainty more readily. In this case the organisation has less control and is reactive rather than proactive, and the tendency is to look towards the group rather than the individual.

The Japanese provide a good example of this type of culture with their emphasis on teamwork. Japanese managers are well known for their ability to motivate their employees and create harmony, intense involvement and a deep commitment to the company's goals.

Europeans, like Americans, are tolerant of racial and religious differences in general, and even more tolerant of individual differences. European employees tend to be less willing than Americans to conform, and tend also to show a lack of respect for authority. It may be argued that this natural dislike of authority can produce advantages for an organisation, with managers delegating decision-making downwards. This encourages staff at lower levels to be creative, and this in turn increases their confidence in their ability to change things which "matter". When appointing staff, European managers are less rigid than Americans and are more likely to "adjust" the job description to fit it to the individual hired.

European companies have a looser concept of corporate culture than exists in the USA or Japan. Dress codes are also much less controlled. European managers are trying to learn from the Japanese how to encourage and improve teamwork with their staff. One of the factors making this difficult is that of the culture and education system which encourages people to compete against one another in order to achieve success.

Finally, Drucker has even suggested that management is itself a "culture", rather than a discipline, and as such has its own set of values, beliefs, tools and language. The real challenge for management, then, lies not in coping with the different cultures of the Germans, Japanese, etc. but in overcoming the limitations of its own culture. The problem is not a simple one, and neither is the solution to it. It lies not in tackling problems in a piecemeal uncoordinated way, using techniques such as quality circles, team-building programmes etc., but in creating an overall fit of all the managerial parts.

**Developing Plans**

We considered in Unit 7 the different structures which multinational organisations adopt. Starting from the simplest, where overseas subsidiary companies are controlled by direct contact between the manager in charge of the subsidiary and the chief executive of the parent company, towards the setting up of international divisions dealing with overseas trade, there is movement from centralised planning at "home", towards devolving responsibility so that planning can take place within the overseas culture.

Transnational company structures, as suggested by Bartlett and Ghoshal, move further towards planning on a local basis taking precedence over a centralised "head office" structure. Where authority and power is decentralised, planning will also be decentralised.

Johnson and Scholes see the issues of structure and control at the corporate level and relationships between businesses and the corporate centre as being a major strategic problem for multinational firms. This is due to the firm being involved in a range of businesses of different types in the form of subsidiary companies in a holding company structure or divisions within a multidivisional structure.

The issue of centralised planning and decision-making versus decentralised has never been resolved. On the one hand it seems that those on the ground at the sharp end of the business, i.e. those based locally, are best placed to do so. On the other hand, an activity in one part of the world must be consistent with corporate policy and so the autonomy of companies established within nation states is subject to the overriding policies of corporate
management. As the role of the corporate decision-maker has grown it has also become more distant, and key decisions about plans and strategies, although formulated at "local" levels in overseas divisions, often have to be referred to a central office.

**Structure**

Many organisations adopt an organisational structure which reflects geography to some extent. This may apply both:

- Domestically, where branches are grouped by area and region, and
- Internationally, where branches and divisions are grouped by country or by groups of countries.

Grouping by country within an international network makes sense for a number of reasons. The organisation may have to report to local regulatory and tax authorities, which requires a "country head office" to consolidate the information required.

Organisations increasingly attempt to align their internal structure with the markets they serve, so that customers will find themselves dealing with staff who are aware of the particular requirements of that market. In the multinational organisation this is usually best served through a divisional structure.

An example of a highly successful company which has always been at the leading edge of innovative organisational structure is Matsushita Electric, which is amongst the fifty largest corporations in the world, and markets its products under such well-established brand names as National, Panasonic, Quasar and Technics.

In the 1930s the founder of the company, Konosuke Matsushita, organised it in terms of divisions, in order to keep the company small and entrepreneurial, and to provide clarity and control. Each division was set up on its own, at a time when the company was involved in manufacturing radios and other small consumer appliances.

Matsushita himself was attracted to the divisional structure because he saw the behavioural advantages, with each division led by a manager motivated to keep a sharp eye on the marketplace, rather like the captain of a ship keeping a look out on weather conditions.

Matsushita was motivated in this decision by four factors:

- A desire to have independent divisional managers whose performance could be clearly measured.
- Due to their self-sufficiency, managers would be driven to establish a strong consumer orientation.
- This would gain the advantages of small companies, in particular their flexibility.
- Specialisation of divisions would train managers much more quickly, thus providing a pool which would be needed as the company expanded.

He balanced this move towards decentralisation by centralising some key functions:

- a comprehensive accounting system
- a company "bank" into which profits from the divisions were paid, and from which they could apply for funding for capital improvements
- centralised personnel function
- centralised training.

Over the years the company has been flexible in terms of centralisation and decentralisation as the founder deemed necessary in the prevailing environmental conditions, but throughout the centralisation of the four key functions has remained.
D. SOCIAL RESPONSIBILITY

What do you understand social responsibility to mean?

Koontz and O'Donnell see it as a personal responsibility. They define it as "the personal obligation of everyone, as he acts in his own interests, to assure the rights and legitimate interests of all others are not impinged".

They see it as a social obligation owed by individuals and not by organisations.

Marks and Spencer, on the other hand, see it as an obligation of organisations in respect to their relationship with the community in which they operate. In their annual review for 2001 they were pleased to report that in MORI's annual study they remained in the ten most respected major companies in terms of social responsibility. They pointed out that, over a number of years, they had invested 1% of their pre-tax profits in the form of cash, employee time and gifts in kind for charitable causes. They were also willing to support the efforts of their own staff who were involved in charitable causes. In respect of this, they quoted the case of their regional manager's secondment from their Croydon branch to work alongside the National Neighbourhood Watch Association to produce a Guide to Citizenship for Young People.

In this way perhaps Marks and Spencer have found a way in which the social responsibility of their organisation can help the individual's contribution to social responsibility.

From the point of view of organisations, the term applied commonly is corporate social responsibility (CSR), and this is becoming increasingly important as stakeholders themselves become more aware of the issues involved.

Many British companies are interested in and put efforts into CSR but all too often these are informal and unpublicised. By advertising what they are doing, those companies involved can be very helpful in encouraging others to follow their lead.

The government regards CSR as a serious issue and has recently appointed a minister for it. The post, which has been given to Dr K Howells, has two main aspects to it:

- making the business case for CSR, and
- co-ordinating government activity across Whitehall to promote CSR.

Dr Howells is quoted (Director, October 2000) as saying, "Businesses can make a vital contribution to addressing social problems. Business investment in communities is a powerful force for tackling deprivation and promoting a fairer, inclusive society, both at home and abroad. It can also provide communities with new skills, staff resources and access to a wider range of contacts."

He also points out that there are advantages to be gained by businesses in supporting CSR, through working closely with communities, in terms of new marketing opportunities.

"The most important single asset that companies have outside is their reputation. CSR is a way of embellishing and sustaining that reputation, which is just as important as needing to have the best product and the most competitive prices", said Dr Howells.

If we accept that this is true, then CSR is a means of adding value to a company and improving its competitive edge.

So, what does CSR actually do, in addition to making cash donation to charities?

Organisations can donate their skills, experience and time. For example, business people can volunteer their skills to work on specific projects in the field of the arts through schemes such as the Arthur Andersen Skills Bank. The thrust of these schemes is to give the arts an injection of professional advice, and the volunteers benefit themselves from working in a stimulating new environment.
The NatWest Bank similarly helps the arts, by providing skilled members of the boards of art institutions and museums.

In an entirely different area of work, Business Action on Homelessness works with companies in order to put homelessness issues on the corporate agenda. Help can be provided at all levels in this work, from assisting those living on the streets to resettlement programmes.

Overall, companies can, and do, provide help through the donation of cash and/or equipment through staff fund-raising events such as sponsored runs, to employee secondment.

Below are examples of the main questions faced by organisations in respect of CSR:

- How far is CSR legitimate in terms of the money spent on it?
- Will the organisation gain from investing in CSR?
- What is the response of the stakeholders to CSR?
- If you are an employee of Marks and Spencer, do you think the money the company spends on community projects could better be spent on your welfare provision, or improvements to your working conditions?
- If you are a shareholder of Lloyds TSB, do you think the £30 million or so per year they hand out to CSR should be at least partly returned through dividends? Do you think the community at large has more respect for a company such as Tesco Stores for involving itself in community projects?

These are the kind of question that corporations need to address when making decisions about CSR. Whatever they decide CSR is here to stay, and many believe that public pressure will cause it to become a necessity. It is already seen not as a constraint but as an aim in itself.

E. BUSINESS ETHICS

Nature of Ethical Issues

In recent years the subject of corporate social responsibility has widened into what is generally referred to as business ethics. First of all, let us define what we mean by "ethics". A dictionary definition describes ethics as "a moral philosophy which teaches people their duty, and the reasons for it".

Therefore, we might say that ethics are principles concerned with interpersonal behaviour. If they are such principles, then:

- They should be universally applicable.
- They should provide the standards by means of which the conduct of people can be compared.
- They can be taught, and thus help to establish generally acceptable standards of conduct.

Many business and professional groups, for example in the legal and medical fields, have adopted codes of conduct for their membership which help to establish a standard of acceptable behaviour, and these in turn help to further ethical practices.

The way in which organisations perform their activities within society has an effect both on society in general and on individuals and their values. This raises questions about the role of managers in the area of strategic management in terms of ethical practices, and the way they treat people.
The range of ethical issues that potentially face the manager is enormous. Below are some of the more important.

(a) **Keeping to Laws and Regulations**

Often managers must decide whether or not to break laws or ignore regulations pertaining to their and their companies’ activities.

(b) **Telling the Truth**

Managers must also often decide when to tell the truth or at least how much information to provide.

(c) **Showing Respect for People**

The business manager can face dilemmas with regard to standards of ethical behaviour relating to how people, and specifically staff and employees are treated.

(d) **Doing No Harm**

For many this first rule of medical ethics is considered to be the most important ethical consideration for any business manager. There is no doubt that managers do face dilemmas with regard to this principle. In this case, harm could mean harm to particular people or perhaps the wider environment and society.

These then are some of the key types of ethical issue managers face. Within these broad categories managers are faced with specific issues such as, for example, product safety, misleading advertising, unethical employment practices, etc.

**Ethical Issues at Different Levels**

Johnson and Scholes suggest that the ethical issues which concern both businesses and public-sector organisations operate at three different levels:

- **The macro level**, which concerns their role at the national and international level of the organisation of society.

- **The corporate level**, which focuses on the ethical issues concerning individual corporate entities, both in the private and the public sectors, when selecting and implementing strategies.

- **The individual level**, which concerns the behaviour of individuals within organisations.

**Approaches to Ethical Issues**

In considering the position taken up by organisations in terms of ethical conduct we can identify four broad categories which between them form a spectrum, from minimal concern with ethics to making ethics central to the organisation’s purpose.

- In the first category the role of the organisation is seen to be focused on its business performance in terms of making a profit. As Milton Friedman put it, “the business of business is business”, and “the only social responsibility of business is to increase its profit”. This type of business regards social issues (for which we can read ethical issues) as none of their concern, and that these are best left to society to decide for itself by legislation what is acceptable and what is not.

- In the second category come those organisations which look beyond making a profit for shareholders to consideration of the wider group of stakeholders. Here a limited amount of sponsorship or involvement in “worthy causes” is seen as being of economic value in improving the public image of the organisation.

- The third category embraces the interests of stakeholders to a greater extent and sees its role as going beyond just the obvious business targets of employing people and providing profits, to “looking after their people”. Paternalist companies, such as the
chocolate manufacturer J S Fry, saw their role as providing decent working conditions and improving the environment as well as creating profit. Their principle of providing a "factory in a garden" at Keynsham, near Bristol, was an example of this philosophy.

- The final category, which includes many charitable bodies, comprises organisations whose raison d’être is to meet society’s needs. For these organisations finance is less important than the provision of an acceptable level of service. Unfortunately, without some source of income, whether by sponsorship or taxation, they cannot exist and so they face the problem of trying to reconcile these two.

There are a number of examples where the ethical face of business has been a public issue. In the 1980s, Barclays Bank was accused of supporting the apartheid regime in South Africa and, as a consequence, a boycott of the bank had a considerable negative impact on its business.

There are increasing numbers of "ethical investors", who put money only into companies whose objectives and methods they approve. There has also been a rapid expansion in the demand for "fair trade" products: companies selling these guarantee a “fair” price to producers in Third World countries, and/or return a proportion of their profits to social investment in those countries.

Perhaps the best known example of an ethical company is that of the Body Shop, set up by the late Anita Roddick with her husband Gordon and based on what she referred to as its DNA: its very strong social, ethical and environmental stance. She said she would like "to be judged by our actions in the larger world, by the positive difference we make".

From the above we may summarise the following four alternative ethical positions which a company may adopt: short-term shareholder interests, longer-term shareholder interests, multiple stakeholder obligations and "shaper of society".

(a) **Short-Term Shareholder Interests**
This is the "business is business" stance as described by Milton Friedman, in which the primary objective is to satisfy the short-term interests of shareholders through the strategies and policies which the company pursues. This type of company concentrates on short-term profit which will increase shareholder value and returns.

Other, wider, ethical issues with respect to other stakeholder groups, or to the community in general, are regarded as not its responsibility.

(b) **Longer-Term Shareholder Interests**
This position is also largely concerned with shareholder interests but takes account of the premise that the longer-term interests of shareholders may well benefit from developing good relationships with other stakeholders; so being concerned with the wider issues will, in the long term, result in higher profits and returns for the company’s shareholders.

(c) **Multiple Stakeholder Obligations**
Here the interests of the wider group of stakeholders are taken into account. These include employees, customers, suppliers, distributors and the community at large.

Unlike those companies which meet only the minimum statutory obligations, these companies go beyond minimum requirements in order to achieve a balance between the interests and expectations of their shareholders and those of other groups of stakeholders.

Problems can arise for companies in this category in terms of conflict between social responsibility and company survival, or between social responsibility and shareholder expectations.

Many public-sector organisations fit into this category.
(d) **Shaper of Society**

This category contains those organisations whose raison d’être is primarily to effect changes in society in accordance with the needs of the community. Financial and shareholder interests are regarded as being of only secondary importance.

The dilemma faced by such organisations is how commercial they are prepared to be in order to carry out their social role. The answer will depend to some extent on circumstances, and also on the structure of the organisation. For example, a company without shareholders, such as a private family company, or a public service organisation, would find it easier to adopt this stance.

The larger charities, such as Oxfam, are in a similar position, where they are accused by some of being too commercial and of spending too high a proportion of their income in internal administration.

In considering these alternative ethical positions it is important to remember that they will have a major impact on the organisation's operations, including its strategies.

**Encouraging Ethical Behaviour**

There are a number of steps that a company can take to encourage ethical behaviour on the part of its staff. Some of the main ones are as follows:

- Ensure top management commitment to ethical issues in the organisation.
- Establish clear corporate guidelines and policies with regard to ethical issues and practices.
- Communicate ethical guidelines and policies to all staff, preferably through a written code of ethics.
- Encourage staff to be open about ethical problems and dilemmas they face. Establish "ethics hotlines" which allow employees to bypass normal chains of command.
- Conduct ethics audits on a regular basis to identify any serious breaches of ethical policies.
- Conduct ethics training on a regular basis.
- Devise systems of motivation and remuneration/reward which encourage conformance to ethical practices and standards.

In conclusion, ethical issues are now a major factor for the corporate planner. The corporate planner must understand the range of ethical issues for the modern business and how to resolve the potential dilemmas to which these give rise. The planner can take several steps to encourage more ethical behaviour and practices in the organisation.

**F. ENVIRONMENTAL ISSUES**

I think we could have titled this "environment matters", because it does, to all of us. Some of the areas causing concern today include deforestation, global warning, decline in fossil fuel supplies and "fishing out" of the oceans.

How do these affect strategic planning?

(a) **Deforestation**

With many people showing concern for the disappearance of forests, these companies which use wood and wood products in their business have had to look either to alternative materials or to sustainable sources in order to maintain their client/customer base.
One of the ways this can be achieved is by recycling wood and paper products. Thus the pen I am using to write these original draft notes has its carcass made from recycled paper, and was supplied by Friends of the Earth.

(b) Global Warming
Though there is still some debate, it is now generally accepted that we need to reduce carbon dioxide emissions worldwide, with particular implications for certain businesses such as car manufacture and those factory sites which give off carbon dioxide. This has resulted in a number of strategic decisions having to be made, such as the use of catalytic converters, and gas filtration systems.

(c) Decline in World Stocks of Fossil Fuels
This has led to such changes as legislation in the UK on engine size for cars, with reductions in road fund licences for smaller sizes, and to investment in sustainable energy sources, such as wind farms.

(d) Disappearance of Fish Stocks
This has resulted in fishing quotas being cut for European fishermen, resulting in a large decrease in the English fishing fleets operating out of Devon and Cornwall. At the same time it has encouraged the setting up of fish farms, particularly for salmon in Scotland.

Green Chemistry
Another factor becoming increasingly important is known as "green chemistry". Introduced in the early 1990s this is defined as the design of chemical products and processes that reduce or eliminate the use and generation of hazardous substances. The hazards in this definition include: toxicity; physical hazards, such as explosion or fire; global climate change; and resource depletion.

The following criteria are used in the selection of materials used as inputs into processes:

- Methods used to obtain starting materials, by mining etc. should have a minimum impact on the natural environment.
- Material inputs should be of low, or no, toxicity.
- Starting materials should be renewable.
- Where possible, starting materials should be waste products from other processes.

Often the best and least expensive options for reducing environmental deterioration are the re-use of products, or, where this cannot be done, recycling products. Much is already being achieved through household recycling programmes where the waste products collected can be re-used either to make the same product again, such as glass bottles, or in the manufacture of a different product, such as the use of aluminium cans as a source of aluminium for the manufacture of any appropriate product.

G. PLANNING IN THE INNOVATIVE AND ENTREPRENEURIAL ORGANISATION

In the immediate future organisations and particularly corporate planners will face continued challenges stemming from the need to innovate and adopt more entrepreneurial approaches. As we have seen throughout these Units rapid change is now the order of the day for most organisations.

Of course technological change and innovation are not new, but what is new is the pace at which technology and products change. Corporate planners are likely to have to cope with
an increasingly rapid pace of technological change and innovation. As a result, planners will have to deal with, for example, shorter product life-cycles and, possibly, the growth of whole new technologies and industries. Competition will come from new and often unpredictable directions, and investment in technological change and innovation will increase.

There are many implications of this for the process of strategic management, but in particular the manager will have to deal with the following:

- The need for improved technological forecasting techniques
- An increased emphasis on innovation and new product development in strategic plans
- The need to have extremely flexible planning systems and organisational structures
- The need for flexible and adaptable staff and skills in the planning and implementation of change in the organisation
- The need to encourage and reward risk-taking and a more entrepreneurial culture in the organisation.

As we discussed in Unit 1, Mintzberg characterised entrepreneurial strategies as follows:

Strategy which involves vision and concept attainment, which is intuitive and non-analytical, thrives on uncertainty and is geared to seeking out opportunities. It is often based on the personal vision of the chief executive and may not be made explicit.