Strategy definitions

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Strategy and its origins

Strategy is multi-dimensional and multifaced

- Analyzing the competitive arena صحنه/میدان مسابقات
- Planning and acting
- Being flexible, creative and innovative
- Partnering
- Creating alliances

Strategy born in the military context

Military parallelism

- Competitive arena -> battlefield
- Competitors -> enemies
- Company -> army
- Assets and resources -> weapons
- Entrepreneur/manager -> general

As a result of this parallelism strategy was referred to as “strategic management” which couples strategy with the roles of the executives who are charge of formulating, planning and driving it.

How to **operationally** define strategy

In order to give an answer to this question we have to put ourselves in the realm of decisions.

We should start from the assumption that **strategy is defined and made of a set of strategic decisions.**

Strategic decision:

- It acts on the long term
- It requires a significant amount of resources
- It has multi-dimensional, transversal and deep impacts on the individual level
- It's hardly reversible عرضی

Tactics

Opposite to strategic decisions and are place in the realm of more **operational decisions**

There's a connection between **strategy and tactics**:

While in strategy you set long term objectives and you plan to achieve such objectives, **tactics** reference to **how you concretize and implement your strategy by means of actions performed on a daily basis**.

Operational definition of strategic decision: A strategic decision is a decision that has long term, significant, multi-dimensional and non reversible effects **on the final goal of the organization;** it usually requires large amount of resources; and it usually requires top management involvement

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Strategy is an **integrated, comprehensive plan** which:

- **Identifies** the **scope** and the **direction** of the organization
- **Aims at obtaining long term performance superior to competitors** (with reference to the goals identified)
- **Integrates a consistent set of strategic decisions**

The military way of looking at strategy is to view it as a space between politics and tactics:

Politics is derived from a purpose or cause, strategic y incorporate this purpose and is concerned with how to achieve the policy or goal with the means available , Tactics are the particular movements and actions while engaged in battle

In business, strategy maintains the majority of these characteristics, and further explores their company and management -related aspects (like those of competition and advantage)

Ken Ohmae , in “the mind of strategist” , 1983, tells us that

“ what business strategy is all about is “**competitive advantage**”

“The Sole purpose of strategic planning is to enable a company to gain, as efficiently as possible, a sustainable edge over its competitors “

“Strategy thus implies an attempt to alter a company’s strength relative to that of its competitors the most efficient way”

Bruce Anderson - the origin of strategy - 1989

“ strategy is a deliberate search for a plan of action that will develop a business’ competitive advantage and compound it “

“The difference between you and your competitors are the basis for your advantage “

“The objective is to enlarge the scope of your advantage , which can only happen At someone else’s expenses”

Business strategy **does not aim any more at crunching your opponents** , but it assumes that you have some goal, you have resources to reach the goal, and are operating in a context where other entities may have their own goals that overlap and compete with yours .

Hence, **strategy reflects on how to formulate a plan** (made **of consistent strategic decisions**) to establish and maintain an advantage on such entities that we call competitors.

The levels of strategy

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STRATEGY, PERFORMANCE AND COMPETITIVE ADVANTAGE

Strategy is a long-term plan made of a consistent set of strategic decisions that aims at identify a scope and directions for the company as well as achieving and sustaining performance superior than competitors

The original question behind strategy is:

Why do firms competing in the same industry enjoy different performance ?
Why firms that are in similar context can be successful or fail ?

Because they make different strategic decisions and employ a different strategy.

Success is creating and sustaining performance
Competitive advantage is creating and sustaining a superior performance compared to your competitors

Only firms whose performance is superior than competitors may actually claim that are leaders in the market

What kind of performance is strategy related to?
How can strategic performance be measured?

By creating economic and financial value.

Strategic results can be measured by a simple economic notion:
margin = price - cost

If your margin is superior to your competitors you have a competitive advantage

STRATEGY AND VALUE CREATION

CREATING VALUE

Value proposition It's a selected bundle of products and/or services **targeting a group of customers** and satisfying **well-defined** needs

It's how you create value for your target customers

We could define 3 approaches that may lead to **value creation**:

1. **Technology driven-approach**: **innovation** is driven by a scientific breakthrough or a technological opportunity; this is followed by product design and manufacturing; and in turn the product is presented to customers and sold;

   Its efficient and is a good way to **leverage** internal sources of innovation

   Criticalities: the **market doesn't directly affect the value generation process**. The product is presented to the customers only after its realization: customers are seen as passive objects and Marketing is involved only in the last steps of value generation.

2. **Market driven approach**: The first step of **value generation requires the identification of customers' needs**; value is hence defined on the basis of the target market's characteristics, and products/services design and manufacturing are driven by customers' needs. ***Value communication*** by means of **marketing levers** plays a major role in this approach. **Market and customers** have a paramount role for strategy , as they **provide inputs for the company** : **they are the first sources of ideas and innovation**. In this approach a **strong relationship between strategy and marketing is established.**

3. **Customer co-creation approach**: an evolution of market driven approach where customers become a functional source of innovation, in the sense that **not only companies identify customers' needs but also work together with them to co-create the value proposition that will address their needs**

WHERE TO CREATE VALUE: BUSINESS AREA (BA) AND STRATEGIC BUSINESS UNIT (SBU)

The **BA** is the **strategic interpretation of a market, an industry**, and is defined by a **homogeneous** and **defined** set of competitors offering similar value propositions to satisfy a **homogeneous** set of customers' needs . The **BA is where a company operates**

The **SBU** is the part of the company that operates in and serves a given business area. It's how the company organizes and structures itself to serve a market or industry.

THREE LEVELS OF STRATEGY

There are 3 distinct levels of strategy:

1. **Corporate strategy level**

   Strategy defines in which industries and markets the company is going to compete.
   So the company is seen as a bundle, or portfolio, of different markets and SBUs

   Ex: Virgin group: music , gyms, telecommunications etc

   At this level the corporate management looks at the overall portfolio to evaluate whether it's balanced or not in terms of: the presence of cash absorbing strategic business units that **must be balanced** by cash generating SBUs by considering the different SBUs **lifecycle** and the **correlation** among different SBUs

   SBUs lifecycle:
   Emerging business
   Fast growing business
   Mature business
   Declining business

   Considering correlation we're looking for synergies among SBUs so **the value** of two SBUs together is more than the sum of the value of such activities kept separate.

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   Synergies can create **CORPORATE COMPETITIVE ADVANTAGE**
   An advantage that doesn't come from the single business, but from the combination of different business's

   Corporate management defines 2 major aspects which represents the **objectives of Corporate strategy**:

   1. the general strategic objectives and guidelines to provide to each SBU

2. the resources or constraints to achieve such general objectives

These aspects are passed on to the second level of strategy : the business level

2. **Business strategy level:**

   Here **general** managers receive **general goals and a budget** from the corporate level, and **specify them into business specific objectives**. The overall aim spins to create and sustain a **business competitive advantage** when compared to competitors

   All the decisions made at this level lead to the **formulation of a business strategy** (**which follows and shall be consistent with the corporate strategy**)

3. **Functional or operational level**

   Business strategy is translated into **functional and operational objectives** for each SBUs function (and this is where we talk about **strategy execution**)

   Example

   Grow in the market and make investments is a corporate objective that may be set
   At a business level such objective can be translated as “achieve +10% in 2 years”.
   At a functional level concerning the marketing and sales function the business objective can be further specified as increasing marketing and sales effort thanks to a given amount of investment.

Business strategy formulation

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Business strategy: vision and mission

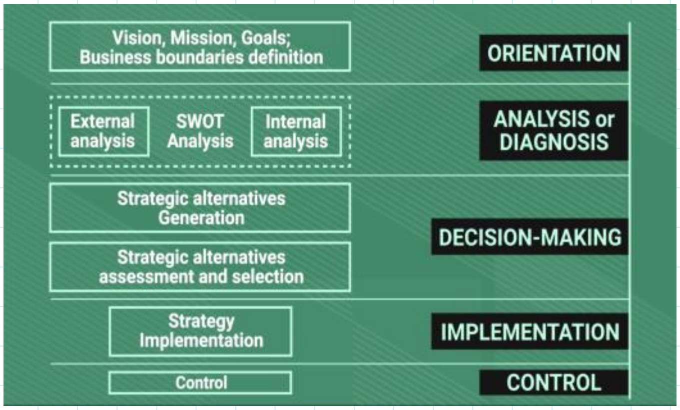
Business strategy aims at creating a sustainable competitive advantage that is a performance superior than competitors, within a give industry or business area

As such, business strategy formulates the objectives and a strategic plan that a SBU will follow and implement within the BA

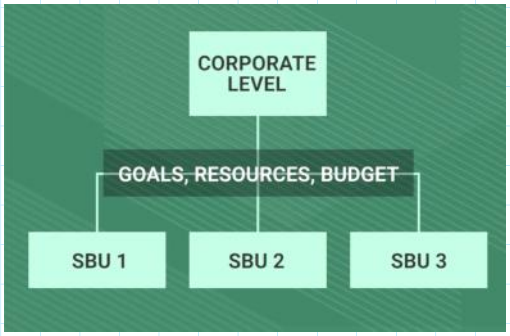
Strategy formulation **at a business level** follows a sequence of logical steps and building blocks, referred as **business strategy formulation process.**

As a whole, such process is made of a number of steps belonging to 5 micro phases:

1. **Orientation (or direction setting)**
2. **Analysis or diagnosis**
3. **Decision making**
4. **Implementation**
5. **Control**



Each SBU receive general goals and resources or a budget to reach those goals by the Corporate strategy, and formulates its business strategy accordingly.



The process starts with a first step that **translates corporate goals and directions into the specific business area**: this happens by means of three key concepts in strategy :

- **The vision**
- **The mission**
- **The strategic objectives**

The vision and the mission are often unclearly defined by companies: sometimes you find one and not the other, or they are overlapped and their boundaries become blurred

However they're both essential for strategy, and they play a complementary role in its formulation.

The vision is the long term view on the best possible evolution of the **business area** the company operates in. It describes how the industry will positively evolve and **draws a path that the company (as well as other competitors)** may follow .

The vision is also known as **industry foresight**.

Example

Microsoft's vision in the late '80 was:

"A chicken in every oven, a computer in every house"

Although funny and generic, it implies a few important ideas:

1. Wealth will be more and more widespread , allowing more and more people to satisfy their basic needs (food, get something to eat)
2. Such people might have a wealth surplus that they may wish to use for more refined needs satisfied by means of other products and services like the personal computer

The idea about the future was different from the one held by other competitors, who believed computers would find their way in the corporate world , rather than becoming something single individual would use in their own homes.

This vision set a path for Microsoft's strategy , a path that led to the evolution of computers for end users and consumers.

MISSION

A mission is **the strategic role** a given company wishes to play within the path set by the vision.

It is also known as **strategic intent**

For instance, Microsoft's mission, according to its vision, might have been "to become the leader in the personal computers area "

Vision is **industry-specific**, as it embraces your business area's evolution (and might be shared by other competitors too), your **mission** is **firm-specific**, as it tells the company how it should develop its strategy according to the trends foreseen by the vision.

Business strategy: objectives, boundary & strategy analysis

The strategic formulation process at a Business level starts with the Orientation macro-phase, which encompasses our strategic direction or path, embodied in the vision, as well as our expected strategic role within such path, that comes with the mission.

However, while both the vision and the mission have a long-term motivational role, they are not enough to set the boundaries and targets for strategy formulations.

A third concept should hence be introduced, that is, **strategic objectives**.

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Strategic objectives or goals steer the whole strategy formulation process, in its analysis or diagnosis, decision-making, implementation and, above all, control macro-phases.

To be strategic, **objectives** shall have some key features:

1. **Specific**: they shall be relatable to what they are focused on and they shall convey a clear message on what's to achieve;
2. **Measurable**: there has to be one or more clear indicator, since you can't improve what you can't measure;
3. **Appropriate**: they must be consistent with the company's overarching vision and mission; کلی-غالب
4. **Realistic**: goal setting theory tells managers to set objectives that are challenging, but not perceived as neither impossible nor too easy (because both ways lead to demotivation);
5. **Timely**: they must be related to a clear deadline to achieve them

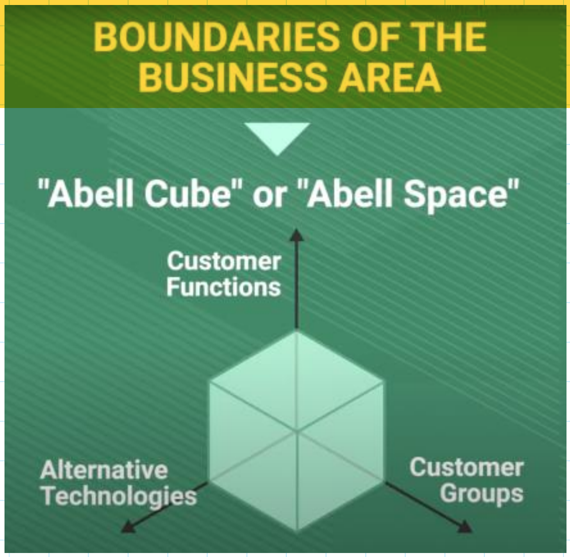
Strategic objectives with these features are called "SMART"

Once the vision, mission and strategic objectives are defined,
it's important to further clarify the boundaries of the business area the SBU will cover.

These boundaries will represent an input for the analysis or diagnosis macro-step of the process.

A possible way to define a business area's boundaries is to employ the so called **Abell Cube** or **Abell Space**, which gives a three dimensional definition of the business in terms of three key factors:

- **customer groups**, which answers to the question "who do competitors in the industry serve?"
- **customer functions**, so the "what?" customer needs are satisfied by the offer;
- **alternative technologies available** to provide such customer functions, by means of different products and services.



The intersection of these 3 axes X, Y and Z creates a space or cube that delimits the business area boundaries

With the business area definition, we conclude the "orientation" macro-phase.

ANALYSIS OR DIAGNOSIS MACRO-PHASE

This macro-phase is the core of the strategy formulation process at a business level, since **it aims at deeply investigating the context and environment the company operates in**, and which will influence, in turn:

- **the possibility to achieve its strategic objectives;**
- **the business strategies to reach such objectives;**
- **the chances to create and sustain a competitive advantage.**

The analysis or diagnosis macro-phase results from the combination of two complementary perspectives:

- An **external perspective**, which is called **external strategy analysis**;
- An **internal perspective**, which is labeled as **internal strategy analysis**

External strategy analysis considers the external environment a given company operates in by means of its Strategic Business Unit. **it analyzes the industry and business area**.

Within such external environment, we have to look for the **overall trends and phenomena that may constitute an opportunity or, vice versa, a threat for all competitors operating in the industry.**

In the external strategy analysis, the point of view is hence that of the average generic player in the business area (not our own company's standpoint).

So, the considerations we'll draw on external opportunities and threats are **industry-wise**, **not firm-wise**, and should apply to **the average player in the industry**, not just to a specific company.

The **internal strategy analysis** focuses on a specific company operating in the business area, **and aims at comparing it to its main direct competitors to underscore its key strengths and weaknesses**, that is, **the possible sources of competitive advantage or disadvantage it may have.**

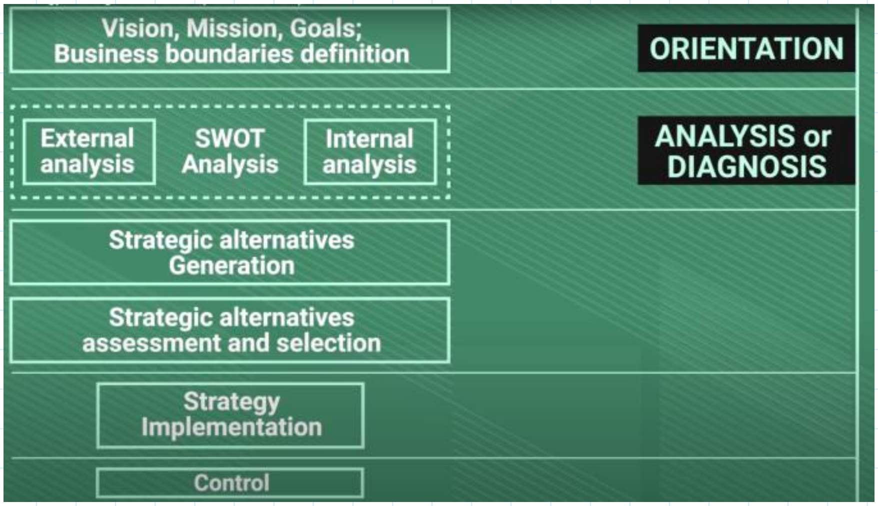
Within this step, the company analyzed is compared to its competitors by means of benchmarking, and the firm-specific characteristics that give it an edge on competition (or, on the contrary, create some negative gaps to be filled) are disclosed.

The thoughtful combination of an external perspective with an internal one will disclose insights that will feed and inform the subsequent steps of strategy formulation at a Business level.

Business strategy: strategic alternatives

The strategy formulation process at a Business level starts with the Orientation phase, which sets the company's direction, or vision, declares its role, or mission, and puts forward a list of objectives strategy should help achieving.

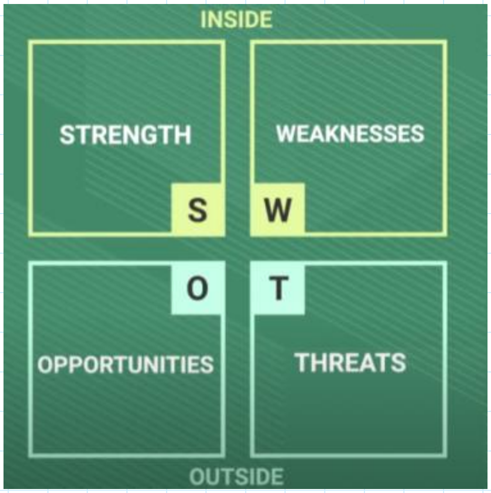
Orientation is followed by the Analysis or Diagnosis macro-phase.



Within such phase, the company analyzes both its external environment (that is, its industry) and its internal one (that is, its own structure and inner dynamics) to gather data and insight that should inform its strategy.

The combination of an external and internal strategy analysis creates the basis for a matching between **opportunities and threats coming from the outside with strengths** and weaknesses emerging from the inside.

This matching goes under the pretty well-known name of SWOT Analysis, nothing but an acronym for Strengths and Weaknesses stemming from the inside, and Opportunities and Threats coming from the outside.

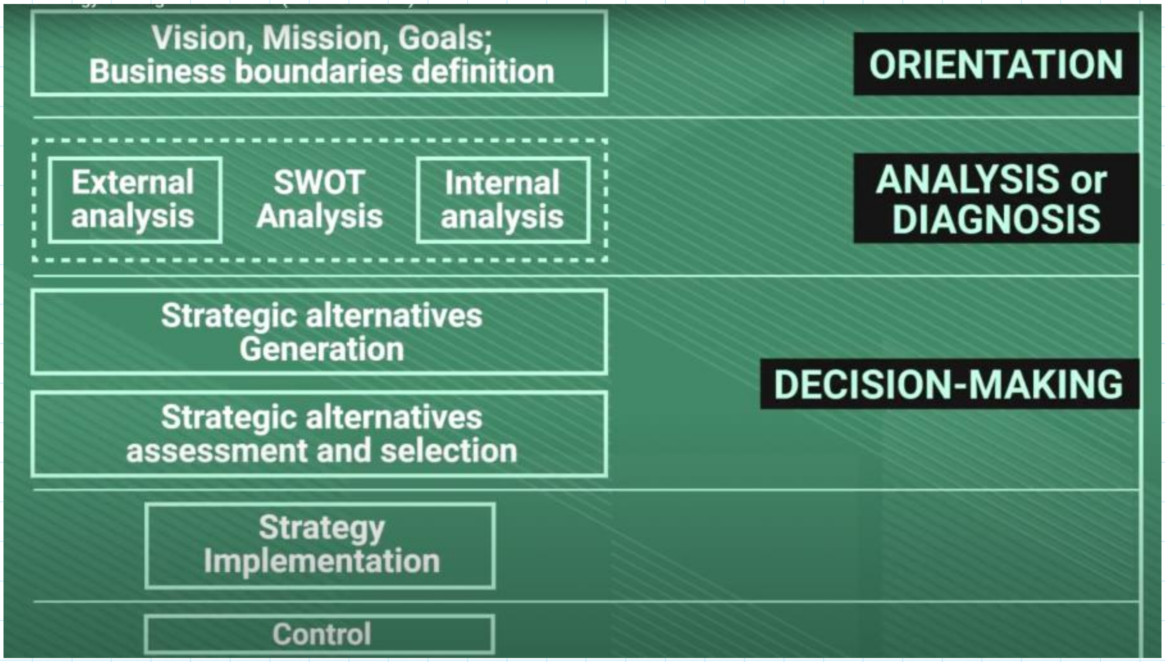


SWOT is used in many contexts due to the fact that it's quite an easy and straightforward tool.

Notwithstanding this, the SWOT analysis **is the core of the strategy formulation process at a Business level, since it is from such combined perspectives that the business strategy of the company arises.**

More specifically, by crossing external Opportunities and Threats with internal Strengths and Weaknesses, the company may understand, for instance: **what are its Strengths to leverage to exploit opportunities**; what are its **Strengths it may use to defend itself from a Threat**; and wh**at are its Weaknesses that do not allow it to properly take advantage of an Opportunity, or maybe that intensify the negative effect of a Threat**.

Performing wise and insightful combinations of these four elements allows us to enter the Decision-making phase of the process, whose first step refers to Strategic Alternatives Generation.



In this step, the SWOT analysis allows the company, and the decision maker, **to formulate a set of possible strategic alternatives or strategic decisions at a business strategy level**.

Exploiting an Opportunity with a Strength is indeed a strategic decision, since it is long term, it requires lots of investments and resources, it is cross-functional and hardly reversible.

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So the overall set of strategic decisions that will constitute a company's business strategy basically emerges from the SWOT.

Of course, **not all strategic alternatives can be implemented, because of the lack of resources or a possible mutual exclusivity.**

The strategic alternatives must hence be assessed and evaluated in terms of their consistency with the vision, mission and goals, the **resources available** in terms of budget and their **possible contribution to achieve and sustain the company's**

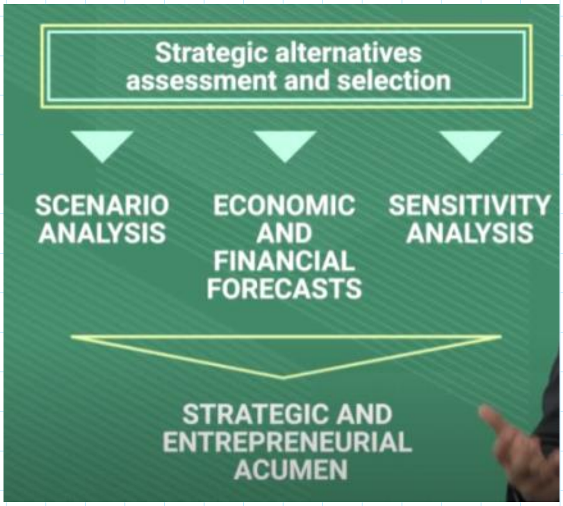
ultimate goal, that is, value creation by means of competitive advantage.

This **assessment could be done by means of scenario analysis and economic and financial forecasts, and sensitivity analysis**.

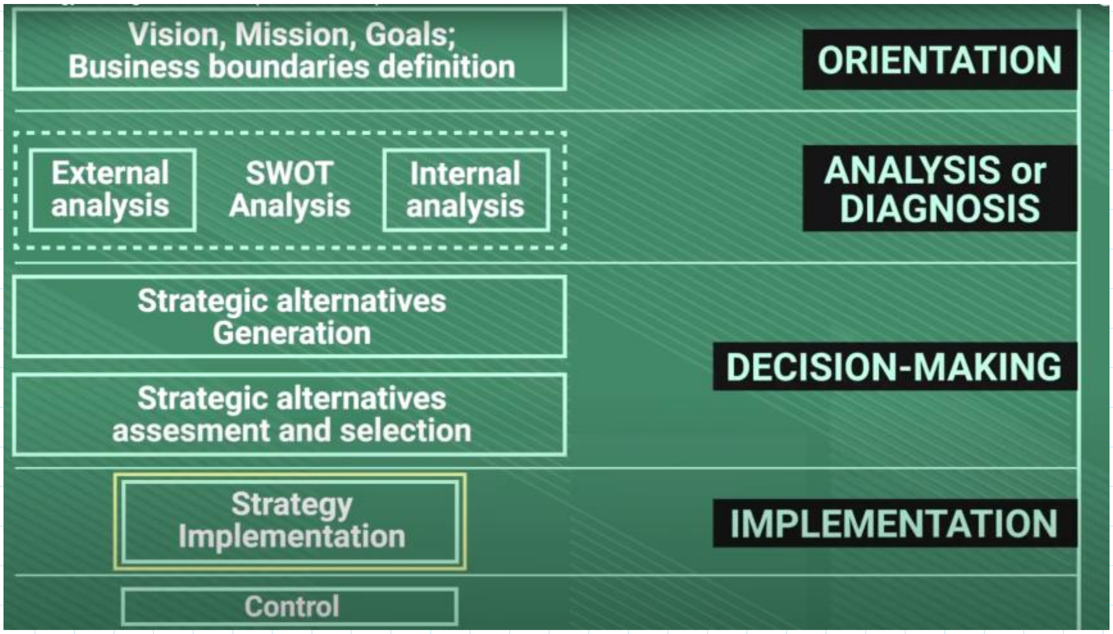
However, since this constitutes the heart of the entrepreneur's or manager's decision-making role, it will be her or his strategic and entrepreneurial acumen to determine **1**.

This decision-making step is labeled Strategic alternatives assessment and selection.

After **one or more strategic alternatives are selected, they are embodied in the company's business strategy.**



The decision-making macro-phase ends, and is followed by the strategy implementation one.



Here, the **strategy is executed by means of a number of consistent tactical choices** that are chained to one another and should lead to **achieving the overall strategic objectives**.

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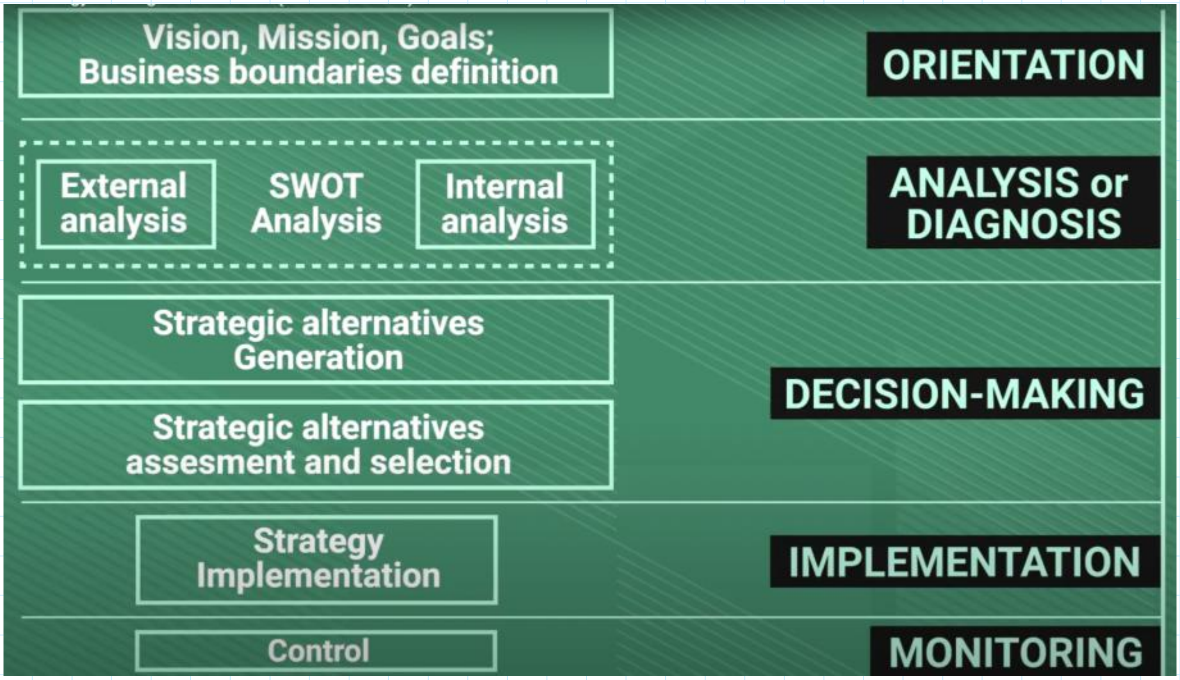
Strategy execution gets strategy down to the basics, and **encompasses decisions in each given function or unit.**

In order to support strategy execution managers may resort to different models: the framework that is widely employed to support strategy implementation is the so called «**business model**», **which considers the implications of a company's business strategy on a unified set of building blocks and parameters.**

Once the strategy is implemented, it is time to **Monitor and assess whether such implementation was successful or not, in terms of achieving the overall strategic objectives.**

This is the monitoring macro-phase, where the results obtained are confronted with the goals planned.



Usually, the monitoring macro-phase is executed through a **control step that corresponds to the budgeting variance analysis**, **to quantify any delta between the expected and achieved performance and understand what was the cause of such positive or negative variance.**

The Monitoring macro-phase is **usually run annually, and may lead to confirm the long-term goals set in the orientation phase, or trigger a review of such objectives.**

In the latter case, a strategic **re-planning starts**, **involving new objectives, but maybe even requiring a new vision, mission and a new SWOT.**

The Monitoring macro-phase closes the Business Strategy formulation process.

Although we presented strategy formulation at a business level as a linear, waterfall process, it is far from being that straightforward.

This only happens in ideal conditions, where no feedback or feedforward is needed.

However, in the real cases we may have to go back to one step, to jump another, and so on.

The most important thing is that all steps are considered at least once, and lead to the formulation and planning of a strategy to achieve competitive advantage within the company's given business.

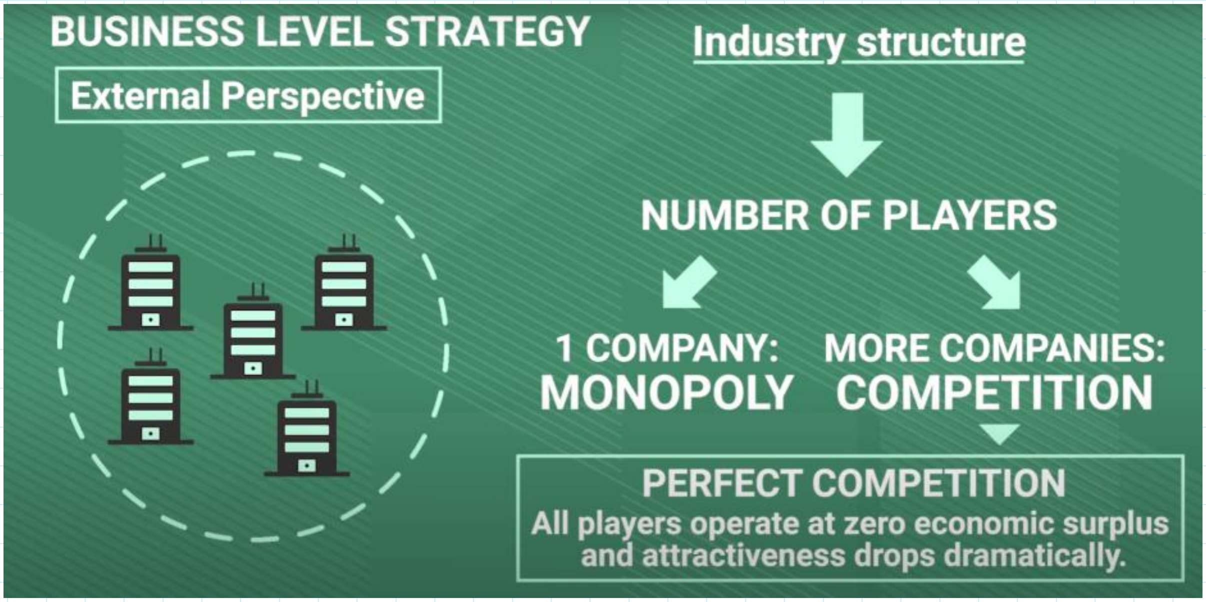
EXTERNAL AND INTERNAL STRATEGY ANALYSIS

Formulating a strategy at a Business level requires obtaining a deeper understanding of the overall environment the company operates in.

Such environment involves two perspectives: the **external** and the **internal** ones.

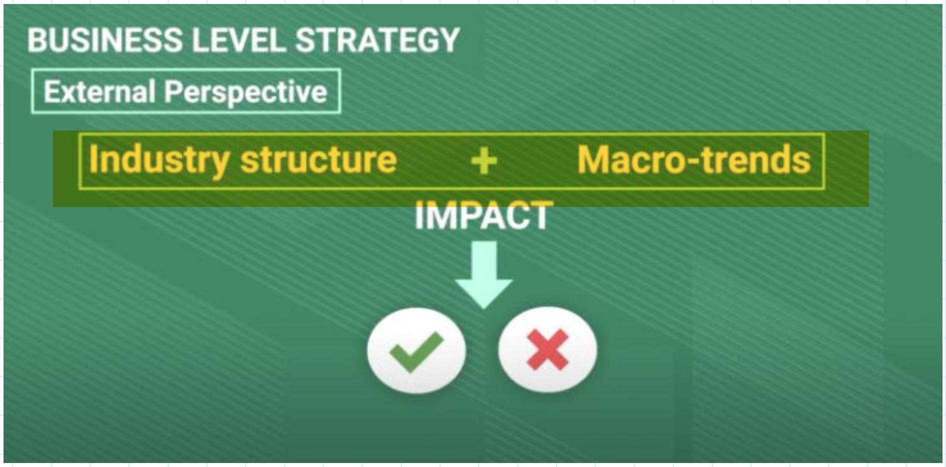
The **external perspective considers** the set of **competitors** populating a **business area**, **as well as all the determinants of industry structure**. For industry structure, I mean the inner characteristics and defining elements an industry is built on.

For Instance, let's consider **the number of players** operating in a market as a determinant of its structure: if the market is populated by only one company, we call it a **Monopoly**, which will have given characteristics like **no competition** and **significant attractiveness**; as the number of competitors grows, the structure of the industry changes and aligns to the ideal notion of **perfect competition**, where all players operate at **zero economic surplus** and **attractiveness drops dramatically**.



Beyond the market structure, the external environment may hide a number of **political**, **economic**, **social** and **technological macro-trends** that may affect the industry and the way firms compete in it.

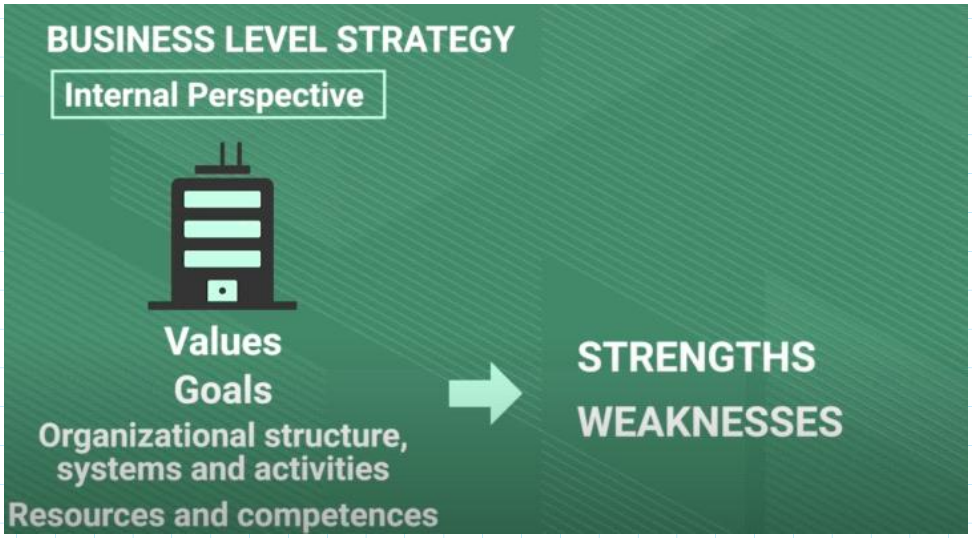
Both the **industry structure** and the **environmental macro-trends** identified may impact the companies operating in the industry investigated, with impacts that are either positive or negative.



Should the expected impact be positive, we'd consider it an **Opportunity**; should it be negative, we would label it a **Threat**.

The **internal perspective**, instead, refers to the **company's values**, **goals**, as well as its **organizational structure**, **systems** and **activities**; and its **resources** and **competencies**.

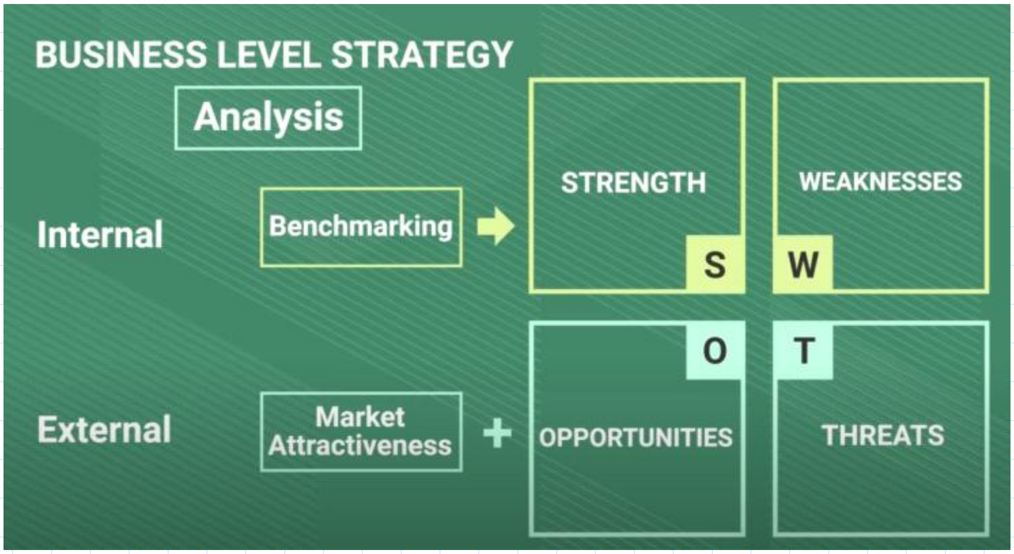
All of these elements may constitute a company's key **strengths** and **weaknesses**, that is, the **possible sources of competitive advantage or disadvantage** it may have.



So, the core of the strategy formulation process at a business level lies in the **strategy analysis steps**, which considers and matches both the **external** and the **internal** environment.

- At an external level, we have to identify **Opportunities** and **Threats**, as well as assessing **Market attractiveness** (that is, **whether the market is averagely profitable or not**).

- At an internal level, **by means of a comparison with competitors** that is called **benchmarking**, we have to disclose our **company's strengths** and **weaknesses**, which may represent the sources of competitive advantage (or disadvantage).



To understand why the external and internal environments play such a paramount role for **strategy**, let's go back to its original issue: strategy is inherently related to the notion of **performance**, since a different strategy may lead companies operating in the same industry to success or failure.

- **Economically**, performance can be assessed in terms of: **Margin**, that is **Price – Cost**.

- **Market attractiveness** can be measured as the **average margin** (or **profitability**) enjoyed by the players operating in it.

So, from an **external standpoint**, the **industry will affect a company's performance since industry determinants will drive the attractiveness** (that is, average profitability of players) **up or down**.

From an **internal perspective**, the **company's inner structure and dynamics will affect its ability to achieve and sustain competitive advantage**, that is, a differential margin compared to your competitors.

Analyzing the external and internal environments hence allows strategists to uncover the sources of profitability and performance.

The strategy analysis step that encompasses both external strategy analysis and internal strategy analysis hence goes under the name of **SWOT Analysis**.

This is the acronym for **Strengths, Weaknesses, Opportunities and Threats**.

SWOT analysis is one of the earliest **strategy frameworks**.

About its history, SWOT wasn't born as we know it today. It was developed back in the 60s starting from the work by Albert Humphrey at Stanford: Humphrey was investigating why corporate planning failed, so he came up with the SOFT model, where the elements he used were: "What is good in the present is Satisfactory, good in the future is an Opportunity; bad in the present is a Fault and bad in the future is a Threat".

This model was later modified by Urick and Orr during a seminar held in Zurich in 1964, as they replaced Satisfactory with Strength and Fault with Weakness, giving rise to the SWOT framework we currently use.

SWOT's goal is to give strategic directions for structuring strategic analysis.

The underlying theory is that assessment of a company's competitive position should combine both an external and an internal analysis.

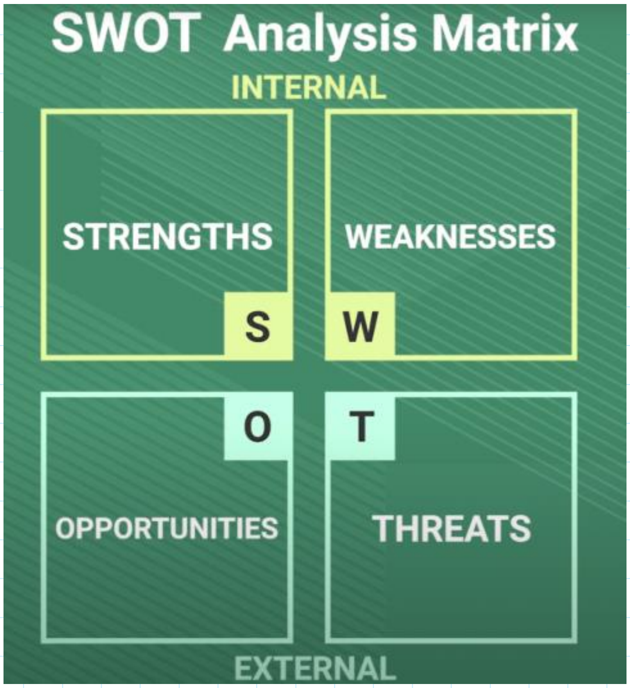
SWOT is widely used by executives and managers as an analytical tool to support strategy formulation, because it's considered a simple, compact and unified tool, which provides a good strategic summary and is also efficient for expository and communication purposes. Indeed, **by means of a SWOT, strategic decision-makers may formulate a set of different strategic alternatives (or strategic decisions) that will be built in their business strategy.**

HOW TO BUILD A SWOT ANALYSIS MATRIX

SWOT is a framework to support the strategy formulation process at a Business level.
But how does the SWOT tool work?

To **operationally** apply it, we should build up the so called **SWOT analysis matrix**.

The SWOT matrix is a 2X2 table whose four cells report a list of the external opportunities and threats a company is facing, as well as the strengths and weaknesses the company shows compared to its competitors.



This matrix hence couples two different perspectives: the **external one**, which requires to consider **industry determinants** and **trends assessed** from the point of view of the average competitor in the business area; and the **internal one**, which takes the point of view of the specific company and compares its distinctive characteristics with those of competitors.

Following these complementary perspectives, we should now fill these four cells: how to do so?

Os, Ts, Ss and Ws may result from a **brainstorming activity**, where managers or experts assess the industry and the company according to their professional expertise, **without any specific template or guideline** driving the process.

However, though this is a common approach due to its relative simplicity, it may also end up being **simplistic** and overly **unstructured**, as in complex and kaleidoscopic business environments, key elements may be simply forgotten or underestimated even by skilled executives.

So I propose the SWOT analysis matrix is not just filled in through brainstorming, but each cell is fed by the application of **structured strategy analysis models**.

For instance, **external strategy analysis could be informed** by the **Five Competitive Forces** model and the **PEST Analysis**.

While **internal strategy analysis** could be supported by the **Value Chain model** and the **Resource-based view** of the **company**, which looks for its core resources and competencies.

These structured models deserve a detailed description, and will be covered in the next lectures.

Now that we know how to fill the matrix, how should we use it?

We should ask ourselves some wise questions that may reveal useful insights about the strategic alternatives we have at hand, by mixing and matching strengths and weaknesses with opportunities and threats.

The SWOT analysis is a critical step of the strategy formulation process since it is from the combined external and internal perspectives that the business strategy of the company arises.

More specifically, by crossing external O-T with internal S-W, the company may understand, for instance: **what are its Strengths it may leverage to exploit Opportunities; what are the Strengths it may use to defend itself from a Threat; and what are the Weaknesses that do not allow it to properly take advantage of an Opportunity, or maybe that amplify the negative effect of a Threat.**

As a result, the SWOT analysis allows the company, and the decision maker, to **formulate a set of possible strategic alternatives** or **strategic decisions at a business strategy level**.

Exploiting an Opportunity with a Strength is indeed a strategic decision, since it is: **long term**, it **requires investments** and **resources**, it is **cross-functional** and **hardly reversible**.

So **the overall set of strategic decisions that will constitute a company's business strategy basically emerges from the SWOT.**

Let's build up a general example: a generic player operating in a given business area may apply the SWOT analysis and come up with this result.

The Opportunities arising from the external environment are:
- new markets emerging;
- demand increase;
- a new patent or license;

while the threats are:

- New restrictive regulations;
- Aggressive national competitors;
- Competition from emerging markets;
- Substitute products.

Moving to the inside of the company, its Strengths lie in:

- strong Brand awareness
- high Product Quality
- high Perceived value
- customer Loyalty
- Effective distribution
- significant Scale

The company also has weaknesses compared to competitors, like:

- Limited geographical coverage
- Little cash flow
- Lack of management leadership
- Low flexibility
- Low operations effectiveness.

By thoughtfully and creatively considering these elements, some strategic alternatives to pursue may emerge, like:

- Launch new products in new markets based on high quality;
- Strengthen the brand to protect the company's offer from substitutes;
- Use perceived value to increase premium price and make cash flows grow.

Some of these alternatives may be mutually exclusive, while others may be synergistic and consistent with one another.

Managers have the task to properly formulate, select and balance these strategic alternatives stemming from the SWOT analysis, which adds up to constitute their company's Business Strategy.

EXAMPLES OF SWOT APPLICATION

SWOT Analysis allows strategic decision makers to systematize the analysis of the external and internal environments their companies compete in.

Now that we know how to create and use the matrix, let's work on it with a real-world example.

Let's consider the food industry and let's focus on a leading player operating as an international fast food chain.

How would you formulate a SWOT for such player?

Applying the SWOT Matrix requires to first identify the business area (in order to define external strategy analysis' boundaries), and then a player of reference. In this case, we select the fast food business area and a leading international fast food chain.

A **SWOT** based on brainstorming (rather than a structured approach) applied to this company may provide the following result.

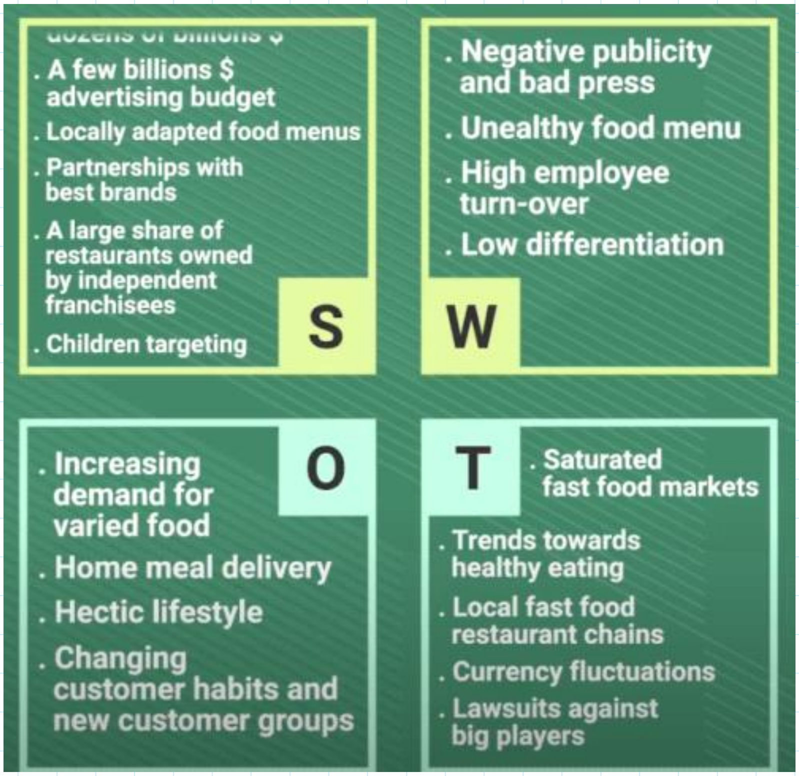
As **Opportunities**, we could identify:

- Increasing demand for varied food,
- Home meal delivery,
- Hectic lifestyle, پر جنب و جوش
- Changing customer habits, and
- New customer groups.

The trends representing **Threats** are:
- Saturated fast food markets in the developed economies
- Trend towards healthy eating (since we are focusing on fast food, rather that the food industry in general)
- Local fast food restaurant chains
- Currency fluctuations
- Lawsuits against big players

Moving down to the **internal analysis**, a leading player's **Strengths** could be:
- having the largest fast food market share in the world;
- showing a Brand recognition valued dozens of billion $;
- A few billion dollars advertising budget;
- Locally adapted food menus;
- Partnerships with best brands;
- a large share of restaurants owned by independent franchisees; دارنده امتیاز
- Children targeting

Concerning its **Weaknesses**, we may underscore:
- Negative publicity and bad press;
- the Unhealthy food menu;
- high employee turnover;
- Low differentiation.



The company could hence formulate strategic alternatives such as:
1) include an healthier diet (salads);
2) Launch home delivery based on its strong distribution network and brand;
3) Be more transparent about its food properties (calories, fats).

1.

These strategic alternatives can be **assessed**, **selected** and **bundled together** to create an overall **business strategy**.

We could make many other examples of SWOT application in different industries.
Notwithstanding the specific case we select, a key principle should always stand:

the perspective and standpoint should change from the external to the internal analysis, and should be that of the average industry player concerning external analysis, while it should consider the specific company of reference compared to its competitors, when it comes to internal analysis.

Let me stress again why **SWOT is so important for strategy: since strategy is a link between the internal and the external environments, SWOT supports strategy in playing this fundamental role.**

According to **Grant**, successful strategies have some common traits:

1) they start from clear, consistent, long term goals,
2) bundled with a deep understanding of the external competitive environment
3) and show an objective appraisal of internal resources.

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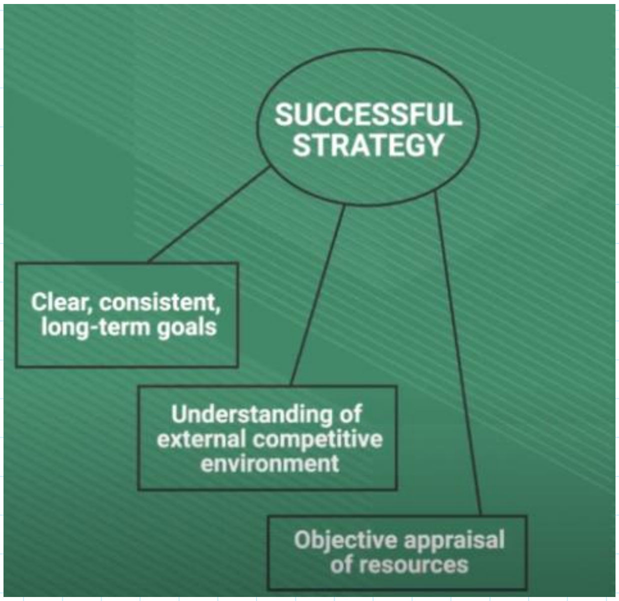


These elements (where the last explicitly stem from a SWOT), **coupled with an effective strategy implementation**, may lead to a **sustainable competitive advantage**.

The relationship existing between strategy, performance and value is :

strategy is ultimately related to performance and value creation, its goal being pursuing and sustaining competitive advantage (that is, a profitability higher than competitors).

COMPETITIVE ADVANTAGE AND COMPETITIVE DIFFERENTIALS

Strategy formulation at a business level starts with the definition of vision, mission and strategic objectives, in line with the general orientation of strategy that is linked to the creation of value.

After this, decision makers perform an analysis of the external and internal environments, called strategy analysis.

At the level of a strategic business unit, strategy analysis is made up of two main components: an external analysis and an internal one.

The **external analysis is used to evaluate the attractiveness and the average profitability of the business area examined, by detecting environmental opportunities and threats influencing the definition of strategies and their performances**.

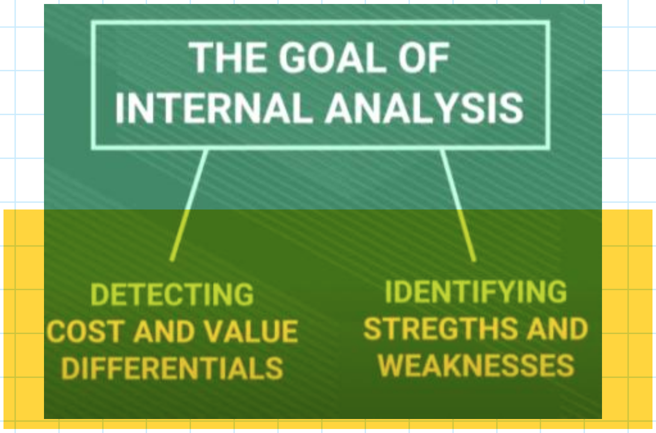
Internal strategy analysis, which is essential to complete the information that we obtained from an external environment assessment done with models like the five competitive forces and PEST analysis.

Once we have defined the average industry attractiveness, we need to evaluate the ability of a single company, operating in that industry, to create and sustain a competitive advantage.

The concept of **competitive advantage**, from a strategic point of view, **is linked to the chance the company will obtain performances and profitability that are higher than those of competitors.**

This definition highlights the key role of performance in strategy analysis, and closely links competitive advantage to the notion of margin, measured as price minus cost.

The goal of internal analysis is that of detecting competitive differentials of cost and of value for our strategic business unit, compared to competitors, also identifying the company's strengths and weaknesses.



Competitive differentials are simply **elements characterizing the performances of the company and influencing margin**.

Since margin is calculated as price minus cost, **competitive differentials** will, on the one hand, **influence the ability of**

the company to work with lower costs, so increasing efficiency, and on the other hand, **determine the chance to increase the output's added value**, thus **making the product and the service offered more attractive to the customer**.

Value differentials, also called **attractiveness differentials**, represent **effectiveness drivers**,
and they have a positive effect on the price that the customer is willing to pay to get a given product or service.

A **combination of positive differentials of cost or value will determine the strengths and the sources of competitive advantage** for the company if compared to competitors, whereas **negative differentials will represent disadvantages or a source of competitive disadvantage**.

Strategic competitive differentials are created by the possibility and ability of companies to make use of specific characteristics of the economic system, like for example:

- **the non-linearity in the relations between economic variables**, like economies of scale or the cost of capital;
- **the inertia and the difficulties in reversing the dynamics** of those economic variables;
- **the inequality in accessing markets outlets, specific resources**, knowledge or information and cost asymmetries;
- **stretch**, or variability in commitment, productivity and creativity of people on the basis of their motivation.

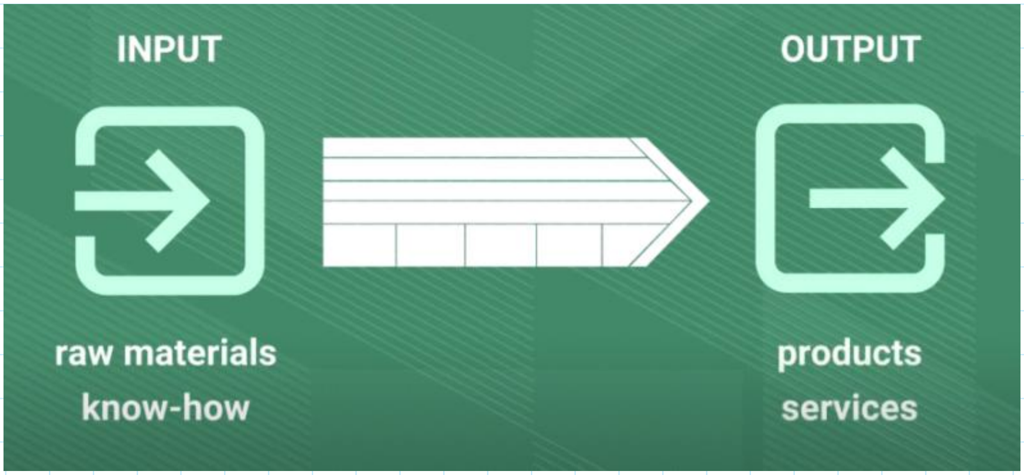
Companies can leverage these asymmetries and unbalances and disequilibria to outperform their rivals and create competitive advantage. عدم تقارن

THE VALUE CHAIN MODEL

Internal strategy analysis aims at identifying and analyzing the sources of companies' competitive advantage.
A methodological tool to support such process is the so called **value chain model**.

The value chain model, proposed by **Michael Porter** from Harvard Business School in his 1985 book "Competitive advantage", **is based on the idea that we cannot analyze competitive differentials if we consider the company in an aggregated way, as a black box, separated by the company's customers and suppliers**.

What **we have to do is to break up the company into single activities or sub-activities, contributing to the process of transformation of inputs** (like raw materials or know-how), **into outputs** (that is, products or services).



The value chain model offers a fine-grained **representation of all the activities carried out within the company, and also of the internal and external links among the activities themselves**.

The idea at the basis of it is that **the strengths and weaknesses of a company are linked to the way the value chain is designed, structured and run**.

More specifically, **the model tries to identify the differentials of cost and value through an analysis that considers three levels**.
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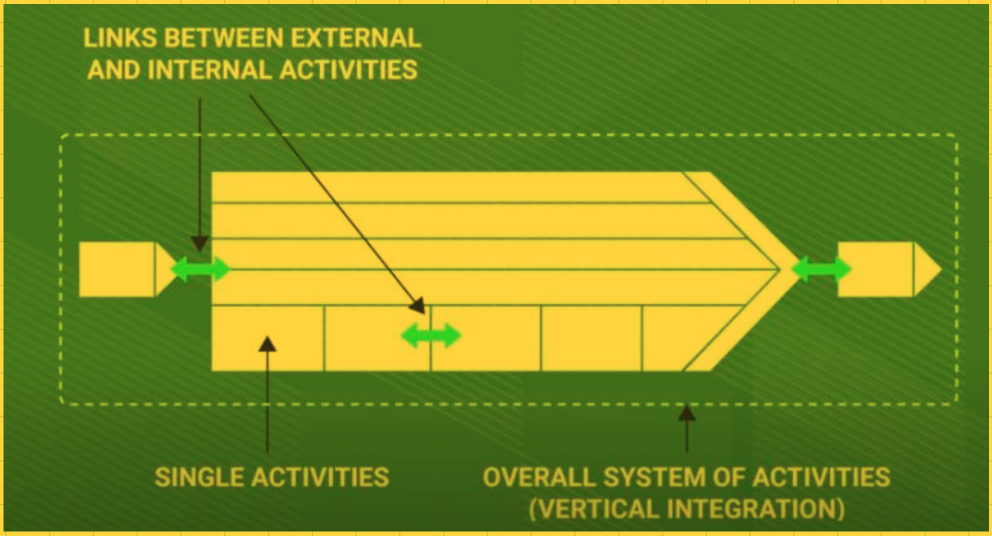
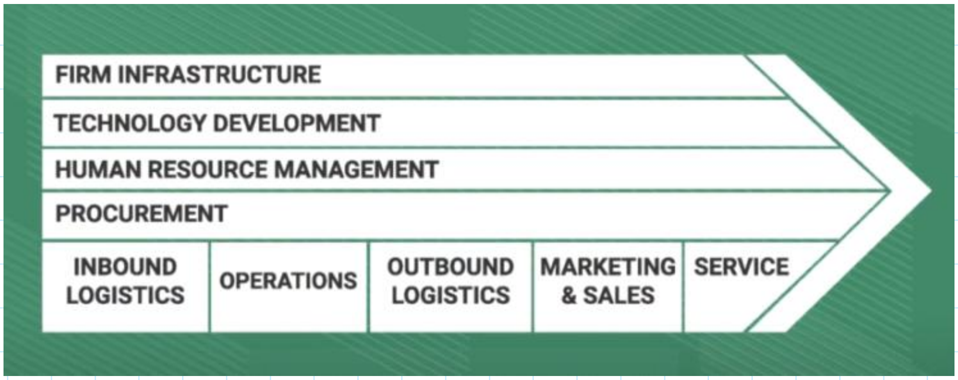
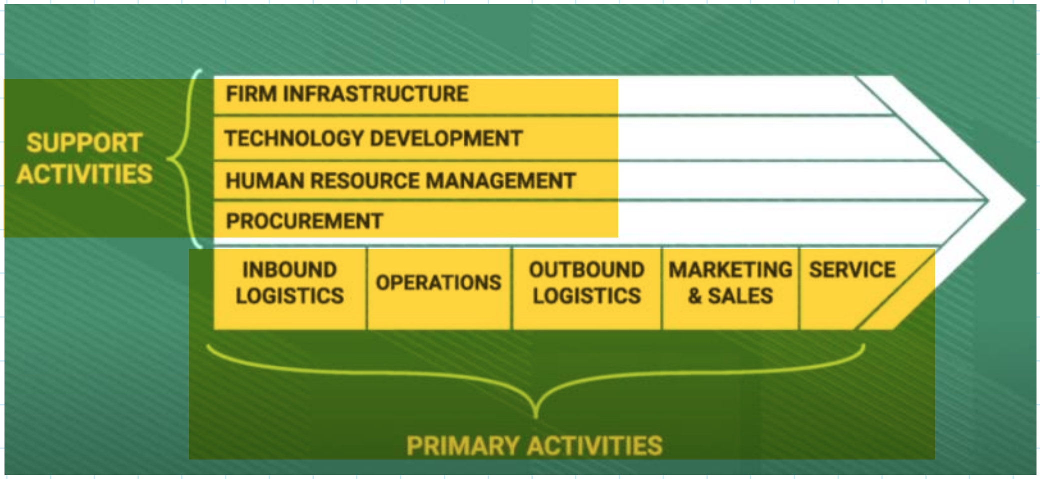
First, **the way single activities are designed and carried out**; second the **links between the internal activities** and **such internal activities with those of the customers and suppliers**; and **third, the overall system of activities, also called level of vertical integration**.



The original value chain model, developed by Porter for manufacturing companies, is shown in this figure.



The value chain is made up of **five basic activities called primary activities**, and of **four crosscutting activities** called **support activities**.



Primary activities are those directly contributing to the transformation of inputs into outputs and to the creation of a value perceived by the client.

More in detail, among primary activities, we have:
inbound logistics, that is the activities associated to the receiving, storing, transporting and delivering the inputs used in the transformation process; **operations**, that is the activities leading to the transformation of inputs into finished products or services;
outbound logistics, that is activities required to store the finished product and physically distribute it to customers;
marketing and sales, that is all those activities aimed at informing the customer about a product, so that the costumer will then buy it, through advertisement, promotion, managing of selling channels and so on; and finally **pre-and after sale service**, that is installation, technical assistance, provision of spare parts and so on.

Support activities, conversely, have no direct impact on the transformation of inputs into outputs or on the creation of the value perceived by the client, but they represent crosscutting and enabling **processes needed to constantly carry out primary activities**.

They provide the inputs, human resources, technologies and other functions.

Among these activities, the model highlights **procurement**, that is, every activity linked to input acquisition, like raw materials, components, machines, technologies and services, needed for the good functioning of the company, like supplier selection, negotiation & rating.

A second activity refers to **managing human resources** in terms of scouting, selection, hiring, training, appraisal and empowerment of personnel.

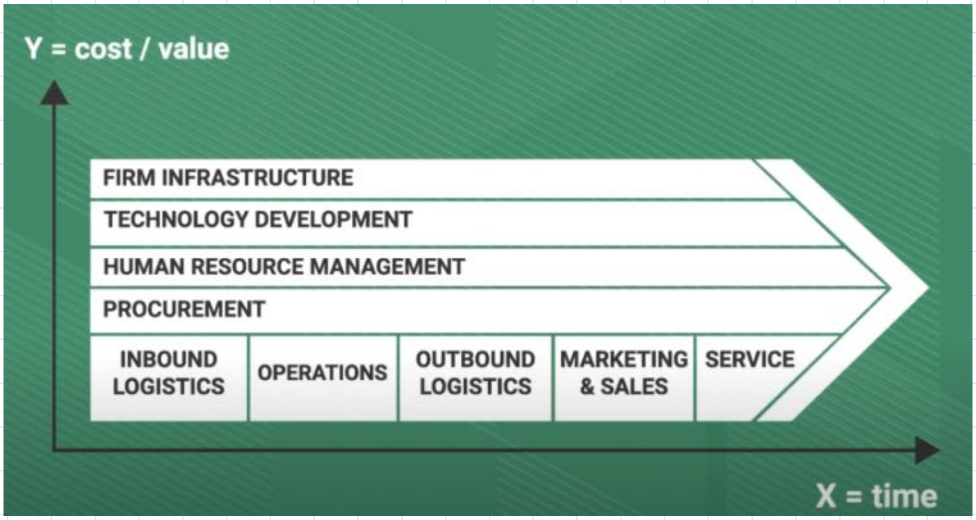
A third support activity is **research and development**, related to technology development, engineering and the management of the company's technological portfolio.

Finally, the model considers those **infrastructural activities** that constitute the company's backbone, like management, administration, strategic planning, finance, legal services, but also activities which might look less relevant, like managing of the company's canteen. غذاخوری

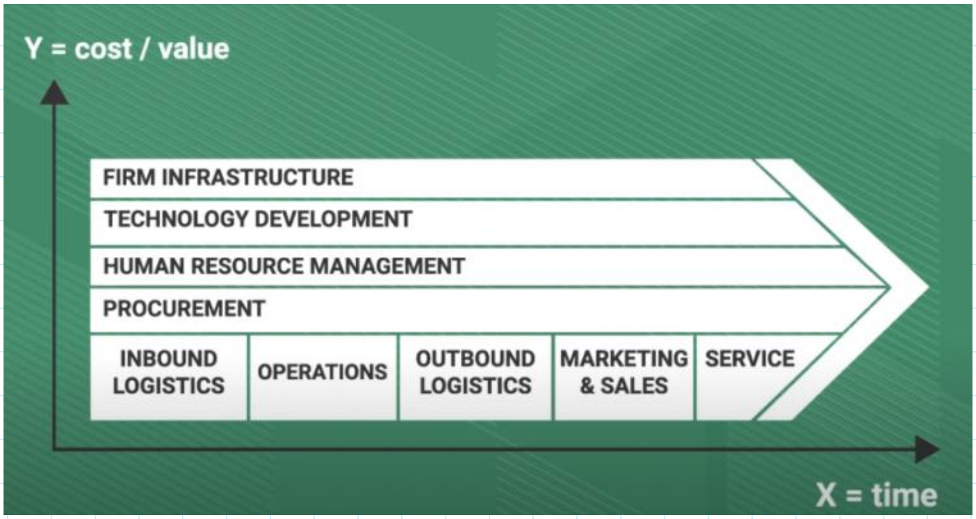
As anticipated, **acquired inputs brought into the company thanks to inbound logistics**, go **through the transformation process activities and are turned into a final output, either physical or intangible.**

If we want to show this process in a general way through a graph, we can take a generic value chain where we identify primary activities at its basis, and the crosscutting or support activities at the top.

We associate to this generic value chain the positive quadrant of a Cartesian coordinate system; we mark on the **X axis** the **time factor**, so that we take into account the **input passing through the chain activities**. On the **Y axis**, we mark on the one side, the **cost factor** on the other side the **value factor**.

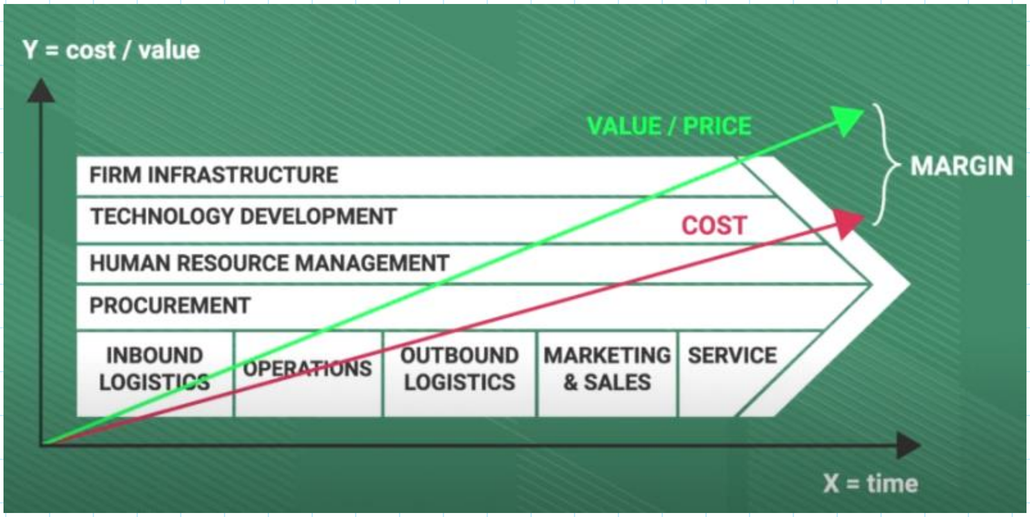


Now, through the graph, we can underline the fact that, as the input goes through the different activities (starting from the cost of buying raw materials), it increasingly includes a growing set of costs: logistic, production, marketing and selling costs, service costs, and costs linked to crosscutting activities.



At the same time though, **activities play a role in increasing the value of input**.
What happens is that **activities have a role in creating value, and are therefore called value-added activities.**

At the end of the transformation of inputs into outputs, there will be an output whose value will be higher than the cost. **The delta that is created in the difference between cost and value is actually the margin**.



This is how performance, driven by its determinants of cost and value, builds up as we move along the company's value chain.

VALUE CHAIN MODEL'S APPLICATION PRINCIPLES

The value chain model **supports the identification of a company's cost and value differentials**, which in turn determine its strengths and weaknesses that sustain or hinder its ability to create competitive advantage.

Before getting into the details of this analysis of competitive differentials, I will briefly state the principles that should be used when adopting this framework.

Unlike external analysis, where the models of the five competitive forces and PEST are applied to a generic company,

1.**the point of view of the value chain is that of the specific company analyzed.**

2.**value chain is both firm and industry specific**, so it refers to a specific strategic business unit working in a specific business area.

Companies having a diversified portfolio and operating in different markets, will have to develop as many value chains as the number of SBUs they control.

The last application principle is based on the fact that the model is

3.**relatively flexible**: it was first developed for manufacturing companies, but it can be adapted to other sectors like the service one.

So, as a consequence, **primary and support activities proposed in the model can be reviewed and the value chain can be remodeled on the basis of specific activities carried out by the company analyzed and influencing its cost and value**.

When remodeling the value chain, however, keep in mind that no matter how deeply you modify the traditional template, the following features of the model will always hold true.

There will always be a distinction between primary and support activities. **You will always be looking for cost and value differentials determining competitive advantage** and you should always carry out an **internal analysis identifying positive and negative differentials of cost or value within three levels**.

1) the level of the single activity,
2) the level of the links among internal and external activities
3) the level of the overall system of activities.

VALUE CHAIN & SINGLE ACTIVITIES: COST COMPETITIVE ADVANTAGE

Internal strategy analysis carried out through the value chain model is aimed at identifying the competitive advantage of the company compared to competitors.

That **competitive advantage can depend on positive differentials of cost and of value or attractiveness.**

Let's now focus on the sources of cost competitive advantage.
These sources will depend on the way the value chain is structured in terms of **single activities**, **links among activities** and on the **basis of the overall value system**, also called **level of vertical integration**.
If we consider the first level (that is, single activities), cost competitive advantage (or disadvantage) can depend on the way the **company organizes and carries out specific primary or support activities**.

The analysis of single activities is carried out following a specific set of steps.

The first step requires **identifying significant activities** in terms of:

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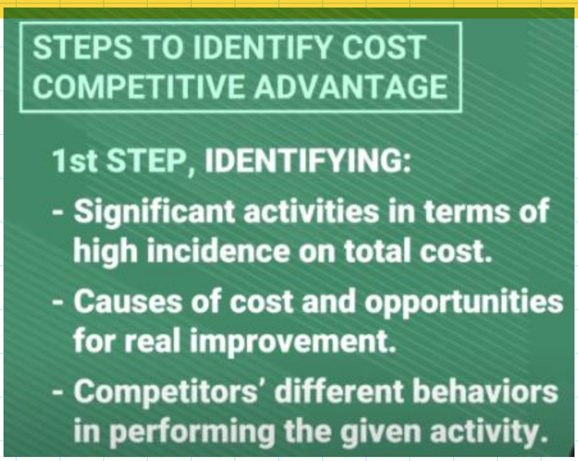
- **high incidence on total cost**;
- **causes of cost and opportunities for real improvement**. For example, if the origin of costs is exogenous, as in a costs linked to the fulfilment of legal obligations, there are basically few levers to modify it. Conversely, if the causes of costs are endogenous and linked to the way the business is structured and managed, there are possible chances of improvement.
- **competitors' different behaviors in performing the given activity** (since a comparative evaluation of competitor's choices in the activity can indeed help detecting new opportunities and sources of competitive differentials).



The **second step** refers to **the evaluation and the quantification of costs of specific activities considered as significant, and also their benchmarking with costs covered by major competitors** in carrying out the same activities.

When applying the value chain model, this is when the main operational issues may arise.
As we evaluate internal costs covered to perform the business activity, **we can face problems** linked to inconsistent or **inaccurate internal accounting** or to the **difficulty in assessing shared activities**, like administration.

We can solve these problems by implementing a more sophisticated overall accounting, management control system based on state-of-the-art cost allocation methods, like the so called activity-based costing.

Nevertheless, improving and innovating internal accounting can be expensive in terms of time and money.

Now, if simply collecting information within the company is complex, we may wonder how difficult it could be to collect detailed information on the costs covered by competitors.

Information on competitors is nevertheless essential, given the mainly comparative nature of internal analysis, which is based on the comparison with competitors' costs and revenue in order to deduce the existence of positive or negative differentials.

Managers carrying out an internal strategy analysis can rely on a set of primary and secondary sources which are complementary when trying to obtain information on competitors' costs.

Among primary sources, we can mention the so-called "**knowledge spillover**", which is the collection of information from direct sources by hiring competitors' employees. These human resources, formerly employed by competitors, can describe methods and costs of the activities carried out in the companies they were working for.

This data collection model entails a set of problems, like: **the protection of competitors' information, which could be covered by non-disclosure agreements** (or NDAs) signed by former employees; **the costs of hiring competitors' employees**, who are probably expecting an wage higher than the one they earned before; and the **chance that competitors might one day do the exact same thing to the company**, by hiring its own key employees.

Another primary source for data collection is represented by the so-called **benchmarking clubs**, that is, associations organized around a trusted third party, which collects data and information on a specific market by contacting all the main players working in it, in order to elaborate aggregated and comparative industry studies.

These studies are then shared among the companies taking part in the research project:
data are often anonymous and represent a basis to carry out comparative analysis on competitors' costs and revenues.

Politecnico di Milano's School of Management itself, and its applied research group of the Digital Innovation Observatories I collaborate with, often performed this role of trusted- third party, which collected data among the main operators of several markets and then presented data both in an aggregated way and offering a high level of detail on specific activities.

It is also possible to collect relevant information on competitors' costs and revenues by talking to their supply chains partners, that is with their customers and suppliers.

Secondary sources of information on competitors are represented by public documents, like the financial statement, public tenders or company's profiles.

The third and last step of costs analysis focuses on identifying specific cost drivers, that is, those factors explaining the origins of costs. Every activity has a specific cost structure, therefore costs drivers can be different from one activity to another, as well as from one player to another.

VALUE CHAIN & SINGLE ACTIVITIES: COST DRIVERS - PART 1

The value chain analysis of a company's cost competitive advantage requires to identify **cost drivers**, that is, **the causes or origins behind primary and support activities' costs differentials**.

Let's consider the main cost drivers.

First of all, we can analyze **the level of saturation of production capacity** of what is called **the technology and organizational configuration of the company**.

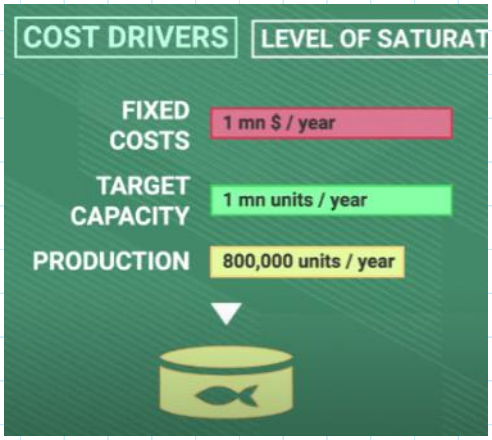
The underlying idea is that every company defines the technology and organizational method it will use to plan, develop and coordinate those activities needed to put products on the market.
These methods are called **technology and organizational configuration**.
Within this configuration, each functioning activity can be carried out by using assets or facilities, which can be represented by a plant, a machine or even an information system.
The asset is planned and sized on the basis of the so-called "**target capacity**" that is the yearly output capacity enabling

the company **to use production factors in the most efficient way possible.**

So, if the **actual production** is set at the target capacity, such production capacity is saturated, and the **average cost per unit is minimum**.

However, **whenever we produce less than the asset's target capacity, under-saturation may occur**; in under-saturation, fixed costs like firm infrastructure and fixed assets cannot be spread on the maximum possible volume, so average cost per unit increases.

To give an example, should fixed costs be 1 million dollars per year, and target capacity 1 million units or transactions per year, by placing our actual production at target capacity we would spread fixed costs and obtain an impact of 1 dollar per unit produced or transaction performed; if under-saturation occurs, and actual production is 800,000 units per year, fixed costs impact on a single unit or transaction is 1.25 dollars, and average cost per unit increases.



Conversely, in oversaturation, we have **higher costs due to assets overstretch, waste, overtimes, and malfunctioning**; these additional costs still determine an **increase in average cost per unit**. So, given that both over or under saturation conditions are suboptimal, why do they occur?

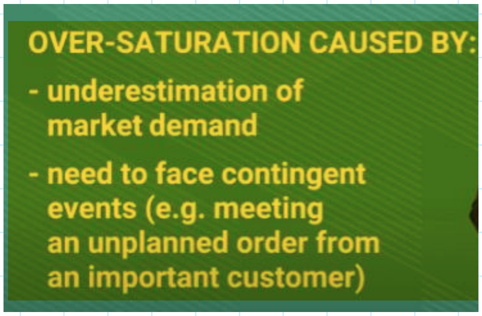
The answer is in the complexity of real situations companies face:

Under-saturation can be a consequence of a **mistake in forecasting demand**, leading to an **oversizing of the production system**, but it can also be a **deliberate strategic choice the company makes in order to create surplus resources that raise entry barriers to the business area**, thus preventing or reducing the threat posed by new entrants considered in the five forces model.

what are they?

shouldt be understimation??
its correct cause its related to the target capacity

Even **over-saturation** can stem from a mistake in forecasting demand, in this case leading to an **under-sized technology and organizational configuration**.
The asset can nevertheless get over-saturated to face contingent events, like meeting an unplanned order by an important customer, whose **strong bargaining power can force the company to accept the order even though the costs are high**.

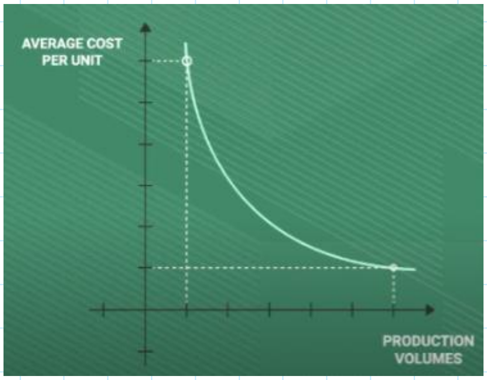


Let's now mention a second cost driver, linked to the level of saturation; let's talk about the so-called **scale economies**.

The level of saturation has a short-term impact and concerns already functioning companies.
We can expect that in the **long term** a generic company constantly finding itself in under or over saturation, will choose a different asset by selecting one with a target capacity that is designed to meet the real market demand.

A consequence of this is the assumption that **the same activity can be carried out with different infrastructural and organizational models of the activity itself**, which means, **different technology and organizational configurations, on the basis of the scale and volumes to be produced**.

The idea at the basis of scale economies is that **scale and average cost per unit are inversely related**, so when the production volumes per year increase, the average cost per unit drops.



This happens because in the long term, given a certain scale, the company can select the technology and organizational configuration that best suits that scale, aiming at reducing the average cost per unit and at improving performances.

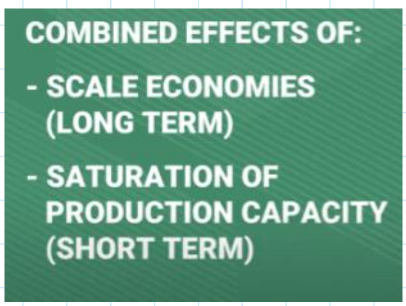
When **the scale grows**, the company takes advantage of a set of non-linear events, like the advantages of **standardization**, **specialization** of labor and **critical mass**, in order to design and create a more effective plant, if compared to plants with lower scale.

the minimum size or amount of resources required to start or maintain a venture

Naturally, adopting a bigger and better asset will require **investments**.
Still, investments in an asset that is closer to the state-of-the-art, both from a technological and an organizational point of view, is justified by an increase in the scale it has to produce.

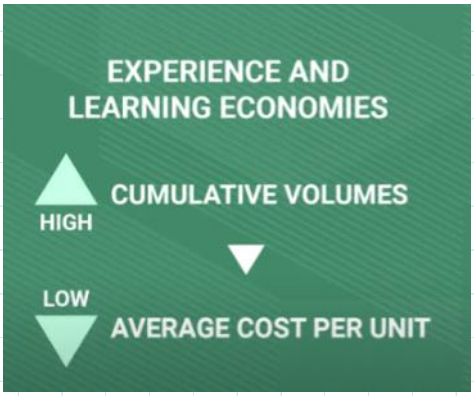
Just to consider a trivial example, if you need to produce one car per year, you can do that in your garage with basic technologies in a workshop fashion (since your scale does not justify additional investments), and that car will have a high cost per unit.
But if you need to manufacture 1 million cars per year, such volume will justify an investment in automation, which represents another **technological and organizational configuration** with a much lower cost per unit.

As a whole, **the cost drivers of scale economies and saturation level have combined effects**, since **costs per unit of activities depend both on long-term choices of sizing the technology and organizational configuration**, **on the basis of the scale for which the company was conceived, and on the actual level of saturation of the chosen plant in the short-term.**



VALUE CHAIN & SINGLE ACTIVITIES: COST DRIVERS - PART 2

A similar trend with synergistic effects on scale economies is that of a further determinant, called **experience and learning economies**, according to which **average cost per unit drops when the cumulative volumes produced by a company throughout its history increase**.



This was empirically proven, as it is a result of the experience and learning effect acquired by operators who are increasingly able to **improve the efficiency of processes developed thanks to a growingly increased comprehension, repetition and rationalization**.

Experience economies have a dynamic origin, linked to irreversibility and timing:
the first movers in a market can have a **cost advantage linked to the only fact that they have accumulated production over time**, and therefore **they acquired more experience on the activity connected to it**, compared to competitors who entered the market later.

The positive effect of experience and learning on **cost differentials can be defended if the experience is shared inside the company, but tacit outside of it**.
Learning has to be collective among employees and managers, but the company shouldn't hire suppliers or consultants to formalize the experience and reuse it in its activities.

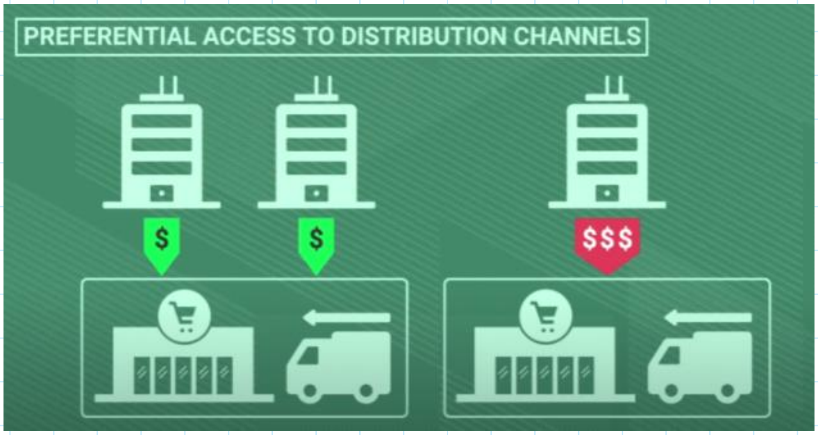
On the contrary, **the learning effect is weak in case of relevant changes in context and radical innovations introduced by competitors or by new entrants, which substantially disrupt the way the activity is carried out and reset the curve of experience**, thus forcing all
players to start from zero and acquire experience in the new process.

Localization of activities is also a possible cost determinant, as it has an effect on a series of elements such as **supply and transportation costs** and it is affected by the **choice's timing**.

Whenever localization is strategically relevant, and there is a natural or regulatory limit to the maximum number of actors entering the most favorable markets, **localization becomes a significant source of cost competitive advantage**, **as well as a barrier to new entrants**.

Preferential access to distribution channels is partly linked to the topic of **localization** and considers how the actual access to distribution channels can **determine outbound logistic costs of competitors**.

For instance, competitors can bear different costs to access existing channels, or set up their own proprietary channels.



Costs can also be determined by **institutional factors**: in some industries, public administration and authorities define **which and how many actors** can compete in the market (for instance, by providing specific licenses), they approve **regulations** (for instance, environmental regulations), **they establishing duties, incentives and disincentives.**

motivation

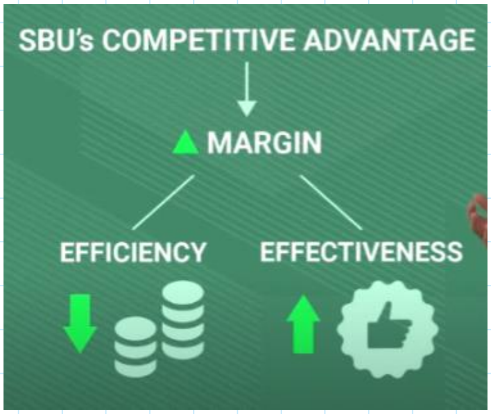
When the role of public institutions is key, a company's or an companies group's political ability to obtain government contacts and state aid through activities traditionally called **lobbying or advocacy**, can be a source of competitive differentials from an internal point of view, or an **entry barrier** from an external point of view.

As a whole, the full list of cost drivers I discussed should be assessed to determine the origins of a company's cost competitive advantage or disadvantage compared to its rivals.

VALUE CHAIN & SINGLE ACTIVITIES: VALUE DRIVERS

The value chain **is the internal strategy analysis tool to assess the competitive advantage of a strategic business unit, that is, the SBU's ability to obtain higher margins than direct competitors**.

These higher margins can be achieved by **aiming at efficiency**, so at cost reduction, or by focusing on **effectiveness**, that is, the creation of value for the customer.



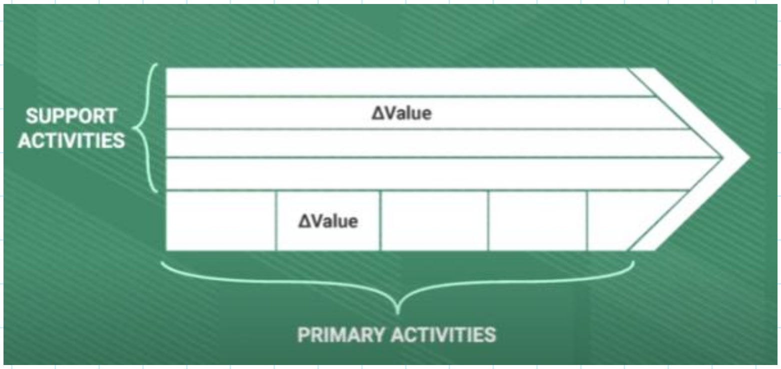
Whenever value for customer is created, **the company's offer is differentiated from the one of competitors and appears as unique**, thus escaping a competition based merely on price (and the related price wars).

To assess a company's value competitive advantage based on effectiveness at the level of single value chain activities, we should follow the same steps described to disclose a cost-based advantage:

1. we start by **identifying value-significant activities**;
2. we then proceed by **evaluating and quantifying value contribution of specific activities considered as significant**;
3. and by **benchmarking with value created by major competitors in carrying out the same activities**;
4. and eventually we conclude the process by **identifying specific value drivers**.

Within a company's value chain, **effectiveness can be driven by value drivers or value differentials residing in both**

primary and support activities.



Value drivers translate into the **higher price that customers will be willing to pay due to increased product performances**, **either tangible** (based on real functions), **or intangible** (linked to the brand-induced perceptions or emotions).

These value competitive advantages can depend on key elements of uniqueness in the company.

Quality is a major factor influencing the ability of the company to differentiate itself; in order to avoid a generic interpretation, we will define quality both as the **nominal product performance**, that is the so-called **compliance quality with project requirements** (or in-house quality), and **the quality of actual performances when the product or service is used on the field and determines a given customer experience** (referred to as in-field quality).

Time also has an influence on value differentials, both in terms of **delivery time**, **punctuality and time-to-market**.

For example, a fast and on-time delivery can have a higher mark-up price, both in transactions between companies and between companies and the final customer.

Flexibility in accepting adjustments to what was previously agreed upon or planned, and the ability to carry out those unplanned adjustments in a short time can be another differentiating element for a company.

The same is true for **the service level associated to the offer**, considering both services incorporated in the product and services complementary or ancillary to it.

Variety and customization of the offer, in terms of wide product range and the ability to customize products according to the customers' special needs, can have a positive effect on the price charged.

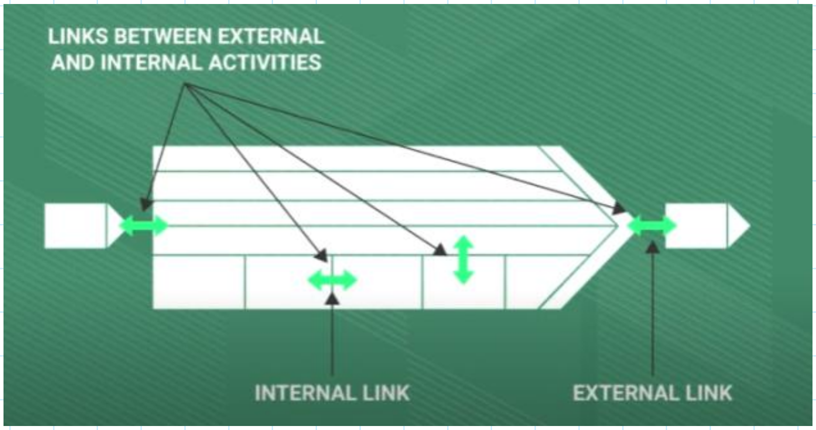
And finally, **brand and company reputation** can strengthen the perception of uniqueness of products. This is the aim of marketing campaigns and experience-based customer journeys, which can be sometimes very expensive to set up and orchestrate, but improve both brand awareness and brand image.

A combination of the value drivers reported here can explain a company's ability (or inability) to create and sustain a competitive advantage based on value and differentiation.

VALUE CHAIN & LINKS BETWEEN ACTIVITIES

So far we have discussed how to face the first level of analysis in the value chain, that is, the one of single activities.

Let's now focus on the second level of analysis: **the links between activities**.
These links concern both **internal relationships** among value chain activities in a specific company - like the link between inbound logistics, production and outbound logistics - and **external relationships** with value chains of suppliers upstream, and customers downstream.



Some of the costs coming from **internal links** among activities are **inventory costs for stock** the different phases of the production process, and costs of internal movements.

Value can also be affected by internal links, as quality can be preserved or deteriorate as materials move from one activity to another (like operations and distribution); or adequate actions on support activities like investments in R&D can benefit a company's brand and the way it's perceived as innovative by customers.

External link costs and value may depend, again, on raw material inventory management (also influenced by the input's packaging), or on **the relationship between** the company's and **the supplier's production system**, or on in-house quality control costs (that is on internal quality control), or on in-field control (to check how the product performs on the market), or even the definition of incentivizing service level agreements between the company and its' suppliers and customers to align the whole supply chain on the same objectives of value creation.

Since optimizing links among activities can reduce costs and maintain or increase the value of the product or service, in recent years new management techniques and approaches were introduced to improve such links among activities, like for instance lean manufacturing, "just in time" and "concurrent engineering".

VALUE CHAIN & SYSTEM OF ACTIVITIES: VERTICAL INTEGRATION - PART 1

In the value chain analysis, after cost and value determinants are identified and analyzed at the level of single activities and of links between activities, **they have to be detected at the overall system of activities level**, thus evaluating the cost and value advantages or disadvantages coming from a company's decisions on which activities should be performed internally or should be outsourced.

This is the third and last level of analysis, and considers the overall value system, in order to evaluate the level of **vertical integration**. ادغام-تلفيق

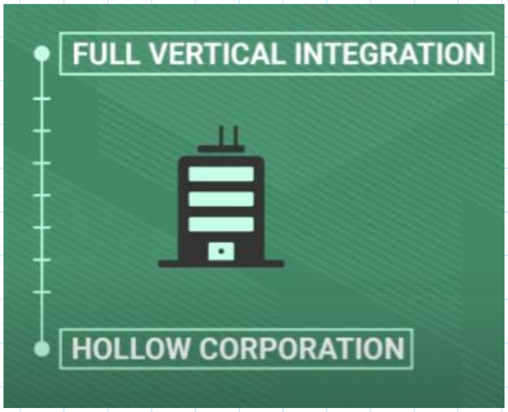
To define vertical integration, let's consider a company internalizing and therefore integrating every activity, from the gathering of raw material to the selling of a product or service to final consumers in a business-to-consumer approach.

Such a company is said to have a full vertical integration, as **it performs all the activities in the supply chain**.

A classic example of a completely integrated company is Ford in the '20s, which took care of the collection of raw materials like wood, iron and rubber, up to the distribution of vehicles to the final customer.

The opposite alternative to vertical integration is the so-called **hollow corporation**, **only performing coordination and financial control activities within the company**, thus delegating all the other activities to outside suppliers through outsourcing. محول کردن

These two alternatives are the ends of the continuum of solutions available for companies, which can decide to perform some activities internally, choosing hierarchy (that is, I perform inside and I am structured consequently), or give other activities in outsourcing, thus turning to the market.



Vertical integration means **hierarchic system**, whereas **outsourcing** means **turning to the external market**.

سلسله طبقاتی

Why does the level of vertical integration pertain to the discussion on the value chain?

مربوط و وابسته بودن

Because **competitive advantage can depend on these strategic make-or-buy-choices**, as the costs or value associated to carrying out an activity can be different depending on whether the activity is integrated or externalized. These choices also have an influence on the structure of the value chain, that will include more or less activities.

And we know that strengths and weaknesses of the company depend on the structure of the value chain.

VALUE CHAIN & SYSTEM OF ACTIVITIES: VERTICAL INTEGRATION - PART 2

Let's consider **the pros and cons of the make choice,** which means carrying out activities within the company, in turn increasing the company's vertical integration level.

A first advantage will be the **dropping or disappearing of transaction costs**: but what are transaction costs?

They are the costs to be borne in order to work with the external market, to carry out a commercial transaction with one or more third-party suppliers.

If I can perform an activity within the company, I will not need a supplier and I will eliminate costs for scouting, evaluation and selection of suppliers (let's consider, for example the vendor-rating process) as well as administration and legal costs (like costs to draft a contract) and potential logistic costs.

جستجو

A second advantage, at the same time, is that I will **internalize the supplier's margin**, **as I will have to pay no margin to third parties**. The only costs borne in this make option are internal costs for performing and managing activities.

Other advantages are the **increased control on activities' costs**, guaranteed by direct execution, together with **better control and development of potential core resources and skills linked to the internalized activity itself**, like know-how or adopted procedures, which over time, will be otherwise acquired and covered only by suppliers.

A last advantage of the make-option is **the elimination of the problem of reliance on the supplier**, which often leads to the company losing sight of real costs of the activity and to weakening control of resources that are possibly key for competitive advantage.

The make-option has nevertheless also a number of disadvantages, which also dually represent **the advantages of the buying or outsourcing option**.

First of all, **our company could be less efficient than a given external supplier in carrying out the activity, due to the effect of "scale economies" and "experience economies"**. Suppliers are likely to carry out the same activity for a number of customers and will therefore have a higher scale and learning speed than the single company can achieve alone. They will have higher production levels, quickly running down the experience curve, with positive effects on average cost per unit.

Another obvious disadvantage of the make option is **the higher investment in fixed capital**, **since in order to carry out the activity within the company, the need in capital can be high and expenses include long term assets representing fixed costs, which are not related to production volumes**.

Indeed, contrarily to making, **the buying option is a way to turn fixed costs into variable costs depending on the actual**

volumes the company supplies from the external market.

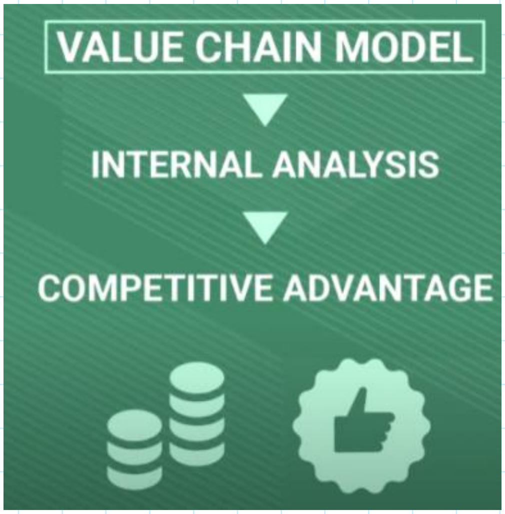
The make-option also requires **costs linked to hierarchic coordination of the activity**, which becomes part of the company itself; it is important to underline, though, that even **outsourcing partially entails coordination costs**, as the company changes its role from executor to coordinator, thus controlling the supplier's work.

Another problem linked to the make-option is the **lack of motivation that could arise in highly integrated companies**, as human resources performing non-core activities can feel poorly motivated, or **low incentives to efficiency and effectiveness may be present when captive market conditions arise**, that is, a company or SBU is forced by corporate rules to acquire as inputs the outputs of another SBU belonging to the same corporate portfolio.

The combined assessment of these pros and cons should drive a company's strategic decision favoring vertical integration or outsourcing.

VALUE CHAIN: MODEL'S LIMITATIONS

The Value chain model, as a whole, is extremely **useful to support the strategy decision process** for **internal analysis**, in order to identify and make use of sustainable competitive advantage sources of cost and value.



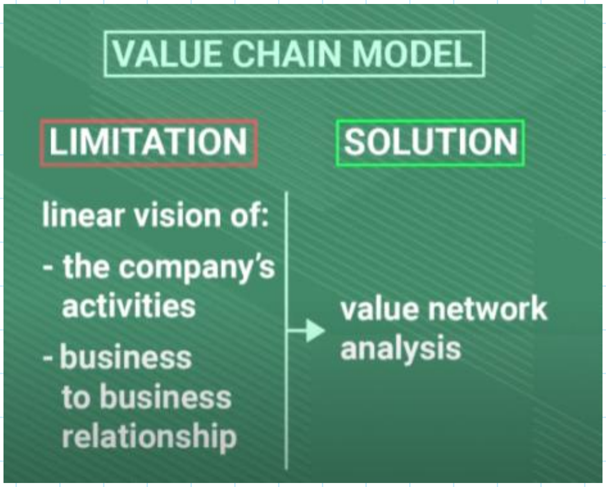
Nevertheless, just like any model trying to identify and describe the complexity of real-life situations, this **framework has a set of limitations**:

- **it is very manufacture-oriented** as it was designed for manufacturing companies in the first place. In order to solve this problem we need to modify and customize Porter's original value chain and redefine activities to help them better suit the needs of a specific company analyzed

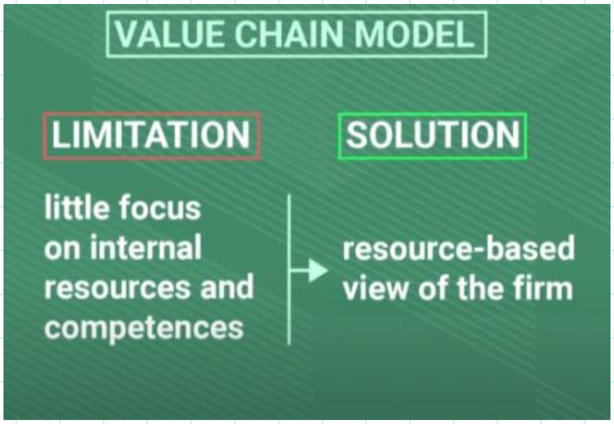
- **traditional approach to the value chain** sees it as a **mainly sequential, linear set of activities thanks to which input is turned into output**.

- The **value chain approach may imply that business-to-business relationships among companies to create an industry's products and services are also fundamentally linear**.

This linear vision of company's internal processes and industry relationships was recently questioned by research on **value networks**, which claims that the link between activities creating or destroying value in a market is not always linear: overlapping, circular or vertical links can appear among different layers of activities covered by the same or different companies.



- The last limitation refers to the **value chain's alleged poor ability to focus on the so called internal resources and competencies that drive a company's competitive advantage**. This criticism led to the rise of a stand-alone stream on strategy research and practice focusing on internal analysis: the so-called resource-based view of the firm.


VALUE CHAIN MODEL
LIMITATION
SOLUTION
little focus
on internal
resources and
competences
resource-based
view of the firm

Generic Strategies

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GENERIC STRATEGIES: COST LEADERSHIP, DIFFERENTIATION, FOCUS

A company's business strategy is formulated through a set of intertwined logical steps.

جدایی ناپذیر

After defining the vision, mission and objectives for the company (that stem from the general objectives at a Corporate level), we carry out an external analysis of the market in order to identify the main threats and opportunities.

This step is supported by models such as the Five Forces model and PEST Analysis.

We should also carry out an internal analysis to understand what are the company's strengths and weaknesses as opposed to competitors.

This time, we leverage the value chain model (possibly supported by a resource-based view).

Strategic analysis is not over, though, since we need to match results of the two analyses, external and internal, to draw to important conclusions guiding us in formulating our business strategy.

This critical matching process is summarized by the SWOT analysis, where the acronym stands for strengths, weaknesses, opportunities and threats.
The goal of the SWOT analysis is that of helping the decision-maker to tap strengths in order to seize opportunities, and at the same time carry out defensive actions aimed at improving weaknesses and at protecting the company from threats.

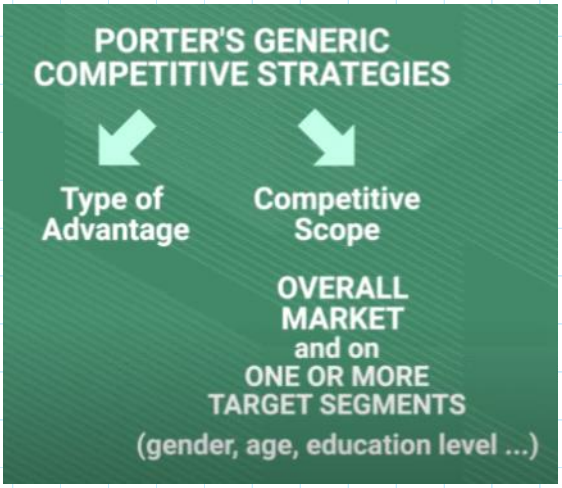
Indications coming from the SWOT analysis are used in devising strategic alternatives available to companies.

Michael Porter proposes a generic classification of these alternatives, called **generic competitive strategies**.

In order to create and sustain a competitive advantage, the company has to choose among a **limited number of generic strategies**, distinguishing themselves for **type of advantage** and **competitive scope**.

Companies can try and achieve a **cost advantage**, if aiming at **efficiency**, **or** the advantage can be **uniqueness and value**, **when pursuing effectiveness**.

As **for scope**, the company can work **both on the overall market and on one or more target segments**, identified through the choice of adequate demand segmentation variables, like gender, age, education level, or other more sophisticated elements like attitude and behavior.



Operating on an overall market and trying to obtain **cost advantages** leads to the adoption of a **cost leadership strategy**.

A cost leader aims at being the producer with the **lowest costs on the market, by leveraging cost drivers like scale economies, learning or localization**.

The opposite generic strategy is that of **differentiation**, where you still work with a broad scope of action, but tap **value drivers with a positive effect on price**, like **quality, timing and service level;** the company **aims therefore at presenting its product or service as unique, if compared to the one offered by competitors**, thus **avoiding a competition based solely on price pressure.**

If we identify different **clusters of customers**, whose needs are homogenous within the cluster but different across different clusters, we pursue a **focus strategy on one or more target segments.**

Focusing can rely on **cost or value**, leading to a focused cost leadership or a focused differentiation.

When it comes to generic competitive strategies, Porter has quite a draconian approach; **he believes that these strategy cannot be pursued at the same time**.

سفت و سخت/شدید

So **those who follow more than one generic strategy have a profitability below the average and risk to get "stuck in the middle"**, as he writes.

A company **will have to select a single generic strategy,** and that choice will have to be consistent with the value chain structure and the **competitive drivers** characterizing it.

همخوان و هماهنگ

Cost leadership will then be based on delta efficiency and **differentiation on delta effectiveness**.

This rigid stance was criticized and reviewed by many scholars, underling the fact that there are exceptions to the general rule, leading to **hybrid strategies of cost leadership and differentiation**.

For example, there can be strong cost advantages enabling the company to have surplus resources for differentiation.

Or, again the company can carry out **radical changes in technology or organization**, modifying the internal structure and offering opportunities in terms of efficiency and effectiveness.

Once the company has formulated its whole business strategy, based on one or more strategic alternatives coming from the SWOT and aligned with an overall orientation provided by Porter's generic strategy, **this strategy should be implemented in a business model through an adequate execution.**

Sometimes this is a very challenging step, as **planning gets tested against reality**, and **misalignments may emerge**.

Considering these misalignments and the differences between performances expected and the performance obtained pertains to the **control phase**, ending the strategy formulation process and starting a **feedback cycle that feeds future planning**.

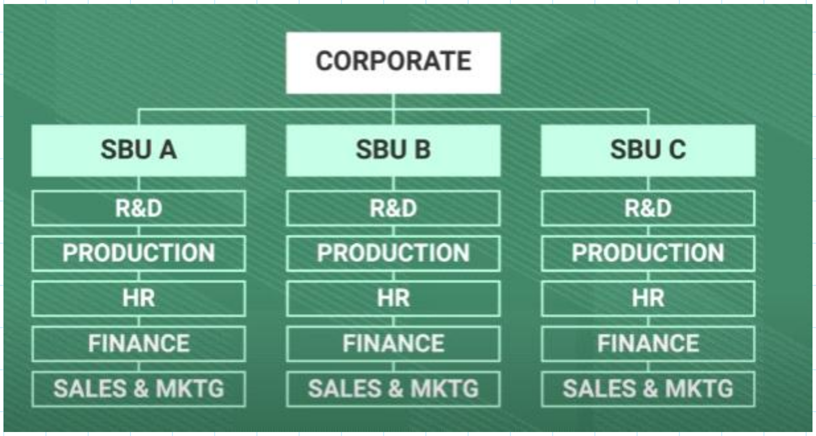
مربوط و وابسته بودن

CORPORATE STRATEGY & DIVERSIFICATION STRATEGY: DEFINITIONS

Strategy, that is the quest towards a sustained performance higher than competitors, **is formulated and planned on distinct though intertwined level**s.

More specifically, the level of Strategy are three:

1. **Corporate Strategy level**,
2. **Business Strategy level**
3. **Functional or operational leve**l.

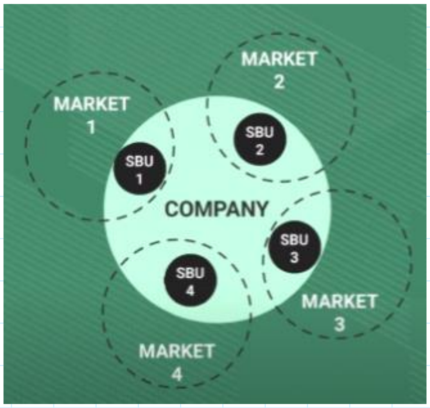


Let's focus on the **Corporate level**, so as to define Corporate Strategy.

The **main goal** of Corporate Strategy is to **manage financial resources allocation to the portfolio of different Strategic Business Units the overall company is made of**.

At this level, **strategy defines in which industries and markets the company is going to compete**.

So the company is seen from an helicopter view as a bundle, or portfolio, of different markets and Strategic Business Units.



The key issues to deal with at this level are:

1. first, **to analyze and compare the competitive positioning of each business, and of the overall business portfolio**;
2. second, **to suggest a generic strategic orientation to each business** (that will be further specified at a Business Strategy level);
3. and third, **to define criteria and priorities for financial resources allocation to each business** (cash generating vs. cash absorbing SBUs), looking for an overall portfolio's financial equilibrium.

In terms of **scope**, Corporate Strategy considers a **Product Scope** and a **Geographical Scope**.

About the **Product scope**, they key question to address is **how focalized or specialized should the company be in terms of the range of product it supplies**. For instance, a company like Coca-Cola is specialized in the beverages industry, while General Electric is diversified and it operates in multiple industries. Concerning the **Geographical scope**, the corporate management **shall consider what is the geographical spread of activities for the company**: on the one hand, we have global companies, such as Procter&Gamble or Toyota. On the other hand, we may find some companies which have decided to focus on one country only.

Also, the definition of the **level of vertical integration** may be achieved by adding or removing streamlined SBUs to or from the overall portfolio is another **scope** decision taken at the Corporate level. Here we find both highly integrated companies, such as Samsung, and companies that outsource several activities of their value chain, like Apple.

So, as a whole, corporate strategy focuses on some fundamental topics that lead back to **product range**, **geographical coverage** and **level of vertical integration**.

All of these **corporate strategies that aim at changing the scope of a company's portfolio** go under the name of "**diversification strategies**".

Diversification is a Corporate level strategy aimed at entering new business areas which the corporation is not currently serving (and creating new SBUs to serve such new business areas).

Considering the **transaction costs theory**, which compares the hierarchy vs market alternatives, **diversification is** hence **a choice of "hierarchy"**, that is, **internalizing a new business within the corporate portfolio, rather than externalizing or outsourcing the activity and related business to the market.**

However, **diversification is not the only option**:
when should we decide to diversify rather than, for instance, go for brand franchising, that is, selling our brand to third parties to receive royalties in return?

As we said, **brand franchising is not a diversification strategy**
since the company does not create an internal organization (that is, a SBU) to cover the industry. So, this represent an example of the “market” option.

To investigate the issue, Robert Grant, in his book “Contemporary Strategy Analysis”, makes the example of Harley Davidson. That brand is not only associated to motorbikes, but also to a broad range of gadgets like T-shirts and so on. However, Harley Davidson does not own the companies that produce and sell those gadgets,
it only rents its brand to them. Why?
To understand it, we should consider two parameters: **scope economies**, and **transaction costs**.

Scope economies are scale economies applied to a wider range or family of activities performed:
the higher the aggregated volume per year of the products range the company produces (by adding up different products), the lower the average cost per unit.

Transaction costs are the costs to bear to set up an agreement with the “market”.

By combining the effects of scope economies and transaction costs, we learn a fundamental rule about **diversification**.

Diversification is more favorable than other alternatives (e.g. brand franchising) when the following criteria are met: **scope economies** are present, so aggregating the production of more activities within the company’s boundaries lowers average cost per unit. **And transaction costs are high**, so internally performing a new activity is more convenient than outsourcing it to an external party.

This rule should guide Corporate management’s decision concerning diversification strategies.

CORPORATE COMPETITIVE ADVANTAGE: CORRELATED VS NON-CORRELATED PORTFOLIOS

As **Business strategy** has the ultimate goal of **creating a business competitive advantage**, based on cost or value positive differentials in the industry, **corporate strategy pursues a corporate competitive advantage**.

The sources of such advantage vary on the basis of the kind of portfolio **that results from the diversification strategies put in place.**

Basically, two main typologies of business portfolios exist: a **Correlated portfolio** and a **Non-correlated (or conglomeral) portfolio**.

In a **correlated portfolio**, the business areas show similarities in the **customer needs satisfied, and the products and services sold are operationally related.**

In a **non-correlated portfolio**, such correlation becomes blurred, and products and services offered are apparently unrelated. Usually, real-world cases of business portfolios do not strictly belong to one of these categories.

Real portfolios are a mix of the two extreme solutions.
Then, what are the pros and cons of these two kinds of portfolios?
And how are they related to the notion of corporate competitive advantage?

In a correlated portfolio, the following advantages emerge:

- **operational synergies** (like economies of scale, economies of scope, and critical mass), **sharing of resources and competencies and similarities in markets and customers.**

The **disadvantages** refer to: **higher risk, related to the fact that all markets are somewhat similar and will enjoy the same positive or negative trends at the same time**; and **high managerial complexity**, due to the need to rethink, redesign and aggregate activities and processes to merge different SBUs **and actually make scale and scope economies happen**.

In a **non-correlated portfolio**, the following advantages emerge:

- **risk diversification**, since different business will experience different performances and trends;
- the so-called **bank effect**, as cash-generating SBUs will be used as an internal bank to feed cash-absorbing SBUs within the corporate portfolio;
- better use of **top human resources**, since the presence of highly skilled and specialized professionals will be justified by the chance to make them move from one SBU, market or country to another whenever they are needed, also creating diversified career paths;
- **sharing of infrastructural activities** common to all SBUs, like **planning, administration, finance and control**.

On the contrary, there are some **disadvantages**, determined by:
- **organizational complexity**, due to merging companies speaking different languages and traditionally covering unrelated markets and customers;
- **cultural heterogeneity**, as different **companies bundled in the same portfolio could not share the same key values**;
- and **few operational synergies**, limiting the ability to purse scale and scope advantages.

To wrap it all up, **corporate competitive advantage** (that is, the ability to outperform competitors thanks to different strategies at a corporate level) stems from: **operational synergies within correlated portfolios**
and/or **financial synergies within non correlated portfolios** (related to the bank effect).

Corporate managers should use both these levers wisely to formulate an effective Corporate strategy.

CORPORATE PORTFOLIO MATRIXES: AN INTRODUCTION

Corporate strategy's main goals are to manage financial resources allocation to the portfolio of different Strategic Business Units the overall company is made of, while at the same time driving the decisions on whether to enter new business areas and or grow, hold position or divest from the business areas already covered.

Corporate strategy's formulation should hence start with the analysis of the current company's portfolio, that is, the mapping of the products of a company, which allows to understand if such portfolio is balanced or not from a financial and strategic perspective.

In order to support this process, the most widespread tools used by corporate managers are the so called **portfolio matrixes**.

The basic idea behind such matrixes is to represent a diversified company's BA in a simple visual model to support Corporate Strategy definition.

These tools start from the following Key assumption: **Long-term profitability of each SBU in the portfolio depends on**: **Business Area attractiveness, and SBU competitive positioning in the Business Area**.

But eventually, what does this mean?

Well, this is nothing but a synthesis of external and internal strategy analysis: for each SBU in the portfolio, we are evaluating market attractiveness (which results from external analysis) and competitive positioning and advantage (coming from internal analysis).

Portfolio matrixes are hence a sort of SWOT analysis in brief where we map not a single strategic business unit, but the corporate portfolio as a whole. Hence, the main objectives of a portfolio matrix are: **to analyze the competitive advantage coming from the managing of a SBU's portfolio**; **to support the choice of a business portfolio (Corporate Strategy definition)**; **to provide some guidelines to SBUs for the definition of their own business strategy**; and **to analyze the corporate strategies of competitors**.

THE BCG MATRIX - PART 1

Corporate portfolio matrixes support strategic decision makers in their choices of financial allocation and general strategic direction for the strategic business units they control.

Over the years, several consulting companies have created their version of the portfolio analysis.

The most popular ones are the **BCG matrix**, elaborated by the **Boston Consulting Group**, and **the GE-**

Mckinsey matrix, designed by McKinsey consultancy firm for the General Electric corporation.

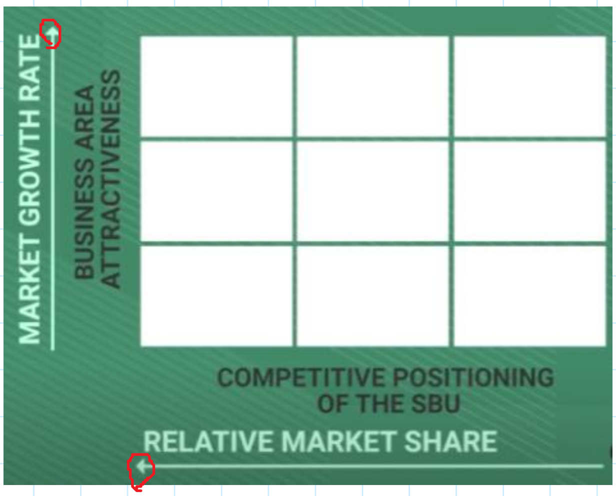
The BCG matrix, also known as **the growth-share matrix**, was developed by The Boston Consulting Group in 1968 and has these main goals: **to verify the bank effect**; **to shape a business portfolio that is well balanced from a financial point of view**; **to define a virtuous cycle strategy**; **and to analyze the strategies of competitors**.

مفيد

As all portfolio matrixes, the BCG describes products and SBUs in terms of just two factors: **business area attractiveness** and **competitive positioning of the SBU**.

However, two basic assumptions are made: First, **Business Area attractiveness** can be measured through **"Market growth rate"**.
Market growths implies that price wars are less likely, and as customer base expands, offer can catch up with demand.

Second, **SBU competitive positioning** can be measured through "**Relative market share**": a company having a relative market share higher than its main competitors can benefit from cost advantages depending on size (economies of scale and experience, production capacity saturation, and so on).



How to calculate relative market share?

We should consider our company's total market share (let's say, 30%) and divide it by our biggest competitor's market share.
Should we assume our biggest competitor's market share is 20%, our relative market share would be 1.5.
B**eing higher than 1, we know our SBU is the market leader in terms of share, so it benefits from the abovementioned advantaged**.
Should we change our assumption and claim the competitor's total share is 60%, our relative market share is then 0.5, **so it's smaller than 1**. **This means our SBU is a follower in the market**.
Less strict applications of relative market share calculation do not require our company to necessarily be the market share leader to be deemed "strong" in the market, and consider the average of our 3, 5 or maybe 10 best competitors' total market shares as a benchmark. This tends to lower the denominator and increase our likelihood to have a relative share above 1.

Now that we know about its assumptions , I can show you how the BCG Matrix looks like.

On the X axis, **we consider SBUs competitive positioning and we chart it through the relative market share**. As we know, the mathematical threshold to be considered market leader is 1, so from right to left, our SBU will be either a follower or a leader.

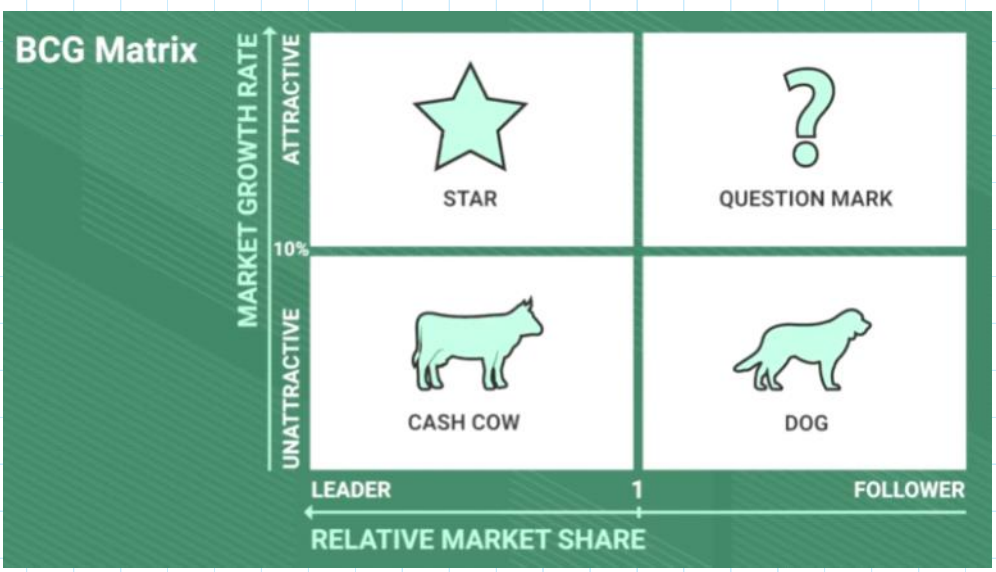
On the Y axis, **we consider market attractiveness we approximate through market growth rat**e.
There is not mathematical threshold here, since the definition of a growth level to label a market as promising is partly subjective.

Back in the '60, an astounding 10% growth rate was considered a good level to discriminate between promising and shrinking markets; now, we should probably lower the bar, considering
4 to 5% (or sometimes even zero) as a growth threshold.

An SBU positioned at the bottom of the matrix operates in an **unattractive market**, while at the top of the matrix we find **growing (and attractive) business area**.

The BCG matrix crosses the relative market share and the market growth rate, to obtain 4 different cells, that correspond to 4 different SBUs positions from a static perspective.

A strong SBU in a growing market is called a **star**.
A strong SBU in a market that's not growing more that the threshold set (or is even shrinking) is labeled a cash cow.
A weak SBU in a fast growing market, instead, is a question mark.
While **a weak SBU in an unattractive market is called a dog**.



THE BCG MATRIX - PART 2

These 4 positioning are easy to memorize, but still **don't tell us much about the strategic and financial**

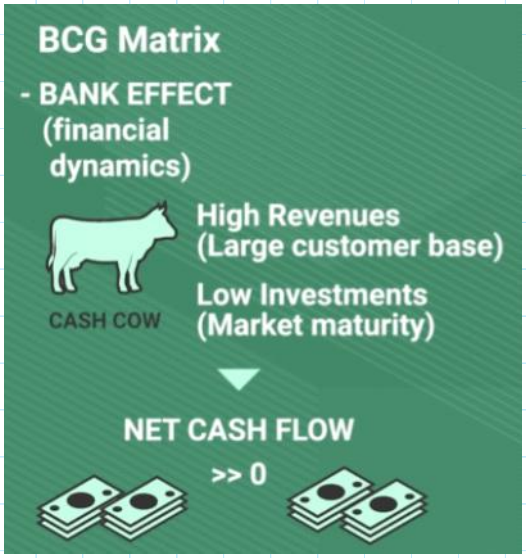
dynamics occurring within them: we hence need to move from a static to dynamic perspective to get the most out of the matrix.

More specifically, we should consider two interplaying dynamics:
The Bank effect (or financial dynamics) and **the SBUs and market lifecycle** (or lifecycle dynamics).

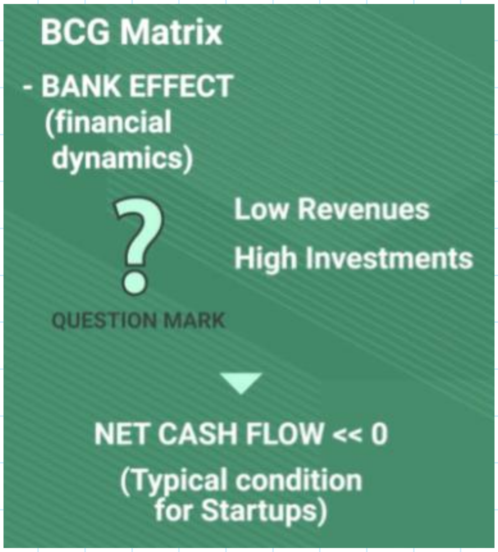
Let's start considering the financial dynamics.

Statically, a **star apparently seems the best place to be**: but financially speaking, although a high relative market share guarantees high revenues, market growth requires high investments to catch up with it and protect SBU's leadership from possible competitors. As a result, net cash flows (that is, the financial measure of performance) for stars is approximately zero.
Stars are not generating cash, or they might even need to absorb some.

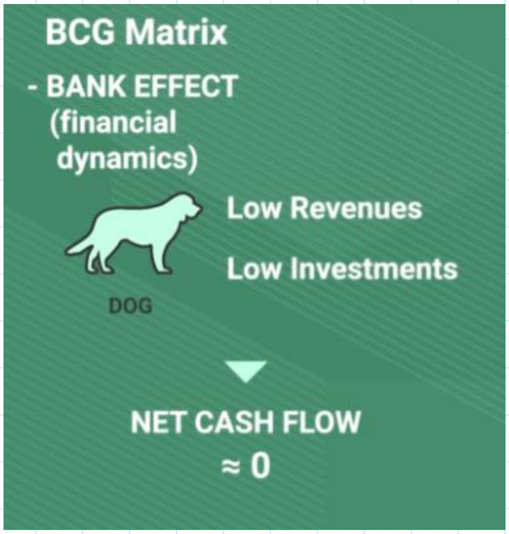
Following this logic, it's easier to understand what a **cash cow** positioning implies: **cash cows enjoy high revenues thanks to a large customer base, while require low investments thanks to the market's maturity: the resulting net cash flows will be high**.
These SBUs are hence strong cash generators, which should be "milked" for cash.



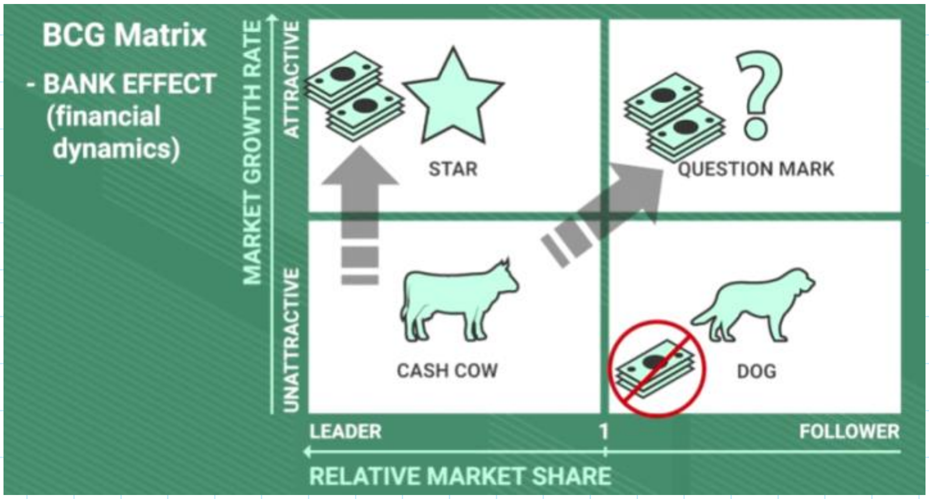
Question marks don't show high revenues due to a low market share, and contemporarily require heavy investments to follow growth and challenge competitor's leadership.
This leads to high cash absorption, a typical condition startup companies face.



Dogs are businesses where both competitive positioning and attractiveness are low, so low revenues match low need for investments, a**nd net cash flow are approximately zero**.



Following a **financial dynamic**, net cash flows should be taken from cash cows are redirected to a selection of question marks the corporation wants to bet on, and to those stars financially in need; following the strict guidelines from the matrix, dogs should be divested, **unless they show strong synergies with cash cows, stars or selected question marks.**



The financial dynamics combines with the business lifecycle dynamics, possibly triggering a **virtuous cycle**. A **startup SBU is born as a question mark with uncertain fate**, but if properly managed and supplied with financial resources, it becomes a star; a star market, sooner or later, will stop growing, thus turning into a cash cow or mature market; and a mature market in the long run will either disappear, thus leaving the matrix, or become a dog to be divested from.

So, to wrap it all up:

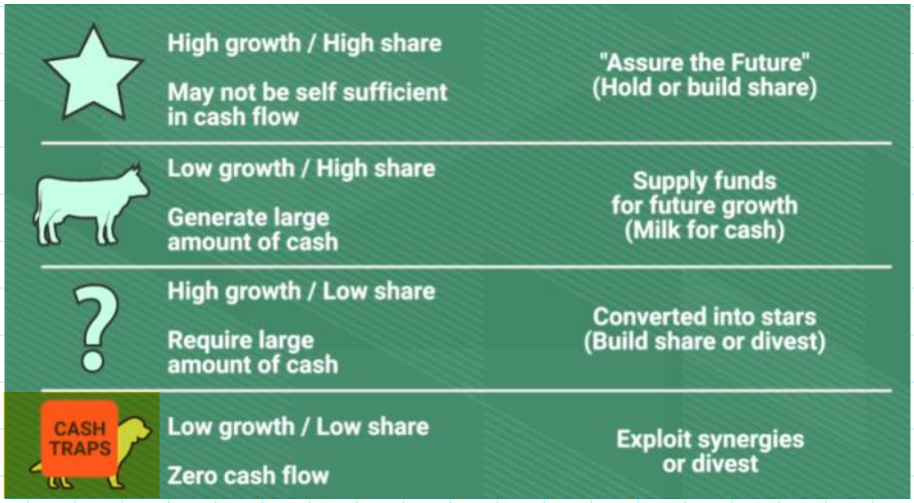
- **Stars are high-growth, high-share products which may or may not be self-sufficient in cash flow**.
- **Cash Cows are products with high market share and slow growth, which characteristically generate large amounts of cash.**
- **Question Marks are products with high growth but low share. They require large amounts of cash to maintain market share, and still larger amounts to gain share.**
- **Dogs are products with low market share and slow growth, which neither generate nor require significant amounts of cash.**

Maintaining share usually requires the reinvestment of any profits as well as additional capital.

These products are often called «cash traps».
The recommended corporate strategies for each SBU positioning are summarized here.

All products eventually become either cash-cows or dogs.
The value of a product is completely dependent upon obtaining a leading share of its market before growth slows.

The balanced portfolio has: stars whose high shares and high growth assure the future; cash-cows that supply funds for that future growth; and question marks to be converted into stars.
Dogs need dedicated strategies, mostly concerned with exploitation of synergies with other SBUs, or divestiture.



THE GE-MCKINSEY MATRIX

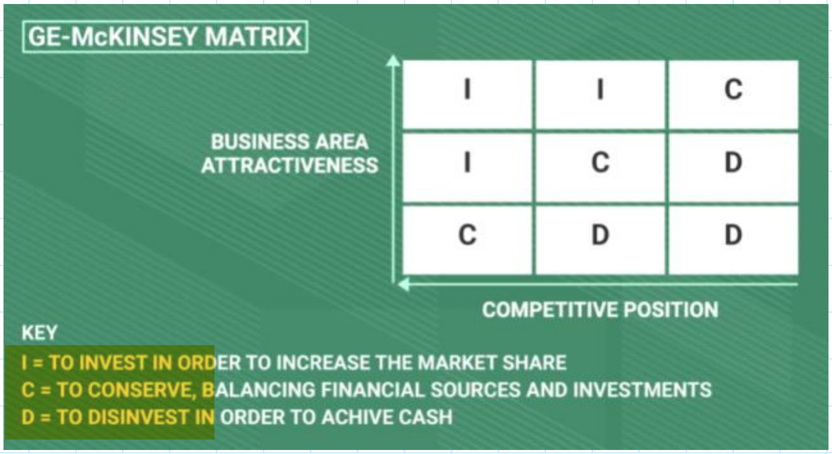
The GE-McKinsey matrix was developed in 1971 by McKinsey at the request of General Electric, to support the management its diversified corporate portfolio.

This matrix adopts two dimensions, similarly to the BCG matrix approach: **market segment attractiveness**; and **business strength**.

Contrarily to the BCG matrix, which employs two simple indicators (market growth and relative market share) as proxies of attractiveness and competitive positioning, **each of the GE-McKinsey dimensions is built up from a large number of variables.**

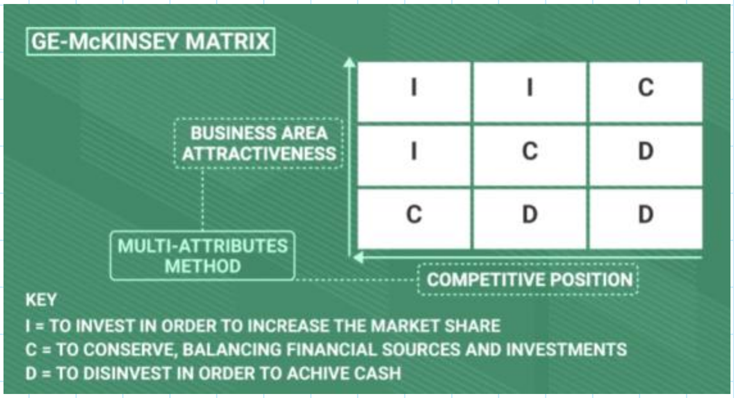
This leads to the **multi-attributes approach** characterizing this strategic tool.

By systematically weighting those variables, **each business** (or product) **is classified into one of nine cells in a 3 x 3 matrix**.



Like the BCG matrix, this approach aims to compare investment opportunities.

As stated above, the difference lies in the fact that **multiple measures are used to assess market attractiveness and competitive position**.



GE-McKinsey's main goals are: **to allocate resources correctly; to choose the businesses to invest in**; **to maintain and to divest; and to analyze the strategies of competitors**.

So the GE-McKinsey matrix uses a **multi-attribute approach to position SBUs into 9 cells**, coming from the crossing of the axes «industry attractiveness» and «SBU competitive positioning».

Such multi attribute approach works as follows.

Industry attractiveness is measured by several parameters, such as:
Market size, **Growth rate**, **Profit margin potentials**, **Competitive intensity**, **Cyclical or seasonal sales**, **Position on learning curve**.
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Those parameters are assigned a weighting factor by the decision maker, on the basis of their relative importance. After that, the decision maker assigns each parameter a rating from 1 to 10.
The final score for each parameter is calculated by multiplying the weight by the rating.

INDUSTRY ATTRACTIVENESS

	WEIGHTING FACTOR		RATING (1-10)		SCORE
MARKET SIZE	%	X		=	
GROWTH RATE	%	X		=	
PROFIT MARGIN POTENTIALS	%	X		=	
COMPETITIVE INTENSITY	%	X		=	
CYCLICAL OR SEASONAL SALES	%	X		=	
POSITION ON LEARNING CURVE	%	X		=	
	TOT 100%				

The weighted average resulting from the sum of all scores **provides an indication about industry attractiveness**.

Similarly, relative SBU positioning and its strengths are calculated as a weighted average of the following parameters: **Relative market share, Price competitiveness, Product or service quality perception, Marketer's knowledge of customers and the market, Sales effectiveness, and Geographical coverage**.

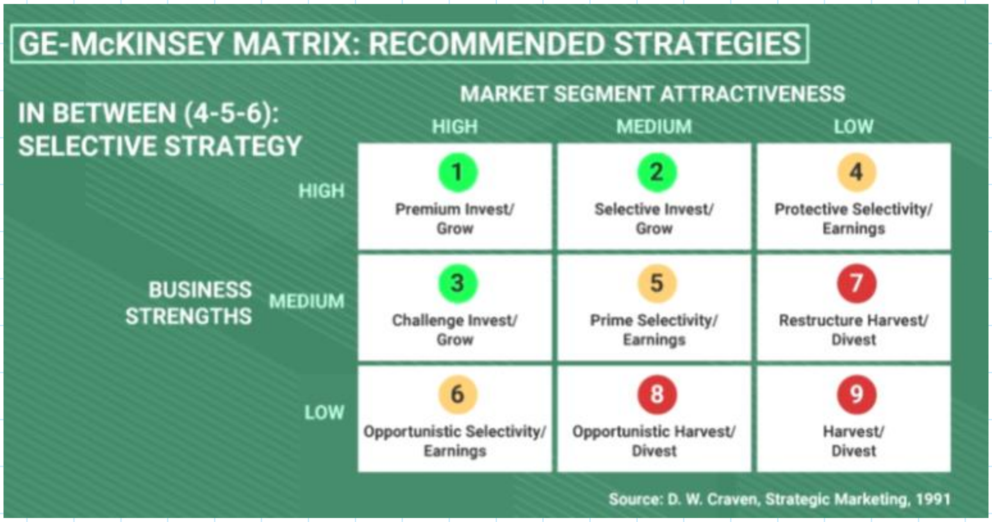
BUSINESS STRENGTHS	WEIGHTING FACTOR		RATING (1-10)		SCORE
RELATIVE MARKET SHARE	%	X		=	
PRICE COMPETITIVENESS	%	X		=	
PRODUCT OR SERVICE QUALITY PERCEPTION	%	X		=	
MARKETER'S KNOWLEDGE OF CUSTOMERS AND THE MARKET	%	X		=	
SALES EFFECTIVENESS	%	X		=	
GEOGRAPHY COVERAGE	%	X		=	
	TOT 100%				

The crossing of industry attractiveness and business strengths allows to position a given SBU in one of 9 cells, for which specific guidelines or recommended strategies are provided.

SBUs whose positioning is deemed desirable are placed in cells 1, 2 and 3 at the top-left corner of the matrix: here, the tool suggests an Invest/Grow strategy.

SBUs with an undesirable positioning (from 7 to 9) should be treated with a Harvest/Divest strategy.

While SBUs with an in-between positioning (from 4 to 6) should be managed with a selective strategy mostly aimed at generating earnings.



After having analyzed these matrixes in detail, what are their main pros and cons when we compare them?

The BCG tool is simple but simplistic.
In fact, growth may not mean attractiveness, since attractiveness is driven by many structural determinants beyond growth, as the five forces teach us; moreover, relative market share may not mean competitive advantage, since niche strategies may prevail.

On the contrary, **GE-McKinsey is extremely detailed, but it requires expensive analyses to be completed**.

Also, it becomes **subjective** as decision makers have to decide the weighting factors and the rating.

Usually, **the two matrixes are used in a combined way when assessing a company's portfolio and formulating a corporate strategy**.

CONCLUSIONS

In the fourth and concluding week of this course we tackled strategy formulation at a Corporate level.

We defined what Corporate strategy is, we identified its main goals and connections with the Business Strategy level; we also learnt how to, make decision about diversification strategies based on the notions of scope economies and transaction costs; we identified the pros and cons of Correlated vs Non-correlated Corporate portfolios of Strategic Business Units; we applied Corporate Portfolio matrixes to formulate a Corporate Strategy, with specific references to the tools of the BCG Matrix and the GE-McKinsey matrix. And eventually we discussed about the overarching issue of creating Corporate competitive advantage through consistent Corporate portfolio choices.

I'm aware that some of the traditional theories, models, concepts and approaches we discussed are and might even seem pretty old: however, I warmly encourage you not to disregard their descriptive, methodological and sometimes normative power.

These strategy analysis and formulation models are still widely employed in today's companies, and they provide the foundations for more recent innovative approaches in strategy.