STRATEGIC THINKING

GORDON PEARSON

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Gordon J. Pearson

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For My Father

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Preface

Currently, the thrust of management development and education is very much on practical competence. The key question to be asked after any management training or teaching session is, 'what can participants *do* as a result of the training, that they could not do before?'. The former, rather more academic question, 'can they remember enough to pass an exam?' is increasingly recognized as irrelevant.

So far this emphasis on competences has tended to focus more on the skills required by junior and middle managers: communications skills; the ability to work effectively in, and lead, a team; the ability to delegate and motivate team members. There has been little emphasis on competency at strategic management level.

Yet there seems to be no intrinsic reason why training in strategic management should not also be competency-based. My experience on the academic side of management has only served to reinforce this view. Strategic thinking can be learned as a practical skill, just as can team-building or effective presentations. At any rate this is the point of view I have taken in writing this book.

I have not written primarily for those young men and women with a high quality first degree under their belts but no significant managerial experience, who pause to collect an MBA *en route* to a high flying job in finance or the City. It is written rather for those business managers on whom our industry depends for its future. They are likely to have several years' experience and wish to extend their theoretical and practical knowledge and expertise. Many of them achieve this through their own individual efforts, while others may take a formal qualification such as an MBA, a DMS or a professional diploma appropriate to their own functional responsibilities. Typically, they achieve this on a part-time basis while fulfilling their normal day-to-day managerial jobs.

When they have read this book they should be able to think about the strategy of their business from several different perspectives and understand which of these is likely to be more important to their business and its particular situation.

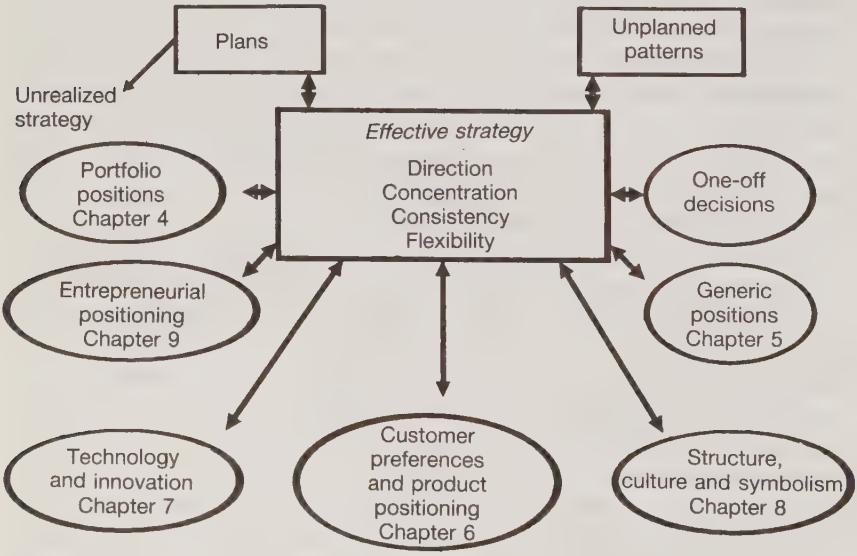
Thus, I hope it will be received by these practising managers as a contribution, however small, to competence in doing strategy.

Plan of the Book

The prologue to the book takes a broad view of the current business environment so that the various perspectives on strategic thinking discussed throughout the subsequent text can be considered against this backdrop.

Chapters 1 and 2 then introduce some of the basic concepts of strategy and seek to clarify some definitions and confusions currently apparent.

Chapters 3 to 9 suggest a number of different strategic thinking frameworks which have been widely used in practice. Each framework has its own strengths and weaknesses fitting it for particular circumstances. Moreover, each framework is both a way of looking at the



Inputs and outputs of effective strategy.

process of strategy and also represents both the inputs and outputs of strategy as indicated in the summary figure below. In many cases the inputs to strategy are likely to involve aspects of several frameworks, and the outputs from the strategy process are also likely to impact on the position of the business relative to several frameworks. However, for the sake of clarity, each framework is discussed separately, chapter by chapter.

Chapter 10 provides some pointers as to the relevance of the various strategic perspectives and provides a simple model of organizational characteristics which highlights many of the key issues discussed in previous chapters.

At the end of each chapter is a short discussion case where the reader is invited to consider a set of circumstances from a variety of viewpoints. These discussion cases are not orthodox case studies and do not include quantitative data – there are no balance sheets or profit and loss accounts, or even quantified sales forecasts. There is therefore no calculation or quantitative analysis of any kind. The aim is to focus the reader's thinking on some of the essential strategic issues, and in particular on how different people in different roles or circumstances may be pressured to take a particular decision. They have all been found useful in interactive management training sessions where the aim is to provide the opportunity for group discussions of these real life situations.

Acknowledgements

I am hugely indebted to three categories of people who have helped, directly and indirectly, with the production of this book.

Firstly, there are those management writers, researchers, consultants and practitioners whose work I have been influenced by and who, I hope, I have overtly acknowledged in the text. A book like this inevitably leans on, and is to some extent derived from, the work of some individuals more than others. Amongst the great and good in management literature I owe a particular debt to Drucker, Mintzberg and Porter. In addition I must also acknowledge the work of the Boston Consulting Group whose thinking influenced my practical work at an early stage of my management career. I am grateful to them for permission to reproduce Figures 4.2 to 4.7. Experience curves and business portfolios are now part of history and do not reflect the thrust of Boston's current approach to business strategy, but they have been extremely influential and encapsulate a number of important strategic concepts.

Secondly, there are those professional people with whom I have enjoyed personal contact over the years and particularly during the completion of my doctoral research at Manchester Business School. Notable among these are Jack Clyde, formerly of Urwick Orr and Mills & Allen, and my supervisors at Manchester, Alan Pearson and Derreck Ball, both of the R&D Research Unit at Manchester Business School.

Thirdly, and most importantly, a more personal debt of gratitude is owed to Eileen Pearson of Pearson Kirk Management Research and Training. Her expertise in management development and training has been a continuous spur to practicality in dealing with a topic which sometimes risks becoming too academic.

Finally, I must acknowledge Susie, William and Robert for their stoic good humour.

PROLOGUE

A view of the strategic context

We are cursed, as the Chinese would have it, by living in interesting times. There is a revolution in technology caused by the coincidence of an unprecedented number of fundamental inventions and discoveries which are reaching the stage of commercial exploitation more or less together. Businesses will either participate in this revolution or be swept aside by those that do. But investment in innovation – the decision to invest in something new in order to change the business and improve it – is, by definition, long term.

Simultaneously, and in no small part resulting from the technological revolution, there is also a revolution in financial practices and institutions. Markets which were set up to provide long term finance, have become so efficient that the long term can be measured in weeks or even days. Taking a long term view on a stock exchange, in the face of severe short term volatility, can be regarded as irrational, even irresponsible.

The requirement on businesses to maximize short term profits inevitably inhibits decisions to invest long term in innovation and leads to cut backs in the 'change functions' such as research and development (R&D). Consequently a technological gap opens up between those businesses which invest long term and those which are forced to the short term view. The outcomes of both sets of decisions are self-fulfilling and so the technological gap widens further.

The effects of the technological revolution are all-pervasive, affecting our quality of life, eliminating work, stimulating tremendous economic growth and providing business with exciting new competitive weapons. A new approach to strategic management is needed which will help firms grasp the opportunities, rather than slide down what Hayes and Garvin (1982) referred to as the 'disinvestment spiral'.

Innovation, the process of invention and its commercial exploitation,

is the strategic competitive tool of today and it is available to all businesses, no matter how small or how mature. For now, and perhaps the next ten or fifteen years, innovation will be *the* vital ingredient of business success.

However, much of manufacturing industry has been unwilling, or unable, to make long term commitments, afraid to be involved in risk if it can possibly be avoided. Management has adopted the philosophy of the accounting profession; conservatism, prudence and the avoidance of risk have become aims in their own right. The hard-nosed financial realist regards innovation with cynicism, and the cynicism is consequently fulfilled.

The validity and usefulness of any particular approach to strategic management depends very much on the situation in which it is to be used. Planning systems devised in the 1960s are not likely to be the most appropriate for managements in the 1990s simply because the world has changed. Mass production of standard product is now rarely an adequate response. Innovation is no longer concerned with putting stripes in toothpaste or bigger fins on automobiles. Growth is no longer guaranteed positive. Market dominance is no longer an end in itself and may even be a source of vulnerability, implying as it does a professional, financial and psychological commitment to today's technology, or yesterday's. The world is changing and management's approach to strategy needs to change with it.

The financial environment

Business is subject to almost irresistible short term financial pressure from the financial sector which originally existed to serve the purposes of industry. Now that sector has developed so extensively that the roles appear to have become reversed. Industry, and particularly manufacturing, is in danger of becoming almost an incidental pretext for the transactions of the financial sector.

The dominance of the financial world restricts the extent to which strategic management can exploit the opportunities now presented. Strategies are necessarily being shaped to provide quick returns. Shareholder wealth can more easily be increased, it seems, by opportunistic acquisitions than by persevering in the development of product manufacture. Thus, innovations are not available to a management who are instructed to milk their cash cow to the last. Organic growth is

of little interest to many such firms, and the long term is discounted to insignificance.

The more efficiently financial markets work, the more it pays to take a short term view. This simple fact is the basic reason why the financial sector works against the long term interests of industry. As the City of London and Wall Street have become relatively more efficient, so they have become less able to support the manufacturer of products. Who wants to invest in developing the next generation of technology? How can the manufacturer persuade shareholders to remain patient for five or ten years while the development is completed and brought into profit, when their concerns are with weeks, days and sometimes even hours? What do neutral shareholders do if they can change £100 into £150 overnight?

This tension between industry and the financial world has long existed in New York and London, but has not existed to the same extent elsewhere in the world. Anglo–Saxon manufacturers have consequently learned to be increasingly sceptical of financiers. This is not because of the rogues who occasionally come to the surface, but because the interests of the manufacturing and financial sectors no longer coincide. Financial institutions may have come into existence to raise finance for long term and risky ventures such as merchanting expeditions across the high seas, or large scale investments like the railways, but this mutual interest no longer works. These institutions cannot now be relied on to provide the necessary stability in their financing. Their very efficiency has undermined their original purpose. Equity finance is no longer long term.

The New York and London markets are the most efficient and are also conducted in the international language. By comparison, the German market is unsophisticated and relatively inefficient. There are no quick Deutschmarks to be made, no well-oiled machine to induce the German investor to take the short term view. The same used to be true of Tokyo, where artificial restrictions have in the past been operative. As a consequence these countries have enjoyed more stable and fruitful capital investment records. However, because of its industrial success Japan's problem is less to do with taking a long term view in its financing decisions, than to do with trying to find a stable long term home for its surplus funds.

The efficiency of the financial markets is based on more information, available faster and cheaper. Dealing is easier, faster and cheaper. Big investors use short term performance measurement surveys to make fast returns and would be widely regarded as eccentric and irrational if they based their investment decisions on other than purely financial

grounds. Inevitably they take the corporate raider's money as soon as anyone else's. The innovative business can expect scant support from the financial world if its requirements are for long term finance.

The financial culture is becoming increasingly dominant and is hostile to the long term investments required to participate in the progress of technology.

The technological environment

Looking at the past it is easy to see how dramatic technological progress has been and how, once started, it seems to go forward with an ever quickening momentum. We either participate in it, or we let it steamroller over us.

At the beginning of the nineteenth century no country in Europe had yet reattained the living standard of Imperial Rome. But over the past hundred years or so, real income per head rose by 700 per cent on average, labour productivity by 1,200 per cent and median exports by over 6,000 per cent (Madison, 1982). The real per capita income in the United States in 1870 was about the same as it is in the Philippines today, and slightly below that of Egypt. Growth rates in this period have exploded by comparison with anything ever achieved before. The explanation is simple, technological innovation. Otherwise, as Baumol put it, 'the economic history of the period, and its contrast with the world's economic performance in the previous, say, fifteen centuries, is difficult to account for' (Baumol, 1986).

Technological innovation, whether it is the product itself or the process of its production, is the engine which drives economic, social and organizational change. In the past, war has also been a stimulus and some such changes may also have resulted from the effects of plague. But today technological innovation is the key.

The connection between innovation and economic growth has been widely accepted since the original work of Kondratiev which was developed by Schumpeter in the 1930s (Schumpeter, 1939). Economists may disagree in detail, but most analysts associate the great expansions with periods when major innovations coincided (see Ray, 1980). Piatier (1984), for example, in his study for the European Commission identified three such 'revolutions' as illustrated in Figure 0.1.

The first, the eighteenth century industrial revolution, was based on innovations in coal energy, steel and the steam engine which gave rise to the mechanization of textiles and other manufacturing industries,

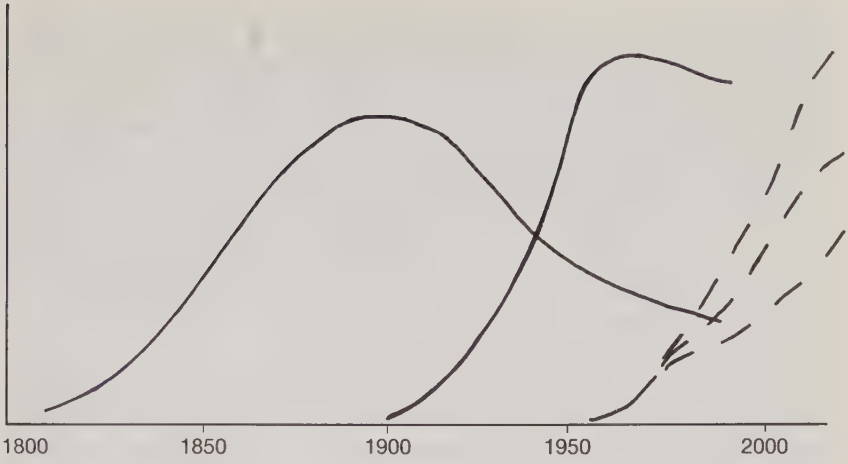


Figure 0.1 *The three industrial revolutions.*

plus the development of railway transport on a massive scale and the launching of inorganic chemistry. The ingredients of this revolution and its results in terms of economic growth are readily identifiable and dramatic.

> Coal, steel, railways, textiles and inorganic chemistry grew up and grew old together: the 1930s depression was neither a short term economic crisis, nor a crisis of capitalism, but signalled the end of a great wave of major innovations. (Piatier, 1984)

The second had its embryonic phase in the 1930s and was based on oil, motor vehicles, aircraft, sheet steel, organic chemistry and synthetic materials. The growth from this revolution was interrupted by the second world war, but was realized in the period of post-war reconstruction in the 1950s and 1960s, slowing down in the 1970s, perhaps being brought to an early maturity by the oil price crises of the mid-1970s, but definitely in decline by the 1980s.

The third revolution, still in its growth phase, is based primarily on electronics, information technology, new forms of energy and energy substitute, biotechnology, molecular engineering, genetic engineering, ocean development and possibly new forms of transport or transport substitute.

Differing forecasts have been made for this third revolution. It is uncertain when the period of rapid growth will peak, though the general consensus is that it will be before the turn of the century. As

yet biotechnology and genetic engineering have hardly started but already their impact on agriculture is apparent. Researchers have successfully inserted a gene into plants which provides resistance to a commercial herbicide, glyphosate, and the probability is that protected crop seeds and herbicide will in due course be sold as a package. Breakthroughs are being achieved with the injection of foreign DNA into monocot plants such as cereals. Already massive grain surpluses, beef mountains, wine lakes, butter mountains and the like are commonplace in the West. If only 2 per cent p.a. productivity gain is maintained then around a third of today's farmland will be surplus to agricultural requirements in twenty years' time.

Molecular engineering will in due course make no less an impact with, for example, new synthetic materials surpassing the performance characteristics of steel at an inherently lower cost. The current practice of melting metal could eventually be consigned to museums and small craft units.

The electronics and information technology strands of the revolution have reached the stage of commercial exploitation, but even now this is still in an early phase. Commercial exploitation is rippling out from a core which is still bubbling with primary innovations, e.g. breakthroughs in high temperature superconductivity (i.e. conduction of electricity with zero power loss), a potentially more revolutionary and far-reaching innovation than the transistor itself.

The results of these innovations are that products and services are becoming cheaper, more reliable, more flexible, more sophisticated and intelligent. Flexibility and variety will be instantly available. One-offs will be as cheap as standard products. Labour costs will become largely irrelevant. The implications will be revolutionary for all firms, large or small and whether at the forefront of technology or languishing in the maturest of mature industries.

This third revolution is also changing the nature of work. The jobs that remain by the turn of the century are likely to be either ultra high-skilled manufacturing jobs, high-skilled professional services associated with production, or in distribution and personal services. Inevitably shorter hours, shorter working lives and more part-time work are resulting. Some of these effects are already being experienced across manufacturing as a whole, not simply the new, high technology industries.

Thus changes in technology are causing other organizational and social changes, which will themselves feedback into industry generating needs for further new products and services. The revolution is all-pervasive.

Mature business is full of potential for innovation, just as are the

new industries themselves. What are the chances of setting the stock-markets alight with a hamburger chain? Or a barber shop? Or a chain of dentistry offices? Or making and selling living room furniture, doughnuts, high quality chinaware, writing instruments, household paints or textile yarns? Yet, as Drucker pointed out (Drucker, 1985), all these mundane, and certainly mature, activities have yielded the sort of profits growth that the popular imagination has been led to associate only with the newer 'high tech', high growth industries.

Major changes in the structure of markets usually result from the efforts of one or more participants to improve their position by aggressive pricing strategies. Such improvements are generally only available at a very substantial cost so that only the biggest firms can afford to do this. Thus there is a natural tendency for the big to get bigger and the smaller firms to be driven into small niches of the market. The market structure is therefore set firm. However, during the course of a technological revolution, when all manner of new products and new processes are becoming available, competitive positions become less rigid, the market structure becomes fluid and individual firms can achieve major changes in their position at a relatively low cost.

The present technological revolution will, over the next decade or so, present just such a window of opportunity. But it will not continue indefinitely. As with the previous revolutions, the new technologies will grow up and mature together. By the turn of the century the competitive jelly will have set and major inroads to new markets will then again only be achieved at great cost. Right now the opportunities are there for the taking. As commercial applications of the current wave of new technologies become available, so opportunities will multiply. Each of the strands of new technology, electronics, information technology, biotechnology, genetic engineering, molecular engineering, ocean development, etc., will all offer opportunities for changing the competitive rules and structures. Some businesses will make huge strides while others will be blasted out of existence.

Globalization

A third contextual issue with which strategic management of the 1990s must contend is globalization. This is implicit in much of what has been said about the technological revolution. It is not a new phenomenon.

The impact of global competition has long been apparent in Britain. The story has often been recounted by the Engineering Council and