Module 1 - Introduction

1.2.1 Managers definition of strategy

The Planning approach:

- Set objective, analyse environment, make forecasts and work out plan
- Assumptions with this approach:
    - The future can be predicted accurately enough to make rational choices
    - It's possible to detach strategy formulation from everyday management
        - but data goes out of date quickly & who decides what data is relevant?
    - Its possible to forego short term benefit in order to gain long term advantage – everyone may be focused on next quarters figures
    - Strategies proposed are capable of being managed in the way proposed - change is difficult
    - CEOs has knowledge and power to freely choose amongst options
    - After analysis, strategy does not need to be altered to reflect changing circumstances
    - Implementation is a separate phase that comes after strategy has been agreed
- This approach often fails as individuals become committed to strategic plan & not company success

Emergent Strategy

- Assumes people are not totally rational and logical
- React to events as they occur

- Based on :
    - Managers can only handle a relatively small number of options
    - Managers are biased in interpretation of data
    - Managers likely to seek a satisfactory solution rather than maximise profits
    - Organisations consist of coalitions of interest groups
    - When making decisions, managers pay as much attention to a company culture and politics as to resource availability and external factors
    - Strategy not planned before event but emerges over time
    - Claims that world is too complex to be rationalised

Resource Based Strategy

- It assumes that strategy is basically concerned with the search for competitive advantage and that this lies in company's resources
- Resources: physical, human, financial, intellectual
- Competencies arise from continual deployment and integration of resources over time and across activities
- Core competencies and distinctive capabilities (advantages over competitors) form a company's **strategic capabilities**
- Roles of strategic capabilities in creating sustainable competitive advantage depends on several characteristics:
    - Rarity
    - Complexity
    - Causal ambiguity – difficulty in attributing cause and effect to superior performance
    - Culture

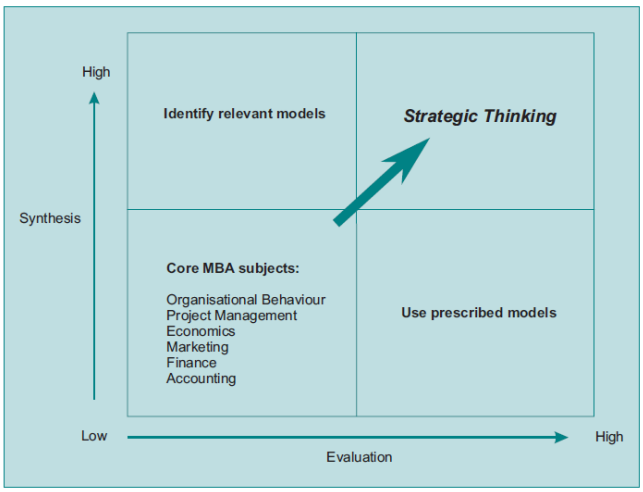
Wicked vs. Tame problems

- Problems can be defined as tame (like a mathematical problem) or wicked (like a strategic one) [Ritell]

Table 1.1 **Tame and Wicked problems**

Property	Tame	Wicked
1 Ability to formulate the problem	Can be written down	No definitive formulation
2 Relationship between problem and solution	Can be formulated independently of solution	Understanding problem is same as solving it
3 Testability	Either true or false	Solutions good or bad relative to each other
4 Finality	Clear solution	No clear end and no obvious test
5 Tractability	Identifiable list of operations can be used	No exhaustive identifiable list of operations
6 Level of analysis	Can identify root cause	Never sure whether a problem or a symptom
7 Reproducibility	Can be tested over again as in a laboratory	Only one try: no room for trial and error
8 Replicability	May occur often	Unique

1.2.7 Strategic Planning and Strategic Thinking



- Two skills are key to strategic thinking: Synthesis and Evaluation

1.3 The process of Strategy and Decision Making

- CEO's questions
    - How well are we performing?
    - What should we do in the future?
    - How can we achieve successful change?

- Elements of strategic planning:
    - **Structure** : individual managers backgrounds give them structure in which to tackle problems; e.g. marketing manager will talk in terms of competitive advantage
    - **Analysis**: what information is important and what's irrelevant
        - Do not confuse rigour with numbers
        - Precision is not essential
        - Data can be expressed as:
            - Relative orders of magnitude
            - Positive or negative
            - Quantitative or qualitative
    - **Integration**: take views of all stakeholders and merge them into a vision
    - **Evaluation**: devise measures which generate information on how well objectives are being obtained e.g. ROI, market share, NPS
    - **Feedback** – strategies need to be aligned with actual events

1.4 Business vs. corporate strategy

- Analogous to corporate strategy vs. SBU strategy

1.5 Development of Strategic Ideas

- **Divisionalisation** – decentralise of activities into divisions or SBUs -> makes corporations more manageable but raised fundamental issues of control
- **Diversification** – quest for synergy -> assimilation of different but related businesses
- Increased acquisitions drove the price up and made it more difficult to get value for money
- **Portfolio planning** – difficulties in managing diversity lead to balanced portfolio of products
- More sophisticated capital markets meant internally financing rising star product with cash cows didn't make sense, external financing was available
- **Restructuring** – corporate raiders taking over failed companies and releasing value
- Value based planning (e.g. NPV) used extensively
- **Core businesses**: performance of conglomerates had not been improved by take overs
- Focus on linking businesses based on core competencies, like technologies, product development, human resources
- **Parenting advantage** – four ways a corporate parent might add value together with reservations attached to each:
    - *Stand alone influence*: parenting activities like performance monitoring, monitoring capex, human resource management, product strategies
    - The more a parent extends into SBU, the more value it will destroy. Better to have a SBU manager work full time on something rather than parent manager part time
    - *Linkage influence*: parent encourages relationships to capitalise on synergy
        - But SBU managers would have been free to establish linkages if there is no parent - enlightened self interest
    - *Functional and service influence*: parent provides functional leadership and cost effective services
- Can parent company beat the specialists e.g. provide better supply chain than DHL?
- Corporate development activities: role of parent is buying and selling businesses and redefining new businesses.
- Majority of corporately sponsored acquisitions fail
- Globalisation: large number of international mergers to compete in new global market place. No guarantee of economies of scale
- Knowledge : tacit knowledge (learned on the job) is difficult to identify

1.6 Is Strategic Planning only for top management

- Company benefits of strategic planning:
    - Individual manager is able to see where their sub unit falls into the overall system of objectives
    - Manager is better able to make arguments for a proposal which is consistent with overall corporate objectives
    - Being involved in implementing strategy doesn't necessarily mean you are up to date in the latest strategic direction, as it can change
- Individual Benefit of Understanding Strategic Planning
    - Knowing strategy may personally benefit manager who can position themselves to take advantage of it

- Personal Proposals that are in keeping with corporate goals will be favourably looked upon

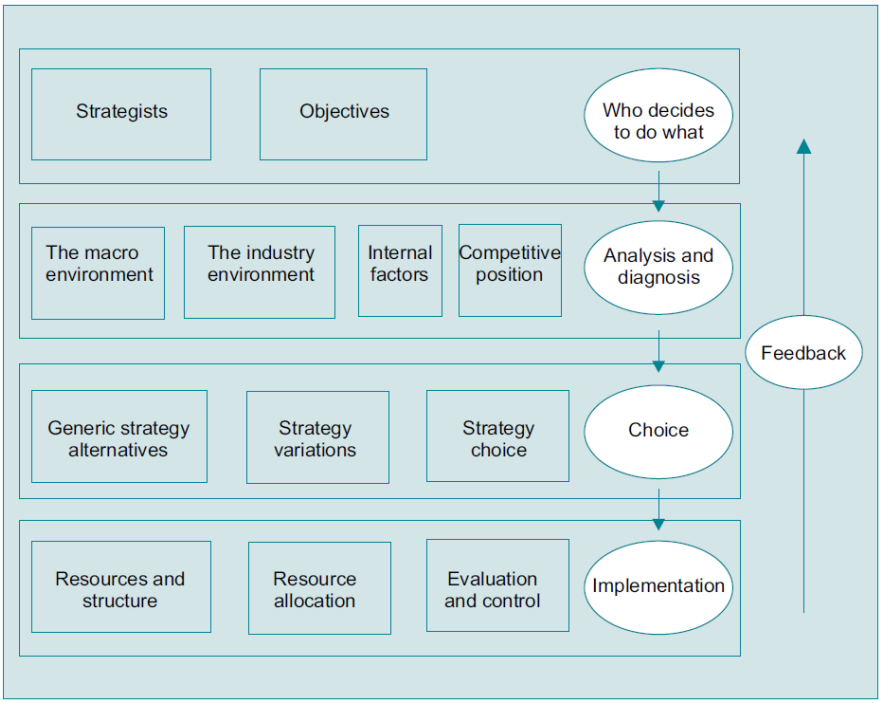
Module 2: Modelling the Strategic Planning Process

2.1.1 Components of a Model

1. Setting company goals
2. Forecasting Payoffs of different courses of action
3. Forecasting shortfalls of different courses of action
4. Identifying potential strategies
5. Selecting the best strategy mix
6. Organisation and implementation
7. Control and reappraisal
8. Feedback to previous activities

- Benefits of modelling planning:
  - Provides a structure
  - Simplifies complex processes
  - Acts as a check list
  - Identifies areas of disagreement
- Costs of modelling planning:
  - Imparts a mechanistic impression to the process
  - Introduces rigidity to a dynamic process
  - Gives impression that strategy can be derived from a model

2.1.3 The Strategic Process model



- General questions which arise from the model include:
    - Do the strategists have the appropriate characteristics for the type of company? Have they formulated clear objectives?
    - Has adequate analysis of the environment and the company been carried out?
    - Was an appropriate choice of strategy made in the light of the potential options?
    - Were company resources used effectively to achieve the strategic objectives?
    - Was the company able to learn from subsequent feedback and adapt accordingly?

2.2 Strategy Making

- Individuals, not companies, make decisions – but decisions are constrained by the organisation and its traditions

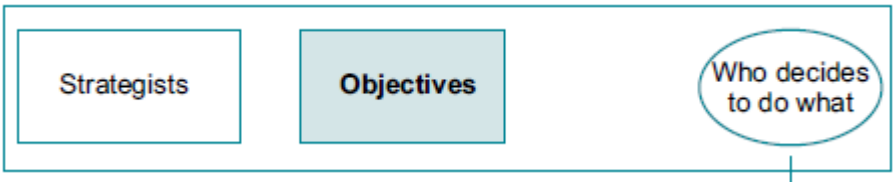
2.2.1 Strategy and the Evolution of the Company

- The roles undertaken by decision makers is dependant on the stage of the company's evolution:
    - Small or Entrepreneurial : single product, little formal structure, controlled by owner/manager
    - Integrated: single product line, vertically integrated with specialised functions, owner/manager retains control over strategic decisions, most operating decisions are delegated through policy
    - Diversified: Multi product company with formalised managerial systems, uses objective criteria (e.g. ROI), product market decisions, delegated to head of SBUs

2.2.2 Strategists

- Different companies at different stages of evolution require different types of strategist
- Roles in the strategy process model:
    - **Strategist, entrepreneur and goal setter** – not just CEO, often delegated to managers
    - **Analyser and competitor** – manager needs to be constantly aware of change in economic environment, efficiency of company and competitive position
    - **Strategic decision maker** – at times managers will be assessing strategy decisions, at other times they will be making them
    - **Implementer and Controller** – once decisions have been made the manager has a key role to play in making them happen
    - **Communicator** – manager keeps everyone aware of changes in direction
- There is a degree of conflict in the above roles – control vs. entrepreneurialism

Module 3 – Company Objectives



3.1 Setting Objectives:

- Key question: what are we trying to achieve?
- Key danger: the plan becomes more important than the objective

3.2 From Vision to Mission to Objectives:

- Steps:
    1. Develop the mission statement
    2. Disaggregate the mission
    3. Derive objectives
- Mission Statement should:
    - Define the business the organisation is in
    - Be clear
    - Provide focus

3.2.1 Defining the business of the organisation

- Its worth asking what business a company is really in
- Questions:
    - What is the productive scope of the company – this influences skill set required
        - e.g. do you buy in (negotiators required) or make your own product (bottle makers required, for a beer company)?
    - What's the market positioning?
        - Do you control distribution and marketing channels? Do you own the brand?
    - What's the breath and focus of the company?
        - Example soft drinks as a replacement for alcoholic drinks or as a replacement for tea/coffee. Or Railway companies in the transport business
    - What's the target market? Is it a compliment to another product or a replacement?

3.2.2 Deriving the mission statement

- After business definition comes mission statement
- Factors related to mission statement:
    - Quality of company's products
    - Degree of differentiation
    - Geographical area which is served
    - Target segment

- Mission statement can be aspirational

3.2.3 Disaggregating the Mission

- Break it down into constituent parts
- Need to modify the mission statement for the company as a whole so that it can be applied to individual parts of the organisation

3.2.4 Setting Objectives

- Mission must be stated in measurable performance targets = objectives

3.3 The Gap Concept

- This shows what has to be accomplished to achieve specific objectives
- What is the desired outcome?
- What will be the expected outcome if we make no change to strategy
- Closing of gap between desired and expected outcomes = company objective
- Once gap has been identified, three questions must be tackled
    - Does the gap arise because of external or internal factors (e.g. economic conditions vs. internal skills deficiency)
    - Does the company have the potential resources to close the gap
    - Can a strategy be developed which will close the gap

3.4 Credible Objectives

- Setting of realistic objectives is a constant process which is always under review
- An objective may not be feasible now, but may become so in terms of where company is expected to be in the future
- Objectives should be consistent – reducing marketing costs while make more sales is not consistent

3.5 Quantifiable and non Quantifiable objectives

- Objectives are usually expressed in terms of a number of components,
- A company can attempt to link a non quantifiable target to ROI e.g. how much will spending €20K on a social club increase the productivity of the workforce

3.6 Aggregate Objectives

- 'Maximising Shareholder wealth' is a way of having one objective which can be applied to a large range of products and SBUs

3.7 Disaggregated Objectives

- Aggregate objectives must be translated into something lower level managers can understand and are consistent with overall objectives
    - E.g. must ensure production objectives are in line with sales objectives (correct level of stock) and those are in line with SBU objectives, which are linked to overall corporate ones

3.8 The Principal Agent problem

- This is the need of the principal (boss) to assign tasks to agent (worker) that are in line with principals objectives without having to constantly monitor agent activity
    - E.g. CEO has a bonus linked to profit, but short term profit is boosted artificially by cutting R&D
- Its due to a information asymmetry between principal and agent
- Objectives and incentives have to be aligned

3.9 Means and Ends

- What is to be achieved should be differentiated from how it should be achieved

3.10 Behavioural Objectives vs. Economic and Financial Objectives

- Economic & Financial approach to objectives stresses specifying metrics in economic or financial terms
- Behavourist approach states that effective interpersonal process greatly improve the chance of success
- The two approaches are complementary

3.11 Economic Objectives

- Economists always ask 'what is being maximised?' – they look at how many resources will maximise a particular objective
    - For example, a financial objective could be to 'maximise the contribution from the sales of a certain product'. An economist would try to balance the financial contribution with the amount of resources being applied to it (diminishing marginal returns)
- Economists say that consumer try to maximise their wellbeing, companies maximise profits

3.12 Financial Objectives

- NPV, IRR
- Capital Sum = Earnings/(i-g); i=interest rate, g = growth in earnings

- Capital Asset Pricing Model => uses a combination of risk free interest rate (taken from govt bonds) and some allowance for risk of project (equity risk premium)
- ROI = net income/value of assets
- Problem includes whether to include the value of assets after depreciation or use average book value

Table 3.2 Return on investment over time

Year	1	2	3	4	5
Cash flows	175	250	350	400	400
– Depreciation	200	200	200	200	200
Net income	–25	50	150	200	200
Book value start year	1000	800	600	400	200
– Depreciation	200	200	200	200	200
Book value end year	800	600	400	200	0
Average book value	900	700	500	300	100
Return on investment	–2.8%	7.1%	30.0%	66.7%	200%

- E.g. above in yr 4 the 66.7% ROI = net income/average book value = 200/300; but in yr 5 ROI=200% based on the same net income!
- ROI doesn't discount to present value
- Trends in ROI can be useful e.g. ROI of company dropping from 18% to 8% in one year means something's amiss
- Shareholder wealth = expected income stream/interest rate; Several stages to estimating shareholder wealth
    - Stage 1: Decide on planning period – typically 5 years
    - Stage 2: Determine cost of capital – using CAPM
    - Stage 3: decide on residual cash flow – the net cash flow at end of planning period
    - Stage 4: determine the cash flows during the planning period
    - Stage 5: calculate NPV of cash flows during planning period
    - Stage 6: Calculate the present value of residual cash flow
    - Stage 7: Add the NPV, PV of residual cash flow, Marketable Securities (non wealth producing assets minus debt)

Table 3.3 Estimating shareholder wealth ($million)

			Cash flows Year					
Shareholder wealth	PV flows	PV residual	1	2	3	4	5	6+
857	393	464	100	110	120	130	140	140

- Assume 15% cost of capital
- 393 above is found by NPV calculation on years 1 through 5: $(100/1.15 + 110/1.15^2 + ...)$
- 464 = 393 plus PV of year 6 (140), but do it over 5 yrs not 6 as the residual cash is available at end of yr 5 = $140/(1.15)^2 = 71$ & 71+393 = 464
- Its good to compare what people are working on to what difference it makes to shareholder value

3.13 Social Objectives

- Corporate Social Responsibility (CSR) = companies must have objectives which are broader than simply maximising profits
- Arguments against CSR: No efficiency criteria

3.14 Stakeholders

- Includes shareholders, local community, suppliers, government
- Each has a different interest:

Table 3.5 **Stakeholders and their interests**

Stakeholder	Interest
Shareholders	Return on investment
	Risk
Managers	Salary
	Advancement
Employees	Salary
	Advancement
	Security
	Fair treatment
Suppliers	Prompt payment
	Repeat orders
Customers	Relative value for money
	Quality
	Availability
Creditors	Cash flow
	Financial stability
Local community	Lack of negative externalities
	Employment prospects
Government	Payment of taxes
	Lawful operation

- Possibility of conflict of interest between stakeholders
- Influence:
    - Shareholders usually exert little influence on day to day running of company; larger investment funds may club together and exert power at AGM
    - Creditors: some creditors have people on board (e.g. VC's)
- Stakeholder Maps

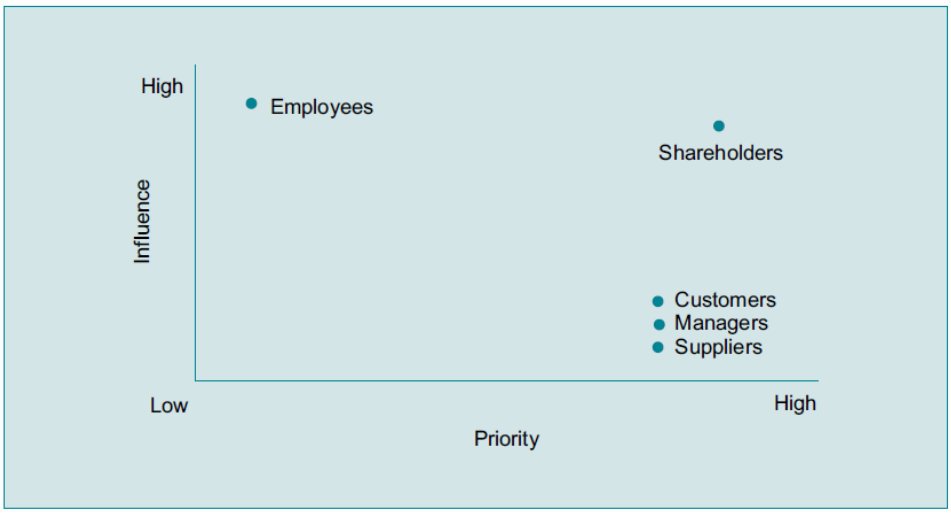


Figure 3.2 **A stakeholder map**

- For example, company moving into new market would need employees on board, as they have high influence, even if they are low priority.

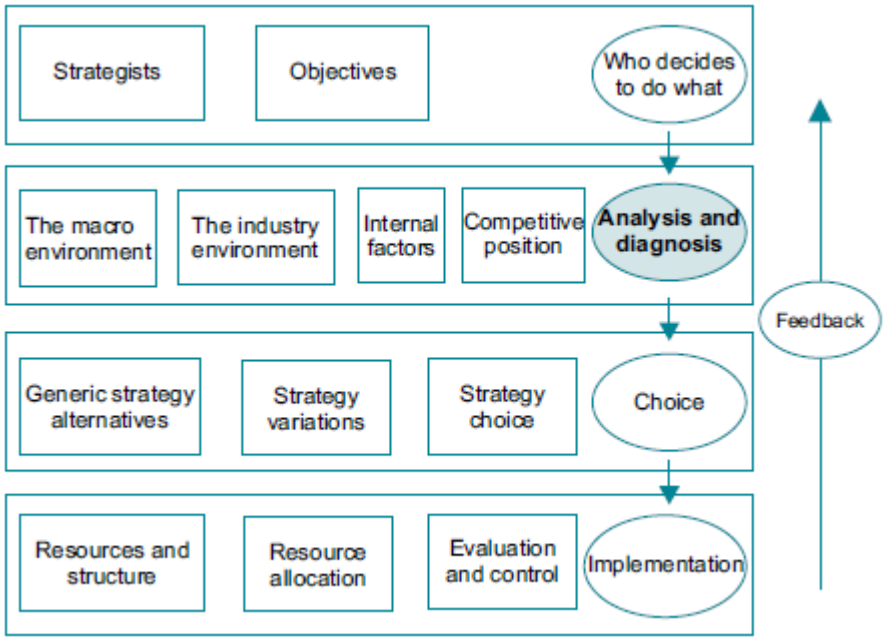
3.15 Ethical Considerations

- Moral behaviour is difficult to define for companies and managers
- Whats moral today maybe immoral tomorrow (e.g. fur)
- Different considerations of what is moral or immoral (e.g. bribes)

3.16 Are objectives SMART?

- **S**pecific **M**easurable **A**chievable **R**elevant and **T**ime-bound
- Specific: may be impossible to be specific about aggregate objectives like quality; typically easier to be specific about means vs. ends – should concentrate on ends!
- Measurable – qual factors may not be quantifiable e.g. happiness of workforce
- Achievable – easier to gauge with benefit of hindsight, not so easy at the time
- Relevant – should be in keeping with resource capability of company
- Time-bound: will always be a degree of guessing

Module 4 – The Company and the Economy



4.1 The Company in the economic environment

- A company must look at **P**olitical, **E**conomic, **S**ocial and **T**echnological environment before identifying strategic possibilities = PEST review
- ETOP review = **E**nvironmental **T**hreat and **O**pportunity **P**rofile
- External sources: newspapers, statistical publications, trade journals
- Internal: management accounts, performance measures, consultancy reports

4.2 Revenue and Costs: the basic model

- Revenue = total market x market share x price
- Outlay = number of workers x wage rate + units of capital x price + units of material x price

Table 4.1 Some determining factors

Variable	Determining factors
Total market	National income; Foreign national income; Population; Preferences; Competing products; Product life cycle
Market share	Price; Marketing expenditure; Marketing strategies; Competitor marketing expenditure; Competitor strategies
Price	Demand conditions; Competitive reaction; Competitive advantage; Market segmentation
Workforce	Labour market conditions; Regional supply variations; Wage rate offered; Working conditions
Wage rate	Labour market conditions; Unemployment rate
Capital	Capacity of the capital goods sector
Capital price	Capital market conditions
Materials	Capacity of suppliers
Materials price	Materials market conditions

4.3 The workings of an economy

- Several reasons for analysing and trying to understand the economy
    - Must understand which events are in control of company vs. out of company's control
    - Must be aware of whether economic changes represent opportunities or threats
    - Understanding how the economy works enables more accurate predictions
- Macroeconomics covers:
    - GNP generated from demand and supply
    - Role of expectations
    - Money support and the rate of interest
    - The rate of interest and investment expenditure
    - Factors affecting the demand for and supply of imports and exports
    - Exchange rate and international financial flows

4.3.1 Understanding and using economic information

Table 4.2 **UK economic indicators**

	Last year	This year (early)
Economic indicator	Change over year	Recent changes
Gross National Product	3.2%	0.5%
Industrial output	1.1%	−1.5%
Retail sales (volume)	4.3%	−1.1%
Investment expenditure	−1.1%	−3.2%
	Current value	
Unemployment rate	5.8%	6.2%
Inflation rate	9.3%	7.0%
Wage inflation rate	12.2%	8.0%

- Last year:
    - Economy growing, but:
    - Investment expenditure declining
    - Price and wages increasing above inflation (economy overheating)
- This year
    - Slow down in economic activity (GNP)
    - Unemployment increased, while inflation and wages down…..boom of last year is over
- Conclusions (assuming CEO only has last years data & CEO is involved in the B2B, not B2C)
    - GNP growth was fuelled by retail sales (consumer boom)
    - Despite boom, investment was down – companies selling from inventories and/or imports increased
    - Wage costs rose faster than inflation
- If last years pattern rolls into this year:
    - Revenue = Total Market x Market Share x Price
      = 0.99 [-1.1%] x 1 x 1.093 = 1.08 => cash flows increase by 8%
    - Assumes inflation raises prices by 9.3% and total market shrinks by 1% (or 1.1%), finally market share remains static
- Outlay = Number of workers x wage rate+ capital x price + material x price

    - We know wage inflation = 12% , assuming other costs increase the same than this outstrips the 8% increase in revenues
- However trends may not continue because:
    - Customer expenditure boom will likely cause an increase in investment expenditure in near term => increase capacity
    - Relatively low unemployment figures => skill shortage
    - Govt may increase interest rates to tackle inflation
- Given gloomy early figures from this year, CEO may be better holding off on any investment

4.3.2 Supply and demand in the economy

- Total value of goods and service = Gross National Product (GNP)
- Potential output = when labour is fully employed and there is no spare capacity
- First question = what is the difference between actual and potential output?
- Unemployment is comprised of:
    - Structural unemployment – when whole industries close e.g. miners
    - Frictional employment – between jobs, little can be done about this in short term
    - Demand related unemployment – caused by difference between actual and potential output, varies a lot in the short term

4.3.3 Unemployment and Inflation

- Low unemployment leads to increased wages, capital costs and material prices as there is a supply bottle neck
- Demand pull inflation when too much money chasing too few goods
- Usually even if unemployment grows, wages are slow to reduce (wages are sticky)

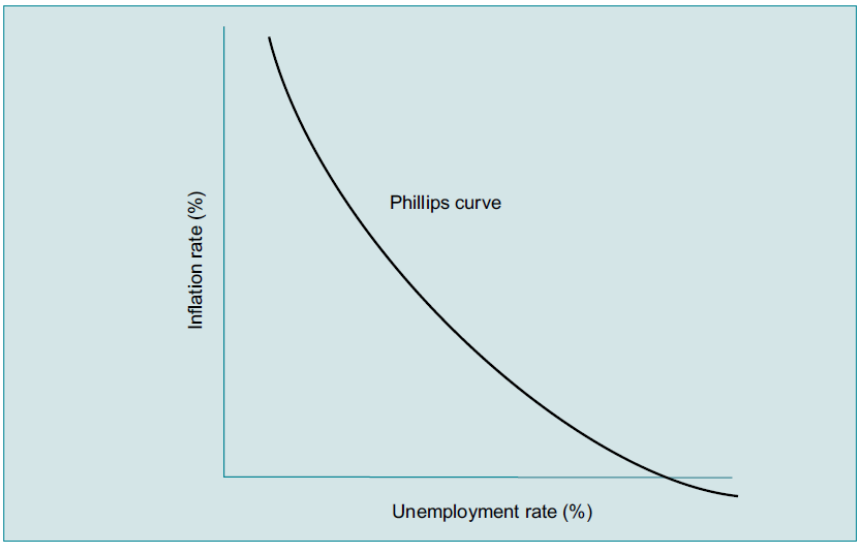


Figure 4.2 **The Phillips curve**

- Usual relationship shown above
- However in 1970s we had stagflation – high unemployment and inflation

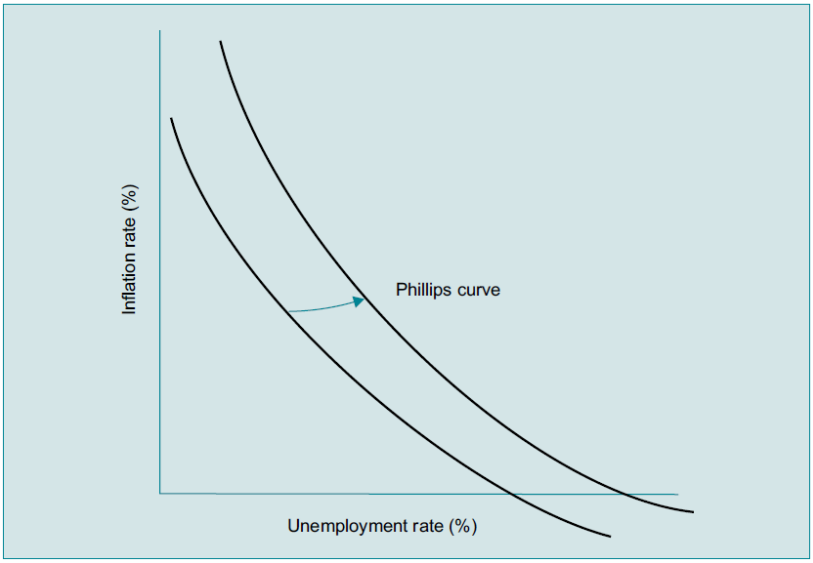


Figure 4.3 **The shifting Phillips curve**

- Curve had shifted because people had expectation that inflation would stay high
- To remove expectation of continued high inflation, monetarists keep money supply constant - this is better than letting unemployment to grow as a way of reducing inflation
- CEOs must look at inflation when signing forward based contracts

4.3.4 The International Economy

- Even companies selling domestically are up against import competitors
- Relative Inflation Rates:
    - exchange rates don't always compensate for different inflation rates in two countries
    - Relative costs may increase domestically vs. foreign if domestic rates are expected to increase faster than foreign
- Exchange rate fluctuations
    - Exchange rates are now effected mostly be capital flows rather than value of imports vs. exports
    - Capital flows are influenced by relative interest rates and expectations
    - There are constant cyclical as foreign exchange dealers sell short and long to guess the movement of a currency
- If company believes a currency is undervalued, then perhaps breaking into that market now and incur losses but build market share. Then when currency appreciates, we will earn more back in our domestic currency.
- Competitive Advantage of Nations
    - Domestic factor conditions – specialised resources e.g. skilled manpower
    - Related and supporting industries – suppliers

- Demand conditions – e.g. fascination with miniaturisation in Japan
- Strategy, structure and rivalry – competition at home
- Country Specific advantage => export to foreign markets
- Company Specific advantage => invest in foreign markets e.g. Toyota in Britain

4.4 Forecasting: What will happen next?

- Even vague forecasts can be useful – even forecasting the direction of change is useful e.g. GNP up or down
- Leading indicator can be used for forecasting e.g. number of new house builds useful for window glazing company
- The business cycle is comprised of
  - The general trend over time
  - The underlying smooth cycle
  - Random fluctuations

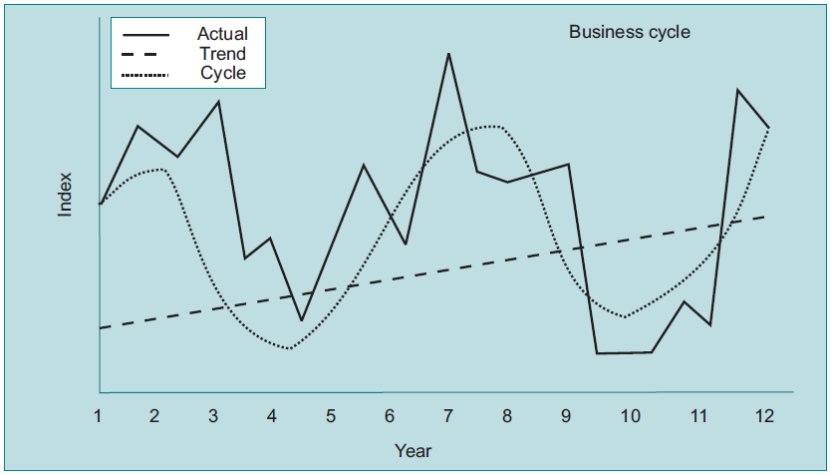


Figure 4.4 **Interpreting the business cycle**

- Important to ask
  - What is the trend – the long term growth in potential output (in the case of an economy)
  - What is the underlying cyclical pattern – can use peak and troughs of unemployment
  - What random influences are likely to be disturbing this trend – changes in govt policy or exchange rate changes
  - If half way up the peak – invest

4.5 PEST analysis

- Checklist of Political, Economic, Social and Technological factors can be used alongside macro economic forecasts
- Political – changes in political climate can have far reaching implications for company operations
- Economic: macro and micro influences

- Social – changes in demographics, social norms – tends to be qualitative
- Technological change

Factor	Issues	Threat
Political	The company is likely to be constrained by the new government, exposed to increased, competition and possibly lower demand than expected	High
Economic	The imminent economic slow down, competition from gas and higher costs of coal	High
Social	Trends which are possibly going to find expression through improved insulation and alternative power sources	High
Technological	Research into alternative energy sources starting to pay off	High

4.6 Environmental Scanning

- Need to constantly scan for changes to PEST

4.7 Scenarios

- Scenario = investigation of implication of possible futures for company
- Can be short term e.g. competitor dropping price
- Long term e.g. inflation drops to zero
- State different PEST scenario assumptions, and then the implications for each of them – again in PEST format

4.8 The Economy and Profitability

4.8.1 Implications for company sales and revenues

- Impact on sales of changes in economic activity depends on GNP elasticity e.g. food vs. GNP = not as responsive as CD players vs. GNP
- Example: GNP forecast to drop 4% , company has 15% share of CD player market. GNP elasticity = 1.5. How are sales effected if elasticity = 0?

Table 4.5 Revenue and GNP elasticity

GNP elasticity	Total market	Market share (%)	Total sales	% change
0.0	1 000	15	150	
1.5	940	15	141	−6.0
1.5	940	16	150	0

- Above shows 0 elasticity = no change in sales
- 1.5 elasticity means 4% x 1.5 = 6%. Total market will drop by 6% => 1000 x 94% = 940 = market
- One way around this is to attempt to increase market share by 1% to 16%
- Distribution of national expenditure amongst the components of a product is also import
    - Example: taxes drop but so does govt spending = demand increases for consumer goods but not goods related to govt spending e.g. defence industry

4.8.2 Competitive Reaction and the economic environment

- If competitor does not conduct analyses of GNP trends and elasticity, they could be stuck with falling market share, in a declining market with decreasing competitive pricing

Table 4.7 Volatile revenues

Period	Total market	Market share (%)	Price	Total revenue	% change
1	100	20	10	200	
2a	95	18	9	154	−23
2b	90	15	8	108	−46

- Cumulative effect of all the drop can be dramatic (e.g. 23% fall in 2a above)

4.8.3 Implications for Inputs and Company costs

- Outlay = number of workers x wage rate + units of capital x price + units of material x price
    - Example: 10% increase in demand due to GNP growth, it intends to increase purchase of inputs by 10%
- Three scenarios on what happens to input prices
    - 1 - They will all be unchanged
    - 2a – they will all increase by 5%
    - 2b – labour and materials increases by 15%, capital by 10%

Table 4.8 Cost scenarios

Scenario	Labour		Capital		Materials		Total cost	% change
	Units	Wage	Units	Price	Units	Price		
Base	100	100	50	200	500	20	30 000	
1	110	100	55	200	550	20	33 000	+ 10
2a	110	105	55	210	550	21	34 650	+ 16
2b	110	115	55	220	550	23	37 400	+ 25

- Its likely that an increase in the GNP growth will also mean increases to input prices – ignoring them could mean ignoring up to 25% increase in total costs
- The real threat in ignoring changes in the economy is that competitors will take pre-emptive action which will lead to a loss of competitive position

4.9 Environmental Threat and Opportunity Profile: Part 1

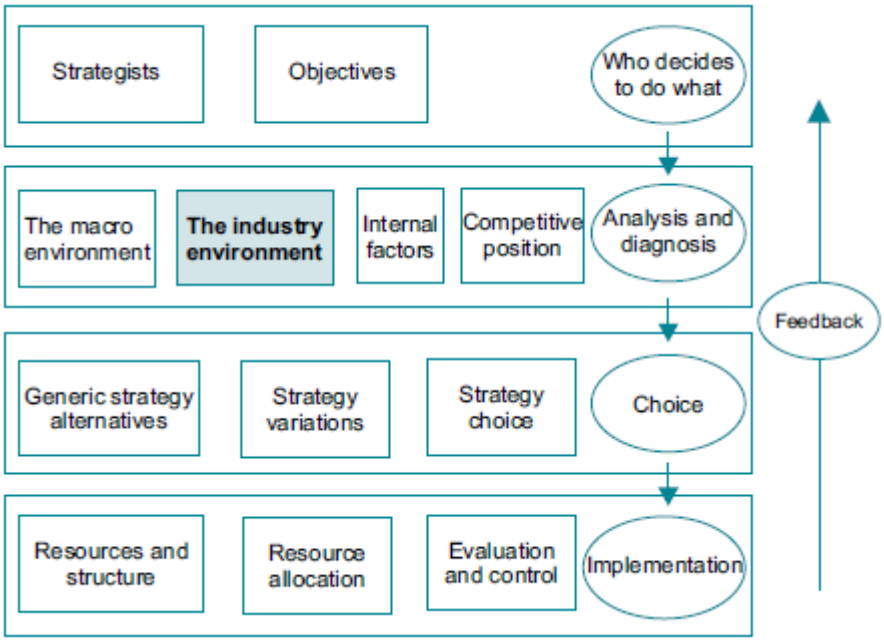
- Need to prioritise changes in environment according to the effect they may have
- Draw up a profile of how changes in the environment are likely to present threats and opportunities = ETOP (Environmental Threats and Opportunities)
- Approach:
    - Use the PEST approach as a checklist
    - Apply economic ideas to economy wide influences
    - Consider international factors - exchange rates and international competitive influences
    - Use environmental scanning approach to think beyond immediate situation
    - Put together some scenarios to help put factors into context
    - Build a profile of opportunities and threats

- To put this all together into an ETOP:
  - List relevant environmental factors which have been identified
  - Analyse whether each is likely to exert positive or negative impact on sales and costs, and whether there are openings for competitive response
  - Determine relative importance of the threats and opportunities, and rank them accordingly

Table 4.9 Environmental threat (–) and opportunity (+) profile

Sector		Threat or opportunity
International	–	Expected appreciation of exchange rates
	+	Growth in Eastern Bloc economies
Macroeconomic	–	Tax rate increase to fight inflation
	+	Prospect of reduced interest rates

Module 5 - The company and the market



5.1 The Market

- At the corporate level the type of market issues confronted include:
  - Are we in the right markets
  - What resources should be allocated to the development of our various markets
- At business level
  - What price should we be charging
  - How much should we spend on marketing

5.2 The Demand Curve

- What happens to total revenue when price is changed
- Change in revenue = change in price x change in quantity
- If Price = elastic price reduction will lead to higher revenue
- Shape of demand curve will tell you whether price is elastic or inelastic
- Shape can be different at different price points e.g. very elastic up to a point and then inelastic => there is a sweet spot
- Its assumed that no other variable other than price is changed – e.g. price of competition do not change in response to your price change

5.2.1 Demand factors

- Different factors affect demand for a product in different ways – some affect market as a whole other (market size) others only potential company sales
- Determinants of Market Size
  - Product lifecycle

    - Business cycle
    - Exogenous shocks e.g. regulation change
    - GNP elasticity
    - Exchange rates
- Determinants of Market Share
    - Price
    - Marketing
- Demand curve can be shifted
    - left - less quantity for same price e.g. product in a mature part of lifecycle
    - right – increase in GNP and market segment is GNP elastic

5.2.2 Demand Curve and Market Share

- Direct relationship between demand curve and market share => shape of curve -> amount of market share that can be grabbed if price is dropped

Table 5.3 **Increase in market share and demand**

Company	Current market share (%)	Increase desired (%)	Increase in demand (%)
A	5	2.5	50
B	50	2.5	5

- Company A would likely have to give a much larger price drop to achieve its goal of 2.5% increase market share vs. Company B
- If price is very inelastic (demand curve steep), company B may also have to drop prices dramatically to achieve goal
- Don't need detailed info to do above analysis – just info from sales teams is OK
- A large price drop may alert competitors and they drop price, moving demand curve to left and hence smaller price drop may be better
- Revenue = Total Market x Market Share x Price
- Demand curve can be expressed thus: Revenue = Total Units Sold x Price
- Holding Total Market constant, if you increase price you can increase revenue while market share is falling: example below shows this (it assumes competitors don't react)

Table 5.4 **Changes in market share and revenue**

Price ($)	Quantity	Market share (%)	Revenue ($)	Change in revenue (%)
1	95	23.8	95	
2	90	22.5	180	89.5
3	85	21.3	255	41.7
4	80	20.0	320	25.5
5	75	18.8	375	17.2
6	70	17.5	420	12.0
7	65	16.3	455	8.3
8	60	15.0	480	5.5
9	55	13.8	495	3.1
10	50	12.5	500	1.0
11	45	11.3	495	−1.0
12	40	10.0	480	−3.0
13	35	8.8	455	−5.2

- The effect depends on where you are on demand curve – e.g dropping price from €12 to €11 increases revenue, as does increasing price from €6 to €7

- Strategic objective of increasing market share may not be compatible with maximising revenue

5.2.3 Demand Curve and Marketing expenditure:

- You can hold price steady and see what effect increasing marketing expenditure will have:

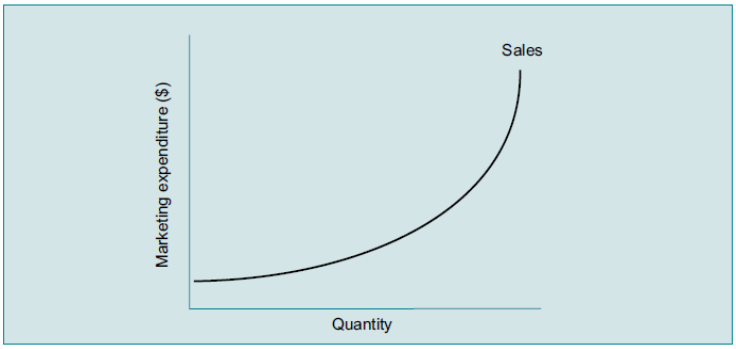


Figure 5.2 **Marketing expenditure and sales**

- Marketing can also shift demand curve to right – this requires changing peoples preferences, which is very hard to do
- Shifting to right and moving along the demand curve means marketing campaign based on price drop
- Substitutive and Complementary goods can shift demand curve
- Marketing expenditure can increase market share, while an increase in price of substitutive good may increase your total market, while your product still has the same market share of that total market
- Brand Loyalty => reduces price elasticity:

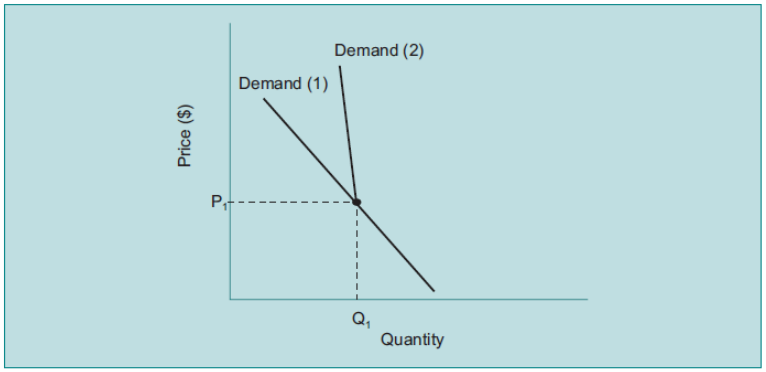


Figure 5.4 **Marketing and elasticity**

- Increasing price above P1 means that fewer sales are lost because of increased brand loyalty = difficult
- More likely that increase brand loyalty will mean demand curve less likely to shift left in response to competitive action

5.2.4 Estimating the Demand curve

- Cannot just join price and quantity points that may have been taken at different times when market environment may have changed

5.3 Competitive Reaction

5.3.1 Gaming Theory

- Zero sum game – a company can only build market share at the expense of its competitors e.g. cigarette market – as overall the total market size is static or reducing
- Price setting w/o collusion ⇨ prisoner's dilemma (potential costs & benefits, high degree of uncertainty, competitor unpredictability)
- Unless there is trust and commitment / agreement there is incentive for one party to break ranks

5.3.2 The Kinked Demand curve

- Demand curve below show a company which would have a sharp reduction in demand should it increase its price, and very little extra demand with a price reduction

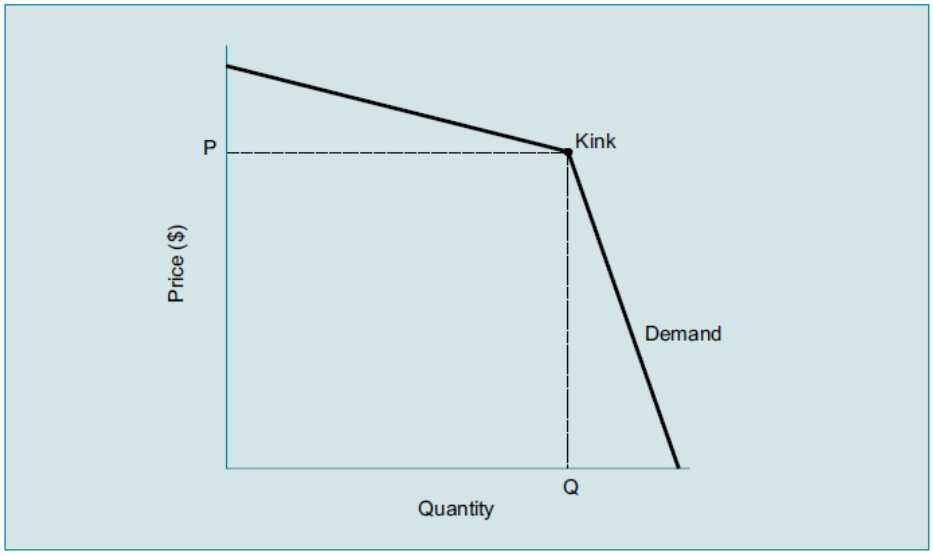


Figure 5.6 **The kinked demand curve**

- Revenue here is maximised at current price (P)
- Reducing price means lower revenues, so can only be justified if the higher market share means higher net contribution
- Kinked curve means that a significant price change is required - but risk is that competitors may follow

5.3.3 Competitive Pricing

- Three forms of competitive pricing
    - **Price Leadership** – they lead, smaller competitors follow
    - **Limit pricing** – incumbent erects low price to prevent competition. If new entrant arrives, logic says that incumbent increases price to maximise future profits – doesn't necessarily happen

    - **Predatory pricing** – firm sets price to drive competition out – must have low costs or large cash reserves
- The above are extremes and aren't found in reality

5.4 Segmentation

- Demand curve will be different for different segments
- Market demand curve is summation of demand curves for different segments
- Ideally set prices different for different segments to maximise revenue
- Characteristics of a segment if it is to be exploitable
    - **Identifiable** - sufficient common features that enable segment to be identified
    - **Demand related**: must have at least one demand related characteristic e.g. willingness to pay for quality
    - **Adequate size**
    - **Attainable** – can be reached by advertising/marketing
- Key steps for carrying out segmentation analysis
    - Identify the most important **segmentation variables**
        - *Identify key product characteristics*
        - *Derive characteristics of the target segment*
        - *Identify location* (physical, income, class...) of the target segment
    - Construct a **segmentation matrix** – where a profitable gap could exist in the market e.g. high end hotels in a particular area
    - Analyse **segment attractiveness** –e.g. demand curve, barriers to entry etc.
    - Identify **key success factors** - Customer characteristics? Customer willingness to pay? Enough customers? Can they be reached?

5.4.1 Pricing in Segments

- Charge higher price in markets with low demand elasticity and lower in ones with higher
- Accounting is used to calculate marginal cost – critical as you may end up with poor profit performance while capturing market share.

5.4.2 Product differentiation

- Changing the characteristics of a product to suit a segment
- Two key drivers for a product's success:
    - *Perception of price versus similar products*
    - *The degree to which consumers perceive the product as a different offering*

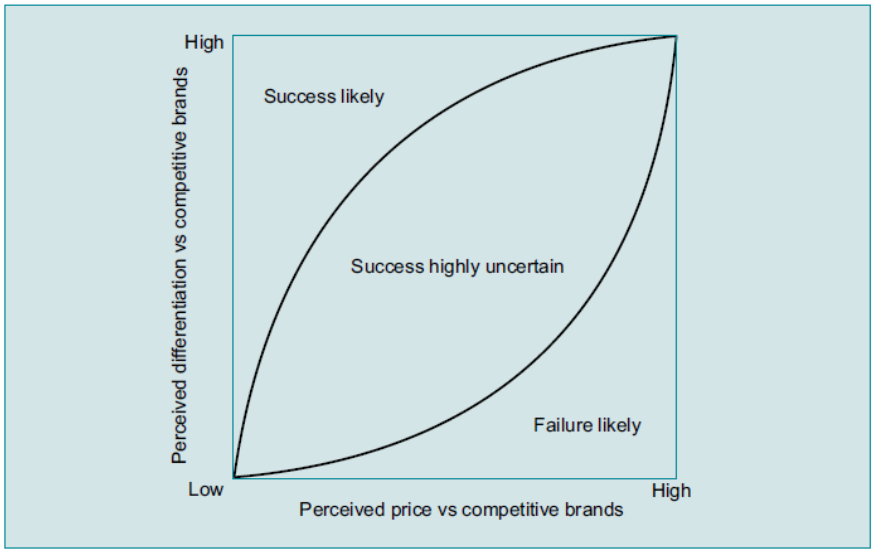


Figure 5.7 **Perceived price / differentiation**

- Product with low differentiation and high price vs. competitors highly unlikely to succeed
- Marketing campaigns can try to differentiate product and move it to success likely area
- Can launch differentiate product at high price and then reduce over time as competitors react
- Need to be aware of current position in matrix and where it is likely to go

5.5 Product Quality

- **Transcendent** quality – can only be recognised in the light of experience – not very usable
- **Product based** quality – can be high costs making attributes which don't matter to consumer high quality e.g. 100m depth watches
- **User based** quality – what quality is in eyes of consumer, define 'ideal' points and meet them
- **Production** based quality – conformance to specifications
- **Value based** quality – will consumers value (and pay for) extra quality

5.5.1 Dimensions of Quality

- Quality can potentially be assessed by defining dimensions of quality
  - *Performance*
  - *Features*
  - *Reliability*
  - *Conformance*
  - *Durability*
  - *Serviceability*
  - *Aesthetics*
  - *Overall perceived quality*

- Statistical methods can be used to attach weights to each dimension when measuring overall perceived quality
- Different segments will apply different weights – potentially identifying niches
- Similar approach to price would look for product attributes (and weight) that would enable company to understand how much consumers will pay for different attributes

5.5.2 Quality and Strategy

- A company cannot assume it can charge a higher price after improving product quality
- Most attempts at TQM failed
- Quality training, process improvement etc. do not in themselves offer competitive advantage - they can be imitated by competitors
- Open culture, employee empowerment however do create advantage
- Tacit (implicit) characteristics, not tools and techniques, produce advantage
- TQM can drive out inefficiencies, after which quality improvements have a cost
- Need to understand which quality improvement will have maximum effect on market share vs. minimum effect on production cost

5.6 Product Lifecycles

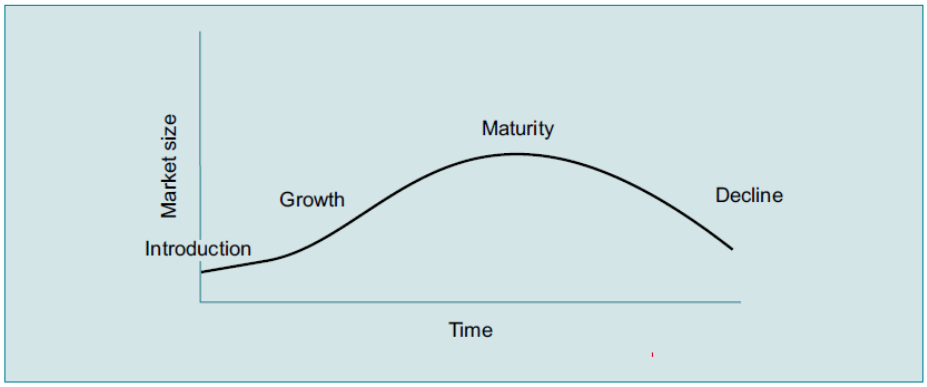


Figure 5.8 Product life cycle

- Above graph can refer to product or an industry
- Stage in lifecycle affects profitability, capacity utilisation and competitive reaction
- Introduction
    - High spend on capacity and marketing
    - Negative cash flow and lots of unknowns
- Growth
    - More investment in capacity
    - Increase in marketing and sales promotions to grab market share
    - Low prices means low profits
- Maturity
    - Can gear capacity to demand with JIT
    - Price no longer has to be kept below competitors to keep market share
    - Marketing costs reduced

- Decline
    - Company has to decide when to exit and phase out capacity
    - Must recognise this phase so you don't invest
- Transition from growth to maturity
    - Crucial to recognise this to avoid losses
    - Difficult to know when the market growth rate has started to fall
- Difficult to differentiate from business life cycles vs. product one
- Differences in strategy over the course of the lifecycle

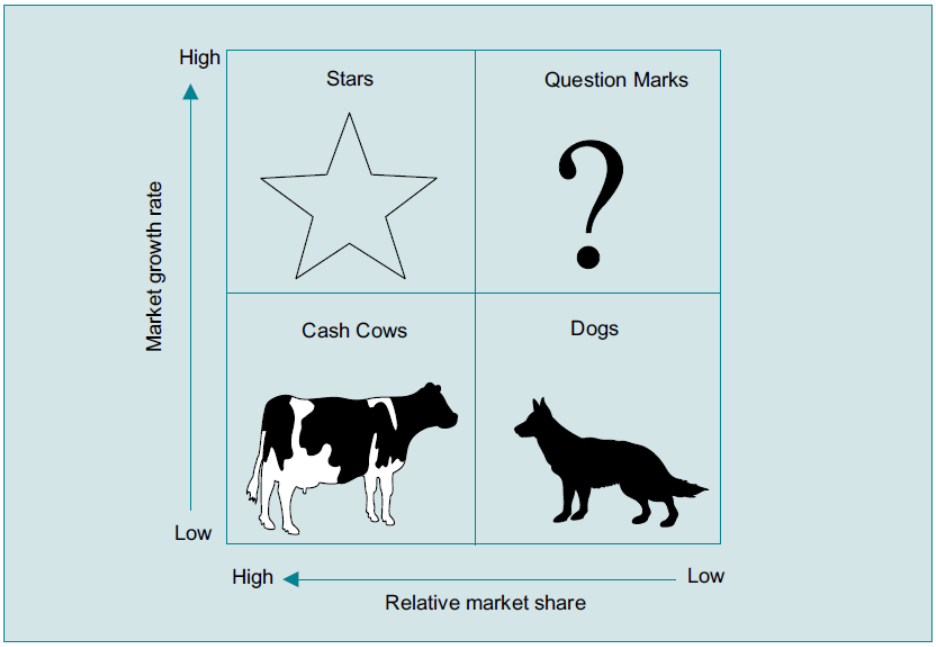
Decision	Introduction	Growth	Transition	Maturity	Decline
Price	Low	Low	Increase	Market	Market
Marketing	High	High	Reduce	Low	Low
Capacity	High	High	Reduce	JIT	Reduce
Investment	High	High	Reduce	Replacement	Zero

- Competitor entering at growth stage is OK, but at maturity stage v. expensive to establish themselves
- When defining different stages you can use
    - Total market (# of TV sets in the world) – not much use
    - Market Sales (number and value of TV sets sold this year) – this is key
    - Company sales (number and value of TV sets sold by company this year – not to be used as total market size
- Revenue = Total Market x Market Share x Price – all else being stable, it's the total market that drives revenue and hence why product lifecycle is so important
- Factors in forecasting product lifecycle:
    - Substitutes: are there other ways of satisfying the want - e.g. fax replacing telex
    - Technology: will a rapid change in technology make product obsolete
    - Durability and replacement: new TV sales are based on replacement

5.7 Portfolio models

5.7.1 The BCG Relative Share Growth Matrix

- Focuses on relative market share & product life cycle
- Relative market share is influenced by
    - Economies of scale – lower relative unit cost
    - Experience effect – labour more experienced hence lower per unit labour costs
    - Product Cycle growth stage – low price & over capacity may mean low profits
    - Product Cycle mature stage – potential higher cash flow



- The Dog
    - little change of making profits in future as low share of mature market
    - Gaining market share means high marketing cost and/or price reductions, which competitors may just respond to
    - Costs are sunk so managers should consider canning it
    - Could be in a niche and making profits
- Question Mark – may succeed as market matures, probably running at loss, managers need to decide on its future
- Star – should try to maintain market share until market growth ceases and make it a cow
- Cash Cow – apply JIT and reduce marketing spend to milk cash flows
- Strategy Implications:

BCG classification	Characteristic	Strategy implication
Cash Cow	Profitable	Defend
Cash Cow	Loss making	Missed transition: review capacity, investigate JIT, consider pricing and elasticity
Cash Cow	Declining sales and market share unchanged	Entering decline stage; reduce capacity, marketing and investment
Dog	Profitable	Probably no economies of scale; potentially vulnerable so monitor closely
Dog	Loss making	Divest
Star	Large losses	Possibly entering transition to maturity: cut back on capacity and marketing
Star	Losing market share	Increase marketing and reduce price
Question Mark	Severe losses	Determine if there is sufficient time to develop into Star
Question Mark	Gaining market share	Maintain resource allocation to develop into Star

- Demand curve analysis can be used in growth phase to find out where to price to maximise market share

- Once market mature, don't focus on market share, price to maximise revenues

5.7.2 Other Portfolio models

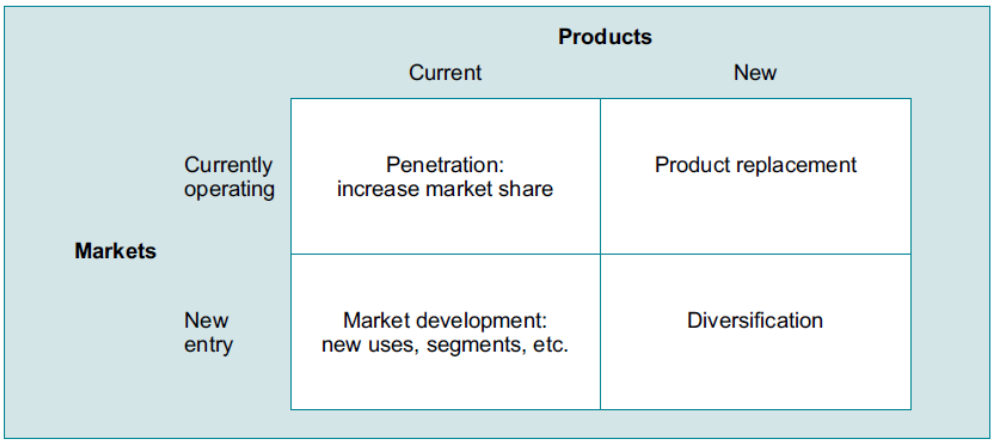
- McKinsey model
- Business strength – variables like capacity utilisation, relative cost
- Industry attractiveness – growth rate, profitability, cost trends and industry structure
- Variables weighted and scored to give overall rating for two dimensions

5.7.3 Limitations of Portfolio models

- Based on assumptions –
    - not all dogs lose money
    - Maybe limited economies of scale

5.7.4 Portfolio models and corporate strategy

- Optimum portfolio is one in which cash cows generate sufficient cash flows to produce adequate returns to shareholders and to fund question marks and stars
- Should develop a portfolio in which products are linked so as to benefit from the competencies of the corporation
- Too much diversification could make portfolio unmanageable
- Can try and predict competitor portfolio strategy e.g. attacking a competitors star may result in competitor responding, while attacking its cash cow may not illicit a response
- There may be principal-agent problems between SBUs and corporate e.g. SBU unwilling to let go of star which doesn't fit corporate portfolio
- Ansoffs growth vector:



- Penetration: If a company wishes to grow relative to competitors on the basis products which it sells in existing markets, it can only do so by increased penetration => increased market share
    - In a Mature market this means turning a dog into a cash cow
    - In a Growing market this means turning a question mark into a star

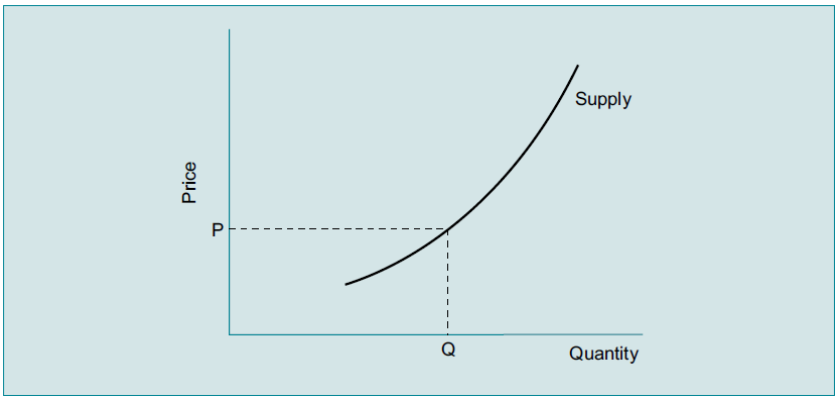
- Product Replacement: Maybe that a current version of product is not going to penetrate further, hence replacement required
- Market Development: e.g. new geographical locations or new segments. Success depends on pricing and marketing approaches
- Diversification: no direct experience of market or product e.g. Lamborghini make tractors

5.7.5 Strategy and Product Information

- The information a manager needs on a product in order to make good decisions:
    - *Price elasticity*
    - *Income elasticity*
    - *Effect of marketing on the position of the demand curve*
    - *Competitive conditions in the industry*
    - *Size and growth of the market*
    - *Relative market share*
    - *Product life cycle*

5.8 Supply

- Supply and cost considerations are just as important as demand when looking at competitive advantage
- Supply curve shows the amount which companies in total would be willing to sell at different prices, holding other factors constant
- Position of supply curve (up or down) depends on supply curve



5.8.1 The industry supply curve and strategy

- Shape of supply curve influences company strategy
- If curve is more vertical = inelastic supply curve (large increase in price does not result in much more units being supplied) – so a large demand is likely to result in a higher price rather than more units to satisfy that demand
- If curve is more horizontal = elastic supply curve (small increase in price results in large increase in units being supplied) – so a large demand is likely to result in more units to satisfy that demand rather than higher price
- Factors which influence supply curve:

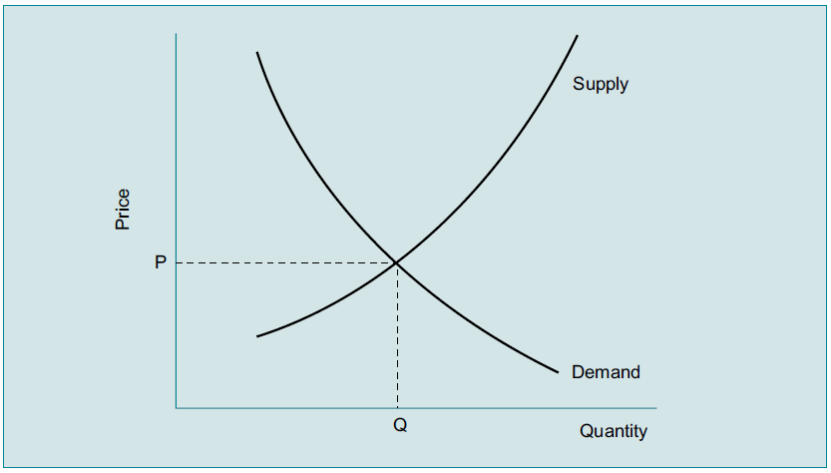
- *Current level of capacity utilisation*
- *Cost of increasing capacity*
- *Availability and wage costs of additional employees*
- *Availability of raw materials*
- *Potential of new competitors to enter market*

5.8.2 Shifting the industry supply curve

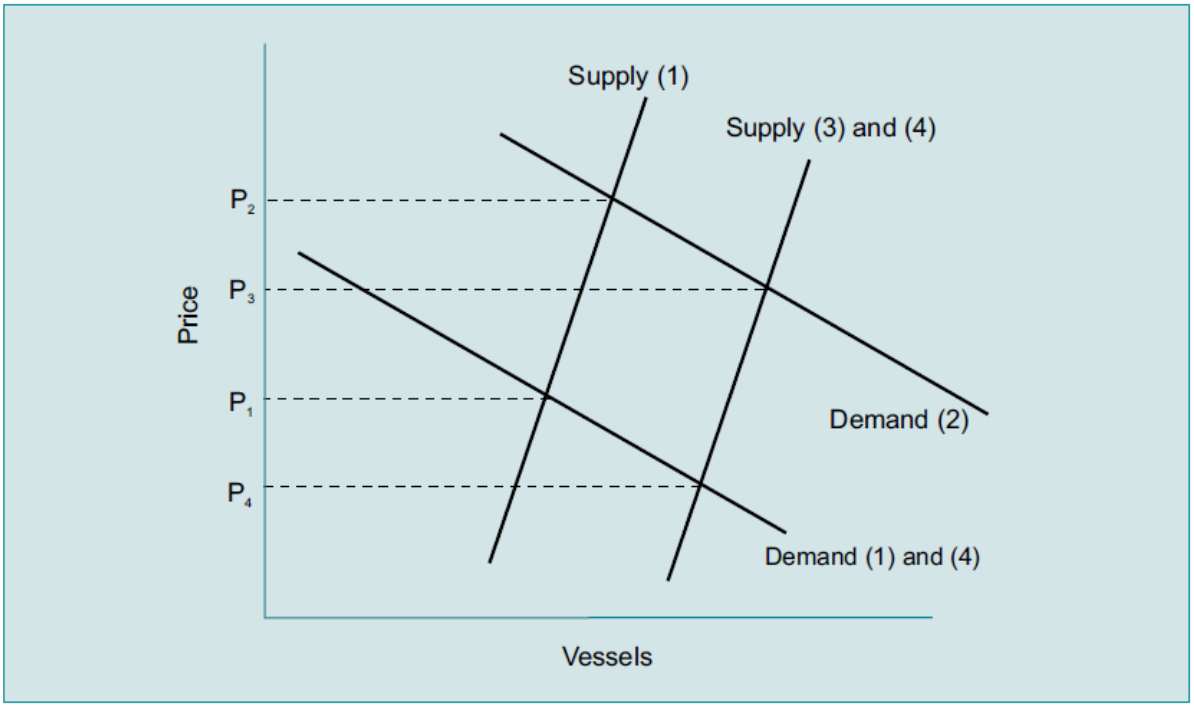
- Any factor which changes costs will have an effect on the supply curve e.g. oil cost increases => supply curve shifts to left (less supply at same price)

5.9 Markets and prices

- Price are determined by the interaction of demand and supply



- Taking the example of a shipping company

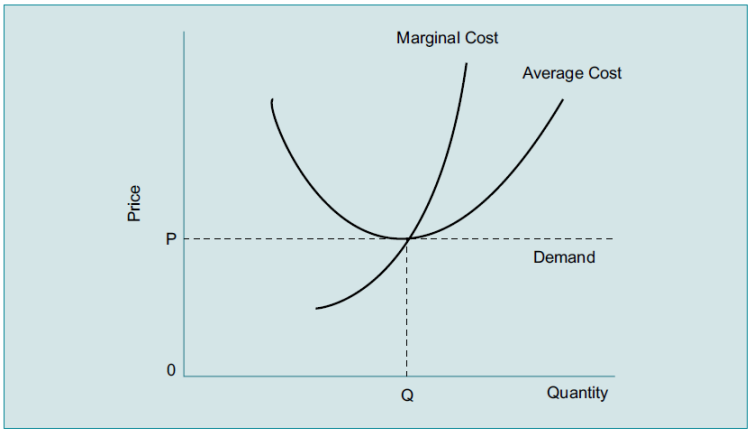


- At initial price P1, supply is inelastic because any increase in demand would require taking ships out of storage, which is not much use in the short term
- If demand increases in the short term, the price has to rise to P2
- In the longer term the supply curve increases and price changes to P3
- Then demand then falls, and price drops to P4
- In industries (like shipping) where supply curves are inelastic, changes in demand have big effects on price
- Entry of competitors -> increase in supply, emergence of substitutes->reduce in demand

5.10 Market structures

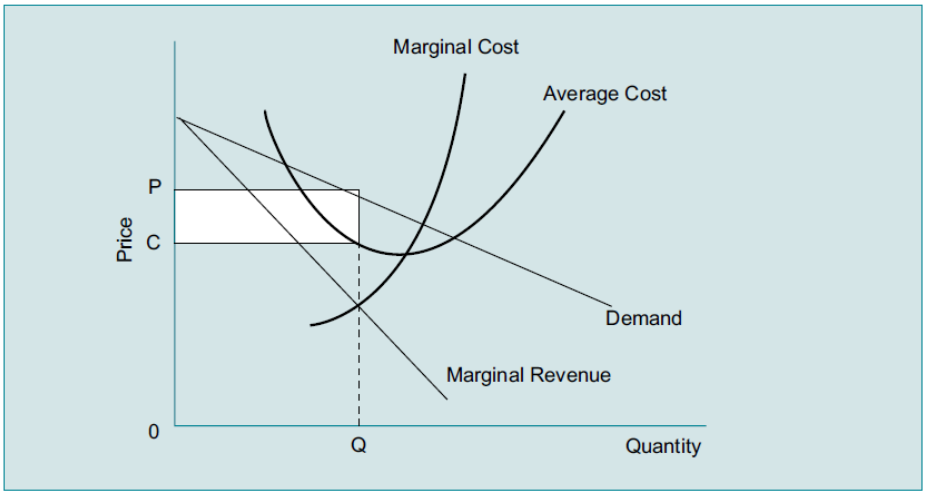
- Market structure is the main determinant of long term profitability

5.10.1 Perfect Competition



- Average cost is U shaped – economies of scale last for a while but eventually average cost per unit goes up as quantity goes up – AVC includes opportunity cost of capital = normal rate of profit
- In a perfect market, demand curve is horizontal – all firms are price takers rather than price makers, if you increase price you lose all sales, people switch to competitor who has exactly the same product as yours. Reduce price, everyone switches to you
- Demand curve is tangential to AVC – showing the prices are pushed down to the very minimum = level of the opportunity cost of capital
- At price P, output is Q which is where marginal cost of producing one more unit of output = marginal revenue (P) . If firm produces more than Q, then marginal cost would be > than marginal revenue (= a loss).

5.10.2 Monopoly



- Profit maximising output is where marginal cost = marginal revenue = at Q and at price P
- Difference between price 0P and 0C (average cost) is monopoly price per unit and white rectangle is the total monopoly profits
- If a competitor enters market, demand curve is pushed to left (same price would command less units) and competitors would keep entering until demand curve is at a tangent to AVC curve – any more competitors coming in would find that there is no Quantity at which they can sell that covers AVC.
- Same effect occurs if costs increase (e.g. increase labour costs through more competition in market place) - AVC curve goes left
- Key questions for a manger:
    - What is happening to demand curve
    - What is happening to cost curve
    - What market imperfections do we depend on for our profits (e.g. barriers to entry)
    - Are there potential market imperfections which we have not yet capitalised on?

5.10.3 Barriers to Entry

- Barriers to entry are either Structural (outside the control of firm) or Strategic (in their control)
- Structural include:
    - Size of market
    - Capital requirements
    - Sunk costs (cost of exit – like the route setup costs for airlines)
    - Legislation
    - Economies of scale
    - Experience effect
- Strategic:
    - Reputation
    - Pricing
    - Access to distribution channels

5.10.4 Contestable Markets

- Strategic barriers are not effective without structural ones in place
- Markets where entry costs are not sunk, and so exit is costless, are called perfectly contestable markets
- These markets never offer incumbent more than the normal rate of profit, as they have to drop prices to stop new entrants = different from monopoly

5.10.5 Oligopoly

- Relatively few competitors means game theory can come into play
- Competitors can respond quickly to price changes, hence its important to build brand and differentiation

5.11 The Role of Government

- Market failures = inability of market to prevent pollution

5.11.1 Government and rule making

- Government should determine the framework of rules in which markets function, including
    - Employment law e.g. difference between US and Europe
    - Monopoly
    - Health and Safety
    - Separation of management and ownership – what responsibility management has to the shareholders e.g. Enron
- These rules change when governments change

5.11.2 Govt and Regulating

- Pollution has a social cost
- Approaches to this are:
    - Attempt to internalise the cost for the pollution e.g. company involved in fishing rights for river
    - Regulating output e.g. emission standards

5.11.3 Government and Allocating

- Public goods – lighthouses, power grid

5.12 The Structural Analysis of Industries

- A firm in a competitive market is a price taker
- Degree of competition depends on five forces:

- **Rivalry of industry competitors**
  - Profit largely depends on market structure

Number of firms	Type of market	Basis for competition
Many	Perfect	Price
Few	Oligopoly	Differentiation
One	Monopoly	Price (to deter entrants)

  - Also lifecycle stage and competitive actions influence rivalry and hence degree of competition
- **Threat of new entrants**
  - Economies of scale, regulation, entry price, technological factors
- **Threat of substitutes** e.g. cut price airlines vs. channel tunnel
- **Suppliers bargaining power** e.g. unions
- **Buyers bargaining power** - to estimate the balance of power between buyers and sellers
  - Monopoly power
  - Brand identity
  - Switching costs
  - Number of buyers
  - Income elasticity
  - Perceived differentiation
  - Information

5.12.1 Profiling the Five forces

Company	1	2
Threat of new entrants	High	Low
Threat of substitutes	High	Low
Bargaining power of suppliers	Low	High
Bargaining power of buyers	Low	High
Industry rivalry	Low	High

- In example above:
  - Company 1 focuses on potential competitors and tech change (threat of subs)
  - Company 2 tries to get better deal from suppliers, marketing to buyers and cost position vs. rivals
- These factors can change over time, for example it worked against small independent in town traders but then in favour of supermarkets based in town

5.12.2 Criticisms of the Five Forces model

- It gives the impression that all forces are of equal importance – but it is just a structure in which to analyse
- It focuses on threats whereas many companies engage in cooperation and alliances
- It doesn't deal with internal issues like human resources and efficiency

5.13 Strategic Groups

- Strategic groups are set of firms in an industry which are similar to one another and different from firms outside the group on one or more key dimension of their characteristics and strategy
- Identifying groups makes it possible for the firm to indentify close and distant competitors
- Ways of classifying groups:
    - *Organisation* – scale, degree of vertical integration, distribution channels
    - *Product characteristics* – quality, image, level of technology
    - *Financial structure* – return on assets, gearing

5.14 First Mover Advantage

- First mover = companies that entered introductory or growth phase of product lifecycle
- Advantage may be gained by economies of scale (which can be maintained) and experience effect (declines over time), but only if share of market is maintained
- Second mover advantage = not having to bear costs of R&D

5.15 An overview of macro and micro models

Macro models	Focus
Macroeconomics	Determination of GNP and business cycles, GNP elasticity, interest rates, inflation, unemployment and their relationship to company costs, revenues and profits
Competitive advantage of nations	National market factors which relate to the source of competitive advantage
Forecasting	Predicting changes in key factors in the economy and the market place
PEST	Checklist of factors which may affect the company in the future
Environmental scanning	Identifying and tracking potentially important changes
Scenarios	Speculating about the future and assessing the company's ability to respond
Micro models	**Focus**
Demand and supply	Interpreting the impact of changes in market conditions
Market structures	Types of competition and intensity of rivalry
Game theory	Deriving competitive response with limited information
Segmentation	Identifying unexploited opportunities in existing markets
Differentiation	Product positioning
Quality	Determinant of demand and differentiation
Life cycle	Dynamic product management
Portfolio models	Strategic management
Strategic groups	Company positioning
Five forces analysis	Identifying competitive forces
First mover advantage	Capitalise on early lead

5.16 Is Competition changing?

- No empirical evidence that competition is more severe now than it used to be
- Competitive forces vary among industries and over time

5.17 Environmental Threat and Opportunity Profile: Part 2

- ETOP can be expanded to include the above market factors
- Below shows the threats and opportunities associated with introducing a health food product:

Microeconomic	–	Price of alcohol falling in real terms
	+	Shop opening regulations repealed
	–	Competition within the strategic group
Socioeconomic	–	Report on sugar: no health influence
	+	Increase in outdoor activities
Market	–	More substitutes appearing
	+	Growth has been steady
Supplier	–	Strikes in prospect
	+	Take-over by multinational

Module 6 – Internal analysis of the company

6.1 Opportunity Cost

- Opportunity Cost = cost of best option forgone
- Present all options when considering a financial investment is important

6.2 Fixed Cost, Variable costs and Sunk Costs

- Accounting principles when applied to financial decisions can lead to incorrect NPV – e.g. allocating overheads to additional output
- Sunk costs should be ignored

6.3 Marginal Analysis

- Only relevant costs should be taken into account in making pricing and output decisions
- Marginal cost = Outlay(q+1) – Outlay (q); where q = level of output
- Marginal cost (MC) exclude fixed cost and hence can be much lower than average cost
- While MC<price, keep selling
- In the case of a price reduction, it only makes sense if MC<Marginal Revenue
- In short run, production capability of company is assumed constant – in long run it can change and hence fixed costs can change
- In case where a company has remaining inventory, it should sell it so that revenue (price x quantity) is maximised, rather than just price – i.e. sell up to the point where MR is 0

6.4 Diminishing Marginal Product

- Output product doesn't always vary linearly to input resources and so MC can vary e.g. trying to maximise output from an acre of land
- When deciding to balance resources between alternatives, optimum point is when the marginal product (Output $/ Input $) is equal between the two alternatives

6.5 Profit Maximisation

- Profit maximisation is an extension of keep selling while MC<price – i.e. while profit is still being generated
- In the case of price reduction, keep selling till MC=MR

6.6 Estimating Product Costs

- Many accounting systems cannot product accurate answers on product costs and how they vary with production

- Accountants favour average costs over marginal one's
- Average costs include arbitrary cost allocations & include sunk costs
- **Activity Based Costings** allocate costs to activities rather than products – it focuses attention on whether the cost of activities is outweighed by their value add
- Still the problem of identifying the cost drivers for activities
- Important to understand whether an increase in unit cost is due to outside factors (business cycles and exogenous shocks) or due to management of labour (which will effect companies position w.r.t. competitors)

6.7 Accounting Techniques: Break Even, Payback and Sensitivity

- We need techniques to answer:
  - How many units need to be sold before investment is covered (break even)
  - How long it takes until the initial outlay is paid back (payback)
  - What happens if some of the assumptions are wrong (sensitivity)

- **Break even**:
  - Total Cost= Sales x Variable cost + Fixed Cost
  - Total Revenue = Sales x price
  - Breakeven: Total Cost = Total Revenue
  - Sales x Variable cost + Fixed Cost = Sales x price
  - Breakeven sales = Fixed Cost/ (Price – Variable)
- You can look at cumulative sales across times and markets;
  - Cumm sales = (Total market x market share)1 + (Total market x market share)2 ……
- You can calculate the market share required to give you cumm sales = breakeven

- **Payback**
  - Use cash flows, but doesn't discount them

Table 6.3 **Payback**

Cash flow	$-A_1$	A_2	A_3	A_n
Payback	$-A_1$	$A_2 - A_1$	$A_2 + A_3 - A_1$	$A_2+A_3+\ldots+A_n-A_1$

- **Sensitivity Analysis**
  - Can be carried out on various dimensions of performance
  - Identify combination of circumstances that are necessary for success

- **Accounting Ratios**
  - Formal finance techniques do not tell you how well resources are actually being deployed
- **Return on Net Assets**
  - RONA = (Revenue - costs) / Net assets
  - Difficult to calculate true value of assets given depreciation and inflation

- If company sells an asset and leases a replacement, RONA can increase as cash goes to NA and smaller lease cost - but it doesn't necessary mean that company is more efficient

- **Gearing**
  - Companies have three sources of income
    - Retained profits
    - Equity issues
    - Loans
  - Loan Debt has first dibs on profits and hence is cheaper than equity finance
  - Gearing = Debt/Shareholder equity or Debt/Total Assets
  - What's the optimal gearing?
    - A good track record means it's easy to get a loan, hence a management team who have constrained growth may be risk averse
    - Higher gearing ratio means company is more reliant on steady profits

- **Quick Ratio**
  - Quick ratio = (Current assets – Inventories)/ Debt
  - <1 means assets cannot cover debt

- Applying the ratio's
  - RONA – how efficient company is being run
  - Gearing – ability to raise more money
  - Quick ratio – exposure to risk

Ratio	Scenario A	Scenario B
RONA	5%	15%
Gearing	85%	40%
Quick ratio	0.8	1.2

- Company A:
  - Is earning about the same from its assets as the average bank interest rate
  - Is highly leveraged
  - Cannot cover current liabilities

6.9 Benchmarking

- Typical questions:
  - Why are competitors return on capital greater than ours
  - How does competitors financial strength compare to ours (in terms of gearing, cash reserves…)
- Treat benchmarking with caution:
  - Not comparing like with like – are portfolios similar, similar life stage, similar competitive pressures?

- Doesn't tell you how the performance has been achieved

6.10 Research and Development

- Often dynamic resource allocation is more important than static efficiency
- R&D = competitive advantage

6.10.1 Research and Innovation

- Two stages to the problem of allocating resources to research:
  - Deciding how much to spend
  - Identifying potentially profitable products among the possibilities produced by research
- Company must also consider opportunity cost of research expenditure vs. marketing and other spends
- Sometimes research spend is kept at constant % of total sales
- Difficult to split of research spend from product development
- Research expenditure: indicative factors:
  - *Measurement of research expenditure*
  - *Past research budget*: constant or variable
  - *Expenditure as proportion of sales*, total cost
  - *Track record* of new ideas
  - *Spill over effects* (money spent on research actual goes towards product development)
  - *Power base* – strong personalities in research dept

6.10.2 Development

- Product development = product selected for development from the prototype
- Can be conflicts in dev phase: tech vs. finance vs. marketing
- Innovation process:
  - Invention
  - Prototype
  - Patent
  - Development
  - Launch
  - Market Exploitation
- Each stage must be managed effectively and link between phases must be efficient

6.11 Human Resource Management

- HR very important:
  - People = resource
  - Ability of people to adapt to change can be a powerful constraint on success

- Four types of culture:
    - *Power culture* – small group dominates decision making (e.g. small company)
    - *Role culture* – relies on process and structure to make decisions
    - *Task culture* – org geared to solve specific problems of limited duration e.g. ad agency
    - *Personal culture* – people pay little attention to org, and concentrate on self gratification e.g. consultants
- Often problems implementing strategy are blamed on culture, when in fact it could be something like a principal agent problem e.g. incentive system not aligned with corporate objectives

6.12 Scope of Company

- Company needs to define its business to arrive at a sensible mission statement and derive objectives

6.12.1 Economies of Scale, Economies of Scope and Diversification

- Reasons for economies of scale:
    - **Indivisibilities**: e.g. minimum order quantity or minimum production run
    - **Technical relationships**: e.g. doesn't take twice the time to build twice the size of oil tanker
    - **Specialisation**: workers become adapted to a task e.g. knowledge workers
- Differs from industry to industry
- **Economies of scope** = reduction in unit cost as the number of products is increased rather that the number of units produced
- May be cheaper for one firm to produce two goods than for two firms to do so because:
    - ***Sharing inputs*** among several inputs e.g. 3M produces adhesives and sellotape (which uses adhesives)
    - ***Reputation***: Rolls Royce reputation carries over to aerospace
    - ***R&D spillover***: e.g. space exploration produces non stick frying pans
    - ***Ability to compete*** in a range of related industries
- Often economies of scope are used as an excuse for diversification – not always true
- Motives for diversification (apart from economies of scale & scope):
    - *Minimise management risk* – stabilising cash flows
    - *Add value through parenting function*
    - *To apply the dominant management* logic: e.g. Enron

6.12.2 Synergy

- Synergy is independent of the size of the company
- Synergy is similar to economies of scope, the whole is greater than the sum of the parts
- Two problems with synergy:
    - Difficult to identify where benefits of synergy are likely to be generated

    - Little empirical evidence to guide a company as to where synergy exists
- Synergy is likely to originate from:
    - *Corporate management*: making optimum use of capacity – similar SBUs
    - *Economies of scale*
    - *Vertical integration*
    - *Capacity utilisation* - sharing spare capacity
    - *Joint production*
    - *Innovative stimulus* - new ideas and approaches

6.12.3 Vertical Integration

- This relates to the part of the supply chain (raw materials->manufacture…) which is controlled by the company
- Forward integration is when producer of raw material gets involved in the marketing
- Backwards integration is when manufacturers get involved in raw materials production
- Key question for vertical integration: should companies produce good itself or buy it in?
- Benefits of buying it in from the market (=market facing firms) rather than producing itself:
    - Market firms can achieve **economies of scale**
    - Market firms have **market competition** to toughen them up, don't have to have rigorous internal controls to ensure efficiency
- Costs of buying it in from market include:
    - **Coordination of production flows** may be compromised as supplier may have other priorities from time to time
    - **Suppliers may leak info to competitors**
    - **Transaction costs**
- Costs associated with internal production:
    - There can be **mismatches of output** between different stage of production
    - Business at different stages can present different **strategic problems**
    - **Risk** at each stage of production compounds the overall risk
- Two incorrect arguments in favour of vertical integration
    - You avoid giving a supplier a slice of your profit – it doesn't matter, the question is whether you would make more profit if you took on the supplier's tasks, which is unlikely
    - To avoid paying a higher price to suppliers in period of peak demand – it doesn't matter, making profit does
- Internal contract better than an external one with supplier:
    - External contract can't take into account all the eventualities
    - Difficult to define and measure key metrics
    - Neither party wants to give the other all information
    - Supplier may be able to take advantage of company's vulnerabilities once contract signed
- Vertical integration can be good because:
    - Needs more powerful governance structures - boss can sort internal arguments out

    - Parties (manufacturing and marketing) have to get on because it's a permanent relationship
    - All parties feel bound with common objective

6.13 The Value Chain

- A company can be visualised as a chain of value producing activities which starts with input at one end and sales at the other
- Value chain can be broken into: primary activities (inbound logistics, ops, outbound logistics, sales, service) and support activities (procurement, tech, HR, management systems)
- The total chain is something that competitors find very hard to replicate

6.14 Competence

- Competency (or capabilities) are those aspects of competitive performance which a company is relatively good at
- It's not just being better at one thing, it's how competencies are combined in such a way that the resulting organisation cannot be readily imitated
- Often comes down to core product approach vs. SBU mentality
- SBUs can be efficient, but if autonomy is carried too far then it may:
    - Under invest in core competencies
    - Imprison resources within the SBU
    - Bounded innovation – cannot leverage innovation across company
- Core competencies should
    - Give potential access to a wide variety of markets
    - Make a significant contribution to perceive customer benefits of the end product
- Characteristics of core competencies:
    - Difficult to identify
    - Difficult to copy
    - Do not reside within SBUs
    - Relatively rare
- There are three levels of competency
    - **Systems** – goals, culture and org design of a company -> help identify opportunities for diversification
    - **Distinctive capabilities** (routines/processes) – can be leveraged during process of diversification
    - **Core inputs** (resources) – used to create new products and services

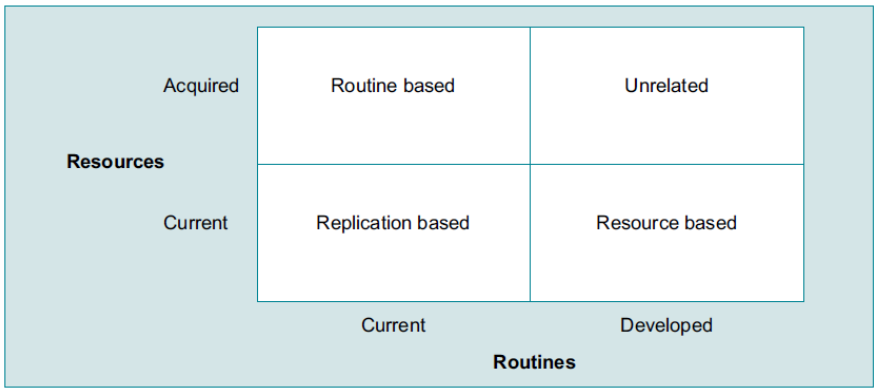


Figure 6.7 **Competence based diversification**

- Routine based diversification
    - New resources need to be added to company, but same routines used to manage them
        - Example: Power companies moving into other utilities like water
- Resource based diversification
    - Company produces outputs which utilise existing resources but which require different routines e.g. University needs different routines to change from class based to distance learning
- Replication based diversification
    - Least risky form – based on expansion using existing resources and routines e.g. Building society becoming a full bank
- Unrelated Diversification e.g. Virgin

6.15 Strategic Architecture

- This is the way in which a company's collection of unique attributes is combined together
- Based on a company's value chain and core competencies
- Firms have relationships with
    - Employees (internal architecture)
    - Suppliers or customers (external architecture)
    - Groups of firms engaged in related activities (networks)
- Value of architectures lies:
    - Capacity of organisations to create organisational knowledge and routines
    - Respond flexibility to changing circumstances
    - Achieve open exchanges of information
- Strategic architecture is unique to each company and leads this uniqueness leads to competitive advantage
- Two factors contribute to the protection of competitive advantage
    - Casual ambiguity – difficult to know what characteristics lead to competitive advantage
    - Uncertain imitability…..and so its hard to copy these characteristics
- Often short term solutions are offered for the long term problem, which really is the loss of competitive advantage

Time period	Economics	Strategy
Short run	Vary one factor of production	Deal with cash flow problems, react to competitors, seize new opportunities
Long run	Vary all factors of production	Develop a linked portfolio, build on core competence, focus on generic strategies

- Characteristics of competitive advantage in a stable market: cash cow

Characteristic	Advantage	Source
High market share	Relatively low cost	Asset
No new customers	Barrier to entry	Asset
Customer loyalty	Reputation	Distinctive capability
Fixed plant capacity	Full utilisation	Asset
Stable labour force	Top of experience curve	Asset

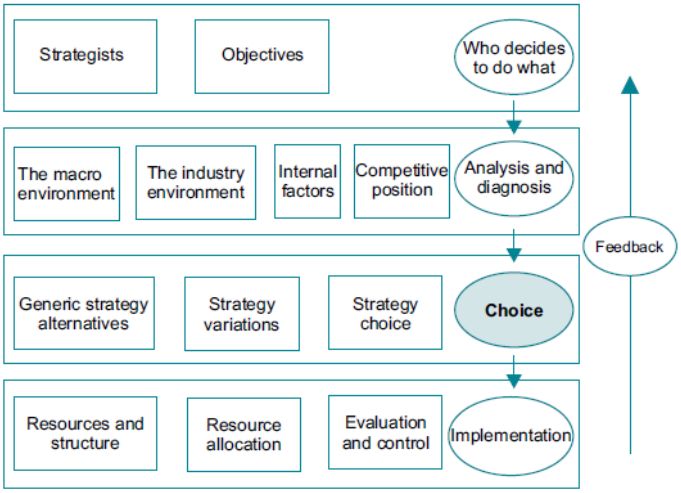
    - It's a combination of strategic assets and distinctive capabilities
- In a value chain, its important to identify those factors which affect different components of the value chain and how they combine to produce profitability and shareholder value

6.16 Strategic Advantage Profile

- We can construct a profile which summarises where competitive strengths or weaknesses are likely to lie and then rank them
- Could do it by functional group (as shown below) or by component of value chain

Internal area		Competitive strength (+) or weakness (–)
Research	+	Recently invented a temperature control
	–	Team has a narrow vision
Development	+	Reduced lead time by 15%
	–	Costs are usually overrun by 20%
Production	+	Working at full capacity
	–	High labour turnover rate
Marketing	+	Computerised customer databank
	–	Lack of technically qualified salespeople
Finance	+	Share price is buoyant
	–	Lack of liquidity

Module 7 – Making Choices among Strategies



7.1 A Structure for Rational Choice

- We must investigate structure within which choices are made among competing options

7.2 Strengths, Weaknesses, Opportunities, Threats

- SWOT is first step in company assessing what it needs to do to protect current market position and potential strategic thrusts
- The Strategic Advantage Profile (SAP) can be used as a starting point – you can compare it with the ETOP to see which strengths and weaknesses (SAP) match the opportunity (ETOP)
- Below is a general SAP – which is starting point

Table 7.1 Strategic advantage profile

Internal area		Competitive strength (+) or weakness (–)
Research	+	Recently invented a temperature control
	–	Team has a narrow vision
Development	+	Reduced lead time by 15%
	–	Costs are usually overrun by 20%
Production	+	Working at full capacity
	–	High labour turnover rate
Marketing	+	Computerised customer databank
	–	Lack of technically qualified salespeople
Finance	+	Share price is buoyant
	–	Lack of liquidity

- Above shows strengths and weaknesses with regard to a hypothetical opportunity which came out of a ETOP – that of govt shifting spending from railway to road
- Can list SWOT in a different form:

Table 7.2 SWOT analysis

Strengths	Opportunities
Potentially first in market	Truck market expansion
Marketing database	
Weaknesses	**Threats**
Full capacity	Foreign competition
Low labour productivity	
Lack of salespeople	
Cash flow	

- Two ways to align the SWOT:
    - Strengths take advantage of opportunities, and tackle weaknesses to counter threats
    - Strengths address threats, but weaknesses means you cannot take advantage of opportunities => need to convert weaknesses to strengths
- Three uses of SWOT
    - Familiarise executives with company and operations
    - Generates understanding of the basis on which company competes
    - Provide basis for deciding on strategic moves and the allocation of resources
- There is ambiguity in what is a strength vs. weakness, opp vs. threat
- Environment is constantly moving = a problem with SWOT

7.3 Generic Strategies

7.3.1 Corporate Level Generic Options

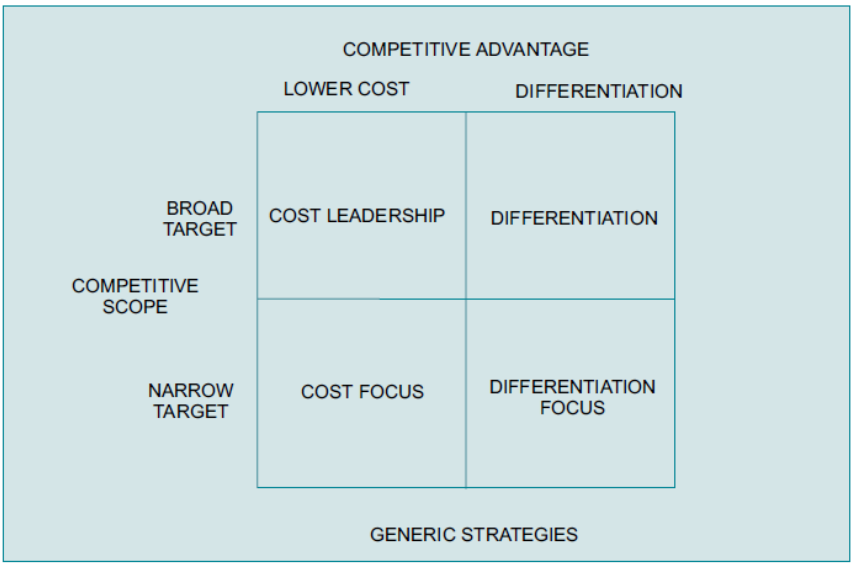
- First step is to define:
    - What business are we in
    - How diversified should we be
    - Whether we should diversify horizontally or vertically
    - Whether we should shrink (retrench), grow or stay the same (Stability)
- Stability – might choose this because
    - Relatively small performance gap
    - Markets are mature – not need to invest
    - Internal weaknesses – inefficient resource allocation need to be addressed before expansion
    - Unstable financial history – build up a stable track record
    - Poor economic prospects – economies on a downturn
    - Competitive threat – company needs to prepare rather than expanding
    - Perceived cost of change – expansion = change
    - Managers averse to risk – why change a good thing
- Expansion:
    - Diversifying Risk – build portfolio of products
    - Searching for competencies – line of business may seem to be synergistic
    - Economies of scale
    - Experience effects – advantage may only be short term
    - Building advance capacity - economic upturn expected

    - Managerial motivation – bonuses for total revenue
- Retrenchment (downsizing, delayering, restructuring)
    - Product Lifecycles – products EOL
    - Dogs – get rid of them
    - Overextended markets – some markets not economic
- Combination – different strategies for different SBUs or different policies followed sequentially
    - Opportunity cost – may have to retrench before following stability or expansion
    - Product Portfolio – some products/SBUs in expansion while other in retrenchment
- Assessing Generic Strategies – follow whichever increases value of the company

7.3.2 Business Level Generic Options

- Exploitation of individual product markets as opposed to overall resource allocation problems
- Strategy defined by approach to individual products or groups of products
- Four main strategies:
    - Cost Leadership
        - Objective = unit costs significantly lower than competitors
        - Company needs to
            - Have/achieve high market share
            - Have/achieve efficient resource allocation
        - Once attained, cost leadership must be maintained
        - Suitable when product is a commodity
        - Needs up front investment to build market share and efficiencies
    - Differentiation
        - Segmenting market and charging differently in different markets
        - Not worried about market share or relative costs, as product is not homogenous
        - Finding a characteristic that matters and adding it
    - Focus:
        - Identify market niches where you can avoid confrontation with competitors e.g. very fast delivery couriers
        - Within this niche, you can focus on cost or differentiation e.g. Morgan sports cars
    - Stuck in the middle
        - Company which doesn't specialise in any of the above is stuck in the middle – constantly at the whim of competitive forces

Competitive Scope and Competitive Advantage



- Companies still have to make a decision between cost and differentiation even if it has identified a narrow niche e.g. large car producers compete on cost, luxury ones on differentiation
- Switching between generic strategies has implications, which is why many acquisitions fail
- Unless value chain and generic strategy should be aligned, or else you can lose cost leadership or differentiation and become stuck in the middle

Generic strategy	Concerns and characteristics
Cost leadership	Optimum plant size
	Process engineering skills
	Simple product design
	Statistical quality control
	Quantitative incentives
	Tight resource controls
	Tight financial reporting system
	Achieving economies of scale
Differentiation	Branding
	Design
	Marketing
	Advertising
	Service
	Quality
	Creativity in R&D
Focus	Matching products with customers
	After sales service
	Dedicated work force

7.3.3 Decision Maker generic strategies

- Approach to strategy depends on characteristics of decision maker :
    - Prospector is concerned with identifying new market opportunities, less interested in internal organisation

- Analyser looks at sophisticated internal information systems and detailed investigation of options
- Defender wants to maintain current market position
- Reactor deals with circumstances as they arise

7.3.4 Generic Strategies and company performance

- What is the appropriate strategy given the circumstances of the company, the positioning of its products and past behaviour of its managers
- Three main issues:
  - Generic strategy is a means, company performance is the end
  - Long term value is not reflected in changes to short term cash flow
  - It's not scientific, hence heavily dependent on experience of the decision maker

7.4 Identifying Strategic variations

- Virtual limitless strategic options – need to reduce them down to just a few

7.4.1 Related and Unrelated options

- Related diversification seems better than unrelated
- Four reasons to diversify
  - Minimise risk – for management, not shareholders
  - Economies of scope - applying management skills in one business to another, but without knowing new business in detail difficult to say whether this will work
  - Add value through parenting function
  - Benefit from synergy
- Company producing baby food may feel they can diversify into toys, as they feel both markets are related - but that may focus on the wrong related variable (kids)
- Factors which are likely to contribute to long term returns are:
  - Reaping economies of scope across SBUs that share the same strategic asset e.g. distribution chain – but this is different between baby food and toys
  - Using a core competency in new SBU e.g. knowledge of childrens market
  - Using a core competency to create a new strategic asset quicker eg. Building up a new distribution chain for toys may be quicker, having done so for baby food
  - Company's pool of core competencies can be expanded as it learns new skills e.g. building the toy distribution may help in baby food

7.4.2 Vertical integration

- This provides similar types of problems to related and unrelated diversification

7.4.3 Acquisitions

- Most acquisitions don't produce much value, common outcomes are
    - Temporary rise in value of combined firm, then falls
    - Most returns accrue to target firms shareholders
    - Acquiring firms shareholders receive negligible returns
- Why do it then?
    - May be a strategic fit in the form of unrealised value potential because:
        - Development expenditure has been insufficiently spent
        - Marketing strategy has not produced opportunities
        - Resource management has been poor
        - Expected increase in demand
        - Weak products
    - Buying into markets
    - Reducing competitive pressures
    - Quest for synergy
    - Balancing portfolio
    - Developing core competencies

7.4.4 Alliances or Joint Ventures

- Take many forms:
    - Licensing agreements
    - Franchise agreements
    - Relational contracting
    - Relational management
    - Consortia
    - Virtual corporations
    - Virtual functions
    - Joint ventures
- No better performance than take overs, probably because no contract can foresee all eventualities and often there is reason for one side to cheat
- Chain of command often unclear

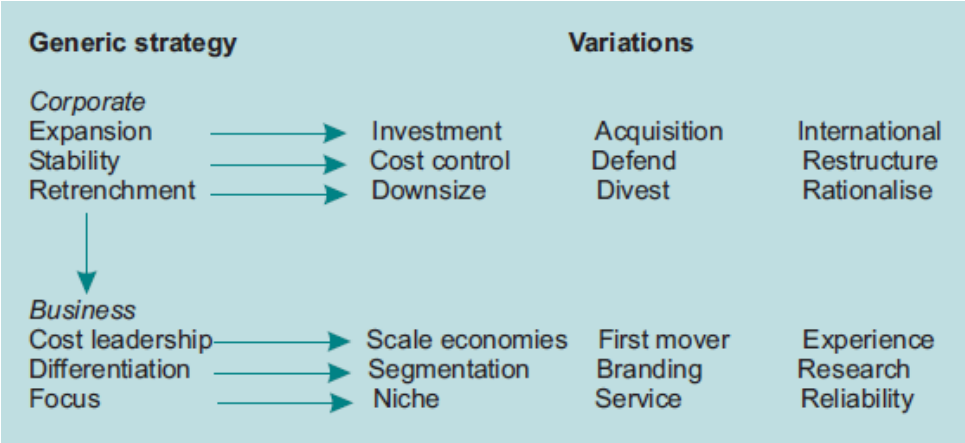
7.4.5 International Expansion

- Competitive conditions in another country may be significantly different
- Competitive advantage in one location may not be readily transferred abroad e.g. Hong Kong hotels have high worker: guest ratio, which would make then too expensive in Europe
- Its necessary to focus on what elements of competitive advantage can be transferred readily e.g. Toyota manufacturing techniques
- Several other variables which complicate operations on an international scene:
    - Volatile Exchange rates - to hedge against this potentially setup production facilities in the countries you are selling in

- Relative factor costs - especially differences in labour costs
- Productivity variations country to country –
- Governments often protect home production – may force you to setup production in specific countries
- Cultural norms can vary - can lead to industrial unrest
- Information gathering and interpretation more complicated across different countries

7.4.6 From Generics to Variations

- Selecting a generic strategy means implementation of a variation



- Corporate strategies not mutually exclusive – can follow expansion by investment and international expansion
- Corporate choices must be underpinned by business level generic strategies e.g. in retrenchment its likely that business strategy will be cost leadership and focus
- A strategy variation which contributes to long term competitive advantage is likely to
  - Consistent with objectives e.g. if objective = market dominance in national market then no international expansion
  - Suitability in terms of company resources e.g. strength in internal cost control may not be suitable for differentiation strategy
  - Feasibility: e.g. may not be possible to follow a strategy without commitment of key personnel
- Example: company wishes to pursue corporate strategy of expansion, then it has a choice of variations:

Strategic variation	For	Against
Related and unrelated	Potential for synergy	Difficult to define relatedness
Vertical integration	Direct control over supplier	Lose market discipline
Acquisitions	Potential of unrealised value	May bid away potential benefits
Joint ventures and alliances	Avoid implementation problems	Prisoner's dilemma
International expansion	Transfer competitive advantage	Exchange rate volatility

7.5 Strategy Choice

- Identification and selection of a strategy option that maximises shareholder wealth
- Shareholder wealth cannot be the only measure because:
    - Future too uncertain to be captured in cash flow NPV projection
    - Strategy is concerned with means as well as end – must be able to carry out strategy

7.5.1 Shareholder wealth

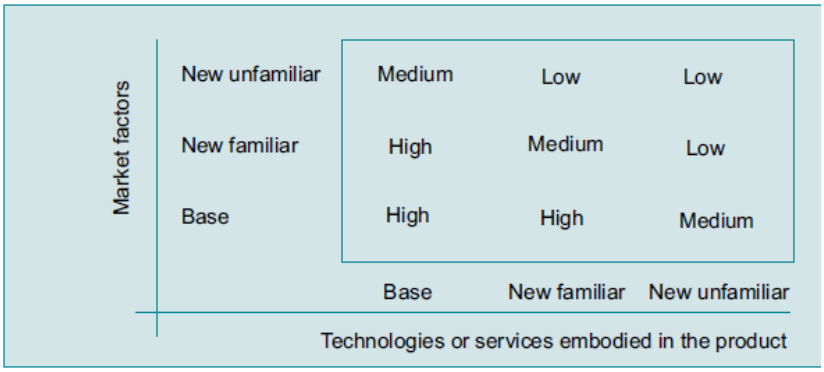
- Expansion strategies may have higher NPV over 5 years than Stability ones, but lower cash flows in early years may make it a no go
- Useful to break up shareholder value by SBU, and compare the resource allocation (costs) of each SBU and their contribution to shareholder wealth (in terms of %)

7.5.2 Performance gaps

- Gap analysis can help identify the correct strategy to follow in order to close the gap
- The extent of the gap indicates whether the company has to undertake a significant reallocation of resources to close the gap e.g. if gap in small then maybe stability is best
- The ways of closing the gap can be identified e.g. focusing on internal or external factors like marketing or cost control

7.5.3 Corporate management

- Familiarity matrix allows you to rank products in a portfolio in terms of unfamiliar markets and/or technologies



7.5.4 SBU Management

- Strategy choice at SBU level is concerned with exploitation of products and markets, and ensuring resources are allocated effectively
- Project Appraisal form is useful to define explicitly the impact of a particular product

Year		1	2	3	4	5	6	7
Development	($m)	8	8					
Total market	(000)	100	120	150	200	250	250	100
Market share	(%)			13	15	15	15	15
Price	($)			1 395	1 200	1 200	1 395	1 395
Unit cost	($)			692	630	610	600	600
Contribution	($m)			14	17	22	30	12
Cumulative cash flow	($m)	−8	−16	−2	15	37	67	79
Net present value	($m)	34		Cost of capital		15%		

- You can have different scenarios, e.g. making the product into cash cow by increasing market share from 15% to 20% by reducing price

7.5.5. Risk and Uncertainty analysis

- First step is to ascertain what information is available about likelihood of future events
- You can attach subjective probabilities to arrange of outcomes

Outcome	Probability	Expected value
−100	0.1	−10
50	0.2	10
200	0.7	140
Average		Expected value
50		140

- Contingency planning is ensuring that the strategy is capable of responding to a wide range of scenarios , two types:
    - Process of attempting to minimise loss due to risk
    - Strategic response to major unpredictable events

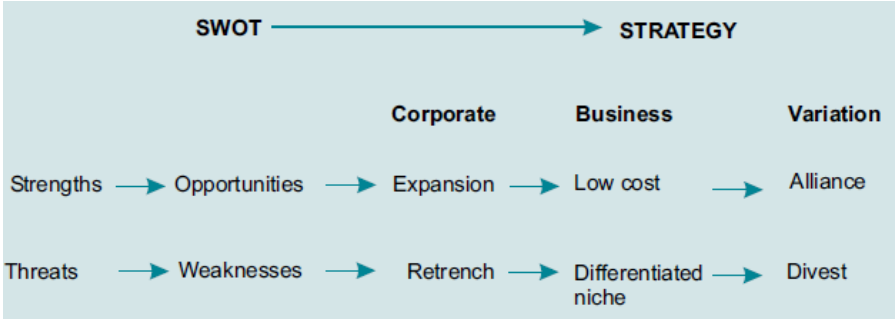
7.5.6 Managerial perceptions:

- Factors which effect decision makers
    - External Dependence on supplier, customer or shareholder
    - Attitude to Risk – some may chose whichever has the lowest potential loss, conservative is often confused with being risk averse
    - Previous strategies – just because they worked previously doesn't mean they will continue doing so
    - Managerial power relationships e.g. very egotistical CEO
    - Consensus decisions – paradox of voting – A better than B better than C better than A
    - Are decisions rational – emotions cloud judgement

7.5.7 From SWOT to Generics

- Step 1 – identify appropriate entries for each box in SWOT
- Step 2 – make judgements of their relative importance based on ETOP and SAP
- Step 3 – align strengths with opportunities, and weaknesses with threats

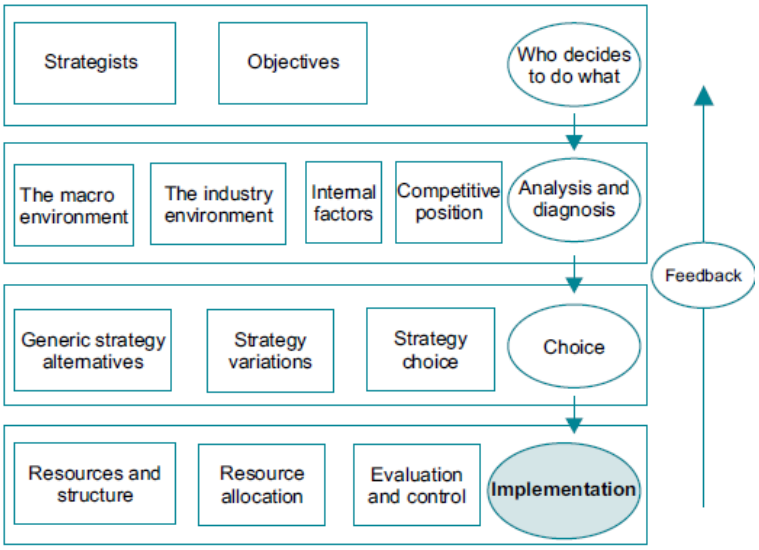
- What happens if Strengths/Opp shows expansion whereas Weaknesses/Threats shows retrench?



- Is there some way of operating on the weakness so the need to retrench is avoided while leaving the way for expansion to happen?

Module 8 - Implementing and Evaluating Strategy

- Choosing a strategy is not an end in itself – you need a mechanism to make it happen



8.2 Organisational Structure

- The main types of company structure are:
  - Functional (U form) - e.g. marketing, R&D
  - Divisional (M form) – SBUs by product type or geography, each with own functional structure
  - Holding company – parent plays less direct role in determination of strategy than divisional, may still have financial controls over divisions and decides on JVs & acquisitions
  - Matrix – for when economies of scope mean it makes sense to organise across more than one dimension – this may lead problems of direction and control
  - Networks – organised by function, geography or customer base. Direction and control issues

Functional structure	
Advantages	**Disadvantages**
Specialisation	Coordination among functions
Division of labour	Concentration on functional rather than
Simplifies training	company objectives
Preserves strategic control	Coordination among departments
	Lack of broadly trained managers
Divisional structure	
Advantages	**Disadvantages**
Divisional performance can be expressed	Coordination among specialised areas
in terms of profit	Communication between functional specialists
Coordination among functions	Duplication of functional services
Develops broadly trained managers	Loss of strategic control to divisional managers
Holding structure	
Advantages	**Disadvantages**
Risk spreading	Probable lack of synergy
Financial strength for new market entry	Game theory problems
	Game theory problems
Matrix structure	
Advantages	**Disadvantages**
Flexibility and adaptability	Slow decision making – general agreement
Less bureaucratic	required
Close coordination	Specific responsibility often unclear
	Highly dependent on effective teams

- Must consider
    - which structure will contribute to value creation e.g. does having a corporate centre just increase cost
    - which structure will be able to handle change
- Selecting appropriate structure means balancing
    - Scale and scope economics
    - Transaction costs
    - Agency costs
    - Information flows
- When trying to decide if a new production facility in France should be setup (Divisional) or just leverage an existing one in Ireland (Functional), need to consider the pros and cons on primary and secondary value chain activities:

Value chain	Functional	Divisional	Advantage
Primary activity			
In bound logistics	Requires central warehouse plus distribution	Possible to operate JIT	+
Operations	Two different production processes on site	Dedicated production lines	+
Out bound logistics	Orders shipped from England to France	Production near customers	+
Marketing	One department dealing with different markets	Dedicated marketing teams	+
Service	Service teams spend a long time travelling	Service teams know the language and are near customers	+
Support activity			
Procurement	Economies of scale in purchasing	Direct access to French suppliers	+
Technology	Product specifications can be kept in step	Products may diverge	–
Human resource management	No cultural problems	Require dedicated HRM team for French employees	–
Management systems	Single integrated management process	Management teams focused on different markets	+

- Divisional is better for primary activities

8.3 Resource Allocation

- Resource allocation must be in line with strategic thrust e.g. expansion cannot occur in budget reductions
- Often good to focus on value chain when comparing strategic objectives with resource allocation e.g. sales drive means more salespeople means HR needs resources

8.3.1 Management of Change

- Reallocation of resources means changing what people do
- In times of change corporate culture should reward adaptability, innovation and flexibility
- Change must be implemented in the context of the company's culture, which can be
    - Power – unpredictable e.g. change here may not take into account principal/agent problem
    - Role – resistant
    - Task – change is norm
    - Personal - unpredictable
- Incentives can help change, but must be aligned with company and individual objectives e,g. stock manager is incentivised to keep stock low but this hits sales
- Incentives must be based on targets that are consistent and achievable

8.3.2 Critical Success Factors

- Must identify the success factors that will key to implementing the strategy e.g. purchase of a capital asset or implementing a incentive structure

- To do this:
    - Detailed understanding of available resources
    - Resources which will be required
    - Sequence of events
    - How individuals will respond to change required
- Example, success factors in changing Star to cash cow or question mark to star:

Factor	Star to Cash Cow	Question Mark to Star
Capacity	Eliminate excess capacity	Maintain excess capacity
Marketing	Be prepared to reduce as market matures	Maintain at high level
R&D	Reduce	Maintain at high level
Price	Set to competitive level	Set lower than competitors

8.3.3 Management Style

- Management skills within company may not match requirements for strategic change e.g. cash cow SBU manager different from one require to manage a star
- Leadership style may have to change e.g. Porche family

8.3.4 Budgets

- Two approaches to corporate resource allocation:
    - Use competitive bidding: capital is allocated to groups (each of which have their own SBUs) based on a ratio of total requested by them and then the group (not corporate) manager allocates to SBUs based on value created
    - Corporate allocates directly to SBU using ratio of value added

8.4 Evaluation and Control

- Different approaches to controlling planning outcomes:
    - Rely on financial indicators
    - Others take into account a wider range of measures to reflect competitive positioning e.g. market share
- Four types of companies:
    - Loose control – high degree of planning, but flexible approach to control
    - Financial control – low planning, and concentrate on financial measurements
    - Planning control – high planning, reliance on financials and no subjective measurements
    - Strategic control – balanced measures
- Following steps are required:
    - Select relatively few appropriate objectives
    - From these derive suitable targets
    - Identify a series of milestones over time

- Some objectives cannot be measured with accuracy, hence ongoing subjective evaluation is necessary

8.5 Feedback

- Not sufficient to scan the environment and monitor company performance, must be able to act
- Communication channels – JIT information to the right people must be passed up and down the org
- Ability to adapt – must be able to change quickly , culture may be a barrier
- Learning organisation – can org learn from and build on experience

8.6 The Augmented Process Model

- Key to implementing strategy is knowing at all times the company's competitive position
- This is obtained by integrating models into the strategic process model

Who Decides To Do What	Analysis And Diagnoses	Analysis And Diagnoses (cont'd)	Choice	Implementation
Objectives	*The general environment*	*Internal factors*	*Generic strategy alternatives*	*Resources and structure*
Business definition	Macroeconomic analysis:	Value chain	Corporate and business strategy	Divisional, functional, matrix
Mission	unemployment, inflation,	Shareholder value analysis	Stability, expansion,	Managerial style
Shareholder wealth	interest rate, exchange rate	Competence	retrenchment	Critical success factors
Gap analysis	Forecasting	Architecture	Combination	Incentives
Means and ends	Competitive advantage of	Experience curve	Cost leadership	
Ethics	nations	Economies of scale	Differentiation	*Resource allocation*
Profit maximisation	Environmental scanning	Innovation	Focus	Opportunity cost
Growth vector	PEST	Economies of scope	Segmentation	Marginal analysis
Stakeholder map	Scenarios	Synergy		Optimisation
Credible, quantifiable, disag-		Joint production	*Strategy variations*	Budgets
gregated, economic, financial	*The industry and international*	Opportunity cost	Diversification: related and	Critical success factors
	environment	Marginal analysis	unrelated	
Strategists	Demand and supply, price	Ratios	Vertical integration	*Evaluation and control*
Principal agent	determination, elasticity	Gearing	Mergers and acquisitions	Performance measures
Prospector, analyser, defender,	Barriers to entry	Cash flow	Joint ventures and alliances	Ratios
reactor	Forms of competition: perfect,	Benchmarking	Pricing: leadership, limit,	Degree of Planning and type of
Risk aversion	imperfect, oligopoly, monopoly	Human resource management	predatory	Control
Team composition	Segmentation	Culture: power, role, task,		Monitoring systems
Group dynamics	Differentiation	personal	*Strategy choice*	
	Quality		Risk analysis	
	Strategic groups	*Competitive position*	Managerial perceptions	
		Product life cycle	Net present value	
		Market share	Familiarity	
		Portfolio analysis	Scenarios	
		Perceived differentiation	Break even	
		Strategic groups	Payback	
		Competitive reaction	Sensitivity	
		First mover	SWOT	
		Five forces	Game theory	
		Elements of competitive advantage		
		ETOPS		
		Strategic advantage profile		

Feedback
Communication
Management style
Adaptability
Learning organisation

- Who does what?
  - Original objectives set on the basis of a vision of company's future – how it might grow and application of gap analysis
  - Influenced by principal agent issue
- Analyses and Diagnoses
  - Should be a continuous process
- Choice
  - Is choice being pursued as originally intended and is choice still appropriate
  - Alignment of strategy with subsequent events is key
- Implementation and feedback

- Are company’s structure and resource allocation consistent with strategy