THIRTEENTH EDITION

EXPLORING STRATEGY

Richard Whittington • Duncan Angwin • Patrick Regnér
Gerry Johnson • Kevan Scholes

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Welcome to *Exploring Strategy*

Strategy is a crucial subject. It's about the development, success and failure of all kinds of organisations, from multinationals to entrepreneurial start-ups, from charities to government agencies, and many more. Strategy raises the big questions about these organisations – how they grow, how they innovate and how they change. As a manager or an entrepreneur, you will be involved in shaping, implementing or communicating these strategies.

Our primary aim with *Exploring Strategy* is to give you a comprehensive understanding of the issues and techniques of strategy. We can also help you get a great final result in your course. You can make the most of the text by:

- Exploring hot topics in cutting-edge issues such as business models, indigenous leadership theory, platform strategy, entrepreneurship and strategy practice.
- Drawing on our new 'Working with Strategy' chapter providing practical advice about how to think strategically and carry out case analyses and strategy assignments.
- Engaging with our 'Thinking Differently' sections to access novel and distinctive perspectives on core

themes in strategy.

- Using the ‘Strategy Lenses’ to think critically and originally about key topics and to set you on your way to better grades in your assignments and exams.
- Pursuing some of the recommended readings at the end of each chapter. They’re specially selected as accessible and valuable sources that will enhance your learning and give you an extra edge in your course work.

We want *Exploring Strategy* to give you what you need: a comprehensive view of the subject, an ambition to put that into practice, and – of course – success in your studies. We hope that you’ll be as excited by the key issues of strategy as we are!

So, read on and good luck!

Richard Whittington Duncan Angwin Patrick Regnér Gerry Johnson Kevan Scholes **Richard Whittington MA, MBA, PhD** is Professor of Strategic Management at the Saïd Business School and Millman Fellow at New College, University of Oxford. He is author of eleven books, including *Opening Strategy: Professional Strategists and Practice Change, 1960 to Today* (2019), and has previously been Associate Editor of the *Strategic Management Journal*. He has had full or visiting positions at the Harvard Business School, HEC Paris, Imperial College London, the University of Toulouse and the University of Warwick. He is active in executive education and consulting internationally.

Duncan Angwin, MA, MPhil, MBA, PhD is the Dean of Nottingham University Business School. He has authored twelve books, over fifty refereed articles in journals such as *Academy of Management Learning & Education, Administrative Science Quarterly (ASQ), California Management Review, MIT Sloan Management Review,* and *Organization Studies* and has served on many editorial boards including *Journal of Management Studies.* He teaches strategy to executives internationally. He has won in excess of €10mn in research grants and currently focuses on international M&A and strategy practices. Duncan is also an elected council member of the Chartered Association of Business Schools (CABS).

Patrick Regnér, BSc, MSc, PhD is Professor of Strategic Management at Stockholm School of Economics. He has published in leading journals like *Strategic Management*

Journal, Journal of International Business, Human Relations, etc. and serves on several editorial boards including *Academy of Management Review*, *Journal of Management Studies* and *Long Range Planning*. He has extensive teaching experience on all academic levels at several international institutions. He does executive teaching, consulting and coaching with managers and organisations active worldwide and is senior advisor at strategy advisory firm Value Formation. His current research focuses on strategy creation and business models.

Gerry Johnson, BA, PhD is Emeritus Professor of Strategic Management at Lancaster University School of Management. He has also taught at Strathclyde Business School, Cranfield School of Management, Manchester Business School and Aston University. He is the author of numerous books and his research has been published in many of the foremost management research journals in the world. He also works with senior management teams on issues of strategy development and strategic change.

Kevan Scholes MA, PhD, DMS, CIMgt, FRSA is Principal Partner of Scholes Associates – specialising in strategic management. He is also Emiritus Professor of Strategic Management and formerly Director of the Sheffield Business School, UK. He has extensive experience of teaching strategy to undergraduate and postgraduate students inside and outside the UK, as well as of management development work in private and public sector organisations. He has been an advisor on management development to a number of national bodies and is a Companion of The Chartered Management Institute.

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Richard Whittington
Saïd Business School, University of Oxford
Duncan Angwin
Nottingham University Business School
Patrick Regnér
Stockholm School of Economics
Gerry Johnson
Lancaster University Management School
Kevan Scholes
Sheffield Business School
With the assistance of
Jason Evans
Clive Kerridge

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United Kingdom

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Cross-cutting themes

Three important contemporary themes cut across the individual chapters of Exploring Strategy: non-profits, sustainability and digital transformation. They are introduced and defined in Chapter 1.3.4. Meanwhile, we summarise relevant materials as they appear in the chapters (see also the main index).

Preface

We are delighted to offer this thirteenth edition of *Exploring Strategy.* With sales of previous editions now approaching one and a half million worldwide, and a ranking by the *Financial Times* (31 May 2021) as the most influential strategy textbook worldwide, we believe we have a tried and tested product. Yet the strategy field is constantly changing. For this edition, therefore, we have thoroughly refreshed all chapters, with new concepts, new cases and new examples throughout. Here we would like to highlight three principal changes, while recalling some of the classic features of the book.

As well as more detailed changes, the thirteenth edition has the following principal changes:

- **a strong focus on non-profits, sustainability and digital transformation:** this book features *three cross-cutting themes* reflecting contemporary strategic conditions and issues that are increasingly important and attractive to students
- **practical guidance on working with strategy**: a new Chapter 2 introduces students to the fundamental tools of strategic thinking, explains the use of frameworks in strategy and guides students in case study analysis and presentations
- **an appreciation of 'non-Western' approaches to strategic issues**: we introduce readers to concepts and approaches that come from outside the mainstream of strategic thinking, for

example Jugaard innovation, the ubuntu view on stakeholders, hoshin kanri and indigenous leadership theories.

At the same time, *Exploring Strategy* retains its longstanding commitment to a comprehensive and real-world view of strategy. In particular, this entails a deep concern for:

- **Process:** we believe that the human processes of strategy, not only the economics of particular strategies, are central to achieving long-term organisational success. Throughout the book, we underline the importance of human processes, but in particular we devote Part III to processes of strategy formation, implementation and change.
- **Practice:** we conclude the book with a chapter on the Practice of Strategy (Chapter 17), focused on the practicalities of managing strategy. Throughout the book, we introduce concepts and techniques through practical illustrations and applications, rather than abstract descriptions.

Many people have helped us with the development of this new edition. Jason Evans and Clive Kerridge have led in coordinating the case collection. We have consulted carefully with reviewers and our Advisory Board, made up of experienced lecturers, many of whom are adopters of the book. Many other adopters of the book provide more informal advice and suggestions – many of whom we have had the pleasure of meeting at our annual teachers' workshops. This kind of feedback is invaluable and we hope you will keep the comments flowing. Also, our students and clients at Nottingham University, Oxford University, Stockholm School of Economics, Sheffield Hallam and the many other places where we teach are a constant source of

ideas and stimulus. We also gain from our links across the world, particularly in Austria, Ireland, the Netherlands, Denmark, Sweden, France, Canada, China, Australia, New Zealand, Hong Kong, Malaysia, Morocco, Singapore and the USA. Many contribute directly by providing case studies and illustrations and these are acknowledged in the text.

Finally, we thank those organisations that have been generous enough to be written up as case studies. We hope that those using the book will respect the wishes of the case study organisations and *not* contact them directly for further information.

Richard Whittington (richard.whittington@sbs.ox.ac.uk) *Duncan Angwin* (Duncan.Angwin@nottingham.ac.uk) *Patrick Regnér* (patrick.regner@hhs.se) *Gerry Johnson* (gerry.johnson@lancaster.ac.uk) *Kevan Scholes* (KScholes@scholes.u-net.com) April, 2022

Reviewers

We would like to thank the following academics who reviewed for this edition of *Exploring Strategy* or the first release of *Exploring Strategy Revel*:

Exploring Strategy features

This thirteenth edition of *Exploring Strategy* builds on the established strengths of this best-selling textbook. A range of in-text features and supplementary features have been developed to enable you and your students to gain maximum added value from the teaching and learning of strategy.

- **Outstanding pedagogical features.** Each chapter has clear learning outcomes, practical questions associated with real-life illustrations and examples that students can easily apply to what they have learnt.
- **Flexibility of use.** You can choose to use either the Text and Cases version of the book, or – if you don't use longer cases (or have your own) – the Text-only version.

The two versions are complemented by a concise version of the text, *Fundamentals of Strategy,* and instructors also have the option of further customising the text. Speak to your local Pearson Sales Representative if you would like to explore customisation options.

- **Up-to-date materials.** We have fully revised all chapters, incorporating new research and updating references so that you can easily access the latest research.
- **Encouraging innovative and critical thinking.** The Strategy Lenses and commentaries are designed to encourage critical thinking, while each chapter ends with a 'Thinking Differently'

section, introducing students to new and distinctive approaches to key issues of the chapter.

- **Our ‘three circles’ framework** – depicting the overlapping issues of strategic position, strategic choices and strategy-in-action – also challenges a simple linear, sequential view of the strategy process.
- **Case and examples.** A wide range of Illustrations, Case Examples and (in the Text and Cases version) longer Case Studies are fresh and engage with student interests and day-to-day experience. Many of these are entirely new to this edition; others have been extensively revised. We draw these examples from all over the world and use examples from the public and voluntary sectors as well as the private.
- **Teaching and learning support.** You and your students can access a wealth of resources detailed in the Exploring Strategy Online section that follows this.
- **Teachers’ workshop.** We run an annual workshop to facilitate discussion of key challenges and solutions in the teaching of strategic management.

Exploring Strategy Online

A wide range of supporting resources are available at: www.pearsoned.co.uk/exploringstrategy.

Resources for students

- **Key concept audio and Video summaries** that you can download or listen to online
- **Classic cases** – from previous editions of the book.

Resources for instructors

- **Instructor's manual** which provides a comprehensive set of teaching support, including guidance on the use of case studies and assignments, and advice on how to plan a programme using the text
- **PowerPoint slides** containing key information and figures from the book
- **Classic cases** from previous editions of the book.

Digital Courseware

Revel is an interactive learning environment designed for how you want to teach – and how your students want to learn. Cleverly combining reading material with interactive videos, quizzes and writing activities, it enriches the learning experience and boosts student performance.

We have launched *Exploring Strategy* in Revel, which offers interactive media, including videos and writing activities, within the narrative content to reinforce key concepts and encourage exploration and application of a complex and diverse subject area. It caters to today's modern strategy students, who need a hands-on, applied and current exploration to the subject.

Unlike any existing resource, Revel for Strategy allows lecturers to bring strategy to life and drive engagement across large classes, increasing students' understanding of the key concepts, encouraging them to reflect on their actions, build confidence, and helping them to evaluate the impact of their decisions.

MyStrategyExperience is an engaging and rigorous simulation designed to bring together the theory and practice of strategy making in the realistic environment of a dynamic organisation and industry. The simulation puts students on the board of directors in a global advertising agency and allows them to make a strategic analysis of the business, put together a business plan and then make a number of challenging decisions on the future strategy of the company.

As students set and implement strategy, they will see the impact of their decisions on financial and non-financial measures of performance within the simulated company. Your students will need to balance strategic opportunities with inherent risk, thus gaining knowledge and insights relevant to their strategic studies.

The simulation draws on the content of *Exploring Strategy* and the two can be used to complement each other on a strategy course.

For more information about Revel or MyStrategyExperience, contact your local Pearson Sales Representative or visit **https://www.pearson.com/uk/educators/higher-education-educators/products-and-services/course-resources-and-content.html**.

Chapter 1

Introducing strategy

Key terms

business-level strategy

corporate-level strategy

digital transformation

exploring strategy framework

functional-level strategy

mission statement

non-profit organisations

purpose

strategy definition

strategy statements

sustainable development

three-horizons framework

vision statement

Learning outcomes

After reading this chapter, you should be able to:

- Recognise *the purpose* of an organisation.
- Summarise the strategy of an organisation in a *'strategy statement'.*

- Distinguish between *corporate, business* and *functional* strategies.
- Identify key issues for an organisation's strategy using the *Exploring Strategy* Framework.
- Understand different people's roles in *strategy work.*
- Appreciate the importance of different *organisational contexts, academic disciplines* and *theoretical lenses* to practical strategy analysis.

1.1 Introduction

The Chief Executive Officer (CEO) of a medium-sized manufacturing business knew they had problems. Home-market demand was falling for their products just as new aggressive competitors were introducing highly innovative ones of their own. The company was also facing interruptions in its overseas supply chain. The CEO wondered what to do: find new international markets for growth; invest more in product innovation to match competitors; use more local suppliers. A consulting company was hired to provide strategy advice and Claudia, a junior in the consulting team, knew she would have to carry out a systematic strategic analysis to understand the company's business model, assess the challenges posed by competition and shifting market demand, and identify broader opportunities and threats from the wider environment. She would need to base her recommendations on data and analysis. Claudia would also have to propose an implementation plan for the strategy.

The problems presented by the CEO to the consultants are ones of strategy. Strategy is concerned with key issues for the future of the organisation. For instance, how should the company compete in the future with aggressive new entrants? What growth options are there for the company? If internationalisation is a good strategy, what would be the optimal method to achieve this and what might be the resourcing implications? All of these strategy questions are vital to the future survival of the organisation.

Strategy questions naturally concern entrepreneurs and senior managers at the top of their organisations. But these questions

matter more widely. Outside of the organisation, stakeholders such as investors, including shareholders and banks, influence the strategy. Inside the organisation, middle managers also have to understand the strategic direction, both to know how to get top management support for their initiatives and to explain it to the people they are responsible for. Anybody looking for a management-track job needs to be ready to discuss strategy with their potential employer. Indeed, anybody taking a job should first be confident that their new employer's strategy is actually viable. There are even specialist career opportunities in strategy, for example like Claudia, as a strategy consultant or as an in-house strategic planner, often key roles for fast-track young managers.

This book is relevant to any kind of organisation responsible for its own direction into the future. Thus, the book refers to large private-sector multinationals and small entrepreneurial start-ups; to family businesses, both large and small; to public-sector organisations such as schools and hospitals; and to non-profits such as charities or sports clubs. Strategy matters to almost all organisations, and to everybody working in them.

In this chapter you will begin with examining the main definitions of strategy, build your understanding of strategy's purpose, be introduced to the *Exploring Strategy* Framework for analysing an organisation's strategy and increase your awareness of working with strategy in different contexts (see Figure 1.1). But first, why is the book entitled *Exploring Strategy*?

1.1.1 Why 'Exploring Strategy'?

There are a large number of strategy textbooks available on the market so it is important to realise why readers choose *Exploring Strategy.* As strategists, we believe that one of strat-egy's distinctive features is that it draws upon many other perspectives, including economics, finance, marketing, operational management, organisational behaviour and psychology, to name a few. However, many strategy textbooks adopt a single disciplinary focus, such as an economics perspective, that ignores these other critical issues. Others focus much more on the behavioural side of strategy and largely overlook the importance of finance and economics. *Exploring Strategy* is distinctive in emphasising a comprehensive view of strategy, and this will enable you to explore the insights of many disciplinary perspectives including both the economics of strategy and the people side of managing strategy in practice.

Figure 1.1 Strategy: its definition, purpose, analysis and work

Figure 1.1: Long Description

A further reason for the word ‘Exploring’ in the title is rooted in the practical world of strategy work. Our focus on the practicalities of strategy reveals that there are rarely obvious answers. Indeed, many strategy problems are highly complex and managers should beware of over-simplified ‘solutions’. Therefore, in strategy, it is important both to recognise the real scope of problems and to explore several options. Through exploration you will widen your awareness of practical issues relevant to strategy, recognise how many issues interconnect, and be able to probe each option carefully before making informed choices. We therefore believe that the major strengths of *Exploring Strategy* – its comprehensiveness and focus upon practice – will help reduce your risk of myopia to enable you to produce well-informed, grounded solutions to complex strategic problems.

We also believe that ‘Exploring’ in the title is appropriate as this is a research-led book, drawing upon world-class research and including the latest thinking on key strategic topics. These feature throughout *Exploring Strategy* and particularly pioneering work is found in the ‘Thinking Differently’ sections at the ends of chapters. The ‘Strategy Lens’ sections at the end of the main parts of the book also introduce novel and distinctive themes. These will ensure that you are at the cutting edge of strategy.

Exploring Strategy also explores a wide range of organisational and geographic contexts. Through a diverse and substantial selection of illustrations and case studies, we include large multinationals as well as medium-sized and entrepreneurial start-up

firms. We give weight not only to ‘for-profit’ companies but also family businesses that may also be social, public-sector and other non-profit organisations. We examine these not only in developed economies but also in a wide range of emerging markets. This broad base of organisations and contexts will give you a wider knowledge base than is common in other strategy texts.

1.2 What is strategy?[1]

The term strategy has been traced back to sixth century BC Greece and combined the words *stratos (*army spread out over the ground), and *agein* (to lead).[2] To this practical consideration of managing and directing a large complex force, the importance of strategy was highlighted by the Chinese military philosopher Sun Tzu, who defined strategy as 'the great work of the organization. In situations of life or death, it is the Tao (path) of survival or extinction'. Since that time, there have been many new definitions of the word strategy, particularly by the military but, in the 1960s, Alfred Chandler, strategy's founding theorist, brought strategy formally into a business context.[3] Subsequent definitions of strategy have continued to refine our understanding of the term and several prominent ones are examined below.

1.2.1 Defining strategy

Figure 1.2 shows the strategy definitions of several leading strategy theorists: Alfred Chandler and Michael Porter, both from the Harvard Business School, Peter Drucker from Claremont University, California, Henry Mintzberg, from McGill University, Canada, and Richard Rumelt from the University of California. Each points to important elements of strategy. Chandler emphasises a logical flow from the determination of goals and objectives to the allocation of resources. Porter focuses on deliberate choices, difference and competition. Rumelt argues for coherence in policies and action to

address high-stakes challenges. Drucker suggests that it is a theory about how a firm will win.[4] A critical perspective on strategy is by Henry Mintzberg, who takes the view that strategy is less certain than assumed in the definitions above. He uses the word 'pattern' to allow for the fact that strategies do not always follow a deliberately chosen and logical plan, but can emerge in more ad hoc ways. Sometimes, strategies reflect a series of incremental decisions that only cohere into a recognisable pattern – or 'strategy' – after some time.

Figure 1.2 Definitions of strategy

Sources: A.D. Chandler, *Strategy and Structure: Chapters in the History of American Enterprise*, MIT Press, 1963, p. 13; M.E. Porter, 'What is strategy?', *Harvard Business Review*, November–December 1996, p. 60; P.F. Drucker, 'The theory of business', *Harvard Business Review*, September–October 1994, pp. 95–106; H. Mintzberg, *Tracking Strategies: Towards a General Theory*, Oxford University Press, 2007, p. 3.

Figure 1.2: Long Description

Our fundamental definition of strategy is: **strategy is the long-term direction of an organisation**. We shall add to this definition later in the chapter, but already this implies a more comprehensive view than some of those definitions above. Thus, for example, the long-term direction of Amazon is from book retailing to retailing more generally. For Disney, it is from cartoons to diversified entertainment. Our fundamental definition has advantages. First, the long-term direction of an organisation can include both deliberate, logical strategy and more incremental, emergent patterns of strategy. Second, long-term direction can include both strategies that emphasise difference and competition, and strategies that recognise the roles of cooperation and even imitation.

The three elements of this strategy definition – the long term, direction and organisation – can each be explored further. The strategy of Tesla Motors illustrates important points (see Illustration 1.1):

Figure 1.3 Three horizons for strategy

Source: Adapted from M. Baghai, S. Coley and D. White, *The Alchemy of Growth*, Texere Publishers, 2000. Figure 1.1, p. 5.

Figure 1.3: Long Description

Illustration 1.1 Tesla Motors: the future is electric!

Are there enough Teslas in the world?

Source: Jim West/Alamy Stock Photo

Launched in 2008, the Tesla Roadster's staggering acceleration (Model S 0–60 mph in 2.1 seconds), shattered forever the image of electric cars as slow golf buggies or geriatric transport. By 2022, Tesla Motors was worth more than $1trn, more valuable than the world's nine next largest car companies. Its charismatic chairman, visionary and main funder is PayPal cofounder, and SpaceX CEO, Elon Musk.

Tesla was originally the brainchild of three Silicon Valley engineers worried by global warming. Lithium-ion battery improvements meant Tesla could build a high-performance sports car with lower prices than competitors and with zero emissions. They recognised the opportunities raised by continuing advances in battery performance. Tesla provides zero emission electric power generation from its 'giga' battery factory and Tesla Energy now sells batteries for homes and business and aims to offer an energy system for the world. The company's mission is: 'The company aims to speed up the world's transition to sustainable energy sources by making electric vehicles and other energy products more affordable'.

Tesla's strategy has been to succeed in the high end of the market, where customers will pay a premium for innovative sports cars, and then go down market with higher volume and lower price models. All free cash flow is ploughed back into R&D to drive down costs and bring follow-on products to market as fast as possible. Customers buying the Roadster and Model S were actually paying for the development of cheaper cars: first the Model 3, a slower, low-cost family car launched in 2019, and then the Model Y mid-sized SUV launched in 2020.

New product introduction and scaling up have caused problems. Tesla accounted for 24 out of the 31 investigations by US safety regulators into advanced driver-assistance systems in 2016–2022. In 2020, the influential JD Power survey of new car owners recorded the most complaints for Tesla of all brands in the USA. The final production of the Model 3 had come three years late. Elon Musk talked of 'production hell', with cars coming off the production line requiring extensive additional work (at one point, Tesla was producing cars without seats and asking dealers to bolt them on in the showrooms).

Elon Musk is highly outspoken, sometimes causing outrage on Twitter and famously dismissing financial analysts in a formal meeting for their ‘boring bonehead questions’. His groundless claims about taking the company private led financial regulators to charge him with securities fraud, forcing him to step down as Chairman for three years.

Competition looms from established competitors such as BMW, Volkswagen, Hyundai, Toyota and Nissan. These companies are pouring billions into hybrid and fully electric cars and have well-established manufacturing and supply-chain capabilities for large-scale production (Toyota’s 2021 production volume was more than eight times that of Tesla). Some manufacturers, such as Volvo (owned by China’s Geely), are aiming to cease petrol and diesel car production entirely in the next 10 years. New electric vehicle competitors are also springing up such as the Chinese Nio, which has lower-priced cars due to clever battery-switching technology, and American Formula E battery designer and manufacturer, Lucid, which now produces a car that outperforms Tesla on range and has better recharging systems. Toyota is among companies investing in hydrogen fuel cell cars which have a much longer range and much quicker charging times than electric cars.

Nonetheless, Tesla’s new overseas factories in Germany and China plus the cheaper Model 3 and Model Y cars drove 2021 sales to 936,000 units, up 71 per cent on the previous year. The company produced a record profit of $5.5bn and Tesla was forecasting a further 50 per cent growth in sales for 2022. With a mission to save the planet, maybe Elon Musk’s outspokenness is not so inappropriate.

Sources: (1) D. Baer, ‘The making of Tesla’, *Business Insider,* 11 November 2014; (2) Sainato, ‘How do they expect to run without us’, theguardian.com, 30 January 2019; (3) ‘Tesla expects 50% growth despite supply chain woes, BBC News Business, 27.01.22; (4) R. Water and P. Campbell, ‘Tesla: Reality begins to collide with the Elon Musk’s vision’, *Financial Times,* 15 June 2018.

Questions

1 How does Tesla Motor's strategy fit with the various strategy definitions in Figure 1.2?

2 What seems to account both for Tesla's success and for its 2021-22 difficulties?

- *The long term.* Strategies are typically measured over years, for some organisations a decade or more. The importance of a long-term perspective on strategy is emphasised by the 'three horizons' framework shown in Figure 1.3. **The three-horizons framework suggests organisations should think of their businesses or activities in terms of different 'horizons', defined by time.** *Horizon 1* businesses are basically the current core activities. In the case of Tesla Motors, Horizon 1 includes the original Tesla Roadster car and subsequent models. Horizon 1 businesses need defending and extending but the expectation is that, in the long term, they risk becoming flat or declining in terms of profits (or whatever else the organisation values). *Horizon 2* businesses are emerging activities that should provide new sources of profit. For Tesla, that might include the new mega-battery business. Finally, there are *Horizon 3* possibilities, which are more open and for which outcomes are even more uncertain. These are typically risky research and development projects, start-up ventures, test-market pilots or similar: at Tesla, these might be further solar electric initiatives, and maybe other types of transportation. For a fast-moving organisation like Tesla, *Horizon 3* might generate profits a few years from the present time. In a pharmaceutical company, where the R&D and regulatory processes for a new drug take

many years, *Horizon 3* might be a decade ahead. While timescales might differ, as industries and types of firm can move at different rates, the basic point about the 'three horizons' framework is that managers need to avoid focusing on the short-term issues of their existing activities. Strategy involves pushing out Horizon 1 as far as possible, at the same time as looking to Horizons 2 and 3.

- *Strategic direction.* Over the years, strategies follow some kind of long-term direction or trajectory. The strategic direction of Tesla Motors is from the disruptive competitive business model of the electric car to a diversified set of solar power offerings. Sometimes, a strategic direction only emerges as a coherent pattern over time. Typically, however, managers and entrepreneurs try to set the direction of their strategy according to long-term *objectives.* In private-sector businesses, the objective guiding strategic direction is usually maximising profits for shareholders. However, profits do not always set strategic direction. First, public-sector and charity organisations may set their strategic direction according to other objectives: for example, a sports club's objective may be to move up from one league to a higher one. Second, even in the private sector profit is not always the sole criterion for strategy. Thus, family businesses may sometimes sacrifice profits for family objectives, for example passing down the management of the business to the next generation. The objectives behind strategic direction always need close scrutiny.
- *Organisation.* In this book, organisations are not treated as discrete, unified entities. Organisations involve many

relationships, both internally and externally. This is because organisations typically have many internal and external *stakeholders,* in other words people and groups that depend on the organisation and upon which the organisation itself depends (see Chapter 6). Internally, organisations are filled with people, typically with diverse, competing and more or less reasonable views of what should be done. For instance, the original co-founder and CEO of Tesla, Eberhard, was fired by new Chairman Elon Musk and their public disagreement has continued for 15 years. In strategy, therefore, it is always important to look *inside* organisations and to consider the people involved and their different views. Externally, organisations are surrounded by important relationships, for example with suppliers, customers, alliance partners, regulators and investors.

Because strategy typically involves managing people, relationships and resources, the subject is sometimes called 'strategic management'. This book takes the view that managing is always important in strategy. Good strategy is about the practicalities of managing as well as the analysis of strategising.

1.2.2 Purpose, vision, mission, objectives

What is a strategy for? Harvard University's Cynthia Montgomery[5] answers by arguing that the core of strategy is defining and expressing a clear and motivating purpose for the organisation. Whether in the private or public sector, this purpose is generally loftier than just maximising profits: it could be to improve the

environment or help the wider community for instance. Such a broader view of purpose is more likely to motivate employees and stakeholders than profits alone. Indeed, focusing exclusively on short-term profits can be detrimental to longer-term value creation**.**

- **Organisational Purpose is the reason why a company exists**. It stems from internal drivers, such as the founders' and subsequent organisational leaders' beliefs and commitments, and external drivers including stakeholder influences (see Chapter 6 for further elaboration). Purpose is also influenced by broader contextual pressures, such as environmental shocks from a pandemic or climate change, that may cause firms to revisit and adjust their purpose. If the stakeholders of an organisation can relate to such a purpose it can be highly motivating.[6] According to Montgomery, the stated purpose of the organisation should address two related questions: *how* does the organisation make a difference; and *for whom* does the organisation make that difference? These questions challenge strategists to move from the abstract concept of purpose towards concrete action. Chapter 6 examines purpose in more depth.
- A **vision statement is concerned with the future the organisation seeks to create.** The vision typically expresses an aspiration that will enthuse, gain commitment and stretch performance. So, here the question is: 'What do we want to achieve?' Porras and Collins suggest managers can identify this by asking: 'If we were sitting here in twenty years what do we want to have created or achieved?' They cite the example of Henry Ford's original vision in the very early days of automobile

production that the ownership of a car should be within the reach of everyone. For the Swedish music site Spotify, the vision is to become ‘the Operating System of music’, a universal platform for listening just as Microsoft is for office software.

- A **mission statement** **aims to provide clarity about what the organisation is fundamentally there to do on a daily basis,** for employees and stakeholders. It can be thought of as a way of moving forwards towards the vision. This is often expressed in the apparently simple but challenging question: ‘What business are we in?’ Two linked questions that can clarify an organisation’s ‘business’ are: ‘What would be lost if the organisation did not exist?’; and ‘How do we make a difference?’ Though they do not use the exact term ‘mission statement’, Collins and Porras[7] suggest that understanding the fundamental mission can be done by starting with a descriptive statement of what the organisation actually does, then repeatedly delving deeper into the organisation’s mission by asking ‘Why do we do this?’ They use the example of managers in a gravel and asphalt company arriving at the conclusion that its mission is to make people’s lives better by improving the quality of built structures. At the University of Utrecht in the Netherlands, the mission includes educating students, training the next generation of researchers and addressing social issues.
- *Objectives* are statements of specific outcomes that are to be achieved**.** In the for-profit sector, these are often expressed in precise financial terms, for instance, the level of sales, profits or share valuation in one, two or three years’ time.[8] In non-profit organisations, objectives will focus on providing services to

target groups rather than financial objectives, although the organisation will need to generate sufficient income to cover their costs. Increasingly, organisations are also setting objectives referred to as 'the triple bottom line', by which is meant not only economic objectives such as those above, but also environmental and social objectives to do with their corporate responsibility to wider society (see Section 6.3).

Figure 1.4 shows a four-step hierarchy that connects the broad, abstract concept of purpose to narrower, concrete objectives by way of the organisation's vision and mission.

Purpose, vision and mission statements can offer more enduring sources of direction and motivation than dry financial objectives. However, these statements should be authentic and meaningful. Purpose, vision and mission statements are sometimes ineffective because they are too bland and too wide-ranging,[9]

1.2.3 Strategy statements

David Collis and Michael Rukstad[10] at the Harvard Business School argue that all entrepreneurs and managers should be able to summarise their organisation's strategy with a 'strategy statement'. **Strategy statements should have three main themes: the fundamental** *goals* **(purpose, vision, mission or objectives) that the organisation seeks; the** *scope* **or domain of the organisation's activities; and the particular** *advantages* **or capabilities it has to deliver all of these.**

Figure 1.4 Strategic hierarchy

Figure 1.4: Long Description

Purpose, vision, mission and objectives have been described above in 1.2.2 so here we concentrate on the other two main themes, scope and advantage, with examples of all three given in Illustration 1.2:

- *Scope.* An organisation's scope or domain refers to three dimensions: customers or clients; geographical location; and extent of internal activities ('vertical integration'). For a university, scope questions would be these: first, which academic departments to have (a business school, an engineering department, and so on); second, which activities to do internally themselves (vertically integrate) and which to externalise to subcontractors (for example, whether to manage campus restaurants in-house or to subcontract them); and third, whether to operate campuses outside the home country (for example, in Illustration 1.2, the University of Nottingham now has campuses in China and Malaysia as well as its home country of England).

- *Advantage.* This part of a strategy statement describes how the organisation will achieve the objectives it has set for itself in its chosen domain. In competitive environments, this refers to the *competitive* advantage: for example, how a particular company or sports club will achieve goals in the face of competition from other companies or clubs. The organisation needs to be better than others at achieving its particular goal. In the public sector, advantage might refer simply to the organisation's capability in general. But even public-sector organisations frequently need to show that their capabilities are not only adequate, but superior to other rival departments or, perhaps, to private-sector contractors.

Collis and Rukstad suggest that strategy statements covering goals, scope and advantage should be no more than 35 words long. The three themes are deliberately made highly concise. Brevity keeps such statements focused on the essentials and makes them easy to remember and communicate. Thus, for Tesla, a strategy statement might be: 'To accelerate the advent of a sustainable solar economy by developing and incorporating superior battery-based technologies into compelling mass-market electric products and bringing them to market as soon as possible.' Of course, such strategy statements are not always fulfilled. Circumstances may change in unexpected ways. In the meantime, however, they can provide a useful guide both to managers in their decision making and to employees and others who need to understand the direction in which the organisation is going. The ability to give a clear strategy statement is a good test of managerial competence in an organisation.

As such, strategy statements are relevant to a wide range of organisations. For example, a small entrepreneurial start-up can use a strategy statement to persuade investors and lenders of its viability. Public-sector organisations need strategy statements not only for themselves, but to reassure clients, funders and regulators that their priorities are the right ones. Voluntary organisations need persuasive strategy statements in order to inspire volunteers and donors. Thus, organisations of all kinds frequently publish materials relevant to such strategy statements on their websites or annual reports. Illustration 1.2 provides published materials on the strategies of two very different organisations: the technology giant Samsung from the private sector and the University of Nottingham in the UK from the public sector.

Illustration 1.2 Strategy statements Both Samsung Electronics, the Korean telecommunications, computing and TV giant, and the University of Nottingham, a leading British university, publish a good deal about their strategies.

Samsung Electronics

At Samsung, we follow a simple business philosophy: to devote our talent and technology to creating superior products and services that contribute to a better global society.

Every day, our people bring this philosophy to life. Our leaders search for the brightest talent from around the world, and give them the resources they need to be the best at what they do. The result is creating superior products and services that contribute to a better global society. Samsung promises to perform responsibly as a leading global

company and believes ethical management is not only a tool for responding to rapid changes in the global business environment but also a vehicle for building trust with various stakeholders.

According to Samsung's motto, it intends to give the world inspiration to create the future of electronics. This vision reflects Samsung Electronics' commitment to inspiring its communities by leveraging Samsung's three key strengths: 'New Technology', 'Innovative Products', and 'Creative Solutions'. As part of this vision, Samsung has mapped out a specific plan of investing $250 billion in the next three years to enhance capabilities in artificial intelligence, biopharmaceuticals, semiconductors and robotics industries. The aim is to strengthen its global position in competitive industries, such as the chip market, as well as to provide new opportunities for growth in next-generation telecommunications and robotics. To this end, Samsung has also established three strategic approaches in its management: 'Creativity', 'Partnership', and 'Talent'.

University of Nottingham Strategy A member of the prestigious Russell Group of Universities, the University of Nottingham is one of the UK's largest, with 48,000 students from 150 countries spread across campuses in Nottingham, China and Malaysia. Founder Jesse Boot's sentiments of discovery, enterprise and the advancement of the human condition, combined with commitment to improving health and well-being, are embedded in the University's culture.

In a recently announced new strategy, the University is to become one without borders, engaging with the opportunities presented by a changing world and creating an ambitious and creative culture to enable it to change the world for the better. This will allow the University to make an outstanding contribution to supporting the United Nations Sustainable Development Goals (SDGs).

Through its excellent campuses, the University is energised to engage locally and globally and to reach out to a wide range of stakeholders. It will continue to develop its campuses to meet contemporary needs of staff and students for new kinds of space, to enable secure and inclusive environments that support community well-being, and to foster an education that is more than a degree but includes a rich and stimulating social, cultural and sporting life open to all. The aim is to further evolve into one university with campuses in three countries and, to facilitate this, a global mindset is being cultivated among staff and students to enrich and deepen international engagement in teaching and research.

Through an inclusive and entrepreneurial environment that supports mental and physical well-being, the University will solve problems and improve lives through education, research and knowledge exchange and help prepare students to lead rich and fulfilling lives. The University will focus on recruiting students and staff with the highest potential and desire to succeed and will put in place measures to eliminate the attainment gaps between students from diverse backgrounds. Equality will be embedded in decisions about staff recruitment, reward and progression. While the intention is not to grow the University population much further, it will reach out to new potential students across the world, attracting those who wish to access online resources, continuing professional development and lifelong learning.

Sources: Edited extracts from www.samsung.com and the University of Nottingham Strategy, www.nottingham.ac.uk.

Questions

1 Construct short strategy statements covering the goals, scope and advantage of Samsung and the University of Nottingham. How much do the different private and public sector contexts matter?

2 Construct a strategy statement for your own organisation (university, sports club or employer). What implications might this statement have for your particular course or department?

Figure 1.5 Levels of strategy

Figure 1.5: Long Description

1.2.4 Levels of strategy

So far, we have considered an organisation as a whole but, inside an organisation, strategies can exist at three main levels (see Figure 1.5).

- **Corporate-level strategy is concerned with the overall scope of an organisation and how value is added to the**

constituent businesses of the organisational whole. Corporate-level strategy issues include geographical scope, diversity of products or services, acquisitions of new businesses, and how resources are allocated between the different elements of the organisation. For Tesla, moving from car manufacture to battery production for homes and businesses is a corporate-level strategy. Being clear about corporate-level strategy is important: determining the range of businesses to include is the basis of other strategic decisions, such as acquisitions and alliances.

- **Business-level strategy is about how the individual businesses (or operating units) should compete in their particular markets** (this is often called ‘competitive strategy’). These might be stand-alone businesses, for instance entrepreneurial start-ups, or ‘business units’ within a larger corporation. Business-level strategy typically concerns issues such as innovation, appropriate scale and response to rivals’ moves. For Tesla this means rolling out a lower cost electric car to build volume and capture market share in advance of potential competitor entry. In the public sector, the equivalent of business-level strategy is decisions about how units (such as individual hospitals or schools) should provide best-value services. Where the businesses are units within a larger organisation, business-level strategies should clearly fit with corporate-level strategy.
- **Functional-level strategies are concerned with how the components of an organisation deliver effectively the corporate- and business-level strategies in terms of**

resources, processes and people. For example, in 2021 Tesla organised an ‘AI Day’, showing off its artificial intelligence initiatives and plans in order to accelerate the recruitment of more AI engineers required to support its strategy of growth and innovation. In most businesses, successful business strategies depend, to a large extent, on decisions that are taken, or activities that occur, at the functional level. Functional decisions need, therefore, to be closely linked to business-level strategy. They are vital to successful strategy implementation.

This need to link the corporate, business and functional levels underlines the importance of *integration* in strategy. Each level needs to be aligned with the others. The demands of integrating levels define an important characteristic of strategy: strategy is typically *complex,* requiring careful and sensitive management. Strategy is rarely simple.

1.3 The *Exploring Strategy* Framework

In order to help you to evaluate an organisation's strategy, this book provides a framework that emphasises the interconnected nature of strategic issues. The *Exploring Strategy* Framework includes *analysing the strategic position* of an organisation; assessing *strategic choices* for the future; and managing *strategy in action*. These three elements provide the structure for the three Parts of the book. They are represented by the three circles of Figure 1.6.

Figure 1.6 The *Exploring Strategy* Framework

Figure 1.6: Long Description

A complete strategy analysis should always include all three major areas; together they provide you with a practical template for studying strategic situations. The following sections of this chapter will introduce the strategic issues that arise under each of these elements of the *Exploring Strategy* Framework. But, first, it is important to understand why the framework is drawn in this particular way.

Figure 1.6 could have shown *strategic analysis, strategic choice* and *strategy in action* in a linear sequence – first understanding the strategic position, then making strategic choices and finally turning strategy into action. Indeed, this logical sequence is implicit in the definition of strategy given by Alfred Chandler (Figure 1.2) and many other textbooks on strategy. However, as Henry Mintzberg recognises, in practice, the elements of strategy do not always follow this linear sequence. Choices often have to be made before the position is fully understood. Sometimes, too, a proper understanding of the strategic position can only be built from the experience of trying out a strategy in action. The real-world feedback from launching a new product is often far better at uncovering the true strategic position than remote analysis carried out in a strategic planning department at head office.

The interconnected circles of Figure 1.6 are designed to emphasise this potentially non-linear nature of strategy. Position, choices and action should be seen as closely related and, in practice, none has priority over another. Although the book divides its subject matter into three Parts in sequence, this does not mean that

the process of strategy must follow a logical series of distinct steps. The circles are overlapping and interdependent. The evidence provided in later chapters will suggest that strategy rarely occurs in tidy ways and that it is better not to expect it to do so.

However, the *Exploring Strategy* Framework does provide you with a comprehensive and integrated framework with important insights in how to work effectively with strategy. First, Chapter 2 introduces some basic frameworks for working with strategy, underlining the distinctive characteristics of strategic thinking. Thinking slow (system 2 thinking), anticipating others' needs and reactions (allocentricism) and seeing the interconnections of the big picture (systems thinking) are all important elements of working with strategy. Then the following three Parts of the book (Chapters 3 to 17) explore, in turn, how to analyse an organisation's *position,* consider the *choices* it has and how strategies might be put into *action.* You can use each of these chapters to help you ask fundamental strategy questions and to select essential concepts and techniques that will help you answer them. Working systematically through questions and answers will provide you with the basis for persuasive strategy recommendations.

1.3.1 Strategic position

The strategic position is concerned with the impact on strategy of the external environment, the organisation's strategic resources and capabilities, the organisation's purpose and stakeholders and the organisation's culture**.** Understanding these factors is central for

evaluating future strategy. These issues, and the fundamental questions associated with them, are covered in Part I of this book:

- *Macro-environment.* Organisations operate in complex multi-level environments. At the macro level, organisations are influenced by political, economic, social, technological, ecological and legal forces. Chapter 3 poses the question: what are the key macro drivers of change that are shaping the future of organisations and their sectors?
- *Industry and sector.* At the more immediate level within the industry or sector, competitors, customers and suppliers also present challenges. The key issues in Chapter 4, therefore, are: how attractive is this immediate industry or sector and what can be done to improve it?
- *Resources and capabilities.* Each organisation has its own strategic *resources* (e.g., machines and buildings) and *capabilities* (e.g., technical and managerial skills) that support its position in a market. Chapter 5 asks whether the organisation's resources and capabilities are adequate to the challenges of its environment and the level of its goals.
- *Purpose and stakeholders.* Purpose has already been introduced, but Chapter 6 investigates how the values of key stakeholders define the purpose of an organisation. Tying stakeholder values together into a coherent organisational purpose is the role of *corporate governance* which is the structures and systems by which organisations are held accountable for their actions. The key questions here are: is the purpose of an organisation an appropriate one and are managers sticking to it?

- *Culture and strategy.* Chapter 7 explores how organisational cultures can also influence strategy. These cultures are typically a product of an organisation's history, industry or geography. The consequence of culture can be *strategic drift*; a failure to create necessary change. A fundamental question here, therefore, is: how does culture fit with the required strategy?

Using the Exploring Strategy Framework in conjunction with Illustration 1.1, points to the following positioning issues for Tesla Motors. What is the future of the company given the macro social, economic and political demands for the business both to be environmentally sustainable and conform to regulatory standards? Are its distinctive capabilities really valued sufficiently by consumers to provide a financial return to investors and to allow sustained investment in further innovative products? How will Tesla cope with rising competition from car industry giants that are now selling electric and hybrid cars?

1.3.2 Strategic choices

Strategic choices involve the options for strategy in terms of both the *directions* in which strategy might move and the *methods* by which strategy might be pursued**.** For instance, an organisation might have a range of strategic directions open to it: the organisation could diversify into new products; it could enter new international markets; or it could transform its existing products and markets through radical innovation. These various directions could be pursued by different methods: the organisation could acquire a business already active in the product or market area; it could form alliances with

relevant organisations that might help its new strategy; or it could try to pursue its strategies on its own. Typical strategic choices, and the related fundamental questions, are covered in the five chapters that make up Part II of this book, as follows:

- *Business strategy and models.* There are strategic choices in terms of how the organisation seeks to compete at the individual business level. For example, a business unit could choose to be the lowest cost competitor in a market, or the highest quality. The fundamental question in Chapter 8, then, is what strategy, and what business model, should a company use to compete?
- *Corporate strategy* and diversification*.* The highest level of an organisation is typically concerned with issues of corporate scope; in other words, which businesses to include in the portfolio. This relates to the appropriate degree of *diversification,* with regard to products offered and markets served. Corporate-level strategy is also concerned with internal relationships, both between business units and with the corporate head office. Chapter 9 addresses the fundamental questions of which businesses you should be in and how you should manage them.
- *International strategy.* Internationalisation is a form of diversification, but into new geographical markets. Chapter 10 addresses the fundamental question: where internationally should the organisation compete?
- *Entrepreneurship and innovation.* Most existing organisations have to innovate constantly simply to survive. Entrepreneurship, the creation of a new enterprise, is an act of innovation too. A fundamental question in Chapter 11, therefore, is whether the organisation is innovating appropriately.

- *Mergers, acquisitions and alliances.* Organisations have to make choices about methods for pursuing their strategies. Many organisations prefer to build new businesses with their own resources. Other organisations develop by acquiring other businesses or forming alliances with complementary partners. The fundamental question in Chapter 12, therefore, is whether to buy another company, ally or to go it alone.

Again, issues of strategic choice are relevant to the case of Tesla Motors (Illustration 1.1). The *Exploring Strategy* Framework asks the following kinds of questions here. Should Tesla continue to produce new higher volume cheaper cars or stick to its previous specialised sports car products? How far should it widen the scope of its businesses: is producing batteries for homes really helping or detracting from car production? Where should Tesla innovate next?

1.3.3 Strategy in action

Managing strategy in action is about how strategies are formed and how they are implemented**.** The emphasis is on the practicalities of managing. These issues are covered in the five chapters of Part III, and include the following, each with their own fundamental questions:

- *Evaluating strategies.* Managers have to decide whether existing and forecast performance is satisfactory and then choose between options that might improve it. The fundamental evaluation questions in Chapter 13 are as follows: are the options *suitable* in terms of matching opportunities and threats;

are they *acceptable* in the eyes of significant stakeholders; and are they *feasible* given the capabilities available?

- *Strategy development processes.* Strategies are often developed through formal *planning* processes. But sometimes the strategies an organisation actually pursues are *emergent* – in other words, accumulated patterns of ad-hoc decisions, bottom-up initiatives and rapid responses to the unanticipated. Given the scope for emergence, the fundamental question in Chapter 14 is: what kind of strategy process should an organisation have?
- *Implementing strategy.* Once a strategy is developed, the organisation needs to organise for successful implementation. Chapter 15 addresses both the 'hard' issues of implementation, for example structure and systems and the 'softer' ones' of culture and procedural justice. The fundamental question, therefore, is: what kinds of hard and soft elements are required for the chosen strategy?
- *Leadership and strategic change.* In a dynamic world, strategy inevitably involves change. Managing change involves *leadership,* both at the top of the organisation and lower down. There is not just one way of leading change, however: there are different *styles* and different *levers* for change. So, the fundamental question in Chapter 16 is: how should the organisation manage necessary changes entailed by the strategy?
- *The practice of strategy.* Inside the broad processes of strategy development and change is a lot of hard, detailed work. The fundamental questions in Chapter 17 are: *who* should do this

strategy work, the *activities* involved in the work, and the *methods* they can use to do it.

With regard to strategy in action, the *Exploring Strategy* Framework raises the following kinds of questions for Tesla. How will Tesla return value to shareholders going forwards? Should Tesla move towards a more disciplined strategy development process rather than depend on the vision of Elon Musk? Does Tesla need more structure and systems? Are the right people and methods being used in Tesla's strategy-making activities?

Thus, the *Exploring Strategy* Framework offers you a comprehensive methodology for analysing an organisation's position, considering alternative choices, and selecting and acting on strategies. This review of the main elements of the framework now allows us to refine and extend our earlier broad definition of strategy in Section 1.2.1 to state that **'Strategy is the long-term direction of an organisation, formed by choices and actions about its resources and scope to create advantageous positions relative to competitors and peers within changing environmental and stakeholder contexts.'**

1.3.4 Cross-cutting themes: non-profits, sustainability and digital transformation

Running through the elements of the *Exploring Strategy* framework are many major themes including non-profit organisations, sustainability and digital transformation.

Non-profit organisations

These organisations are operated for a collective, public or social benefit, unlike for-profit businesses that aim to generate profit for their owners. **Non-profit organisations are self-governing, non-profit distributing and involve some degree of voluntary participation**.[11] Any revenues that a non-profit organisation generates in excess of its costs are to be reinvested in the purpose of the organisation and not paid out for private gain. Although non-profits are not driven by profit, they must bring in sufficient funds to allow the organisation to deliver on its purpose. Non-profits gain their funding from sponsors such as government, donors and sponsorships, as well as from what they can generate from the sale of products or services. These various funds enable non-profits to deliver on their purpose for social benefit. The end user of the service, therefore, is often not the prime source of funds for the non-profit organisation. For example, hospitals may not charge patients but instead receive funds from governments or donors, and even generate some revenues from on-site retail facilities. Non-profits include a wide range of organisations including schools and universities, hospitals, charities, theatres, social clubs, religious associations, cooperatives and social enterprises. Chapter 6 provides more detail on non-profits and discusses hybrid organisational forms.

Strategy tools and techniques are relevant to non-profits as well as for-profit organisations. Strategy can help non-profit organisations make better decisions, improve coordination and achieve sustainable outcomes. For example, strategy tools can help with organisational purpose, vision, mission, goals (Chapter 1), identify major environmental threats and opportunities (Chapter 3), identify

key capabilities (Chapter 5), manage organisational governance (Chapter 6), link goals to resource allocation decisions (Chapter 14) and inform organisational design and change (Chapters 15 and 16). Non-profits that charge users for their services, such as museums or sports clubs, often operate in competition with for-profit companies. While their aim is not to generate a profit, their need to meet budgets to sustain the enterprise means their strategic calculations are not much different to their for-profit competitors. Where non-profits do not charge their users for services, they still compete with other non-profits for funding from sponsors, such as governments and philanthropic foundations. Non-profit concepts and examples occur throughout *Exploring Strategy* therefore: refer to *non-profit* in the index for detail of relevant sections.

Sustainability

Widespread awareness of climate change in particular is changing stakeholder perceptions of the role of organisations in society. Customers, employees, communities and even investors are now pressing organisations to be fully accountable for their impact upon the natural environment and the wider society. The 2022 United Nations Global Compact launched the world's largest sustainability initiative, with over 14,000 companies in 162 countries, which aims to align companies' strategies and operations with principles relating to the environment, human rights, labour and anti-corruption. Through 'Agenda 2030', 17 Sustainable Development Goals (SDGs) are identified that aim to help businesses act responsibly and to address global challenges such as climate, water, food, poverty, conflict and inequality (see Chapters 3 and 6).

Sustainable development strategies involve managing positive relationships with organisations' natural and social environments at the same time as meeting their economic needs.[12] Organisations therefore need to meet three major interacting goals for creating positive impact: 1) economic, 2) natural and 3) social. Following sustainability principles can be beneficial to organisations through reducing resource costs (more efficient processes and minimising waste), reducing regulatory costs (for example, penalties for non-compliance with pollution or health and safety standards), protecting and building company reputation, differentiating products and services, attracting and retaining environmentally and socially conscious employees and discovering new and exciting opportunities.[13]

For strategists, taking sustainability seriously will affect the goals and targets of the company (see Chapter 1), requires attention to the wider business environment (Chapter 3), understanding how sustainability affects the industry (Chapter 4), how the organisation's resources and capabilities may be sourced and deployed (Chapter 5), affects the generation of sustainable strategic options and the sources and magnitudes of risk (Chapter 13), influences organisation and wider change (Chapter 16) and affects stakeholders (Chapter 6). Refer to *Sustainability* in the index for detail of particularly relevant sections.

Digital transformation

The twenty-first-century organisational landscape is being challenged by **digital transformation**, the **pervasive and discontinuous change triggered and shaped by the widespread**

use of digital technologies.[14] The rise of the Internet of Things (IoT), cloud based computing, 3-D printing, big data analytics, machine learning, blockchain and digital product service integration (also known as servitisation) are leading to the transformations of key business operations and processes and they also affect products, organisation structures and management concepts in profound ways. For instance, Germany's largest company, Siemens, focused until fairly recently upon heavy engineering in power generation systems, trains and infrastructure, but has now undergone a transformation with the acquisition of many digital technology companies and the disposal of many engineering interests. Siemens has thus changed fundamentally from a manufacturing giant into a digital services provider. Digital transformation is not just limited to businesses but is also relevant for public sector and non-profit organisations. For example, city authorities are increasingly using smart technologies to deal with air pollution, traffic congestion, cyber security and fresh food supply, necessitating new alliances between public and private sector partners.[15]

Digital transformation can affect all aspects of an organisation and relates to many sections in *Exploring Strategy*. For instance, digital transformation relates to the technology element of PESTEL analysis in Chapter 3, ecosystems in Chapter 4, business models and platforms in Chapter 8 and innovation in Chapter 11. Digital transformation is an important element of the leadership and strategic change issues considered in Chapter 16 and digital tools are now playing an increasing role in the practice of strategy, as

discussed in Chapter 17. Refer to *Digital transformation* in the index for detail of particularly relevant sections.

1.4 Strategy careers

Strategy work, defined as the effort needed to make strategy happen, exists at almost all levels of management and among external powerful stakeholders, often being co-evolved with investors, regulators and advisers, and even media. Within organisations, strategy work is not just the preserve of top decision makers but middle and lower-level managers also have to understand and contribute to their organisation's strategic objectives. Managers have to communicate strategy to their teams,[16] and will achieve greater performance from them the more convincing they are. Indeed, as responsibility is increasingly decentralised in many organisations, middle and lower-level managers play a growing part in shaping strategy themselves. Because they are closer to the daily realities of the business, lower-level managers can be a crucial source of ideas and feedback for senior management teams. Being able to participate in an organisation's 'strategic conversation' – engaging with senior managers on the big issues facing them – is therefore often part of what it takes to win promotion.

For many managers, then, strategy is part of the job. However, there are also careers focused upon strategy, for instance, strategy specialists in both private and public sectors. Many large organisations have in-house strategic planning or analyst roles.[17] Typically requiring a formal business education of some sort, strategic planning is a potential career route for many readers of this book, especially after some functional experience, and may lead to a board-level position. Strategy consulting has been a growth industry

in the last decades, with the original leading firms such as McKinsey & Co., the Boston Consulting Group and Bain joined now by more generalist consultants such as Accenture, IBM Consulting, and PwC, each with its own strategy consulting arm.[18] While strategy consultants may aspire to becoming partners of consultancy firms, it is not unusual for them to move into board-level positions in other organisations. Business graduates are in demand for strategy consulting roles, such as that of Claudia in the opening example.[19]

The interviews in Illustration 1.3 give some insights into the different kinds of strategy work that managers and strategy specialists can do. Galina, the manager of an international subsidiary, Chantal, a strategy consultant, and Harminder, heading a strategy office in a non-profit organisation all have different experiences of strategy, but there are some common themes also. All find strategy work stimulating and rewarding. The two specialists, Chantal and Harminder, talk more than Galina of analytical tools such as scenario analysis, sensitivity analysis and hypothesis testing. Galina discovered directly the practical challenges of real-world strategic planning, having to adapt the plan during the first few years in the United Kingdom. She emphasises the importance of flexibility in strategy and the value of getting her managers to see the 'whole picture' through involving them in strategy making. But Chantal and Harminder too are concerned with much more than just analysis. Chantal emphasises the importance of gaining 'traction' with clients, building consensus in order to ensure implementation. Harminder also realises that delivering recommendations is just the beginning of the strategy process and getting buy-in from key stakeholders is critical for implementation. He sees strategy and

delivery as intimately connected, with people involved in delivery needing an understanding of strategy to be effective, and strategists needing to understand delivery.

Strategy therefore pervades a wide variety of jobs and can also be the specific focus of a career. It covers a wide territory from formulation to implementation, requiring a broad set of technical and social skills[20] and, while individual strategists may focus on a particular aspect of strategy, effective outcomes mean it is crucial to link analysis with implementation on the ground. It is complex work that real people do. An important aim of this book is to equip readers to do this work better.

Illustration 1.3 Strategists

For Galina, Chantal and Harminder, strategy is a large part of their jobs.

Galina

At the age of 33, after a start in marketing, Galina became managing director of a Russian-owned British IT company. As well as developing the strategy for her local business, she has to interact regularly with headquarters: 'Moscow is interested in the big picture, not just the details. They are interested in the future of the business.'

She had to adapt substantially the subsidiary's strategic plans:

> 'When we first came here, we had some ideas about strategy, but soon found the reality was very different to the plans. The strategy was not completely wrong, but in the second stage we had to change it a lot: we had to change techniques and adapt to the market. Now we are in the third stage, where we have the basics and need to focus on trends, to get ahead and be in the right place at the right time.'

Galina works closely with her management team on strategy, taking them on an annual 'strategy away-day' (see Chapter 17): 'Getting people together helps them see the whole picture, rather than just the bits they are responsible for. It is good to put all their separate realities together.'

Galina is enthusiastic about working on strategy:

> 'I like strategy work, definitely. The most exciting thing is to think about where we have come from and where we might be going. We started in a pub five years ago and we have somehow implemented what we were hoping for then. Strategy gives you a measure of success. It tells you how well you have done.'

Her advice is: 'Always have a strategy – have an ultimate idea in mind. But take feedback from the market and from your colleagues. Be ready to adjust the strategy: the adjustment is the most important.'

Chantal

Chantal is in her early thirties and has worked in Paris for one of the top three international strategy consultancies since graduating in business. Consulting was attractive to her originally because she liked the idea of helping organisations improve. She enjoys strategy consulting because: 'I like solving problems. It's a bit like working on a mystery case: you have a problem and then you have to find a solution to fit the company, and help it grow and to be better.'

The work is intellectually challenging:

> 'Time horizons are short. You have to solve your case in two to three months. There's lots of pressure. It pushes you and helps you to learn yourself. There are just three to four in a team, so you will make a significant contribution to the project even as a junior. You have a lot of autonomy and you're making a contribution right from the start, and at quite a high level.'

Consulting work can involve financial and market modelling (see Chapters 4 and 13), interviewing clients and customers, and working closely with the client's own teams. Chantal explains:

> 'As a consultant, you spend a lot of time in building solid fact-based arguments that will help clients make business decisions. But as well as the facts, you have to have the ability to get traction. People have to agree, so you have to build consensus, to make sure that recommendations are supported and acted on.'

Chantal summarises the appeal of strategy consulting: 'I enjoy the learning, at a very high speed. There's the opportunity to increase your skills. One year in consulting is like two years in a normal business.'

Harminder

In his early forties, Harminder is a UK citizen working overseas in Saudi Arabia, heading up a key part of the Strategy and Planning Office in a large hospital with a multi-million-pound investment responsibility.

> 'Rational linear analysis is very important here. We have an abundance of data from all the major consultancies and a number of high-profile US academic advisors and need to assemble it for forecasting and trend analysis purposes. A great deal of time is taken crafting documents for key stakeholders. Informally, we use a range of strategy tools and techniques including statistical analysis, scenario analysis (see Chapter 3), sensitivity analysis (see Chapter 13), hypothesis testing (see Chapter 17) and also carry out many internal surveys to monitor implementation progress.'

Harminder has been surprised by the sheer amount of time and effort needed to consult key internal and external stakeholders personally: 'I have to consult every project manager and director and, more importantly, politically powerful and rich external stakeholders, regardless of their knowledge – and they have to be flattered to get buy-in.'

What Harminder likes about the job is making a difference by: ‘changing people’s perceptions, getting powerful individuals to make decisions and understand the reasons – rather than hiding behind endless committees (see Chapter 17)’.

Source: interviews (interviewees anonymised).

Questions

1 Which of these strategy roles appeals to you most – manager of a business unit in a multinational, strategy consultant or in-house strategy specialist? Why?

2 What would you have to do to get such a role?

1.5 Studying strategy

This book is both comprehensive and serious about strategy. To understand the full range of strategy issues – from analysis to action – it is important to be open to the perspectives and insights of key disciplines such as economics, finance, marketing, sociology and psychology. To be serious about strategy means to draw as far as possible on rigorous research about these issues. This book aims for an evidence-based approach to strategy, hence the articles and books referenced at the end of each chapter.[21]

This book therefore covers equally the three main branches of strategy research: conventionally, these are known as strategy *context,* strategy *content* and strategy *process.* In terms of the *Exploring Strategy* Framework (Figure 1.6), *content* broadly relates to positioning, *content* to choice and *process* to action. Each of these branches contains various research streams whose lessons can be readily applied to practical questions of strategy issues. Figure 1.7 shows the three branches and their respective research streams: these are listed in the approximate historical order of their emergence as strong research streams, the arrows representing the continuously developing nature of each. In more detail, the three branches and the characteristic analytical approaches of their main research streams are as follows:

- *Strategy context* refers to multiple layers of environment, internal and external to organisations. All organisations need to take into account the opportunities and threats of their external

environments. *Macro-environmental analysis* has been an enduring theme in strategy with early recognition of the influence of political, economic, social, technological, environmental (green) and legal trends since the 1960s. Subsequently, researchers have focused upon various additional themes including institutional pressures establishing the ‘rules of the game’ within which companies operate. *Industry analysis* took off as a research tradition in the early 1980s, when Michael Porter showed how the tools of economics could be applied to understanding what makes industries attractive (or unattractive) to operate in.[22] From the 1980s too, *cultural analysts* have used sociological insights into human behaviour to point to the importance of shared cultural understandings about appropriate ways of acting. In the internal context, cultural analysts show that strategies are often influenced by the organisation’s specific culture. In the external context, they show how strategies often have to fit with the surrounding industry or national cultures. *Resource-based view* researchers focus on internal context, looking for the unique characteristics of each organisation.[23] According to the resource-based view, the economic analysis of market imperfections, the psychological analysis of perceptual or emotional biases, and the sociological analysis of organisational cultures should reveal the particular characteristics (resources) that contribute to an organisation’s specific competitive advantages and disadvantages.

- *Strategy content* concerns the content (or nature) of different strategies and their probability of success. Here the focus is on the merits of different strategic options. *Strategy and*

performance researchers started by using economic analysis to understand the success of different types of diversification strategies. This research continues as the enduring central core of the strategy discipline, with an ever-growing list of issues addressed. For example, contemporary strategy and performance researchers examine various new innovation strategies, different kinds of internationalisation and all the complex kinds of alliance and networking strategies organisations adopt today. These researchers typically bring a tough economic scrutiny to strategy options. Their aim is to establish which types of strategies pay best and under what conditions. They refuse to take for granted broad generalisations about what makes a good strategy.

- *Strategy process* examines how strategies are formed and implemented. Research here provides a range of insights to help managers in the practical processes of managing strategy.[24] From the 1960s, researchers in the *strategic planning* tradition have drawn from economics and management science in order to design rational and analytical systems for the planning and implementing of strategy. However, strategy involves people: since the 1980s, *choice and change* researchers have been pointing to how the psychology of human perception and emotions, and the sociology of group politics and interests, tend to undermine rational analysis.[25] The advice of these researchers is to accept the irrational, messy realities of organisations, and to work with them, rather than to try to impose textbook rationality. Finally, since the early 2000s, *strategy-as-practice* researchers have been using micro-

sociological approaches to closely examine the human realities of formal and informal strategy processes.[26] This tradition focuses attention on how people do strategy work, and the importance of having the right tools and skills.

Figure 1.7 Strategy's three branches

Figure 1.7: Long Description

From the above, it should be clear that studying strategy involves perspectives and insights from a range of academic disciplines. Issues need to be ‘explored’ from different points of view. A strategy chosen purely on economic grounds can easily be undermined by psychological and sociological factors. On the other hand, a strategy that is chosen on the psychological grounds of emotional enthusiasm, or for sociological reasons of cultural acceptability, is liable to fail if not supported by favourable economics. As underlined by the four strategy lenses to be introduced later, one perspective is

rarely enough for good strategy. A complete analysis will typically need the insights of economics, psychology and sociology.

1.6 Exploring strategy further

So far, we have stressed that strategic issues are typically complex, best explored from a number of points of view. There is no simple, universal rule for good strategy. This section introduces two further ways of exploring strategy: one depending on context, the other depending on perspective.

1.6.1 Exploring strategy in different organisational types

Although the basic elements of the *Exploring Strategy* Framework are relevant in most circumstances, how they play out precisely is likely to differ according to different organisational types. Non-profit and for-profit organisations have been discussed earlier in the chapter and applying the *Exploring Strategy* Framework can also help surface key issues in other organisational types:

- *Start-ups and small businesses.* With regard to positioning, small businesses will certainly need to attend closely to the environment, because they are so vulnerable to change. But, especially in small businesses, strategic purpose will be a determining issue: for instance, this may not necessarily just be profit, but might include objectives such as remaining independent and maybe even a pleasant lifestyle. The range of strategic choices is likely to be narrower than for larger businesses: for a small business, acquisitions may not be

affordable, though they may have to decide whether to allow themselves to be acquired. Some issues of strategy in action will be different; for example, strategic change processes will not involve the same challenges as for large, complex organisations.

- *Multinational corporations.* In this context, positioning in a complex global marketplace will be very important. Each significant geographical market may call for a separate analysis of the business environment. Likewise, operating in many different countries will raise positioning issues of culture: variations in national culture imply different demands in the marketplace and different managerial styles internally. Strategic choices are likely to be dominated by international strategy questions about which geographical markets to serve. The scale and geographical reach of most multinationals point to significant issues for strategy in action, particularly those of organisational structure and strategic change.
- *Family businesses.* These firms vary widely in size and scope so their positioning issues will range widely depending upon competitive strength in their industry. However, this may not be the most important positioning issue as strategic purpose may be a defining issue. For instance, profit may not be of foremost consideration as objectives such as family control, handing over to the next generation and maybe even a pleasant lifestyle may be regarded as of greater importance. Depending on the size of the family business, resource constraints may or may not be a limiting issue in terms of strategic options but for large initiatives such as making an acquisition, or being acquired, family

concerns will probably be uppermost in decision makers' minds. In terms of strategy in action, family businesses are likely to need to deal with particular complexities around strategic change and leadership.

In short, while drawing on the same basic principles, strategy analysis is likely to vary in focus across by different organisational types. As the next section will indicate, it is often helpful therefore to apply different lenses to strategy problems.

1.6.2 Exploring strategy through different 'strategy lenses'

Exploring is a distinctive feature of this book and it means being critical of existing approaches as well as looking for new and different things. In particular, exploring strategy involves searching for new angles on strategic problems as we believe a comprehensive assessment of an organisation's strategy needs more than one perspective. In order to help you build your awareness of different perspectives on strategy, we introduce 'four strategy lenses'. These lenses present distinct, theoretically informed perspectives on strategy that enable you to perceive different ways of perceiving strategy. The four strategy lenses cover ways of looking at strategy issues differently in order to generate additional insights**.** These different perspectives will help you criticise prevailing approaches and raise new issues or solutions. Thus, although drawn from academic theory, the lenses should also be highly practical in the job of doing strategy.

The four strategy lenses consist of:

- *Strategy as design,* which might be likened to an architect's approach that is systematic, analytical and logical.
- *Strategy as experience,* which recognises that taken-for-granted assumptions and ways of doing things, biases and routines, will influence strategy.
- *Strategy as variety,* which focuses on new ideas and innovation bubbling up in unpredictable ways in an organisation.
- *Strategy as discourse,* which focuses upon the ways that managers use language to influence strategy making – that strategy talk matters.

None of these lenses is likely to offer a complete view of a strategic situation. The point of the lenses is to encourage the exploration of different perspectives: first from one point of view and then from another. This might help in recognising how otherwise logical strategic initiatives might be held back by cultural experience, unexpected ideas and self-interested strategy discourse.

To appreciate the full value that the four strategy lenses framework brings to your understanding of strategy, see the Commentary at the end of Part I, coming after you have had a chance to work with some key strategy frameworks relevant to strategic position. The four lenses are revisited after each succeeding Part of the book so that you can develop deeper insights into those Parts.

Key takeaways

- In addressing organisational strategy, you should recognise the comprehensive nature of the strategy, including both deliberate and emergent strategy and implementation as well as formulation. This is reflected in the following definition: '*Strategy is the long-term direction of an organisation, formed by choices and actions about its resources and scope to create advantageous positions relative to competitors and peers in changing environmental and stakeholder contexts*.'
- You can summarise a strategy with a *strategy statement*, which should include an organisation's *goals, scope* of activities and the *advantages* or *capabilities* it brings to these goals and activities.
- You should address strategy at appropriate levels: for example, *corporate-level strategy* is concerned with an organisation's overall scope; *business-level strategy* is concerned with how to compete; and *functional strategy* is concerned with how corporate and business-level strategies are actually delivered. These levels need integrating.
- The *Exploring Strategy* Framework can be used as a basic template for strategy. This points to three major elements in any strategy: understanding the *strategic position,* making *strategic choices* for the future and managing *strategy in action.*
- You can get involved in strategy work as a *manager* in an organisation, or in a specialist role such as *strategic planner* or *strategy consultant.*
- When thinking about strategy, address issues of strategy *context, content* and *process*, drawing insights not just from one disciplinary source but all three of economics, sociology and psychology.
- Although the fundamentals of strategy may be similar, you should recognise the distinctive issues raised by different *organisational contexts,* for example small businesses, multinationals or the public sector.

- Use the four strategy lenses of *design, experience, variety* and *discourse* to critically evaluate strategic issues from a variety of perspectives.

Work assignments ✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

1.1 Write a strategy statement for an organisation of your choice (for example, the Airbnb end of chapter case, or your university), drawing on strategy materials in the organisation's annual report or website.

1.2 Using the *Exploring Strategy* Framework of Figure 1.6, map key issues relating to strategic position, strategic choices and strategy into action for the Glastonbury* case, or an organisation with which you are familiar (for example, your university, or your own organisation).

1.3 Go to the website of one of the major strategy consultants such as Bain, the Boston Consulting Group or McKinsey & Co. What does the website tell you about the nature of strategy consulting work? Would you enjoy that work?

1.4 * Using Figure 1.6 as a guide, show how the elements of strategic management differ in:

(a) a small or family business (e.g., Mormor Magda*, HomeCo*, Glastonbury*)

(b) a large multinational business (e.g., Siemens*, Megabrew*, Unilever)

(c) a non-profit organisation (e.g., Vaasa City*, EMMAUS*).

Recommended key readings

It is always useful to read around a topic. As well as the specific references below, we particularly highlight:

- For a review of the recent evolution of strategy, read R. Whittington, '*Opening Strategy: Professional Strategists and Practice Change 1960 to today',* Oxford University Press, 2019.
- Two stimulating overviews of strategic thinking in general, aimed particularly at practising managers, are C. Montgomery, *The Strategist: Be the Leader your Business Needs*, Harper Business, 2012; and R. Rumelt, *Good Strategy/Bad Strategy: the Difference and Why it Matters,* Crown Business, 2011.
- Two accessible articles on what strategy is, and might not be, are M. Porter, 'What is strategy?'*, Harvard Business Review,* November–December 1996, pp. 61–78; and F. Fréry, 'The fundamental dimensions of strategy', *MIT Sloan Management Review,* vol. 48, no. 1 (2006), pp. 71–75.
- For contemporary developments in strategy practice, see business newspapers such as the *Caixin* and *China Daily* (China), *Financial Times* (UK), *Handelsblatt* (Germany), *Les Echos* (France), *The Economic Times* (India) and the *Wall Street Journal* (USA), and business magazines such as *Business Week, The Economist, L'Expansion* and *Manager-Magazin.* Several of these have well-informed Asian editions. See also the websites of the leading strategy consulting firms: www.mckinsey.com; www.bcg.com; www.bain.com.

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Case Example

A viable unicorn? Airbnb

Duncan Angwin

Source: AlesiaKan/Shutterstock

The effect of the COVID-19 pandemic on Airbnb – the online accommodation platform – was nothing short of an apocalypse. The previous forecasts for 2020 were for revenues of $10bn and net income of $3.3bn, and yet Airbnb generated just $3.4bn in revenue and made a loss of $4.6bn for the year. However, Airbnb went public in December 2020 in a successful IPO (Initial Public Offering) that raised $3.5bn from investors whilst, during 2021, bookings rebounded as recreational travel and rural destinations became popular. While some commentators had thought the pandemic would see the demise of Airbnb, others concluded that Airbnb had proven it could be a viable Unicorn.

Origins

In the US venture capital industry, a Unicorn is that rare animal, a start-up company whose valuation exceeds $1bn dollars. These Unicorn valuations are no guarantee of long-term viability: notable Unicorn flops include the note-taking company Evernote, games company Zynga and health tech company Theranos. However, since its launch in 2007, Airbnb has reached a 2021 valuation of $113bn. The company was founded by Joe Gebbia and Brian Chesky as a simple website with pictures of their loft-turned-lodging space – complete with three air mattresses on the floor and the promise of a home-cooked breakfast in the morning. Gebbia and Chesky realised there was often demand at conferences and festivals where hotels would fill up quickly. After adding a payment facility to their website, which allowed them to charge up to 15 per cent of the booking (host pays 3 per cent; traveller 6–12 per cent), by April 2009, they were breaking even.[1]

Growth

Gaining angel investor funding from Harminder Graham, co-founder of Y Combinator (a start-up mentoring programme) the company provided an app and website that connects people seeking lodging with renters who have listed their personal houses, apartments, or guest rooms on either platform. Quickly, the company expanded to 8,000 cities worldwide, increased the number of employees to 500 and moved to offices in the design district of San Francisco.

In 2010, Airbnb was experiencing sluggish listings due to poor presentation of properties. Through using professional photographers, which are now automatically available to hosts, properties began to be presented more professionally and this rapidly increased guest demand, as it helped to build trust. In addition, Airbnb Social Connections was introduced, which leverages users' social graphs via Facebook Connect. This shows whether friends have stayed, or are friends, with the host and allows guests to search for hosts based on other characteristics, like alma mater. Again, this reassures potential guests.

With further venture funding in 2011, Airbnb expanded through acquisitions acquiring their largest UK-based competitor Crashpadder just before the 2012 Summer Olympics in London. Offices were opened in Paris, Barcelona and Milan. Airbnb's growth was explosive with a higher valuation than the Hyatt and Wyndham hotel groups by 2014 and more guest nights booked than Hilton Hotels. By 2016, Airbnb was valued at $25bn – more than any other hotel group.[2]

Airbnb proved attractive to guests and hosts as its listings were far superior to others available at the time, such as Craigslist. Listings were more personal, with better descriptions and nicer photos. The rooms were cheaper than equivalent ones at hotels and had more of a personal flavour. For instance, in a recent stay in Paris, a user noted the host had left a selection of food in the refrigerator, a bottle of wine on the counter for her guests and a welcoming note suggesting good places nearby to eat out and

convenience shops. Staying in another person's apartment makes the visitor feel far more at home than an anonymous hotel room. For many young guests and hosts, Airbnb fitted into the contemporary sharing culture exemplified by easyCar Club, where users can rent their car to others, and Girl Meets Dress, that allows girls to borrow and lend their dresses for special occasions. For hosts, rents provide a source of income to help pay for soaring accommodation costs in many major cities.

Figure 1 Airbnb early growth story/AirBnB – From 3 guys renting mattress to $10 billion in seven years

Figure 1: Long Description

Managing growth

CEO Brian Cesky penned a memo in 2013 to his top management team, as follows:[3]

> **Hey team,**
>
> **Our next team meeting is dedicated to Core Values, which are essential to building our culture. It occurred to me that, before this meeting, I should write you a short letter on why culture is so important to [co-founders] Joe, Nate, and me.**
>
> **. . . In 2012, we invited Peter Thiel [a major investor] to our office. This was late last year, and we were in the Berlin room showing him various metrics. Midway through the conversation, I asked him what was the single most important piece of advice he had for us.**
>
> **He replied, 'Don't f*** up the culture.'**
>
> **This wasn't what we were expecting from someone who just gave us $150mn. I asked him to elaborate on this. He said one of the reasons he invested in us was our culture. But he had a somewhat cynical view that it was practically inevitable once a company gets to a certain size to 'f*** it up'.**

Source: Founder and CEO Brian Cesky penned a memo in 2013

Accordingly, the company began to manage its culture more deliberately. For example, Joe had become concerned that, as the company grew, it had become less open to dialogue. To encourage more discussion, he invented the notion of 'elephants, dead fish and vomit'. As he explains: 'Elephants are the big things in the room that nobody is talking about, dead fish are the things that happened a few years ago that people can't get over, and vomit is that sometimes people just need to get something off their mind and you need someone to just sit there and listen.'[4] All three need to be aired. Airbnb also established a series of annual meetings called One Airbnb, bringing together employees (called 'Airfam') from all around the world to the San Francisco base for four-

day conferences at which everyone can meet the founders, discuss strategy and also talk about both their work roles and their hobbies. The company has ‘ground control’ staff in every office in the world dedicated to making the company culture ‘come alive’, organising pop-up birthday celebrations, anniversary parties or baby showers. The company is rigorous in its recruitment policy, committed to hiring ‘missionaries, not mercenaries’.

At the same time, the founders had begun to ask themselves again: ‘What is our mission? What is the big idea that truly defines Airbnb?’ As they recalled in their own words: ‘It turns out the answer was right in front of us. For so long, people thought Airbnb was about renting houses. But really, we’re about home. You see, a house is just a space, but a home is where you belong. And what makes this global community so special is that for the very first time, you can belong anywhere. That is the idea at the core of our company.’[5]

Airbnb in 2021

Anyone anywhere in the world can list spare space from a room to a tree house, from a castle to an island in Fiji, with prices ranging from $50 to $2,000 per night. The headquarters’ walls are covered with world maps dotted with hundreds of coloured pins, charting world domination. Pre-pandemic, Airbnb was so popular that one of their rooms was booked every two seconds.

The company is now focused on the whole travel trip with an emphasis on delivering local experiences. This focus on hospitality is not just about where you stay, but what you do – and who you do it with – whilst you’re there. Airbnb has introduced Neighbourhoods and local lounges, partnering with local coffee shops that can offer free wifi, a comfortable setting and local guidebooks. They have also acquired a small start-up that connects guests with locals who can answer their questions and Airbnb also offers cleaning services. The Airbnb website and apps now have subtle animations and flashier

imagery to convince customers that it is more than a hotel service and more of a lifestyle brand. The focus is firmly on ‘belonging’.

With over one billion cumulative guest arrivals as more people began travelling after the easing of the pandemic, Airbnb posted record host earnings of $12.8bn during 2021. In the face of rising inflation, increasing numbers of families were applying to become hosts to supplement their incomes. Company profits were also up, but this was credited to the loss of a quarter of Airbnb’s workforce during the pandemic. Long stays now made up around 20 per cent of all bookings and were the fastest growing segment. Airbnb had an estimated 6 million listings (more than the top 10 hotel chains combined) in over 100,000 cities in over 220 countries.

Prior to the pandemic, Airbnb had been providing a strong challenge to hotels with prices 30–80 per cent lower than local operators. However, this was provoking a reaction. Hotels fought back by arguing Airbnb rooms were dangerous and unsafe as they were unregulated. For example, in San Francisco, although one must have a permit to rent for under 30 days, residents were still illegally listing personal homes and apartments. Similar problems were being experienced in New York where an ‘illegal hotel law’ was passed preventing people from subletting apartments for less than 29 days. Other cities across the world were imposing stringent regulations as local residents were crowded out of attractive city centres by short-term rental properties. In Paris, at one point the largest market in the world for Airbnb with over 60,000 apartments on offer, the mayor complained the city was being turned into an ‘open-air museum’. The city responded by tightening up on the registration and advertising of accommodation, as well as placing a 120 days per year limit on rentals. The European Union also gave Airbnb an ultimatum about the lack of price transparency, while governments were widely raising concerns over hosts not paying tax on rental earnings.

During the pandemic, Airbnb’s business model had been more resilient than its rivals, with revenues down less than for travel-aggregator Expedia and Booking.com. However, coming out of the pandemic in 2022, growth rates were lower than for the major hotel

groups as well as Expedia and Booking.com.[6] This weakness was concealed somewhat by the high profitability achieved by Airbnb's sharp cost-cutting on product development, marketing and staffing.

The future

Some critics have forecast a fundamental change in Airb nb's fortunes, arguing the company's shares are over-priced, with competitors such as Homestay (hosts are present), Home Exchange, Vrbo, Kid & Coe (family friendly), onefinestay (luxury accommodation) and others chipping away at its business model. Hotel chains such as Marriot International are also adding home-rentals to their offerings. Cities and regulators continue to show negative reactions towards short-term rental.[7] So-called 'professional hosts' (typically with multiple listings or properties) have been very damaged by the pandemic, leading to a shortage of accommodation as demand rises. However, other commentators focus on Airbnb's achievement of creating a new way to holiday, through massive expansion of the accommodation base and destination possibilities while providing a convenient way for hosts to monetise their accommodation. For these commentators, Airbnb's game-changing model still has a long way to run. As CEO Brian Chesky says, 'the trick is to be optimistic'.[8]

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Questions

1 Sticking to the 35-word limit suggested by Collis and Rukstad in Section 1.2.3, what strategy statement would you propose for Airbnb?

2 Carry out a ‘three-horizons’ analysis (Section 1.2.1) of Airbnb, in terms of both existing activities and possible future ones. How might this analysis affect its future strategic direction?

3 Using the headings of environment, industry, resources and capabilities, purposeful strategy and culture, seen in Section 1.3.1, identify key positioning issues for Airbnb and consider their relative importance.

4 Following on from the previous questions and making use of Section 1.3.2, what alternative strategies do you see for Airbnb?

5 Converting good strategic thinking into action can be a challenge: examine how Airbnb has achieved this by considering the elements seen in Section 1.3.3.

Chapter 2

Working with strategy

Key terms

allocentricism

issue trees

SWOT analysis

strategic plan

system maps

thinking slow

Learning outcomes

After reading this chapter, you should be able to:

- Recognise the value of *thinking slow* in strategy
- Understand how to apply analytical frameworks in strategy, including *SWOT*
- Appreciate *the role of theory* in strategic frameworks
- Grasp key strategic thinking techniques including *allocentricism*, *system mapping* and *issue trees*
- Recognise the components of an effective *strategic plan*
- *Prepare strategy cases* and make persuasive *presentations* of strategic analyses

2.1 Introduction

As outlined in the previous chapter, the practical aspects of working with strategy are central to this book. For students and practitioners, strategy involves a good deal of work. An entrepreneur may quickly come up with an idea for a business, but there is a lot more to do in turning the idea into the strategy of a real enterprise. This work will involve careful strategic thinking, analysis using various strategy frameworks, formulating strategic plans, and communicating and presenting them to multiple stakeholders including potential employees and potential partners and investors. In similar fashion, a strategy case study for a student will require several readings, application of appropriate strategic frameworks, perhaps discussion in a small group and, possibly, some kind of final presentation.

This chapter addresses fundamental issues in strategy work important not only for entrepreneurs and managers, but for you as a student. The focus here therefore is on how both practitioners and students can best address strategic issues that will often seem very complex and uncertain. In your practice and in your studies, you will find that good strategy work involves careful and holistic strategic thinking, various forms of strategy analysis, the savvy use of strategy frameworks and tools, skill in sizing up an organisation's overall situation, good judgement, plans for implementation and, finally, understanding of how to communicate your strategy analyses and recommendations. Strategy is typically about the future of the whole organisation, not just one function, so it's not surprising that it can take a good deal of work.

Figure 2.1 summarises the structure of this chapter and key issues. Section 2.2 introduces strategic thinking, in particular the notion of *thinking slow*. Section 2.3 then goes on to consider the role of strategy frameworks in strategic thinking, using SWOT analysis as an initial example. Various thinking techniques, such as *allocentricism*, *issue trees* and *system mapping* are introduced in Section 2.4 as underlying ways of approaching strategic problems. Section 2.5 then considers strategy analysis procedures, including the analysis of published *case studies* and the investigation of real organisations. Section 2.6 finally addresses developing strategy in the form of *strategic plans*, criteria for a *'good strategy'*, and communicating strategy through *presentations*.

Figure 2.1 Key issues in strategy work

Figure 2.1: Long Description

2.2 Strategic thinking

Strategic thinking is not like everyday thinking. This section introduces *slow thinking*, *convergent* and *divergent* thinking and the role of *checklists*.

2.2.1 Thinking slow

Strategy involves a different way of thinking from what we use in most of our lives. Nobel prize-winner Daniel Kahneman describes two fundamental thought processes: *thinking fast* and *thinking slow*.[1] Thinking fast is intuitive, quick and decisive: Kahneman calls this System 1 thinking. **Thinking slow is deliberative, analytical and thorough**: Kahneman calls this System 2 thinking. In biological evolution, thinking fast helped early humans act quickly when hunting prey or escaping predators. Today, thinking fast is still good for most everyday situations, where it is a waste of time to 'overthink' things: for example, when deciding which lunchtime sandwich to buy or whether to run for a bus. But strategy requires thinking slow – and our biology makes that surprisingly hard to do.

Kahneman warns that thinking slow is required in complex situations where the stakes are high and there is time to collect more information. These situations describe most strategic problems. Getting decisions wrong in strategy could cost an organisation its survival. But since humans' evolutionary origins, thinking fast is our natural reaction to most problems, even strategic ones. We have a tendency to jump to conclusions and be over-confident in our first

impressions. Thinking slow is about making the time to consider all the angles, gather more information and challenge initial opinions.

What does thinking slow mean in practice? It means that a full strategy analysis, both for practitioners and students, consists of many steps. It requires various frameworks, a great deal of quantitative and qualitative data, multiple iterations, and finally presenting in a way that clearly identifies key issues and makes persuasive recommendations. The eventual strategy presentation may look simple, but this simplicity typically conceals a great deal of hard and complex work. When entrepreneurs make their initial 'elevator pitches' describing their strategies to investors, they may only take the 60 seconds equivalent to a brief ride in an elevator. However, behind that 60-second pitch will typically be many long days and nights of thought. Thinking slow about strategy means not rushing to conclusions, both as a practitioner and as a student.

In this book, we offer a variety of strategy frameworks and tools to help you 'think slow' about strategy. In particular, the Thinking Differently perspectives, at the end of each chapter, will help you pause and reflect on alternative ways of seeing the strategic issues you have in hand. In a similar way, the four strategy lenses presented at the end of each of the three main Parts – Design, Emergence, Variety and Discourse – offer you contrasting ways of understanding what is going on. Take the time to apply different thinking and diverse lenses to the strategic issues that follow throughout the book.

2.2.2 Two brains

Thinking slow in strategy is important, but that does not mean everything is resolved just by analysis. The Canadian management theorist Henry Mintzberg captures the need for holistic judgement in strategy by using the metaphor of two sides of the human brain – the right hemisphere of the brain and the left.[2] The left brain is commonly associated with rational, linear and explicit thinking, while the right brain is more intuitive, holistic and implicit. The left-brain analyses – breaks problems down into parts. The right-brain synthesises – integrates things into an overall picture. Just as for humans in general, Henry Mintzberg concludes that both right and left-brain approaches are necessary for strategy. Of course, we need left-brain analysis. But strategy often involves taking a position in situations of complexity, ambiguity and incomplete information. In those kinds of situations, analysis cannot do everything. Right-brain integration and judgement are required as well.

The metaphor of two brains is reflected in the distinction between two kinds of thinking often used in strategy: ‘convergent’ and ‘divergent’.[3] Convergent thinking is like the left-brain: analytical and focused. Divergent thinking is closer to the right-brain: creative and receptive to a wide range of ideas and information. There are certain strategic planning activities that benefit from convergent thinking: precise numbers and clear targets are often central in strategic plans. But for designing the imaginative, breakthrough strategies that may underly these plans, managers, entrepreneurs and students need divergent thinking as well. The implication is that creativity techniques such as brainstorming and bringing in diverse points of view have an important part to play in strategy, especially at the

beginning of the process. Thorough analysis can then test in detail the divergent strategic options that result.

In sum, strategy requires a broad range of skills. Thinking slow, as in Section 2.2.1, is not just a matter of analysis. It is also a matter of allowing space for more right-brain or divergent thinking. Creativity, synthesis and judgement are important as well as rigour, analysis and calculation. Strategy analysis will rarely produce an answer on its own; you need judgement as well. The point of analysis at the final uncertain moment of decision is to give you and your audiences confidence that you have good reasons for coming down on one side of the argument or another.

2.2.3 Checklists

The techniques in *Exploring Strategy* are designed to help you think slower – in other words, be strategic and consider all the angles before making recommendations. Many of these techniques take the form of checklists. Checklists help ensure that you are comprehensive in your thinking, covering the qualitative issues amenable to the right-brain as well as the quantitative issues favoured by the left.

Checklists are a key thinking tool in many professions. Surgeons before the first cut, airline pilots before take-off and structural engineers before completing their designs all use checklists.[4] They precede any significant action by carefully checking that all necessary items have been considered first. For example, surgeons check blood types, airline pilots check aircraft doors and structural engineers check material strengths. None of the items on their own

take very much expertise. But, in complex conditions, it is very easy to forget quite simple things and think too fast. Where the stakes are high, as in surgery, passenger aircraft and bridges or dams, it is wise to slow the thinking down before taking action.

Strategy is the same: it is hard for strategists to remember everything that might be relevant on their own, but the consequences of forgetting something can be huge. That is why many strategy frameworks involve checklists. In this chapter, we shall use SWOT analysis, an initial checklist helping you to think about the overall strategic position of an organisation. In Chapter 3, we shall use PESTEL as a list of factors (political, economic, social, technological, ecological and legal) that are important in the macro-environment. In Chapter 4, Porter's Five Forces reminds you that the attractiveness of industries relies on all five factors of rivals, buyers, suppliers, new entrants and substitutes. These checklists should not be under-estimated. As we shall see with even one of the simplest ones, SWOT, these checklists often lead on to additional analyses and are underpinned by research.

2.3 Strategic frameworks

This book introduces many strategic frameworks for thinking about strategic issues. As an illustration of these frameworks, this section introduces SWOT analysis, underlines the value of using multiple frameworks and shows how theory can provide useful guidelines for applying frameworks in practice.

2.3.1 SWOT analysis

SWOT analysis involves the systematic analysis of an organisation's strengths, weaknesses, opportunities and threats. SWOT is the most widely used strategy framework in the world and, as it is so familiar, it will be used here as an example of how classic strategy frameworks can be used and, sometimes, misused.[5] SWOT's own strength is that it is simple conceptually, easy to remember and reasonably comprehensive. SWOT can also be used to evaluate existing and possible future strategies and as a basis for generating strategic options. The components are as follows:

- *Strengths* are those internal factors that make an organisation superior and more competitive than its peers. They constitute an organisation's distinct advantages and include resources or capabilities that the organisation holds that can be used effectively to achieve its objectives. Strengths might include a skilled workforce, a unique technology or a valuable brand.

- *Weaknesses* are limitations, faults, or defects within the organisation that will keep it from achieving its objectives. It is what an organisation does poorly or where it has inferior capabilities or resources compared to its peers and the competition. Weaknesses might include poor information technology systems, a negative or cynical organisational culture or a bad reputation with customers.
- *Opportunities* include any favourable current or prospective situation in the organisation's environment, such as a trend, change, or overlooked need. It is something that supports the demand for a product or service (new or existing) and permits the organisation to enhance its position relative to its peers. An opportunity might include the rapid growth of a relevant market segment or the emergence of a new technology that the organisation is well-placed to exploit.
- *Threats* include any unfavourable situation, trend or impending change in an organisation's environment that is currently or potentially damaging to its ability to achieve its objectives. It may be an external barrier, constraint, or risk that might inflict problems or harm on the organisation. For example, a threat could be a downturn in demand, powerful suppliers, or the arrival of a new competitor in the market.

Figure 2.2 SWOT matrix

	Positive	*Negative*
Internal forces	**S**trengths	**W**eaknesses
External forces	**O**pportunities	**T**hreats

Figure 2.2: Long Description

Typically, an organisation's strengths and weaknesses are made up of factors over which it has some control, for example the organisation's technologies, workforce, brands, mission, and so on. An organisation usually has less control over its opportunities and threats, for example macro-economic conditions, climate change or government regulations. However, it is easy to over-estimate the ease with which internal factors can be managed (organisational cultures are very hard to change) and sometimes organisations can exert some control on external factors (for example, they might be able to influence regulatory standards). With regard to all SWOT factors, it is important to consider necessary actions. The point of strategy is to develop strengths, reduce weaknesses, seize opportunities and guard against threats.

The *TOWS matrix*, sometimes termed a collision matrix, is a useful way of transforming SWOT analysis into strategic actions (see Figure 2.3).[6] The matrix builds directly on the information in a SWOT exercise. Each box of the TOWS matrix can be used to identify options that address a different combination of the internal factors (strengths and weaknesses) and the external factors (opportunities

and threats). For example, the top left-hand box prompts a consideration of options that use the strengths of the organisation to take advantage of opportunities in the environment. A company may use its technology strengths to reduce CO2 emissions and thus exploit opportunities for low climate-impact products, for example. The bottom right-hand box prompts options that minimise weaknesses and also minimise threats. For example, this might include the need to develop an information technology system to better service clients or partnerships with other organisations to deal with threats from new competitors.

On the face of it, SWOT seems to be an attractively simple form of analysis, but the result can fall short. The most frequent failings in SWOT analyses are the following:

- *Confusing the internal and the external.* It is important to recognise that opportunities and threats are external to the organisation being analysed, whereas strengths and weaknesses are internal. The whole purpose of the framework is to contrast external opportunities and threats with internal strengths and weaknesses in order to understand the *degree of fit* between the organisation and its context. Figure 2.2 makes the distinction between the internal and the external very clear. Without recognising this distinction, the value of SWOT is severely reduced. The aim of the analysis is to identify the extent to which strengths and weaknesses are relevant to the changes taking place in the environment (as in TOWS analysis). In responding strategically to the environment, the goal is to reduce identified threats and take advantage of the best opportunities.

- *Long lists.* Compiling long lists of items in each box is not the same as doing a SWOT analysis. What matters is to be clear about what is most significant and what is less so, based on a rigorous and systematic analysis of all items. Managers and entrepreneurs need focus. Prioritising the issues that really matter implies keeping the SWOT brief. Three rules can be helpful here. First, focus on strengths and weaknesses that differ in *relative* terms compared to competitors or comparable organisations and leave out areas where the organisation is equal with others (think ‘better’/‘worse’, not just ‘strength’/‘weakness’). What you do better is why customers, employees and funders choose your organisation rather than somebody else’s. What you do worse is where rivals will steal the advantage. Second, only focus on opportunities and threats that are directly *relevant* for the specific organisation and industry and leave out any general and broad factors outside the focal organisation’s existing or potential domains: an international or technological opportunity for which your organisation has no relevant strengths is not worth listing. Third, summarise the results and draw concrete *conclusions* based on the analysis (the TOWS matrix below can help here). SWOT analysis should finish with clear implications.
- *Stopping at SWOT.* A final danger is substituting the SWOT for a comprehensive and deeper strategy analysis. SWOT analysis is an engaging and fairly simple tool to be used either as an introductory overview or as an effective summary of more detailed analysis (the approach *Exploring Strategy* generally advocates). It can also be a useful vehicle to communicate

strategy. However, it is not a substitute for in-depth strategy analysis. There are two main dangers if it is used on its own. First, without more thorough analysis (typically using more frameworks), managers tend to fall back on preconceived and biased views, while students rely on first impressions. Thorough analysis helps to challenge entrenched or superficial views. Second, without further analysis, SWOT can lack specificity or depth. Identifying very general strengths, for example, does not explain the underlying reasons for those strengths or to what degree those strengths are distinctive advantages relative to rivals. The rest of this book will provide many concepts and techniques by which each of the elements of SWOT – strengths, weaknesses, opportunities and threats – can be more deeply analysed. SWOT is rarely the only analytical tool you will need.

Figure 2.3 The TOWS matrix

		Internal factors	
		Strengths (S)	**Weaknesses (W)**
External factors	**Opportunities (O)**	**SO Strategic options** Generate options here that use strengths to take advantage of opportunities	**WO Strategic options** Generate options here that take advantage of opportunities by overcoming weaknesses
	Threats (T)	**ST Strategic options** Generate options here that use strengths to avoid threats	**WT Strategic options** Generate options here that minimise weaknesses and avoid threats

Figure 2.3: Long Description

2.3.2 Using multiple frameworks

While SWOT concerns both external and internal factors in strategy, it is usually just a start. Strategy problems are typically multilevel and complex, so that they can rarely be approached just by a single framework. Instead, they often require multiple frameworks and specific ones for different levels of analysis and for different aspects of the organisation. The frameworks used to analyse the macro-environment (Chapter 3) are not adequate to analysing the industry level of the environment (Chapter 4). Similarly, frameworks used for business-level strategy (Chapter 8) are not appropriate for the corporate-level strategy issues of the organisation as a whole (Chapter 9). If the strategic problem is internal, then the frameworks required are likely to relate to specific aspects such as organisational resources and capabilities (Chapter 5), organisational culture (Chapter 7), or organisational structure (Chapter 15).

It is thus necessary to sort out what type of strategy frameworks to apply. For students, some guidance will come where a case study question invites the use of a specific framework, either through the language of the question, such as ‘identify the strengths and weaknesses of the organisation’, or by specifically asking for a particular framework such as SWOT. However, for most real-world strategy problems, for student assignments requiring investigations of a particular organisation and for many case study exercises, the right frameworks are not obvious. You will need to carefully choose what frameworks to use for what levels of analysis and for which aspects of the strategic problem. One of the most common mistakes in strategy analysis is to start analysing at one level, but

unintentionally to move to another. For example, an industry analysis should not confuse an individual organisation's characteristics with those of the whole industry. An individual organisation may have strong brands, but those on their own would not create sufficient entry barriers to protect the industry as a whole from invasion by new competitors. If other industry players had weak brands, new competitors could enter and change the competitive dynamics of the whole industry, perhaps eventually challenging even the strong-branded player (see Chapter 4). It is thus important to figure out on what levels of analysis different parts of the strategy problem are located and then apply the appropriate frameworks to the right level.

Illustration 2.1 What makes a good SWOT?

Refer back to Illustration 1.1 Tesla Motors: the future is electric. In response to the instruction: 'Analyse Tesla Motors' competitive position in the motoring industry', the following SWOT analysis was carried out.

Strengths	Weaknesses
• Disruptive innovation skills • Massive $1trn capitalisation • Strong vision of save the planet • Large-scale battery production • Customers willing to pay a premium price for performance	• Little car making experience • Cars have limited range • CEO Elon Musk • Now making cheaper, slower cars
Opportunities	**Threats**
• Manufacturing hybrid petrol/electric cars to extend range and access larger car market • Applying technology to electric vertical takeoff and landing (eVTOL) vehicles	• Rising competition from existing car manufacturers

The conclusion to the analysis was that Tesla Motors has many strengths and few weaknesses. The strengths are such that they allow Tesla to seize the opportunities presented and also overcome the weaknesses and threats identified, due to huge capitalisation and innovative strengths. Tesla is strongly positioned in the car industry.

Questions

Review Illustration 1.1 Tesla Motors and the SWOT analysis above. Answer the following questions:

1 Examine the SWOT analysis above and indicate whether you believe it to be:

(i) inadequate

(ii) barely adequate

(iii) reasonable

(iv) good

(v) outstanding

and explain your judgement.

2 In what ways do you think the SWOT analysis above, could be improved or extended to assess the competitive position of Tesla Motors?

At the same time, it is often insightful to apply more than one relevant framework to a particular problem. Frameworks ‘frame’ issues in particular ways: in other words, they point to some issues while neglecting others. The assumptions and focus of each framework can limit the view. Such limits can be best countered by using different frameworks to examine the same issue. Each framework potentially illuminates different aspects of the issue. The Thinking Differently sections at the end of each chapter particularly help in bringing different ways of framing issues. For example, the Thinking Differently section in Chapter 6 contrasts the calculative and individualistic approach of stakeholder analysis to the more cultural and communal approach of ubuntu philosophy. Similarly, the four lenses of Design, Emergence, Variety and Discourse offer alternative ways of framing issues.

When using several frameworks, it is generally important to try to link different pieces of analysis. Otherwise, the result is a set of disparate analyses that don’t really inform one another and so don’t

add up to much insight. The real value of a strategic analysis is building up a cumulative and powerful strategic picture of the organisation as a whole. An overall view that integrates the important issues in a coherent way should be the eventual outcome of strategy analysis. All analysis needs a conclusion.

2.3.3 Frameworks and theories

So far, the chapter has hinted that frameworks are often much more than just their superficial appearances. Underlying frameworks are typically concepts, theories and research that give confidence in their validity, insight into their results and guidance to practical usage.

Even a checklist like SWOT has acquired some underlying theoretical underpinnings. SWOT emerged from the practical consulting activities of the Stanford Research Institute and Urwick Orr in the early 1960s, but it has since been reinforced by theoretical developments in academia.[7] Thus, Jay Barney, the founder of the influential resource-based view of strategy (see Chapter 5), introduced his theory in terms of SWOT.[8] For him, strengths and weaknesses are about competitive (or relative) advantage or disadvantage. According to the resource-based view, such competitive advantage is based on having valuable, rare, inimitable and non-substitutable resources and capabilities. This theoretical insight from the resource-based view provides an important reminder in using SWOT. Strengths and weaknesses are relative, assessed on the basis of what your rivals have or do not have. Claimed strengths can be rigorously assessed against the criteria of value, rarity, inimitability and non-substitutability.

In the same way, Michael Porter has introduced a more specific and systematic way of analysing opportunities and threats in an industry. His Five Forces framework for analysing the attractiveness of industries (see Chapter 4) has strong roots in economics theory and research about the importance of market power for profitability.[9] Michael Porter himself did some of this research in Harvard University's Economics Department. His choice of rivalry, buyer power, supplier power, substitutes and entry threat as the five forces is not arbitrary, therefore: the potential influence on profits of each force is confirmed by research. The resulting guideline for practice is not to short-cut your industry analysis by omitting any of the five forces.

This kind of underpinning in research is the reason why *Exploring Strategy* frequently refers to academic sources. Knowing that frameworks are backed by rigorous academic theory and research should give you confidence in their validity: they have been probed for intellectual coherence and tested against real-world data. This basis in research also reminds you to be careful about altering or short-changing frameworks: they are typically the way they are for very good reasons.

2.4 Strategic thinking techniques

This section introduces three general techniques for thinking strategically and that underpin many more specific strategy frameworks: *allocentricism*, which is about looking broadly; *issue trees*, which are about thinking deeply; and *system mapping*, which is about seeing links. All of these techniques are applicable to life's problems in general, but they have particular value in strategy.

2.4.1 Allocentricism

In our personal lives, we are often tempted to be egocentric, thinking first about ourselves. Morality tells us instead to be 'allocentric', to think about others.[10] In strategy, allocentrism is not just a matter of morals; it is vital to strategic success. **Allocentricism involves thinking not only about your own organisation but about other actors, for example customers, suppliers, rivals, partners and governments**. Their concerns, strengths and reactions are likely to matter to your success. Allocentricism encourages you to think broadly rather than just about yourself.

Allocentrism is fundamental to many of the concepts and frameworks in this book. As discussed earlier in this chapter, SWOT analysis is not so much about your strengths and weaknesses, but about whether you are better or worse than your competitors. A strength is valuable if it gives you an advantage vis-à-vis others. It follows that you can only complete a SWOT analysis of your own organisation when you have analysed the strengths and weaknesses

of your key competitors. Similarly, the concept of competitive advantage in Chapter 5 clearly relies on your position relative to competitors. The effectiveness of business strategies also depends on competitor counter-moves (see Chapter 8). For example, a strategy of price cutting depends on the capacity of your competitors to respond in kind: if they match your price cut, then you will not gain sales but you will depress profit margins. With regard to acquisitions (Chapter 12), you have got to take into account not only how the target company will respond, but also the reactions of rivals who might want to bid more for the target.

The concept of allocentrism therefore helps us avoid egocentrism in strategic analysis. It puts brakes on over-confident 'fast thinking' (Section 2.2.1) by challenging us to think hard about the strengths, weaknesses, motives and reactions of other organisations. Strategy is not all about you; it is about the others upon whom your success depends. In strategy, allocentric analysis puts others first.

2.4.2 Issue trees

Big issues are often like tree trunks, with branches reaching out to many subsidiary issues. For example, a big issue for you personally might be how to pay back your credit card debt. Subsidiary issues would include how to cut your expenditure and how to raise your income. Each of these subsidiary issues contains further subsidiary issues of their own: can you cut your expenditure by eating out less or by not taking a holiday; can you increase your income by getting a promotion or by changing your job altogether? Strategy typically involves big issues too, and issue trees can provide a structure to

help you think deeply about these issues, drilling down several layers.[11] The branches of strategic issues can stretch very far.

Issue trees involve the systematic breaking-down of big issues into subsidiary issues for further analysis. Many of the strategic choices addressed in Part II of this book lend themselves to issue tree analysis. For example, your big strategic issue might be how to grow your organisation. Subsidiary issues would be whether you can get enough growth from your existing markets, or whether you will have to diversify into new markets (see Chapter 9, Corporate Strategy). Sub-issues to each of these alternatives are whether to grow by entering a new market on your own (organic), or to acquire or merge with another organisation already in that market (M&A), or to form an alliance with an organisation capable of helping you into the market. Figure 2.4 maps out an issue tree for the big issue of growth. You could, of course, use issue trees to address other big issues such as how to improve profitability or how to develop a more environmentally sustainable business. For profitability, the first two subsidiary issues would be whether to raise revenues or cut costs; further subsidiary issues would flow from there (do you raise revenues by increasing volumes or by increasing prices, and so on?).

Figure 2.4 Structure of an issue tree (MECE)

Figure 2.4: Long Description

A goal in issue tree analysis is to construct a set of subsidiary issues that are mutually exclusive and collectively exhaustive (MECE).[12] Mutually exclusive means that issues (or options) are logically distinct, requiring separate analysis; collectively exhaustive means that you have covered all practical issues (or options). For example, for the growth issue in Figure 2.4, the MECE sub-issues of organic, M&A and alliance are each exclusive in the sense of being separate options for analysis (though options can be combined in the final strategy) and exhaustive in considering the whole range of possibilities. Issue trees help you think deeply by making sure that you cover issues and sub-issues (collectively exhaustive) and that you analyse each of them separately (mutually exclusive).

2.4.3 System mapping

Systems thinking is about not seeing issues in isolation.[13] **System maps show the consequential links between the elements of a strategic problem**. In a system, all the parts are interconnected, so changing one part is liable to have knock-on effects ('feedback loops') on all the other parts. Often, a small change can set off a chain of events that is much bigger than the initial change. For example, in the interdependent ecosystems of nature, a pesticide that kills a particular pest impacts the small predators that feed on that pest and, in turn, impacts the larger predators that feed on the smaller ones. Mapping such consequential links is a good way of anticipating such impacts.

Many strategy situations are like the interdependent ecosystems of nature. One element of an organisation is connected closely to many other elements. For example, the strategic success of the Apple iPhone is dependent upon a system (often even called an ecosystem) of mutually reinforcing products: the Apple Store, iCloud, Apple Music, iPads, iPods, the Mac, and so on. iPhones work well because they smoothly connect to so many other products. Many of the concepts and frameworks in this book involve systems thinking. For example, Chapter 4 describes business ecosystems; Chapter 5 explores 'value systems' of interconnected customers and suppliers; Chapter 11 explores the role of business ecosystems like Apple's in innovation; Chapter 15 describes the importance of keeping all organisational elements aligned together ('configured') during strategy implementation, as in the McKinsey 7S framework. A system map can bring out the key interdependencies that strategists need to bear in mind.

Illustration 2.2 provides a partial system map of urban indigenous food insecurity in Canada, showing consequential links between and within six separate subsystems or sectors. Two key takeaways from this map are: first, indigenous food security is not only about nutrition, but also about culture and mental health; and second, strategic interventions must involve the environment and government as well as economics. Mapping systems in this kind of way makes clear that strategic problems cannot be addressed piecemeal. If you identify a strategic weakness, what else has to be fixed to resolve it properly? If you identify a strategic opportunity, what supporting actions are needed to make your strategy actually work? Going back to Section 2.2.1, system mapping helps you ‘think slow’ because it points to the links that are typically so important in strategy.

2.5 Strategy analysis procedures

As a student, you may be asked to analyse a published case study in preparation for a class discussion or as an assignment or an examination. Sometimes, you will be asked to treat a real organisation as a case, involving research through published and other sources and choice about which analytical frameworks to use. This too could be the task for an executive or consultant working in the real world of practice. Job interviews also often ask candidates to analyse a short case. This section offers guidance on how to analyse both published case studies and real organisations.

Illustration 2.2 Mapping the urban indigenous food system in Canada

A student systems map shows the strategic challenge in addressing food insecurity for indigenous Canadians.

In 2021, three students from the University of British Columbia – Cathy Zhu, Emily Chau and Anika Cheng – came first among teams from 56 international institutions in the 'Map the System' competition run by the Skoll Centre for Entrepreneurship at the University of Oxford. Their project examined the system that underpinned food insecurity for urban indigenous people in British Columbia.

One in three indigenous households living in urban environments, such as Vancouver, suffer food-insecurity – constraints on access to sufficient, safe and nutritious food. Indigenous peoples have traditionally harvested foods such as salmon, game and

shellfish for themselves. The movement to urban areas has deprived Indigenous peoples of these traditional food sources, making them reliant upon the economics of the market.

The team mapped the interconnected nature of the food system for Indigenous peoples. Figure 2.5 is a partial and stylised representation of their final map. The map is extensive, recognising the roles of the environment, food systems, the health sector, the economic sector, social systems and the government sector in determining food insecurity among indigenous peoples in Canadian cities. The red dashed arrows show just some of the consequential links within these systems and sectors and between them. For example, in the environmental sector, pollution has an impact on ecosystem diversity, which in turn leads to a lack of cultural foods, which then affects the cultural determinants of health among indigenous urban people. Chronic disease in the health sector leads to low incomes in the economic sector and then to high demands on social welfare programmes in the social system.

The team drew two key insights from their map: 1) indigenous food insecurity is a complex and systemic issue where strategic interventions have failed to achieve sustainable success for decades; and 2) the current dominant Western worldview of food as a commodity ignores indigenous worldviews that food is connected to the land and that, consequently, food impacts not only physical well-being, but also mental, spiritual and emotional. Strategic interventions addressing indigenous food insecurity must, therefore, recognise the place food has not only in nutrition but also in health, social systems and the environment.

Questions

1 The figure provides just a partial map of the system elements and links underpinning urban indigenous food insecurity. What other elements and links could you expect to be important?

2 On the basis of this map and any other elements and links you could add, what strategic interventions would you prioritise and how would they be coordinated across the six subsystems and sectors?

Figure 2.5 Partial systems map of urban indigenous food insecurity in Canada

Source: Adapted and simplified from A. Cheng, C. Zhu and E. Chau, 'Unique Get Together Society (UGTS) and Urban Indigenous Food Insecurity in British Columbia', University of British Columbia. Available at: https://mapthesystem.sbs.ox.ac.uk/files/ugtsurbanindigenousfoodinsecurityvisualmappdf [accessed: May 2022].

Figure 2.5: Long Description

2.5.1 Analysing strategy cases

Typically, a published case study is a description of a situation faced by entrepreneurs or managers in a real organisation. Cases come in many forms and often include complex problems on different levels of analysis. *Exploring Strategy* offers cases of a range of lengths, from the short cases at the end of each chapter to the longer ones available in the *Text and Cases* edition. Cases also come from diverse environments, industries and sectors, both profit and non-profit. *Exploring Strategy*'s cases are drawn from all around the world, and include a wide variety of organisations, from global tech companies to a regional arts festival. However, underneath this diversity, published cases are frequently characterised by the following:

- Descriptions of significant organisational problems, issues and decisions.
- Unstructured and multifaceted data and information on the environment and an organisation.
- Both qualitative and quantitative data, not all of which is necessarily relevant to the case problems.
- Various strategic levels of analysis (macro environment, industry/sector, organisation, etc.) that are not always explicitly separated.
- Problems and assumptions that are not clearly stated, and no obvious guidelines about how to address the issues or

problems.

Just as in the real world, there is a lot of confusing and 'noisy' information. There will also be ambiguity and gaps in the information. It is your job to decide what is important, how to interpret the information you have and what you can reasonably assume. It is unlikely that the case has any unambiguously right or wrong 'answers'. Strategy does not involve the certainty of mathematics. Strategy looks into the future; it is about people; it involves the unpredictable reactions of other organisations. It is important, therefore, to accept a degree of uncertainty. What matters is reasoned recommendations based on thorough analysis.

For class discussions, there are two fundamental recommendations for preparing cases.[14] These recommendations are simple but cannot be overstated:

- *Focus your preparation.* Check carefully the specific tasks set by your lecturer for the case. Prepare at least initial responses to any specific question before each case discussion. You are not expected to come to class with all the answers but, without prior preparation, a case discussion will have little value for you and is likely to be rather empty. Preparation means reading the case at least twice: the first reading may involve getting a quick overall view of what is going on; the second reading might be more detailed and involve taking notes. You will probably then have to focus on particular parts of the case more deeply. If advised by your lecturer, take the opportunity to discuss the case in groups beforehand. Unless advised otherwise, you should generally stick to the materials in the case itself, with no

need to do further research on the case organisation or sector. Illustration 2.3 provides some suggestions about preparing for case discussions.

- *Be an active communicator*, both in presenting your own ideas and questions and as a listener. Being an active communicator does not imply that you present all the right solutions, but that you can suggest parts of answers, ask good questions or build on the contributions of other classroom participants. Contributing is a great way of crystalising your own understanding: communicating is how you learn. Of course, students who are constantly intervening in the discussion are not necessarily contributing or learning more. However, a good case discussion is one in which you join in. You will learn more and enjoy it more.

2.5.2 Analysing real organisations

In the previous section, we focused upon analysing a published case study where all the necessary information is provided in a limited number of pages. However, you may be asked as part of your course (perhaps the final assignment) to investigate a real organisation and its strategy. This is much closer to strategy in the real world where you will be given a strategy problem to solve (for instance, whether to enter a new market) and where you will have to gather the data yourself (for instance, on market and competitor trends). Often, these investigations are more engaging, because they involve contemporary situations and even your own choice of organisation. However, they can be more work because of the

unstructured nature of problems and data. There are at least three things to consider:

- The *key problems, issues or dilemmas* for the organisation. A real organisation will give fewer clues about these than in a published case study which is associated with a specific part of the course or chapter of *Exploring Strategy*. You will have to decide for yourself what problems, issues or dilemmas have priority – in other words, which demand most urgent managerial attention. It will be important to explain your choice of priorities. A SWOT analysis can be a good place to start with deciding priorities, but more analysis is likely to be required. The organisation's own published reports and media or other observer commentary will also provide you with clues (but don't forget that organisations are often unwilling to acknowledge their own problems).
- The *scope of comparison*. A published case study will provide you with data going over the period of time that the case study author regards as relevant and will describe the rival or peer organisations that are most salient. In a real-world investigation, you have to decide for yourself both which other organisations you should be comparing with and over what period of time that comparison should stretch. For example, how does your organisation's financial performance, revenue growth or service delivery compare with previous years; how do they compare with other similar or rival organisations? Remember that one or two years of data is rarely enough to suggest a trend. Equally, on the principle of allocentricism (Section 2.4.1 above),

strengths are always relative and opportunities depend on other organisation's actions too.

- Available *data sources*. Published case studies provide you with data in a neat package. In an investigation of a real organisation, one of the most arduous tasks is obtaining all the data you need in a form that is amenable to analysis (especially comparing over time and across organisations). Some data will be easy to obtain as it will be freely available through Google or similar search engines. However, critical factors are the quality of the data: is it accurate, up to date, comprehensive and reliable? Garbage in is likely to lead to garbage out. Another important consideration is whether you have the right types of data. Here frameworks and techniques from *Exploring Strategy* can give you strong pointers in terms of the data you need for your analysis and prevent you from being too limited in your view. Remember that qualitative data (for example, a significant incident, a quote from a customer or a revealing image) can be as insightful as quantitative data. Table 2.1 provides a summary of key types of data valuable for investigating real organisations. Check with your institution's library about what sources and databases it has available. Sometimes, you may have to fill data gaps by making certain assumptions, but you should be clear about the reasons for these.

Illustration 2.3 Case preparation steps

There are multiple integrated steps in preparing for a case discussion.

These steps include the following:

1 **Get a sense of the main case problems, issues, decisions and relevant facts.**

The sooner you can define and structure the central problems of the case the better, as this will help you to determine how to analyse and 'solve' the case. Hence, start by considering the following questions:

- What appears to be the core case problem or issue, or critical decisions?
- If there are assigned questions and/or readings, do they give any hints of the main problems, issues and decisions?
- What level of analysis seems to be most important (macro environment, industry/sector and/or individual organisation)?
- What seem to be the key relevant facts and exhibits (don't neglect the appendices or any financial data)?

2 **Identify what concepts, frameworks, and tools may help in analysing the case.**

Once you have grasped the main problems and issues of the case, you can move to the next step and determine what methods are going to be most useful. You might ask:

- Where does the case appear to fit into your overall course structure (i.e., in relation to which parts of the course, or which *Exploring Strategy* chapters or which other readings)?
- What types of general problems and levels of analysis appear to be most relevant (e.g., business strategy or overall corporate strategy; diversification strategy or international strategy; strategy development or strategy implementation)?

3 **Apply the relevant strategy theories, concepts, frameworks, tools, etc.**

When you have a reasonably good idea of the case, you can start to apply the relevant theories, concepts and frameworks:

- How can the chosen frameworks and tools be applied and adapted to the specific case problems?
- How do the concepts and methods assist in finding solutions to the case problems?
- What are the most significant implications from each of the chosen strategy frameworks and tools?

4 **Assess alternative solutions, answers and decisions.**

The outcomes of your analyses and reflections should help you to determine possible solutions. Some of the questions to consider at this stage, therefore, include the following:

- What type of analysis proved most useful?
- What alternative solutions or options are there to the identified case problems?
- What data and facts in the case support your analysis and possible solutions?

5 **Suggestions for formulating conclusions and decisions.**

Finally, you need to prepare your conclusions and any proposals for decisions. Hence, some important considerations and questions here include the following:

- What are the main conclusions from the analysis?
- Which alternatives and options seem most useful and why?
- What decisions should managers or any other decision maker take and why?

Questions

1 Ignoring the specific questions set by *Exploring Strategy*, examine either the Case example for Chapter 1 (Airbnb) or the Case example for this chapter (Canal+) and go through step 1 above. What are the main issues or problems in this case, going beyond the specific questions?

2 What issues or problems are there in these cases that are not wholly covered by the frameworks or concepts that you have been specifically asked to apply to these cases?

Once the data for your investigation has been collected, then the guidelines for case study analysis outlined in the previous section can be followed. Of course, the question that follows analysis is how to present the resulting recommendations.

Table 2.1 Types of data sources for investigating real organisations

2.6 Developing and communicating strategy

The output of both real-world strategy work and student assignments is often a strategic plan. This section addresses the key elements within a strategic plan, characteristics of a good (and bad) strategy, and issues to do with presenting strategic plans and other forms of strategy work.

2.6.1 Developing a strategic plan

A strategy assignment, or a real-organisation investigation, will often involve designing an overall strategic plan. For example, your lecturer might ask you as a final assignment to develop a strategic plan for a particular organisation. **A strategic plan is a roadmap for seizing the opportunities and minimising the threats facing an organisation**. The material for developing such a plan will be found throughout *Exploring Strategy* as a whole.[15] It is important to remember that a strategic plan does not involve just an analysis of the strategic position (the subject of Part I of this book) or final strategic choices (the subject of Part II). An essential part of any strategic plan will be considering its implementation, the main theme of the final Part III Strategy in action. Implementation would involve issues like the management of change, the choice of organisational structure and the roles of organisational leaders. A strategic plan that is impossible to implement is not worth the paper it is written on.

Every strategic plan will have its own distinctive components but, as a rough initial guide, such plans might include the following:

- *Purpose, vision, mission and objectives statement.* What the organisation is trying to achieve is the point of the whole strategy, and the critical starting place. While this is the starting place, in practice, you might iterate back to this in the light of other elements of the strategic plan: original objectives might need to be changed in the light of what the analysis shows is actually achievable. It is worth checking back with earlier statements that the organisation may have made to ensure consistency. Both Sections 1.2.2 and 6.2 provide more guidance on purpose, vision, mission and objectives.
- *Environmental analysis.* This should cover the key issues identified in terms of the whole of the environment, both macro trends and more focused issues to do with customers, suppliers, competitors and ecosystem partners. You should not stop at the analysis but draw clear strategic implications (see Chapters 3 and 4).
- *Resource and capability analysis.* This should include a clear identification of the key strengths and weaknesses of the organisation, in terms of resources, capabilities and its products relative to its competitors and include a clear statement of competitive advantage (see Chapter 5).
- *Business model.* This should describe the value proposition for customers, the arrangement of resources and capabilities that produces this value and the associated revenue and cost structures (see Chapter 8).

- *Strategic options.* This will set out a number of possible strategic initiatives that might be pursued to improve the organisation's strategic position. These should be clearly related to the environmental and organisational analyses and support the various objectives of the organisation (see Chapters 6, 8 and 12).
- *Proposed strategy.* This should show clearly why this proposed strategy is superior to the foregoing options. It should show how it is suitable in terms of purpose, vision, mission and objectives; how it is acceptable to key stakeholders and feasible in terms of implementation. Some quantitative estimates of required financial investment and expected returns are likely to be important here (see Chapter 13).
- *Additional resources.* The team will need to provide a detailed analysis of the resources required, with options for acquiring them. Critical resources are typically financial, so the plan should show sources of funds. Other important resources might be human, particularly managers or people with particular skills. A clear and realistic timetable for implementation is also needed (see Chapter 16).
- *Key changes.* What does the plan envisage are the key changes required, for example in structures, systems and culture, and how are these to be managed? (See Chapters 14, 15 and 16.)

2.6.2 Good and bad strategy

The previous section covered standard elements of a strategic plan, but how can one determine whether you have a good or bad

strategy? Richard Rumelt's book *Good Strategy/Bad Strategy* is designed to cut through to the essence of good strategy.[16]

Rumelt criticises strategy for being confused with success as strategies can be both successful and unsuccessful. He points out that, without action, or implementation, strategy is just blue-sky 'wheel spinning'. For Rumelt, a good strategy has an essential logical structure that contains three elements:

- *Diagnosis.* This defines the challenge facing the organisation. It answers the question of what is holding the organisation back from its goals. The diagnosis typically simplifies the complex reality by identifying particular factors as critical, often using a metaphor. In its early days, Tesla might have defined itself as a David taking on the Goliaths of the traditional car industry. That would suggest the problems and opportunities of scale as critical factors.
- A *guiding policy*. This refers to the basic parameters guiding strategy. It is not the strategy itself, but rather guardrails identifying the boundaries of appropriate action. For Tesla, that might have been electric vehicles, not hydrogen.
- A set of *coherent actions* For Rumelt, actions are essential to good strategy. He points to the importance of coherence, however. Actions should be mutually reinforcing and not independent. For Tesla, investment in the giga battery factories reinforces the growth and innovation strategy.

These three elements of good strategy correspond broadly to the three Parts of this book, examining position, choice and action.

Bad strategy is more than just the absence of good strategy but has a logic of its own. For Rumelt, there are four main indicators of bad strategy:

- *Fluff.* Using esoteric or faddish words to give an illusion of high-level thinking.
- *Failure to face a challenge.* Inability to define the challenge, meaning a strategy cannot be evaluated or improved. Organisations may also actively avoid analysing obstacles as leadership does not like negative thoughts.
- *Mistaking goals for strategy.* Treating strategy as an exercise in goal setting and not problem solving; just focusing on statements of desire rather than making workable plans for overcoming obstacles
- *Bad strategic objectives.* These are bad when they fail to address critical issues or they are impracticable. A common sign of bad objectives is the 'dog's dinner' – a mess of organisational initiatives that try to cover all the bases and fail to focus resources and actions.

You can use Rumelt's criteria of good and bad strategy to check your own strategic recommendations, either in assignments or in practice.

2.6.3 Presenting strategy

It's all very well carrying out good quality strategy analysis and coming to well-reasoned conclusions, but you need to communicate these effectively. As a student, you might have to present your analysis and recommendations in a written examination or report, or

as a classroom presentation, perhaps supported by slides. Similar principles apply to each.

There are two underlying principles for effective strategy communications of all sorts:

- *Focus.* Communications need to focus on the key issues and components of the strategy. If the presenter cannot show they are clear on these, then it cannot be expected that others will be. It is also helpful to avoid unnecessary detail or complex language. Like the widely used acronym KISS, 'Keep it simple, stupid', communications are generally improved through greater simplicity of language. CEO Jack Welch's famous statement that General Electric should be 'either Number One or Number Two' in all its markets is remembered because of this clear focus on the importance of being a dominant player wherever the company competed.
- *Impact.* Communications should be impactful. Analyses should be followed by clear statements of implications. Remember also that graphics – such as charts, diagrams, pictures and drawings – have much greater impact on recipients than text and bullet points, too often the mainstays of PowerPoint presentations.[17]

  The use of charts and graphics greatly improve recipient recall and also improve recipient understanding of the multiple dimensions of a strategy. The term 'stratography' has been coined to underline the importance of good graphics for effective strategy communications.[18]

As part of a class assignment or examination, you may be asked to do a strategy presentation. Sometimes, this is also part of a job

interview, for example presenting a brief strategy case analysis. The strategy presentation itself is often as important as the strategic thinking and analysis behind it. This may seem unfair, but even the best strategy can be undermined if not clearly communicated. A strategy analysis is often part of a broader strategy presentation, and it normally includes some basic and vital components that need to be considered carefully, motivation, purpose, methods, analytical frameworks, and conclusions, as follows:

- *Motivation and background.* This part explains why the presentation is needed and is of importance. It can be very brief and, for example, simply state that a strategy analysis of the business landscape is required to better understand new and fierce entrants and competition. Alternatively, if the background is more complex, it needs to be longer, for example, carefully explaining the need for a strategic shift, like discarding one product area and launching an entirely new one, and, thus, why a strategy analysis of this is presented.
- *Purpose.* A crystal-clear purpose helps the audience to understand the objective of the presentation and why they should attend to it and possibly act on it. It should be as clear, crisp and simple as possible. It assists not only the audience, but the presenter as well because it determines the central focus and helps ensure that the presentation is kept ‘on message’ and avoids any unnecessary digressions. In fact, one of the most significant challenges in a strategy presentation is to keep it focused and sufficiently brief. This is the true challenge in making any convincing strategy presentation. It is an easy

mistake to add content that deviates from the main purpose and message.

- *Methods and approach.* This can range from more simple strategy reflections and analyses to more sophisticated methods including primary research and information collection and use of advanced strategy analysis frameworks and calculations. Research and information collection approaches used should be mentioned in order to make clear any limitations to the work and strengthen the legitimacy of the conclusions (e.g., published sources, interviews, surveys, internet searches, literature reviews, etc.). Furthermore, if it is a detailed strategy analysis, it should be made explicit on what level it is conducted (see Section 2.3.2 above: macro, industry/sector, or organisation). Determining the level of analysis is of crucial importance and makes sure levels are not conflated. If multiple levels are included in full strategy analysis, this should be stated too.
- *Overviews, analytical frameworks, and tools.* This is the central part and can be more or less sophisticated, ranging from simple strategy overviews and analyses to inclusion of more complex and diverse frameworks on different levels of analysis. For example, it may include a simple description of the current strategy situation for an organisation or be more intricate and involve various in-depth analyses and strategy frameworks on the macro environment, industry and organisational resources and capabilities. This section thus makes up the body of a strategy analysis presentation and may include several elements, but make sure not to sacrifice the quality of analyses for the quantity of analytical frameworks: it is generally better to

do a few crucial things well than many things superficially. An audience will be distracted from the main message if too many aspects are included. It is not a question of ‘the more the merrier’.

- *Conclusion and main message.* It may seem obvious that the conclusion needs to be very clear but often strategy presentations include too much information that cannot be clearly concluded in a main message to the audience. Remember that the conclusion is a summary of the main message and argument, not a summary of all the supporting analyses and facts: a central message and idea beats any number of analyses made. Strategy analysis presentations frequently get entangled into a range of different complex analyses to the extent that overall results and conclusions become indistinct. Besides limiting the number of analytical tools, the best way to approach this is to make main points explicit along the way and bring those together at the end and provide an overall conclusion. In this way, a common thread is also kept throughout the presentation where each individual part builds on the others. Preferably, the conclusion is contained on one slide on which the whole argument is summarised. Remember that the conclusion and message should deliver on the purpose and thus tie the introduction and end together. If they do not, you may need to walk back, and review the presentation.

Strategy presentations are often in a PowerPoint (PPT) or similar format and Table 2.2 summarises some brief practical tips. The key issue for a PPT strategy presentation is to make sure that the slides

say what you want them to say and deliver on the overall purpose. There is no point in throwing in slides and shallow analyses that are simply ‘nice to have’; they should rather all somehow deliver on the main purpose and message (you can have some slides as an appendix at the back). Keeping on message assures there is a common thread throughout the presentation.

Table 2.2 also includes some pointers for verbal presentations that may be useful when presenting PPTs in front of an audience, your class, for example. It may help to create an opener that pleases the audience somehow and gets them on your side from the beginning, perhaps a brief anecdote or a striking image related to the presentation, but be careful of any jokes that risk undermining the presentation. There is no need to be nervous and, even if you do show slight nervousness, that is not a big deal – everybody has more nerves than they actually show and, anyway, you do not have to be perfect to be a successful presenter. It can help to get audience eye contact and show some passion (why should the audience be interested if you do not seem so?). Remember, however, that the specific purpose, audience and context matters for the final format of both verbal and written strategy presentations. In addition, your strategy course syllabus and instructor may provide specific instructions for your presentations that may differ from our suggestions in Table 2.2. Keep to the specified time!

Table 2.2 Brief tips for strategy presentations

Key takeaways Strategy is a kind of work and *Exploring Strategy* is about helping you do this work better, whether as a student or as a practitioner. Some key takeaways from this chapter are:

- When considering strategy, *think slow*: be reflective and analytical, not fast and superficial.
- Use strategy frameworks (such as *SWOT* and *TOWS*) appropriately, at the right level of analysis, in combination, respecting theoretical underpinnings and always with a conclusion.
- Draw on the principles of *allocentricism* to think about others, *issue-trees* to drill deeper into problems and *system mapping* to recognise consequential links.
- Learning from case studies involves *good preparation* and *active communication* – you are wasting your time without these.
- Your *strategic plan* should draw on the whole of this book: Part I on strategic *position*, Part II on *choices* and Part III on putting strategy into *action*. Avoid the characteristics of bad strategy: fluff, ignoring challenges, desires rather than plans and lack of focus.
- Strategies need to be understood by key audiences: invest in *communication* and *presentation*.

Recommended key readings

- Daniel Kahneman's (2011) *Thinking, Fast and Slow*, Penguin Books, is a classic that will help you make better decisions both in strategy and life more generally. A good practical guide to approaching many strategic problems is B. Garrette, C. Phelps and O. Sibony (2019) *Cracked It! How to Solve Big Problems and Sell Solutions Like Top Strategy Consultants*, Springer.

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11. See B. Garrette, C. Phelps and O. Sibony (2019) *Cracked It! How to Solve Big Problems and Sell Solutions Like Top Strategy Consultants*, Springer or A. Chia (2019) ‘Distilling the essence of the McKinsey way: The problem-solving cycle’, *Management Teaching Review*, 4(4): 355–70.
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Case Example Canal+: Competing with Giants Frédéric Fréry In 2022, Vincent Bolloré, President of the French media conglomerate Vivendi, told the French Senate: ‘The giant Vivendi is a little dwarf.’ Vivendi was certainly a giant in the French media business, owning the television and cinema group Canal+, the publishing company Editis, the magazine portfolio of Prisma Media and the video games company Gameloft. But Bolloré’s point was that, against some of its competitors, its $18bn (about €16.5bn) annual revenues were tiny. In particular, its television and cinema business Canal+, was under attack from Amazon ($469bn total annual revenues), Apple ($378bn revenues) and Netflix ($30bn revenues).

Canal+ had been founded in 1984 as a subscription-based television company. In 2021, the company had 8.7 million subscribers in France, plus an extra 13.7 million in 40 other countries in the rest of Europe, Africa and Asia. A Canal+ subscriber might pay about $23 per month to subscribe to a full package of video services. Canal+ also operated three major national free-to-air channels based on advertising. StudioCanal

was a European leader in the production, acquisition and distribution of feature films and TV series. It owned one of the world's most extensive libraries with over 7,000 titles from more than 60 countries. It also produced and distributed television series through a network of European production companies, including StudioCanal Original. Canal+ had been involved in creating many hits, from David Lynch's surrealist movie classic *Mulholland Drive* to the rap comedy series *All the Way Up*. In year-end 2020, Canal+ had revenues of $6.2bn and profits of $0.5bn. Since Vivendi's sale of Universal Music in 2021, Canal+ had been the group's largest activity.

Historically, Canal+ had based its success on two pillars – football and cinema – but both these were coming under challenge. For many years, Canal+ had enjoyed the exclusive broadcasting rights to the French top football league, Ligue 1. However, the company lost these exclusive rights in 2018 to the Spanish Mediapro company; when Mediapro failed, Canal+ rebid for the rights in 2021, but ended up sharing them with Amazon Prime, broadcaster of the English Premier League. A similar challenge was coming for Canal+'s close relationship with the French film industry. Through a specific legal scheme sponsored by the French Government, Canal+ was the main financier of the French film industry with around €190 million investment per year, in exchange for an exclusive right to show all French movies before other TV channels. However, Netflix was now producing its own French programming (Netflix Originals), for which the Canal+ exclusivity agreement did not apply. In only 7 years since its arrival, Netflix had successfully attracted 5 million subscribers in France.

For Canal+, the time had come to update its understanding of the strategy of Netflix and its other challengers. Its main shareholder, Vivendi's Vincent Bolloré, was clear. He told the French Senate: 'Our treasure is our history. It is this treasure which can be exported . . . We can make something a little bit more subtle and refined than *Spiderman*.'

Netflix reinvents the television industry Netflix was founded in 1997 by Reed Hastings and Marc Randolph as a mail-order

DVD (digital video disc) sales and rental business. The idea was to compete against large video rental stores like Blockbuster or Hollywood Video, which had thousands of outlets in the USA at that time. In 1998, Netflix focused on online DVD rental service and launched its first website, with 925 titles available. It followed in 1999 with a monthly subscription. The company went public in 2002, and it reached 1 million subscribers in 2003.

In 2007, 10 years after its debut – and thanks to the growth of high-speed Internet – Netflix introduced its streaming service while maintaining its DVD online rental service. The streaming service expanded internationally (in Canada) in 2008, then in Latin America in 2011, in parts of Europe in 2012 and in Japan in 2015. The first Netflix Original programme, *House of Cards*, was produced in 2013. Between 2011 and 2021, the number of subscribers increased tenfold (see Figure 1).

In early 2022, Netflix was available in 190 countries and its market capitalisation exceeded $170 billion. It had over 220 million users worldwide and was attracting 1.5 million more each month. Its brand name was almost synonymous with video-on-demand and binge-watching, and it alone consumed 15 per cent of the global Internet bandwidth. In the 2021 financial year, its revenue was $29.5 billion (+19 per cent compared to 2020) and its net profit $5.1 billion (+85 per cent). Series like *Squid Game*, *Stranger Things* or *La Casa de Papel* (*Money Heist*) had established themselves in popular culture, and Oscar-winning directors, such as Martin Scorsese, David Fincher, Alfonso Cuarón or Bong Joon Ho were working with Netflix. Worldwide, Netflix spent $17bn on content production in 2020. Netflix's French productions included the mystery series *Lupin*, which became a global hit. As a result of this extensive production activity, plus acquisitions, Netflix had an ever-growing library of titles, with 5,800 in the USA (library sizes varied by country).

Figure 1 Number of Netflix's paid streaming subscribers at the end of the respective year (in millions)

Figure 1: Long Description

A competitive market By 2022, of course, Netflix was not alone, with a host of new video streaming players emerging from the USA over the last decade. Only two years after its 2019 launch, Disney+ boasted more than 118 million subscribers worldwide, followed by Amazon Prime Video with 100 million users, and AT&T-Time Warner's HBO Max with over 70 million. Apple launched its Apple TV+ offering in 2019, but had only 20 million subscribers by the end of 2021.

Like Canal+, none of these American competitors was available worldwide. For instance, all of them – including Netflix – were blocked in China. Amazon Prime Video, thanks to the global reach of Amazon, was available in 200 countries. Due to various

agreements with local third-party TV providers, HBO Max was present in most of the Americas (but not in Canada), in large parts of Europe (but not in the UK, France, Germany, Italy, The Netherlands or Belgium), and not at all in Asia. In France, HBO programmes were distributed by Canal+.

The growth of competition, and the variety of business models (some drawing on advertising, some part of service bundles) was driving down prices. Netflix offered its Standard plan (HD, up to two screens at a time) for $12.99 (about €12) per month in the USA. Apple TV+ was at only $4.99 per month (and free for three months following the purchase of an Apple device). Disney+ was charging $7.99 per month, but also proposed a bundle that included Disney+, EPSN+ (a sports streaming platform) and Hulu (a video streaming platform founded in 2007 and acquired by Disney in 2019) for $13.99. HBO Max was charging a minimum price of $9.99 per month for its 'Ad-Supported' plan and $14.99 for its 'Ad-Free' plan. Amazon's approach was different, since Amazon Prime Video was included in its Prime bundle ($139 per year in the USA, but only €49 per year in France), which also gave access to free express delivery, exclusive discounts and unlimited photo storage, among other benefits.

In terms of content, there was considerable variety too. Apple+ had a small catalogue so far. However, Disney's catalogue was unrivalled, with the *Disney*, *Pixar*, *Marvel*, *Star Wars* and *Fox* licences, and it was constantly developing new programmes. HBO Max, with the *Game of Thrones* or *Friends* series and the *Harry Potter* or *DC Comics* franchises, was also a formidable competitor. In May 2021, Amazon spent $8.45 billion to acquire MGM studios (*James Bond*, *Rocky*, *The Handmaid's Tale*, etc.), and produced the first season of its *Lord of the Rings* television series for $465 million. Amazon Prime Video was planning to invest around $10 billion each year in original contents. Such huge investments in content were driving an inflationary spiral in terms of costs of production, with star actors and producers in massive demand and enjoying record rewards.

More choice for consumers implied lower loyalty to platforms. Users realised they couldn't get all their preferred content in one place: in 2021, 20 per cent of subscribers reported cancelling a service in order to switch to another one (sometimes, after watching a specific series). Netflix had the lowest cancellation rate in the industry, followed by Disney+. In addition, video piracy was on the rise, with between 4–25 per cent of internet users consuming illegal content each week, and approximately 50 million people worldwide were using Netflix without paying, but by sharing passwords with friends or relatives. This practice was costing Netflix more than $6bn per year.

Moreover, there were close substitutes to television and film, such as YouTube and the Chinese video-based social networking service TikTok. Video games were an important alternative pastime too, one that had been attracting huge investments from the technology giants: in early 2022, Microsoft bought the leading games company Activision Blizzard for $69bn. In 2021, Facebook changed its name to Meta in order to mark its entry into the metaverse, a virtual reality global interface for all online activities from social networking, through video to games. Netflix CEO Reed Hastings commented: 'We compete (and lose) with Fortnite more than with HBO.' All these various alternative forms of entertainment threatened attention saturation among consumers: there would simply be no time to watch Canal+ movies.

Consequences for Canal+

In 2019, in order to maintain its attractiveness, Canal+ decided to include a Netflix subscription within its premium streaming plan, which also offered a curated catalogue of thousands of movies, pay-per-view options, and access to award-winning shows such as *The Bureau* or *Spiral*, for a total of €40.99 ($46) per month. In 2020, Canal+ added access to Disney+ to this plan. As a consequence, since Canal+ already distributed HBO programmes in France, it gave access to three of the major streaming platforms through its own single offer. As an aggregator, Canal+ also proposed beIN SPORTS streaming platform as an option. The idea was to position Canal+ as a 'one-stop shop' for all the

platforms, with two potential benefits for viewers: its price was lower than the subscriptions to the different services would be on their own; and its own interface, MyCanal, was designed to smooth the experience for the viewers, with seamless access to the different catalogues.

In parallel with this aggregation strategy, Canal+ also announced in late 2021 that it was planning to add a new series every week on its platform, and it renewed its financing – and exclusivity – agreement with the French movie industry. The leader of the French cinema production industry declared: ‘At a time when the market is being upended by the entry of the [American] streaming companies, the [French] cinema industry wants to keep Canal+ as its principal partner’. At the same time, to build up scale in the French media market generally, it announced a takeover bid for another leading French media conglomerate, Groupe Lagardère, which had major stakes in television, radio, book publishing, newspapers and magazines (2021 revenues $5bn). In 2021, MyCanal was used by nearly 12 million users per month in France, with 10 hours of content consumed per week on average per subscriber, and access via 15 million connected TV devices (set-top boxes, smart TVs, video game consoles, etc.). Up to 120,000 pieces of content were available at any time on the platform, with 1,100 new pieces added per day. Thus, by a combination of aggregation and investment, the French dwarf was bulking up – but was this enough in its battle with the giants?

Sources: *Les Echos*, 17 September 2019, 19 January 2021 and 2 February 2022; *Variety*, 20 April 2021 and 27 May 2021; *Statista*; *medium.com*, 5 November 2019; *Interpret*, 8 June 2021; *Deloitte Insights*, 1 December 2021; *Sport Index*, March 2021; *ZDNet.com*, 21 February 2021, 23 and 30 January 2022; netflixinvestor.com.

Questions

1 Identify the main strengths and weaknesses of Canal+.

2 Identify the main threats and opportunities for Canal+.

3 Using the findings of the first two questions, construct a SWOT diagram.

4 In the light of this SWOT, what do you think of Canal+’s strategy?

Long Description

Part I

The strategic position

This part explains:

- How to analyse an organisation's position in the external environment – both macro environment and industry or sector environment.
- How to analyse the determinants of strategic capability – resources, capabilities and the linkages between them.
- How to understand an organisation's purposes, taking into account corporate governance, stakeholder expectations and business ethics.
- How to address the role of history and culture in determining an organisation's position.

Introduction to Part I

This part of the book is concerned with understanding the strategic position of the organisation. There are five chapters, organised around two themes. The first theme is the organisation's strategic *potential,* in other words what it *can* do. The second theme is the organisation's strategic *ambitions,* what it actually *seeks* to do, sometimes deliberately and sometimes not so deliberately (see Figure I.1).

Strategic potential is addressed as follows:

- Chapters 3 and 4 consider how different environments can be rich in opportunities or hostile, imposing threats and constraints.
- Chapter 5 considers how each organisation has its own particular strategic resources and capabilities, and how these can enable or constrain strategies.

Organisational ambitions are addressed in the following two chapters:

- Chapter 6 is about ambition in terms of the purposes that organisational stakeholders seek and the ways in which it is governed.
- Chapter 7 examines how an organisation's culture may shape the ambitions of an organisation, often in taken-for-granted and hard-to-change ways.

There is an important strategic dilemma that runs through Chapters 3, 4 and 5. How much should managers concentrate their attention on the external market position and how much should they focus on developing their internal capabilities? On the external side, many argue that environmental factors are what matter most to success: strategy development should be primarily about seeking attractive opportunities in the marketplace. Those favouring a more internal approach, on the other hand, argue that an organisation's specific strategic capabilities should drive strategy. It is from these internal characteristics that distinctive strategies and superior performance can be built. There can be a real trade-off here. Managers who invest time and resources in developing their external market position (perhaps through acquiring companies that are potential competitors) have less time and resources to invest in managing their internal capabilities (for example, building up research and development). The same applies in reverse.

Figure I.1 Strategic position

Chapters 6 and 7 raise another underlying issue. To what extent should managers' ambitions for their organisations be considered as free or constrained? Chapter 6 explains how the expectations of investors, regulators, employees and customers can often influence strategy. Chapter 7 raises the constraints on managers exercised by organisational culture. Managers may be only partially aware of these kinds of constraints and are often in danger of underestimating the hidden limits to their ambitions.

Understanding the extent of managers' freedom to choose is fundamental to considering the issues of strategic choice that make up Part II of this book. But, first, Part I provides a foundation by exploring the question of strategic position.

Chapter 3

Macro-environment analysis

Key terms forecasting

key drivers for change

macro-environment

non-market environment

organisational field

PESTEL analysis

scenarios

Learning outcomes After reading this chapter, you should be able to:

- Analyse the broad macro-environment of organisations in terms of *political, economic, social, technological, ecological* and *legal* factors *(PESTEL).*
- Recognise the influence of *non-market* factors as well as *market* factors on organisational strategy.
- Evaluate different approaches to environmental *forecasting.*
- Draw on the full range of macro-environment analysis, identify *key drivers for change*.
- Construct alternative *scenarios* in order to address possible environmental changes.

Long Description

3.1 Introduction

Organisations depend upon their environments for their survival. Here environments are being understood in their widest sense – to include political, economic, social, technological and legal factors as well as ecological ones. These environmental factors supply both opportunities and threats. The clustering of young people in high-rent cities provides opportunities for new co-living businesses offering flexible, shared and welcoming accommodation. The rise of the metaverse creates new opportunities for hardware manufacturers such as Nvidia, Samsung and Sony. On the other hand, video-conferencing company Zoom has faced regulatory threats in the USA because of its alleged ties to the Chinese Government. It is clearly important that entrepreneurs and managers analyse their environments as carefully as they can in order to take advantage of environmental opportunities and minimise threats.

As summarised in Figure 3.1, environments can be considered in terms of two 'layers', with individual organisations at the centre. This chapter focuses on organisations' *macro-environments,* the outermost layer. **The macro-environment consists of broad environmental factors that impact, to a greater or lesser extent, many organisations, industries and sectors.** For example, the effects of macro-environmental factors such as the rise of virtual reality technologies, economic growth rates, climate change and aging populations go far beyond one industry or sector, impacting a wide range of activities from tourism to agriculture. The second layer within this broad macro-environment is the *industry,* or *sector*. This

layer consists of organisations producing the same sorts of products or services, for example the automobile industry or the healthcare sector. This layer also includes specific *competitors, markets* and *ecosystems* within the industry or sector. Figure 3.1 shows dotted lines separating the macro-environment from the industry and sector level: the boundaries between the macro-environment and the industry and sector level are permeable, with macro-environmental factors penetrating to the level below. For example, the automobile industry faces shifts in competition and market tastes but is also affected by macro-environmental factors such as economic growth (booms and busts in the world economy for example), government regulation (on carbon emissions for example) and changing technologies (such as electric battery technology). This chapter focuses on the macro-environment, whereas Chapter 4 will analyse industries and sectors and their component competitors, markets and ecosystems. Chapters 5 and 6 examine the individual organisations at the heart of Figure 3.1: again, the dotted lines separating organisations from the environment signify their openness to environmental change.

Figure 3.1 Layers of the organisational environment

Figure 3.2 Analysing the macro-environment

Figure 3.2: Long Description

The fundamental purpose of a macro-environmental analysis is to identify the *key drivers for change*, to trace these drivers down to industries or sectors, and then to consider implications for the

strategies of specific organisations. Organisations often do not notice the implications of macro-environmental changes until it is very late, sometimes too late. Thus, many traditional automobile producers were slow to grasp the opportunities and threats of electric battery technologies; many oil and steel producers underestimated the need to invest strategically in sustainable energy sources. This chapter introduces various analytical tools and concepts that can help keep organisations alert to macro-environmental change. Organisations need to respond strategically in order to minimise threats and seize opportunities.

The chapter is organised in three main sections:

- *PESTEL* factors examine macro-environmental factors according to six key types: political, economic, social, technological, ecological and legal. These factors include both *market* and *non-market* aspects. PESTEL analysis aims at identifying *key drivers for change*.
- *Forecasting,* which aims to predict, with varying degrees of precision or certainty. Macro-environmental forecasting draws on PESTEL analysis and often makes use of three conceptual tools: *megatrends, inflexion points* and *weak signals.*
- *Scenario analysis* is a technique that develops plausible alternative views of how the environment might develop in the future. Scenario analysis differs from forecasting because it avoids predictions about the future; it is more about *learning* about different possible futures.

The structure of this chapter is summarised in Figure 3.2. The end-of-chapter case on Gasunie considers non-market strategy; political,

technological, ecological and legal factors; the megatrend towards decarbonisation; and scenarios for a sustainable Dutch economy.

3.2 PESTEL analysis

This section introduces a key tool for analysing the broad macro-environment of an organisation: PESTEL analysis. Providing a wide overview, PESTEL is likely to feed into both environmental forecasts and scenario analyses.

The PESTEL framework is one of several frameworks (including the similar 'PEST' framework) which categorise environmental factors into key elements.[1] **PESTEL analysis highlights six environmental factors in particular: political, economic, social, technological, ecological and legal.** PESTEL is a checklist encouraging a comprehensive analysis of factors: all six need considering. The list particularly underlines that the environment includes not only markets, but non-market factors too. Organisations need to consider both market and non-market aspects of strategy:[2]

- The *market environment* consists mainly of suppliers, customers and competitors. These are environmental participants with whom interactions are primarily economic. Here, companies typically compete for resources, revenues and profits. Pricing, quality and innovation are often key strategies here. The market environment is discussed extensively in Chapter 4, but issues such as economic cycle are also considered in this chapter (Section 3.2.2). For private sector organisations, the market environment has typically been the most explicit target for strategy (with exceptions where governments or regulators are important).

- The *non-market environment* concerns primarily social, political, legal and ecological factors, but can also be impacted by economic factors. **The non-market environment typically involves interactions with non-governmental organisations (NGOs), politicians, government departments, regulators, political activists, campaign groups and the media.** Non-market factors are obviously important for organisations reliant on grants or subsidies, for example schools, hospitals and charities. However, non-market factors can be very important for business organisations too. For example, non-market factors are particularly relevant where governments or regulators are powerful (for instance in the defence and healthcare sectors); where consumer sensitivities are high (for instance in the food business); or in societies where political, business and media elites are closely interconnected (typically smaller countries, or countries where the state is powerful). Thus, the Norwegian Government's radical policies in favour of electric vehicles created an opportunity for companies like Tesla much greater than those in other European countries (by 2021, 90 out of every 1,000 cars in Norway were electric, against 20 in Sweden and a European average of just 6). On the other hand, campaigners in South Africa have halted Shell's oil exploration projects in order to protect small-scale farming and fishing by indigenous communities.
- In traditional strategy theory, the non-market environment has been treated as external to organisational strategy, not something that can be easily influenced strategically. However, the non-market environment is increasingly seen as a key

potential target for strategy, something that can be shaped by individual organisations. In the non-market environment, organisations advance their interests by building reputation, connections, legitimacy and influence with key groups such as politicians, regulators and the media. Lobbying, public relations, networking, philanthropy and collaboration are key non-market strategies. The digital tech industry has become the European Union's largest spender on lobbying in the face of increasing regulation on privacy, disinformation and competition.[3]

The following sections consider each of the PESTEL elements in turn, providing key analytical concepts and frameworks for each. It is important to note that these particular concepts and frameworks are often just starting points for addressing each of the PESTEL elements; there may be more analysis to be done. PESTEL analyses can feed into SWOT analyses, particularly the opportunities and threats (see Chapter 2). Just as for SWOT, PESTEL analyses can be done using published sources (e.g., company annual reports, market research reports, media articles and consultants' analyses) or more extensively by direct discussion with managers, customers, suppliers, consultants, academic experts, government officials and financial analysts. Ideally, interviews should not rely just on an organisation's managers, who may have limited views. Illustration 3.1 provides a PESTEL analysis of the Chinese ride-hailing company Didi based on published sources.

Illustration 3.1 A PESTEL for DiDi In early 2022, investors saw a bleak future for DiDi, China's dominant

ride-hailing app company. But there were opportunities too.

Long Description

DiDi is the Uber of China, controlling 90 per cent of the Chinese ride-hailing market. In June 2021, the company listed on the New York Stock Exchange, achieving a market capitalisation of $68bn. By early 2022, Didi's capitalisation had fallen to just $16.5bn. The collapse in DiDi's value suggested investors had radically lowered their expectations for its future. A PESTEL analysis can help explain why, identifying DiDi's environmental threats – and identifying some opportunities.

For DiDi, a PESTEL analysis based on published sources shows a growing preponderance of macro-environmental threats over opportunities (specific industry analysis will be dealt with in Chapter 4). In the figure above, the scale of opportunities and threats on each of the PESTEL dimensions is indicated by the relative extent of the bars. Just taking some issues for illustration, the figure shows more and typically longer bars on the threats side than the opportunities side. Thus:

- *Political*: China's President Xi Jinping was taking an increasingly hard-line against China's tech giants such as DiDi, Alibaba and Baidu, who were seen as excessively

dominating their markets or as developing dangerous ties with the USA. On the other hand, there may be opportunities for local partnerships with regional and city administrations to help solve traffic congestion problems.

- *Economic*: travel demand may slow as China's economic growth is handicapped by increasing labour shortages and the country's reduced reliance on export-based growth. However, continued growth in ride-hailing internationally may create more opportunities, as does diversification into home delivery services.
- *Social*: an aging population, more working from home, strict approaches to pandemic disease controls and traffic congestion problems in major cities may increase consumers' need to use taxis.
- *Technological*: the rise of autonomous vehicles threatens a ride-hailing business reliant on independent drivers and may let new competitors in to the market (Chinese internet giant Baidu is trialling autonomous vehicles in Beijing). On the other hand, improvements in artificial intelligence offer opportunities for more efficient services.
- *Ecological*: the growth of taxis on the streets encouraged by ride-hailing apps increases congestion, traffic accidents and pollution. City governments may restrict growth. However, electric vehicles offer a solution to the problem of pollution.
- *Legal*: governments are increasingly keen to regulate tech businesses, including the ride-hailing industry, which often began in domains that legislators had never imagined. DiDi has already faced major regulatory penalties for passenger safety and data security issues. On the other hand, regulatory barriers might handicap new entrants.

Questions

1 In the light of this PESTEL analysis, what strategic actions would you prioritise as a leader of DiDi?

2 This Illustration is just a partial analysis undertaken at one point in time. What other macro-environmental threats or opportunities might DiDi face and how have these changed since 2022, the time this Illustration was written?

3.2.1 Political

The political element of PESTEL highlights the role of the state and other political factors in the macro-environment. There are two important steps in political analysis: first, evaluating the importance of political factors; second, carrying out political risk analysis.

Figure 3.3 is a matrix that distinguishes two variables helpful to identifying the importance of political factors:

- The role of the *state*: in many countries and sectors, the state is often important as a direct economic factor, for instance as a customer, supplier, owner or regulator of businesses.
- Exposure to *civil society* organisations: civil society comprises a whole range of (non-state) organisations that are liable to raise political issues, including political lobbyists, campaign groups, social media or traditional media.

To take an example from Figure 3.3, the defence industry faces a highly politicised environment. Defence companies typically have high direct state involvement: national armed services are, of course, key customers, while states are often owners of their national defence companies. At the same time, defence companies are often highly exposed to groups from civil society, for instance campaigners

against the international arms trade. By contrast, food companies face less direct state involvement: most food companies are privately owned and operate in private-sector markets. However, the political environment is still important for food companies, as they are typically exposed to pressures from civil society in the form of fair-trade campaigners, labour rights organisations and health lobbying groups. Pressures from civil society organisations can increase state involvement by demanding additional regulation, for instance health standards for food products. Canals are often state-owned but nowadays are typically not highly exposed to political pressures from civil society organisations. Industries can rapidly change positions: thus, privacy and misinformation concerns have placed internet companies such as Meta (Facebook) much more under scrutiny by governments, civil liberties groups and consumers.

Organisations that face politicised environments, especially those operating in many countries, should carry out *political risk analysis,* the analysis of threats and opportunities arising from potential political change. There are two key dimensions to political risk analysis, micro and macro:[4]

Figure 3.3 The political environment

Figure 3.3: Long Description

- The *macro* dimension. The macro dimension of political risk refers to the risks associated with whole countries: for instance, Nigeria, Russia or Venezuela. Many specialist organisations publish relative rankings of countries' macro political risks. Western European countries are typically ranked low in terms of macro political risk, as even changes of government following elections do not bring fundamental change. On the other hand, some Middle Eastern countries rank high in terms of macro-political risk, because changes of government there can be sudden and radical.[5]
- The *micro* dimension: this relates to the specific risk of particular organisations or sectors within a country. It is important to distinguish between macro-political risk and specific micro-level risk. China is typically ranked medium political risk on the macro dimension but, for some Japanese companies in China, the

micro risk is higher. For many Chinese consumers, resentment of Japan is strong and Japanese car companies are, from time to time, targeted by nationalist boycotts.

3.2.2 Economic

The macro-environment is also influenced by macro-economic factors such as currency exchange rates, interest rates and fluctuating economic growth rates around the world. It is important for an organisation to understand how its markets are affected by the prosperity of the economy as a whole. Managers should have a view on how changing exchange rates may affect viability in export markets and vulnerability to imports. They should have an eye to changing interest rates over time, especially if they have to borrow to fund strategic investments. They should understand how economic growth rates rise or fall over time. There are many public sources of economic forecasts that can help in predicting the movement of key economic indicators, though these are often prone to error because of unexpected economic shocks: the COVID epidemic starting in 2020 was one such shock to economic growth.[6]

A key concept for analysing macro-economic trends is the *economic cycle.* Despite the possibility of unexpected shocks, economic growth rates have an underlying tendency to rise and fall in cycles: several years of good growth are likely to be followed by a couple of years or so of lower or even negative growth. These cycles link to other important economic variables. For example, rises in interest rates are likely to decrease economic growth rates as consumers cut back on credit cards and businesses borrow less for

investment. Awareness of cycles reinforces an important pattern in the macro-environment: good economic times do not last forever, while bad economic times eventually lead to recovery. The key is to identify cyclical turning points.

Managers making long-term strategic decisions should assess where they stand in the overall economic cycle. For example, after several years of rapid growth, a company might be tempted to borrow in order to invest in new capacity: in Figure 3.4, this would be year 202x. However, any new facilities might not be needed in the subsequent slowdown, leaving the company with over-capacity which still needs to be paid for at a time of low growth. On the other hand, two or three years of slowing growth might make a company over-cautious about new investment. But after the cyclical turning point of year 202y in Figure 3.4, the company might face under-capacity and be unable to match recovering demand. Rivals who had invested in extra capacity (or new products) would be able to seize the advantage, leaving the over-cautious company struggling to catch up. In assessing the economic environment, therefore, it is crucial not to assume that current economic growth rates will continue. Before making any strategic investment, you should ask where you are in the current economic cycle.

Some industries are particularly vulnerable to economic cycles, for example:

- *Discretionary spend* industries: there tend to be strong cyclical effects where purchasers can easily put off their spending for a year or so. Thus, demand for furniture, restaurants and cars tends be highly cyclical because people can easily delay or curtail spending on these for a while. After a period of reduced

spending, there is liable to be a strong upturn as pent-up demand is finally released into the market.

- *High fixed cost* industries: industries such as airlines, hotels and steel suffer from economic downturns because high fixed costs in plant, equipment or labour tend to encourage competitive price-cutting to ensure maximum capacity utilisation when demand is low. For example, an airline might try to fill its seats in the face of falling demand simply by offering cheap tickets. If its competitors do the same, the resulting price-war will result in low profits for all the airlines.

Figure 3.4 Economic cycles and strategic investments

Figure 3.4: Long Description

3.2.3 Social

The *social* elements of the macro-environment have at least two impacts upon organisations. First, they can influence the specific nature of demand and supply, within the overall economic growth

rate. Second, they can shape the innovativeness, power and effectiveness of organisations.

In the first place, there are a number of key aspects of the social environment that can shape demand and supply. These can be analysed under the following four headings:

- *Demographics.* For example, the aging populations in many Western societies create opportunities and threats for both private and public sectors. There is increasing demand for services for the elderly, but diminishing supplies of young labour to look after them.
- *Distribution.* Changes in wealth distribution influence the relative sizes of markets. Thus, the concentration of wealth in the hands of elites over the last quarter century has constrained some categories of 'middle-class' consumption, while enlarging markets for certain luxury goods (yachts, private aircraft, etc).
- *Geography.* Industries and markets can be concentrated in particular locations. In the United Kingdom, economic growth has, in recent decades, been much faster in the London area than in the rest of the country. Similarly, industries often form 'clusters' in particular locations: thus, there are high concentrations of scientists and engineers in California's Silicon Valley (see also Chapter 10).[7]
- *Culture.* Changing cultural attitudes can also raise strategic challenges. For example, new ethical attitudes are challenging profit-maximising investment strategies in the financial services industry. Changing cultural attitudes can be linked to changing demographics. The rise of 'Generation Z' (those born after 1997, and thus from childhood immersed in mobile technologies) is

changing expectations about media, consumption and education.

A second important social aspect of the macro-environment is organisational networks, with significant implications for innovativeness, power and effectiveness. These networks are frequently described as 'organisational fields'.[8] An **organisational field is a community of organisations that interact more frequently with one another than with those outside the field.** These organisational fields are partly *economic* as they may include competing organisations within the industry or sector, as well as customers and suppliers in the marketplace (see Chapter 4). However, the concept of organisational fields also emphasises non-economic or *social* interactions with other organisations. Such social interactions may be with other businesses, for instance via managers who are members of the same industry associations or sporting clubs, or via non-executive directors who sit on several company boards. There may also be interactions with political organisations such as governments and campaign groups, legal entities such as regulators, and employee groups, such as professional associations and trade unions. The organisational field is therefore much broader than just industries or markets. Because of the importance of social networks, managers need to analyse the influence of a wide range of organisational field members, not just competitors, customers and suppliers.

Networks and organisational fields can be analysed by means of *sociograms,* maps of potentially important social (or economic) connections.[9] For a new hi-technology enterprise, important network connections might be links to leading universities, other innovative

firms or respected venture capitalists, for example. Sociograms can help assess the effectiveness of networks and identify who is likely to be most powerful and innovative within them. Three concepts help to understand effectiveness, innovativeness and power:

Figure 3.5 Sociogram of networks within an organisational field

C's immediate network is denser than A's; B is a broker; A is a more central hub than C.

Figure 3.5: Long Description

- *Network density* typically increases network effectiveness. Density refers to the number of interconnections between members in the network map. Effectiveness is increased by density because the more interconnections there are, the better the sharing of new ideas between network members. Everybody is talking to each other, and nobody with potentially useful information is isolated. It is easier to mobilise the whole network

in support of new initiatives. In Figure 3.5, the network on the right (organisation C's network) is denser than the network on the left (A's network).

- *Broker positions,* which connect otherwise separate groups of organisations, are often associated with innovativeness. Brokers' innovation advantage stems from their ability to link valuable information from one group of organisations with valuable information from the other group. Because they provide the connection between the two groups, they are able to exploit this combination of information before anybody else. In Figure 3.5, organisation B is a broker, connecting the two networks on the right- and left-hand sides.
- *Central hub positions* typically provide power within networks. A central hub connects many organisations. Hubs have power because network members rely on them for interconnection with other members. Hubs are also potentially innovative because they can collect ideas from the whole network, and they hear about what is going on in one part of the network before most other parts. In Figure 3.5, both A and C are hubs. However, organisation A is more central in its immediate network than organisation C (all network members must pass through A) and, to this extent, is more powerful relative to its network members.

Sociograms can have clear implications for strategic action. For example, organisation A could gain an advantage over organisation B by establishing direct interaction with organisation C, undermining B's exclusive broker position. On the other hand, organisation E could increase its innovativeness and improve its power relative to

organisation A by making a direct connection to organisation D in the right-hand network.

Sociograms can be drawn for key people as well as organisations: individuals are often the link between organisations anyway. Personal networks are important in many societies, for example the network of former consultants at the elite McKinsey & Co. strategy consulting firm, or networks of company directors, or the interpersonal *guanxi* networks that prevail in China. Illustration 3.2 describes the relationships that McKinsey developed to support the French President Emmanuel Macron and that may have helped obtain large consulting contracts during the COVID crisis of 2020–21 (these could be described as part of McKinsey's non-market strategy). The crucial issue in analysing social networks is how hub positions, brokering roles and network density are likely to affect a particular organisation's power, innovativeness and overall effectiveness.

3.2.4 Technological

Further important elements within the macro-environment are *technological*, such as the metaverse, nanotechnology or blockchain, whose impacts can spread far beyond single industries. As in the case of internet streaming, new technologies can open up opportunities for some organisations (e.g., Spotify and Netflix), while challenging others (traditional music and broadcasting companies). Chapter 11 will discuss specific strategies surrounding innovative new technologies in more detail.

Meanwhile, it is important to carry out the macro-environmental analysis of technology in order to identify areas of potential innovative activity. There are five primary indicators of innovative activity:[10]

- *Research and development budgets:* innovative firms, sectors or countries can be identified by the extent of spending on research, typically reported in company annual reports and government statistics.
- *Patenting activity:* firms active in patenting new technologies can be identified on national patent registers such as the United States Patents and Trademarks Office.
- *Citation analysis:* the potential impact of patents and scientific papers on technology can be measured by the extent to which they are widely cited by other organisations, with data available from Google Scholar, for instance.
- *New product announcements:* organisations typically publicise their new product plans through press releases and similar media.
- *Media coverage:* specialist technology and industry media will cover stories of the latest or impending technologies, as will various social media.

Illustration 3.2 COVID's covert connections The world's leading strategy consulting firm, McKinsey & Co, gained a crucial role in the French response to COVID. Presidential connections may have helped.

In January 2020, two of McKinsey & Co's Associate Directors in France, Karim Tadjeddine and Thomas London, appeared in front of an inquiry by the French Parliament's Senate into 'The Growing Influence of Consulting Firms on Public Policy'. In the first year of the COVID crisis, between March 2020 and February 2021, €11.35mn had been spent by the Ministry of Health on seven consulting firms, including McKinsey, which alone had received €4mn. Among the services McKinsey had supplied was providing a staff member as 'liaison officer' for coordinating vaccine logistics at Public Health France. A senator asked: 'Don't you think that there are civil servants within our administration who could carry out this mission?' Tadjeddine, Head of McKinsey's public sector practice in France, replied simply: 'Yes'.

McKinsey has a large public sector consulting practice worldwide, with over 520 specialist consultants and more than 5,400 projects in the public and social sectors, spread across more than 105 countries. Tadjeddine explained to the French Senate: 'Advising the public sector is now a common practice, particularly in Germany, the United Kingdom and the Scandinavian countries.' In the United Kingdom, the public sector made up 22 per cent of the whole consultancy market, against 9 per cent in France.

McKinsey was well-connected with the French state. President Sarkozy, elected in 2007, was the first politician to make extensive use of consulting companies, spending about €250 million during his tenure in order to facilitate reforms. McKinsey was one of the beneficiaries alongside other major firms such as Deloitte, BCG and Accenture. It was at this time that Emmanuel Macron, then a fast-rising civil servant working on economic reform, first met a group of McKinsey consultants working on a 'pro bono' (charity) basis under the leadership of McKinsey's French Head of the time, Eric Labaye. Among the group showing off their Excel spreadsheet expertise, one young consultant stood out: Karim Tadjeddine. In 2015, Macron sought advice from McKinsey again when working on further economic reforms for then President François Hollande. When the next year Macron left his civil servant role to launch a bid for the French Presidency himself, he again called on friends in McKinsey. About 10 McKinsey consultants joined

Macron's campaign as volunteers, with one taking on the job of party director and another the job of chief number-cruncher. A leak of Macron's emails during the campaign revealed correspondence with Karim Tadjeddine. Around this time, Macron provided the preface to a book on economic policy to which Tadjeddine contributed and which was edited by Thomas Cazenave, who would become head of the government department responsible for coordinating consulting contracts in Macron's presidency.

After Macron won the presidential election in 2017, he made several senior-level appointments in his new government direct from McKinsey, including the Chief of Staff in the Finance Ministry and Deputy Director at the Statistics Department. Eric Labaye, whom Macron had first met back in 2007, was appointed Head of the École Polytechnique, the elite engineering school where many high-flying French civil servants begin their higher education. McKinsey was well-placed to assist during the coming COVID crisis.

In fact, France got off to a slow start with COVID vaccinations, with the first one delivered on 27 December 2020. At that time, nearly 50 per cent of health ministry officials were estimated as suffering from burn-out. The ministry's capacity was said to have been undermined by two decades of budget cuts. Two McKinsey partners and seven McKinsey consultants set to work on coordinating the vaccine roll-out. One year after the start of the vaccination programme, France was ahead of Germany, Norway, Sweden, Switzerland and the United Kingdom in the share of people fully vaccinated.

Sources: *Archyde*, 23 January 2022; *La Depèche*, 6 February 2022; *Politico*, 8 February 2021 and 20 January 2022.

Questions

1 Identify four ways in which consulting companies such as McKinsey develop close relationships with government.

2 What are the pros and cons of relying on consulting companies for public sector work?

Figure 3.6 Roadmap to net zero carbon emissions

Source: Based on International Energy Authority report, 'Net Zero by 2050: A Roadmap for the Global Energy Sector', May 2021.

Figure 3.6: Long Description

Although there is some variation between firms, sectors and countries in how far their innovative activity is reflected by these kinds of indicators, generally they will help to identify areas of rapid technological change and locate centres of technological leadership. For example, nearly 390,000 artificial intelligence patent applications were filed in China in the year to 2021, accounting for 75 per cent of

the world total.[11] For any organisation seeking a strong position in artificial intelligence, links with China are likely to be important.

Many organisations also publish technology roadmaps for their sectors going forward.[12] *Technology roadmaps* project into the future various product or service demands, identify technology alternatives to meet these demands, select the most promising alternatives and then offer a timeline for their development. Thus, they provide good indicators of future technological advances, typically with implications for many industries and sectors. Figure 3.6 provides a simplified technology roadmap for the world's movement towards 'net zero' in terms of Gigatonnes of CO_2 emissions, based on the International Energy Authority's 2021 report. Highlighted here are how electric cars will account for 60 per cent of sales by 2030, aviation will switch to majority low-emission fuels by the 2040s, and solar panels and wind will account for 70 per cent of electricity generation by 2050.

3.2.5 Ecological

Within the PESTEL framework, the second E stands for *ecological* macro-environmental issues, such as pollution, waste and climate change. Environmental regulations can impose additional costs, for example pollution controls, but they can also be a source of opportunity, for example for businesses permitted to supply renewable energy to national electricity grids.

When considering ecological issues in the macro-environment, there are three sorts of challenges that organisations may need to meet:[13]

- *Direct pollution* obligations are an obvious challenge, and nowadays typically involve not just cleaning up ‘at the end of the pipe’ (for example, disposing of waste by-products safely), but also minimising the production of pollutants in the first place. Having clean processes for supply, production and distribution is generally better than managing the consequences of polluting after the fact.
- *Product stewardship* refers to managing ecological issues through both the organisation’s entire value chain and the whole life cycle of the firm’s products. Stewardship here might involve responsibility for the ecological impact of external suppliers or final end users. It will also involve responsibility for what happens to products at ‘end of life’, in other words how they are disposed of when consumers have no more use for them. Thus, car manufacturers are increasingly responsible for the recycling and safe disposal of old cars.
- *Sustainable development* is a criterion of increasing importance and refers not simply to reducing environmental damage, but to whether the product or service can be produced indefinitely into the future. This sustainability criterion sets constraints on the over-exploitation of particular sources of raw materials, for instance in developing countries, and often raises issues regarding the economic and social well-being of local communities.

In assessing the macro-environment from an ecological point of view, all three criteria of pollution, stewardship and sustainability need typically to be considered.

The extent to which these ecological criteria are important to organisations relies on three contextual sources of pressure, as indicated on the left-hand side of Figure 3.7. The first two of these pressures arises directly from the macro-environment:

- *Ecological.* Clearly ecological issues are more likely to be pressing the more impactful they are: a chemical company may have more to worry about than a dance studio. However, there are three less obvious characteristics to assess. First, ecological issues become more salient the more *certain* they are. For example, as doubts have reduced about the facts of global warming, so the pressures on organisations to act on it have increased. Pressures are also likely to be greater the more *visible* ecological issues are: aircraft pollution is more salient as an issue than shipping pollution because aircraft are more obvious to ordinary citizens than pollution done far out to sea. Similarly, the *emotivity* of the issue is liable to be a factor: threats to pandas generally get more attention than threats to hyenas. Ecological analysis therefore requires assessing certainty, visibility and emotivity.
- *Organisational field.* Ecological issues do not become salient just because of their inherent characteristics. The extent of pressure is influenced by how ecological issues interact with the nature of the organisational field. An organisational field with highly *active* regulators or campaign groups will clearly give saliency to ecological issues. However, high levels of field *interconnectedness* will also increase the importance of ecological issues: within densely interconnected networks, it is

harder to hide damaging behaviour and peer pressure to conform to ecological standards is greater.

- *Internal organisation.* The personal *values* of an organisation's leadership will clearly influence the desire to respond to ecological issues. Actual responsiveness will rely on the effectiveness of managerial *systems* that promote and monitor behaviours consistent with ecological obligations.

Figure 3.7 Contexts and motives for ecological issues

Source: Substantially adapted from: P. Bansal and K. Roth (2000) 'Why companies go green: a model of ecological responsiveness', *Academy of Management Journal,* 43(4), 717–36 (Figure 2, p. 729.)

Figure 3.7: Long Description

Although ecological issues can exercise unwelcome pressure, there are potentially strong organisational motives to respond. As indicated

on the right-hand side of Figure 3.7, the three kinds of contextual pressure can satisfy a variety of motives. Fundamentally, there is of course a sense of ecological *responsibility*: thus, the personal values of the organisation's leaders might stimulate ecological initiatives, or routine production systems might reduce pollution. However, another outcome can be *legitimacy,* as reflected in regulatory compliance and a good reputation with consumers. Finally, responding to ecological issues can even enhance *competitiveness.* For example, minimising waste in production processes for pollution reasons can reduce costs. Green products are attractive in the marketplace and often command a price premium.

3.2.6 Legal

The final element in a PESTEL analysis of the macro-environment refers to *legal* aspects. These can cover a wide range of topics: for example, labour, environmental and consumer regulation; taxation and reporting requirements; and rules on ownership, competition and corporate governance. In recent years, the relaxation of legal constraints through deregulation has created many new business opportunities, for example the looser financial regulations of many Asian economies has allowed faster regional adoption of fintech than in Europe. However, regulations can also handicap organisations: e-cigarette companies such as Juul have run into important legal issues as regulators have caught up with the new technology.

Legal issues form an important part of the *institutional environment* of organisations, by which is meant the formal and informal 'rules of the game'.[14] This concept of institutional

environment suggests that it can be useful in a PESTEL analysis to consider not only formal laws and regulations but also more informal norms: the 'L' can be stretched to cover all types of rules, formal and informal. Informal rules are patterns of expected ('normal') behaviour that are hard to ignore. Thus, regardless of the law, there are fairly explicit norms regarding proper respect for the ecological environment. As in Illustration 3.3 on Columbian concrete company Argos, the United Nations' 17 *Sustainable Development Goals*, setting targets on issues from the elimination of poverty to clean water and sanitation, exert strong pressures on even the most polluting industries.

Formal and informal rules vary sufficiently between countries to define very different institutional environments, sometimes known as 'varieties of capitalism'.[15] These *varieties of capitalism* have implications for the ways in which business and management are done in those environments and the prospects for success, both for insiders and for outsiders. Although every country differs in detail, three broad varieties of capitalism have been identified, whose formal and informal rules lead to different ways of doing business:

- *Liberal market economies* are institutional environments where both formal and informal rules favour competition between companies, aggressive acquisitions of one company by another and free bargaining between management and labour. Companies in these liberal market economies tend to raise funds from the financial markets and company ownership is either entrepreneurial or, for older companies, widely dispersed among many shareholders. These economies tend to support radical innovation and are receptive to foreign firms. Although

neither is perfectly representative, the United States and the United Kingdom correspond broadly to this type of institutional environment.

- *Coordinated market economies* encourage more coordination between companies, often supported by industry associations or similar frameworks. There are legal and normative constraints on hostile acquisitions on the one hand, and various supports for consensual and collective arrangements between management and labour on the other. Companies in these coordinated market economies tend to rely on banks for funding, while family ownership is often common. These economies support steady innovation over the long run and, because of coordination networks, are typically less easy for foreign firms to penetrate. Again, neither is perfectly representative, but Germany and Japan correspond broadly to this type of institutional environment.
- *Developmental market economies* tend to have strong roles for the state, which will either own or heavily influence companies that are important for national economic development. Formally or informally, the state will often encourage private-sector firms to coordinate between themselves and with national economic policy-makers. Labour relations may be highly regulated. Banks, often state-owned, will be a key source of funding. Long-term, infrastructural and capital-intensive projects may be favoured, but foreign firms will often be at a disadvantage. Although each is very different in its own way, Brazil, China and India all have aspects of this developmental market economy environment.

Illustration 3.3 Grupo Argos: sustainability made concrete A Columbian cement company addresses its sustainable development goals.

Grupo Argos is a Columbian cement and infrastructure company with 14,000 employees throughout South and Central America as well as the USA and Caribbean. Argos' President, Jorge Mario Velásquez, has explained his strategic approach: 'We define our strategy as a balance between economic, social, and environmental performance. As a company, we want to act in a responsible way with society and the environment producing superior returns to our investors. Today, I cannot conceive of a business that only focuses on making money; a company must be responsible in the way that it conducts business, treats people, interacts with society, and creates value for the community where it operates.'

Grupo Argos' sense of responsibility is challenging, given how polluting its main product is. Cement is a key input into concrete, the most widely used construction material in the world. Cement production processes are a major source of CO_2, contributing around 8 per cent of annual global CO_2 emissions. In addition, these processes use almost a tenth of the world's industrial water. Quarries for raw materials degrade the landscape and release polluting dust into the atmosphere.

However, concrete also plays a crucial role in social and economic development, providing housing, schools, roads, water supply, flood mitigation and many other important facilities. Columbia needs more infrastructural investment: for example, the country ranks 104th in the world for the quality of its roads; the average home contains 1.2 rooms per person – against the Organization of Economic Cooperation Development (OECD) average of 1.8 rooms – and only 76.1 per cent of dwellings have private access to an indoor flushing toilet, considerably less than the OECD average of 95.6 per cent. Alternatives to concrete are not very attractive. Steel, asphalt and plasterboard are all more energy intensive, and using more timber is liable only to increase deforestation.

Grupo Argos recognises its roles in both reducing pollution and improving lives. It prioritises 4 of the 17 United Nations Sustainable Development Goals (SDGs), as follows: SDG 9, building resilient infrastructure, promoting inclusive and sustainable industrialisation and fostering innovation; SDG 11, making cities and human settlements inclusive, safe, resilient and sustainable; SDG 13, combating climate change by regulating emissions and promoting renewable energy; and SDG 17, building partnerships for implementing sustainable development.

Camilo Abello, Senior Director of Sustainability at Grupo Argos, explains how the company's commitment to sustainability has developed through two decades: 'The businesses have evolved and matured in all this time. Currently, sustainability is an integral part of corporate and competitive strategy . . . We passed an initial stage years ago, in which raising general awareness and creating value in internal culture was prioritised, into the current stage, where sustainability is at the heart of all corporate decisions.' Every subsidiary, and the group as a whole, has a Sustainability and Governance Committee in which company directors address sustainability issues.

Among the company's sustainability initiatives are: 'green cement', a new product that reduces CO_2 by 35 per cent compared with traditional cement; new concrete mixtures that reduce CO_2 by 30 per cent and allow better water flow in the event of flooding; Edifica, a prefabrication construction process that generates less CO_2 and reduces waste; Viaforte, a road construction innovation using fewer raw materials; and the Green Sacks initiative by which the company collects cement bags to be reused by other industries. In addition, Grupo Argos carries out a number of philanthropic initiatives, for example, tree planting (more than 4 million so far), university scholarships (including 25 for journalists) and financial support for female-led businesses, working with other leading organisations to close the economic gender gap.

Sources: https://www.thebusinessyear.com/colombia-2018/silver-cross-for-sustainability/interview [accessed: May 2022]; 'Making Concrete Change: Innovation in Low-carbon Cement and Concrete', Chatham House, 2018;

https://www.oecdbetterlifeindex.org/countries/colombia/ [accessed: May 2022]; Grupo Argos, ESG Databook: Sustainable Development Goals, 2020; https://www.grupoargos.com/en-us/sustainability/materiality/sustainability-vision [accessed: May 2020]; *World Cement*, 19 March, 2021.

Questions

1 How should Grupo Argos rank its four United Nations SDGs in order of importance?

2 Given your own personal ethical position, would you work for a cement company like Grupo Argos?

A macro-environmental analysis of any particular country should therefore include an assessment of the local variety of capitalism and the extent to which it favours particular kinds of business and strategy.

3.2.7 Key drivers for change

The previous sections have introduced a variety of concepts and frameworks for analysing each of the PESTEL factors, particularly at a macro-level. As can be imagined, analysing these factors, together with their interrelationships, can produce long and complex lists of issues. Rather than getting overwhelmed by a multitude of details, it is necessary after a PESTEL analysis to step back and identify the *key drivers for change* in a particular context.[16] **Key drivers for change are the environmental factors likely to have a high**

impact on industries and sectors, and the success or failure of strategies within them.

Key drivers translate macro-environmental factors to the level of the specific industry or sector. Thus, social and legislative changes discouraging car use might have different and greater effects on supermarkets than, for example, retail banks. Identifying key drivers for change in an industry or sector helps managers to focus on the PESTEL factors that are most important and that must be addressed most urgently. Without a clear sense of the key drivers for change, managers will not be able to take the strategic decisions that allow for effective responses: to return to the example above, the supermarket chain might address reduced car use by cutting the number of out-of-town stores and investing in smaller urban and suburban sites. It is important that an organisation's strategists consider each of the key drivers for change, looking to minimise threats and, where possible, seize opportunities.

3.3 Forecasting

In a sense, all strategic decisions involve forecasts about future conditions and outcomes. Thus, a manager may decide to invest in new capacity because of a forecast of growing demand (condition), with the expectation that the investment will help capture increased sales (outcome). PESTEL factors will feed into these forecasts, for example in tracking economic cycles or mapping future technologies. However, accurate forecasting is notoriously difficult. After all, in strategy, organisations are frequently trying to surprise their competitors. Consequently, **forecasting takes three fundamental approaches to the future based on varying degrees of certainty: single-point, range and multiple-futures forecasting.** This section explains these three approaches and also introduces some key concepts that help explore the direction of future change.

3.3.1 Forecast approaches

The three approaches to forecasting are explored in the following list and illustrated in Figure 3.8:[17]

- *Single-point forecasting* is where organisations have such confidence about the future that they will provide just one forecast number (as in Figure 3.8 i). For instance, an organisation might predict that the population in a market will grow by 5 per cent in the next two years. This kind of single-point forecasting implies a great degree of certainty. Demographic trends (for instance the increase in the elderly

within a particular population) lend themselves to these kinds of forecasting, at least in the short term. They are also often attractive to organisations because they are easy to translate into budgets: a single sales forecast figure is useful for motivating managers and for holding them accountable.

- *Range forecasting* is where organisations have less certainty, suggesting a range of possible outcomes. These different outcomes may be expressed with different degrees of probability, with a central projection identified as the most probable (the darkest shaded area in Figure 3.8 ii), and then a range of more remote outcomes given decreasing degrees of likelihood (the more lightly shaded areas). These forecasts are often called ‘fan charts’, because the range of outcomes ‘fans out’ more widely over time, reflecting growing uncertainty over the longer term. These ‘fan charts’ are often used in economic forecasting, for example, economic growth rates or inflation.
- *Alternative futures forecasting* typically involves even less certainty, focusing on a set of possible yet distinct futures. Instead of a continuously graduated range of likelihoods, alternative futures are discontinuous: they happen or they do not, with radically different outcomes (see Figure 3.8 iii). These alternatives might result from fundamental policy decisions. For example, for a country approaching a significant election, outcome A might reflect the consequences for economic growth or environmental policy of one party winning the election; outcome C might reflect the consequences of a radically alternative party winning that election; while outcome B in the middle would represent some sort of coalition between the two

parties following the election. It is possible to put probabilities to each of these outcomes too: for example, outcome A might have a 40 per cent probability, while outcomes B and C would be 30 per cent each. These kinds of alternative futures are often fed into scenario analyses (see Section 3.4), though not as simple forecasts.

Figure 3.8 Forecasting under conditions of uncertainty

Figure 3.8: Long Description

3.3.2 Directions of change

It is helpful in forecasting to keep an eye on the fundamental directions of likely change. Managers need to check their forecasts are consistent with major trends and to be alert to possible turning points. Three concepts help focus both on major trends and on possible turning points that might invalidate existing forecasts:

- *Megatrends* are large-scale political, economic, social, technological, ecological or legal movements that are typically

slow to form, but that influence many areas of activity, possibly over decades.[18] A megatrend typically sets the direction for other factors, including key drivers for change in particular sectors. Thus, the social megatrend towards aging populations in the West influences other trends in social care, retail spending and housing. The megatrend towards global warming affects agriculture, tourism and, with more extreme climatic events, insurance. It is important to identify major megatrends because they influence so many other things. Forecasts should be checked for consistency with such trends.

- *Inflexion points* are moments when trends shift in direction, for instance turning sharply upwards or downwards.[19] For example, after a long decade of investment, 2021 may have seen an inflexion point for African tech businesses, with no fewer than five 'unicorn' companies achieving valuations of over $1bn. The experience of working from home during COVID may have tipped the trend against working in the office. Inflexion points are likely to invalidate forecasts that extrapolate existing trends. It is important to grasp the inflexion point at the moment when trends just start to turn, in order either to take advantage of new opportunities early or to act against escalating decline as soon as possible.
- *Weak signals* are advanced signs of future trends and are particularly helpful in identifying inflexion points.[20] Typically, these weak signals are unstructured and fragmented bits of information, often perceived by observers as 'weird'. A weak signal for the future global success of Korean cultural products – for example, girl group BLACKPINK, Oscar-winning film

Parasite and Netflix hit *Squid Game* – was the breakout hit *Gangnam Style* in 2012, the first YouTube video to reach a billion viewers. It is important to be alert to weak signals, but it is also easy to be overwhelmed by ‘noise’, the constant stream of isolated and random bits of information without strategic importance.[21] Some signs of truly significant weak signals (as opposed to mere noise) include: the repetition of the signal and the emergence of some kind of pattern or trend (recall hashtags such as #BlackLivesMatter or #MeToo); vehement disagreement among experts about the signal’s significance; and an unexpected failure in something that had previously worked very reliably.

3.4 Scenario analysis

Scenarios offer plausible alternative views of how the macro-environment might develop in the future, typically in the long term. Thus, scenarios are not strategies in themselves, but alternative possible environments that strategies have to deal with. Nor are they just forms of contingency planning, checking for the impacts of variations in one or two key variables (for example, sales up or down by 10 per cent). Rather, scenarios are means for challenging the fundamental and often implicit assumptions managers have about the future. These implicit assumptions are the basis for *ghost scenarios*, the scenarios that unconsciously influence decision making without much conscious thought.[22] Typically, ghost scenarios just assume 'business as usual' going into the future. It is valuable to make explicit these ghost scenarios and to contrast them with alternative views. Scenario analyses should raise the possibility of radical and discontinuous change.

Illustration 3.4 Scenarios for 'wind-tunnelling'

In 2020, the European Commission's Directorate-General for Research and Innovation launched four scenarios looking out to 2040.

Source: Adapted from European Commission, Directorate-General for Research and Innovation, Strategic Intelligence Foresight System for European Union Research and Innovation (R&I) Framework Programmes (SAFIRE), 2020.

Long Description

The European Union is committed to long-term research and innovation policy. In 2019–20, the European Commission's Research & Innovation Strategy and Foresight Unit led a scenario exercise supported by a small group of specialised consultants. The point of the scenarios was to check innovation policies for robustness and to test them like prototype cars in a wind-tunnel: 'Scenarios offer a glimpse into a set of possible global futures. This is a useful asset for policy makers to refer to when considering future policy and strategy, and checking for robustness and flexibility. The scenarios can also be used for "wind-tunnelling", in which the implications of different scenarios are considered, to allow identification of the opportunities and challenges of a policy in different scenarios.'

The scenarios team developed two key axes upon which the next two decades might depend. The vertical axis in the figure below describes the extent to which protectionism or globalism would characterise international relations (*exclusionary* or *inclusionary*). An exclusionary world would be protectionist economically, but also nationalist politically with a fragmentation of internationalist power blocs (e.g., a breakdown of the European

Union). An inclusionary world would be global economically, progressive politically and be secured by continuing power blocs like the European Union. The horizontal axis describes the extent to which people and nations would be prepared to transform their geopolitical and economic systems in the face of challenges like climate change or rather carry on more or less as normal (*demanding change* or *resisting change*). Change resistance would involve continued consumerism and commitment to current economic models. A demand for change would be associated with new, more climate-friendly economic models.

The two axes of exclusion/inclusion and demanding/resisting change define four scenarios, each given an evocative title based on different kinds of tree:

- The *redwood* scenario describes a world resistant to change, but still globalist, and – as implied by the redwood symbol – with strong power blocs.
- The *bamboo* scenario is more open to change but is also based on strong power blocs. The bamboo implies strength through flexibility. Like the roots of the bamboo, there would be interconnections and a readiness to extend in new directions.
- The *oak* scenario implies isolation, standing alone in a fragmented world and defying change. The oak symbolises strength but also rigidity.
- The *willow* scenario projects single strong units, but ones that are flexible and responsive to change.

Each of these scenarios has different implications for research over the next 20 years. For example, the bamboo scenario would be consistent with collaborative, international and transdisciplinary research programmes, likely to achieve great progress. In the oak scenario, such collaborative research would likely be less effective. Instead, secretive and competitive research programmes would be the rule, with individual countries seeking advantage over their rivals but achieving less progress because of working on their own. Thus the ‘wind-tunnel’ of different scenarios can help the European Union think about what kinds of long-term research programmes it should be investing in.

Questions

1 What do you think the implications for research programmes might be of the willow and redwood scenarios?

2 Could this basic two-axis scenario framework be transferred from research policy to business strategy? What, for example, might be the implications of the four scenarios for a company like DiDi (Illustration 3.1).

Scenario analysis is typically used in conditions of high uncertainty, for example where the environment could go in several highly distinct directions.[23] However, scenario analyses can be differentiated from alternative futures forecasting (Section 3.3.1), as scenario planners usually avoid presenting alternatives in terms of finely calculated probabilities. Scenarios tend to extend too far into the future to allow probability calculations and, besides, assigning probabilities directs attention to the most likely scenario rather than to the whole range. The point of scenarios is more to learn than to predict. Scenarios are used to explore the way in which environmental factors inter-relate and to help keep managers' minds open to alternative possibilities in the future. A scenario with a very low likelihood may be valuable in deepening managers' understanding – even if it never occurs.

While there are many ways to carry out scenario analyses, the process often follows five basic steps (summarised in Figure 3.9):[24]

Figure 3.9 The scenario process

Figure 3.9: Long Description

- *Defining scenario scope* is an important first step in the process. Scope refers to the subject of the scenario analysis and the time span. For example, scenario analyses can be carried out for a whole industry globally, or for particular geographical regions and markets. While businesses typically produce scenarios for industries or markets, governments often conduct scenario analyses for countries, regions or sectors (such as the future of healthcare or higher education). Scenario time spans can be either for just a few years or for a decade or so. The appropriate time span is determined partly by the expected life of investments. In the energy business, where oil fields might have a life span of several decades, scenarios often cover 20 years or more.
- *Identifying the key drivers for change* comes next. Three variables are important in defining distinct key drivers: *impact*, in order to focus on what matters (there is no point in over-thinking the trivial); *uncertainty,* in order to make different scenarios worthwhile (there's no point in developing alternative scenarios when only one outcome is likely); and *mutual independence,* so

that the drivers are capable of producing significantly divergent or opposing outcomes (there's no point in considering factors individually if they lead to the same outcome anyway). In the oil industry, for example, political stability in the oil-producing regions is one major uncertainty; another is the development of new exploration technologies, enabling the quick and efficient identification of new oil fields. These could be selected as key drivers for scenario analysis because both are uncertain and regional stability is not closely correlated with technological advance. Key drivers are typically identified by research involving media sources, analysis of specialised reports, consultations with internal and external experts, consultations with suppliers and customers, and the hiring of consultants.

- *Developing scenario 'stories'.* As in films, scenarios are basically stories. Having selected opposing key drivers for change, it is necessary to knit together plausible stories that incorporate both key drivers and other factors into a coherent whole. These stories are often encapsulated with striking titles: for example, with regard to climate change, oil company Shell has developed three scenarios: the 'Sky 1.5' scenario, where the experience of COVID encourages leaders to act fast and invest heavily in emissions-reducing technologies; the 'Waves' scenario where decarbonisation is late, but finally fast; and 'Islands', where decarbonisation is late and slow.[25] Striking titles help to communicate scenarios and embed them in strategic discussions. See also the tree names in Illustration 3.4.
- *Identifying impacts* of alternative scenarios on organisations is the next key stage of scenario building. For example, in

Illustration 3.4, collaborative research programmes that would thrive in the bamboo scenario would do much less well than in the oak scenario. It is important for an organisation to carry out *robustness checks* in the face of each plausible scenario and to adapt strategies that appear vulnerable and develop contingency plans in case they happen.

- *Monitor progress.* Once the various scenarios are drawn up, organisations should monitor progress over time, to alert themselves to whether and how developments actually fit scenario expectations. Here it is important to identify indicators that might give early warning about the final direction of environmental change, and at the same time set up systems to monitor these. Effective monitoring of well-chosen indicators should facilitate prompt and appropriate responses. In Illustration 3.4, successive events such as the Ukraine crisis of 2022 might adjust expectations of which scenarios are most likely.

Because debating and learning are so valuable in the scenario-building process, and they deal with such high uncertainty, some scenario experts advise managers to avoid producing just three scenarios. Three scenarios tend to fall into a range of ‘optimistic’, ‘middling’ and ‘pessimistic’. Managers naturally focus on the middling scenario and neglect the other two, reducing the amount of organisational learning and contingency planning. It is therefore typically better to have two or four scenarios, avoiding an easy mid-point. It does not matter if the scenarios do not come to pass: the value lies in the process of exploration and contingency planning that the scenarios set off.

Thinking differently The crowdsourced forecast

Do we need experts to forecast anymore?

We usually think of forecasts (Section 3.3) as the product of small groups of experts. But there is a different way. Forecasts can be 'crowdsourced', using the collective judgement of many different kinds of people, not just experts. There are two principal ways of using such 'wisdom of crowds' in forecasting: prediction markets and internet media analysis.

Prediction markets are markets designed specifically to combine the scattered information of many participants (the 'crowd') into values (for instance, market prices or betting odds) that can be used to make predictions about specific future events.[26] Examples are the Iowa Electronic Market and PredictIt.org for betting on the outcome of elections. In US presidential elections, market participants buy a contract that pays a dollar if, for instance, a Democrat wins the election. The more money participants are prepared to pay for that contract, the more likely it appears that a Democrat will indeed win that election. Such markets have had varied success: they failed to predict the 2016 election of President Trump, but they estimated President Biden's 2020 win much more accurately than opinion polls or many pundits. At the time of writing, in early 2022, PredictIt is forecasting an easy win for President Macron in the 2022 French presidential elections. Alphabet (Google) uses similar prediction markets to forecast the success of possible new products: if many people within the company are prepared to bet on their success, then probably the new products will indeed turn out well. The bets of many employees may be more reliable than the self-interested forecasts of the product's own developers.

Internet media such as Twitter and Google can also provide forecasts, applying artificial intelligence to the 'big data' drawn from many millions of users. For example, Google Trends analysis of search terms such as 'weddings' and 'condoms' informed predictions about personal relationships and fertility during the unprecedented

uncertainty of the COVID epidemic.[27] Others analyse the mix of positive and negative sentiments expressed by ordinary people in Twitter feeds to forecast the direction of financial markets, up or down.[28] Data about what people are interested in, or how they feel, provides valuable clues to what will happen next.

Questions

Why might experts make bad forecasters in the case of: i) presidential elections; ii) new product developments?

Key takeaways It is vital that organisations be alert to the opportunities and threats of the macro-environment. This chapter therefore proposes the following:

- In designing a strategy, you should consider both *market* and *non-market* factors in the macro-environment, for example, using *PESTEL* (political, economic, social, technological, ecological and legal) analysis.
- You should follow up on a PESTEL analysis by identifying the *key drivers for change* coming from the macro-environment.
- When making forecasts, you should determine the best approach to the future given the nature of the specific macro-environment: *single-point*, *range* or *multiple futures*.
- When making macro-environmental forecasts, you should identify the *megatrends* in the environment, ask whether the environment is at or near an *inflexion point*, and ask yourself whether there are any *weak signals* whose significance is being underestimated.
- If there is uncertainty in the environment (and there usually is), ask what plausible and useful alternative *scenarios* there are and how they differ from the organisation's existing *ghost scenario*.

Work assignments ✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

3.1 For an organisation of your choice, carry out a PESTEL analysis and identify key opportunities and threats. Use Illustration 3.1 as a model. For simplicity, choose an organisation that is focused on a limited number of industries. What are the key drivers for change?

3.2 For your own country, or any other country with which you are familiar, look up the political risk as assessed by Aon, the Economist Intelligence Unit or similar (see endnote 5 in References at the end of the chapter). How far do you agree with this assessment?

3.3 For the last year or two, review the forecasts for national or global economic growth made by key forecasting organisations such as the OECD or the World Bank (see references in endnote 6). How accurate were they? What accounts for any difference between forecast and outcomes?

3.4 * For the same organisation as in assignment 3.1, and using Illustration 3.4 as one possible model, construct four scenarios for the evolution of its macro-environment (or main industry or sector). What implications are there for the organisation's strategy?

Integrative assignment

3.5 Carry out a full analysis of an industry or sector of your choice (using, for example, PESTEL and scenarios). Draw both on the macro-environmental factors in this chapter and the Five Forces analysis of Chapter 4. Consider explicitly how the industry or sector is affected by globalisation (see Chapter 10, particularly Figure 10.2 on drivers) and innovation (see Chapter 11, particularly Figure 11.5 on product and process innovation).

Recommended key readings

- An overview of techniques for thinking ahead is in P. Tetlock and D. Gardner (2015) *Superforecasting: The Art and Science of Prediction*, Crown. See also for scenarios, R. Ramirez and A. Wilkinson (2016) *Strategic Reframing: The Oxford Scenario Planning Approach*, Oxford University Press.
- A collection of academic articles on PEST, scenarios and similar is the special issue of *International Studies of Management and Organization,* vol. 36, no. 3 (2006), edited by Peter McKiernan.

References

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Case example

Gasunie: hydrogen pipedreams

Mark Eldridge and Richard Whittington

The Chief Executive of Gasunie, Han Fennema, had a problem. Gasunie owns the Dutch natural gas transmission network with over 12,000 kilometres of pipeline, plus a further 3,100 kilometres of pipelines in Germany. It also has huge underground gas storage facilities in the north of the Netherlands and a major share in a Liquid Natural Gas port terminal in Rotterdam. But the European Union and Dutch Government are both committed to carbon neutrality by 2050, with natural gas (a hydrocarbon) planned for elimination. Many alternative energy sources – such as solar or wind power – would make no use of Gasunie's infrastructure. All the company's gas pipelines, storage and port facilities risked becoming so-called 'stranded assets'.

Hydrogens: grey blue and green

Solar, wind and hydroelectricity offer quick and proven contributions to the challenge of decarbonisation. The strategy consulting firm McKinsey & Co. writes: 'By 2030, 64 percent of the European Union's emissions reduction [could] be achieved by large-scale electrification and increases in energy efficiency, accounting for 47 percent and 17 percent, respectively.' The Netherlands, flat and situated on the North Sea, has plenty of wind (remember all those quaint Dutch windmills).

But Gasunie transmits gas, not electricity. Here hydrogen gas could be a solution. Hydrogen (H_2) is the most abundant chemical substance in the universe, constituting roughly 75 per cent of all mass. Producing electricity from solar or wind power is cheap, but there are important industrial processes such as steel making, cement production and refining processes that are not readily decarbonised with electricity. Equally, wind and solar can be intermittent, causing either over or under supply. Storage is key and hydrogen is cheaper and more effective than electricity to store and transport. Hydrogen can also be used to decarbonise a number of industrial processes.

The problems come because hydrogen only exists as part of a compound, most commonly in the form of water (H_2O) but also in hydrocarbons such as natural gas (mainly methane CH_4). To be used for fuel, hydrogen must be released from its bond with oxygen in water or extracted from hydrocarbons. The different ways of obtaining hydrogen define its three basic types: ‘grey’, ‘blue’ or ‘green’.

Grey hydrogen is produced from natural gas in a process that releases a great deal of carbon dioxide (CO_2). This CO_2 is among the most significant long-lived greenhouse gas in Earth's atmosphere, contributing to global warming and ocean acidification. Royal Dutch Shell, based in London and Rotterdam, is one of the largest natural gas producers in the world.

Blue hydrogen relies on natural gas using the same basic process, but here the CO_2 is captured and stored underground. This carbon capture process is intended to prevent the CO_2 ever escaping into the Earth’s atmosphere. Blue hydrogen would leave a crucial supply role for the existing large oil and gas producing companies.

Green hydrogen is produced entirely differently, using water instead of natural gas. The bond with oxygen is cracked by using electrolysis, using energy from non-carbon renewable fuels, particularly solar or wind. The trouble is the electrolysis technology required to produce green hydrogen is currently very expensive and not forecast to be economically competitive with blue hydrogen until the 2030s.

The pipeline and storage facilities developed for grey hydrogen can be adapted for blue hydrogen, albeit at considerable cost. Green hydrogen too can make use of adapted infrastructure and can also be piped in from countries with sunnier climates. But green hydrogen can be produced on a very local basis too, potentially reducing the need for existing pipelines and storage. For Gasunie, blue hydrogen looks like an attractive medium-term solution to its potential problem of stranded assets.

The Dutch champion: Gasunie

Gasunie was founded in 1963 in order to distribute natural gas from the recently discovered gas field in the north of the Netherlands, the ninth largest in the world. It is wholly owned by the Dutch state. With one of the largest gas pipeline networks in Europe (including a pipeline to the United Kingdom and a stake in the Nord Stream 2 pipeline from Russia), Gasunie currently transports nearly a quarter of all the gas consumed in the European Union.

Natural gas has been to the Netherlands what oil is to the Gulf States, driving Dutch social policy and industrial development since the 1950s. Today, the Dutch economy has the eighth highest energy consumption per capita in the world. Energy consumption is split between natural gas (38 per cent), oil (35 per cent), coal (11 per cent), biofuels and waste (5 per cent), and 11 per cent from nuclear, wind, solar, hydropower and geothermal. Natural gas ac;counts for 85 per cent of the heating in Dutch homes; the European Union average is 38 per cent.

However, the Dutch are also highly environmentally aware. In 2019, the Dutch government passed the National Climate Act (‘Klimaatakkoord’), promising to halt natural gas production domestically by 2030. By 2050, all buildings must be low carbon emission, with a national reduction of all greenhouse gas emissions by 49 per cent by 2030 and 95 per cent by 2050. The Dutch economy, built historically on gas, now had the dilemma of how to generate green energy, while keeping the lights on.

Gasunie intends to be as central to Dutch energy in the coming years as it has been since its foundation. In 2020, Gasunie established its ‘Vision 2030’, where it stated:

By 2030, we will have transformed from a gas transmission company into a broad energy infrastructure company . . . We will play a key role in achieving the ambitious climate goals set in the Netherlands, Germany and the European Union.

The comwas considerable uncertainty ahead, with different bundles of approaches feasible, but in any case affirmed:

We are ambitious in our plans. Over the coming ten years, we intend to invest billions in the energy transition, both on our own and with partners. Not all of the plans are set in stone, but in all of the transition scenarios imaginable, we are part of the solution as a public open-access service provider.

Energy scenarios

In 2021, the chief executives of ten leading Dutch energy companies, including Gasunie, published four scenarios plotting the various paths by which the Netherlands could achieve a climate-neutral energy system by 2050. They intended these scenarios to show the ‘clear choices that will have to be made by our society, both in parliament and in the business community [and] the impact of these choices in terms of use of space, costs and practicality . . . ’ The report explained that the four scenarios ‘are not intended as blueprints for the future’; they just projected ‘four views of what our society could be like in 2050’. All four scenarios assumed Dutch climate neutrality by 2050. The four scenarios varied in both the amount and the mix of energy required:

- *Regional scenario*: here, the emphasis is on control by local communities and citizens, with a high level of autonomy as a key aim. Solar energy and onshore wind energy will grow significantly, while industry shrinks and decarbonises through electrification and the use of green hydrogen. Total Dutch final demand would be 476 Terrawatt Hours (TWh). Wind would provide 232.7 TWh of final demand; hydrogen 69.1 TWh.
- *National scenario*: in this scenario, the national government takes control in driving the development towards (near) self-sufficiency. The emphasis is on green electricity. Industry stays at the same level as today and decarbonises through electrification and the use of green hydrogen. Total Dutch final demand would be 548 TWh. National leadership facilitates large-scale national projects, especially around offshore wind power: wind would provide 267.2 TWh of final demand. Hydrogen would be used principally for back-up power stations and in transport, accounting for 124 TWh of final demand.
- *European scenario*: here leadership comes from the European Union level, with incentives to decarbonisation provided by a European carbon tax. Industry grows, while reducing its carbon emissions through electrification and the use of hydrogen.

Total Dutch demand would be 721 TWh. The share of solar and wind energy is lower than in the first two scenarios, but overall growth would still drive wind to 270.5 TWh of final demand. Hydrogen would account for 138 TWh of final demand.

- *International scenario*: in this scenario, energy developments are led by the market. This scenario expects low industrial growth, so Dutch final demand is depressed as in the Regional scenario to just 476 TWh. However, the Dutch buy the least expensive options in international markets, importing green hydrogen from countries where electricity can be produced with cheap solar energy: hydrogen would account for 185 TWh of final demand. There is less need for local wind power for generating green hydrogen, so wind demand would be 243.2 TWh.

Gasunie's non-market strategy

The four scenarios presented very different kinds of futures for a gas transmission company like Gasunie. The Regional scenario projected only one third of the hydrogen demand of the international scenario. Gasunie was keeping several options open, including both blue and green hydrogen projects. Blue hydrogen was attractive as a transitional fuel because it promised the most direct use of its existing natural gas infrastructure, but green hydrogen was recognised as central long term.

The company has therefore been very involved in lobbying on behalf of both kinds of hydrogen in national and European policy arenas. One of the main lobbying organisations backed by Gasunie is Hydrogen Europe. This is a lobbying business with over 300 member organisations and 17 full-time staff in Brussels, the heart of the European Union's policy making. Gasunie supplies one board member; other board members include representatives from the Norwegian company Equinor (the second largest natural gas supplier in Europe) and from major energy users such as German steel company Salzgitter and Japanese automobile company Toyota. Hydrogen Europe is just part of a network of lobbying activity by gas companies. In a 2020 report, three investigative organisations estimated that gas lobbyists were spending around €60

million a year trying to influence Brussels policy making. The report also identified numerous meetings between natural gas interests and senior European Commission representatives (163 meetings in just 9 months), plus a so-called ‘revolving door’ where influential European Commission officials were finding jobs in advisory firms working for major gas companies.

In 2020, the European Commission published its European Hydrogen Strategy. This strategy adopted the industry’s preferred description of both blue and green hydrogen as ‘clean’. The European Union promised regulatory and financial support for carbon capture research and investment, essential to the effectiveness of blue hydrogen. The European Union also rebranded the existing grey hydrogen pipeline network as Europe’s ‘Hydrogen Backbone’, with financial support for retrofitting pipelines for blends of grey gas and ‘clean hydrogen’. The Dutch politician Frans Timmermans, First Vice-President of the European Union and European Commissioner for Climate Action, declared: ‘Hydrogen rocks, and I am committed to making it a success!’ .

Gasunie’s assets looked like not being stranded after all. CEO Han Fennema observed: ‘In the hydrogen world, everything is going faster than we thought it would.’ And then in 2022 Russia cut off European gas supplies.

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Questions

1 Assess the PESTEL opportunities and threats facing Gasunie at the beginning of the case, summarising using the graphic in Illustration 3.1. A PESTEL for DiDi.

2 Assess the relative importance of market and non-market strategy for Gasunie

3 Should the four scenarios have considered the possibility of *not* achieving climate neutrality by 2050?

Chapter 4

Industry and sector analysis

Key terms

business ecosystems

complementor

industry

market

market segment

network effects

Porter's Five Forces framework

strategic groups

Learning outcomes

After reading this chapter you should be able to:

- Define industries and use *Porter's* competitive *Five Forces framework* to analyse industries or sectors: rivalry, threat of entrants, substitute threats, customer's power and supplier power.
- On the basis of the five competitive forces, define *industry attractiveness* and identify how the forces can be managed.
- Understand what *business ecosystems* are and how *complementors* are an important sixth factor in an industry analysis.

- Understand different *industry types* and how industries develop and change in *industry life cycles* and how to make Five Forces analyses dynamic through *comparative industry structure analysis*.
- Analyse strategic and competitor positions in terms of *strategic groups* and *market segments*.

Long Description

4.1 Introduction

In the last chapter, we considered how the broad macro-environment influences opportunities and threats. The impact of these general factors tends to surface in the immediate environment of the specific industry or sector and this nearby environment is the focus of this chapter. For example, Samsung's strategy depends on the smartphone industry: here it must take account of competitors' strategies, customers' needs, and the supply of phone components, for example microchips. Similarly, a hospital needs to consider actors in the healthcare sector including clients, other healthcare providers and the supply of healthcare inputs such as pharmaceuticals. This suggests that it is crucial for managers to carefully examine the industry or sector and the actors these involve in order to determine what strategy to pursue.

The focus here is thus on the middle 'industry' and 'sector' layer in Figure 3.1, which involves central actors that influence an organisation's long-term survival and success including competitors, customers or clients, and suppliers. **An industry is a group of firms producing products and services that are essentially the same**.[1] Examples are the automobile industry and the airline industry. Industries are also often described as 'sectors', especially in public services (e.g., the health sector or the education sector). Industries and sectors are often made up of several specific markets or market segments. **A market is a group of customers for specific products or services that are essentially the same (e.g., a**

particular geographical market). Thus, the automobile industry has markets in North America, Europe and Asia, for example.

This chapter examines four main topics and provides different frameworks and concepts for understanding the industry or sector with the structure, summarised in Figure 4.1:

- Industry analysis using the *Competitive Five Forces Framework*, which examines five essential industry forces: competitors, customers, potential entrants, suppliers and substitutes.
- Fundamental industry structures and dynamics, which include examinations of underlying economic *industry types* and how industries evolve through *industry life cycles*, which might influence changes in the five forces that can be examined with a *comparative five force analysis*.
- How organisations not only compete but cooperate and work together to create value in *business ecosystems* in which diverse actors complement each other in creating value and *complementors* thus becomes yet another factor or force to consider besides the five competitive forces.
- A more fine-grained understanding of competition within an industry or sector including examinations of *strategic groups*, groups of organisations with similar strategies and of *market segments*, groups of customers with similar needs.

Figure 4.1 Industry and sector environments: the key topics

Figure 4.1: Long Description

4.2 Industry analysis

Industries vary widely in terms of their long-term attractiveness, as measured by how easy it is for participating firms to earn high profits. A key determinant of profitability is the extent of competition and the strength of buyers and suppliers and this varies between industries. Where competition and buyer and supplier strengths are low, and there is little threat of new competitors, participating firms should normally expect good profits. Profitability between industries can thus vary considerably depending on these forces; for example, the pharmaceutical industry has performed very well historically while others, like the airline industry, have underperformed.[2]

Understanding the nearby environment is important for non-profits and public-sector bodies too. The influence and power from suppliers, including service providers and sub-contractors, are critical if they are to fulfil their goals. Even in cases where non-profits and public-sector organisations do not have buyers in the real sense, there are grantmakers of different kinds that have influence on the social impact provided by them. Moreover, while cooperation sits at the centre of many non-profits and public-sector organisations, there is competition too. For example, there are numerous charities that provide similar or identical services and thus compete for contributors and supporters.

Porter's Five Forces framework[3] **assists industry analysis and helps to identify industry attractiveness in terms of five competitive forces: (i) extent of rivalry between competitors; (ii) threat of entry; (iii) threat of substitutes; (iv) power of buyers;**

and (v) power of suppliers. These five forces together determine an industry's 'structure' and its attractiveness (see Figure 4.2). Once this has been understood, the five forces can help set an agenda for action on various critical issues: for example, what specific strategy to pursue in order to control excessive rivalry in a particular industry? Managers should try to find positions where the organisation can best defend itself against strong competitive forces or where they can influence them in its favour. The rest of this section first discusses how to define the scope of an industry and then introduces each of the five forces in more detail and discusses the implications of these for strategy. Illustration 4.2 summarises industry and sector analysis and provides an overview of its various steps.

4.2.1 Defining the industry

The first step in an industry analysis is to define the industry. If defined incorrectly, there is a risk that the whole analysis becomes flawed and significant strategy aspects are overlooked. There are three fundamental issues to consider here:

Figure 4.2 The Five Competitive Forces Framework

Source: Adapted from *Competitive Strategy: Techniques for Analyzing Industries and Competitors* by Michael E. Porter, copyright © 1980, 1998 by The Free Press. All rights reserved.

Figure 4.2: Long Description

- The industry must not be defined too broadly or too narrowly. For example, if an entrepreneur considers starting a taxi business in Stockholm and makes an industry analysis it would be much too broad to define the industry as ‘the Swedish

personal transportation industry' while 'the minicab industry in central Stockholm' would be too narrow. The first definition would include such a wide variety of actors that the analysis risks becoming meaningless, while the second risks excluding important competitors (e.g., taxi firms from the suburbs).

- The broader industry value chain needs to be considered. Different industries often operate in different parts of a value chain or value system and should be analysed separately (see Section 5.4.2 for a discussion of value systems). For example, the iron ore industry delivers to the steel manufacturing industry that in turn delivers to a wide variety of industries such as automobiles and construction. These three stages in the broader value chain or system should be analysed separately.
- Most industries can be analysed at different levels, for example different geographies, markets and even different product or service segments within them (see Section 4.5.2 below). Thus, the airline industry has different geographical markets (Europe, China, and so on) and it also has different service segments within each market (e.g., leisure, business and freight). The competitive forces are likely to be different for each of these markets and segments, with distinct buyers, suppliers and barriers, etc. In addition, larger corporations often operate in diverse markets and segments and would thus analyse each separately. For example, Electrolux, the Swedish appliance manufacturer, organises its major appliances (refrigerators, washing machines, etc.) in regional geographical markets, but also has two global business segments (small appliances and professional products) and would analyse all these separately.

> Michael Porter has his own rule of thumb and suggests that you are likely dealing with distinct industries if there are differences between them in more than one competitive force, or where differences in any force are large.

The specific strategy question or organisation at issue might also provide an indication of how to define the industry. Sometimes, however, there is no ideal way of drawing the industry borders. Under these circumstances, the important thing is to draw them clearly. They must be drawn consistently when it comes to what actors are inside and outside the industry. In particularly complex cases, it might be necessary to try out both narrower definitions to identify details and broader ones to avoid overlooking important actors. Finally, industry borders may change over time depending on macro-environment changes and moves by competitors (as discussed below in Section 4.3.2).

4.2.2 The competitive forces

The main message of the competitive five forces is that industries where these are strong are not attractive, which has important implications for how to form competitive strategies. Excessive competitive rivalry, powerful buyers and suppliers and the threat of substitutes or new entrants will all combine to squeeze profitability. Although initially developed with businesses in mind, the Five Forces Framework is relevant to most organisations. It can thus provide a useful starting point for strategic analysis even where profit criteria may not apply. In the public sector, it is important to understand how powerful suppliers can push up costs; in the charity sector, it is

important to avoid excessive rivalry within the same sector and market. Not-for-profits may also want to consider how likely a grant provider for an organisation or member of a charity organisation would substitute for someone else providing similar services.

It's important to keep in mind that a five forces analysis is an industry-level analysis rather than an analysis of an individual firm or group of firms. Hence, even if the ultimate purpose is to find a strategy for an individual firm, it should be left out to start with except as part of rivalry. It often makes sense to start the analysis with this force as it defines the various core players from the very beginning and this is thus discussed first below.

Competitive rivalry

At the centre of five forces analysis is the rivalry between the existing players – 'incumbents' – in an industry. The more competitive rivalry there is, the worse it is for incumbents. *Competitive rivals* are organisations aiming at the same customer groups and with similar products and services (i.e., not substitutes). In the European airline industry, Air France/KLM and British Airways/Iberia (IAG) are rivals; high-speed trains are a 'substitute' (see below). Five factors tend to define the extent of rivalry in an industry or market:

- *Competitor concentration and balance.* Where competitors are numerous or of roughly equal size or power, there is the danger of intensely rivalrous behaviour as competitors attempt to gain dominance over others, through aggressive price cuts, for example. Conversely, less rivalrous industries tend to have one or two dominant organisations, with the smaller players reluctant

to challenge the larger ones directly (e.g., by focusing on niches to avoid the ‘attention’ of the dominant companies).

- *Degree of differentiation.* In a commodity market, where products or services are poorly differentiated, rivalry is increased because there is little to stop customers switching between competitors and the only way to compete is on price. Petrol is a commodity market, for instance.
- *Industry growth rate.* In situations of strong growth, an organisation can grow with the market, but in situations of low growth or decline, any growth is likely to be at the expense of a rival and meet with fierce resistance. Low-growth markets are, therefore, often associated with price competition and low profitability. The *industry life cycle* influences growth rates, and hence competitive conditions (see Section 4.3.2).
- *High fixed costs.* Industries with high fixed costs, perhaps because they require high investments in capital equipment or initial research, tend to be highly rivalrous. Companies will seek to spread their fixed costs (i.e., reduce unit costs) by increasing their volumes: to do so, they typically cut their prices, prompting competitors to do the same and thereby triggering price wars in which all competitors in the industry suffer.
- *High exit barriers.* The existence of high barriers to exit – in other words, high closure or disinvestment costs – tends to increase rivalry, especially in declining industries. Excess capacity persists and consequently incumbents fight to maintain market share. Exit barriers might be high for a variety of reasons: for example, high redundancy costs or high investment

in specific assets such as plant and equipment which others would not buy.

The threat of entry

How easy it is to enter the industry influences the degree of competition. The greater the threat of entry, the worse it is for incumbents in an industry. An attractive industry has high barriers to entry that reduce the threat of new competitors. *Barriers to entry* are the factors that need to be overcome by new entrants if they are to compete in an industry. Illustration 4.1 describes the entry barriers into the banking industry and the obstacles they provide for new entrants. Five important entry barriers are:

- *Economies of scale.* Scale is extremely important in some industries: for example, in pharmaceuticals, where there are extremely high fixed costs for extensive R&D and marketing that must be spread over high levels of output (see Chapter 8 for further details on economies of scale). Once incumbents have reached large-scale production, it will be very expensive for new entrants to match them and, until they reach a similar volume, they will have higher unit costs. Another scale barrier comes from *experience curve* effects that give incumbents a cost advantage because they have learned how to do things more efficiently than an inexperienced new entrant could possibly do (see Section 8.3.1). Until the new entrant has built up equivalent experience over time, it will tend to produce at higher cost. In addition to these supply-side economies of scale, there are ‘demand or buyer side’ economies of scale, or *network effects* in some industries, as buyers value being in a ’network’ of a large

number of other customers (see Section 4.4.2 below for further details).[4]

- *Customer switching costs.* When customers switch products or services to the entrant, they may face extra costs to meet new product requirements, may need to retrain employees or modify their business processes. Switching between large integrated software systems may, for example, incur high switching costs.
- *Capital requirements.* The level of financial resources needed to enter an industry can prevent entry. To enter the pharmaceutical industry, for example, huge research and development investments over many years are needed. While large corporations may have access to the capital needed, it may limit the number of likely entrants.
- *Access to supply or distribution channels and other incumbency advantages.* In many industries, incumbents have had control over supply and/or distribution channels. Sometimes, this has been through direct ownership (vertical integration), sometimes, just through customer or supplier loyalty. Similarly, incumbents may have access to proprietary technology (e.g., patents), or brand identity (e.g., Coca-Cola).
- *Expected retaliation.* If an organisation considering entering an industry believes that the retaliation of an existing firm will be so great as to prevent entry, or mean that entry would be too costly, this is also a barrier. Retaliation could take the form of a price war or a marketing blitz. Just the knowledge that incumbents are prepared to retaliate is often sufficiently discouraging to act as a barrier.

Illustration 4.1 Banking barriers busted by fintech Although banking entry barriers have been very high, the fintech banking revolution has started to tumble them.

The high barriers to entry in financial services include structural barriers due to basic industry conditions such as economies of scale, network effects and regulation. The latter is significant in this industry; to protect the safety and stability of the financial system, there are high regulatory walls. While incumbents may complain as authorities introduce new regulations, they often promote them once in place as they raise barriers for new entrants.

In the UK, regulatory and other barriers have resulted in a ‘Big Five’ domination: HSBC, Barclays, Royal Bank of Scotland, Lloyds and Santander. Other markets are very similar with ‘Big Five’ in Canada, ‘Big Three’ in Spain and the Netherlands and ‘Big Four’ in Sweden. The dilemma for regulators is that they should not only secure the stability of the financial system, but they also have the objective to make sure banks deliver more efficiency and services for customers through increased competition. To act on this second objective, regulators have started to encourage more entrants and assist them to find cracks in the barriers without totally breaking them. For example, Managing Director of Britain’s Payment Systems Regulator, Hannah Nixon, proposed: There needs to be a

fundamental change in the industry to encourage new entrants to compete on service, price and innovation in an open and transparent way.

The regulators have been heard in this respect as an entirely new breed of potent rivals has started to break the barriers during the last few years, so-called ‘fintech’ (finance and technology) start-ups have been flourishing. They seek to improve and automate the delivery and use of various financial services including retail banking, business banking, payments, lending, etc. Investments into fintech firms in the UK now trails only the USA. Helped by new IT technologies, software, and mobile banking they have been able to break many banking barriers and there are now over 2,500 fintech start-ups in the UK according to a Deloitte report. London City has been a key driver in this with the world’s highest concentration of financial and professional services firms. It provides a beneficial banking ecosystem for some of these start-ups where they can find new partners complementing their services, suppliers and other supporting actors.

Although far from all fintechs have full banking licenses, larger companies have started to seek them, for example Revolut, a leading UK fintech firm. The CEO and founder of Revolut, Nikolay Storonsky, says that they are creating a ‘global financial super app’ that allows customers to ‘manage all their financial needs through a single platform’: We want our global app to offer customers 10x better value and 10x better service and security than they can achieve anywhere else.

While incumbent banks also try to jump on this fintech bandwagon, they face challenges as they are often bound by regulations that have protected them from entrants.

Sources: D. Dawkins (2021) ‘As Revolut Becomes U.K.’s Most Valuable Fintech, Its Founder Is Now Worth $7 Billion’, *Forbes*, 15 July; Deloitte, ‘The UK FinTech Landscape’, available at: https://www2.deloitte.com/uk/en/pages/financial-services/articles/uk-fintech-landscape.html [accessed: May 2022]; H. Jones (2016) *Reuters*, 25 February; N. Megaw (2021) ‘FCA warns UK fintechs against comparing themselves to banks’, *Financial Times*, 19 May.

Questions

1 Evaluate the strengths of the banking industry's entry barriers according to Porter's criteria.

2 Assess how the fintech start-ups have started to break up the banking barriers.

3 How would you evaluate the behaviour of banks trying to keep competition out from an ethical point of view?

The threat of substitutes

Substitutes are products or services that offer the same or a similar function and benefit to an industry's own products or services but have a different nature. For example, aluminium is a substitute for steel; a tablet computer is a substitute for a laptop; charities can be substitutes for public services. Managers often focus on their competitors in their own industry, and neglect the threat posed by substitutes. Substitutes can reduce demand for a particular type of product as customers switch to alternatives – even to the extent that this type of product or service becomes obsolete. However, there does not have to be much actual switching for the substitute threat to have an effect. The simple risk of substitution puts a cap on the prices that can be charged in an industry. Thus, although Eurostar trains have no direct competitors in terms of train services from Paris to London, the prices it can charge are ultimately limited by the cost of flights between the two cities. When there are several potential substitutes, it helps to consider which ones are more of a threat compared to others by ranking them.

There are two important points to bear in mind about substitutes:

- *Extra-industry effects* are the core of the substitution concept. Substitutes come from outside the incumbents' industry and should not be confused with competitors' threats from within the industry. The value of the substitution concept is to force managers to look outside their own industry to consider more distant threats and constraints. If the buyers' *switching costs* for the substitute are low, the threat increases. The higher the threat, the less attractive the industry is likely to be.
- *The price/performance ratio* is critical to substitution threats. A substitute is still an effective threat, even if more expensive, so long as it offers performance advantages that customers value. Thus, aluminium is more expensive than steel, but its relative lightness and its resistance to corrosion give it an advantage in some automobile manufacturing applications. It is the ratio of price to performance that matters, rather than simple price.

The power of buyers

Buyers are the organisation's immediate customers, not necessarily the ultimate consumers. If buyers are powerful, then they can demand low prices or costly product or service improvements.

Buyer power is likely to be high when some of the following four conditions prevail:

- *Concentrated buyers.* Where a few large customers account for the majority of sales, buyer power is increased. This is the case for items such as milk in the grocery sector in many European countries, where just a few retailers dominate the market. If a

product or service accounts for a *high percentage of total purchases* of the buyer, their power is also likely to increase as they are more likely to 'shop around' to get the best price and therefore 'squeeze' suppliers more than they would for more trivial purchases.

- *Low switching costs.* Where buyers can easily switch between one supplier and another, they have a strong negotiating position and can squeeze suppliers who are desperate for their business. Switching costs are typically low for *standardised products and undifferentiated commodities* such as steel. They are also likely to be low when the buyers are *fully informed* about prices and product performance.
- *Buyer competition threat.* If the buyer has the capability to supply itself, or if it has the possibility of acquiring such a capability, it tends to be powerful. In negotiation with its suppliers, it can raise the threat of doing the suppliers' job themselves. This is called *backward vertical integration* (see Section 9.5), moving back to sources of supply, and might occur if satisfactory prices or quality from suppliers cannot be obtained. For example, some steel companies have gained power over their iron ore suppliers as they have acquired iron ore sources for themselves.

It is very important that *buyers* are distinguished from *ultimate consumers*. Thus, for companies like Procter & Gamble or Unilever (makers of shampoo, washing powders, and so on), their buyers are retailers such as Carrefour or Tesco, not ordinary consumers. Carrefour and Tesco have much more negotiating power than an ordinary consumer would have. The high buying power of such

supermarkets is a strategic issue for the companies supplying them. It is often useful therefore to distinguish '*strategic customers*', powerful buyers (such as the retailers) towards whom the strategy should be primarily orientated. In the public sector, the strategic customer is typically the provider of funds, rather than the consumer of services: for a pharmaceutical company, the strategic customer is the hospital, not the patient.

The power of suppliers

Suppliers are those who supply the organisation with what it needs in order to produce the product or service. As well as fuel, raw materials and equipment, this can include labour and sources of finance. The factors increasing supplier power are the converse to those for buyer power. Thus, s*upplier power* is likely to be high where there are:

- *Concentrated suppliers.* Where just a few producers dominate supply, suppliers have more power over buyers. The iron ore industry is now concentrated in the hands of three main producers, leaving the steel companies, still relatively fragmented, in a weak negotiating position for this essential raw material.
- *High switching costs.* If it is expensive or disruptive to move from one supplier to another, then the buyer becomes relatively dependent and correspondingly weak. Microsoft is a powerful supplier because of the high switching costs of moving from one operating system to another. Buyers are prepared to pay a premium to avoid the trouble, and Microsoft knows it.

- *Supplier competition threat.* Suppliers have increased power where they are able to enter the industry themselves or cut out buyers who are acting as intermediaries. Thus, airlines have been able to negotiate tough contracts with travel agencies as the rise of online booking has allowed them to create a direct route to customers. This is called *forward vertical integration*, moving up closer to the ultimate customer.
- *Differentiated products.* When the products or services are highly differentiated, suppliers will be more powerful. For example, although discount retailers like Walmart are extremely powerful, suppliers with strong brands, like P&G with Gillette, still have high negotiating power. Also, if there are no or few substitutes for the input, the supplier group will be more powerful, like pilots' unions in the airline industry.

Most organisations have many suppliers, so it is necessary to concentrate the analysis on the most important ones or types. If their power is high, suppliers can capture all their buyers' own potential profits simply by raising their prices. Star football players have succeeded in raising their rewards to astronomical levels, while even the leading football clubs – their 'buyers' – struggle to make money.

4.2.3 Implications of the Competitive Five Forces

The Five Forces Framework provides several useful insights into the forces at work in the industry or market environment of an organisation. The objective is more than simply listing the strength of

the forces and their underlying driving factors. It is rather to determine whether the industry is a good one to compete in or not and to conclude whether there are advantageous strategic positions where an organisation can defend itself against strong competitive forces, can exploit weak ones or can influence the forces in its favour. The aim of the five forces analysis is thus an assessment of the *attractiveness* of the industry and any possibilities to *manage strategies* in relation to the forces to promote long-term survival and competitive advantage. It is thus important to note that not all competitive positions in an attractive industry are attractive and all positions in an unattractive industry are not unattractive. As Illustration 4.2 shows, these considerations make up the last three steps in an industry analysis together with an assessment of industry change, which is discussed in the next section. When each of the five forces has been evaluated, the next step is thus to understand the implications of these:

- *How can the five forces be managed?* Industry structures are not necessarily fixed but can be influenced by deliberate managerial strategies. Managers should identify strategic positions where the organisation best can defend itself against strong competitive forces, can exploit weak ones or can influence them. As a general rule, managers should try to influence and exploit any weak forces to its advantage and neutralise any strong ones. For example, if barriers to entry are low, an organisation can raise them by increasing advertising spending to improve customer loyalty. Managers can buy up competitors to reduce rivalry and to increase power over suppliers or buyers. If buyers are very strong, an organisation

can try to differentiate products or services for a specific customer group and thus increase their loyalty and switching costs. Managing and influencing industry structure involves many issues relating to *strategic choices* and *business strategy* and will be a major concern of Chapter 8.

- *Which industries to enter (or leave)?* One important purpose of the Five Forces Framework is to identify the relative attractiveness of different industries: industries are attractive when the forces are weak. In general, entrepreneurs and managers should invest in industries where the five forces work in their favour and avoid, or disinvest from, markets where they are strongly unfavourable. Entrepreneurs sometimes choose markets because entry barriers are low: unless barriers are likely to rise quickly, this is precisely the wrong reason to enter. Chapter 9 further examines these strategic choices and corporate strategy and what to consider when deciding whether to invest into or divest out of various industries.
- *How are competitors affected differently?* Not all competitors will be affected equally by changes in industry structure, deliberate or spontaneous. If barriers are rising because of increased R&D or advertising spending, smaller players in the industry may not be able to keep up with the larger players and be squeezed out. Similarly, growing buyer power is likely to hurt small competitors most. Strategic group analysis is helpful here (see Section 4.5.1).

Although originating in the private sector, five forces analysis can have important implications for organisations in the public and charity sectors too. While collaborations are important for these

organisations, they also compete for grants, donations, credibility in providing social impact, talent, board members, supporters, etc. For example, the forces can be used to adjust the service offer or focus on key issues. Thus, it might be worth switching focus from an arena with many crowded and overlapping services (e.g., social work, probation services and education) to one that is less rivalrous and where the organisation can do something more distinctive. Similarly, strategies could be launched to reduce dependence on particularly powerful and expensive suppliers, for example energy sources or high-shortage skills. Substitutes need to be considered and managed too.

Illustration 4.2 Steps in an industry analysis

There are several important steps in an industry analysis before and after analysing the five forces.

Emily wants to start a coffee shop and perhaps even try to grow the business into several outlets. She needs to consider the following steps and questions:

1 **Define the industry clearly.** Do the actors in the industry face the same buyers, suppliers, entry barriers and substitutes?

- *Vertical scope:* What stages of the industry value chain/system?
- *Product or service scope:* What products or services? Which ones are actually parts of other, separate industries? What segments?
- *Geographic scope:* Local, national, regional or global competition?

Emily should consider that many diverse businesses serve coffee. They include not only local cafés and coffee shop chains, but fast food chains, kiosks and restaurants.

The definition also depends on whether Emily intends to start in an urban or rural area.

2 **Identify the actors of each of the five forces and, if relevant, define different groups within them and the basis for this.** Which are the:

- competitors that face the same competitive forces? (Compare point 1 above.)
- buyers and buyer groups (e.g., end customers vs intermediaries, individual vs organisational)?
- suppliers and supplier groups (e.g., diverse supplier categories)?
- potential entrants?
- substitutes?

Given a clear industry definition, the identification of the actors for each force should be rather straightforward for Emily, but groups within them need to be considered. On the supplier side, for example, they not only include inputs like coffee, but also the landlord of the premises and labour supply.

3 **Determine the underlying factors of and total strength of each force.**

- Which are the main underlying factors for each force? Why?
- Which competitive forces are strong? Which are weak? Why?

Not all underlying factors on the five force checklists will be equally relevant for Emily. With respect to buyers, for example, the products' degree of standardisation and prices matter most, while others are less important.

4 **Assess the overall industry structure and attractiveness.**

- How attractive is the industry? Why?
- Which are the most important competitive forces? Which control profitability?
- Are more profitable competitors better positioned in relation to the five forces?

For Emily, several of the forces are quite strong, but some are relatively more important for profitability. In addition, some competitors, like large coffee chains, are

better positioned versus the five forces than others.

5 **Assess recent and expected future changes for each force.**

- What are the potential positive/negative changes? How likely are they?
- Are new entrants and/or competitors changing the industry structure in any way?

For example, Emily needs to consider the proliferation of coffee chains during the last few years and that pubs and bakeries have improved their coffee offerings lately. Maybe she can also spot possible changes in consumer trends and growth.

6 **Determine how to position your business in relation to the five forces.** Can you:

- exploit any of the weak forces?
- neutralise any of the strong forces?
- exploit industry change in any way?
- influence and change the industry structure to your advantage?

To cope with the forces, Emily could possibly identify a concept that would attract a certain group of customers, even if buyers have many choices in urban areas. This could neutralise threats from competition and entry somewhat and perhaps provide loyalty from some customers.

Sources: M.E. Porter (2008) 'The five competitive forces that shape strategy', *Harvard Business Review*, vol. 86, no. 1, pp. 58–77; J. Magretta (2012) *Understanding Michael Porter: The Essential Guide to Competition and Strategy*, Harvard Business Review Press.

Questions

1 Help Emily and go through each step above. Answer the questions and make a complete analysis. What is your assessment of the industry?

2 Based on your analysis: How should Emily handle the different forces? What strategic options should she consider?

4.3 Industry types and dynamics

The Five Forces Framework is the most well-known strategy tool for industry analysis, but it has to be used carefully. First, industry types and their underlying economic characteristics should be considered as they have major implications on industry attractiveness and what competitive strategies are available. Second, even though industry structures are typically fairly stable, they do change, and some can be in flux for considerable periods of time. This suggests that basic industry types and industry dynamics in competitive forces need to be considered. This section thus first examines fundamental industry types and then industry change and dynamics.

4.3.1 Industry types

The Five Forces Framework builds on theories in economics[5] and it helps to identify the main types of industry structure. They vary from consolidated industries with just one or a few firms with high profitability to fragmented ones with many, sometimes thousands, firms with lower profitability (see Table 4.1). In practice, particular industries are typically not pure representatives of these types but, nonetheless, it is helpful to have these broad categories in mind in order to compare the attractiveness of industries and likely broad patterns of competitive behaviour within them. Three basic types are:

- *Monopoly.* A monopoly is formally an industry with just one firm with a unique product or service and therefore no competitive rivalry. Because of the lack of choice between rivals and few

entrants, there is potentially very great power over buyers and suppliers. This can be very profitable. Firms can still have monopoly power where they are simply the dominant competitor based on network effects for example: Google has at least 60 per cent market share of the US search engine market, which gives it price-setting power in the internet advertising market. See Illustration 4.3 for a discussion of Facebook's dominance. Other industries are monopolistic because of economies of scale: water utility companies are often monopolies in a particular area because it is uneconomic for smaller players to compete. For this reason, the government sometimes gives one firm the right to be the only supplier of a product or service.

- *Oligopoly.* An oligopoly is where just a few often large firms dominate an industry, with the potential for limited rivalry and threat of entrants and great power over buyers and suppliers. With only a few competitors, the actions of any one firm are likely highly influential on the others: therefore, all firms must carefully consider the actions of all others. The iron ore market is an oligopoly, dominated by Vale, Rio Tinto and BHP Billiton. In theory, oligopoly can be highly profitable, but much depends on the extent of rivalrous behaviour, the threat of entry and substitutes and the growth of final demand in key markets. Oligopolistic firms have a strong interest in minimising rivalry between each other so as to maintain a common front against buyers and suppliers.[6] Where there are just two oligopolistic rivals, as for Airbus and Boeing in the civil airline industry, the situation is a *duopoly*.

- *Perfect competition.* Perfect competition exists where barriers to entry are low, there are countless equal rivals each with close to identical products or services, and information about prices, products and competitors is perfectly available. Competition focuses heavily on price, because products are so similar and competitors typically cannot fund major innovations or marketing initiatives to make them dissimilar. Under these conditions, firms are unable to earn more profit than the bare minimum required to survive. Agriculture often comes close to perfect competition (e.g., potatoes, apples, onions, etc.) and so do street food vendors in major cities. Few markets, however, are absolutely perfectly competitive. Markets are more commonly slightly imperfect so that products can be differentiated to a certain degree and with information not completely available for everyone. A number of small firm service industries rather have this character, such as restaurants, pubs, hairdressers, shoe repairs.[7]

Table 4.1 Industry types

It has also been argued that there are '*hypercompetitive industries*'. Hypercompetition occurs where the frequency, boldness and aggression of competitor interactions accelerate to create a condition of constant disequilibrium and change.[8] Under hypercompetition, rivals tend to invest heavily in disruptive innovation, expensive marketing initiatives and aggressive price cuts, with negative impacts on profits.

Industry structures change over time and industries can evolve from one type to another, depending on the macro-environment, the degree of industry maturity and competitive strategies in the industry with consequences for competitive force strengths. These industry dynamics are discussed next.

4.3.2 Industry structure dynamics

Industry structure analysis can easily become too static: after all, structure implies stability.[9] However, industries are not always stable. To begin with, industry borders can change over time and this needs to be considered when first defining an industry. For example, many industries, especially in high-tech arenas, are converging. Convergence is where previously separate industries begin to overlap or merge in terms of activities, technologies, products and customers.[10] Technological change has brought convergence between the old telephone, photographic and the PC industries, for example, as mobile phones have become smartphones with camera and video, emailing and document editing functions. Hence, companies that once were in separate industries, such as Samsung in mobile phones, Sony in cameras and Apple in computers, are now in the same smartphone industry.

As discussed in the previous chapter, the broader macro-environment also tends to influence the more specific industry environment through changes in the industry structure. These key drivers for change are likely to alter the industry and scenario analyses can be used to understand possible impacts (see Section 3.4). This sub-section examines two additional approaches to

understanding change in industry structure: the *industry life-cycle* concept and *comparative five forces analyses*.

The industry life cycle

The industry life-cycle concept proposes that industries start small in their development or introduction stage, then go through a period of rapid growth (the equivalent to ‘adolescence’ in the human life cycle), culminating in a period of ‘shake-out’. The final two stages are first a period of slow or even zero growth (‘maturity’), and then the final stage of decline (‘old age’). The power of the five forces typically varies with the stages of the industry life cycle (see Figure 4.3).[11]

The *development stage* is an experimental one, typically with few players, little direct rivalry and highly differentiated products. The five forces are likely to be weak, therefore, though profits may actually be scarce because of high investment requirements. The next stage is one of *high growth*, with rivalry low as there is plenty of market opportunity for everybody. Low rivalry and keen buyers of the new product favour profits at this stage, but these are not certain. Barriers to entry may still be low in the growth stage, as existing competitors have not built up much scale, experience or customer loyalty. Suppliers can be powerful too if there is a shortage of components or materials that fast-growing businesses need for expansion. The *shake-out stage* begins as the market becomes increasingly saturated and cluttered with competitors. Profits are variable, as increased rivalry forces the weakest competitors out of the business. In the *maturity stage*, barriers to entry tend to increase, as control over distribution is established and economies of scale and

experience curve benefits come into play. Products or services tend to standardise, with relative price becoming key. Buyers may become more powerful as they become less avid for the industry's products and more confident in switching between suppliers. Profitability at the maturity stage relies on high market share, providing leverage against buyers and competitive advantage in terms of cost. The *decline stage* can be a period of extreme rivalry, especially where there are high exit barriers, as falling sales force remaining competitors into dog-eat-dog competition. However, survivors in the decline stage may still be profitable if competitor exit leaves them in a monopolistic position. Figure 4.3 summarises some of the conditions that can be expected at different stages in the life cycle.

Figure 4.3 The industry life cycle

Figure 4.3: Long Description

It is important to avoid putting too much faith in the inevitability of life-cycle stages. One stage does not follow predictably after another. First, industries vary widely in the length of their growth stages. Many internet-based industries have matured quickly and moved through the stages in less than a decade, for example online travel and dating services. Second, some industries can rapidly ‘de-mature’ through radical innovation. Likewise, since the mobile telephony handset industry matured, it has later been revived by the introduction of smartphones and smartwatches. Managing in mature industries is thus not necessarily just about waiting for decline, but making efforts to reinvent products, services and strategies over time in a *potential rejuvenation* into a new life cycle.[12] For example, Netflix was active in the DVD rental services industry, but did not wait for it to decline and die and instead rejuvenated itself as a streaming services company. However, even if the various stages are not inevitable, the life-cycle concept does remind managers that conditions are likely to change over time. Especially in fast-moving industries, five forces analysis needs to be reviewed quite regularly.

Comparative industry structure analyses

The previous section raised the issue of how competitive forces may change over time. The industry life cycle thus underlines the need to make industry structure analysis dynamic. This implies that we not only need to understand the current strength of the competitive forces, but how it may change over time. One effective means of

doing this is to compare the competitive five forces over time in a simple ‘radar plot’.

Figure 4.4 provides a framework for summarising the power of each of the five forces on five axes. Power diminishes as the axes go outwards. Where the forces are low, the total area enclosed by the lines between the axes is large; where the forces are high, the total area enclosed by the lines is small. The larger the enclosed area, therefore, the greater is the profit potential. In Figure 4.4, the industry at Time 0 (represented by the red lines) has relatively low rivalry (just a few competitors) and faces low substitution threats. The threat of entry is moderate, but both buyer power and supplier power are relatively high. Overall, this looks like only a moderately attractive industry to invest in.

However, given the dynamic nature of industries, managers need to look forward. Figure 4.4 represents five years forward by the green lines. Managers are predicting, in this case, some rise in the threat of substitutes (perhaps new technologies will be developed). On the other hand, they predict a falling entry threat, while both buyer power and supplier power will be easing. Rivalry will reduce still further. This looks like a classic case of an industry in which a few players emerge with overall dominance. The area enclosed by the green lines is large, suggesting a relatively attractive industry. For a firm confident of becoming one of the dominant players, this might be an industry well worth investing in.

Comparing the five forces over time on a radar plot thus helps to give industry structure analysis a dynamic aspect. The lines are only approximate, of course, because they aggregate the many individual elements that make up each of the forces into a simple composite

measure. With this warning in mind, such radar plots can, nonetheless, be both a useful device for initial analysis and an effective summary of a final, more refined and dynamic analysis.

Figure 4.4 Comparative industry structure analysis

Figure 4.4: Long Description

4.4 Ecosystems and complementors

Porter's Five Forces sees organisations as battling against each other for share of industry value. However, another view rather emphasises how organisations not only compete but cooperate to create value. It emphasises the importance of a community of interacting organisations that work together like in a biological ecosystem. In such a system it becomes important to understand how diverse actors complement each other in creating value for themselves and for customers. This section first discusses business ecosystems and then a central feature of them, complementors.[13]

4.4.1 Ecosystems

Ecosystems for businesses have been described quite broadly to include virtually all actors surrounding a company from all those in and around the industry or sector to all those in the macro environment. We rather build on work in strategy and in particular Ron Adner's definitions that emphasise the importance of collaboration and alignment in producing customer value and how these matter for strategy in an ecosystem.[14] A **business ecosystem then is an arrangement through which a group of mutually dependent and collaborative partners interact and combine their individual offerings into a coherent customer solution to create value for all**.

In contrast to traditional market-based bilateral collaborations and vertical supply chain relations, business ecosystems emphasise

multilateral communities of connected partners.[15] What sets them apart from regular customer–supplier relations is that customers can choose among products or the offering elements supplied by the ecosystem participants without the need of a single supplier integrating these for the customer. The participants are interdependent and bound together based on some standard in a 'core ecosystem' (see Figure 4.5). Consider the system around the Swiss corporation Nestlé's Nespresso with its single-use coffee capsules.[16] Nespresso produces proprietary capsules while some major external coffee machine producers like Swiss Jura, German Krups, and Italian De'Longhi have permission to manufacture machines specifically designed to work with the capsule. Customers buy capsules from Nespresso and decide which machines to buy from which manufacturer and need not buy a single combined offering from Nespresso. Ecosystems are also important for innovations; 'innovation ecosystems' are discussed in Chapter 11.

Figure 4.5 A business ecosystem

Figure 4.5: Long Description

There are various roles and interests among organisations within an ecosystem. Ecosystems may involve both cooperation and competition between organisations, even though all participants have a common goal to create value and customer offerings. This combination of competition and cooperation is sometimes described as co-opetition.[17] To continue with the example above, Nespresso cooperates with machine manufacturers based on their capsule patent by giving them permission to produce capsule-compatible machines that others could not. They in turn can cooperate in developing coffee machines, but they also compete against each other in selling them to customers and Nespresso may play one off against another when choosing what brands to feature in their own shops. The significance of ecosystems suggests that, besides a

competitive force analysis, an additional analysis of ecosystems may be needed when organisations must align and coordinate multilaterally to create value. The focus in this analysis is on a sixth factor or 'force', complementors, which is discussed next.

4.4.2 Complementors

A complementor enhances another organisation's business attractiveness such that customers value the organisation's product or service more when they also have the complementor's product or service. Continuing the example from above, customers of course value Nespresso's capsules more when they also have, for example, Krups' coffee machines. This suggests that not only suppliers, distributors, substitutes, etc. need to be analysed, but companies that independently provide complementary products or services directly to mutual customers. Hence, complementors need to be analysed as well.[18] Nespresso and Krups are thus dependent on each other to create value and need to consider this carefully in their strategies. App providers offer another example: they are complementors to Apple and Android smartphone and tablet providers because customers value the iPhone or Android phones more if there are a wide variety of complementary appealing apps to download. This suggests that Apple and other smartphone sellers need to take app provider complementors into consideration when forming their strategies and vice versa.

Illustration 4.3 Meta's Facebook challenges

The curse on social networks – Facebook may be next to fall despite its network effects, ecosystem and complementors

Mark Zuckerberg, Facebook CEO

Source: REUTERS/Alamy Stock Photo

History shows it's far from obvious that any social network incumbent can dominate long term. Friendster early on pioneered online communities three years before Facebook came in 2005, but it was soon overtaken by MySpace that appealed to even more and younger users with their music videos. However, soon Facebook started to attract teenagers with its new features with corresponding losses for MySpace. This illustrates that social networks quickly can gain millions of users and huge valuations, but can just as quickly face slowing growth, users leaving in millions and final collapse. Further back in internet history, there are several similar implosions: BBS, CompuServe, AOL, etc. It seems there may be a curse on social networks.

Facebook and its founder, Mark Zuckerberg, however, understood early the significance of superior network effects and ecosystems. Once you have created the ecosystem around the platform and got ahead of everyone else in network effects, you

must create high switching costs for users to move to another social network and hinder others from building one. Hence, as soon as Instagram became the biggest mobile photo-sharing service with many younger users posting content there rather than on Facebook, it was acquired. Next Facebook acquired the messaging service WhatsApp, as users started to move their activities to mobile platforms.

Facebook thus successfully built not only the most popular social network worldwide with close to 3bn users, but the third, fourth, and seventh largest networks: WhatsApp (2bn), Instagram (ca1,5bn) and Facebook Messenger (ca1bn). Add to that a superior ecosystem including a whole range of complementors including software application developers (developing specific Facebook apps), hardware developers (proprietary computing and servers handling data, algor-ithms, etc.), ad network companies and third-party applications and services (Spotify, Candy Crush, Tinder, etc.). The effect of their superior network effects and ecosystem were very high entry barriers, low rivalry, and low buyer power in the social network industry.

Rivals such as Twitter and Reddit did not trouble Facebook, but when new social networks like Snap and TikTok arrived, things became more challenging. Facebook was denied any acquisition possibilities as the new platforms were simply not willing to sell and regulators had also started to investigate Facebook's dominance. Nevertheless, Facebook then simply imitated their services in Facebook Stories and Reels respectively. It thus seemed Facebook may have overcome the curse of social networks after all.

However, when Facebook rebranded itself to become Meta in late 2021 and Facebook's user growth rate started to slow, it was clear Facebook might not be an historic social network exception. As acknowledged by CEO Mark Zuckerberg himself when explaining falling profits in early 2022:

> The thing that is so unique is that TikTok is so big as a competitor already and also continues to grow at quite a fast rate off of a very large base. Even though we're compounding extremely quickly, we also have a competitor that is compounding at a pretty quick rate too.

These words sent shock waves over Wall Street and Meta shares tumbled 20 per cent, which was the biggest one-day drop in market capitalisation for a company ever. A consultant and analyst noted:

> Nobody was expecting it. There is no other way to react to that other than Facebook is facing an existential threat from TikTok.

Sources: *Statista* 2022 (Most popular social networks worldwide as of January 2022, ranked by number of monthly active users); R. Waters (2022) *Financial Times*, 4 February; H. Murphy (2022) *Financial Times*, 3 February; R. Waters (2016) *Financial Times*, 29 January.

Questions

1 What made Meta's Facebook so powerful in the first place?

2 Which are Facebook's primary rivals and how are they challenging Facebook?

There are three characteristics of complementors and core business ecosystems that need to be considered:

- *Non-generic, unique complementarities.* The focus in core ecosystems is non-generic, unique complementarities that need to be structured and coordinated like in the Nespresso example above. Most fundamentally 'A does not function without B' (capsules not functioning without a capsule-compatible machines). However, there are numerous complementarities around that are generic and not unique and where there is no need for an ecosystem to align and structure various interdependent participants to create value. Electricity, for

example, is complementary to countless products and services, but it can be purchased generically on a market.[19] An illustrative example: ‘A teacup, boiling water, and a tea bag may all be needed to make a cup of tea, but the complementarities are generic, not specific.’ Hence, while customer value is created by combining these elements into a cup of tea, the organisations behind teacups, water and tea bags do not need to coordinate their actions in an ecosystem. They are generic complementarities and consumers can buy them separately from anyone on a market and combine them on their own. Note that, while suppliers of coffee to Nespresso are dependent on the ecosystem and add value to it, they are not unique complementarities and therefore not part of the core ecosystem. They are rather part of an ‘outside ecosystem’, which can also include other actors that contribute to the ecosystem, but that are generic complementarities (see lower part of Figure 4.5). In Nespresso’s case, for example, the outside ecosystem also involves not-for profit and government partners including organisations that support coffee growers, that encourage biodiversity and sustainability and those that focus on poverty eradication and education.

- *Ecosystem leaders.* Generic complementarities can be turned into specific ones by an organisation that designs and leads an ecosystem. In fact, the Nespresso example discussed in this section signifies this. Nespresso took generic complementarities between coffee and coffee-making machines and turned them into non-generic unique complementarities. They did so by putting the coffee into patented capsules and invited external

manufacturers like Krups and Jura to produce co-specialised machines for these capsules. This created a tightly integrated and coordinated set of actors, bound together by standards and Nespresso's patent, including Nespresso capsules and machine manufacturers. In addition, coffee producers, and other complementors are also dependent on the business ecosystem designed and led by Nespresso.

- *Network effects.* Customers may not only value a product more if they also have another complementary product or service as discussed above, but also if other customers use the same product or service.[20] When this is the case, the product or service shows network effects or network externalities. **There are network effects in an industry when one customer of a product or service has a positive effect on the value of that product for other customers**. This implies that the more customers that use the product, the better for everyone in the customer network. This suggests a complementarity between diverse customers' activities. For example, the value of the online auction site eBay increases for a customer as the network of other sellers and buyers grows on the site. The more goods that are offered, the better for customers and this makes eBay's site and services more attractive to users than smaller competitors. Network effects are very important for Facebook's ecosystem too (see Illustration 4.3). They thus need to be carefully analysed as they can make an industry structurally attractive with high barriers to entry, low intensity of rivalry and power over buyers as entrants and rivals can't compete with

other companies' larger networks and buyers become locked into them.[21]

In some industries, complementors and network effects work in tandem. In the smartphone and tablet industries, for example, they operate in two steps. First, app providers are complementors to Apple as customers are more attracted to the iPhone and iPad if there are many apps. Second, when more customers are attracted to these products, the network of users grows, which increases the user value even further. For Apple, then, the complementary app providers attract more users and this in turn provides for network effects that attract even further users. Other industries where competitors need to consider both complementors and network effects are video gaming (e.g., Nintendo) and computer operation systems industries (e.g., Microsoft). These two latter industries are sometimes considered to be 'platform' industries, and this is discussed in Chapter 8 (see Section 8.4.3).

4.5 Strategic groups and market segments

An industry or sector may be too high a level to provide for a detailed understanding of competition. The five forces can impact differently on different kinds of players, requiring a more fine-grained understanding. For example, Hyundai and Porsche may be in the same broad industry (automobiles), but they are positioned differently: they are protected by different barriers to entry and competitive moves by one are unlikely to affect the other. It is often useful to disaggregate. Many industries contain a range of companies, each of which have different capabilities and compete on different bases. Some of these competitor differences are captured by the concept of *strategic groups*. Customers too can differ significantly, and these can be captured by distinguishing between different *market segments*. Thinking in terms of different strategic groups and market segments provides opportunities for organisations to develop highly distinctive positionings within broader industries or sectors. An illustration of the importance of disaggregation of industries and sectors, and the implications of this, is provided by Illustration 4.4 on the charity sector. Besides disaggregating the analysis of an industry or sector, these approaches may help in understanding how value is created differently by different organisations.

4.5.1 Strategic groups

Strategic groups are organisations within the same industry or sector with similar strategic characteristics, following similar strategies or competing on similar bases.[22] These characteristics are different from those in other strategic groups in the same industry or sector. For example, in the grocery retailing industry, supermarkets, convenience stores and corner shops each form different strategic groups. There are many different characteristics that distinguish between strategic groups and these can be grouped into two major categories of strategic dimensions.[23] First, the *scope* of an organisation's activities and second, the *resource commitment* (see Figure 4.6). Which characteristics are relevant differs from industry to industry, but typically important are those characteristics that separate high performers from low performers.[24] This suggests that there may be profitability differences between different strategic groups and the differing dimensions can then become the focus of what strategy to pursue. It helps to make a competitive force analysis first as it identifies different types of rivals and groups.

Figure 4.6 Characteristics for identifying strategic groups

Strategic dimensions are based on the extent to which organisations differ in terms of characteristics such as:

Scope of activities

- Extent of product (or service) range
- Extent of geographical coverage (e.g., national, regional, global)
- Number of market segments served
- Distribution channels used

Resource commitment

- Extent (number) of branding
- Marketing effort (e.g., advertising spread, size of salesforce)
- Extent of vertical integration
- Product or service quality
- R&D spending and technological leadership (leader vs follower)
- Size of organisation

Figure 4.6: Long Description

Strategic groups can be mapped onto two-dimensional charts – for example, one axis might be the extent of product range and the other axis the size of marketing spend. One method for choosing key dimensions by which to map strategic groups is to identify top performers (by growth or profitability) in an industry and to compare them with low performers. For example, proprietary pharmaceutical companies, selling patented medication, have a higher profitability than generic ones, which sells medication after patents have expired. They belong to two distinct strategic groups based on the strategic dimensions of R&D spending and prices charged. However, depending on what industry is analysed and where, different characteristics may be relevant to distinguish between strategic

groups. Figure 4.7 shows strategic groups among Indian pharmaceutical companies, with research and development intensity (R&D spend as a percentage of sales) and overseas focus (exports and patents registered overseas) defining the axes of the map. These two axes do explain a good deal of the variation in profitability between groups. The most profitable group is the Emergent globals, those with high R&D intensity and high overseas focus. On the other hand, the Exploiter group spends little on R&D and is focused on domestic markets and is less profitable.

The strategic group concept is useful in at least three ways:

- *Understanding competition.* Managers can focus on their direct competitors within their particular strategic group, rather than the whole industry, as rivalry often is strongest between these. In general, strategic groups are influenced differently by the competitive forces and this focus thus allows for a more specific industry structure analysis.
- *Analysis of mobility barriers.* Of course, moving across the strategic group map to take advantage of opportunities is not costless. Often, it will require difficult decisions and rare resources. Strategic groups are, therefore, characterised by ‘mobility barriers’, obstacles to movement from one strategic group to another. Mobility into the Emergent global group will not be easy for the Exploiters in Figure 4.7. Mobility barriers are the equivalent to barriers to entry in five forces analysis, but between different strategic groups. As with barriers to entry, it is good to be in a successful strategic group protected by strong mobility barriers, to impede imitation.

- *Analysis of strategic opportunities.* Strategic group maps can identify the most attractive competitive positions within an industry and the bases for these. Some positions may also be relatively under-occupied and thus might be unexploited opportunities. On the other hand, there may be logical reasons for this, and they could turn out to be impossible to exploit and likely to damage any entrant.

Figure 4.7 Strategic groups in the Indian pharmaceutical industry

Source: Developed from R. Chittoor and S. Ray (2009) 'Internationalisation paths of Indian pharmaceutical firms: a strategic group analysis', *Journal of International Management*, vol. 13, pp. 338–55.

Figure 4.7: Long Description

4.5.2 Market segments

The concept of strategic groups discussed above helps with understanding the similarities and differences in terms of competitor characteristics. Industries can also be disaggregated into smaller and specific market sections known as segments. The concept of market segment focuses on differences in *customer* needs. A **market segment**[25] **is a group of customers who have similar needs that are different from customer needs in other parts of the market**. Where these customer groups are relatively small, such market segments are often called 'niches'. Dominance of a market segment or niche can be very valuable, for the same reasons that dominance of an industry can be valuable following five forces reasoning.

Illustration 4.4 Subgroups and segmentation in the charity sector To understand charities' nearby environments, they need to be disaggregated into specific charity sector groups, subgroups within these and contributor segments.

There are about 170,000 charities in the UK and the total amount donated is €51bn (£41bn, $66bn). The charity and philanthropy sectors are large and important in other European countries too. Donations in Germany amount to €22bn (£18bn, $29bn), in France to €20bn (£16bn, $26bn) and in Spain to around €4bn (£3bn, $5bn). To analyse and understand charity sectors and organisations' strategies within them, they need to

be disaggregated into smaller groups and segments. No matter what type of charity, it is important to understand in which specific sector it is active, what main subgroups are involved, and who the main contributors and supporters are.

First, there are different fundamental types of charity sectors. Specific charity sectors include those focused on animals, arts and culture, community development, education, environmental issues, health causes, human services, and NGOs (non-government organisations) of different types. The structures and characteristics of these sectors differ with important implications for charities' strategies. However, this is still too high level to provide a meaningful analysis and understanding.

A next useful step is to determine what diverse subgroups exist within a specific charity sector. The arts and culture charity sector, for example, includes several subgroups: public broadcasting and media, museums and art galleries, libraries and historical societies and performing arts. Similarly, health charities can be subdivided into different subgroups like disease and disorder, medical research, patient and family support and medical services and treatment. The specification of these subgroups helps to identify which charity organisations are active in them, what specific causes they support and which their contributors are. This can be of great help for how to manage a charity strategically and how to create value for the cause and its supporters.

Another more fine-grained division can be made into different donor or contributor segments to determine variation in their needs with implications for strategy and fundraising. There may be numerous donor subpopulations for the same cause and charity with significant differences in their wants. The donor pool may include charity members, non-members giving annually, those donating in conjunction with special occasions like anniversaries or holidays, cause or crisis contributors and people who want to receive some incentive in return (calendars, entries in raffles, etc.). Besides donors, there may of course be other significant supporters that give their time as volunteers or give things or services. Understanding various types of contributors and

supporters helps charities to deliver meaningful value and content that appeals to their specific interests.

To provide detailed comprehension of the link between charities and their contributors, they can be further segmented into other category types like by the amounts they contribute, by the recency and frequency of donations, by relationship length with the charity and, of course, by age and other people characteristic factors. This can be useful for understanding how to create value for specific contributors and perhaps for specialisation on a specific charity subgroup and contributor segment to build a niche strategy.

In sum, to analyse and manage charities strategically it is important to distinguish between specific types of charities, various subgroups within them and between diverse contributor and supporter groups.

Questions

1 Choose a charity for environmental causes or any charity that you support or would like to support: how would you distinguish between different subgroups and segments within it?

2 How could the five forces be used to analyse the charity sector in which your chosen charity is active?

Table 4.2 Some bases of market segmentation

Segmentation should reflect an organisation's strategy[26] and strategies based on market segments must keep customer needs

firmly in mind. Therefore, two issues are particularly important in market segment analysis:

- *Variation in customer needs.* Focusing on customer needs that are highly distinctive from those typical in the market is one means of building a long-term segment strategy. Customer needs vary for a whole variety of reasons – some of which are identified in Table 4.2. Theoretically, any of these factors could be used to identify distinct market segments. However, the crucial bases of segmentation vary according to market. In industrial markets, segmentation is often thought of in terms of industrial classification of buyers: steel producers might segment by automobile industry, packaging industry and construction industry, for example. On the other hand, segmentation by buyer behaviour (e.g., direct buying versus those users who buy through third parties such as contractors) or purchase value (e.g., high-value bulk purchasers versus frequent low-value purchasers) might be more appropriate. Other types of segments based on clients' needs may be relevant too, as demonstrated in Illustration 4.4 on the charity sector. Being able to serve a highly distinctive segment that other organisations find difficult to serve is often the basis for a secure long-term strategy.
- *Specialisation* within a market segment can also be an important basis for a successful segmentation strategy. This is sometimes called a 'niche strategy'. Organisations that have built up most experience in servicing a particular market segment should not only have lower costs in so doing, but also have built relationships that may be difficult for others to break down.

Experience and relationships are likely to protect a dominant position in a particular segment. However, precisely because customers value different things in different segments, specialised producers may find it very difficult to compete on a broader basis. For example, a small local brewery competing against the big brands on the basis of its ability to satisfy distinctive local tastes is unlikely to find it easy to serve other segments where tastes are different, scale requirements are larger and distribution channels are more complex.

Thinking Differently

From five forces to one

An alternative view focuses on how value is created A 'value network model' based on cooperative game theory aspires to replace Porter's competitive forces framework.[27] This alternative model emphasises how a firm creates value together with suppliers and buyers in a network. They then compete for a share of that value based on a *single competition force* that each player has.

In this framework, firms, suppliers and buyers comprise a *value network* of transactions that create value to be shared among them. When these players transact with each other, they thus *create* value together. However, they also compete over how much of that value each player *captures*. A firm wants to make transactions with certain suppliers and customers to create value, but also to make sure to capture as much of that value as possible. The more alternative transaction partners each player (firm, supplier or buyer) has, the stronger it becomes as it can threaten to opt out for another player. For example, the more suppliers a firm can transact with, the higher the value capture for the firm as it gains negotiating power the more alternatives it has.

Each player thus has a *competition force* and the strength of it depends on how many others the player *could* create value with. If a player has many alternative partners to create value with, the strength of its competition force goes up as it can threaten to make transactions with someone else and can thus bargain up its share of the value pie created. How much value each player captures thus depends on the level of interest in each player from others and how well a given player persuades others in its network to part with value.

Questions

1 How would you compare the ‘value network model’ including one single force with Porter’s five forces when making an industry analysis?

2 What is the benefit of focusing on value creation compared to Porter’s approach?

Key takeaways

- To identify possible strategies, the *industry or sector* need to be carefully analysed apart from the macro environment (middle layer in Figure 3.1).
- Use the *competitive five forces* to analyse industries and sectors: barriers to entry, substitutes, buyer power, supplier power and rivalry. These forces help you determine industry or sector attractiveness and possible strategies.
- If organisations are mutually dependent and need to be aligned to create value, analyse *complementors* and the *business ecosystems* they belong to.
- To consider change and make industry analysis more dynamic, use *industry life cycle* and *comparative five forces radar plots*.
- Specific strategic gaps or opportunities can be identified by using *strategic group* analysis and *market segment* analysis (the inner layers in Figure 3.1).

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

4.1 Drawing on Section 4.2, carry out a five forces analysis of the pharmaceutical industry* or SAB Miller's position in the brewing industry (Megabrew*). What do you conclude about that industry's attractiveness?

4.2 Drawing on Section 4.2.3, identify an industry with network effects. Consider what those might involve; why customers prefer certain services, products and companies over others and why they may not easily switch to other services and companies.

4.3 Drawing on Section 4.3, and particularly using the radar plot technique of Figure 4.4, choose two industries or sectors and compare their attractiveness in terms of the five forces (a) today; and (b) in approximately three to five years' time. Justify your assessment of each of the five forces' strengths. Which industry or sector would you invest in?

4.4 With regard to Section 4.4.1 and Figure 4.6, identify an industry (e.g., the car industry or clothing retailers) and, by comparing competitors, map out the main strategic groups in the industry according to key strategic dimensions. Try more than one set of key strategic dimensions to map the industry. Do the resulting maps identify any under-exploited opportunities in the industry?

4.5 * Drawing on Section 4.2.3, and particularly on Figure 4.5, identify critical complementors in an industry with which you and your peers are familiar (e.g., smartphone companies). Using your own estimates (or those of your peers), what complementors are unique and thus non-generic and which are generic and to what extent are there network effects present?

Integrative assignment

4.6 * Carry out a full analysis of an industry or sector of your choice (using, for example, five forces and strategic groups). Consider explicitly how the industry or sector is affected by globalisation (see Chapter 10, particularly Figure 10.2 on drivers) and innovation (see Chapter 11, particularly Figure 11.5 on product and process innovation).

Recommended key readings

- The classic book on the analysis of industries is M.E. Porter (1980) *Competitive Strategy*, Free Press. An update is available in M.E. Porter (2008) ‘The five competitive forces that shape strategy’, *Harvard Business Review*, vol. 86, no. 1, pp. 58–77.
- For an in-depth discussion of how to apply Porter’s Competitive Force Frameworks, see J. Magretta (2012) *Understanding Michael Porter: The Essential Guide to Competition and Strategy*, Harvard Business Review Press.
- For an insightful discussion of ecosystems, see J. Fuller, M.G. Jacobides and M. Reeves (2019) ‘The myths and realities of business ecosystems’, *MIT Sloan Management Review*, 60(3), pp.1–9.

References

1. See M.E. Porter (1980) *Competitive Strategy: Techniques for Analyzing Industries and Competitors*, Free Press, p. 5.
2. See endnote 1 above and M. Porter (2008) 'The five competitive forces that shape strategy', *Harvard Business Review*, vol. 86, no. 1, pp. 58–77 and G. Yip, T.M. Devinney and G. Johnson (2009) 'Measuring long term superior performance: The UK's long term superior performers 1984–2003', *Long Range Planning*, vol. 42, no. 3, pp. 390–413. See also www.damodaran.com [accessed: May 2022] for industry profitability differences in various geographical regions.
3. For a discussion and guide to Porter's ideas about strategy see J. Magretta (2012) *Understanding Michael Porter – The Essential Guide to Competition and Strategy*, Harvard Business Review Press. C. Christensen (2001) 'The past and future of competitive advantage', *Sloan Management Review*, vol. 42, no. 2, pp. 105–9, provides an interesting critique and update of some of the factors underlying Porter's Five Forces. A critical overview of Porter's thinking is also provided in R. Huggins and H. Izushi (eds) (2011) *Competition, Competitive Advantage, and Clusters: The Ideas of Michael Porter*, Oxford University Press.
4. D. McIntyre and M. Subramarian (2009) 'Strategy in network industries: a review and research agenda', *Journal of Management*, vol. 35, pp. 1494–512.
5. The Five Forces Framework builds on the structure-conduct-performance (SCP) model in industrial organisation economics. It

stipulates that the industry *structure* determines firm *conduct* that, in turn, influences industry *performance*. SCP categorises industry structure into four main types: monopoly, oligopoly, monopolistic competition and perfect competition. See J. Lipczynski, J. Wilson and J. Goddard (2009) *Industrial Organization – Competition, Strategy, Policy*, Prentice Hall/Financial Times.

6. Explicit cooperation among the firms to limit competition or cartels are prohibited in most developed, nations, but there is also 'tacit collusion'. In tacit collusion companies cooperate to reduce competition without any formal agreement. It is facilitated by a small number of rivals, a homogenous product or service and costs and high barriers to entry. Tacit collusion can also be illegal under certain circumstances. See J. Lipczynski, J. Wilson and J. Goddard, *Industrial Organization – Competition, Strategy, Policy*, 2009, Prentice Hall/Financial Times.
7. Economists name these markets *'monopolistic competition'* as firms can still create a position or niche for which they have some monopoly power over pricing.
8. This definition is from R. D'Aveni (1994) *Hypercompetition: Managing the Dynamics of Strategic Maneuvering*, Free Press, p. 2.
9. There is a discussion of the static nature of the Porter model, and other limitations, in M. Grundy (2006) 'Rethinking and reinventing Michael Porter's five forces model', *Strategic Change*, vol. 15, pp. 213–29.
10. See, for example, F. Hacklin, B. Battistini and G. Von Krogh (2013) 'Strategic choices in converging industries', *MIT Sloan*

Management Review, 55.1: 65–73.

11. A classic academic overview of the industry life cycle is S. Klepper (1996) ‘Industry life cycles’, *Industrial and Corporate Change*, vol. 6, no. 1, pp. 119–43.
12. A. McGahan (2000) ‘How industries evolve’, *Business Strategy Review*, vol. 11, no. 3, pp. 1–16.
13. This section partly builds on one of the most comprehensive reviews of ecosystems and complementors: M.G. Jacobides, C. Cennamo and A. Gawer (2018) ‘Towards a theory of ecosystems’, *Strategic Management Journal*, 39(8), 2255–76.
14. See R. Adner (2017) ‘Ecosystem as structure: An actionable construct for strategy’, *Journal of Management*, 43(1), 39–58 and (2006) ‘Match your innovation strategy to your innovation ecosystem’, *Harvard Business Review*, 84(4), 98. For an early discussion of ecosystem type of competition and cooperation, see J.F. Moore (1993) ‘Predators and prey: a new ecology of competition’, *Harvard Business Review*, 71(3), 75–86.
15. For a discussion of ecosystems, see A. Shipilov and A. Gawer (2020) ‘Integrating research on interorganizational networks and ecosystems’, *Academy of Management Annals*, 14(1), 92–121 and B. Lingens, L. Miehé and O. Gassmann (2021) ‘The ecosystem blueprint: How firms shape the design of an ecosystem according to the surrounding conditions’, *Long Range Planning*, 54(2).
16. Michael Jacobides, London Business School, gives Nespresso as an example in M.G. Jacobides (2019) ‘In the ecosystem economy, what’s your strategy?’, *Harvard Business Review*, 97(5), 128–37.

17. See A. Brandenburger and B. Nalebuff (1996) *Co-opetition*, Doubleday, New York and K. Walley (2007) ‘Coopetition: an introduction to the subject and an agenda for research’, *International Studies of Management and Organization*, vol. 37, no. 2, pp. 11–31.
18. For a study of complementors in ecosystems, see R.D. Wang and C.D. Miller (2020) ‘Complementors’ engagement in an ecosystem: A study of publishers’ e-book offerings on Amazon Kindle’, *Strategic Management Journal*, 41(1), 3–26. On the dangers of complementors, see D. Yoffie and M. Kwak (2006) ‘With friends like these’, *Harvard Business Review*, vol. 84, no. 9, pp. 88–98. For an early discussion of complementors, see A. Brandenburger and B. Nalebuff (1995) ‘The right game’, *Harvard Business Review*, July–August, pp. 57–64.
19. This is an illustrative quote from M.G. Jacobides, C. Cennamo and A. Gawer (2018) ‘Towards a theory of ecosystems’, *Strategic Management Journal*, 39(8), p. 2262.
20. For an overview of empirical research of strategy and network effects, see D.P. McIntyre and M. Subramaniam (2009) ‘Strategy in network industries: a review and research agenda’, *Journal of Management*, pp. 1–24. For a general discussion of the role of networks externalities and standards, see C. Shapiro and H.R. Varian (2013) *Information Rules: A Strategic Guide to the Network Economy*, Harvard Business Press. For a more formal discussion of network effects, see G.G. Parker and M.W. Van Alstyne (2005) ‘Two-sided network effects: A theory of information product design’, *Management Science*, 51(10), 1494–1504.

21. If network effects are present, a standard strategic advice for companies has been to move in first and grow fast to capture those effects before anyone else, as this would provide an advantage over competitors, but it has been demonstrated that there are other issues to consider: A. Hagiu and S. Rothman (2016) ‘Network effects aren’t enough’, *Harvard Business Review*, 94(4), 64–71; and H. Halaburda and F. Oberholzer-Gee (2014) ‘The limits of scale’, *Harvard Business Review*, April, pp. 95–9.
22. For examples of strategic group analysis, see G. Leask and D. Parker (2007) ‘Strategic groups, competitive groups and performance in the UK pharmaceutical industry’, *Strategic Management Journal*, vol. 28, no. 7, pp. 723–45; and W. Desarbo, R. Grewal and R. Wang (2009) ‘Dynamic strategic groups: deriving spatial evolutionary paths’, *Strategic Management Journal*, vol. 30, no. 8, pp. 1420–39 and F. Mas-Ruiz, F. Ruiz Moreno and A. Ladrón de Guevara Martínez (2014) ‘Asymmetric rivalry within and between strategic groups’, *Strategic Management Journal*, vol. 35, no. 3, pp. 419–39.
23. These characteristics are based on Porter, endnote 1 above.
24. Strategic groups may also be associated with an organisation’s own identity; see for example V. Anand, M. Joshi and A.M. O’Leary-Kelly (2013) ‘An organizational identity approach to strategic groups’, *Organization Science*, vol. 24, no. 2, pp. 571–90.
25. A useful discussion of segmentation in relation to competitive strategy is provided in M.E. Porter (1985) *Competitive Advantage*, Free Press, Chapter 7. See also the discussion on

market segmentation in P. Kotler, G. Armstrong, J. Saunders and V. Wong (2008) *Principles of Marketing*, 5th European edn, Financial Times Prentice Hall, Chapter 9.

26. For a discussion of how market segmentation needs to be broadly related to an organisation's strategy and not only narrowly focused on the needs of advertising, see D. Yankelovich and D. Meer (2006) 'Rediscovering market segmentation', *Harvard Business Review*, February, pp. 73–80.
27. M.D. Ryall (2013) 'The new dynamics of competition', *Harvard Business Review*, vol. 91, no. 60, pp. 80–7.

Case example

Game-changing digital forces in the global advertising industry Peter Cardwell

This case is centred on the global advertising industry which faces significant strategic game-changing forces driven by technological innovation, the rise of consumer spending in developing economies, changes in consumer media consumption and pressures from major advertisers for results-based compensation.

In the second decade of the new millennium, advertising agencies faced a number of unanticipated challenges. Traditional markets and industry operating methods, developed largely in North America and Western Europe following the rise of consumer spending power in the twentieth century, were being radically reappraised.

Source: PixelMe/Shutterstock

The industry was subject to game-changing forces from the so-called ‘digital revolution’ with the entry of search companies like Google, Facebook and Amazon as rivals for advertising budgets on mobile devices. Changing patterns in global consumer markets impacted on both industry dynamics and structure. Budgets being spent through

traditional advertising agencies were being reduced as industry rivalry intensified with the entry of specialist consultancies.

Overview

Traditionally, the business objective of advertising agencies is to target a specific audience on behalf of clients with a message that encourages them to purchase a product or service. This is done largely through the concept of a brand being communicated via media channels. Brands allow consumers to differentiate between products and services and it is the job of the advertising agency to position the brand so that it is associated with functions and attributes that are valued by target consumers. These brands may be consumer brands (e.g., Procter & Gamble, Unilever, L'Oréal) or business-to-business (B2B) brands (e.g., IBM, Cisco and UPS). Some brands target both consumers and businesses (e.g., Microsoft and Apple).

As well as private-sector brand companies, governments spend heavily to advertise public-sector services, such as healthcare and education, or to influence individual behaviour (such as 'Stay alert, control the virus, save lives'). For example, the UK Government had an advertising budget of close to £200mn (€232mn) in the pandemic/post-pandemic period. Charities, political groups, religious groups and other not-for-profit organisations also use the advertising industry to attract funds into their organisation or to raise awareness of issues. Together, these account for approximately 3 per cent of advertising spend.

Advertisements are usually placed in selected media (TV, press, radio, mobile and desktop internet, etc.) by an advertising agency acting on behalf of the client brand company; thus, they are acting as 'agents'. The client company employs the advertising agency to use its knowledge, skills, creativity and experience to create advertising and marketing to drive consumption of the clients' brands. Clients traditionally have been charged according to the time spent on creating the advertisements plus a commission based on the media and services bought on behalf of clients. However, in recent years,

larger advertisers such as Coca-Cola, Procter & Gamble and Unilever have been moving away from this compensation model to a ‘value’ or results-based model based on a number of metrics, including growth in sales and market share.

Ad industry growth

Money spent on advertising has increased dramatically over the past two decades and, in 2021, was over $221 billion (€190bn, £160bn) in North America and $648 billion worldwide. While there might be a decline in recessionary years, it is predicted that spending on advertising will exceed $686 billion globally by 2022.

The industry is shifting its focus as emerging markets drive revenues in geographic sectors that would not have been significant 5 to 10 years ago, such as the Latin America countries and the Middle East and North Africa. This shift has seen the emergence of agencies specialising in Islamic marketing. Future trends indicate the strong emergence of consumer brands in areas of the world where sophisticated consumers with brand awareness are currently in the minority (see Table 1).

Table 1 Global advertising expenditure by region (US$ million, at 2021 average rates)

Source: Dentsu Adspend Forecasts, July 2021

In terms of industry sectors, 7 of the top 25 global advertisers are car manufacturers. However, the two major FMCG (fast-moving consumer goods) producers, Procter & Gamble and Unilever, are in the three top spots for global advertising spend. Healthcare and beauty (L’Oréal), consumer electronics (Samsung), fast food, beverage and confectionery manufacturers are all featured in the top 25 global advertisers. The top 100 advertisers account for nearly 50 per cent of the measured global advertising economy.

Despite the increase in worldwide advertising revenues, the holding companies that own the world’s largest advertising groups: WPP, Omnicom, Publicis and Interpublic

Group (see Table 2), are under intense pressure in a changing business environment to deliver shareholder value.

Intensifying competition

Advertising agencies come in all sizes and include everything from one- or two-person 'boutique' operations (which rely on freelance outsourced talent to perform most functions), small to medium-sized agencies, large independents to multinational, through to multi-agency conglomerates employing over 100,000 people. The industry has gone through a period of increasing concentration through acquisitions, thereby creating multi-agency conglomerates such as those listed in Table 2. While these conglomerates are headquartered in London, New York, Paris, Tokyo and Beijing, they operate globally.

Table 2 Top 10 multi-agency conglomerates: 2020–21, by revenue, profit before interest and tax, number of employees and agency brands

Source: WPP, Omnicom, Publicis Groupe, IPG, Dentsu, AdWeek Large multi-agency conglomerates compete on the basis of the quality of their creative output (as indicated by industry awards), the ability to buy media more cost-effectively, market knowledge, global reach and increasingly range of digital services as these budgets have increased substantially (see Table 3). Some agency groups have integrated vertically into higher-margin marketing services. Omnicom, through its Diversified Agency Services, has acquired printing services and telemarketing/customer care companies. Other agency groups have vertically integrated to lesser or greater degrees.

Many small specialist agencies are founded by former employees of large agencies. In turn, smaller specialist agencies are often acquired by the large multi-agency conglomerates in order to acquire specific capabilities to target new sectors or markets or provide additional services to existing clients.

With the development of the internet and online search advertising, a new breed of interactive digital media agencies became a growing force. These agencies differentiate themselves by offering a mix of web design/development, search engine marketing, internet advertising/marketing, or e-business/e-commerce consulting. They are classified as ‘agencies’ because they create digital media campaigns and implement media purchases of ads on behalf of clients on social networking and community sites such as YouTube, Facebook, Instagram, Weixin/WeChat, TikTok and other digital media.

Digital crosses the divide

Search companies such as Google, Bing and Yahoo and social network Facebook, exploit their ability to interact with and gain information about millions of potential consumers of branded products. Facebook and Google have effectively become a ‘digital duopoly’ to the extent that they represent over 65 per cent of the global digital desktop and mobile ad market, according to eMarketer, the research group. By 2020, Google had a 70 per cent market share of the $146.1bn spent on search advertising globally.

Digital search and mobile advertising budgets are increasing faster than other traditional advertising media as search companies like Google and Facebook generate revenues from paid search as advertisers discover that targeted ads on mobile and desktop are highly effective. Apple also jumped on the mobile ad bandwagon and tripled market share after making changes to its iPhone privacy policy which obstructed rivals, including Facebook, from targeting ads at consumers. This continues as a steady trend that has seen digital’s share of ad spend increase from 13.5 per cent in 2010 to half of global advertising spend – the long-predicted ‘crossing the digital divide’ (see Table 3).

Sir Martin Sorrell, the former CEO of WPP the world’s largest multi-service agency group, pointed out that Google is a rival for the service relationships with WPP’s clients. WPP group spent more than $6.5bn of its clients’ ad budgets with Google in 2019 and $2.6bn with Facebook. Sorrell called Google a ‘frenemy’ – the combination of ‘friend’ and

‘enemy’. Google is a ‘friend’ where it allows WPP to place targeted advertising based on Google analytics and an ‘enemy’ where it does not share these analytics with the agency and becomes a potential competitor for the customer insight and advertising traditionally created by WPP.

Table 3 Share of global advertising expenditure by media, 2019–22 (%)

Source: Dentsu, e-Marketer, Statista, July 2021.

Table 4 Growth in ad spend within digital by type of content 2019–22 (% y-o-y)Global year-on year % growth within digital

Source: Dentsu, eMarketer.com.

Mobile ad spending on sites such as YouTube, Pinterest and Twitter, continues to increase at the expense of desktop, taking a bigger share of marketers’ budgets. The shift to mobile ad spending and the move to more engaging content (see Table 4) is being driven mainly by consumer demand and digital is predicted to be over 59 per cent of total digital ad spending in the USA.

Entry of ‘big data’ technology consultancies The analysis of ‘big data’ is playing an increasingly important role in helping to create targeted and personalised advertising campaigns for the world’s major marketers. Technology consultancies, such as Accenture Interactive and IBMiX, as well as the large accountancy firms PwC Digital Services and Deloitte Digital, all with global reach, are now competing for a share of the advertising market by acquiring creative agencies to add to

their ‘big data’ digital services and now comprise 5 of the top 10 agencies (see Table 2) ranked on the basis of turnover.

Their services include programmatic advertising and the use of artificial intelligence algorithms that analyse consumer behaviour allowing for real-time campaign optimisations towards an audience more likely to convert to the advertiser’s product or service, which is a major innovation, the impact of which is still being assessed.

This has led some industry experts to observe that ‘Madmen’ (a reference to Madison Avenue in New York where, historically, many advertising agencies situated their offices) now need to become ‘Mathsmen’, as data analytics and artificial intelligence are seen to be becoming more important than creativity, which traditional advertising agencies have relied upon as a differentiator. This is enabling them to offer a range of services to the major marketing companies that compete directly with traditional advertising agencies.

The disruptive change in the advertising industry at the beginning of the twenty-first century started with the internet. The convergence of internet, TV, smart phones, tablets and laptop computers and the rise of digital as a medium for brand communication has had a major impact on the advertising industry.

Factors that have driven competitive advantage to date may not be relevant in the future. Traditionally, the advertising industry has embodied the idea of creativity as the vital differentiator between the best and the mediocre – and individuals have often been at the heart of this creativity. The emergence of data analytics, programmatic advertising and the use of artificial intelligence algorithms are disruptive to ‘business as usual’ in the industry. A key question is whether creativity will be important in the future, in relation to breadth of services, global reach and data analysis.

Source: Dentsu, Statista, eMarketer, Ad Week July 2021, Financial Times Limited 2021.

Questions

1 Carry out a five forces analysis of the advertising industry. What are the strengths of the five forces and what underlying factors drive them? What is the industry attractiveness?

2 What strategic group dimensions and strategic groups can you identify? What are the differences between them?

3 Which PESTEL factors are driving changes in the industry? Which factors are becoming more negative or positive for the major advertising agencies?

Chapter 5

Resources and capabilities analysis

Key terms

distinctive resources and capabilities

dynamic capabilities

inimitable resources and capabilities

profit pools

rare resources and capabilities

resource-based view

resources and capabilities

threshold resources and capabilities

value chain

value system

VRIO analysis

Learning outcomes

After reading this chapter you should be able to:

- Identify organisational *resources* and *capabilities* and how these relate to the strategies of organisations.
- Analyse how resources and capabilities might provide sustainable competitive advantage on the basis of their *Value, Rarity, Inimitability* and *Organisational support (VRIO).*

- Diagnose resources and capabilities by means of *VRIO analysis, value chain analysis, activity systems mapping,* and *benchmarking*.
- Consider how resources and capabilities can be developed based on *dynamic capabilities.*

Long Description

5.1 Introduction

Chapters 3 and 4 emphasised the importance of the external environment of an organisation and how it can create both strategic opportunities and threats. However, it is not only the external environment that matters for strategy; there are also differences between organisations that need to be considered. For example, car manufacturers compete within the same industry, but with markedly different success in electric vehicles. Volkswagen has been successful based on its engineering capabilities and brand while others like Honda have found it more difficult to establish a competitive position. Tesla has successfully entered from outside the industry based on its specialised electric and battery capabilities. It is not so much the characteristics of the environment that explain these differences in performance, but differences in organization-specific *resources and capabilities.* This puts the focus on variations between companies within the same environment and how they vary in their resources and capabilities arrangements.[1] It is thus the strategic importance of organisations' resources and capabilities that is the focus of this chapter.

Capabilities and resources matter for non-profits and the public sector too. Charities compete and need to make sure they have capabilities that are superior or at least match others. Public-sector organisations like the British Broadcasting Corporation (BBC) need to have appropriate resources and capabilities to compete against streaming service providers like Netflix. Public hospitals must

consider their distinctive resources and capabilities in relation to private hospitals and other public ones.

Two key notions underlie the analysis of resources and capabilities. The first is that organisations are not identical but have different resources and capabilities; they are 'heterogeneous' in this respect. The second is that it can be difficult for one organisation to obtain or imitate the resources and capabilities of another. The implication for managers is that they need to understand how their organisations are different from their rivals in ways that may form the basis of sustainable competitive advantage and superior performance. These concepts underlie what has become known as the **resource-based view** (RBV) of strategy pioneered by Jay Barney at the University of Utah: **that the competitive advantage and superior performance of an organisation are explained by the distinctiveness of its resources and capabilities.**[2]

The chapter has four further sections and the key issues posed by the chapter are summarised in Figure 5.1:

- Section 5.2 discusses the foundations of what *resources* and *capabilities* are. It also draws a distinction between *threshold* resources and capabilities required to compete in a market and *distinctive* resources and capabilities that may be a basis for achieving competitive advantage and superior performance.
- Section 5.3 explains the ways in which distinctive resources and capabilities can contribute to *sustained competitive advantage*. In particular, the importance of the *Value, Rarity, Inimitability and Organisational support* (VRIO) of resources and capabilities is explained.

- Section 5.4 moves on to consider different ways resources and capabilities might be analysed. These include *VRIO analysis, value chain* and *value system analysis, activity systems mapping* and *benchmarking.*
- Finally, Section 5.5 discusses some of the key issues of *dynamic capabilities* and how resources and capabilities can be created, developed and managed.

Figure 5.1 Resources and capabilities: the key issues

Figure 5.1: Long Description

5.2 Foundations of resources and capabilities

Given that writers use different terms and concepts, it is important to understand how concepts relating to resources and capabilities are used in this book. The **resources and capabilities of an organisation contribute to its long-term survival and, potentially, to competitive advantage.** However, to understand and to manage resources and capabilities, it is necessary to explain their components.[3]

5.2.1 Resources and capabilities

Resources are the assets that organisations have or can call upon while capabilities are the ways in which those assets are deployed. A shorthand way of thinking of this distinction is that resources are 'what we *have*' (nouns) and capabilities are 'what we *do*' (verbs). Other terms are sometimes used, for example 'capabilities' and 'competences' are often used interchangeably.[4] Note that intangible assets like brands and intellectual property including patents and copyrights most often are considered resources even if they are not something an organisation physically has.

Resources and capabilities are typically related, as Table 5.1 shows. Resources are certainly important, but how an organisation employs and deploys its resources in the form of capabilities matters at least as much for long-term survival. There would be no point in

having state-of-the-art equipment if it were not used properly. Using the preparation of food as illustration, resources can be considered as ‘ingredients’ and capabilities the ‘cooking’: good ingredients need good cooking, but bad cooking is liable to spoil good ingredients. The efficiency and effectiveness of physical or financial resources, or the people in an organisation, depend not just on their existence, but on the system and process capabilities by which they are managed. These can, for example, involve the relationships and cooperation between people, their adaptability, their innovative capacity, the relationship with customers and suppliers, and the experience and learning about what works well and what does not. Illustration 5.1 shows examples of how executives explain the importance of the resources and capabilities for their strategies in their different organisations.

5.2.2 Threshold and distinctive resources and capabilities

A distinction needs to be made between resources and capabilities that are at a threshold level and those that might help the organisation achieve competitive advantage and superior performance. **Threshold resources and capabilities** **are those needed for an organisation to meet the necessary requirements to compete at all in a given market and achieve parity with competitors in that market.** Without these, the organisation could not survive over time. For example, start-up businesses may simply not have or cannot obtain the resources or capabilities needed to compete with established competitors. Identifying threshold

requirements is, however, also important for established businesses. There could be changing *threshold resources* required to meet minimum customer requirements: for example, the increasing demands by modern multiple retailers of their suppliers mean that those suppliers must possess a quite sophisticated IT and digital infrastructure simply to stand a chance of meeting retailer requirements. Or there could be *threshold capabilities* required to deploy resources to meet customers' requirements and support particular strategies. Retailers do not simply expect suppliers to have the required digital infrastructure, but to be able to use it effectively so as to guarantee the required level of service.

Illustration 5.1 The importance of resources and capabilities

Diverse organisations all emphasise how capabilities are central to their strategies.

Naspers

The South African company Naspers is a global consumer internet group and technology investor and Africa's largest corporation based on market capitalisation.

Naspers CEO Bob van Dijk emphasises how they invest in artificial intelligence (AI) and machine learning (ML) capabilities throughout their various business segments: 'We will invest more in building our AI and ML capabilities for strategic advantage – accelerating the adoption of AI by design and significantly increasing the number of ML modules in production across the group. Aided by AI and ML, we will adopt and drive a data-first approach in and across segments.' Naspers further specify: 'Building on the foundation we established in the last financial year, we have significantly extended our capabilities in AI and ML across the group. The teams have grown as has the capacity to

execute across our three core segments: Classifieds, Payments and Fintech, and Food Delivery.'[1]

The Australian Red Cross

To achieve the vision of improving the lives of vulnerable people, the Australian Red Cross emphasises the crucial role of capabilities in its strategic plan. 'Capabilities are integral to our overriding strategy to create one Red Cross,' writes CEO Robert Tickner. The Australian Red Cross distinguishes between technical competency and behavioural capability. The former refers to specialist skills and may include such competencies as project management, financial management, community development, social work, administrative or information technology. The latter involves investing in a diverse workforce and supporter base, with strong engagement of 'young people, Aboriginal and Torres Strait Islander people, and other culturally and linguistically diverse people'. The emphasis is on people who are engaged, dynamic, innovative, entrepreneurial and motivated to realise the vision and goals.[2]

Infosys

The Indian company Infosys is a global leader in information technology, outsourcing, system integration services and IT consulting. It is listed as one of the world's most reputable companies with close to 150,000 employees worldwide. The company's 'Infosys 3.0 strategy' is taking a further step to provide more advanced IT products and services, which requires investments in new resources and capabilities. Infosys CEO S.D. Shibulal comments: 'We continue to make focused investments in our organisational capabilities.'

The strategy emphasises innovation and focuses on higher-value software. Innovation abilities are central for this, as stated on the website: 'The foundation of our innovation capability is our core lab network – Infosys Labs – and the new thinking that our team of over 600 researchers brings to the table.' The strategy thus requires human resource

and training capabilities including the ability to attract, employ, educate and retain new high-quality engineers.'[3]

AstraZeneca

For AstraZeneca, a leading British-Swedish global pharmaceutical company, both resources and capabilities feature prominently when they describe their strategy: 'R&D resources: We have approximately 8,400 employees in our R&D organisation, working in various sites around the world. We have three strategic R&D centres: Gaithersburg, MD, US; Gothenburg, Sweden; and Cambridge, UK'; 'We are using our distinctive scientific capabilities, as well as investing in key programmes and focused business development, to deliver life-changing medicines'; '[Our] Distinctive R&D capabilities: Small molecules, oligonucleotides and other emerging drug platforms, as well as biologic medicines, including immunotherapies, and innovative delivery devices'; 'We will also harness our internal capabilities to develop robust strategies on data and analytics, software engineering and cloud technology – all of which will support the business and its various transformation programmes.'[4]

Sources: (1) Naspers annual report, 2020, p.13 and pp.63–5; (2) Australian Red Cross Capability Framework, www.redcross.org.au/ [accessed: July 2022]; (3) *Financial Times,* 13 August 2012; *Financial Times,* 11 September 2012; www.infosys.com © Infosys [accessed: May 2022]; (4) AstraZeneca Annual Report 2017, pp. 4–32.

Questions

1 Categorise the range of resources and capabilities highlighted by the executives above in terms of Section 5.2 and Table 5.1.

2 To what extent and why might these resources and capabilities be the basis of *sustained* competitive advantage?

3 Imagine you are the general manager of an organisation of your choice and undertake the same exercise as in questions 1 and 2 above.

Table 5.1 Resources and capabilities

Identifying and managing threshold resources and capabilities raises a significant challenge because threshold levels will change through the activities of competitors and new entrants and, thus, as critical success factors change. To continue the example above, suppliers to major retailers did not require the same level of IT, digital and logistics support a decade ago. But the retailers' drive to reduce costs, improve efficiency and ensure availability of merchandise to their customers means that their expectations of their suppliers have increased markedly in that time and continue to do so. So, there is a need for those suppliers continuously to review and improve their digital and logistics resource and capability base just to stay in business.

While threshold resources and capabilities are important, they do not in themselves create competitive advantage or the basis of superior performance. They can be thought of as 'qualifiers' to be able to compete at all with competitors, while distinctive resources and capabilities are 'winners' required to triumph over competitors. **Distinctive resources and capabilities are required to achieve competitive advantage.** These are dependent on an organisation having a distinctiveness or uniqueness that is of value to customers and that competitors find difficult to imitate. This could be because the organisation has *distinctive resources* that critically underpin

competitive advantage and that others cannot imitate or obtain – a long-established brand, for example. Or it could be that an organisation achieves competitive advantage because it has *distinctive capabilities* – ways of doing things that are unique to that organisation and effectively utilised so as to be valuable to customers and difficult for competitors to obtain or imitate. For example, Apple has distinctive resources in smartphone technologies including in its innovation platform (see Chapter 11) and in its powerful brand, together with distinctive capabilities in design and in understanding consumer behaviour.

Gary Hamel and C.K. Prahalad argue that distinctive capabilities (or competences) typically remain unique because they comprise a *bundle* of constituent skills and technologies rather than a single, discrete skill or technology. They refer to this as *core competences* and the emphasis is thus on the linked set of resources, capabilities, skills and activities.[5] In the Apple example above it is thus the combination and linkages of all the resources and capabilities that make them distinctive, qualifying them as core competences in Hamel's and Prahalad's words. Section 5.3 that follows discusses in more depth the role played by distinctive resources and capabilities in contributing to long-term, sustainable competitive advantage. Section 5.3.3 explores further the importance of linkages.

5.3 Distinctive resources and capabilities as a basis of competitive advantage

As explained above, distinctive resources and capabilities are necessary for sustainable competitive advantage and superior economic performance. This relates to the importance of relative strength versus other actors as emphasised in a SWOT analysis. In the public sector and non-profit context, the equivalent concern is thus how to sustain relative superior performance and set the organisation apart from others that have a similar purpose. This section considers four key criteria by which resources and capabilities can be assessed in terms of them providing a basis for achieving competitive advantage: **Va**lue, **R**arity, **I**nimitability and **O**rganisational support – or **VRIO.**[6] Figure 5.2 illustrates these four fundamental steps and the questions they address and how they have an additive effect. Distinctive resources and capabilities thus need to meet all four criteria.

Figure 5.2 VRIO

Figure 5.2: Long Description

5.3.1 V – value of resources and capabilities

Resources and capabilities are valuable when they create a product or a service that is of value to customers and enables the organisation to respond to environmental opportunities or threats. There are three components to consider here:

- *Value to customers.* It may seem an obvious point to make that resources and capabilities need to be of value to customers but, in practice, it is often ignored or poorly understood. For example, a resource and capability may historically have been of value to customers but may no longer be. In addition, managers may seek to build on resources and capabilities that

they may see as valuable, but that do not meet customers' requirements in this regard. Or they may see a distinctive capability as of value simply because it is unique, although it may not be valued by customers. Having resources and capabilities that are different from other organisations is not, of itself, a basis of competitive advantage.

- *Taking advantage of opportunities and neutralising threats.* The most fundamental point is that to be valuable resources and capabilities need to address opportunities and threats that arise in an organisation's environment. This points to an important complementarity with the external environment of an organisation (Chapter 3 and 4). An external opportunity is addressed when a resource or capability increases the value for customers either through lowering the price or by increasing the attractiveness of a product or service. For example, IKEA has valuable resources in its cost-conscious culture and size and related capabilities that lower its costs compared to competitors and this addresses opportunities of low-priced designed furniture for customers that competitors do not attend to. Using a resource and capability that fails to exploit opportunities or neutralise threats risks not creating value and even decreasing revenues and increasing costs.
- *Cost.* The product or service needs to be provided at a cost that still allows the organisation to make the returns expected of it. The danger is that the cost of developing or acquiring the resources and/or capabilities to deliver what customers especially value is such that products or services are not profitable.

Managers should therefore consider carefully which of their organisation's activities are especially important in providing such value and which are of less value. Value chain analysis and activity systems mapping, explained in Sections 5.4.2 and 5.4.3, can be of help here.

5.3.2 R – rarity

Resources and capabilities that are valuable but common among competitors are unlikely to be a source of competitive advantage. If competitors have the same or similar resources and capabilities, they can respond quickly to the strategic initiative of a rival. As soon as it becomes evident that these are valued by customers, they are introduced widely by competitors that typically have access to the same technology. **Rare resources and capabilities**, on the other hand, **are those possessed uniquely by one organisation or by a few others.** Here competitive advantage is longer-lasting. For example, a company can have patented products or services that give it an advantage. Some libraries have unique collections of books unavailable elsewhere; a company can have a powerful brand; or mining companies can have access to unique mining sites. In terms of capabilities, organisations can have unique skills or business processes developed over time or make use of special relationships with customers or suppliers not widely possessed by competitors. However, it can be dangerous to assume that rarity will simply endure. It may, therefore, be necessary to consider other bases of sustainability for competitive advantage as follows.

5.3.3 I – inimitability

It should be clear by now that the search for resources and capabilities that provide sustainable competitive advantage is not straightforward. Having resources and capabilities that are valuable to customers and relatively rare is important, but this may not be enough. Sustainable competitive advantage also involves identifying **inimitable resources and capabilities** – **those that competitors find difficult and costly to imitate or obtain or substitute.** If an organisation has a competitive advantage because of its particular marketing and sales skills, it can only sustain this if competitors cannot imitate, obtain or substitute for them or if the costs to do so would eliminate any gains made. Often, the barriers to imitation lie deeply in the organisation in linkages between activities, skills and people. Neither non-profit nor public-sector organisations can afford to have redundant and imitable resources and capabilities. Thus, these too need to evaluate to what extent they have unique resources and capabilities, although they may not have direct competitors.

At the risk of over-generalisation, it is unusual for competitive advantage to be explainable by differences in the tangible resources of organisations since, over time, these can usually be acquired or imitated (key geographic locations, certain raw material resources and intangible resources like brands, etc., can, however, be exceptions). Advantage is more likely to be determined by the way in which resources are deployed and managed in terms of an organisation's activities; in other words, on the basis of capabilities.[7] For example, as indicated above, it is unlikely that an IT system will

improve an organisation's competitive standing in itself, not least because competitors can probably buy something very similar on the open market. On the other hand, the capabilities to manage, develop and deploy such a system to the benefit of customers may be much more difficult and costly to imitate. Compared to physical assets, capabilities tend to involve more intangible imitation barriers. In particular, they often include *linkages* that integrate activities, skills, knowledge and people both inside and outside the organisation in distinct and mutually compatible ways. These linkages can make capabilities particularly difficult for competitors to imitate and there are three primary reasons why this may be so. These are summarised in Figure 5.3 and are now briefly reviewed.

Figure 5.3 Criteria for the inimitability of resources and capabilities

Figure 5.3: Long Description

Complexity

The resources and capabilities of an organisation can be difficult to imitate because they are complex and involve interlinkages. This may be for two main reasons:

- *Internal linkages.* There may be linked activities and processes that, together, deliver customer value. The discussion of activity systems in Section 5.4.3 below explains this in more detail and shows how such linked sets of activities might be mapped so that they can be better understood. However, even if a competitor possessed such a map, it is unlikely that it would be able to replicate the sort of complexity it represents because of the numerous interactions between tightly knit activities and decisions.[8] This is not only because of the complexity itself but because, very likely, it has developed on the basis of custom and practice built up over years and is specific to the organisation concerned. For example, companies like IKEA and Ryanair[9] still enjoy competitive advantages despite the availability of countless case studies, articles and reports on their successes.
- *External interconnectedness.* Organisations can make it difficult for others to imitate or obtain their bases of competitive advantage by developing activities together with customers or partners such that they become dependent on them. Apple, for example, has many intricate linkages with various app

developers, partners and music labels that others may find difficult to imitate.[10]

Causal ambiguity[11]

Another reason why resources and capabilities might be difficult and costly to imitate is that competitors find it difficult to discern the causes and effects underpinning an organisation's advantage. This is called *causal ambiguity* and it may exist in two different forms:[12]

- *Characteristic ambiguity.* Where the significance of the characteristic itself is difficult to discern or comprehend, perhaps because it is rooted in the organisation's culture or based on tacit knowledge. For example, the know-how of the buyers in a successful fashion retailer may be evident in the sales achieved for the ranges they buy year after year. But this may involve subtleties like spotting new trends and picking up feedback from pioneering customers that may be very difficult for competitors to comprehend so they will find it difficult to imitate.
- *Linkage ambiguity.* Where competitors cannot discern which activities and processes are dependent on which others to form linkages that create distinctiveness. The expertise of the fashion buyers is unlikely to be lodged in one individual or even one function. It is likely that there will be multiple and complex links to a network of suppliers, fashion experts, style bloggers and designers to understand the market. Indeed, in some organisations the managers themselves admit that they do not fully comprehend the linkages throughout the organisation that

deliver customer value. If this is so, it would certainly be difficult for competitors to understand them.

Culture and history

Resources and capabilities that involve complex social interactions and interpersonal relations within an organisation can be difficult and costly for competitors to imitate. For example, capabilities can become embedded in an organisation's culture. Coordination between various activities occurs 'naturally' because people know their part in the wider picture, or it is simply 'taken for granted' that activities are done in particular ways. IKEA, for example, builds its strategy on their strong organisational culture (see the Case example in Chapter 8). We see this also in high-performing sports teams and in groups of people that work together to combine specialist skills as in hospital operating theatres.

Linked to this cultural embeddedness is the likelihood that such capabilities have developed over time and in a particular way through history. The origins and history by which capabilities and resources have developed over time are referred to as *path dependency*.[13] Sometimes, organisations become locked in to particular trajectories, or 'paths', by commitments made earlier in their histories. Path dependencies describe how early events and decisions establish 'policy paths' that have lasting effects on subsequent events and decisions.[14] Path dependency is like the ruts made in a dirt track by passing vehicles over time. Vehicles have almost no option but to continue along those ruts: it is very difficult to switch to another track. Similarly, organisations can become dependent on a strategic path that is very difficult for competitors to

imitate, as indicated above. In this respect, path dependency may be advantageous and contribute to inimitability. However, this path is also difficult for the organisation with the advantage to alter and it thus risks becoming locked in to the path. Such lock-in could begin with a decision which, of itself, may not appear especially significant, but which then has unforeseen and hard to reverse consequences. For example, airlines easily become locked in on particular aircraft types (e.g., Boeing): once systems for crew-training and spare parts availability have become optimised for one particular aircraft type, it is extremely expensive to move to another aircraft type (e.g., Airbus). As conditions change, path dependencies can thus also be a source of dangerous inflexibility.

Tacit organisational knowledge is often part of inimitability as discussed above. It is personal, context-specific knowledge and therefore hard to formalise and communicate. For example, it could be the knowledge of a highly experienced sales force or research and development team; or the experience of a top management team in making many successful acquisitions. It is therefore not only distinctive to the organisation, but likely to be difficult to imitate or obtain. In contrast, *explicit knowledge* is knowledge that can be articulated and transmitted in formal systematic ways. It can take the form of a codified information resource such as a systems manual or files of market research and intelligence.[15] Many organisations that have tried to improve the sharing of knowledge by relying on IT-based systems have come to realise that, while some knowledge can usefully be codified and built into computer-based systems, it can be very difficult to codify the knowledge that truly bestows competitive advantage.

5.3.4 O – organisational support

Providing value to customers and possessing capabilities that are rare and difficult to imitate provide a potential for competitive advantage. However, the organisation must also be suitably organised to support these capabilities, including appropriate organisational processes and systems. This implies that, to fully take advantage of the resources and capabilities, an organisation's structure and formal and informal management control systems need to support and facilitate their exploitation (see Chapter 15 for further discussions of organisational structure and systems). The question of organisational support works as an 'adjustment factor'. Some of the potential competitive advantage can be lost if the organisation is not organised in a way that it can fully take advantage of valuable, rare and inimitable resources and capabilities. For example, if an organisation has a unique patent underlying a product that customers value, it may still not be able to convert this into a competitive advantage if it does not have the appropriate sales force to sell the product. Supporting capabilities have been labelled *complementary capabilities* as, by themselves, they are often not enough to provide for competitive advantage, but they are useful in the exploitation of other capabilities that can provide for this.[16] In brief, even though an organisation has valuable, rare and inimitable capabilities, some of its potential competitive advantage may not be realised if it lacks the organisational arrangements to fully exploit these.

Organisations also need support from various stakeholders that provide unique capabilities that, in concert with other resources and

capabilities, provide for competitive advantage.[17] For example, it may be employees with distinctive skills, like software specialists or individuals with unique personal networks like public relations professionals. There are two significant aspects to consider here. First, stakeholders that provide access to resources and capabilities that are unique and vital for competitive advantage need to be compensated. If not, they may not contribute and, without them, there simply will be no competitive advantage. Second, their bargaining power will be decisive for how much of the competitive advantage and resulting profits an organisation is able to appropriate.[18] If they are very strong, they can bargain away most of the gains for themselves or simply walk away. For example, investment bankers are an investment bank's main resource and capability but walk out of the office every evening and can threaten not to come back. Thus, they are very well compensated based on their capabilities including relationships, experience, and skills. 'Thinking Differently' at the end of this chapter discusses the significance of how capabilities may be grounded in individuals.

In summary, and from a resource-based view of organisations, managers need to consider whether their organisation has resources and capabilities to achieve and sustain competitive advantage. To do so, they need to consider how and to what extent it has resources and capabilities that are (i) valuable; (ii) rare; (iii) inimitable; and (iv) supported by the organisation.

5.4 Analysing resources and capabilities

So far, this chapter has been concerned with explaining concepts associated with the strategic significance of organisations' resources and capabilities. This section now provides some ways in which they can be understood and diagnosed. It can be quite difficult to discern where the basis of competitive advantage lies. Hence, if managers are to manage the resources and capabilities of their organisation, the sort of analysis explained here, the VRIO analysis tool, the value chain and system, activity systems and benchmarking are centrally important. If resources and capabilities are not understood at these levels, there are dangers that managers can take the wrong course of action.

5.4.1 VRIO analysis

One lesson that emerges from an understanding of the strategic importance of resources and capabilities is that it can be difficult to discern where the basis of competitive advantage lies. The strict criteria of the VRIO framework discussed above (see Section 5.3) can conveniently be used as a strategic tool to analyse whether an organisation has resources and capabilities to achieve and sustain competitive advantage. **A VRIO analysis thus helps to evaluate if, how and to what extent an organisation or company has resources and capabilities that are (i) valuable, (ii) rare, (iii)**

inimitable and (iv) supported by the organisation. Table 5.2 summarises the VRIO analysis of capabilities and shows that there is an additive effect. Resources and capabilities provide sustainable bases of competitive advantage the more they meet all four criteria. This analysis can be done for different functions in an organisation (technology, manufacturing, purchasing, marketing and sales, etc.) or more fine-grained for individual resources and capabilities and activities. Another approach is to evaluate different sections of the value chain or system with this tool (see Section 5.4.2 below).

Table 5.2 The VRIO framework

Source: Adapted with the permission of J.B. Barney and W.S. Hesterly, *Strategic Management and Competitive Advantage,* Pearson, 2012.

Sometimes, it may be challenging to establish the exact competitive implication, for example, when a resource or capability is on the border between sustained or temporary competitive advantage . However, for managers, it is most important to distinguish between sustained or temporary competitive advantage vs competitive parity or competitive disadvantage (see Table 5.2). If it is difficult to discern whether a function, resource or capability provides for sustained competitive advantage, it may help to divide it into subparts. For example, manufacturing in itself may not provide for competitive advantage, but perhaps product engineering or design will. And, even if machines and equipment generally do not provide for competitive advantage, there may be a particular type of equipment that does. Illustration 5.2 gives an overview of various steps in a resource and capability analysis.

5.4.2 The value chain and value system

The value chain describes the categories of activities within an organisation which, together, create a product or service. Most organisations are also part of a wider **value system**, **the set of inter-organisational links and relationships that are necessary to create a product or service.** Both are useful in understanding the strategic position of an organisation and where valuable resources and capabilities reside.

The value chain

If organisations are to achieve competitive advantage by delivering value to customers, managers need to understand which activities their organisation undertakes that are especially important in creating that value and which are not. This can then be used to model the value generation of an organisation. The important point is that the concept of the value chain invites the strategist to think of an organisation in terms of sets of activities. There are different frameworks for considering these categories: Figure 5.4 is a representation of a value chain as developed by Michael Porter.[19]

Primary activities are directly concerned with the creation or delivery of a product or service. For example, for a manufacturing business:

- *Inbound logistics* are activities concerned with receiving, storing and distributing inputs to the product or service including materials handling, stock control, transport, etc.
- *Operations* transform these inputs into the final product or service: machining, packaging, assembly, testing, etc.

- *Outbound logistics* collect, store and distribute the product or service to customers; for example, warehousing, materials handling, distribution, etc.
- *Marketing and sales* provide the means whereby consumers or users are made aware of the product or service and are able to purchase it. This includes sales administration, advertising and selling.
- *Service* includes those activities that enhance or maintain the value of a product or service, such as installation, repair, training and spares.

Illustration 5.2 Steps in a resource and capabilities analysis There are several important considerations involved when analysing resources and capabilities.

Emily (from Illustration 4.2) wants to start a coffee shop and perhaps even try to grow the business into several outlets. She needs to think about the following steps and questions when considering resources and capabilities:

1 **List all important resources and capabilities in the industry or sector.** To get a better overview, categorise them according to the functions they are located in. Which are the most important:

- *resources*?
- *capabilities*?
- more fine-grained *activities*?

Emily should consider all important resources and capabilities of diverse coffee businesses (local cafés, coffee shop chains, fast food chains, restaurants, etc.). Even

if she does not need all, it is important to produce a gross list not to miss any necessary ones or any that may provide for competitive advantage.

2 **Categorise threshold versus distinctive resources and capabilities.** Among potential competitors, which are the:

- *threshold* resources and capabilities – those necessary to compete at all?
- *distinctive* resources and capabilities – those required for competitive advantage?

The threshold category should be rather straightforward for Emily. However, distinctive competitive advantages are likely to differ between different coffee businesses and companies and some may lack them altogether.

3 **Identify what specific actors to compare resource and capabilities relative strengths with.** Which are the relevant:

- competitors that pursue a similar strategy as yours?
- competitors that potentially could pursue a similar strategy as yours?

For Emily, not all coffee businesses will be equally relevant to compare with. For example, as she intends to start up with a coffee shop and perhaps expand to several, local coffee shops and coffee chains nearby her location will thus be most relevant initially.

4 **As a first step in a VRIO analysis, determine if there are any competitive advantages at all in resources and capabilities in different functions (evaluating degree of competitive advantages follows next).**

- What are the answers for each VRIO question (Figure 5.2 and Table 5.2)?
- Are there *competitive disadvantages*, *parity*, or *advantages*? Why? How?

Emily needs to consider the additive effect of the four VRIO criteria and evaluate her position in relation to competitors. Even if she does not have competitive advantages

to start with, she might be able to avoid disadvantages and at least achieve parity with other coffee shops.

5 **If competitive advantages were identified above, determine to what degree they are temporary or sustained in finalising the VRIO analysis.**

- Return to the prior answers to *rarity* and *inimitability* (Figure 5.2 and Table 5.2): Are there *temporary* or *sustained* competitive advantages when comparing with specific relevant actors (point 3 above)? Why? How?

A careful evaluation may help Emily to identify areas where she has or could potentially build competitive advantages. She should particularly examine any internal and external linkages among resources and capabilities as such relationships often provide a basis for competitive advantage.

6 **Assess how to compensate for any competitive disadvantages and how to build competitive advantages.** For resources and capabilities, can you:

- neutralise weak ones?
- extend or modify and thus upgrade any stronger ones to gain competitive advantage?
- acquire, build or create entirely new ones to gain competitive advantage, perhaps in cooperation with external actors?

To cope with any disadvantages, Emily can benchmark with competitors to upgrade resources and capabilities at par with them. To build competitive advantage she could possibly identify a customer concept based on some unique resources and capabilities, which at least partly could fulfil the rarity and inimitability criteria.

Questions

1 Emily's initial idea is a 'universally sustainable and eco-friendly coffee shop'. Help Emily and go through each step above and answer the questions and make a

complete analysis. What is your assessment of her initial idea?

2 Based on your analysis: How should Emily make sure she at least has a few resources and capabilities that fulfil the VRIO criteria and thus competitive advantage?

Figure 5.4 The value chain within an organisation

Source: Adapted with the permission of The Free Press, a Division of Simon & Schuster, Inc., from *Competitive Advantage: Creating and Sustaining Superior Performance* by Michael E. Porter. Copyright © 1985, 1998 by Michael E. Porter. All rights reserved.

Figure 5.4: Long Description

Each of these groups of primary activities is linked to *support activities* which help to improve the effectiveness or efficiency of primary activities:

- *Procurement.* Processes that occur in many parts of the organisation for acquiring the various resource inputs to the primary activities. These can be vitally important in achieving scale advantages. So, for example, many large consumer goods companies with multiple businesses nonetheless procure advertising centrally.
- *Technology development.* All value activities have a 'technology', even if it is just know-how. Technologies may be concerned directly with a product (e.g., R&D, product design) or with processes (e.g., process development) or with a particular resource (e.g., raw materials improvements).
- *Human resource management.* This transcends all primary activities and is concerned with recruiting, managing, training, developing and rewarding people within the organisation.
- *Infrastructure.* The formal systems of planning, finance, quality control, information management and the structure of an organisation.

The value chain can be used to understand the strategic position of an organisation and analyse resources and capabilities in three ways:

- As a *generic description of activities.* Figure 5.4 might be appropriate as a general framework here or a value chain more specific to an organisation can be developed. The important thing is to ask: (i) which separate categories of activities best describe the operations of the organisation; and (ii) which of these are most significant in delivering the strategy and achieving advantage over competitors? For example, the value

chain can help managers understand if there is a cluster of activities providing benefit to customers located within particular areas of it. Perhaps a business is especially good at outbound logistics linked to its marketing and sales operation and supported by its technology development. It might be less good in terms of its operations and its inbound logistics.

- In analysing the competitive position of the organisation by using the *VRIO analysis* for individual value chain activities and functions (see Section 5.4.1 above).
- To *analyse the value and cost of activities* of an organisation. This could involve the following two steps:
    - *Identifying sets of value activities.* Which activities add most value to the final product or service (and in turn to the customer) and which do not? For example, it is likely that in a branded pharmaceutical company research and development and marketing activities will be crucially important. It can also be important to establish which sets of activities are linked to or are dependent on others and which, in effect, are self-standing.
    - *Relative importance of activity costs internally.* In which activities and how can costs be reduced? Does the significance of costs align with the significance of activities? Can costs be reduced in some areas without affecting the value created for customers? For example, organisations that have undertaken such analyses often find that central services have grown to the extent that they are a disproportionate cost and do not add value to other sets of activities or to the customer. Can some activities be

outsourced (see Section 9.5.2), for example, those that are relatively free-standing and do not add value significantly? Can cost savings be made by increasing economies of scale or scope; for example, through central procurement or consolidating currently fragmented activities (e.g., manufacturing units)?

The value system

A single organisation rarely undertakes in-house all of the value activities from design through to the delivery of the final product or service to the final consumer. There is usually specialisation of activities so, as Figure 5.5 shows, any one organisation is part of a wider *value system* of different interacting organisations. There are questions that arise here that build on an understanding of the value chain and value system:

Figure 5.5 The value system

Source: Adapted with the permission of The Free Press, a Division of Simon & Schuster, Inc., from *Competitive Advantage: Creating and Sustaining Superior Performance* by Michael E. Porter. Copyright © 1985, 1998 by Michael E. Porter. All rights reserved.

- The *'make or buy'* or *outsourcing* decision for a particular activity is critical: which activities most need to be part of the internal value chain because they are central to achieving competitive advantage? There may also be activities that do not generate competitive advantage in themselves, but that the organisation needs to control as they enable the exploitation of competitive advantage in other parts of the value chain, as indicated in Section 5.3.4. H&M, for example, is dependent both on suppliers of textiles and clothing manufacturers to be able to offer clothes with reduced environmental impact. Hence, they have invested in new ventures that recycle textile fibres in the first part of the value system while they refrain from investing in clothes manufacturers, but instead cooperate closely with them in this respect. This is an exemplification of how organisations need to work across value systems to achieve competitive advantage based on sustainability. It is often referred to as building *circular value systems* or chains promoting a circular economy.[20] Illustration 5.3 shows another example of how to control different parts of the value system. Value system analysis was used by the Valley Group in the Nepalese poultry industry as a way of identifying what they should focus on in securing a steady supply of chicken and developing a more profitable structure. While their analysis resulted in integration along the value system, it is increasingly common to outsource activities as a means of lowering costs (see Section 9.5). Just

as costs can be analysed across the internal value chain, they can also be analysed across the value system. If activities are less costly when performed by others without any adverse effects, it may make more sense to leave these to others along the value system.

- *What are the activities and cost/price structures of the value system?* It's essential to understand the entire value system and its relationship to an organisation's value chain as changes in the environment may require outsourcing or integration of activities depending on changing cost/price structures. The more an organisation outsources, the more its ability to evaluate and influence the performance of other organisations in the value system may become a critically important capability in itself and even a source of competitive advantage. For example, the quality of a cooker or a television when it reaches the final purchaser is influenced not only by the activities undertaken within the manufacturing company itself, but also by the quality of components from suppliers and the performance of the distributors.
- *Where are the profit pools*?[21] **Profit pools refer to the different levels of profit available at different parts of the value system.** Some parts of a value system can be inherently more profitable than others because of the differences in competitive intensity (see Section 4.3.1). For example, in the computer industry, microprocessors and software have historically been more profitable than hardware manufacture. The strategic question becomes whether it is possible to focus on the areas of greatest profit potential. Care has to be exercised here. It is one

thing to identify such potential; it is another to be successful in it given the capabilities an organisation has. For example, engineering firms may recognise the greater profit potential in providing engineering consulting services in addition to or instead of manufacturing. Nonetheless, many have found it difficult to develop such services successfully either because their staff do not have consultancy capabilities or because their clients do not recognise the firms as having them.

- *Partnering.* Who might be the best partners in the various parts of the value system? And what kinds of relationships are important to develop with each partner? For example, should they be regarded as suppliers or should they be regarded as alliance partners (see Section 12.4)?

Illustration 5.3 An integrated value system in the Nepalese poultry industry Integrating the value system under complex conditions.

Raj Kumar Bhattarai, Nepal Commerce Campus, Tribhuvan University The Valley Group has moved from backyard farming and selling 13 kilograms of broilers' meat in 1981 to becoming the Nepal poultry market leader despite a context including decades of political insurgency, economic turmoil and social unrest. They have managed the value system and supply chain problems of the Nepal decentralised and scattered poultry-keeping activities. Gradually, they have integrated various elements of the value system while leaving supplementary elements to other organisations.

The complex context, including an absence of law and order, frequent general strikes, shortage of supplies and energy and poor transport infrastructure, resulted in

irregularities in the supply of commercial chicks, their feeds and medicines. The Valley Group managers recognised that various industrial customers, such as hotels and food processing firms, preferred those suppliers that could meet their steady demand for poultry products. Supply regularity thus emerged as a primary determinant of business success. The managers then vertically and horizontally integrated various parts of the value system. They developed a sustained network of reciprocal interdependence in order to ensure the quality and regularity of poultry products and services thereof, even under the difficult circumstances.

The poultry value system begins from genetic engineering that passes through the foundation stock, primary breeder (known as grandparents that produce the parent stock – the breeders), parent stock, hatcheries, farmhouses, slaughter/processing houses, and finally the selling outlets (see table). The primary breeder produces breeder eggs that hatch into breeder chicks, whose eggs further hatch into day-old commercial chicks. These chicks (baby chicken hatched from the breeder eggs) are raised into live broilers (aged chicken reaching slaughter-weight at between five to seven weeks) in farm houses. The live broilers are then transported to slaughter/processing houses in order to portion, pack and prepare them for sales outlets.

The Valley Group integrated itself into various parts of the value system to secure a regular supply of live broilers to meet the steady demand of poultry products from the market. First, the difficult circumstances made it problematic for farmers to receive live broilers and feed consistently, which resulted in the irregular supply of broilers. This led the Valley Group to establish Valley Poultry and Valley Feed in order to ensure a steady supply of chicks and feeds respectively to the farmers, which could then grow the chicks to live broilers on a regular basis. A second element that prevented the regular supply from the farmers was that they were not confident that there would be a steady market demand for their live broilers. This resulted in the Valley Mart that buys live broilers directly from the farmers. The broilers are then slaughtered and processed and, finally,

high-quality chicken, chicken sections, processed and packed items are steadily made available in Valley Cold Store.

Source: Prepared by Raj Kumar Bhattarai, Nepal Commerce Campus, Tribhuvan University.

Questions

1 Draw up a value system and value chains for another business and organisation in terms of the activities conducted within each part (see Figure 4.5).

2 Would it make sense to integrate or outsource some of the various value chain activities in this value system in relation to the focal organisation?

3 What are the strategic implications of your analysis – what would you do?

5.4.3 Activity systems

The discussion so far highlights the fact that all organisations comprise sets of resources and capabilities, but that these are likely to be configured differently across organisations. It is this variable configuration that makes an organisation and its strategy more or less unique. So, for the strategist, understanding this matters a good deal.

VRIO and value chain analysis can help with this, but so too can understanding the more fine-grained activity systems of an organisation. As the discussion above in Section 5.3 has made clear, the way in which resources are deployed through the organisation actually takes form in the activities pursued by that organisation; so it is important to identify what these activities are, why they are

valuable to customers, how the various activities fit together and how they are different from competitors.

Some scholars,[22] including Michael Porter, have written about the importance of mapping activity systems and shown how this might be done. The starting point is to identify what Porter refers to as 'higher order strategic themes'. In effect, these are the ways in which the organisation meets the critical success factors determining them in the industry. The next step is to identify the clusters of activities that underpin each of these themes and how these do or do not fit together. The result is a picture of the organisation represented in terms of activity systems, such as that shown in Figure 5.6. It shows an activity systems map for the Scandinavian strategic communications consultancy, Geelmuyden Kiese.[23] The core higher-order theme at the heart of its success is its knowledge, built over the years, of how effective communications can influence 'the power dynamics of decision-making processes'. However, as Figure 5.6 shows, this central theme is related to other higher-order strategic themes (rectangles) as listed below (each of which is underpinned by clusters of supporting activities; see ovals in Figure 5.6):

- Working at a *strategic level* based on its own *in-house methodology,* prioritising those clients where such work is especially valued.
- A *clear stance on integrity of communication* and always advises openness of communication rather than suppression of information and only deals with clients that will accept such principles.
- Staff are given *high degrees of freedom* but with some absolute criteria of responsibility, including strict rules for handling clients'

confidential information and strict sanctions if such rules are broken.

- Recruitment is based on ensuring this responsibility and largely on the basis of *values of openness and integrity* but also humour. The emphasis is on recruiting junior personnel and developing them based on a mentoring system and, thus, the company believes it offers the best *learning opportunities* in Scandinavia for young consultants.
- *Strong financial incentives* for top performance including rewards for the development of junior personnel and based on the internal evaluation of leadership qualities and performance.

The various activities represented in an activity map can also be seen as parts of a value chain. However, activity systems mapping encourages a greater understanding of the complexity of resources and capabilities – important if bases of competitive advantage are to be identified and managed. An activity systems map emphasises the importance of different activities that create value to customers pulling in the same direction and supporting rather than opposing each other. So, the need is to understand (i) the fit between the various activities and how these reinforce each other and (ii) the fit externally with the needs of clients. It is these linkages and this fit that can be the bases of sustainable competitive advantage. In combination, they may be *valuable* to clients, truly distinctive and therefore *rare.* Moreover, while individual components of an activity system might be relatively easy to imitate, in combination, they may well constitute the complexity and causal ambiguity rooted in culture and history that makes them *inimitable.* Finally, there can be activities in the system that in themselves do not provide for

competitive advantage, but that provide *organisational support* for other activities that do.

Figure 5.6 Activity systems at Geelmuyden.Kiese

Figure 5.6: Long Description

It should also be asked if there are activities that are not required in order to pursue a particular strategy or if some activities do not contribute to value creation. If activities do not do this, why are they being pursued by the organisation? Whether Ryanair used activity mapping or not, it has systematically identified and done away with

many activities that other airlines commonly have (adjustable seats, pre-boarding assigned seats, in-flight drinks and meals, etc.).

5.4.4 Benchmarking

Benchmarking is used as a means of understanding how an organisation compares with others.[24] It may be organisations that compete in the same industry or sectors, typically competitors, or other organisations that perform the same or similar functions. Many benchmarking exercises focus on outputs such as standards of product or service, but others do attempt to take account of organisational capabilities. It is often used by non-profits and state and local governments that may not have direct competitors for comparison and may not be helped by some of the other tools.[25]

Broadly, there are two approaches to benchmarking:

- *Industry/sector benchmarking.* Insights about performance standards can be gleaned by comparing performance against other organisations in the same industry sector or between similar service providers against a set of performance indicators. Some public-sector organisations have, in effect, acknowledged the existence of strategic groups (see Section 4.5.1) by benchmarking against similar organisations rather than against everybody: for example, local government services and police treat ‘urban’ differently from ‘rural’ in their benchmarking and league tables. However, an overriding danger of industry norm comparisons (whether in the private or the public sector) is that the whole industry can be performing badly and losing out

competitively to other industries that can satisfy customers' needs in different ways.

- *Best-in-class benchmarking.* Best-in-class benchmarking compares an organisation's performance or capabilities against 'best-in-class' performance – from whichever industry – and therefore seeks to overcome some of the above limitations. It may also help challenge managers' mindsets that acceptable improvements in performance will result from incremental changes in resources or capabilities. For example, Southwest Airlines improved refuelling time by studying the processes surrounding Formula One Grand Prix motor racing pit stops.[26]

The importance of benchmarking is, then, not so much in the detailed 'mechanics' of comparison but in the impact that these comparisons might have on reviewing resources and capabilities underlying performance. But benchmarking has two potential limitations:

- *Surface comparisons.* If benchmarking is limited to comparing outputs, it does not directly identify the reasons for relative performance in terms of underlying resources and capabilities. For example, it may demonstrate that one organisation is poorer at customer service than another, but not show the underlying reasons. The benchmarking exercise should therefore be treated as the start of a deeper investigation into the explanation of differences.
- *Simply achieving competitive parity.* Benchmarking can help an organisation to develop capabilities and create value in the same way as its competitors and those best-in-class. However,

the best performance that can be expected out of this exercise is to achieve a threshold level and competitive parity. For organisations with competitive disadvantage, this can be highly rewarding but, to achieve competitive advantage, an organisation needs to move further and develop its own distinctive resources and capabilities.

5.5 Dynamic capabilities

The previous section was concerned with analysing resources and capabilities. This section considers what managers can do to manage and improve resources and capabilities. If resources and capabilities for competitive advantage do not exist, then managers need to consider if they can be developed. Also, if they are to provide a basis for long-term success, resources and capabilities cannot be static; they need to change. University of Berkeley economist David Teece has introduced the concept of **dynamic capabilities**, by which he means **an organisation's ability to renew and recreate its resources and capabilities to meet the needs of changing environments.**[27] He argues that the resources and capabilities that are necessary for efficient operations, like owning certain tangible assets, controlling costs, maintaining quality, optimising inventories, etc., are unlikely to be sufficient for sustaining superior performance long term.[28] These '*ordinary capabilities*' allow companies to be successful and earn a living now by producing and selling a similar product or service to similar customers, but are not likely to provide for long-term survival and competitive advantage in the future.[29]

In other words, there is a danger that capabilities and resources that were the basis of competitive success can, over time, be imitated by competitors, become common practice in an industry or become redundant as its environment changes. So, the important lesson is that, if resources and capabilities are to be effective over time, they need to change; they cannot be static. Dynamic

capabilities are directed towards that strategic change. They are dynamic in the sense that they can create, extend, or modify an organisation's existing ordinary capabilities. New product development is a typical example of a dynamic capability and strategic analysis is another. Learning through experimentation, for example in the public sector, also constitutes a form of dynamic capability.[30] Outlet expansion by chain retailers such as Starbucks or Zara is yet another example as it extends ordinary capabilities.[31] Dynamic capabilities may also take the form of relatively formal organisational systems, such as reorganisation, recruitment and management development processes and cooperating with others through alliances or acquisitions, by which new skills are learned and developed.[32] Illustration 5.4 provides an example of dynamic capabilities in the context of mobile and smartphones, but also shows that they are not necessarily a guarantee for future success.

Teece suggests the following three generic types of dynamic capabilities:

- *Sensing.* Sensing implies that organisations must constantly scan, search and explore opportunities across various markets and technologies. For example, companies in the PC operating systems industry, like Microsoft, sensed the threats from and opportunities in cloud computing services and applications.
- *Seizing.* Once an opportunity is sensed, it must be seized and addressed through new products or services, processes, activities, etc. Microsoft, for example, seized opportunities by launching their own cloud computing services, Azure.
- *Reconfiguring.* To seize an opportunity may require renewal and reconfiguration of organisational capabilities and investments in

new technologies, manufacturing, markets, etc. For example, Microsoft's inroads into cloud computing and related software and apps required major changes in its existing PC and game console resources and capabilities. The company needed to discard some of its old capabilities, acquire and build new ones and combine them.

This view of dynamic capabilities relates directly to the framework for this book: strategic position, strategic choices and strategy in action (see Figure 1.3). Sensing capabilities are to do with understanding an organisation's strategic position; seizing opportunities relate to making strategic choices; and reconfiguration is to do with enacting strategies.

As Teece acknowledges, dynamic capabilities are likely to have 'micro-foundations'[33] in people's behaviour within organisations, such as the way in which decisions get taken, personal relationships, and entrepreneurial and intuitive skills. This puts the focus on individual behaviour and the significance of beliefs, social relationships and organisational processes in capability management, which is discussed in 'Thinking Differently' at the end of this chapter.[34]

As suggested above, dynamic capabilities may take different forms and there are thus many ways in which managers might create, extend or upgrade resources and capabilities including more experimental ones. Several approaches to manage resources and capabilities are discussed in other parts of this book:[35]

- *Internal capability development.* Could resources and capabilities be added or upgraded so that they become more

reinforcing of outcomes that deliver against critical success factors? This might be done, for example, by:

- *Building and recombining capabilities.* Creating entirely new capabilities that provide for competitive advantage requires entrepreneurship and intrapreneurship skills. Managers can build managerial systems and a culture that promote capability innovation or form new venture units outside the rules of ordinary R&D and product development (see Chapter 11).[36]
- *Leveraging capabilities.* Managers might identify resources and capabilities in one area of their organisation, perhaps customer service in one geographic business unit of a multinational, which are not present in other business units. They might then seek to extend this throughout all the business units, but capabilities might not be easily transferred because of the problems of managing change (see Chapter 16).
- *Stretching capabilities.* Managers may see the opportunity to build new products or services out of existing capabilities. Indeed, building new businesses in this way is the basis of related diversification, as explained in Chapter 9.

- *External capability development.* Similarly, there may be ways of developing resources and capabilities by looking externally. For example, they could be attained or developed by acquisition or entering into alliances and joint ventures (see Chapter 12).
- *Ceasing activities.* Could current activities, not central to the delivery of value to customers, be done away with, outsourced or reduced in cost? If managers are aware of the resources and

capabilities central to bases of competitive advantage, they can retain these and focus on areas of cost reduction that are less significant (see Chapter 8).

Illustration 5.4 Dynamic capabilities (and rigidities) in mobile telephone companies

Dynamic capabilities can help firms sense and seize opportunities and reconfigure ordinary capabilities in changing environments.

Companies in the mobile telephone industry have built on their dynamic capabilities in their effort to adapt to environmental changes. They have identified and evaluated new opportunities (sensing); addressed these with new products (seizing) and renewed and redeployed their capabilities accordingly (reconfiguring), as illustrated in the table.

The pioneers in mobile telephony, Ericsson and Motorola, managed to sense and explore an entirely new mobile telephony market. They satisfied and captured value in that market by recombining and redeploying telecommunication and radio capabilities. However, they remained stuck in these early mobile telephone capabilities and were followed by Nokia. Nokia sensed new opportunities as it realised that mobile phones' awkward design and functionality were not suited to what had become a mass consumer and fashion market. The company seized these new opportunities, offering improved designs and functionality. However, they later suffered as they were unable to reconfigure their product design and mobile operating system capabilities further.

Source: RayArt Graphics/Alamy Stock Photo

Apple, with a long legacy in consumer electronics products, explored additional opportunities. They realised that most phones, even the improved ‘smartphones’, still maintained a complex and unintuitive interface with limited multimedia functionalities. Apple addressed this by introducing an upgraded multimedia platform smartphone with an intuitive and simple interface combined with complementary services like the App Store and iTunes. They built on a recombination of its prior design, interface and consumer behaviour capabilities and (for them) new mobile phone capabilities. They, in turn, were followed by Samsung, which used their digital electronics capabilities and the open innovation model of Google’s Android operating system (OS). Samsung transformed their capabilities further to capture value in the premium priced segment via their Galaxy phones and successfully established market leadership position in a new more productivity-oriented phablets smartphone category (combining the size format of phones and tablets). They have become number one in smartphone sales with Huawei and Apple as two and three.

While dynamic capabilities helped mobile phone companies to adapt, they are no guarantee for keeping ahead as the ordinary capabilities they develop risk becoming rigidities when markets and technologies move fast. Companies need to detect and alleviate rigidities quickly; otherwise, competitors may emerge with more appropriate capabilities in a constantly changing environment.

Source: Prepared by Patrick Regnér, Stockholm School of Economics and Muhammad Amjad, Salford Business School, University of Salford.

Questions

1 What type of dynamic capabilities could help smartphone companies avoid becoming stuck in their old resources and capabilities?

2 Why is it difficult for some firms to successfully seize opportunities and reconfigure their capabilities?

3 (a) Can you sense any possible future opportunities in smartphones?

(b) How could they possibly be seized and developed (reconfigured) by the smartphone companies?

Thinking differently Micro-foundations of capabilities

A new view emphasises the individuals behind capabilities

In the discussion of dynamic capabilities above (Section 5.5) it was noted that 'micro-foundations' of people's behaviour underlie them and, earlier, that an organisational stakeholder may be crucial for competitive advantage creation and appropriation

(Section 5.3.4).[37] From this perspective, then, the focus is not so much on organisations' resources and capabilities as on the individuals behind them. The emphasis is on human and social capital and on how individuals' decisions and actions aggregate up to the organisational level and shape resources and capabilities.[38]

The emphasis of this alternative 'micro-foundations' approach is thus on individuals and their social interactions. Instead of taking capabilities as the point of departure, micro-foundations start with individuals' beliefs, preferences and activities. The focus is on key individuals, often those at the top or outstanding researchers, and their ambitions, competences, and social networks. It is thus these individuals' decisions and choices that determine capabilities, strategy and organisational performance.

The focus on micro-foundations suggests that organisations should carefully consider how individual's skills, activities and choices can develop and change resources and capabilities. However, it may be difficult to observe, determine and isolate a single individual's contribution to competitive advantage due to cognitive and psychological biases (see Chapter 17). Organisational capabilities are also often built over extended periods of time (see Chapter 14), which often go beyond the tenure of individuals. Even if it would be possible to identify an individual's contribution, it still poses a challenge as it is likely that the individual in question then also can understand her /his value and thus simply can walk out of the door to extract this value her/himself.[39]

Questions

Pick an organisation mentioned in this chapter (e.g., Apple, IKEA, Microsoft, Ryanair, Starbucks, Zara) or one you admire and would like to work for: What micro-foundations (e.g. individuals and their competences, skills, networks, choices, activities) do you think underlie their resources and capabilities?

Key takeaways

- To assess the ability of an organisation to compete at all in a market, consider *threshold* resources and capabilities and to evaluate the ability to achieve sustained competitive advantage, consider unique and *distinctive* resources and capabilities.
- To evaluate sustainable competitive advantage in resources and capabilities, examine the *VRIO* criteria of being *Valuable, Rare, Inimitable* and *supported by the Organisation.*
- To diagnose organisational resources and capabilities, several approaches are available:
    - Make a *VRIO analysis* of resources and capabilities to evaluate if they contribute to competitive advantage.
    - Analyse an organisation's *value chain* and *value system* as a basis for understanding how value to a customer is created and can be developed and how costs can be reduced.
    - Use *activity systems mapping* as a means of identifying more detailed activities that underpin resources and capabilities.
    - Employ *benchmarking* as a means of understanding the relative performance of organisations, especially if there are no direct competitors.
- If the environment changes and resources and capabilities need to be modified or changed, employ *dynamic capabilities: sensing, seizing* and *reconfiguring*.

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

5.1 Using Table 5.1, identify the resources and capabilities of an organisation with which you are familiar; your university or school, for example. Alternatively, you can answer this in relation to, H&M* or Formula One* if you wish.

5.2 Undertake a VRIO analysis of the resources and capabilities of an organisation with which you are familiar in order to identify which resources and capabilities meet the criteria of: (a) value, (b) rarity, (c) inimitability and (d) organisational support (see Section 5.3; Figure 5.2 and Table 5.2). You can answer this in relation to H&M* or Formula One* or the end of chapter case, 'Reconfiguring retailing resources' (Amazon vs Walmart), if you so wish.

5.3 Undertake a value chain or system analysis for an organisation of your choice (referring to Illustration 5.3 could be helpful). You can answer this in relation to a case study in the book such as Ryanair* or the end case, 'Reconfiguring retailing resources' (Amazon vs Walmart), if you wish.

5.4 For a benchmarking exercise to which you have access, make a critical assessment of the benefits and dangers of the approach that was taken.

5.5 For an industry or public service of your choice, consider how the resources and capabilities that have been the basis of competitive advantage (or best value in the public sector) have changed over time. Why have these changes occurred? How did the relative strengths of different companies or service providers change over this period? Why? Did dynamic capabilities play any role? Which?

Integrative assignment

5.6 Prepare a VRIO analysis for an organisation of your choice (see Illustration 5.2). Explain why you have chosen each of the factors you have included in the analysis, in particular their relationship to other analyses you have undertaken in this chapter and in Chapter 4. What are the conclusions you arrive at from your analysis and how would these inform an evaluation of strategy (see Chapter 13)?

Recommended key readings

- For an understanding of the resource-based view of the firm, an early and much cited paper is by Jay Barney (1991) ‘Firm resources and sustained competitive advantage’, *Journal of Management,* vol. 17, pp. 99–120. For a critical discussion of the resource-based view, see J. Kraaijenbrink, J.-C. Spender and A.J. Groen (2010) ‘The resource-based view: a review and assessment of its critiques’, *Journal of Management,* vol. 36, no. 1, pp. 349–72, 19.
- A comprehensive book on dynamic capabilities is written by C. Helfat, S. Finkelstein, W. Mitchell, M. Peteraf, H. Singh, D. Teece and S. Winter (2007) *Dynamic Capabilities: Understanding Strategic Change in Organisations,* Blackwell Publishing.

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2. The concept of resource-based strategies was introduced by B. Wernerfelt (1984) ‘A resource-based view of the firm’, *Strategic Management Journal*, vol. 5, no. 2, pp. 171–80. The seminal and most cited paper is by Jay Barney (1991) ‘Firm resources and sustained competitive advantage’, *Journal of Management,* vol. 17, no. 1, pp. 99–120. There are many books and papers that explain and summarise the approach: for example, J.B. Barney, D.J. Ketchen Jr and M. Wright (2021) ‘Resource-based theory and the value creation framework’, *Journal of Management,* 47(7), pp.1936–55.
3. The literature most commonly differentiates between ‘resources’ and ‘capabilities’. See, for example, an early article by R. Amit and P.J.H. Schoemaker (1993) ‘Strategic assets and organizational rent’, *Strategic Management Journal*, vol. 14, pp.

33–46 and Jay Barney's book: J.B. Barney (2014) *Gaining and Sustaining Competitive Advantage*, Pearson.

4. 'Capabilities' is commonly used in both research and in practice-oriented writings and in discussions within organisations. As Illustration 1 shows, organisations frequently refer to their capabilities when describing their strategies. Nevertheless, the term 'competences' is still used by some organisations and managers.
5. Gary Hamel and C.K. Prahalad were the academics who promoted the idea of core competences in the early 1990s to refer to an organisation's unique competences; 'The core competence of the corporation', *Harvard Business Review,* vol. 68, no. 3 (1990), pp. 79–91. This idea of driving strategy development from the resources and capabilities or competences of an organisation is also discussed in G. Hamel and C.K. Prahalad (1993) 'Strategy as stretch and leverage', *Harvard Business Review,* vol. 71, no. 2, pp. 75–84.
6. The VRIO criteria were introduced by Jay Barney in J.B. Barney (2014) *Gaining and Sustaining Competitive Advantage,* Addison-Wesley, 1997 (2014). Originally the acronym *VRIN* was used to also emphasise 'non-substitutability' as a separate component and how competitors must not be able to substitute a valuable, rare and inimitable capability for another. However, this is now encompassed by the 'Imitation' factor. Hence, in the VRIO framework 'Imitation' encompasses both direct replication of a resource and capability and substitution for it. Direct replication refers to the difficulty or impossibility to replicate resources and capabilities. Substitution rather refers to the difficulty to substitute

resources and capabilities for another. For example, if it is impossible to replicate a specific marketing expertise of a leading firm, a competitor may instead try to substitute this by cooperating with a marketing consultancy. If neither direct replication of this expertise nor substituting it by the consultancy is possible, then this capability is inimitable.

7. This is borne out in a meta-study of research on RBV by S.L. Newbert (2007) 'Empirical research on the resource-based view of the firm: an assessment and suggestions for future research', *Strategic Management Journal,* vol. 28, pp. 121–46.
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9. For example, see the Ryanair case in the case study section of this book (*Text and Cases* version only).
10. Even collaboration in terms of open innovation or strategic openness where there are common-pool resources may be a source of competitive advantage, contrary to established logic in the RBV where an individual firm controls inimitability. For a discussion of this, see O. Alexy, J. West, H. Klapper and M. Reitzig (2018) 'Surrendering control to gain advantage: Reconciling openness and the resource-based view of the firm', *Strategic Management Journal*, 39(6), 1704–27.
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12. The distinction between and importance of characteristic and linkage ambiguity is explained by A.W. King and C.P. Zeithaml (2001) ‘Competencies and firm performance: examining the causal ambiguity paradox’, *Strategic Management Journal,* vol. 22, no. 1, pp. 75–99.
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17. For a discussion of stakeholders and the resource-based view, see J.B. Barney (2018) ‘Why resource-based theory’s model of profit appropriation must incorporate a stakeholder perspective’, *Strategic Management Journal*, 39(13), 3305–25.
18. For a discussion of who can appropriate gains from competitive advantage, see R.W. Coff (1999) ‘When competitive advantage doesn’t lead to performance: The resource-based view and stakeholder bargaining power’, *Organization Science*, 10(2), 119–33; and M. Blyler, and R.W. Coff (2003) ‘Dynamic capabilities, social capital, and rent appropriation: Ties that split pies’, *Strategic Management Journal*, 24(7), 677–86.
19. An extensive discussion of the value chain concept and its application can be found in M.E. Porter (1985) *Competitive Advantage,* Free Press.
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Case example Reconfiguring retailing resources Amazon vs Walmart: battling for distinctive competitive advantage Patrick Regnér

Introduction

The US retailing giants Amazon and Walmart have dominated two different sides of retail. Amazon has been the disruptor in e-commerce since 1995 while Walmart was the pioneer in brick-and-mortar discount retailing when it started in 1962. For long, the two did not compete directly, but they have become fierce competitors in a new retailing landscape. Today, e-commerce and brick-and-mortar retailing converge into more of an omnichannel approach – an integration of physical channels (offline) and digital channels (online) to offer a unified customer experience. This marks a dramatic shift from their usual playbooks, Amazon in online and Walmart in brick-and-mortar. Now, they are going head-to-head in copying and experimenting with each other's retailing resources, capabilities and activities. While Walmart continues to be bigger with total net worldwide sales of $559bn compared with Amazon's $386bn in 2020, Amazon's market cap surpassed Walmart's already in 2015.[1] The two giants battle to acquire and build appropriate resources and capabilities suitable for the new retailing era. As Janey Whiteside, Walmart's chief customer officer, tells the *Financial Times*:[2]

> **It's competition for top of mind: what is the place you think of when you think, 'I want to buy a soccer ball, I want a dress, I want ground beef? The retailer that wins that top-of-mind [battle] becomes the go-to destination.**

Technology The two companies' investments in state-of-the-art technology reflect their different retailing backgrounds. As

an e-commerce pioneer, Amazon has introduced much of the necessary resources and capabilities for large-scale e-commerce. To support their website and app, Amazon built the cloud computing service, Amazon Webservices (AWS), which provided a solid digital technology infrastructure. It offered computing and storage capabilities for an increasing number of products and services and its success made Amazon also offer it to outside businesses.

Amazon acquired warehouse automation company Kiva 2012 and turned it into Amazon Robotics and continued to make substantial robot investments. Alongside the hundreds of thousands of employees at its fulfillment centers around the globe, Amazon uses close to 350,000 mobile drive unit robots.[3] Amazon also launched multiple hardware devices like e-reader Kindle, the tablet Fire, digital media player Amazon Fire TV and the voice command device Amazon Echo including digital assistant Alexa. A primary objective for these is to obtain more and better data to target products. Amazon pioneered web customisations and its AI supported recommendation engines not only exploit customer history, but shop cart mixes, similar users' shop carts, other personal preferences, behaviours, etc.

Walmart had been a pioneer in virtually all retailing technologies including launching its own satellites, first to use checkout barcodes, point of sales scanners, data interchange with suppliers, RFID,[4] etc. It has one of the largest US private databases tracking consumer patterns. In online technologies, however, it was initially a laggard, even though it early launched Walmart.com in the mid-1990s and tried to advance online technologies. After Amazon's great success, however, it made heavier e-commerce investments. From 2010 onwards, it made a string of acquisitions and several high-profile recruitments to build digital capabilities. It acquired search engine company Kosmix, renamed Walmart Labs and located in Silicon Valley, which brought competencies in advanced algorithms and personalised search and eventually employed over 3,000 engineers.

To gain further e-commerce capabilities, it acquired Jet.com in 2016, a marketplace for other retailers and acquired several specialty retailers like Bonobos, Hayneedle, etc. In 2020, the brick-and-mortar and e-commerce technologies were merged and became Walmart Global Technology. It also partnered with Google for voice shopping via Google Express and Home and took part-ownership of TikTok's US operations in 2020. In addition to its store cobots (collaborative robots for human-robot interaction), it added autonomous robotics to its regional distribution centres in a partnership with the US automation company Symbotic in 2021. CEO Doug McMillon is devoted to Walmart's digital transformation: **We're committed to building a larger, healthier ecommerce business. We're making progress on many fronts, but we need to do more and move faster.**

> **It's time for us to dial up our aggressiveness even more** [Walmart is] **in an early stage of building a new business model.**[5]

Stores and platforms Amazon dominates online while Walmart dominates offline, but they are both trying to catch up on each other's home turf. At the centre of Amazon's business is its AWS-based website and app platform on

which both products and customers have grown exponentially. From the early 2000s, it added multiple categories besides books and also launched Amazon Marketplace to allow third-party sellers on its platform. There are 20 marketplaces globally, including millions of sellers accounting for up to 90 per cent of listed products. Based on its popular premium subscriber service Prime, launched in 2015, customers get one-day free shipping for a flat yearly fee (then $79 and two-day shipping; now $139 and one-day shipping).

The more products, the more customers are attracted to Amazon's platform and the more customers the more third-party sellers like to do business on it. Hence, early on, it carefully built and managed network effects and ended up with the largest e-commerce platform in the world. It also added several other services and complementors where Amazon Prime members receive advantageous offers. These services include video streaming Amazon Prime Video, online music streaming Prime music, audiobooks provider Audible and acquired video game streaming Twitch.

In brick-and-mortar, Amazon experimented with and increased its presence step by step, eying the fact that more than 80 per cent of US retail sales remain offline. Especially grocery is far more dependent on bricks-and-mortar and offered the biggest potential for Amazon. As Vice-President of grocery, Stephenie Landry said:[6]

> **Our goal, from a grocery perspective, is to give customers the absolute best experience in terms of selection, price, quality, and convenience, no matter where they want to shop. All those shopping experiences** [online and offline] **should support one another.**

Table 1 Amazon and Walmart comparison

Source: Company reports, Statista (2020); from: D. Deagon (2021) ‘Amazon Vs. Walmart: The Epic Battle of Retail Kings Gets Hot’, *Investor’s Business Daily*, 23 August; and S. Hyken (2021) ‘Amazon Vs. Walmart – Goliath Vs. Goliath’, *Forbes*, 28 November.

Amazon first entered groceries with Amazon Fresh in 2006–7, an online and physical drive-in pick-up store. Whole Foods, with 470 upscale natural-food stores, was acquired in 2017. These were reconfigured to work like Amazon Fresh, which was relaunched in 2018 as a full offline supermarket, including trolleys fitted with computer vision, monitoring items picked and with Alexa voice assistants on every aisle. Physical bookstores were established in 2014 and, some years later, Amazon Go was launched, a fully automated convenience offline store without any checkouts. Analysts’ expected next step in Amazon’s bricks-and-mortar strategy would be clothing.

Walmart is huge compared to Amazon and employs 2.3mn in 24 countries and operates over 10,500 stores globally. Since the very beginning, its slogan has been ‘EDLP’ – Every Day Low Prices – based on the basic idea of high economies of scale and low prices. They are not only the largest retailer in the world, but the largest company overall based on turnover, giving them tremendous power over suppliers, something they are infamously known to exploit.

Although Walmart.com was launched already in 1995, it was inferior compared to only online retailers. Besides conflicts with store managers that did not want to drive sales online, there was also a general scepticism as most e-commerce, including Amazon, lost money initially. In the beginning of the 2000s, however, Walmart gained some success with their Site to Store concept including free shipping for online shopping with store pick up. The aim was to use their supremacy in bricks-and-mortar for e-commerce as 90 per cent of the US population live within 10 miles of a Walmart store. They offer over 80mn items online, the vast majority through its third-party sellers’ marketplace, even though it’s a fraction of what is available on Amazon. During the 2010s, they continued to closely integrate their stores and warehouse outlets with online and this seemed successful as they overtook Amazon in grocery e-commerce sales in 2020[7] and total online sales grew

by close to 80 per cent in 2021. However, they still only had 7 per cent of US e-commerce compared to Amazon's 40 per cent.[8] They expanded their customer loyalty program Walmart+ 2020–21 to compete with Amazon Prime, including fuel discounts and speedier shopping in stores as well as free online grocery delivery.

Logistics and distribution **The two giants had their strengths in different areas of logistics and distribution. Since Amazon set up their first fulfillment centres, they established more than 100 in the USA and close to 200 worldwide. Amazon started with third-party logistics but invested more and more in their own delivery services to avoid too much dependence on outside logistics like UPS and FedEx. This includes huge investments in air cargo hubs (one in the USA and one in Germany), over 80 cargo aircrafts and thousands of Amazon-branded trucks and trailers.**

To gain control and speed up last mile deliveries, Amazon started to establish smaller sorting centres for individual item picking. Prime Now hubs were thus established in densely populated areas in the USA and abroad with an exclusive focus on 1–2-hour deliveries to Amazon Prime members. Early on, Amazon introduced Amazon Hub Lockers, now available everywhere in over 900 US cities. They pioneered drone delivery systems with their Prime Air drones and Amazon Key, an in-home and in-car delivery service.

Walmart's fully integrated distribution and logistics set-up is one of the largest globally with 158 US distribution centres and around 200 outside the USA and a huge trucking fleet with 9,000 tractors, 80,000 trailers and more than 11,000 drivers.[9] It includes the most advanced inventory tracking systems and data-driven storage optimisation besides state-of-the-art merchandise assembly technologies and cross-docking systems (loading trucks on the other side without merchandise being stored). It was upgraded to deal with e-commerce from 2015 onwards, adding new automated fulfillment centres customised

to the local market. These were designed for small two-day shipping orders and regional and other distribution centres were also made to be better designed to fulfill e-commerce. Walmart also launched automated robot pickup towers inside stores. However, they were abandoned as customers preferred their quick curbside collection, which first proved to be a strength in groceries and increasingly so for other items.

Sources:

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Questions

1 Compare Amazon and Walmart and, based on the data from the case (and any other sources available), use the frameworks from the chapter and analyse their resources and capabilities:

   (a) What are their respective resources and capabilities?

   (b) What are their respective threshold and distinctive resources and capabilities?

2 Based on your initial analysis and answers to question 1, carry out one VRIO analysis for Amazon and one for Walmart:

   (a) What do you conclude?

   (b) To what extent does Amazon and Walmart respectively have resources and capabilities with sustained competitive advantage?

3 If you were a strategy consultant to Amazon and Walmart respectively, what advice would you give when it comes to resources and capabilities? Would you give them the same advice, or would it differ?

Chapter 6

Purpose and stakeholders

Key terms

Corporate social responsibility

governance

governance chain

hybrid organisations

purpose

stakeholders

stakeholder mapping

values

Learning outcomes

After reading this chapter you should be able to:

- Relate organisational *values* to an organisation's organisational purpose.
- Undertake *stakeholder analysis* in order to identify the power and attention of different stakeholder groups.
- Analyse the strategic significance of different *ownership models* for an organisation's strategy.
- Evaluate the implications for organisational purpose of *corporate social responsibility* and organisational *hybridity*.
- Propose *organisational governance systems* appropriate for safeguarding organisational purpose.

Long Description

6.1 Introduction

BlackRock is the world's largest asset management company, responsible for investments from pension funds, insurance companies, individuals, charities and universities totalling $9 trillion. In the Spring of 2021, Larry Fink, BlackRock Founder and Chief Executive, issued the latest of his annual 'letters to CEOs', the leaders of the companies he invests in. Reviewing lessons from the COVID crisis, he noted how 'purposeful companies' – committed to environmental, social and governance (ESG) objectives – had outperformed others. Larry Fink concluded: 'It is clear that being connected to stakeholders – establishing trust with them and acting with purpose – enables a company to understand and respond to the changes happening in the world. . . . The more your company can show its purpose in delivering value to its customers, its employees, and its communities, the better able you will be to compete and deliver long-term, durable profits for shareholders.'[1]

For Larry Fink, the most powerful investor in the world, it is clear that organisational purpose matters. **Purpose is concerned with the value an organisation seeks to create for its stakeholders, potentially including both financial and non-financial forms of value.** Purpose defines what a strategy is *for*: in other words, what the organisation is trying to achieve with its strategy. For a for-profit business, purpose might include not only making profits but creating value by providing products or services that enhance people's lives in various ways. As in Figure 1.4 in Chapter 1, purpose can provide a broad and inspiring frame within which strategic vision, mission and

objectives can be defined. Vision, mission and objectives should flow logically from purpose. Strategy is purposeful when purpose coherently informs the key strategic decisions of an organisation.

However, coherence around purpose is hard to achieve, with the potential for conflict, particularly between financial and non-financial forms of value. The chapter therefore addresses the relationship between purpose and the *goals* of various stakeholder groups. **Stakeholders are those individuals or groups that depend on an organisation to fulfil their own goals and on whom, in turn, the organisation depends.** It is the goals of stakeholders – including investors, customers, employees and communities – that typically inform organisational purpose. However, stakeholders vary in what they seek. Tying stakeholder goals together into a coherent organisational purpose is the role of organisational *governance*, the structures and systems by which organisations are held accountable for their actions. Effective governance is essential to keeping purpose and strategy aligned with the goals of the stakeholders upon which the organisation depends.

The three rings in Figure 6.1 encapsulate the relationships involved in purposeful strategy. At the core are the *values* (or ideals) that underpin stakeholder goals. These values are building blocks for the organisational purpose that forms the second ring. It is the outer ring of governance that should hold these elements together, ensuring that decision makers are accountable for consistency between the values, purpose and actual strategy. If this third ring of governance fails, then coherence between values, purpose and strategy is liable to collapse. Incoherence means confused employees internally and frustrated stakeholders externally.

This chapter addresses organisational purpose as follows:

- Section 6.2 starts with the *values* of organisational *stakeholders,* from which organisational purpose is formed.
- Section 6.2 continues with *stakeholder mapping*, analysing which stakeholders are most powerful and most attentive to strategic issues and then focusing on *owners*, typically a particularly powerful group of stakeholders.
- Section 6.3 then turns to *organisational purpose* itself, with its incorporation of both narrow economic goals and higher goals, such as environmental sustainability and societal welfare.
- Section 6.3 also considers *corporate social responsibility* and the management of *hybrid* organisations that combine widely different values in their strategies.
- Finally, Section 6.5 considers issues of *governance*, the systems that hold organisations accountable for the delivery of their organisational purpose.

Figure 6.1 Values, purpose and governance

The final Thinking Differently section considers the African concept of *ubuntu*, a more mutualistic way of considering stakeholders than the calculative traditional approach. The chapter case considers purpose and stakeholder interests at the Brazilian oil giant Petrobras.

6.2 Organisational and stakeholder values

Organisations often talk of ‘creating value’. For many organisations, this just means creating financial value in terms of profits. However, organisations can create value in other senses, for example, helping disadvantaged communities or introducing life-enhancing innovations. This section is concerned with the full range of values (or ideals) that can both inspire strategy and guide behaviours as it is implemented. As in Figure 6.1, these values are at the heart of strategy. Ultimately, organisational values derive from the values held by the organisation’s various stakeholders. Consistency with the values of important stakeholders (whether investors, employees or customers) is essential for organisations in order to maintain the support that allows continued operations. Ignoring the values of any one of these stakeholders can be fatal to the organisation. Investors can sell out, employees lose motivation and customers turn away in disgust.

6.2.1 Organisational values

Many organisations have explicit statements of their guiding values. These **organisational values are the underlying and enduring ideals, beliefs and principles that guide an organisation’s strategy and define the way that the organisation should operate**.[2] Values are, quite literally, what organisations value. For

example, the Charityworks organisation, devoted to recruiting and developing young talent in the United Kingdom non-profit sector, declares its values to include innovation, creativity, commitment and fun.[3] The leading strategy consulting firm McKinsey & Co. describes itself as a 'values-driven organisation', whose core values include putting the client's interests ahead of the firm's, maintaining an independent perspective and preserving client confidentiality. For McKinsey, these values 'inform both our long-term strategy as a firm and the way we serve our clients on a daily basis'. Recognising the challenges of staying true to its values, the firm reserves one day a year to reflect as a group on the meaning of its values for its work and the lives of its employees.[4]

These values define an organisation's operating principles, for example, fun at Charityworks or putting clients first at McKinsey. They set guidelines on what can and cannot be done. Adopted strategies should not violate these values. Values can also set the goals of strategy, crucial to issues of strategy evaluation, discussed in Chapter 13. By setting strategic goals, values shape what an organisation creates for its stakeholders as part of its purpose. For Charityworks above, the value of innovation would define a goal of creating new services, with success based, for example, on the number of young charity workers trained and employed. Values inform goals and then goals determine what is actually achieved. Thus, values shape the fundamental direction of strategy, providing the guiding light for what is appropriate for the organisation as a whole. Values are key drivers for strategy.

Values can be identified from the formal values statements many organisations publish, though these espoused values may differ from

values operating in practice. It is important to check formal value statements with what organisations actually do. Nonetheless, even operating values cannot diverge too far from the broader ideals from within the surrounding society: these are the norms of the institutional environment in Chapter 3. Even if they are operating within the letter of the law, organisations that flagrantly breach societal values will lose customers, alienate employees and embarrass investors (see Illustration 6.3 on Rio Tinto). Two sets of institutional norms are particularly influential on the values of contemporary organizations:

- the United Nations' 17 *Sustainable Development Goals* (SDGs) are a particularly influential source of values, with aspirations ranging from the elimination of poverty, through gender equality to climate protection (see also Chapter 3). In 2019, 17 leading corporations declared their support for the SDGs, declaring themselves 'Business Avengers'. These companies included Coca-Cola, Mars, Microsoft, Nike and Unilever. Recognising the 2030 deadline for delivering the SDGs, the 17 companies described the 2020s as the 'Decade of Delivery', promising to incorporate the United Nations' goals into their individual strategies. Thus, the consumer products company Unilever has a 'Compass Strategy' with specific targets such as 25 per cent recycled plastic usage by 2025 and zero emissions by 2030 (see Illustration 6.1 on Unilever).
- Another contemporary norm influential on values is *equality*, d*iversity and inclusion* (EDI). Diversity refers to the range of people employed within an organisation: such diversity might include gender, ethnicity, age, physical abilities, sexuality,

cognitive style, religion, education or class. Inclusion refers to whether this range of people feel that they belong and are truly heard, with representation at the top levels of the organisation. Equality refers to the policies that support diversity and inclusion in the organisation, ensuring that everybody has fair opportunities: this might include policies on gender or specific ethnic groups, for example. Strategies drawing on the values of equality, diversity and inclusion can make good business sense. The French energy management company Schneider Electric follows an EDI strategy for at least three reasons: it helps motivate employees; it reflects the diversity of its markets around the world; and it gives top management the breadth of perspectives it needs for strategic decision making in a complex business environment.[5]

Although many large companies do commit to widely shared values in society, they can experience conflict between the concerns of different stakeholders. The creation of 'shareholder value' in the form of financial profit for owners may contradict the broader social values of an organisation's other stakeholders.[6] See Illustration 6.1 on Unilever, for example. It is important, therefore, to understand the variety of stakeholders impacting on strategy and to grasp which stakeholders are most influential.

6.2.2 Stakeholder groups[7]

Organisational values are derived from the organisation's stakeholders. Their values shape both strategic decisions and the effectiveness of strategy implementation. Stakeholders are those

who have some *kind of stake in the future* of the organisation. These stakeholders depend on the organisation and, reciprocally, the organisation typically depends on them. Charities and non-profit organisations clearly have a range of stakeholders including both the groups they serve and those who fund them. However, profit-driven companies too can be very diverse in their stakeholders. In the Petrobras case at the end of this chapter, the Brazilian oil company identifies no fewer than 13 groups of stakeholders, including investors, customers, suppliers, the workforce, public authorities, scientists and local communities.

To the extent their organisations depend on them, managers must take all stakeholders into account. However, stakeholder demands can diverge widely: for instance, in many companies, profit maximisation on the part of investors may come at the expense of customers who want quality products, employees who want good jobs and groups in the wider society who want a clean environment. Each of these stakeholders has different degrees of power. It is important, therefore, that managers understand who their stakeholders are, what they value and which have most influence upon the organisation. Accordingly, stakeholders can be usefully divided into five (potentially overlapping) types, categorised according to the nature of their relationship with the organisation and how their values might influence strategic direction (see Figure 6.2):

- *Economic stakeholders,* including suppliers, customers, distributors, banks and owners (shareholders). The values of these stakeholders are typically economically orientated, concerned for profits, prices or similar. However, economic stakeholders may also adopt more social values, for instance

the sustainability of their supply chain. In 2022, 70 per cent of shareholders in Costco, the huge US warehouse chain, defied advice from the company's directors and voted for net-zero greenhouse gas emissions by 2050.

- *Social/political stakeholders,* such as policy-makers, local councils, regulators and government agencies that may influence the strategy directly or via the context in which strategy is developed. The values of these stakeholders are typically complex and diverse: they might try to combine social values with other benefits such as economic growth in their locality.
- *Technological stakeholders,* such as key adopters, standards agencies and ecosystem members supplying complementary products or services (e.g., apps for particular mobile phones). For these stakeholders, values such as innovation and information-sharing are typically important.
- *Community and society stakeholders,* who are affected by what an organisation does: for example, those who live close to a facility or, indeed, groups in the wider society. These stakeholders typically espouse social values, though economic benefits such as local jobs might be important too. Unilever emphasises 'planet and society' among its stakeholders (see Illustration 6.1).
- *Internal stakeholders,* who may be specialised departments, local offices and factories, or employees at different levels in the hierarchy. These internal stakeholders will share many of the values of society at large, but they will also have an economic interest in the success of the particular part of the organisation

in which they work. Unilever explicitly includes employees among its six sets of stakeholders.

Illustration 6.1 Unilever's purposeful mayonnaise?

In 2022, one of Unilever's major investors launched a stinging attack on Unilever's attachment to corporate purpose.

Unilever is a major consumer goods company with over 400 brands, including Dove soap, Dollar Shave Club, Sunsilk hair products, Hellman's mayonnaise, and both Ben & Jerry's and Magnum ice-creams. It employs 150,000 people around the world and sells products in 190 countries. Unilever identifies six stakeholders: its own employees, customers (retailers and supermarkets), end consumers, planet and society, suppliers and shareholders. The company claims four shared values: integrity, respect, responsibility and pioneering. Unilever also prides itself on its nineteenth-century origins as a business making cheap soap to help ordinary people keep clean on a daily basis, thereby fighting typhoid. Today, 2.5 billion people use its products every day. Unilever declares of its strategy: 'We are driven by our purpose: to make sustainable living commonplace.'

In line with this purpose, Chief Executive Alan Jope had launched Unilever's Compass strategy, focused on three challenges: 'to drive purpose and encourage behaviour change through more of our brands; to embed sustainability further into every part of our business; and to do more to actively bring others along with us'. In 2021, he explained his goal: 'to prove incontrovertibly that sustainable business does drive superior profit growth'. According to him, the big global challenges of climate change and inequality were a marketing opportunity: 'By making solutions to these challenges, the focus of our attention – and the essence of our brand propositions – we connect even more directly

with the billions of people around the world we serve.' Jope took as his example the Unilever mayonnaise brand Hellman's: 'Fighting against food waste – that is the purpose of Hellmann's.'

However, investors had mounting concerns over Unilever's strategy and performance. Since narrowly defeating a hostile takeover bid by the profit-driven US food company Kraft Heinz in 2017, its share price had trailed behind those of rivals such as Nestlé and Procter & Gamble. Ominously, the US activist Fund Manager Trian, which had intervened to boost the profit-focus of Procter & Gamble over recent years, had taken a stake in Unilever during 2021. In early 2022, top-10 shareholder Terry Smith declared his impatience with Unilever's low growth and poor profitability. Smith described Jope's account of Hellman's mayonnaise as 'ludicrous': He complained that top management talked too much 'corporate gobbledy-gook' and that it was 'obsessed with publicly displaying sustainability credentials at the expense of focusing on the fundamentals of the business'. Smith's punchline was: 'A company which feels it has to define the purpose of Hellmann's mayonnaise has, in our view, clearly lost the plot.'

CEO Alan Jope was responding to pressure from shareholders for greater growth already. In particular, Unilever was trying to re-orientate away from the low growth food businesses (of which Hellmann's was a part) towards businesses with better prospects such as health and beauty. At the end of 2021, Jope launched a $50bn takeover bid for GlaxoSmithKline's (GSK) consumer health unit, which had products like painkillers and vitamins. But GSK rejected the bid and Unilever dared not raise the price. When news of the failed bid came out, Unilever's shares dropped to their lowest level in five years, down a fifth from their level in 2019 when Alan Jope had become CEO.

Following the failure of his bid for GSK's consumer health unit, Alan Jope moved rapidly to 'Plan B'. The company announced a reorganisation into five business groups with cuts to 1,500 management job and cost-savings of €600mn over two years. Cost reductions would be key to improving profitability. Corporate purpose was played down.

Jope explained: purpose is ‘the icing on the cake, not the cake. It comes on top of getting the basics right’.

Main sources: Unilever Annual Report and Accounts, 2020; *Financial Times*, 12 January 2022 and 24 February 2022.

Questions

1 Describe how Unilever’s prioritisation of different stakeholders has seemed to change during the events in this Illustration. Why?

2 In what ways do you think that products such as Hellmann’s mayonnaise or Ben & Jerry’s ice cream can be made compatible with Unilever’s purpose?

Figure 6.2 Stakeholders of a large organisation

Source: Adapted from R.E. Freeman (1984) *Strategic Management: A Stakeholder Approach,* Pitman. Copyright 1984 by R. Edward Freeman.

Figure 6.2: Long Description

6.2.3 Stakeholder mapping[8]

Given that there are often so many stakeholders, it is useful to categorise them according to their likely influence on strategic decisions. In weighing up strategies, not all values are equal. Organisations are coalitions of stakeholders, each of which has different levels of power and each of which gives different amounts of attention to strategic issues.[9] **Stakeholder mapping identifies stakeholder power and attention in order to understand**

strategic priorities. Strategic priorities normally have to be consistent with the values of the most powerful and attentive stakeholders.

The power/attention matrix shown in Figure 6.3 classifies stakeholders in relation to the *power* they hold and their *attention* to particular strategic issues. The matrix allows different stakeholders to be plotted according to relative positions along continuous axes running from low to high. Stakeholders can be plotted on the matrix either according to the overall power and attention they exert on the organisation's strategy in general or according to the power and attention they exert on particular issues. While plotting stakeholders according to overall power and attention is a useful summarising device, it is important to understand that, in practice, stakeholder positions are likely to vary according to each issue: stakeholders may have more power in some domains than others and will care more about some issues than others. For example, shareholders may pay more attention to profits than to inclusion and diversity issues, while employees might take the opposite view. Power and attention can be assessed as follows.

Figure 6.3 Stakeholder mapping: the power/attention matrix

Adapted from R. Newcombe (2003) 'From client to project stakeholders: a stakeholder mapping approach', *Construction Management and Economics,* vol. 21, no. 8, pp. 841–8.

Figure 6.3: Long Description

Power[10]

In designing strategy, it is important to understand which stakeholders are most powerful. *Power* is the ability of individuals or groups to persuade, induce or coerce others into following particular strategies**.** Power not only derives from people's hierarchical position within an organisation or from formal corporate governance arrangements. Power can also be a function of the resources or know-how they control or the networks they have built up. For example, the walk-outs by Google engineers during 2018 were

effective in changing the company's approach to sexual harassment because the company depended so much on the engineers' expertise and support.[11]

The wide range of power sources underlines the importance of recognising different indicators of power. The powerful are not just those sitting at the top of the formal hierarchy. Some people may be influential because of their informal *status* within the organisation, for instance, as significant innovators in the past or as trusted advisers to top management.[12] Alternatively, they may be powerful because they provide a crucial resource and are collectively well-organised, as in the case of the Google engineers.

Attention

Attention matters as well as power.[13] *Attention* refers to how closely stakeholders monitor the activities of an organisation. Stakeholders vary in the attention they pay and which issues they care about. Even powerful stakeholders may not attend closely to everything. For example, many companies have institutional shareholders (e.g., pension funds) as major shareholders, but because these shareholders hold shares in many different companies, they may not care greatly about the detailed strategy of any single company.

In assessing the attention that stakeholders are likely to pay, three factors are particularly important:

- *Criticality*: stakeholders will pay more attention to issues that are critical for them. For example, shareholders might not see health and safety at work as critical, but employees very likely will.

- *Channels*: stakeholders will pay more attention where there are good channels of information and communication. For example, it is increasingly common nowadays for chief executives to invite their shareholders to ‘strategy days’ or ‘strategy reviews’, providing opportunities for detailed discussions of strategy that might otherwise not be possible.[14] Where channels are poor, stakeholders may be unable to pay sufficient attention even to issues they regard as critical: for example, many ethical investors (such as religious and political groups) care passionately about employment conditions for overseas workers, but lack the information channels to find out about them.
- *Cognitive capacity*: sometimes, stakeholders simply do not have the cognitive capacity to process all the information they have. Thus, institutional investors may have access to a host of information about the strategies of all the various companies they invest in, but reduce complexity by focusing on simple measures such as forecast financial earnings, rather than the details of company strategy.

The power/attention matrix of Figure 6.3 indicates the type of relationship that managers might typically establish with stakeholders in the different quadrants. Generally, relationships are more intense as they progress from quadrant D up to quadrant A. Thus, cultivating the support of key players (quadrant A) is of greatest importance: these might be major investors, for example. However, it is also important to satisfy the sleeping giants in quadrant B: these might be government regulators. Although sleeping giants might generally be relatively passive, difficulties can

arise when dissatisfaction awakens their attention and they reposition to segment A: here they may challenge the strategy. The gadflies in quadrant C, for example, community campaign groups, can usually be managed largely by information provision. Although not powerful themselves, it is important not to alienate such stakeholders because they can influence more powerful stakeholders: for example, community campaigners might awaken the giants in quadrant B.

The power/attention matrix is a useful tool for analysing potential coalitions of stakeholders for or against particular decisions. Aligning potential supporters for strategic initiatives is often crucial in the process of strategic change (see Chapter 16). Building supportive stakeholder coalitions is at the core of strategy, therefore.

6.2.4 Owners

Owners are typically key stakeholders in strategic decisions. However, their power and attention can vary according to different *ownership models.* Moreover, different owners may have different values.

Figure 6.4 Ownership, management and purpose

Figure 6.4: Long Description

There are many different ways organisations are owned, and the boundaries between them often blur.[15] However, it is useful to distinguish four main ownership models, each with different implications for strategy. Figure 6.4 ranges these four models along two axes. The horizontal axis describes the dominant modes of management, ranging from wholly *professional* (with managers employed for their professional expertise) to wholly *personal* (with managers employed because of their personal relationships with owners). The vertical axis describes the extent to which organisational values are focused on *profit* as an exclusive goal or

on profit as just one of a *mix of values.* In each case, there is a range along the axes: organisations with the same ownership model may vary in their relative positioning. Nonetheless, organisations with particular ownership models do tend to behave in distinctive ways.

The four main ownership models are as follows:

- *Publicly quoted companies* (often called publicly traded companies or public limited companies) are the most important ownership model in economies such as the USA, Europe, Japan and many others. These companies' shares are 'quoted' on public stock exchanges. In other words, their shares can be bought and sold by the public, either in the form of individual investors or, frequently, institutions such as pension funds, banks or insurance companies.[16] Usually, owners do not manage publicly quoted companies themselves, but delegate that function to professional managers. In this sense, owners of publicly quoted companies sacrifice some power, and reduce their attention. However, in principle, company managers work to make a financial return for their owners – that is why the public usually buy the shares in the first place. In terms of Figure 6.4, therefore, most publicly-quoted companies focus their strategies on profit. However, profit maximisation is rarely a simple goal for companies. There is often a delicate balance to be struck: short-term profits might be improved by cutting research budgets or taking advantage of loyal customers, but such action may well be at the expense of long-run profitability. In relation to the vertical axis in Figure 6.4, publicly quoted companies may, therefore, vary in how much they focus on profit objectives.

- *State-owned enterprises* are wholly or majority owned by national or sometimes regional governments. These state-owned enterprises make up about 10 per cent of the world economy, being particularly important in a wide range of countries such as Brazil, China, Russia and Singapore.[17] In state-owned enterprises, politicians typically delegate day-to-day control to professional managers, though they may attend more closely to major strategic issues. State-owned enterprises usually have to earn some kind of profit in order to fund investment and build financial reserves, but they are also likely to pursue a range of other objectives that are in keeping with government policy. Chinese state-owned enterprises, for example, are prepared to sacrifice some profits in order to secure access to overseas resources such as minerals or energy.
- *Entrepreneurial businesses* are businesses that are substantially owned and controlled by their founders. Founders are typically very powerful, because of their ownership, the respect they are held in and their deep knowledge of their businesses. Founders head some major companies. For example, Daniel Ek still runs Spotify, the world's largest audio streaming service founded in 2006. Nonetheless, as they grow, entrepreneurial businesses are likely both to rely more on professional managers and to draw in external investors in order to fund new opportunities. Typically, entrepreneurial companies need to attend closely to profit in order to survive and grow.[18] However, entrepreneurs may vary in their profit focus. For example, Jeff Bezos, as

founder of Amazon, for a long time favoured growth strategies over short-term profitability.

- *Family businesses* are typically businesses where ownership by the founding entrepreneur has passed on to his or her family, on account of the founder's death or retirement, for instance. Family firms account for 70 per cent of GDP in the global economy and 60 per cent of global employment.[19] Most family businesses are small- to medium-sized enterprises, but they can be very big: Ford, Fiat, Samsung and Walmart, the largest retailer in the world, are all under family ownership and retain significant family involvement in top management roles. However, family members may lack the skill and inclination to attend closely to strategy. Family businesses, therefore, often bring in professional managers, even while retaining ultimate family control: the Chief Executive of Ford is a non-family member, but the Executive Chairman is still William Ford Jr. For family businesses, retaining control over the company, passing on management to the next generation and ensuring the company's long-term survival are often very important objectives, and these might rule out profit-maximising strategies that involve high risk or require external finance. Therefore, a family business might diversify into lots of small businesses rather than engage in one large one, because that would minimise risk and give a chance to younger family members to work in distinct areas of activity.[20] See Illustration 6.2 on Zee Entertainment for a family business trying to pass on control to the next generation.

As well as these four main types of ownership model, there are several other variants that play smaller but still significant roles in the economy, as follows:[21]

- *Private equity funds* buy firms in order to supply capital and managerial expertise, with the aim of boosting performance and selling the firms on for a profit after several years. Private equity-owned firms usually pursue strategies likely to show sharply improved financial performance within a limited time period.
- *Non-profit* organisations are typically owned by a charitable foundation: they may need to make some kind of surplus to fund investment and protect against hard times, but their strategies are fundamentally about social missions.
- *Partnerships* are owned and controlled by senior employees (the partners) and are important in many professional services such as law and accounting where collective commitments to professional standards are important. As in the earlier example of McKinsey (a form of partnership), professional standards of independent advice may work against short-term profit objectives.
- *Employee-owned* firms spread ownership among employees as a whole. Prominent examples of employee-owned firms include W. L. Gore & Associates, famous for Gore-Tex, the Spanish Mondragon Cooperative, with 75,000 employees, and John Lewis, one of the UK's leading retailers. Profits are important, but are shared with employees, who also favour secure jobs.
- *Benefit corporations* (or B corporations) have a legal status committing them to the joint pursuit of commercial goals and

public benefits (in the UK, they are called community interest companies). Examples include the trendy Warby Parker glasses company, which donates glasses to people in need, and Patagonia, the outdoors company that supports the environment.

Clearly, everybody should know how the ownership of their own organisation relates to its strategy: as above, strategy for a state-owned business is likely to be very different from that of a publicly quoted company. However, it is also important for managers to understand the ownership of other organisations with which they engage, for example, competitors and partners. Different ownership models will drive their strategic decisions in sometimes unconventional directions. Without understanding the relationship between ownership and strategies, it is easy to be surprised by competitors and partners with different priorities to your own. For example, Western public mining companies have often found themselves outbid for overseas mining opportunities by Chinese state-owned enterprises, which are keen to secure raw material supplies at almost any price.

Illustration 6.2 Succession: Zee's father and son problem Investors rebel against family-dominated governance at Zee Entertainment Enterprises

Subhash Chandra Goenka (who goes by just his first two names) is the billionaire chairman of his family's business, the Indian conglomerate Essel Group. In 1991, Chandra launched Zee Entertainment Enterprises as India's first satellite television company. With a record of producing cheap and cheerful mass-market entertainment, Zee has since grown into a giant of the Indian media market with revenues of just over $1bn. It accounts for about 19 per cent of India's television viewership and has also built important digital platforms, with over 150 exclusive original titles and a library of 4,500 movies. Zee describes its purpose as 'to create the extraordinary'. The company also declares: 'our leaders are the north to our compass. Their experience, diversity, commitment, passion and determination inspire to go beyond.'

But, in 2021, it was leadership that was becoming the problem at Zee. Subhash Chandra had long ago withdrawn from executive leadership of the company, serving as Chairman Emeritus. Two sons were now prominent in the business: Amit Goenka, President Digital Businesses and Platforms and Punit Goenka, Managing Director and CEO of Zee as a whole. Punit Goenka had taken control of Zee in 2009 at the age of 33. His promotion came after an earlier career in his father's various businesses as well as a couple of failed enterprises of his own. He had successes at Zee, allowing the creative talents at the company sufficient space to develop some notable hits (for example, the dance competition *Dance India Dance*). However, Punit stood in marked contrast to his maverick entrepreneurial father. One former manager commented about when Punit

came into the office: ‘That he wouldn’t say anything different or radical is a stretch. Goenka wouldn’t say anything at all.’

Investors were becoming increasingly concerned. By 2021, Zee’s share price was less than one third of what it had been just three years earlier. At the same time, Punit Goenka had enjoyed a 46 per cent pay rise, while he’d had a 20 per cent cut. Moreover, Subhash Chandra had had to sell a large chunk of his shares in the company because of disastrous investments elsewhere: his stake had fallen from 35 per cent of the company to just 4 per cent. One of the investors who had picked up shares in the fire-sale had been the giant US asset manager Invesco, ending up as the largest shareholder with 18 per cent. In an open letter of complaint about the situation at Zee, Invesco wrote in September 2021: ‘the promoter family of Zee [the Goenkas], with the support of its current board of directors, continues to evade accountability to its ordinary shareholders, who own 96% of Zee’s equity. This lack of governance oversight by Zee’s current board has permitted Zee’s deep entanglement with the financial distress of its founding family . . . ’. Invesco’s letter demanded new independent directors, transparency about dealings with the Goenka family’s other businesses and the removal of Punit Goenka as CEO. Zee’s share price leapt by 40 per cent on the news of this shareholder revolt.

Subhash Chandra reacted strongly, using his own television station to declare: ‘Zee is not a company – it is an emotion. The audience is the owner. If they want to let the company go, I can’t do anything. But I trust them – and the government – that they will not let this happen.’ A member of the Upper House of the Indian Parliament, and a supporter of the governing BJP Party, Chandra whipped up nationalist sentiment against foreign investors. At the same time, he sought out a rescuer. Just 10 days after the Invesco letter, Zee announced a merger with the Indian operations of the Japanese company Sony. Sony would own 53 per cent of the merged entity, but Chandra’s son Punit Goenka would remain as CEO.

Main sources: *Financial Times*, 13 October 2021; *ZeeBiz*, 5 October 2021; *Moneycontrol*, 14 September 2021; https://stg.zee.com/about-us/ [available: June 2022].

Questions

1 What does the case of Zee tell us about the possible dangers of family ownership?

2 What would you advise Sony to do with regard to the management and governance of the new merged company (see Section 6.4)?

6.3 Organisational purpose

The notion of organisational purpose acknowledges that organisations may be driven by non-economic values. While many organisations are exclusively focused on profit, and some employees motivated primarily by the financial rewards, purpose increasingly draws on the social values of key stakeholders. Purpose becomes strategic when it is incorporated into the mission, vision and objectives of the organisation (see Chapter 1). Mission, vision, objectives and purpose should all be aligned. Organisations frequently publish their mission, vision and purpose on their websites, though (as with values) these official declarations should be read critically.

However, while purpose does acknowledge obligations to society at large, commitments to social responsibility can vary from the minimal to the transformational. Purpose can also introduce tensions between financial and social interests: organisations become 'hybrids', combining different principles for action. This section explores different levels of commitment to corporate social responsibility and ways of managing organisational hybridity.

6.3.1 Social responsibility[22]

An underlying theme in this chapter is the question of whether organisations are just for the benefit of a primary stakeholder, such as the shareholders of a company, or whether they have a responsibility to a wider group of stakeholders. This section

considers different approaches to *corporate social responsibility* in strategy.

The regulatory environment may determine an organisation's minimum obligations towards its stakeholders. However, stakeholders typically expect greater responsibility on the part of organisations, and managers' own personal ethics are likely to set higher standards too. **Corporate social responsibility** (CSR) **is the commitment by organisations to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large.**[23] CSR is, therefore, concerned with the ways in which an organisation exceeds its minimum legal obligations. Social responsibility feeds into organisational purpose.

Table 6.1 Corporate social responsibility approaches

Different organisations take different approaches to CSR. Table 6.1 outlines four basic types to illustrate these differences. They represent progressively greater commitments to the higher goals of organisational purpose and a greater breadth of criteria against which strategies will be judged. The discussion that follows also explains what such approaches typically involve in terms of the ways companies act.[24] Illustration 6.3 discusses the approach of leading mining company Rio Tinto, plunged into crisis in 2020.

The *laissez-faire* view (literally 'let do' in French) represents an extreme stance. In this view, organisations should be let alone to get on with things on their own account. Proponents argue that the only

responsibility of business is to make a profit and provide for the interests of shareholders.[25] There is no direct responsibility to any other stakeholders beyond what is prescribed by law. It is the government's job to protect society through legislation and regulation. Expecting companies to exercise social duties beyond this only confuses decision making, introduces additional costs and undermines the accountability of managers to their shareholders. In this view, society benefits anyway from the profits: after all, these can either be used for further investment in the business or be paid out to shareholders, who may be pensioners relying on the income or similar. This laissez-faire stance may be taken by executives who are persuaded of it ideologically or by smaller businesses that do not have the resources to do other than minimally comply with regulations. There is no organisational purpose in the sense of commitment to higher goals than financial performance.

Enlightened self-interest is guided by recognition of the potential long-term financial benefit to the shareholder of well-managed relationships with other stakeholders. Here, the justification for social responsibility is that it makes good business sense. For example, an inspiring organisational purpose will generate employee energy and improve internal collaboration.[26] Building supportive coalitions with a range of stakeholders, even critical ones, can increase organisational resilience in times of crisis.[27] It is this sense of enlightened self-interest that BlackRock chief Larry Fink was appealing to in his letter to CEOs at the beginning of this chapter. Indeed, there is mounting evidence that responsible strategies can also reward shareholders.[28] Thus, like any other form of investment or promotion expenditure, corporate philanthropy or welfare

provision might be regarded as sensible expenditures. These enlightened self-interest organisations often publish *Environmental-Social-Governance (ESG)* or *Integrated* reports, providing public indicators of their performance across a range of measures relating to the environment, human capital and governance arrangements, for example.[29] Enlightened self-interest does allow for organisational purpose, with higher goals than just profit, but it does not expect these higher goals to entail any long-term sacrifice.

Illustration 6.3 Rio Tinto follows the rules

Explosive decisions at Australian-British mining corporation Rio Tinto cost top management their jobs

Rio Tinto is the world's second largest mining corporation, producing iron ore, copper, diamonds, gold and uranium all over the world. It has joint head offices in London and Melbourne and worldwide revenues of $63bn in 2021. It is highly profitable, with profits before tax multiplying more than ten times in the period 2003–21. But, at the end of 2020, its CEO, Jean-Sébastien Jacques, and two other senior executives were forced by investors to leave their jobs.

The source of the trouble was a Rio Tinto iron ore mine in the Pilbara region in northern Australia. Pilbara comes from an Aboriginal word for 'dry'. The region is sparsely populated, hot and characterised by a red dust that speaks to its rich iron deposits. Rio Tinto has operated in the area since 1996, now possessing 16 mines supported by four port terminals and 1,700 kilometres of rail track. The Pilbara operations have 13,600 employees; 12 per cent of the residential workforce are Aboriginal.

In 2013, Rio Tinto got permission to expand one of its mines to pursue a further $135mn worth of iron ore. But expansion meant blasting two Aboriginal rock shelters,

Juukan Gorge 1 and 2. These rock shelters dated back 46,000 years and were the only inland site in Australia showing continuing human occupation through the last Ice Age. Burchell Hayes, leader of the local Aboriginal people, protested: ‘To us, it is not rocks and carvings. To us this is precious. It means something to us: many years ago, our ancestors looked after this. It was very important to them and now it’s passed on to us and that’s why it’s very important for us to look after this.’

Rio Tinto got legal permission to expand its mines before they fully discovered the significance of the rock shelters. Full knowledge only came from an archaeological report received afterwards. Top management chose not to read this report and the company proceeded with the mine expansion anyway. Local people were not told of three options for mine expansion that would have preserved the rock shelters. Indeed, they did not hear of the planned blast until 14 May 2020, the day after the company began to set explosives around the shelter. Despite local objections, Rio Tinto continued its preparations and hired lawyers to prevent any protests. Rio Tinto delayed a few more days, then blew the two shelters to smithereens.

CEO Jean-Sébastien Jacques told a subsequent Australian parliamentary inquiry that he was not aware of the significance of the shelters until after they had been exploded. The company simply relied on the permission granted back in 2013; it was not obliged, under the relevant legislation, to revise its plans, in the light of subsequent knowledge. Nonetheless, angry investors demanded action. Top 10 investor Legal & General stated: ‘Managing the social licence to operate is crucial for all mining companies. We are disappointed by this incident and are concerned about the implications for the ongoing relationship with local communities.’ CEO Jacques and the two other senior executives were forced out.

Local people were not entirely against Rio Tinto. The company provided jobs and a share of mining revenues went to the local community. Leader Burchell Hayes called for co-management of resources: ‘That co-management is to ensure that those voices that are normally silent when it comes to . . . mine development, mine planning, that there is

a voice there, a traditional owner voice. To make sure that they're hearing us and we work together to get an outcome where we are able to still protect and preserve our cultural landscape and the mining companies are able to continue doing their work.'

Sources: *Guardian,* 18 May 2021; *Financial Times*, 7 June 2020; 7 August 2020; *Science Alert*, 28 May 2020.

Questions

1 Which of the four approaches to CSR did Rio Tinto appear to follow (see Table 6.1)? What approach would you recommend for a mining company operating in sensitive locations around the world?

2 With regard to governance and management (see Section 6.4), what should investors insist on for Rio Tinto in the future?

A *forum for stakeholder interaction*[30] explicitly incorporates multiple stakeholder interests and expectations rather than just shareholders as influences on organisational purposes and strategies. Here, the argument is that the performance of an organisation should be measured in a more pluralistic way than just through the financial bottom line. Such organisations typically adopt the principle of *sustainability* in strategy, offering a better quality of life by attending to all three dimensions of environmental protection, social responsibility and economic welfare. Performance here is often measured and rewarded in terms of *the triple bottom line* – social and environmental benefits as well as profits (see Section 13.2.1). Companies in this category might retain uneconomic units to preserve jobs, avoid selling 'anti-social' products and be prepared to

bear reductions in profitability for the social good. This approach does accept some possible sacrifice in pursuit of the higher goals of organisational purpose.

Shapers of society regard financial considerations as of secondary importance or a constraint. These are visionary organisations seeking to transform society and social norms. Public-sector organisations, social movement organisations and charities are often committed to this kind of stance. There are also *social entrepreneurs* who found new organisations that earn revenues but pursue a specific social purpose (see Chapter 11). For example, Traidcraft UK is a public limited company with a chain of retail shops that fights world poverty by promoting 'fair trade'. For shapers of society, the social role is the *raison d'être* of the business, not profits. Financial viability is important only as providing the means for continuing the social mission. These organisations adopt the strongest form of organisational purpose.

6.3.2 Managing hybrid organisations

For many organisations, the different stakeholder values that inform organisational purpose effectively makes them organisational hybrids. **Hybrid organisations combine values and structures that would not normally go together**.[31] Many public-sector organisations have to combine potentially conflicting values: for example, Amsterdam's city authority trades off some economic growth against achieving social goals (see Illustration 6.4 on Amsterdam's doughnut economic model). Similarly, social enterprises combine what would otherwise be charity or public-

sector objectives with private-sector business models: for example, as a B corporation (see Section 6.2.3), coffee-company Cafédirect sells coffee commercially but donates half its profits to its coffee growers. However, organisational purpose means that even purely private sector organisations can take on hybrid characteristics: businesses strive to reconcile economic motives with social and environmental commitments (see again Illustration 6.1 on Unilever).

One way in which hybrid organisations manage these combinations of values and structure is the *virtuous circle* model (see Figure 6.5a). Here, strategy is set to serve both social objectives and financial objectives at the same time. The social and the financial feed into each other in a self-reinforcing circle. The pursuit of social goals provides some economic benefit (for example, more committed employees or more attractive products), thereby generating more profits which, in turn, can be invested into advancing social goals still further. This is the enlightened self-interest model of Section 6.3.1. Managing virtuous circle organisations involves making sure that financial objectives continue to serve social objectives. For example, the more profits Cafédirect makes, the more it can give to its coffee growers, and (hopefully) the higher quality of its coffee beans.

Illustration 6.4 Amsterdam: doughnut or bagel?

The city of Amsterdam's doughnut model trades-off economic growth against social and sustainability goals.

Amsterdam is the capital of the Netherlands, with a population of nearly 900,000. It is home to the fifth largest sea port in Europe and the third largest airport (Schiphol), the headquarters city for leading Dutch companies such as Philips, TomTom and Booking.com, and the European base for many US technology companies such as Uber, Netflix and Tesla. Moreover, Amsterdam is both beautiful with its canals and culturally rich, with its famous Rijksmuseum and many festivals, including the Amsterdam Gay Pride and the Cannabis Cup.

Yet, Amsterdam has problems and a doughnut may be part of the solution. To start with the problems, these include health, housing, crime, poverty and climate. For example, around 40 per cent of Amsterdam's citizens are overweight and 49 per cent have a moderate to high risk of depression or anxiety. In 2018, almost 60,000 home-seekers applied for social housing, but only 12 per cent were successful. Almost 20 per cent of city tenants are unable to cover their basic needs after rent. Because of the urban heat-island effect, temperatures in Amsterdam can be up to 5°C warmer than surrounding areas.

The city of Amsterdam believes that doughnut economics can help. Doughnut economics is the creation of Oxford economist Kate Raworth. The thinking is symbolised by a ring doughnut. The circular doughnut itself describes a regenerative and distributive economy, built on enough economic growth to deliver a safe and just space for humanity but not too much to endanger it long term. The doughnut ring is the social foundation for this regenerative and distributive economy: there must be enough economic growth to deliver social necessities such as housing, health and gender equality. This hole in the middle of the doughnut is a place nobody should be left in: not enough growth. Outside the doughnut ring is a zone that goes beyond the world's ecological ceiling, involving dangers such as ozone layer depletion, biodiversity loss and air pollution. The doughnut's outside edge is where economic growth exceeds the limits of a sustainable economy.

In doughnut economics, maximising economic growth is no longer the primary objective. Instead, policy analysis is based on distances from the centre of the doughnut. Traveling out from the centre, the first economic risk is of not going far enough to reach a safe and just space for humanity (the ring itself): the economy falls short in terms of housing, health, equality, and so on. The second risk is of going too far from the centre, overshooting the ring and breaching the ecological ceiling: rapid economic growth jeopardises the climate, biodiversity, and so on. The point of doughnut economics is to set economic objectives so they exactly reach the mid-point of safety and justice, attaining the social foundation but not going so far that they exceed the ecological ceiling. The safety and justice of the doughnut's actual ring is the sweet spot for policy, neither too much nor too little.

In 2020, Amsterdam's city government officially adopted doughnut economics as a guide to policy. This led to several innovative initiatives. Many citizens lacked the computer access to participate fully in city life, but instead of just buying new computers, the city collected old computers and refurbished them to give to those in need. Similarly, the city has established repair shops for clothing, so that old clothes are not just thrown away. In the massive Beach Island housing project, all materials must have 'passports' so that when the buildings are taken down, the city can recycle the parts.

Sceptics complain that doughnut economics is superficial, compromising with a fundamentally unsustainable form of capitalism. The Beach Island housing might be recyclable, but profit-driven developers had negotiated the provision of less cheap housing than normally required by the city. One local Socialist councillor complains: 'We don't need doughnut economics; we need bagel socialism.'

Sources: *Amsterdam City Doughnut: A Tool for Transformative Action*, Doughnut Economics Action Lab (DEAL), *et al.*; *Time Magazine*, 22 January 2021; *Jacobin*, 24 September 2021.

Questions

1 Could the concept of doughnut economics be translated to the context of a private company? How does it relate to the dynamic balance model (Section 6.3.2) of hybrid organisations?

2 To what extent is doughnut economics enough to solve problems like adequate housing (see the Beach Island example)? Is there anything else that could be done?

This virtuous circle model of mutually reinforcing social and financial objectives is exemplified by the *shared value* approach of Harvard Business School's Professor Michael Porter.[32] The principle of shared value involves creating economic value by addressing social needs and challenges. Social demands are not a constraint but a source of economic opportunity. There are three key opportunities for creating shared value:

- *By reconceiving products and markets:* for example, food companies might redefine their product as about health rather than taste.
- *By redefining productivity in the value chain:* for example, reducing both cost and carbon emissions by sourcing locally rather than from far away.
- *By building local communities ('clusters'):* for example, improving workforce skills by investing in local education facilities.

A second way of managing the challenges of hybridity is the *dynamic balance* model. This fits situations where social and financial objectives conflict with each other. In these situations, there are real trade-offs between different objectives: one stakeholder group is liable to benefit at the expense of others, at least in the short term. Here, strategy must navigate between opposing values, with the balance between them adjusting to circumstances over time (Figure 6.5b). This is closer to the stakeholder interaction model of Section 6.3.1 and is the situation that faces many organisations, especially in highly competitive markets.

The dynamic balance model offers three ways of managing the tensions between social and financial objectives:[33]

- Establishing *organisational guardrails*: top managers can install structures or systems that safeguard the social aspects of purpose. For example, in 2019, Facebook (now Meta) responded to criticisms of its social media by setting up an independent Oversight Board, including 20 societal leaders and industry experts from outside the company. This Oversight Board helps keep Facebook's strategy within certain limits, for example, on privacy and hate-speech. In Figure 6.5b, the guardrails might be seen as the two horizontal arrows that set boundaries for organisational conduct: although strategy might go closer to either financial or social goals at various points in time, it never goes over either boundary.
- *Dynamic decision-making*: here, decision makers recognise the importance of responding flexibly to changing circumstances, altering the balance between financial and social goals over time. In Figure 6.5b, this flexibility is represented by the curving

strategy line between the two horizontal guardrails. Thus, the yoga-apparel company Lululemon Athletica oscillates between an employee-centric culture and a more hard-hitting managerial style. The company avoids settling on one extreme or another and, instead, repeatedly readjusts as circumstances require. In favourable economic times, it might be possible to do more for social goals; in tougher times, it might be better to focus temporarily on financial goals.

- *Both/and leadership*: leaders need to be committed to both social and financial aspects of organisational purpose, not see themselves as the guardians of just one or the other. For example, the chief finance officer (CFO) should regard themself as the guardian of *both* financial *and* social assets. The CFO is not just worried about money. Conversely, the Chief Purpose Officer (CPO) – a senior management role at companies ranging from accountants Deloitte to healthcare company Roche – should champion *both* financial performance *and* social purpose. The CPO is not just a champion of purpose. The principle of both/and supersedes either/or.

Figure 6.5 Two models of purpose in hybrid organisations

Figure 6.5: Long Description

6.4 Organisational governance

Organisations are held accountable for their purpose by systems of corporate governance. **Governance is concerned with the structures and systems of control by which managers are held accountable to those who have a legitimate stake in an organisation.**[34] Key stakeholders in governance are typically the owners, but may include other groups such as employee representatives. Connecting stakeholder values with management action is a vital part of strategy. Failures in governance have contributed to calamitous strategic choices in many leading companies, even resulting in their complete destruction. In 2020, the CEO of Wirecard, the German fintech company, was arrested on suspicion of falsifying financial accounts and the company went bankrupt with debts of €3.5bn and a further €1.9bn unaccounted for. The non-executive directors of the company, its auditors and the German financial regulator had all failed to ensure proper control over the company. With the survival of whole organisations at stake, governance is increasingly recognised as a key strategic issue.

Managers and stakeholders are linked together via the governance chain. **The governance chain shows the roles and relationships of different groups involved in the governance of an organisation.** In a small family business, the governance chain is simple: there are family shareholders, a board with some family members and there are managers, some of whom may be family too. Here there are just three layers in the chain. However, large publicly quoted corporations have more extended governance

chains, potentially diluting accountability for strategy. Figure 6.6 shows a governance chain for a typical large, publicly quoted corporation. Here, the size of the organisation means there are extra layers of management internally, while being publicly quoted introduces more investor layers too. Thus, individual investors (the ultimate beneficiaries) often invest in public corporations through investment funds such as unit trusts or pension funds. Investment funds then invest in a range of companies on behalf of beneficiaries, providing them with limited reports on portfolio performance. In turn, the investment funds receive reports from the companies they invest in, in the form of briefings and annual accounts, the responsibility of company boards of directors. Boards are themselves at the top of an internal chain, in which each layer reports on performance against budgets and target, both quantitatively and qualitatively (i.e., verbal reports). In sum, the managers at the bottom are accountable to the ultimate beneficiaries at the top, but only through many layers of reporting. Beneficiaries may not even know in which companies they have a financial stake and have little power to influence companies' strategies directly.

Figure 6.6 The chain of corporate governance: typical reporting structures

Source: Adapted from David Pitt-Watson, Hermes Fund Management.

Figure 6.6: Long Description

Economists analyse the relationships in such governance chains in terms of the *principal–agent model*.[35] Here, 'principals' employ 'agents' to act on their behalf, just as homeowners pay estate agents to sell their homes. Classically, the principal is simply the owner and the agent is the manager. However, the reality for large publicly

quoted corporations is usually more complex, with principals and agents at every level. In Figure 6.6, the beneficiaries are the ultimate principals and fund trustees and investment managers are their immediate agents in terms of achieving good returns on their investments. Further down the chain, company boards can be considered as principals too, with senior executives their agents in managing the company. Thus, there are many layers of agents between ultimate principals and the managers at the bottom, with the reporting mechanisms between each layer liable to be imperfect.

The governance issues in principal–agent theory arise from three problems:

- *Knowledge imbalances.* Agents typically know more than principals about what can and should be done. After all, it is they who are actually doing the job and they have presumably been hired for their expertise.
- *Monitoring limits.* It is very difficult for principals to monitor closely the performance of their agents. This limit is made worse because principals usually have many investments, so their attention is likely to be split several ways.
- *Misaligned incentives.* Unless their incentives are closely aligned to principals' interests, agents are liable to pursue other objectives that reward them better. Principals might introduce bonus schemes in order to incentivise desired performance, but then agents may game the system: for example, they might use their superior knowledge to negotiate bonus targets that are, in reality, easy to meet.

Principal–agent theory, therefore, stresses the importance of knowledgeable principals, effective monitoring systems and well-designed incentives in order to make sure that large organisations actually pursue the purposes that their owners set for them. Illustration 6.3 on Zee Entertainments reveals some of the problems of shifting ownership and the mixing of principal and agent roles.

Thinking Differently Ubuntu ethics versus stakeholder analysis

The southern African idea of ubuntu prioritises relationships rather than stakes

Ubuntu comes from the word for 'humanness' in the Nguni language spoken widely in southern Africa. The South African leader Archbishop Desmond Tutu explained: 'Ubuntu is very difficult to render into a Western language. It speaks of the very essence of being human. When we want to give high praise to someone, we say: "Yu, u nobuntu"; "Hey, he or she has ubuntu". This means they are generous, hospitable, friendly, caring and compassionate. They share what they have. It also means my humanity is caught up, is inextricably bound up, in theirs. We belong in a bundle of life.'

This human ethic of ubuntu offers a very different way of recognising mutuality in organisations than the Western stakeholder approach. The stakeholder approach is calculative and analytical, weighing up interests, power and attention: participants matter according to the size of their stakes. Ubuntu is about human relationships. Participants matter not because of their stakes, but because of the length and depth of their relationships. Participants do not have separate interests in an organisation but a shared identity in the common enterprise. Ubuntu is about the dignity of all. Goodwill rather than the satisfaction of wants is a governing principle.

The ubuntu ethic leads to some specific kinds of management practice. One or even two sets of ‘stakeholders’ would never be prioritised wholly above others. Decisions would be consensual, avoiding outright opposition from one group or another. Relationships would be put above efficiency: a long-term supplier would be retained even if a new supplier offered a lower price. Leaders would be ‘servants’ of their communities and teams.

Of course, ubuntu has a downside. It is sometimes associated with nepotism, giving undue weight to family and other close relationships. But when so much about stakeholders is hard to calculate and analyse precisely, the broad ethic of ubuntu may be a good place to start out from.

Sources: D. Lutz (2009) ‘African Ubuntu Philosophy and Global Management’, *Journal of Business Ethics*, vol. 84, pp. 313–28; M. Woermann and S. Englebrecht (2019) ‘The Ubuntu Challenge to Business: from Stakeholders to Relationholders’, *Journal of Business Ethics*, vol. 94, pp. 29–38.

Questions

1 Explain the ways in which ubuntu could (in principle at least) produce more benefits for all organisational participants than a calculative approach such as stakeholder analysis.

2 Are there situations where ubuntu might be disadvantageous?

Key takeaways In undertaking any strategy analysis, it is important to understand what the strategy is *for*, in other words, what it aims to do. This chapter, therefore, raises several key issues that you should address:

- Make sure the organisation's fundamental *values* align with its organisational *purpose*.
- Check how well does the organisational purpose fit the values of the most *powerful* and *attentive* stakeholders.
- Assess how appropriate is the organisation's commitment to corporate social responsibility, on the range from *laissez-faire* to *shaper of society*.
- Ask to what extent the organisation is a *hybrid*, and how does the organisation manage any tensions between financial and social goals, either as a *virtuous circle* or as a *dynamic balance*?
- Design *governance* arrangements to ensure the alignment of the values of key stakeholders with the strategy of the organisation, particularly with regard to potential tensions between *principals* and *agents*.

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

6.1 For an organisation of your choice, identify its values (based on a formal statement from its annual report or website). Consider what would be good measures of such value-driven behaviour in practice, and assess how you think the organisation is doing in these respects (alternatively, take one of the examples in the chapter: Charityworks, McKinsey & Co. or Unilever).

6.2* Using the stakeholder mapping power/attention matrix, identify and map out the stakeholders for the Evaluating the Mexican Narco-trafficking Business case* or an organisation of your choice in relation to:

(a) current strategies

(b) different future strategies of your choice.

What are the implications of your analysis for the strategy of the organisation?

6.3 For an organisation of your choice, identify its main owners. What implications does its ownership have for strategy?

6.4* Identify the key corporate social responsibility issues that are of major concern in the The Global Pharmaceutical Industry*, H&M in fast fashion*, or PensionBee* industries or an industry or public service of your choice. Compare the approach of two or more organisations in that industry, and explain how this relates to their competitive standing.

6.5* For Petrobras (end of chapter case) or Seplat* or an organisation of your choice, map out a governance chain that identifies the key players through to the beneficiaries of the organisation's good (or poor) performance. To what extent do you think managers are:

(a) knowledgeable about the expectations of beneficiaries

(b) actively pursuing their interests

(c) keeping them informed?

Integrative assignment

6.6 Using specific examples, suggest how changes in corporate governance and in expectations about corporate social responsibility may require organisations to deal differently with environmental opportunities and threats (Chapters 3 and 4) or develop new capabilities (Chapter 5).

Recommended key readings

- A recent practical treatment of corporate purpose is C. Mayer and B. Roche (2021) *Putting Purpose into Practice: The Economics of Mutuality*, Oxford University Press. A broad textbook covering both corporate governance and corporate social responsibility is A. Rasche and M. Morsing (2017) *Corporate Social Responsibility: Strategy, Communication, Governance,* Cambridge University Press. Specifically on corporate governance, a leading guide is B. Tricker (2015) *Corporate Governance: Principles, Policies and Practices*, 3rd edn, Oxford University Press. For a comprehensive review of corporate social responsibility, see A. McWilliams, D.E. Rupp, D.S. Siegel, G.K. Stahl and D.A.Waldman (eds) (2019), *The Oxford Handbook of Corporate Social Responsibility*, Oxford University Press.

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3. https://www.charity-works.co.uk/mission-vision-values/ [accessed: June 2022].
4. https://www.mckinsey.com/about-us/overview/our-purpose-mission-and-values [accessed: June 2022]. There have been several occasions in McKinsey's history when the firm has not lived up to its stated values, including advising the Purdue pharmaceutical company on the miss-selling of addictive opioids and working with corrupt organisations in South Africa.
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9. W. Ocasio (2011) 'Attention to attention', *Organization Science,* vol. 22, no. 5, pp.1286–96.
10. D. Buchanan and R. Badham (1999) *Power, Politics and Organisational Change: Winning the Turf Game,* Sage, provide a useful analysis of the relationship between power and strategy.
11. R. Whittington and B. Yakis-Douglas (2020) 'The Grand Challenge of Corporate Control: Opening strategy to the normative pressures of networked professionals', *Organization Theory* vol.1, no. 4: 2631787720969697.

12. M. Nordqvist and L. Melin (2008) ‘Strategic planning champions: social craftspersons, artful interpreters and known strangers’, *Long Range Planning,* vol. 41, no. 3, pp. 326–44.
13. W. Ocasio, T. Laamanen and E. Vaara (2018) ‘Communication and attention dynamics: an attention-based view of strategic change’, *Strategic Management Journal,* vol. 39, no., pp. 155–67. See also Chapter 16.
14. R. Whittington, B. Yakis-Douglas and K. Ahn (2016) ‘Cheap talk? Strategy presentations as a form of impression management’, *Strategic Management Journal,* vol. 37, no. 12, pp. 2413–24.
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Case example Petrobras: keep on trucking *Petrobras has a complex set of stakeholders, but it has been Brazil's truckers who have recently been behind the firing of two Chief Executives.*

Petrobras (Petróleo Brasileiro) is Brazil's largest company. It was established by the Brazilian Government in 1953 with a monopoly of oil production in the country. The inspiration was the nationalistic slogan 'O petróleo é nosso' ('The oil is ours'). At the time, Brazil produced only 2,700 barrels of oil per day. By 2021, Petrobras was producing a record 2.2 million barrels of oil per day, with about 0.4 million barrels of gas per day as well. The company targets a production increase of more than 15 per cent over the coming five years, particularly from the company's off-shore operations in the Atlantic. Petrobras describes its purpose today as to 'purpose today as providing energy in a way that is ethical, safe and competitive and to ensure prosperity and to be the best in their field focusing on oil and gas and creating value and sustainability whilst maintaining safety and a respect for people and environmental issues.'

Petrobras' stakeholders Petrobras' recent history has involved a complex relationship with a Brazilian state that has oscillated between detachment and intervention. As such a large company, it is an important source of revenues for the Brazilian state: in 2021, Petrobras paid $27 billion in dividends to the federal government. However, Petrobras' monopoly in Brazilian oil production was formally ended in 1997 and foreign companies were allowed into the country for the first time. That same year, the company was partly

privatised, with shares eventually floated on the New York Stock Exchange. The Brazilian Government still directly or indirectly owns 64 per cent of the voting shares. The Florida investment management firm GQG Partners owns nearly 5 per cent of the shares, and the Scotland-based Baillie Gifford investment firm owns nearly 3 per cent.

However, it is not just investors who matter. Petrobras itself identifies 13 sets of stakeholders: the workforce, civil society organisations, communities, competitors, consumers, customers, investors, partners, press, public authorities, resellers, the scientific and academic community, and suppliers. The company's annual report comments: 'We undertake activities with great capillarity [network connectedness] that put us in daily contact with a wide variety of audiences . . . We are in constant dialog [sic] with these groups.'

With regard to stakeholders within the company itself, Petrobras has just over 40,000 employees, down from 86,000 in 2013. In addition, there are over 90,000 service providers operating in various Petrobras units. Petrobras participates in the Brazilian Government's Gender and Race Equity Program. In 2020, about 85 per cent of management positions in the company were held by people identifying as white (against about 45 per cent of the Brazilian population as a whole); about 20 per cent of managers were women. Given that many of its investments risk displacing indigenous peoples, Petrobras committed to consultation with affected communities and pledged to 'avoid or reduce the need for permanent displacement of individuals and communities as much as possible, but when necessary promote equal treatment [and] actions that guarantee similar or better living conditions than existing ones.' Believing in the energy of culture and sport as well, Petrobras offers an extensive programme of sponsorship for the arts and sporting activities.

Suppliers had been one set of stakeholders that have recently enjoyed undue priority. As a major part of the Brazilian economy, Petrobras has very large contracts to give out,

in construction and many other industries. In 2014, a judicial investigation known as Lava Jato (Operation Carwash) was initiated into corruption associated with these contracts. Jobs for Petrobras would be over-charged, and part of the profit would be paid back to the company's executives at Petrobras and to politicians from various political parties. By the end of 2017, 300 people had been convicted for their parts in the corruption. Among the many high-profile convictions were the former President of Brazil, Lula da Silva, who was sentenced to 12 years in jail; the Chief Executive of Odebrecht, the biggest engineering and contracting company in Latin America, who was sentenced to 19 years in jail; and the Chief Executive of Petrobras itself, Aldemir Bendine, who was sentenced in 2016 to 11 years in jail.

Pedro Parente took on the role of Petrobras Chief Executive in 2016 on three conditions: in future, the company's managers would be hired on merit rather than political connections; economic rationality would dictate strategy, not politics; and the company would manage petrol pricing, independent of politics. A new Brazilian law banning political appointments in state enterprises provided support for his independent approach. Parente sold for $2.35bn a major stake in one of Petrobras' key oilfields to the Norwegian oil company Statoil. He also prepared for the sale of the company's vast petrol station network. By early 2018, Parente was able to declare a turnaround from losses to profits before extraordinary expenses (these include a $3bn settlement on a shareholder lawsuit in the USA). Debt was cut by 12 per cent. The stock price had quadrupled from the depths of 2016.

However, Parente then ran into trouble. The Brazilian economy was only recovering slowly from an economic crisis, estimated to be its worst ever, between 2014 and 2016. The *Financial Times* described the economy as moving 'from zombie to walking dead'. Unemployment was still high and inflation was running ahead of wage growth. Petrobras responded by increasing its diesel prices by 10 per cent. For Brazilians, fuel prices had reached their second highest level ever, higher than those in the USA. This particularly mattered to one powerful set of stakeholders: truck drivers.

Petrobras stakeholders map

Source: www.petrobras.com.br/en/about-us/profile/stakeholders/ [accessed: June 2022]

Long Description

The 600,000 members of the Brazilian Truckers Association responded to the diesel price rise by going on strike. Truckers blocked roads with their trucks and burning tires. Petrobras' workers, whose numbers had been cut by a third in the previous four years, joined the strike as well. There were 10 days of chaos and sporadic violence. Airports ran out of fuel, factories shut down, hospitals ran short of medicines and supermarkets could not be supplied. Strike actions only died down after Brazil's then President cut the diesel price by 12 per cent and the judiciary started levying heavy fines on the trade unions. Discouraged by the reversal of pricing policy, Petrobras' Chief Executive Pedro Parente resigned in June 2018. The company's share price fell by 15 per cent.

New regimes One prominent politician who had offered qualified support to the truckers was Jair Bolsonaro. A former army officer, Bolsonaro was a strong Brazilian nationalist. He was keen to exploit the country's vast natural resources, whether those in the off-shore oil-fields in which Petrobras specialised or in the Brazilian forests with their huge potential for agriculture, logging and mining. In the presidential elections of October 2018, Bolsonaro emerged triumphant. President Bolsonaro pledged to promote national pride and economic liberalism. Bolsonaro's new Economics Minister would be the former investment banker and University of Chicago economist Paulo Guedes, an enthusiast for privatisation and free markets.

At the beginning of 2019, Petrobras got a new Chief Executive, Roberto Castello Branco. Castello Branco was another University of Chicago economist, a personal friend of Paulo Guedes and a believer in the market. Even before taking up formal office, Castello Branco got involved in developing Petrobras' 2019–2023 Business and Management Plan. The Plan committed the company to the divestment of non-core businesses and to partner with foreign companies where their resources could help in local developments. At the same time, the Plan set ambitious targets for further debt reduction and profitability improvements. Investment would be cut by roughly a third. The company declared its intent to achieve a 'cultural transformation', with a strong emphasis on efficacy, merit, flexibility and value. In his inaugural speech as Chief Executive, Castello Branco declared: 'The company's core competency is in oil exploration and production in large fields in ultra-deep waters. The focus should be on the assets of which Petrobras is the natural owner, those from which it can get the maximum possible return.' By early 2019, Petrobras' stock price was two thirds higher than it had been at the time of Pedro Parente's resignation in the summer of the previous year.

The focus on the core competency of oil exploration and production had implications for Petrobras' sustainability strategy. During the second decade of the century, Petrobras had entered into renewables, for example, partnering in 2017 with the French energy company Total to help it develop a low-carbon energy mix. Now, CEO Castello Branco determined to get out of its renewable initiatives such as the wind-power business and a small solar energy development. The purpose of Petrobras was still energy, but not any kind of energy: it would just do what it did best. Sustainability initiatives would be focused on decarbonising oil and gas production, for instance, by reducing the burning off of surplus gas produced in the oil production process and making its off-shore production platforms all electric. The company targeted a 25 per cent reduction in carbon emissions from operations by 2030.

CEO Castello Branco was also committed to market-pricing and, as the world recovered from the COVID crisis, oil prices internationally were moving up too. Petrobras took advantage by pricing its domestic fuels according to the international market. From December 2020 to February 2021, the company announced four price hikes, amounting together to a 35 per cent rise. Many poor households, reliant on gas canisters for cooking, were badly affected and so too of course were the truckers. Some truckers went on strike, prompting fears of a re-run of the violent and crippling strikes of 2018. President Bolsonaro faced elections in 2022 and truckers were a core part of his support. First, Bolsonaro cut taxes on diesel. Then he fired Castello Branco. Petrobras' share price fell by a fifth in a single day.

Again, Petrobras got a new CEO. Bolsonaro appointed Joaquim Silva e Luna, a 71-year-old general in the reserve army who had previously been a defence minister. Silva e Luna had no experience of the oil industry. However, as trucker unrest continued throughout the year, new CEO Luna kept in touch with the truckers' leaders, saying: 'Petrobras seeks to understand society's actors, evaluate the best way to contribute to all of them and is always open to dialogue.'

Note: **in English, the final ‘as’ in Petrobras is pronounced similarly to the initial ‘as’ in the English word ‘ascertain’.**

Main sources: www.petrobras.com.br/en/society-and-environment/sustainability-report/ [accessed: June 2022]; https://petrobras.com.br/en/about-us but there is a page linked there which is : https://petrobras.com.br/en/about-us/strategic-plan/ [accessed: June 2022]; *Financial Times,* 4 March 2021; *CPG.com*, 6 July 2021; *Off-shore energy.biz*, 4 January 2019.

Questions

1 To what extent has Petrobras kept true to its stated purpose and vision in the period described by the case?

2 Identify at least five key conflicts between stakeholders' interests at Petrobras. Which are the most powerful stakeholders?

3 Identify at least two ways in which ownership has influenced the strategy of Petrobras.

Chapter 7

Culture and strategy

Key terms

cultural web

legitimacy

organisational culture

organisational identity

paradigm

recipe

strategic drift

Learning outcomes

After reading this chapter you should be able to:

- Analyse how *history, geography and organisational fields* influence the culture of an organisation.
- Analyse the influence of an *organisation's culture* on its strategy using the *cultural web.*
- Recognise organisational *identity* claims, as distinct from actual organisational culture.
- Identify organisations that may be experiencing symptoms of *strategic drift.*

Long Description

7.1 Introduction

Ren Zhengfei, founder of Chinese mobile phone manufacturer Huawei, likes to talk about his company's 'wolf culture'. This opportunistic and aggressive culture is an important driver of Huawei's rapid growth from foundation in 1987 into a multinational corporation with 200,000 employees worldwide and sales of over $120bn by 2021. In little more than three decades, Huawei's wolves have taken the company into new markets such as laptops, cloud services and the Internet of Things and established it as the world's largest applicant for international patents (see also Illustration 7.3).

Huawei exemplifies the importance of culture for strategy more generally. In this book, **organisational culture is the taken-for-granted assumptions and behaviours of an organisation's members**. Culture's influence penetrates deep within organisations. Mark Fields, former President of Ford Motor Company, famously remarked: 'culture eats strategy for breakfast'. By this, Fields was emphasising how culture helps to define the strategy of the organisation. However, the importance of culture does not mean that strategy itself is pointless: rather, culture should be seen as *part* of the strategy, something that can be a source of competitive advantage and, to some degree, something that can be managed strategically too.

Organisational culture is a key strategic factor therefore. As in Chapter 5, culture can provide organisations with hard-to-imitate knowledge about how to do things distinctively and well: in this sense, organisational culture is potentially a basis for competitive

advantage. This chapter explores the roles of culture more deeply, with a particular emphasis on how culture helps shape strategic choices, as follows:

- Section 7.2 explores where organisational cultures come from in the first place, particularly the influences of *history*, *geography* and organisational *fields.*
- Section 7.3 examines the elements of organisational cultures and *subcultures,* distinguishing the various layers.
- Section 7.3 also introduces the *cultural web* as a framework for the analysis of organisational cultures, elaborating seven interlocking components.
- The chapter concludes with Section 7.4 considering two ways in which culture directly influences strategic choices: more deliberately through the concept of *organisational identity* and more passively through the concept of *strategic drift*. Figure 7.1 summarises the structure of this chapter.

Figure 7.1 Culture and strategy

Figure 7.1: Long Description

7.2 History, geography and fields

At a minimum, culture involves shared values and expectations about life, including organisational life.[1] Huawei's culture values opportunism and aggression. Shared values and expectations are influenced by the history of the organisation and its members, by the geographies from which they come and by the 'fields' (communities or sectors) in which they operate.

7.2.1 Historical influences

Many organisations' websites have sections describing their 'roots', their 'history' or their 'heritage'. For example, the large Indian Tata Group, founded in 1868, recalls how its founder, Jamsetji Tata, was 'a patriot and a humanist' whose ideals still shape its five core values of integrity, responsibility, excellence, pioneering and unity.[2] The cultures of entrepreneurial start-ups are often informed by their founders' personal histories. At Spanx, the shapewear company, the proactive culture of seizing opportunities comes from how founder Sara Blakely was inspired by the early deaths of three close friends while she was still a teenager: Blakely learned that you should take every opportunitie you get in life. History, therefore, is a fundamental part of organisational culture and, thereby, strategy itself.[3]

Figure 7.2 is a schematic representation of four kinds of relationship between the past and current organisational cultures: *continuity, selection, rupture* and *rediscovery*.[4] The horizontal axis looks back from the present to organisational origins. The vertical

axis offers a rough measure of relative cultural distance from the organisation's origins, with continuity representing the least distance and rupture the greatest. However, history does not simply determine the culture; it is often something that is actively curated or even consciously manipulated. History is a resource to be managed.

Figure 7.2 Four relationships between history and culture

Figure 7.2: Long Description

Historical continuity

Organisational cultures often become deeply entrenched. New recruits are attracted by particular cultural features and these features become entrenched as employees consciously or unconsciously reproduce them over time. Leaders who have come up through the organisation tend to support the culture that produced them. In Figure 7.2, this kind of continuity is represented by a

continuous line, sloping gently from the organisation's original culture. The slope acknowledges some movement as the organisational culture adapts to a changing environment, but change is steady and small: the Tata Group's Indian patriotism today is different from Jamsetji Tata's patriotism under the British Raj, but there is continuity in the importance of patriotic values. With continuity, strategy is liable to follow largely consistent trajectories; stakeholders and competitors can expect few big surprises.

However, continuity is not simply passive. The Italian design icons Alessi, Alfa Romeo, Ducati and Piaggio actively manage their companies' pasts, investing in corporate museums and commissioning books to retell their corporate histories.[5] At Piaggio, the marker of Vespa scooters and founded in 1884, the Chairman describes the importance of the company's history 'to understand the value of what we have done, make sense of our actions, and draw inspiration and a new impetus for the future'. Companies can draw on the historic designs found in their corporate museums to inspire new products and use stories of the glorious past to strengthen the emotional bonds of employees and customers with their companies' products. BMW maintains a futuristically designed museum in Munich as an inspiration for its designers: the old cars on display affirm continuities with an illustrious past while the dramatic architecture points to the future. Piaggio sees its historical continuity as a distinctive strength: 'Our competitors do not have a history they can use as we do.'

Historical selection

In Figure 7.2, the second historical influence on culture highlights deliberate selectivity with regard to the past. The dashed line represents elements from an organisation's history that are selected for inclusion in the organisation's present strategy. The gaps between the dashes indicate that the past is only partially incorporated into the present strategy: there is not complete continuity, with gaps being filled as required. History is a resource that can be drawn upon in pieces, giving the culture legitimate roots but without the risk of being trapped wholly in old-fashioned nostalgia. The result can be relatively extensive change.

The large Japanese brewery Gekkeikan, founded in the seventeenth century, exemplifies this selective approach to corporate culture.[6] In the nineteenth century, family leaders enunciated principles for the brewery that emphasised family values, Buddhism, the importance of employees and dedication to the production of the best sake in Japan. These principles resonated for over a hundred years. However, in 1997, the company's fourteenth generation family leader laid out a set of three 'Basic Principles' that emphasised creativity in terms of management and technology, humanity towards employees and the production of the best sake in the world. At the end of the twentieth century, Gekkeikan recognised that the original commitments to family values and Buddhism were no longer appropriate. However, the company added a new emphasis on creativity while retaining its historic promises to employees and quality production. This moment of selective change is represented by point A in Figure 7.2: the continuous evolution after that point is again represented by the sloping line subsequent to that.

Historical rupture

Whereas the previous two relationships suggest various degrees of respect for history, sometimes organisations attempt radical cultural change, making a wholesale rupture with their past. Here, history's purpose can be to sharpen the contrasts between the radical changes required in the present and the unhelpful legacies of the past (indeed, the old is often simplified, in a variant of the selective approach above). In Figure 7.2, rupture is represented by the large vertical shift in corporate culture at point A.

This kind of historical rupture is typically emphasised by managers dealing with crisis, for example, radical technological disruption (see Chapter 11) or severe performance deficits (see Chapter 16). History is important as the benchmark against which to measure cultural change. In 2021, US energy giant Chesapeake Energy went bankrupt after the failure of the previous strategy based on environmentally unfriendly shale oil and debt-fuelled expansion (the responsible CEO died in a car-crash the day after being charged for corruption). Chesapeake's new CEO emphasised the company's rupture with the past: 'Our gas will be responsibly sourced. We will not break the balance sheet. We are not the old Chesapeake.'

Historical rediscovery

Another form of change is that which rediscovers the old culture, or at least parts of it. Such rediscovery often comes after some kind of strategic failure. As reflected in the downward movement at point B in Figure 7.2, the organisation attempts to rediscover valuable elements of the old culture after deviating radically from the original track. Like the selectivity approach above, there are legitimacy

benefits here, but this approach is about turning back rather than justifying the new. Reference to the better times of the past provides a clear image of what is required and makes the rejection of the recent past more absolute. The template for the new culture lies in the past.

As an example, in 2018, the Italian fashion company Benetton, famous in the 1980s and 1990s for its bright colours and bold advertising, brought back as senior managers co-founder Luciano Benetton and his sister Guiliana: the two aged respectively 83 and 81. Luciano Benetton argued that, in a time of disposable 'fast fashion', the Benetton tradition of durable classic designs could be a source of renewed competitive advantage. One of the company's first acts under the new/old management was to reissue a line of t-shirts from the last century.

Given the potential importance of history, historical analysis can provide insight into an organisation's current and future strategy. There are two key forms of historical analysis:

- *Chronological analysis.* This involves setting down a chronology of key events in the organisation's history. Organisations will often provide a basic chronology on their websites, but strategic disasters are likely to be underplayed on these, so further analysis using independent sources will often be useful. It is valuable here to identify key events that are seen as turning points as they may indicate future turning points to come. For example, the arrival of Tim Cook at Apple following the death of founder Steve Jobs is a key turning point in the company's history, suggesting that his own future departure may be another moment of radical change.

- *Historical storytelling.* How do people tell their organisation's history? As above, many organisations will have parts of their websites dedicated to their histories, and some even commission business historians to write books on their histories.[7] The stories people tell can offer revealing clues about how the organisation sees its past, not least in terms of the origins of success. IKEA often tells the story of how flat-packed furniture began at the company when a worker of the company disassembled a table to fit inside a car. Stories also have implications for future strategy. At IKEA, the story of flat-pack promotes practical improvisation and adaptiveness in strategy. IKEA's strategy is unlikely to be wholly top down and discontinuous.

Illustration 7.1 The family bank For the Rothschild family, two centuries of banking experience can be useful.

In 2018, Alexandre de Rothschild became the head of Rothschild & Co., a Anglo-French bank that traces its existence seven generations back to Mayer Amschel Rothschild, born in 1743 in Frankfurt's Jewish ghetto. Alexandre was just 37 years old. He had trained at the French École Supérieure du Commerce Extérieur, then worked in US investment banking and private equity, before spending a decade back in France managing parts of the family business. Rothschild & Co. has 3,500 employees in over 50 offices around the world, with 3 main businesses: Global Advisory, Wealth and Asset Management, and Merchant Banking. The Rothschild family owns 49 per cent of the company and controls 58 per cent of the voting rights.

The French banking business was founded in 1812 by one of the five sons that Mayer Amschel Rothschild originally sent out from Germany to various countries around Europe. Another successful son established, in 1810, the London bank that funded the British war against Napoleon in this period (the other sons established banks in Austria, Italy and Switzerland). However, the French business suffered two major blows in the twentieth century: first, Nazi persecution forced the family to flee to New York during the war; second, the election of Francois Mitterand as French President led to the bank's nationalisation in 1981. The head of the bank Guy de Rothschild is often quoted as saying in the 1980s: 'First Jewish under Pétain (the French President who collaborated with the Nazis); now pariah under Mitterand. That is enough for me.' Guy de Rothschild retired from banking, going back to the United States in disgust.

However, in 1984, his son David de Rothschild established a small specialised bank in France under the name of Paris Orléans, an old company that the family had owned since the mid-nineteenth century. He had very little capital and a staff of just 10, including his cousin who had returned from a finance career on Wall Street. However, David de Rothschild was supported by the head of the London Rothschild bank, Evelyn de Rothschild, as well as by various prominent French businessmen, including the head of a Marseille bank that had helped the Rothschilds during the war. The family had always been well connected in France, with the old bank having trained Georges Pompidou, French President during the 1970s, and the new bank training Emmanuel Macron, elected President in 2017. In 1993, Paris Orléans won the contract for privatising the French car giant Renault, marking its return to large-scale banking.

David de Rothschild instituted several management principles for his bank. He promoted collegiality rather than the internal competition common in investment banking. He refused to act for companies engaged in hostile or predatory takeovers. Unlike similar boutique banks, he did not offer senior managers any shares. For him, all this was important to the family nature of the business.

At the same time, from 2002 onwards, the Parisian and London Rothschild banks began to cooperate more, sharing out markets as 'Groupe Rothschild'. In 2012, the two banks merged completely, under the leadership of David de Rothschild. In 2015, the banking name of Paris Orléans was replaced by Rothschild & Co. Its logo was a shield with five arrows, representing the five sons of Mayer Amschel Rothschild.

Under the leadership of Alexandre de Rothschild, the merged bank looked set to do more in the world of high technology. However, Rothschild & Co's website in 2018 states clearly: 'As a business controlled by certain members of the English and French Rothschild families, we have always been driven by the Rothschild family motto "*Concordia, Integritas, Industria*" (consensus, integrity and hard work).'

Sources: Les Echos, 16 April 2018; *Financial Times,* 30 June 2018; **www.rothschildandco.com** [accessed: June 2022].

Questions

1 In terms of Figure 7.2, how would you describe Rothschild & Co's relationship with its history? In what ways is its history valuable?

2 Which elements of the cultural web (Figure 7.6) are prominent in this account of Rothschild banking?

7.2.2 Geographical influences

Many researchers have shown how attitudes to work, people, the long-term and other important factors vary in different geographies, national or regional. Such differences have been shaped by powerful forces concerned with history, religion and even climate over many

centuries. Geert Hofstede of Maastricht University traces cultural differences between the countries of southern and northern Europe to the boundaries of the Roman Empire 2,000 years ago.[8] For example, he suggests Germanic cultures tend towards Individualism while Latin cultures are more Collectivist (or group-orientated). According to Hofstede, these kinds of entrenched cultural differences still influence the way organisations are managed around the world. One cultural factor that is particularly important for strategy is Future Orientation: Chinese, German, Japanese and South Korean cultures tend to be high in Future Orientation, implying greater commitment to long-term strategies. When Chinese technology company Alibaba was founded in 1999, it declared its aspiration to last 102 years, crossing three centuries.

International human resources consultancy SpencerStuart surveyed 12,800 *Harvard Business Review* readers globally to identify cultural patterns across the world.[9] Although this sample was biased towards English-speakers in international business organisations, some clear differences emerged. SpencerStuart differentiated cultures on two dimensions:

- attitude towards people, either independence or interdependence: independence implies individualism rather than group orientation
- attitude towards change, either flexibility or stability: flexibility implies a preference for adaptability over consistency.

These two dimensions defined eight cultural orientations: for example, one orientated towards *enjoyment* of work, high on Independence and relatively high on flexibility; one orientated

towards *order*, high on interdependence and relatively high on stability; and another orientated towards *results*, keen on individual performance. Figure 7.3 identifies the regions that ranked highest relative to others in terms of each of these orientations (the differences between the highest and second highest can be small and Africa is highest on two orientations). On this basis, South America ranks highest on enjoyment and Western Europe is highest for order. These different orientations have implications for strategy. For example, organisations with a *learning* orientation, associated particularly with Africa, may tend towards more experimental strategies than organisations with a *safety* orientation, associated with Eastern Europe.

While geographical cultural differences can be important, they should not be exaggerated. Generalising about countries or regions should be done very cautiously. After all, countries vary widely within themselves: consider the cultural differences between different parts of Nigeria, Southern and Northern Italy or the East and West Coasts of the United States.[10] Individuals too differ enormously within a particular geographical culture. It is crucial not to stereotype. Nevertheless, certain geographical cultural tendencies can be observed and we should be sensitive to the ways in which people from different geographies may vary. When discussing strategic options in an international context, it is helpful to be aware that not everybody will be equally comfortable with flexibility or independence and that colleagues, customers and competitors might not share your particular ‘Future Orientation’.

Figure 7.3 How corporate cultures differ around the world

Source: Adapted from: SpencerStuart, 'Culture Alignment Framework — a uniquely powerful tool for aligning strategy and culture', available at: https://www.spencerstuart.com/what-we-do/our-capabilities/leadership-consulting/organizational-culture [accessed: June 2022] and J. Yo-Jud Cheng and B. Groysber (2020) 'How Corporate Cultures Differ Around the World', HBR.org, 8 January.

Figure 7.3: Long Description

7.2.3 Field influences[11]

As in Chapter 3, an organisational field is a community of organisations that interact more frequently with one another than with those outside the field and that have developed a shared culture. Fields can extend beyond the economic actors of particular

industries, for example, firms, customers and suppliers. They can also include relevant regulators, professional bodies, university researchers, specialist media and even campaign groups. The concept of field extends analysis beyond just economic transactions to include wider networks and the shared assumptions and beliefs that interacting network members have.

For example, in the organisational field of pharmaceuticals, there are many different types of organisation, such as pharmaceutical companies, hospitals, pharmacies, regulators, government health departments, university researchers, campaign groups, and specialist journals and media. The roles of each are different, they all have cultural specificities and their views on how pharmaceutical benefits should be achieved may vary widely. However, despite their differences, all these organisations share a commitment to the ideal that health is a good thing and worth striving for; they interact frequently regarding this ideal; they have developed shared ways of understanding and debating issues that arise; and they operate a set of standard procedures helping them interact with each other. Similar cultural coherence is common in other organisational fields: for example, professional services such as law and education or sectors such as software development and journalism.

Where such shared assumptions and beliefs are powerful, these organisational fields help set the institutional ‘rules of the game’ (Section 3.2.6) or ‘institutional logics’ (see Thinking Differently at the end of this chapter). Through these rules or logics, fields influence the ways managers see their activities, define strategic options and decide what is appropriate. Three concepts are useful here:

- *Categorisation.* The ways in which members of an organisational field categorise (or label) themselves and their activities have significant implications for what they do.[12] To cat-egorise a mobile phone as primarily a personal computer or a fashion statement rather than a phone changes the whole strategy. Over time, members of an organisational field tend to converge on dominant categorisation schemes. For instance, the early car industry had competing categories of 'horseless carriage' and 'automobile'; in computing, there were competing categories of 'pen-computing' and 'tablets' to describe more or less the same thing. Converging on the categories of automobile and tablet helped define the respective industries' subsequent developments.
- *Recipes.* Because of their shared cultures, organisational fields tend to cohere around standard ways of doing things, or 'recipes'. **A recipe is a set of assumptions, norms and routines held in common within an organisational field about the appropriate purposes and strategies of field members.**[13] In effect, a recipe is the 'shared wisdom' about what works best. In English Premier league football, the standard approach is a 'talent-based recipe', where teams compete each year to hire the best players because they believe that individual talent is what delivers results. An alternative recipe of developing team spirit and skills over the long term, as in Germany, is little contemplated in the English Premier league. Accordingly, English and German football clubs tend to follow different strategies.

- *Legitimacy.* Where categories and recipes have become strongly institutionalised over time, they become the only legitimate way of seeing and behaving. **Legitimacy is concerned with meeting the expectations within an organisational field in terms of assumptions, behaviours and strategies.** By conforming to legitimate norms within the field, organisations can secure regulatory approval, financial support, supplier commitment and public endorsement. Non-conformist strategies may be risky because important stakeholders (such as customers or bankers) may not see such behaviours as appropriate. Therefore, organisations tend to *mimic* each other's strategies. There may be differences in strategies between organisations, but those differences tend to be limited by what is seen as legitimate: organisations seek 'optimal distinctiveness', trading off competitive differentiation for the benefits of legitimacy.[14] Legitimacy helps explain why accounting firms and universities, for example, tend to mimic each other, following similar strategies, promoting similar products and hiring similar people. It might be reckless for an accounting firm or university to embark on a radically different strategy.

Illustration 7.2 Learn the culture proper to each. University pays a price for success The controversy surrounding the University of Bath's Vice-Chancellor raises issues about both corporate culture and organisational field.

In 2018, Glynis Breakwell stepped down after 17 years as Vice-Chancellor (chief executive) of the University of Bath. For a new university situated outside any major city,

the University of Bath had experienced remarkable success during Breakwell's term of office. She had presided over a doubling in student numbers since her start in post. The University had achieved the highest possible ratings from the government's teaching assessment system, it ranked among the top 12 universities for research in the United Kingdom and, overall, it was rated as the country's fifth-best university in the influential *Guardian University 2018* guide. Yet, Breakwell retired from her position surrounded in controversy.

The University's motto is taken from the Latin poet Virgil: 'Learn the culture proper to each after its kind.' This is a message of respect. The University's 2016–21 Strategic Plan reinforced this message by describing as one of its five key attributes: 'A supportive culture: creating a welcoming, inclusive community that values the individual and supports the realisation of their potential.' However, by the last year of Breakwell's tenure, one of the University's trade union leaders was accusing her of creating a 'culture of fear'.

Breakwell had been well rewarded for the university's successes. Breakwell's total package increased from £349,000 in 2011 to £451,000 in 2016, a proportional rise far ahead of that of most of her staff, taking Breakwell's pay to the highest among British universities. The number of other staff in the University who were paid more than £100,000 rose from just 2 when Breakwell took over to more than 50 by 2014. The University had also bought a prestigious mansion in the centre of Bath as living accommodation for Breakwell.

At the same time, Breakwell kept a tight grip on other labour costs. Breakwell had always refused to negotiate with local trade unions and non-academic pay lagged other local employers. For academics, the university had become one of the country's leaders in the use of zero-hours contracts, by which staff were hired by the hour, often at short notice. Many postgraduate teachers were stuck on the very lowest pay grade on the national scale and – unlike at other universities – were unable to progress higher.

In 2017, Breakwell was awarded another large pay increase by a committee on which she herself sat and voted. Protests among students and both academic and non-academic staff broke out. A senior member of the University complained: ‘[Breakwell] represents an idea of the university as “business” that most of us do not share.’ Newspapers and politicians denounced Breakwell’s pay and four Members of Parliament resigned from the University’s advisory board. Among the controversy, student applications for entry to Bath in 2018 fell by nearly 6 per cent, while competitor universities were expanding. Breakwell was obliged to promise her retirement at the end of the academic year.

The University carried out an inquiry, recommending attention to the University’s culture ‘with a view to improving transparency, rebuilding trust and encouraging two-way communication’. Professor Ian White was appointed as the new Vice-Chancellor, at a salary around half of what Breakwell had been paid. The President of the University of Bath Students’ Union said: ‘The recruitment process for our new Vice-Chancellor was transparent, inclusive and wide-ranging . . . We had the chance to hear about Ian White’s values and vision for the University. As a result, I am confident that Ian White is the right choice for Bath. I believe we can all look forward to an exciting and bright future for our University.’

Sources: Guardian, 24 November 2017; *Bath Chronicle,* 23 November 2017 and 6 September 2018; University of Bath press release, 3 September, 2018, available at: www.bath.ac.uk/announcements/university-of-bath-appoints-new-vice-chancellor/ [accessed: June 2022].

Questions

1 In what respects did the University of Bath’s culture under Breakwell appear to diverge from that outlined in the 2016–21 strategic plan and what could be done to reduce this apparent divergence?

2 Identify key elements in the university's organisational field and explain the importance of these to the controversy.

7.3 Organisational culture

The chapter began by defining organisational culture and the last section identified three important influences on it. This section unpicks the concept further in order to trace how culture influences strategy. Edgar Schein defines organisational culture as the 'basic assumptions and beliefs that are shared by members of an organisation, that operate unconsciously and define in a basic taken-for-granted fashion an organisation's view of itself and its environment'.[15]

An organisation's culture is composed of many different elements. Edgar Schein proposes four layers (see Figure 7.4):[16]

- *Values* may be easy to identify in terms of those formally stated by an organisation since they are often explicit, perhaps written down (see Chapters 1 and 6). The values driving a strategy may, however, be different from those in formal statements. For example, BlackRock, the world's largest investment group, is accused of hypocrisy for declaring its commitment to divest from the coal industry at the same time as retaining in its portfolio companies that still have significant coal-related businesses (see also its purpose statement in Chapter 6.1). It is important to delve beneath espoused values to uncover underlying, perhaps taken-for-granted, values that can help explain the strategy actually being pursued by an organisation.
- *Beliefs* are more specific. They can typically be discerned in how people talk about issues the organisation faces; for example, a

belief that the company should not trade with particular countries or a belief in the rightness of professional systems and standards. The international relief organisation Oxfam begins its Global Strategic Framework 2020–2030 with a statement: ‘What we believe in’. Top of its beliefs is the power of people to change things for themselves, with Oxfam’s role being only to support and champion the initiatives of those experiencing poverty and injustice.

- *Behaviours* are the day-to-day ways in which an organisation operates. This includes the work routines, how the organisation is structured and controlled and ‘softer’ issues around symbolic behaviours (see Section 7.4 below). These behaviours may become the taken-for-granted ‘ways we do things around here’ that are potentially the bases for inimitable strategic capabilities, for example, the ways in which design and marketing managers cooperate to create great products (see Section 5.3). However, routinised behaviours can also be significant barriers to achieving strategic change (see Section 7.4.2 on strategic drift).
- *Taken-for-granted assumptions* are the core of an organisation’s culture which, in this book, we refer to as the organisational *paradigm.* The **paradigm is the set of assumptions held in common and taken for granted in an organisation.** In effect, these shared assumptions concern fundamental aspects of the organisation that, in turn, guide people in that organisation about how to view and respond to different circumstances that they face. The paradigm can underpin successful strategies by providing a common understanding of what is important strategically, but again it can be a major problem when major

strategic change is needed (see Section 7.4). The importance of the paradigm is discussed further in Section 7.4.

Figure 7.4 Culture in four layers

Figure 7.4: Long Description

The concept of culture implies coherence, hence the common expression of ‘corporate culture’. However, organisational cultures are often not perfectly unified. Just as national cultures contain local cultures, so can organisations contain subcultures. For example, the role of geographical influences means that a multinational corporation’s culture is likely to vary in different parts of the world. The importance of professional fields may create differences between the various functions in an organisation: finance

professionals have different training, careers and reference points to marketing professionals. In strategic decision making, therefore, it is important to recognise the different subcultures that managers may be bringing to the process, even within the same organisation. You should not assume that colleagues have the same values and beliefs as yourself.

7.3.1 Analysing culture: the cultural web

In order to understand the existing culture and its effects, it is important to be able to analyse an organisation's culture. The cultural web[17] is a means of doing this (see Figure 7.5). The **cultural web shows the behavioural, physical and symbolic manifestations of a culture** that inform and are informed by the taken-for-granted assumptions, or paradigm, of an organisation. It is, in effect, the inner two ovals in Figure 7.4. The cultural web can be used to understand culture in any of the frames of reference discussed above but is most often used at the organisational and/or subunit levels. The seven elements of the cultural web are as follows:

- The *paradigm* is at the core of Figure 7.5. As previously defined, the paradigm is the set of assumptions held in common and taken for granted in an organisation. The paradigmatic assumptions are, quite likely, very basic. For example, a common problem in engineering firms is the propensity of people to focus on the technical excellence of products rather than customer-perceived needs. Or the paradigm of practitioners in the National Health Service in the UK is about

curing illnesses. It is quite likely that, even if the rational view is to build a strategy around the engineering firm's customer needs or in healthcare to prevent illness (as distinct from curing it), people in those organisations may still interpret issues and behave in line with the paradigm. So, understanding what the paradigm is and how it informs debate on strategy matters.

- *Rituals and routines* point to the repetitive nature of organisational cultures. *Routines* refer to 'the way we do things around here' on a day-to-day basis.[18] At their best, routines lubricate the working of the organisation, and may provide a basis for distinctive organisational capabilities. However, they can also represent a taken-for-grantedness about how things should happen: routines can lead people to deal with situations semi-automatically and are difficult to change. For example, managers trying to achieve greater customer focus in engineering firms often report that customer-facing sales engineers routinely tend to tell customers what they need rather than listening to their needs. The *rituals*[19] of organisational life are particular activities or special events that emphasise, highlight or reinforce what is important in the culture. Examples include training programmes, promotion and assessment procedures, sales conferences, and so on. An extreme example, of course, is the ritualistic training of army recruits to prepare them for the discipline required in conflict. However, rituals can also be informal activities such as drinks in the pub after work or gossiping around water coolers.
- The *stories* told by members of an organisation to each other, to outsiders, to new recruits, and so on, may act to embed the

present in its organisational history and also flag up important events and personalities. They typically have to do with successes, disasters, heroes, villains and mavericks (who deviate from the norm). They can be a way of letting people know what is conventionally important in an organisation.[20]

- *Symbols* are objects, events, acts or people that convey, maintain or create meaning over and above their functional purpose. For example, office furniture and layouts, cars and job titles have a functional purpose, but they are also typically signals about status and hierarchy. Particular people may come to represent especially important aspects of an organisation or historic turning points. The form of language used in an organisation can also be particularly revealing, especially with regard to customers or clients: defining executive education clients as ‘course participants’ rather than ‘students’ makes a significant difference to how teaching staff interact with them.
- *Power* was defined in Chapter 6 as the ability of individuals or groups to persuade, induce or coerce others into following certain courses of action. So, *power structures* are distributions of power to groups of people in an organisation. The most powerful individuals or groups are likely to be closely associated with the paradigm and long-established ways of doing things.
- *Organisational structures* are the roles, responsibilities and reporting relationships in organisations. These are likely to reflect power structures and how they manifest themselves. Formal hierarchical and mechanistic structures may emphasise that strategy is the province of top managers and everyone else is ‘working to orders’. Structures with less emphasis on formal

reporting relationships might indicate more participative strategy making. Highly decentralised structures (as discussed in Chapter 15) may signify that collaboration is less important than competition, and so on.

- *Control systems* are the formal and informal ways of monitoring and supporting people within and around an organisation and tend to emphasise what is seen to be important in the organisation. They include measurements and reward systems. For example, public-service organisations have often been accused of being concerned more with stewardship of funds than with quality of service. This is reflected in their control systems, which are more about accounting for spending rather than with quality of service. Remuneration schemes are a significant control mechanism. Individually based bonus schemes related to growth are likely to signal a culture of individuality, internal competition and an emphasis on sales volume rather than teamwork and quality.

Figure 7.5 The cultural web of an organisation

Figure 7.5: Long Description

Illustration 7.3 describes the culture of the Chinese technology company Huawei, introduced at the beginning of this chapter. It can be seen that the central paradigm of the wolf culture has been supported by many mutually reinforcing elements of the cultural web.

If an analysis of the culture of an organisation is to be undertaken, there are some important issues to bear in mind:

- *Questions to ask.* Figure 7.6 outlines some of the questions that might help build up an understanding of culture using the cultural web.

- *Statements of cultural values.* As explained in Chapter 1 and Chapter 6, organisations may make public statements of their values, beliefs and purposes, for example in annual reports, mission or value statements and business plans. There is a danger that these are seen as useful descriptions of the organisational culture. But this is likely to be, at best, only partially true and, at worst, misleading. This is not to suggest that there is any organised deception. It is simply that the statements of values and beliefs are often carefully considered and carefully crafted statements of the aspirations of a particular stakeholder (such as the CEO) rather than descriptions of the actual culture. For example, an outside observer of a police force might conclude from its public statements of purpose and priorities that it had a balanced approach to the various aspects of police work – catching criminals, crime prevention and community relations. However, a deeper probing might reveal that (in cultural terms) there is the 'real' police work (catching criminals) and the 'lesser work' (crime prevention, community relations).
- *Pulling it together.* The detailed 'map' produced by the cultural web can be a rich source of information about an organisation's culture, but it is useful to integrate the elements into a summary of the culture. Sometimes, this is possible by means of graphic descriptors. For example, managers who undertook a cultural analysis in the UK National Health Service (NHS) summed up their culture as 'The National Sickness Service'. Although this approach is rather crude and unscientific, it can be powerful in terms of organisational members seeing the organisation as it

really is – which may not be immediately apparent from all of the detailed points in the cultural web. It can also help people to understand that culture may drive strategy; for example, a 'national sickness service' will prioritise strategies for curing sick people above strategies of health promotion and prevention. So, those favouring health promotion need to understand that they have to change the culture as well as the strategy.

Illustration 7.3 Huawei's wolves Chinese technology-giant Huawei celebrates both the wolf and the mattress.

The founder of Huawei, Ren Zhengfei, has described culture as the company's 'nuclear bomb', a crucial weapon in its competitive armoury. After nine years' service in the Chinese military, Ren is fond of military language. He talks of his frontline staff as his 'troops', while executives are compared to 'generals'. In Huawei's headquarters, a piece of framed calligraphy reads: 'Sacrifice is a soldier's highest cause. Victory is a soldier's greatest contribution.'

Huawei is famous for its 'wolf culture'. A blog associated with the company explains: first, wolves are blood-thirsty; second, they are tough; third, they hunt in packs. As

Huawei expanded, its wolves had first to fight against telecoms equipment giant Ericsson and then mobile phone colossi such as Apple and Samsung. Rewards were highly geared to sales growth and the company would let go of its 5 per cent of lowest performers each year. This wolf culture has sometimes attracted allegations of bribery and intellectual property theft. The company distinguishes between ‘red lines’ of business conduct and so-called ‘yellow lines’, to be interpreted more flexibly. For Ren Zhengfei (born in 1944 and with memories of Chinese famines), a company rule need not be sacrosanct: ‘If it blocks the business from producing grain, then we all starve to death.’

Company employees have often needed the toughness of the wolf. The company still recalls the office mattresses of the early years when employees would routinely work through the night. It celebrates the resilience of Huawei engineers in maintaining services during a terrorist attack in Mumbai and an earthquake in Algeria. Corporate images often have a Himalayan theme, referencing Huawei’s mobile phone coverage for an Everest expedition. New recruits undergo boot-camp-style training courses with morning jogs, classes on the company’s culture, and improvisations about how employees would serve their customers in war zones.

Today, the company needs resilience again as it reels from sanctions and boycotts imposed by the USA and many Western countries on grounds of national security. Revenues dropped by 30 per cent in 2020. Huawei has invested heavily in diversifying into new services (such as cloud computing) and developing new technological capabilities (such as semiconductors) that are less dependent on the West. Ren Zhengfei encouraged his researchers to look long-term: ‘Your (research) paper may even have a fate like van Gogh’s paintings – nobody showed interest in them for more than 100 years, but now they are priceless.’ He added: ‘van Gogh starved.’

Another blow to the company was the detention in Canada of Ren Zhengfei’s daughter, Meng Wanzhou, from 2018 to 2021 on allegations of sanctions-busting in Iran. Meng Wanzhou was co-chairman of Huawei, Chief Financial Officer and known as the ‘Huawei Princess’, presumed successor to Ren Zhengfei who still serves as CEO in his

late 70s. Ren Zhengfei controls about only 1 per cent of Huawei's shares, with the remainder owned by the company's trade union. Long-serving employees receive share certificates, which gives them a cut of the profits but which they must return on leaving the company (except on retirement). Ren Zhengfei has a veto on some corporate decisions, but he has promised to pass this power on to a group of seven senior executives. He explains: 'I'm more of a figurehead instead of a demanding leader. The Executive Committee of our Board of Directors is the demanding leader. We established this management system by learning from the UK's constitutional monarchy. In the UK, a monarch's power is limited by the law, and the law lies in the hands of Parliament . . . The monarch serves a primarily ceremonial role and does not intervene in politics. At Huawei, I have the right to veto certain things, but I don't actually have much power.'

Sources: E. Flamholtz (2017) 'Corporate Culture: the "Nuclear Bomb" of Huawei', *LinkedIn*, April; *Irish Times*, 19 December 2018; Ren Zhengfei's Interview with Sky News, *Huawei.com*, 2019; *Financial Times*, 29 September 2021.

Questions

1 Map Huawei's organisational culture to the cultural web elements of paradigm, stories, symbols, power, organisation structure, control styles and rituals and routines.

2 Are there any possible inconsistences in the account here? Where there is inconsistency, what do you think is more likely to be true?

Figure 7.6 The cultural web: some useful questions

Stories
- What core beliefs do stories reflect?
- What stories are commonly told, e.g. to newcomers?
- How do these reflect core assumptions and beliefs?
- What norms do the mavericks deviate from?

Symbols
- What objects, events or people do people in the organisation particularly identify with?
- What are these related to in the history of the organisation?
- What aspects of strategy are highlighted in publicity?

Routines and rituals
- Which routines are emphasised?
- Which are embedded in history?
- What behaviour do routines encourage?
- What are the key rituals?
- What assumptions and core beliefs do they reflect?
- What do training programmes emphasise?
- How easy are rituals/routines to change?

Power structures
- Where does power reside? Indicators include:
  (a) status
  (b) claim on resources
  (c) symbols of power
- Who 'makes things happen'?
- Who stops things happening?

Control systems
- What is most closely monitored/controlled?
- Is emphasis on reward or punishment?
- Are controls rooted in history or current strategies?
- Are there many/few controls?

Organisational structures
- What are the formal *and* informal structures?
- How rigid are the structures?
- Do structures encourage collaboration or competition?
- What types of power structure do they support?

Overall
- What do the answers to these questions suggest are the (few) fundamental assumptions that are the paradigm?
- How would you characterise the dominant culture?
- How easy is this to change?
- How and to what extent do aspects of the web interrelate and re-enforce each other?

Figure 7.6: Long Description

7.4 Deliberate and emergent cultural impacts

Culture impacts on many key aspects of strategy. As in Chapter 5, a distinctive culture can be the source of hard-to-imitate differentiation. Organisational culture impacts on strategy implementation (see Chapter 15) and strategic change (see Chapter 16). Culture also shapes strategy development. Chapter 14 will address strategy development more extensively, but here we note two kinds of cultural impact on strategy: deliberate, as in the managerial design of organisational identities; and emergent, as in the gradual processes of strategic drift.

7.4.1 Organisational identity

The concept of **organisational identity** **refers to how organisations express and project a sense of organisational self: a claim about 'who we are'**. Organisational identity *claims* are often prominent on websites and other official materials. For example, the German chemicals company Merck has a brochure entitled simply 'Who we are'. According to the brochure: 'We are Merck, a vibrant science and technology company. Science is at the heart of everything we do.' Identity is about how organisational insiders want to see themselves; organisational *image* is about how outsiders do see the organisation. Identity is more explicit than organisational culture but frequently refers back to elements of that

culture, at least as perceived by managers. In that sense, organisational culture is distinct from identity, but can provide initial building blocks for the deliberate construction of organisational identity.[21]

Managers and entrepreneurs are often proactive in defining organisational identity because it is important for recruiting employees, interacting with customers, dealing with regulators and guiding strategy. Thus the Danish lager company Carlsberg went through a very deliberate process of changing its claimed identity from a brewer to a fast-moving consumer goods company, with important ramifications for the skills it required (marketing more than brewing) and the kind of products it would sell (not just beer).[22] Plausible identity claims are important for entrepreneurial start-ups as well: there are significant benefits with customers and investors if they can define themselves as the next generation, rather than a 'me-too'. The controversial WeWork, founded in 2010, defined its identity as a technology-driven and trendy provider of coworking office space, temporarily achieving a valuation of $47bn by 2019. Arguably, WeWork was basically just an ordinary (and loss-making) office-leasing company: in 2021, as scepticism about its identity claims increased, WeWork's value fell to about $8.5mn.

Identity claims are often made in the negative: not only 'who we are' but also 'who we are not'.[23] These 'anti-identities' are often powerful guides to strategy, because the comparison points out obvious ways of being different. When the Indian Motorcycle Company relaunched in the USA in 2013, it marked its difference from traditional US market-leader Harley-Davidson: 'We are not Harley-Davidson and are not setting out to do what Harley-Davidson

does. We are Indian Motorcycle . . . Indian has a legacy for being at the cutting edge of technology and innovation so that is something you can expect from us.'

7.4.2 Strategic drift

Sometimes, organisational culture has a less deliberate influence on strategy, as in the emergent pattern of strategy development depicted in Figure 7.7. **Strategic drift**[24] **is the tendency for strategies to develop incrementally on the basis of cultural influences, failing to keep pace with a changing environment.** With strategic drift, strategy emerges from the unconscious biases of the organisation's existing culture, reinforcing inertia. Strategy emergence is further discussed in Chapter 14.

A famous example of strategic drift is the Kodak camera company. Once dominant in analogue cameras and chemical-based film, Kodak failed to respond to the rise of digital cameras and smartphones. Kodak never fully committed to digital, even though it had produced one of the first prototype digital cameras and its engineers had multiple times forecast the rise of digital. Instead, the company made several half-hearted experiments with digital technologies: for instance, trying to marry traditional film with new technology, the company provided users with a digital preview of shots taken and an indicator of the number of hard-copy prints required. Kodak's outdated culture was reinforced by having all its key operations based in the small city of Rochester and by the power of its film division, the traditional source of its profits. The company went bankrupt in 2012.[25] More recently, many internal combustion

engine car manufacturers have been slow to invest in the potential of electric vehicles, as demonstrated by the relative speed of Tesla. Arguably, energy companies such as ExxonMobil are showing similar tendencies to strategic drift with their failure to invest in renewable sources: see Illustration 7.4.

Figure 7.7 identifies four phases in the process of strategic drift, leading either to the organisation's death or to transformational change:

- *Incremental strategic change* is the first phase, involving small adjustments. In many organisations, there are long periods of relative continuity during which established strategy remains largely unchanged or changes very incrementally. After all, where the environment is changing slowly (as in Figure 7.7 at this point), there is no need for more radical change. Where the pace of environmental change is slow, managers can also experiment with a variety of small-scale responses to change, waiting to see what works before adopting the best solution.
- *Strategic drift* emerges when the rate of environmental change starts to outpace the rate of the organisation's strategic change. Phase 2 of Figure 7.7 shows environmental change accelerating. However, the organisation's rate of change is still incremental, leading to a growing gap with the accumulated environmental change.
- *Flux* is the third phase, triggered by the downturn in performance caused by the growing gap between organisation and environment. In this phase, strategies may change but in no very clear direction: changes may even be reversed, so that strategies loop back on themselves. There may be internal

disagreements among managers as to which strategy to follow, quite likely based on differences of opinion as to whether future strategy should rely on historic capabilities or whether those capabilities are becoming redundant.

- *Transformation or death* is the final phase in Figure 7.7. As things get worse, there are two possibilities: (a) The organisation may die, either through bankruptcy – as Kodak did in 2012 – or by takeover by another organisation; or (b) the organisation may go through a period of *transformational change,* which brings it back to the level of cumulated environmental change. Such change could take the form of multiple changes related to the organisation's strategy or perhaps a change to its whole business model (see Section 8.4), as well as changes in top management, organisational culture and organisation structure.

Figure 7.7 Strategic drift

Figure 7.7: Long Description

Illustration 7.4 Is Exxon the new Kodak?

As it resists the shift to renewables, will the US oil giant ExxonMobil end up like Kodak, which died because of its fatal commitment to old film technology?

ExxonMobil is the 23rd largest company in the world by revenues, tracing its origins to John D. Rockefeller's Standard Oil founded in 1870. When Exxon merged with Mobil in 1999, it became the world's largest energy company. However, in 2021, the small activist hedge fund Engine No. 1 warned that climate change meant that ExxonMobil was now facing an 'existential risk' and launched a battle to change the company's focus on oil and gas. Engine No. 1 warned the company and its shareholders: 'A refusal to accept that fossil fuel demand may decline in decades to come has led to a failure to take even initial steps towards evolution, and to obfuscating rather than addressing long-term business risk.' The survival of the company was at stake.

But ExxonMobil believed strongly in the future of fossil fuels. Since the 1980s, the company has lobbied against climate change measures, being one of the co-founders of the Global Climate Coalition, a group of large US companies opposed to the regulation of greenhouse gas emissions. In 2019, ExxonMobil spent over $40 million on lobbying and social media to influence climate policy. The company has not always shown great concern for its environmental impacts. In 1989, one of Exxon's fuel-tankers, the Exxon Valdez, spilt 11 million gallons of oil off the coast of Alaska, with consequent estimated deaths of 250,000 seabirds, 300 harbour seals and 22 killer-whales. The company challenged the compensation payments and continues, to this day, to rely much more heavily than its rival oil companies on the single-hull tanker design responsible for the

spillage. In 2017, the company's then CEO Rex Tillerson left ExxonMobil to take a senior position in the new administration of President Donald Trump, a famous climate change sceptic.

ExxonMobil's own strategy reflected its belief in the future of fossil fuels. It had no renewable energy products, by contrast with the substantial renewable portfolios of rivals Total and BP. The company's new CEO Darren Woods – a Texan and lifer in ExxonMobil – asked of renewables: 'What can we bring to those opportunities other than a cheque book?' Renewables were outside ExxonMobil's core competence, while the market had low barriers to entry and was getting increasingly crowded. Instead, ExxonMobiil was committed to reducing the 'carbon intensity' of its oil and gas production, with carbon capture technology intended to mitigate environmental impacts. But projected expenditure on carbon capture was only 3 per cent of total investment by the company. Unlike BP, for example, which was projecting radical falls in global demand, ExxonMobil expected oil demand to rise by 10 per cent in the coming two decades. It was investing heavily in big new oil projects in New Mexico and Guyana. With production expected to grow, Engine No. 1 claimed that ExxonMobil's carbon emissions would actually rise by 2025.

Engine No. 1 held only 0.02 per cent of Exxon's shares, but campaigned vigorously for the support of other investors, some of whom were concerned about the environment, while others were agitated by falls in the share price, losses during the COVID crisis, and investment plans that were widely seen as extravagant. At the investor meeting of May 2021, the hedge fund proposed the election of four new members to the twelve-person board, all more sympathetic to climate issues. In a dramatic move, ExxonMobil management delayed the closure of the vote for an hour, trying to rally its own supporters. In the end, three of Engine No. 1's nominees were elected, with the support of ExxonMobil's two largest investors Vanguard and BlackRock. A representative of the hedge summed up the message for ExxonMobil: 'plan for a world where maybe the world doesn't need your [oil] barrels'.

Sources: Engine No. 1, Reenergize ExxonMobil/Investor Presentation, May, 2021; *Financial Times*, 25 April and 27 May 2021; and *NPR*, 8 June 2021.

Questions

1 To what extent is ExxonMobil's resistance to renewables a case of strategic drift?

2 Suggest at least two options for ExxonMobil after the appointment of the three new directors. What might be the difficulties of each?

Strategic drift is a common phenomenon. The consultants McKinsey & Co. point out that the tendency is for 'most companies to allocate the same resources to the same business units year after year'.[26] It usually takes significant performance decline to prompt transformational change: a study of 215 major UK firms over the 20-year period 1983–2003 identified only 4 that could be said to have *both* maintained consistently high levels of performance *and* effected major transformational change over that period.[27] There are four main reasons why it is hard to avoid strategic drift:

- *Uncertainty.* Strategic drift is not easy to see at the time. Chapters 3 and 4 provide ways of analysing the environment, but such analyses are rarely unambiguous. It takes time for managers to be sure of the direction and significance of environmental changes. Changes may be temporary, for instance, the result of cyclical downturns that will soon be reversed or of fashions that may soon pass. It is easier to see

major and irreversible changes with hindsight; it is hard to grasp their significance as they are happening.

- *Path dependency and lock-in.* As in Section 7.2, the historical trajectory of the organisation might lock organisations into strategies that are costly to change, at least in the short term. For example, capabilities that have historically been the basis of competitive advantage can be difficult to abandon in favour of developing new and untested capabilities. In this sense, old capabilities can become *core rigidities,* rather than core competences capable of supporting new businesses.[28] Similarly, *existing relationships* can become shackles that inhibit significant change.[29] Thus, managers may be reluctant to break relationships with important customers, suppliers and employees built up over many years for the sake of some emerging and uncertain opportunity.
- *Cultural entrenchment.* Culture can exert a strong influence over strategy. The paradigmatic set of taken-for-granted assumptions may prevent managers from seeing certain issues: organisational *identities* (such as ‘we are a brewing company’, not a ‘fast-moving consumer goods company’) can shape views of environmental opportunities and threats.
- *Powerful* people, whose skills and power bases relate to the old strategy, may naturally resist change too. This was partly the case at Kodak, where the powerful film division feared being made redundant by digital technology. These kinds of issues are explored further in Chapter 16.

Thinking Differently Institutional logics versus organisational culture

Societal-level institutional logics can be both sources of conflict and sources of inspiration for organisational cultures Institutional logics are socially constructed sets of mat-erial practices, assumptions, values and beliefs that shape human cognition and behaviour across domains of activity, typically at a societal level.[30] To put it more simply, what we think and how we behave are influenced by the informal rules of the society we live in. These rules come in distinct and coherent sets: for instance, every society has informal rules about how to behave in the different domains of business, the family, national politics and professions. However, we remain sensitive to all these rules, even when we are operating in one particular domain.

This notion of institutional logic comes from the institutional theory tradition associated with the concept of organisational fields, with its emphasis on legitimate behaviour (see Section 7.2.3). It has at least two radical implications for the notion of organisational culture. First, organisational cultures can never be wholly 'organisational': they will certainly be impacted – and sometimes distorted – by logics from outside the organisation. Second, organisational cultures can never be entirely coherent and unified: they will always be 'plural', i.e., cross-cut by multiple logics from external the society, such as those of the family or profession.

These institutional logics mean that business decisions are rarely purely business decisions. Familial responsibilities may be influential in a family business; professional

identities and standards may be influential in a law firm or architectural practice; patriotism or home-country culture may shape strategic moves in a multinational (consider Tata in Section 7.2). These pluralistic logics can be a source of conflict, of course. But institutional logics can also be a source of inspiration for organisations: professionalism or family spirit can be powerful ingredients in organisational cultures.

Questions

How might institutional logics shape such strategic choices as diversification, innovation and internationalisation (see Chapters 8, 9 and 10) for:

(a) a family-business owner looking to pass on the business to the next generation of children;

(b) a state-owned enterprise from a commodity-hungry country such as China;

(c) a growth-seeking professional services firm, in accounting for example, considering new businesses to operate in?

Key takeaways It is important to recognise the many ways in which culture can affect strategy, for example, as a source of differentiation, as a cohesive force for organisations, as an inspiration for new strategies and as a barrier to change. So, important implications are:

- Be explicit about how far your organisation's strategic choices are unconsciously shaped (or trapped) by cultural influences drawn from its *history*, *geography* or *field.*
- Use history proactively to inspire or legitimise your organisation's strategy, drawing on historical *continuity*, *selection*, *rupture* or *rediscovery* approaches.
- Analyse your organisation's *corporate culture* and identify whether *subcultures* matter for strategy, as sources of resistance or of renewal.
- Identify the cultural *paradigm* of the organisation and assess how far it is reinforced by the seven elements of the *cultural web.*
- Consider how the organisation presents itself in terms of its *identity* and how closely its identity *claims* fit with reality.
- Assess how well the organisation's culture is keeping pace with the environment in order to identify any danger of *strategic drift.*

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

7.1* In the context of Section 7.2, undertake a historical analysis of the strategic development of an organisation of your choice and consider the questions: how much continuity is there and what caused any strategic changes?

7.2 Identify an organisation that describes its culture publicly (use a Google search on ‘our culture’ plus ‘business’ for example). What do they mean by culture and how does it fit with the description of culture in this chapter?

7.3 Identify a company reputed to have a strong and positive culture (e.g., via Fortune’s ‘Best Companies’, Glassdoor’s ‘Best Places to Work’, or LinkedIn’s ‘Most In-Demand Employers’). What is attractive about this company’s culture, how is it sustained and to what extent is it a competitive advantage?

7.4 Use the questions in Figure 7.6 to identify elements of the cultural web for Uber (end of chapter case), Dare to Know (Dauphine)*, Bell Pottinger* or an organisation of your choice (for example, your business school).

7.5 Identify an organisation that, in your view, is in one of the phases of strategic drift described in Section 7.4 (Google search ‘disappointing results’ or ‘slow growth’ plus ‘business’ or ‘company’). How and why did it get into this state?

Integrative assignment

7.6* Choose an example of a major change in strategy of an organisation. Explain to what extent and how its strategic capabilities and its organisation culture changed. (Refer to Chapters 5, 7 and 16.)

Recommended key readings

- For a comprehensive and critical explanation of organisational culture, see M. Alvesson (2012) *Understanding Organisational Culture*, 2nd edn, Sage. For some practical applications, see B. Groysberg, J. Lee, J. Price and J. Cheng (2018) ‘The leader’s guide to corporate culture’, *Harvard Business Review*, 96(1): 44–52.

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Case example

Has Uber overcome the ubermensch?

A new CEO attempts cultural change at the controversial transport network company

Travis Kalanick, Uber's founder

Source: Justin Lane/EPA/Shutterstock

Since its foundation in 2009, Uber Technologies has grown into a $17.5bn multinational, with services from ride-hailing to package deliveries, food delivery and freight transport. Uber is a platform company, meaning that Uber does not own its vehicles or, in the original model, employ its drivers: revenues come from a commission on each booking. Under the leadership of its founder, Travis Kalanick, the company's culture had been widely described as 'toxic'. Since 2017, a new CEO, the quietly spoken Dara Khosrowshahi, has been looking to create a new kind of organisation. But five years later, there was a question mark on his performance.

Uber's Ubermensch

For Uber, the years to 2017 were heavily marked by its entrepreneurial Chief Executive and Co-founder, Travis Kalanick. A product of the Californian tech culture, Kalanick had already had a mixed entrepreneurial record when he started the Uber taxi company. His first business, Scour, was a peer-to-peer sharing business, sued by numerous publishers and bankrupt in 2000. His second business, Red Swoosh, was another peer-to-peer business, which was successfully sold for $19mn in 2007, despite Kalanick's committal for tax fraud and perjury. Kalanick's personal style in the early years was unusual: he wore a cowboy hat and referred to himself as the Wolf, after the apparently cool fixer in the violent Tarantino film *Pulp Fiction.* At the same time, Kalanick was a fan of the libertarian philosopher Ayn Rand, adopting as his Twitter avatar the cover of her book *The Fountainhead,* a celebration of heroic individualism.

Given this personal background, Uber's name is probably no accident: it recalls the notion of *Übermensch* ('superior being') associated with the German philosopher Friedrich Nietzsche (famous for declaring the death of God). Uber's launch was certainly highly aggressive, seeking to be among the first to enter cities internationally and then working quickly to establish local dominance. This search for early-mover advantage frequently involved defying local regulations regarding car-hire businesses. Kalanick's philosophy was one of 'principled confrontation'. The motto was: 'it is easier to ask for forgiveness than for permission.' Uber would typically commence operations in a city, then, if faced by regulatory opposition, mobilise public support and professional lobbyists to campaign for regulatory change. In Portland, Oregon, the transportation commissioner called Uber's management 'a bunch of thugs'. By the end of 2015, however, Uber was already operating in about 400 cities around the world, from Abu Dhabi to Zurich. Revenues were $1.5bn (€1.3bn; £1.1bn).

Many of Uber's practices reflected a strong belief in the free market. For example, Uber uses dynamic (or 'surge') pricing, where prices are adjusted simply according to market demand. This could result in controversial price hikes. In 2014, during a terrorist siege in central Sydney, prices rose by 800 per cent as people rushed to get out of

danger. This was widely seen as exploiting people's fear but, for Uber, it was just a matter of supply and demand. Similarly, the contract between drivers and Uber was held to be a simple market transaction, with drivers treated as independent businesses rather than employees. When an Uber driver complained to Kalanick about how difficult it had become to finance his car in the wake of pricing cuts imposed by the company, Kalanick responded that drivers took on car loans at their own risk. Drivers should estimate future prices themselves; Uber would not guarantee their profitability.

Uber could also turn the market against competitors. When Gett and Lyft launched competitive services in New York in 2013–14, Uber organised its local employees to order cars from the new rivals, only to cancel orders when they were on their way. Uber even provided special phones and credit cards to enable these orders. Lyft was able to identify 177 Uber employees that had ordered and cancelled 5,560 orders over several months.

Uber made use of its software expertise as well. One of its most famous pieces of software was something called Greyball. Greyball was developed to identify individuals who the company suspected of using its services improperly, for instance people suspected of violating terms of service. However, Greyball could also be used to deny service to law enforcement agents and those with credit cards or phones associated with regulatory agencies. This was a tactic used in Portland, Oregon, for instance. Another piece of software was called God View, which allows Uber to track the movements of particular individuals: again, this was used to follow law enforcement agents, but was used widely within the company for personal and entertainment reasons. Finally, Uber developed the Ripley software, a secret 'panic button' that enabled the company to respond to government raids on Uber offices by immediately locking, shutting off and changing passwords on staff computers.

Uber's culture was special too. Kalanick adopted 14 core values for the company, including: big bold bets, a champion's mindset, principled confrontation, always be hustlin' (sic) and meritocracy and toe-stepping. The result was a culture with few

restraints, where the successful seemed to be forgiven for conduct that might otherwise be punished. When Emil Michael, one of Uber's senior vice-presidents, was caught up in a scandal about digging into the private lives of journalists perceived as hostile to the company, Kalanick defended him, and indeed pulled him on-stage at a major meeting to praise him as an exemplar of Uber's culture.

This culture created a challenging work environment, particularly for women. Kalanick has referred to his company as 'Boob-er' because of how its high profile boosted his personal dating. In 2017, only 15.1 per cent of Uber's engineers, product managers and scientists were female. During 2017, the female engineer Susan Fowler published an account of her time at Uber that went viral on the internet. She recorded sexual harassment by her manager and very weak responses from the company to her complaints: 'Upper management told me he was a high performer . . . and they wouldn't feel comfortable punishing him for what was probably just an innocent mistake on his part.' Investigation with other female colleagues discovered that this kind of harassment and response was very common within the company. More generally, Fowler described 'a game-of-thrones political war raging within the ranks of upper management'.

Susan Fowler's blog captured widespread attention in part because of its resonance with the MeToo movement, then newly emerging to advance the cause of women in the workplace, particularly with regard to harassment. It also prompted more general criticisms of Uber's practices, and particularly the conduct of Travis Kalanick. Uber's employees stopped wearing proudly their company t-shirts in the streets of San Francisco, their headquarters city. Fearing for the value of its investment in the company, the venture capital firm Benchmark brought together investors holding 40 per cent of Uber's voting shares to demand Kalanick's resignation. In June 2017, Kalanick finally stepped down as Chief Executive of the firm he himself had founded.

Uber's new Dad

In August 2017, Dara Khosrowshahi, former Chief Executive of Expedia, took over as CEO. One of his first tasks was to change Uber's culture. He wrote on his LinkedIn page: 'The culture and approach that got Uber where it is today is not what will get us to the next level . . . our culture needs to evolve.' Using 20 working groups of Uber employees, Khosrowshahi developed eight new 'cultural norms'. Some were the same as Kalanick's old core values, for example, on the importance of big, bold bets. Others were new, for example, with regard to employee diversity: 'We celebrate differences.' One cultural norm in particular seemed to mark a sharp change from the Kalanick era: 'We do the right thing. Period.'

Khosrowshahi moved rapidly to repair relations with local city administrations, with London and New York particularly important. In London, where Uber had 3.6 million users and 45,000 drivers, the local administration had refused to renew its licence to operate, with the company's policy regarding the reporting of crimes a particular complaint. The UK and Ireland General Manager who had ultimate responsibility was replaced by Tom Elvidge, who had previously run Uber London locally. Three non-executive directors from outside the company were appointed to the local company's board, and policies were changed in a range of areas, from crime reporting to drivers' hours. In 2018, the company had its licence renewed. Although tensions with drivers and local communities continued, Elvidge reflected that the threat to its London licence had been 'a wake-up call for a company that had grown incredibly fast but that needed to grow up'.

In New York, Uber's largest North American market with 75,000 drivers, there was trouble too, with an Uber driver being charged with kidnapping a female passenger and local regulators imposing a cap on new drivers. Again, Uber put in new management, bringing in their Houston manager to run the local operation. The new manager, Sarfaz Maredia, adopted a less combative stance with regulators and introduced more safety measures. Maredia declared: 'We're trying to build a successful, sustainable business, a

company we can be proud of, not next year or the year after, but for many years down the road.'

Khosrowshahi also established a central safety team in Phoenix, Arizona, to handle the growing number of complaints regarding both drivers and passengers. The team had been just 23 strong in July 2017 but, by the beginning of 2019, it had grown to 125. Eighty per cent of complainants are contacted personally within one hour of first notification. For complaints that are deemed potentially serious, drivers or passengers are immediately suspended. The company promised to report statistics on complaints. A company representative commented: 'The numbers are going to be disturbing because anything over one is disturbing, but then when you think about the fact that we do 100mn rides a week around the world, it's a lot of rides.'

Khosrowshahi's new regime was not untroubled. The company's head of human resources, Liane Hornsey, suddenly resigned a year into her tenure following an investigation into how she had handled employee grievances in the company. At a company 'all-hands' meeting in late 2018, Khosrowshahi faced tough employee questions about the culture of Uber's Advanced Technology Group (ATG) following *Business Insider*'s investigations into the killing of a pedestrian by an Uber test-car in self-driving mode. ATG engineers had turned off the ability to stop the car quickly. One employee asked: '*Business Insider* called ATG's culture "toxic" and referred to "missed warning signs, vast dysfunction and rampant infighting". Any truth to this?'. Khosrowshahi defended ATG's top management, calling *Business Insider* sensationalist. Nonetheless he conceded: 'We have screwed up . . . It [the investigation] does reflect what is true, which is we have gone through a lot . . . Our test now is: Can the team come together and build something better?' Uber was not entirely free of the company's founder either. Travis Kalanick was one of Uber's largest shareholders and continued to sit on the company's board of directors.

Shareholders were not entirely happy indeed. At the company's Initial Public Offering in 2019, the company had achieved a share-price of $45 but, by 2022, the price had

drifted down to around $35. The company was still growing fast and moving closer to profitability, but it had exited some innovative businesses such as autonomous cars. Some wondered whether Uber had lost its mojo under Khosrowshahi's leadership: he had become known as 'the Dad of Silicon Valley'. He explained: 'My goal in life is not to build the most sexy company. It is to build the best company.'

Main sources: *Business Insider,* 24 January and 29 November 2018; *Financial Times,* 25 June, 28 December 2018, 17 November 2021; *New York Times,* 1 December 2018 and 16 July 2021; *Fintecology*, 17 April 2021. See also the 2022 Showtime series *Super Pumped*.

Questions

1 With reference to Figure 7.2, how would you describe Uber's relationship under Dara Khosrowshahi with its history under Travis Kalanick?

2 Referring to Section 7.3, analyse Uber's culture under Travis Kalanick in terms of values, beliefs, behaviours and taken-for-granted assumptions (the 'paradigm'). How has Khosrowshahi changed the culture and how successful is the change?

Commentary on

Part I The strategy lenses

As in Chapter 2, *Exploring Strategy* aims to give you practical help in working with strategy concepts and ideas. This Commentary introduces four strategy lenses each of which offers a different point of view on strategy. These lenses help you to explore strategy 'critically'.[1] Critical here is meant positively, not negatively: it is about having more than one angle on any particular issue. Being critical helps you to recognise different perspectives, thereby motivating more strategic options, stronger supporting evidence and proper appreciation of partners and competitors. Being critical is ultimately practical: it will make you more persuasive with regard to your own chosen positions, helping you convince your

teachers, your fellow students or your work colleagues. Using the strategy lenses to explore strategic issues critically is consistent with Daniel Kahneman's System 2 reflective thinking that is so integral to most strategic decision making (Chapter 2.2): it is important not to leap immediately to the one apparently obvious conclusion. Dig deeper; look wider.

The last few chapters have already introduced many points of view, each offering different insights into what matters in strategy. Some of these reflect a strong economics orientation, for instance, macro-economic cycles and the Five Forces in Chapters 3 and 4. Others are more sociological, such as the highlighting of legitimacy in Chapters 3 and 6. Some concepts and frameworks emphasise opportunities for innovation, as with the dynamic capabilities of Chapter 5. Others stress conservatism in organisations, for example strategic drift and organisational culture in Chapter 7. Generally, the chapters assume objectivity in analysis, but issues such as the principal–agent problem in Chapter 6 warn of the scope for divergent political interests in organisations, while organisational culture too can be a source of bias. What should be clear

from these chapters, therefore, is that there are many different ways of seeing strategy. Each of them suggests different questions, generates different kinds of insights and demands different types of evidence.

The strategy lenses organise many of these different perspectives into four basic approaches to exploring strategic issues. Each of these lenses will help you generate distinct kinds of questions, options and evidence. They each have distinct implications for practice too.

The four strategy lenses are as follows:

- *The design lens views strategy development as a logical process of analysis and evaluation.* This is the most commonly held view about how strategy is developed and what managing strategy is about. Options and evidence here are generated by objective analysis using formal concepts and frameworks.
- *The experience lens views strategy development as the outcome of people's taken-for-granted assumptions and ways of doing things.* Strategy through the experience lens puts people, culture and history centre stage in strategy development. Options need to respect the past, and evidence is likely to draw heavily on previous experience.
- *The variety lens views strategy as resulting from the bubbling up of new ideas from the variety of people in and around organisations.* According to this lens, strategy emerges not just from the top, but also from the periphery and the bottom of the organisation. It is

important to question top management views, and recognise the potential value of options coming from all round the organisation, and even from outside.

- *The discourse lens views language as important both for understanding and changing strategy and for managerial power and identity.* Through this lens, unpicking managers' language can uncover hidden meanings and political interests. Choosing the right language is also important to legitimating options and evidence.

The critical exploration of strategy through these four lenses is useful because they all raise different questions and suggest different approaches. Think of everyday discussions you have. It is not unusual for people to say: 'But what if you looked at it this way instead?' Taking just one view can lead to a partial and perhaps biased understanding. Looking at an issue another way can give a much fuller picture, generating new and different insights. For example, is a proposed strategy the result of objective analysis or is it rather the reflection of the proposer's personal experience or political self-interest? The lenses can also prompt different options or solutions to strategic problems. For example, again, should organisations rely just on top managers to create new strategies, or rather look towards the bottom of the organisation to uncover existing experiments and initiatives that have greater potential? Thus, taking a critical perspective on strategy can help managers and students consider a wider range of issues and responses.

The rest of this Commentary explains the lenses in more detail, showing how they each relate to the following three key dimensions of managing strategy:

- *Rationality:* the extent to which the development of strategy is rationally managed. The design lens assumes high rationality, but the other lenses question this.
- *Innovation:* the extent to which strategy is likely to develop innovative, change-oriented organisations, or alternatively consolidate past experience and existing power structures.
- *Legitimacy:* the extent to which strategy analysis and discourse is involved in sustaining managers' power and identities in organisations.

This Commentary concludes with a short case on Meta (formerly Facebook), illustrating how the four lenses can be used to explore a real company's strategy. There will be shorter Critical Commentaries later in the book helping readers to reflect on the concepts and frameworks highlighted in Parts II and III. Meanwhile, this Commentary relates mostly to the material in the first seven chapters of this book.

The design lens

The design lens evokes an image of the strategist as detached designer, drawing up precise blueprints distant from the messy realities of action. In terms of the three key dimensions, the design lens therefore puts a strong premium on rational analysis and decision-making (see Figure C.i).[2] Because of its overt commitment to optimising the performance of organisations, the design lens tends also to be highly legitimate. Rational analysis is what counts, not passion or intuition. However, this commitment to dry analysis can sometimes work against innovation.

Figure C.i Design lens

Figure C.i: Long Description

The design lens is associated broadly with strategy theorists such as the former Lockheed Corporation strategic planner

Igor Ansoff or the economics-trained Harvard Business School Professor Michael Porter.[3] It has its origins in traditional economists' expectations about perfect information and 'rational economic man' and is further informed by management science techniques for resource optimisation. The design lens is also how strategy is often explained in textbooks, by teachers and indeed by managers. The design lens makes the following three assumptions about how strategic decisions are made:

- *Systematic analysis is key.* Although there are many influences on an organisation's performance, careful analysis can identify those that are most significant. In this view, calculating the attractiveness of an industry using Porter's Five Forces (Chapter 4), and identifying strategic capabilities using Valuable, Rare, Inimitable and Organisational support criteria (Chapter 5), would be standard processes for estimating future performance.
- *Analysis precedes action.* In the design lens, strategy is generally seen as a linear process. Decisions about strategy are separate from and precede implementation. From this point of view, therefore, environmental analysis – for example, projecting scenarios or forecasting industry life cycles (Chapters 3 and 4) – is the crucial first step in strategy making.
- *Objectives should be clear.* Rational analysis and decision making need unambiguous criteria by which to evaluate options. Missions and visions (Chapter 1)

should be set in advance as precisely as possible, with little scope for adjustment as new opportunities or constraints are discovered in action.

These design lens assumptions about how decisions should be made are, in turn, associated with two key views about the nature of organisations:

- *Organisations are hierarchies.* It is the responsibility of top management to plan the destiny of the organisation. The responsibility of the rest of the organisation is simply to implement the strategy decided at the top.
- *Organisations work mechanically.* This hierarchical approach implies a view of organisations as engineered systems or even machines. Pulling the right organisational levers should produce predictable results. Principal–agent problems can be controlled by the appropriate gearing of incentives (Chapter 6). Even organisational cultures (Chapter 7) can be designed from above.

Implications

The design lens has practical implications for both managers and students. From the design point of view, it is worth investing extensive time in formal analysis, especially economic forms of analysis. Formal strategic planning and financial calculations are crucial parts of the design lens approach. But even if strategic plans do not always produce the expected results, there are two further reasons for taking a design lens approach:

- *Dealing with complexity and uncertainty.* The design lens provides a means of talking about complex and uncertain issues in a rational, logical and structured way. Even if rational analysis can sometimes over-simplify or convey undue precision, it is usually better than just concluding that everything is all much too complicated for any kind of plan or calculation. Strategy is more than guesswork.
- *Meeting stakeholder expectations.* As well as the sheer analytical value of a design approach, adopting rational procedures is something that important stakeholders (see Chapter 6) such as banks, financial analysts, investors and employees typically expect. For these audiences, analysis is highly legitimate. Taking a design lens approach is therefore an important means of gaining the support and confidence of significant internal and external actors.

Technical and elitist forms of strategy analysis can also have implications for managerial power and personal identity. These side effects will be discussed further with the discourse lens later.

In summary, the design lens is useful in highlighting the potential value of systematic ana-lysis, step-by-step sequences and the careful engineering of organisational objectives and systems. However, the design lens does have its limits. In particular, a narrow design lens tends to underestimate the positive role of intuition and experience, the scope for unplanned and bottom-up initiatives, and the power effects of strategy analysis. Different lenses can provide useful insights into these other elements of strategy.

Strategy as experience

The experience lens sees strategy as coming less from objective analysis on a clean sheet of paper and more from the prior experience of the organisation's managers. History and culture matter. Strategy is shaped by people's individual and collective taken-for-granted assumptions and ways of doing things. As indicated in Figure C.ii, the experience lens therefore places less emphasis than the design lens on rationality. It also sets low expectations in terms of innovation and change. Legitimacy is important, but this is defined in terms of tradition, routines and culture rather than simple appeal to analysis and 'the facts'.

The experience lens is based on a good deal of research about how strategies actually develop in the real world. As early as the 1950s, Nobel Prize winner Herbert Simon was developing the so-called Behavioural Theory of the Firm, based on how managers really behave.[4] Contemporary researchers into 'Behavioural Strategy' underline two kinds of problem for rational analysis in practice:

- *External constraints:* Behavioural Theory points to real-world barriers to rationality: for example, it is difficult to obtain all the information required for comprehensive analysis; it is hard to forecast accurately in an uncertain future; and there are cost and time limits to undertaking complete analyses. In these conditions, managers often 'satisfice' when analysing strategic options: in other

words, they settle for adequate solutions rather than the rational optimum.

- *Internal psychological limitations:* Behavioural Theory underlines how managers suffer from ‘bounded rationality’, human limitations on the intellectual ability to process information and carry out analysis. They are also liable to ‘cognitive bias’: in other words, managers tend to be selective in the attention they give to issues and often automatically favour some types of solutions rather than others.

Figure C.ii Experience lens

Figure C.ii: Long Description

Cognitive bias is typically based on managers’ experience, both individual and collective:

- *Individual experience* can particularly shape managers’ taken-for-granted assumptions about what is important

and what kinds of actions work best. Influential sources of experience can be education and training. For example, accountants tend to see things differently to engineers; MBAs are often accused of favouring excessively analytical approaches to solving problems. Other kinds of influential individual experience are personal careers. Thus, a manager who had spent his or her career in the traditional automobile industry (for instance, Ford or BMW) might find it difficult to take seriously new entrants such as DiDi or Tesla. Differences in individual experience within an organisation can lead to debate and negotiation between managers with divergent views about what is important and what should be done. Sometimes, such negotiation can slow decision making down and lead to excessive compromise. Stakeholder mapping (Chapter 6) of different managers' power and attention can be useful in resolving divergent views.

- *Collective experience* tends to form habitual patterns of thinking and acting, which can translate into standard responses to strategic issues. One kind of collective experience is encapsulated in organisational culture, as discussed in Chapter 6. Another kind of collective experience is reflected by national culture: so, for instance, Chinese and US managers may see the world differently (see also Chapter 10). A third kind of collective experience is embodied in industry 'recipes' (Chapter 6), based on years of regular interaction

between existing competitors: for example, managers in the clothing industry come to believe over time that style is important to success, even though new ideas from outside the industry imply that new technologies may be the source of competitive advantage in the future. By contrast to individual experience, collective experience tends to suppress debate in management teams, and it becomes hard to challenge the consensus. A consequence can be ‘strategic drift’ (Chapter 6), with everybody agreeing to continue as before, even in the face of environmental change.

Implications

The experience lens has significant implications for strategy. First there are three important warnings:

- *Analysis is typically biased to some extent.* All managers – and even students – bring their own particular experience to any set of strategic issues. It is very hard to analyse a situation as if from a clean sheet of paper. You should distrust claims to complete objectivity. Ask yourself where people are coming from.
- *Watch out for undue conservatism.* Experience is likely to lead to routinised responses, even to new problems. Tried-and-tested solutions become too legitimate; managers become powerful because of successes experienced in the past. ‘Path dependency’ and ‘lock-in’ are enduring risks (Chapter 6). Organisations can end up like old-fashioned generals, always fighting the last war.
- *Change is hard.* Because of conservatism, strategic change is liable to require long and difficult processes of persuasion (see Chapter 15). Continuity is often the default option. Relying on ‘objective analysis’ in making the business case for change will rarely win over hearts as well as minds.

On the other hand, the experience lens has some positive practical advice:

- *Analysis can cost more than it's worth.* Because good information is hard and expensive to get, and because analysis can consume too much time, sometimes, it is sensible simply to cut short information search and analysis. Depending on the availability of information and the ability to analyse it, beyond a certain point, it might be sensible just to drop the analysis.
- *Experience may provide the best guide.* If analysis is not going to produce good answers, then relying on the rules-of-thumb ('heuristics') and instincts of experienced managers may be at least as effective. Sometimes, a quick response that is half right is better than an analytical response that is only slightly better but much slower.
- *Challenge the consensus.* While established rules-of-thumb can be effective, sometimes, it is necessary to challenge the consensus in an organisation. As in Chapter 13, 'groupthink' is a risk. The need to challenge existing approaches is often the motivation for bringing in new leaders from outside the organisation in order to manage strategic change (Chapter 15).

Figure C.iii Variety lens

Figure C.iii: Long Description

Strategy as variety

The extent to which the design and experience lenses help explain innovation is rather limited. The variety lens, on the other hand, emphasises innovation and change. However, as indicated in Figure C.iii, the variety lens puts low value on rational analysis and tends to give little weight to what is simply legitimate in an organisation. Viewed through the variety lens, strategies are seen as emerging from the different ideas that bubble up from the variety in and around organisations.

The variety lens builds on two theoretical perspectives from the natural sciences, both emphasising spontaneity. First, there is *evolutionary theory,* in which natural phenomena evolve through a Darwinian process of Variety, Selection and Retention.[5] Various genetic mutations emerge as more or less random experiments; some variations are selected for success by their environments; and these successful variations may be retained over the long term because of continuing good environmental fit. Second, there is *complexity theory,* where phenomena are characterised by complex, dynamic sets of interactions, so that small events can have surprisingly large effects.[6] An example is the famous butterfly effect, where the flap of a butterfly's wings in Brazil triggers a series of escalating knock-on effects that eventually cause a tornado in far-way Texas. In both evolutionary and complexity theories, variety in the form of many small experiments or interactions can lead to large

and enduring outcomes. These outcomes are generated spontaneously, with very little top-down direction.

Moving from nature to strategy, the variety lens de-emphasises the deliberate decision making of the design lens. Likewise, the emphasis on spontaneity contrasts with the conservatism of the experience lens. For human organisations, the three elements of evolutionary theory work as follows:

- *Variety.* Organisations and their environments offer a rich 'ecology' for the generation of different ideas and initiatives. There are many kinds of people and many kinds of circumstance. Sales people working closely with customers may be able to sense new opportunities at least as well as top managers at headquarters. Since people interact with their environment throughout the organisation, new ideas often come from low down in the hierarchy, not just from the top.[7] Complexity theorist Bill McKelvey refers to this as the 'distributed intelligence' of an organisation.[8] Variety can even come from apparent mistakes, just as genetic mutations come from imperfect genes. A famous example is Post-it Notes™, which originated from an 'imperfect' glue being applied to paper, but resulted in a semi-adhesive for which the researcher saw market potential.
- *Selection.* In nature, selection is 'blind', determined by environmental fit rather than deliberate intervention. In organisations, selection can be nearly as blind, with strategies selected more according to how well they

match prevailing cultures or standard decision rules, rather than by objective analysis and evaluation. In this view, there is an ‘internal ecology’ within organisations, with ideas and initiatives winning out against competing ideas and initiatives according to their internal fit.[9] A good idea may fail simply because it does not meet existing selection rules, regardless of its overall merits: for example, a company may apply standard return on capital criteria that are outdated on the basis of the current real cost of capital (see Chapter 11 on strategy evaluation). On the other hand, as in complexity theory, ideas can gain rapid momentum as they attract ‘positive feedback’: the support of one important set of actors can attract the support of another, and the support of that set of actors attracts the support of still others, and so on, in an escalating process. Thus, selection mechanisms can be self-reinforcing, speeding the passage of both good and bad ideas.

- *Retention.* As well as processes of selection, there are processes of retention. Retention refers to the preservation and reproduction over time of selected variations.[10] Retention may happen as particular policies or preferences become embedded in the organisation. Retention may be achieved by instituting formal procedures: for example, job descriptions, accounting and control systems, management information systems, training and organisation structure. Often, it is done through more informal processes of routinisation, in

which simple repetition of certain routine behaviours leads to the eventual imprinting of such routines in the culture and capabilities of the organisation.

Implications

A key insight from the variety lens is that managers need to be wary of assuming they can wholly control the generation and adoption of new ideas. However, there are a number of things managers can do to foster initiatives and prevent the undue suppression of good ideas. At the same time, the variety lens points both managers and students to distinctive sources of innovation in organisations. We highlight three key implications:

- *Allow for emergence.* Rather than being deliberately designed, strategies often emerge from the bottom and the periphery of organisations, accumulating coherence over time. As in Chapter 1, Henry Mintzberg's definition of strategy as an emergent 'pattern' rather than an explicit statement is widely relevant. Managers and students should not necessarily trust in the stated strategic vision and mission (Chapter 1), but rather look to what is actually happening, especially on the ground. The future of an organisation may well be emerging from somewhere far beyond headquarters' formal initiatives. Indeed, in many industries, large firms frequently watch the interesting experiments and initiatives of small independent firms, and then buy them up.[11]
- *Encourage interaction, experiment and change.* From a variety lens point of view, organisations can be too

stable and ordered. To generate variety, managers should promote potentially disruptive interactions across internal and external organisational boundaries: cross-departmental initiatives are important internally and communication with customers, suppliers, partners and innovators should be extensive externally. Alphabet (formerly Google) encourages experiments by giving staff 20 per cent of their time to pursue their own projects. Complexity theorists recommend regular change in order to stay at the dynamic ‘edge of chaos’, the delicate balancing point where organisations neither settle down into excessive stability nor topple over into destructive chaos.[12]

- *Attend to key rules.* If strategies tend to get adopted according to their fit with established organisational cultures or investment criteria, then managers need to attend at least as much to setting the context for strategy as to individual strategic decisions. As above, managers should create a context conducive to interaction, experiment and change. But they should particularly attend to the key selection and retention rules by which strategies are allowed to emerge. Drawing on complexity theory, Kathy Eisenhardt encourages the design of ‘simple rules’, a few clear guidelines for strategy selection and retention.[13] For example, the movie studio Miramax only selects movies that revolve round a central human condition (e.g., love), feature an appealing but flawed central character,

and have a clear storyline. At the games company Valve, the rule is new games projects get automatic approval if three software engineers volunteer to work on them.[14]

Strategy as discourse

In many ways, management is about discourse – i.e., talking and writing. Managers spend 75 per cent of their time communicating: for example, gathering information, persuading others or checking up on progress.[15] In particular, strategy has a high discursive component, involving both talk and text. Strategy is debated in meetings, written as formal plans, explained in annual reports and media releases, presented on PowerPoints, and passed on to employees via blogs and social media.[16] The discourse lens recognises this discursive component as central to strategy. Here, as indicated in Figure C.iv, the legitimacy of discourse is particularly important. The importance of legitimacy, however, can work against both objective rationality and organisational innovation.

An important influence on the discourse lens is the work of the French philosopher Michel Foucault. Foucault stresses the subtle effects that language can have on understanding, power and personal identities. For example, he shows how changing scientific discourses in the seventeenth and eighteenth centuries redefined insanity as treatable illness rather than natural foolishness.[17] The insane now had a new identity, medically ill, and became subject to a new power, the medical doctors with the task of curing them. In a similar way, the 'financialisation' discourse, emerging in the 1990s and early 2000s, sought to redefine the purpose of the firm as solely about shareholder value,

enhancing the power of investors to insist on short-term financial results rather than long-term strategic investments.[18] Those taking a discourse lens are therefore sensitive to how strategy discourse can shape understanding, change personal identities and disseminate power.

Figure C.iv Discourse lens

Figure C.iv: Long Description

These three effects of strategy discourse are explored as follows:

- *Shaping understanding.* The language of strategy has characteristics that make it convincing to others.[19] Its concepts and jargon have high legitimacy in many organisations. Here the discourse lens reveals the design lens in another light. The legitimacy of strategy discourse gives the analytic apparatus of the design

lens a persuasiveness that often goes beyond the technical effectiveness of the analysis itself. Drawing on established techniques such as Porter's Five Forces (Chapter 4) or fashionable concepts such as ecosystems (Chapter 4) can add to the authority of strategic recommendations. The ability to write inspiring vision and mission statements (Chapter 1) can help motivate a whole organisation. The justification of strategic change by the radical rhetoric of hypercompetition (Chapter 4) or disruptive innovation (Chapter 11) may give legitimacy to radical actions that might otherwise be rejected as excessive.[20] In other words, managers draw on the rhetoric of strategy and the apparent 'rightness' of strategy concepts to convince others they should comply.

- *Defining identities.* How managers talk about strategy also positions them in relation to others, either by their own deliberate choice or as a result of how they are perceived.[21] Discourse therefore influences the identity and legitimacy of managers as 'strategists'. The ability to use the rational analytical language of the design lens helps define managers as legitimate participants in the strategy process. Of course, sometimes, other kinds of discursive identity may be appropriate. For example, in some contexts, the language of the heroic leader (Chapter 16) or the innovative entrepreneur (Chapter 11) might offer more support for the decision maker's identity than simple rational analyst. Whatever the

precise identity, the assumptions built into strategy discourse are liable to affect behaviour. For example, lower-level managers and professionals who internalise the strategy discourse of competitiveness and performance as part of their identities come to prioritise those values in their everyday work, subordinating to some degree the administrative or professional values (such as equity or care) that might otherwise be important in their roles.

- *Instrument of power.* Here, strategy discourse is linked to power and control.[22] By understanding the concepts of strategy, or being seen to do so, top managers or strategy specialists are positioned as having the knowledge about how to deal with the really difficult problems the organisation faces. The possession of such knowledge gives them power over others who do not have it. Design lens discourse, with its commitment to demanding forms of technical analysis, can be particularly elitist and exclusive. Thus, mastering the discursive language of the design lens offers a political advantage as well as an analytical one. At the same time, the internalisation of strategy discourse by employees renders them more compliant to the strategy: they see pursuing the strategy as a natural part of their role. In this sense, discourse is associated with power when it attracts followers and is self-reproducing and self-reinforcing. Insofar as strategy discourse serves the interests of the powerful, it may

suppress innovation and change and distort objective rational analysis from the point of view of the organisation as a whole.

Implications

The discourse lens suggests the importance of the appearance, as well as the reality, of rational argument. Through the discourse lens, strategies need to be legitimate, not simply correct. Strategy discourse, moreover, helps define legitimate participants in strategic decision making and gives power to the decisions that are ultimately made. The fundamental lesson for managers and students is that the language of strategy matters.

The implications of the discourse lens have both instrumental and critical aspects:

- *Use strategy discourse skilfully.* The right discourse can add legitimacy to particular strategies or individuals in an organisation.[23] This discourse needs to match particular contexts and circumstances. Justifying a strategy to a potential investor may call for a logical, highly quantitative financial case; explaining the same strategy to employees may involve emphasising implications for job security and career growth. For some organisations, the analytic discourse of the design lens will be a legitimate mode of justification; in other organisations, appeal to technical or professional values may be more effective. The instrumental value of the

discourse lens lies in this: using the right language matters both for justifying and imposing strategies and for participating in strategy discussions in the first place.

- *Treat strategy discourse sceptically.* Just as strategy discourse can be used instrumentally, so should managers and students be ready to take a critical perspective towards such discourse. Are concepts and frameworks being used as a smokescreen for some particular individuals or groups to advance their sectional power and interests, as for example ‘financialisation’ discourse did for investors? Are strengths and weaknesses, threats and opportunities (Chapter 2) being mystified or exaggerated? Are the grandiose ambitions of vision and mission statements just empty rhetoric (Chapter 1)? Seeing strategy as discourse can prompt the healthy questioning of concepts, ideas and rhetoric that might otherwise be taken for granted. The discourse lens encourages managers and students to see through the surface language of strategy to uncover the deeper interests and motives behind it. Adopters of the discourse lens are naturally sceptical.

Conclusion

The core assumptions and the key implications of the four lenses of design, experience, variety and discourse are summarised in Table C.i. They are not offered here as an exhaustive list, but to crystallise the distinctive perspectives of each lens. Indeed, this Commentary as a whole is merely an introduction and you may usefully explore each of the lenses further yourself. After all, each of the lenses presented here actually includes several perspectives themselves. For example, the variety lens builds on both evolutionary theory and complexity theory, each of which offers distinctive points of their own. So, within these lenses there are finer-grained insights to discover. The references at the end of this Commentary should help with deeper exploration of the lenses. In addition, there are whole books written that provide multiple perspectives on strategy, from the four different ones that Richard Whittington offers, to the ten of Henry Mintzberg and his co-authors, or even the 13 'images' provided in the collection by Stephen Cummings and David Wilson.[24]

However, the overarching message that comes from all four lenses is this: in considering a topic like strategy, it is useful to take a critical approach. Being critical involves recognising that one lens is probably not enough, and that every lens has its own value and limitations. You should not necessarily be satisfied with just the rational analysis of the design lens. Use the experience lens to consider sources of

unconscious bias; take a variety lens approach to be sensitive to spontaneous initiatives from the bottom or periphery; stay sceptical by interpreting strategy talk through the discourse lens. It is because different perspectives are important that we shall return to the four lenses in the critical commentaries at the ends of Parts II and III of this book. Throughout your course, we encourage you to approach the topics of strategy with eyes open to different points of view. To get into the habit, you might now want to consider the short Meta case through the four strategy lenses.

Table C.i A summary of the strategy lenses

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Case example

How does Meta make strategy?

As Facebook became Meta in 2021, do the four lenses help explain how the company sets its strategic direction?

Sheryl Sandberg, Facebook Chief Operating Officer

Source: epa european pressphoto agency b.v./Alamy Stock Photo

In October 2021, Facebook's Founder Mark Zuckerberg renamed his company Meta, heralding a new set of metaverse (virtual reality) products to go along with its traditional social media products Instagram, Messenger, WhatsApp and Facebook. Meta's official mission would still be the same as Facebook's had been: 'to give people the power to build community and bring the world closer together'. Zuckerberg explained the logic of the company's strategic move in his Founder's Letter: 'In our DNA, we build technology to bring people together. The metaverse is the next frontier in connecting people, just like social networking was when we got started'. Facebook and the other social media apps would continue, but the metaverse would be the future of connection. Meta was going to pour $10bn into the metaverse business in 2022 and double the metaverse workforce to 20,000 engineers.

But, nearly two decades after its 2004 foundation, Meta's mission to connect is in increasing doubt. The company has become implicated in the dissemination of divisive material in countries ranging from the USA to Myanmar and faces allegations of spreading glamorising images of body dysphoria and suicide to millions of young people. For more than a decade, Facebook, and latterly Instagram, have been seen as at the heart of a 'loneliness epidemic' among young people who withdraw from society as they become demotivated by comparing their lives with the lives portrayed on screen. But when, in 2021, Facebook whistle-blower Frances Haugen exposed the company's own internal research confirming these effects, Mark Zuckerberg was dismissive. In a message to Facebook employees, he wrote: 'I think most of us just don't recognize the false picture of the company that is being painted . . . At the heart of these accusations is this idea that we prioritize profit over safety and well-being. That's just not true.' At the same time as the company was coping with increasing public criticism, it also faced competitive threats as new social media such as TikTok have emerged. By early 2022, the company's shares had fallen by a third from their peak in August 2021.

Meta brings two powerful tools to the reorientation of its strategy – rich data and bottom-up initiative. To start with, Meta is an intensely data-driven and analy-tical company. More than 11 per cent of its employees hold PhDs. The company holds enormous amounts of data on users around the world and has direct access to key pipelines for news and business. The company has traditionally believed in distributing its data as widely as possible among employees, so that all decision making is fact-based. One of the company's senior engineers recalls of the first decade of Facebook's existence: 'In Facebook, one of our major goals was growth – how to get to 1 billion users. Part of that was evaluating different templates, layouts and calls to action. People had different theories about this – some said sleek, sophisticated approaches would work best, others supported simple calls to action. We tested with user groups, analysed the data and decided to go for simplicity.' Analysis drove the strategy.

At the same time, the distribution of data also allows for bottom-up innovation. The Facebook's 'People you may know' feature was developed following the initiative of engineers on the ground using the rich data resources the company has. Facebook is also a big user of 'hackathons' to address company issues. Here, Facebook employees gather every few months for all-night coding sessions, traditionally fuelled by Chinese food provided by the company (they continued virtually through the COVID pandemic). Hackathons are informal and non-hierarchical, inspired by the casual but intense work style of Zuckerberg and his comrades in the company's early years. Ad-hoc inter-departmental teams form spontaneously around ideas arising from participants, and work through the night (or over a weekend) to take them forward far enough for the company to adopt them as official projects. Ideas that have originated in these hackathons include Facebook's 'Like' button, 'Safety Check' and 'Donations'. A senior manager explains the spirit: 'There are only two rules: you have to work on something outside your day job and, if it's your first hackathon, you have to hack.'

Despite the company's abilities to harness enormous troves of data and the energy of its hackers, Meta still faces challenges in altering its strategic direction. Since its

foundation, the company has adopted a ‘growth-at-all costs’ mentality. An internal memo from a senior Facebook executive in 2016 expressed the philosophy: **We connect more people. That can be bad if they make it negative. Maybe it costs a life by exposing someone to bullies. Maybe someone dies in a terrorist attack coordinated on our tools. And still we connect people. The ugly truth is that we believe in connecting people so deeply that anything that allows us to connect more people more often is *de facto* good.**

This growth at all costs mentality had helped drive Facebook to 3.5 billion monthly active users by 2022. But the start of that year also saw a drop in active users for the first time in the company’s history. The financial markets responded by slashing Meta’s share price by more than a quarter. Something seemed broken in the company’s strategic formula.

Mark Zuckerberg, still Chairman and Chief Executive, and Sheryl Sandberg, Chief Operating Officer since 2008, were of course major shapers of this strategic formula. Zuckerberg, still only 37 in 2022, has led the company since dropping out of Harvard University during his undergraduate degree. Aged 52, Sandberg’s prior business experience had almost all been at Google, from where she brought the techniques that turned Facebook from a social network to a profit-driven powerhouse. However, there has been increasing pressure from major investors for change at the top. Zuckerberg insists he is staying and, regarding Sandberg, adds: ‘Sheryl is a really important part of this company . . . . she’s been an important partner for me [since 2008]. And I’m really proud of the work we’ve done together, and I hope that we work together for decades more to come.’

In explaining the reorientation towards the metaverse, Zuckerberg said in an interview: ‘One of the things that I’ve found in building the company so far is that you can’t reduce everything to a business case upfront. I think a lot of times the biggest opportunity is you kind of just need to care about them and think that something is going to be awesome

and have some conviction and build it.' Nobody knows how the metaverse will play out, but Zuckerberg thinks it awesome enough to start with a $10bn bet.

Main sources: *ZdNet,* 26 April 2017; *Business Insider,* 20 June 2017; *Techspot,* 20 March 2018; *CNBC News,* 20 November 2018; *SeekingAlpha,* 30 January 2019; Mark Zuckerberg, *Facebook pages,* passim, 4 February 2019; *Financial Times,* 29 October 2021; *Stratchery*, 28 October 2021.

Questions

1 Explain which of the four lenses are relevant to strategy-making at Meta. Which do you think explains most about what is happening there?

2 How would you bring change to Meta? (You may wish to consult Chapter 16.)

Business strategy
Corporate strategy
International
II
Strategic choices
Entrepreneur-ship
Aquisitions & alliances
I
Strategic position
III
Strategy in action

Part II

Strategic choices

This part explains strategic choices in terms of:

- How organisations relate to competitors in terms of their competitive business strategies and how they configure their business models.
- How broad and diverse organisations should be in terms of their corporate portfolios.
- How far organisations should extend themselves internationally.
- How organisations are created and innovate.
- How organisations pursue strategies through organic development, acquisitions or strategic alliances.

Introduction to Part II

This part is concerned with the strategic choices, or options, potentially available to an organisation for responding to the positioning issues discussed in Part I of the book. There are three overarching choices to be made, as shown in Figure II.1. These are:

- Choices as to *how an organisation at a business level positions itself in relation to competitors.* This is a matter of deciding how to compete in a market. For example, should the business compete on the basis of cost or differentiation? Or is competitive advantage possible through being more flexible and fleet-of-foot than competitors? Or is a more cooperative approach to competitors appropriate? These business strategy questions, together with business model considerations, are addressed in Chapter 8.
- Choices of *strategic direction*: in other words, which products, industries and markets to pursue. Should the organisation be very focused on just a few products and markets? Or should it be much broader in scope, perhaps very diversified in terms of both products (or services) and markets? Should it create new products or should it enter new territories? These questions relate to corporate strategy, addressed in Chapter 9, international strategy in Chapter 10 and innovation and entrepreneurial strategy, as discussed in Chapter 11.

- Choices about *methods by which to pursue strategies.* For any of these choices, should they be pursued independently by organic development, by acquisitions or by strategic alliances with other organisations? This is the theme of Chapter 12.

The discussion in these chapters provides frameworks and rationales for a wide range of strategic choices. But some words of warning are important here:

- *Strategic choices relate back to analysis of strategic position.* Part I of the book has provided ways in which strategists can understand the macro environment (Chapter 3), identify forces at work in the industry and sector (Chapter 4), identify and build on resources and capabilities (Chapter 5), identify an overall purpose and meet stakeholder expectations (Chapter 6) and build on the benefits, as well as be aware of the constraints, of their organisation's cultural and historical context (Chapter 7). Exploring these issues will provide the foundation for considering strategic options. However, the *Exploring Strategy* Framework (Figure 1.3) implies that issues of position, choice and action overlap. Thus, working through the choices of Part II is also likely to feed back into the initial analysis of strategic position. Similarly, the potential of some strategic choices will only be revealed in action, the theme of Part III.
- *Key strategic issues.* Choices have to be made in the context of an organisation's strategic position, of course.

But here it is important that the analysis of strategic position distinguishes the *key strategic issues* from all the many positioning issues that are likely to arise. Analysis needs to avoid producing a very long list of observations without any clarity of what such key issues are. There is no single 'strategy tool' for this. Identifying key strategic issues is a matter of informed judgement and, because managers usually work in groups, of debate. The analytic tools provided can help, but are not a substitute for judgement.

Figure II.1 Strategic choices

Chapter 8

Business strategy and models

Key terms

business model

competitive advantage

competitive strategy

cost-leadership strategy

differentiation strategy

focus strategy

game theory

hybrid strategies

multi-sided platform

strategic business unit (SBU)

strategy canvas

Learning outcomes After reading this chapter you should be able to:

- Assess business strategy in terms of the *generic competitive strategies* of *cost leadership, differentiation* and *focus*.
- Understand the logic of *hybrid strategies* and how new strategies can be identified with the help of the *strategy canvas*.
- Apply principles of *interactive strategies* and *game theory* and the benefits of *competition vs cooperation* to business strategy.

- Identify and apply *business model* components: *value creation, configuration* and *capture.*
- Assess and understand diverse *multi-sided platform strategies*.

Long Description

8.1 Introduction

This chapter is about two fundamental strategic choices for a business or other kind of organisation: first, what business strategy it should choose and, second, what business model it should adopt. Business strategies are about how to compete in a marketplace. A restaurant, for instance, has to decide a range of issues such as food concept, menus, décor and prices in the light of local competition from other restaurants. Exclusive restaurants that receive two or three stars in the French restaurant guide *Michelin*, for example, of course have a completely different business strategy compared to McDonalds. The former with a luxury niche strategy and the latter with a low-cost low-price focus.

Another important choice is to identify the relationship between the value created for customers and other participants, the organisational activities that create this value and how the organisation and other participants can capture value from this – a *business model.* For instance, Amazon was a pioneer with its e-commerce business model that contrasted with bricks-and-mortar retailers. Over time, however, business models get established and many other retailers also entered into e-commerce. This shows that organisations need to consider what business model to build on – established or new ones or both.

Business strategy and business models are not just relevant to the private business sector. Charities and public-sector organisations also compete and have business models. Thus, charities compete between each other for support from donors. Public-sector

organisations also need to be ‘competitive’ against comparable organisations in order to satisfy their stakeholders, secure their funding and protect themselves from alternative suppliers from the private sector. Schools compete in terms of examination results, while hospitals compete in terms of waiting times, treatment survival rates, and so on. Likewise, these sectors need to consider what value is created for whom and how organisational activities contribute to this in a business model. Although some of the detailed implications may vary between sectors, wherever comparison is possible with other similar organisations, basic principles of business strategy and models are likely to be relevant. Very few organisations can afford to be demonstrably inferior to peers. Most have to make choices on key competitive variables such as costs, prices and quality.

Business strategy and models are fundamental also to the many business units that typically make up large diversified organisations. They typically include several decentralised ‘strategic business units’ in different product or service areas each with their own business strategy, depending on the served market. **A strategic business unit (SBU) supplies goods or services for a distinct domain of activity** (sometimes called ‘divisions’ or ‘profit centres’). For example, Nestlé’s ice-cream SBU must decide how to compete against local artisanal ice cream companies. These kinds of business strategy issues are distinct from the question as to whether Nestlé should own an ice-cream business in the first place: this is a matter of corporate strategy, the subject of Chapter 9.

Figure 8.1 shows the main three themes that provide the structure for the rest of the chapter:

- *Generic competitive strategies*, including cost leadership, differentiation, focus and hybrid strategies.
- *Interactive strategies*, building on the notion of generic strategies to consider interaction with competitors wherever competitors' moves are interdependent, and including choices between competition and cooperation based on *game theory.*
- *Business models*, including the three basic components of *value creation, value configuration* and *value capture.*

Figure 8.1 Business strategy and models: three main themes

Figure 8.1: Long Description

8.2 Competitive strategies

This section introduces the competitive element of business strategy, with cooperation addressed particularly in Section 8.3. **Competitive strategy is concerned with how a company, business unit or organisation achieves competitive advantage in its domain of activity.** Competitive strategy therefore involves issues such as costs, product and service features and branding. In turn, **competitive advantage is about how a company, business unit or organisation creates value for its users both greater than the costs of supplying them and superior to that of rivals.** Competitive advantages should underpin competitive strategies. There are two important features of competitive advantage. To be *competitive* at all, an organisation must ensure that customers see sufficient value that they are prepared to pay more than the costs of supply. To have an *advantage,* the organisation must be able to create greater value than competitors. In the absence of a competitive advantage, an organisation's competitive strategy is always vulnerable to competitors with better products or offering lower prices.

There are two fundamental means of achieving competitive advantage. An organisation can have structurally lower *costs* than its competitors. Or it can have products or services that are *differentiated* from competitors' products or services in ways that are so valued by customers that it can charge higher prices that cover the additional costs of the differentiation. In defining competitive strategies, Michael Porter adds a further dimension based on the

scope of customers that the business chooses to serve.[1] Businesses can choose to focus on narrow customer segments, for example a particular demographic group such as the youth market. Alternatively, they can adopt a broad scope, targeting customers across a range of characteristics such as age, wealth or geography.

The distinctions between cost, differentiation and scope define a set of competitive 'generic' strategies: in other words, basic types of strategy that hold across many kinds of business situations and are feasible no matter how attractive or unattractive an industry is. If the competitive forces are strong, as in an unattractive industry, they help neutralise these. The strategies are illustrated in Figure 8.2. In the top left-hand corner is a strategy of *cost leadership,* as exemplified in the British food and grocery market by retailers such as Asda. Asda seeks to use huge economies of scale and extremely tight cost discipline to achieve systematically lower costs compared to competitors. Waitrose, in contrast, pursues a strategy of *differentiation,* offering a range of quality, fresh and environmentally friendly products focused on the upper market with relatively higher prices. Porter distinguishes between cost focus and differentiation focus, but for him narrow scope is such a distinctive fundamental principle that these two are merely variations on the same basic theme of narrowness. For example, delicatessens target a relative narrow group of higher end customers with their high food quality and provenance. They thus often achieve a higher price for their distinctive products through their *differentiation focus* strategy. On the other hand, Iceland Foods has a *cost focus* strategy concentrated on frozen and chilled foods that reduces costs compared to generalist competitors with broader product ranges.

The rest of this section discusses these three generic competitive strategies in more detail together with hybrid strategies and Blue Ocean strategy.

Figure 8.2 Three competitive generic strategies

Source: Adapted with the permission of The Free Press, a Division of Simon & Schuster, Inc., from *Competitive Advantage: Creating and Sustaining Superior Performance* by Michael E. Porter. Copyright © 1985, 1998 by Michael E. Porter. All rights reserved.

Figure 8.2: Long Description

8.2.1 Cost-leadership strategy

Cost-leadership strategy involves becoming the systematically lowest-cost organisation in a domain of activity. For example, Ryanair pursues a relentless low-cost strategy in the European airline industry. The airline saves costs in virtually every aspect of its

operation from purchasing a single type of aircraft (without reclining seats) to selling tickets primarily online (over 90 per cent of sales) to low employee costs (second lowest in Europe). There are four key *cost drivers* that can help deliver cost leadership, as follows:

- *Input costs* are often very important, for example labour or raw materials. Many companies seek competitive advantage through locating their labour-intensive operations in countries with low labour costs. Examples might be service call centres in India or manufacturing in South East Asia and China. Location close to raw material sources can also be advantageous.
- *Economies of scale* refer to how increasing scale usually reduces the average costs of operation over a particular time period, perhaps a month or a year. Economies of scale are important wherever there are high fixed costs. Fixed costs are those costs necessary for a level of output: for example, a pharmaceutical manufacturer typically needs to do extensive R&D before it produces a single pill. Economies of scale come from spreading these fixed costs over high levels of output: the average cost due to an expensive R&D project halves when output increases from one million to two million units. Economies of scale in purchasing can also reduce input costs. The large airlines, for example, are able to negotiate steep discounts from aircraft manufacturers. For the cost-leader, it is important to reach the output level equivalent to the *minimum efficient scale.* Note, though, that *diseconomies of scale* are possible. Large volumes of output that require special overtime payments to workers or involve the neglect of equipment maintenance can soon become very expensive. As to the left in

Figure 8.3, therefore, the economies of scale curve is typically somewhat U-shaped, with the average cost per unit actually increasing beyond a certain point.

- *Experience*[2] can be a key source of cost efficiency. The *experience curve* implies that the cumulative experience gained by an organisation with each unit of output leads to reductions in unit costs (see Figure 8.3 to the right). For example, for many electronic components, per unit costs can drop as much as 95 per cent every time the accumulated volume doubles. The efficiencies are basically of two sorts. First, there are gains in labour productivity as staff simply learn to do things more cheaply over time (this is the specific *learning curve* effect). Second, costs are saved through more efficient designs or equipment as experience shows what works best. The experience curve has three important implications for business strategy. First, entry timing into a market is important: early entrants into a market will have experience that late entrants do not yet have and so will gain a cost advantage. Second, it is important to gain and hold market share, as companies with higher market share have more ‘cumulative experience’ simply because of their greater volumes. Finally, although the gains from experience are typically greatest at the start, as indicated by the steep initial curve to the right in Figure 8.3, improvements normally continue over time. Opportunities for cost reduction are theoretically endless. Figure 8.3 compares the experience curve (to the right) and economies of scale (to the left) in order to underline the contrast here. Unlike scale, where diseconomies appear beyond a certain point, the experience curve implies at

worst a flattening of the rate of cost reduction. However, completely new production technologies from competitors can potentially introduce even steeper experience effects and further improved cost savings.

- *Product/process design* also influences cost. Efficiency can be 'designed in' at the outset. For example, engineers can choose to build a product from cheap standard components rather than expensive specialised components. Organisations can choose to interact with customers exclusively through cheap web-based methods, rather than via telephone or stores. Organisations can also tailor their offerings in order to meet the most important customer needs, saving money by ignoring others.

Figure 8.3 Economies of scale and the experience curve

Figure 8.3: Long Description

There are two tough requirements for cost-based strategies. First of all, the principle of competitive advantage indicates that a business's cost structure needs to be systematically *lowest* cost (i.e., lower than all competitors'). Having the second-lowest cost structure implies a competitive disadvantage against somebody. Competitors

with higher costs than the cost leader are always at risk of being undercut on price, especially in market downturns. For businesses competing on a cost basis, systematic cost leadership is always more secure than being second or third in terms of costs. The US financial investments company Vanguard is a good example of this, as discussed in Illustration 8.1.

The second requirement is that low cost should not be pursued in total disregard for quality. To sell its products or services, the cost leader has to be able to meet market standards. For example, low-cost Chinese car producers exporting to Western markets need to offer not only cars that are cheap, but cars that meet acceptable norms in terms of style, safety, service network, reliability, resale value and other important characteristics. Cost leaders have two options here:

- *Parity* (in other words, equivalence) with competitors in product or service features valued by customers. Parity allows the cost leader to charge the same prices as the average competitor in the marketplace, while translating its cost advantage wholly into extra profit (as in the second column of Figure 8.4). The Brazilian steel producer CSN, with its cheap iron-ore sources, is able to charge the average price for its steel and take the cost difference in greater profit.
- *Proximity* (closeness) to competitors in terms of features. Where a competitor is sufficiently close to competitors in terms of product or service features, customers may only require small cuts in prices to compensate for the slightly lower quality. As in the third column in Figure 8.4, the proximate cost-leader still earns better profits than the average competitor because its

lower price eats up only a part of its cost advantage. This proximate cost-leadership strategy might be the option chosen initially by Chinese car manufacturers in export markets, for example.

Figure 8.4 Costs, prices and profits for competitive generic strategies

Figure 8.4: Long Description

Illustration 8.1 Vanguard's low-cost strategy in asset management and financial advice The US company Vanguard pioneered a distinct low-cost strategy in the mutual fund industry and is now exporting it world-wide.

Mutual funds are managed by investment companies that raise money from multiple customers and invest the money in a group of assets (stocks, bonds, money market instruments, etc.). Each customer, often as part of a retirement plan, owns shares that represent a portion of the holdings of the fund. They are charged an annual fee that covers investment advisory fees, administrative costs, distribution fees, and other operating expenses. The traditional way of competing in the industry was by actively managed and differentiated investments that tried to generate as high returns as possible and thus being able to charge higher fees. The emphasis was on the business performance end of the business by offering differentiated funds with higher returns. Vanguard instead focused on the cost end of the business and offered customers considerably lower annual fees and costs. Most comparisons showed that Vanguard's fees or expense ratios were 65–80 per cent less than the industry average depending on investment assets. The company also launched the industry's first index mutual fund that passively followed a stock market index without ambitions to generate a better performance than the market, but which outperformed many actively managed funds.

Pennsylvania-based Vanguard is the world's second-largest asset manager and has started to export its low-cost focus worldwide. Sean Hagerty, Vanguard's European head asserts: We knew that it would be more challenging to build a direct to consumer business in Europe than in the US. But the experience in the UK has emboldened our ambitions to bring better value for money to investors throughout Europe.[1]

Lowering costs is in Vanguard's DNA and their low-cost strategy involves several components. First, unlike competitors, it does not need to make a profit. Tim Buckley, chief investment officer explained: We are not a listed company. We're a mutual company. We're owned by our clients. So, when we make a profit, we have two choices. We can roll that profit back into the business or we can pay it out to our owners, our clients, in the form of lower expenses. Over the years, we have lowered expenses and that has attracted more clients.[2]

Second, Vanguard distributed its funds directly to customers and did not need to pay commissions of around 8 per cent to brokers. Third, the company internalised investment advisory functions of the funds at cost instead of using external investment advisers that would charge a premium. Fourth, Vanguard relied on a no-nonsense thrifty organisational culture where managers were incentivised to control cost and no one, not even senior executives, flew first class. Fifth, the company had only a few retail centres and spent less on advertising than anyone else in the industry. Last, but not least, as one of the largest asset managers globally it gained large economies of scale.

The next step for Vanguard is to do to the growing financial advisory services industry what it has done to the mutual fund industry. Based on various digital services and other cost reductions, they offer advisory services at a fraction of the cost of competitors. The Vanguard Personal Advisor Service charges annually 0.3 per cent on assets compared to the industry average of 1 per cent: Can we provide really super-high quality advice at a very low cost and do that in a very large way, and change the market? I think we can. We continue to think of our primary mission to reduce the complexity and cost of investing across the board.[3]

Source: (1) C. Flood (2021) *Financial Times,* 15 August; (2) D. Oakley (2015) *Financial Times,* 4 March; (3) S. Foley (2014) *Financial Times,* 8 December; (4) Michael Mackenzie and Chris Flood, *Financial Times*, 24 June.

Questions

1 What type of competitive strategy, low-cost, differentiation, focus or hybrid, would you suggest as a way of competing with Vanguard?

2 Using various digital services is one approach to lower costs in financial advisory services, as indicated above. What other ways could there be to lower costs to support a low-cost strategy in this new area for Vanguard?

8.2.2 Differentiation strategy

The principal alternative to cost leadership is differentiation.[3] **Differentiation strategy involves uniqueness along some dimension that is sufficiently valued by customers to allow a price premium.** For example, German manufacturer Miele pursues a differentiation strategy in the domestic appliance industry. Its European manufactured, high-quality and durable dishwashers, washing machines and stoves are targeted towards higher income households at a price premium. Relevant points of differentiation vary between markets. Within each market too, businesses may differentiate along different dimensions. In clothing retail, competitors may differentiate by store size, locations or fashion. In cars, competitors may differentiate by safety, style or fuel efficiency. Where there are many alternative dimensions that are valued by customers, it is possible to have many different types of differentiation strategy in a market. Thus, even at the same top end of the car market, BMW and Mercedes differentiate in different ways, the first typically with a sportier image, the second with more conservative values. In brief, there are various aspects to consider in pursuing a differentiation strategy and below are three primary differentiation drivers to consider:

- *Product and service attributes.* Certain product attributes can provide *better or unique features* than comparable products or services for the customer. For example, the Dyson vacuum cleaner with its unique technology provides customers with a better suction performance compared to competitors. The possibilities of product differentiation are, however, virtually endless and only limited by the creativity of an organisation. They may include differences in colour, design, speed, style, taste, innovation, etc. For vacuum cleaners, other companies may, for example, differentiate themselves on the basis of user convenience or design rather than suction performance. In building a basis for differentiation, it is vital to identify clearly the customer on whose needs the differentiation is based. This is not always straightforward; for example, it may be either an intermediate distributor or end customer (see Section 4.4.2).
- *Customer relationships.* Besides more tangible differences in product and service characteristics, differentiation can rely on the relationship between the organisation providing the product and the customer. This often relates to how the product is perceived by the customer. The perceived value can increase through *customer services and responsiveness.* This can include distribution services, payment services or after sales services, among other things. For example, Zalando, Europe's leading online fashion retailer, offers not only free shipping, but free returns and a 'bill-me-later' service. Products can also be differentiated for the individual customer through *customisation.* This is the case for a variety of consumer goods from athletic shoes to cars and also for business-to-business companies like

German software company SAP that not only sells its standardised software but customises it to meet specific customer needs. Finally, *marketing and reputation,* including emotional and psychological aspects, that an organisation projects can be another basis for differentiation. Building on brand image is common for products that otherwise are difficult to differentiate; this is a foundation for Coca-Cola's and Starbucks' strategies for example. Illustration 8.2 demonstrates a differentiation strategy based on customer relationship in the milk market.

- *Complements.* Differentiation can also build on linkages to other products or services. The perceived value of some products can be significantly enhanced when consumed together with other product or service complements compared to consuming the product alone (see Section 4.2.6). Apple has created the complementary services iTunes and App Store free of charge for the consumer, which differentiate its products (iPhone, iPad, etc.) with the possibility to charge a premium. Considering how customers benefit from consuming two products or services in tandem and a way of bundling products and services together to increase the value for the customer is thus another way of differentiation.

Illustration 8.2 Milk differentiation Oatly became an international success based on sustainability and humour Milk used to be regular, skimmed, or semi-skimmed, but today's milk market is full of differentiation attempts. Swedish oat milk producer

Oatly stands out. It went from a modest unknown oat milk producer to one of the world's most recognisable brands in less than a decade.[1] It is with thanks to Toni Petersson, the entrepreneur and strategist behind Oatly. He and his marketing team has created a novel and somewhat confrontational brand voice: quirky, frivolous and clearly humorous. Environmental benefits are central with slogans like 'Ditch milk – swap to oat drink and save 73% in CO2e'. The CEO himself has frequently featured in ads singing, 'Wow, no cow' during the Super Bowl, and debating with talking cows: arguing that oat milk tastes as good as dairy milk but generates much lower emissions.

Sustainability is thus central to Oatly's competitive strategy and mission. As expressed by the CEO:[2]

> I think for people today, sustainability is more of an ideology. It's a structured belief system, almost like a religion. But in this case, it's relied on what science says in regard to climate change and environmental issues.

Oatly has practically made drinking oat milk a lifestyle statement for the young and trendy – the 'post milk generation' as they express it. The Swedish dairy industry sued them when using the slogan 'Milk, but made for humans', but they won the marketing battle when publishing the lawsuit. A European-wide ad campaign was called 'Are You Stupid?' As many worldwide are (lactose) intolerant to milk, as the CEO says:[3]

> Our founders just figured, OK, if the vast majority of the world population are intolerant to milk why don't we make something that is actually designed for human beings not baby cows?

The brand is available in over 20 countries globally including more than 30,000 coffee shops and over 60,000 retail outlets. At the US launch, they approached high-end coffee shop baristas in places like New York City:[4]

> We thought . . . if you were able to take the recommendation of your local barista you see every day, and try our product through an expertly prepared latte or cappuccino, that would be a really amazing way to kind of be introduced to even just the idea of oat milk.

Oatly launched a brand partnership with Starbucks and even seemed to attract critics: a *New York Times* journalist who 'hates oat milk' gave them the two top positions when rating nine oat milks.[5] Oatly also attracted high-profile investors like Oprah Winfrey, Starbucks CEO Howard Schultz and Jay-Z. As proof of their achievements and future growth prospects, they successfully raised $1.4bn in an initial public offering (IPO) on Nasdaq with a valuation of $10bn for the whole company at the limited offer price. The IPO prospect claimed the brand speaks to 'consumer priorities of sustainability, trust and health'.

It seems Oatly has managed to uniquely differentiate themselves to allow a price premium 2.5 times regular milk despite simply selling oats and water. However, besides dairy and oat milk there is more competition in 'alt milk', dairy-free milk alternatives. Differentiation comes from multiple plant-alternatives: almond, soy, hemp, cashew, potatoes, coconut, rice, peas, peanuts, macadamia, etc. In addition, Silicon Valley start-ups have entered making lab-grown, 'animal-free' (regular) milk based on inserting a genetic code into yeasts that replicates part of a cow's DNA and fed with sugar it is brewed to multiply like beer. Moreover, the world's supremo drink brand, Coca-Cola, entered in 2020 with 'designer milk': Fairlife makes lactose-free and ultra-filtered milk with 50 per cent more protein and 50 per cent less sugar than regular milk. It looks as if Toni Petersson has competition cut out for him and must continue differentiating.

Sources:

1 E. Terazono and J. Evans (2021) ‘Oatly chief faces test as oat milk goes public with $10bn valuation’, *Financial Times*, 20 May.
2 Interviewed by Goldman Sachs, ‘Toni Petersson, Chief Executive Officer of Oatly’, Talks at GS.
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5 M. Sullivan (2019) ‘9 Oat Milks, Ranked (By Someone Who Hates Oat Milk)’, *New York Times*, 23 September.

Other sources: F. Pretty, F. (2022) ‘In photos: biotech start-ups challenge dairy industry’, *Financial Times*, 8 March; Coca-Cola press release, 1 March 2020; oatly.com.

Questions

1 Which are the most important customer relationships, product attribute and other elements in Petersson’s competitive strategy?
2 Provided the intense competition, how sustainable is Oatly’s differentiation strategy?

There is an important condition for a successful differentiation strategy. Differentiation allows higher prices, but usually this comes at a cost. To create valuable differentiation typically involves additional investments, for example in R&D, branding or staff quality. The differentiator can expect that its costs will be higher than those of the average competitor. But, as in the fourth column of Figure 8.4,

the differentiator needs to ensure that the additional costs of differentiation do not exceed the gains in price. It is easy to add on additional costs in ways that are not valued sufficiently by customers. The historic failures under British ownership of the luxury car companies Rolls-Royce and Bentley against top-end Mercedes cars are partly attributable to the expensive crafting of wood and leather interiors, the full cost of which even wealthy customers were not prepared to pay for. Just as cost-leaders should not neglect quality, so should differentiators attend closely to costs, especially in areas irrelevant to their sources of differentiation.

8.2.3 Focus strategy

Porter's emphasis on competitive scope distinguishes focus as a third generic strategy. A **focus strategy** **targets a narrow segment or domain of activity and tailors its products or services to the needs of that specific segment to the exclusion of others.** Focus strategies come in two variants, according to the underlying sources of competitive advantage, cost or differentiation. In air travel, Ryanair follows a *cost focus strategy,* targeting price-conscious travellers with little need for connecting flights. In the domestic detergent market, the Belgian company Ecover follows a *differentiation focus* strategy, gaining a price premium over rivals on account of its ecological cleaning products targeted at environmental conscious customers.

The focuser achieves competitive advantage by dedicating itself to serving its target segments better than others that are trying to cover a wider range of segments. Serving a broad range of segments can bring disadvantages in terms of coordination,

compromise or inflexibility. Focus strategies are, therefore, able to seek out the weak spots of broad cost-leaders and differentiators:

- *Cost focusers* identify areas where broader cost-based strategies fail because of the added costs of trying to satisfy a wide range of needs. For instance, in the UK food retail market, Iceland Foods has a cost-focused strategy concentrated on frozen and chilled foods, reducing costs against discount food retailers with a wider product range and more diverse suppliers which have all the complexity of fresh foods and groceries as well as their own frozen and chilled food ranges.
- *Differentiation focusers* look for specific needs that broader differentiators do not serve so well. Focus on one particular need helps to build specialist knowledge and technology, increases commitment to service and can improve brand recognition and customer loyalty. For example, ARM Holdings dominates the world market for smartphone and tablet chips (see Illustration 11.4), despite being only a fraction of the size of the leading microprocessor manufacturers, AMD and Intel, which also make chips for a wide range of computers.

Successful focus strategies depend on at least one of three key factors:

- *Distinct segment needs.* Focus strategies depend on the distinctiveness of segment needs. If segment distinctiveness erodes, it becomes harder to defend the segment against broader competitors. For example, Tesla Motors started to target a narrow segment with its expensive premium electric vehicles. However, if the boundaries become blurred between Tesla's

focus on electric cars used by affluent environmentally conscious consumers and electric cars used by general consumers, it could become easier for competitors to also attack this distinctive niche.

- *Distinct segment value chains.* Focus strategies are strengthened if they have distinctive value chains that will be difficult or costly for rivals to construct. If the production processes and distribution channels are very similar, it is easy for a broad-based differentiator to push a specialised product through its own standardised value chain at a lower cost than a rival focuser. In detergents, Procter & Gamble cannot easily respond to the Belgian ecologically friendly cleaning products company Ecover because achieving the same environmental soundness would involve transforming its purchasing and production processes.
- *Viable segment economics.* Segments can easily become too small to serve economically as demand or supply conditions change. For example, many high street speciality shops have disappeared because of the convenience of online shopping and its underlying economies of scale.

8.2.4 Hybrid strategy

There is a fundamental trade-off between low cost and differentiation so managers face a crucial choice between the generic competitive strategies. As earlier indicated, the lowest-cost competitor can always undercut the second lowest-cost competitor. For a company seeking advantage through low costs, therefore, it makes no sense

to add extra costs by half-hearted efforts at differentiation. For a differentiator, it is self-defeating to make economies that jeopardise the basis for differentiation. For a focuser, it is dangerous to move outside the original specialised segment, because products or services tailored to one set of customers are likely to have inappropriate costs or features for the new target customers. Managers are generally best to consider the trade-offs and choose which generic strategy they are pursuing and then stick to it. Otherwise, Porter warns, there would be a danger of being *stuck in the middle,* doing no strategy well.

However, **hybrid types of strategies that combine different generic strategies** are possible under certain conditions. For example, American Southwest Airlines pursues a low-cost strategy with their budget and no-frills offering. However, its brand also signals differentiation based on convenience including frequent departures and friendly service. Some companies start out with one strategy that is later combined with another. McDonald's first followed a product differentiation strategy, but later its fast-food leader position allowed the company to emphasise scale and low costs as well. Some companies sustain hybrid strategies over long periods of time: for example, furniture store IKEA, which uses substantial scale advantages to combine relatively low prices with differentiated Scandinavian design (see end of chapter case). Nevertheless, hybrid strategies are rather complex and should be pursued with great caution. They require diligent considerations as the fundamental trade-off between low cost and differentiation has to be resolved. They are often firmly grounded in one basic generic

strategy and then carefully supplemented with another like in the Southwest Airlines' case.[4]

There may also be specific circumstances in which the generic strategies can be combined.[5] It is possible for a company to create two separate strategic business units (SBUs), each pursuing different generic strategies and with different cost structures. The challenge, however, is to prevent negative spillovers from one SBU to another. For example, a company mostly pursuing differentiated strategies is liable to have high head office costs that the low-cost SBUs will also have to bear. On the other hand, a cheap cost-leader might damage the brand value of a sister SBU seeking differentiation. Sometimes, technological innovations allow radical improvements in both cost and quality. Internet retailing, for example, reduces the costs of merchandise, at the same time as increasing differentiation by greater product range and, through online reviews, better advice.

In sum, hybrid strategies are not uncommon, but rather difficult to pursue and generic strategies do remind managers that trade-offs are critical. It is very easy for managers to make incremental decisions that compromise the basic generic strategy. As profits accumulate, the successful cost leader will be tempted to stop scrimping and saving. In hard times, a differentiator might easily cut back the R&D or advertising investments essential to its long-term differentiation advantage. Consistency with generic strategy provides a valuable check for managerial decision making.[6]

8.2.5 Blue Ocean Strategy

The competitive strategies discussed above allow companies to identify feasible and profitable positions no matter industry character and attractiveness. Nevertheless, there is an apparent risk that managers get locked into historic and current market boundaries and strategies and fail to imagine entirely new strategies in an industry. To assist managers to envision completely new strategies, W. Chan Kim and Renée Mauborgne at INSEAD propose the use of a ‘strategy canvas’. It can help managers think creatively about the relative positioning of competitors in an industry to find uncontested market spaces by differentiating and/or reducing costs. They suggest managers should aim for ‘Blue Oceans’, new market spaces where competition is minimised and avoid ‘Red Oceans’, where industries are already well-defined and rivalry is intense. Blue Oceans evoke wide empty blue seas with huge opportunities, while Red Oceans are associated with cut-throat red bloody competition. The Blue Ocean concept thus aims at identifying potential spaces in the environment with little competition.

The strategy canvas tool compares competitors according to their performance on critical success factors (CSFs) in order to establish potential strategies for the future. A value innovator is a company that manages to identify new CSFs that are either particularly valued by customers (differentiation) or which provide a significant advantage in terms of cost (low cost) and thus competes in ‘Blue Oceans’. Figure 8.5 shows a strategy canvas for QB House (Quick Beauty), a Japanese barbershop that created a blue ocean in Japan and that has rapidly been growing in Asia and the USA. The horizontal axis shows the range of CSFs that an industry competes on and the vertical axis captures the offering level that buyers

receive across all of these key factors. The strategy canvas captures the current factors of competition of the industry, but also offers ways of challenging these and creatively trying to identify new competitive offerings. The canvas highlights the following three features:

- Critical success factors (CSFs) are those factors that either are particularly valued by customers or provide a significant advantage in terms of cost. The CSFs are therefore likely to be an important source of competitive advantage or disadvantage. Figure 8.5 identifies five established critical success factors in the Japanese barbershop market (price, reservation desk, extra services, hair treatment range and hygiene). Note there are also three new CSFs (time savings of haircut and waiting and an ‘airwash system’), which will be discussed under the third subhead, value innovation.
- Value curves are a graphic depiction of how customers perceive competitors’ relative performance across the critical success factors. Figure 8.5 reflects how a haircut at an average Japanese barbershop can take an hour and include all the established CSFs including application of towels, coffee and tea service, shoulder rubbing, hair and skin treatments, etc. with the actual haircut only being a fraction of the time spent. QB on the other hand has a radically different value curve, characteristic of a ‘value innovator’.
- Value innovation is the creation of new market space by excelling on established critical success factors on which competitors are performing badly and/or by creating new critical success factors representing previously unrecognised customer wants. In Figure 8.5, QB is a value innovator in both senses.

First, it excels on the established customer need of hygiene including a sanitation facility for each chair and new towels and combs for every customer. Second, QB realised that many working professionals did not have time and need for an hour-long haircut procedure. They stripped away most of the extra steps and concentrated on basic haircuts. In addition, to eliminate the time-consuming wash and dry practice, they created an ‘air wash system’ (an overhead hose that ‘vacuum off’ every cut-off hair). Haircutting is reduced to ten minutes and the price is $9 (£5.50, €6.75), far from the traditional $27–45 and still with almost 50 per cent increase in hourly revenue per barber.

Figure 8.5 Strategy canvas for the Japanese barbershop industry

Source: Based on Figure 3.4 in W.C. Kim and R. Mauborgne (2015) *Blue Ocean Strategy*, Harvard Business School Press.

Figure 8.5: Long Description

The example in Figure 8.5 shows how traditional Japanese barber shops compete in a red ocean focused on traditional CSFs. In contrast, QB creatively both reduced costs by doing away with multiple steps in the long winding haircutting procedure and added differentiation in hygiene and substantial time savings in relation to existing competition and thus created a Blue Ocean.

8.3 Interactive strategies

Blue Ocean strategy shows that competitive strategies need to be chosen, and adjusted, in the light of competitors' strategies. If everybody else is in a red ocean chasing after differentiation then a cost leadership strategy might be sensible. Thus, business strategy choices *interact* with those of competitors. This section starts by considering business strategy in the light of competitor moves and countermoves. It then addresses game theory more generally, which helps managers choose between competition and more cooperative strategies.

8.3.1 Interdependence between rivals

Competitors' strategies are interdependent and interact through moves and countermoves. The generic strategies of cost leadership and differentiation should thus not be seen as static positions, but as dynamic trajectories. Wherever competitors' moves are interdependent, economically viable positions are always in danger of being superseded as competitors enter and move in with alternative strategies. Figure 8.6 plots diverse moves and countermoves and underlines the dynamic and interactive nature of business strategy. It provides a detailed example of the sequence of decisions and possible options involved in competitive interaction.[7] This illustrates the situation of a business facing a low-price competitor, for example a high-cost Western manufacturer facing

possible attack by cheap imports from Asia. There are three key decisions:

Figure 8.6 Responding to low-cost rivals

Source: Reprinted by permission of *Harvard Business Review.* Exhibit from 'A framework for responding to low-cost rivals' by N. Kumar, December 2006. Copyright © 2006 by the Harvard Business School Publishing Corporation. All rights reserved.

Figure 8.6: Long Description

- *Threat assessment.* The first decision point is whether the threat is substantial or not. If there is a threat, the high-cost organisation should not automatically respond to a low-price competitor by trying to match prices: it is likely to lose a price

war with its existing cost structure. The high-cost organisation needs a more sophisticated response.

- *Differentiation response.* If there are enough consumers prepared to pay for them, the high-cost organisation can seek out new points of differentiation. For example, a Western manufacturer may exploit its closeness to local markets by improving service levels. At the same time, unnecessary costs should be stripped out. If increased differentiation is not possible, then more radical cost solutions should be sought.
- *Cost response.* Merger with other high-cost organisations may help reduce costs and match prices through economies of scale. If a low-cost business is synergistic with (in other words, has benefits for) the existing business, this can be an effective basis for an aggressive cost-based counter-attack. If there is neither scope for further differentiation or synergy between the existing business and a possible new low-cost business, then the existing business must sooner or later be abandoned. For a Western manufacturer, one option might be to outsource all production to low-cost operators, simply applying its design and branding expertise. Another option would be to abandon manufacturing in favour of becoming a ‘solutions provider’, aggregating manufactured components from different suppliers and adding value through whole-systems design, consultancy or service.

Equivalent decisions would have to be made, of course, by a low-price competitor facing a differentiator. When coffee chains like US Starbucks entered the coffee market with its expensive coffee local coffee shops had first to decide whether they were a serious long-

term threat, and then choose how far they should either try to match their ambiance, image and features or increase the price differential between their coffee and Starbucks' premium prices.

These kinds of moves and countermoves are a constant feature of markets with continuous change. This is especially true in very fast-moving environments, which Richard D'Aveni terms 'hypercompetitive' (see Section 4.3.1).[8] In these conditions, it may no longer be possible to plan for sustainable positions of competitive advantage and it may actually destroy competitive advantage by slowing down response. Managers have to be able to act faster than their competitors. 'Thinking Differently' at the end of this chapter highlights the importance of transient rather than sustainable advantage.

8.3.2 Game theory

The competitive moves and counter-moves in the previous section make it clear that competition sometimes can escalate in a way that is dangerous to all competitors. It can be in the self-interest of organisations to restrain competition and even to collaborate. Game theory provides important insights into competitor interaction and when to compete and when to cooperate.[9] The 'game' refers to the kinds of interactive moves two players make in a game of chess. **Game theory encourages an organisation to consider competitors' likely moves and the implications of these moves for its own strategy.** Game theorists are alert to two kinds of interaction in particular. First, game theorists consider how a *competitor response* to a strategic move might change the original

assumptions behind that move: for example, challenging a competitor in one area might lead to a counter-attack in another. Second, game theorists are sensitive to the *strategic signals*, or messages, their moves might convey to competitors, for example with regard to how fiercely they seem willing to defend their position in a particular market. In the light of possible attacks and counter-attacks, game theorists often advise a more cooperative approach than head-to-head competition. Collaboration with some competitors may give competitive advantage over other competitors or potential entrants.

Game theory is particularly relevant where competitors are *interdependent.* Interdependence exists where the outcome of choices made by one competitor is dependent on the choices made by other competitors. For example, the success of price cuts by a retailer depends on the responses of its rivals: if rivals do not match the price cuts, then the price-cutter gains market share; but, if rivals follow the price cuts, nobody gains market share and all players suffer from the lower prices. Anticipating competitor counter-moves is clearly vital to deciding whether to go forward with the price-cutting strategy.

There are two important guiding principles that arise from interdependence:

- *Get in the mind of the competitors.* Strategists need to put themselves in the position of competitors, take a view about what competitors are likely to do and choose their own strategy in this light. They need to understand their competitors' game plan to plan their own.

- *Think forwards and reason backwards.* Strategists should choose their competitive moves on the basis of understanding the likely responses of competitors. Think forwards to what competitors might do in the future, and then reason backwards to what would be sensible to do in the light of this now.

Game theory insights can be gained through two methods. On the one hand, *war gaming* is helpful where it is important to get stakeholders to deeply appreciate each other's positions through actually playing out their respective roles, and where there is uncertainty about the range of outcomes. Illustration 8.3 provides a public policy example of war gaming and using game theory principles when changing and improving public-sector services. On the other hand, *mathematical game theory* is useful where there is a clear but limited range of outcomes and the values associated with each outcome can be reasonably quantified.

One of the most famous illustrations of mathematical game theory is the *prisoner's dilemma.* Game theorists identify many situations where organisations' strategic decisions are similar to the dilemma of two prisoners accused of serial crimes together and being interrogated in separate prison cells without the possibility of communicating with each other. The prisoners have to decide on the relative merits of: (i) loyally supporting each other by refusing to divulge any information to their interrogators; and (ii) seeking an advantage by betraying the other. If both stay silent, they might get away with most of their crimes and only suffer some lesser punishment, perhaps for just one or two offences. The interrogators, though, will tempt each of them to divulge full information by offering them their freedom if only they betray their fellow criminal. However,

if both betray, then the judge is unlikely to be grateful for the confessions and will punish them for all their crimes. The dilemma for each of the prisoners is how much to trust in their mutual loyalty: if they both refuse to divulge, they can both get away with the lesser punishment; on the other hand, if one is sure that the other will not betray, it makes even more sense to betray the loyal one as that allows the betrayer to go totally free. The two prisoners are clearly interdependent. But because they cannot communicate, they each have to get in the mind of the other, think forwards to what they might do, and then reason backwards in order to decide what their own strategy should be – stay silent or betray.

The prisoner's dilemma has its equivalence in business where there are two major players competing head-to-head against each other in a situation of tight interdependence. This is the position of Airbus and Boeing in the aircraft business or British Airways and Virgin in transatlantic travel. It would be relevant to the strategic decisions of two such interdependent companies in a range of situations: for example, if one company was thinking about making a major investment in an innovative new product that the other company could match. For two such competitors to communicate directly about their strategies in these situations would likely be judged illegal by the competition authorities. They therefore have to get into each other's minds, think forwards and reason backwards. How will the other company act or react and, in the light of that, what strategy is best? The prisoner's dilemma is awkward because cooperation is simultaneously attractive and difficult to achieve. A distinctive feature of game theory is that it frequently highlights the

value of a more cooperative approach to competitor interaction, rather than aggressive competition.

Illustration 8.3 Game theory in practice in the public sector

Game theory and war gaming can provide insights when changing and improving public-sector services.

Game theory has not become a common strategic tool. It has often been considered too theoretical and focused on single solutions to be able to cope with real-world messy managerial problems. However, it has been proposed that instead of using game theory to predict a single optimal solution it can be used to generally understand advantages and disadvantages with different strategic options.

When public-sector organisations try to change and improve public services, they frequently need to partner with and interact with a variety of organisations. They need to collaborate with other public-sector organisations, with private companies and not-for profit organisations. Success therefore depends not only on the public-sector organisation itself, but on several other partners. This requires an insight into partners' intentions and how they may behave. This is central to game theory – understanding what strategic options different players have, what their objectives are and how they will act under different circumstances.

The basic principles of game theory can thus be used to evaluate changes and improvements of public sector services. The English National Health Service (NHS) has, for example, used war games to better prepare them for government reforms. War gaming began as a military preparation that places players in the positions of different actors (e.g., enemies or allies) and ask them to play out a sequence of moves and counter-moves as if they were the actors themselves. A basic principle underlying the game is that to know your enemy you must become your enemy in the play. Another

consideration is that you need to test your own plan and strategy in confrontation with the (played) enemy.

In a war game for healthcare systems, teams are assigned to play the role of different stakeholders including payers, hospitals, physician groups, regulators and suppliers. In a first round, the teams are then asked to respond to a given challenge. The actions each team can consider are stipulated by the game's rules, which are based on realistic rules of the healthcare system. In subsequent rounds, each team reacts to the moves the other teams have made. Through several rounds, every team acts on its own strategies and reacts to the moves of other teams. The aim is not primarily to determine a winner, but to develop new insights. War games make participants think carefully about how they would act, react to and interact with others under specific conditions. In this way, participants gain a better understanding of other players' perspectives and possible actions. This helps them to anticipate how various actors will behave under different conditions. The participants also gain a better understanding of their own organisation's strengths and weaknesses in interactions with others.

The principles of game theory can thus be of more general assistance and it has been suggested that public organisations and their leaders should:

1 Be knowledgeable about partners, their strategies, needs and decision making
2 Be flexible adjusting their own strategies or objectives to meet the overall aim
3 Develop clear lines of partnership communication and decision making
4 Share the power equally between parties
5 Get agreement on partnership operation and benefits
6 Consider own roles and motives for engaging with the partnership
7 Create partner trust

Sources: Partly adapted from T. Meaklim (2013) 'Game theory: what prisoners and stags can teach public leaders', *The Guardian*, 27 November and *International Journal of Leadership in Public Services,* 9(1/2), 2013, pp. 22–31; E. Bury, J. Horn and D. Meredith

(2011) ‘How to use war games as a strategic tool in health care’, *Health International,* 11, pp. 28–37.

Questions

1 Besides the public sector, can you think of other business situations where war games could be useful?

2 War games could possibly play a role when preparing for strategic change at a university. What stakeholders or players would be relevant and what would their interests be?

Collaboration between some organisations in a market may thus be preferred under certain circumstances. *Tacit collusion,* where companies agree on a certain strategy without any explicit communication between them, is thus not uncommon; for example, agreeing to avoid price competition. It is facilitated by industries or sectors with few competitors, homogenous products and high entry barriers. In short, while organisations need to avoid illegal collusion, business strategy includes cooperative options as well as competitive ones.[10] Game theory thus encourages managers to consider how a ‘game’ can be transformed from lose–lose competition to win–win cooperation.

8.4 Business models

Business models have become increasingly popular as internet-based and platform companies such as Airbnb, Spotify and Uber have conquered the world with their new models. They are particularly useful when explaining more complex business interrelationships. Consequently, the business model concept is commonly discussed in relation to strategy today. Building on David Teece's work, this chapter carefully distinguishes business models from business strategy.[11] **A business model describes a value proposition for customers and other participants, an arrangement of activities that produces this value, and associated revenue and cost structures.**[12] Most fundamentally, it concerns the manners and mechanisms of an organisation's value creation, configuration and capture. Competitors often have the same or similar business models, but their business strategy and basis for competitive advantage can still differ.

When entrepreneurs in new start-ups have entered old industries with new business models in recent years, they have frequently changed industry dynamics and competition in radical ways. The new models often involve more complex interrelationships between various actors than traditional ones and involve more parties than just a buyer and seller with more than one capturing value. Illustration 8.4 discusses how Uber's business model has revolutionised the taxi industry globally involving three parties: Uber, drivers and riders. The remainder of this section first discusses three fundamental elements of business models, some typical business

model patterns and finishes with an examination of a common business model: the multi-sided platform.

8.4.1 Value creation, configuration and capture

Business models describe business transactions and interrelationships between various parties and are best explained in terms of three interrelated components (see Figure 8.7).[13] The first emphasises *value creation,* a proposition that addresses a specific customer segment's needs and problems and those of other participants. The second component is the *value configuration* of the resources and activities that produce this value. The final *value capture* part explains revenue streams and cost structures that allow the organisation and other stakeholders to gain a share of the total value generated.[14]

Illustration 8.4 Uber's ubiquitous business model The on-demand transportation service that has revolutionised the taxi industry.

Source: NARAPIROM/Shutterstock

Uber has become a dominant transportation company in the world without owning a single taxi. After its start, in San Francisco 2009, it has quickly expanded to over 70 countries and 10,500 cities worldwide. Uber only employs around 30,000 but has close to 4 million drivers and 118 million monthly active users and generates over 5 billion rides a year. The company grew exponentially and expanded into food delivery (Uber Eats), couriers, package delivery and freight transportation. By now, their smartphone app and business model are well-known and even infamous; riders use their app account to request a car and drivers get a notification and can accept or decline. Customers can track time of arrival and the meter via the app and get an option to rate the driver and the driver also has the option to rate the customer. Customers can avoid drivers with low ratings and drivers can avoid passengers with low ratings.

The basic resources of Uber include their technological platform and app, but they do not own any cars or employ any drivers. Drivers own the cars and are self-employed and apply to Uber to become a driver. Uber's activities are configured to match customers with a nearby driver and car. In addition to matchmaking, the platform and app include pricing and payment, car tracking and review systems. Uber thus structures the value for both customers and drivers through the development of sophisticated software and algorithms that optimise matchmaking, pricing and reviews for different cities and local

markets. Uber captures its profit and value by typically taking a 20–25 per cent cut on all rides except for special promotions to customers and/or drivers and in areas where they face competition from similar services. Besides generating a margin, these revenues should cover their expenses to cover R&D, technology development, marketing, local infrastructure and their own local employees in each city.

The company was valued over $80bn in an IPO in May 2019 and, two years later, was valued at $91bn, but there was still a small problem: Uber continues to lose money. Was the business model wrong? Many certainly thought so, not least some investors, and there were several significant challenges. Uber faced an increasing number of competitors as the model was easy to imitate; Lyft is a significant competitor in the USA and in China they were defeated by Didi Chuxing, which acquired their operations. In addition, they have faced regulatory pushbacks across multiple countries as Uber ignored or evaded local regulations. Regular taxi drivers were of course not satisfied with the competition, but moreover Uber drivers did not need to pay the steep prices for taxi licences and it was also claimed the company used offshore companies to minimise taxes. Other controversies included the exploitation of gig working drivers with low payment and insecurity resulting in lawsuits, Uber anti-union efforts and various other conflicts worldwide. In brief, the jury was thus still out regarding the benefits of the business model that seemed to ignore several stakeholders except for customers who enjoyed cheap rides.

Sources: K. Korosec (2018) ‘Uber CEO: ride hailing will be eclipsed by scooters, bikes and even flying taxis’, *Techcrunch.com*; *Techtrends.tech,* 2018; Bradshaw, T. (2021) *Financial Times*, 7 June. D. Lee (2020) ‘Uber investors look for route to profits’, *Financial Times*, 6 February; J. Joshua Chaffin and D. Lee (2022) ‘Uber to list New York City taxis on its app as old foes make peace’, *Financial Times,* 24 March 24; https://appinventiv.com/blog/uber-statistics/ [accessed: June 2022]. See also the end-of-chapter case for Chapter 7: Has Uber overcome the ubermensch?

Questions

1 In terms of Figure 8.7, what are Uber's value creation, value configuration and value capture components?

2 If you were the head of a traditional taxi company, how could you change your business model to compete with Uber?

Figure 8.7 Business model components

Figure 8.7: Long Description

The business model of the San Francisco-based accommodation broker Airbnb, for example, *creates value* for both the customers that rent the apartment, house or private room and for the hosts that offer their homes for rent (see also Chapter 1 Case example). The Airbnb website conveniently provides a platform for exchange activities between the hosts and guests. These activities are *configured* via the web platform so that hosts list, describe and present pictures of

their homes and customers are thus offered a wide selection of accommodation to choose from and rent. A review system of both accommodation and guests is available to build references and prevent deception. Finally, both hosts and Airbnb *capture value* from this business model. Hosts receive guest payments and Airbnb gets a 6–12 per cent commission fee on guest reservations, a 3 per cent to process the payment to the host and guest credit card processing fees. This points managers and entrepreneurs to three basic and interdependent attributes of business models:

- *Value creation.* A key part of a business model describes what is offered and how value is thus created for the various parties involved: customers, partners and other participants. The main concern here is thus the targeted customer segment and how their needs are fulfilled and their problems solved, but also how to create value for any other parties involved.
- *Value configuration.* A second component explains how various interdependent resources and activities in the value chain underlie the value proposition, for example, technology, equipment, facilities, brands, managerial processes, etc. (for a discussion of the value chain, see Section 5.4.3). These factors are part of an activity system that not only explains what activities create value, but how they are linked and what participants perform them (for activity systems see Section 5.4.3). While this system is centred on the organisation, it can also involve activities conducted by customers, partners and other participants.[15]
- *Value capture.* A business model also describes the cost structure of resources and activities and the revenue stream

from customers and any other parties. In addition, this component shows how the value created will be apportioned between the organisation and any other stakeholders involved. For a company, then, this last component also describes how profit is made while for not-for-profits and the public sector there are of course no expectations of financial gain.[16]

Two points need to be emphasised here:

- First, once established in an industry, business models are often taken for granted. All businesses rely on business models but, as they mature and become standardised, they are rarely questioned. Until Airbnb and others started their services, few thought about or challenged the traditional 'hotel business model' and how value creation, configuration and capture were interrelated in this model. There may have been efforts to change individual business model components, but few changed or differentiated the whole model and the relationships between the components as Airbnb did. Business models thus often become institutionalised and part of an industry's 'recipe' (see Section 7.2.3).
- Second, while competitors may share business models, their business strategy can still differ. Walmart, for example, shares the same discount retailer model with several competitors, but has a distinct lowest-cost strategy; cutting costs systematically throughout its value chain. Likewise, Airbnb in the example above has the same business model as Wimdu and many other competitors. However, Airbnb's extensive selection of accommodation from over 5 million listings in more than

100,000 cities in 200 countries surpasses any competitor and thus differentiates them. Because of this size, both customers and hosts are likely to prefer Airbnb over competitors as guests are offered more accommodation and hosts more guests. The more customers that use their service, the better it is for every customer in their network of guests and hosts and Airbnb thus has an advantage based on network effects (see Section 4.2.6 for network effects).

8.4.2 Business model patterns

Even though business models often become established within industries, over time, companies use them competitively. New entrants often use new business models to be able to compete successfully with established players. It is thus important for managers to understand what type of business model pattern their business builds on and how it may differ from other competitors. It should be noted, however, that business model patterns are described at various levels of detail and sometimes only emphasise one or two business model components.[17] There are multiple business models around, but three typical patterns include the following:

- *Razor and blade.* This is perhaps the most well-known business model pattern, but its primary focus is on the value capture component, which makes it more of a revenue model. It builds on Gillette's classic model of selling razors at a very low price and the compatible replacement blades at a quite high price.[18] This model of selling two technically interlinked products

separately is quite common. For example, mobile operators offer consumers a cheap or even a free mobile phone and then catch them through a two-year fee-based subscription plan. In other industries, it is the services, maintenance and parts that are priced expensively while the basic product is sold at relatively low margins. This is, for example, the case for ink-jet printers; they are sold at relatively low prices, but manufacturers make their margins on selling expensive ink. It is also common in industrial goods with an emphasis on expensive services; for example, Rolls Royce and GE and others in the jet engine industry and for Otis and Schindler and other players in the elevator industry.

- *Freemium.* This business model pattern name comes from combining ‘free’ and ‘premium’ and it primarily relates to online businesses. It refers to how a basic version of a service or product is offered for free so as to build a high volume of customers and eventually convince a portion of the customers to buy a variety of premium services. Revenue is generated by the premium-buying customers. They are often only a small portion of the total user volume, but their revenues can be enough and can also be used to attract even more users. The photo-sharing service Flickr uses this business model pattern. Flickr offers the basic service of uploading and sharing photos for free while generating revenues through extra services for a subscription fee including unlimited uploading and storing of photos. Flickr also uses contextual advertising and cooperation with retail chains and other photo service companies besides subscription fees to generate revenue. Other businesses that use this model

are the business-oriented social networking service LinkedIn and the streaming music service Spotify. The aim of freemium, however, is not only to convince premium customers, but to attract a larger volume of customers as the value of the service increases with more users. It means that the enterprise can gain network effects based on a large installed base of adopters (see Section 4.2.6).

- *Peer-to-peer (P2P).* This model brings people and/or businesses together without necessarily having to go through a middleman and often includes not-for profit operators with a focus on sustainability. It is based on cooperation among individuals aided by an app, website or some other online or communication service and can include all sorts of peer-to-peer transactions. Transactions include offerings of specific services like education, lending personal things that may be rarely used but expensive, such as hobby-building tools, or providing loans peer to peer.[19] An example of the latter is California-based Kiva, an international non-profit micro-finance website that aims to alleviate poverty by allowing everyday people in developed nations to finance low-income entrepreneurs and students in developing nations. This business model pattern has even been described as a potential new economic model, a sharing economy, as it does not necessarily require a business intermediary third party. However, business platform intermediaries often step in to make exchanges smoother. For example, within countless car-sharing organisations there are many local not-for-profit peer-to-peer intermediaries, but also global for-profit ones like Zipcar, owned by the US car rental

multinational Avis. Airbnb is also a peer-to-peer model and so is Uber, but they build on for-profit platforms. This is often referred to as a 'multi-sided platform' business model, which is discussed in the next section.

8.4.3 Multi-sided platforms and strategies

Another common business model is the multi-sided platform,[20] which is behind some of the most valuable firms in the world. The so-called US 'FAANG' (Facebook, Apple, Amazon, Netflix and Google) and Chinese 'BAT' (Baidu, Alibaba and Tencent) companies all build on platforms. **A multi-sided platform brings together two or more distinct, but interdependent groups of participants to interact on a platform.**[21] They are distinct as they perform separate functions on the platform, and they are interdependent as the platform is of value to each group of participants only if the other group is also present. The platform YouTube, for example, includes creators of videos, viewers of videos, and advertisers. A multi-sided platform comes in many different shapes and can be a technology (e.g., Microsoft's PC operating system), a product (e.g., Nintendo's video game console), or a service (Uber's transportation service; see Illustration 8.4). Multi-sided platforms can also be non-for profit, like Kiva referred to above, with donors on one side and recipients on the other for example.[22]

Multi-sided platforms often overlap with other business model patterns, as at Airbnb, for instance, with a peer-to-peer model or at Netflix, which primarily is a subscription model. Also, platforms are not an entirely new phenomena; malls, for example, are platforms

that allow consumers and merchants to interact directly with each other and newspapers link subscribers with advertisers. As indicated by the name, there are several platform sides, most commonly two, that perform different functions.[23] Uber's platform, for example, has car drivers on one side and passengers on the other (see Illustration 8.4) and Nintendo has game developers on one side and gamers on the other: see Table 8.1 for further examples. In contrast, on a single-sided platform, like a telecommunication operator, all participants perform similar functions – making or receiving calls. Over time, platforms often introduce new types of interactions and participants on the platform and thus new value creation. LinkedIn, for example, started out by linking professionals to recruiters, but is now a three-sided platform including advertisers and they have started to introduce corporations as a fourth side. Similarly, Amazon started as an online bookseller and today is a truly multi-sided platform including not only other goods, but various types of merchants, sellers and advertisers.

Network effects (see Section 4.2.3) are intimately related to multi-sided platforms as the more participants, the better for everyone on the platform. For video games console platforms, for example, the gamers are on one side and favour consoles with a wide variety of games. This makes them dependent on the other side of the platform, the game developers, which in turn favour platforms with a large enough customer group to regain their development costs for the games. This shows that the value of the platform increases for both groups as more customers or gamers use it. It suggests a network effect as customers have a positive effect on the value of the product or platform for other customers. Web search companies

like Google also rely on a similar pattern. For them, the two sides of the platform involve consumer searchers on the one hand and advertisers that sponsor links on the search website on the other. The more searchers that use Google the better for advertisers and the better data for Google to refine search results and the better quality of the searches the better for consumers.

Table 8.1 Platform providers

There are three important factors to consider in platform strategies:

- *Platform distinctiveness and size.* As with any product and service, a platform must have distinctive features in competition with other platforms to attract participants in the first place. Quality and quantity of content and services, reliability, speed, ease of use, trustworthiness, etc. are all important factors, but the size of the platform's network is also essential. The total potential market size must be sufficiently large to begin with to make a platform valuable and network effects are crucial. This involves a chicken-and-egg problem: the platform attracts participants by being large, but to become large it needs to have enough participants. Besides offering superior services, one way to approach this problem and reach a critical mass network is to subsidise one or all the sides of the platform. Uber, for example, often subsidises drivers when entering a new market. Another approach, common among technology platforms, is to offer open-source software packages and services to attract software and hardware developers to join the platform (see

Section 11.2.3 and Illustration 11.4). A third tactic is to piggy-back on another platform, like US PayPal initially did on eBay.

- *Choosing platform sides.* Deciding what sides or complementors (see Section 4.2.3) to include and how many is sometimes obvious, as for Airbnb, but adding more sides may generate further growth and value as further network effects kick in. However, adding new ones may introduce competition between the platform and a participant or between platform participants or harm in other ways the relationship between participants. Amazon, for example, has other merchants selling the same goods that they sell themselves on the platform and hence, must carefully consider the balance between cooperation and competition. LinkedIn faces a challenge when inviting corporate participants in, as professionals may not want their current employers to be present when they may be searching for a new job. There is also a risk that participants allowed on the platform try to build their own platform and migrate users to it, like game producer Zynga tried to do with Facebook (Meta).[24]
- *Multi-homing costs.* A platform participant is 'multi-homing' when using more than one platform at the same time.[25] For example, music fans that stream, download, store and share tunes on more than one music site are multi-homing. This may, however, incur transfer costs for some platforms, like the inconvenience of transferring all photos from Instagram to Flickr on image-hosting service platforms. Multi-homing costs are thus costs of being affiliated with and maintaining presence on multiple platforms.[26] Platform companies aim for high multi-homing costs for platform participants to keep them generating value on their platform

rather than on competing ones. It can thus be quite costly for participants to use multiple platforms. Besides costs of finding and joining more than one there may be costs for additional competences to operate on another platform and the time and effort it takes to use multiple platforms may also incur costs. For example, it's very expensive for an app and software developer to build simultaneously for both Apple and Android. There are also user switching costs of permanently leaving one platform for another. For example, for users to move from an Android to an iPhone smartphone platform there are transferring costs of moving apps, contacts, messages, files, etc. besides learning a different operating system. The size of multi-homing costs differs between platforms. Facebook, for example, has quite high multi-homing costs for users as transferring all data is extremely cumbersome, but Uber has very low multi-homing costs. A taxi driver can exist simultaneously on Uber, Lyft or any other service; she or he can even have two or multiple phones on at the same time, and riders can clearly switch.

Thinking Differently **Transient rather than sustainable advantage Some question to what extent sustainable competitive advantage is possible at all in today's fast changing world.**

Section 8.4.1 indicated that in hypercompetitive environments it may not be possible to form business strategies that provide for sustainable competitive advantage. Some argue that the era of sustainability in competitive advantage is over altogether as most industries today are too turbulent. It is claimed that competitors and customers have become too unpredictable to form any single long-term strategy. Companies with strong

and long-lasting positions like IKEA are argued to be exceptions (see end-of-chapter case example). In this view, then, it is a waste of effort to invest in sustainable advantages; better to invest in a series of *transient advantages*.[27]

In this new era, managers thus need to constantly start new strategic initiatives and have a portfolio of several transient competitive advantages. They need to think of advantages as fleeting and going through a life cycle. Each competitive advantage has a launch stage that identifies an opportunity and raises resources to capitalise on it. Next is a ramp-up period in which the business is brought to scale, which leads into a phase of exploitation where market shares and profits are gained. Finally, there is a phase of inevitable erosion as competitors enter and weaken the advantage, which may force the company to exit. A company thus needs to catch new advantages continuously as old ones expire; freeing up resources from the old to invest in the new. Even if each advantage is temporary, a portfolio of several different advantages would always provide an advantage somewhere. Hence, if managers continuously start strategic initiatives and build many transient advantages, they could still get ahead of competitors.

Questions

If IKEA chose not to build on sustainable competitive advantage, how could it build on many transient advantages?

Key takeaways

- To seek competitive advantage in markets, the focus is on the *business* rather than *corporate* level.
- Use Porter's *generic strategy* framework to identify competitive strategies including *cost-leadership, differentiation, focus*, which helps in sorting out fundamental trade-offs between low cost and differentiation and to identify any potential *hybrid* strategies.
- If competitors' moves are *interdependent*, not least under *hypercompetitive* conditions, sustainable competitive advantage may be difficult to achieve and then competitor moves and countermoves need to be carefully considered.
- Use *game theory* and thinking to get in the mind of and understand competitors and think forwards and reason backwards about competitive as well as cooperative strategies.
- Use *Blue Ocean strategies* and a *strategy canvas* to identify possible ways of neutralising strong competitive forces and thus avoiding *Red Oceans* with many similar rivals and low profitability.
- To evaluate a *business model*, which describes the business logic of an enterprise, analyse its three basic elements: *value creation, value configuration* and *value capture.*
- To analyse *multi-sided platforms*, consider the two or more distinct, but interdependent, groups of participants it brings together to create value on the platform.

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Case* edition.

8.1 What are the advantages and what are the disadvantages of applying principles of business strategy to public-sector or charity organisations? Illustrate your argument by reference to a public-sector organisation of your choice.

8.2 Using Porter's generic strategies, identify examples of organisations following strategies of differentiation, low cost or low price, and stuck-in-the-middle or hybrid. How successful are these strategies?

8.3* You have been appointed personal assistant to the chief executive of a major manufacturing firm, who has asked you to explain what is meant by 'differentiation' and why it is important. Write a brief report addressing these questions.

8.4* Choose a company that you are familiar with (e.g., Spotify, Netflix, Apple). How do the business model components (value creation, configuration and capture) apply to the company?

8.5* Drawing on Section 7.3.2 (on game theory), write a report for the chief executive of a business in a competitive market (e.g., pharmaceuticals* or Formula One*) explaining when and in what ways cooperation rather than direct competition might make sense.

Integrative assignment

8.6 Applying game theory ideas from Section 8.3.2 to issues of international strategy (Chapter 10), how might a domestic player discourage an overseas player from entering into its home market?

Recommended key readings

- The foundations of the discussions of generic competitive strategies are to be found in the writings of Michael Porter, which include *Competitive Strategy* (1980) and *Competitive Advantage* (1985), both published by Free Press. For an in-depth discussion of how to apply Porter's Frameworks, see J. Magretta (2012) *Understanding Michael Porter: The Essential Guide to Competition and Strategy*, Harvard Business Review Press.
- An influential development on Porter's basic ideas is W.C. Kim and R. Mauborgne (2015) *Blue Ocean Strategy: How to Create Uncontested Market Space and Make Competition Irrelevant*, Harvard Business School Press.
- There is much written on game theory but a good deal of it can be rather inaccessible to the lay reader. Exceptions are R. McCain (2014) *Game Theory: A Non-technical Introduction to the Analysis of Strategy*, World Scientific.
- For an evaluation of research on business models, see L. Massa, C.L. Tucci and A. Afuah (2017) 'A critical assessment of business model research', *Academy of Management Annals*, vol. 11, no. 1, pp. 73–104. Multisided platforms and the strategies they use are discussed by M.A. Cusumano, A. Gawer and D. B. Yoffie in *The Business of Platforms: Strategy in the Age of Digital Competition, Innovation, and Power*, 2019.

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2. P. Conley, *Experience Curves as a Planning Tool,* available as a pamphlet from the Boston Consulting Group. See also A.C. Hax and N.S. Majluf, in R.G. Dyson (ed.) (1990) *Strategic Planning: Models and Analytical Techniques,* Wiley.
3. B. Sharp and J. Dawes (2001) 'What is differentiation and how does it work?', *Journal of Marketing Management,* vol. 17, nos 7/8, pp. 739–59, reviews the relationship between differentiation and profitability.
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6. The Strategy Clock (See D. Faulkner and C. Bowman (1995) *The Essence of Competitive Strategy*, Prentice Hall) is a tool that allows for a dynamic approach for examining alternative generic

strategies that gives scope for hybrid strategies. It includes differentiation, low cost and hybrid zones with two distinctive dimensions: prices to customers in a horizontal dimension and perceived product benefits in a vertical dimension. The clock's circular design in relation to the dimensions allows for more continuous choices than a sharp contrast between cost leadership and differentiation: there is a full range of incremental adjustments that can be made around the clock as organisations explore different directions. For a full overview of the clock, see D. Faulkner and C. Bowman (1995) *The Essence of Competitive Strategy,* Prentice Hall.

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8. R. D'Aveni (1994) *Hypercompetition: Managing the Dynamics of Strategic Maneuvering*, Free Press.
9. For readings on game theory, see B. Nalebuff and A. Brandenburger (1997) *Co-opetition,* Profile Books; R. McCain (2003) *Game Theory: A Non-technical Introduction to the Analysis of Strategy,* South Western; and, for a summary, S. Regan (2007) 'Game theory perspective', in M. Jenkins and V. Ambrosini (eds) *Advanced Strategic Management: a Multi-Perspective Approach,* 2nd edn, Palgrave Macmillan, pp. 83–101. A practical example is in H. Lindstedt and J. Müller (2009) 'Making game theory work for managers', *McKinsey Quarterly*, December.
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through Partnering, Harvard Business School Press; *Creating Collaborative Advantage,* ed. Chris Huxham, Sage, 1996; and D. Faulkner (1995) *Strategic Alliances: Cooperating to Compete,* McGraw-Hill.

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model: A theoretically anchored robust construct for strategic analysis', *Strategic Organization,* vol. 11, no. 4, pp. 403–11.

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15. For a discussion about activity systems in business models, see C. Zott and A. Raphael (2010) 'Business model design: an activity system perspective', *Long Range Planning*, vol. 43, no. 2, pp. 216–26 and R. Casadesus-Masanell and J.E. Ricart (2010) 'From strategy to business models and onto tactics', *Long Range Planning,* vol. 43, no. 2, pp. 195–215.
16. For a discussion of business models for sustainability that also includes not-for-profits, see B. Cohen and J. Kietzmann (2014) 'Ride on! Mobility business models for the sharing economy', *Organization & Environment,* vol. 27, no. 3, 279–96.
17. There are thus multiple labels around and diverse patterns are often combined into a single business model for a particular enterprise. Airbnb's model is an example of this. On the one hand, it is sometimes called a 'peer-to-peer model' as it is based on cooperation among individuals but, on the other, it is often referred to as a 'multi-sided platform model' as they connect, one side, hosts, with another, guests; see below for the details on

these two models. See A. Afuah (2019) *Business Model Innovation,* 2nd edn, Routledge, for a general discussion about various business models.

18. The model is sometimes also referred to as a ‘cross-subsidisation’ model as one basic product is inexpensive and sold at a discount, while the second dependent product or service needed to get the basic product functional is sold at a considerably higher price. Others refer to it as a ‘bait and hook’ pattern as it lures consumers in.
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24. See M.W. Van Alstyne, G.G. Parker and S.P. Choudary (2016) ‘Pipelines, platforms, and the new rules of strategy’, *Harvard Business Review,* vol. 94, no. 4, pp. 54–62.
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Case example The (new) IKEA approach *The world's largest furniture retailer experiments with its traditional business model.*

Patrick Regnér and Kevan Scholes

Introduction

Opening a store on London's expensive Oxford Street instead of on the cheap outskirts of big cities, selling via Alibaba's Tmall store instead of via its own big-box stores and buying IKEA furniture instead of selling it. Has the founder Ingvar Kamprad's demise in 2018 made IKEA management crazy and turned his world-famous business model totally upside down just like IKEA did once with traditional furniture retailing? Well, IKEA has started to experiment with its traditional approach. It was the world's largest home furnishings company with some 12,000 products in 465 stores in 63 markets by 2021. For the year ending 31 August 2021,[1] revenue had grown to €41,9bn and net profits were €1.6bn. The company had 225,000 co-workers (of which 40,000 were in production and distribution).[2] In 2021, there were 775 million store visits and IKEA online channels had 5 billion visitors with online sales increasing 73 per cent and accounting for 26 per cent of total sales.[3]

IKEA's approach vs competitors IKEA was founded by Ingvar Kamprad in 1943 in the small Swedish town of Älmhult and opened its first furniture store in 1958. The company's success had been achieved through the now legendary IKEA business approach – revolutionary in the furnishing industry of its early years (see first two columns in Table 1). The guiding business philosophy of Kamprad was that of

improving the everyday life of people by making products more affordable. This was achieved by massive (+20 per cent) reductions in sales prices vs competitors which, in turn, required aggressive reductions in IKEA's costs. Former CEO Anders Dahlvig (1999–2009) says in his book about IKEA that there were five reasons for their success:[4]

> **1. Design, function, and quality at low prices; 2. Unique (Scandinavian) design; 3. Inspiration, ideas, and complete solutions; 4. Everything in one place; 5. 'A day out', the shopping experience . . . You may well say that they are similar to those of most companies. The difference . . . is that IKEA is much better at delivering on these customer needs than are other retailers . . . Most competitors focus on one or at most two of these customer needs. High-street shops focus on design and inspiration. Out-of-town low-cost retailers focus on price. Department stores focus on choice. The real strength of IKEA lies in the combination of all five.**

IKEA's direct competitors had other solutions to home furnishings and were highly fragmented with competition occurring locally rather than globally including competitors of diverse types:

- Multinational furniture retailers (all considerably smaller than IKEA) including, for example, the Danish company Jysk.
- Multi-branch retail furniture outlets whose sales were mainly in one country, such as DFS in the UK. The USA market was dominated by such players (e.g., Bed, Bath & Beyond Inc.).
- Companies specialising in just part of the furniture product range and operating in several countries – such as Poggenpohl from Germany in kitchens and Swedish Hästens in beds.

- Non-specialist companies that carried furniture as part of a wider product range. In the UK, Sainsbury's subsidiaries Argos and Habitat was number one. In the UK, general DIY companies such as Kingfisher were attempting to capture more of the bottom end of the furniture market.
- Small and/or specialised retailers and/or manufacturers. These accounted for the biggest share of the market in Europe.

In 2020, it was estimated that the UK market was about £14.4bn,[5] of which IKEA had £1.9bn share.

Dahlvig continued to explain IKEA's competitive strategy: **You can choose to adapt your company's product range to the markets you are operating in, or you can choose to shift the market's preference toward your own range and style. IKEA has chosen the latter. By doing this, the company can maintain a unique and distinct profile. This is, however, a more difficult path to follow . . . A significant understanding of the customer's situation at home is the basis for IKEA's product development. [6]. . . For most competitors, having the lowest price seems to mean being 5 to 10 per cent cheaper than the competition on comparable products. At IKEA, this means being a minimum 20 per cent cheaper and often up to 50 per cent cheaper than the competition.[7]**

At the foundations of the strategy were huge economies of scale and Dahlvig explained that the strategy crucially requires the design and control of their wider value chain: **The secret is the control and coordination of the whole value chain from raw material, production, and range development, to distribution into stores. Most other companies working in the retail sector have control either of the retail end (stores and distribution) or the product design and production end. IKEA's vertical integration makes it a complex company compared to most, since it owns both**

production, range development, distribution, and stores . . . This included backward integration by extending the activities of Swedwood (IKEA's manufacturing arm) beyond furniture factories, into control over the raw materials, saw mills, board suppliers, and component factories.[8]

Adding new elements in a new competitive landscape Would the IKEA approach continue to work as new competition started to enter the scene and the business landscape was changing? External observers had started to question this and, when new management came in mid-2018, it came as a surprise for many they did too. There were thus several initiatives to combat competitive threats on the horizon. The new chief executive Jesper Brodin thought radical change was warranted:[9]

> **We recognise that the retail landscape is transforming at a scale and pace we've never seen before. As customer behaviours change rapidly, we are investing and developing our business to meet their needs in better and new ways. We are going to look into a transformation of our business. We are at a point where it is less business than usual than we have experienced in the past.**

First, and most apparent, IKEA had been too slow online compared to many extant and potential retail competitors like giants like US Amazon and Chinese Alibaba. Even though the share of online sales had increased substantially in the last couple of years, it was much thanks to the shutdowns during the COVID crisis with fewer store sales and more online. Online shopping generally had grown exponentially over the years and, for environmental and convenience reasons, younger urban consumers questioned the IKEA approach of driving far outside cities and many did not even have a car.

IKEAs new transformation includes entirely novel elements added to the traditional IKEA approach, like increasingly moving away from only having big-box stores outside

big cities (see Table 1, last column for new elements). This also involved turning parts of existing big-box stores into fulfilment centres for online shopping not to increase costs. For IKEA, the change was something more than an omnichannel approach[10] and rather involved a fully integrated concept of physical and digital shopping, they called it 'phygital'. To develop it, they launched a set of experiments.

First, these included pick-up points in small towns that could not support a regular IKEA store, where customers collect online purchases. Second, IKEA launched a new set of stores that were significantly smaller than normal for cities not large enough to support full-size outlets. Third, city-centre stores in larger cities were launched with many products on sale like the one launched in Paris holding thousands of different products. A fourth approach were planning studios like the one in the centre of Stockholm for kitchens and the one in Madrid for bedrooms and wardrobes. Finally, larger stores in major cities were launched with several of the above features. For example, in late 2021, IKEA bought the former Topshop flagship store in London's Oxford Circus for £378mn, which will open in 2023 and have accessories, some furniture and also planning studios.[11] To assist their new approach, IKEA acquired augmented reality (AR) start-ups and technologies to help customers further with their home furniture planning.

A second potential competitive threat was the flourishing furniture rental start-ups and other alternative furniture solutions in the new sharing economy. Even though this still accounted for a small share of the market, consumers were increasingly environmentally concerned, which threatened much of the old IKEA approach. Among IKEA's responses was a buy-back and resell service where customers sell their IKEA furniture to the company for a refund card of up to 50 per cent of the original value. They offered spare parts to customers to prolong product life and started a trial with leasing office and home equipment. The ambition was to make IKEA fully circular by 2030, which included making lampshades of leftover rice straw, tablecloths of recycled plastic washed up from the Mediterranean Sea and turning plastic bottles into kitchen fronts. They sold only LED lamps, rechargeable batteries and, of course, the Swedish meatballs were available in a

plant-based version.[12] IKEA claimed they bought all wood (98 per cent) from certified or recycled sources, but they had been alleged for buying illegal Russian wood and were also criticised for not closing their mega centre malls there after the invasion of Ukraine, although IKEA did close all their own stores there.

Table 1 IKEA's 'upside-down' approach and new elements

Being environmentally ambitious would not increase prices according to IKEA as renewable energy was cheaper and, for example, recycled plastic cost less than new, as the CEO Jesper Brodin expressed it: 'The new economy is built on being resource smart and thus being climate smart.'[13] In addition, sustainability needed to be affordable, as another IKEA representative expressed it: 'Sustainability can't only be for the rich or for the thick wallet.'[14]

A third area where IKEA also met intense and new forms of competition, but also great opportunities, was in emerging markets like India and China. China is the company's fastest growing market and, even though the vision remained the same, 'IKEA's founder's vision of creating a better life for the many has motivated', it was challenging to compete on price-relative local competition. IKEA's products were considered expensive in these markets. To remedy this, they first focused on low-priced items, but also, step by step, substantially lowered prices. Crucially, stores were allowed to source almost 50 per cent locally (against company average of about 25 per cent) in order to keep prices competitive. Online shopping was more firmly rooted in China than anywhere else and the Chinese giant Alibaba was thus another formidable competitor. IKEA had been slow online in China with less than 10 per cent of the revenue in the country. This led them to another major change: For the first time ever, they started to sell online in 2020 via a third-party platform as they started selling via Alibaba's Tmall.

Source: Kevin Foy/Alamy Stock Photo

While India has been an important country in the IKEA supply chain for more than 30 years, it was not until 2018 that IKEA opened the first flagship store there. The aim was to invest $1.5bn and expand quickly into other cities and also establish smaller format stores in central urban locations. If IKEA faced local price competition in China, it was even worse in India. Besides stiff price competition from smaller local players, there were new start-ups like Bangalore-based Urban Ladder. Moreover, the biggest retailer overall in the world, Walmart, had acquired the local online giant Flipcart.

Some of the experiments with the old IKEA approach seemed to work while for others it was too early to tell. For CEO Jesper Brodin, it was important to integrate all the new with the old into a coherent integrated business model and make it profitable:[15]

> **The most important thing for me for furniture as a service is to make it profitable. We need to scale it up at a higher speed, we need to make it part of the business model.**

Questions

1 Identify where (in their value chain and system) and how IKEA have achieved cost leadership.

2 Identify how IKEA have achieved differentiation from their competitors.

3 Explain how IKEA try to ensure that their 'hybrid' strategy remains viable and does not become 'stuck-in-the-middle'.

4 How would you explain IKEA's business model changes in terms of value creation, configuration and capture? What are the implications for a circular value chain and system?

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Chapter 9

Corporate strategy

Key terms

BCG matrix

corporate strategy

diversification (related and unrelated/conglomerate)

divestment

dominant logic

economies of scope

outsourcing

parenting advantage

synergies

vertical (forward and backward) integration

Learning objectives

After reading this chapter you should be able to:

- Identify alternative strategy options, including *market penetration, product development, market development* and *diversification.*
- Distinguish between different diversification strategies (*related, unrelated* and *conglomerate* diversification) and evaluate *diversification drivers.*

- Assess the relative benefits of *vertical integration* and *outsourcing.*
- Evaluate the ways in which a *corporate parent* can add or destroy value for its portfolio of business units.
- Analyse *portfolios* of business units and judge which to invest in and which to divest.

Long Description

9.1 Introduction

Chapter 8 was concerned with *competitive strategy* – the ways in which a single business unit or organisational unit can compete in a given market space, for instance, through cost leadership or differentiation. However, organisations may choose to enter many new product and market areas. For example, Tata Group, one of India's largest companies, began as a trading organisation and soon moved into hotels and textiles. Since that time, Tata has diversified further into steel, motors, consultancy, technologies, tea, chemicals, power, communications. As organisations add new units and capabilities, their strategies may no longer be solely concerned with *competitive strategy* in one market space at the business level, but with choices concerning different businesses or markets. **Corporate strategy is about the overall scope of the organisation and how value is added to the constituent businesses of the organisation as a whole.** Choices about business areas, industries and geographies to be active in will determine the direction(s) an organisation might pursue for growth, which business unit(s) to buy and dispose of, and how resources may be allocated efficiently across multiple business activities. For Tata, the corporate strategy questions are whether it should enter any more industries, whether it should exit some, and how far it should integrate the businesses it retains. For large public-sector organisations and charities, similar choices have to be made. For instance, Monash University in Melbourne Australia has expanded its scope of activities by investing in overseas campuses and also announced closing courses as a

result of the COVID pandemic. These choices, indicated in Figure 9.1, inform decisions about how broad an organisation should be. This ‘scope’ of an organisation is central to *corporate strategy* and the focus of this chapter.

Scope is one of the most fundamental questions in strategic management and raises questions about how firms should adjust in order to grow or contract in anticipation, or reaction to, environmental turbulence such as COVID and Brexit.[1] Scope is concerned with how far an organisation should be diversified in terms of two different dimensions: products and markets. As the Tata example shows, an organisation may increase its scope by engaging in industries different from its current ones. Section 9.2 introduces a classic product market framework that uses these dimensions for identifying different growth directions for an organisation. This indicates different *diversification* strategies open to an organisation. Growth underpins diversification choices and this can lead to increasing market power, reducing risk and exploiting superior internal processes (Section 9.3). The performance implications of diversification are reviewed in Section 9.4.

Figure 9.1 Strategic directions and corporate-level strategy

Figure 9.1: Long Description

Another way of increasing the scope of an organisation is *vertical integration* (Section 9.5). It allows an organisation to act as an internal supplier or a customer to itself (as, for example, an oil company supplies its petrol to its own petrol stations). Alternatively, the organisation may decide to *outsource* certain activities – to 'dis-integrate' by subcontracting an internal activity to an external supplier – or *divest* (dispose of) in order to improve overall organisational focus and efficiency. The scope of the organisation may therefore be adjusted through growth or contraction.

Diversified corporations that operate in different areas of activity will have multiple SBUs (strategic business units) each with their own strategies for their specific markets. SBUs can be held accountable for their own success or failure. Nevertheless, corporate head office, the 'corporate level', needs to select an appropriate portfolio of individual SBUs and manage them by establishing their

boundaries, perhaps by market, geography or capability, so they add value to the group.[2] The value-adding effect of head office to individual SBUs that make up the organisation's portfolio is termed **parenting advantage** (Section 9.6). Their ability to add value effectively may give them a competitive advantage over other corporate parents in acquiring and managing different businesses.[3] But just how do corporate-level activities, decisions and resources add value to businesses?

In order to decide which industries and businesses organisations should invest in or dispose of, the corporate centre needs to assess whether the *portfolio* of businesses is worth more under its management than the individual businesses would be worth standing alone. Section 9.7 reviews portfolio matrices, which are useful techniques to inform corporatelevel choices about businesses to invest in and those to divest.

This chapter is not just about large commercial businesses. Small businesses may also have different business units. For example, a local building company may be undertaking contract work for local government, industrial buyers and local homeowners. Not only are these different market segments, but the mode of operation and capabilities required for competitive success in each are also likely to be different. Moreover, the owner of that business has to take decisions about the extent of investment and activity in each segment. Public-sector organisations such as local government or health services also provide different services, which correspond to business units in commercial organisations. Corporate-level strategy is also highly relevant to the appropriate drawing of organisational boundaries in the public sector. Privatisation and outsourcing

decisions can be considered as responses to the failure of public-sector organisations to add sufficient value by their parenting.

9.2 Strategy directions

A central corporate strategy choice is the direction in which a company should grow. Ansoff's classic corporate strategy matrix[4] (Figure 9.2) suggests four basic directions for organisational growth. Typically, an organisation starts in box A and may choose between *penetrating* still further within box A or increasing its diversity along the two axes of increasing novelty of markets or products. Increasing the diversity of products and/or markets is known as 'diversification'. **Diversification involves increasing the range of products or markets served by an organisation. Related diversification involves expanding into products or services with relationships to the existing business.** Thus, in Ansoff's matrix, the organisation has two related diversification strategies available: taking its existing products/services into *new markets* (box C), or developing its *product/service* (box B) for its existing markets. In each case, the further along the two axes, the more diversified the strategy. Alternatively, the organisation can move in both directions at once, following a *diversification* strategy with altogether new markets and new products/services (box D). Thus **unrelated diversification involves moving into products or services with no relationships to existing businesses.**

Figure 9.2 Corporate strategy directions

Source: Adapted from H.I. Ansoff (1988) *Corporate Strategy,* Penguin, Chapter 6. Ansoff originally had a matrix with four separate boxes but, in practice, strategic directions involve more continuous axes. The Ansoff matrix itself was later developed – see reference 1.

Figure 9.2: Long Description

Ansoff's axes can be used for brainstorming strategic options, checking that all four boxes have been properly considered. Illustration 9.1 shows the pressures facing pipe organ builder Casavant Frères, its strategic responses and raises questions about their next strategic direction. The next section will consider each of Ansoff's four main directions in detail.

9.2.1 Market penetration

For a simple, undiversified business, the most obvious strategic option is often increased penetration of its existing market, with its

existing products. **Market penetration implies increasing share of current markets with the current product or service range.** This strategy builds on established capabilities and does not require the organisation to venture into uncharted territory. The organisation's scope is exactly the same. Moreover, greater market share implies increased power vis-à-vis buyers and suppliers, greater economies of scale and experience curve benefits.

However, organisations seeking greater market penetration may face three constraints:

- *Retaliation from competitors* is likely as other competitors in the market defend their share. Increased rivalry might involve price wars or expensive marketing battles, which may cost more than any market-share gains are actually worth. Fierce retaliation is more likely in low-growth markets, as gains in volume will be more at the expense of other players. Where retaliation is a danger, organisations seeking market penetration need resources and capabilities that give a clear competitive advantage. In low-growth or declining markets, it can be more effective simply to acquire competitors. Some companies have grown quickly in this way. For example, Indian company LNM (Mittal) moved rapidly in the 2000s to acquire struggling steel companies to become the largest steel producer in the world.
- *Legal constraints.* Greater market penetration can raise concerns from official competition regulators concerning excessive market power. Most countries have regulators with the powers to restrain powerful companies or prevent mergers and acquisitions that would create such excessive power. In the United Kingdom, the Competition Commission can investigate

any merger or acquisition that would account for more than 25 per cent of the national market, and either halt the deal or propose measures that would reduce market power. The European Commission has an overview of the whole European market and can similarly intervene.

- *Economic constraints.* Market penetration may also not be an option where economic constraints are severe, for instance, during a market downturn or public-sector funding crisis. Here, organisations will need to consider the strategic option of *retrenchment:* withdrawal from marginal activities in order to concentrate on the most valuable segments and products within their existing business. However, where growth is still sought after, the Ansoff axes suggest further directions, as follows.

Illustration 9.1 Choosing new directions at Casavant Frères?

Sustainable strategies for a pipe organ manufacturer?

Casavant Frères concert organ

http://apoba.com/members/northeast/qc/casavant-freres [accessed: July 2022].

The world's largest organ builder is 140-year-old Casavant Frères (Quebec, Canada) who designs, manufactures and installs pipe organs in churches, concert halls, schools and homes. Founded in 1879, their first organ outside Canada was in the USA (1895). Others followed in Boston and New York, and a second workshop was opened in Michigan (1912). Their first European organ was in Paris (1923) and Japan and Rhodesia followed in 1927. Most installations were North American, but Australia was entered in 1982. Since its success in 2014 when it installed Opus 3900 (CDN$4mn, 6,489 pipes) in Montreal's 2,000 seater concert hall, sales had fallen from 30 (1970s) to just 5–10 per year. With CDN$10mn in sales, split equally between new organs in North America, Asia, restorations and renovations, but with fixed costs of £3.5mn, variable costs of a similar magnitude and an uncertain order book, the future of the company was in doubt.

A lot of craftwork goes into making an organ, such as woodworking, pipe making, tuning and adjustment and electrical and hydraulic systems. Casavant Frères has been described as the Mercedes Benz of organ builders, producing 95 per cent of its instruments in-house to a very high standard of craftsmanship. It takes three years to train employees and they can be hard to find. Their instruments boast unique inventions such as concave pedal boards and electronic innovations in coupling, switching, multi-memory and digital tablets.

The North American market, with 65,000 instruments, was near saturation. Large concert halls were not often constructed, most churches had organs already and church attendance had declined substantially. Despite some recent uplift in demand for large concert organs, the opportunity to build one might not come along for years. Churches were now interested in smaller organs or renovations and over one hundred organs are fully refurbished each year. Universities and schools have a large number of old practice instruments that need renovation or replacement.

Refurbishments add greatly to the life of the instrument, which may be over 100 years old. Generally done by the original manufacturer, it is a less competitive market and, with

3,000 organs still in use, Casavant Frères has significant ongoing demand. In addition, all organs require regular tuning and maintenance, normally twice a year, although this tends to be done by cheaper and faster local companies. The North America new organ market is worth $70m and Casavant Freres has 10 per cent market share. They are less active in the tuning and maintenance market, worth $30mn.

In 2005, Casavant Frères discovered the huge potential of the Chinese market with more than 8,000 Christian churches, as well as 50 cities with more than 5 million inhabitants with concert halls and music schools. The company invests a lot of time building customers across Asia and with one third of their sales going there, they are the most active North American builder in the region. The market is highly competitive, though, driving down margins, as European manufacturers also face saturated home markets. With lots of regional variation in decision makers, selling in China is costly in time and money and unqualified Chinese agents can lose the company sales. However, there are no plans for an assembly workshop in China.

In 2008, the financial crisis led to a significant decline in orders. Thirty employees had to be let go and production volume fell below break-even. To protect jobs two new organs were developed: ‘Inspiration’ for church or concerts and ‘Performance’ for practice. The Inspiration model is small, with fewer than 1,000 pipes, and needs few repairs for 50 years. At $175k–$250k, it aims to compete with electronic organs ($75k–$125k) which need refurbishing every 10 years. Launched in 2017, the Performance organ can be manufactured in just 1,400 hours (custom organs requiring 21,000hrs).

Advances in digital technology, such as touch screens, digital notepads and playback systems have been incorporated in pipe organs, but new electronic organs can provide true samples of organ sounds in compact, cheaper and more affordable instruments. To Casavant Frères, though, these are just glass diamonds.

Sources: J.W. Kunz and S. Poisson-de Haro (2019) ‘Sustainability Challenges for an SME in an Artisanal Sector: Casavant Frères Pipe Organs’, *International Journal of Case Studies in Management*, vol. 17, no. 1; J.D. Pinzón Correa and S. Poisson-de Haro

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Questions

1 Using the Ansoff matrix, explain Casavant Frères' growth over time.

2 What strategy would you recommend for the future?

9.2.2 Market development

Market development can be more attractive than product/service development by being potentially cheaper and quicker to execute. **Market development involves offering existing products/services to new markets.** Typically, of course, market development entails some product development as well, if only in terms of packaging or service. Nonetheless, market development remains a form of related diversification given its origins in similar products. Market development takes two basic forms:

- *New users.* For example, original users of aluminium, packaging and cutlery manufacturers, are now joined by users in aerospace and automobiles.
- *New geographies.* Often internationalisation but also new country regions.

In all cases, it is essential that market development strategies be based on products or services that meet needs in the new market. Simply offloading traditional products or services in new markets is

likely to fail. Market development often faces problems of lacking the right marketing skills and brands to win unfamiliar customers. On the management side, the challenge is coordinating between different users and geographies, which might all have different needs (see Chapter 10).

9.2.3 Product and service development

Product and service development is where organisations deliver modified or new products (or services) to existing markets. This can involve varying degrees of diversification along the horizontal axis of Figure 9.2. For Apple, developing its products from iPhone to iPad to Apple Watch involved little diversification: although the technologies differed, Apple was targeting the same customers and using very similar production processes and distribution channels. Despite the potential for benefits from relatedness, product development can be an expensive and high-risk activity for at least two reasons:

- *New resources and capabilities.* Product development strategies typically involve mastering new processes or technologies that are unfamiliar to the organisation. For example, the digital revolution is forcing universities to reconsider the way learning materials are acquired and provided to students and the nature of the student/academic interface. High-quality content available free online and virtual engagement with students now raise the question of how universities should add new digital products and how they should consider redeploying their resources in the future. Success is likely to depend on a willingness to acquire

new technological capabilities, to engage in organisational restructuring and new marketing capabilities to manage customer perceptions. Thus, product development typically involves heavy investments and can have high risk of project failures.

- *Project management risk.* Even within fairly familiar domains, product development projects are typically subject to the risk of delays and increased costs as extension of current strategy focus often leads to growing project complexity and changing project specifications over time. For example, the UK's high-speed rail project, HS2, was originally projected to cost £32.7bn in 2010, estimated to cost £56bn in 2018 and now commentators are suggesting it will end up costing between 20 per cent and 60 per cent more than that, making it the world's most expensive railway.

9.2.4 Unrelated diversification

Whereas related diversification takes the organisation beyond existing markets and its existing products, where operational links remain with the core business, **unrelated diversification is when an organisation expands into markets, products and services completely different from its own**. Motives behind this include pure growth desires or risk diversification, as good performing businesses could balance out poor performing ones, or financial cost reductions due to becoming a larger organisation.

It is important to note that the distinction between related and unrelated diversification is often a matter of degree as relationships

that might have seemed valuable in related diversification may not turn out to be as valuable as expected. Thus, the large accounting firms have often struggled in translating their skills and client contacts developed in auditing into effective consulting practices. Similarly, relationships may change in importance over time, as the nature of technologies or markets changes.

An extreme form of unrelated diversification is *conglomerate diversification*, where there are no operational or strategic linkages between multiple business, as each remains on its own. The logic of conglomerate diversification is a financial one of balancing a portfolio of investments. Such conglomerate strategies are often not trusted by many observers because there are no obvious ways in which the businesses can work together to generate additional value, over and above the businesses remaining on their own. In addition, there is often an additional bureaucratic cost of the managers at headquarters who control them. For this reason, conglomerate companies' share prices can suffer from what is called the 'conglomerate discount' – in other words, a lower valuation than the combined individual constituent businesses would have on their own.[5]

9.3 Diversification drivers

Diversification might be chosen for a variety of reasons, including response to macro-competitive changes and managerial ambitions,[6] with some more value-creating than others.[7] Growth in organisational size is rarely a good enough reason for diversification on its own. Indeed, growth can often be merely a form of 'empire building', especially in the public sector. Diversification decisions need to be approached sceptically.

Four potentially value-creating drivers for diversification are as follows:

- *Exploiting* **economies of scope***.* These refer to cost savings that can be achieved through sharing inputs, sharing distribution and also through applying the organisation's existing resources or capabilities to new markets or services.[8] If an organisation has under-utilised resources or capabilities that it cannot effectively close or sell to other potential users, it is efficient to use these resources or capabilities by diversification into a new activity. In other words, there are economies to be gained by extending the scope of the organisation's activities. For example, many universities have large resources in terms of halls of residence, which they must have for their students but which are under-utilised out of term-time. These halls of residence are more efficiently used if the universities expand the scope of their activities into conferencing and tourism during holiday periods. Economies of scope may apply to both *tangible*

resources, such as halls of residence, and *intangible* resources and competences, such as brands or staff skills.

- *Stretching corporate management capabilities.* This is a form of economies of scope, and refers to applying the skills of talented corporate-level managers (referred to as 'corporate parenting skills' in Section 9.6) to new businesses. The **dominant logic is the set of corporate-level managerial capabilities applied across the portfolio of businesses.**[9] Corporate-level managers may have capabilities that can be applied even to businesses not sharing resources at the operating-unit level.[10] Thus, the French luxury-goods conglomerate LVMH includes a wide range of businesses – from champagne, through fashion, jewellery and perfumes, to financial media – that share very few operational resources or business-level capabilities. However, LVMH creates value for these specialised companies by applying corporate-level competences in developing classic brands and nurturing highly creative people that are relevant to all its individual businesses. See also the discussion of dominant logic at Berkshire Hathaway in Illustration 9.3 later.
- *Exploiting superior internal processes*: These can be more efficient than external processes in the open market. In emerging markets, where markets for capital and labour sometimes work less well, it may be necessary to internalize these. For example, China has many conglomerates because they are able to mobilise internal investment, develop managers and exploit networks in a way that single business Chinese companies, relying on imperfect markets, cannot. For example, China's largest privately owned conglomerate, the Fosun Group,

owns steel mills, pharmaceutical companies and China's largest retailer, Yuyuan Tourist Mart.[11] In addition, very high regional growth rates and lack of competitive pressures may lead to broader diversification in emerging markets as these factors allow organisations to choose strategy more freely.

- *Increasing market power*.[12] Being diversified in many businesses can increase power vis-à-vis competitors in at least two ways. First, having the same wide portfolio of products as a competitor increases the potential for *mutual forbearance,* where retaliation across the whole range of the portfolio can discourage the competitor from making aggressive moves. Two similarly diversified competitors are thus likely to forbear from competing aggressively with each other. Second, having a diversified range of businesses increases the power to *cross-subsidise* one business from the profits of the others. The ability to cross-subsidise can support aggressive bids to drive competitors out of a particular market and, being aware of this, competitors without equivalent power will be reluctant to attack that business.

Where diversification creates value, it is described as 'synergistic'.[13] **Synergies are benefits gained where activities or assets complement each other so that their combined effect is greater than the sum of the parts** (the famous 2 + 2 = 5 equation). For instance, when Disney corporation purchased Marvel for $4bn, it was able to use its vast library of comic book superheroes across all its business activities such as the theme parks, TV shows and

consumer products. However, synergies are often harder to identify and more costly to extract in practice than managers like to admit.[14]

Indeed, some drivers for diversification involve negative synergies, in other words value destruction. Three potentially value-destroying diversification drivers are:

- *Responding to market decline* is one common but doubtful driver for diversification. Rather than let the managers of a declining business invest spare funds in a new business, conventional finance theory suggests it is usually best to let shareholders find new growth investment opportunities for themselves. For example, Kodak, the US photo film corporation, spent billions of dollars on diversification acquisitions such as chemicals, photocopiers and telecommunications in order to compensate for market decline in its main product. Many failed and Kodak went bankrupt.
- *Spreading risk* across a range of markets is another common justification for diversification. Again, conventional finance theory is very sceptical about risk-spreading by diversification.[15] Shareholders can easily spread their risk by taking small stakes in dozens of very different companies themselves. Diversification strategies, on the other hand, are likely to involve a limited range of fairly related markets. While managers might like the security of having more than one market, shareholders typically do not need each of the companies they invest in to be diversified as well – they would prefer managers to concentrate on managing their core business. However, conventional finance theory does not apply to private businesses, where owners have a large proportion of their assets tied up in their

company: here it can make sense to diversify risk across a number of distinct activities, so that if one part is in trouble, the whole business is not pulled down.

- *Managerial ambition* can sometimes drive inappropriate diversification. For example, Vijay Mallya, exiled and bankrupt Chairman of UB Group, an Indian conglomerate involved in alcoholic beverages, aviation infrastructure, real estate and fertiliser, diversified further into airlines with Kingfisher Airlines. This seemed in keeping with his extravagant lifestyle and pursuit of glamour but there were no obvious synergies, and the airline industry was not competitive – leading to the collapse of Kingfisher and the loss of other key group assets. Managers such as Mallya might gain short-term benefits in terms of prestige and financial rewards from diversification, but going beyond his areas of true expertise soon brought financial disaster.

9.4 Diversification and performance

Because many large corporations today are diversified, but also because diversification can sometimes be in management's self-interest, many scholars and policy makers have been concerned to establish whether diversified companies really perform better than undiversified companies. After all, it would be deeply troubling if large corporations were diversifying simply to spread risk for managers, to save managerial jobs in declining businesses or to generate short-term benefits for managers.

Research studies of diversification have particularly focused on the relative benefits of related diversification, unrelated and conglomerate diversification. Researchers generally find that related or limited diversifiers outperform both firms that remain specialised and those that have unrelated or extensively diversified strategies.[16] One reason for related diversification being advantageous is that resources, capabilities and technologies are familiar. This means firms can reconfigure resources internally allowing greater agility in redeploying resources and exiting a segment.[17] This allows firms to follow the core of the industry sector as the sector evolves over time and empirical evidence from the US banking industry finds this results in superior performance outcomes for banking firms.[18] It also explains how new types of relatedness and synergy may emerge just as old ones wither away. In short, the diversification–performance relationship tends to follow an inverted (or upside-down) U-shape (Figure 9.3). The implications of this finding have been that companies have tended to pursue lower levels of unrelated

diversification over time and recent research now suggests that the average performance outcomes for unrelated diversifiers are improved, thus smoothing the curve in Figure 9.3.[19] The implication is that some diversification is good – but not too much.

However, these performance studies produce statistical averages. Some related diversification strategies fail – as in the case of some accounting firms' ventures in consulting – while some conglomerates succeed – as in the case of Fortune 500 science and technology innovator Danaher. The case against unrelated diversification is therefore not solid, and there are currently question marks over the wide diversifications of the large US tech giants such as Meta (Facebook), Amazon and Alphabet (Google). Some of these wide diversifications may make sense in terms of capabilities and platforms, such as Amazon Web Services (AWS) in e-tailing and keeping customers on its platform. However, some may be more questionable. Google, for instance, has made 268 acquisitions from small start-ups with valuable patents and talented engineers, to multi-billion-dollar companies such as Motorola in telecoms ($12.5bn) and Nest in home controllers ($3.2bn). In terms of industries, FAANG acquisitions do appear scattergun, although, from a capabilities point of view, there are perhaps more synergies. Effective dominant logics can also play in favour of wider diversification. For instance, easyGroup with interests including planes, hotels, cars and gyms has a strong dominant logic around business model innovation in mature industries. This might apply to the US tech giants, but they also sit on vast amounts of cash and their huge size means most acquisitions are relatively small,

meaning there is much less scrutiny from financial markets and other stakeholders, allowing more opportunistic behaviour.

Figure 9.3 Diversity and performance

Figure 9.3: Long Description

Conglomerate diversification might also be appropriate in different national contexts, where there is market failure in terms of institutional weaknesses such as poor law enforcement, lack of quality labour, illiquid capital markets and capricious political contexts. Here, multi-business internal processes may be more effective in providing capital or skilled labour to component businesses than external markets. In contexts where internal processes work better than external market processes, unrelated diversification may make sense.[20] The conclusion from the

performance studies is that, although on average related diversification pays better than unrelated, any diversification strategy needs to be mindful of context and be subject to rigorous questioning on its particular merits.

9.5 Vertical integration

Another form of diversification, and another direction for corporate strategy, is vertical integration. **Vertical integration** **describes entering activities where the organisation is its own supplier or customer.** Thus, it involves operating at another stage of the value system (see Section 5.4.2). This section considers both vertical integration and vertical disintegration, particularly in the form of outsourcing.

9.5.1 Forward and backward integration

Vertical integration can go in either of two directions:

- **Backward integration** is movement into input activities concerned with the company's current business (i.e., further back in the value system). For example, acquiring a component supplier would be backward integration for a car manufacturer.
- **Forward integration** is movement into output activities concerned with the company's current business (i.e., further forward in the value system). For a car manufacturer, forward integration would be into car retail, repairs and servicing.

Thus, vertical integration, like other forms of diversification, increases corporate scope. The difference is that it brings together activities up and down the same value system, while diversification typically involves more or less different value systems. However, because realising synergies involves bringing together different

value systems, diversification (especially related diversification) is sometimes also described as *horizontal integration.* For example, a company diversified in cars, trucks and buses could find benefits in integrating aspects of the various design or component-sourcing processes. The relationship between horizontal integration and vertical integration is depicted in Figure 9.4.

Vertical integration often appears attractive as it seems to 'capture' some of the profits gained by retailers or suppliers in a value systems – the retailers' or suppliers' profits. This is one way in which the power of buyers and suppliers identified in the competitive forces framework can be neutralised (see Chapter 4). However, there are two dangers. First, vertical integration involves investment. Expensive investments in activities that are less profitable than the original core business will be unattractive to shareholders because they are reducing their *average* or overall rate of return on investment. Second, even if there is a degree of relatedness through the value system, vertical integration is likely to involve quite different resources and capabilities. Thus, car manufacturers forwardly integrating into car servicing found managing networks of small service outlets very different from managing large manufacturing plants. Growing appreciation of both the risks of diluting overall returns on investment and the distinct capabilities involved at different stages of the value system has led many companies in recent years to vertically *dis*-integrate.

Figure 9.4 Diversification and integration options: car manufacturer example

Figure 9.4: Long Description

9.5.2 To integrate or to outsource?

Where a part of vertically integrated operations is not adding value to the overall business, or a partner organisation can manage it better, it may be replaced through outsourcing or subcontracting. **Outsourcing is the process by which value chain activities previously carried out internally are subcontracted to external suppliers.** In other words, the organisation continues to offer its products and services based on external inputs instead of providing those in-house (see Illustration 9.2). The argument for outsourcing to suppliers is often based on their unique capabilities that allow lower costs to the sourcing organisation. Suppliers may have lower wages, scale economies, expertise, more professional employees and better incentives. Suppliers may have access to better technology and may be more effective than the sourcing organisation. Outsourcing may

also allow the organisation to be more flexible in reducing the size of its balance sheet and allowing it to adjust to market demand. Specialists in a particular activity are therefore likely to have superior capabilities than an organisation for a particular activity not central to its business. A specialist IT contractor is usually better at IT than the IT department of a healthcare company.

However, Nobel prize-winning economist Oliver Williamson has argued that the decision to integrate or outsource involves more than just superior capabilities. His *transaction cost framework* helps analyse the relative costs and benefits of managing ('transacting') activities internally or externally.[21] Assessing whether to integrate or outsource an activity, Williamson warns against underestimating the long-term costs of *opportunism* by external subcontractors. Subcontractors are liable over time to take advantage of their position, either to reduce their standards or to extract higher prices. Market relationships tend to fail in controlling subcontractor opportunism where:

- there are *few alternatives* to the subcontractor and it is hard to shop around
- the product or service is *complex and changing,* and therefore impossible to specify fully in a legally binding contract
- investments have been made in *specific assets,* which the subcontractors know will have little value if they withhold their product or service.

Illustration 9.2 Outsourcing – a broken model?

Outsourcing Cambridge University Hospitals Trust's patient record system.

It seemed a good idea for the UK-based Cambridge University Hospitals Trust to outsource its patient records system. The current system of circulating paper notes to a limited number of users, mainly General Practitioners, took time and money. Mindful of pressures upon funding, turning paper data into an electronic database accessible by handheld devices in real time, and cheaper to operate, was very attractive. However, the Trust did not have expertise in-house and so turned to external provider, US software company, Epic, to design and build a new electronic patient record system, e-Hospital, for £200mn. It went live in 2014 and then the troubles started.

Accident and emergency performance fell by 20 per cent in two years and the system produced inaccurate discharge information, meaning patients might not receive the right sort of care afterwards. There were also problems providing timely information to patients and various healthcare professionals. Reasons given for these problems included staff confusion over the new system and difficulties in getting locum cover because they were not familiar with the system and therefore became harder and more expensive to find. The difficulties became so serious that the Trust ended up in 'special measures' due to the financial problems. An official report concluded: 'The Trust underestimated the scale and challenges of implementing its new electronic patient

record system, e-Hospital, and the impact this would have on its provision of healthcare for its patients. These issues led to significant cost increases and a failure to realise the benefits the system could provide.'

The Trust was not alone in experimenting with outsourcing. Many local authorities have seen their budgets cut by as much as 40 per cent since 2010 and are struggling to reduce costs and improve efficiency. It is estimated they have outsourced £120bn per year of services to private companies to save money and improve efficiency. Local authorities often lack the necessary professional judgement, technical experience and practical skills to assess complex contracts so private companies with expensive lawyers are advantaged. Particularly difficult are contracts for social services with qualitative and complex outcomes that are often hard to assess. Maybe not surprisingly, private contractors are more driven by profit than good service, but there are also many instances of them obtaining contracts through bidding low and subsequently raising prices by increasing the amount of work or by arguing over specification. In addition, there are examples in social care that they pay their employees less than the minimum wage.

Several major setbacks suggest that the outsourcing model in public services may now be broken. An example is the collapse of corporate behemoth Carillion with £1.5bn in debts and just £29mn in cash in 2018. In order to win contracts, Carillion had initially underbid for thousands of school meal, hospital and court cleaning services that became unviable when there were delays and costs overruns. In another example, the Care Quality Commission has written to 84 local authorities telling them that as many as 9,300 elderly people are at risk of losing home care services, as private provider Allied Healthcare may cease services when a loan payment becomes due. But insourcing is not easy. Over 40 per cent of local authorities have now 'in-sourced' significant proportions of their contracts, particularly those relating to IT and technology. However, during the outsourcing period, many ran down their expertise and technical resources. In lower skilled, more labour-intensive jobs, it seems costs can only be reduced through

lower wages, worse conditions and fewer employees, so it may make little difference whether services are in-sourced or out-sourced.

Sources: K. de Freytas-Tamura (2018) *The Independent,* 6 February; R. Mulgan (2017) *Sunday Morning Herald,* 27 April; J. Super (2018) *Financial Times,* 9 February; G. Burton (2017) *Computing,* 26 April; Editorial, *The Observer,* 4 February 2018; L. Presser (2016) *The Guardian,* 2 March; J. Jolly (2018) *The Guardian,* 6 November.

Questions

1 Why do local authorities outsource?

2 What are the problems with outsourcing?

This transaction cost framework suggests that the costs of opportunism can outweigh the benefits of subcontracting to organisations with superior resources and capabilities. For example, mining companies in isolated parts of the Australian outback typically own and operate housing for their workers. The isolation creates specific assets (the housing is worth nothing if the mine closes down) and a lack of alternatives (the nearest town might be a hundred miles away). Consequently, there would be large risks to both partners if the mine subcontracted housing to an independent company specialising in worker accommodation, however strong its capabilities. Transaction cost economics therefore offers the following advice: if there are few alternative suppliers, if activities are complex and likely to change, and if there are significant investments in specific assets, then it is likely to be better to vertically integrate rather than outsource.

In sum, the decision to integrate or subcontract rests on the balance between:

- *Superior resources and capabilities.* Does the subcontractor have the potential to do the work significantly better?
- *Risk of opportunism.* Is the subcontractor likely to take advantage of the relationship over time?

9.5.3 Divestment

- **Divestment occurs when the organisation decides to pull out of one or more of its businesses.** This often occurs with unrelated diversified businesses, SBUs with poor operating performance, poor stock market performance and the arrival of a new CEO. For instance, Catherine MacGregor, new CEO at French multi-utility group, Engie, plans to dispose of €10mn of non-core businesses in order to double its investment in renewable generation capacity and to lift the 30 per cent discount to its share price compared with the European utilities sector. Activist shareholders, such as Carl Icahn, Nelson Peltz and Daniel Loeb, can also drive divestments. Estimates vary but as many as 1,000 companies have been subjected to activist demands in a single year. Divestment allows the parent to reduce the scope of its portfolio of businesses and this can raise the overall value of the organisation.
- The decision to divest may occur if the SBU in question is not adding value to the firm and the price obtained through sell-off is more than its standalone value. But before divestment happens it is important to consider whether the business might be

restructured in such a way that its contribution to the group could be improved. Also, it is important to consider if there are interdependencies with other SBUs where divestment might damage a SBU that is retained. Divestment should also be considered for SBUs that are adding value to the group but a better corporate parent can be found, provided that a really good price can be obtained and other synergies within the organisation are not damaged.

There are two main types of divestment: (i) *sell-off* and (ii) *spin-off.*

- In a *sell-off*, the SBU is sold to another company. If the acquirer uses a lot of debt to buy the sell-off this is termed a leveraged buy-out (LBO) and, if the SBU management team raises finance to buy the business, it is a management buy-out (MBO).
- In a *spin-off*, the shares of the SBU are distributed to parent organisation shareholders and the business is listed on the stock exchange. There are many recent examples including ABB, Thyssenkrupp, GE, Johnson& Johnson, Toshiba, Hitachi.

Sometimes, the parent organisation may not want to be rid of the SBU entirely and may therefore prefer an *equity carve out.* Here, the organisation sells a portion of SBU shares to the public in an initial public offering (IPO) and retains a significant amount of shares for itself so they can keep control. Generally, this is a temporary arrangement but it has advantages of both establishing a market price that the organisation can use to negotiate a full sell-off and, if it occurs before a spin-off, of generating cash. Figure 9.5 shows a decision tree for a divestment decision.

Figure 9.5 Divestiture decision

Source: Adapted from P. Puranam and B. Vanneste (2016) *Corporate Strategy*. Cambridge University Press.

Figure 9.5: Long Description

9.6 Value creation and the corporate parent

There is some evidence that corporate parents can add value to their constituent businesses.[22] However, this is not always the case and where there is no added value, or where there may be a better parent, it is usually best to divest the businesses. Thus, in 2021, Verizon divested AOL and Yahoo to private equity house Apollo for $5bn (acquired for $9bn) as they were not premium media assets as hoped but legacy ones trying to compete with Alphabet and Meta (Facebook). In the public sector too, units such as schools or hospitals are increasingly being given freedom from parenting authorities, because independence is seen as more effective. Some academics even challenge whether corporate-level strategy adds any value at all.[23] The following section examines how corporate parents can both add and destroy value, and considers three different parenting approaches that can be effective.

9.6.1 Value-adding and value-destroying activities of corporate parents[24]

Corporate parents need to demonstrate that they create more value than they cost. This applies to both commercial and public-sector organisations. For public-sector organisations, privatisation or outsourcing is likely to be the consequence of failure to demonstrate value. Companies whose shares are traded freely on stock markets

face a further challenge. They must demonstrate they create more value than any other rival corporate parents could create. Failure to do so is likely to lead to a hostile takeover or break-up. Rival companies that think they can create more value out of the business units can bid for the company's shares, on the expectation of either running the businesses better or selling them off to other potential parents. If the rival's bid is more attractive and credible than what the current parent can promise, shareholders will back it at the expense of incumbent management.

In this sense, competition takes place between different corporate parents for the right to own and control businesses. In this 'market for corporate control', corporate parents must show that they have *parenting advantage,* on the same principle that business units must demonstrate competitive advantage. They must demonstrate that they are the best possible parents for the businesses they control. Parents therefore must be clear on how they create value. In practice, however, parenting activities can be value-destroying as well as value-creating.

Value-adding activities[25]

There are five main types of activity by which a corporate parent can potentially add value:

- *Envisioning.* The corporate parent can provide a clear overall vision or *strategic intent* for its business units.[26] This should guide and motivate business unit managers to maximise corporation-wide performance through commitment to a common purpose. Envisioning should also provide stakeholders with a *clear external image* about what the organisation as a

whole is about: to reassure shareholders about the rationale for having a diversified strategy in the first place.[27] Finally, a clear vision provides a *discipline* on the corporate parent to stop its wandering into inappropriate activities or taking on unnecessary costs.

- *Facilitating synergies.* The corporate parent can facilitate cooperation and sharing across business units, so improving *synergies* from being within the same corporate organisation. This can be achieved through incentives, rewards and remuneration schemes.
- *Coaching.* The corporate parent can help business unit managers develop capabilities, by coaching them to improve their skills and confidence. Corporate-wide management courses are one effective means of achieving these objectives, as bringing managers across the business to learn strategy skills also allows them to build relationships between each other and perceive opportunities for cooperation.
- *Providing central services and resources.* The centre can provide capital for *investment* as well as central services such as treasury, tax and human resource advice. If these are centralised, they may have *sufficient scale* to be efficient and can build up *relevant expertise.* Centralised services often have greater *leverage*: for example, combining many business unit purchases increases bargaining power for shared inputs such as energy. This leverage can be helpful in *brokering* with external bodies, such as government regulators, or other companies in negotiating alliances. Finally, the centre can have an important role in managing expertise within the corporate

whole, for instance by *transferring managers* across business units or by creating shared *knowledge management* systems via corporate intranets.

- *Intervening.* Finally, the corporate parent can also intervene within its business units to ensure appropriate performance. The corporate parent should be able to closely *monitor* business unit performance and *improve performance* either by replacing weak managers or by assisting them in turning around their businesses. The parent can also *challenge and develop* the strategic ambitions of business units, so good businesses are encouraged to perform even better.

Value-destroying activities

However, there are three ways in which the corporate parent can inadvertently destroy value:

- *Adding management costs.* Most simply, corporate staff and facilities are expensive. Corporate staff are typically the best-paid managers with the most luxurious offices. It is the actual businesses that have to generate the revenues that pay for them and, if corporate centre costs are greater than the value they create, then corporate staff are net value-destroying.
- *Adding bureaucratic complexity.* As well as these direct financial costs, there is the ‘bureaucratic fog’ created by an additional layer of management and the need to coordinate with sister businesses. These typically slow down managers’ responses to issues and lead to compromises between the interests of individual businesses.

- *Obscuring financial performance.* One danger in a large diversified company is that the under-performance of weak businesses can be obscured. Weak businesses might be cross-subsidised by stronger ones. Internally, the possibility of hiding weak performance diminishes the incentives for business unit managers to strive as hard as they can for their businesses: they have a parental safety net. Externally, shareholders and financial analysts cannot easily judge the performance of individual units within the corporate whole. Diversified companies' share prices are often marked down, because shareholders prefer the 'pure plays' of standalone units, where weak performance cannot be hidden.[28]

These dangers suggest clear paths for corporate parents that wish to avoid value destruction. They should keep a close eye on centre costs, both financial and bureaucratic, ensuring that they are no more than required by their corporate strategy. They should also do all they can to promote financial transparency, so that business units remain under pressure to perform and shareholders are confident that there are no hidden disasters.

Overall, there are many ways in which corporate parents can add value. It is, of course, difficult to pursue them all and some are hard to mix with others. For example, a corporate parent that does a great deal of top-down intervening is less likely to be seen by its managers as a helpful coach and facilitator. Business unit managers will concentrate on maximising their own individual performance rather than looking out for ways to cooperate with other business unit managers for the greater good of the whole. For this reason, corporate parenting roles tend to fall into three main types, each

coherent within itself but distinct from the others.[29] These three types of corporate parenting role are summarised in Figure 9.6.

Figure 9.6 Portfolio managers, synergy managers and parental developers

Source: Adapted from M. Goold, A. Campbell and M. Alexander, *Corporate Level Strategy,* Wiley, 1994.

Figure 9.6: Long Description

9.6.2 The portfolio manager

The *portfolio manager* operates as an active investor in a way that shareholders in the stock market are either too dispersed or too inexpert to be able to do**.** In effect, the portfolio manager is acting as an agent on behalf of financial markets and shareholders with a view

to extracting more value from the various businesses than they could achieve themselves. They identify and acquire under-valued assets or businesses and improve them. They may not be much concerned about relatedness, typically adopting a conglomerate strategy. Portfolio managers do not get closely involved in the routine management of the businesses, only acting over short periods of time to improve performance by target setting, intervention and the provision (or withdrawal) of investment.

Portfolio managers seek to keep the cost of the centre low, with small corporate staff and few central services, leaving the business units alone so that their chief executives have a high degree of autonomy. They set clear financial targets for those chief executives, offering high rewards if they achieve them and likely loss of position if they do not. Such corporate parents can, of course, manage quite a large number of such businesses because they are not directly managing the everyday strategies of those businesses.

Many portfolio managers exist and are successful (see Illustration 9.3), finding and investing cheaply in under-performing companies. Private equity firms such as Blackstone operate a portfolio management style, typically investing in, improving and then divesting companies in loosely knit portfolios. For example, in 2021, Blackstone, with $649bn in assets and revenues of $6bn, owned companies in automotive, energy, entertainment, hotels, real estate, water treatment, banking, railway operation and seed development.

9.6.3 The synergy manager

Obtaining synergy is often seen as the prime rationale for the corporate parent.[30] The *synergy manager* is a corporate parent seeking to enhance value for business units by managing synergies across business units. Synergies are likely to be particularly rich when new activities are closely related to the core business. In terms of value-creating activities, the focus is threefold: envisioning building a common purpose; facilitating cooperation across businesses; and providing central services and resources. For example, at German electrical manufacturer Siemens, they drive performance across the business with a common vision, provide central services and investment to scale up businesses and, through integrating digital capabilities, are facilitating cross-business cooperation.

However, achieving such synergistic benefits involves at least three challenges:

- *Excessive costs.* The benefits in sharing and cooperation need to outweigh the costs of undertaking such integration, both direct financial costs and opportunity costs. Managing synergistic relationships tends to involve expensive investments in management time.
- *Overcoming self-interest.* Managers in the business units have to want to cooperate. Especially where managers are rewarded largely according to the performance of their own particular business unit, they are likely to be unwilling to sacrifice their time and resources for the common good.
- *Illusory synergies.* It is easy to overestimate the value of skills or resources to other businesses. This is particularly common when the corporate centre needs to justify a new venture or the

acquisition of a new company. Claimed synergies often prove illusory when managers actually have to put them into practice.

The failure of many companies to extract expected synergies from their businesses has led to growing scepticism about the notion of synergy. Synergistic benefits are not as easy to achieve as would appear. For example, Hewlett Packard's failure to reap benefits from the acquisition of British software company Autonomy has resulted in lawsuits and a write-down of €3.8bn (£3bn, $5bn). Nevertheless, synergy continues to be a common theme in corporate-level strategy, as Illustration 9.4 on Chipotle shows.

Illustration 9.3 Eating its own cooking: Berkshire Hathaway's parenting The challenge of managing a highly diverse set of businesses for shareholders.

From a small struggling textile business in the 1960s, Warren Buffet, Berkshire Hathaway's 91-year-old billionaire Chairman and CEO, has built a $873bn conglomerate, one of the largest in the world. Its businesses were highly diverse, including insurance companies, carpets, building products, clothing and footwear manufacturers, retail companies, utilities, and a private jet service. It also held significant long-term minority stakes in Coca-Cola, General Electric and major US airlines and has been building stakes in Apple and Amazon. Since 2007, Berkshire has spent over $100bn on acquisitions. But, as Buffet remarked, the size of Berkshire Hathaway now makes it hard to find deals that make a difference – a bit like 'elephant hunting'.

Annual reports explained how Buffet and Deputy Chairman Charlie Munger run the business: **Charlie Munger and I think of our shareholders as owner-partners, and of ourselves as managing partners. (Because of the size of our shareholdings we are**

also, for better or worse, controlling partners.) We do not view the company itself as the ultimate owner of our business assets but instead view the company as a conduit through which our shareholders own the assets . . . In line with Berkshire's owner-orientation, most of our directors have a major portion of their net worth invested in the company. We eat our own cooking.

Berkshire has a clear 'dominant logic': **Charlie and I avoid businesses whose futures we can't evaluate, no matter how exciting their products may be. In the past, it required no brilliance for people to foresee the fabulous growth that awaited such industries as autos (in 1910), aircraft (in 1930) and television sets (in 1950). But the future then also included competitive dynamics that would decimate almost all of the companies entering those industries. Even the survivors tended to come away bleeding. Just because Charlie and I can clearly see dramatic growth ahead for an industry does not mean we can judge what its profit margins and returns on capital will be as a host of competitors battle for supremacy. At Berkshire we will stick with businesses whose profit picture for decades to come seems reasonably predictable. Even then, we will make plenty of mistakes.**

Explaining how they manage their subsidiary businesses, Buffet said: **We subcontract all of the heavy lifting to the managers of our subsidiaries. In fact, we delegate almost to the point of abdication: though Berkshire has about 340,000 employees, only 25 of these are at headquarters. Charlie and I mainly attend to capital allocation and the care of our key managers. Most are happiest when they are left alone to run their businesses, and that is just how we leave them. That puts them in charge of all operating decisions and of dispatching the excess cash they generate to headquarters. By sending it to us, they don't get diverted by the various enticements that would come their way were they responsible for deploying the cash their businesses throw off. Furthermore, Charlie and I are exposed to a much wider range of possibilities for investing these funds than any of our managers could find.**

However, closer analysis suggests that its acquired industrial businesses – it is the second largest industrial concern in the USA – achieve lacklustre profits with a return on equity of 6 per cent, meaning Berkshire's sustained compound annual growth rate of 8–9 per cent is supported by excellent financial operations that also have low debt levels. Why then is Berkshire buying large industrials that require high premiums and where there are no synergies? In 2021, Berkshire Hathaway still had $144bn in cash to invest. Should the aging billionaire investor reload his 'elephant gun' for another acquisition, return surplus cash to investors, or wait for another recession?

Questions

1 In what ways does Berkshire Hathaway fit the archetypal portfolio manager (see Section 9.6.2)?

2 Warren Buffet still had $144bn in spare cash to invest. Suggest industries and businesses he would be unlikely to invest in.

9.6.4 The parental developer[31]

The *parental developer* seeks to employ its own central capabilities to add value to its businesses. This is not so much about how the parent can develop benefits *across* business units or transfer capabilities between business units, as in the case of managing synergy. Rather, parental developers focus on the resources or capabilities they have as parents which they can transfer *downwards* to enhance the potential of business units. For example, a parent could have a valuable brand or specialist skills in financial management or product development. It would seem that

McDonald's believed it had identified a parenting opportunity with its acquisition of Chipotle (Illustration 9.4). Parenting opportunities tend to be more common in related rather than unrelated diversified strategies and are likely to involve exchanges of managers and other resources across the businesses. Key value-creating activities for the parent will be the provision of central services and resources. For example, a consumer products company might offer substantial guidance on branding and distribution from the centre; a technology company might run a large central R&D laboratory.

There are two crucial challenges to managing a parental developer:

- *Parental focus.* Corporate parents need to be rigorous and focused in identifying their unique value-adding capabilities. They should always be asking what others can do better than them, and focus their energy and time on activities where they really do add value. Other central services should typically be outsourced to specialist companies that can do it better.
- *The 'crown jewel' problem.* Some diversified companies have business units in their portfolios that are performing well but to which the parent adds little value. These can become 'crown jewels', to which corporate parents become excessively attached. The logic of the parental development approach is: if the centre cannot add value, it is just a cost and therefore destroying value. Parental developers should divest businesses[32] they do not add value to, even profitable ones. Funds raised by selling a profitable business can be reinvested in businesses where the parent can add value.

9.7 Portfolio matrices

Section 9.6 discussed rationales for corporate parents of multi-business organisations. This section introduces models by which managers can determine financial investment and divestment within their portfolios of business.[33] Each model gives more or less attention to at least one of three criteria:

- the *balance* of the portfolio (e.g., in relation to its markets and the needs of the corporation)
- the *attractiveness* of the business units in terms of: (i) their individual business strength and market share, and (ii) the growth rates of their markets or industries
- the '*fit*' that the business units have with each other in terms of potential synergies or the extent to which the corporate parent will be good at looking after them.

Illustration 9.4 **Chipotle: doing things differently**

Struggling to find parenting advantage.

Chipotle Mexican Grill had always done things rather differently from the rest of the restaurant industry. Its outlets were not in the busiest locations, it spent lots on food, rarely added to the menu, didn't serve breakfast, do drive-throughs, franchises, or much advertising. And yet, by 2015, it was a $22bn burrito empire. Despite its success, why did owner McDonald's sell it, especially when McDonald's own sales and stock price had dropped, as it became associated with the USA's obesity epidemic?

Founded in 1993 in Denver, USA, by Steve Ells, and relying initially on parents and wealthy friends for initial funding, Chipotle's fast casual dining business soon needed significant capital to expand beyond its 13 stores. In 1998, McDonald's made a $50mn investment in Chipotle as part of the group's expansion that included Boston Market, Donatos Pizza, Pret a Manger, Aroma Cafe. It also investigated other businesses such as dry cleaning, a maid service and mowing the lawn.

McDonald's brought distribution systems, real estate expertise, construction knowledge and organisational structure along with its capital investment. To McDonald's, Chipotle brought new products – fresh cilantro, red onions and avocados. 'Our Portland distribution centre smelled like a produce house – our product is fresh but sealed in bags for shelf-life purposes' (McDonald's executive). Only one product was common to both companies – a five-gallon bag of Coca-Cola syrup.

Coming from a standardised, rules-based, efficiency-oriented culture, McDonald's executives were startled when they first visited Chipotle's headquarters. People brought their dogs into the office and Steve Ells walked around in blue jeans. Chipotle employees showed McDonald's executives how they scrubbed the grill by hand – 'there's got to be a better system – maybe a power-tool' (McDonald's executive)? They showed food could be customised as customers walked down the line. 'If you want a bit more or less, nobody ever says no. They might charge you but it doesn't slow the process.'

By 2005, McDonald's owned 90 per cent of Chipotle. They pressed Chipotle to do drive-throughs, breakfasts and advertising, and suggested the name Chipotle Fresh Mexican Grill. Steve Ells hated the idea and was beginning to be resented at McDonald's for rejecting everything.

Chipotle did franchise eight restaurants for McDonald's but they didn't succeed, costing a lot to be bought back. 'We just do it differently – the way we approach our food and our culture' (Steve Ells). McDonald's invited Steve to visit their chicken farm in Arkansas but he was repelled and soon realised sourcing from small farms dramatically improved the taste of his food. Chipotle food costs ran at 30–32 per cent of total costs, similar to up-market restaurants and McDonald's executives found this difficult to accept: 'That's ridiculous: that's like a steakhouse.' But Steve Ells was now focusing on ingredients and food integrity.

After seven years Chipotle's contribution to McDonald's bottom line was small, despite 500 restaurants which investors wanted co-branded. Franchisees were getting distracted and Chipotle was increasingly unhappy about McDonald's supply chain. Jim Cantalupo, McDonald's CEO, had already begun to sell off partner brands and the stock price had begun to rise. It was time for a McSplit.

Since leaving McDonald's, Chipotle's worth had risen to $53.4bn (2021), with revenues of £5,5bn, 2,622 locations (2019), 64,000 employees and business was booming. McDonald's pocketed $1.5bn (after $360mn investment).

Sources: Chipotle: the definitive oral history, www.bloomberg.com/graphics/2015-chipotle-oral-history [accessed: June 2022].

Questions

1 What parenting advantages did McDonald's perceive it might bring to Chipotle?

2 Despite its success, why was Chipotle spun-off?

9.7.1 The BCG (or growth/share) matrix[34]

One of the most common and longstanding ways of conceiving of the balance of a portfolio of businesses is the Boston Consulting Group (BCG) matrix (see Figure 9.7). The **BCG matrix uses market share and market growth criteria for determining the attractiveness and balance of a business portfolio.** High market share and high growth are, of course, attractive. However, the BCG matrix also warns that high growth demands heavy investment, for instance, to expand capacity or develop brands. There needs to be a balance within the portfolio, so that there are some low-growth businesses that are making sufficient surplus to fund the investment needs of higher-growth businesses.

The growth/share axes of the BCG matrix define four sorts of business:

- A *star* is a business unit within a portfolio that has a high market share in a growing market. The business unit may be spending heavily to keep up with growth, but high market share should

yield sufficient profits to make it more or less self-sufficient in terms of investment needs.

- A *question mark* (or problem child) is a business unit within a portfolio that is in a growing market, but does not yet have high market share. Developing question marks into stars, with high market share, takes heavy investment. Many question marks fail to develop, so the BCG advises corporate parents to nurture several at a time. It is important to make sure that some question marks develop into stars, as existing stars eventually become cash cows and cash cows may decline into dogs.
- A *cash cow* is a business unit within a portfolio that has a high market share in a mature market. However, because growth is low, investment needs are less, while high market share means that the business unit should be profitable. The cash cow should then be a cash provider, helping to fund investments in question marks.
- *Dogs* are business units within a portfolio that have low share in static or declining markets and are thus the worst of all combinations. They may be a cash drain and use up a disproportionate amount of managerial time and company resources. The BCG usually recommends divestment or closure.

The BCG matrix has several advantages. It is a good way of visualising different needs and potentials of all the diverse businesses within the corporate portfolio. It warns corporate parents of the financial demands of what might otherwise look like a desirable portfolio of high-growth businesses. It also reminds corporate parents that stars are likely eventually to wane. Finally, it

provides a useful discipline to business unit managers, underlining the fact that the corporate parent ultimately owns the surplus resources they generate and can allocate them according to what is best for the corporate whole. Cash cows should not hoard their profits.

Figure 9.7 The growth share (or BCG) matrix

Figure 9.7: Long Description

However, there are at least four potential problems with the BCG matrix:

- *Definitional vagueness.* It can be hard to decide what high and low growth or share mean in particular situations. Managers are often keen to define themselves as ‘high-share’ by defining their

market in a particularly narrow way (e.g., by ignoring relevant international markets).

- *Capital market assumptions.* The notion that a corporate parent needs a balanced portfolio to finance investment from internal sources (cash cows) assumes that capital cannot be raised in external markets, for instance, by issuing shares or raising loans. The notion of a balanced portfolio may be more relevant in countries where capital markets are under-developed or in private companies that wish to minimise dependence on external shareholders or banks.
- *Unkind to animals.* Both cash cows and dogs receive ungenerous treatment, the first being simply milked, the second terminated or cast out of the corporate home. This treatment can cause *motivation problems,* as managers in these units see little point in working hard for the sake of other businesses. There is also the danger of the *self-fulfilling prophecy.* Cash cows will become dogs even more quickly than the model expects if they are simply milked and denied adequate investment.
- *Ignores commercial linkages.* The matrix assumes there are *no commercial ties to other business units* in the portfolio. For instance, a business unit in the portfolio may depend upon keeping a dog alive. These commercial links are less important in conglomerate strategies, where divestments or closures are unlikely to have knock-on effects on other parts of the portfolio.

9.7.2 The directional policy (GE–McKinsey) matrix

A related way to consider a portfolio of businesses is by means of the *directional policy matrix*,[35] which categorises business units into those with good prospects and those with less good prospects. The matrix was originally developed by McKinsey & Co. consultants in order to help the US conglomerate General Electric manage its portfolio of business units. Specifically, the directional policy matrix positions business units according to (i) how attractive the relevant market is in which they are operating, and (ii) the competitive strength of the SBU in that market. Attractiveness can be identified by PESTEL or five forces analyses; business unit strength can be defined by competitor analysis, for instance, the strategy canvas (see Chapter 8). Some analysts also choose to show graphically how large the market is for a given business unit's activity, and even the market share of that business unit, as shown in Figure 9.8. For example, managers in a firm with the portfolio shown in Figure 9.8 will be concerned that they have relatively low shares in the largest and most attractive market, whereas their greatest strength is in a market with only medium attractiveness and smaller markets with little long-term attractiveness.

The matrix also offers strategy guidelines given the positioning of the business units. It suggests that the businesses with the highest growth potential and the greatest strength are those in which to invest for growth. Those that are the weakest and in the least attractive markets should be divested or 'harvested' (i.e., used to yield as much cash as possible before divesting).

Figure 9.8 Directional policy (GE-McKinsey) matrix

Figure 9.8: Long Description

The directional policy matrix is more complex than the BCG matrix. However, it can have two advantages. First, unlike the simpler four-box BCG matrix, the nine cells of the directional policy matrix acknowledge the possibility of a difficult middle ground. Here, managers have to be carefully selective. In this sense, the directional policy matrix is less mechanistic than the BCG matrix, encouraging open debate on less clear-cut cases. Second, the two axes of the directional policy matrix are not based on single measures (i.e., market share, such as brand and reputation, customer loyalty, relative cost position and market growth). Business strength can derive from many other factors than market share, such as brand and reputation, customer loyalty, relative cost position, and industry attractiveness does not just boil down to industry growth rates and can include competitive intensity, risks, industry profitability, industry

size. On the other hand, the directional policy matrix shares some problems with the BCG matrix, particularly about vague definitions, capital market assumptions, motivation and self-fulfilling prophecy and ignoring commercial linkages. Overall, however, the value of the matrix is to help managers invest in the businesses that are most likely to pay off.

So far, the discussion has been about the logic of portfolios in terms of balance and attractiveness. The third logic is to do with 'fit' with the particular capabilities of the corporate parent.

9.7.3 The parenting matrix

The *parenting matrix* focuses upon synergy creation from parenting and introduces parental fit as an important criterion for including businesses in the portfolio.[36]

Businesses may be attractive in terms of the BCG or directional policy matrices, but if the parent cannot add value, then the parent ought to be cautious about acquiring or retaining them. Therefore, it is important to assess the fit between each SBU's critical success factors (see Section 8.2.5) and the capabilities (in terms of competences and resources) of the corporate parent. In other words, does the corporate parent have the necessary 'feel', or understanding, for the businesses it will parent? In addition, can the parent add 'benefit' to the SBU through parenting opportunities such as bringing in marketing expertise? For the benefit to be realised, of course, the parent must have the right capabilities to match the parenting opportunities. A corporate parent should avoid running '*Alien*' businesses that it has no feel for and can't benefit from.

‘*Ballast*’ businesses for which a corporate parent has high feel but can add little benefit should either be run with a very light touch or be divested. ‘*Heartland*’ businesses, which are those the parent understands well and can continue to add value to, should be at the core of future strategy. ‘*Value trap’* businesses are dangerous as there are opportunities to add value, but the parent’s lack of feel may do more harm than good. For maximum synergies, parents should concentrate on actual or potential businesses, where there is both high feel and high benefit.[37]

Figure 9.9 The parenting matrix: the Ashridge Portfolio Display

Source: Adapted from M. Goold, A. Campbell and M. Alexander, *Corporate Level Strategy,* Wiley, 1994.

Figure 9.9: Long Description

Thinking Differently Are multi-businesses more agile than single businesses?

Is resource deployment affected by context?

This chapter has argued that corporate strategy may add value to the multi-business (see Section 9.6.1) through facilitating cooperation and sharing of non-financial resources across SBUs. However, do the contexts within which multi-business firms operate, and their single business competitors, matter? In a turbulent world of industry shocks, when business needs to adjust faster than ever, it may be that multi-business can adapt more quickly to volatile industries. Multi-businesses may be more agile than single businesses, through non-financial resource deployment giving them a competitive advantage.[38]

A recent article by Dickler and Folta[39] has investigated empirically whether multi-business firms are more aggressive in withdrawing resources from less attractive industries in their portfolio and more aggressive in shifting them towards more attractive businesses. In volatile markets, this should provide multi-businesses with significant advantages over single businesses, where resources can be productively deployed elsewhere and if this internal redeployment is more efficient than obtaining resources in the external market. In essence, the multi-business firm should be able to both grow revenues faster than single business firms in growing industries and also retrench revenues more quickly in less attractive industries. Dickler and Folta find compelling evidence that compared with single businesses of a similar size and in the same industries, multi-businesses are able to expand their revenues 12 per cent, and retrench revenues 37 per cent, more aggressively in growing and contracting industries, through flexible redeployment of resources such as employees, production capacity and

equipment. This variation in performance is particularly the case when there is resource similarity, opportunity diversity and external market illiquidity.

Resource deployment flexibility takes on more value when the costs of adjusting resources for internal redeployment are lower and where external market frictions are higher.[40] This may explain, to some extent, why diversified companies are more prevalent in some countries than others.

Questions

Evaluate the arguments for and against diversification for Berkshire Hathaway (Illustration 9.3) or Casavant Frères (Illustration 9.1).

Key takeaways Except for the smallest, most organisations (including public sector and charity organisations), have more than one activity. In considering the strategy of these organisations, you are likely therefore to have to address the following kinds of corporate strategy issues:

- Whether the organisation has the right *scope* in terms of the range of activities it is involved in.
- Whether the organisation is benefiting from the *synergies* available from *related* diversification or whether it is gaining sufficiently from the *risk reduction* and *portfolio management* available from *unrelated* diversification.
- Whether the organisation has the right degree of *vertical integration*, backwards or forwards.
- If the organisation is not benefitting from diversification or integration, consider *divestment* and *outsourcing,* particularly in the light of relative *capabilities* and the transaction costs of *opportunism.*
- If a diversified portfolio of businesses is to be retained, consider how best corporate parents can add value to business units, whether as a *portfolio manager,* a *synergy manager* or a *parental developer.*
- Whether there are insights into investment or disinvestment available from various multi-business models such as the *BCG matrix,* the *directional policy matrix* and the *parenting matrix.*

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the Text and Cases edition.

9.1 Using the Ansoff axes (Figure 9.2), identify and explain corporate strategic directions for any one of these case organisations: Ryanair*, Neuromag*, Megabrew*.

9.2 Go to the website of any large multi-business organisation (e.g., Alphabet, Megabrew*, Siemens, Tata Group, Virgin Group) and assess the degree to which its corporate-level strategy is characterised by (a) related or unrelated diversification and (b) a coherent 'dominant logic' (see Section 9.3).

9.3 For any large multi-business corporation (as in Section 9.2), Siemens* or the Virgin Group, explain how the corporate parent should best create value for its component businesses (as portfolio manager, synergy manager or parental developer: see Section 9.6). Would all the businesses fit equally well?

9.4* For any large multi-business corporation (as in Section 9.2), Megabrew* or the Virgin Group, plot the business units on a portfolio matrix (e.g., the BCG matrix: Section 9.7.1). Justify any assumptions about the relative positions of businesses on the relevant axes of the matrix. What managerial conclusions do you draw from this analysis?

Integrative assignment

9.5 Take a case of a recent merger or acquisition (see Chapter 12), and assess the extent to which it involved related or unrelated diversification (if either) and how far it was consistent with the company's existing dominant logic. Using share price information (see **www.bigcharts.com** or similar), assess shareholders' reaction to the merger or acquisition. How do you explain this reaction?

Recommended key readings

- An accessible discussion of corporate strategy is provided by P. Puranam and B. Vanneste (2016) *Corporate Strategy. Tools for analysis and strategic decision making,* Cambridge University Press.
- L. Capron and W. Mitchell (2012) *Build, Borrow or Buy: solving the growth dilemma,* Harvard Business Press, provides a good review of the arguments for and against different modes of growth.
- A good review of the current state of corporate portfolio management research is provided by M. Nippa, U. Pidua and H. Rubner (2011) 'Corporate portfolio management: appraising four decades of academic research', *Academy of Management Perspectives,* November, pp. 50–66.
- For a review of diversification performance, see M. Schommer, A. Richter and A. Karna (2019) 'Does the diversification–firm performance relationship change over time? A meta-analytical review', *Journal of Management Studies,* 16 July.

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2. For a detailed discussion as to how organisational structures might ‘address’ an organisation’s mix of SBUs, see M. Goold and A. Campbell (2002) *Designing Effective Organizations: How to Create Structured Networks,* Jossey-Bass. Also K. Eisenhardt and S. Brown (1999) ‘Patching’, *Harvard Business Review,* vol. 77, no. 3, p. 72.
3. The importance of parenting is underlined by a recent study that found a SBU’s corporate parent may account for more financial performance than the industry in which the SBU competes: B.S. Vanneste (2017) ‘How much do industry, corporation and business really matter? A meta-analysis’, *Strategy Science,* vol. 2, no. 2, pp. 121–39.

4. This figure is an extension of the product/market matrix: see I. Ansoff, *Corporate Strategy,* 1988, Chapter 6. The Ansoff matrix was later developed into the one shown above.
5. The concept of the conglomerate discount emerged during the 1970s and legitimated a wave of take-overs of large lacklustre, publicly quoted companies, that were subsequently restructured to unlock shareholder value. A recent study by S. Bressan and A. Weissensteiner (2021) 'The financial conglomerate discount: insights from stock return skewness', *International Review of Financial Analysis,* vol. 74 March, shows financial conglomerates continue to trade at a discount compared with a matched portfolios of specialised stand-alone banks.
6. J. Hautz, M. Mayer and C. Stadler (2013) 'Macro-competitive context and diversification. The impact of macro-economic growth and foreign competition', *Long Range Planning,* vol. 47, pp. 337–52.
7. For discussions of the challenge of sustained growth and diversification, see A. Campbell and R. Parks (2005) *The Growth Gamble,* Nicholas Brealy; and D. Laurie, Y. Doz and C. Sheer (2006) 'Creating new growth platforms', *Harvard Business Review,* vol. 84, no. 5, pp. 80–90.
8. On economies of scope, see D.J. Teece (1982) 'Towards an economic theory of the multi-product firm', *Journal of Economic Behavior and Organization,* vol. 3, pp. 39–63.
9. See R. Bettis and C.K. Prahalad (1995) 'The dominant logic: retrospective and extension', *Strategic Management Journal,* vol. 16, no. 1, pp. 5–15.

10. F. Neffke and M. Henning (2013) ‘Skill relatedness and firm diversification’, *Strategic Management Journal,* vol. 34, no. 3, pp. 297–316 show that internal skills may aid in the diversification process.
11. See C. Markides (2002) ‘Corporate strategy: the role of the centre’, in A. Pettigrew, H. Thomas and R. Whittington (eds), *Handbook of Strategy and Management,* Sage. For a discussion of Chinese diversification patterns, see A. Delios, N. Zhou and W.W. Xu (2008) ‘Ownership structure and the diversification and performance of publicly-listed companies in China’, *Business Horizons,* vol. 51, no. 6, pp. 802–21. See M.C. Mayer, C. Stadler, and J. Hautz (2014) ‘The relationship between product and international diversification: the role of experience’, *Strategic Management Journal*, for a discussion of the importance of experience in driving diversification.
12. These benefits are often discussed in terms of ‘multimarket’ or ‘multipoint’ competition: see J. Anand, L. Mesquita and R. Vassolo (2009) ‘The dynamics of multimarket competition in exploration and exploitation activities’, *Academy of Management Journal,* vol. 52, no. 4, pp. 802–21.
13. M. Goold and A. Campbell (1998) ‘Desperately seeking synergy’, *Harvard Business Review,* vol. 76, no. 2, pp. 131–45. See also Y.M. Zhou (2011) ‘Synergy, coordination costs, and diversification choices’, *Strategic Management Journal,* vol. 32, no. 6, pp. 624–39.
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(2013) ‘Skill relatedness and firm diversification’, *Strategic Management Journal,* vol. 34, no. 3, pp. 297–316.

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16. L.E. Palich, L.B. Cardinal and C. Miller (2000) ‘Curvilinearity in the diversification-performance linkage: an examination of over three decades of research’, *Strategic Management Journal,* vol. 21, pp. 155–74. The inverted-U relationship is the research consensus, but studies often disagree, particularly finding variations over time and across countries. For context sensitive studies, see M. Mayer and R. Whittington (2003) ‘Diversification in context: a cross national and cross temporal extension’, *Strategic Management Journal,* vol. 24, pp. 773–81; and A. Chakrabarti, K. Singh and I. Mahmood (2007) ‘Diversification and performance: evidence from East Asian firms’, *Strategic Management Journal,* vol. 28, pp. 101–20. There are also variations by type of diversification – see M. Geoffrey, G.M. Kistruck, I. Qureshi and P.W. Beamish (2011) ‘Geographic and product diversification in charitable organizations’, *Journal of Management,* vol. 39, no. 2, pp. 496–530.
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18. N. Cetorelli, M.G. Jacobides, S. Stern (2021) ‘Mapping a sector’s scope transformation and the value of following the evolving

core', *Strategic Management Journal*, vol. 42, pp. 2294–2327.

19. M. Schommer, Richter, A. and Karna, A. (2019) 'Does the Diversification–Firm Performance Relationship Change Over Time? A Meta-Analytical Review', *Journal of Management Studies,* vol. 56, no. 1, pp. 270–98.
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21. For a discussion and cases on the relative guidance of transaction cost and capabilities thinking, see R. McIvor (2009) 'How the transaction cost and resource-based theories of the firm inform outsourcing evaluation', *Journal of Operations Management,* vol. 27, no. 1, pp. 45–63. See also T. Holcomb and M. Hitt (2007) 'Toward a model of strategic outsourcing', *Journal of Operations Management,* vol. 25, no. 2, pp. 464–81.
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30. See A. Campbell and K. Luchs (1992) *Strategic Synergy,* Butterworth–Heinemann.
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Case example

Grand strategies in vision

by Peter Barton

Seeing opportunities

Most wearers of prescription eyewear and sunglasses are aware of the large retail brands on their high street and, increasingly online, as well as many of the brand names that they sell. What many are less aware of is the giant companies that operate the manufacturing of the vast majority of the products behind this industry, which was worth $109bn (£82bn/€93bn) in 2018 and is set to grow 7.4 per cent each year until 2023 to around $167bn (£125bn/€142bn) (ResearchAndMarkets.com, 2018).

While the continued growth in prescriptive eyewear came about in part due to a rapid worldwide population increase, the number of those requiring corrective prescriptions has also risen dramatically. This may be partially down to wider awareness and eye testing but it is also due to a lack of time spent outdoors, increased use of screens and LED lighting and the impact of most populations living longer. Notably, there is a global epidemic of myopia (short-sightedness), which has increased roughly two-fold in just a couple of decades. Reportedly, in the 1950s in China, around 10 to 20 per cent of the population were short-sighted but this has risen to around 90 per cent.

Vision as fashion

Up until the 1980s, glasses were largely seen as medical devices with functional designs, despite labels such as Christian Dior and Pierre Cardin attempts to bring fashion to the market. It wasn't until the early 1990s that the global manufacturing giant Luxottica played a large part in bringing fashion to the industry through the licensing of the fashion brand Giorgio Armani, and then Prada, Ralph Lauren, Gucci and Chanel. Other major brand manufacturers have since emerged, including Safilo, the world's second largest manufacturer of eyewear, which manages rival fashion brands such as Carrera, Dior, Fendi, BOSS, Tommy Hilfiger and Jimmy Choo.

Luxottica (formerly)

Luxottica was founded by Italy's current highest individual taxpayer Leonardo Del Vecchio who originally started with a workshop in Agordo, in Italy, in 1961. He grew his company into the world's largest maker of frames with two notable objectives: to do everything itself, and to focus on fashion. Progressively, he set about controlling every element in the supply chain, sourcing raw materials, making all parts of the frames which involves around 200 manufacturing stages to produce and, later, the stores where they were sold. Del Vecchio, the current Chairman, was recently quoted as saying: 'Although today we are strong, life has taught me that you should never think of having arrived; I believe that you should always have the courage to reinvent yourself and innovate' (Luxottica Report, 2016). This attitude to ownership, control and innovation has enabled Luxottica to control standards, bringing higher quality products to market faster and in higher quantities.

	BURBERRY	BVLGARI
CHANEL	COACH	DKNY
DOLCE & GABBANA		GIORGIO ARMANI
MICHAEL KORS	MIU MIU	OAKLEY
OLIVER PEOPLES		
POLO RALPH LAUREN	PRADA EYEWEAR	RALPH LAUREN
		STARCK EYES
TIFFANY & Co.	TORY BURCH	VALENTINO
VERSACE	VOGUE	

List of Luxottica brands: www.luxottica.com/en/eyewear-brands [accessed: June 2022].

Long Description

The most valuable optical brand in the world is Ray-Ban, which now generates more than $2bn (£1.5bn) in sales for Luxottica each year, making it an impressive brand turnaround. Luxottica bought Ray-Ban from Bausch & Lomb in 1999 at a time when the brand was at a notable low with Ray-Bans reportedly being sold at petrol stations for just $19 (£14/€16). Having promised to protect thousands of jobs at four factories in the USA and Ireland, Del Vecchio quickly closed the plants and shifted production to Italy and China. His next move was, perhaps, less expected as he withdrew Ray-Ban from 13,000 retail outlets, increasing their prices and significantly improving quality: the number of layers of lacquer on a pair of Wayfarers increased from just two to over 30. Once the brand had regained its prestige across its core styles, including Aviators, Wayfarers and Clubmasters, he then introduced a highly successful prescription glasses range.

The other important frame brand to Luxottica is Oakley but this was a brand acquired through much hostility. In 2000, Luxottica asked all its suppliers to reduce its prices to them, but despite its stores making up over 25 per cent of Oakley's business, Oakley refused to comply. Del Vecchio's response was to produce Ray-Bans reportedly more

similar to Oakley's designs leading to Oakley suing them in 2001, which ultimately ended in an out-of-court settlement. Perhaps as a show of strength from Del Vecchio, in 2007, Luxottica purchased Oakley for $2.1bn (£1.5bn).

As a result of many acquisitions and significant brand growth, Luxottica now supplies over 25 per cent of the world's frames, catering for multiple market segments. As quoted in *The Guardian* (2018), Luxottica's Chief Operating Officer Striano says: 'Luxottica has around 27,000 models in production at any one time and turns out 400,000 frames a day catering for global fashion demands as well as widely different face shapes that vary from country to country.'

While establishing its business in frame manufacturing, in the 1990s, Luxottica sought to diversify its portfolio of optical businesses across the optical supply chain. Del Vecchio listed Luxottica on the New York stock exchange and, in 1995, acquired a conglomerate five times larger than itself called US Shoe through a hostile takeover for $1.4bn (£1.05bn/€1.2bn). US Shoe was founded in 1879 and included LensCrafters, the USA's largest optical store. Del Vecchio promptly sold all non-optical elements of the business and filled all the stores with Luxottica's own glasses putting it in competition with thousands of competing opticians that it already supplied. Jeff Cole, the former Chief Executive of Cole National Corporation, an even larger optical retailer that sold out to Luxottica in 2004 said, 'When they buy a company, they spend a little time figuring it out and kick out all the other suppliers.'

This is a growth formula that they have continued to adopt around the world including through Sunglass Hut, John Lewis Opticians and David Clulow in the UK, Óticas Carol in Brazil, Xueliang Glasses in Shanghai or Ming Long Store in Hong Kong. Luxottica now has almost 9,000 stores and supplies over 100,000 opticians around the world.

HAL Holdings

Two other giants in the global optical market include designer frame manufacturer Safilo and retail-focused Grand Vision, both of which are owned and controlled by HAL Holdings.

Safilo operates an extensive wholly owned global distribution and wholesale network in over 40 countries servicing almost 100,000 selected stores with its diverse brand portfolio. The direct management of proprietary brands ensures bigger margins, while licensed brands allow for a larger portfolio, through different consumer and distribution segments.

List of Safilo brands: http://www.safilogroup.com/en/2-licensed-brands [accessed: June 2022].

Source: DANIEL LEAL-OLIVAS/AFP/Getty Images and Bloomberg/Getty Images.

Long Description

While HAL Holding's other major interest, Grand-Vision, has some of its own frame brands as well as contact lens brands, its main operation is the overarching control and governance of over 7,000 optical stores serving over 150 million customers across 44 countries and with sales of over €3.6bn (£3.1bn) in 2017. GrandVision sources a large portion of its premium designer frames from Safilo but is also free to source from other suppliers including Luxottica.

Figure 1 GrandVision's historical revenue

Source: http://investors.grandvision.com/key-figures

Figure 1: Long Description

Figure 2 Recent GrandVision M&A activity

Figure 2: Long Description

GrandVision can trace its roots back to 1891 when Christian Nissen opened its first store in Helsinki, Finland. However, it wasn't until 1996 that HAL Holdings stepped in by first acquiring the Dutch and Belgian operations of Pearle Vision, which then led to the eventual merger of Pearle to create GrandVision in 2011. Since, GrandVision has continued to seek growth in new markets as well as acquire and merge into existing retail brands, rolling out its largely standardised formula across each market. For example, in the UK, Vision Express increased its number of stores from around 300 stores to over 600 stores in the space of 5 years (see Vision Express Industry Case example). This rapid expansion has helped to grow the manufacturing part of the business as well as other products sold through its stores. While its relationship to Safilo remains at arm's length, as GrandVision's principal designer frame supplier, the knock-on effect has seen Safilo's revenues exceed €1 billion in 2018 despite still failing to make a profit for the previous three years.

Operating a two-tier governance structure consisting of a Management Board and Supervisory Board, GrandVision is set up and structured to deliberately ensure that the subsidiaries in each country can be close to their own markets. Its strategic priorities are to continue expansion into new markets as well as expand and enhance existing ones.

Long Description

For Vision Express in the UK, all our department teams, from marketing to purchasing, make it their job to understand the market and its needs. GrandVision's role is to support us in delivering it to the market. A large part of this comes from the economies of scale and leverage of synergies on a greater scale than if it was just us. So this model enables us to have preferential buying to ensure the delivery of economic value. We are also hungry to learn best practices from others that have had success and relate it back to opportunities within our own market. The longevity of retail brands such as Vision Express in the UK, Apollo-Optik in Germany, Grand Optical in France is clear testament to

their commitment and they have no intention to destroy that or create a homogenous brand.

CEO of Vision Express, Jonathan Lawson

When rival giants collide

On 1 October 2018, GrandVision's and Safilo's biggest competitor, and the world's largest supplier of eyewear, Luxottica merged with global giant Essilor, which itself supplies over 45 per cent of the world's prescription lenses.

The merging of Luxottica with the French multinational Essilor has made the newly named company 'EssilorLuxottica' comfortably the world's largest optical company valued at around $50bn (£37bn) with over 140,000 employees and a customer base of over 1.4 billion, which, to put it in perspective, is more than either Microsoft (1.2 billion) or Apple have (1.3 billion). Essilor's Chairman and Chief Executive, Hubert Sagnières, believes that the merger between Luxottica and Essilor will enable them to equip the planet with eyewear over the coming decades. 'The Luxottica frames with our lenses will be a hugely powerful force' (Stothard, 2017, *Financial Times*).

Essilor itself was the merger of two French optical companies, Essel and Silor, which merged in 1972. Specialising in plastic lenses, as opposed to glass, they were renowned for inventing the first progressive/multi-focal lens, allowing people to see both close-up and far away, which they branded under the name 'Variux'. Essilor has acquired more than 250 other companies in the past 20 years, including online glasses retailer MyOptique in 2016. It now supplies around 350,000 stores around the world, which is over three times that of Luxottica. It also holds over 8,000 patents and it is focused on new technologies in lenses, such as building upon Google's failed concept of Google Glass with the idea to project information from the internet such as emails, maps, messaging and social media.

While most people have heard of neither Luxottica or Essilor, the creation of EssilorLuxottica is likely to have a great impact upon the industry as the control of supply within the industry is held by fewer manufacturers operating more brands across diverse retail and legal environments. *The Guardian* quotes Dr Gorny (Head of R&D Essilor) as

saying: ‘There is nothing close to that firepower once the combination is done. You have the global footprint. You can play all the courts.’

However, its ability to integrate effectively is yet to be seen and will not be without a potential clash of cultures. Insiders say that Luxottica is run like a monarchy with little clear management structure, whereas Essilor is clearly defined and organised with 55 per cent of its employees as shareholders. Furthermore, despite inherent optimism, both companies reported an early sales dip in 2018, with Essilor dropping 5.8 per cent and Luxottica 11 per cent, which they put down to fluctuating currencies, bad weather and a dip in wholesale revenue.

Sources: S. Knight (2018) ‘The spectacular power of Big Lens’, *The Guardian,* 10 May, available at: https://www.theguardian.com/news/2018/may/10/the-invisible-power-of-big-glasses-eyewear-industry-essilor-luxottica [accessed: July 2022]; ‘AOP Profession Threat and Opportunities’, available at: www.aop.org.uk/advice-and-support/threats-and-opportunities-in-the-profession [accessed: June 2022]; R. Calver (2010) ‘The Health and Social Security Act 1984 and the price of spectacles among corporate practices in the United Kingdom (1980–2007): a review’, *Ophthalmic and Physiological Optics,* vol. 30, no. 2 , pp. 113–23; C. Fulop and K. Warren (1993) ‘Deregulation and its impact on the opticians’ market: a comparison of the forecasts of both proponents and opponents with events in practice’, *International Journal of Advertising,* vol. 12, no. 3, pp. 257–78; Essilor website: https://www.essilor.com/essilor-content/uploads/2016/10/Essilor_Press_Release_Forbes_most_innovating_companies_24_August_2016-.pdf [accessed: July 2022]; GrandVision website: www.grandvision.com/ [accessed: June 2022]; T. Hockley (2012) ‘A giant leap by small steps: The Conservative Party and National Health Service reform’ (Doctoral dissertation, The London School of Economics and Political Science (LSE)); Luxottica website: www.luxottica.com/en [accessed: June 2022]; Luxottica Group, ‘2016 Investor and analyst presentation’, 2 March 2016, www.luxottica.com/sites/luxottica.com/files/2016_03_02_-

_luxottica_2016_investor_and_analyst_presentation_-_transcript_2.pdf [accessed: June 2022]; E. McCormick (2016) ‘Lens group features on the “100 Most Innovative Companies” list for a sixth year’, *Forbes,* 1 September 2016, www.aop.org.uk/ot/industry/eyewear-and-lenses/2016/09/01/essilor-named-on-forbes-list [accessed: June 2022]; M. Olczak (2015) ‘Chain-store pricing and the structure of retail markets’, *Journal of Industry, Competition and Trade,* vol. 15, no. 2, pp. 87–104; ‘Optical Goods Retailing’, February 2018, Mintel; ResearchAndMarkets.com (2018), ‘Global $167 Billion Eyewear Market Report 2018 with Forecasts to 2023 by Product, Gender, and Distribution Channel’, www.researchandmarkets.com/research/lvw69x/global_167?w=4 [accessed: June 2022]; Safilo website: www.safilogroup.com/en/; M. Stothard (2017) ‘Hubert Sagnières, Essilor CEO, on an eyewear megamerger’, *Financial Times,* 11 June, www.ft.com/content/10bde3b0-33ea-11e7-99bd-13beb0903fa3 [accessed: June 2022]; G.S. Valentina Za (2017) ‘Luxottica CEO exits eyewear giant ahead of Essilor merger’, 15 December, www.reuters.com/article/us-luxottica-ceo/luxottica-ceo-exits-eyewear-giant-ahead-of-essilor-merger-idUSKBN1E92IB [accessed: June 2022]; www.-grandvision.com/about-us/exclusive-eyewear-brands/frames-and-sunglasses [accessed: June 2022].

Questions

1 With reference to Ansoff's matrix, show how Luxottica and GrandVision have evolved over time. What can you conclude from each?

2 How does GrandVision compete in its market?

3 How do you think that GrandVision adds or destroys value for its portfolio?

4 With the creation of EssilorLuxottica, what would you recommend for GrandVision's future strategy?

Note: 'Glasses' (or spectacles) are referred to as 'eye-glasses' in the USA.

Chapter 10

International strategy

Key terms

CAGE framework

entry mode strategies

global integration

global–local dilemma

global sourcing

global strategy

international strategy

local responsiveness

Porter’s diamond

staged international expansion model

Yip’s globalisation framework

Learning outcomes

After reading this chapter you should be able to:

- Assess the *internationalisation drivers and potential* of different markets.
- Identify sources of competitive advantage in international strategy, through both exploitation of *local factors* and *global sourcing*.

- Understand the difference between *global integration* and *local responsiveness* and *four main types of international strategy*.
- *Rank markets* for entry or expansion, considering attractiveness, cultural and other forms of distance and competitor retaliation threats.
- Assess the relative merits of different *market entry strategy modes*, including joint ventures, licensing and franchising and wholly owned subsidiaries.

Long Description

10.1 Introduction

The last chapter introduced market development as a strategy, in relation to the Ansoff axes (see Section 9.2.3). This chapter focuses on a specific but important kind of market development, operating in different geographical markets. Many types of organisations expand internationally and face new customer needs and are challenged by local economic, regulatory, political and cultural institutions that often differ substantially from home. There are of course the large traditional multinationals such as Nestlé, Toyota and McDonald's. But recent years have seen the rise of emerging-country multinationals from Brazil, India and China. The Indian conglomerate Reliance Industries Limited, for example, has operations in five continents. New small firms, like internet-based start-ups, are also increasingly 'born global', building international relationships right from the start. For example, Spotify was created to become international and worldwide from the very start. Likewise, not-for-profit organisations like the Red Cross and Doctors without Borders have been working internationally from early on. Public-sector organisations also must make choices about collaboration, outsourcing and even competition with overseas organisations. For example, European Union legislation requires public service organisations to accept tenders from non-national suppliers.

Figure 10.1 identifies the five main themes of this chapter, with international strategy as the core. The themes are as follows:

- *Internationalisation drivers.* Drivers of an organisation's internationalisation include market demand, the potential for

cost advantages, government pressures and inducements, and the need to respond to competitor moves. Given the risks and costs of international strategy, managers need to know how strong the drivers are to justify adopting an international strategy in the first place.

- *Geographical and firm-specific advantages.* In international competition, advantages might come from firm-specific and geographical advantages. Firm-specific advantages are the unique resources and capabilities proprietary to an organisation, as discussed in Chapter 5. Geographical advantages might come both from the geographic location of the original business and from the international configuration of their value system.
- *International strategy.* If drivers and advantages are sufficiently strong to merit an international strategy, then a range of strategic approaches are opened up, from the simplest export strategies to the most complex transnational strategies.
- *Market selection.* Having adopted the broad approach to international strategy, the next question is which country markets to prioritise and which to steer clear of. Here managers need to consider differences and distances in economic, regulatory, political and cultural institutions.
- *Entry strategy mode.* Finally, once target countries are selected, managers must determine how they should enter each particular market. Again, export is a simple place to start, but there are licensing, franchising, joint-venture and wholly owned subsidiary (acquisition or ‘greenfield’ investments) alternatives to consider as well.

Figure 10.1 International strategy: five main themes

Figure 10.1: Long Description

The chapter takes a cautious view on international strategy. Despite the widespread talk of increasing 'globalisation', there are many challenges and pressures for being local or regional as well. Impediments to global integration and connectedness remain high and the degree of globalisation is often overstated and has slowed down since the financial crisis of 2008 and the COVID-19 pandemic.[1] The chapter will therefore distinguish between international strategy and global strategy.[2] **International strategy refers to a range of options for operating outside an organisation's country of**

origin. Global strategy is only one kind of international strategy. **Global strategy involves high coordination of extensive activities dispersed geographically in many countries around the world**.

10.2 Internationalisation drivers

There are many general pressures increasing internationalisation. Barriers to international trade and investment are now lower than they were a couple of decades ago. Better international legal frameworks mean that it is now less risky to deal with unfamiliar partners. Improvements in communications – from cheaper air travel to the internet – make movement and the spread of ideas much easier around the world. New economic powerhouses such as China, India and Brazil are generating new opportunities and challenges for business internationally.[3]

However, far from all internationalisation trends are one-way. Nor do they hold for all industries. Trade barriers exist for some products, especially those relating to defence technologies, and barriers have increased since the financial crisis of 2008. Recent trade tensions make certain companies not welcome in some countries, like Huawei in the USA and Facebook and Twitter in China. Many countries also protect their leading companies from takeover by overseas rivals. In addition, markets vary widely in the extent to which consumer needs are standardising – compare computer and mobile operating systems to the highly variable national tastes in chocolate. The COVID pandemic exposed many companies to the vulnerability of global value chains and made some of them more regional instead. Some so-called multinationals are, in fact, concentrated in very particular markets, for example, North America and Western Europe, or have a quite limited set of international links, for example, in supply or outsourcing arrangements with just one or two countries

overseas. In short, managers need to beware of ‘global boloney’, by which economic integration into a single homogenised and competitive world is wildly exaggerated[4] and realise that there even are tendencies of de-globalisation.[5] The US discount retailer Walmart has learned the hard way that international markets are not only very different from home but differ significantly from each other (see Illustration 10.1).[6]

Given internationalisation’s complexity, international strategy should be underpinned by a careful assessment of trends in each particular market. George Yip at China Europe International Business School provides a framework for analysing ‘drivers of globalisation’. These drivers can be thought of as ‘internationalisation drivers’ more generally. Therefore, **Yip’s globalisation framework sees international strategy potential as determined by market drivers, cost drivers, government drivers and competitive drivers** (see Figure 10.2).[7] In more detail, the four internationalisation drivers are as follows:

- *Market drivers.* A critical facilitator of internationalisation is standardisation of market characteristics. There are three components underlying this driver. First, the presence of *similar customer needs and tastes*: for example, the fact that, in most societies, consumers have similar needs for easy credit has promoted the worldwide spread of a handful of credit card companies such as Visa. Second is the presence of *global customers*: for example, car component companies have become more international as their customers, such as Toyota or Ford, have internationalised, and required standardised

components for their factories around the world. Finally, *transferable marketing* promotes market globalisation: brands such as Coca-Cola are still successfully marketed in very similar ways across the world.

- *Cost drivers.* Costs can be reduced by operating internationally. Again, there are three main elements to cost drivers. First, increasing volume beyond what a national market might support can give *scale economie*s, both on the production side and in purchasing of supplies. Companies from smaller countries such as the Netherlands, Sweden and Taiwan tend, therefore, to become proportionately much more international than companies from the USA, which have a vast market at home. Scale economies are particularly important in industries with high product development costs, as in the aircraft industry, where initial development costs need to be spread over the large volumes of international markets. Second, internationalisation is promoted where it is possible to take advantage of variations in *country-specific differences*. It thus makes sense to locate the manufacture of clothing in Africa or Bangladesh where labour is still considerably cheaper, but to keep design activities in cities such as New York, Paris, Milan, or London, where fashion expertise is concentrated. The third element is *favourable logistics*, or the costs of moving products or services across borders relative to their final value.
- *Government drivers.* There are three main factors here that facilitate internationalisation. First, *reduction of barriers to trade and investment* has accelerated internationalisation. During the last couple of decades, governments have reduced restrictions

on both flow of goods and capital. The World Trade Organisation has been instrumental in reducing trade barriers globally.[8] Similarly, the emergence of regional economic integration partnerships like the European Union (EU), the Association of Southeast Asian Nations (ASEAN) Economic Community and the United States–Mexico–Canada Agreement (USMCA) has promoted this development. No government, however, allows complete economic openness and it typically varies widely from industry to industry, with agriculture and high-tech industries related to defence likely to be particularly sensitive. Even if trade barriers have been reduced, the last few years have seen a push back and some trade tensions. For example, the USA has raised trade tariffs, renegotiated international trade agreements, and blocked sensitive Chinese technology companies. Likewise, US companies like Google and Facebook have encountered barriers and regulations from Chinese authorities. *The liberalisation and adoption of free markets* in many countries around the globe have also encouraged international trade and investments. Economic and free market reforms in China and later in Eastern Europe and Russia have been followed by market-based reforms in numerous Asian, South American, and African economies.[9] A third important government factor is *technology standardisation*. Compatible technical standards make it easier for companies to access different markets as they can enter many markets with the same product or service without adapting to local idiosyncratic standards.

- *Competitive drivers.* These relate specifically to globalisation as an integrated worldwide strategy rather than simpler international strategies (see Section 10.4). These have two elements. First, *interdependence* between country operations increases the pressure for global coordination. Company value chains are increasingly fragmented with suppliers, manufacturing and sales dispersed over a range of different countries facing various competitive and customer pressures. For example, a business with a plant in Mexico that sources parts in Brazil and serves both the USA and the Japanese markets must coordinate carefully between the different locations: surging sales in one country, or a collapse in another, will have significant knock-on effects on the other countries. The second element relates directly to competitor strategy. The presence of *globalised competitors* increases the pressure to adopt a global strategy in response because competitors may use one country's profits to cross-subsidise their operations in another. A company with a loosely coordinated international strategy is vulnerable to globalised competitors because it is unable to support country subsidiaries under attack from targeted, subsidised competition. The danger is of piecemeal withdrawal from countries under attack, and the gradual undermining of any overall economies of scale that the international player may have started with.

Figure 10.2 Drivers of internationalisation

Source: Adapted from G. Yip (2003) *Total Global Strategy II*, Financial Times Prentice Hall, Chapter 2.

Figure 10.2: Long Description

Illustration 10.1 Walmart: international successes and failures The biggest retailer in the world has found that internationalisation is considerably more challenging than expansion at home.

Walmart began its international operations in 1991 and Walmart International grew constantly up until 2018, with sales of $120bn (£72bn, €90bn) in 2020, accounting for about 23 per cent of Walmart's overall sales. It included close to 700,000 employees in close to over 6,000 stores and 11 e-commerce websites in 28 countries. Internationalisation results have, however, been mixed as Walmart has struggled to understand local buying patterns, competitors, culture and regulations, not least in emerging markets.

Walmart first entered the Americas and has since expanded into ever more distant geographic markets. The early entry into Canada and Mexico was successful, but South America's largest market, Brazil, was considerably more challenging. Its challenges included regulatory problems, strong competition from the French supermarket chain Carrefour and being unable to convince shoppers about Walmart's 'everyday low prices' model.

European expansion performance has similarly been mixed. The acquisition of the ASDA Group in the UK was relatively successful at first, even though it struggled against local competition and, two decades later, they sold their majority stake in 2020. In Germany, Walmart experienced eight years of struggle that ended in a market exit. First, it did not have enough scale economies compared to local competitors, like Aldi, with strong relationships with German suppliers and already catering to price-conscious consumers. Second, cultural mistakes were made as customers did not approve of US

service practices. A third challenge was Germany's then strict regulations on location and opening hours. German workers also resisted Walmart's workplace customs, resulting in labour union conflicts.

Walmart's first Asian expansion into South Korea met strong local competition and failed to meet local customer needs; it also ended in exit after eight years. China has been more of a mixed picture. On the one hand, sales have steadily increased; over 400 stores have been established and they make a profit. On the other hand, the cultural distance was considerably larger than first anticipated. An early discovery was that Chinese consumers prefer frequent shopping trips in contrast to Walmart's home-based experience where customers drive to out-of-town stores and fill their cars with large multi-packs. While it encountered a completely different international market, it also faced large regional variations in this vast and multi-ethnic country. It has also struggled with local regulations and food safety issues and tough competition from Carrefour.

After some disappointing years with international sales dropping over 10 per cent, Judith McKenna, a long-time Asda Executive and Executive Vice-President of Strategy, was promoted to President and CEO of Walmart International. She has partly shifted the strategy towards more mergers, acquisitions and partnerships: in India, the largest online retailer Flipkart was acquired and, in Brazil, the majority stake in the operations was sold and in Latin America Corner shop, a fast-growing online grocery app was acquired: 'The transaction is an important step forward in accelerating the company's . . . growth in Latin America . . . [their] digital expertise, technology and capabilities will strengthen our successful businesses in Mexico and Chile and provide learning for other markets in which we operate.'

Sources: R. Dudely (2014) 'Wal-Mart's everyday low prices fail to stir Brazilians', *Bloomberg Business*, 23 April; A. Felsted (2015) 'Chinese grocery sales forecast to rise by a third: Food & beverages, *Financial Times*, 24 August; *Thomson Reuters Street Events*, 'Wal Mart Stores Inc 22nd Annual Meeting For The Investment Community', Edited Transcript, 14 October 2015; L. Whipp (2016) 'Walmart to close 269 stores as it

revamps online presence', *Financial Times*, 5 January; N. Bose (2018) 'Walmart attempts international turnaround with UK, India tie-ups', 29 April. Reuters; Judith McKenna, Walmart President and CEO in: J. Webber (2018) 'Walmart boosts LatAm ecommerce push with Cornershop purchase', *Financial Times*, 13 September.

Questions

1 What are the internationalisation drivers Walmart International has struggled with?

2 What might be the dangers for a large Western retailer in staying out of emerging markets?

The key insight from Yip's drivers framework is that the internationalisation potential of industries and sectors is variable. There are many different factors that can support it, as indicated above, but others can inhibit it. For example, customer needs and tastes for many food products inhibit their internationalisation and local governments often impose tariff barriers, ownership restrictions and local content requirements on foreign entrants. Similarly, for non-governmental organisations (NGOs) some factors may back internationalisation while others hinders it. Illustration 10.2 demonstrates this for NGOs. In sum, an important step in determining an internationalisation strategy is a realistic assessment of the true scope for internationalisation in the particular industry or sector.

Just as for product and service diversity, the relationship between internationalisation and performance has been extensively researched.[10] Similar to the findings on product/service

diversification, shown in Section 9.4, it has been suggested that there is an inverted U-shaped relationship between internationalisation and performance. While the potential performance benefits of internationalisation are substantial, the combination of diverse locations and diverse business units also gives rise to high levels of organisational complexity. Hence, at some point, the costs of organisational complexity may exceed the benefits of internationalisation. However, the evidence on whether and how multinationality affects performance is far from determined and other relationships have been suggested. Some studies have suggested that, in contrast to firms in the manufacturing sector, internationalisation may not lead to equally improved performance for service-sector firms. This is due to service firms in some sectors being highly regulated and sensitive to cultural differences, such as banks or accountants.[11] Compared to single-business firms, it has been suggested that product-diversified firms are likely to do better from international expansion because they have already developed the necessary skills and structures for managing internal diversity. At the other end of the spectrum, there is general consensus that firms that are highly diversified in terms of both product and international markets are likely to face excessive costs of coordination and control leading to poor performance. As many firms have not yet reached levels of internationalisation where negative effects outweigh possible gains and because of current scepticism with regard to the benefits of high levels of product diversification, many companies currently opt for reducing their product diversity while building their international scope. Unilever, for example, has been combining a

strategy of growing internationalisation with de-diversification (see Section 9.3).

10.3 Geographic sources of advantage

A company entering a market from overseas typically starts with considerable *dis*advantages relative to local competitors, which will usually have superior knowledge of the local market and its institutions. When firms expand internationally, they thus start with a *liability of foreignness* and face additional costs of doing business compared with local firms as these already have established relationships with customers, suppliers, and authorities.[12] A foreign entrant must therefore have significant firm-specific competitive advantages for it to overcome these inherent advantages of local competitors. Tesco's failure in the USA is an example of this. After seven years and investments of about £1bn (€1.2bn) in its US 'Fresh & Easy' business, Tesco was forced to withdraw. Unlike in the UK, Tesco had limited competitive advantage over the strong US domestic retailers. Internationalisation thus requires building on the sources of sustainable competitive advantage that we have discussed earlier in Chapters 5 and 8 including the organisation's unique strengths in resources and capabilities and business strategy. While these *firm- or organisation-specific advantages* are important and need to be transferable, competitive advantage in an international context also depends on *country-specific or geographic advantages*.[13]

As the earlier discussion of cost drivers in international strategy has shown, the geographical location of activities is a crucial source

of potential advantage and one of the distinguishing features of international strategy relative to other diversification strategies. Bruce Kogut at Columbia University has explained that an organisation can improve the configuration of its *value chain and system* (see Section 5.5.3) by taking advantage of country-specific differences.[14] There are two principal opportunities available: the exploitation of particular *locational advantages*, in the company's home country, and sourcing advantages overseas via an *international value system*. Managers need to appraise these potential sources of competitive advantage carefully: if there are no firm-specific or geographical competitive advantages, international strategy is liable to fail.

10.3.1 Locational advantage: Porter's diamond[15]

Countries and regions within them, and organisations originating in those, often benefit from competitive advantages grounded in specific local conditions. They become associated with specific types of enduring competitive advantage: for example, the Swiss in private banking, the northern Italians in leather and fur fashion goods, and the Taiwanese in laptop computers. Michael Porter has proposed a four-pointed 'diamond' to explain why some locations tend to produce firms with competitive advantages in some industries more than others (see Figure 10.3). Specifically, **Porter's diamond suggests that locational advantages may stem from local factor conditions; local demand conditions; local related and supporting industries; and from local firm strategy structure**

and rivalry. These four interacting determinants of locational advantage work as follows:

- *Factor conditions.* These refer to the ‘factors of production’ that go into making a product or service (i.e., raw materials, land and labour). Factor condition advantages at a national level can translate into general competitive advantages for national firms in international markets. For example, the linguistic ability of the Swiss has traditionally provided a significant advantage to their banking industry. Cheap energy has traditionally provided an advantage for the North American aluminium industry.
- *Home demand conditions.* The nature of the domestic customers can become a source of competitive advantage. Dealing with sophisticated and demanding customers at home helps train a company to be effective overseas. Sophisticated local customers in France and Italy have helped keep their local fashion industries at the leading edge for many decades.
- *Related and supporting industries.* Local ‘clusters’ of related and mutually supporting industries can be an important source of competitive advantage. These are often regionally based, making personal interaction easier. In northern Italy, for example, the leather footwear industry, the leatherworking machinery industry, and the design services that underpin them group together in the same regional cluster to each other’s mutual benefit. Silicon Valley forms a cluster of hardware, software, research and venture capital organisations that together create a virtuous circle of high-technology enterprise.
- *Firm strategy, industry structure and rivalry.* The characteristic strategies, industry structures and rivalries in different countries

can also be bases of advantage. German companies' strategy of investing in technical excellence gives them a characteristic advantage in engineering industries and creates large pools of expertise. A competitive local industry structure is also helpful: if too dominant in their home territory, local organisations can become complacent and lose advantage overseas. Some domestic rivalry can be an advantage, therefore. For example, the Swiss pharmaceuticals industry became strong in part because each company had to compete with several strong local rivals.

Porter's diamond model underlines the environmental conditions and structural attributes of nations and their regions that contribute to their competitive advantage and to firms coming from them. It has been used by governments aiming to increase the competitive advantage of their local industries. The argument that rivalry can be positive has led to a major policy shift in many countries towards encouraging local competition rather than protecting home-based industries. Governments can also foster cooperation between suppliers and buyers on a domestic level (i.e., building clusters of related and supporting industries in particular regions).

For individual organisations, however, the value of Porter's diamond is to identify the extent to which they can build on home-based advantages to create competitive advantage in relation to others internationally. To compete with local actors, organisations must carefully exploit the distinct environmental conditions and structural attributes illustrated in Figure 10.3. For example, Volvo Trucks, the Swedish truck and construction equipment manufacturer, has achieved global success by building on a local network of

sophisticated engineering partners and suppliers and a local demand orientated towards reliability and safety. Before embarking on an internationalisation strategy, managers should thus seek out sources of general locational advantage to underpin their company's individual sources of advantage.

Figure 10.3 Porter's diamond – the determinants of national advantages

Source: Adapted with permission of The Free Press, a Division of Simon & Schuster, Inc., from *The Competitive Advantage of Nations* by Michael E. Porter. Copyright © 1990, 1998 by Michael E. Porter. All rights reserved.

Figure 10.3: Long Description

Illustration 10.2 The fast-paced internationalisation of non-governmental organisations (NGOs) Multiple drivers support the geographic expansion of NGOs

Besides governments and private firms, non-governmental organisations (NGOs) play an important role in solving some of the world's most severe challenges. They engage in different activities such as relieving suffering and starvation, providing basic social services, promoting poor people's general interests, protecting the environment, etc. To do this, they have internationalised extensively during the last decades. For example, Médecins Sans Frontières, or Doctors Without Borders, have grown substantially and spread geographically and now include a global network of 70 countries with over 35,000 personnel including local doctors, nurses, other medical professionals, logistical experts, engineers and administrators.

The internationalisation of NGOs shows fundamental similarities with the expansion of multinational corporations including internationalisation drivers, depending on their specific context. While NGOs don't have a market *per se*, there are market-like factors including standardisation of basic needs, availability of financial support globally and the possibility of marketing in similar ways across the world. As for corporations, there are possible cost reductions for NGOs by operating internationally. Besides potential lower

general costs, there are scale economies in various functions and the possibility to exploit lower costs for certain competencies in some countries. Even if NGOs do not necessarily compete against each other, there are competitive drivers like international interdependencies between countries and international organisations with similar objectives that may increase the potential for internationalisation. Finally, government factors including trade policies and lower trade barriers that have driven internationalisation of corporations also contribute to NGOs moving in the same direction. For NGOs, host government policies comprising independence and democratisation are most important and technical standardisation also plays a role. Some NGO internationalisation drivers in terms of Yip's framework are as follows: Market drivers

- Needs to respond to social problems wherever they occur.
- Global funds and fundraising opportunities.
- Transferable marketing, campaigning and fund raising.

Cost drivers

- Scale economies in fundraising, purchasing and campaigning.
- Country-specific differences in costs for certain competencies.
- Lower general costs (labour, campaigning, programs, logistics, etc.).

Competitive drivers - Interdependence with international partners (other NGOs, UN, other organisations and private enterprises).

- International competitors/organisations with similar objectives (competing for funds and resources internationally).

Government drivers - Ease of international trade policies including deposits, payments, remittances, etc.

- Independence and democratisation of host governments.
- Standardisation and expansion of international communication, travel and general computer technologies.

Apart from the internationalisation drivers above corresponding to Yip's framework (see Figure 10.2), there are other related ones that are more specific to NGOs. For example, the growth of intergovernmental bodies like the IMF, the World Bank, the European Union, and others have increased the international need for NGOs as they sponsor projects worldwide. Pressure from volunteers that want specific NGOs to enter their regions and countries is also important. In addition, NGOs are increasingly supported and encouraged to enter new countries as the social role of local government may be declining or lacking. Finally, NGOs can also gain legitimacy and credibility by being present internationally.

Sources: J. Siméant (2005) 'What is going global? The internationalization of French NGOs "without borders"', *Review of International Political Economy*, 12:5, December, 851–83; J. Baguley, C. Cornforth and G. Mallory 'What drives Non-Governmental Organizations (NGOs) to internationalise?', report, Open University Business School, Walton Hall.

Questions

1 What internationalisation drivers do you think were most important for Médecins Sans Frontières or Doctors Without Borders (or any NGO of your choice) to enter its specific countries?

2 How does Médecins Sans Frontières or Doctors Without Borders (or any NGO of your choice) strategy fit into a broader international value system including suppliers, channels, recipients/ beneficiaries, donors, etc. (see also Figure 5.5)?

10.3.2 The international value system

However, the sources of geographic advantage need not be purely domestic. In addition, as companies continue to internationalise, the country of origin becomes relatively less important for competitive advantage. For companies with most of their sales abroad, like the telecom giant Ericsson with over 95 per cent of sales outside its home country Sweden, the configuration of the international environments where they operate is at least as important as their domestic environment. This implies that for international companies, advantage also needs to be drawn from the international configuration of their *value system* (see Section 5.5.3). Here, the different skills, resources and costs of countries around the world can be systematically exploited in order to locate each element of the value chain in that country or region where it can be conducted most effectively and efficiently. Large multinational companies often develop and manage complex global or regional supply chains in this way. This may be achieved through both foreign direct investments and joint ventures but also through **global sourcing: purchasing services and components from the most appropriate suppliers around the world, regardless of their location**. For example, in the UK, for many years, the National Health Service has been sourcing medical personnel from overseas to offset a shortfall in domestic skills and capacity.

Locational advantages can be of different kinds. Facebook, for example, has located huge centres for their servers in the northern part of Sweden not only because of the low-energy cooling costs due to a cold climate, but because of local digital technology capabilities

and skills and Sweden's policy of low CO_2 emissions. Two major locational advantages can be identified:

- *Cost advantages* include labour costs, transportation and communications costs and taxation and investment incentives. Labour costs are important. US and European firms, for example, have moved much of their software programming tasks to India where a computer programmer costs a US firm about one quarter of what it would pay for a worker with comparable skills in the USA. As wages in India have risen, however, some IT firms have started to move work to even more low-cost locations such as Thailand and Vietnam.
- *Unique local capabilities* may allow an organisation to enhance its competitive advantage. Gradually, value-creating and innovative activity become geographically dispersed across multiple centres of excellence within multinational organisations.[16] For example, leading European pharmaceuticals company GSK has R&D laboratories in Boston and the Research Triangle in North Carolina in order to establish research collaborations with prominent universities and hospitals in those areas. Internationalisation, therefore, is increasingly not only about exploiting an organisation's existing capabilities in new national markets, but about developing and drawing on capabilities found elsewhere in the world.

10.4 International strategies

Given their organisation-specific advantages and the ability to obtain sources of international competitive advantage through geographic home-based factors or international value systems, organisations still face difficult questions about what kind of international strategy to pursue. The fundamental issue in formulating an international strategy is to balance pressures for *global integration* versus those for *local responsiveness*.[17] Pressures for **global integration encourage organisations to coordinate their activities across diverse countries to gain efficient operations**. The internationalisation drivers discussed above (Section 10.2) indicate forces that organisations can build on to achieve lower costs and higher quality in operations and activities on a global scale. However, there are conflicting pressures that also encourage organisations to become locally responsive and meet the specific needs in each individual country (see Section 10.5.1 below). Values and attitudes, economics, political institutions, cultures and laws differ across countries, which imply differences in customer preferences, product and service standards, regulations and human resources that all need to be addressed. These two opposing pressures – global integration vs local responsiveness – put contradictory demands on an organisation's international strategy. High pressure for global integration implies an increased need to concentrate and coordinate operations globally. In contrast, high pressure for **local responsiveness implies a greater need to disperse operations and adapt to local demand**.

This key problem is sometimes referred to as the **global–local dilemma: the extent to which products and services may be standardised across national boundaries or need to be adapted to meet the requirements of specific national markets**. For some products and services – such as TVs – markets appear similar across the world, offering huge potential scale economies if design, production and delivery can be centralised. For other products and services – such as processed food – tastes still seem highly national-specific, drawing companies to decentralise operations and control as near as possible to the local market.

This dilemma between global integration and local responsiveness suggests several possible international strategies, ranging from emphasising one of the dimensions, to complex responses that try to combine both. Organisations need to assess to what degree there are potential advantages of cost and quality of global integration and balance those pressures against the need to adapt products and/or services to local conditions. This section introduces four different kinds of international strategy, based on strategic choices and management about this balance (see Figure 10.4). The four basic international strategies are:[18]

- *Export strategy.* This strategy leverages home country capabilities, innovations and products in different foreign countries. It is advantageous when both pressures for global integration and local responsiveness are low, as shown in Figure 10.4. Companies that have distinctive capabilities together with strong reputation and brand names often follow this strategy with success. Rolex, the luxury watch company, for example, centralises its design and manufacturing in Geneva,

Switzerland and distributes its products in exclusive stores around the globe. The downside of this approach is the limits of a home country centralised view of the business with risks of skilled local competitors getting ahead. For Rolex, which thrives on their watches being considered timeless masterpieces and symbols of luxury and prestige worldwide this is not a major problem, however.

- *Multi-domestic strategy.* This is a strategy that maximises local responsiveness. It is based on different product or service offerings and operations in each country depending on local market conditions and customer preferences. Each country is treated differently with considerable autonomy for each country manager to best meet the needs of local markets and customers in that particular country. As with the export strategy, this strategy is similarly loosely coordinated internationally. The organisation becomes a collection of relatively independent units with value chain activities adapted to specific local conditions. This multi-domestic approach is particularly appropriate when there are strong benefits to adapting to local needs and when there are limited efficiency gains from integration. It is common in food and consumer product industries where local idiosyncratic preferences are significant. Marketing-driven companies often pursue this type of strategy. For example, Nestlé, the Swiss multinational food and drink company, often tailors its products to local tastes with different brands within the same product category in different countries.[19]

  The disadvantages of a multi-domestic strategy include manufacturing inefficiencies, a proliferation of costly product and

service variations and risks towards brand and reputation if national practices become too diverse.

- *Global strategy.* This is a strategy that maximises global integration. In this strategy, the world is seen as one marketplace with standardised products and services that fully exploits integration and efficiency in operations. The focus is on capturing scale economies and exploiting location economies worldwide with geographically dispersed value chain activities being coordinated and controlled centrally from headquarters. In these respects, this strategy is the exact opposite to the multi-domestic strategy. A global strategy is most beneficial when there are substantial cost or quality efficiency benefits from standardisation and when customer needs are relatively homogeneous across countries. It is a common strategy for commodities or commodity-like products. For example, Mexican Cemex, one of the largest cement companies in the world, follows a global strategy with centralised and shared services in information technology, R&D, human resources and financial services across countries and regions. Non-commodity companies can also follow a global strategy, like Sweden's retailer IKEA. Based on a strong home base, they standardise products and marketing with limited local adaptation to gain maximum global integration efficiency. The drawback of the global strategy is reduced flexibility due to standardisation that limits possibilities to adapt activities and products to local conditions. This has, for example, led IKEA to make minor modifications of some furniture offerings to suit local tastes.

- *Transnational strategy.* This is the most complex strategy that tries to maximise both responsiveness and integration. Its aim is to unite the key advantages of the multi-domestic and global strategies while minimising their disadvantages. In addition, it maximises learning and knowledge exchange between dispersed units. In this strategy, products and services and operational activities are subject to minimum efficiency standards, adapted to local conditions in each country. In contrast to the multi-domestic strategy, however, this strategy also leverages learning and innovation across units in different countries. The value chain configuration includes an intricate combination of centralised manufacturing to increase efficiency combined with distributed assembly and local adaptations. Coordination is neither centralised at home nor dispersed in foreign countries, but knowledge flows between units are encouraged from wherever ideas and innovations come from. The major advantage of this strategy is its capacity to support efficiency and effectiveness while at the same time being able to serve local needs and leverage learning across units. However, while it is argued that transnational strategies are becoming increasingly necessary, many firms find it difficult to implement given its complexity and the fundamental trade-off between integration and responsiveness. ABB, the Swiss–Swedish engineering giant, was once identified as the archetypal transnational company, but later ran into serious problems.[20] They have since tried to find the middle ground in a more regional strategy – a compromise discussed below.

Figure 10.4 International strategies: global integration vs local responsiveness

Figure 10.4: Long Description

In practice, these four international strategies are not distinct, as indicated by the overlapping ovals in Figure 10.4. They are rather illustrative examples of alternative international strategies with global integration and local responsiveness being matters of degree rather than sharp distinctions. Moreover, choices between them will be influenced by changes in the internationalisation drivers introduced earlier. It is rare that companies adopt a pure form of international strategy; instead, they often blend approaches and are located somewhere between the four strategies. As exemplified above, IKEA has a global strategy, but also makes some minor local adaptations, which may eventually move the company towards more of a transnational strategy.

Often regions (e.g., Europe or North America) play a larger role in international strategy than individual countries or global expansion. Thus, many multinationals compromise between local and global

logics by opting for *regional strategies*.[21] The aim of this strategy is to attain some of the economic efficiency and location advantages while simultaneously reaching local adaptation advantages. Regions are treated as relatively homogenous markets with value chain activities concentrated within them. Sales data suggests that many multinational companies follow this type of strategy focused on one or two regions including the triad of Europe, North America and/or Japan/Asia.[22] For example, over 85 per cent of all cars sold within each of these regions are built in that same region. This regional approach to international strategy shows that distances and differences between nations are still relatively large (see Section 10.5.1 below), which makes global integration difficult.

These differences can, however, be exploited in arbitrage for value creation. *Arbitrage* implies that multinationals take advantage of price differences between two or more markets by purchasing goods cheaply in one market and selling them at a higher price in another. For example, Walmart is known for sourcing much of what the company sells in the USA from China. Not only purchasing price differences, but differences in labour costs, in knowledge, capital and taxes can be exploited by operating in diverse countries. The potential for arbitrage in multinationals is substantial and it has been suggested as a third significant international strategy dimension, besides integration and responsiveness.[23] Finally, different international strategies require diverse organising requirements for success, which are discussed in Chapter 15 (Section 15.2.1).

10.5 Market selection and entry

Having decided on an international strategy built on significant sources of competitive advantage and supported by strong internationalisation drivers, managers next need to decide which countries to enter. There are substantial differences in customer needs and in economic, regulative–administrative, political, and cultural institutions. Countries can initially be compared using standard environmental analysis techniques, for example along the dimensions identified in the PESTEL framework (see Section 3.2) or according to the five forces (Section 4.3) for specific industries. However, there are specific determinants of market attractiveness that need to be considered in internationalisation strategy: the intrinsic characteristics of the country and market. A key point is how initial estimates of country attractiveness can be modified by considering various measures of *distance* and the likelihood of competitor *retaliation*. The section concludes by considering different *entry strategy modes* into national markets.

10.5.1 Country and market characteristics

A common procedure for evaluating a nation's potential for entry is to analyse its economic conditions (GDP, income growth rates per capita, etc.) and perhaps other aggregate measures of competitiveness and political stability. Based on this, a company can choose the most attractive country. However, Tarun Khanna and Krishna Palepu from Harvard Business School have shown that this

may not be enough, especially not for emerging markets.[24] These are often equally attractive on composite economic measures but may differ considerably on the specifics of institutional infrastructure. They emphasise that regulatory systems, contract-enforcing mechanisms, specialised intermediaries and other 'soft' infrastructure like the availability of market information need to be carefully evaluated. These kinds of *institutional voids* must then be taken into consideration when evaluating country attractiveness, besides composite country rankings.[25] The end of chapter case describes a company for which institutions triumph over most other international challenges.

The PESTEL framework (see Chapter 3) can thus be used here as it not only considers economic factors but broader institutional ones as well. This suggests that at least four of its elements can be of help in evaluating and comparing countries for entry:

- *Political.* Political environments vary widely between countries and can alter rapidly. Russia, since the fall of communism, has seen frequent swings for and against private foreign enterprise. It is important to determine the level of *political risk* before entering a country. In the extreme case, governments simply take over companies. For example, the Argentinian Government nationalised the Spanish oil company Repsol's 57 per cent stake in Argentina's largest oil company and General Motor's plant in Venezuela was seized by the authorities. Governments can, of course, also create significant opportunities for organisations. For example, the British Government has traditionally promoted the financial services industry in the City of London by offering tax advantages to high-earning financiers

from abroad and providing a ‘light-touch’ regulatory environment.

- *Economic.* Key comparators in deciding entry are levels of gross domestic product and disposable income that help in estimating the potential size of the market. Fast-growth economies obviously provide opportunities and, in developing economies such as China and India, growth is translating into an even faster creation of a high-consumption middle class. At the same time, entirely new high-growth markets are opening up in Africa, including Nigeria and Ghana.
- *Social.* Social factors will clearly be important, for example, the availability of a well-trained workforce or the size of demographic market segments – old or young – relevant to the strategy. Cultural variations also need to be considered, for instance, in defining tastes in the marketplace.
- *Legal.* Countries vary widely in their legal regime, determining the extent to which businesses can enforce contracts, protect intellectual property or avoid corruption. Similarly, policing will be important for the security of employees, a factor that in the past has deterred business in some African countries.

Pankaj Ghemawat from Spain’s IESE Business School emphasises that what matters is not just the attractiveness of different countries relative to each other, based on PESTEL, for example. He points out that the compatibility of the countries with the internationalising firm itself and its country of origin is what really matters.[26] Thus, Ghemawat underlines the importance of *match* between country and firm. For firms coming from any particular country, some countries are more ‘distant’ – or mismatched – than others. For example, a

Spanish company might be ‘closer’ to a South American market than an East Asian market and might therefore prefer that market even if it ranked lower on standard criteria of attractiveness. As well as a relative ranking of countries, therefore, each company must add its assessment of countries in terms of closeness of match. Illustration 10.3 describes how a company tries to bridge distances through collaboration in partnerships with start-ups.[27]

Ghemawat’s ‘CAGE framework’ measures the match between countries and companies according to four dimensions of distance, reflected by the letters of this acronym. Hence, the **CAGE framework emphasises the importance of cultural, administrative, geographical and economic distance**, as follows and illustrated in Table 10.1:

- *Cultural distance.* The distance dimension here relates to differences in language, ethnicity, religion and social norms (see Section 7.2.2 for key dimensions upon which national cultures tend to differ). Cultural distance is not just a matter of similarity in consumer tastes, but extends to important compatibilities in terms of managerial behaviours and, in this respect, US firms might be closer to Canada than to Mexico, for example. Orientations on key cultural dimensions may thus differ. According to the GLOBE survey of 17,000 managers from 62 different societal cultures around the world, US managers appear to be typically more risk-taking, while Chinese managers are more autonomous.[28]
- *Administrative and political distance.* Here, distance is in terms of incompatible administrative, political or legal traditions. Colonial ties can diminish difference, so that the shared heritage

of France and its former West African colonies creates certain understandings that go beyond linguistic advantages. Institutional weaknesses or voids – for example, slow or corrupt administration – can open up distance between countries. So too can political differences: Chinese companies are increasingly able to operate in parts of the world that US companies are finding harder, for example parts of Africa and the Middle East.

- *Geographical distance.* This is not just a matter of the kilometres separating one country from another, but involves other geographical characteristics of the country such as size, sea access and the quality of communications infrastructure. Transport infrastructure can shrink or exaggerate physical distance. France is much closer to large parts of Continental Europe than to the United Kingdom thanks to its high-speed rail network and because of the barrier presented by the English Channel and the latter's relatively poor road and rail infrastructure. Another example is the Brazilian mining company Vale, which has developed mega-ship carriers for its Chinese exports to limit the effect of geographic distances.
- *Economic.* The final element of the CAGE framework refers particularly to wealth distances and differences in cost and quality of various inputs and infrastructure. There are of course huge disparities in wealth internationally with about 3.5 billion people beneath the poverty income threshold of less than $2 a day.[29] Multinationals from rich countries risk losing out on large markets if they only concentrate on the wealthy elites overseas. C.K. Prahalad pointed out that the aggregated wealth of those at

the ‘base of the pyramid’ in terms of income distribution is very substantial and represents a large market opportunity. If rich-country multinationals develop new capabilities to serve these markets, they can bridge the economic distance, and thereby both significantly extend their presence in booming economies such as China and India and bring to these poor consumers the benefits that are claimed for Western goods. See Illustration 10.4 for examples of innovative bases of pyramid strategies.

Table 10.1 The CAGE country distance framework

Source: Excerpt from P. Ghemawat (2001) ‘Distance still matters’, *Harvard Business Review*, September; and P. Ghemawat (2007) *Redefining Global Strategy: Crossing Borders In A World Where Differences Still Matter*, Harvard Business School Publishing.

Illustration 10.3 Collaboration between a multinational and start-ups The BMW – MRS.ai Partnership: how BMW localised its offering in China.

BMW, the German automotive multinational, has been working on localising its offering in China – including by collaborating with Chinese start-ups that have a deep knowledge of local customers. Multinational enterprises like BMW that have established a presence in multiple international markets through wholly owned subsidiaries face the challenge of balancing global and local considerations. This is especially so in markets that are at a considerable distance from the company’s home country – such as in the case of a Western multinational operating in China.

MRS.ai is a Shanghai-based start-up with which BMW has collaborated to provide an ‘intelligent’ service to its Chinese customers by using enterprise-level artificial intelligence (AI) agents. MRS.ai was co-founded by Mingke Luo, a young UK-educated entrepreneur,

who believed in the power of AI to provide a premium service to every customer. Notably, in relation to ‘next-generation’ customer journey management, things need to be done very differently in China compared to Germany owing to differences in language and consumer behaviour. Moreover, there are differences in terms of which digital ecosystems are dominant – home-grown giants like Baidu, Alibaba and Tencent dominate, as opposed to Western companies like Facebook or Google – as well as the vast influence that the government has on regulating business.

The partnership started when BMW China IT Innovation and BMW Startup Garage, the division tasked with partnering with entrepreneurial ventures, made efforts to identify potential collaborators in different parts of the world. Mingke Luo observes, ‘After landing in Shanghai from Munich, the BMW team had a pitch session with a batch of start-ups. MRS was among them. We had been developing our technologies in stealth mode with a vision: every brand will have AI managing the entire customer life journey.’

Given BMW’s interest in what it viewed as a promising start-up, MRS.ai was invited to work on a three-month pilot project to develop a proof of concept (PoC) offering to demonstrate its capabilities and compatibility with BMW’s technology. MRS.ai not only had an expertise in creating intelligent virtual ‘agents’ (i.e., digital entities that would field queries from customers) but also a good understanding of Chinese consumer behaviour. Since many users of the internet in China have leapfrogged the PC era and engaged primarily with the mobile internet era, there is a high degree of sophistication in the use of mobile apps which MRS.ai had a good grasp of and could ensure that the expectations of BMW’s Chinese customers were met.

At the end of the three-month period, there was a ‘demo day’ when MRS.ai and other start-ups that were developing PoCs showcased their offerings. Luo states, ‘MRS was the winner of that demo day. Receiving a high score in assessment of PoC itself was great, but not enough. Most importantly, all the concerns and challenges from technology to commercialisation, from delivery to data security and compliance, had been raised, assessed, and thoroughly answered. The foundation of the path from PoC to production

was well paved.' Thereafter, during the next seven months, MRS.ai developed a fully-fledged version of the AI agent.

Luo reports that, subsequently, 'Several AI agents were designed and deployed, more are on the way. These AI agents are now serving BMW customers in the China market in multiple domains including BMW Financial Service.' He says BMW is keen to explore possibilities to collaborate in other markets as well, including in Germany. This will become feasible when MRS.ai opens offices overseas – which it is working on. In this way, not only is BMW leveraging the partnership with MRS.ai as part of its localisation efforts in China but also the Chinese start-up is utilising the partnership for its own internationalisation efforts.

Shameen Prashantham, China European China Europe International Business School (CEIBS).

Questions

1 How does BMW benefit from partnering with a local start-up in the Chinese market?

2 What are some advantages that MRS.ai brings to the partnership with BMW by virtue of being embedded in the Chinese entrepreneurial and digital ecosystems?

10.5.2 Competitive characteristics

Assessing the relative attractiveness of markets by PESTEL and CAGE analyses, including careful examinations of institutions, is a significant first step. Thinking Differently at the end of this chapter highlights the significance of institutions for market entry and

selection and considers an entirely new strategy view based on them. However, there is also a second element, which relates to competition. Here, of course, Michael Porter's Five Forces Framework can help (see Section 4.3) and it is important to observe that an attractive industry in the home market can be unattractive in another country. For example, country markets with many existing competitors, powerful buyers (perhaps large retail chains such as in much of North America and Europe) and low barriers to further new entrants from overseas would typically be unattractive. An additional consideration is the likelihood of retaliation from other competitors.

In the Five Forces Framework, retaliation potential relates to rivalry and entry, but managers can extend this by using insights directly from 'game theory' (see Section 8.3.2). It takes competitor interdependence, including moves and countermoves, into consideration. Here, the likelihood and ferocity of potential competitor reactions are added to the simple calculation of relative country market attractiveness. As in Figure 10.5, country markets can be assessed according to three criteria:[30]

- *Market attractiveness* to the new entrant, based on PESTEL, CAGE and five forces analyses, for example. In Figure 10.5, countries A and B are the most attractive to the entrant.
- *Defender's reactiveness*, likely to be influenced by the market's attractiveness to the defender but also by the extent to which the defender is working with a globally integrated, rather than multi-domestic, strategy. A defender will be more reactive if the markets are important to it and it has the managerial capabilities to coordinate its response. Here, the defender is highly reactive in countries A and D.

- *Defender's clout*, that is the power that the defender is able to muster in order to fight back. Clout is typically a function of share in the particular market, but might be influenced by connections to other powerful local players, such as retailers or government. In Figure 10.5, clout is represented by the size of the bubbles, with the defender having most clout in countries A, C, D and F.

Illustration 10.4 Base of the pyramid strategies

Base of the pyramid strategy means more than just low prices and involves designing new products, forming partnerships, reshaping distribution channels and introducing novel financing solutions.

Product design

A key problem in the developing world is the poor quality of piped water. Unilever Hindustan, India's largest consumer goods company, owned by Anglo-Dutch Unilever, developed a water filter that makes water as safe as boiling it. It is marketed and sold through the wide Unilever distribution network. The filter has attracted over three million households, mainly in India's mega- or middle-sized cities. However, at $35 (€26), it is still unattainable for millions of Indians who live on less than a dollar a day. In an effort to reach rural customers, Unilever has introduced a light-version (lower capacity) of the filter. The success of the product on the Indian market has led Unilever Hindustan to introduce the water filter in other markets in Asia, Eastern Europe and South Africa.

Partnerships

First, Energy Oorja started as a partnership between the Indian Institute of Science Bangalore and British Petroleum (BP) Emerging Consumer Market (ECM) division to

develop a stove using the ‘power of innovation and a strong understanding of consumer energy needs’. It was later acquired by The Alchemists Ark, a privately held business consulting firm. The First Energy Oorja stoves are low-smoke, low-cost stoves, which work on pellets – an organic biofuel made of processed agricultural waste. First Energy Oorja works in close partnership with both local non-governmental organisations and dealer networks in rural markets to distribute and market the stove. This distribution model ensures that the product reaches remote Indian locations and the stove had reached over 3,000 households.

Distribution channels

Bayer CropScience, a global firm that develops and manufactures crop protection products, initiated a Green World venture in Kenya. It introduced small packs of pesticides and trained a network of small, rural agrodealers to guide and educate small farmers on product handling and use. It also provided further support and marketing via radio. Bayer CropScience carefully selected dealers based on their reputation in the community and sales volumes. Today, about 25 per cent of its horticultural retail revenues in Kenya now come from Green World stores.

Financial solutions

Cemex, a global cement corporation from Mexico, has been an innovative pioneer in designing a microfinancing system, ‘Patrimonio Hoy’ (Property Now), for the poor in Mexico and later in the rest of Latin America. In the past, building houses for this group had often proved lengthy and risky because without savings or access to credit, low-income families could only buy small amounts of building material at a time. Patrimonio Hoy is a solution to this. It is a combination of savings and credit schemes in which Cemex provides collateral-free financing to customers via a membership system based on small monthly fees. Customers demonstrate their savings discipline by regular monthly payments and Cemex develops trust in them by delivering building raw materials early on credit. The programme is a success and has reached 265,000 families

so far with a further commitment to provide at least 125,000 additional low-income families with affordable housing.

Sources: Business Call to Action, 2016; Swiss Agency for Development and Cooperation, 2011; Institute for Financial and Management Research, 2012; E. Simanis and D. Duke (2014) 'Profits at the Bottom of the Pyramid', *Harvard Business Review*, October; A. Karamchandani, M. Kubzansky and N. Lalwani (2011) 'Is the bottom of the pyramid really for you?', *Harvard Business Review*, March 2011; *Business Today*, December.

Questions

1 Can you imagine any risks or dangers that Western companies might face in pursuing base of the pyramid strategies?

2 Is there anything that Western companies might learn from base of the pyramid strategies in emerging markets that might be valuable in their home markets?

Figure 10.5 International competitor retaliation

Source: Reprinted by permission of *Harvard Business Review*. Exhibit adapted from 'Global gamesmanship' by I. MacMillan, S. van Putter and R. McGrath, May 2003. Copyright © 2003 by the Harvard Business School Publishing Corporation. All rights reserved.

Figure 10.5: Long Description

Choice of country to enter can be significantly modified by adding reactiveness and clout to calculations of attractiveness. Relying only on attractiveness, the top-ranked country to enter in Figure 10.5 is country A. Unfortunately, it is also one in which the defender is highly reactive, and the one in which it has the most clout. Country B becomes a better international move than A. In turn, country C is a better prospect than country D because, even though they are equally attractive, the defender is less reactive. One surprising result of taking defender reactiveness and clout into account is the re-

evaluation of country E: although ranked fifth on simple attractiveness, it might rank second overall, if competitor retaliation is allowed for.

This sort of analysis is particularly fruitful for considering the international moves of two interdependent competitors, such as Unilever and Procter & Gamble or British Airways and Singapore Airlines. In these cases, the analysis is relevant to any aggressive strategic move, for instance, the expansion of existing operations in a country as well as initial entry.

10.5.3 Entry mode strategies

Once a particular national market has been selected for entry, an organisation needs to choose how to enter that market. **Entry mode strategies differ in the degree of resource commitment to a particular market and the extent to which an organisation is operationally involved in a particular location**. In order of increasing resource commitment, the four key entry mode types are: *exporting*; contractual arrangement through *licensing or franchising* to local partners; *joint ventures* with local companies, in other words the establishment of jointly owned businesses; and *wholly owned subsidiaries*, through either the acquisition of established companies or 'greenfield' investments; the development of facilities from scratch.

This *staged international expansion* model emphasises the role of experience and learning in determining entry mode strategy. Internationalisation typically brings organisations into unfamiliar territory, requiring managers to learn new ways of doing business.[31] The **staged international expansion model proposes a**

sequential process whereby companies gradually increase their commitment to newly entered markets, as they build knowledge and capabilities. Thus, firms might enter initially by exporting or licensing, thereby acquiring some local knowledge while minimising local investments. As they gain knowledge and confidence, firms can then increase their exposure, perhaps first by a joint venture and finally by creating a wholly owned subsidiary. For example, the leading Danish wind turbine manufacturer Vestas first entered the US market through exports. Subsequently, Vestas established manufacturing and R&D facilities in Eastern Colorado to strengthen its competitive position versus domestic players and now supplies 90 per cent of components required for the assembly of a final turbine within the USA.

There are advantages and disadvantages for each entry mode strategy depending on a range of factors including resource and investment requirements, control, risks, transport costs, trade barriers, entry speed, etc. Table 10.2 lists some of these fundamental factors that can help guide managers in choosing between market entry modes, but case-specific factors need to be considered as indicated towards the end of this section:

- *Export* is the baseline option and has the advantage of requiring relatively fewer resources and risks while offering speedy entry and possibilities to fully exploit production economies in prevailing facilities. However, a potential disadvantage is of course transportation costs and the possibility that products can be manufactured cheaper locally. Limited control of marketing and sales and possible international trade barriers are other drawbacks.

- *Licensing or franchising* involves a contractual agreement whereby a local firm receives the right to exploit a product technology or a service concept commercially for a fee during a specific time period. Soft-drink companies like Coca-Cola use license agreements for its drinks and brands internationally and fast-food chains like McDonald's use franchise arrangements. Resource commitments can be kept low as local partners bear the primary financial and political risks while entry can be relatively quick. The main disadvantage with this entry mode is potential lack of control over technologies and product and service quality plus a possible risk of technological leakage and poor quality.
- *Joint ventures* are jointly owned companies where the international investor shares assets, equity and risk with a local partner. This implies that resource and financial commitments are limited compared to full ownership, and financial and political risks are also reduced. Another advantage is the ability to build on the local partner's knowledge of customer needs and local institutions. In some countries, China for example, joint ventures may be the only option for foreign investors in certain sectors. An important drawback, however, is the risk of losing control over technologies to the partner, even if agreements can be made to lower this risk. Another disadvantage is disagreements and conflicts between the partners when the joint venture evolves and changes over time. Companies balance the trade-offs between these advantages and disadvantages in different ways. For example, Sweden's heavy truck maker Volvo has set up joint ventures in China while its competitor Scania,

also headquartered in Sweden, has decided not to enter into Chinese joint ventures due to the risk of losing control of its technological expertise.

- *Wholly owned subsidiaries* involve 100 per cent control through setting up entirely new greenfield operations or by acquiring a local firm. This entry mode has the advantage of giving the company strong control over technologies, operations, sales and financial results. It also allows for exploiting production and coordination economies among diverse units globally. On the negative side, this mode of entry involves substantial resource commitments and costs besides risks for larger firms even though the latter can be lowered somewhat if acquiring a local company (but acquisitions involve their own challenges; see Section 12.5.2). Acquisitions are a common entry mode in the auto industry, including a whole range of acquisitions during the last decade from Chinese Geely's acquisition of Volvo Cars to Indian Tata Motors' acquisition of Jaguar and Land Rover to Italian Fiat's mega acquisition of Chrysler.

Other case-specific factors are also liable to enter the calculation of appropriate entry mode besides those discussed above and displayed in Table 10.2. For example, if global coordination of various value chain and system activities across different countries is essential, wholly owned subsidiaries would be the principal entry mode. Entry mode choice and characteristics of course also depend on company size. Entry speed for small and medium-sized companies, for example, may be rather quick through a wholly owned mode if a small local unit is set up or acquired (see below).

Table 10.2 Comparison of entry mode strategies

It should now be clear that each entry mode strategy involves important trade-offs between various factors and managers need to carefully consider the specific situation, case and context when trying to choose the optimal entry mode. For example, if entering an entirely new and unknown market a joint venture may be preferable as a local partner could provide valuable market and institutional knowledge. However, if the international investor's products build on unique and patented technologies and the ability to enforce contracts and protect intellectual property is weak, a wholly owned subsidiary may still be the wiser choice.

The gradualism of staged international expansion outlined above has, however, recently been challenged by two phenomena:

- '*Born-global firms*' are new small firms that internationalise rapidly at early stages in their development.[32] New technologies now help small firms swiftly link up to international sources of expertise, supply and customers worldwide. For such firms, waiting till they have enough international experience is not an option: international strategy is a condition of existence.[33] For example, companies such as Instagram and Spotify internationalised quickly from being small start-ups. The early, rapid internationalisation of born-global firms is common today and it is estimated that some 20 per cent of new enterprises in Europe belong to the born-global category.[34]
- *Emerging-country multinationals* also often move quickly through entry modes. Prominent examples are the Chinese white-goods multinational Haier, the Indian pharmaceuticals company

Ranbaxy Laboratories and Mexico's Cemex cement company.[35] Such companies typically develop *unique capabilities* in their home market that then need to be rolled out quickly worldwide before competitors catch up. For example, Haier became skilled at very efficient production of simple white goods, providing a cost advantage that is transferable outside its Chinese manufacturing base. Haier now has factories in Italy and the USA, as well as the Philippines, Malaysia, Indonesia, Egypt, Nigeria and elsewhere around the world. The rapid internationalisation made by emerging multinationals from China has largely been based on acquisitions.[36]

10.6 Subsidiary roles and strategies in multinational firms

Headquarters in multinational corporations are responsible for overall strategic orientations, but subsidiaries also pursue their own strategies.[37] For example, it has been demonstrated how they can be important for innovation and thus take on strategic roles on their own.[38] In this way, international strategies imply different relationships between subsidiary operations and the corporate centre. The complexity of the strategies followed by organisations such as General Electric or Unilever can result in highly differentiated networks of subsidiaries with a range of distinct strategic roles. Subsidiaries may play different roles according to the level of local resources and capabilities available to them and the strategic importance of their local environment. Corporate headquarters can assign these roles, but subsidiaries sometimes also take on roles more independently (see Figure 10.6):[39]

- *Strategic leaders* are subsidiaries that not only hold valuable resources and capabilities, but are also located in countries that are crucial for competitive success because of, for example, the size of the local market or the accessibility of key technologies. Japanese and European subsidiaries in the USA often play this role. Subsidiaries are seen as playing important strategic roles with entrepreneurial potential for the whole multinational organisation.[40] Subsidiaries and subunits are thus either

assigned strategic roles or take autonomous strategic initiatives. Hewlett Packard, for example, is known to have used both approaches.

- *Contributors* are subsidiaries located in countries of lesser strategic significance, but with sufficiently valuable internal capabilities to nevertheless play key roles in a multinational organisation's competitive success. The Australian subsidiary of the Swedish telecommunications firm Ericsson played such a role in developing specialised mobile phone systems.
- *Implementers*, though not contributing substantially to the enhancement of a firm's competitive advantage, are important in the sense that they help generate vital financial resources. In this sense, they are similar to the 'cash cows' of the Boston Consulting Group matrix, but the danger is that they turn into the equivalent of 'dogs' (see Figure 10.6).
- *Black holes* are subsidiaries located in countries that are crucial for competitive success but with low-level resources or capabilities. This is a position many subsidiaries of US and European firms found themselves in over long periods in Japan. They have some of the characteristics of 'question marks' in the Boston Consulting Group matrix, requiring heavy investment (like an astrophysicist's 'black hole,' sucking matter in).[41]

Figure 10.6 Subsidiary roles in multinational firms

Source: Reprinted by permission of Harvard Business School Press. From *Managing across Borders: The Transnational Solution* by C.A. Bartlett and S. Ghoshal. Boston, MA 1989, pp. 105–11. Copyright © 1989 by the Harvard Business School Publishing Corporation. All rights reserved.

Figure 10.6: Long Description

Thinking Differently An institution-based view of strategy

A new strategy view focused on institutions rather than competition and capabilities has been proposed.

The primary difference between strategies at home compared to in foreign markets is the lack of knowledge of local customer needs and local institutions. While the emphasis traditionally has been on responding to the former, recently, there has been an increased

focus on the latter. It was observed in Section 10.5.1 that local economic, regulatory, normative, political and cultural-cognitive institutions often differ substantially from those in home markets. They include local market regulations, rules, practices and behaviour that local actors take for granted, but that can be severely constraining and challenging for a foreign company.

It has been argued that current strategy views largely ignore the importance of institutions despite research demonstrating how institutions significantly influence strategic decision making. Therefore, it has been suggested that strategy needs a new third view in addition to the industry and competitive focused view by Michael Porter (see Chapter 4) and the resource and capabilities-based view (see Chapter 5).[42] The argument is that managerial strategic choices must not only consider these aspects, but also local market's institutional characteristics.

Managers thus need to consider several choices in relation to institutions. For example, if the local institutions work in favour of the organisation, managers can try to re-enforce and stabilise them by cooperating with local competitors and regulators. However, if the institutions are constraining and difficult to change, the only choice for the organisation may be to adapt to and follow them. Managers in powerful organisations could possibly choose to actively resist institutions and even change them. For example, they can try to influence local regulations or the legitimacy of various local business practices.[43]

Questions

Why would institutions be of particular importance for strategy in emerging economies?

Key takeaways

- To evaluate the internationalisation potential in any particular market, Yip's four *drivers of internationalisation* can be used: *market, cost, government* and *competitors' strategies*.
- To overcome liability of foreignness, a company must exploit not only *firm-specific advantages*, but *geographic sources of advantage* that can be drawn from both national sources of advantage, as captured in Porter's diamond, and global sourcing through the international value system.
- Organisations need to balance between advantages of global integration against needs of local adaptation and chose from four main types of international strategy: *export strategy, multi-domestic strategy, global strategy* and *transnational strategy*.
- To *select markets* for international entry or expansion, organisations must evaluate *attractiveness* (for example PESTEL factors), the multidimensional measures of *distance* (like the CAGE considerations) and any expectations of competitor *retaliation*.
- To enter a new international market, organisations need to choose from several entry mode strategies*: export, licensing* and *franchising, joint ventures* and *wholly owned subsidiaries*.
- Subsidiaries of international firms can be managed based on *portfolio methods* just like businesses in a diversified firm.

Work assignments

✱Denotes more advanced work assignments.

* Refers to a case study in the *Text and Case* edition.

10.1 Using Figure 10.2 (internationalisation drivers), compare two markets you are familiar with and analyse how strong each of the drivers is for increased international strategy.

10.2 Visit the websites of the following companies and try to plot their international strategies in one of the four international strategy types of Figure 10.4 (each company primarily fits one strategy): Nestlé, ABB, Louis Vuitton and Lenovo.

10.3 Using the CAGE framework (Section 10.5.1), assess the relative 'distance' of the USA, China, India and France for a British company (or a company from a country of your choice).

10.4 Using the diverse modes of international market entry of Figure 10.6, classify the entry mode of H&M*, Teva* or AB InBev (Megabrew* case) or any other multinational corporation with which you are familiar.

10.5* Critically evaluate the suggestion that globalisation is mostly beneficial for companies.

10.6 Take any part of the public or not-for-profit sector (e.g., education, health) and explain how far internationalisation has affected its management and consider how far it may do so in the future.

Integrative assignment

10.7 As in Section 10.2, use the four international strategies of Figure 10.4 to classify the international strategy of H&M* or AB InBev (Megabrew* case) or any other multinational corporation with which you are familiar. Drawing on Section 14.2.4, how does this corporation's organisational structure fit (or not fit) this strategy?

Recommended key readings

- A useful text on international business and strategy is written by S. Collinson, R. Narula and A.M. Rugman (2020) *International Business*, Pearson.
- For an overview of important theoretical perspectives of the MNC, see M. Forsgren (2017) *Theories of the Multinational Firm*, 3rd edn, Edward Elgar.
- A good collection of academic articles is available in T. Devinney, T. Pedresen and L. Tihanyi (2010) *The Past, Present and Future of International Business and Management*, Advances in International Management, Emerald.
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8. Useful industry-specific data on trends in openness to trade and investment can be found at the World Trade Organization’s website, www.wto.org [accessed: June 2022].
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Case example

Tomra's institutional challenges

Ivar Padrón-Hernández and Patrick Regnér

Price, competition, and technology are the least of Tomra's worries in their international push for recycling.

A Tomra reverse vending machine.

dpa picture alliance/Alamy Stock Photo

Tomra was founded in response to a 1970s Norwegian recycling law with two provisions. First, it added a deposit to beverage containers to be paid by regular consumers. Second, it required supermarkets and other retailers to accept empty containers returned by consumers, and to return deposits. Aimed primarily to combat littering, which was getting increased attention in the public debate, this new legislation led to confusion at retailers, who found themselves busy handling sticky, smelly bottles and administering pocket change deposits to shoppers. On top of it all, the extra labour costs and space allocation did not bring any financial gain to retailers. Tomra sought to

alleviate retailers of these burdens through their so-called reverse vending machine. This machine automated the collection of beverage containers, the sorting of different materials and sizes through various sensors, and the return of deposits through printed receipts that could be exchanged for cash at the register.

Born out of Scandinavian bottle recycling legislation

Tomra was founded in response to a 1970s Norwegian recycling law with two provisions. First, it added a deposit to beverage containers to be paid by regular consumers. Second, it required supermarkets and other retailers to accept empty containers returned by consumers, and to return deposits. The legislation was welcomed by consumers as it aimed primarily to combat littering, which was getting increased attention in the public debate. However, the law led to confusion at retailers, who found themselves busy handling sticky, smelly bottles and administering pocket change deposits to shoppers. On top of it all, the extra labour costs and space allocation did not bring any financial gain to retailers. Tomra sought to alleviate retailers of these burdens through their so-called reverse vending machine. This machine automated the collection of beverage containers, the sorting of different materials and sizes through various sensors, and the return of deposits through printed receipts that could be exchanged for cash at the register. For Tomra, profits were gained in the sale and maintenance of their machines, as well as when selling collected recyclables to other firms in the circular recycling economy.

Short-lived spread of deposit legislation

The reverse vending machine was an instant success in Norway, and Tomra saw large jumps in demand as new countries, mostly in Northern Europe, introduced similar legislation and retailers swiftly conformed. Ten US states also passed deposit bills starting in the 1970s, leading to further internationalisation and big hopes for global recycling and revenues for Tomra. By the 1980s, however, this development came to a halt. Proposed deposit bills in other US states were met with lobbying by deep-pocketed

industry actors and Southern and Eastern Europe showed less enthusiasm for similar recycling legislation, as did emerging economies. While machine maintenance and handling rights of collected material accounted for a large part of Tomra's revenue, global growth prospects suddenly seemed less rosy.

Considering ever-increasing environmental consciousness in broader society, the lack of spread in deposit legislation came as a surprise. It was certainly not due to a lack of effectiveness: By the turn of the millennium, container redemption rates in deposit US states ranged between 72–96 per cent, compared to the national average of 44 per cent. Similar differences could be observed in otherwise comparable European countries. Combined with the fact that beverage containers account for a large share of roadside litter, the visual impact of such legislation was noticeable. Still, proposed laws did not pass and Tomra faced pressures from shareholders to continue growing their business, which had been secured largely through a consolidation of local recycling companies. Although Tomra's primary concern had always been recycling, and they often saw themselves on the NGO side in lobbying wars against beverage and retail businesses, shareholders expected steady growth as with any other listed for-profit firm.

This situation called for action at Tomra, which had been an engineering-driven manufacturer without any strong needs for marketing capabilities. The main reason for this was that growth had historically relied on new deposit legislation, which forced their customers to buy reverse vending machines. While there were some competitors, none could compete with the technological sophistication of Tomra's machines and, as a result, Tomra commanded a large global market share. Still, as mentioned by a manager, purchases were often done grudgingly: '[Retailers] say that their business is to sell groceries, not to collect garbage.' Suddenly, Håkon Volldal, Executive Vice-President of Collection Solutions, and his team had to make active decisions for their further internationalisation. Instead of hoping to be able to piggyback on deposit legislation in new markets, this required careful analysis of the viability of different locations and

solutions. What countries should they enter? Should they strive for deposit legislation in all markets or try to develop alternative business models?

From passive to active internationalisation

Above all, Volldal and his top management team faced the fundamental question in all internationalisation of what country, or countries, to enter. They could target markets adjacent to those where Tomra were already established, such as Germany and the United Kingdom, in the hope that short geographic distance would bring familiarity with Tomra's products and approach. Citizens in these countries would perhaps have seen and even used reverse vending machines when travelling in their home region. Conversely, Tomra could target countries based not on proximity but on the market size of beverage containers, littering tolerance, the authority of governments able to pass national laws, or a myriad of other characteristics that could imply readiness to adopt reverse vending machines.

A related decision for Volldal and his team was how to enter new countries. Should they invest in setting up their own greenfield operations, or would it be better to find local partners? The executive team was often contacted by faraway actors interested in establishing licensing agreements or joint ventures in their home countries. Reflecting the broad societal relevance of reverse vending machines, these organisations could come from widely different industries. Waste collection companies, supermarket chains, machinery manufacturers and environmental NGOs all had different reasons for wanting to partner up with Tomra, and equally disparate business plans for how to succeed in a market without deposit legislation.

As for the business case for reverse vending machines, Tomra faced two possible approaches. They could either engage in lobbying to introduce deposit legislation, or in other ways attempt to motivate customers to use reverse vending machines when recycling their empty beverage containers.

The deposit lobbying option

Tomra could try to turn public opinion in well-fitting countries. It could focus on the public by joining forces with environmentalist and other pro-deposit organisations. Efforts could also be made to target lawmakers more directly in countries with advanced discussions on recycling legislation.

This is a high-risk, high-return strategy that pays out greatly if successful but is inherently unpredictable. Political processes take time and the opposing side in the lobbying war includes strong industry actors, including multinational beverage firms and Tomra's retail outlet customers. At worst, years of struggling could result in a law being voted down, sending Tomra back to the drawing board.

In Germany, Tomra took part in a prolonged struggle to introduce a federal deposit and came out victorious but exhausted. Their success could largely be attributed to the rise of the Green Party and its clear emphasis on environmental issues. Although Germany in one swoop became Tomra's largest market, lobbying has seen little success in other markets, such as Texas. Opponents include a variety of strong industry actors, united in their unwillingness to take on the inevitable financial costs of an efficient recycling system. These alliances have proven formidable opponents, as mentioned by a Director of Strategic Development: '[O]ur side of the lobby doesn't have [. . .] as deep pockets [. . .] so we just don't spend like they do, and we don't get the results that they do. It's kind of that simple. Right? Our government affairs is Chuck, he's one guy. . . '

Experimenting with non-deposit solutions

Another way forward is by creating demand that does not depend on legislation. Instead, non-deposit solutions call for other, culturally related sources of motivation, such as environmental or littering concerns, social pressures to be a responsible citizen, etc. For supermarkets, schools, sports stadiums and other potential premises for reverse vending machines, motivators include customer attraction and retention. For example, if grocery

shoppers know that they can dispose of their recyclables, they might choose one supermarket over another and combine recycling with shopping in the same trip.

Compared with kerbside pickup of recyclables or simply mixing one's waste for incineration or landfills, reverse vending machines do require some effort, time, and inconvenience. Particularly for non-deposit solutions, where there are no apparent financial incentives for consumers, there is a need for alternative motivation. These can be related to societal and moral ideals that trump consumers' inconvenience of having to bring empty bottles to reverse vending machines. For machine operators, often ambiguous virtues must be weighed against purchase and maintenance costs, and the possible reduction of shelf space from housing a reverse vending machine.

After more than a decade of non-deposit experimentation, Tomra saw a viable business model take form in Japan, where they tied up with a large retailing chain after years of experimentation. Consumers would return bottles without financial incentives – a recycling practice that was already in place, albeit not with reverse vending machines as the mode of collection. As put by Senior Vice-President Aleksander Mortensen: '. . . it's very hard to have a sustainable model [. . .] without financial incentives. I know Japan is, I think, the rare exception, because of the cultural discipline that's in place there.'

What to do, and where?

The choice between deposit or non-deposit solutions is central for Tomra's further internationalisation. It will differ depending on country and market characteristics including political, legal, cultural, and other factors. Due to Tomra's dominant position in the market, these factors took precedence over traditional market factors such as costs and rivals. While Tomra was born from legislation and very much engineering-driven, it cannot rely on new deposit laws to pave the way for global expansion. As mentioned by Volldal, they must work proactively to ensure future growth: '. . . what would make our lives easier is to have deposit systems [everywhere]. But it's also complete unrealistic to

hope for, takes too long to change, and we can’t really control it. We can spend 10 years supporting such a process, we can throw a lot of money on it, use up a lot of resources [without knowing the outcome]. . . ’

Sources: ‘Padrón-Hernández, I., ‘When International Strategy Meets Local Institutions: Subsidiary Influence in the Context of Headquarter Initiatives’, PhD dissertation, Stockholm School of Economics.

Questions

1 Are Tomra's advantages mostly firm-specific or geographic? How much does Porter's diamond help in explaining Tomra's competitiveness?

2 What are the most important elements of the PESTEL and CAGE frameworks for Tomra's future internationalisation? Do they differ between deposit and non-deposit solutions?

3 If you were part of Volldal's executive team and had to select three new countries to enter, beside those mentioned in the case, which ones would you choose and why?

4 How could Tomra balance between the needs to integrate globally and being responsive to local markets? Which are the arguments for and against maximising local responsiveness?

Chapter 11

Entrepreneurship and innovation

Key terms

Diffusion

Disruptive innovation

Innovation ecosystems

Entrepreneurial life cycle

Entrepreneurship

First-mover advantage

Innovation

Open innovation

Opportunity recognition

S-curve

Social entrepreneurs

Learning outcomes

After reading this chapter you should be able to:

- Anticipate key issues facing entrepreneurs in *opportunity recognition*, in making choices during the *entrepreneurial process* and in various *stages of growth*, from start-up to exit.
- Evaluate opportunities and choices facing *social entrepreneurs* as they create new ventures to address social problems.

- Identify and respond to key *innovation dilemmas*, such as the relative emphases to place on technologies or markets, product or process innovations and open versus closed innovation.
- Anticipate and, to some extent, influence the *diffusion* (or spread) of innovations.
- Decide when being a *first-mover* innovator or a fast second-mover imitator is most appropriate in innovation, and how an *incumbent* organisation should respond to innovative challengers.

Long Description

11.1 Introduction

As discussed in Chapter 1, strategy concerns an organisation's long-term direction and one important dimension of this is to create new value and competitive advantages for the future. This chapter is about identifying opportunities and creating new products and services, technologies, resources and capabilities. This is significant both for start-ups in new industries and for established organisations in mature ones.

Entrepreneurship and one of its most central ingredients and outcomes, innovation, are fundamental not only for creating value for customers, organisational growth and prosperity, but also generally for today's economy. All businesses start with an act of entrepreneurship, but established firms also practise entrepreneurship to find growth opportunities and new innovative products and services. This is termed corporate entrepreneurship or 'intrapreneurship', whereas pursuing a public good may be termed 'social entrepreneurship'.

Promoting greater innovation and entrepreneurship is thus crucial to the improvement of all firms and public services. However, it also poses hard choices. For example, how can new and valuable opportunities be identified and what are the essential considerations involved? Should a company always look to be a pioneer in new technologies, or rather be a fast follower such as Samsung typically is? How should a company react to radical innovations that threaten to destroy their existing revenues? The chapter thus focuses particularly on the choices involved in entrepreneurship and

innovation aimed at creating new value that benefits organisations and society. Figure 11.1 identifies four major themes of this chapter. Within this framework, this chapter will first examine entrepreneurship and then innovation:

- Section 11.2 addresses *entrepreneurship*. The section starts with a discussion of a central step in strategic entrepreneurship, *opportunity recognition*, which captures conditions under which products and services satisfy market needs or wants in the environment. Other steps in the *entrepreneurial process* then follow. They provide a foundation for further entrepreneurial *growth stages* from start-up to growth, maturity and possibly finally to exit. Finally, this section introduces *social entrepreneurship*, which explains how individuals and small groups can launch innovative and flexible new initiatives that larger public agencies are unable to pursue.
- Section 11.3 discusses three fundamental *innovation dilemmas*: technology push as against market pull; product innovation rather than process innovation; and, finally, open versus closed innovation including the importance of innovation ecosystems for the former. None of these is an absolute ‘either-or’ dilemma, but managers and entrepreneurs must choose where to concentrate their limited resources.
- Once created, innovations will be diffused among users over time and diffusion pace depends on various product and demand features. Section 11.4 considers issues surrounding the *diffusion*, or spread, of innovations in the marketplace. Diffusion processes often follow *S-curve patterns*, raising further typical

issues for decision, particularly with regard to tipping points and tripping points.

Figure 11.1 Entrepreneurship and innovation: four major themes

- Section 11.5 completes the discussion of innovation by considering choices about timing. This includes *first-mover* innovation advantages and disadvantages, the advantages of being '*fast second*' into a market, and the issue of how established *incumbents* can be innovative and respond to innovative challengers.

11.2 Entrepreneurship

All organisations need to renew their strategies and explore entirely new opportunities and competitive strategies and advantages for the future. This suggests that, besides start-ups, established organisations also need to be entrepreneurial. **Entrepreneurship is a process by which individuals, start-ups or organisations identify and exploit opportunities for new products or services that satisfy a need in a market**.[1] This section introduces some key issues for entrepreneurial innovators including opportunity recognition and the entrepreneurial process. It emphasises some of the challenges of entrepreneurship, the way ventures tend to evolve through various growth stages and concludes by considering social entrepreneurs.[2]

11.2.1 Opportunity recognition

Opportunity recognition means recognising an opportunity, i.e., circumstances under which products and services can satisfy a need in the market or environment and is central for any form of strategic entrepreneurship whether by small start-up, corporate or social entrepreneurs.[3] This involves an entrepreneur or entrepreneurial team identifying trends in the environment and combining resources and capabilities into the creation of new products or services. Opportunity recognition thus involves three important and interdependent elements: the entrepreneur or

entrepreneurial team, the environment and resources and capabilities (see Figure 11.2):

Figure 11.2 Entrepreneurial opportunity recognition

Figure 11.2: Long Description

- *Entrepreneur or entrepreneurial team.* The entrepreneur or team drives and integrates the various parts of an entrepreneurial process including scanning and spotting trends in the environment (see Section 3.2), linking these to existing resources and capabilities (see Chapter 5) or acquiring appropriate ones and recombining them. However, they are often alert to opportunities and able to deal with uncertainty, willing to take risks, highly motivated, optimistic and persuasive as they coordinate resources from their social networks. Entrepreneurship, however, normally includes a team and the

managing of relationships with other partners and sometimes other and bigger companies (see Illustration 11.1).[4]

- *Environmental trends and marketplace gaps.* Building on macro trends and possible marketplace gaps is likely to be central in identifying an opportunity. This includes observing economic, technological, social and political trends (as with PESTEL; see Section 3.2) and linking them to specific customer needs that are currently not satisfied. Spotting macro trends, industry and strategic group analysis and Blue Ocean thinking can be very useful for identifying new market opportunities (see Sections 3.2 and 8.2.5). For example, the GPS fitness-tracking app Run keeper, with around 50 million users. It addresses the market gap of runners' needs to be able to track and engage with their progress. Moreover, it builds on health awareness and fitness trends, the proliferation of smartphones, users and apps, globalisation of markets and the increased possibility to integrate apps across various social media platforms like Facebook and WeChat.
- *Resources and capabilities.* Having access to resources and capabilities are an important part of opportunity recognition. Various helpful ways of mapping and evaluating them were discussed in Chapter 5 (VRIO, value chain, activity systems, etc.; see Sections 5.3 and 5.4.3). For small start-ups, the necessary resources and capabilities frequently draw upon the knowledge and experiences and competences of the people involved (see Illustration 11.1). Given this, many would conclude that the best approach for entrepreneurship is to start up a new venture from scratch. Independent entrepreneurs such as Ingvar

Kampard of IKEA many years ago, and Larry Page and Sergey Brin of Google are examples of this entrepreneurial approach (see Chapters 8 and 14 end cases).

11.2.2 Entrepreneurial process steps

The first step of opportunity recognition explained above is likely to be followed by five other development steps of an entrepreneurial venture (see Figure 11.3 for an overview of these steps).[5] Before developing a *business plan* (see Section 14.2.2), an entrepreneur and start-up can usefully include an initial *feasibility analysis* (see Chapter 13). This would critically assess an entrepreneurial idea in terms of product or service viability, market opportunity and financing to establish if it can be turned into a business at all. Next, *industry conditions and competitors* are often considered. Competitive positions can be evaluated with the help of five forces and strategic groups analyses (see Sections 4.2 and 4.4) and competitors' potential to imitate the venture's resources and capabilities can be examined with the VRIO analysis (see Section 5.3). One of the most important considerations in the entrepreneurial process is to *choose a business model and strategy* (see Chapter 8). A start-up thus needs to consider how to create value for the customers, how to manage revenues and costs, how to generate a margin and whether to build on an established business model or create a new one. In addition to this, a distinct competitive strategy position and advantage need to be identified. Hence, entrepreneurs will typically have to choose between the competitive strategies of differentiation, cost and focus or any possible hybrid strategy (see Section 8.2).

Finally, the new venture's financial strength in terms of *financing and funding* need to be carefully examined (see Chapter 13).

Figure 11.3 Steps in an entrepreneurial process

Source: Adapted from B.R. Barringer and R.D. Ireland (2012) *Entrepreneurship – Successfully launching new ventures*, 4th edn, Pearson.

Figure 11.3: Long Description

Illustration 11.1 Entrepreneurs, start-up teams and external relationships Entrepreneurs are often stereotyped as heroic individuals, but entrepreneurship is rarely done alone – it often builds on a team, pre-existing organisational experience and external relationships.

Apple

Steve Jobs has often been celebrated as the heroic innovator and entrepreneur behind Apple, but he too relied heavily on external relationships. From the very beginning, Apple did not only involve Jobs, but his founding partner Steve Wozniak. They started in a garage, but built heavily on their experiences with more established organisations. Wozniak worked at HP and Jobs at Atari and this helped them gain access to crucial knowledge and contacts for the development of the start-up. When their venture had become more established, they left their employers and incorporated Apple Computer. Apple's much later successes with the iPod and later the iPhone and iPad have also relied on important external relationships. The music player application SoundJam MP was externally acquired early on and an external entrepreneur was vital for developing iTunes. Apple also initially worked with the then leading mobile telephone maker Motorola to develop a smartphone.

Facebook

One of today's most successful and well-known entrepreneurs is Mark Zuckerberg, who started a photo-rating site called Facemash from his dorm room by using Harvard's online student photographs. Zuckerberg did not rely on previous organisational experiences, but built on his programming skills and involved others with complementary skills early on. Based on his previous experience with Facemash, he founded the social networking website Facebook together with other fellow Harvard students to develop and grow the site. The team (Dustin Moskovitz, Chris Hughes and Eduardo Saverin) brought various skills including programming, promotion, graphics, financing and other business expertise. To focus entirely on Facebook and attract further talent and financing to their team Zuckerberg and Moskovitz abandoned their education at Harvard and moved to California and Silicon Valley. There, Zuckerberg continued to build on external business expertise together with venture capitalist investors to further grow the company.

Hewlett Packard

The entrepreneurial team William Hewlett and David Packard, founders of the famous computing and printer company HP, are oft-quoted examples of the garage stereotype. But digging beneath the stereotype soon reveals a more complex story, in which relationships with large companies can be important right from the start. Often, entrepreneurs have worked for large companies beforehand and continue to use relationships afterwards, like in the Apple example above. While Hewlett came fairly directly out of Stanford University's laboratories, Packard worked at General Electric and Litton Industries. They built extensively on their previous social relationships and ties when setting up HP. The company used Litton Industries' foundries early on, and later used relationships at General Electric to recruit experienced managers.

Sources: P. Audia and C. Rider (2005) 'A garage and an idea: what more does an entrepreneur need?', *California Management Review*, vol. 40, no. 1, pp. 6–28; D. Kirkpatrick (2010) '*The Inside Story of the Company That Is Connecting the World*', Simon & Schuster.

Questions

1 Based on the experiences of Apple, Facebook and HP what elements of skills and expertise do you think a new venture requires?

2 How would you form a venture team if you set up your own start-up?

While these entrepreneurial process steps are important, it must be noted that it is an iterative rather than sequential process and thus not necessarily quite as simple as indicated by Figure 11.3 (see also Thinking Differently at the end of this chapter). The steps do not necessarily neatly follow on from each other and typically include setbacks along the way. The process thus often involves continuous

experimentation and the original business itself may evolve quite radically. This is sometimes referred to as a '*pivoting*', which means making major changes in some dimension of the venture based on market and external feedback.[6] For example, Starbucks started off in 1971 selling espresso makers and coffee beans rather than brewed coffee. It was after a visit to Italy in 1983 that entrepreneur Howard Schultz (former chairman, president and CEO) started to brew and sell Starbucks coffee in the first coffeehouse. At this time, however, it was a European-style coffeehouse with classical music and waiters, completely different from the Starbucks café it eventually became. See Illustration 11.2 for how entrepreneurs identify various business opportunities and experiment around them. The important role of experimentation or pivoting also suggests that many entrepreneurs will fail. For every revolutionary entrepreneur that has recognised new opportunities, created new markets and beaten off well-resourced challengers, there are countless forgotten failures. No matter how the entrepreneurial process develops or the degree of experimentation and set-backs, ventures develop through diverse growth stages, and this is discussed next.

11.2.3 Stages of entrepreneurial growth

Entrepreneurial ventures are often seen as going through four growth stages (see Figure 11.4). The **entrepreneurial life cycle progresses through start-up, growth, maturity and exit**. Of course, most ventures do not make it through all the stages – the estimated failure rate of new businesses in their first year is more than one-fifth, with two-thirds going out of business within six years.[7]

However, each of these four growth stages raises key questions for entrepreneurs:

Figure 11.4 Stages of entrepreneurial growth

Figure 11.4: Long Description

Illustration 11.2 Our Zanzibar Hotel Group The story of two paradise island entrepreneurs.

Florence Karaba and Christian Stadler, Warwick Business School

Sixteen years ago, Madiha and Salim Khatib ended a year of travelling with a stop in Zanzibar, a tropical island in the Indian Ocean and autonomous region of Tanzania. ‘It took us exactly, I think, 10 minutes to decide that we want to stay here,’ Salim explains. To make this possible, they decided to open a small boutique hotel, Casa del Mar, in Jambiani. At the time, there was no proper road connecting the small fishing village to Paje, a slighter bigger and more developed tourist spot.

Besides the difficulty of getting to their chosen location, the young entrepreneurs faced three immediate obstacles. First, there was a widely held – but inaccurate – belief that foreigners are not allowed to buy land. Salim eventually managed to secure an audience with a Zanzibari Minister who was impressed by the 28-year old’s intention to create local jobs and helped to clear this bureaucratic hurdle. Second, getting access to funding is a challenge in Zanzibar. The couple sold their belongings in Israel and borrowed some money from family members to collect sufficient capital. Finally, they were planning to build a hotel that was quite different from what local construction companies were used to. Coming from a family of architects and artists, the couple decided to concentrate on design and finishes at a time when, for security purposes, it was rather common to have iron bars on windows facing the sea. To bring their vision to life, they set up their own construction team.

Only seven and a half months after laying the foundations, Casa del Mar was up and running. Bookings were good but Salim was reluctant to take a loan to fund further expansion. ‘All of the investments I did was without the help from banks,’ meaning that he did not take any loans, he notes, explaining that local interest rates are simply too high. So, the first opportunity to grow presented itself in construction, not tourism. A German guest who loved the hotel’s architecture wanted to build a house in the area. Salim was eager to help, offering to build the house in four months for a fixed price. Having studied in Germany, he speaks the language fluently – a factor that instilled trust with the client. Salim had his first construction opportunity and investments to grow the construction team were comparatively small.

In subsequent years, the construction team grew and Salim and his wife also added more hotels to their growing empire. As their expertise in sales and marketing grew, they saw the next opportunity. Talking to a friend who owned a four-room villa, Salim noticed that he could probably increase his occupancy rate considerably. ‘I can double it for you, for 10 per cent of sales,’ he told him, adding, ‘If we are not doubling this one, don’t pay me.’ Recalling the conversation, he smiles: ‘And we did double plus 20 per cent.’

Today, around 25 per cent of the annual $4.5 million revenues are generated in the marketing business, 5–10 per cent in construction and the rest in several hotels, including the new flagship Fun Beach Hotel. Employing 250 people, the couple built one of the largest businesses on the Eastern side of Zanzibar. And they continue to explore new ideas. The latest: creating bricks from recycled glass.

Florence Karaba and Christian Stadler, Warwick Business School

Questions

1 What contributed to Madiha and Salim Khatib identifying their business opportunities?
2 The couple added various businesses over time. How have the different steps in the entrepreneurial process been handled?
3 Would you take the same approach when starting a hotel in the UK or Germany?

- *Start-up.* One key challenge at this stage with implications for both survival and growth is sources of capital. Loans from family and friends are common sources of funds and bank loans and credit cards can provide funding too. In addition, there is often government funding especially for new technologies or economically disadvantaged social groups or geographical areas. *Venture capitalists* are specialised investors in new

ventures and usually insist on a seat on the venture's board of directors and may install their preferred managers. Venture capitalist backing has been shown to significantly increase the chances of a venture's success, but they typically accept only about 1 in 400 propositions put to them.

- *Growth.* A key challenge for growth is management. Entrepreneurs have to be ready to move from 'doing' to 'managing'. Typically, this transition occurs as the venture grows beyond about 20 employees. Many entrepreneurs make poor managers: if they had wanted to be managers, they would probably be working in a large corporation in the first place. The choice entrepreneurs have to make is whether to rely on their own managerial skills or to bring in professional managers.
- *Maturity.* The challenge for entrepreneurs at this stage is retaining their enthusiasm and commitment and generating new growth. This is a period when entrepreneurship can change to *intrapreneurship*, the generation of new ventures from inside the organisation (see Section 11.5.2). An important option is usually *diversification* into new business areas, a topic dealt with in Chapter 9. Chinese Tencent, for example, has moved from a messenger app to online gaming and e-commerce and further into banking.
- *Exit.* Exit refers to departure from the venture, either by the founding entrepreneurs, or by the original investors, or both. At the point of exit, entrepreneurs and venture capitalists will seek to release capital as a reward for their input and risk-taking. Entrepreneurs may consider different routes to exit: a *trade sale* of the venture to another company or, for highly successful

enterprises, an *initial public offering* (IPO), the sale of shares to the public. IPOs usually involve just a portion of the total shares available, and may thus allow entrepreneurs to continue in the business and provide funds for further growth. In 2021, the Swedish oat-milk company Oatly raised $10bn in an IPO, while the two brothers behind the venture retained 4.4 per cent ownership of the company (see Illustration 8.2). It is often said that good entrepreneurs plan for their exit right from start-up, and certainly venture capitalists will insist on this.

Entrepreneurs who have successfully exited a first venture often become *serial entrepreneurs*. They are people who set up a succession of enterprises, investing the capital raised on exit from earlier ventures into new growing ventures.

11.2.4 Social entrepreneurship

Entrepreneurship is not just a matter for the private sector. The public sector has seen increasing calls for a more entrepreneurial approach to service creation and delivery. The notion of social entrepreneurship has become common. **Social entrepreneurs are individuals and groups who create independent organisations to mobilise ideas and resources to address social problems, typically earning revenues but on a not-for-profit basis**. Independence and revenues generated in the market give social entrepreneurs the flexibility and dynamism to pursue social problems that pure public-sector organisations are often too bureaucratic, or too politically constrained, to tackle. Social entrepreneurs have pursued a wide range of initiatives, including small loans (‘micro-

credit') to peasants by the Grameen bank in Bangladesh, employment creation by the Mondragon cooperative in the Basque region of Spain, and fair trade by Traidcraft in the United Kingdom. This wide range of initiatives raises at least three key choices for social entrepreneurs.[8]

- *Social mission.* For social entrepreneurs, the social mission is primary. The social mission can embrace two elements: end objectives and operational processes. For example, the Grameen bank has the end objective of reducing rural poverty, especially for women. The process is empowering poor people's own business initiatives by providing micro-credit at a scale and to people that conventional banks would ignore.
- *Organisational form.* There are three basic forms of social entrepreneurism: first, purely non-profits with all resources used to address a social mission. Second, a hybrid form including some minor commercial aspects. Third, social companies that are business and profit oriented, but with investors wanting both social and financial returns. For example, Cafédirect, the fair-trade beverages company, pays dividends to their shareholders, but also pays fair trade premiums for their crops and invests up to 50 per cent of their profits back into the grower communities they buy from. Many social enterprises take on co-operative forms, involving their employees and other stakeholders on a democratic basis and thus building commitment and channels for ideas.
- *Business model.* Social enterprises typically rely, to a large extent, on revenues earned in the marketplace, not just government subsidies or charitable donations. Housing

associations collect rents, micro-credit organisations charge interest and fair-trade organisations sell produce. Social entrepreneurs are no different from other entrepreneurs, therefore, in having to design an efficient and effective business model (see Section 8.4). This business model might involve innovative changes in the value chain. Thus, fair-trade organisations have often become much more closely involved with their suppliers than commercial organisations, for example, advising farmers on agriculture and providing education and infrastructure support to their communities.

Social entrepreneurs, just like other entrepreneurs, often have to forge relationships with large commercial companies. Harvard Business School's Rosabeth Moss Kanter points out that the benefits to large companies can go beyond a feel-good factor and attractive publicity. She shows that involvement in social enterprise can help develop new technologies and services, access new pools of potential employees, and create relationships with government and other agencies that can eventually turn into new markets. Illustration 11.3 presents an example of a social enterprise in Africa.

11.3 Innovation dilemmas

One important ingredient and outcome of entrepreneurship is innovation. It is of importance not only for start-ups, but for all firms, including large companies that continuously need to develop new and innovative products and services to successfully compete. Innovation is more complex than just invention. *Invention* involves the conversion of new knowledge into a new product, process or service. **Innovation involves the conversion of new knowledge into a new product, process or service** and **the putting of this new product, process or service into actual commercial or other use**. Innovation is a key aspect of business-level strategy and models too, as introduced in Chapter 8, with implications for cost, price, differentiation and sustained competitive advantage. Moreover, it is a dynamic capability that can renew organisational resources and capabilities, as discussed in Chapter 5. Innovation, however, raises fundamental strategic dilemmas for strategists that stem from this extended process. Strategists have to make choices with regard to three fundamental issues: how far to follow technological opportunity as against market demand; how much to invest in product innovation rather than process innovation and how far to open themselves up to innovative ideas from outside.

Illustration 11.3 The frugal surgical device

Arbutus Medical offers safe and affordable surgical devices to wherever they are unavailable.

Yasser Bhatti, MBS College Orthopaedic surgical drills and saws are expensive tools costing up to £20k. To overcome this cost barrier, orthopaedic surgeons in low- and middle-income countries (LMICs) have typically used hand drills. But they are cumbersome to use and can be imprecise. Lately, surgeons realised that household hardware drills, which can cost as little as £50, are similar, in terms of functionality, to clinical drills. The main difference lies in the form, whereby clinical drills can be sterilised at high temperatures and hardware drills cannot.

Local surgeons in African countries began to improvise and make do by wrapping a commercially available hardware drill with sterilised drapes to provide a crude cover; an example of a *jugaad innovation*. Matthew Prime, former UK-based Orthopaedic Registrar and now Head of Evidence at Roche, Switzerland, witnessed this practice in Malawi and reminisces, 'When I went to Malawi on a clinical fellowship in 2012, I was impressed to witness the ingenuity of local surgeons in resolving their immediate and urgent needs by frugally and flexibly innovating with simple solutions. They are showing us, particularly here in the West, the forgotten value of such spontaneity in problem solving.'

Subsequently, in 2013, a group of biomedical engineering students from the University of British Columbia visited Mulago Hospital in Uganda and pursued design, engineering and manufacturing processes to convert this jugaad practice into a *frugal innovation*. Consequently, Arbutus Medical Inc. was founded in 2014 as a for-profit but with a social vision to provide '*Safe surgery for every patient*'. With funding from several social impact investors, by July 2021, the company had reached 47 countries, impacted 318,450 lives and is planning to enable 5 million surgeries by 2030.

The flagship product is the Arbutus Drill Cover. The beauty lies in the simplicity of the idea inspired from users in Africa and the sophistication is in the engineering required to meet high regulatory standards in North America. The innovativeness is in using a double-layered surgical-grade textile connected via a waterproof chuck adapter interface to create a Level 4 fluid and pathogen resistant barrier (the highest in the industry)

between the non-sterile drill on the inside and the sterile surgical environment outside. The cover can be washed, sterilised and reused multiple times.

The benefits in using the Arbutus product include the far lower upfront cost of commercial hardware drills, the ability to readily replace drills in the event of breakdown as they can be found in most hardware shops globally, and the faster sterilisation turnaround time it offers to operating room staff enabling them to carry out more surgeries. Incumbent drills are difficult to repair or replace not just because of cost but also long importation lead times.

The start-up faces stiff competition. In the developed markets, Stryker, Depuy-Synthes, Conmed (Hall), Smith & Nephew, and Zimmer are the big players. Incumbent companies offer reconditioned drills in target market areas of the Arbutus drill, but lately have also developed less costly alternative models. In developing markets, low-cost Chinese competitors such as Ruijin and Bojin are strong contenders.

As a social enterprise, the company's mission to offer safe surgery where it is not available, and the expectations of its social impact funders means its main target market remains the developing world. However, Arbutus Medical also offers significant cost savings to health systems in developed countries. The company has piloted its products in Canada, the USA and in the UK. However, to become a successful reverse innovation, the company needs to invest in further costly clinical trials and convince healthcare professionals to switch to the frugal innovation – an uphill task for any innovator.

Yasser Bhatti, MBS College *Sources*: Research conducted by Yasser Bhatti (MBS College), Matthew Harris (Imperial College London), and Matthew Prime (Roche Holding AG).[14]

Questions

1 What should the social enterprise Arbutus Medical do to remain innovative and competitive in the face of large, entrenched incumbents offering expensive devices as well as in the face of low-cost companies offering copycat products?

2 Should Arbutus Medical invest in scaling up and diffusing its products to the developed world or remain focused on the developing world?

11.3.1 Technology push or market pull

People often see innovation as driven by technology. In the pure version of this *technology push* view, it is the new knowledge created by technologists or scientists that pushes the innovation process. Research and development laboratories produce new products, processes or services and then hand them over to the rest of the organisation to manufacture, market and distribute. According to this push perspective, managers should listen primarily to their scientists and technologists, let them follow their hunches and support them with ample resources. Generous R&D budgets are crucial to making innovation happen. For example, estimates for making a new drug show that the costs can be close to $1bn (£0.6bn, €0.75bn).

An alternative approach to innovation is *market pull*. Market pull reflects a view of innovation that goes beyond invention and sees the importance of actual use. In many sectors, users, not producers, are common sources of important innovations. In designing their innovation strategies, therefore, organisations should listen in the first place to users rather than their own scientists and technologists. There are two prominent but contrasting approaches to market pull:

- *Lead users*: according to MIT professor Eric Von Hippel, in many markets, it is lead users who are the principal source of innovation.[9] In medical surgery, top surgeons often adapt existing surgical instruments in order to carry out new types of operation. In extreme sports, such as snowboarding or windsurfing, it is leading sportspeople who make the improvements necessary for greater performance. In this view, then, it is the pull of market experts that is responsible for innovation. Managers need to build close relationships with lead users such as the best surgeons or sporting champions. Marketing and sales functions identify the lead users of a field and then scientists and technologists translate their inventive ideas into commercial products, processes or services that the wider market can use.
- *Frugal innovation*: at the other end of the user continuum is the pull exerted by ordinary consumers, particularly the poor in emerging markets.[10] Rather than the expensive research-intensive model of the traditional technology push approach, frugality is the guiding principle here: in other words, trying to do more with less. Frugal innovation involves sensitivity to poor people's real needs. Responding not only to these users' lack of money, but also to the tough conditions in which they live, frugal innovation typically emphasises low cost, simplicity, robustness and easy maintenance. A related concept is '*jugaad innovation*', which is an Indian concept that describes human ingenuity in solving life or technology problems through improvisation while having resource and money constraints.[11] It is often from these types of ideas that frugal innovation starts. One perspective of

frugal innovation advocates for good-enough performance and features, while another perspective stipulates that quality cannot be discounted for the poor in respect of safety concerns.[12] When frugal innovations diffuse from developing country contexts to developed or higher-income country contexts, this pattern of diffusion is referred to as *reverse innovation*.[13] Illustration 11.3 on the Arbutus Medical serves as an example of a frugal innovation offering low cost, simplicity but, above all, safe surgery, without compromising on quality to achieve positive health outcomes.

The lead user and frugal innovation approaches are opposite ends of a spectrum, one elitist, the other basic. Many organisations will choose somewhere in between, but increasingly corporations and governments are turning to alternative and less costly and resource demanding innovation forms. But, fundamentally, both approaches share a key insight: innovations do not just come from scientific research, but can be pulled by users in the external market.

There are merits to both the technology push and market pull views. Relying heavily on existing users can make companies too conservative and vulnerable to disruptive technologies that uncover needs unforeseen by existing markets (see Section 11.5.2). On the other hand, history is littered with examples of companies that have blindly pursued technological excellence without regard to real market needs. The key is to manage the balance actively between the extremes of technology push and market pull. For a stagnant organisation looking for radical innovation, it might be worth redeploying effort from whichever model currently predominates: for

the technology push organisation to use more market pull or for the market pull organisation to invest more in fundamental research.

11.3.2 Product or process innovation

Just as managers must manage the balance between technology and market pull, so must they determine the relative emphasis to place on product or process innovation. *Product innovation* relates to the final product (or service) to be sold, especially with regard to its features; *process innovation* relates to the way in which this product is produced and distributed, especially with regard to improvements in cost or reliability. Some firms specialise more in product innovation, others more in process innovation. For example, Apple is well-known for its continuous product innovations including personal computers, smartphones, tablets, watches, earphones, etc.; Zara, the Spanish fashion retailer, has emphasised process innovation in its supply chain and manufacturing, allowing the company to swiftly respond to new market demands and get new products into stores within just a couple of weeks. *Business model innovation* is still another form of innovation and thus involves reorganising value creation, configuration and capture into an entirely new business model (see Section 8.4).[15]

The relative importance of product innovation and process innovation typically changes as industries evolve over time.[16] Usually, the first stages of an industry are dominated by product innovation based on new features. Thus, the early history of the automobile was dominated by competition as to whether cars should be fuelled by steam, electricity or petrol, have their engines at the

front or at the rear, and have three wheels or four.[17] Industries eventually coalesce around a *dominant design*, the standard configuration of basic features: after Henry Ford's 1908 Model T, cars generally became petrol-driven, with their engines at the front and four wheels. Once such a dominant design is established, innovation switches to process innovation, as competition shifts to producing the dominant design as efficiently as possible. Henry Ford's great process innovation was the moving assembly line, introduced in 1913. Finally, the cycle is liable to start again, as some significant innovation challenges the dominant design: in the case of cars, recently the emergence of electric powered cars with forerunners like Tesla.

Figure 11.5 provides a general model of the relationship between product and process innovation over time. The model has several strategic implications:

- *New developing industries* typically favour product innovation, as competition is still around defining the basic features of the product or service.
- *Maturing industries* typically favour process innovation, as competition shifts towards efficient production of a dominant design of product or service.
- *Small new entrants* typically have the greatest opportunity when dominant designs are either not yet established or beginning to collapse. Thus, in the early stages of the automobile industry, before Ford's Model T, there were more than a hundred mostly small competitors, each with its own combination of product features. The recent challenge to the petrol-based dominant

design has provided opportunities to entrepreneurial companies such as Tesla.

- *Large incumbent firms* typically have the advantage during periods of dominant design stability, when scale economies and the ability to roll out process innovations matter most. With the success of the Model T and the assembly line, by the 1930s, there were just four large US automobile manufacturers, namely Ford, General Motors, Chrysler and American Motors, all producing very similar kinds of cars.

Figure 11.5 Product and process innovation

Source: Adapted from J. Abernathy and W. Utterback (1975) 'A dynamic model of process and product innovation', *Omega*, vol. 3, no. 6, pp. 639–56, with permission from Elsevier.

Figure 11.5: Long Description

This sequence of product to process innovation is not always a neat one. In practice, product and process innovation are often pursued in tandem. For example, each new generation of microprocessor also

requires simultaneous process innovation in order to manufacture the new microprocessor with increasing precision. However, the model does help managers confront the issue of where to focus, whether more on product features or more on process efficiency. It also points to whether competitive advantage is likely to be with small new entrants or large incumbent firms. Other things being equal, small start-ups should time their entry for periods of instability in dominant design and focus on product rather than process innovation.

11.3.3 Open or closed innovation

The traditional approach to innovation has been to rely on the organisation's own internal resources – its laboratories and marketing departments. Innovation in this approach is secretive, anxious to protect intellectual property and avoid competitors free-riding on ideas. This 'closed' model of innovation contrasts with the 'open model' of innovation.[18] **Open innovation involves the deliberate import and export of knowledge by an organisation in order to accelerate and enhance its innovation**. The motivating idea of open innovation is that exchanging ideas openly is likely to produce better products more quickly than the internal, closed approach. Speedier and superior products are what are needed to keep ahead of the competition, not obsessive secrecy.[19]

Open innovation is being widely adopted. For example, technology giant IBM has established a network of 10 'collaboratories' with other companies and universities, in countries ranging from Switzerland to Saudi Arabia. Swedish music streaming

service Spotify arranges ‘music hack days’ in various locations around the globe where developers are invited for a day of free food, drink and work on discussing and developing new applications. *Crowdsourcing* is an increasingly popular form of open innovation and means that a company or organisation broadcasts a specific problem to a crowd of individuals or teams, often in tournaments with prizes awarded to the best solution.[20] Companies such as Procter & Gamble, Eli Lilly and Dow Chemicals use the network company InnoCentive to set innovation ‘challenges’ (or problems) in open competition over the internet. They run thousands of challenges based on a solver network of around 400,000 ‘solvers’. Similarly, Starbucks crowdsourcing platform has generated close to 200,000 customer ideas and implementation of over 300.

Open innovation typically requires careful support of collaborators. In particular, high-technology firms nurture independent companies through successive waves of innovation around their basic technological platforms (see Section 8.4.2).[21] Intel, whose microprocessors are used by a host of computer, tablet and smartphone companies, regularly publishes ‘roadmaps’ outlining several years ahead the new products it expects to release, allowing developers, suppliers and customers to plan their own new product development processes. In this way, platform companies foster communities of other companies around their platforms.

The communities formed around innovation platforms are referred to as **innovation ecosystems and consist of a group of mutually dependent and collaborative partners that need to interact to innovate and create value for all**. These are similar to business ecosystems (see Section 4.2.3) but focused on

collaborative innovation. Rather than building on traditional bilateral collaborations they build on multilateral communities of connected suppliers, software developers, technology entrepreneurs and makers of complementary technologies, hardware, and software around a company platform.[22] For example, Alphabet and Microsoft nurture various innovation ecosystems around their platforms (see Section 8.4.3). Most fundamentally, the innovation ecosystem partnership includes a platform innovator and a set of innovation complementors, that together create value rather than doing so independently. However, while they share the interest to grow the whole market around the innovation and platform, they compete over how the value is distributed among the various ecosystem participants. Apple's ecosystem of apps around the iPhone, for example, benefit both them and app developers that get the benefit of a large and often lucrative market. Apple has paid out over $100bn to app developers since the App Store's inception, but they also charge a 30 per cent fee based on the app sales. Small entrepreneurial firms wishing to participate in such innovation ecosystems thus must be skilled in managing relationships with powerful technological leaders.[23] Ecosystems also compete with each other, for example, the Alphabet Android innovation ecosystems for smartphones is a significant competitor to Apple's iOS ecosystem. Intel's innovation ecosystem mentioned above is a competitor with ARM's extensive open innovation ecosystem, described in Illustration 11.4.

The balance between open and closed innovation depends on three key factors:

- *Competitive rivalry.* In highly rivalrous industries, partners are liable to behave opportunistically and steal innovations. Closed innovation is better where such rivalrous behaviours can be anticipated.
- *One-shot innovation.* Opportunistic behaviour is more likely where innovation involves a major shift in technology, likely to put winners substantially ahead and losers permanently behind. Open innovation works best where innovation is more continuous, so encouraging more reciprocal behaviour over time.
- *Tight-linked innovation.* Where technologies are complex and tightly interlinked, open innovation risks introducing damagingly inconsistent elements, with knock-on effects throughout the product range.

Illustration 11.4 ARM's extensive innovation ecosystem Innovation ecosystems, including the alignment of hundreds of partners, is central for platform technology companies.

In the world of connected devices including smartphones, tablets, wearables and storage, British-based and Japanese SoftBank-owned semiconductor company ARM Holdings has an 85–90 per cent market share worldwide. Their success is often explained by their extensive innovation ecosystem. It is central to their business model of only creating and developing its core microprocessor chips and then licensing the technology as intellectual property (IP) for open innovation rather than manufacturing and selling its own set of final products.

ARM designs core processors that read in instructions to perform specific actions that make smartphones, tablets, etc., function. These instructions are linked together in a way that in real time they make up our smartphone or tablet experience; everything we do on these and other devices must be processed by the processor. Whenever we open an app or folder, write a text message or watch a video, it requires a core processor.

ARM is a design company that creates the process architecture and an instruction set (a basic set of capabilities and features a processor makes available to software applications). They then license this to partner companies that improve it and pair it with whatever hardware and software seems appropriate (e.g., wireless connectivity, graphics, USB connections and various connected devices or applications).

Although ARM only has around 6,000 employees, its partner innovation ecosystem includes over 1,000 partners over the entire semiconductor value chain from device chip design to application software providers (see exhibit). First, the ARM architecture is only a basic building block including the overall ‘intelligence’ of a device and thus needs to be designed for any larger system. For example, Apple has a large staff of engineers working on ARM processors and, similarly, Qualcomm and Texas Instruments design larger systems based on ARM. They pair the ARM architecture with a variety of independent ‘IP block’ suppliers, which make up a central part of the innovation ecosystem. These suppliers develop pre-defined modules supporting specific functions and then re-sell this as a ‘system-on-a-chip’ for smartphones and tablets. Next, there are other partners that conduct the actual manufacturing of the chips, like Samsung.

Towards the end of the value chain, there are OEM device producers and distributors like Huawei and, finally, application software companies that develop applications that run on the devices (e.g., Meta, Google). Besides these ecosystem partners there are distributors that provide access to ARM technology for independent software developers, training partners that deliver training information. Some companies, like Samsung, participate in several parts of ARM's innovation ecosystem.

Simplified overview of ARM's innovation ecosystem

It's not only the ARM technology itself that attracts ecosystem partners, but their comprehensive web-based developer site including technical support and consultancy, partner forums and blogs, documentations, textbooks, education and research support. ARM not only profits from licensing its chips IP to various ecosystem actors, but also through royalty on every product unit that contains its IP. In brief, both ARM and all the ecosystem participants benefit from a steadily growing ARM innovation ecosystem and its output.

Sources: P.J. Williamson and A. De Meyer (2012) 'Ecosystem advantage: how to successfully harness the power of partners', *California Management Review*, vol. 55, no. 1, Autumn; H. Shaughnessy (2012) 'Intel vs. ARM: battle of the business model', *Forbes*, 24 February; M. Smith (2012) 'What is an ARM processor? Everything you need to know', makeuseof.com, 4 December; ARM.com, 2018; H. Glimstedt, 'Re-thinking Apple's entry and platform leadership in smartphones', mimeo, Stockholm School of Economics, 2019.

Questions

1 How can ARM attract and manage so many innovation ecosystem partners?

2 Can you identify other technology platform companies and their innovation ecosystem partners?

11.4 Innovation diffusion

This chapter has been concerned with entrepreneurship and its outcome in the form of diverse sources and types of innovation, for example technology push or market pull. This section moves to the diffusion of innovations after they have been introduced.[24] **Diffusion is the process by which innovations spread among users**. Since innovation is typically expensive, its commercial attractiveness can hinge on the pace – extent and speed – at which the market adopts new products and services. This pace of diffusion is something managers can influence from both the supply and demand sides, and which they can also model using the S-curve.

11.4.1 The pace of diffusion

The pace of diffusion can vary widely according to the nature of the products concerned. It took 28 years for the television to reach 50 per cent of ownership and use in the USA and the mobile phone only half that time. The pace of diffusion is influenced by a combination of supply-side and demand-side factors, over which managers have considerable control. On the *supply side*, pace is determined by product features such as:

- *Degree of improvement* in performance above current products (from a customer's perspective) that provides incentive to change. For example, it may take a while for the change to 5G smartphones before sufficient performance improvement prompts more rapid switching in many markets.

- *Compatibility* with other factors: for example, smartphones become more attractive with more apps. Managers and entrepreneurs therefore need to ensure appropriate complementary products and services are in place (see Section 4.2.6).
- *Complexity*, either in the product itself or in the marketing methods being used to commercialise the product: unduly complex pricing structures, as with many financial service products such as pensions, discourage consumer adoption. Simple pricing structures typically accelerate adoptions.
- *Experimentation*, the ability to test products before commitment to a final decision – either directly or through the availability of information about the experience of other customers. Free initial trial periods are often used to encourage diffusion.
- *Relationship management*, in other words, how easy it is to get information, place orders and receive support. Managers and entrepreneurs need to put in place an appropriate relationship management process to assist new and existing users.

On the *demand side*, simple affordability is, of course, key. Beyond this, there are three further factors that tend to drive the pace of diffusion:

- *Market awareness.* Many potentially successful products have failed through lack of consumer awareness – particularly when the promotional effort of the innovator has been confined to 'push' promotion to its intermediaries (e.g., distributors).
- *Network effects* refer to the way that demand growth for some products accelerates as more people adopt the product or

service. Once a critical mass of users has adopted it, it becomes of much greater benefit for others to adopt it too. With close to 3 billion users, Facebook is a natural social network for many and TikTok increasingly attracts many younger users with 1 billion users (see Section 4.4.1).

- *Customer propensity to adopt*: the distribution of potential customers from early-adopter groups (keen to adopt first) through to laggards (typically indifferent to innovations). Innovations are often targeted initially at early-adopter groups – typically the young and the wealthy – in order to build the critical mass that will encourage more laggardly groups – the poorer and older – to join the bandwagon.

11.4.2 The diffusion S-curve

The pace of diffusion is typically not steady. Successful innovations often diffuse according to a broad *S-curve* pattern.[25] The shape of the **S-curve** **reflects a process of initial slow adoption of innovation, followed by a rapid acceleration in diffusion, leading to a plateau representing the limit to demand** (Figure 11.6). The height of the S-curve shows the extent of diffusion; the shape of the S-curve shows the speed.

Figure 11.6 The diffusion S-curve

Figure 11.6: Long Description

Diffusion rarely follows exactly this pattern but, nonetheless, the S-curve can help managers and entrepreneurs anticipate forthcoming issues. In particular, the S-curve points to four likely decision points:

- *Timing of the 'tipping point'.* Demand for a successful new product or service may initially be slow but then reaches a *tipping point* when it explodes onto a rapid upwards path of growth.[26] A tipping point is where demand for a product or service suddenly takes off, with explosive growth.
- *Timing of the plateau.* The S-curve also alerts managers to a likely eventual slowdown in demand growth. Again, it is tempting to extrapolate existing growth rates forwards, especially when they are highly satisfactory. But heavy investment immediately before growth turns down is likely to leave firms with over-

capacity and carrying extra costs in a period of industry shake-out.

- *Extent of diffusion.* The S-curve does not necessarily lead to one hundred per cent diffusion among potential users. Most innovations fail to displace previous-generation products and services altogether. For example, in music, traditional LPs are still preferred over smartphone streaming by some connoisseurs and DJs.
- *Timing of the 'tripping point'.* The tripping point is the opposite of the tipping point, referring to when demand suddenly collapses.[27] For example, the presence of network effects can lead to relatively limited customer defections setting off a market landslide. Such landslides are very hard to reverse. This is what happened to social networking sites in the past and Facebook considered this risk when they acquired Instagram as younger users started to move there. Now, of course, younger users are defecting this site and going to TikTok (see Illustration 4.3).

To summarise, the S-curve is a useful concept to help managers and entrepreneurs avoid simply extrapolating next year's sales from last year's sales. However, the tripping point also underlines the fact that innovations do not follow an inevitable process. Netflix, for example, did manage to move from a tripping point in DVD rentals to a new S-curve of digital streaming.[28] Most innovations, of course, do not even reach a tipping point, let alone a tripping point.

11.5 Innovators and imitators

A key choice for managers is whether to lead or to follow in innovation. The S-curve concept seems to promote leadership in innovation. First-movers get the easy sales of early fast growth and can establish a dominant position. There are plenty of examples of first movers who have built enduring positions on the basis of innovation leadership: Coca-Cola in drinks and Hoover in vacuum cleaners are powerful century-old examples. However, many first movers also fail. Spotify and Rdio both launched their music streaming services in 2008 with the former successfully sweeping the market while the latter went bankrupt in 2015.

11.5.1 First-mover advantages and disadvantages

A **first-mover advantage** **exists where an organisation is better off than its competitors as a result of being first to market with a new product, process or service**. Fundamentally, the first mover is a monopolist, theoretically able to charge customers high prices without fear of immediate undercutting by competitors. In practice, however, innovators often prefer to sacrifice profit margins for sales growth and, besides, monopoly is usually temporary. There are six potentially more robust first-mover advantages:[29]

- *Network effects* suggest that a customer of a product or service has a positive effect on the value of that for other customers

and, if they are present and captured by an individual firm, it may be very difficult, if not impossible, for late entrants to catch up and build their own network of customers (see Section 4.2.3).

- *Experience curve benefits* accrue to first movers, as their rapid accumulation of experience with the innovation gives them greater expertise than late entrants still relatively unfamiliar with the new product, process or service (see Section 8.3.1).
- *Scale benefits* are typically enjoyed by first movers, as they establish earlier than competitors the volumes necessary for mass production and bulk purchasing, for example.
- *Pre-emption of scarce resources* is an opportunity for first movers, as late movers will not have the same access to key raw materials, skilled labour or components, and will have to pay dearly for them.
- *Reputation* can be enhanced by being first, especially since consumers have little ‘mind-space’ to recognise new brands once a dominant brand has been established in the market.
- *Buyer switching costs* can be exploited by first movers, by locking in their customers with privileged or sticky relationships that later challengers can only break with difficulty. Switching costs can be increased by establishing and exploiting a *technological standard*.

It is clear from the above that first movers have several potential advantages, but the experience of Microsoft that launched the first tablet computer, which failed, shows that first-mover advantages are not necessarily overwhelming. Late movers can imitate technological and other innovation at less expense than originally incurred by the

pioneers and can observe what worked well and what did not work well.[30]

Given the potential advantages of late movers, managers and entrepreneurs face a hard choice between striving to be first or coming in later. London Business School's Costas Markides and Paul Geroski argue that the most appropriate response to innovation, especially radical innovation, is often not to be a first mover, but to be a '*fast second*'.[31] A fast second strategy involves being one of the first to imitate the original innovator and thus building an 'early mover advantage'. Thus, fast second companies may not literally be the second company into the market, but they dominate the second generation of competitors. For example, the first jet airliner was the British de Havilland Comet with Boeing being a successful follower.[32]

Three factors need to be considered in choosing between innovating and imitating:

- *Capacity for profit capture:* the importance of innovators to capture for themselves the profits of their innovations. David Teece of the University of California Berkeley emphasises that this may be challenging if the innovation is *easy to replicate* and if *intellectual property rights* are weak, for example, where patents are hard to define or defend.[33]
- *Complementary assets*: the possession of assets or capabilities necessary to gain an advantage. For example, the possession of assets or capabilities necessary to scale up the production and marketing of the innovation. For organisations wishing to remain independent and to exploit their innovations themselves,

there is little point in investing heavily to be first mover in the absence of the necessary complementary assets.[34]

- *Fast-moving arenas:* where markets or technologies are moving very fast and especially where both are highly dynamic, first movers are unlikely to establish a durable advantage.

11.5.2 The incumbent's response

Definitions of entrepreneurship often emphasise pursuing opportunities and developing innovations without immediately being constrained by the resources under present control. This refers to the fact that incumbent organisations and companies mostly are constrained by their existing resources, capabilities, activities and vested interests. This suggests that innovation can be challenging and innovations from others can be a threat for established companies in a market. Kodak's dominance of the photographic film market was made nearly worthless by the sudden rise of digital photography.

As Harvard Business School's Clay Christensen has shown, the problem for incumbents can be twofold.[35] First, managers can become too attached to existing assets and skills: understandably, as these are what their careers have been built on. Second, relationships between incumbent organisations and their customers can become too close. Existing customers typically prefer incremental improvements to current technologies, and are unable to imagine completely new technologies. Incumbents are reluctant to 'cannibalise' their existing business by introducing something radically different. After all, as in Figure 11.7, incumbents usually

have some scope for improving their existing technology, along the steady upwards trajectory described as Technology 1. Innovations on this trajectory are termed ‘sustaining innovations’, because they at least allow the existing technology to meet existing customer expectations.

The challenge for incumbents, however, is disruptive innovation. A **disruptive innovation** **creates substantial growth by offering a new performance trajectory that, even if initially inferior to the performance of existing technologies, has the potential to become markedly superior**. This superior performance can produce spectacular growth, either by creating new sets of customers or by undercutting the cost base of rival existing business models. Such disruptive innovation involves the shift from Technology 1 in Figure 11.7 to Technology 2. Disruptive innovations are hard for incumbents to respond to because poor performance in the early days is likely to upset existing customer relationships and because they typically involve changing their whole business model (see Chapter 8). Thus, in the music industry, the major record companies with traditional CDs first responded to online music simply by prosecuting new distribution forms such as Napster, but today streaming services such as Spotify dominate.

Sometimes, however, incumbents do respond. The mobile phone disrupted the fixed telephony business, but Ericsson managed to continue its leadership in telephony systems. To encourage innovation and be responsive to potentially disruptive innovations, there are three different approaches:

Figure 11.7 Disruptive innovation

Sources: Reprinted by permission of Harvard Business School Press. From *The Innovator's Solution* by C. Christensen and M.E. Raynor. Boston, MA (2003). Copyright © 2003 by the Harvard Business School Publishing Corporation. All rights reserved.

Figure 11.7: Long Description

- *Develop a portfolio of real options.* Companies that are most challenged by disruptive innovations tend to be those built upon a single business model and with one main product or service. Columbia's Rita McGrath and Wharton's Ian MacMillan recommend that companies build portfolios of *real options* in order to maintain organisational dynamism.[36] Real options are limited investments that keep opportunities open for the future (for a more technical discussion, see Section 13.4.2). Establishing an R&D team in a speculative new technology or acquiring a small start-up in a nascent market would both be examples of real options, each giving the potential to scale up fast should the opportunity turn out to be substantial. McGrath and MacMillan's portfolio identifies three different kinds of

options (Figure 11.8). Options where the market is broadly known, but the technologies are still uncertain, are *positioning options*: a company might want several of these, to ensure some position in an important market, by one technology or another. On the other hand, a company might have a strong technology, but be very uncertain about appropriate markets, in which case it would want to bet on several *scouting options* to explore which markets are actually best. Finally, a company would want some *stepping stone* options, very unlikely in themselves to work, but possibly leading to something more promising in the future. Even if they do not turn a profit, stepping stones should provide valuable learning opportunities. An important principle for options is: 'Fail fast, fail cheap, try again.'[37]

- *Corporate venturing.* New ventures, especially when undertaken from a real options perspective, may need protection from the usual systems and disciplines of a core business. It would make no sense to hold the managers of a real option strictly accountable for sales growth and profit margin: their primary objective is preparation and learning. For this reason, large incumbent organisations often establish relatively autonomous 'new venture units', sometimes called new venture divisions, which can nurture new ideas or invest externally and acquire novel and untried businesses with a longer-term view.[38] BMW, for example, set up a completely separate business unit to develop its first mass-produced electric car, BMW i. The company was concerned that its focus on the internal

combustion engine would risk the success of the development of the BMW i.

- *Intrapreneurship.* This approach rather emphasises the individual and the ability to perform entrepreneurial activities within a large organisation.[39] Companies can thus encourage employees throughout the organisation to be creative and develop entrepreneurial ideas as part of their regular job. Alphabet has intrapreneurship programmes that aim at creating a start-up culture within the larger corporation. Likewise, IBM has various initiatives to encourage intrapreneurship and innovation, such as 'Intrapreneurship@IBM' and the 'IBM Jam sessions'. Intrapreneurship, however, can also be autonomous from, and in conflict with, corporate management and is thus not always to be encouraged. For example, Ericsson's global leadership in mobile telephone systems initially started out with a group of intrapreneurs in confrontation with corporate strategy and management.[40]

Whether by developing real options, internal venture units or equivalent means, it is clear that established incumbents need to be able to support a spirit of intrapreneurship.[41]

Figure 11.8 Portfolio of innovation options

Sources: Reprinted by permission of Harvard Business School Press. From *The Entrepreneurial Mindset* by I. MacMillan and R.G. McGrath. Boston, MA (2000), p. 176. Copyright © 2000 by the Harvard Business School Publishing Corporation. All rights reserved.

Figure 11.8: Long Description

Thinking Differently Entrepreneurship: discovery or creation?

An alternative view suggests that opportunities are created rather than discovered.

This chapter has emphasised opportunity recognition as one stage in a sequence of entrepreneurial process steps. This builds on the dominating *discovery* perspective of opportunities, but there is also an alternative, *creation* view.[42]

The influential *discovery* perspective argues that opportunities exist independently from entrepreneurs and are generated by external shocks and changes. They can include technological, regulatory or social changes that generate opportunities to be

discovered. This perspective suggests there are already seeds of opportunity in industries and markets waiting to be discovered by entrepreneurs.

In contrast, the *creation* view emphasises that opportunities are intimately linked with entrepreneurs themselves and their understanding of and engagement with potential new products. In this view, entrepreneurs do not have to wait for external changes; instead, they create opportunities through repeatedly interacting with and developing their beliefs about new products and customer needs. They do this through actively trying out product ideas and forming opportunities around them. Seeds are thus not discovered in this view; instead, entrepreneurs explore through iterative processes what can grow where and themselves plant and create new seeds of opportunity.

The two views have different implications for how to manage entrepreneurship. The discovery perspective relies on traditional forms of strategic planning and decision making (see Section 14.2). Entrepreneurs collect and analyse information and carefully make predictions and decisions concerning product market potential. The creation view suggests a more complex process. Entrepreneurs do not so much carefully collect information to get answers; rather they try to ask the right questions, experiment, use trial and error, and adapt around potential new products (see Section 14.3).

Questions

1 Alphabet is often celebrated as a highly entrepreneurial and innovative company including not only the Google search engine, but YouTube, Android and Waymo self-driving cars and many products and services. To what degree do you think they have relied on discovering or creating opportunities?

Key takeaways

- Opportunity recognition is central for an entrepreneur, and she/ he needs to consider its three interdependent elements carefully: the *environment*, the *entrepreneur or entrepreneurial team* and *resources and capabilities*.
- As an entrepreneur, you typically develop your venture in a set of *entrepreneurship process* steps: a *business plan*, a *feasibility analysis, industry conditions and competitor analysis, business model and strategy* choice and *financing* and *funding*.
- Entrepreneurs must skilfully address diverse challenges and dilemmas they face in different *stages of entrepreneurial growth*: start-up, growth, maturity and exit.
- Entrepreneurs interested in addressing social problems need to thoroughly consider *appropriate missions, organisational forms and business models* in *social entrepreneurship*.
- As an entrepreneur, you face three fundamental innovation dilemmas that need to be resolved: relative emphasis to put on *technology push* or *market pull*; whether to focus on *product* or *process innovation*; and, finally, how much to rely on *open innovation* and related *innovation ecosystems* or more *closed innovation*.
- Be aware of and consider the different requirements as innovations often diffuse according to *an S-curve model* in which slow start-up is followed by accelerating growth (the 'tipping point') and, finally, a flattening of demand (and a potential 'tripping point').
- As an innovator, you can capture *first-mover advantages but* remember *'fast second' strategies* are often more attractive.
- Someone working in an incumbent business should beware *disruptive innovations* and consider developing *portfolios of real options*, organising *new venture units* or encouraging '*intrapreneurship*' to stave off inertia.

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

11.1 Use Figure 11.2 and try to identify the three elements (entrepreneur/team, trends/gaps and resources/capabilities) behind the opportunity recognition in Pensionbee* and Ryanair*.

11.2 With reference to the entrepreneurial life cycle, identify the position of Globalwork (end of chapter case) or Mormor Magda's Ice Cream*. What managerial issues might this case company anticipate in the coming years?

11.3 Use the internet to identify a social entrepreneurial venture that interests you (via www.skollfoundation.org, for example), and, with regard to Section 11.2.4, identify its social mission, its organisational form and its business model.

11.4* For a new product or service that you have recently experienced and enjoyed, investigate the strategy of the company responsible. With reference to the dilemmas of Section 11.3, explain whether the innovation was more technology push or market pull, product- or process-driven, or based on open versus closed innovation.

11.5 Go to a web traffic site (such as alexa.com) and compare over time trends in terms of 'page views' or 'reach' for older sites (such as Amazon.com) and newer sites (such as spotify.com, or any that have more recently emerged). With reference to Section 11.4, how do you explain these trends and how would you project them forward?

11.6* With regard to a new product or service that you have recently experienced and enjoyed (as in Section 11.4), investigate the strategic responses of 'incumbents' to this innovation. To what extent is the innovation disruptive for them (see Section 11.5.2)?

Integrative assignment

11.7 Consider a for-profit or social entrepreneurial idea that you or your friends or colleagues might have. Drawing on Section 17.4.4, outline the elements of a strategic plan for this possible venture. What more information do you need to get?

Recommended key readings

- B.R. Barringer and R.D. Ireland (2019) *Entrepreneurship – Successfully Launching New Ventures*, 6th edn, Pearson, provides details of all entrepreneurial process steps.
- P. Trott (2017) *Innovation Management and New Product Development*, 6th edn, Pearson provides a comprehensive overview of innovation strategy issues.
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Case example

Globalwork – Building a start-up in Colombia

Heiko Schmidt, Sandra Milena Santamaria-Alvarez and Martha Reyes-Sarmiento (Universidad EAFIT)

Discovering an opportunity

When a company needs to hire a new employee, it usually receives information provided by job candidates on their background and experience. This provides candidates with an opportunity to cheat to improve their chances of getting hired. In Latin American countries such as Colombia, the occurrence of this fraud has led companies to introduce regular background check procedures. These procedures are either carried out by Human Resource (HR) departments or outsourced to small local service providers, and often take a week or longer. This slows down hiring processes considerably in countries where resignations can happen without prior notice and where turnover is high in many industries. When Sebastian, Founder and CEO of Globalwork, looked at these existing procedures, he saw an opportunity to speed them up using technology.

To seize the opportunity, he and his mother Silvia founded Globalwork in 2017. Located in Medellín, Colombia, Globalwork checks candidates' educational, employment and criminal background in less than 24 hours for HR Departments in several Latin American countries. They also interview candidates at home, a common practice to verify the information. For these checks, they rely on a cloud software interface and a network of close to 60 freelance psychologists to conduct the interviews. Once an agreement is signed between Globalwork and a company, the company gets access to the cloud interface, which allows it to upload candidates' information, solicit specific checks, and see a progress tracker. It also allows Globalwork to track solicited and performed services that are invoiced bi-monthly, distributes the checking tasks among Globalwork employees and the freelancers, and aids in checking extant security-relevant databases, such as police records, among others. Once the checking process is complete, Globalwork sends an end-report with the results to the company, which is displayed via the cloud interface.

Globalwork's first years were marked by ups and downs. Its initial rapid growth was halted by the economic crisis caused by COVID, resulting in a challenge to innovate for

survival and the need for strategic choices regarding the best path to a promising future.

Creating a start-up

In 2010, after the death of his father, Sebastian and his mother Silvia took over the father's business: a small firm dedicated to private investigations and checks on employees, which primarily served corporate security, not HR. Neither Sebastian nor Silvia had sufficient managerial experience and skills. They had other commitments and lacked the time, knowledge, and capabilities to run the business. Sebastian described the years before founding Globalwork as 'a very difficult time; a disaster, really'. Silvia had to invest most of her savings to compensate for the losses of the failing legacy company.

Soon, Sebastian decided to quit school to focus on the business. He started connecting to the local entrepreneurship ecosystem and different support programs for budding entrepreneurs. By talking in detail with human resource executives and based on his knowledge of the checking services of the legacy business, he realised that companies had an unresolved need he thought he could solve technologically: quick hiring processes that prevented risks and mistakes. Silvia increasingly took on a supporting role while Sebastian became the lead entrepreneur and strategist. He decided to close the legacy firm and found a new business focused on this opportunity: Globalwork. Sebastian started to hire his own employees, while forming an external support team to complement the internal capabilities and skills, as shown in Figure 1.

Initially, Sebastian acquired the necessary technological, entrepreneurial and administrative skills to finish developing the venture idea through multiple incubators and accelerators. These programs focus on helping entrepreneurs on their journey by providing them with resources, training and mentors. Sebastian started calling potential customers in September 2017, before incorporating the venture two months later. He focused on clients with immediate hiring needs and high employee turn-over, such as temporal services and call centres. Globalwork secured its first client in February 2018,

selling services for USD 2,720. It then grew quickly, reaching monthly sales of USD 10,200 in April 2018.

That same month, Globalwork was accepted into an international accelerator program called 500 Start-ups, which combined a venture capital investment of USD 45,000 and a four-month educational program. Sebastian spent these months in Mexico City, managing Globalwork remotely, while connecting to the international start-up scene.

Figure 1

Figure 1: Long Description

Sales continued to increase and Globalwork grew from 5 Colombian employees in 2018 to almost 30 employees from Bolivia, Colombia, Venezuela and Mexico at the end of 2019, some of them working remotely. Globalwork also started to export services to Mexico and Panama. Sales continued to grow rapidly, from roughly USD 130,000 in 2018 to approximately USD 360,000 in 2019. In December 2019, Globalwork received

another USD 60,000 from angel investors, some of whom became very active in helping Sebastian co-create strategic plans and budgets.

A promising future

The steady sales growth signalled a promising future. Sebastian began 2020 with plans to scale up and internationalise further. The money from angel investors was intended to provide the company with some of the capital needed for this process. In addition, a credit line of around USD 350,000 was being negotiated with a major bank to make the necessary investments in personnel and technology. Sebastian felt that he needed more professional talent to accomplish his exponential growth objectives. This prompted him to hire people with experience in major MNEs to provide structure and introduce best practices, such as leaders for sales, technology and communications.

From the company's very inception, innovation was done by 'listening to clients' and 'solving the client's problem', two mantras within the company. New software features were almost always developed in communication with clients. Although many of these steps were initially carried out manually by an operations team and freelance psychologists, the clients' needs were met by increasing automation of the process. For example, the development of a progress tracker, the automatic mailing to references, and digitalisation of different steps.

A bolt from the blue

The COVID crisis of March 2020, in combination with other social and economic factors, created a perfect economic storm in Colombia. The national unemployment rate increased by almost 10 per cent in a single month. For Globalwork, whose main service depended upon hiring, the results were disastrous. Sales dropped by 90 per cent in April (see Figure 2). In addition, the pre-approved credit line fell through. In anticipation of the full national lockdown, Globalwork and other Colombian companies went 100 per cent remote within three days of the virus detection in Colombia. Any thoughts of scaling and internationalizing were dropped immediately, and Globalwork started to struggle for survival.

Figure 2 Evolution of invoiced service orders

Figure 2: Long Description

Recognising the magnitude of the threat, Sebastian and his area leaders asked themselves which other products or services they could develop to generate revenue.

Within a week, Sebastian and his team held an internal weekend hackathon focused on the question ‘How can we help?’. They initially developed a free emotional support hotline using volunteers from their network of independent psychologists and launched it within two days. It was promoted on national radio within a week. Recognising the potential based on customer and investor feedback, Globalwork converted the hotline first into a freemium and then into a paid ‘emotional well-being’ service over the course of the next months. The service was sold to organisations whose employees could then freely consult with Globalwork psychologists. Aggregate data about the consultations was provided to organisations, enabling an overview of the emotional state within the organisation while respecting patient integrity. It was marketed to pre-existing customers as an appropriate response to the pandemic, the ensuing lockdowns, and the corresponding adaptation, stress and mental health challenges of their employees. Despite its apparent promise, the service did not generate sufficient revenue or investor interest to solve the increasingly desperate cash-flow problem.

Another innovation was triggered by the request of a major customer. A bank had shifted to remote work and worried about compliance regarding home-office legislation and information security. They asked Globalwork to provide virtual inspections of many employees’ home working environments within a short time frame, which Globalwork gladly provided through their network of freelance psychologists. These ‘home-office’ inspections were quickly marketed to other potential customers. Both new services had only mixed success, due partly to their novelty and the uncertainty of clients regarding their value, and partly to spending freezes by many companies.

Sebastian expressed the challenge as follows:

> **My hypothesis is that emotional well-being and home-office [inspections] imply a behavioural change by the client: not everyone is willing to make it. Maybe we need to find that early adopter. Currently, we are running against a wall in the market. Which specific segment should we work on to launch our innovation?**

Meanwhile, Globalwork had to cut its monthly costs, from USD 42,000 to USD 10,500 by applying voluntary salary reductions and letting several employees go. When publicly announcing the cuts and leaving team members, Sebastian described the situation as ‘the most difficult week for me since we started Globalwork’. As the year progressed, crisis fatigue settled in, and Sebastian changed his perception regarding the type of employees the company needed at the current stage, from professional talent towards ‘firefighters’ – employees who would detect and solve problems proactively, regardless of working hours.

Back to a promising future

Globalwork survived the year 2020 with significant changes, through a mix of innovations, a small follow-on round of investments by previous angel investors, and the acquisition of clients in the health sector, which needed to hire many employees as fast as possible, given the pandemic. In January 2021, Globalwork participated virtually in a Swiss incubator focused on growth, which provided another investment of USD 20,000. Rising sales figures and a consequent growth in company's size led Sebastian to worry again about hiring talent that had been lost in the downturn, especially technical experts who also had managerial experience and leadership potential. However, Globalwork still had severely diminished resources and could not afford to hire many leading employees at once. Neither did they have the necessary capacity to grow their traditional security checks, emotional well-being service, and the home-office inspections simultaneously. How should Globalwork deal with its severe resource disadvantage and which services should it focus on?

The traditional background checking services of potential employees were in constant demand. The emotional well-being service was increasingly recognised as novel and desired by new customers but had sales figures below 5 per cent of total revenue. Moreover, it was considered a 'nice-to-have' in the still difficult economic conditions. The home-office inspections had almost ceased after competing occupational risk insurers had built up their capabilities. However, Sebastian still felt that they had an advantage over the competitor's services and was reluctant to abandon the innovation. Having already overcome significant challenges in the last four years, Sebastian and Globalwork's leadership team were confidently preparing themselves to face these challenges and any new opportunities.

Questions

1. What opportunity is Globalwork trying to exploit and what are the team, resources, and environmental factors that shaped Globalwork's initial opportunity recognition and development?
2. Describe characteristics of Globalwork's entrepreneurial growth stages and how they were impacted by the crisis.
3. How is Globalwork facing the innovation dilemmas?
4. Which concepts and frameworks from the chapter could help Sebastian decide which services to focus on in the future?

Chapter 12

Mergers, acquisitions and alliances

Key terms

acquisition

collaborative advantage

collective strategy

corporate entrepreneurship

divestment

merger

organic development

strategic alliance

Learning outcomes

After reading this chapter you should be able to:

- Identify key strategic motives.
- Distinguish the key issues in successful management of different growth options.
- Understand how to make appropriate choices between *organic development*, *mergers and acquisitions* and *strategic alliances.*
- Identify the *key success factors.*

Business strategy
Corporate strategy
International
II
Strategic choices
Entrepre-neurship
Acquisitions & alliances

12.1 Introduction

Mergers, acquisitions and alliances are all common methods for achieving growth strategies and are often in the news. For example, in 2022, Microsoft announced it planned to buy gaming company, Activision Blizzard, the publisher of Call of Duty, World of Warcraft and Diablo, for $68.7bn. This would be the biggest acquisition in the company's history and would help grow their gaming business across mobile, PC and Xbox consoles in response to the recent successes of competitor, Sony. In a previous year, Microsoft used a different growth method when it announced an expansion of its alliance with NEC Corporation to help customers accelerate cloud adoption and digital transformation, through sharing each other's AI and Internet of Thing (IoT) capabilities, and leveraging Microsoft Azure and 365 with NEC's networks and IT expertise. As these examples show, acquisitions and alliances are big business with major implications for the strategic development of companies.

This chapter therefore addresses mergers, acquisitions and alliances as key methods for pursuing strategic options. It will consider them alongside the principal alternative of 'organic' development, which is relying on a company's own resources to pursue a growth strategy. Figure 12.1 shows how the main strategic options considered in the previous three chapters – diversification, internationalisation and innovation – can all be achieved through mergers and acquisitions, alliances or organic development. Of course, these three methods can also be used for many other

strategies as well, for example, consolidating markets or building scale advantages.

The chapter starts with organic development as organisations are likely to rely on internal resources for growth as the least risky route forwards. The chapter then introduces mergers and acquisitions (M&A) and then strategic alliances as two principle external growth options. The final section compares these external options against the internal option of organic development. M&A and alliances fail frequently and so a fundamental question is when to acquire, when to ally or when to 'do it yourself'? The final section also considers key success factors in M&A and strategic alliances. At the end of this chapter, a new insight into understanding M&A performance is presented.

Figure 12.1 Three strategy methods

12.2 Organic development

The default method for pursuing a strategy is to 'do it yourself', relying on internal capabilities. Thus **organic development is where a strategy is pursued by building on, and developing, an organisation's own capabilities.** For example, supercar manufacturer McLaren has just launched a new car, Artura, which represents a new era for the firm as it is its first series production hybrid. This is not an adaptation of earlier cars but a new car with new electrical systems, new engine, new transmission, carbon light weight body and a new platform which presented many significant technical hurdles to overcome. McLaren chose to pursue this do-it-yourself (DIY) method of development as it already had experimented with some of the components in earlier cars.

There are five principal advantages to relying on organic development:

- *Knowledge and learning.* Using the organisation's existing capabilities to pursue a new strategy can enhance organisational knowledge and learning. Direct involvement in a new market or technology is likely to promote the acquisition and internalisation of deeper knowledge than a hands-off strategic alliance, for example.
- *Spreading investment over time.* Acquisitions typically require an immediate upfront payment for the target company. Organic development allows the spreading of investment over the whole timespan of the strategy's development. This reduction of

upfront commitment may make it easier to reverse or adjust a strategy if conditions change.

- *No availability constraints.* Organic development has the advantage of not being dependent on the availability of suitable acquisition targets or potential alliance partners. There are few acquisition opportunities for foreign companies wanting to enter the Japanese market, for example. Organic developers also do not have to wait until the perfectly matched acquisition target comes onto the market.
- *Strategic independence.* The independence provided by organic development means that an organisation does not need to make the same compromises as might be necessary if it made an alliance with a partner organisation. For example, partnership with a foreign collaborator is likely to involve constraints on marketing activity in external markets and may limit future strategic choices.
- *Culture management.* Organic development allows new activities to be created in the existing cultural environment, which reduces the risk of culture clash that could occur with external growth options.

The reliance of organic development on internal capabilities can be slow, expensive and risky. It is not easy to use existing capabilities for major leaps in terms of innovation, diversification or internationalisation, for example. However, organic development can be very successful and be sufficiently radical to merit the term 'corporate entrepreneurship'. **Corporate entrepreneurship refers to radical change in the organisation's business, driven principally by the organisation's own capabilities.**[1] Bringing

together the words ‘entrepreneurship’ and ‘corporate’ underlines the potential for significant change or novelty not only by external entrepreneurship (see also corporate venturing in Section 11.5.2), but also by reliance on internal capabilities from within the corporate organisation. Thus, for car manufacturer McLaren, the creation of the Altura was an important entrepreneurial step, taking it into a new plug-in hybrid supercar market in the hope that this might give it an edge over its competitors and grow new consumer demand.

The concept of corporate entrepreneurship is valuable because it encourages a creative attitude inside the firm. Often, however, organisations have to go beyond their own internal capabilities and look externally for methods to pursue their strategies. This chapter will examine two of these methods, M&A and strategic alliances.

12.3 Mergers and acquisitions

Mergers and acquisitions (M&A) attract a lot of attention as they generally involve large sums of money and can affect a wide range of stakeholders. They can also provide a speedy means of achieving major strategic objectives. However, they can also lead to spectacular failures, because the acquirer is forced to withdraw at great financial and strategic expense. For instance, Verizon acquired AOL in 2015 for $4.4bn and Yahoo in 2017 for $4.5bn, which they combined into Verizon Media to provide digital content and advertising. This business struggled and 90 per cent was sold off in 2021 for $5bn.

12.3.1 Defining M&A

M&A are about the combination of organisations. In an acquisition (or takeover), an acquirer *takes control* of another company through share purchase. Thus **acquisition is achieved by purchasing a majority of shares in a target company.** Most acquisitions are *friendly,* where the target's management recommends accepting the deal to its shareholders. Acquirers prefer this, as target management is more likely to work with them to integrate both companies. Sometimes, acquisitions are *hostile,* where target management refuses the acquirer's offer. In this circumstance, the acquirer appeals directly to the target's shareholders for ownership of their shares. Relations between the bidder and the target management team during a hostile deal can be very bad tempered, with the latter

obstructing efforts to obtain key information and often creating problems for post-deal integration. In general, acquirers are larger than target companies, although there may be ‘reverse’ takeovers, where acquirers are smaller than their targets.

A **merger** differs from an acquisition, as it is **the combination of two previously separate organisations in order to form a new company.** Merger partners are often of similar size, with expectations of broadly equal status, unlike an acquisition where the acquirer generally dominates. In practice, the terms ‘merger’ and ‘acquisition’ are often used interchangeably, hence the common shorthand M&A.

M&A can also happen in the public and non-profit sectors: for example, in the UK, in response to sustained pressures to reduce costs, local councils are being encouraged to merge to achieve greater levels of efficiency. Publicly owned institutions frequently build up highly distinctive cultures or systems of their own, as if they were in fact independent organisations. Where there are major cultural or systems differences between organisations, the scale and depth of the managerial issues approximate to those that would be involved in a change of ownership. ‘Merger’ is therefore often used in such cases as that better reflects the scale of the task involved than simply ‘reorganisation’.

12.3.2 M&A contexts

M&A do not happen in a vacuum but are embedded in historical, geographic and organisational contexts.

- *Historical context.* Since records began in the late nineteenth century, M&A have shown a cyclical quality, involving high peaks and deep troughs. Thus, 2021 saw record high levels of activity with $5.1trn of deals, far higher than the years leading up to the pandemic. It is worth noting that, even in troughs, there remain significant numbers of M&A deals, as M&A is an important and constant way in which businesses adjust to changing contexts. M&A cycles are broadly linked to changes in the global economy but are also influenced by new regulations, the availability of finance, stock market performance, technological disturbances and the supply of available target firms. They may also be driven by over-optimism on the part of managers, shareholders and bankers during upturns, and by exaggerated loss of confidence during downturns. This cyclical pattern suggests that there are better times than others for making an acquisition. At the top of a cycle, target companies are likely to be very highly priced, which may reduce the chances of long-term success for an acquirer. These cycles should warn managers that M&A may have a strong fashion element and, in an upturn, managers should really ask whether acquisitions are justified.
- *Geographical context.* Global activity in mergers has traditionally been dominated by North America and Western Europe. China has also been very active in large-scale acquisitions in order to access Western markets or technology, such as the world's largest smartphone contract manufacturer, Wingtech Technology's acquisition of Dutch semiconductor manufacturer Nexperia BV and its subsequent bid in 2021 for the UK's largest microchip manufacturer Newport Wafer Fab. While

approximately one-third of all M&A are *cross border*, and M&A continues to spread into new geographies, many national governance systems put barriers in the way, especially for hostile acquisitions. The majority of M&A are within national boundaries and, while this means that the obstacles of different national institutions and cultures are avoided, in many countries there are still very significant regional differences that can come into play and influence M&A outcome.[2]

- *Organisational context.* Although M&A is generally talked about as one company taking over another, often small acquisitions are subsumed within a larger acquirer, which is likely to be engaged in a wide range of other activities that might also include other acquisitions and alliances. Trying to integrate a newly acquired company into a shifting mix of other, often larger strategic initiatives can create significant internal stresses.[3]

12.3.3 M&A strategy

M&A strategies are often a complex mix of strategic, financial and managerial[4] motives (see Illustration 12.1) that can sometimes be difficult to disentangle.

Strategic motives for M&A

Strategic motives for M&A involve improving the competitive advantage of the organisation. These motives are often related to the reasons for diversification in general (see Section 9.3). Strategic motives can be categorised in three main ways:[5]

- *Extension.* M&A can be used to extend the reach of a firm in terms of geography, products or markets. For instance, Canadian Pacific Railway's acquisition in 2021 of Kansas City Southern, with railways in Mexico and Panama, for $31bn, will create the first railroad to connect Canada to Mexico.
- *Consolidation.* M&A can be used to consolidate the competitors in an industry. Bringing together two competitors can increase market power by reducing competition, and thus enable price rises for customers,[6] increase efficiency through reducing surplus capacity or sharing resources, for instance, head-office facilities or distribution channels, and increase production efficiency through increased bargaining power with suppliers and increasing scale of production. Many of these strategies lay behind Morrison's acquisition of Safeway, mentioned in Illustration 12.1.
- *Resources and capabilities.* The third broad strategic motive for M&A is to increase an acquirer's resources and capabilities. High-tech companies such as Apple, Alphabet and Cisco regard acquisitions of entrepreneurial technology companies as a part of their R&D effort. Indeed, having acquired around 100 companies over the last 6 years, Apple is making an acquisition every 3 or 4 weeks. Instead of researching new technologies from scratch, they allow entrepreneurial start-ups to prove the idea, and then take over these companies in order to incorporate the technological capability within their own portfolio (see Section 11.5.2). In addition, acquisitions might also enable an acquirer to deploy its own capabilities and resources to a greater extent, such as Alphabet (see Illustration 12.2),

providing huge visibility to acquired company products and services. Publicly quoted companies can often add value to acquired private companies by bringing in expertise gained through experience of complying with stock market regulation, such as more sophisticated management techniques, and they may also bring specialised capabilities such as turnaround or reengineering competencies. While acquiring capabilities can be additive to the acquirer it is also important to note that acquirers may also perceive that industries are converging (see Section 4.3.1) and so acquisition can reposition the acquirer. For example, Google acquired smart glasses manufacturer North in order to position itself for ambient computing, where messages and navigation can be projected onto the lenses, in anticipation of the convergence of computing and vision.

- In many instances acquirers may buy different capabilities, believing them to be just extensions, but subsequently recognise they fundamentally change their business model. For instance, Siemens' acquisition of internet companies has fundamentally altered the way the company is structured, turning the business from heavy engineering into one focused on engineering solutions.

Illustration 12.1 US private equity acquisitions resurge Supermarket group Morrisons accepts £7bn private equity takeover.

Private equity firms make long-term investments on behalf of their investors in other companies, typically through acquisitions. In the first half of 2021, private equity acquisitions broke a 40-year record with $500bn of deals, pushing global M&A activity to an all-time high. One of the largest agreed deals was US private equity group, Clayton, Dublier & Rice's (CDR) offer of £7bn, for UK supermarket group Morrisons. This was the highest offer in a close sealed bid auction contest with CDR offering 287p per share and another US private equity group, Fortress, offering 286p, valuing its offer at £6.7bn. Morrison's share price had risen 35 per cent with the first bid in June, from 178p to 240p, and 287p represented an increase of 61 per cent on pre-bid levels. The board recommended CDR's offer to its shareholders.

Before the 2020–22 pandemic, Morrison's had acquired UK supermarket group Safeway in order to strengthen its position in the grocery sector. While this turned a regional player into a national one, with 500 stores and over 110,000 staff, Morrison's was still in fourth position in the industry pre-pandemic, with 10 per cent of the market behind market leader Tesco (27 per cent), Sainsbury's (16 per cent) and Asda (14 per cent). It also faced strong performances from low-cost operators Lidl and Aldi and high-quality supermarkets, M&S and Waitrose. Supermarket share prices were subdued for some time before the pandemic due to strong competition and average operating margins of just 1.9 per cent over the previous five years. Despite supermarket businesses performing strongly during the pandemic, share prices remained low. Morrison's share prices, while rising a little above Tesco, remained below pre-pandemic

levels. The low share-price was despite growing market share with increased online and in-store capacity, expansion of its partnership with Amazon, a click-and-collect service as well as home deliveries and successful trial with Amazon backed last mile delivery group Deliveroo. While this uplift in performance might be a one off, and post-pandemic revival of the hospitality sector was expected to dent supermarket sales, some perceive a fundamental change in the industry towards scaling up online shopping and a dissolving of the boundary between physical and online commerce to meet customer needs.

No other supermarkets made takeover bids for Morrisons, probably due to competition rules and also their own subdued share prices. The emergence of several US private equity bidders for the group has been described as pandemic plundering, as private equity firms had spent more on buying UK listed companies in eight months than they had in the previous five years. The UK might have appeared attractive as it was one of the economies hardest hit by the pandemic and the value of the pound had not yet recovered. The deals might also have reflected some confidence in post-pandemic, post-Brexit Britain. Morrisons was perhaps more attractive than other supermarkets as it did not have the legacy bets of competitors such as Tesco and Sainsbury's who had spent heavily on international expansion, banking and non-grocery retail. In addition, discounters Lidl and Aldi had deliberately under-invested in online channels, which some viewed as an error. Morrisons owns 85 per cent of its real estate which could be sold and leased back. This would increase profits. Also increasing the leverage (debt) of the company would greatly improve return on equity for shareholders. To allay fears, CDR has said they view Morrison's freehold property portfolio as a strength allowing operational control. Nonetheless, some investors argue CDR will not bring any additional value to Morrisons.

Sources: https://www.bbc.co.uk/news/business-58273916 [accessed: June 2022]; https://internetretailing.net/strategy-and-innovation/morrisons-backs-bid [accessed: June 2022]; https://www.investorschronicle.co.uk/ideas/2021/02/11/rethink-supermarkets-and-start-with-morrisons/ [accessed: June 2022]

Questions

1 Share prices should reflect the true value of a company's current and future earnings. Therefore, why has Morrison's share price increased so dramatically since June?

2 Why are private equity companies so keen to acquire Morrisons?

Other types of acquiring entities have somewhat different strategies for acquisition. For instance, private equity acquirers may draw upon a wider pool of external information and expertise than is available to target companies and, where the acquirer has a portfolio of companies, mutual collaborations can be beneficial. In extreme cases, which are proving popular during 2021, publicly listed companies that are barely trading, sometimes termed 'zombie' companies, may be acquired by successful private businesses in order to benefit from the public listing. Acquiring these 'shell companies' (as they have form but little substance i.e., little or no commercial activity), or SPACs (special purpose acquisition company), where investors create an IPO into which a private company can be injected, is a hot trend on Wall Street in 2021. Former unicorn WeWork's original IPO imploded in 2019 but, in 2021, it has merged with SPAC BowX to enable it to become a publicly listed company valued at $9bn. Public listing provides several benefits including access to cheaper financing, but it can take years to obtain through direct application and, as WeWork realised, doesn't always succeed.

Financial motives for M&A

Financial motives concern the optimal use of financial resources, rather than directly improving the actual business. There are three main financial motives:

- *Financial efficiency.* An acquirer with a strong balance sheet (i.e., has plenty of cash) may help improve a highly indebted target company (i.e., a weak balance sheet). The target can save on interest payments by using the acquirer's assets to pay off its debt, and it can also get investment funds that it could not have accessed otherwise. The acquirer may also be able to drive a good bargain in acquiring the weaker company. Also, an acquirer with a booming share price can purchase targets very efficiently by offering to pay target shareholders with its own shares (equity), rather than paying with cash up front. Private equity acquirers are often accused of financial engineering to achieve superior performance and they may use the assets of the target company to increase its borrowing, sometimes called 'leveraging up', in order to improve shareholder returns.
- *Tax efficiency.* Sometimes, there may be tax advantages from bringing together different companies. For example, profits or tax losses may be transferable within the combined organisation in order to benefit from different tax regimes between industries or countries. Sometimes called 'tax inversion', this motive lay behind several US companies considering overseas acquisitions until new US regulations discouraged such deals.
- *Asset stripping or unbundling.* Some companies are effective at spotting other companies whose underlying assets are worth

more than the price of the company as a whole. This makes it possible to buy such companies and then rapidly sell off ('unbundle') different business units to various buyers for a total price substantially in excess of what was originally paid for the whole. Asset stripping is a charge often levelled at private equity acquirers as opportunistic profiteering. However, if the business units find better corporate parents through this unbundling process, there can be a real gain in economic effectiveness.

Managerial motives for M&A

As for diversification (see Section 9.3), M&A may sometimes serve managers' more than shareholders' interests. 'Managerial' motives are therefore self-serving rather than efficiency-driven. M&A may serve managerial self-interest for two reasons:

- *Personal ambition.* These can take three forms regardless of the real value being created. First, senior managers' personal financial incentives may be tied to short-term growth targets or share-price targets that are more easily achieved by large and spectacular acquisitions than the more gradualist and lower-profile alternative of organic growth. Second, large acquisitions attract media attention, with opportunities to boost personal reputations through flattering media interviews and appearances. This 'managerial hubris' (vanity) effect can mean managers who have been successful in earlier acquisitions become over-confident and embark on more and more acquisitions, each riskier and more expensive than the last.[7] Finally, acquisitions provide opportunities to give friends, family

and colleagues greater responsibility, helping to cement personal loyalty by developing individuals' careers.

- *Bandwagon effects.* As noted earlier, acquisitions are highly cyclical. In an upswing, there are three kinds of pressure on senior managers to join the acquisition bandwagon. First, when many other firms are making acquisitions, financial analysts and the business media may criticise more cautious managers for undue conservatism. Second, shareholders may fear that their company is being left behind, as they see opportunities for their business being snatched by rivals. Last, managers may worry that, if their company is not acquiring, it will become the target of a hostile bid itself. For managers wanting a quiet life during a 'merger boom', the easiest strategy may be simply to join in. The danger is making an unnecessary acquisition and it can be a reason for paying too much.

In sum, there are multiple motives for M&A and these will depend upon the nature of the acquirer, its management and stakeholders as well as the surrounding contexts. The general consensus is that the average performance of deals is unimpressive, with some evidence suggesting that over half fail,[8] and many have sought to find explanations for poor performance in good and bad motives as well as company and contextual differences. A recent contingency analysis of M&A,[9] studying different configurations of pre-acquisition factors such as market booms and bust, different acquirer strategies and CEO motivations, reveals significant variation between deal types with some exhibiting superior performance and others underperforming. However, that study also finds an overall failure rate of around 50 per cent, which is a similar problematic

performance level as other alternative growth methods such as joint ventures. Nevertheless, it is worth asking sceptical questions of any M&A strategy. The converse can be true of course: there can be bad reasons for resisting a hostile takeover. Senior managers may resist being acquired because they fear losing their jobs, even if the price offered represents a good deal for their shareholders.

12.3.4 M&A processes

Acquisitions take time. First, the acquirer needs to be clear on its growth strategy and the level of resources and stakeholder support needed to enable an acquisition. It can then embark on a search process to identify an acquisition target with the best possible fit. These pre-bid processes may take years but sometimes can be completed very rapidly indeed. Then there is the process of negotiating and bidding for the target company: to agree on terms and conditions and the right price. Importantly, managers should be deciding on the extent to which the target business will need to be integrated as this will have significant implications for the amount of time required to create value. In other words, acquisitions are a process that elapses over time and is not just a simple transaction. Each step in the process imposes different tasks on managers. This section will consider four key steps: growth strategy, target investigations and choice, bid negotiation and integration.

Growth strategy

Section 12.3.3 has already outlined the main considerations in an M&A strategy, but there is a lot of other work that needs to be done

before embarking on an M&A transaction. First, it is important to ensure that the strategy of the acquirer is driving the wish to make an acquisition, rather than the other way around – an attractive looking deal is driving the strategy. Reflecting on the overall strategy will also enable the acquirer to consider other growth strategies to ensure that M&A is the most appropriate way forwards. It is then important for the acquirer to ensure that it has the necessary resources and capabilities in place, or can procure them, in order to finance and manage the acquisition. It is also prudent to consider the levels of stakeholder support for any bid the acquirer might make. Many firms appoint specific investment banks, lawyers and accountants to help assist in these aspects of the process if these skills do not reside in-house.

Target investigations and choice in M&A

The amount of work in selecting and evaluating targets is significant. In order to make just 50 software acquisitions, IBM had to assess around 500 different potential acquisition targets, choosing not to proceed in the vast majority of cases.[10] In the search process, there are two main criteria to apply: strategic fit and organisational fit.[11]

- *Strategic fit.* This refers to the extent to which the target firm strengthens or complements the acquiring firm's strategy. Strategic fit relates to the original strategic motives for the acquisition: extension, consolidation and capabilities. Managers need to assess strategic fit very carefully. The danger is that potential synergies (see Section 9.3) in M&A are often exaggerated in order to justify high acquisition prices. Also, negative synergies ('contagion') between the companies

involved are easily neglected[12] when amalgamating business models, resulting in value destruction.

- *Organisational fit.* This refers to the match between the management practices and routines, cultural practices and staff characteristics between the target and the acquiring firms. Large mismatches are likely to cause significant integration problems. International acquisitions can be particularly liable to organisational misfits, because of cultural and language differences between countries, as well as geographic distance, although the extent to which there is actual cultural clash will be determined by the extent of integration intended. Alphabet's acquisition of Nest (Illustration 12.2) raises interesting questions about organisational fit.

Figure 12.2 The acquisition process

Together, strategic and organisational fit determine the potential for the acquirer to add value, the parenting issue raised in Section 9.6, and is an interesting question posed by private equity's acquisition of Morrisons (Illustration 12.1). Where there is bad organisational fit, attempts by the acquirer to integrate the target are likely to destroy value, regardless of how well the target fits strategically. For instance, Amazon's acquisition of Whole Foods in

2017 led to people crying at work, scorecards being used to punish and terminate contracts and employees taking steps to unionise.[13]

Strategic and organisational fit can be used to create a screen according to which potential acquisition targets can be ruled in or ruled out. Note that, because the set of firms that meet the criteria *and* that are actually available for purchase is likely to be small, it is very tempting for managers to relax the criteria too far in order to build a large enough pool of possible acquisitions. Strict strategic and organisational fit criteria are particularly liable to be forgotten after the failure of an initial acquisition bid. Once having committed publicly to an acquisition strategy, senior managers are susceptible to making ill-considered bids for other targets ‘on the rebound’.

Strategic and organisational fit are important elements of ‘due diligence’ – a structured investigation of target companies that focuses on key aspects of the target business, such as ownership and organisation, resources and capabilities, finances, management, markets, customers and suppliers, other external relationships and future growth potential. Due diligence generally takes place before a deal is closed and, if it is performed badly, it can lead to serious post-acquisition difficulties. For example, Hewlett-Packard wrote down its $11bn acquisition of Autonomy by $5bn on the basis of poor information and a lawsuit is still in progress. Due diligence also extends through the negotiation phase.

Negotiation in M&A

The negotiation process in M&A is critical to the outcome of friendly deals. If top managements cannot agree because the price or terms and conditions are unacceptable, or they cannot agree on who will

run the combined organisation post-deal, the transaction will not take place. In terms of price, offer the target too little, and the bid will be unsuccessful: senior managers will lose credibility and the company will have wasted a lot of management time. Pay too much, though, and the acquisition is unlikely ever to make a profit net of the original acquisition price.

Ways in which the price is established by the acquirer are through the use of various valuation methods, including financial analysis techniques such as payback period, discounted cash flow, asset valuation and shareholder value analysis (see Chapter 13).[14] For acquisition of publicly quoted companies, the market value of the target company's shares can act as a guide. Typically, acquirers do not simply pay the current market value of the target, but have to pay a so-called *premium for control.* This is the additional amount an acquirer has to pay to win control compared to the ordinary valuation of the target's shares as an independent company. Depending on the state of the financial markets, this premium is often around 30 per cent greater than the current market value of target shares. Where the target resists the initial bid, or other potential acquirers join in with their own bids, so-called 'contested acquisitions', this premium will rise and it is very easy for bid prices to escalate well beyond the true economic value of the target.

It is therefore very important for the acquirer to be disciplined regarding the price that it will pay. Acquisitions are liable to the *winner's curse* – in order to win acceptance of the bid, the acquirer may pay so much that the original cost can never be earned back.[15] The negative effects of paying too much can be worsened if the acquirer tries to justify the price by cutting back essential

investments in order to improve immediate profits. In what is called the *vicious circle of overvaluation,* over-paying firms can easily undermine the original rationale of the acquisition by cutting costs on exactly the assets (e.g., brand-marketing, product R&D or key staff) that made up the strategic value of the target company in the first place.

Integration in M&A

The ability to extract value from an acquisition will depend critically on how it is integrated with the acquirer. Integration is frequently challenging because of problems of organisational fit. For example, there might be strong cultural differences (see Section 7.4), incompatible financial or information technology systems (see Section 15.2) or 'incompatible routines (see note 13 for examples)'. Poor integration can cause acquisitions to fail (see Illustration 12.2 for the way Alphabet has managed its talent acquisition). Getting the right approach to integration of merged or acquired companies is crucial.

The most suitable approach to integration depends on two key criteria:[16]

- *The extent of strategic interdependence.* This is the need for the transfer or sharing of capabilities (for example, technology) or resources (for example, manufacturing facilities). The presumption is that significant transfer or sharing through tight integration will enable the 'creation' of value from the acquisition. Of course, some acquisitions 'capture' value purely through the ownership of assets and so there is less need for integration.

These unrelated or conglomerate diversifications (see Section 9.2) may only be integrated in terms of their financial systems.

- *The need for organisational autonomy.* Where an acquired firm has a very distinct culture, or is geographically distant, or is dominated by prima donna professionals or star performers, integration may be problematic. For this reason, some acquisitions need high levels of organisational autonomy. But, in some circumstances, it is the distinctiveness of the acquired organisation that is valuable to the acquirer.[17] In this case, it is best to learn gradually from the distinct culture, rather than risk spoiling it by hurried or overly tight integration.

As in Figure 12.3, therefore, these two criteria result in five integration approaches[18] which have important implications for the length of integration period and choice of top management for the acquired company:

- *Absorption* is preferred where a high level of strategic interdependence is necessary and there is little need for organisational autonomy. Absorption requires rapid adjustment of the acquired company's old strategies, structures, resources and capabilities to the needs of the new owner, and changes to its culture and systems. In this type of acquisition, it is usual to appoint a new top manager in order to manage the organisation differently.[19]
- *Preservation* is appropriate where the acquired company is well run but not very compatible with the acquirer. The high need for autonomy and low need for integration may be found in conglomerate deals. The preservation style depends on allowing

acquired company strategies, resource and capability configurations, cultures and systems to continue much as before. Acquirer-led changes are generally confined to the essential minimum such as adjusting financial reporting procedures for control and carried out in a slow piecemeal fashion. In this situation, it is advisable to retain the incumbent top manager.

- *Symbiosis* is indicated where there is a strong need for strategic interdependence, but also a requirement for high autonomy – perhaps in a professional services organisation dependent on the creativity of its staff. Symbiosis implies that both acquired firm and acquiring firm learn the best qualities from the other. This learning process takes significant time and it is best to retain the incumbent top manager in the early stages to stabilise the acquisition before bringing in a new top manager to make far-reaching changes. This is the most complex of the integration approaches.
- *Intensive care* takes place where there is little to be gained by integration. These acquisitions may occur when the acquired company is in poor financial health and very rapid remedial action is required.[20] The acquirer will not integrate the company into its own business to avoid contamination but will impose stringent short-term targets and strategies in order to solve its problems. In more aggressive turnaround cases, the incumbent top manager will typically be replaced but otherwise the incumbent is retained for a smoother transition. These businesses may often be for subsequent sale.

- *Reorientation acquisitions* occur when the acquired company is in good health and well run but there is a need to integrate central administrative areas and align marketing and sales functions. Distinctive resources of the acquired company, though, are left alone and there are few changes to internal operations. In order to drive through changes quickly, a new top manager is generally brought in to run the acquired company.

Illustration 12.2 Money can't buy everything To evolve, Alphabet needs to acquire big, but does it have the right post-acquisition skills?

With $136bn in cash, there was speculation that Alphabet, formerly Google, might make a big acquisition, as shareholders would otherwise press for a special dividend or share repurchase.

Prior to becoming Alphabet, Google had always been a serial acquirer with over 230 deals. Few were in excess of $1bn, although the top 15 cost more than $23.5bn in total. Many of Google's most well-known products, including Android, YouTube, Maps, Fitbit, Docs and Analytics, came from acquisitions.

Originally, Google did not set a priority on fit between its target companies and its own organisation. Acquisitions were simply ways to enter new markets, gain talent or give Google a stronger foothold where its own efforts had failed. For instance, acquiring YouTube came after Google Video stalled. Soon, there were too many separate products and CEO Larry Page reorganised into seven core product areas in 2011. There were fewer acquisitions just to hire talent and deals now had to pass his 'toothbrush test' – a product you use daily to make your life better. A target must also enhance an existing product and be scalable.

Most of Google's acquisitions had been start-ups. Retaining start-up founders can be very difficult as they think of themselves as entrepreneurs who like doing their own thing. Many acquirers have struggled to retain the expertise they have spent millions acquiring. However, Google has retained at least 221 start-up founders while closest competitor Yahoo retained only 110. Google competed with other potential purchasers on offering huge resources to founders to enable them to initiate their product visions faster. Founders were asked what their product would look like with a billion users. For instance, Keyhole's founders were asked to adapt their desktop digital mapping software for urban planning to work on the web. It became Google Maps – the world's largest source of location data. And Google would give entrepreneurs space to innovate, handle contracts, patents and intangibles. However, unless acquisitions were large, few continued to run independently. Often, founders were rolled up inside another group in the company and they couldn't make decisions as freely as before. This affected their willingness to remain.

When Google approached Tony Fadell, CEO of Nest, the maker of the learning thermostat, the question was how he wanted to spend his time. He had limited resources for expansion and was working always on managing the day-to-day. Google promised a big payday, retention of the Nest brand name, investment for expansion and time to develop new products. Nest was one of Google's largest acquisitions at $3.2bn and was intended to build Google's smart home initiative of connecting devices that anticipate human behaviour. Post-acquisition, Fadell didn't need formal approval for anything, although he met regularly with Larry Page and, when Alphabet was formed, Nest became a separate company under its umbrella.

Alphabet is facing multiple threats with declining share of desktop searches, Facebook taking advertising dollars, Amazon stealing product search queries in the mobile market and the fast rise of TikTok. It needs new revenue sources to compete effectively and innovate continually – 'it can't all be from within'. Although skilled at acquiring small companies, Google had had less success with larger acquisitions as the biggest,

Motorola Mobility, $12.5bn, failed and was later disposed of. Nest has recently been folded into Google Home Division and this is now rebranded as Google Nest. Tony Fadell left saying Alphabet suddenly came in and changed all the rules. Replacement CEOs came and went in quick succession as Nest underperformed. Nest may now be an extension of Google's ambitions in the smart home market, after years of vacillating within the Alphabet/Google organisational structure, or maybe Nest is now truly gone.

Sources: http://beyondthedeal.net/blog/2012/05/30/google-acquisitions-and-integrations-a-tale-of-two-cities/ [accessed: June 2022]; *Business Insider,* 2 May 2015; TIME.com, 15 April 2015; Quartz, 15 August 2015; Wired.com, 14 January 2015.

Questions

1 Using the post-acquisition integration matrix, Figure 12.3, compare Google's early style of acquisition management with the integration of Nest.

2 How has Google managed to be successful in retaining entrepreneurial talent?

Figure 12.3 Post-acquisition integration matrix

Source: Adapted from Angwin, D. N. and Meadows, M. (2015) New integration strategies for post acquisition management, *Long Range Planning*, 48(4): 235–251.

Especially for absorption, symbiosis and re-orientation strategies that require significant organisational interactions, acquisition success will depend upon how well the integration process is managed. For some types of integration, such as symbiosis, the acquired company and parent may well experience a long-term ongoing co-evolving process.[21] Here, methods of managing strategic change, explained in Chapter 16, will be relevant. However, because acquisitions often involve the loss of jobs, sudden career changes, management relocations and the cancellation of projects, it is argued that organisational justice, the perceived fairness of managerial actions, in terms of rewards, processes and communications, is particularly important for successful integration[22] (see Chapter 15).

12.3.5 M&A strategy over time

M&A strategies evolve over time as deals are rarely one-off events for an organisation. Companies that make multiple acquisitions are termed *serial acquirers.* When acquisitions occur closely together, these can be very demanding of managerial time and skills. However, repeating the acquisition process does provide an opportunity for acquiring companies to learn how to do M&A better.[23] An in-house M&A function can therefore add value through engaging in general strategic decisions via information gathering and analysis, technical execution including target investigation, negotiation skills and planning for integration before transacting a deal. The M&A function would collect data, define a formalised M&A process, develop checklists and templates, establish M&A committees and roundtables to collect and distribute information, apply accumulated knowledge to transactions and establish a central, company-wide steering committee to support specific transactions. This would enable a firm's M&A knowledge and accumulated experience to be captured and also allow a firm to be proactive. There is some evidence to suggest that an in-house M&A function improves M&A performance.[24] One serial acquirer with a strong in-house capability is Cisco Systems with over 240 acquisitions, costing around $70bn.

When a business no longer fits the corporate strategy, it may be sold. This is termed divestiture (or **divestment**).[25] This is a central part of 'asset stripping' strategy (see Section 12.3.3), but ought to be on the agenda of every diversified corporation. The key determinant of divestiture is whether the corporate parent has 'parenting advantage': in other words, the corporate parent can add more value

to the business unit than other potential owners of the business (see Section 9.6). Where there is no parenting advantage, the business should be divested for the best obtainable price. Corporate parents are often reluctant to divest businesses, seeing it as an admission of failure. However, a dynamic perspective on M&A would encourage managers to view divestures positively. Funds raised by the sale of an ill-fitting business can be used either to invest in retained businesses or to buy other businesses that fit the corporate strategy better. Obtaining a good price for the divested unit can recoup any losses it may have originally made. Sometimes, however, a less positive reason for divesture is pressure from competition authorities, which may force the sale of businesses to reduce companies' market power. For example, during 2018, the UK supermarket chain Sainsbury's was bidding to acquire competitor Asda for £7.3bn, from US owners Walmart. Potentially, they would have become market leader and dominated the UK marketplace. The Competition and Markets Authority decided Sainsbury's would become overly dominant in the UK market place and so quashed the deal. This decision may well have influenced Sainsbury's decision to not bid for Morrisons, see Illustration 12.1.

Acquisitions, therefore, are an important method for pursuing strategies but they are not easy to carry out and can be adopted for misguided reasons. It is therefore important to consider alternatives growth strategies.

12.4 Strategic alliances

M&A bring together companies through complete changes in ownership. However, companies also often work together in strategic alliances that involve collaboration with only partial changes in ownership, or no ownership changes at all as the parent companies remain distinct. Thus, **a strategic alliance is where two or more organisations share resources and activities to pursue a common strategy.** Companies may be involved in very significant numbers of strategic alliances and these may be part of extensive networks, or ecosystems (as described in Chapter 4) which, themselves, can bring advantage to the firm. Strategic alliances are a popular method among companies for pursuing strategy and can account for a significant portion of company revenues.[26]

Alliance strategy challenges the traditional organisation-centred approach to strategy in at least two ways. First, practitioners of alliance strategy need to think about strategy in terms of the collective success of their networks as well as their individual organisations' self-interest.[27] **Collective strategy is about how the whole network of alliances, of which an organisation is a member, competes against rival networks of alliances.** Thus, for Microsoft, competitive success for its Xbox games console has relied heavily on the collective strength of its network of independent games developers which currently runs at 24 studios including Bethesda (makers of Fallout and The Elder Scrolls), Arkane (Prey), Machine Games (Wolfenstein 2), 343 Industries (Halo), Mojang Studies (Minecraft), Playground (Fable), Rare (Sea of Thieves),

World's Edge (Age of Empires) and ZeniMax (Fallout 76). Part of Microsoft's strategy must include developing a stronger ecosystem of games developers than its rivals such as Sony and Nintendo. Collective strategy also challenges the individualistic approach to strategy by highlighting the importance of effective collaboration. Thus, success involves collaborating as well as competing. **Collaborative advantage is about managing alliances better than competitors.**[28] For Microsoft to maximise the value of the Xbox, it is not enough for it to have a stronger network than rivals such as Sony and Nintendo, but it must be better at working with its network in order to ensure that its members keep on producing the best games. The more effectively it collaborates, the more successful it will be. Illustration 12.3 describes Apple's approach to collective strategy and collaboration for the iPad.

12.4.1 Types of strategic alliance

In terms of ownership, there are two main kinds of strategic alliance:

- *Equity alliances* involve the creation of a new entity that is owned separately by the partners involved. The most common form of equity alliance is the *joint venture,* where two organisations remain independent but set up a new organisation jointly owned by the parents. For example, Mount Sinai Health System, the New York network of hospitals and medical research centres, created a joint venture with RenalytixAI, a company specialising in diagnostic texting, to form Kantaro Biosciences that subsequently created the first COVID-19 antibody testing kit made for research purposes. One form of

equity alliance is a *consortium alliance,* which involves several partners setting up a venture together. For instance, Amazon, Berkshire Hathaway and JPMorgan Chase created an independent alliance operation in order to cut health care costs and improve services for their one million employees.

- *Non-equity alliances* are typically looser, without the commitment implied by ownership. Non-equity alliances are often based on contracts. One common form of contractual alliance is franchising, where one organisation (the franchisor) gives another organisation (the franchisee) the right to sell the franchisor's products or services in a particular location in return for a fee or royalty. McDonald's restaurants and Subway are examples of franchising. Licensing is a similar kind of contractual alliance, allowing partners to use intellectual property such as patents or brands in return for a fee. Long-term subcontracting agreements are another form of loose non-equity alliance, common in automobile supply. For example, the Canadian subcontractor Magna has long-term contracts to assemble the bodies and frames for car companies such as Ford, Honda and Mercedes.

Illustration 12.3 Apple's iPad advantage?

Gaining competitive advantage through collaboration?

With much fanfare, Apple unveiled the latest generation (Gen 4) iPad Air which is compatible with the same accessories as the iPad Pro 2020, such as the magic keyboard, apple pencil and smart keyboard folio. It has the same camera sensor and connectivity features but has better performance at lower cost than the iPad Pro and a

more modern design with unique colour options. Innovations and stylishness are Apple's hallmarks and explain its continued dominance of the highly competitive tablet market. However, the first customers into the shop on launch day are people who just can't wait to tear the gadget apart – they wish to analyse its component parts through tear-down analysis.

Tear down analysis shows Apple's iPads rely on a global network of suppliers with STMicroelectronics in Europe providing power management, Sony of Japan supplying image sensors, Qualcomm in the USA delivering 5G chips, Korean firms LG Displays providing LCDs and SK Hynix supplying memory chips, Taiwan's Ennostar adding LEDs and other LCD components and China companies, ATL and USI providing batteries and communications parts. However, Apple had always protected its intellectual property. No hardware was licensed, ensuring control of production and maintenance of its premium pricing policy. It was impossible for any independent company to manufacture cheap iPads, in the way, for instance, Taiwanese manufacturers produced cheap IBM/Microsoft-compatible personal computers in the 1980s.

iPad's success has attracted a swarm of companies into the accessory market, such as Griffin (USA) and Logitech (Switzerland) supplying attractive add-ons including ultra-thin keyboards, cases and touch-screen stylus. Apple licensed them the necessary technology and benefited from attractive complementary products and royalties. But the relationship was arm's-length, with no advanced information about new products. Apple originally jealously controlled access to iOS. However, in 2008, iPhone, and later iPad, were opened up to third parties to allow them to develop apps, thus stimulating the new App stores industry. The attractiveness of iOS and strong consumer demand encouraged software developers to produce for Apple first, and Apple's App Store now has 2.2mn apps, generating around $85bn – around 64 per cent of total app revenue.

Consumers like the iPad's ease of use and vast ecosystem but there are challenges. Amazon's low-cost Fire tablets offering Amazon Prime services and apps, Samsung's Galaxy Tab, with improved screen resolution and android operating system challenging

iPad's technology and sharing many characteristics of other ecosystems with streaming apps and a consistent user experience along with compelling design and openness to non-Apple standards. Microsoft aimed to profit from its hardware with its tablet, Surface, but lacks a comparable software ecosystem to Apple and its tie to Windows could be a hindrance. Google now has the largest app store, Google Play Store, with 3.5mn android apps, and is growing fast although with less revenue than Apple's app store and with some lower quality apps.

iPad is a phenomenal success, with sales in excess of 450 million units since 2010. However, it operates in a highly competitive sector where competitor products are increasingly similar in appearance and Apple's market share has fallen significantly. Apple's success is not just down to the attractive appearance of its devices, but due to its underpinning collaborative networks. However, Apple's App store is coming under scrutiny by the European Commission's antitrust unit as potentially anti-competitive and this could damage Apple's philosophy of controlling products from end to end. Apple's devices all work with each other, allowing iCloud stored data to be used and synchronised between them. This connectedness also allows paid services such as TV+, Music and News+ to be readily accessed on any device. Called continuity, seamless interaction between all devices is unique to Apple. The real consumer battle, therefore, is not so much the attractiveness of an Apple device, but rather the superior experience achievable through device connectedness to networks. Consumers buy the ecosystem rather than the gadget.

Sources: G. Linden, K. Kraemer and J. Dedrick (2009) 'Who captures value in a global innovation network?' *Communications of the ACM,* vol. 52, no. 3, pp. 140–05; Tablet Wars: *The Telegraph* 6 November 2012; F. MacMahon (2012) 'Tablet Wars', 4 December, *BroadcastEngineering.com.*

Questions

1 What are the pros and cons of Apple's tight control of licensing?

2 What role has 'ecosystem' played in Apple's competitive advantage?

The public and voluntary sectors often get involved in both equity and non-equity strategic alliances. Governments have increasingly encouraged the public sector to contract out the building and maintenance of capital projects such as hospitals and schools under long-term contracts. Individual public organisations often band together to form purchasing consortia as well. A good example of this is university libraries, which typically negotiate collectively for the purchase of journals and books from publishers. Voluntary organisations pool their resources in alliance too. For example, relief organisations in areas suffering from natural or man-made disasters typically have to cooperate in order to deliver the full range of services in difficult circumstances. Although public- and voluntary-sector organisations might often be seen as more naturally cooperative than private-sector organisations, many of the issues that follow apply to all three kinds of organisation.

12.4.2 Motives for alliances

Strategic alliances allow an organisation to rapidly extend its strategic advantage and generally require less commitment than other forms of expansion. Key motivators are sharing resources or activities, entering new markets, gaining knowledge and reducing risk. Four broad rationales for alliances can be identified, as summarised in Figure 12.4:

- *Scale alliances.* Here organisations combine in order to achieve necessary scale. The capabilities of each partner may be quite similar (as indicated by the similarity of the A and B organisations in Figure 12.4), but together they can achieve advantages that they could not easily manage on their own. Thus, combining together can provide economies of scale in the production of outputs (products or services). Combining might also provide economies of scale in terms of inputs, for example by reducing purchasing costs of raw materials or services. Thus, health management organisations often combine together to negotiate better prices with pharmaceutical companies. Finally, combining allows the partners to share risk as well. Instead of organisations stretching themselves to find enough resources on their own, partnering can help each partner avoid committing so many resources of its own that failure would jeopardise the existence of the whole organisation.
- *Access alliances.* Organisations frequently ally in order to access the capabilities of another organisation that are required in order to produce or sell their products and services.For example, in countries such as China and India, a Western company (in Figure 12.4, organisation A) might need to partner with a local distributor (organisation B) in order to access effectively the national market for its products and services. Here, organisation B is critical to organisation A's ability to sell. Access alliances can work in the opposite direction. Thus, organisation B might seek a licensing alliance in order to access inputs from organisation A, for example, technologies or brands. Here, organisation A is critical to organisation B's ability to

produce or market its products and services. Access can be about tangible resources such as distribution channels or products as well as intangible resources such as knowledge and social/political connections.

- *Complementary alliances.* These can be seen as a form of access alliance, but involve organisations at similar points in the value network combining their distinctive resources so that they bolster each partner's particular gaps or weaknesses. Figure 12.4 shows an alliance where the strengths of organisation A (indicated by the darker shading) match the weaknesses of organisation B (indicated by the lighter shading); conversely, the strengths of organisation B match the weaknesses of organisation A. By partnering, the two organisations can bring together complementary strengths in order to overcome their individual weaknesses. An example of this is the Nissan–Renault alliance where a complementarity lies in Renault getting access to the Japanese car company's manufacturing expertise, particularly in diesel engines, while Nissan obtains access to European markets (see Illustration 12.4).
- *Collusive alliances.* Occasionally, organisations secretly collude together in order to increase their market power. By combining together into cartels, they reduce competition in the marketplace, enabling them to extract higher prices from their customers or lower prices from suppliers. Such collusive cartels among for-profit businesses are generally illegal, so there is no public agreement between them (hence the absence of brackets joining the two collusive organisations in Figure 12.4) and regulators will act to discourage this activity. For instance, in

2019, the EU Commission opened an investigation into possible collusion between two French Retailers, Casino and Intermarché over sales activities, as their purchasing alliance did not provide lower prices for consumers. In non-profit sectors, collusive alliances do take place and they may also be justified politically in sensitive for-profit industries such as defence or aerospace due to national interests and where the costs of development are far greater than an individual firm can sustain.

It can be seen that strategic alliances, like M&A, have mixed motives. Cooperation is often a good thing, but it is important to be aware of collusive motivations. These are likely to work against the interests of other competitors, customers and suppliers.

Figure 12.4 Strategic alliance motives

12.4.3 Strategic alliance processes

Like M&A, strategic alliances need to be understood as processes unfolding over time. Many alliances are relatively short-lived, although there are examples of some that last for very long periods indeed. For example, General Electric (USA) and SNECMA (France) have been partners since 1974 in a continuous alliance for the development and production of small aero-engines – this arrangement has been recently extended to 2040. The needs and capabilities of the partners in a long-standing alliance such as this are bound to change over time. However, the absence of full ownership means that emerging differences cannot simply be reconciled by managerial authority; they have to be negotiated between independent partners. This lack of control by one side or the other means the managerial processes in alliances are particularly demanding. The management challenges, moreover, will change over time.

Illustration 12.4 All good things come to an end?

Co-evolutionary troubles at the Renault Nissan alliance

Renault Nissan alliance structure

Widely hailed as one of the great successes in the automotive industry, the Renault Nissan alliance sold more vehicles worldwide than any other car maker in the first 6 months of 2018, with an estimated 5.5 million sales. This is a far cry from the alliance's origins in 1999 when the auto industry was in a period of rapid consolidation and both Nissan and Renault were struggling. Renault was just recovering from a failed merger with Volvo, and a new CEO, Carlos Ghosn, had been appointed to streamline the company. He was highly effective in doing so, earning him the nickname 'le cost killer', but Renault lacked access to the fast-growing Asian market. Nissan, on the other hand, was in financial trouble, with $20bn in debt and limited exposure to the European market.

The aim of the alliance was for both companies to maintain their own brand identities and running of their own businesses, while achieving substantial cost savings in sharing engineering, purchasing, research and production. For instance, both companies now share common platforms for cars that allow them to use similar components for production (see figure) – just four car platforms account for 75 per cent of all group production.

When the Alliance started, Renault invested in Nissan to prevent its collapse and acquired 43 per cent of voting shares. Ghosn then carried out sweeping changes at Nissan over four years, firing over 20,000 people, closing five production plants, changing the corporate culture to a performance-based one, raising margins to an unheard of 9 per cent, and reducing supplier power that was harming profitability. Ghosn's aim has been to focus on profitability and strengthening collaboration. However, despite deepening this very successful alliance, Ghosn was arrested in November 2018 over alleged under-reporting of his earnings and misusing company assets. He subsequently fled Japan to the Lebanon. The Nissan board fired him shortly thereafter. This has exposed fractures in the Renault Nissan alliance, raising concerns about its future.

The voting structure and shareholdings of the Alliance are shown in the figure. Nissan has a 15 per cent stake in Renault but no voting rights due to French laws preventing reciprocal control. The French government has increased its stake in Renault to 15 per cent and this has doubled their votes, due to European rules. However, Renault shares have fallen in value significantly and Nissan has grown strongly, relative to Renault, in both volume of cars and profitability. There is no doubt Nissan could now easily afford to take over Renault but it is unlikely the French government would like to see a National Champion in foreign hands. Nissan could buy 10 per cent more of Renault shares on the open market to take its stake to 25 per cent. Under Japanese law this would mean the French company losing its voting rights in Nissan, and Renault directors could be removed from its board. They would then be able to undo the alliance. Potentially, Renault could take over Nissan through further share purchases, but its finances are very weak and it may do better to reduce its stake to free up cash. Alternatively, both companies could work together to cope with the difficult Ghosn situation, try to restore trust, and rejuvenate the alliance.

Sources: D. Fickling (2018) 'Separating Renault-Nissan would be bloody', *Automotive News,* 20 November; T. Leggett and D. Palumbo (2018) 'Carlos Ghosn: five charts on

the Nissan boss scandal', *BBC*, 25 November.

Questions

1 Why is the Renault Nissan alliance in trouble?

2 What would you propose for the future of the alliance?

The fact that neither partner is in control, while alliances must typically be managed over time, highlights the importance of two themes in the various stages of the alliance process:

Figure 12.5 Strategic alliance evolution

Source: Adapted from E. Murray and J. Mahon (1993) 'Strategic alliances: gateway to the new Europe', *Long Range Planning,* 26, p. 109.

- *Co-evolution.* Rather than thinking of strategic alliances as fixed at a particular point of time, they are better seen as co-

evolutionary processes.[29] The concept of co-evolution underlines the way in which partners, strategies, capabilities and environments are constantly changing. As they change, they need realignment so that they can evolve in harmony. A co-evolutionary perspective on alliances therefore places the emphasis on flexibility and change. At completion, an alliance is unlikely to be the same as envisaged at the start.

- *Trust.* Given the probable co-evolutionary nature of alliances, and the lack of control of one partner over the other, trust becomes highly important to the success of alliances over time.[30] This comprises two parts: structural (which refers to the expectation that a partner will not act opportunistically) and behavioural (the degree of confidence a firm has in its partner's reliability and integrity). All future possibilities cannot be specified in the initial alliance contract. Each partner will have made investments that are vulnerable to the selfish behaviour of the other. This implies the need for partners to behave in a trustworthy fashion through the whole lifetime of the alliance. Trust in a relationship is something that has to be continuously earned. Trust is often particularly fragile in alliances between the public and private sectors, where the profit motive is suspect on one side, and sudden shifts in political agendas are feared on the other.

The themes of trust and co-evolution surface in various ways at different stages in the lifespan of a strategic alliance. Figure 12.5 provides a simple stage model of strategic alliance evolution. The amount of committed resources changes at each stage, but issues of trust and co-evolution recur throughout:

- *Courtship.* First, there is the initial process of courting potential partners, where the main resource commitment is managerial time. This courtship process should not be rushed, as the willingness of both partners is required. Similar criteria apply to alliances at this stage as to acquisitions. Each partner has to see a strategic fit, according to the rationales in Section 12.3.3. Equally, each partner has to see an organisational fit. Organisational fit can be considered as for acquisitions (Section 12.3.4). However, because alliances do not entail the same degree of control as acquisitions, mutual trust between partners will need to be particularly strong right from the outset.
- *Negotiation.* Partners need, of course, to negotiate carefully their mutual roles at the outset. In equity alliances, the partners also have to negotiate the proportion of ownership each will have in the final joint venture, the profit share and managerial responsibilities. There is likely to be a significant commitment of managerial time at this stage, as it is important to get initial contracts clear and correct and it is worth spending time working out how disputes during the life of the alliance will be resolved. Although the negotiation of ownership proportions in a joint venture is similar to the valuation process in acquisitions, strategic alliance contracts generally involve a great deal more. Key behaviours required of each partner need to be specified upfront. However, a ruthless negotiation style can also damage trust going forward. Moreover, co-evolution implies the need to anticipate change. In an acquired unit, it is possible to make adjustments simply by managerial authority. In alliances, initial contracts may be considered binding even when starting

conditions have changed. It is wise to include an option for renegotiating initial terms right at the outset.

- *Start-up.* This involves considerable investment of material and human resources and trust is very important. First, the initial operation of the alliance puts the original alliance agreements to the test. Informal adjustments to working realities are likely to be required. Also, people from outside the original negotiation team are typically now obliged to work together on a day-to-day basis. They may not have the same understanding of the alliance as those who initiated it. Without the mutual trust to make adjustments and smooth misunderstandings, the alliance is liable to break up. This early period in an alliance's evolution is the one with the highest rate of failure.
- *Maintenance.* This refers to the ongoing operation of the strategic alliance, with increasing resources likely to be committed. The lesson of co-evolution is that alliance maintenance is not a simple matter of stability. Alliances have to be actively managed to allow for changing external circumstances. The internal dynamics of the partnership are likely to evolve as the partners build experience. Here again, trust is extremely important. Gary Hamel has warned that alliances often become 'competitions for competence.'[31]

  Because partners are interacting closely, they can begin to learn each other's particular competences. This learning can develop into a competition for competence, with the partner that learns the fastest becoming the more powerful. The more powerful partner may, consequently, be able to renegotiate the terms in its favour or even break up the alliance and go it alone. If, on the

other hand, the partners wish to maintain their strategic alliance, trustworthy behaviour that does not threaten the other partner's competence is essential to maintaining the cooperative relationships necessary for the day-to-day working of the alliance.

- *Termination.* Often, an alliance will have had an agreed time span or purpose right from the start, so termination is a matter of completion rather than failure. Here, separation is amicable. Sometimes, the alliance has been so successful that the partners will wish to extend the alliance by agreeing a new alliance between themselves, committing still more resources. Sometimes, too, the alliance will have been more of a success for one party than the other, with one partner wishing to buy the other's share in order to commit fully, while the other partner decides to sell out. The sale of one party's interest need not be a sign of failure as their strategic agenda may have changed since alliance formation. However, sometimes it can end in bitter divorce (see Illustration 12.4). Termination needs to be managed carefully, therefore. Co-evolution implies that mutual trust is likely to be valuable after the completion of any particular partnership. Partners may be engaged in several different joint projects at the same time. For example, Cisco and IBM are partners on multiple simultaneous projects in wireless communications, IT security, data centres and data storage. The partners may need to come together again for new projects in the future. Maintaining mutual trust in the termination stage is vital if partners are to co-evolve through generations of multiple projects.

Like M&A, alliances exhibit high rates of failure of up to 70 per cent where they fail to meet the goals of parent companies.[32] There is some evidence that prior experience with joint ventures helps overall performance, especially if an alliance capability is created.[33] It may take many years to gradually introduce alliance management processes. For an alliance capability to succeed, there needs to be consistent sponsorship and support from top management.

12.5 Comparing acquisitions, alliances and organic development

It is clear that all three methods of M&A, strategic alliances and organic development have their own advantages and disadvantages. There are also some similarities. This section first considers criteria for choosing between the three methods, and then draws together some key success factors for M&A and alliances.

12.5.1 Buy, ally or DIY?

Very many, perhaps as much as half of M&A and strategic alliances, fail.[34&35] Acquisitions can go wrong because of excessive initial valuations, exaggerated expectations of strategic fit, underestimated problems of organisational fit and all the other issues pointed to in this chapter. Alliances also suffer from miscalculations in terms of strategic and organisational fit but, given the lack of control on either side, have their own particular issues of trust and co-evolution as well. With these high failure rates, acquisitions and alliances need to be considered cautiously alongside the default option of organic development (do-it-yourself).

The best approach will differ according to circumstances. Figure 12.6 presents a ‘buy, ally or DIY’ decision tree that can help in choosing between acquisitions, alliances and organic development based upon three key factors:[36]

- *Urgency.* Acquisitions are a rapid method for pursuing a strategy. Illustration 12.2 shows how Google expanded rapidly through making many acquisitions – something that might have taken far longer if attempted organically. Alliances too may accelerate strategy delivery by accessing additional resources or skills, though usually less quickly than a simple acquisition. Typically, organic development (DIY) is slowest: everything has to be made from scratch.
- *Uncertainty.* It is often better to choose the alliance route where there is high uncertainty in terms of the markets or technologies involved. On the upside, if the markets or technologies turn out to be a success, it might be possible to turn the alliance into a full acquisition, especially if a buy option has been included in the initial alliance contract. If the venture turns out a failure, then at least the loss is shared with the alliance partner. Acquisitions may also be resold if they fail but often at a much lower price than the original purchase. On the other hand, a failed organic development might have to be written off entirely, with no sale value, because the business unit involved has never been on the market beforehand.
- *Type of resources and capabilities.* Acquisitions work best when the desired resources or capabilities are 'hard', for example, physical investments in manufacturing facilities. Hard resources such as factories are easier to put a value on in the bidding process than 'soft' resources such as people or brands. Hard resources are also typically easier to control post-acquisition than people and skills. If CDR's bid for Morrisons (see Illustration 12.1) is really about real estate acquisition and

refinancing, then cultural difficulties are likely to be minimal. However, greater ‘soft’ integration might pose the risk of significant cultural problems. Sometimes, too, the acquiring company’s own image can tarnish the brand image of the target company. Acquisition of soft resources and competences should be approached with great caution. Indeed, the DIY organic method is typically the most effective with sensitive soft capabilities such as people. Internal ventures are likely to be culturally consistent at least. Even alliances can involve culture clashes between people from the two sides, and it is harder to control an alliance partner than an acquired unit.

Figure 12.6 Buy, ally or DIY

There may also be other factors that might be included in the decision tree such as the modularity of capabilities. For instance, if the capabilities being sought reside in a clearly defined part of the proposed partner's organisation, and assuming that section would not be for sale, then an alliance with that part of the business would make sense, leaving the partners to run the rest of their businesses independently. There is no need to buy the whole organisation. The DIY method could be effective, if there is time, as the new business could be developed under the umbrella of a distinct 'new venture division' (see Section 11.5.2), rather than involving the whole organisation.

Of course, the choice between the three options of buy, ally and DIY is not unconstrained. Frequently, there are no suitable acquisition targets or alliance partners available. The key message of Figure 12.6 remains, nonetheless: it is important to weigh up the available options systematically and to avoid favouring one or the other without careful analysis.

12.5.2 Key success factors

Figure 12.6 indicates that, despite high failure rates, M&A and strategic alliances can still be the best option in certain circumstances. The question then is how to manage M&A and alliances as effectively as possible.

Strategic fit is critical in both M&A and alliances. The target or the partner should suit the desired strategy. It is very easy to overestimate synergies – and neglect negative synergies – in alliances as well as M&A. However, *organisational fit* is vital as well,

in both cases. In particular, cultural differences are hard to manage, especially where people resources are important. Because of the lack of control, organisational fit issues are liable to be even harder to manage in alliances than in acquisitions, where the ownership rights of the buyer at least provide some managerial authority. *Valuation*, likewise, is a crucial issue in both M&A and equity alliances. Acquisitions are liable to the 'winner's curse' (Section 12.3.4) of excessive valuation, particularly where there have been bid battles between competitors.[37] But even alliance partners need to assess their relative contributions accurately in order to ensure that they do not commit too many resources with too little return and too little control.

M&A and alliances each raise some very distinct issues to manage. At the start of the process, alliances rely on courtship between willing partners, whereas that need not be the same for M&A. Mergers do require mutual willingness, of course, but, if negotiations go poorly, there often remains the option of the *hostile takeover* bid. The process of a hostile bid is principally about persuading shareholders rather than talking with the target's managers. In M&A, a crucial issue is the right approach to *integration*: absorption, preservation, symbiosis, intensive care, re-orientation. In strategic alliances, the option to fully integrate the two partners into a single whole does not exist. Rather, the task is the continued maintenance of a partnership between independent organisations that must *co-evolve.* Finally, *divesture* of acquired units and the *termination* of alliances tend to differ. Divestures are typically one-off transactions with purchasers, with limited consequences for future relationships. On the other hand, the way in which alliances

are terminated may have repercussions for important future relationships, as new projects and simultaneous projects often involve the same partners. In sum, it can be seen that the necessity for courtship, co-evolution and sensitive termination frequently makes the strategic alliance process a much more delicate one than acquisition.

Thinking Differently Time to rethink strategic alliances?

How digital transformation will affect strategic alliances of the future

The digital revolution, with cloud-based applications, Internet of Things (IoT), 3D printing, big data analytics, machine learning, blockchain and servitisation, is transforming the ways businesses work. Digital transformation is accelerating fundamental changes in business processes, competencies and models, often to the point of businesses and industry disruption. This has profound implications for how strategic alliances should be organised in the future.

Traditional strategic alliance management aims to maintain a partner relationship for maximal benefit over a period of years. However, digital transformation is making traditional models of alliance management obsolete. Firms will have to update their capabilities to be more flexible, agile and even allow ad-hoc virtual collaborations with much shorter life cycles. There will also be longer-term pressures for open innovation and servitisation in product service contracts, thus requiring ambidextrous alliance capabilities. Developments in blockchain and cloud computing capabilities will allow coopetitive and hybrid collaborations between competitors, as there can be greater trust, enabling warehousing, fleets and even human resource sharing. With the blurring of industry boundaries, companies may find alliance partners becoming competitors on

different platforms, requiring greater technology collaboration earlier, faster capability build and rapid partner switching. Cyber security to protect key resources will become increasingly important. Any one firm is unlikely to be able to master all technologies and capabilities so, competitive advantage is likely to be found in managing ecosystems where strategic alliances will provide critical linkages within and cross sector. Indeed, there are already increasing numbers of alliances between businesses in historically quite different industries such as automotive firms and AI firms, and oil exploration companies and high-tech companies.

Digital transformation will change the way we perceive strategic alliances with different motivations, incentives and mechanisms from previous decades. In particular, strategic alliances are likely to be more dynamic, exhibit non-linear trends due to rapid technology change, and have less distinct boundaries than before, leading to a wider pool of innovation as a source of competitive advantage. Indeed, knowledge sharing is likely to play a greater role than before in driving strategic alliances and expanding firm boundaries.[38]

Questions

Will the factors that made strategic alliances successful in the past still be applicable in the future?

Key takeaways

- When choosing a growth strategy, remember to consider all of the following three methods: *M&A, strategic alliances* and *organic development.*
- In making an acquisition, consider whether your approach is likely to have to be *friendly* or *hostile*, and think through the implications of this.
- Examine critically the motives for an acquisition, considering whether they are *strategic, financial* or *managerial.*
- Remember that mergers and acquisitions are a process with the following stages: *target choice, valuation* and *integration.* Each stage needs to be planned for ahead.
- For strategic alliances, consider whether *equity* or *non-equity* deals would work best.
- Remember, there can be several key motives for strategic alliances, each with different implications for choice and management: *scale, access, complementarity and collusion.*
- In designing a strategic alliance, recognise the importance of allowing for both *co-evolution* and *trust.*
- In order to choose whether to use acquisition, alliance or organic methods of expansion, consider three key factors: *urgency, uncertainty and type of capabilities.*

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

12.1 Write a short (about 10 lines) statement to a chief executive who has asked you to advise whether or not the company should develop through M&A. Write a similar statement to a chief executive of a hospital who is considering possible mergers with other hospitals.

12.2* For a recently announced acquisition, track the share prices (using www.bigcharts.com, for example) of both the acquiring firm and the target firm in the period surrounding the bid. What do you conclude from the behaviour of the share prices about how investors regard the bid? Which company's investors are likely to benefit more?

12.3* For a recently announced acquisition, or for the acquisition of Morrisons by CDR (Illustration 12.1), the acquisition of TopNet in the end of chapter case, or Nest by Google (Illustration 12.2), explain which post-acquisition integration approach might be most appropriate in these situations and why other integration approaches may be less effective.

12.4* With reference to either the bid for Morrisons (Illustration 12.1), Megabrew*, the merger of two French universities*, or end of chapter case, explain why, when the objectives are the mutual creation of value, acquirers choose to make M&A rather than alliances.

12.5* Explain which development approach is a family-owned company likely to prefer.

Integrative assignment

12.6* With so many M&A failing, explain why managers continue to transact these deals. In particular, consider alternative methods for strategic realignment that may be available to an organisation as well as the possible consequences of a company not using M&A. Now interpret your answer in terms of all the stakeholders who may be affected by an M&A transaction. What conclusions can you draw?

Recommended key readings

- A comprehensive book on M&A is: D. DePamphilis (2019) *Mergers, Acquisitions and Other Restructuring Activities*, 10th edn, Academic Press, Elsevier. For some alternative perspectives, see the collection by D.N. Angwin (ed.) (2007) *M&A,* Blackwell.
- A useful book on strategic alliances is B. Tjemkes, P. Vos and K. Burgers (2017) *Strategic Alliance Management*, Taylor and Frances.
- A book that contrasts the benefits of different modes of expansion is L. Capron and W. Mitchell (2012) *Build, Buy, Borrow: Solving the Growth Dilemma,* Harvard Business Review Press.

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9. D.N. Angwin, U. Urs, N. Appadu, I. Thanos and S. Vourloumis, ‘Does M&A strategy matter? A contingency perspective’, *European Management Journal*, forthcoming.
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39. The authors would like to thank Mehdi Khemiri, Founder and ex CEO of TopNet, for his kind and generous assistance in the preparation of this case study. Professor Duncan Angwin is Dean of Nottingham University Business School and Professor of Strategic Management; Dr Ioannis Thanos is Assistant Professor of Management at the Athens University of Economics and Business in Greece; Maha Chaieb is the Director of Executive Programs at the Mediterranean School of Business (MSB), Tunis.

Case example

A successful exit: the acquisition of TopNet by Tunisie Telecom

Duncan Angwin,[39] Ioannis Thanos and Maha Chaieb

Introduction

On 14 June 2010, Tunisie Telecom, Tunisia's state-owned Telecom operator, acquired TopNet, the largest privately owned Tunisian provider of internet access and broadband Internet network (ADSL), paying USD 10mn. Montasser Ouaili, CEO of Tunisie Telecom, remarked, 'The acquisition meets the demands of Tunisian customers for a better quality and range of internet services. By purchasing TopNet, Tunisie Telecom is seeking to strengthen its leadership position in the country.' For Mehdi Khemiri, CEO and Founder of TopNet, this deal represented the conclusion to an astonishing growth story, allowing him to exit at the top. This case raises a number of interesting questions including: Why did Tunisie Telecom want to buy TopNet? Why did TopNet's CEO Mehdi Khemiri want to sell? Were there other options for TopNet apart from selling the business? Was the acquisition of TopNet the right decision for Tunisie Telecom compared to other strategic options such as organic development or a strategic alliance? How should both companies be integrated? Was the deal successful?

The acquirer: Tunisie Telecom

Tunisie Telecom was founded in 1995 and is the incumbent telecom operator in Tunisia, North Africa. It began by providing landline telephone services and, in 1998, initiated its first cellular line. By the time of the deal, Tunisie Telecom had more than 8 million subscribers in Tunisia and abroad and posted 1.296 billion TND (c. $1bn) revenues in 2009, with a year-on-year growth rate of 4.3 per cent. Tunisie Telecom had been

planning for an IPO, but it was recognised that the acquisition of an internet company might make the deal look all the more attractive to the markets and potential investors.

The telecoms sector was changing fast in Tunisia. At this time, besides having an ADSL contract with an internet service provider, customers also had to have a contract with a fixed-line provider, Tunisie Telecom, meaning two different suppliers for their ADSL services. However, in July 2009, Orange Tunisia, a new entrant, was given a licence to be the first universal operator, allowing it to offer 3G mobile services and a fixed line. This was a real threat for Tunisie Telecom as customers were looking for an all-in-one offer to avoid dealing with different suppliers at the same time. Tunisie Telecom needed to offer bundled internet services to avoid loss of market share. One way might have been to try to start up its own internet service provider. This organic expansion would have taken time and produced a price war. Alternatively, they could have acquired one of the four independent private internet service providers at the time that included TopNet, Globalnet, Hexabyte and Tunet.

The acquired: TopNet

TopNet was founded in 2001. By 2009, it was the leading provider of internet services in Tunisia, with 48 per cent market share, amounting to 200,000 ADSL subscribers, 500 resellers and 12 commercial agencies. Revenues in 2009 were TND 23.3 million ($18mn). The company had more than 500 employees. In terms of services, TopNet offered residential ADSL and enterprise services, VSAT, VPN services and data centre services. Just before the deal, TopNet revenues were growing very quickly at 70 per cent a year for 2007–8 and at 33 per cent for 2008–9 at which time its capital was TND 2 million ($1.5mn). See figure 1 for information about TopNet's financial figures.

The main reason for TopNet's huge success was down to the great deal of effort the company put into marketing and communications. As Khemiri said, 'There wasn't a major difference in technology between the five private internet providers, it was really a matter of the best marketing and communications to give excellent service quality'. TopNet had

the best know-how and, most importantly, the best customer satisfaction in the whole telecoms industry.

There were a number of reasons why TopNet was available for acquisition. The Founder, Khemiri, had previously worked in the USA in a start-up that was acquired. After one year the acquirer decided to stop the acquired business and so Khemiri left. He had always dreamt of beginning his own start-up company but, from that point on, he also believed the most important thing to plan for was exit. So, when TopNet was formed, he was already thinking about exit. He also wanted to exit the business with a successful start-up record.

Strategically, the TopNet CEO faced four major issues. Although the market had grown rapidly over the previous nine years, it was now slowing down as the industry moved into a mature phase. Khemiri felt this would require a different style of management that was less concerned with fast growth and more focused on achieving better cost efficiencies and he didn't feel that this was his strength. TopNet needed to grow and this required substantial resources that the company lacked at that moment. Also, it was clear that Tunisie Telecom was thinking that it had to engage in the internet sector to avoid its customers switching to another provider, with Orange being a major threat to their business model. The major risk was that Tunisie Telecom would either consider buying one of TopNet's competitors or would create their own internet service provider. Khemiri said, 'I didn't know how aggressive Tunisie Telecom would be and I wanted to avoid a commercial war.' Thinking about his employees, Khemiri also felt that an acquisition by Tunisie Telecom would secure their employment, an important consideration in Tunisia, as 'in a start-up, anything can happen'.

Figure 1 The development of TopNet

The deal

Discussions about a deal started in August 2009 and took nearly a year to complete. TopNet's financial advisor was SWICORP who assisted the management of TopNet and the shareholders in designing the best strategy for the company. SWICORP managed the sales process and one unusual feature of the negotiations was that Khemiri never spoke directly with Tunisie Telecom. The reason he gave was that this might lead him to make emotional responses in negotiations, as TopNet was his creation and so he was very attached to the business.

Tunisie Telecom said in negotiations that they were also talking to other internet providers and not just TopNet alone. They also stated the price they were prepared to pay – 'take it or leave it' – and would not explain the basis for their valuation and the parameters they used. There was a great deal of discussion about expected market growth rates and Khemiri was very clear on his view that the market was reaching maturity in term of number of subscribers. A data room was created by TopNet and Tunisie Telecom's due diligence led them to ask for guarantees that, after the acquisition, key people would remain within the company. Other important aspects of the deal process were that:

- TopNet's CEO signed a non-compete agreement for a two-year period after the acquisition
- TopNet committed to cooperate in the exchange of information after the acquisition

- TopNet agreed to indemnify Tunisie Telecom for any loss, such as any decrease in the net assets of TopNet or any increase in TopNet liabilities.

Negotiating the deal absorbed a huge amount of Khemiri's time to the extent that, during the last six months of the process, 'I wasn't involved at all in running the (TopNet) business'. However, prior to that point, he had 'spent significant time in building management quality, structures and systems in the company, so I wasn't necessary for Tunisie Telecom'.

Commenting on negotiating the price of the acquisition, Khemiri said, that: 'When using financial indicators in discussion about a business, it is all about mathematics, but when speaking with someone face to face, it is difficult. If there is just one buyer, then the buyer knows he has a lot of power. We started with some objectives but, on the first day, we forgot about the method. In the end, we got a fair price, but it is not scientific – it's the real world.' The final contract ran to over 500 pages and 'I read it 10 times – I knew it word by word'. It was a long and very difficult process with eight months spent on the legal part and around three to four months on the price. The price itself was not the most difficult part but, by the end of the process, 'I was so tired, I wanted to sign anything'. The deal was finally completed in June 2010 at a price of TND16.6 million ($10mn).

After the acquisition

After the acquisition, Tunisie Telecom appointed a new CEO, Feriel Beji, to TopNet. All of TopNet's employees were retained (apart from Khemiri, TopNet's CEO) and, with this deal, they all gained significant job security. Since the acquisition, Tunisie Telecom has changed TopNet's CEO three times.

After the deal, it seems that Tunisie Telecom didn't really do anything to integrate the acquisition. TopNet top and middle management are not very happy with the situation and some of the best ones have now left the company. The remaining ones say they feel like 'functionairies – government employees' and often feel demotivated. Reflecting on the situation, Khemiri said that neither Tunisie Telecom nor TopNet prepared the

employees for the acquisition. He said, ‘it came as a shock to them’. The companies didn’t prepare for the next steps as ‘we didn’t know if we would make an agreement on the deal, and one morning I woke up saying “I don’t have to sell” and the next morning I woke up saying “I do have to sell”. We also didn’t know how to prepare the employees and how to announce it. After signing an agreement, we were waiting for the approval of the regulator and that only happened at the very last moment. We had an agreement that had an end date for signing: 15’ June. We signed on the very last day.’

Figure 2 Tunisian market growth rates

2009	2010	2011	2012	2013	2017
367	478	541	512	518	563
53,1%	30,2%	13,18%	–5,4%	1,2%	2,1%

However, since the acquisition, TopNet has increased its market dominance to a market share of around 60.3 per cent (see https://thd.tn/adsl-topnet-leader-du-marche/ [accessed: June 2022]) and its turnover has increased by about 300 per cent. Interestingly, Orange’s overall share of the internet service provider market has declined from 23 per cent (2010) to 11 per cent (2018). However, in the mobile market, Orange is in a different position, showing strong growth from 6 per cent (2010) to 26.9 per cent (2018), whereas Telecom Tunisie has seen its share decline from 41 per cent (2010) to 31 per cent (2018).

Despite its impressive increase in market share since the deal, TopNet customers today seem to be showing some dissatisfaction with service quality, as it is not the same as before. It is also noteworthy that it is difficult for existing customers to leave, as terminating contracts is quite complicated. Nevertheless, the TopNet brand is very strong and this helps continue attracting new customers.

After the sale of TopNet, Khemiri left the company and now spends his time investing in other start-ups as a ‘business angel’. He likes working with small teams and the

challenges of getting businesses off the ground. More recently, he has realised that just investing is not enough for him and so he has invested in several start-ups mostly in the technology area.

Questions

1 Why did Khemiri want to exit his company? Why did he choose to be acquired rather than offer shares to the market in an IPO or another exit strategy?

2 Why did Tunisie Telecom want to acquire TopNet? Was this the best expansion method?

3 Identify and comment on the type of the deal between TopNet and Tunisie Telecom (merger/acquisition, friendly/hostile, domestic/cross-border, horizontal/ vertical/ related/ unrelated).

4 Referring to the post acquisition integration matrix (see Figure 12.3), how should Tunisie Telecom integrate TopNet?

Commentary on

Part II Strategic choices The central concern of Part II has been the strategic choices available to organisations, including business strategy and models, diversification, internationalisation, new ventures and innovation, acquisitions and alliances. Although the chapters provide various rationales and evidence for these strategic choices, this book recognises that the decisions between them are often not wholly objective and rational. Indeed, the four contrasting 'strategy lenses' (introduced in the Commentary at the end of Part I) each propose very different expectations about strategic decisions. This Commentary applies the same four lenses to the issues raised in Part II, focused on strategic choices. The four lenses raise questions about how to generate the options for strategic choice, assumptions about other organisations, and what is likely to

matter in the success of various options.

Design lens

The design lens places high value on extensive information search and analysis for generating strategic options. Logical, optimal choices are important. The design lens therefore recommends you to:

- *Consider all options*: strategy choices should be made between a large initial range, with techniques such as the Ansoff growth matrix (Chapter 9.2) used to generate options.
- *Ensure fit between choice and purpose*: preferred options should be checked carefully for consistency with stakeholders' interests and goals (Chapter 6).
- *Be hard-headed*: there is nothing sacred about even long-standing parts of the organisation. As with the BCG portfolio approach (Chapter 8.8), just close or dispose of 'dogs'.

Experience lens

In this view, strategy develops incrementally based on the past history and culture of the organisation and its members. So, the set of strategic options to choose from is unlikely to be comprehensive and cultural factors can generate behaviours different from those that might be expected on a simplistically rational point of view. You should therefore:

- *Challenge standard responses*: for example, just because a particular diversification option (Chapter 9) or international entry mode (Chapter 10) has always worked before, does not mean that the same should be done again.
- *Respect cultural differences*: in integrating acquisitions (Chapter 12), cooperating with alliance partners (Chapter 12) or going international (Chapter 10), the experience lens suggests it is very important to take account of the other organisation's history and culture, as well as more objective factors.
- *Adjust competitor analysis*: if experience shapes strategy, simple analyses of competitor interaction, as sometimes in game theory (Chapter 8), may need to be adjusted in order to avoid exaggerating the likely speed of competitors' moves or making excessive assumptions about the rationality of their responses.

This commentary, therefore, reconsiders some of the issues of Part II in the light of the four strategy lenses. Note that:

- There is no suggestion here that any one of these lenses is better than the others. It is usually beneficial to explore strategic options using more than one lens, in order to get more than one point of view.
- For a deeper understanding of this Commentary, you might want to review the Part I Commentary, following Chapter 7, which provides a fuller introduction of the four lenses, plus an illustrative case.

Variety lens

The emphasis here is on the variety and spontaneity of strategic options and their possible origins in the organisational periphery. The variety lens is orientated towards innovation. Thus, the variety lens encourages you to:

- *Look beyond top management*: from a variety lens point of view, the strategies generated by top management are liable to be limited, so you should look more broadly for ideas about strategic options, for instance by using ‘open innovation’ or ‘market pull’ approaches (Chapter 11).
- *Learn from acquisitions and partners*: if the top has no monopoly of wisdom, exploring acquired units or alliance partners (Chapter 12) for underappreciated initiatives or capabilities might uncover new strategic options going far beyond what was planned in the original acquisition or alliance.
- *Expect surprises*: in an environment liable to spontaneous innovation, you should be sensitive to the potential for sudden ‘disruptive innovations’ and consider holding a strong portfolio of ‘real options’ (Chapter 11).

Discourse lens

According to this lens, the strategic options that rise to the surface will typically be shaped by the legitimate discourse of the organisation and the underlying self-interest of various managers. The discourse lens recognises the power of language. So, you should:

- *Watch your language*: attend to discursive framing of your strategic options, recognising the emotional resonance of labels such as ‘star’ and ‘dog’ in portfolio analyses, for instance (Chapter 9) and the different meanings such labels might have in various national cultures (Chapter 11).
- *Distrust others’ language*: strategic options that draw heavily on apparently legitimate or fashionable discourses such as synergy (Chapter 9), innovation and entrepreneurship (Chapter 10) or partnership and ecosystems (Chapter 12) should be probed particularly critically for shaky reasoning or self-interested motives.
- *Look out for managerial interests*: the discourse with which strategic options are framed may hide managerial self-interest, especially in regard to strategies such as unrelated diversification (Chapter 9) or aggressive acquisitions (Chapter 12) that often perform badly for shareholders but bring glory and reward to managers.

Evaluating
Processes
III
Strategy
in action
Practice
Implementing
Leading &
changing
I
Strategic
position
II
Strategy
choices

Part III

Strategy in action

This part explains:

- Criteria and techniques that can be used to evaluate organisational performance and strategic options.
- How strategies develop in organisations; in particular, the processes that may give rise to intended strategies or to emergent strategies.
- The way in which organisational structures and systems of control are important in organising for strategic success.
- The leadership and management of strategic change.
- Who strategists are and what they do in practice.

Introduction to Part III

The first two parts of the book have been concerned with how a strategist can think through and manage better the strategic position of an organisation and the strategic choices available to it. In this part of the book, the focus moves to strategy in action. It is concerned with how a strategy actually takes shape in an organisation, how it is implemented and what strategists do.

The next chapter, Chapter 13, explains ways in which managers can assess the performance of the strategic options introduced in Part II and then evaluate alternatives. It stresses both economic and non-economic performance measures and then introduces three criteria to apply in making further choices. *Suitability* asks whether a strategy addresses the key issues relating to the opportunities and constraints an organisation faces. *Acceptability* asks whether a strategy meets the expectations of stakeholders. And *feasibility* invites an explicit consideration of whether a strategy could work in practice. In each case, tools and techniques of evaluation are provided, explained and illustrated.

Chapter 14 examines two broadly different explanations *of how strategies actually develop* in organisations. Do strategies come about in organisations through a sequence of first analysis and then implementation? In other words, do strategies develop on the basis of deliberate intent? Or is

strategy more emergent, for example, on the basis of people's experience or as a result of responses to competitive action? And what are the implications of these different explanations for managing strategy?

Chapter 15 directly addresses strategy implementation. The chapter considers both '*hard*' and '*soft'* methods of implementation. Hard methods are more possible to design precisely, for example, organisational structures and systems. Soft methods are less precise and refer to issues such as cultural change, procedural justice and sensemaking. The chapter considers how successful implementation requires these both hard and soft methods to work together in order to create mutually reinforcing configurations that match the organisation's strategy.

The development of a new strategy may also require significant change for an organisation and this is the theme of Chapter 16. The *leadership of strategic change* is examined, first by acknowledging that managing change is not the same in all organisations; in other words, change context matters. The chapter then examines different approaches to managing change, including styles of managing change and the variety of levers employed to manage strategic change. The chapter concludes by revisiting the importance of context to consider how different levers might be employed in different change contexts.

This part of the book then concludes by discussing *what strategists themselves actually do.* It examines three issues in the practice of strategy. The first is: who gets included in

strategy-making activities? Participants in strategy making can be managers at all levels, with consultants and planners too. Second, what activities do strategists get involved in: these range from selling strategic issues to strategy communications. Lastly, there are the kinds of methodologies that strategists use, including strategy workshops, projects, hypothesis testing and business plans.

Chapter 13

Evaluating strategies

Key terms

acceptability

balanced scorecard

cost-benefit analysis

decision trees

Du Pont model

evaluation

feasibility

gap analysis

returns

risk

SAFE

suitability

triple bottom line

Learning outcomes

After reading this chapter you should be able to:

- Assess organisational performance using *gap analysis.*
- Assess performance outcomes using different *economic* and *effectiveness* measures.
- Assess financial performance using different techniques.

- Use SAFE (*Suitability, Acceptability, Feasibility* and *Evaluation*) to identify optimal strategic options.

13.1 Introduction

In 2022, the Chief Executive of Countryside Properties, a large house builder in the UK, left after the company failed to benefit from the UK property boom that had created huge profits for its competitors. The company's operating profits had more than halved, year on year, house completions had fallen by more than a third and £700mn was wiped off the value of its shares on the stock market. Meanwhile, competitor Persimmon reported a boom in sales. Countryside's interim CEO stated he would conduct a strategic review. In considering the future strategy for the company, he would need to address two key questions: what level of performance must be achieved, and what criteria should he use to evaluate his options?

This chapter is about assessing current organisational performance and evaluating different strategic options. It follows the focus in Part II on various strategic choices such as differentiation, diversification, internationalisation, innovation and acquisitions. Now it is time to consider how to judge these strategies. Managers have to assess how well their existing strategies are performing and evaluate alternatives. This chapter focuses on the use of systematic criteria and techniques for objective analysis – a rational 'Design' perspective (see the Strategy Lenses in the Commentary to Part 1). Chapter 13 considers the role of such formal methods within the complex processes of strategy development as a whole.

In this chapter, we first establish the actual or projected performance of an organisation, drawing upon a range of

organisational performance measures. We introduce *gap analysis* as a tool for assessing the extent to which this performance departs from desired levels and this may indicate the scale of the strategic initiatives needed to close the gap. To evaluate possible strategic initiatives, we propose four elements to allow systematic assessment. These are summarised by the acronym **SAFE**: **S***uitability,* **A***cceptability,* **F***easibility,* **E***valuation. Suitability* assesses whether a strategy addresses key strategic challenges an organisation faces, *Acceptability* determines whether a strategy meets stakeholder expectations, *Feasibility* examines its practicality and *Evaluation* synthesises these assessments for the most optimal strategy, as on their own each of the first three criteria criterion may suggest different strategies to take forwards.

Figure 13.1 organises the key elements of this chapter. Here, managers identify the extent of any gap between desired and actual or projected performance, using different methods of performance assessment, and then assess strategic options for filling any such gap. The adopted options themselves eventually feed back into performance in the future.

Figure 13.1 Evaluating strategies

13.2 Gap analysis

The opening Countryside example showed how poor organisational performance can have profound strategic implications for the strategy of an organisation. Clearly, stakeholder expectations had not been met and this led to the resignation of the CEO and the review of the business. A tool for assessing organisational performance is **Gap analysis**, which **compares actual or projected performance with desired performance.**[1] Common metrics in the for-profit sector include revenues, profits, patents created and new product launches. Metrics in the non-profit sector include clients served, service quality, waiting lists and funds raised. Gap analysis is useful for identifying performance shortfalls ('gaps') and, when involving projections, can help in anticipating future problems. The size of the gap provides a guide to the extent to which strategy needs to be changed. Figure 13.2 shows a gap analysis where the vertical axis is some measure of performance (for example, sales growth or clients served) and the horizontal axis shows time, both up to 'today' and into the future. The upper line represents the organisation's desired performance, perhaps a set of targets or the standard set by competitor organisations. The lower line represents both achieved performance to today, and projected performance based on a continuation of the existing strategy into the future (this is necessarily an estimate). In Figure 13.2, there is already a gap between achieved and desired performance showing performance is unsatisfactory and the gap is projected to become even bigger on the basis of the existing strategy. Assuming ongoing commitment to

the desired level of performance, the organisation clearly needs to adjust its existing strategy in order to close the gap.

13.2.1 Performance measures

Gap analysis relies upon measures of organisation performance but there are many techniques available with diverse organisations preferring different measures. However, they broadly fall into two categories of *economic* and *effectiveness* measures,[2] with economic ones being far more widely used. Economic measures suffer from limitations that are discussed below and which the broader effectiveness measures attempt to address.

Economic performance measures refer to direct measures of success in terms of economic outcomes. These economic outcomes have three main dimensions:

1. Performance in *product markets*: for example, sales growth or market share. For non-profit organisations, this might be growth in membership or money raised for charities. Variations in these figures may be seen as a lead indicator of a company's competitiveness in its market.
2. Accounting measures of *profitability,* such as profit margin or return on capital employed (ROCE). A useful technique for unpacking the drivers of company profitability is **the Du Pont model** (see Figure 13.3), **which dissects a company's return on capital employed (ROCE) in order to work out the components that add value to, or subtract from the whole.** It is particularly powerful in tracking changes over time and in comparison with competitor ratios. For instance, referring to

Figure 13.3 and looking at selling, general and administrative expenses, if these are increasing over time, and particularly if these seem high in relation to competitors' figures, then the profitability of the business would be improved if attention was paid to reducing these sorts of administrative costs.

3. *Financial market* measures such as movements in share price. Companies watch their share price carefully as it is a key indicator of market sentiment regarding the expected future success of an organisation. As in the opening example of Countryside Properties, the precipitate fall in the value of the company's shares showed the market's lack of confidence in the company's strategy and its CEO.

Figure 13.2 Gap analysis

Economic measures may seem objective, but they can be conflicting and need careful interpretation. Sales growth, for example, may be achieved by cutting prices, but this will mean less

profit from each sale: the profit margin falls consequently. Different performance measures, such as sales growth and profit margin, may point in different directions and so economic performance is best evaluated by more than one measure. It is also why many organisations are now looking to more comprehensive measures of effectiveness as well.

Figure 13.3 The Du Pont model

Source: T. Koller, *et al.* (2010) *Valuation*, 5th edn. Chichester: John Wiley & Sons Ltd.

Effectiveness measures refer to a broader set of performance criteria than just economic. For example, measures reflecting internal operational efficiency or measures relevant to stakeholders such as employees and external communities. Two important broad techniques are the *balanced scorecard* and the *triple bottom line*.

- The **balanced scorecard considers five perspectives on performance simultaneously in order to prevent the dominance of a single perspective**.[3] Thus, it considers (i) the financial perspective, which for a for-profit company typically means focusing upon increasing shareholder value. This can be achieved through revenue growth and productivity gains, such as cost reduction and efficiency gains. Typical measures include profitability or share-price performance; (ii) the customer perspective, as this defines how a company differentiates itself from competitors in the market. This can be assessed using measures such as customer satisfaction or product quality; (iii) the internal business perspective, focuses upon alignment between organisational processes and financial and customer perspectives. Here, productivity measures or project management measures are often used. Often, poor alignment between the internal perspective and the financial and customer perspectives leads to poor outcomes as a company intending to compete on innovation and value-added customer relationships is unlikely to do well if internal focus is upon cost reduction; (iv) the innovation and learning perspective, which assesses the employee capabilities and skills and corporate climate needed to support a strategy. Typical measures include new product introductions or employee skills so that human resources and information technology align with the other perspectives; and, finally, (v) the sustainability perspective, which assesses social and environmental measures of performance.[4] Social measures can include improving quality of life, such as health and well-being, diversity and inclusion. Typical measures of sustainability

relate to promoting environmental awareness and resource utilisation (reduce, reuse, recycle). The performance measures of each perspective can be cascaded down through the organisation to individual business units to allow overall alignment. By integrating overall financial goals with strategic and operational targets, the balanced scorecard ensures that the pursuit of short-run financial goals is not at the expense of the longer-term strategic positioning of the company.

- The **triple bottom line** **pays explicit attention to corporate social responsibility and the environment.** It assesses performance on three dimensions: (i) economic measures of performance such as sales, profits and share price; (ii) social measures, such as employee training, health and safety and contributions to the local community; and (iii) environmental measures such as pollution, recycling and wastage targets. These dimensions form the basis for KPMG's 'True Value' assessment technique[5] that identifies an organisation's material impacts to which analysts apply valuations from a comprehensive database. This can be visualised in a 'True Value Bridge' that enables managers to compare and contrast an organisation's diverse impacts, including socio-economic and environmental impacts using a common financial metric (see Figure 13.4). An example of this being operationalised is NS (Dutch Railways), which recognised not only the positive social good of providing mobility but also the negative effects on society of greenhouse emissions, water consumption and rail noise.[6] As a consequence, NS signed a sustainable energy contract so all trains would become powered by wind energy.

Most listed companies today publish sustainability reports. Dutch brewer Heineken provides a good example of a sustainability report, showing the company's standing on the Dow Jones sustainability index and listing specific social metrics for employees (reducing accident frequency, training, employee volunteering) and environmental metrics (water usage, CO2 emissions and energy consumption).[7]

Both the balanced scorecard and the triple bottom line share a view that overall effectiveness depends not only on economic performance, but on a range of factors that support the long-term prosperity of the organisation.

Figure 13.4 KPMG Value Bridge

Source: Adapted from ‘Valuing your impacts on society: how KPMG True Value can help measure and manage your inputs’, KPMG, kpmg.com/sustainability (2018) ♥ 2018 KPMG International Cooperative https://home.kpmg/be/en/home/services/sustainability-services/true-value-impactmeasurement-and-reporting.html [accessed: June 2022].

13.2.2 Performance comparisons

When considering performance, it is important to be clear about what you are measuring *against*: in other words, performance relative to what? There are three main comparisons to consider:

- *Organisational targets*: a key set of performance criteria are management’s own targets, whether expressed in terms of overall vision and mission or more specific objectives, for instance, economic outcomes such as sales growth or profitability. Investors are particularly sensitive to performance against financial criteria such as earnings (profitability) targets. Failure to meet expectations set by these targets often leads to the dismissal of the organisation’s Chief Executive, as in the example of Countryside Properties at the beginning of this chapter.[8] Performance against organisational targets can be approached via gap analysis, as in Section 13.2 above.
- *Trends over time*: investors and other stakeholders are clearly concerned about whether performance is improving or declining over time. Improvement may suggest good strategy and increasing momentum into the future. Decline may suggest poor strategy and the need for change. However, it is important to take a relevant time period for comparing trends: except in very fast changing markets, it is typically useful to examine trends

over several years in order to smooth out short-run cyclical effects, for example. Note too that performance trends are rarely sustained. It has been shown that only about one in six firms are able to outperform their sector average for as long as five years: there is a strong tendency to revert to the mean.[9] From this perspective, one predictor of future declines in performance is an extended period of good performance in preceding years.

- *Comparable organisations*: the final comparison is performance relative to other similar organisations, as in benchmarking (Section 5.4.4). These are typically competitors, as in the comparison of Countrywide and Persimmon at the beginning of this chapter. Where there are no competitors, or where it is useful to encourage new approaches, comparators can be other organisations doing equivalent things (for example, a utility company might compare its efficiency in billing and customer service with an insurance company, for non-profit organisations such as hospitals, comparison might be made between mortality rates or waiting times). For established companies, it is often possible to compare with competitors' performance using accounting measures such as profitability or sales growth. Again, the trend over an extended time period is generally useful. Similarly, it is possible for quoted companies to compare their share-price performance against that of specific competitors, or against an index of competitors in the same industry, or against the overall index for the stock market in which they are quoted (this is the stock market in which they are competing for investor support). A sustained decline in relative share price typically implies falling investor confidence in future

performance. Note that comparison against individual star performers can often be misleading. Because financial returns are typically related to risk, high performers may simply have undertaken risky strategies, which it might be unwise to imitate.[10] The results of firms that have undertaken similar strategies but finally gone bankrupt or been taken over are unavailable for comparison.

Illustration 13.1 Britain's oldest and worst retailer – WHSmith?

Going, going, gone?

Source: LH Images/Alamy Stock Photo

In 2017, UK general retailer, WHSmith, was once again voted, in a '*Which?*' annual survey of 10,000 shoppers, Britain's worst retailer. It has won this dubious honour five times in eight years for poor service, high prices and run-down shops. Once one of the most respected retailers on the high street, WHSmith is the UK's oldest retailer. It was associated with the start of the school year as it was where parents and children went to buy trendy back-to-school products, comics, DVDs and best-selling novels. However, since 2010, it has become associated with meanness, a penny-pinching approach that has seen products being stacked high and aisles crowded with bizarre over-priced stuff

such as wooden ducks. It no longer attracts browsers and serious shoppers as the stores present an unattractive shopping environment with torn and frayed carpets, messy shelves and congestion. Even the UK budget store, Poundland, is better laid out and cleaner. WHSmith now attracts last-minute customers with no time to shop around, looking for sweets and magazines to keep the family happy on long journeys. Many customers feel prices at WHSmith are outrageous and, at airport shops, they, until recently, demanded to see passengers' boarding passes so they can reclaim the VAT without passing it on.

Although keeping costs under control is understandable in a tough high street environment where book sales have been in decline along with newspapers, customers complain of a scorched earth policy and a feeling of being used and disappointed. Staff levels are cut to a minimum, with self-serving checkouts rather than a friendly face and little spent on improving the shopping experience. WHSmith, though, does seem to be targeting locations such as airports and hospitals where they can get away with high prices. They have also been attacked for offering large bars of chocolate at checkouts at bargain prices so feeding the nation's obesity problem.

A WHSmith spokesperson said: 'We serve 12 million shoppers a week and, despite a challenging retail environment, we continue to open new shops, and to maintain our presence on the UK high street.' However, sales have remained steady (see Graph 1) since 2010, and WHSmith has recently had to dispose of some stores. Maybe the bid they made in November 2018 to take over iconic US brand Barnes & Noble, renowned for very convivial spacious stores, easy chairs and coffee bars, may provide needed book expertise and scale?

Sources: S. Butler (2018) 'WH Smith rated UK's worst high street shop by Which? readers', *The Guardian,* 29 May; L. Cernik (2018) 'Worst store in Britain? Here's why I still love WH Smith', *The Guardian,* 29 May; M. Lynn '(2015) The dismal decline of WH Smith', *Management Today,* October.

Questions

1 In your view, is WHSmith a successful company?

2 What metrics do you use to support your conclusion?

WHSmith selected data

WHSmith Group and high street revenues

13.2.3 Complexities of performance analysis

Before considering strategy evaluation, we should underline the complex nature of performance analysis. We have already indicated how some measures might be contradictory in the short term at least: for example, sales growth can be obtained by reducing profit margins. Multi-dimensional measures of effectiveness such as the balanced scorecard or the triple bottom line are particularly subject to trade-offs: it is easy to see how cutting back on costly environmental protection policies could improve short-term profits.

However, there are three further sources of possible complexity. First, organisations are liable to manipulate outcomes in order to meet key performance indicators.[11] For example, organisations can defer non-urgent expenditures or book sales orders early in order to meet short-term earnings targets. Second, organisations can legitimately manage performance perceptions and expectations: they are not wholly objective and fixed. For example, CEOs frequently communicate with key investors, financial analysts and the media so as to ensure favourable interpretations of strategies and results.[12] Finally, what matters in terms of performance often changes over time. For example, measures of corporate social responsibility such as the triple bottom line have become more important in recent times and, since the financial crisis, banks have had to attend more to measures of capital adequacy to prove they are secure against bad debts.

13.3 SAFE

Gap analysis in the previous section may expose organisational underperformance, either current or anticipated. To improve the situation, initiatives will be required and the acronym SAFE is a method to identify preferred strategic options. **SAFE** stands for **S***uitability,* **A***cceptability,* **F***easibility,* **E***valuation*. See Table 13.1 for a summary.

13.3.1 Suitability

Suitability is concerned with assessing which proposed strategies address the *key opportunities and threats* **an organisation faces** through an understanding of the strategic position of an organisation: it is therefore concerned with the overall *rationale* of a strategy. A suitability analysis is likely to draw extensively from the concepts and frameworks introduced in Parts I and II of this book. However, at the most basic level, a suitability analysis involves assessing the extent to which a proposed strategy:

- exploits the *opportunities* in the environment and avoids the *threats*; and
- capitalises on the organisation's *strengths* and avoids or remedies the *weaknesses.*

Table 13.1 SAFE and key questions

The concepts and frameworks already discussed in Chapters 3 to 7 can be especially helpful in understanding suitability. Some examples are shown in Table 13.2; other frameworks and techniques from Part I could be used in equivalent ways. However, the various techniques will raise many issues. It is therefore important that the key strategic issues are identified from among all these. A major skill of a strategist is to be able to work out what really matters. Strategy is about priorities; long lists should be avoided.

Table 13.2 Suitability of strategic options in relation to strategic position

The discussions about possible strategic choices in Part II were concerned not only with understanding what choices might be available to organisations but also providing reasons why each might be considered. So, the examples in those sections also illustrate why strategies might be regarded as *suitable.* Table 13.3 summarises these points from earlier sections (particularly Chapters 9 and 12) and provides examples of reasons why strategies might be regarded as suitable. There are, however, also a number of screening techniques that can be used to assess the suitability of proposed strategies by reviewing their relative merits against key opportunities and constraints.

Ranking and screening

Here, possible strategies are assessed against key factors relating to the strategic position of the organisation and a score (or ranking) established for each option. For example, Illustration 13.2 shows

how each strategic option for Heineken either addresses, doesn't deal with, or has no effect on key strategic factors, shown by ticks, crosses and question marks. One of the advantages of this approach is that it forces a debate about the implications and impacts of specific key factors on specific strategic proposals. Ranking therefore helps overcome the unconscious biases of each individual manager.

More sophisticated approaches to ranking can assign weightings to factors in recognition that some will be of more importance in the evaluation than others. It should, however, be remembered that assigning numbers, of itself, is not a basis of evaluation; any scoring or weighting is only a reflection of the quality of the analysis and debate that goes into the scoring.

Strategic options can also be considered against a range of future scenarios (see Section 3.4) where a high degree of uncertainty exists. Suitable options are ones that make sense in terms of the various scenarios. As a result of such analysis, it may be that several strategic options need to be 'kept open', perhaps in the form of contingency plans. Or it could be that an option being considered is found to be suitable in different scenarios. Indeed, a criterion of strategy evaluation for the energy company Shell is that a chosen strategy needs to be suitable in terms of a range of different crude oil prices.

Table 13.3 Examples of suitability

One of the other advantages of screening through scenarios is that, as managers screen the possible strategies in terms of the different scenarios, they come to see which would be most suitable

in different environmental contexts. This can then sensitise managers to the need for changes in strategy, or changes in strategic emphasis, given changes in the environment.

As Chapter 5 shows, the likely bases of competitive advantage reside in the strategic resources and capabilities of an organisation. Screening for bases of competitive advantage therefore requires an analysis of how the proposed strategy is underpinned by resources and capabilities that satisfy the VRIO criteria of valuable, rare, inimitable and organisationally-supported (see Chapter 5). The various strategic options can be compared systematically against VRIO's four criteria in a simple matrix, with the options as horizontal rows and the individual VRIO criteria as columns (see Table 5.2).

Decision trees

Decision trees can also be used to assess strategic options against a list of key factors. Here options are 'eliminated' and preferred options emerge by progressively introducing requirements that must be met (such as growth, investment or diversity). Illustration 13.3 provides an example. The end point of the decision tree is a number of development opportunities. The elimination process is achieved by identifying a few key elements or criteria that possible strategies need to achieve. In Illustration 13.3 these are perceptions of market demand, level of new competitor threat and intended resource commitment. As the illustration shows, anticipating a sustained fall in market demand suggests that future strategy should rank options 1–4 more highly than options 5–8. At the second step, the higher perceived threat of new competitors would rank options 1 and 2 above 3 and 4, but a lack of willingness

to commit significant resources to the new strategy would suggest an international alliance may be the best way forward. The danger here is that the choice at each branch on the tree can tend to be simplistic. For example, as the illustration points out, answering ‘yes’ or ‘no’ to resource commitment does not allow for the wide variety of options that might exist within this strategy.

13.3.2 Acceptability

The second criterion in the SAFE framework is acceptability. **Acceptability is concerned with whether the expected performance outcomes of a proposed strategy meet the expectations of stakeholders.** These can be of three types, the ‘3 Rs’: **R***eturn,* **R***isk* and *stakeholder* **R***eactions.* It is sensible to use more than one approach in assessing the acceptability of a strategy.

Return

The first R is **returns**. These are **measures of the financial profitability and effectiveness of a strategy.** In the private sector, investors and shareholders expect a financial return on their investment. In the public sector, funders (typically government departments) are likely to measure returns in terms of the ‘value for money’ of services delivered. Attention often focuses on financial metrics of efficiency but measuring return for non-profits is notoriously difficult as there is great diversity in the sector in terms of multiple, often conflicting, stakeholder interests. Nevertheless, three types of performance metric can be used that include success in mobilising resources, staff effectiveness and progress in fulfilling

mission. The exact specification of these metrics will vary by non-profit organisation.[13]

Measures of return are a common way of assessing proposed new ventures or major projects within businesses. An assessment of the financial effectiveness of any specific strategy should be a key criterion of acceptability.

Financial analysis[14]

There are four common approaches to financial return (the first three approaches are shown in Figure 13.5 on page 412):

- *Return on capital employed (ROCE)* calculates profitability in relation to capital for a specific time period after a new strategy is in place (see Figure 13.3 for ROCE drivers). For the example in Figure 13.5(a), a ROCE of 10 per cent is anticipated by year 3. The ROCE (typically profit before interest and tax – PBIT – divided by capital employed) is a measure of the earning power of the capital resources used in implementing a particular strategic option (see Section 13.3.4 below). A similar measure is *return on invested capital (ROIC),* famously used by Michael Porter (2008) as a method to determine the extent of a company's competitive advantage. It enables comparison across companies in a particular industry to assess relative performance. Expressed as a formula, it is ROIC = Net operating profits after tax/total invested capital. For other measures of investment return, see endnote 15.[15]
- The *payback period* assesses the length of time it takes before the cumulative cash flows for a strategic option become positive.

In the example in Figure 13.5(b), the payback period is three and a half years. This measure has the virtue of simplicity and is most often used where the difficulty of forecasting is high and therefore risk is high. In such circumstances, this measure can be used to select projects or strategies that have the quickest payback. Thus, acceptable payback periods vary from industry to industry. A venture capitalist investing in a start-up may expect a fast return, whereas public infrastructure projects such as road building may be assessed over payback periods exceeding 50 years. One problem with the basic payback period method is that it assumes that forecast cash flows are equally valuable in the future, however risky or distant: €100 predicted in three years' time is given the same weight as € 100 next year. Organisations therefore often use 'discount' methods to allow for greater uncertainty in the more distant future.

- *Discounted cash flow (DCF)* is a widely used investment appraisal technique using common cash-flow forecasting techniques. Earnings are discounted the further into the future they are, to reflect future risk and the time value of money (money today is more valuable than money tomorrow). Applying the discount rate to future cashflows results in the net present value (or NPV) of the project. Where there are several projects and limited resources, the project with the best NPV should be selected. Taking the example of DCF in 13.5(c), once the cash inflows and outflows have been assessed for each of the years of a strategic option they are discounted by an appropriate cost of capital. This cost of capital (or discount rate) is the 'hurdle' that projects must exceed. In the example, the cost of capital of

10 per cent reflects the rate of return required by those providing finance for the project – shareholders and/or lenders. The projected after-tax cash flow of €2mn at the start of year 2 is equivalent to receiving €1.82mn now (€2mn multiplied by 0.91 or 1/1.10). This is the *present value* of receiving €2mn at the start of year 2 at a cost of capital of 10 per cent. Similarly, the after-tax cash flow of €5mn at the start of year 3 has a present value of €4.13mn – €5mn multiplied by 1/1.10 squared. By adding up all the present values for each year over the project's life, in this case seven years, the *net present value (NPV)* is calculated. This NPV works out at €8.78mn, which is the extra value this strategic initiative will generate during its entire lifetime. However, it would be sensible to undertake a *sensitivity analysis*, for example by assuming different levels of sales volume increases, or different costs of capital in order to establish what resulting NPV measures would be and at what point NPV falls below zero. For example, in Figure 13.5(c) a cost of capital rate of about 32 per cent would produce a zero NPV. Such sensitivity testing is, then, a way in which DCF can be used to assess risk.

- *Shareholder value analysis* (SVA) is a variation on DCF analysis in that it values the whole business rather than specific projects. It focuses on the creation of value for shareholders as measured by share price performance and flow of funds. The approach relies upon identifying the key 'value drivers' for value creation in the business such as sales growth, profit margin improvement, capital investment decisions, capital structure decisions, cost of capital, and their effect on future cash flow. It is calculated by

dividing the estimated total net value of a company based on present and future cash flows, by the value of its shares.

Illustration 13.2 'Refreshing' Heineken

Selecting the most suitable strategic option through ranking.

Dutch brewing giant Heineken, the world's third-largest brewer, faced many challenges in 2022. Before COVID, the world beer market had been slowing down with the rise of alternative beverages, tighter regulations and global economic slowdown. Craft beers had also been on the rise. Nevertheless, developing countries still offered significant growth opportunities – areas in which Heineken was already strong. Heineken was also threatened by the creation of the world's largest brewer from AB InBev's takeover of SABMiller that created the world's largest brewer (three times Heineken's size and with much higher margins). COVID had hit Heineken hard, having to cut 8,000 jobs and seeing its profits fall for the first six months of 2020 to a loss of € 297mn. However, they had now bounced back to a profit of € 1.03bn (2021) with first half sales up some 14 per cent, and strong growth in the Americas and in low or no alcohol products. Heineken's controlling family was fiercely protective of the company's heritage and believed growth and value could continue for shareholders. Nevertheless, how could Heineken 'refresh' its strategy?

Heineken could grow organically, increasing marketing at premier sports events to complement its promotion of world-class tennis at the US Open and Wimbledon – its flagship brand had faired particularly well since sponsoring the Euro 2020 football tournament. A second option might be to expand its cider and Weiss beer production and distribute globally to address new consumer tastes. Neither option, though, might be sufficient to compete against a new industry giant. Option three could be to merge with family-owned Carlsberg, the fourth largest brewer in the world. A merger would result in 40 per cent of the European market, significantly strengthen their combined Asian

presence and build on their joint venture, and achieve sourcing and operations synergies. Although Carlsberg might not be so expensive due to recent poor performance, a merger might not address the rise in beer alternatives and be acceptable to the Carlsberg family. Option four, to merge with Diageo, would give access to a wide range of liquors, spirits and whisky to complement Heineken's beers and provide opportunities in the new mixed drinks sector. However, there could be ownership concerns as Diageo was twice Heineken's size. This would be less of a problem with a fifth option, merging with US company Moulson Coors, that would play to Heineken's strengths in brewing and greatly strengthen its US presence with synergies in supply, logistics and distribution. But this would not address the market slowdown or the rise of craft brewers. Option six, therefore, might be to invest in craft brewers. Heineken could supply capital and distribution as well as brewing know-how. It would keep Heineken close to consumer trends and possibly provide new products. However, this might take time and association with Heineken might make a craft brewer immediately lose their status. It might also set back Heineken's industry-leading efforts in corporate sustainability.

The table on the adjoining page relates each strategic option to key strategic factors from a SWOT analysis (see Chapter 2.3). A tick indicates addressing favourably a strategic option, an 'x' means not addressing an option, and a '?' means its uncertain if an option is addressed. The final column sums the ticks and subtracts the 'x's to indicate a net level of option suitability that can be then ranked. Options can be further debated against the SWOT analysis and then attention can focus upon the most favoured ones in terms of acceptability and feasibility.

√ = *favourable x = unfavourable ? = uncertain A = most favourable B = possible C = unsuitable Sources*: *Business Insider,* 17 September 2015; Bloomberg, 16 September 2015; *New York Times,* 8 October 2015; www.diageo.com; www.theheinekencompany.com/about-us/company-strategy; *Wall Street Journal,* 23 September 2015.

Questions

1 Are there other strategic options or factors Heineken should consider?

2 How could you improve the ranking analysis?

3 Consider the most favoured option in terms of acceptability and feasibility criteria.

It is important to remember there are no absolute standards for good or poor return. It will differ between industries and between different stakeholders, so that shareholders might prefer a higher return, while employees might prefer higher salaries. So, it is important to establish what return is seen as acceptable by which stakeholders. There are also three further problems of financial analysis:

- *The problem of uncertainty.* Be wary of the apparent thoroughness of financial analysis. Most were developed for the purposes of investment appraisal. Therefore, they focus on discrete projects where the additional cash inflows and outflows can be predicted with relative certainty, such as a retailer opening a new store. In many strategic contexts, such assumptions are not necessarily valid as outcomes are much less certain. It is as strategy implementation proceeds that outcomes become clearer (see ‘real options’ discussion below).
- *The problem of specificity.* Financial appraisals tend to focus on direct *tangible* costs and benefits rather than the strategy more broadly. However, it is often not easy to identify such costs and benefits, or the cash flows specific to a proposed strategy, since

it may not be possible to isolate them from other ongoing business activities. Moreover, such costs and benefits may have spillover effects. For example, a new product may look unprofitable as a single project. But it may make strategic sense by enhancing the value of other products in a company's portfolio.

- *Assumptions.* Financial analysis is only as good as the assumptions built into the analysis. If assumptions about sales levels or costs are misguided, for example, then the value of the analysis is reduced, even misleading. This is one reason why sensitivity testing based on variations of assumptions is important.

Illustration 13.3 How to decide among strategy options at a family business – a decision tree analysis

At the beginning of the book, a case was described where Claudia, a junior consultant was tasked with coming up with some options for the CEO of a medium-sized family business. The business was facing new aggressive competition in its main European markets and falling demand for its products. The CEO was wondering whether now was the right time to aggressively build market share or make an acquisition in a new international market for growth, or to invest further in new product innovation. Claudia knew the firm was financially sound with a strong balance sheet, but profits were beginning to decline and the level of appetite for significant investment

wasn't clear. The CEO seemed enthusiastic at the prospect of expansion into new international markets and had even mentioned that she would be receptive to the idea of making an acquisition if the right opportunity presented itself.

In order to help the decision process, Claudia identified some key criteria that would be used to help identify appropriate strategic options, including current market growth rate, the level of threat posed by new competitors and how much resources the firm would commit to a new strategy. Using a decision tree approach (see adjoining page), Claudia was able to determine the best strategic options based on the key criteria. Also, it might help remove certain options currently being discussed that would not fit those criteria and might even give rise to other alternatives that had previously not been mentioned.

The analysis indicates that, if the CEO perceives the core market to be in decline due to falling sales and attack from competitors, then inorganic expansion overseas might be preferred strategic options (1–4) over options 1–5. As a further step, if the business was prepared to commit significant resources to the expansion, then international acquisition might be the preferred option. If perceptions of the threat of market downturn and competitor entrance are lower, then more organic options might be preferred and a more defensive marketing strategy pursued.

Despite the clarity of choice that the decision tree presents about which strategic option would be the most appropriate for the client, Claudia was concerned that the choices were perhaps a little too simplistic and didn't allow for a range of answers. She also worried that further conversations with the CEO might yield other important criteria that were not included in the analysis.

Questions

1 Try reversing the sequence of the key criteria, redraw the tree and see if this results in a different set of strat-egic outcomes?

2 Claudia subsequently found out that the CEO was also wondering about whether to expand within the same business area or to diversify into a new one. Redraw the tree with this new fourth criteria and see what 16 strategic options you generate.

Figure 13.5 Assessing profitability

(a) Return on capital employed

(b) Payback period

(c) Discounted cash flow (DCF)

Real options[16]

Many of the previous approaches value strategic initiatives on a stand-alone basis. There are, however, situations where the strategic benefits and opportunities only become clear as implementation proceeds. For example, a diversification strategy may develop in several steps: it may take many years for the success of the initial diversification move to become clear and for possible follow-up opportunities to emerge. In these circumstances, the traditional DCF

approach discussed above will tend to undervalue an initial strategic move because it does not take into account the value of options that could be opened up by the initiative going forward.[17] In pharmaceuticals, for example, many research projects fail to produce new drugs with the intended benefit. There could, however, be other outcomes of value to a failed project: the research could create valuable new knowledge or provide a 'platform' from which other products or process improvements spring. So, a strategy should be seen as a *series* of 'real' options. A 'real' option[18] is the right, but not the obligation, to undertake certain business initiatives. For instance, it might include an opportunity at a specific time to invest, expand or defer a capital investment project. Illustration 13.4 provides an example. A real options approach to evaluation, therefore, typically increases the expected value of a project because it adds the expected value of possible future options created by that project going forward. There are four main benefits of this approach:

- *Bringing strategic and financial evaluation closer together.* Arguably, it provides a clearer understanding of both strategic and financial return and risk of a strategy by examining each step (option) separately.
- *Valuing emerging options.* In taking such an approach, it allows a value to be placed on new options made available by the initial strategic decision. The value of the first step is increased by the opportunities that it opens up.
- *Coping with uncertainty.* Advocates of a real options approach argue it provides an alternative to profitability analyses that requires managers to make assumptions about future conditions

that may well not be realistic. As such, it can be linked into ways of analysing uncertain futures such as scenario analysis (Section 3.4). Applying a real options approach provides managers with greater flexibility and enables them to defer irreversible decisions as far as possible because the passage of time will clarify expected returns – even to the extent that apparently unfavourable strategies might prove viable at a later date.

- *Offsetting conservatism.* One problem with financial analyses such as DCF is that high hurdle or discount rates set to reflect risk and uncertainty mean that ambitious but uncertain projects (and strategies) tend not to receive support. The real options approach, on the other hand, tends to value higher more ambitious strategies. There have, therefore, been calls to employ real options together with more traditional financial evaluation such as DCF. In effect, DCF provides the cautionary view and real options the more optimistic view (see Illustration 13.4).

Note that a real options approach is more useful where a strategy can be structured in the form of options – for example, where there are stages, as in pharmaceutical development – such that each stage gives the possibility of abandoning or deferring going forward. It would not give the same advantages of flexibility to a project where major capital outlay was required at the beginning.

Risk

The second R is the *risk* an organisation faces in pursuing a strategy. **Risk concerns the extent to which strategic outcomes**

are unpredictable, especially with regard to possible negative outcomes. Risk is therefore linked with outcome, return, so that a higher risk is generally associated with the chances of a higher return and a lower risk with lower return – the so-called 'risk-return tradeoff'. The reason is low risk opportunities tend to attract many competitors, so driving down returns. Risk can be high for organisations with major long-term programmes of innovation, or where high levels of uncertainty exist about key issues in the environment, or where there are high levels of public concern about new developments – such as genetically modified crops.[19] A key issue is to establish the acceptable level of risk for the organisation. Is the organisation prepared to 'bet the company' on a single strategic initiative, risking total destruction, or does it prefer a more cautious approach of maintaining several less unpredictable and lower-stakes initiatives? Formal *risk assessments* are often incorporated into business plans as well as the investment appraisals of major projects. Chosen strategies should be within the limits of acceptable risk for the organisation. Young entrepreneurs may have a higher tolerance for risk than established family businesses, for example. Importantly, risks other than ones with immediate financial impact should be included, such as risk to corporate reputation or brand image. Developing a good understanding of an organisation's strategic position (Part I of this book) is at the core of good risk assessment. However, the following tools can also be helpful in a risk assessment.

Illustration 13.4 Deciding about sustainable energy under high uncertainty A real options approach

to deciding about wind farms in Serbia.

Concerns about global warming and environmental sustainability have led Serbia's energy regulator to increase investment in green energy so renewable energy rises as a proportion of total national energy production, from 21 per cent to 27 per cent.

In an analysis of wind farms, research by Loncar and colleagues recognises that Serbia is at an early stage of development with opportunities, such a national renewable energy strategy, lack of large competitors, a well-maintained energy grid and subsidies such as investment and tax benefits. However, there are many macro risks including weather volatility, environmental noise, animal deaths, the visual effect on the landscape, government instability, changes in legislation, fluctuations in macro-economic factors such as exchange rates, interest rates and inflation and a high corruption index. There are also financial risks such as accessing capital and keeping debt under control; market risks from increasing numbers of competitors and falling electricity prices; implementation risks including problems of construction and grid integration due to site access difficulties; and operational risks with unproven technologies.

Loncar, *et al.* performed a discounted cashflow analysis on a 15 MW wind farm project over 25 years. Taking into account 12 years of government-subsidised prices, 6 years of premiums and a further 7 years at market rates, assuming electricity prices would rise at 2 per cent per year, and using two sets of discount rates (8 per cent for the first 12 years and 12 per cent thereafter), and a risk free rate of 4 per cent (Eurozone 10-year government benchmark bond yield) implementation costs and income could be discounted to provide a net present value (NPV). Containing 37 assumptions, the model estimated a NPV of €1.8mn, a payback period of 16 years and a profitability index showing for every €1 invested the wind farm would only earn €0.074. The certainty that the NPV payback from the windfarm would be greater than zero was only 55 per cent, which does not inspire confidence, especially with highly uncertain future cashflows.

Loncar, *et al.* then used a real options method to examine the same data. Using a sequential approach after initial investment, gave options at two years of: (1) **expand** (if a favourable market response); (2) **abandon** the business and sell off assets (if negative outcomes); (3) **keep the option open**. Further options after 12 years included: (1) repower the wind farm with newer more efficient equipment; (2) contract or shrink capacity; (3) abandon or sell the business; or (4) keep the business running. Loncar, *et al.* calculated a binominal lattice model to show option value at key decision points, based on underlying asset value, implementation costs, time to maturity, volatility of project returns, risk-free rate and opportunity costs. Not all options were positive, but the analysis revealed it would be best to invest at the beginning, expand to year 3 and then contract in year 13. The certainty that this option would produce a NPV return greater than zero, was 100 per cent. In addition, even having determined this optimal path, management would retain the opportunity to steer a different course and react quickly if cashflows did not meet expectations.

Compared to the DCF analysis, the real options analysis revealed lower risk and higher returns for the wind farm. On that basis the investment in the wind farm would be a reasonable decision. The real options approach justified opportunities for renewable energy that a standard financial approach would have neglected.

For further details, see D. Loncar, I. Milovanovic, B. Rakic and T. Radjenovic (2017) ‘Compound real options valuation of renewable energy projects: The case of a wind farm in Serbia’, *Renewable and Sustainable Energy Reviews*, vol 75, pp.354–67

Questions

1 Why is there a difference in predicted net present value outcome between the DCF and real options approaches to assessing a new wind farm in Serbia?

2 For strategists, when might a real options model assessment of a strategic initiative be suitable?

Sensitivity analysis[20]

Sometimes referred to as *what-if* analysis, sensitivity analysis allows each of the important assumptions underlying a particular strategy to be questioned and challenged. In particular, it tests how sensitive the predicted performance outcome (e.g., profit) is to each of these assumptions. For example, the key assumptions underlying a strategy might be that market demand will grow by 5 per cent a year, or that a new product will achieve a given sales level, or that certain expensive machines will operate at 90 per cent loading. Sensitivity analysis asks what would be the effect on performance (for example, profitability) of variations on these assumptions. For example, if market demand grew at only 1 per cent, or by as much as 10 per cent, would either of these extremes alter the decision to pursue that strategy? This can help develop a clearer picture of the risks of making particular strategic decisions and the degree of confidence managers might have in a given decision.

Financial risk[21]

Financial risk refers to the possibility that the organisation may not be able to meet the key financial obligations necessary for survival. Managers need to ensure that strategies meet acceptable levels of financial risk. Two key measures are important here.

First, there is the level of *gearing,* the amount of debt the company has relative to its equity. Strategies that increase the gearing (or ‘leverage’) of a company also raise the level of financial risk. This is because interest payments on debt are mandatory and inflexible: if performance dips and the interest cannot be paid, the company risks bankruptcy.

A second kind of financial risk measure relates to an organisation’s *liquidity.* Liquidity refers to the amount of liquid assets (typically cash) that is available to pay immediate bills. Many businesses fail not because they are inherently unprofitable, but because of a lack of liquid assets, whether their own or obtained through short-term loans. For example, a small manufacturer with a rapid growth strategy may be tempted to take on lots of orders, but then find that they have to pay their suppliers for the raw materials before they actually receive the payments for the goods they have produced. During the COVID pandemic, some universities struggled to maintain their liquidity as research income and overseas student numbers temporarily fell, leading to the prospect of forced mergers with stronger institutions.[22] Ultimately, an organisation that cannot pay its bills risks bankruptcy.

Break-even analysis

Break-even analysis[23] is a simple and widely used approach that allows variations in assumptions about key variables in a strategy to be examined. It demonstrates at what point in terms of revenue the business will recover its fixed and variable costs and therefore break even. For example, if a company is thinking of selling a new product priced to retailers at €8, it will need to take into account its fixed

costs of manufacturing of €500,000 and the contribution to profit from each sale of €4.90 (this is the sale price of €8 minus variable costs of €3.10). Using the formula: **Break-even point (units) = fixed costs divided by contribution to profit (price of the produce minus the costs of making the product)** This means the breakeven point will be 102,040 units.

Break-even analysis can therefore be used to assess the risks associated with different price and cost structures of strategies.

Cost-benefit analysis[24]

One type of analysis that links both costs and benefits is **cost-benefit analysis** **(CBA). It is often used to determine the strengths and weaknesses of different strategic alternatives and may also be the basis for comparing courses of action.** It also recognises that profit measures may be too narrow an interpretation of return. This is particularly so in non-profit organisations where social goods are of prime importance. For instance, should a new airport be constructed? Should a hospital be closed?

The cost-benefit concept suggests that a money value should be put on all the costs and benefits of a strategy, including tangible and intangible returns to people and organisations other than the one 'sponsoring' the project or strategy. For example, on the benefits side, health economists have invented the concept of quality-adjusted-life-year (QALY), estimated by the years of life remaining for a patient following a particular treatment and weighting this with a quality-of-life score (1.0 = full health, 0.0 = death). This kind of analysis enables calculating the benefit net of costs from health

interventions so that managers can choose those which maximise benefits from limited healthcare resources. Of course, in practice, monetary valuation is often difficult.[25] However, cost-benefit's major advantage is forcing managers to be explicit about the various factors that influence strategic choice. Even if people disagree on the numbers that should be assigned to particular costs and benefits, at least they can argue their case on common ground and compare the merits of the various arguments.

Reaction of stakeholders

The third R is the likely *reaction* of stakeholders to a proposed strategy. Section 6.2.3 showed how *stakeholder mapping* can be used to understand the political context and consider the political agenda in an organisation. It also showed how stakeholder mapping can be used to consider the likely reactions of stakeholders to new strategies and thus evaluate the acceptability of a strategy. There are many situations where stakeholder reactions could be crucial. Chapter 6 covers a range of stakeholders but the following show how they may evaluate strategy differently. For example:

- *Owners* (e.g., shareholders, including private individuals as well as investment funds, venture capitalists, private equity, family owners, the state) will have financial expectations to be met so that a proposed strategy that might reduce profitability or dilute their voting power is likely to be unacceptable.
- *Bankers* and other providers of interest-bearing loans are concerned about the *risk* attached to their loans and the competence with which this is managed. The extent to which a proposed strategy could affect the capital structure of the

company could be a concern if, for instance, it would increase the gearing ratio (of debt to equity), which indicates how sensitive the company's solvency is to changes in its profit position. Similarly, a reduction in interest cover that shows the extent to which profits can cover interest payment, would be of concern to bankers as would be changes in a company's *liquidity,* as deterioration may mean the need for additional loans and a change in the company's risk profile. So, a key question is: how will the proposed strategy affect liquidity?

- *Government agencies and regulators* are important stakeholders in industries such as telecommunications, financial services, pharmaceuticals and power. They may have what amounts to decision-making powers over aspects of an organisation's strategy, such as price or geographic expansion.
- *Employees and unions and local community* may resist strategic moves such as relocation, outsourcing or divestment if they see them as likely to result in job losses. Matters of business ethics and social responsibility were discussed in Section 6.4.
- *Customers* may also object to a strategy and switch their business to a competitor. For example, a new business model, such as marketing online, might run the risk of a backlash from existing retail channels, which could jeopardise the success of the strategy.

Overall, there is a need to be conscious of the impact on the various stakeholders of the strategic options being considered. Managers also need to understand how the capability to meet the varied expectations of stakeholders could enable the success of

some strategies while limiting the ability of an organisation to succeed with other strategies.

13.3.3 Feasibility

Feasibility is concerned with whether a strategy could work in practice: in other words, whether an organisation has the capacity to deliver a strategy (see Chapter 15 Implementing strategy). An assessment of feasibility is likely to involve two key questions: (a) do the resources and capabilities currently exist to implement a strategy effectively? And (b) if not, can they be obtained? These questions can be applied to any resource area that has a bearing on the viability of a proposed strategy. Here, however, the focus is on three areas: finance, people (and their skills) and the importance of resource integration.

Financial feasibility

A central issue in considering a proposed strategy is the funding required for it. It is therefore important to forecast the *cash flow*[26] implications of the strategy. The need is to identify the cash required for a strategy, the cash generated by following the strategy and the timing of any new funding requirements. This then informs consideration of the likely sources for obtaining funds.

Managers need to be familiar with different sources of funds as well as the advantages and drawbacks of these. This is well explained in standard financial texts.[27] This is not only a matter of the feasibility of a strategy, but also its acceptability to different stakeholders, not least those providing the funds. Decisions on

which funding sources to use will also be influenced by the current financial situation of the organisation such as ownership (e.g., whether the business is privately held or publicly quoted) and by the overall corporate goals and strategic priorities of the organisation. For example, there will be different financial needs if a business is seeking rapid growth by acquisition compared with if it is seeking to consolidate its past performance.

A useful way of considering funding is in terms of which financial strategies might be needed for different 'phases' of the life cycle of a business (as opposed to an industry life cycle). The following describe each life-cycle stage and funding implications:

- *Start-up businesses*[28] are high-risk businesses. They are at the beginning of their life cycle and are not yet established in their markets; moreover, they are likely to require substantial investment. A stand-alone business in this situation might, for example, seek to finance such growth from specialists in this kind of investment, such as venture capitalists who, themselves, seek to offset risk by having a portfolio of such investments. Schemes for private investors (so-called 'business angels') have also become popular. Providers of such funds are, however, likely to be demanding, given the high business risk. Thus, venture capitalists or business angels typically require a high proportion of the equity ownership in exchange for even quite small injections of funds.
- *Growth businesses* may remain in a volatile and highly competitive market position. The degree of business risk may therefore remain high, as will the cost of capital in such circumstances. However, if a business in this phase has begun

to establish itself in its markets, perhaps as a market leader in a growing market, then the cost of capital may be lower. In either case, since the main attractions to investors here are the product or business concept and the prospect of future earnings, equity capital is likely to be appropriate, perhaps by public flotation.

- *Mature businesses* are those operating in mature markets and the likelihood is that funding requirements will decline. If a business has achieved a strong competitive position with a high market share, it should be generating regular and substantial surpluses. Here the business risk is lower and the opportunity for retained earnings is high. In these circumstances, if funding is required, it may make sense to raise this through debt capital as well as equity, since reliable returns can be used to service such debt. Provided increased debt (*gearing* or *leverage*) does not lead to an unacceptable level of risk, this cheaper debt funding will in fact increase the residual profits achieved by a company.
- *Declining businesses* are likely to find it difficult to attract equity finance. However, borrowing may be possible if secured against residual assets in the business. At this stage, it is likely that the emphasis in the business will be on cost cutting, and it could well be that the cash flows from such businesses are quite strong. Risk is medium, especially if decline looks to be gradual. However, there is the chance of sudden shake-out with battles for survival.

People and skills

Chapter 5 showed how organisations that achieve sustainable competitive advantage may do so on the basis of resources and capabilities that are embedded in the skills, knowledge and experience of people in that organisation. Indeed, ultimately the success of a strategy will likely depend on how it is delivered by people in the organisation. These could be managers but they could also be more junior people in the organisation who are nonetheless critical to a strategy, for example as the frontline contact with customers. Three questions arise: do people in the organisation currently have the competences to deliver a proposed strategy? Are the systems to support those people fit for the strategy? If not, can the competences be obtained or developed?

The first step here is the same as suggested in Section 13.3.1 for the screening for competitive advantage. The need is to identify the key resources and capabilities underpinning a proposed strategy, but specifically in terms of the people and skills required. The second step is to determine if these exist in the organisation. It could be, of course, that the proposed strategy is built on the argument that they do. If so, how realistic is this? Or it could be that the assumption is that these can be obtained or developed. Again, is this realistic?

Many of the issues of feasibility in relation to the structures and systems to support such competence development and people are addressed in Chapter 15 on implementing and Chapter 16 on leading strategic change. Other critical questions that need to be considered include:[29]

- *Work organisation.* Will changes in work content and priority-setting significantly alter the orientation of people's jobs? Will managers need to think differently about the tasks that need to

be done? What are the critical criteria for effectiveness needed? Are these different from current requirements?

- *Rewards.* How will people need to be incentivised? Will people's career aspirations be affected? How will any significant shifts in power, influence and credibility need to be rewarded and recognised?
- *Relationships.* Will interactions between key people need to change? What are the consequences for the levels of trust, task competence and values-congruence? Will conflict and political rivalry be likely?
- *Training and development.* Are current training and mentoring systems appropriate? It may be necessary to take into account the balance between the need to ensure the successful delivery of strategy in the short term and the required future development of people's capabilities.
- *Recruitment and promotion.* Given these issues, will new people need to be recruited into the organisation, or can talent be promoted and supported from below?

13.3.4 Evaluation

The final element of SAFE is evaluation. **Evaluation is the process of identifying strategies that pass all the criteria of suitability, acceptability and feasibility.** This is an important stage in the selection process as strategies that may appear excellent under one criteria may fail under another. To take into account there may be conflicting conclusions, there needs to be a synthesis of the strategies selected from the analysis of suitability, acceptability and

feasibility, so that the chosen strategy works for all. This often means that strategies that seemed superior earlier on in the process at the suitability stage may either drop out or require significant adjustment to continue. Often, the chosen strategy is less about what is ‘best’, and more about what is possible.

Four qualifications

There are four qualifications that need to be made about the evaluation process:

- *Management judgement.* Conflicting conclusions can arise from the application of the criteria of suitability, acceptability and feasibility and it is therefore important to remember that the criteria discussed here are useful in helping think through strategic options but are not a replacement for management judgement. Managers faced with a strategy they see as suitable, but which key stakeholders object to, have to rely on their own judgement on the best course of action, but this should be better informed through the analysis and evaluation they have undertaken.
- *Consistency between the different elements of a strategy.* It should be clear from the chapters in Part II that there are several elements of a strategy, so an important question is whether the component parts work together as a ‘package’. So, *competitive strategy* (such as low cost or differentiation), strategy *direction* (such as product development or diversification) and *method*s of pursuing strategies (such as organic development, acquisition or alliances) need to be considered as a whole and be consistent. There are dangers if

they are not. For example, suppose an organisation wishes to develop a differentiation strategy by building on its capabilities developed over many years to develop new products or services within a market it knows well. There may be dangers in looking to develop those new products through acquiring other businesses which might have very different capabilities that are incompatible with the strengths of the business.

- *The implementation and development of strategies* may throw up issues that might make organisations reconsider whether particular strategic options are, in fact, feasible or uncover factors that change views on the suitability or acceptability of a strategy. This may lead to a reshaping, or even abandoning, of strategic options. It therefore needs to be recognised that, in practice, strategy evaluation may take place through implementation, or at least partial implementation. This is another reason why experimentation, low-cost probes and real options evaluation may make sense.
- *Strategy development in practice.* More generally, it should not be assumed that the careful and systematic evaluation of strategy is necessarily the norm in organisations. Strat-egies may develop in other ways. This is the subject of Chapter 14, which follows. The final chapter, Chapter 17, also explains what managers actually do in managing strategic issues.

Thinking Differently

Misrepresenting strategic projects By 2022, the UK's high-speed rail link, HS2, originally estimated to cost £56bn (€67bn) in 2015, was estimated to cost around £106bn (€ 126bn).

Some fear HS2 will become a black hole for public finances. What roles do financials play in strategy evaluation and are they accurate representations of value, or untrustworthy. Cost-benefit analysis, which quantifies all the pros and cons of the strategic project, often underlies investment cases. However, recent research into more than 2,000 public projects has shown that costs are systematically underestimated.[30] Indeed, research into mega-strategic projects such as the German Berlin to Hamburg MAGLEV train, Hong Kong's airport and China's Quinling tunnel suggests many underperform badly with large cost overruns and lower than predicted revenue.[31] For example, the £4.7bn (€ 5.6bn) England to France Channel Tunnel had cost overruns of 80 per cent and less than half projected revenues. Millions in debt were written off and the UK may have been financially better off without it. Retrospectively, commentators often say strategic project figures are seriously flawed, reflecting over-optimism and even lies.

While blamed upon external factors such as unexpected events, stakeholder actions or regulatory constraints, underperformance may be due to *strategic misrepresentation* that distorts the resource allocation process. It exists as persistent budget overruns and cannot be blamed on 'optimism bias' or individual self-deception. It is deliberately designed to deceive others.

While CEOs communicate to ensure favourable interpretations of strategic initiatives, *strategic misrepresentation* is a deliberate distortion of financials based on a rosy future

and budgets that are always underestimated, to mislead investors to buy-in.[32] Once deceived into committing substantial funds, budgets escalate and investors are locked in, with no chance of getting a return unless the project is completed.

Financial figures appear attractively concrete and precise. But be careful that financials are not being used to deceive stakeholders into supporting strategic projects. Make sure that cost estimates are improved through better data, independent audits and performance incentives.[33] Look more closely at the fundamental strategic attractiveness of the strategic option to avoid another project ‘failure’.

Questions

How can you minimise misrepresentation of numbers in a strategy investment case?

Key takeaways

- To understand the extent to which achieved or projected performance diverges from desired performance, and the scale of the strategic initiatives required to close the gap, use *Gap analysis*.
- To assess organisational performance examine both *economic* performance and overall organisational *effectiveness.*
- To evaluate organisational strategies, use **SAFE**: *suitability* to assess strategy against organisational opportunities and threats, *acceptability* to evaluate key stakeholders, *feasibility* to identify the capacity for implementation and *evaluation* to determine whether strategies meet all criteria.
- To determine the *suitability* of strategic options, use ranking, screening through scenarios and decision tree analyses.
- To consider the *acceptability* of a strategy, take into account *Return (ROCE, payback, DCF, SVA cost benefit, real options analyses), Risk (sensitivity analysis and financial risk)* and stakeholder reactions (stakeholder mapping).
- To work out the *feasibility* of a strategy, consider its financial viability and the need for key resources and capabilities throughout the business life cycle.

Work assignments

✱ Denotes more advanced work assignments.

* Denotes case study in the *Text and Case* edition.

13.1 Identify a quoted company (perhaps a company that you are interested in working for) and assess its share-price performance over time relative to relevant national stock-market indices (e.g., S&P 500 for the US, CAC 40 for France or FTSE 100 for the UK) and close competitors. (Sites such as Yahoo Finance or MSN.Money provide relevant data for free.)

13.2 Undertake a ranking analysis of the choices available to ITV or an organisation of your choice similar to that shown in Illustration 13.2.

13.3 Using the criteria of suitability, acceptability and feasibility, undertake an evaluation of the strategic options that might exist for ITV, Mexican NTOs*, Grand Strategies in Vision or an organisation of your choice.

13.4 Undertake a risk assessment to inform the evaluation of strategic options for an organisation of your choice.

13.5 Write an executive report on how sources of funding need to be related to the nature of an industry and the types of strategies that an organisation is pursuing.

13.6* Using examples from your answer to previous assignments, make a critical appraisal of the statement that 'Strategic choice is, in the end, a highly subjective matter. It is dangerous to believe that, in reality, analytical techniques will ever change this situation'. Refer to the commentary at the end of Part II of the book.

Integrative assignment

13.7* Explain how the SAFE criteria might differ between public- and private-sector organisations. Show how this relates to both the nature of the business environment (Chapter 3) and the expectations of stakeholders (Chapter 6).

Recommended key readings

- Readers may wish to consult one or more standard texts on finance. For example: G. Arnold and D. Lewis (2019) *Corporate Financial Management,* 6th edition, Financial Times Prentice Hall; P. Atrill (2020) *Financial Management for Decision Makers*, 9th edition, Pearson.
- R.S. Kaplan and D.P. Norton examine the link between performance measurement and strategic management in 'Transforming the balanced scorecard from performance measurement to strategic management: Part I', *Accounting Horizons,* vol. 15, no., 1 March (2001), pp. 87–104.
- For a review of a wide range of tools and techniques in strategic management, including those related to strategy evaluation, see T. Vuorinen, H. Hakala, M. Kohtamaki and K. Uusitalo (2017) 'Mapping the landscape of strategy tools: a review on strategy tools published in leading journals within the past 25 years', *Long Range Planning*, http://dx.doi.org/10.1016/j.lrp.2017.06.005 [accessed: June 2022].

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Case example ITV: DIY, buy or ally?

Duncan Angwin

ITV is the UK's largest commercial broadcaster and second only in size to the BBC, a public-sector organisation. However, its performance has been static since 2004 with its share price in 2021 being identical at 124p and showing significant decline in 2022. Reasons for the poor performance are well-known, with continuous viewer defections to pay-TV platforms and online, and being tightly coupled with a cyclical advertising market. Although the COVID pandemic resulted in lockdowns that encouraged a rise in TV viewings, as the lockdowns eased, viewings reverted to former levels, although subscription video viewings remained high. It seems ITV management had done a lot of work over the years to little effect and now are in need of a new strategy.

ITV produces creative content and broadcasting for different audience-targeted channels. Capitalised at £4.8bn (€5.7bn; $6.5bn) the main source of ITV's revenue came from advertisers buying slots to air their advertisements on its channels. Revenues had fallen from £3.308bn (2019) to £2.781bn (2020), a 16 per cent decline, and pre-tax profits (EBITDA) of £573mn, were some 21 per cent lower than the previous year of £729mn (2019), due to the COVID pandemic. ITV was now facing challenges. The television advertising market had become saturated, with just 20 per cent of the market, and online media was now accounting for 66 per cent (2021) as viewing habits among the younger generation were changing and the pandemic had seemed to have encouraged greater and sustained online viewing. There was also the possibility of changes to UK legislation. ITV needed to develop a strategy to address these issues.

ITV's market position

ITV had gained its position as the UK's largest commercial broadcaster through a unique blend of content, broadcasting reach and advertising power (see Figure 1).

As an integrated producer broadcaster, ITV created value from world-class content that it developed, owned and distributed around the world. The scale of its free and pay platforms and its £1bn annual investment in its programme budget attracted commercial

audiences that drove its advertising revenue. ITV had increased its lead over its main competitors and, although it was hit hard by the pandemic, advertising revenues bounced back strongly in 2020 with its biggest ever month with the Euro 2020 football tournament and the return of the hugely popular Love Island. Nonetheless, the outlook remains uncertain.

ITV attributed its success to the provision of high-quality content as it attracted a high volume of viewers and this enticed advertisers to place their adverts on their channels. Some of ITV's drama and reality shows were already more popular than the BBC with *Downton Abbey* beating *Sherlock* and *Doctor Who*.

Figure 1 Leading TV broadcasters in the UK 2020 by audience share

(Source: www.statista.com) It also invested significantly in acquiring intellectual property rights and financed productions on and off ITV to gain global distribution rights. As the UK's biggest marketing platform, its channels also enabled it to showcase its own content that could then be sold internationally. As the demand for proven content continued to grow, ITV has been diversifying and driving new revenue streams.

ITV had developed its own online platform in 2007 called ITV player, now called ITV Hub. Although it had attracted viewers, it's premium service Hub + has been rather

unsuccessful, being ranked just seventh in the UK in 2020 with around 0.5mn streaming app subscribers, a long way behind BBC iPlayer in first position with around 25mn, Netflix in second position with around 13.5mn and Amazon Prime Video with around 7.75mn subscribers. ITV Hub, its free service, has at least 30mn registered users.

As well as developing its online and pay revenue, ITV built a global network in the development, production and distribution of content. Through investment in creative pipeline and strategic acquisitions in key creative markets, such as the acquisition of Talpa Media B.V. for £796mn that produced *The Voice*, *I Love My Country* and *Dating in the Dark,* it was building scale in its international content business, exploiting programmes and formats that travel. At the same time, ITV continued to acquire production companies in the UK including a majority stake in World Productions in 2017 that created the BBC hit series *Line of Duty*.

ITV's resources and capabilities ITV's strategic assets were high-quality content (ITV Studios), brand, excellent creative, commercial and operational people. In terms of financial performance, revenue from ITV studios had increased from £554mn (2010) to £1,922 (2019) falling only in 2020 to £1,370.

This strong upward trajectory was driven through purchased international content and organic productions. Shows such as *Love Island*, *The Night Stalker*, and *Vera* all did well as did *Vigil*, produced for the BBC, *Physical* for Apple TV+ and *Snowpiercer* for Netflix. International distribution and pay TV also continued to grow. ITV studios still generated a very significant part of total revenue (42 per cent), down from 47 per cent the previous year, with the majority of income flowing from advertising revenue, which grew from 46 per cent to 48 per cent of the total in 2020. These supported a strong balance sheet that generated free cash flow of £459mn (2020), up from £404mn the previous year.

Figure 2 ITV Revenue breakdown.

	2020 (£mn)	2019 (£mn)
ITV studios (UK)	535	725
ITV studios (USA)	234	271
ITV studios (international)	343	508
Global formats and distribution	258	318
TOTAL ITV STUDIOS	1,370	1,822
Total advertising revenue	1,577	1,768
Direct to consumer	87	84
SDN	73	69
Other	153	142
TOTAL BROADCAST	1,890	2063
TOTAL REVENUE	3,260	3,885

Source: ITV annual report and accounts (2021) In terms of other resources, ITV owned a large content library of 40,000 hours and operated 8 network channels, more than any other UK commercial network. Its strong financial resources and large viewing numbers gave it considerable power in winning licences to show live functions and sports events. Investing in a portfolio of channels and digital assets to reach all demographics also extended the brand. Human resources were supported through training and development.

ITV had world-class production capabilities and it owned several production companies and studios. ITV continuously improved its output and quality, providing 60 per cent of ITV's total channel broadcasting output. it also purchased content from external studios. Content, advertising and broadcasting were of central importance to ITV, giving it advantages over competitors such as the BBC with strong content and broadcasting variety but no advertising and Netflix with much less content and only one medium of distribution.

Online threat

Different entertainment platforms such as online TV and the internet had been growing rapidly in the UK. The traditional TV broadcasting industry had been growing at a per annum growth rate of 3.1 per cent, before the COVID pandemic, but the market was becoming saturated and slowing down. Online TV viewing had grown very rapidly through increasing by 230 per cent in three years (2017–20), stimulated by online video-on-demand (VOD) libraries, such as Netflix, the world's largest VOD provider, with well over 200mn subscribers. Netflix's annual revenue amounted to $24.9bn (2020), with $4.5bn in profits, allowing around $17bn on content spend and the company was capitalised at $274bn. Other large online providers include Amazon Prime with 175mn users, Apple TV+ and Disney+ (who acquired Hulu 2019) has recently moved into the market as well.

By 2015, the internet (43.9 per cent market share), had overtaken television (27.6 per cent) as the biggest advertising platform in the UK. ITV lagged behind in the online content delivery business. There were many complaints and poor reviews about the ITV Hub platform and customers were choosing competing platforms such as BBC iPlayer. This was attributed to technical issues with the catch-up TV platform, called ITV player, and, to some extent, the advertisements shown while streaming the content. BBC's catch-up TV was superior and so ITV re-launched the ITV player as ITV Hub with new features: live TV along with programme catch-up could be aired on all ITV channels so that they could be streamed for 30 days from the day of broadcasting. However, there was strong competition with new platforms from Netflix, Amazon Prime and HBO Go gaining in popularity among viewers in the 15–35 age group. ITV therefore offered advertisement-free content, for a monthly subscription fee, on a new platform, Hub+, aimed at attracting viewers who were deterred by earlier ITV online services that had advertisements. While uptake was low, the pandemic helped drive online advertising for ITV with income surging 30 per cent in the first nine months of 2020 to £1.3bn.

ITV Hub and Hub+ are only for UK audiences whereas Amazon Prime and Netflix already operate worldwide in a global online VOD market that is a very important source of growth in the future. However, the market is highly competitive and many VOD operators struggle to obtain large volumes of superior content and all of them were signing deals for specific shows. For instance, before being acquired by Disney, Hulu signed up for the rights to distribute Seinfeld for $160mn. Alliances and joint ventures are common in the industry and have the attraction of being relatively cheap to set up, measured in millions of dollars rather than billions, although very complex and time-consuming to negotiate, with the risk of termination along the way. In late 2021, ITV's CEO McCall recognised that the economics behind acquisitions might not be attractive to ITV and so is now focusing aggressively on pursuing talent deals, such as backing Nicola Shindler of *It's a sin*, to launch her Quay Street Productions banner with ITV Studios.

Regulatory changes

Favourable government policies towards new internet VOD platforms in the UK were one of the major influences on the broadcasting industry. In addition, there was an active public debate about whether legislation concerning the BBC licence fee should be changed. The BBC was entirely funded by the public through the licence fee. If the government decided to end its charter, the BBC would be forced to compete with commercial broadcasters such as ITV and Channel 5. The impact would probably be worse for Channel 5 as a much smaller entity than ITV, although ITV would also be seriously challenged in terms of competing for advertising revenue. Due to the BBC's power in the broadcasting market, prospective changes could impact the whole broadcasting industry, and ITV would probably lose its place as the biggest commercial platform in the UK.

In addition, the government was also considering whether to privatise Channel 4, through a public offering of shares or even sale to another company. Analysts estimated this would bring around £2bn into the government's coffers which would help bring down some of the national debt, now much inflated by the COVID pandemic. Channel 4 had a good reputation for its content quality, had its own content library, recording studios and broadcasting capability and would be attractive to other media operators. Although Channel 4 funded itself through advertising, if the government decided to sell it, this would have major implications for the way its business was run. Channel 4 executives were said to be concerned that the organisation's ability to take creative risks would be undermined, such that making programmes for unprofitable small audiences that reflected the country's cultural diversity would no longer be viable. As a commercial entity, it would have to make a profit.

Table 1 ITV SWOT analysis

Future strategy

A SWOT analysis had been prepared for the board (see Table 1) that summarised the main issues facing ITV in 2020.

Faced with the strategic issues raised in the SWOT ana-lysis, the board of ITV had to consider whether ITV should pursue organic growth, perhaps through developing its production and online distribution activities, expansion through acquisition and joint ventures, licensing agreements, restructuring of the company to specialise in just one activity and perhaps even selling the business. Which strategic options should they consider and which one should be pursued in the future?

Questions

1 Identify the main strategic issues facing ITV.

2 Suggest a number of strategic options that ITV might pursue.

3 Create three tables to assess the *Suitability*, *Acceptability* and *Feasibility* (**SAF**E) of your strategic options (refer to Table 13.1). In each table, rank your choices.

4 *Evaluate* (SAF**E**) the tables in question three above to generate a ranked list of options and recommend a strategy for ITV to pursue.

Chapter 14

Strategy development processes

Key terms

deliberate strategy

emergent strategy

learning organisation

logical incrementalism

political view of strategy development

strategic planning

Learning outcomes

After reading this chapter you should be able to:

- Understand what is meant by *deliberate* and *emergent* strategy development.
- Identify deliberate processes of strategy development in organisations, including: the role *of strategic leadership, strategic planning systems* and *externally imposed strategy.*
- Identify processes that give rise to emergent strategy development, such as: *logical incrementalism, political processes* and *organisational structures and systems.*
- Consider the *strategy development in different contexts* and ways of managing strategy development in organisations.

Evaluating
Processes
III
Strategy
in action
Practice
Imple-
menting
Leading &
Changing

14.1 Introduction

We are familiar with successful strategies: Google's dominance of internet search; Ryanair becoming one of the most successful airlines in the world; Zara's internationalisation in the fashion market. We also know about failed strategies: Kodak in photography; Nokia in mobile phones; Groupon in daily discount deals. Much of Parts I and II of this book help us understand this. They addressed how strategists might understand the strategic position of their organisation and what strategic choices are sensible. However, none of this directly addresses the question that is the theme of this chapter: *how do strategies actually develop*? (Chapter 17 then examines in more detail the people involved in these processes and what they actually do in developing strategies).

Before Apple's entry into the music player and smartphone businesses with the iPod, iTunes and later the iPhone and iPad, the strategy of the visionary Apple CEO and Co-founder Steve Jobs was 'to wait for the next big thing' according to one source.[1] It was not, therefore, only based on brilliant foresight or a clear strategic plan. The strategy rather developed over time in steps, some of which were designed and intentional, while some simply materialised over time.

Figure 14.1 summarises the structure of this chapter. It is organised around two main views of strategy development: strategy as deliberate and strategy as emergent.[2] The *deliberate strategy* development view is that strategies come about as the result of the conscious intentions of top management. It is related to the *design*

view of strategy development explained in the commentary sections of this book. The second view is that of *emergent strategy* development; that strategies do not develop on the basis of a grand plan, but tend to emerge in organisations over time. The discussion in the Commentaries of the *experience* and *variety* lenses relates to this view. As the chapter will show, however, these two main views of how strategies develop are not mutually exclusive. As Figure 14.1 shows, they are both likely to influence the eventual strategy that actually comes about – the *realised strategy.*

The next section (14.2) of the chapter discusses deliberate strategy development. First, there is an explanation of how strategies may be the outcome of *leadership, 'command'* or *vision* of individuals. This is followed by a discussion of what formal *planning systems* in organisations might look like and the role they play. The section concludes by explaining how strategies might be deliberately *imposed* on organisations from the outside. Section 14.3 of the chapter then switches to views and explanations of how strategies might emerge in organisations. The section offers three views of how this might occur: *logical incrementalism,* the influence of *political processes* in organisations and finally how strategies could be the outcome of *organisational structures and systems.* The final section of the chapter (14.4) raises *implications for managing strategy development* including how different approaches to strategy development may be more or less well suited to different contexts.

Figure 14.1 Deliberate and emergent strategy development

Source: Adapted from H. Mintzberg and J.A. Waters (1985) 'Of strategies, deliberate and emergent', *Strategic Management Journal*, vol. 6, no. 3, p. 258.

Figure 14.1: Long Description

14.2 Deliberate strategy development

Deliberate strategy involves intentional formulation or planning. Such intentionality may take different forms. It could be the intentionality of a *strategic leader,* for example, a CEO or the founder of a firm. It could be through a process of *strategic planning* involving many managers. Or it might be experienced as the *external imposition* of strategy formulated elsewhere.

14.2.1 The role of the strategic leader

An organisation's strategy may be influenced by strategic leaders: individuals or management teams of individuals whose personalities, positions or reputations make them central to the strategy development process. This could be because she or he is the entrepreneur behind the organisation. This is often the case in small businesses and family businesses, but may also persist when a business becomes very large, like with Mark Zuckerberg at Meta (formerly Facebook).[3] Or it could be that an individual chief executive has played a central role in directing the strategy of an organisation, as Michael O'Leary at Ryanair. Research has shown that Founder CEOs compared to other CEOs typically make different contributions to strategic success, at least in terms of market expansion. Founders are more successful at achieving rapid growth in nascent, fast-growing markets, often by applying what they have learned from their previous experience. CEOs that are recruited from outside need more time to build their knowledge and influence but tend to be more

successful in complex market conditions.[4] Illustration 14.1 provides examples of how strategic leaders have influenced different aspects of strategy in their organisations.

Strategy, then, may be – or may be seen to be – the deliberate intention of a strategic leader. This may manifest itself in different ways:

- *Strategic leadership as command.* The strategy of an organisation might be dictated by an individual. This is, perhaps, most evident in single owner-managed small firms, where that individual is in direct control of all aspects of the business. Canadian scholars Danny Miller and Isabel Le Breton-Miller[5] suggest there are advantages and disadvantages here. On the plus side, it can mean speed of strategy adaptation and 'sharp, innovative, unorthodox strategies that are difficult for other companies to imitate'. The downside can, however, be 'hubris, excessive risk taking, quirky, [or] irrelevant strategies'.
- *Strategic leadership as vision.* It could be that a strategic leader determines or is associated with an overall vision, mission, or strategic intent (see Section 1.2) that motivates others, helps create the shared beliefs within which people can work together effectively and guides the more detailed strategy developed by others in an organisation. James Collins and Jerry Porras's study[6] of US firms with long-term high performance concluded that this is a centrally important role of the strategic leader. For example, Ingvar Kamprad, IKEA's founder's vision of creating a better life for the many has motivated and guided subsequent generations of IKEA managers and staff.

- *Strategic leadership as decision making.* Whichever strategy development processes exist, there could be many different views on future strategy within an organisation and, perhaps, much, but incomplete evidence to support those views. One of the key roles of leaders is to have the ability to weigh such different views, interpret data, have the confidence to take timely decisions to invest in key resources or markets and the authority to get others to buy into those decisions. Mary Barra, CEO of General Motors, for example, has successfully led GM out of all its challenges despite diverse views both internally and externally of the corporation's direction.
- *Strategic leadership as the embodiment of strategy.* A founder or chief executive of an organisation may represent its strategy. This may be unintentional but can also be deliberate: for example, Richard Branson no longer runs Virgin on a day-to-day basis, but he is seen as the embodiment of the Virgin strategy and is still frequently the public face of the company.

Illustration 14.1 The influence of strategic leaders Chief executives and founders may have a profound effect on an organisation's strategy.

Helena Helmersson, H&M CEO

Source:

Helena Helmersson on building a sustainable business Helena Helmersson immediately emphasised sustainability as integrative to H&M's strategy when she became the new CEO.[1]

When I was recently offered the opportunity to take on the role as CEO, I already had a clear mission for our sustainability work – to put it at the heart of how we operate and develop the group. Having once been Head of Sustainability in this company, I know the importance of environmental protection, people empowerment and industry transparency to build a sustainable business. These areas are not only close to my heart but very much part of my business perspective.

To put sustainability at the core of our business is a big opportunity to accelerate the pace of change. We need to transform our business moving forward – to secure that we continue to be successful in the future, but also to serve a greater purpose as a company. In order to build a sustainable future, we will have to find new ways. It will require us to rethink how we operate. We will have to develop new technologies, new business models, new processes and a new type of customer relations.

Jeff Bezos on envisioning the future When Amazon was just four years old, CEO Jeff Bezos already emphasised favouring growth over profit in its strategy:[2]

> Amazon.com is a famously unprofitable company. And the question is: Are we concerned about it? The answer is, in the short term, no; and in the long term, of course. Every company needs to be profitable at some point in time . . . Our strategy, and we've consistently articulated this, is that we believe that this opportunity is so

large that it would be a mistake for any management team not to invest in it very aggressively at this kind of critical category formation stage . . . We don't claim it's the right strategy. We just claim it's ours. But we do think it's right. And that it would be a mistake to try to optimize for short-term profitability.

Mike Adamson on strategic priorities British Red Cross Chief Executive Mike Adamson presented an ambitious ten-year strategy in which he identified three areas that they will focus on.[3]

People in emergencies, people who are displaced and people who are falling between the gaps in the health and social care system.

The reason that we're focusing on those three big causes is that we've taken a look at what's going on in the world. We want to try to bring some of the things that make us different and special in who we are to bear on those issues. What we realised is that we need to think longer term because the issues we're trying to tackle are enduring humanitarian issues . . . and we won't find solutions to them in a three-to-five-year business-plan context.

Elon Musk on building new businesses Elon Musk, founder and CEO of electric vehicle manufacturer Tesla Motors and entrepreneur behind PayPal and SpaceX has provided many innovative ideas, but also led them to execution:[4]

Well, a company is a group of people that are organized to create a product or service. That's what a company is. So, in order to create such a thing, you have to convince others to join you in your effort and so they have to be convinced that it's a sensible thing, that basically there's some reasonable chance of success and if there is

success, the reward will be commensurate with the effort involved. And so I think that's it . . . getting people to believe in what you're doing – and in you – is important.

Sources: (1) H&M Group, Sustainability Report, Letter from CEO, 2019, https://hmgroup.com/sustainability/sustainability-reporting/message/ [accessed: June 2022]; (2) Jason Del Rey, 'Jeff Bezos lays out his grand vision', *Recode.net,* 22 November 2015: www.recode.net/2015/11/22/11620874/watch-jeff-bezos-lay-out-his-grand-vision-for-amazons-future [accessed: June 2022]; (3) Civilsociety News, Weakley, K.; https://www.civilsociety.co.uk/news/mike-adamson-why-the-british-red-cross-needs-to-be-thinking-big-and-long-term.html [accessed: June 2022]; (4) Alison van Diggelen, Interviews with Elon Musk Inspire Word Art Series, *Fresh Dialogues,* January 2013.

Questions

1 Can you provide other examples of founders' or chief executives' influence on strategy?

2 What else would you emphasise as an important contribution CEOs make to strategy development?

14.2.2 Strategic planning systems

A second way in which intended strategies develop is through formalised **strategic planning**: **systematic analysis and exploration to develop an organisation's strategy.** Larger organisations and corporations often have quite elaborate strategic planning systems. In a study of such systems in major oil

companies, Rob Grant[7] of Bocconi University noted the following stages in the planning cycle:

- *Initial guidelines.* The cycle's starting point is usually a set of guidelines or assumptions about the external environment (e.g., price levels and supply and demand conditions) and the overall priorities, guidelines and expectations of the corporate centre.
- *Business-level planning.* In the light of these guidelines, business units or divisions draw up strategic plans to present to the corporate centre. Corporate centre executives then discuss those plans with the business managers, usually in face-to-face meetings. On the basis of these discussions, the businesses revise their plans for further discussion.
- *Corporate-level planning.* The corporate plan results from the aggregation of the business plans. This coordination may be undertaken by a corporate planning department that, in effect, has a coordination role. The corporate board then has to approve the corporate plan.
- *Financial and strategic targets* are then likely to be extracted to provide a basis for performance monitoring of businesses and key strategic priorities on the basis of the plan.

Grant found that some of the companies he studied were much more formal and systematised than others (e.g. the French Elf Aquitaine and Italian ENI), with greater reliance on written reports and formal presentations, more fixed planning cycles, less flexibility and more specific objectives and targets relating to the formal plans. Where there was more informality or flexibility (e.g., BP, Texaco and Exxon), companies placed greater emphasis on more general

financial targets. Central corporate planning departments also played different roles. In some organisations, they acted primarily as coordinators of business plans. In others, they were more like internal consultants, helping business unit managers to formulate their plans. Illustration 14.2 is a schematic representation of how strategic planning takes place in a multi divisional corporation.

While larger organisations often have comprehensive strategic planning systems, smaller ones also use strategic planning. A prerequisite for entrepreneurial start-ups that need initial external funding is often to present a detailed strategic business plan. Planning horizons and associated objectives and bases of analysis vary depending on industry and environment conditions. In a complex environment that involves new and emerging technologies, regulations and customer preferences and changing industry borders a new venture may only be able to plan a year ahead. In a fast-moving consumer goods company three- to five-year plans may be appropriate. In companies that have to take very long-term views on capital investment, such as those in the oil industry, planning horizons can be as long as 15 years (in Exxon) or 20 years (in Shell).

Illustration 14.2 Strategic planning in multi-divisional corporations A planning calendar sets out how strategy is coordinated between the corporate centre and business units.

Long Description

Multidivisional, often multinational, corporations face the challenge of developing and coordinating a strategy across many business units throughout the world operating within different divisions. Many do this by means of a planning process that can take place over months.

The aim of the exercise is to develop a plan, often with a five-year time horizon that integrates corporate-level strategy with the strategy of the business units. At the corporate level, this may involve the identification of the sort of businesses and markets that it should be in and the establishing of performance targets for the businesses. Depending on the extent of control exercised from the corporate centre, the plan may also set out how the strategy is to be put into effect across the divisions and businesses and the expected financial outcome of this. This corporate strategy is typically developed and decided by the main board but may well be coordinated by corporate planners based in corporate headquarters. These corporate planners often work with management or planners within divisions where more detailed strategic planning occurs at the business unit level.

Such a planning process is summarised in the figure and may have the following stages:

1 On an ongoing basis, corporate executives will be in touch with key stakeholders – not least investors – to establish what their expectations are for the corporation. These will inform the corporate objectives for the plan.
2 Corporate strategists identify likely key current and future environmental influences on the corporation. To do this, they may consult with external experts (e.g., universities, specialist consultancies, market research companies) as well as the divisions to understand global market developments and assess and identify market opportunities. They may also undertake some form of scenario planning to consider the possible impact of such influences.
3 Steps 1 and 2 will provide the basis for key assumptions and performance objectives that divisions and business units will use to guide strategic thinking at their levels. These may include prompts on key strategic issues that need addressing, the identification of key market, technological and social trends as well as expectations of financial and market performance.
4 Combined strategic and financial plans will then be developed at the business level with the assistance of divisional strategists.
5 Divisional executives or strategists will then coordinate the business level plans to produce divisional strategic plans. It may be that, in so doing, they involve corporate level strategists to ensure that divisional level strategy meet corporate expectations. So, this stage may well involve iteration between corporate, divisional and business levels. Divisional plans will then be submitted to the corporate centre.
6 The final strategic plans and financial plans will be reviewed by the corporate executive board. This may involve executives at divisional or business unit levels presenting their proposals to the board.
7 The final plans agreed will then inform corporate level decisions, such as portfolio planning and therefore mergers, acquisitions and sale of businesses as well as the

allocation of resources to divisions and/or business units.

8 These decisions at corporate level may then require businesses to adjust their own strategic plans, depending on the resources allocated to them or the corporate expectations placed upon them.

Questions

1 What types of strategic issues are likely to be most significant at each stage and level of the planning process?

2 How might a planning process differ in other types of organisation (e.g., local government or a university)?

3 How do other processes of strategy development explained in this chapter relate to this planning calendar?

Strategic planning may play several roles and, typically, four are emphasised:

- *Formulating* strategy by providing means by which managers can understand strategic issues, for example competitive positions (see Chapter 4) and distinctive capabilities (see Chapter 5). Formulation contributes by establishing overall purpose and objectives (Chapter 1 and 6), encouraging the use of analytic tools such as those explained in this book and by encouraging a longer-term view of strategy than might otherwise occur.
- *Learning.* Managers can benefit from planning if they see it as a means of learning rather than a means of ‘getting the right

answers'. Rita McGrath and Ian MacMillan emphasise 'discovery-driven' planning which recognises that plan parameters may change as new information is revealed. It focuses on the need for questioning and challenging received wisdom and the taken for granted.[8]

- *Integration.* Strategic planning systems may have the explicit purpose of coordinating business-level strategies within an overall corporate strategy. They can also provide a valuable forum for negotiation and compromise and, thus, the reconciliation of different views on future strategy.[9]
- *Communicating* intended strategy throughout an organisation and providing clarity on the purpose and objectives of a strategy or strategic milestones against which performance and progress can be reviewed. Communicating strategy is also a very first step towards strategy implementation.

However, it should be recognised that strategic planning and planning systems may also play other roles. If people are encouraged to be involved in planning processes, it can help to create shared *ownership* of the strategy and thus improve employee understanding and commitment required for implementation.[10] It may also provide a forum for middle managers to influence strategic issues beyond their operational responsibilities.[11] Strategic planning can also provide a *sense of security* and logic, not least among senior management who believe they should be seen to be proactively determining the future strategy and exercising control over the destiny of their organisation.

Henry Mintzberg has, however, challenged the extent to which planning provides such benefits.[12] Arguably, there are five main dangers in the way in which formal systems of strategic planning have been employed:

- *Confusing planning with managing strategy.* Managers may see themselves as managing strategy when what they are doing is going through the processes of planning. Strategy is, of course, not the same as 'the plan': strategy is the long-term direction that the organisation follows – the realised strategy in Figure 14.1 – not just a written document. Linked to this may be confusion between budgetary resource allocation processes and strategic planning processes.[13] The two may come to be seen as the same so that strategic planning gets reduced to resource allocation and financial forecasting rather than thinking through the sort of issues discussed in this book.
- *Detachment from reality.* The managers responsible for the implementation of strategies, usually line managers, may be so busy with the day-to-day operations of the business that they cede responsibility for strategic issues to specialists or consultants. However, these rarely have power in the organisation to make things happen. The result can be that strategic planning becomes removed from the reality of operations and the experience and knowledge of operating managers. If formal planning systems are to be useful, those responsible for them need to draw on such experience and involve people throughout the organisation. In the absence of such involvement, there is the danger that the resulting strategy is not owned widely in the organisation.

- *Over-complex planning processes.* There is a danger that the strategic planning process is so bureaucratic that it takes too long or, because individuals or groups contribute to only part of it, they do not understand the whole picture. Likewise, planning can also become over-detailed in its approach, concentrating on extensive analysis that, while technically sound, misses the major strategic issues facing the organisation (see Section 17.3.1). The result can be that the realised strategy at one level, for example the business level, does not correspond to the intended corporate-level strategy. This is particularly problematic in large multi-business firms.
- *Dampening of innovation.* Highly formalised and rigid systems of planning, especially if linked to very tight and detailed mechanisms of control, can contribute to an inflexible, hierarchical organisation with a resultant stifling of ideas and dampening of innovative capacity. This is a reason why new venture units are sometimes set up in larger firms, which do not have to follow their formalised planning systems (see Section 11.5.2).

Strategic planning has continuously been ranked first or second in a survey of management tools used in organisations conducted by Bain,[14] the management consultancy. The evidence of strategic planning resulting in organisations performing better than others is equivocal, however[15] – not least because it is difficult to isolate formal planning as the determining effect on performance. Nevertheless, there is some evidence that planning may be beneficial if it is designed to work in conjunction with bottom-up

emergent processes of strategy development – a process that may be thought of as ‘planned emergence’ of strategy.[16]

While strategic planning remains common, there has been a decline in formal corporate planning departments and a shift to business unit managers taking responsibility for strategy development and planning (see Chapter 17). Strategic planning is also becoming less a vehicle for top-down development of intended strategy and more of a vehicle for the coordination of strategy emerging from below. This includes an increased openness and transparency in strategy development involving more collaborative planning exercises and strategic dialogues.[17] For example, the Indian IT services and software development firm HCL Technologies transformed its business planning process from including a few hundred executives into an online platform open to thousands of people. This development suggests that strategic planning practices increasingly are acknowledging emergent strategy development (see Section 14.3).

Finally, there will very likely be aspects of a deliberate and planned strategy that do not come to be realised in practice. There are several reasons for this: the environment changes and managers decide that the strategy, as planned, should not be put into effect; the plans prove to be unworkable or unacceptable in practice; or the emergent strategy comes to dominate. There is, however, a danger. Managers may espouse a deliberate strategy, perhaps the result of a strategic planning process, but the organisation may be following a different strategy in reality. We experience this as customers of organisations that have stated strategies quite different from what we experience – government agencies that are there purportedly to

serve our interests but act as bureaucratic officialdom, companies that claim they offer excellent customer service but operate call centres that frustrate customers and fail to solve problems, universities that claim excellence of teaching but are more concerned with their staff's research, or vice versa. It should not, however, be assumed that top managers are always close enough to customers to understand the extent of difference between what is intended as the strategy and what is actually happening. Managers need to take steps to check if the deliberate strategy is being realised.

14.2.3 Externally imposed strategy

Managers may face what they see as the imposition of strategy by powerful external stakeholders. For example, the government may dictate a particular strategic direction as in the public sector, or where it exercises extensive regulatory powers in an industry. In the UK, public-sector direct intervention has been employed for schools or hospitals deemed to be under-performing badly, with specialist managers being sent in to turn around the ailing organisations and impose a new strategic direction.

Businesses in the private sector may also be subject to imposed strategic direction, or significant constraints on their choices. A multinational corporation seeking to develop businesses in some parts of the world may be subject to governmental requirements to do this in certain ways, perhaps through joint ventures or local alliances. An operating business within a multidivisional organisation may also perceive the overall corporate strategic direction of its

parent as akin to imposed strategy. For publicly listed companies, financial markets also exercise an influence over strategy, not least through so-called ‘activists’ of different kinds that take an equity stake in a corporation and put public pressure on its management. For example, Sweden’s activist investor Cevian Capital is invested in the German conglomerate Thyssenkrupp and has repeatedly pushed for the company to spin off their elevators, car parts and plant engineering divisions to improve performance and boost shareholder returns. Venture capitalists and private equity (PE) firms may also impose strategies on the businesses they acquire.[18] Swedish PE firm EQT, for example, acquired Nestlé’s skin care unit in 2019, changed its strategic direction and considered an IPO just three years later. Other activists emphasise employee and human rights. For example, Google workers have joined community activists in demands for workplace rights and to halt controversial company policies (see end of chapter Case example Alphabet).[19]

14.3 Emergent strategy development

Although strategy development is often described as though it is the deliberate intention of top management, an alternative explanation is that of **emergent strategy**: that **strategies emerge on the basis of a series of decisions, which forms a pattern that becomes clear over time.** This explains an organisation's strategy, not as a 'grand plan', but as a developing 'pattern in a stream of decisions'[20] where top managers draw together emerging themes of strategy from various decisions and directions, rather than formulating it directly from the top. The pattern that emerges may then, subsequently, be more formally described, for example, in annual reports and strategic plans, and be seen as the deliberate strategy of the organisation. It will not, however, have been the plan that developed the strategy; it will be the emerging strategy that informed the plan. Emergent strategy may, then, be seen as a basis for learning what works in search for a viable pattern or consistent strategy. See Illustration 14.3 for a description of how strategy emerged and then became deliberate in the Swedish multinational industrial company Atlas Copco.

There are different views of emergent strategy[21] and this section summarises the main ones. They are: logical incrementalism, strategy as the outcome of political processes and as the outcome of organisational structure and systems. All three emphasise that strategy development is not necessarily the province of top management alone but may be more devolved within organisations. Figure 14.2 shows how the different views can be thought of in terms

of a continuum according to how deliberately managed the processes are.

14.3.1 Logical incrementalism

The first explanation of how strategies may emerge is that of *logical incrementalism.* This explanation, in effect, bridges deliberate and emergent processes, as it explains how management may deliberately cultivate a bottom-up, experimental basis for strategies to emerge. **Logical incrementalism** was a term coined by James Quinn in his study of how strategies developed in multinational businesses. It is **the development of strategy by experimentation and learning** 'from partial commitments rather than through global formulations of total strategies'.[22] There are three main characteristics of strategy development in this way:

- *Environmental uncertainty.* Managers realise that they cannot do away with the uncertainty of their environment by relying on analyses of historical data or predicting how it will change. Rather, they try to be sensitive to environmental signals by encouraging constant environmental scanning throughout the organisation.
- *General goals.* There may be a reluctance to specify precise objectives too early, as this might stifle ideas and prevent innovation and experimentation. So, more general rather than specific goals may be preferred, with managers trying to move towards them incrementally.
- *Experimentation.*[23] Managers seek to develop a strong, secure, but flexible, core business. They then build on the experience

gained in that business to inform decisions both about its development and experimentation with ‘side-bet’ ventures. Commitment to strategic options may therefore be tentative in the early stages of strategy development. Such experiments are not the sole responsibility of top management and can thus be autonomous. They emerge from what Quinn describes as ‘subsystems’ in the organisation – groups of people involved in, for example, product development, product positioning, diversification, external relations, and so on. Employees can thus take strategic initiatives and form entrepreneurial ventures from the bottom up with important influence on strategy development.[24] Organisations can also encourage this type of experimentation in different ways and, in start-ups, this is often referred to as ‘pivoting’ – making major strategic changes in new ventures based on market feedback (see Section 11.5.2).[25]

Figure 14.2 A continuum of emergent strategy development processes

Figure 14.2: Long Description

Illustration 14.3 From deliberate to emergent to deliberate strategy Atlas Copco's strategic moves into China.

Founded in 1873 in Sweden, Atlas Copco is one of the older multinational companies in the world. At the beginning of the twenty-first century, the company employed around 40,000 employees around the globe, and it was one of the leading suppliers of drill rigs in the world within its business area Mining and Rock Excavation (MR). At the time, they planned to grow further into new international markets. In line with established procedures, managers initiated active and elaborative strategic searches within several countries to assess market potential and estimate future demand. The marketing study results showed how China presented the most exciting growth potential in the coming years. Later, the Vice-President of Atlas Copco articulated the firm's new strategic focus by exclaiming that 'China will play an important role in the future for Atlas Copco' (Vice-President Atlas Copco, 2009).

When the corporation initiated its expansion into China, it was a carefully planned effort. The plan built on the routines and culture supporting the firm's global strategy, which focused on expanding with the company's high-end, state-of-the-art drill rigs into various high-end markets. As one Swedish manager expressed, 'We were simply doing what we always have been doing when expanding internationally; we have quite elaborated routines for how to grow in foreign markets.'

At the time, however, the Chinese mining industry was also undergoing deregulation. Most mining companies became private and smaller with simpler investment procedures and equipment. For example, foreign firms no longer needed to engage in joint ventures with Chinese state-owned companies to act in the market and the new companies needed less sophisticated products. This development triggered engaged discussions within the company concerning the best strategy to expand in China. Many believed that the company should continue to follow the initial strategic plan, which suited the

country's traditional state-owned mines well. Others, however, were critical against how they seemed to follow in old strategic footsteps without regarding the changes in the Chinese market and not exploiting the new potential business opportunities in smaller and midsize companies that the deregulations presented. As one Swedish manager expressed, 'I do not think we had a special strategy for the mid-market at the time.'

The disagreements within the firm led to managers either resisting a new China strategy or taking initiatives to make strategic adjustments that considered the changes in the Chinese market. As managers increased their efforts to understand the changes, they started to travel frequently to China, and Atlas Copco's Vice-President at the time, Björn Rosengren, even relocated his office from Sweden to China. Out of the initiatives, a new strategy emerged. The new strategy reflected the intent to expand among the small private mines in China, alongside the large state-owned mines. On a practical level, this implied the development of new technology and the development of new routines for sales and production that better would fit the conditions of the small private mining market. This would be the strategy moving forward and it turned out to be a successful one as MR, which was later turned into a separate company, Epiroc, increased its customer base within the market segment almost three times within three years.

Mikael Eriksson, Stockholm School of Economics *Sources:* M. Eriksson, R. Drogendijk, U. Holm and M. Forsgren. M (2022) ´How a peripheral subsidiary overcomes organizational resistance to strategic renewal´, Stockholm School of Economics/Uppsala University/University of Groningen, Working paper, 2022.

Questions

1 What are the dilemmas for Atlas Copco when moving from a more deliberate strategy based on the existing global strategic plan to a more emergent China-specific strategy?

2 How do you find the role of diverse views and disagreements within the company when transitioning from the deliberate to the emergent strategy? Are the conflicting views and behaviours within the firm presenting any disadvantages or advantages for the company?

Quinn argued that, despite its emergent nature, logical incrementalism can be ‘a conscious, purposeful, proactive, executive practice’ to improve information available for decisions and build people’s psychological identification with the development of strategy. Logical incrementalism therefore suggests that strategy development can be deliberate, while relying on organisational subsystems to sense what is happening in the environment and to try out ideas through experimentation. Thinking Differently at the end of the chapter describes this in the Japanese strategy approach ‘Hoshin Kanri’.

Arguably, developing strategies in such a way has considerable benefits. Continual testing and gradual strategy implementation provide improved quality of information for decision making and enable the better sequencing of the elements of major decisions. Since change will be gradual, the possibility of creating and developing a commitment to change throughout the organisation is increased. Because the different parts, or ‘subsystems’, of the organisation are in a continual state of interplay, the managers of each can learn from each other about the feasibility of a course of action. Such processes also take account of the political nature of organisational life, since smaller changes are less likely to face the same degree of resistance as major changes. This continual

readjustment makes sense if the environment is considered as a continually changing influence on the organisation.[26] The approach to frequent a strategic direction by reallocating the firm's activities, resources, and attention is referred to as *strategic pivots* in new ventures and early-stage entrepreneurship.[27]

Given logical incrementalism's emphasis on learning, it is a view of strategy development which corresponds to the **'learning organisation'**[28] – an organisation **that is capable of continual regeneration from the variety of knowledge, experience and skills within a culture that encourages questioning and challenge.** Proponents of this view argue that formal structures and systems of organisations typically stifle organisational knowledge and creativity. They argue that the aim of top management should be to facilitate rather than direct strategy development by building pluralistic organisations, where ideas bubble up from below, conflicting ideas and views are surfaced and become the basis of debate; where knowledge is readily shared and experimentation is the norm such that ideas are tried out in action. In many respects, there are similarities here to implications of the variety lens discussed in the Commentaries.

14.3.2 Strategy as the outcome of political processes

A second explanation of how strategies may emerge is that they are the outcome of the bargaining and power politics that go on between executives or between coalitions within an organisation and its major stakeholders. Managers may well have different views on issues and

how they should be addressed; they are therefore likely to seek to position themselves such that their views prevail. They may also seek to pursue strategies or control resources to enhance their political status. **The political view of strategy development** is, then, that **strategies develop as the outcome of bargaining and negotiation among powerful interest groups** (or stakeholders).[29] This is the world of boardroom battles often portrayed in film and TV dramas.

A political perspective on strategic management suggests that the rational and analytic processes often associated with developing strategy (see Section 14.2.2 above and the design lens in the Commentary) may not be as objective and dispassionate as they appear. Objectives may reflect the ambitions of powerful people. Information used in strategic debate is not always politically neutral. A manager or coalition may exercise power over another because they control important sources of information. Powerful individuals and groups may also strongly influence which issues get prioritised. In such circumstances, it is bargaining and negotiation that give rise to strategy rather than careful analysis and deliberate intent. Indeed, strategic planning processes, themselves, may provide an arena within which managers form coalitions to gain influence.

None of this should be surprising. In approaching strategic problems, people are likely to be differently influenced by at least:

- *Position and personal experience* from their roles within the organisation.
- *Competition for resources and influence* between the different subsystems in the organisation and people within them who are

likely to be interested in preserving or enhancing their positions.[30]

- *The relative influence of stakeholders* on different parts of the organisation. For example, a finance department may be especially sensitive to the influence of financial institutions while a sales or marketing department will be strongly influenced by customers.
- *Different access to information* given their roles and functional affiliations.

In such circumstances, there are two reasons to expect strategy development to build gradually on the current strategy. First, if different views prevail and different parties exercise their political muscle, compromise may be inevitable. Second, it is quite possible that it is from the pursuit of the current strategy that power has been gained by those wielding it. Indeed, it may be very threatening to their power if significant changes in strategy were to occur. It is likely that a search for a compromise solution accommodating different power bases will end up with a strategy that is an adaptation of what has gone before.

There are, however, more positive ways of seeing political processes. The conflict and tensions that manifest themselves in political activity, arising as they do from different expectations or interests, can be the source of new ideas[31] (see the discussion on the variety lens in the Commentaries) or challenge old ways of doing things. New ideas may be supported or opposed by different ‘champions’ who will battle over what is the best idea or the best way forward. Arguably, if such conflict and tensions did not exist, neither

would innovation. Further, as Section 16.5 shows, the exercise of power may be important in the management of strategic change.

14.3.3 Strategy as the result of organisational structures and systems

A third view of how strategies may emerge is on the basis of an organisation's structure and systems. Rather than seeing strategy development as about foresight and anticipation taking form in directive plans from the top of the organisation, strategy development can be seen as the outcome of managers, often at lower levels in large organisations, making sense of and dealing with problems and opportunities by applying established ways of doing things. There are echoes here of logical incrementalism, but there is less emphasis on deliberate experimentation. The emphasis is rather on the influence of the structures, systems and routines with which managers are familiar and which guide and constrain their decisions. There are two different explanations to consider here. First, strategy may be steered by managers' *attention to their specific contexts* and how *resources are allocated.* Second, *prior strategic decisions* may guide later strategies. These explanations are discussed below.

Managers' attention and the way resources are allocated may thus direct strategy development.[32] The basic argument is advanced by Harvard's Joe Bower and Clark Gilbert: 'The cumulative impact of the allocation of resources by managers at any level has more real-world effect on strategy than any plans developed at headquarters.'[33] Managers' attention, including both the way they make sense of the environment and the solutions they identify, is determined by each

organisational level's specific context and situation.[34] Hence, structures and systems at different organisational levels form solutions like resource allocation decisions, which then shapes strategy. Smaller resource allocation decisions at any level can then trigger a sequence of increasingly important ones that, in the end, determine overall strategic outcomes.[35] There are thus two main arguments underlying this view of strategy development, shown graphically in Figure 14.3:

- *Organisational systems as a basis for making sense of issues.* Managers are likely to make sense of issues they face on the basis of the systems and routines with which they are familiar, and which directly affect them. Vertical reporting relationships in hierarchies will focus managers' attention on issues within their part of the organisation as distinct from cooperating on wider issues across the organisation. For example, a finance director will be primarily concerned with the financial systems of the organisation or an operations director with operations. Managers in a business unit, close to a market, may pay attention to routines and systems to do with competitors and customers whereas senior corporate executives may be concerned with balancing resource allocation across businesses, with systems relating to financial markets and with government regulation.[36]
- *Organisational systems provide bases of solutions to strategic issues.* Systems and routines also provide solutions that managers can draw on when faced with problems. However, responses may differ depending on the context the managers are in and the associated systems and routines. A common

example is the way in which different responses emerge as a result of a downturn in company performance. Marketing managers, seeing this as a downturn in the market, may originate solutions that are to do with sales promotion and advertising to generate more sales; research and development managers may see it as a need for product innovation and accountants may see it as a need for tighter controls and cost cutting. Each is drawing on the context in which they find themselves and the associated systems and routines for dealing with such problems.

Figure 14.3 Strategy development as the result of structures and systems

Figure 14.3: Long Description

Another explanation of how strategies may emerge on the basis of structures and systems concentrates on how these may be set up for one strategy, but then also guide later strategies. Strategies may

thus emerge based on prior strategic decisions and related structures and systems that inform or constrain further strategy development. This strategy development can be expected if a strategy is successful, as managers seek to maintain a continuity of strategy in a series of strategic moves, each of which makes sense in terms of previous moves. Each strategic move is informed by the rationale of the previous one, such that, over time, the overall strategy becomes more and more established. However, sometimes, this can result in a suboptimal path dependency if the environment and competitive conditions change (see Section 7.2).

In sum, whereas top-down explanations of deliberate strategy development assume that managers' focus of attention will readily cohere around clearly identified overarching strategic issues for the whole organisation and overall allocation of resources, the structures and systems explanation presented here emphasises that: (i) it may not be analysis of an organisation's overall strategic position so much as structures and systems that surface issues that get attended to; and (ii) such issues are likely to be locally defined.

14.4 Implications for managing strategy development

It should be clear from the different views and explanations of strategy development processes that they are not discrete or mutually exclusive: multiple processes are likely to be evident.[37] For example, planning systems exist in most large organisations, but there will also, undoubtedly, be political activity as well. There will also be established structures, systems and procedures that will affect future decisions. As was explained at the beginning of the chapter, then, the strategy of an organisation is likely to develop in both deliberate and emergent ways. Illustration 14.4 describes what has become a classic case of strategy development in both research and teaching; two descriptions of how Honda became incredibly successful when entering the motorcycle market in the USA.[38]

It is also likely that processes of strategy development will be seen differently by different people. For example, senior executives tend to see strategy development in terms of deliberate, rational, analytic planned processes, whereas middle managers see strategy development more as the result of political and cultural processes. Managers in public-sector organisations tend to see strategy as externally imposed more than managers in commercial businesses, largely because their organisations are answerable to government bodies.[39] People who work in family businesses tend to see more evidence of the influence of powerful individuals, who may be the owners of the businesses.

Illustration 14.4 A classic case: Honda entering the US motorcycle market There are different explanations of successful strategy development.

In 1984, Richard Pascale published a paper that described the success Honda had experienced with the launch of its motorcycles in the US market in the 1960s. It is a paper that has generated discussions about strategy development processes ever since. First, he gave explanations provided by the Boston Consulting Group (BCG): The success of the Japanese manufacturers originated with the growth of their domestic market during the 1950s. This resulted in a highly competitive cost position which the Japanese used as a springboard for penetration of world markets with small motorcycles in the early 1960s . . . The basic philosophy of the Japanese manufacturers is that high volumes per model provide the potential for high productivity as a result of using capital intensive and highly automated techniques. Their market strategies are therefore directed towards developing these high model volumes, hence the careful attention that we have observed them giving to growth and market share.

Thus, the BCG's account is a rational one based upon the deliberate intention of building up a cost advantage based on volume.

Pascale's second version of events was based on interviews with the Japanese executives who launched the motorcycles in the USA and demonstrates how the

serendipitous nature of Honda's strategy shows the importance of learning and culture: 'In truth, we had no strategy other than the idea of seeing if we could sell something in the United States. It was a new frontier, a new challenge, and it fitted the 'success against all odds' culture that Mr Honda had cultivated. We did not discuss profits or deadlines for breakeven . . . We knew our products . . . were good but not far superior. Mr Honda was especially confident of the 250cc and 305cc machines. The shape of the handlebar on these larger machines looked like the eyebrow of Buddha, which he felt was a strong selling point . . . We configured our start-up inventory with 25 per cent of each of our four products – the 50cc Supercub and the 125cc, 250cc and 305cc machines. In dollar value terms, of course, the inventory was heavily weighted towards the larger bikes . . . We were entirely in the dark the first year. Following Mr Honda's and our own instincts, we had not attempted to move the 50cc Supercubs . . . They seemed wholly unsuitable for the US market where everything was bigger and more luxurious . . . We used the Honda 50s ourselves to ride around Los Angeles on errands. They attracted a lot of attention. But we still hesitated to push the 50cc bikes out of fear they might harm our image in a heavily macho market. But when the larger bikes started breaking, we had no choice. And surprisingly, the retailers who wanted to sell them weren't motorcycle dealers, they were sporting goods stores.

Sources: This illustration is based on R.T. Pascale (1984) 'Perspectives on strategy: the real story behind Honda's success', *California Management Review,* vol. 26, no. 3 (Spring), pp. 47–72; and H. Mintzberg, R.T. Pascale, M. Goold and R.P. Rumelt (1996) 'The Honda effect revisited', *California Management Review,* vol. 38, no. 4, pp. 78–116.

Questions

1 Are the different accounts mutually exclusive?

2 What different insights can the two accounts provide? How can they be useful?

3 Do you think Honda would have been more or less successful if it had adopted a more formalised strategic planning approach to the launch?

14.4.1 Managing strategy development in different contexts

While there is no one right way in which strategies are developed, it is helpful if managers recognise the potential benefits and pitfalls of different processes of strategy development. Organisations differ in their size, form and complexity. They also face different environments, so different processes for managing strategy may make sense in different circumstances (see also Thinking Differently at the end of this chapter). Figure 14.4 provides a way of considering this by showing how organisations may possibly seek to cope with conditions that are on the one hand more or less static or dynamic and on the other hand more or less simple or complex:[40]

- *In simple/static conditions,* the environment is relatively straightforward to understand and is not undergoing significant change. The organisation itself is also not overly complex; for example, it may be operating in a single market or with a narrow portfolio. Raw materials suppliers and some mass-manufacturing companies are examples. In such circumstances, if environmental change does occur, it may be predictable, so it could make sense to analyse the environment extensively on an historical basis as a means of trying to forecast likely future conditions. In situations of relatively low complexity, it may also

be possible to identify some predictors of environmental influences. For example, in public services, demographic data such as birth rates might be used as lead indicators to determine the required provision of schooling, healthcare or social services. So, in simple/static conditions systematic strategic planning is possible, perhaps with central planners taking the lead. It is also likely that past experience and prior decisions will be a significant influence since little is changing. The potential problem is, of course, that conditions do change; for example, the environment may become more dynamic and the established processes may not be suited to such conditions.

- *In dynamic conditions,* managers need to consider the environment of the future, not just of the past. The degree of uncertainty therefore increases. They may employ structured ways of making sense of the future, such as scenario planning, discussed in Section 3.4, or they may rely more on encouraging active sensing of environmental changes lower down in the organisation where people are operating closer to the changes that are taking place, for example, in the market or in technology. Organisations seek to do this in various ways. For example, through strategy workshops and more open strategy making involving much wider participation in strategy development (see Sections 17.2.5 and 17.4.1). Alternatively, organisations may seek to create conditions that encourage individuals and groups to be sensitive to signals from the changing environment, use forward thinking and challenging, similar to logical incrementalism and organisational learning (Section 14.3.1).

- *Organisations in complex situations* face an environment that is difficult to comprehend. For example, a multinational firm, or a major public service such as a local government authority with many services, is complex because of its diversity. In such circumstances, such organisations may seek structural solutions; for example, they may subdivide their organisation into units where managers have particular expertise and have responsibility for strategic decision making within those units (see Section 15.2.2). Such organisations may, of course, also face dynamic conditions and therefore a combination of complexity and uncertainty. With more and more sophisticated technologies and increased competition, there is an increasing move towards this condition of greatest uncertainty. In such circumstances, it is simply not feasible for top management to understand all the influences on future strategy. There will thus be an even greater need to decentralise strategy thinking and influence within the organisation including an openness for experimentation, pivoting and even trial and error. There are various ways of doing this, including the development of a portfolio of real options, corporate venturing and intrapreneurship (see Sections 11.5.2 and 13.4.1). In situations that are both extremely complex and dynamic, like in the very low right corner of Figure 14.4, there may not be many solutions for strategy development until uncertainty and complexity are reduced.

Figure 14.4 Strategy development in different contexts

Figure 14.4: Long Description

Considering the ways in which strategy may be developed in different contexts in turn has a number of implications:

- *The top management role in strategy development.* Do top managers see themselves as the detailed planners of strategy throughout the organisation; as the ones who set broad strategic direction and cultivate managers below them who can develop more detailed strategies; or as developing their own capabilities to detect and build upon strategies and strategic ideas as they emerge from within the rest of the organisation?
- *The roles of strategic planning.* Strategic planning has different roles to play. The simpler the conditions faced by the organisation, the more it may be possible for planning to direct the strategy. The more the strategy development is decentralised, however, the more there is likely to be the problem of the coordination of an overall strategy for an organisation. In such circumstances, strategic planning may also play a role but as a coordinating and communication

mechanism. This may be useful because it may be important that there is a formal explanation of the strategy for the stakeholders of the organisation.

- *Different strategy development roles at different organisational levels.* There may also be distinct differences in strategy development approaches with managers playing diverse roles at different levels. Executives at the centre may, for example, be more concerned with formal planning, building on existing resources and refining existing strategy while lower-level managers in business units may be more reliant on experimentation and informal contacts and experiences within their markets.[41] This suggests that the building of productive dialogue between different levels may be very important.
- *Strategic inflection points.* Robert Burgelman and Andy Grove[42] argue that all organisations face what they call ‘strategic inflection points’ where there are shifts in fundamental industry dynamics that management need to recognise and act upon. In such circumstances, it may well be that the symptoms are recognised by managers close to such changes who may then press for changes in strategy. The problem may be that others, like top management, may be busily working to maximise returns in the prevailing industry structure. The result could be a build-up of ‘dissonance’ within the organisation. Burgelman and Grove argue that top managers need to learn when to take such dissonance seriously. This relates to organisational ambidexterity (see Section 16.4.3).

Thinking Differently **Hoshin Kanri A Japanese approach to strategy development aims to align strategic goals with operational plans and work action.**

As has been clear from this chapter, strategy development is likely to be both deliberate and emergent in an organisation. A Japanese concept and method that captures this is 'Hoshin Kanri'. It is an approach that both defines and communicates strategy and a management system that ensures organisational members support, adjust and implement it. The objective is to ensure that a company's strategic goals drive progress and action at every level within the company.

Hoshin Kanri is sometimes named Policy Deployment (from 'Hoshin' signifying policy, purpose, or plan and Kanri meaning control, management, or administration). On the one hand, it includes a top-down carefully crafted long-term strategic plan or policy but, on the other, it also involves a bottom-up managerial development and adjustment of strategy. One important aspect of this process is 'catchball' – a back and forth exchange with top management to ensure that strategic goals are well understood and thus that there is strong alignment between strategy and implementation.[43] This goes all the way to the operational level of manufacturing or service delivery. The aim is for the method to increase engagement, commitment and responsibility for strategy.

Hoshin Kanri has become widely popular outside Japan and one of the main reasons is that the method is simple and easy to understand. A few pages explain and communicate what the long-term strategic goals are and how they will be accomplished by specific units, who the responsible leader is and how progress will be measured. This process is often captured in a chart or matrix that specifies what should be done, how and by whom. Most fundamentally, these provide an overview of this 'plan – act – check – adjust' process.

Questions

How does the Hoshin Kanri ‘plan – act – check – adjust’ strategy development process compare with logical incrementalism?

Key takeaways

- You should be aware of and understand the difference between *deliberate strategy* – the desired strategic direction deliberately planned by managers – and *emergent strategy,* which may develop in a less deliberate way from the behaviours and activities inherent within an organisation.
- The foundation of deliberate and intended strategy is formal and systematic *planning systems*, often carried out objectively and dispassionately. It has several advantages for developing strategy, but you must also consider its disadvantages.
- To understand deliberate strategy, you should also consider both the vision of *strategic leaders* and *externally imposed strategy* by external stakeholders like government, private equity and activists.
- To understand and evaluate emergent strategy consider its three ways of development:
    - *Logical incrementalism* and how organisations may proactively develop strategy by experimentation and learning.
    - *Political activity and processes* by which strategies are bargained outcomes of negotiations among organisation managers and sometimes external stakeholders.
    - The process through which *organisational structures* and *systems* favour some strategy projects over others on the basis of resource allocation and prior strategies.
- When managing strategy development processes, the characteristics of *different contexts* need to be considered as they may require different strategic management approaches.

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

14.1 Read the annual report of a company with which you are familiar as a customer (e.g., a retailer or transport company). Identify the main characteristics of the intended deliberate strategy as explained in the annual report, and the characteristics of the realised strategy as you perceive it as a customer.

14.2 Using the different views in Sections 14.2 and 14.3, characterise how strategies have developed in different organisations (e.g., the end-of-chapter case, Alphabet/Google, Siemens* and Mormor Magda*).

14.3* Planning systems exist in many different organisations. What role should planning play in a public-sector organisation such as local government such as Vaasa City,* a not-for-profit organisation, and a multinational corporation such as Megabrew*?

14.4* Incremental patterns of strategy development are common in organisations, and managers see advantages in this. However, there are also risks of strategic drift (Chapter 7). Using the different views in Sections 14.2 and 14.3, suggest how such drift might be avoided.

14.5 Suggest why different approaches to strategy development might be appropriate in different organisations, such as a university, a fashion retailer, a diversified multinational corporation and a high-technology company.

Integrative assignment

14.6 Assume you were asked to advise a chief executive of a long-established, historically successful multinational business with highly experienced managers that is experiencing declining profits and falling market share. What might you expect to be the causes of the problems? What processes of strategy development would you propose to address them?

Recommended key readings

- A classic paper that describes different patterns of strategy development is H. Mintzberg and J.A. Waters (1985) ‘Of strategies, deliberate and emergent’, *Strategic Management Journal*, vol. 6, no. 3, pp. 257–72.
- For an overview of different types of strategy development processes and a collection of strategy process articles, see P. Olk, ed. (2010) *Strategy Process*, Edward Elgar, 2010.
- A recent special issue focuses on strategy process and practice research and their relationship: R.A. Burgelman, S.W. Floyd, T. Laamanen, S. Mantere, E. Vaara and R. Whittington (2018) ‘Strategy processes and practices: dialogues and intersections’, *Strategic Management Journal*, vol. 3, no. 3, pp. 531–58.
- For an overview of strategy process perspectives, see T. Hutzschenreuter and I. Kleindienst (2006) ‘Strategy-process research: what have we learned and what is still to be explored’, *Journal of Management*, vol. 32, no. 5, pp. 673–720.

References

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2. See H. Mintzberg and J.A. Waters (1985) ‘Of strategies, deliberate and emergent’, *Strategic Management Journal,* vol. 6, no. 3, pp. 257–72. This framework has been refined based on the Bower-Burgelman model (see Section 14.3.3) and the strategy-as-practice approach to strategy (see Chapter 17): L. Mirabeau and S. Maguire (2014) ‘From autonomous strategic behavior to emergent strategy’, *Strategic Management Journal,* vol. 35, no. 8, pp. 1202–29.
3. T. Nelson (2003) ‘The persistence of founder influence: management, ownership, and performance effects at initial public offering’, *Strategic Management Journal,* vol. 24, pp. 707–24.
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6. J. Collins and J. Porras (1994) *Built to Last*, Harper Business.
7. R. Grant (2003) ‘Strategic planning in a turbulent environment: evidence from the oil majors’, *Strategic Management Journal,* vol. 24, pp. 491–517.

8. R.G. McGrath and I.C. MacMillan (1995) *Discovery Driven Planning,* Wharton School, Snider Entrepreneurial Center; and R.G. McGrath and I.C. MacMillan (1995) 'Discovery driven planning', *Harvard Business Review,* vol. 24, no. 3, pp. 44–54. Similarly, it has been argued that a primary goal of strategic planning is to build prepared minds that are capable of making sound strategic decisions: S. Kaplan and E.D. Beinhocker (2003) 'The real value of strategic planning, *MIT Sloan Management Review,* vol. 44, no. 2, p. 71.
9. See P. Jarzabkowski and J. Balogun (2009) 'The practice and process of delivering integration through strategic planning', *Journal of Management Studies*, vol. 46, no. 8, pp. 1255–88. P. Spee and P. Jarzabkowski (2011) 'Strategic planning as communicative process', vol. 32, no. 9, pp. 1217–45, also explain how clarity on strategy may emerge as different parties involved iterate versions of the plan.
10. See M. Ketokivi and X. Castaner (2004) 'Strategic planning as an integrative device', *Administrative Science Quarterly,* vol. 49, pp. 337–65.
11. These middle managers are called 'champions' by S. Mantere (2005) 'Strategic practices as enablers and disablers of championing activity', *Strategic Organization,* vol. 3, no. 2, pp. 157–84. See also R. Whittington (2019) *Opening Strategy*, Oxford University Press.
12. Many of these dangers are drawn from H. Mintzberg (1994) *The Rise and Fall of Strategic Planning,* Prentice Hall. For a more recent critical evaluation see R.L. Martin (2014) 'The big lie of

strategic planning', *Harvard Business Review,* vol. 9, no. 1/2, January–February, pp. 3–8.

13. The confusion of strategic planning and budgeting is identified as a significant 'bad strategy' practice by R. Rumelt (2011) *Good Strategy/Bad Strategy: The difference and why it matters,* Profile Books.
14. See https://www.bain.com/insights/management-tools-and-trends-2017/ [accessed: June 2022]. Also, see evidence from other surveys such as G.P. Hodgkinson, R. Whittington, G. Johnson and M. Schwarz (2006) 'The role of strategy workshops in strategy development processes: formality, communication, co-ordination and inclusion', *Long Range Planning,* vol. 39, pp. 479–96; and R. Whittington and Cailluet (2008) 'The crafts of strategy', *Long Range Planning,* vol. 41, pp. 241–7.
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Strategic Management Journal, vol. 20, pp. 889–913. Others have suggested planning may be beneficial in dynamic environments where decentralised authority for strategic decisions is required, but with a need for coordination of strategies: T.J. Andersen (2004) 'Integrating decentralized strategy making and strategic planning processes in dynamic environments', *Journal of Management Studies,* vol. 41, no. 8, pp. 1271–99.

17. D. Stieger, *et al.*, 'Democratizing strategy: How crowdsourcing can be used for strategy dialogues', *California Management Review,* vol. 54, no. 4, pp. 44–68. See also R. Whittington (2019) *Opening Strategy,* Oxford University Press; and a special issue on open strategy: J. Hautz, D. Seidl and R. Whittington (2017) 'Open strategy: dimensions, dilemmas, dynamics', *Long Range Planning*, vol. 50, no. 3, pp. 298–309.
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19. See R. Whittington and B. Yakis-Douglas (2020) 'The Grand Challenge of Corporate Control: Opening strategy to the normative pressures of networked professionals', *Organization Theory*, 1(4), 2631787720969697.
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21. See S. Elbanna (2006) 'Strategic decision making: process perspectives', *International Journal of Management Reviews,* vol. 8, no. 1, pp. 1–20. Another examination of extant strategy process research identified four types of strategy development paths: see P. Olk, ed. (2010) *Strategy Process*, Edward Elgar.

While most scholarly contributions of emergent strategy build on rich qualitative accounts a more recent study combines this with quantitative data: R.A. Thietart (2016) ‘Strategy dynamics: Agency, path dependency, and self-organized emergence’, *Strategic Management Journal*, vol., 37, no. 4, pp. 774–92.

22. See J.B. Quinn (1980) *Strategies for Change,* Irwin, p. 58.
23. For a more extensive discussion of experimentation see O. Sorenson (2003) ‘Strategy as quasi-experimentation’, *Strategic Organization*, vol. 1, p. 337.
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31. See P. Regnér (2003) ‘Strategy creation in the periphery: inductive versus deductive strategy making’, *Journal of Management Studies*, vol. 40, no. 1, pp. 57–82.
32. There are two views of how this may happen: the resource allocation process (RAP) view of strategy development and the attention-based view (ABV). First, the RAP explanation is sometimes known as the Bower–Burgelman explanation of strategy development after two US professors – Joe Bower and Robert Burgelman. Their original studies are J.L. Bower (1972) *Managing the Resource Allocation Process: a Study of Corporate Planning and Investment,* Irwin; and (1983) ‘A process model of internal corporate venturing in the diversified major firm’, *Administrative Science Quarterly*, vol. 28, pp. 223–44. See also J.L. Bower and C.G. Gilbert (2005) ‘A revised model of the resource allocation process’ in J.L. Bower and C.G. Gilbert (eds) *From Resource Allocation to Strategy,* , pp. 439–55, Oxford University Press. The Bower-Burgelman process has recently been extended with a focus on framing practices: R. Kannan-Narasimhan and B.S. Lawrence (2018) ‘How innovators reframe resources in the strategy-making process to gain innovation adoption’, *Strategic Management Journal*, vol. 39, no. 3, pp. 720–58. Second, for ABV, see W. Ocasio (1997) ‘Towards an attention-based view of the firm’, *Strategic Management Journal*, vol. 18 (Summer Special Issue), pp. 187–206.
33. J.L. Bower and C.G. Gilbert (2007) ‘How managers’ everyday decisions create or destroy your company’s strategy’, *Harvard Business Review*, February, p. 2.

34. For similar discussion of this, see B. Wu, Z. Wan and D.A. Levinthal (2014) ‘Complementary assets as pipes and prisms: Innovation incentives and trajectory choices’, *Strategic Management Journal*, 35(9), pp.1257–78.
35. In a study of how Intel became a microprocessor company in the 1980s, Robert Burgelman at Stanford University demonstrated how the resource allocation process influenced strategy. See *Strategy as Destiny: How Strategy Making Shapes a Company’s Future*, Free Press, 2002.
36. Managers may also differ in their attention to opportunity versus threat aspects of the same exogenous changes, see I. Barreto and D.L. Patient ‘Toward a theory of intraorganizational attention based on desirability and feasibility factors’, *Strategic Management Journal*, 34(6), 687–703.
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Case example

From Google to Alphabet to ‘Moonshots’: Strategy development twists and turns

Patrick Regnér

Introduction

In late 2021, Alphabet became the third company in the world to reach a market capitalisation of more than $2trn (€1,5; £1,2) following only Apple and Microsoft.[1] Its main revenues still come from the service whose name has become so synonymous with its primary offering that it has become a commonly used verb, Google. As search revenues soared, more and more businesses were added in other areas and, by 2021, it had acquired over 220 companies. However, the new ventures made investors nervous. As the company expanded, the coherence of the company’s strategy was questioned and some even claimed that the company had developed into a highly diversified conglomerate. Some observers were concerned that, besides search, other businesses in broadband networks, driverless cars, biotech, health, fitness, etc. had not paid off and many innovation attempts had flopped.

Early years and history

Google started as the brainchild of Larry Page and Sergey Brin in 1998 when they were students at Stanford University in the USA with the mission ‘Organise the world’s information and make it universally accessible and useful’. Their search engine gained followers and users quickly and enabled an IPO in 2004, raising a massive $1.67bn. Page and Brin recruited successful CEO Eric Schmidt from Novell Inc. 2001 and the three shared power at the top. Schmidt dealt with administration and Google’s investors and had the most traditional CEO role. There was a famously unstructured style of

operating at Googleplex (Google's HQ) in Mountain View, California; Eric Schmidt claimed their strategy was based on trial and error:

> **Google is unusual because it's really organised from the bottom up . . . It often feels at Google people are pretty much doing what they think best and they tolerate having us around . . . We don't really have a five-year plan . . . We really focus on what's new, what's exciting and how can you win quickly with your new idea.**[2]

Engineers worked in small autonomous teams with quality assured, using peer review rather than classical supervision or clear strategic guidelines and the nature of projects under way at any one time were thus down to employees and not management. The aim was 'moonshots' – big and risky ideas and bets with a high likelihood of failure, but with a small potential to become a huge success.

Google was proud of its laissez-faire approach to management and product development, as explained by CEO Eric Schmidt:

> **Google is run by its culture and not by me . . . It's much easier to have an employee base in which everybody is doing exactly what they want every day . . . But it's a very different model than the traditional, hierarchical model where there's the CEO statement and this is the strategy and this is what you will do, and it's very, very measured. We put up with a certain amount of chaos from that.**[3]

Continued growth and expansion

Google became the dominant player in internet search globally (ca 85 per cent worldwide market share before former giant Yahoo's 4 per cent and Microsoft's 'Bing' 7 per cent and Chinese Baidu with 1 per cent). They thus dominated digital advertising, way ahead of Meta/Facebook, Amazon, Alibaba, Baidu, Twitter and others. While this was a tremendous success, regulators had another perspective on the dominance and there were clear political threats of regulation.

With all the cash generated from Google, the company expanded fast into a range of other businesses and not only based on internal decentralised big and risky innovations but, some would say, increasingly risky acquisitions outside the core. This included companies like Android, YouTube, DoubleClick and Nest:

> **People thought we were crazy when we acquired YouTube and Android and when we launched Chrome, but those efforts have matured into major platforms for digital video and mobile devices and a safer, popular browser.**[4]

As the company grew, sceptical investors started to push for more transparency of the diverse businesses to be able to understand and evaluate their individual performance. There was also concern the strategy was unclear and the company had become an untamed digital diversified conglomerate without a coherent focus. This forced the management to restructure into Alphabet in 2015, a holding company that, besides Google, included their range of other businesses. Larry Page became the CEO of Alphabet and Google cofounder Sergey Brin President, and senior VP Sundar Pichai became CEO of Google. Larry Page argued for forming Alphabet in his blog post:

Google’s strategy development into Alphabet

Alphabet's multiple companies and ventures

Source: CNN Money: available at: https://money.cnn.com/interactive/technology/what-is-googles-new-alphabet/index.html [accessed: June 2022].

Long Description

> **This newer Google is a bit slimmed down, with the companies that are pretty far afield of our main internet products contained in Alphabet instead. What do we mean by far afield? Good examples are our health efforts: Life Sciences (that works on the glucose-sensing contact lens), and Calico (focused on longevity). Fundamentally, we believe this allows us more management scale, as we can run things independently that aren't very related. Alphabet is about businesses prospering through strong leaders and independence.**[5]

The change made the company's structure clearer as the core Google business results were separated from an 'other revenues' category, which included its cloud business and hardware sales and 'other bets' involving the 'moonshots' like healthcare

company Verily, internet service provider Fiber, and self-driving car company Waymo among other ventures within broadband networks, robotics and artificial intelligence.[6] While Alphabet made financial performance transparent, it did not stop further expansion into new business areas. Indeed, the new structure and systems seemed to enforce it and already at the Alphabet launch Larry Page stated:[7]

> **'As Sergey and I wrote in the original Founders letter 11 years ago, 'Google is not a conventional company. We do not intend to become one.' As part of that, we also said that you could expect us to make 'smaller bets in areas that might seem very speculative or even strange when compared to our current businesses'. From the start, we've always strived to do more, and to do important and meaningful things with the resources we have.**
>
> **We did a lot of things that seemed crazy at the time. Many of those crazy things now have over a billion users, like Google Maps, YouTube, Chrome and Android. And we haven't stopped there. We are still trying to do things other people think are crazy but we are super excited about.**

After the formation of Alphabet, the company thus continued its acquisition spree, including another 60 companies, until 2022. In 2021, they closed the deal to acquire Fitbit, the fitness tracking company, for $2.1bn. However, there was still concern the strategy was unclear, and the company had become an untamed digital diversified conglomerate without a coherent focus.

The future: continued bets or focus?

Besides queries concerning the conglomerate structure the total dominance of its online advertising, over 95 per cent by 2021,[8] was of concern for some investors as 'other revenue' businesses did only marginally contribute and 'other bets' still ran at a huge loss. They were also worried about a continued political and regulatory backlash; the European Union had already hit Google with a record antitrust fine of € 4.34 billion euro

($5 billion) for abusing its dominance. The biggest risk was privacy regulation and Alphabet's monopolistic control over certain segments.[9]

Hence, while some investors and shareholders were calmed by the formation of Alphabet, others had started to criticise the strategy from another angle. Shareholder activists organised themselves to break up Alphabet before regulators would force the world's biggest internet ad seller to split into different pieces. While the activist's proposals had no realistic chance of success as the two top executives, Page and Brin, hold 51.3 per cent of shareholder votes, asset manager shareholders like BlackRock Inc. and Vanguard Group Inc. had started to show some support of social and environmental issues. This could, potentially, pressure Alphabet to reconsider its strategy and structure as other shareholders had done when Alphabet was formed. The activist group's proposal read:

> **'Officials in the U.S. & E.U. continue to be concerned about Alphabets market power in view of restrictions on monopolies. . . We believe that shareholders could receive greater value from a voluntary strategic reduction in the size of the company than from asset sales compelled by regulators.'[10]**

The meteoric rise of Facebook (Meta) selling advertising space, was another challenge. Yet another advertising concern was the increased traffic acquisition costs (the money Google pays to phone manufactures, like Apple) and Apple's move to block all third-party cookies by default on its Safari browser, with advertisers, like Google, no longer being able to follow browsers across the internet using tracking technology.[11]

Although search advertising continued to succeed, the effects of forming Alphabet and getting the moonshots to pay off remained to be seen and it was not quite clear what strategy held the diverse portfolio together, as noted by one observer:[12]

> **Projecting a looser corporate structure, meanwhile, will raise the question of why Alphabet's collection of businesses belongs together. If the only things they**

share in common are the group's ample money and ambition, will this be enough to hold it together?

All of this made the evolution of Google into Alphabet and further feel more like part of a process than a settled corporate structure.

In 2019, the founders Larry Page and Sergey Brin surprisingly stepped down from management although still being board members and majority shareholders. They left control to Sundar Pichai who became Alphabet CEO and signalled he would continue the same path. However, there were soon signs that some businesses could be sold off, although he denied any disagreement with Page and Brin:[13]

One of the possibilities for some of these things is that they are standalone companies outside [Alphabet]. I think they [Page and Brin] always envisioned being able to innovate with the structure.

Related to this, he also indicated that AI related businesses may become a common and coherent strategy theme:

Waymo is pushing the state of the art in terms of AI . . . And that applies to robotics. It applies to our search . . . the future across all of these things is connected. That's what gives us the comfort to take a long-term view and invest in them.

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Questions

1 Explain how Google’s/Alphabet’s strategy has been developed over the years.

2 What are the strengths and weaknesses of its approach?

3 In what ways should Google's/Alphabet's approach to strategy development change in the future?

Chapter 15

Implementing strategy

Key terms

agile team

alignment

configurations

divisional structure

functional structure

implementation

matrix structure

procedural justice

sensemaking

structures

systems

Learning outcomes

After reading this chapter you should be able to:

- Identify key contributors to strategy implementation, both *hard* and *soft*.
- Design organisational *structures* and *systems* in order to achieve appropriate *fit* with particular strategies.
- Address issues of *culture, sensemaking* and *procedural justice* in implementation.

- Integrate the contributors to implementation through consistent *strategy alignment* and self-reinforcing *configurations*.

15.1 Introduction

Strategies only become real when they are implemented. If the US multinational retailer Walmart wants to implement its strategy, it needs to get 2.3 million employees spread over 12,000 locations worldwide all pointing in the right direction. In just the same way, a sports team has to ensure that all its individual members coordinate their moves according to their overall game plan: everybody has to know their roles and those of their team-mates and act accordingly, even in the heat of the game. Strategy has to be enacted on the ground. If actions are inconsistent, then even the cleverest strategy will fail because of poor implementation.

This chapter examines strategy implementation (sometimes known as strategy execution). Implementation is important because that is where strategy often goes wrong: strategies may fail not because they are badly chosen but because they are badly executed.[1] **Implementation refers to the translation of a chosen strategy into organisational action in order to achieve strategic goals.** As in Chapter 14, sometimes, it is hard to distinguish strategy implementation as a separate phenomenon from strategy in general: emergent strategy development processes tend to fuse strategy formulation and strategy implementation into a single, continuous process of strategy 'formation'. Moreover, it is important that strategy implementation is adaptive to changing conditions, not thoughtlessly rigid: the plan need not always be implemented precisely as originally envisaged. Nonetheless, any formal strategy process should explicitly consider implementation. As in Chapter 13's

discussion of strategy evaluation, strategy must pass the feasibility test.

Implementation involves many aspects, including the leadership and change activities that are the focus of Chapter 16. However, this chapter focuses on two key themes in implementation. First, there are the 'hard' elements of organisational *structure* and *systems*, dealing with implementation through organisational hierarchy, incentives and planning, for instance.[2] These are the traditional focus of implementation and therefore form the larger part of this chapter. Second, come the 'soft' elements of implementation: here we both recall issues of *culture* from Chapter 7 and introduce two new concepts: *sensemaking* by managers and employees in the implementation process and *procedural justice* for gaining stakeholder commitment to successful implementation.

The sequence of this chapter is summarised by Figure 15.1. Implementation flows from some initial kind of strategic plan (deliberate strategy in the terms of Chapter 14). Implementation is addressed in two parts: hard elements of implementation come in Section 15.2; soft elements come in Section 15.3. As Figure 15.1 indicates, these hard and soft elements need to be integrated into a coherent *configuration* and this configuration should, ideally, be in close *alignment* with the original strategy: these issues are considered in Section 15.4. In practice, of course, the logical sequence of Figure 15.1 is rarely so clear-cut: few strategies are delivered as originally planned; strategy formulation and implementation often fuse together; and, as indicated at the bottom of the figure, implementation feeds back into strategy going forwards (in the terms of Chapter 14, emergent strategy). The chapter's final

Thinking Differently section considers the possibility that you do not need formal hierarchies to deliver strategy.

Figure 15.1 Implementing strategy

Figure 15.1: Long Description

15.2 Hard implementation

There are two key hard elements of organisational design involved in successful strategy implementation: organisational structures and organisational systems. **Structures give people formally defined roles, responsibilities and lines of reporting.** Thus, structures define who does what in strategy implementation and how they are accountable for delivery. These structures can be seen as the skeletons of organisations, providing the basic frameworks on which everything is built. **Systems support and control people as they carry out structurally defined roles and responsibilities.** Systems can be seen as the muscles of organisations, giving them movement and coherence. Formal structures and systems are treated as 'hard' aspects of implementation because their key features can be precisely designed and they are objective rather than subjective (relative to culture, for example). In principle, it is possible to specify exactly which managers any employee reports to and what targets they must meet.

15.2.1 Structural types

Defining roles, responsibilities and reporting structure have major implications for employees' work and interactions.[3] Having the right organisational structure is therefore crucial to strategy implementation. One of the strategy discipline's founders, Alfred Chandler, documents how major corporations such as DuPont and General Motors nearly went bankrupt early in their histories: the

reason was not badly chosen strategies, but the wrong structures to implement the strategies. The companies had become diversified but retained their old, centralised structures. The misfit in structures meant that operating businesses did not have enough autonomy and top managers were overwhelmed by too much detailed information. Chandler concluded that structure must fit strategy.[4] Change the strategy, and you probably have to change the structure as well.

This section reviews three basic structural types: functional, divisional and matrix.[5] Broadly, the first two of these tend to emphasise one structural dimension (or 'axis') over another, either functional specialisms or business divisions. The third mixes structural dimensions more evenly, for instance, trying to give functions and businesses equal weight. Of course, in practice, there are many detailed variations around these structural types and structures are continually evolving. Every organisation has its own specific structure which its managers tend constantly to tweak.[6] However, each basic structure fits particular broad types of strategy. The section concludes by introducing the temporary structures formed by agile teams, which overlay more enduring structures and support innovation strategies.

The functional structure

Even a small entrepreneurial start-up, once it involves more than one person, needs to divide up responsibilities between different people. **The functional structure divides responsibilities according to the organisation's primary specialist roles such as production, marketing and finance.** Figure 15.2a represents a typical organisation chart for such a functional organisation. This kind of

structure is particularly relevant to small or start-up organisations, or larger organisations whose strategic focus is on narrow, rather than diverse, product ranges. Functional structures may also be used within a multidivisional structure (see below), where the divisions themselves may split themselves up according to functional departments (as in Figure 15.2b).

The functional structure has the advantage of giving top management direct hands-on involvement in key activities, from marketing to human resources, and thereby provides greater operational control from the top. This can aid consistent implementation of strategy. However, direct control from the top typically does not work well, as organisations become larger or more diverse. Centralisation in the hands of top functional managers is not good for coping with product or geographical diversity. For example, a central marketing department may try to impose a uniform approach to advertising, regardless of the diverse needs of the organisation's various markets around the world; a central human resources department might try to impose standard recruitment and pay policies on very different sets of employees. Functional structures tend to fit strategies that are narrowly focused. They are typically a poor fit for complex, diversified strategies.

The divisional structure

A divisional structure is built up of separate divisions based on products, services or geographical areas (see Figure 15.2b). Divisionalisation often comes about as an attempt to overcome the problems that functional structures have in dealing with diversification and complexity. The key principle is decentralisation.

Under divisionalisation, divisional managers are given considerable freedom to respond to the specific requirements of their products and markets, using their own set of functional departments. Top management typically does not interfere, but monitors results remotely from headquarters. A similar situation exists in many public services, where the organisation is structured around *service departments* such as recreation, social services and education. Large and complex divisional companies may even have a second tier of subdivisions within their main divisions: thus, a diversified automobile company may have geographic subdivisions within separate car and trucks divisions, for instance, a Trucks (Asia) subdivision.

Figure 15.2 Four common organisation structures

(a) Functional structure

(b) Divisional structure

(c) Matrix structure

(d) Agile team structure

Figure 15.2: Long Description

The divisional structure allows head office to control divisions from a distance simply by monitoring their business performance: in principle, top management need only intervene if targets are being missed (see Section 15.2.1). For divisions, this detachment means less meddling from the top; for the head office, this means less distraction by operational details. Decentralisation to divisions is therefore a good way of implementing diversification or internationalisation strategies. Each product, or each geographical region, can form a semi-autonomous division of its own and manage according to their particular needs. However, divisional structures tend to get in the way of cooperation and knowledge-sharing between business units: divisions can quite literally divide. Expertise is fragmented and division-specific performance targets provide little incentive to collaborate with other divisions. Where diversification or internationalisation strategies require collaboration, simple decentralisation in the form of divisionalisation is a poor structural fit.

Illustration 15.1 Elon Musk reorganises Tesla: time to shower?

Tesla reorganises as it ramps up production of its new Model 3 electric car.

During 2018, the Silicon Valley electric car company Tesla was struggling to produce enough of its first mass-market electric car, the Model 3. The company had 500,000 customer reservations for the new car, but was not yet reaching its production target of 5,000 cars per week. This target was essential for Tesla to break even financially. Company founder, Chairman and Chief Executive Elon Musk claimed he was working so hard at resolving what he described as ‘production hell’ that he was sleeping on the factory floor, with no time to go home and have a shower.

Musk was busy not only with the Model 3 Tesla car. He was closely involved in a whole raft of other companies. In 2002, Musk had created SpaceX, a space transport services company, of which he continued to be CEO and lead designer. In 2006, Musk helped found SolarCity, a solar energy services company that is now a subsidiary of Tesla and operates under his chairmanship. In 2015, Musk co-founded OpenAI, a non-profit research company interested in friendly artificial intelligence. The next year, he had co-founded Neuralink, a neurotechnology company where he acted as CEO. That same year, after getting stuck in a traffic jam, Musk established The Boring Company, a tunnel-construction company aimed at getting traffic moving faster. The Boring Company’s first product, in fact, turned out to be a flame-thrower.

In resolving the problems at Tesla, Musk naturally had a senior management team to help. The most prominent roles in the company were the Chief Financial Officer, the Chief Technology Officer, the Chief People Officer, the Senior Vice-President for

Engineering, the Chief Designer, the Vice-President for Production and the Vice-President for Global Sales. The organisation had grown rapidly in recent years, with total full-time employees reaching 37,000 in 2017, against a couple of thousand in 2012.

However, the financial markets were increasingly sceptical of Tesla's ability to meet its production targets. During the first part of 2018, the stock price fell by nearly a quarter. Musk responded by announcing a new flatter organisation structure in May 2018. In his memo, he wrote: **To ensure that Tesla is well prepared for the future, we have been undertaking a thorough reorganization of our company. As part of the reorg, we are flattening the management structure to improve communication, combining functions where sensible and trimming activities that are not vital to the success of our mission.**

In the period immediately following the announcement of this new flatter structure, Tesla declared 3,000 employees redundant. During 2018, there were significant senior management departures, including those of the Chief People Officer, the Vice-President for Global Sales and the Senior Vice-President for Engineering. To fill the gaps, Musk took direct responsibility for both global sales and engineering on a temporary basis.

Musk explained the 2018 reorganisation to financial analysts in a combative conference call. When asked about how much capital Tesla would need to support its growth, he dismissed the question with a curt: 'Boring, bonehead questions are not cool. Next?' A further question about Model 3 reservations met with the response: 'These questions are so dry, they are killing me.' In August 2018, Musk sent out a tweet that he was going to take the company private, meaning that there would be no public shareholders – and no need to talk to financial analysts any more. The tweet was unfounded and regulators fined both Musk and Tesla separately, $20mn each. Musk was obliged to step down from his chairmanship of Tesla, though allowed to continue as CEO.

Sources: Fortune, 14 May 2018; *Wall Street Journal,* 14 May 2018, *Bloomberg,* 7 September 2018.

Questions

1 In the terms of Section 15.2.1, what kind of structure did Tesla have?

2 Given its strategic challenges, do you agree that, for Tesla, a flatter organisation was the right way to go?

The matrix structure

A matrix structure combines different structural dimensions (axes) simultaneously, for example, product divisions and geographical territories or product divisions and functional specialisms.[7] In matrix structures, staff typically report to two managers rather than one. This dual reporting makes matrix structures complicated, but they can be effective in complex organisations where collaboration between different parts of the organisation is important. Figure 15.2c gives an example of such a structure in a school which has to manage the needs of both subject specialisms (for example, languages or sciences) and of different age groups (for example, lower, middle and upper school cohorts). An individual teacher would report both to a subject specialism head (e.g., languages) and to the head of a student group, e.g., middle school. A similar kind of matrix is often used in multinational businesses, where one structural axis might be products (for example, software and hardware) and the other structural axis might be geographical (for example, the Americas, Europe or Asia). In international businesses, product and geographical matrices, when reinforced by strong collaborative networks between the various

units, are known as *transnational structures*: here, product axes cross many nations while being balanced by the input of geographically local managers.[8]

Matrix structures are potentially attractive as they can combine the advantages of different dimensions at the same time. A consulting firm might have both sector heads who understand clients in particular markets, for example, heads of energy or retail, and heads of specialised groups with particular expertise, for example, information technology or strategy: here, an individual consultant might work with the heads of both energy and strategy. The organisation benefits from specialised expertise, at the same time as being responsive to particular client needs. For this reason, matrix structures are good for implementing complex strategies that require a lot of collaboration and knowledge-sharing. However, replacing single lines of authority with cross-matrix relationships can produce conflict. Staff can find themselves pulled two ways: in the consulting example, the energy head may want different things to the strategy head. The key ingredient in a successful matrix structure can be senior managers who are good at sustaining collaborative relationships across the matrix and coping with the messiness and ambiguity which that can bring. It is for this reason that the matrix is sometimes described as involving a ‘frame of mind’ as much as a formal structure.[9]

The agile team structure[10]

Many organisations nowadays overlay their main structural axes with agile teams. **Agile teams are small, entrepreneurial groups given the autonomy to respond quickly to the needs of (internal or**

external) customers. These teams might typically have eight to ten members, with diverse skills and perspectives. Agile teams are effective in implementing strategies focused on innovation, being close to customers and highly flexible. Teams can start up fast and close down easily: individually, teams are temporary structures, rather than part of a permanent structure. They are like matrix structures, but in motion: they draw fluidly on multiple dimensions of the organisation. Agile teams might be focused on internal customers (for example, solving problems in manufacturing or logistics) or on external customers (for example, addressing the needs of important clients or client groups). Alternative versions of agile teams are project teams, cross-functional teams and taskforces.

Originating within software engineering, the concept of agile teams is being increasingly deployed across all kinds of organisations to address a range of needs (for example, improving the customer experience or streamlining internal business processes). Typically, the fundamental structure of the organisation will be retained, but diverse skills and perspectives are brought together from across functions and business or geographical divisions. In Figure 15.3d, the teams are represented as existing between the axes of the formal structure: their reporting lines to top managers go across structural axes, their dashed boundaries reflect their fluidity and diversity and they are arranged in no clear hierarchy. Some organisations – for example the Dutch ING Bank[11] – might create several hundred agile teams. Although teams are given considerable autonomy to find solutions for themselves, and have

little internal hierarchy, they are held accountable for delivering defined outcomes.

Agile teams are relevant for organisations emphasising innovation and speed. However, even innovative organisations will typically have relatively stable components (such as payroll or site services) for which permanent structural arrangements will normally be appropriate. Moreover, the constant dynamism of agile teams is liable to create confusion and complexity. Some pros and cons of agile teams are evident in Illustration 15.2 on Swedish fintech company Klama. Especially at scale, agile teams need careful organising. Where there are many agile teams, they are often organised in groups (for example, customer experience teams, business process teams) in order to reduce management complexity.

15.2.2 Systems

Structure is a key ingredient in strategy implementation, but they can only work if they are supported by organisational systems, the ‘muscles’ of the organisation. Systems such as planning and targeting help ensure control over strategy implementation. Small organisations may be able to rely on *direct supervision,* where a single manager or entrepreneur monitors implementation in person. But larger or more complex organisations typically need more elaborate systems if they are to enact their strategies as intended. This section considers three systems specifically: planning, performance targeting and internal markets. Organisations normally use a blend of these three control systems, but some will dominate

over others according to the nature of strategic challenges. As with structures, systems should fit the strategies.

Planning systems

Strategy implementation relies on resources, both financial and human. Money must be invested and people set to work. Planning systems govern the allocation of resources and monitor their utilisation.[12] Tight control over resources is often efficient, reducing waste. However, planning systems can be too rigid and fail to anticipate rapid change: planning therefore may sometimes reduce flexibility. This section introduces three types of planning system operated from the corporate centre, developing the more general discussion of strategic planning in Chapter 14.

Goold and Campbell's typology of three *corporate strategy styles* helps to identify the advantages and disadvantages of different planning systems.[13] The three strategy styles differ widely along two dimensions: the *dominant source of planning influence,* either top-down (from the corporate centre to the business units) or bottom-up (from the business units to the centre); and the *degree of performance accountability* for the business units, either tight or reasonably relaxed. As in Figure 15.3, the three corporate strategy styles are positioned on these two dimensions thus:

- The *strategic planning* style is the archetypal planning system, hence its name. In the Goold and Campbell sense, the strategic planning style combines both a strong planning influence on strategic direction from the corporate centre with relatively relaxed performance accountability for the business units. The logic is that if the centre sets the strategic direction, business

unit managers should not be held strictly accountable for disappointing results that might be due to an inappropriate plan in the first place. In the strategic planning style, the centre allocates the resources necessary to achieve the strategic plan and exercises tight control over how the plan is implemented.

- The *financial control* style involves very little central planning. The business units each set their own strategic plans, probably after some negotiation with the corporate centre, and are then held strictly accountable for results. If the businesses devised the plans, then they should take full responsibility for success or failure. Business unit managers in the financial control style have a lot of autonomy in both strategy formulation and strategy implementation. Managers typically receive high bonus payments for success, but failure may easily lead to dismissal.
- The *strategic control* style is in the middle, with a more consensual development of the strategic plan between the corporate centre and the business units and moderate levels of business unit accountability. Under the strategic control style, the centre will typically act as coach to its business unit managers, helping them to see and seize opportunities in a supportive manner.

Illustration 15.2 Agile Klarnanauts As fintech business Klarna grows into a billion-dollar multinational, management uses agile teams to retain its start-up spirit.

Klarna – the Swedish buy-now-pay-later giant – was founded in 2005 by a team of three students from the Stockholm School of Economics. Their business idea had come nearly

last in the School's annual entrepreneurship competition. The three students started the business, nonetheless. By 2021, CEO Sebastian Siemiatkowski – the last of the three students still in the company – was presiding over a business with a $31 billion valuation. Klarna was the highest-valued private 'fintech' in Europe.

Sebastian Siemiatkowski had found managing rapidly growing numbers of people – whom the company call 'Klarnanauts' – especially tricky. He remembered: 'As the company scaled and we started adding more markets and growing fast, for me as CEO and Co-founder, I found that very difficult. As long as we were up to 100 people, I found it easier, I understood how to talk to people, how to get things done, how to develop new products or features and so forth. It was all much less complex. And then we started approaching a couple of hundred people and I felt more and more lost in all of that. It was difficult.'

By 2021, Siemiatkowski had more than 4,000 Klarnanauts all over the world. The company was still essentially focused on buy-now-pay-later. However, it was making a major push into the United States and developing retail banking and physical card businesses as well. The seven top C-suite managers, beyond Siemiatkowski himself, were the Chief Product Officer, the Chief Technology Officer, the Chief Financial Officer, the Chief Operating Officer, the Chief Commercial Officer, the Chief Marketing Officer and the Chief Expansion Officer. All but one of these was Swedish (or originally stationed in Sweden) and all but two had been internal hires. Decision makers are based in the Stockholm HQ, Klarna House, an ultra-modern building with plenty of semla – Swedish cardamom-spiced cream buns – available. The international offices in Berlin, London and Columbus, Ohio are relatively peripheral.

Klarna describes how it uses more than 700 agile teams to maintain start-up pace and flexibility: 'Just like a start-up, we maximise innovation and move at lightning speed. To do this, we turned the traditional corporate hierarchy upside down, splitting up into hundreds of small, autonomous teams.' Teams are small and represent mixed competences, depending on the new products or problems they are addressing: for

example, engineers and product managers might be joined by specialists in analytics, marketing and legal. Once goals have been achieved, the team shuts down and its members disperse to the next challenge. Klarna team practices provide a standard set of daily, weekly and quarterly routines across all teams to ensure flow, speed and alignment. Teams are led by an Accountable Lead who is responsible for the team's deliverables and who reports to a Domain Lead, typically in senior management or the C-suite. Domains are broad functional or business areas, such as Organization & Leadership or Media, each with several teams. To provide some stability in this fluid team environment, all staff are supported by a Competence Lead responsible for guiding their professional growth.

Klarnanauts report on Glassdoor both strengths and weaknesses of the Klarna work environment. One employee complained: 'Very unstructured and messy place where things are spinning too fast and people work their shirts off for no significant rewards'. More balanced, another employee put under pros: 'International culture, autonomy given, chances to progress', but added under cons: 'Rapid growth means some systems & processes are made up as they go along, which can be fun or frustrating!' For another employee, the pros were: 'Moving fast, very interesting problems and clever people.' Cons were: 'Growing so fast there are frictions and unclearness on the interaction of teams.'

Sources: **www.klarna.com/careers/; www.glassdoor.com; sifted.eu/articles/klarna-powerplayers** [accessed: June 2022]; *Techcrunch*, 12 August 2020.

Questions

1 On the basis of the C-suite managers' job titles, what kind of structure does Klarna most resemble? How does Klarna's structure fit its growing international business?

2 Do you think you would enjoy working in the Klarna environment? What do you think your personal pros and cons would be?

Thus, the three corporate strategy styles vary with regard to their reliance on, and application of, planning systems. The strategic planning style is only appropriate in certain circumstances. In particular, it makes sense where there are large, risky and long-range investments to be made: for example, an oil company typically has to take the decision to invest in the 10-year development of an oilfield at the level of corporate headquarters, rather than delegating it to business units whose resources and time horizons may be limited. On the other hand, the financial control style is a good fit where investments are small, relatively frequent and well understood, as typically in a mature, non-capital-intensive businesses.

Figure 15.3 Strategy styles

Source: Adapted from M. Goold and A. Campbell (1989) *Strategies and Styles*, Blackwell (Figure 3.1, p. 39).

Figure 15.3: Long Description

Performance targeting systems

Performance targets focus on the outputs of an organisation (or part of an organisation), such as service levels, product quality, revenues or profits. These targets are often known as *key performance indicators* (KPIs) (see also Chapter 13). Targets should measure how well the strategy is being implemented. However, within specified boundaries, there is often freedom on how targets are exactly achieved.

Performance targeting can be particularly appropriate in certain situations:

- Within *large businesses,* corporate centres may choose performance targets to control their business units without getting involved in the details of how they achieve them (as in the financial control style above). These targets are often cascaded down the organisation as specific targets for subunits, functions and even individuals.
- In *regulated markets,* such as utilities in most countries, government-appointed regulators increasingly exercise control through agreed key performance indicators (KPIs), such as service or quality levels, as a means of ensuring ‘competitive’ performance.[14]
- In *the public services,* governments typically set targets for outputs (such as quality of service) and, more importantly,

outcomes (e.g., patient mortality rates in healthcare).

Many managers find it difficult to develop a useful set of targets. There are at least three potential problems with targets:[15]

- *Inappropriate measures* of performance are quite common. For example, managers often prefer indicators that are easily measured or choose measures based on inadequate understanding of real needs on the ground. The result is a focus on the required measures rather than the factors that might really be important to long-term success. In the private sector, focus on short-term profit measures is common, at the expense of long-run competitive advantage.
- *Inappropriate target levels* are a common problem. Managers are liable to give their superiors pessimistic forecasts so that targets are set at undemanding levels, which can then be easily met. On the other hand, superiors may over-compensate for their managers' pessimism, and end up setting excessively demanding targets. Unrealistically ambitious targets can either demotivate employees who see no hope of achieving them regardless of their effort, or encourage risky or dishonest behaviours in order to achieve the otherwise impossible.
- *Excessive internal competition* can be a result of targets focused on individual or subunit performance. These individual or subunit targets are incompatible with each other. If individuals or subunits are being rewarded on their performance in isolation, they will have little incentive to collaborate with the other parts of the organisation. The struggle to meet individualistic targets will

reduce the exchange of information and the sharing of resources.

These acknowledged difficulties with targets have led to the development of two techniques designed to encourage a more balanced approach to target-setting. The most fundamental technique has been the development of the *balanced scorecard*.[16] As discussed in Section 13.2, balanced scorecards set performance targets according to a range of perspectives, not only financial. A second approach to target-setting is strategy mapping, developing the balanced scorecard idea. *Strategy maps* link different performance targets into a mutually supportive causal chain supporting strategic objectives. Figure 15.4 shows an extract of a strategy map for a delivery company based on the four perspectives of finance, customers, internal processes, and innovation and learning. In this map, investments in well-trained and motivated drivers under the heading of ‘innovation and learning’ lead to on-time deliveries under the heading of ‘internal processes’, and thence to satisfied customers and finally to profitable growth. The causal chain between the various targets underlines the need for balance between them: each depends on the others for achievement. Thus, strategy maps help in reducing the problem of partial measures referred to above; the problems of inappropriate target levels and internal competition are not so easily resolved.

Figure 15.4 A strategy map

Source: Exhibit 1: R. Lawson, W. Stratton and T. Hatch (2005) 'Achieving strategy with scorecarding', *Journal of Corporate Accounting and Finance,* March–April, 62–8 (p. 64).

Figure 15.4: Long Description

Market systems

Market systems (or *internal markets*) can be brought inside organisations to guide internal units to actions consistent with the strategy.[17] Market systems typically involve units contracting for inputs from other parts of an organisation (like a buyer) and, in turn, accepting contracts for providing outputs to other parts of an organisation (like a supplier). They can be harnessed for strategy implementation by giving the units a strategic mandate: for example, a research and development unit would be given a mandate to

support innovation throughout the organisation and other organisational units would contract for their services. Units have to earn their keep in competitive internal markets, while staying faithful to their mandates. Units have freedom to decide exactly how they will achieve their mandates, allowing them to adapt to opportunities as they occur.

Internal markets can be used in a variety of ways. There might be *competitive bidding,* perhaps through the creation of an internal venture capital unit at the corporate centre to support new initiatives. Alternatively, a customer–supplier relationship may be established between a central service department, such as training or IT, and the operating units. Typically, these internal markets are subject to considerable regulation. For example, the corporate centre might set rules for *transfer prices* between internal business units to prevent exploitative contract pricing or insist on *service-level agreements* to ensure appropriate service by an essential internal supplier, such as IT, for the various units that depend on it.

Illustration 15.3 God's work in Malaysia Corrupt practices at Malaysia's sovereign wealth fund reveal problems with Goldman Sachs' control systems.

Lloyd Blankfein, Chief Executive of Goldman Sachs, is famous for declaring that his investment bank is 'doing God's work', so important are his bankers' activities for financing the world economy. However, in 2018, the Department of Justice in the USA charged two former Goldman Sachs bankers, Tim Leissner and Roger Ng, with misappropriating funds from the Malaysian sovereign wealth fund, 1MDB (1Malaysia Development Berhad) and paying bribes to various Malaysian officials. 1IMD appeared to be at the centre of a $2.7bn money laundering and bribery scandal, with Goldman

Sachs closely involved. Malaysia's Prime Minister demanded reparations from Goldman Sachs of $600mn. It was revealed that Lloyd Blankfein himself had met the Malay financier at the heart of the illegal dealings, Jho Low, at least twice.

1MDB was founded by the Malaysian Government in order to stimulate long-term investment in Malaysia, for instance, through the financing of large-scale energy projects. In the early years of this decade, Goldman Sachs was earning about $85mn annually in fees from IMDB. The most spectacular fee came in 2012, when Goldman Sachs helped IMDB to raise $6.5bn in debt intended to fund the wealth fund's various investment projects. The fee for this transaction alone was nearly 10 per cent, $600mn.

The bankers at the heart of this lucrative business were senior managers within Goldman Sachs. The man responsible for originating many of the deals, Andrea Vella, had been co-head of investment banking in Asia-Pacific ex-Japan (he was demoted and suspended by Goldman Sachs in 2018). Tim Leissner was the bank's Chairman of South-East Asia as a whole. Roger Ng had been in charge of South-East Asian sales in Goldman Sachs' fixed-income, currencies and commodities unit.

Goldman Sachs is well-known for its aggressive, bonus-driven culture. It saw the growing South-East Asian economies as key to its own continuing expansion. Crucial to this strategy was Andrea Vella. According to the *International Financial Review,* Vella was 'a veritable magician' in financial deals. He was also well-known for ostentatious living, with his wife famous for driving around Hong Kong in a top-end Maserati.

Explaining how the complex Malaysian deals got past the bank's internal controls, Tim Leissner admitted to a New York court: 'I conspired with other employees and agents of Goldman Sachs very much in line with the [Goldman Sachs] culture to conceal facts from [the company's] compliance and legal employees.' Formally, all deals, including those with 1MDB, are approved by Goldman Sachs' capital and client suitability committees. At the time, these were organised on a regional basis, reporting finally to a central committee in New York. Members of deal teams typically remained in committee

meetings, even though they would abstain from voting. Committees tended to review or approve most proposed deals by consensus. The bank preferred deal teams to attend committee discussions so they could respond immediately to any questions raised by other committee members.

The Federal Reserve Bank of the United States has queried why the Asia-Pacific capital committee, which initially reviewed the first 1MDB deal in 2012, seemed to reject very few deals for being too risky or inappropriate. The Asia-Pacific committee typically met in Hong Kong with Eugene Leouzon, Goldman's Global Chief Underwriting Officer, acting as Co-Chair with Tim Leissner. An inside observer recalled standard practice: 'Tim Leissner and Roger Ng would do the pitch and Leouzon would say, "That is interesting," then Vella would walk in like a rock star.' Apparently, Andrea Vella had been the most influential figure within the Asia-Pacific committee in securing approval for the first 1MDB deal, despite being its originator. Although Vella formally abstained from the decision, he remained in the room and took part in the discussion of the key $6.5bn deal.

Sources: Financial Times, 23 November and 11 December 2018.

Questions

1 In this account, how did Goldman Sachs' systems support the growth strategy and in what respects did they fail with regard to the Malaysian business and more generally?

2 What reforms to these systems would you recommend? What downsides to these reforms might there be?

Internal markets work well where complexity or rapid change makes detailed control through planning impractical. But market

systems can create problems as well. First, they can increase bargaining between units, consuming important management time. Second, they may create a new bureaucracy monitoring all of the internal transfers of resources between units. Third, an overzealous use of market mechanisms can lead to dysfunctional competition and legalistic contracting, destroying cultures of collaboration and relationships. These have all been complaints made against the internal markets and semi-autonomous hospitals introduced in the UK's National Health Service. On the other hand, their proponents claim that these market processes free a traditionally over-centralised health service to innovate and respond to local needs, while market disciplines maintain overall control.

15.3 Soft implementation

Soft implementation includes cultural change, sensemaking and procedural justice. These are labelled ‘soft’ because they are hard to design precisely before initiation, unlike formal structures or performance targets. Cultures, sensemaking and justice frequently evolve during implementation. Soft elements of implementation tend to be subjective rather than objective and qualitative rather than quantitative. They are hard to manage, but getting them wrong can derail the whole implementation process.

15.3.1 Cultural change

As in Chapter 7, organisational culture refers to the taken-for-granted assumptions and behaviours of organisational members. Employee assumptions about what is strategically important, and employee behaviours that are consistent with the strategy, are obviously important to successful implementation. A strategy that aims to ‘put clients first’ will be undermined by organisational members who habitually behave cynically or opportunistically with clients.

Changes in strategy will typically need matching by changes in culture, therefore. Many organisations attempt cultural changes using the following five steps:[18]

- determine the required culture
- analyse the gap between the existing culture and the required culture

- develop a plan to bridge the gap between the existing culture and the required culture
- implement the plan, drawing on the ‘four Rs’: *recruitment* of new employees and managers suited to the new culture; *retraining* of existing employees and managers into the new culture; *reward*, for example, providing promotion opportunities and incentives for individuals displaying appropriate behaviours; and *reinforcement*, for example leadership communications, celebration of exemplary behaviours, and symbolic actions such as changes in slogans, branding, dress codes or buildings
- review the culture change for its success and its consistency with the strategy and take action to sustain the change or adjust it.

While this step approach does contain ‘hard’ elements such as rewards for appropriate behaviours, it is important to recognise that culture is ultimately subjective and hard to control. It is easy to overestimate the ability to define the features of a desired culture precisely. For example, in a university, what exactly does a ‘teaching culture’ mean: does it reward unchallenging teaching that gets high student evaluations or does it encourage teaching innovations that may sometimes fail? Similarly, formal declarations of a new culture are not enough: cultures are marked by considerable continuity (see Chapter 7): cultures are sticky. John Kotter of Harvard Business School argues that it is not what senior leaders *say* but what they *do* that ultimately sets the culture.[19] Leaders are crucial role models in the everyday enactment of culture. For example, the initiative of one large retailer to create a customer-centric culture was undermined when a senior manager angrily ejected a complaining customer from

a retail outlet, a story that spread rapidly throughout the whole company.[20] Cultures are not simply designed upfront; they need continuous reaffirmation.

Illustration 15.4 The International Baccalaureate: 'implementation is the strategy'

A new leader at this leading educational body is inspired by improvisational jazz.

When Finnish civil servant and politician Olli-Pekka Heinonen became Director-General of the International Baccalaureate (IB) in 2021, he was taking over an organisation with many achievements to its name. The IB had been founded in 1968 in Switzerland as a non-profit organisation and sold its examination products and grading services to schools in a system analogous to a franchise network. After more than half a century, the IB was still on a growth trajectory. In the five years preceding Heinonen's appointment, the number of schools offering IB programmes around the world had increased by a third, with a total of over 5,000. More than three quarters of IB programmes were now delivered in the Americas or Asia-Pacific. The IB Diploma is highly-valued by many universities. Santiago Iñiguez, President of IE University in Madrid, Spain, commented: 'IB graduates are very well prepared for university. They receive an international education and are open and tolerant.'

However, the IB faced many challenges. To start with, the IB is often criticised as elitist because of its high fees and demanding final Diploma. Students from poorer backgrounds tend to perform significantly worse on the Diploma than wealthier ones. The IB's administration is often accused of being cumbersome and slow to change. The COVID crisis of 2020–21 had reduced revenues and sparked angry criticism from some schools and students about its grading adjustments.

Heinonen recognised that international opinion had shifted, with a greater stress on diversity and inclusion in education: ‘We need to increase the diversity of our students and curriculum. IB is a reflective organisation: When the world changes and we renew ourselves for each successive generation, we also change.’ In order to promote greater diversity, IB was both lowering certain fees and increasing the availability of scholarships. However, Heinonen also understood that the kinds of knowledge required in the future were changing, with the rise of artificial intelligence and similar technologies: ‘One of those changes is the question of the knowledge, the skills, the values, the attitudes, the competencies [needed] for the world of tomorrow . . . ’ He argued that the purely cognitive skills emphasised traditionally by the IB needed to be supplemented by both more practical and more emotional skills. In Heinonen’s terms, the cognition of the ‘head’ was needed, as well the practicalities of the ‘hands’ and the profundity of the ‘heart’.

Implementing this shift towards hands and hearts would be a challenge, as he would have to persuade his fee-paying schools that top universities would value the hands and the heart as well as the head. Heinonen explained his approach: ‘This is not something we will just come up with in IB headquarters and then push down to schools – it’s something we’re doing together with the larger community, involving the knowledge that there is in our schools. It’s about creating trust for collaboration and finding solutions together, sometimes experimenting with things, piloting things, asking schools who are willing to move faster to find new ways to do that and seeing whether there are wider insights that could be covering the whole organisation.’

Heinonen recognised that everything depended on implementation: ‘Actually, implementation is the strategy. The way you are able to implement things is a very big strategic choice. Teachers won’t obey because somebody says they must. They have to understand why and have the inner motivation to do so. We should be talking more about the concept of imperfect leadership: to admit uncertainty and create learning paths for the larger system to find the solution.’ He compared his approach to jazz

improvisation, with freedom to explore related themes spontaneously: ‘We have to have that larger jazz band trying to play the same tune and improvise.’

Questions

1 Which of the three ‘soft’ approaches to implementation seems most relevant to Heinonen?

2 What are the pros and cons of the image of jazz improvisation as a guide to strategy implementation at an organisation like IB?

15.3.2 Sensemaking

It is essential that middle managers and employees understand the strategies that they are expected to roll out within their units. Broad strategies have to be translated into specific actions according to local conditions and changing circumstances. However, top managers frequently over-estimate their success in communicating their strategies to their teams. According to Massachusetts Institute of Technology scholar Don Sull, one of the ‘myths’ of strategy implementation, is that ‘communication equals understanding’.[21] This gap in understanding applies even to the middle managers on whom top managers rely for implementing their strategies on the ground. Sull and colleagues report from a large-scale survey that only 55 per cent of middle managers can name even one of their company’s top five priorities. Being able to name a priority is just the first step towards understanding what it means in practice.

Chapter 17 takes up several other important aspects of strategy communication. Here we stress the process of strategic sensemaking. Managers have to *make sense* of the strategies that they are responsible for implementing. **Strategic sensemaking is the cognitive and emotional process through which managers understand, interpret and make coherent their changing environments**.[22] Managers make sense of new strategies through the everyday experience of their work and interactions with colleagues. They overlay formal communications with informal conversations, stories, jokes, rumours and gossip. Through this process, strategic sensemaking typically reinterprets, fills out and often diverges from the original strategic plan.

Even successful strategy implementation processes are therefore likely to happen through something like the following sequence of sensemaking (and 'sensebreaking'):[23]

- the *fracturing*, or breaking down, of old ways of understanding the organisation's strategy, often involving some kind of shock to past expectations (sensebreaking)
- the *differentiated* understanding of the new strategy, according to the local sensemaking of particular groups of managers (for example, in different business units or geographical regions)
- the *mutual adjustment* of differentiated understandings as managers come to sufficient consensus to work together as a coherent organisation, at the same time as retaining the local interpretations required to deal with specific circumstances.

The implication of this strategic sensemaking processes is that top managers should not expect their strategies to be perfectly and

consistently implemented by their middle managers. They will be reinterpreted according to changing conditions in each locale. While top managers should invest in communicating their strategies, particularly in challenging employees' old expectations, they should allow for flexibility in interpretation. Strategies provide broad frames within which managers act. Too much detail can get in the way. From the moment a strategic plan is published, it will be changing on the ground. Top managers need to be constantly bringing together their middle managers' varying understandings into an evolving strategic consensus. The strategic plan is not the last word, but part of a continuous process of sensemaking.

15.3.3 Procedural justice

Another aspect of implementation implying that rigid top-down approaches might be counter-productive is procedural justice.[24] **Procedural justice refers to the fairness of the process by which decisions are made.** Procedural justice is different from *distributive justice*, which refers to the fairness in how valued resources (promotions, budgets or similar) are distributed. Strategic changes are always liable to give some parts of the organisation more resources, while others get less. This uneven distribution might be seen as unfair, but the concept of procedural justice implies that the perceived fairness of the *process* matters as well. A just procedure provides reassurance to individuals that they will receive fair outcomes in the future, even if a particular decision outcome is unfavourable.

There are three key dimensions of procedural justice in organisations:[25]

- *engagement*, in other words involving individuals in decisions that affect them, both by asking for their input and allowing debate
- *explanation*, meaning that everyone affected by a decision understands why it was made that way and why some ideas and inputs were finally overridden
- clarity of *expectations,* in other words, individuals have a firm understanding of what is expected of them, before, during and after decisions are made.

Consistent with Section 15.3.2 immediately above, procedural justice places a high emphasis on communications in implementation, but adds the dimension of engagement, allowing two-way interchange.

Procedural justice is important to secure the commitment and loyalty of all stakeholders involved in implementing the strategy: these stakeholders might include subcontractors and suppliers, for example, but employees and managers are typically particularly important. Procedural justice is of course expensive and time-consuming to enact.[26] However, especially in organisations that rely on voluntary effort over and above formal requirements, or that are dependent upon groups of key workers, procedural justice may well be worth the investment. If key managers or employees believe that they are working within an unjust decision-making system, they will do the minimum they can get away with, behave cynically and depart at the first opportunity. Procedural *injustice* is liable to undermine strategy implementation.

15.4 Integrating for implementation

The previous two sections have distinguished between hard and soft elements of implementation. In practice, of course, they should not be considered separately. They should work hand in hand together. When hard and soft are integrated, they become mutually reinforcing. Two concepts help underline this integration: alignment and configuration. Both are effectively extensions of the concept of fit introduced in Section 15.2.1.

15.4.1 Strategic alignment

Strategies are aligned when they are consistent with both organisational goals and organisational characteristics. **Strategic alignment refers to how strategy and organisation should flow logically from the organisation's central goals (or purpose or mission).**[27] Alignment is thus not only about grand statements of purpose and strategy. It emphasises the operational details of organisation, ranging from human resource policies to information technology. In this sense, as in Figure 15.5, alignment can be thought of as a linear approach to consistency: each component should be lined up level on the horizontal axis. If either strategy or organisation slips from this horizontal axis, then there is strategic misalignment. Goals, strategy and/or structure are no longer reinforcing each other positively; there is counter-productive misfit.

Figure 15.5 Strategic alignment

Figure 15.5: Long Description

The implication of strategic alignment is that all *functional areas* need to support the strategy. Human resource policies of recruitment, training, reward and promotion should all be strategically aligned. Policies for information technology, purchasing and marketing should be the same. If a new strategy is to be implemented effectively, then every functional specialism in the organisation needs to review its own functional strategy in order to ensure alignment. If one part of the organisation is out of step, then the whole organisation is liable to trip up.

15.4.2 Strategic configuration

The concept of configuration similarly stresses consistency between elements, but is less linear. **Configurations are the set of**

organisational design elements that fit together in order to support the intended strategy. All elements are connected and each is important to the effectiveness of the others. When all the various elements fit together, they can form a virtuous circle of superior performance, with each element reinforcing the others. This interconnected approach is more consistent with an emergent than deliberate strategy development process (see Chapter 14), because it accepts that elements can feedback on each other. To an extent, structure can influence strategy, and so on.

One comprehensive way of thinking about configuration (and alignment) is the *McKinsey 7S framework*. Developed by the McKinsey consulting company, the McKinsey 7S framework highlights the importance of fit, not just with strategy and structure, but also with systems, staff, style, skills and superordinate goals.[28] All seven elements have to be configured together to achieve effectiveness. The seven elements can therefore serve as a checklist in any organisational implementation exercise: see Figure 15.6. Each element has to be configured to support strategy implementation and, if one is not, the whole strategy may fail. Because we have already addressed strategy, structure and systems, we shall focus on the remaining four elements of the 7S framework in the following:

Figure 15.6 The McKinsey 7S

Source: R. Waterman, T. Peters and J. Phillips (1980) 'Structure is not organization', *Business Horizons,* June, pp. 14–26 (p. 18).

Figure 15.6: Long Description

- *Style* here refers to the leadership style of top managers in an organisation. Leadership styles may be collaborative, participative, directive or coercive, for instance (see Chapter 16). Managers' behavioural style can influence the culture of the whole organisation (see Chapter 6). The style should fit other aspects of the 7S framework: for example, a highly directive or coercive style is not likely to fit a matrix organisation structure.

- *Staff* is about the kinds of people in the organisation and how they are developed. This relates to systems of recruitment, training and reward. A key criterion for the feasibility of any strategy is: does the organisation have the people to match? A common constraint on structural change is the availability of the right people to head new departments and divisions.
- *Skills* relates to staff but, in the 7S framework, refers more broadly to capabilities in general (see Chapter 4). The concept of capabilities here raises not only staff skills but also issues to do with how these skills are embedded in and captured by the organisation as a whole. For example, how do the organisation's training schemes, information technology and reward systems transform the talents of individuals into the organisational capabilities required by the strategy?
- *Superordinate goals* (sometimes known as *shared values*) refers to the overarching purpose of the organisation as a whole, including the mission, vision and objectives that form the organisational purpose (see Chapters 1 and 7). Superordinate (i.e., overarching) goals are placed at the centre of the 7S framework: all other elements should support these.

Thinking Differently Beyond hierarchy?

There are alternatives to bosses and controls.

This chapter has concerned itself mostly with hierarchical structures and systems, used for top-down control. But there are less hierarchical alternatives that can work as well.

One non-hierarchical way of organising is the 'rule-of-three'.[29] Under the rule-of-three, any project within the organisation can get under way so long as three organisational

members agree to do it. The project champion has to persuade two other people that the project is a valid one and worthwhile investing their own work time into. If the champion can win over support from those with the necessary skills to take it forward, the project is deemed worth backing. It does not require the approval of any manager: effectively, employees 'vote with their feet'. As the project continues and perhaps attracts more members, nobody is appointed as formal project manager: instead, project 'leads' emerge by informal consensus, these leads changing as project needs evolve. Differences are normally resolved by discussion. The project goes to market when three project members deem it ready.

This rule-of-three is operated by the games company Valve, with 400 employees and responsible for the games portal Steam and games such as *Half-Life* and *Counter Strike.* Although the company operates non-hierarchically, its owner and Founder Gade Newell exercises strict control over recruitment and dismissal of employees. Pay is high by industry standards and the company operates a very generous bonus policy. Bonuses are awarded non-hierarchically, according to review by peers. There are thus substantial potential benefits to getting involved in a project creating a successful new game, and large costs to investing time in one that fails. Projects that lose the support of the necessary three members are automatically closed down. Valve is estimated to be worth $2bn (€2bn).

Questions What types of industry or sector would this model be likely to work best in, and in what types might it not work well at all?

Key takeaways This chapter emphasises that even the best strategy will fail if badly implemented. This raises the following agenda items:

- once you have designed a strategy, consider both *'hard'* and '*soft'* aspects of strategy implementation
- with regard to hard implementation, identify the kinds of *structures* (functional, divisional, matrix or agile) and *systems* (planning, performance targeting and markets) that will fit the strategy
- with regard to '*soft'* implementation, consider how *cultural change*, *sensemaking* and *procedural justice* can support the strategy, especially as they continuously evolve
- make sure that hard and soft aspects of implementation are properly *integrated*, particularly through the logical flow of *strategic alignment* or the self-reinforcing *configurations* summarised in the *McKinsey 7S framework.*

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

17.1 Go to the website of a large organisation you are familiar with and find its organisational chart (not all organisations provide these, but you can sometimes deduce them from the job titles of senior executives). Why is the organisation structured like this?

15.2 Referring to Section 15.2.2 on the divisional structure, consider the advantages and disadvantages of creating divisions along different lines – such as product, geography or technology – with respect to a large organisation you are familiar with or a case organisation such as Megabrew*.

15.3* Referring to Figure 15.4, write a short executive brief explaining how strategy maps could be a useful management system to monitor and control the performance of organisational units. Be sure to analyse both advantages and disadvantages of this approach.

15.4 As a middle manager with responsibility for a small business unit, which 'strategy style' (Section 15.2.2) would you prefer to work within? In what sort of circumstances or corporate organisation would this style not work so well for you?

Integrative assignment

15.5 Take a recent merger or acquisition (see Chapter 11), ideally one involving two organisations of roughly equal size, and analyse how the deal has changed the acquiring or merged company's organisational structure. What do you conclude from the extent or lack of structural change for the new company going forward?

Recommended key readings

- The best single coverage of this chapter's issues is in R. Daft, J. Murphy and H. Willmott (2020) *Organization Theory and Design*: *an International Perspective*, 4th edition, Cengage. G. Tett (2015) *The Silo Effect*, Little and Brown, is a very readable and stimulating perspective on what can go wrong in organising and some contemporary solutions.
- A recent review of the literature referencing both hard and soft aspects of implementation is A.K. Weiser, P. Jarzabkowski and T. Laamanen (2020) 'Completing the adaptive turn: An integrative view of strategy implementation', *Academy of Management Annals*, July; 14(2):969–1031.

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Case example

Tencent: third time lucky?

Pony Ma, founder of Tencent

Source: Jerome Favre/EPA/Shutterstock

Ma Huateng (‘Pony’ Ma) founded Tencent in 1998 as a provider of internet-enabled instant messaging in China. Twenty years later, Tencent had become Asia’s most valuable company, active in investment, messaging, gaming, entertainment and cloud services. In 2018, Pony Ma was still Chairman and Chief Executive. He was also China’s richest man, owning just under 10 per cent of Tencent’s shares.

But Tencent’s twentieth anniversary year proved a hard one, the company’s share price falling by one-third. Poor internal coordination, new competition and a slow move into cloud services were among the reasons given for the company’s troubles. Tencent’s solution to its challenges was a major reorganisation, the third in its 23-year history. The reorganisation was hailed by the company as ‘a new beginning for the next 20 years’.

Earlier reorganisations

Tencent's two previous reorganisations had each confronted different problems. The company's first major reorganisation came in 2005, when Tencent was approaching a scale of 4,000 people. By training, Pony Ma was an engineer and product manager, always inclined to examine the details of the company's new products. However, the businesses were getting too big and complex for him to manage directly any more, and internal coordination was falling down. The solution in 2005 was to divide the organisation essentially into two independent business groups, 'Business' and 'Platform Development', each led by their own senior managers, with a series of business units reporting to them.

The second reorganisation had come in 2012. Tencent's original messaging service (QQ) had been struggling for some time. One of the problems was how QQ was spread over three different business units (PCs, wireless and internet), themselves in different business groups (business or platform development). One result was a slow response to the rise of smartphones, particularly the Apple iPhone, which was becoming very popular in China.

In a sense, QQ's sluggishness provided an opportunity for Tencent's next great product success, WeChat (Weixin), a multi-purpose messaging, social media and (from 2013) mobile payment app. WeChat originated through Tencent's characteristic process, internal competition between rival projects. Faced by the rise of smartphones, Pony Ma described the two-month development process as 'a matter of life or death' for the company. WeChat was the winning project and, released in 2011, acquired 100 million users within a year (by 2018, it had a billion users). However, WeChat's success – and other developments – created what Pony Ma called 'big company illness'. By 2012, Tencent had 24,000 employees. Ma asked in an email: 'When the size of the team grows bigger, it is easy to breed big business problems. How can we overcome the big business problem and build a world-class Internet company?' His answer was the 2012

reorganisation, a split into seven distinct business groups: Interactive Entertainment, Online Media, Mobile Internet, Social Networking, WeChat and Technology and Engineering.

The 2018 reorganisation

2018 was not only an anniversary year for Tencent: it was also a transitional year in the development of the internet business. Pony Ma explained:

> **The second half of the internet belongs to the industrial Internet. In the first half, Tencent provided users with high-quality services by connecting people. In the second half, building from this foundation, we will support industries and consumers to form more openly connected ecosystems. As an internet-based technology and culture company, technology is Tencent's most solid underlying infrastructure . . . Tencent will use technology as the driving engine to explore the next generation of social and content convergence.**

Pony Ma distinguishes here between two halves of the internet era: the first half was characterised by the rapid growth in consumer internet usage, first in desktop and later in mobile technologies; the second industrial half refers to a maturing of the consumer market and a period when growth will come from collaborating directly with other businesses to digitalise their industries, helping them link to consumers as well. This shift to the second half of the internet had organisational consequences for Tencent. As Pony Ma put it: 'From the management side, the biggest challenge we face is internal organisation. Right now, Tencent needs to get better at doing B2B (business to business services).'

B2B services have indeed been a problem for Tencent. An illustration of the issue is Tencent's performance in cloud services (platforms offering computer power, database storage, applications, and other IT resources, especially to business). Alibaba, a powerful peer in China's technology sector (see Chapter 2 end case), had been an early entrant into cloud services in 2010, and had captured about one third of the Chinese

market by 2017. Tencent hesitated till 2011, with the result that its market share was about a fifth. As Pony Ma said above, it would be very important to create openly connected ecosystems joining consumers and industries. However, although it was developing industry applications, WeChat retained its historical focus on consumers.

Tencent's 2012 structure reinforced a 'silo culture' that did not help in fostering connections. Each business unit was responsible for its own business, encouraging a narrow focus on its specific opportunities, each standing apart like the tall grain silos of the USA. The consequence has been difficulties in sharing ideas, data and even lines of code. Cross-selling to the same client from one part of the business to another has also suffered. Geography exacerbates some of these problems: the business serving iPhones is based in Shenzhen (Tencent's head-office location), while the iPad business is in Beijing, more than 2,000 kilometres away. The WeChat team is mostly located in Guangzhou, 140 kilometres from Shenzhen. Again, internal competition also plays a role. One expert on Tencent, Matthew Brennan, observes of Tencent's system: 'It's called saima, like a horse race – the concept of putting several teams to attack the same opportunity.' When a Chinese competitor, ByteDance, enjoyed great success with its short video apps, Tencent responded by launching a new video app, Yoo, in competition not just with ByteDance but with its own Weishi app. On top of all this, Tencent had grown from 24,000 employees in 2012 to 45,000 in 2017.

Addressing these issues, Tencent moved in 2018 to a new organisational structure based on six groups rather than seven: now there would be interactive entertainment, platforms and content, cloud and smart industries, corporate development, WeChat and technology and engineering (see Figure 1). Although the WeChat Group and the Technology and Engineering Group had been left basically untouched, there was also a lot of movement of businesses between the other groups. Three old business groups – Online Media, Social Networking and Mobile Internet – were entirely disbanded with their businesses absorbed into either the new Cloud and Smart Industries Group (CSIG) or Platforms and Content Group (PCG). CSIG combines a number of businesses aimed at

B2B services: Tencent Cloud, Internet +, Smart Retail, Education, Medical, Safety & Location Based Services and Industry Solutions. PCG is aimed at countering competitors like ByteDance, combining all of Tencent's largest content-centric mobile apps and platforms in a single Group. All non-WeChat platforms and content are now combined within PCG, with the hope of improved sharing of data and content. The Corporate Development Group serves as an incubator for new businesses.Overseeing the various Groups in the 2018 structure is a new Tencent Technical Committee. This committee is intended to foster the sharing of data, key for the development of artificial intelligence (AI) and algorithms, seen as crucial for the delivery of personalised consumer content, amongst much else. Nonetheless, Tencent retains three separate AI teams, one in the Cloud and Smart Industries Group, another in the Technology and Engineering Group and a third in WeChat. More generally, it was not yet evident how the Technical Committee would work with the Technology and Engineering Group.

Figure 1 Tencent 2018 Organisational structure

Figure 1: Long Description

In a declining market, the two weeks following Tencent's 2018 reorganisation announcement saw a 10 per cent drop in the company's share price (larger than the falls of fellow Chinese technology giants Alibaba and Baidu). Nonetheless, at the annual staff meeting soon after the announcement, Pony Ma re-emphasised the importance of

internal connectedness: ‘It is precisely because we hold extensive connections in the consumer internet that we can better serve business (to B) and government (to G) customers. This ability is our magic weapon for our future competitive advantage.’

Sources: M. Brennan (2018) ‘A Deep Dive into Tencent’s Restructuring’, *ChinaChannel,* 3 October; *Financial Times,* 18 and 25 October 2018.

Questions

1 Explain the strategic reasons behind each of the reorganisations (2005, 2012 and 2018) undertaken by Tencent.

2 How adequate is the 2018 reorganisation to Tencent's various challenges at that point? With regard to both 'hard' and 'soft' aspects of implementation, what else might be necessary?

Chapter 16

Leadership and strategic change

Key terms

change kaleidoscope

digital transformation

forcefield analysis

leadership

organisational ambidexterity

resilience

situational leadership

sustainability transformation transactional leaders

transformational leaders

turnaround strategies

Learning outcomes

After reading this chapter you should be able to:

- Identify and assess different *leadership styles,* as related to strategic change.
- Use the *change kaleidoscope* and *forcefield analysis* to analyse how *organisational context* might affect strategic change.
- Identify *types* of strategic change, including digital and sustainability *transformation*.
- Assess the value of different *levers* for strategic change.

Evaluating
Processes
Practice
III
Strategy
in action
Imple-
menting
Leading &
Changing

16.1 Introduction

Daniel Ek is a Swedish serial entrepreneur and founder and CEO of the world's largest audio-streaming business Spotify. Ek encapsulated several themes in this chapter when he explained his shifts in leadership style since starting Spotify in 2006: 'My job looks nothing like it was at the beginning because in a start-up, it's very different than running a public company with a global presence, et cetera, et cetera.'[1] He continued: 'If you're a leader of 10 people versus 1,000 people, your job is so different because you're leader of individual contributors in the first instance and, in the latter instance, you're a leader of leaders.' For Ek, leadership really matters and change is a fact of life. Moreover, what is required of leaders is always changing too.

The theme of strategic change runs through much of this book. Part I of this book examined pressures for strategic change arising from the organisation's environment and its internal position; Part II looked at the kinds of strategic option that might form part of strategic change, such as diversification, internationalisation or innovation. However, central to strategic change is the leadership task of ensuring that people deliver whatever strategic options are finally chosen. While this leadership role is most often associated with chief executives, it may, in fact, occur at different levels in organisations: other senior managers and middle managers often take leadership roles in change as well. This middle managerial leadership is what Ek is referring to when he describes himself as a leader of leaders.

Figure 16.1 provides a structure for the chapter. The chapter opens (Section 16.2) by explaining different *roles* of leaders and different leadership *styles.* A key task of leadership is strategic change. Leaders need to address two issues in considering their approach to change. First, they have to understand the *organisational context,* the extent to which it is receptive or resistant to change: Section 16.3 particularly addresses the forces blocking or facilitating change. Second, leaders have to identify the *type* of strategic change required: Section 16.4 introduces digital transformation, sustainability transformation and turnaround. Understanding the context, and identifying the required type of change, should help leaders select the appropriate *levers* for change: Section 16.5 considers levers ranging from symbolic management to political action. Section 16.6 introduces a cautious note about change by considering common reasons for the *failure* of formal change programmes, pointing to the importance of *informal change* and introducing the concept of *resilience.* The final Thinking Differently section considers indigenous leadership models emphasising collective rather than individualist approaches to leadership.

Figure 16.1 Leadership and change

Figure 16.1: Long Description

16.2 Leadership and strategic change

Leadership is the process of influencing an organisation (or group within an organisation) in its efforts towards achieving an aim or goal.[2] Without effective leadership, the risk is that people in an organisation are unclear about its purpose or lack motivation to deliver the strategy to achieve it. Leadership is associated particularly with strategic change. For example, Harvard Business School's John Kotter argues that 'good management' is about bringing order and consistency to operational aspects of organisations, such as quality and profitability of products and services. Leadership, by contrast, is about 'coping with change'.[3] Thus, strategic change is a crucial underlying theme in this discussion of leadership.

16.2.1 Strategic leadership roles

Strategic leaders come in different forms, each with distinct roles to play in managing strategic change.

Top managers

There are three key roles for top managers, especially CEOs:

- *Envisioning future strategy.*[4] Effective leaders at the top of an organisation need to ensure there exists a compelling vision of the future, communicated clearly to both internal and external

stakeholders. Without a clear and compelling vision, large organisations risk incoherence (see also Chapters 1 and 6).

- *Aligning the organisation to deliver that strategy.* This involves ensuring that people in the organisation are committed to the strategy, motivated to make the changes needed and empowered to deliver those changes. Empowerment includes the structural and systems changes described in Chapter 15 on implementation. It may be necessary to exit managers who are uncommitted to the new strategy, as doubting voices can undermine coherent action.
- *Embodying change.* A strategic leader will be seen by internal and external stakeholders as intimately associated with a strategic change programme. A strategic leader is, then, symbolically highly significant in the change process and needs to be a role model for future strategy (see Section 16.4.5 below on symbolic levers for change).

Middle managers

A top-down approach to managing strategy and strategic change sees middle managers as mere implementers of top management strategic plans. Here, their role is to ensure that resources are allocated and controlled appropriately and to monitor the performance and behaviour of staff. However, middle managers can have more active roles in strategic change. As in Daniel Ek's opening description of Spotify, a company is made up of many leaders. Middle manager leadership roles include:[5]

- *Champions of strategic issues.* Middle managers are often the closest to market or technological shifts that might signal the

need for strategic change. They are also well-placed to identify likely blockages to change. Accordingly, middle managers must gain the attention of senior management for strategic issues that are less visible to the top of the organisation and win senior managers' commitment to appropriate strategic actions. In other words, middle managers must often 'sell' strategic issues to top management, getting their buy-in in order to push strategy forward.[6]

- *'Sense makers' of strategy.* Top management may set a strategic direction, but how it is explained and made sense of in specific contexts (e.g., a region of a multinational or a functional department) may effectively be left to middle managers. They are a crucial *relevance bridge* between top management and members of the organisation at lower levels.[7]
- *Adapters to unfolding events.* Middle managers are uniquely qualified to reinterpret and adjust strategy because they have day-to-day responsibility for implementation at a local or departmental level. A good strategic change programme leaves room for adaptation on-the-ground and over time.

Entrepreneurial leaders

Entrepreneurship can be shown in established organisations and indeed at different levels of large organisations.[8] Similarly, entrepreneurs leading new organisations have to perform many of the roles of managers in established organisations, for example, visioning and embodying change. However, for entrepreneurial leaders (like Spotify's Daniel Ek) creating new enterprises, there are three roles that are likely to be particularly important:

- *Opportunity spotters.* Entrepreneurs typically do not have marketing departments or research laboratories to rely upon to discover new opportunities. Entrepreneurial leaders have to be outward-looking and forward-looking, seeing the opportunities that others might ignore.
- *Resource marshallers.* At the outset, entrepreneurs do not have a set of organisational resources ready to hand. They have to marshal from scratch human, financial and other resources in order to pursue their opportunities.
- *Risk takers.* Typically, entrepreneurs do not have a portfolio of existing businesses to buffer them if a new business fails. Entrepreneurial leaders have to be prepared to take on more risk than leaders of larger or more established organisations.

16.2.2 Leadership styles

Just as there are diverse leadership roles, so there are different styles of leadership. Leaders tend to adopt characteristic 'styles' of behaving and intervening. These leadership styles are often categorised in two broad ways:

- **Transformational (or charismatic) leaders emphasise 'soft' levers for change such as building a vision for their organisation.** Transformational leaders are often highly charismatic individuals (i.e., personally inspiring). Typically, they emphasise soft measures such as those described in Chapter 15.3 on soft implementation. They are particularly likely to invest in creating a sense of mission and energising people to achieve it. Evidence suggests that this approach to leadership is

beneficial for people's motivation and job performance,[9] and is particularly positive for wider business performance when organisations face uncertainty.[10]

- **Transactional leaders emphasise 'hard' levers of change such as designing systems and controls.** The emphasis here is more likely to be on changes of structures, setting targets to be achieved, financial incentives, careful project management and the monitoring of organisational and individual performance. Divestments and cutbacks may feature strongly. Transactional leadership is more common in established organisations.

In practice, transformational and transactional leadership styles are two ends of a continuum, with many feasible points between. Leaders typically combine elements of the two styles, rather than identifying exclusively with one (see Illustration 16.1). Indeed, the notion of **situational leadership encourages strategic leaders to adjust their leadership style to the context they face.**[11] In other words, there is not just one best way of leading: appropriate leadership style changes according to the specific demands of the situation. At the start of this chapter, Daniel Ek at Spotify explained how his style had to change as the company grew. The next section examines how the types of change may determine the appropriate leadership style.

Illustration 16.1 Leadership styles Successful leaders talk about their styles.

Miki Agrawal, CEO of Thinx, Fast Company

Source: Anadolu Agency/Anadolu Agency/Getty Images

Fire Fast

> **Lessons that will continue to inform my leadership for next year: Hire slow, fire fast. My job is not to spend my time policing people and their work ethic, positive attitude, and focused execution – it's to bring in people that just have it in them. Then we can simply focus on what matters: growing the business!**

Miki Agrawal, Founder and CEO of period-proof underwear start-up Thinx, Fast Company, 27 December 2016.

Go Slow

> **You need to go slow to go far. My tendency was, just go fast – I get to the answers really quickly, that was my sprinter mentality. But, as a manager, you look around and there's no one following because they don't feel like you empowered them. So, you have to go slow and ask questions instead of giving answers, and to enrol instead of provide that vision directly.**
>
> *Yamini Rangan, CEO of software company HubSpot, Financial Times, 19 December 2021.*

Go with your Gut

As a leader, I have always aimed to inspire, mentor, lead – and protect. But when I became a CEO, I faced a difficult situation where I learned that not every important move could be coached or arrived at through consensus. Sometimes, you need to just go with your gut, make a decision and tell people the plan. When we had to make the tough decision, it just needed to get done. I didn't have time to dive into a 30-minute discussion and get people on board. They may not have agreed, but it didn't matter. I had to tell them what to do, and they needed to do it because I was telling them.

Heidi Zak, Co-founder and Co-CEO of ThirdLove, a lingerie company. MakeIt, 19 November 2018.

Tune in

I apply the same leadership principles to every part of my life. I tend to be very horizontal in my approach. I don't think of my lab members as working for me; I'm working with them . . . [I believe in] the importance of empathy, of trying to listen and tune into people to bring them on board. I think I learned this from an early age, when I was rather lost in translation, as an only child in a multilingual and multicultural environment.

Edith Heard, Director-General, European Molecular Biology Laboratory, Financial Times, 27 February 2022.

A good way

My definition of leadership is service with people done in a good way . . . The phrase 'in a good way' . . . encompasses a whole philosophy, a way of being, knowing and doing. We have to consider the intentions behind our decisions and actions, we have to be mindful of and acknowledge our ancestors and all

that they've done and maybe endured in order for us to be here today, and we have to learn from their wise practice . . . At the same time, you acknowledge that our decisions today have the potential to affect seven generations into the future, to the children not yet born. This means that there is much responsibility in leadership; decision making and planning encompasses sustainability on so many levels. So, 'in a good way' is a very sophisticated and complex concept.

Misiwaykomiguk Paypomwayotung (or Jacqueline Ottmann in English), Vice-Provost of indigenous engagement at the University of Saskatchewan, Globe and Mail, 5 April 2021.

Command and feedback

As companies get bigger and more complex, leaders need to be more like coaches and conductors than players. If CEOs are running a smaller business, they can literally be involved in virtually everything and make most of the decisions – they often rely on traditional command-and-control tactics. This approach does not work as companies get bigger – the CEOs simply cannot be involved in every major decision. Command and constant feedback may be better than command and control.

Jamie Dimon, Chair and CEO since 2005 of the world's most valuable bank, JPMorgan Chase, CEO Magazine, 8 April 2021.

Questions

1 Which leaders are more transformational, which more transactional and which situational (see Section 16.2.1)?

2 Do you think entrepreneurs such as Agrawal and Zak are systematically very different from managers such as Dimon, Heard and Rangan?

16.3 Analysing the change context

The notion of situational leadership underlines the importance of the *organisational context* in which change is being undertaken.[12] A small entrepreneurial business is a very different context from a large, bureaucratic organisation. Forcefield analysis is one way of assessing the readiness of an organisation for change and the type of style required. Another is the change kaleidoscope.

16.3.1 Forcefield analysis

A forcefield analysis compares the forces at work in an organisation acting either to block or to facilitate change. Thus, forcefield analysis involves identifying those forces that favour change, those that oppose it and those that are more or less neutral. Forces might include impersonal factors such as organisational incentive systems, financial resources or competitive threats. They can also involve people, for example, middle managers working as facilitators or as blockers of change. In Figure 16.2, the strengths of the various forces supporting or resisting change are reflected by the lengths of the arrows: stronger forces have longer arrows. The relative strength of the forces favouring or opposing change indicates the effort required to achieve change. The stronger the forces set against change, the more difficult change will be.

Forcefield analysis helps ask some further key questions:

- What aspects of the current situation would block change, and how can these blocks be overcome? In Figure 16.2, more

training could reduce the blocking effect of employee skills.

- What aspects of the current situation might facilitate change in the desired direction, and how might these be reinforced? In Figure 16.2, increased investment in new technologies might facilitate change.
- What needs to be introduced or developed to add to the forces for change? Here possible additional forces might be informed by McKinsey 7S (Chapter 15).

Illustration 16.2 Transformation at the University of Cape Town A new Vice-Chancellor wrestles with contradictory pressures.

When Mamokgethi Phakeng became Vice-Chancellor of the University of Cape Town (UCT) in 2018, she was the third black woman to head a university that was ranked top for teaching and research throughout Africa. But the timing was tough: 'I was taking on the leadership of the university at a time . . . when shutdowns were the order of the day, faculty deans had resigned, top academics were leaving . . . I took over a university in crisis.'

South Africa still faces entrenched problems of racism and inequality. Despite admitting black students since the 1920s, UCT was far from exempt. More than half the university's professors were classified as White South African (against 9 per cent of the total population) and less then 5 per cent were Black South African. White students still outnumbered Black South African students. UCT has been a centre for both the #RhodesMustFall and #FeesMustFall movements. The first started as a campaign against the UCT campus statue of British imperialist Cecil Rhodes which then spread worldwide. The second was a series of protests against rising student fees, crucial income for a leading research university, but felt disproportionately by poorer black

students. On top of these protests, there were campus shutdowns protesting against gender-based violence in the university.

Against this background, new Vice-Chancellor Phakeng spelt out her transformational vision for UCT: ‘At its core, the transformation we strive for is characterised by excellence. Without this excellence, transformation has no integrity . . . Transformation characterised by integrity recognises that everyone has the potential to transform and to be excellent. It recognises that, as we ensure access from across society, we also strive to ensure opportunities for students and staff to participate fully and have a tangible impact on our world . . . ’

Phakeng undertook a wide range of changes, both in structures and in style. One important structural change was to the university senate (the main academic policy-setting body). Before her arrival, senate membership was reserved for full professors, and so was disproportionately white. Phakeng changed the rules so that each department could nominate two members who were not full professors. She also encouraged more participation in senate debates: ‘To change the academic culture at UCT, we’ve got to set the tone at senate of how to engage even when we disagree with people.’ She created the post of deputy vice-chancellor for transformation in order to promote decolonisation of the curriculum and greater inclusivity. Phakeng also has a distinctive leadership style. She explained: ‘I must do what I know as a scholar, as an academic, as an executive . . . what I know as a woman and what I know as a black person.’ She speaks indigenous languages at work and uses Twitter extensively to stay directly in touch with students: ‘If or when students complain about something on Twitter, I take it seriously. When a student takes to Twitter to complain about a mattress, I actually do go and get that mattress for them because I want them to know that management cares.’

Not everything goes Phakeng’s way. After her first year, the UCT ombud (complaints investigator) reported ‘a number of work-related complaints came to me about professional interactions with the vice-chancellor, where people felt bullied’. When the

Black female Deputy Vice-Chancellor for transformation stepped down in 2021, she was replaced by a retired white male professor. Weak middle management, misgivings over the decolonisation of the curricula and professional jealousy were obstacles to progress. One academic observed of her colleagues: ‘Some feel inclusivity is a threat’. Fees were an enduring issue. In February 2022, protestors occupied a central administration building as more than 1,600 students were at risk of exclusion for payment delays.

Key sources: Nature, 9 April, 2019; *City Press*, 9 December 2020; *Times Higher Education Supplement*, 21 December 2021.

Questions

1 With regard to forcefield analysis (Section 16.3.1), suggest some key blockers and facilitators of change at UCT.

2 With regard to the change kaleidoscope (Section 16.3.2), which contextual features support or resist change?

Figure 16.2 A forcefield analysis

Figure 16.2: Long Description

16.3.2 The change kaleidoscope

Another framework for assessing the change context is the *change kaleidoscope*. Just as a toy kaleidoscope rearranges a set of elements into different patterns, **the change kaleidoscope highlights how contextual features can take various forms supporting or resisting change**. Figure 16.3 identifies eight contextual features:

- The *time* available for change can differ dramatically. A business may face immediate decline in turnover or profits from rapid changes in its markets. This is a quite different context for change compared with a business where the management may

see the need for change as years away and have time to plan it carefully.[13]

- The *scope* of change might differ in terms of either the *breadth* of change across an organisation or the *depth* of cultural change required. For example, a global business with multiple brands is likely to require a high breadth of change, while an established organisation with a long cultural history is likely to demand depth of change.
- *Preservation* of some aspects of an organisation may be needed. For example, some capabilities may be needed for the change, while others can simply be abandoned. Alternatively, some established parts of the organisation may need to be retained in order to generate revenues, while waiting for newer parts to build up strength and economic effectiveness.
- *Diversity* in experience, views and opinions within an organisation may help the change process, providing seeds from which new initiatives can grow. A very homogeneous way of seeing the world, grown up over many years, could hamper change.
- *Capacity* for change in terms of available resources will also be significant. Change can be costly, not only in financial terms, but also in terms of management time.
- *Power* is crucial to creating change. It is easy to assume that chief executives at the top of an organisation have all the power, but often hierarchical levers are not really connected to anything. Grand visions from the top can be ignored. It is important to check that change levers connect to the parts of the organisation that need to move.

- *Capability* at managing change is important for effective change. Large organisations especially need to have access to skilled and experienced change managers. It helps too if the workforce is experienced with change, rather than being set in its ways.
- The *readiness* for change is the final factor. Is there a felt need for change across the organisation, widespread resistance, or pockets of resistance in some parts of the organisation and readiness in others?

Figure 16.3 The change kaleidoscope

Source: Adapted from J. Balogun and V. Hope Hailey (2008) *Exploring Strategic Change*, 3rd edn, Prentice Hall.

Figure 16.3: Long Description

As in the notion of situational leadership (Section 16.2), the appropriate leadership style will vary according to the contextual factors illuminated by the change kaleidoscope. Figure 16.4 indicates how the factors of capabilities and readiness can influence the appropriateness of different change leadership styles. For instance, limited managerial capabilities and low readiness to change might encourage a transactional style: fast, authoritarian change can largely be managed by directive mechanisms like controls and incentives. If the capability is high, but readiness is low, then persuasion will be more necessary; if the reverse, then coaching will help develop the required capabilities. However, all eight factors of the kaleidoscope rarely point in exactly the same direction. Sometimes, the readiness and capability for change are sufficiently high for a leader to adopt a transformational approach, but the time pressure is too great to allow for the typically slow process of creating a new, collective vision. Change leaders need to determine which factors of the change kaleidoscope matter most in particular circumstances and accept that they may have to prioritise some over others. Like a kaleidoscope, factors can shift and rarely perfectly align. The change kaleidoscope encourages a multidimensional analysis of change context and recognises the need for trade-offs between factors.

Figure 16.4 Styles of change leadership according to capability and readiness

Figure 16.4: Long Description

16.4 Types of strategic change

Understanding the change context helps identify the types of strategic change required. This section explores various types of change, differing typically in degrees of discontinuity and speed. However, continuity and change can be combined, as in the concept of organisational ambidexterity.

16.4.1 Strategic transformation

There are two fundamental types of strategic change. *Incremental change* typically builds on existing strategy with a great deal of continuity: change comes in small increments. These increments might include the acquisition of a related business (see Chapter 12) or the reorganisation of business units (Chapter 15). *Transformational change* involves discontinuity with the existing strategy and is deeper and more pervasive. Transformations might involve fundamental changes in the business model (Chapter 8) or the organisational culture (Chapter 7).[14] Transformational change is not necessarily associated exclusively with the transformational leadership style (Section 16.2.2). Transformational change may require some mix of transformational and transactional leadership.

While transformation may come in many forms, two kinds are currently important for many organisations:

- *Digital transformation* **is pervasive and discontinuous change triggered and shaped by the widespread use of digital**

technologies.[15] These technologies might include big data analytics, social media, mobile technology or cloud computing. Transformation extends beyond the adoption of digital technologies in a particular function (for example, using big data to track customers). Rather, transformation is likely to involve fundamental change in the organisation's overall boundaries, routines and organisational culture. As at La Redoute (Illustration 16.3), digital transformation did not just involve automation of the warehouse, but a wholesale cultural change. Digital transformation typically results in much more agile organisations, as the use of digital technologies facilitates future adaptation and change. It is also likely to change the organisation's boundaries as some things become either easier to outsource (e.g., IT services) or better done in-house (e.g., customer service). Geographies may change too, with some functions now possible at a distance (for example, payroll) while others are now performed better locally (for example, manufacture by 3D printing).

- *Sustainability transformation* **is pervasive and discontinuous change of organisational business models, capabilities and operations aimed at creating positive economic, social and environmental impact**.[16] Environmental impact might come through the creation of 'circular' business models, involving the production of durable, recyclable and repairable products. Many consumer product companies have begun a transformation from linear business models (involving the simple dumping of products at the end-of-life) to such circular models (involving the re-use of materials). Apple, for example, has addressed the

issue of ‘e-waste’ by designing a robot named ‘Daisy’, capable of disassembling old iPhones in order to recover the valuable minerals and parts for re-use by the company. As in Illustration 16.4, Sony too is moving towards a more environmentally sustainable model. However, sustainability refers here to social impacts as well as environmental ones, on the grounds that a positive social environment (in terms of employment, education, health and similar) is important also for the long-run sustainability of an organisation. Sustainable transformation also refers to positive economic impacts because it can both create employment (in recycling jobs, for instance) and create profits (through cost-savings and premium pricing).

16.4.2 Turnaround

Strategic change also differs in the speed of execution. **Turnaround strategies emphasise rapidity in change, cost reduction and/or revenue generation, with the aim of fast recovery.** The priority in turnarounds is actions that give rapid and significant improvements. Situations calling for turnarounds include economic recessions, the failure of major investment projects or the sudden collapse of important markets. Turnaround actions go beyond simple cost-cutting. Five key elements of turnaround strategies are:[17]

- *Crisis stabilisation.* The aim is to regain control over the deteriorating position. This requires an immediate focus on cost reduction and/or revenue increase, typically involving some of the steps identified in Table 16.1. There is a danger of cutting long-term investments in research and development, training or

brand-building, with negative implications for the long-term future of the organisation.

- *Management changes.* Changes in management may be required, especially at the top. This usually includes a new chairman or chief executive, as well as changes to the executive team, especially in marketing, sales and finance. Management change is important for three main reasons: first, because the old management may well the cause of the original problems; second, because it may be necessary to bring in management with expertise in turnaround management; and third, because management changes provide the opportunity to bring in new skills and approaches from outside the organisation, different to the old skills and approaches that had led to the original crisis.
- *Gaining stakeholder support.* In a crisis, stakeholders are liable to lose confidence in the future viability of the organisation and reduce their commitment. To have their support, it is vital that key stakeholders (e.g., banks, shareholders, customers and employees) are kept clearly informed of progress.
- *Clarifying the target market(s) and core products.* Central to turnaround success is ensuring clarity on the target market or market segments most likely to generate cash and grow profits. A successful turnaround strategy typically involves getting closer to customers and improving the flow of information, especially to senior levels of management, so as to focus revenue-generating activities on key market segments. Clarifying the target market also provides the opportunity to discontinue or outsource products and services that are eating up time and resources for insufficient returns.

- *Financial restructuring.* The financial structure of the organisation may need to be changed. This typically involves raising additional funds from shareholders or renegotiating agreements with creditors, especially banks. Reducing debt will increase an organisation's robustness in the face of future crises.

Table 16.1 Turnaround: revenue generation and cost reduction steps

Illustration 16.3 Digital transformation at La Redoute In four years, the struggling old-style mail order business has been transformed into one of France's leading ecommerce businesses.

Source: Imagewise Ltd/Shutterstock

Founded in 1837, La Redoute has undergone at least two major transformations in its history. Originally, it had been a simple wool manufacturer but, in 1928, it launched its first mail-order catalogue, focused on knitting. By the 1960s, La Redoute had become France's leading mail-order catalogue, offering clothing, home-furnishing and related products. Manufacturing became a relatively small part of the business. At the beginning of the 1990s, La Redoute was acquired by the entrepreneur Francois Pinault, forming a major part of what became the fashion conglomerate Kering.

However, 1994 saw the birth of the first digital retail giant Amazon, which opened its French site in 2000. By comparison, La Redoute's twice-yearly catalogues, each 1,300

pages long, were cumbersome and unable to adapt to rapid changes in fashion. The company lost €300mn (£260mn; $340mn) in the five years leading up to 2014.

In 2014, Kering sold 51 per cent of La Redoute to two senior managers, Nathalie Balla and Eric Courteille for €1. The rest of the company was sold to 50 senior managers and employees (by 2017, two-thirds of employees were shareholders). Kering also paid the €500mn cost of a major redundancy programme involving 1,200 out of the 3,400 employees at the time.

Balla and Courteille embarked on a digital transformation programme that touched nearly every part of the organisation. One of their senior managers recalls: ‘It was above all a cultural shock . . . La Redoute was very old. It had undergone both the industrial revolution and the internet revolution. We were used to being under the protection of a large group . . . I like to say that we are not a start-up but a restart-up . . . ’ This meant a radical change in mentality. La Redoute had actually launched its first internet site in 1994, but failed to follow through. The manager explained: ‘We were slow to go all in on the transformation. We had to understand that our old mail-order business was finished.’

La Redoute reduced its product range, focusing on women’s and children’s fashion, household linens and furniture. 80 per cent of the products would be own-brand, using the company’s own designs. The sport, toys, beauty and domestic appliance products that had been part of their own range now came from other suppliers through the marketplace part of their platform. Instead of two fat catalogues per year, La Redoute switched to 10 or 11 shorter catalogues annually, refreshed each time. By 2018, 30 per cent of sales were via mobile phone rather than personal computer. Sourcing moved from India and China to Turkey and Morocco to improve responsiveness to changing demand. The warehouse was radically automated, with staff reduced from 2,500 to just 550. The time from receipt of order to dispatch from the warehouse fell from 36 hours to 2 hours.

By 2018, La Redoute was on track to profitability. The retail conglomerate Galeries Lafayette purchased Balla and Courteille’s shares for an undisclosed but substantial

sum. And Balla won the prestigious Veuve Cliquot prize of Frances' Businesswoman of the Year.

Sources: Capital, 16 May 2016; *Culture Formation*, 15 September 2017; *Les Echos,* 16 November 2018.

Questions

1 How many aspects of the business were involved in La Redoute's digital transformation?

2 In terms of a forcefield analysis (Section 16.3.1), how did the forces shift in order to allow the radical changes that came after the sale by Kering in 2014?

16.4.3 Ambidexterity

Organisations do not always have to choose wholly between incremental and transformational change, or rapid and slower change. Organisations can combine various forms of change at the same time. Human ambidexterity is the ability to use both hands equally well. **Organisational ambidexterity is the capacity both to exploit existing capabilities and to explore for new capabilities.**

Organisations typically need to *exploit* the capabilities they have built up over time in order to achieve immediate performance goals. However, exploitation alone tends to allow only incremental change, since strategy is being built on existing strengths. In fast-moving environments, organisations need also to invest in *exploration* in order to innovate and build new capabilities. As in Chapter 5,

capabilities must be ‘dynamic’ so that organisations can renew and recreate their competitive advantages. Organisational ambidexterity captures this simultaneous need to exploit and explore.

However, organisational ambidexterity can be challenging because the different processes associated with exploitation and exploration raise contradictory pressures: ambidexterity involves being both focused and flexible, efficient yet innovative, looking forward and looking backward.[18] Four kinds of approach can help manage ambidexterity:

- *Structural ambidexterity.* Organisations may maintain the main core of the business devoted to exploitation with tighter control and careful planning but create separate units or temporary, perhaps project-based, teams for exploration (see Section 15.2.5). These exploratory units will be smaller in size, less tightly controlled with much more emphasis on learning and processes to encourage new ideas.[19] Alphabet thus restructured in 2015 to place its large and mature search and advertising businesses in the Google subsidiary, while keeping its more exploratory activities apart in the separate Ventures and X subsidiaries.
- *Diversity rather than conformity.* Maintaining a diversity of views within the organisation can help promote ambidexterity. Such diversity might be based on managers with different experience or different views on future strategy, giving rise to useful debate. Such contesting of strategy may come to be ‘normal’ at senior levels in an organisation.[20] Stanford University’s Robert Burgelman[21] also argues that diverse views can be found close

to the market and therefore perhaps at junior levels in an organisation; senior executives need to channel this market or junior-level 'dissonance' into a 'searing intellectual debate' to allow the emergence of a clearer strategic view.

- *The role of leadership.* In turn, this has implications for leadership roles in organisations. Leaders need to encourage and value different views and potentially contradictory behaviours rather than demanding uniformity.[22] This may mean allowing experiments to establish just what makes sense and what does not. However, leaders also need to have the authority to stop such experiments when it becomes clear that they are not worthwhile. This is the 'fail fast' philosophy.[23]
- *Tight and loose systems.* All this suggests that there needs to be a balance between 'tight' systems of strategy development that can exploit existing capabilities – perhaps employing the disciplines of strategic planning – and 'looser' systems that encourage new ideas and experimentation. This combination of loose and tight systems can be given coherence so long as there is some overall common 'glue', perhaps in the form of an organisational mission or culture that allows different units to express the organisation's overall purpose in different ways.

Illustration 16.4 Sony's 'kando' attitude For Japanese electronics giant Sony, purpose drives change in both entertainment and the environment.

In 2018, Sony made a surprising choice of new CEO, its Chief Financial Officer Kenichiro Yoshida. Over the previous five years, Yoshida had helped get Sony out of loss-making

businesses such as laptops, batteries and chemicals, while cutting 20,000 jobs. Sony was now generating record profits. But many Sony employees wondered whether the finance expert had the vision to regenerate a company whose greatest technological successes – the transistor radio, the Sony Walkman and the Trinitron television – seemed long in the past.

Yoshida's answer was to evoke the Japanese attitude of 'kando'. For Yoshida, kando meant the ability to generate excitement and emotional response in consumers. In early 2019, he declared Sony's new corporate purpose: 'to fill the world with emotion, through the power of creativity and technology'. This meant a strategic commitment to entertainment above all else. Yoshida explained: 'Within Sony, we strive to evolve our kando value chain. We engage with creators to generate emotionally impactful kando content and deliver it to users. Sony is a company with origins in electronics, especially electronics dedicated to creating and delivering entertainment content.'

Sony had many assets that could help in developing emotional entertainment. There was the PlayStation gaming console, Sony Music (Britney Spears, The Clash), Columbia Pictures in movies (*Spiderman*), a television manufacturer (Bravia), smartphones (Xperia) and even initiatives in virtual reality. Sony was competing against powerful companies in many of these businesses, for example, Apple, Disney, Microsoft and Samsung. However, compared to his rivals, Yoshida claimed Sony had a greater range of assets: 'We have more room to captivate through cooperation.'

The trouble was that Sony's eight main businesses did not have a tradition of cooperating together. Yoshida admitted: 'It's going to take time to change the culture of this company. But we need to change to become flatter, speedier and more collaborative.' He acknowledged that the company's record profits could work against change: 'In big companies, we tend to become complacent easily when we get some kind of recovery in profit.' One of his first achievements was to bring the PlayStation business and the Sony Pictures business together to transfer the hit game 'Uncharted' to the screen. Another was Sony Pictures creating the musical film *Cinderella*, starring

Sony Music artist Camila Cabello. There were at least 10 more big collaborative projects to come.

But Yoshida sees the kando entertainment drive from a sustainability perspective as well as from a business point of view. He underlined the significance of Sony's emotion-driven purpose: 'Our purpose is the basis of how Sony engages with society. It is also what drives our employees.' The very day after becoming CEO, Yoshida wrote an internal blog post with the title 'Sony as part of the Earth'. There, he pointed to the interconnected nature of business and environmental concerns: 'Companies such as Sony are able to carry out their economic activities because of a healthy global environment. Let's think together how Sony can make ESG [environmental, social and governance] contributions through our growth.' Yoshida tied executive pay to ESG metrics. Although Sony's Japanese manufacturing plants are still heavily reliant on fossil fuels, its European and Chinese sites run entirely on renewables. A heavy plastics user, the company is moving its packaging increasingly to sustainable bamboo and sugarcane fibres. For Kimio Maki, Head of Sony's electronics and medical businesses, the trade-offs around sustainability were worth it: 'Creating products that are friendly to the environment is an added value and that requires a cost. But products that do not take the environment into consideration will be ignored by the customers we are targeting.' For Sony, the term kando increasingly means that emotion and environment can go together.

Questions

1 On this account, which of the various change levers (Section 16.5) are working for Yoshida's changes, which could he use more and which might be working against them?

2 In what respects could Sony's changes be described as a 'sustainability transformation' (Section 16.4.1)? What else could Sony be doing?

Identifying the type of strategic change in hand will assist in selecting the detailed levers for change to be considered in Section 16.5. Meanwhile, following the logic of situational leadership, appropriate leadership styles are likely to vary according to the types of change being sought. Rapid change, for instance, the focused changes associated with turnaround, tends to require more emphasis on the transactional approach. Transformational leadership styles are usually more important in broad and deeper change.

16.5 Levers for strategic change

Having identified both the type of change required and the receptiveness of the context, change leaders must choose between the various levers (or means) for change. Most successful change initiatives rely on multiple levers.[24]

Sometimes, these levers are presented as a sequence as, for example, in Harvard Business School professor John Kotter's Eight Steps for Change (Figure 16.5).[25] Here, the process of change is described as a series of steps, starting from establishing a sense of urgency in the organisation, leading eventually to the institutionalisation of change. These steps provide leaders with a clear progression in the managing of change. However, in practice, many of these levers are likely to be used simultaneously rather than in the kind of logical sequence in Figure 16.5. There are also other levers that can be drawn upon. Some levers for change have already been discussed elsewhere in the text. The importance of strategic vision (a major feature of Figure 16.5) was discussed in Chapter 1 together with the importance of other goals and objectives. The consolidating and institutionalising of change involves the kinds of adjustments of organisational structures and systems described in Chapter 15. This section focuses on seven further levers of change.

Figure 16.5 Kotter's Eight Steps for Change

Source: Adapted from J. Kotter (1996) 'Leading change: why transformation efforts fail', *Harvard Business Review,* March–April, p. 61.

Figure 16.5: Long Description

16.5.1 A compelling case for change

A starting point must be presenting a convincing case for change. This equates to Kotter's first step, establishing a sense of urgency. However, McKinsey & Co, the consultants,[26] warn that, too often, the case for change is made in terms of top management's perception of what is important: for example, meeting expectations of shareholders or beating competition. When most managers and employees are asked, however, there are many more factors that motivate them: for example, the impact on society, on customers, on the local working team, or on employees' personal well-being. In making the case for change, transformational leaders especially need to speak to these different motives, not just to top management perceptions of why change is needed.

16.5.2 Challenging the taken for granted

Often, another early key step in managing strategic change is challenging what can be longstanding mindsets or taken-for-granted assumptions – the organisational paradigm, in the terms of Chapter 7. There are different approaches to challenging the paradigm. One view is that gathering enough objective evidence, perhaps in the form of careful strategic analysis, will be enough to challenge and therefore change the paradigm. However, assumptions can be very resistant to change: people find ways of questioning, reconfiguring and reinterpreting objective analyses in order to bring it in line with the existing paradigm. It may take much persistence to overcome this. Another view is that encouraging people to question and challenge each other's assumptions and received wisdom by making them explicit is valuable. Firms that are good at change often have questioning and 'contestation' embedded within their cultures: this, for example, has been the case for the French cosmetics firm L'Oréal, where they have a presentation theatre specifically called the 'contestation room' (*salle de contestation*).[27]

16.5.3 Changing operational processes and routines

Another lever for strategic change is to start at the bottom, with the basic day-to-day processes and routines of the organisation's operations. Richard Pascale argues: 'It is easier to act your way into a better way of thinking than to think your way into a better way of acting'.[28] In other words, it is easier to change behaviour and, by so

doing, change taken-for-granted assumptions than to try to change taken-for-granted assumptions as a way of changing behaviour.

These processes and routines might be formalised and codified or they might be less formal 'ways we do things around here'. The ways in which colleagues simply communicate with each other, or interact with customers, or respond to mistakes can all be serious blockages to change. Even when changes in routines are not planned from the top, people do change them and this may result in wider strategic change. This may occur through trial and error learning as people experiment with different routines associated with doing their jobs.[29] The overall lesson is that changes in routines may appear to be mundane, but they can have significant impact.

16.5.4 Symbolic management[30]

Change levers are not always of an overt, formal nature: they may also be symbolic. Symbolic does not mean non-substantive. Symbols may be everyday things that are, nevertheless, highly meaningful in the context of a particular situation or organisation. Changing symbols can help reshape beliefs and expectations because meaning becomes apparent in the day-to-day experiences people have of organisations, such as the symbols that surround them (e.g., office layout and décor), the type of language and technology used and organisational rituals. Consider some examples:

- Many *rituals* of organisations are concerned with effecting or consolidating change. For example, there are rites of passage (induction or training programmes) that signify change of

individual roles or award ceremonies that celebrate successful new initiatives. New rituals can be introduced or old rituals done away with as ways of signalling or reinforcing change.

- Changes in *physical aspects* of the work environment are powerful symbols of change. Typical here is a change of location for the head office, relocation of employees, changes in dress or uniforms, and alterations to offices or office space.
- The *behaviour of managers,* particularly strategic leaders, is perhaps the most powerful symbol in relation to change. So, having made pronouncements about the need for change, it is vital that the visible behaviour of change agents be in line with such change.
- The *language* used by change agents is also important.[31] Either consciously or unconsciously, language and metaphor may be employed to galvanise change. Of course, there is also the danger that strategic leaders do not realise the significance of their language and, while espousing change, use language that signals adherence to the status quo, or personal reluctance to change.

However, there is an important qualification to the idea that the manipulation of symbols can be a useful lever for managing change. The significance and meaning of symbols are dependent on how they are interpreted. Since they may not be interpreted as intended, their impact is difficult to predict.

16.5.5 Power and political systems

Strategic change can be a political process: typically, there are winners and losers. To effect change, powerful support may be required from individuals or groups or a reconfiguration of *power structures* may be necessary, especially if transformational change is required.[32] This is equivalent to Kotter's second step in the change process (Figure 16.5), forming a powerful guiding coalition. *Building alliances* and *networks* of sympathisers may be important in overcoming the resistance of powerful resisters. An analysis of power and interest using the stakeholder mapping (Chapter 6) can, therefore, be useful to identify bases of alliance and likely resistance.

However, the political aspects of change management are potentially hazardous. In overcoming resistance, the major problem may simply be the lack of power to undertake such activity. In implementing change, gaining the commitment of a few senior executives at the top of an organisation is one thing; it is quite another to convert the whole of the organisation to an acceptance of significant change.

16.5.6 Timing

How much time is available for strategic change has already been considered as part of the change kaleidoscope (Section 16.3.2). However, choosing the precise time at which to launch strategic change is another variable. The timing of change is often neglected. Choosing the right time can be tactically vital. For example:

- *Building on actual or perceived crisis* is especially useful the greater the degree of change needed. If there is a higher perceived risk in maintaining the status quo than in changing it,

people are more likely to change. Change leaders may take advantages of performance downturns, competitive threats or threatened takeover as catalysts for strategic change. At Sony (Illustration 16.4), the company realised that record profits could undermine the momentum for change.

- *Windows of opportunity* in change processes may exist. The arrival of a new chief executive, the introduction of a new, highly successful product, or the emergence of a major competitive threat may provide opportunities to make more significant changes than might normally be possible. Sony's new CEO Kenichiro Yoshida hoped his arrival might provide such a window of opportunity.

However, it is important to recognise that top management is often not in control of timing. Change is often *mandated,* imposed by government regulations or powerful stakeholders for instance.[33] It may still be important to set up formal change programmes in response to such mandated changes, but here one lever is not under management control.

16.5.7 Visible short-term wins

A strategic change programme will require many detailed actions and tasks. It is important that some are seen to be successful quickly. In Kotter's Eight Steps for Change (Figure 16.5), creating short-term wins is the sixth step. It is often useful to pick some 'low-hanging fruit' – changes that may not be big but can be made easily and yield a quick payoff. This could take the form, for example, of a retail chain introducing a new product range and demonstrating its

success in the market or the breaking down of a long-established routine and the demonstration of a better way of doing things. In themselves, these may not be especially significant aspects of a new strategy, but they may be visible indicators of a new approach associated with that strategy. The demonstration of such wins can therefore galvanise commitment to the wider strategy.

In sum, there are many kinds of change lever available. Which levers are most appropriate depend on the type of change being sought and the context in which it is being carried out. Similarly, leadership style needs to be consistent. For example, political approaches are associated with a more transactional leadership style and are more likely to work in unreceptive contexts seeking limited types of change. On the other hand, symbolic management and transformational leadership styles are particularly important when seeking broad change in receptive contexts.

16.6 Problematising change

Strategic change is often launched as a top-down initiative supported by formal methods of programme and project management. Kotter's Eight Steps for Change (Figure 16.5), with its clear and logical sequence, can lend itself to this kind of deliberate, top-down approach. However, there are three limitations with regard to this formal programmatic approach. First, problems can arise from the process itself. Second, managers may mistake the relative importance of formal and informal change. Third, there is sometimes value in resilience, the capacity to absorb pressures for change.

16.6.1 The problems of formal change

Formal change processes are liable to four particularly common problems, as follows:[34]

- *Death by planning.* The risk is emphasising planning the change programme rather than delivering it. Subcommittees, project teams and working groups become bogged down in analyses, plans and proposals. The result can be 'analysis paralysis'.
- *Organisational exhaustion.* Change is often not a one-off process; it might require an ongoing series of initiatives, maybe over years. However, continuous change is exhausting for managers and employees. 'Change fatigue' can easily set in.
- *Behavioural compliance.* This is where organisation members comply superficially with the change programme without actually 'buying into' it. Employees follow the letter of the law, rather than

its spirit. Because employees do not believe in the desired change, they cynically behave according to the new rules even when the spirit of the change requires something more.

- *Misreading scrutiny and resistance.* Change leaders overreact to either resistance to the change or critical scrutiny of it. Often, this behaviour is seen as negative and destructive. However, scrutiny and resistance can be ways in which 'change recipients' begin to engage with what the changes mean for them. Scrutiny is part of the acceptance process, and may throw up legitimate issues besides. Explicit resistance is easier to address than passive or covert resistance (i.e., behavioural compliance). So, managers should see scrutiny and resistance as potential positives rather than only negatives.

16.6.2 Underestimating informal change

Not only can formal change programmes fail, but managers often do not recognise how informal changes are always happening anyway. According to Hari Tsoukas and Robert Chia, from the Universities of Cyprus and Glasgow respectively, a lot of change happens regardless of formal programmes.[35] They argue that change is an inherent property of organisations, as employees continually adapt and learn in response to changing conditions on the ground. Managers are liable not to recognise this inherent, unmanaged change. Indeed, hierarchy and management control often dampen such change. Thus, managers under-estimate spontaneous, emergent change, while overestimating formal change programmes.

The implication is that top-down planned change programmes can actually get in the way of the local informal adaptations that are more effective because they are closer to market needs. Strategic change can bubble up from the bottom of the organisation. In this view, management's job is to encourage and multiply successful local adaptations, not just impose strategic change from the top.

16.6.3 The need for resilience

Today's environment is characterised by many shocks: for example, COVID and the Ukraine crisis. There may be more organisationally specific shocks too, such as the sudden loss of a key customer or top executive. **Resilience refers to the capacity of organisations to recover from shocks fast and easily after they have happened.**[36] Resilient organisations are good at rebounding from significant setbacks. Instead of emphasising the capacity for positive change, the resilience concepts foregrounds the ability to recover from unwanted change after the event. Resilience is important in turbulent environments, where organisations are at risk of significant unanticipated shocks: for example, the failure of key customers or suppliers, extreme weather events (tsunamis or earthquakes), or sudden changes in government policy.

Strategic resilience can be increased by building financial reserves or creating buffer stocks in vulnerable supply chains. For example, since the Global Financial Crisis of 2008, international banks have been obliged by regulators to increase their resilience to unexpected financial crises by building up their financial reserves. However, both structures and systems can also boost resilience.

Decentralised organisational structures tend to be resilient because shocks can often be isolated in one particular part of the organisation. Some cultures can be resilient too, for instance, by cultivating loyalty or commitment in hard times. Resilience is not costless, of course. Holding financial reserves or buffer stocks is expensive. Managers must judge how much they need to invest in resilience before finally determining their most appropriate structures and systems.

Thinking differently Indigenous leadership

Traditional indigenous cultures are increasingly recognised as having lessons for leaders more generally Sarain Fox is from the Batchewana First Nation in Canada and an entrepreneur and television host and producer. She explains how she thinks the leadership style of indigenous peoples tends to differ from that of non-indigenous peoples: 'Indigenous leadership frameworks are circular rather than pyramidal. I find non-indigenous leadership tends to be organised according to a hierarchy, where certain people control another group of people . . . Indigenous leaders tend to stand among their people, listen to them at every step and speak for them when chosen to do so.'[37]

Fox's First Nation experience is, of course, a particular one (compare Misiwaykomiguk Paypomwayotung in Illustration 16.1). To varying degrees, Canadian experiences differ also from those of indigenous peoples in Africa, Australia, New Zealand, South America and other parts of the world. And, of course, the non-indigenous concepts of leadership

Fox is referring to are indigenous to their own original local contexts in Europe. But she is pointing to widely remarked contrasts in philosophies.[38] Indigenous approaches respect local traditions; non-indigenous approaches tend to make universalistic claims. Most current strategy theory is non-indigenous in the way that it assumes universal validity across the world. This universality assumption is especially problematic when it comes to leadership.

Indigenous concepts of leadership tend to differ from non-indigenous concepts in several fundamental ways. To generalise, indigenous concepts are often more collectivist than individualist. Heroic leaders are less celebrated; servant-leaders are more the ideal. The follower-leader distinction is blurred. Leadership roles do not get delegated from the top; they start as shared from the bottom. Leaders look backwards to the wisdom of older generations as well as forwards to the future. Indigenous leaders are stewards, not just change-agents.

This more collectivist approach has implications for the leadership of change. When, in 2017, Alaskan Senator Dan Sullivan presented his 'Alaskan of the Week' award to the Village Council President from the indigenous village of Igiugig in southwestern Alaska, he praised her personal qualities in leading a 'rural revolution'. When, in 2020, Senator Sullivan again recognised Igiugig's revolution with his 'Alaskan of the Week' award, he gave it to the whole village. Although the Village Council President was important, Sullivan thereby acknowledged the role of collective leadership in achieving change.[39]

Questions

Mamokgethi Phakeng at the University of Cape Town (Illustration 16.2) acknowledges several influences but points also to what she knows as a black (African) person. To what extent does she reflect an indigenous leadership style as described above and would it help her to do so more?

Key takeaways A recurrent theme in this chapter has been that styles and levers of change need to be tailored to the nature of that change. Bearing in mind this general point, this chapter suggests the following:

- You need to determine the appropriate leadership style for change, *transactional* or *transformational*, recognising the need for flexibility as in *situational leadership*.
- Your understanding of the appropriate leadership style should be informed by the *context* for change, based on *forcefield analysis* and/or the c*hange kaleidoscope.*
- You should establish the *type of strategic change* required, whether incremental or transformational, slow or fast (*turnaround*).
- You should decide which *levers for managing strategic change* are likely to be effective, including building a compelling case for change, challenging the taken for granted, changing operational processes, routines and symbols, political processes, timing and quick wins.

Work assignments

✱ Denotes more advanced work assignments.

* Refers to a case study in the *Text and Cases* edition.

16.1 Compare and contrast the different styles of leading change you have read about in the press or in this text (e.g., Travis Kalancik and Dara Khosrowshahi at Uber in Chapter 7, Bernard Foccroulle and Pierre Audi at the Aix Festival in this Chapter or Abbé Pierre at Emmaeus*).

16.2 Drawing on Section 16.2.2, assess the key contextual dimensions of an organisation (such as Uber in Chapter 7) and consider how they should influence the design of a programme of strategic change.

16.3 Use a forcefield analysis (Section 16.3.1) to identify blockages and facilitators of change for an organisation (such as one for which you have considered the need for a change in strategic direction in a previous assignment). Identify what aspects of the changes suggested by this analysis can be managed as part of a change programme and how.

16.4* There are a number of books by (or about) renowned senior executives who have led major changes in their organisations (for example, Karren Brady at Birmingham City and West Ham Football Clubs, Tim Cook at Apple, Satya Nadella at Microsoft). Read one of these and note the levers and mechanisms for change they employed, using the approaches outlined in this chapter as a checklist. How effective do you think these were in the context that the change leader faced, and could other mechanisms have been used?

Integrative assignment

17.5* What would be the key issues for the corporate parent of a diversified organisation with a multi-domestic international strategy (see Chapter 10) wishing to change to a more related portfolio? Consider this in terms of: (a) the strategic capabilities that the parent might require (Chapters 5 and 9); (b) the implications for organising and controlling its subsidiaries (Chapter 15): (c) the likely blockages to such change and; (d) how these might be overcome (Chapter 16).

Recommended key readings

- For a recent summary of research on effective leadership and change, see Y. Oreg and Y. Berson (2019) ‘Leaders’ impact on organizational change: bridging theoretical and methodological chasms’, *Academy of Management Annals*, vol. 13, no.1, pp. 272–307.
- J. Balogun and V. Hope Hailey (2016) *Exploring Strategic Change*, Prentice Hall, 4th edn, builds on and extends many of the ideas in this chapter. In particular, it emphasises the importance of tailoring change programmes to organisational context and discusses more fully many of the change levers reviewed in this chapter.

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Case example

The Festival d'Aix-en-Provence: leading change in a time of crisis

Serge Poisson de Haro (HEC Montreal) and Juan Pinzon (HEC Montreal)

In 2018, Pierre Audi became Director of the Aix Festival of Lyric Art in the south of France. He followed Bernard Foccroulle, a musician whose legacy was a festival internationally renowned for its artistic quality, its role in the training of young artists, and its commitment to opening opera up to a diverse audience. A theatre and artistic director, Audi had been at the helm of Amsterdam's Dutch National Opera for the previous 30 years. Audi's plan for the Festival was ambitious in demanding more opera. Typically an expensive art form, more opera would need more income. Audi stated: 'The festival must be active and creative in a very competitive arena. It is essential to solve a complex economic problem – a model that is at full-stretch with subsidies at only 34 per cent. This implies the search for more donors and a balanced box office [i.e., better ticket sales].'

Barely had Audi arrived than the COVID pandemic emerged. After a difficult year in 2020 due to COVID, the Festival's 2021 season was a smashing success, both with audiences and critics. Donations flooded in. How did Audi get there?

The Festival under Bernard Foccroulle: creative and local

The Aix Festival was created in 1948 and takes place in July each year. The Festival has gained an enviable position in the world of opera. In 2014, it was acknowledged as the Best Opera Festival at the International Opera Awards. Despite far more limited financial

resources, the Festival rivalled those of Salzburg, Glyndebourne and Bayreuth. It was particularly recognised for its creative flair.

Bernard Foccroulle was director of the Aix Festival from 2007 to 2018. Under Foccroulle, the Festival's success was due, among other things, to its humanistic leadership. By 2018, the Festival had become a creators' lab for twenty-first-century opera. It both revisited classical works and presented original creations, such as *Written on Skin*, by George Benjamin, or *Kalîla wa Dimna*, the first opera in Arabic and French. Foccroulle invited the best stage directors, conductors, rising stars and prestigious ensembles (e.g., the Berliner Philharmoniker and the London Symphony Orchestra). On top, he also sought to make the Festival accessible to wider audiences, through Passerelles (free activities targeting students and people in hospitals or prisons) and Aix-en-Juin (an accessible prelude to the Festival targeting local audiences). Other strategic initiatives trained young artists through the Festival's Academy and opened up towards artists and cultures from the southern and eastern Mediterranean region. The Festival d'Aix was nominated European Cultural Ambassador by the European Commission in 2013 and received the 2014 Best Festival Award at the International Opera Awards. Foccroulle also developed a flat management structure for the full-time team of about 50 staff. The Festival's Deputy Director since 2009, Francois Vienne, explained: 'Work was highly collaborative. Everything was done as a team, not only when we shared and worked together but also when decisions were made. We were always in a co-decision mode on all subjects, although Bernard [Foccroulle] had sometimes the final say.'

Foccroulle's transformational vision supported by French government grants allowed the Festival to develop an ambitious audience development policy. But this focus reduced critical discussion of high-cost projects. At the end of Foccroulle's term, the Festival had achieved many successes but some issues remained, especially the capacity to attract private funding. The self-financing ratio of the Festival (the ratio between all revenues – excluding public subsidies – and the total budget) was lower than that for most of other major opera festivals: 65.8 per cent in 2016, against 94 per cent for

the Glyndebourne Festival, 74 per cent for Salzburg Festival and 70 per cent for Bayreuth. At the end of Foccroulle's era, the economic sustainability of this model was in doubt.

Challenges for a new leader

Pierre Audi explained his challenges in 2018: ‘Bernard Foccroulle has made Aix more than a festival of creativity. It is a great university of living art, a place of transmission with its Academy. Now we have to go further on the international scene like Salzburg or Bayreuth, by bringing in artists from all over the world (. . .), and for that we have to raise funds.’ From the moment Audi was appointed, he aimed to present world-class operatic productions at the Aix Festival by partnering with some of the most highly regarded organisations. Audi arrived at the Festival with a transformational vision for the Festival. For his first season in 2019, he planned to invite major foreign orchestras to ensure the participation of prominent conductors. His 2020 programme was particularly ambitious, with the start of the residency of the London Symphony Orchestra and the prestigious conductor Sir Simon Rattle. Audi would also implement a systematic policy of inviting the best French ensembles. Audi’s bet was that his plan would increase the Festival’s attractiveness to both donors and foreign audiences.

From the beginning, Audi’s lofty ambitions entailed tensions within the organisation. This was no surprise since, when he took the helm of the Festival, he stated that ‘we will have to take some risks’. His ambitions would require a major increase of the financial resources allocated to operas. The estimated deficit of the opera programme would be €3mn in 2019 and €4.3mn in 2020, compared to an average of €2.2mn between 2012 and 2017. Deputy Director Vienne and his teams regarded his artistic project with interest but also with worries. According to Vienne ‘Pierre wanted enormous changes (. . .) and in a short time ... With Pierre, we no longer restricted ourselves on the dimension of the artistic works. With him, it is much more let’s go all out for it’. Some of the staff did not believe the Festival, given its limited financial and human resources, could fulfil Audi’s ambitions. According to Vienne, these new initiatives did not initially create a sense of urgency, but rather raised doubts among the staff about the plan’s feasibility. Audi was also seen by some members as a less accessible leader than his predecessor.

At this stage, Vienne knew that he had to support Audi's project, taking care to maintain the cohesion of his teams. At the same time, he had to make Audi understand that not everything in his project seemed possible, and that some elements had to be questioned. Trust between Audi and Vienne grew as they were getting to know each other better. Vienne knew that to ensure the success of the organisation, he had to translate the artistic ambition into practical actions from the whole organisation. By working closely with Audi, Vienne's intuitive abilities allowed him to interpret what arguments would work simultaneously with artists, donors and audiences. Vienne had the trust of the teams and he understood where the Festival should be going under Audi's leadership.

Audi's first season, in 2019, was a season of compromises He had to concede that not all his operatic ambitions could be achieved rapidly, because of financial and practical issues. 2020 was meant to be the first grand season of Audi's era. Then COVID hit.

Continuing strategic change through COVID

Following French Government COVID policy, Pierre Audi announced in April 2020 that all public performances had to be cancelled. The stress among the Festival teams was palpable. Expectations for 2020 season had been high. The organisation had to adapt, rapidly. Management decided that the five operas planned for 2020 would be postponed for 2021, 2022 and 2023. Nevertheless, some artists came to Aix for rehearsals and to perform with very restricted audiences.

Building on the Festival's long-time relationships with media partners, France Musique (the leading French radio for classical music) and Arte (a Franco-German broadcast channel), as well as on Audi's experience in linking the opera to the digital world, the Festival launched its Digital Stage, a dedicated streaming website. Artists and orchestras involved in the cancelled shows and concerts were invited to perform in smaller musical forums and to participate in debates on operatic issues. These unique moments were broadcast for free, enriched with recordings of shows from previous years.

Financing the 2020 season and the 2021 recovery season was secured thanks to government and audience support, and the renewed role of sponsors. The French Government funded business and cultural organisations affected by the COVID crisis, through partial employment schemes, among others. Audi and Vienne decided to create a Support Fund to finance 2021, the relaunch season. Some audience members supported the Festival by forgoing reimbursement for their tickets. Audi got personally involved in working with the marketing and sponsorship department to persuade patrons to increase their donations. The success of the Digital Stage was a solid argument in many cases. One patron extended her support from €400k to €800k. While Audi created tension with staff over his ambitious programming, his personal involvement during the pandemic proved key to securing new funding. He reflected in 2020 on the difficulty and importance of sponsorship: 'It's a huge job. My philosophy here is to reassure by the quality, ambition and attractiveness of our mission.' The 2020 season paradoxically

reinforced the bonds with sponsors: it represented an opportunity to ensure the survival of some of the Festival's endangered community programmes.

Relaunch

2021 was an exceptionally rich relaunch season, offering a record seven new opera productions and fifteen concerts. The lifting of health restrictions for cultural events, thanks to the lobbying of the Festival and other organisations, allowed the Festival to have an almost normal public attendance (38,000 tickets, representing 85 per cent of maximum capacity). The season was a resounding success both for audience and critics. The reviews were among the best in recent history. These results were possible thanks, in part, to the increase in private funding. Donations represented 20 per cent of revenues in 2019, and 25 per cent in 2021 and 31 per cent expected in 2022.

Staff commitment was also crucial. Vienne convinced Audi that a climate of trust was essential, insisting on the importance of two-way communication: ‘I spoke to Pierre a lot, he had to show that he cared about the staff, that he was not isolated in his ivory tower conceiving the program, which was not the case (. . .) It’s funny, at first he said to me, “I’m bringing this to you”, as if we had ordered something from him, and then gradually he joined the team, he became our director, but that took some time and that was good . . . ”.’ Vienne also adapted organisational systems to Audi’s style: instead of general meetings, Vienne ensured that Audi increased individual interactions with other directors and staff. When tensions arose over Audi’s ambitious plan or his top-down style, Vienne emphasised the necessity of creating dialogue by listening and allowing for different perspectives on the plan. Communication relieved tensions. Vienne had to intervene in situations such as the one ‘where another director was paralysed by the challenges and felt incapable to talk to Audi. I found a way to make them talk, asking someone else to help in this communication. I suggested to staff and Pierre that these frictions were understandable but that must be overcome.’ During those uncertain times, Audi and Vienne worked also on achieving and publicising short-term wins, such as an increasing number of major donors.

As the Festival emerged from the COVID crisis, it had more financial support than ever, in particular for innovative artistic projects. In addition, its artistic vision had generated growing international recognition. In late November 2021, Pierre Audi's term of office was renewed until 2027.

Main sources: J.D. Pinzon-Correa and S. Poisson-De-Haro (2021) 'Le Festival d'Aix-en-Provence: Faire vivre l'opéra, un art qui donne sens au monde', *Revue internationale de cas en gestion*; authors' interview with François Vienne, 5 October 2021; *Le Monde*, 4 July 2019; *FranceCulture*, 9 July 2020.

Questions

1 How would you describe the leadership styles of Bernard Foccroulle and Pierre Audi (initially)? What contrasts and changes would you underline?

2 With reference to Section 16.2, how would you describe the leadership role of François Vienne?

3 Analyse the change context at the Festival d'Aix in terms of either the change forcefield or the change kaleidoscope at the time of Pierre Audi's appointment as Director.

Chapter 17

The practice of strategy

Key terms

hypothesis testing

open strategy

strategic issue-selling

strategic planners

strategy projects

strategy workshops

Learning outcomes

After reading this chapter you should be able to:

- Assess who to involve in strategising, with regard to *top managers, strategy consultants, investors, strategic planners, middle managers* and others.
- Evaluate different approaches to strategising activity, including *analysis, issue-selling, decision making* and *communicating.*
- Recognise key elements in various common strategy methods and tools, including *digital strategy tools*, *strategy workshops, projects, hypothesis testing* and *open strategy.*

Evaluating
Processes
Practice
III
Strategy
in action
Imple-
menting
Leading &
Changing

17.1 Introduction

The Boston Consulting Group is the world's first strategy consulting firm, founded in 1963, and is still part of the 'Big Three' strategy consultants known as MBB (McKinsey, BCG and Bain). It employs 22,000 people worldwide and is constantly on the hunt for new strategy consultants, both recent graduates and experienced professionals. The BCG website promises new recruits that 'you'll work alongside some of the world's top minds on cases that reshape business, government, and society. You'll collaborate on challenging projects with team members from many backgrounds and disciplines, increasing your understanding of complex business problems from diverse perspectives and developing new skills and experience to help you at every stage of your career – at BCG and beyond.' Reviews at Glassdoor describe consulting at BCG variously as 'fun, engaging . . . very challenging', 'a tough lifestyle' and 'high stress', but also 'impactful', 'cool' and 'fast-paced'.[1]

These glimpses into life at a Big Three strategy consulting firm underline that strategy is a kind of work. It is something that a whole range of people *do*: entrepreneurs, senior managers, middle managers, consultants and, increasingly, lower-level employees are all involved in making strategy. This chapter examines some of the practicalities of such strategy work. Formal strategy analysis is an important part of this work but, in reality, strategy is more messy and human than that. This final chapter recognises the human aspects of strategy work. Whereas Chapter 14 introduced the overall organisational process of strategy development, this chapter is about

what people do *inside* the process. The aim is to examine the practicalities of strategy-making.

The chapter has three sections, as shown in Figure 17.1:

- *The strategists.* The chapter starts by looking at who gets involved in making strategy**.** It does not assume that strategy is made just by top management. Strategy often involves people from all over the organisation, and even people from outside.
- *Strategising activities.* The chapter continues by considering what kinds of work strategists do in strategy making (strategising). This includes not just the strategy analysis that is an important part of this book, but also the selling of strategic issues, the realities of strategic decision making and the critical task of communicating strategic decisions.
- *Strategising methods.* The final section considers which methods (or tools) are often used in strategising. These methods and tools include digital technologies; strategy workshops; strategy projects and strategy consulting teams and hypothesis testing to guide strategy work.

Figure 17.1 The pyramid of strategy practice

Figure 17.1: Long Description

Figure 17.1 integrates these three sections in a *pyramid of practice*.[2] The pyramid highlights three questions that run through this chapter: *who* to include in strategy making; *how* to carry out strategising activity; and *what* strategising methods to use in this strategising activity. Placing strategists at the top of the pyramid emphasises the role of managerial discretion and skill in strategy making. It is the strategists who drive both the strategising activity and the strategy methods that are at the base of the pyramid. Strategists' choices and skill with regard to activity and methods can make a real difference to final outcomes. This chapter seeks to guide practising strategists through some key choices they may have to make in action.

17.2 The strategists

This section introduces who is potentially involved in strategy. It starts at the top-management level, but also addresses the roles of strategic planners, middle managers, consultants and investors. The roles that employees and other stakeholders sometimes play will be explicitly discussed in Section 17.4 on 'open strategy'.

17.2.1 Chief executives and directors

The conventional view is that strategy is something for the top of the organisation. In large organisations, this view suggests that top managers are clearly separated from operational responsibilities, so that they can focus on overall strategy.[3] If top managers remain closely involved in operations such as sales or service delivery, they are liable to get distracted from long-term issues by their day-to-day responsibilities. Entrepreneurial leaders of start-ups and smaller businesses may have to stay close to operations, but strategy is still a vital part of the role. Neil Patel, Co-founder of the Crazy Egg company, tells busy entrepreneurs: 'Your job is not do everyone's job. Your job is to help others do their job better. The most productive way to do that is to create a strategy.'[4]

However, chief executives are not the only strategists at the top of organisations. Typically, there are top management teams and non-executive directors as well (see Illustration 17.1: The NICE way of strategy). The key elements of these various top roles are as follows:

- The *chief executive officer* (CEO), whether of a large organisation or an entrepreneurial start-up, is often seen as the 'chief strategist'. Harvard Business School theorist Michael Porter stresses the value of a clear strategic leader, somebody capable of setting a disciplined approach to what fits and what does not fit the overall strategy.[5] CEOs of large companies typically spend about one-third of their time on strategy, often involving considerable analysis, advice and debate.[6] Start-up CEOs often have to be more experimental, trying out strategies on the ground and then quickly adopting what works and dropping what does not (the 'fail fast' approach). Even so, successful entrepreneurs typically undertake periods of strategic reflection, pausing before they solidify their business strategies or models.[7] But whether leaders of large organisations or small, CEOs are prone to hubris, excessive confidence in their own strategic judgement.[8] It is often best that CEO do not strategise in isolation. CEOs often look for advice.[9]
- The *top management team* can bring diverse experience and additional insights to the CEO. Typically, top management team members are *executive directors*, with a formal responsibility as constituents of the company board for the strategy of the organisation as a whole. In theory, they should be able to challenge the CEO and increase strategic debate.[10] However, where members have similar backgrounds or must work with strong leaders, top management teams often suffer from '*groupthink*', the tendency to build strong consensus amongst team members and avoid internal questioning or conflict.[11]

Moreover, the capacity to contribute meaningfully to strategy is not easy to develop. As managers transition into top management roles, they often find it hard to detach themselves from their immediate responsibilities. New top managers frequently need to work on developing the skills and confidence required for debating the strategy of the overall organisation.[12]

- *Non-executive directors* (including non-executive chairmen/women) are the other members of the board with formal responsibility for the strategy. They too have a role in increasing the diversity of inputs into the strategising process, being able to draw on their work for other organisations. However, their roles are part-time and semi-detached. Typically, non-executive directors do not generate strategic ideas and rarely do they veto them. Most often, non-executives exert influence through discussion at board meetings, informal consultations before the CEO finalises their strategy or by helping to shape effective strategy processes, for example, by insisting on having more information or better procedures. Non-executives often contribute most effectively to strategy not through formal board meetings with everybody present, but through one-to-one conversations with CEOs on specific issues where they have the most relevant expertise.[13]

Illustration 17.1 The NICE way of strategy

England's National Institute for Health and Care Excellence (NICE) launched a new strategy in April 2021. Strategy Board minutes show some of the inputs to the strategy process.

NICE was established in 1999 as a non-profit public body within the Department of Health and Social Care in England, and now has responsibility for providing guidelines on medicines, clinical practice, health promotion and social care. The aim was to raise standards in medical and social care practice and particularly to end local variations within a National Health Service (NHS) system that is funded by nationwide taxes. NICE has been a controversial pioneer in the cost-benefit analysis of patient care, sometimes denying expensive treatments. NICE has also been criticised for rejecting certain treatments nationally on grounds of cost-effectiveness and for delays in issuing guidance on new treatments. Pressure on NICE is increasing as expensive new therapies are rapidly emerging, problematic for an NHS under severe financial constraints.

In April 2020, Gillian Leng became CEO, promoted from her former role as Deputy CEO. She brought to this position 20 years of experience within the organisation as well as time as both a doctor and a medical researcher. She was replacing a CEO who had been in place since NICE's foundation. Just when the COVID epidemic was beginning, Leng decided to launch a new strategy. The minutes of the NICE Strategy Board give an insight into the strategy process. The Strategy Board meets roughly every three months, typically attended by NICE's non-executive chairman, four or five non-executive directors and about the same number of executive directors, including the CEO. The non-executive team draws on experience from the pharmaceutical industry, medical research, medical practice, nursing practice, medical publishing and health charities.

The NICE Strategy Board of August 2020 reviewed progress with developing the new strategy. Gillian Leng introduced Tracy Burr, a consultant who was working on the strategy development. Burr updated the Board on the initial SWOT and PESTEL analyses, presented the development schedule and explained how she would be meeting with the non-executives individually in the coming weeks. The Board also heard about an external consultation process, particularly with the National Health Service and major pharmaceutical companies. These consultations pointed to the opportunity for NICE to provide more leadership to the sector and the need to create 'living' guidance

that could be rapidly updated. The Board underlined the importance of working with stakeholders The Strategy Board next reviewed the emerging strategy at a strategy awayday in October. The draft strategy was then discussed by the Board in December. The Board supported the emerging vision around dynamic, living guidelines, but highlighted the need for clarity over the schedule of actions, the importance of regular feedback from stakeholders, and the urgency of NICE's own digital transformation. By February 2021, the Board was shifting attention to the organisation design for strategy implementation. Cultural change and new structures were both emphasised, with misgivings expressed about a suggested matrix structure. The next meeting in April raised issues about NICE's capacity to follow through the transformation required by the new strategy. To address this, the Board recommended an internal skills mapping exercise and discussed the use of NHS organisation development consultants.

April 2021 also saw the formal launch of the new five-year strategic plan. The plan acknowledged the contributions of external stakeholders, opinion leaders, patient groups, partner organisations and non-executive directors. The plan also promised rapid, robust and responsive technology evaluation and dynamic, living guidelines. The strategic plan was welcomed by key stakeholders. Following the launch, the Strategy Board regularly interrogated the management on progress against key measures. Gillian Leng herself commented in October 2021: 'Writing a strategy is a bit like writing a guideline. It's not easy by any stretch of the imagination! But it's the implementation of the strategy . . . that's the real challenge.'

Sources: Strategy Board Minutes, available at: https://www.nice.org.uk/About/Who-we-are/Board/Board-strategy-papers [accessed: June 2022]; https://nicetimesmagazine.nice.org.uk/autumn-2021-feature1/index.html [accessed: June 2022].

Questions

1 On the basis of this account, what are the key contributions of the Strategy Board to NICE's strategy?

2 What value do you think consultants can bring to the strategy process, both formulation and implementation?

17.2.2 Strategic planners

Strategic planners are those with a primary responsibility for contributing to the strategy process.[14] Unlike top managers, for whom strategy is just part of their role, strategic planners typically work on strategy for the large majority of their time. Even for large corporations, strategic planning teams are generally no more than a dozen or so.[15] Nonetheless, as in Illustration 17.2, organisations frequently advertise strategic planning jobs (although they often recruit internally as well). Here, the personal specifications give a clear picture of the types of work a typical strategic planner might do.

Strategic planners do not take strategic decisions themselves. However, they typically have at least three important tasks:[16]

- *Information and analysis.* Strategic planners have the time, skills and resources to provide information and analysis for key decision makers. This might be in response to some 'trigger' event – such as a possible merger – or as part of the regular planning cycle. Good information and analysis can leave an organisation much better prepared to respond quickly and confidently, even to unexpected events. Strategic planners can

also package this information and analysis in formats that ensure clear communication of strategic decisions.

- *Managers of the strategy process.* Strategic planners can assist and guide other managers through their strategic planning cycles (see Illustration 14.2 in Chapter 14). This can involve acting as a bridge between the corporate centre and the businesses by clarifying corporate expectations and guidelines. It can also involve helping business-level managers develop strategy by providing templates, analytical techniques and strategy training. This bridging role is important in achieving alignment of corporate-level and business-level strategies. This alignment is often lacking; many organisations do not link financial budgets to strategic priorities, or employee performance metrics to strategy implementation.
- *Special projects.* Strategic planners can be a useful resource to support top management on special projects, such as acquisitions or organisational change. Here, strategy planners will typically work on project teams with middle managers from within the organisation and often with external consultants. Project management skills are likely to be important.

Illustration 17.2 Wanted: strategists The professional networking site LinkedIn often carries advertisements for chief strategy officer, strategic planner or strategy analyst positions from a wide range of organisations.[17] For example, in January 2022, LinkedIn was advertising for strategists at Fraction, a London fintech start-up, the University of

Nebraska-Lincoln, with more than 25,000 students, and Arthan, a small social impact consulting firm based in New Delhi, India.

The following job advertisement is adapted from several recent advertisements for strategy analysts appearing in LinkedIn. It gives an insight into the kind of work strategy analysts do and the skills and background required.

Strategy analyst wanted for a multinational business We are seeking a highly motivated strategy analyst capable of contributing to a fast-growing business with multiple business lines operating in international markets. You will report to the Chief Strategy Officer. The CSO is a key member of the senior management team, reporting to the CEO.

Key responsibilities:

- Lead strategic analysis of important business challenges and opportunities, including the evaluation of both existing businesses and potential acquisitions.
- Develop solutions and action plans based on your strategic analysis, including evaluation of different options.
- Develop financial models and business cases to support your analyses and enable data-driven decision making.
- Distil data, insights and information into clear and compelling written presentations / strategic papers, including for the corporate Board.
- Support countries in developing and delivering their local strategies.

Essential competences:

- Exceptional analytical skills, including financial modelling and strategy evaluation.
- Sophisticated critical thinking and problem-solving skills.

- Excellent written and verbal communication skills.
- Confidence and poise in presenting to management.
- Capacity to manage ambiguity and work under pressure.
- Self-management, with the ability to prioritise workloads and meet deadlines.
- Capable of working with international colleagues at all levels of the organisation.

Desirable qualifications: The 'consulting toolkit', acquired from working with a leading consulting firm. Experience of working in different countries. An excellent academic track record, ideally with an MBA or equivalent professional qualification.

Team:

The person appointed will join an existing team of eight based at the corporate head office in Amsterdam. Some international travel will be required.

Questions

1 What would be the attractions of this job for you? What would be the disadvantages?

2 What relevant skills and experience do you already have, and what skills and experience would you still need to acquire before you were able to apply for this job?

In addition to these tasks, strategic planners typically work closely with the CEO, discussing and helping refine their strategic thinking. Although strategic planners may have only small teams and little formal power, their closeness to the CEO typically makes them well-

informed and influential. Managers throughout an organisation are likely to use them to sound out ideas.

17.2.3 Middle managers

As in Section 17.2.1, a good deal of conventional management theory reserves strategy for the top of the organisation, excluding middle managers. Middle managers are seen as lacking an objective and long-term perspective, being too involved in their operational responsibilities. In this view, middle managers' role is limited to strategy implementation. This is, of course, a vital role (see Chapter 15).

However, there is a strong case for involving middle managers in strategy making itself. First, in fast-moving and competitive environments, organisations often need to decentralise strategic responsibilities to increase speed of response: it takes too long to refer everything to the top. Second, in knowledge-intensive sectors (such as design, consulting or finance, but many others too) the key source of competitive advantage is typically the knowledge of people actually involved in the operations of the business. Middle managers at operational level can understand and influence these knowledge-based sources of competitive advantage much more effectively than remote top managers.

Against this background, there are at least four strategy roles middle managers can play:[18]

- *Information source.* Middle managers' knowledge and experience of the realities of the organisation and its market is likely to be greater than that of many top managers. So, middle

managers are a potential source of information about changes in the strategic position of the organisation.

- *'Sense-makers' of strategy.* Top management may set strategy, but it is often middle managers who have to explain it in the business units. Middle managers are therefore a crucial *relevance bridge* between top management and members of the organisation at lower levels, in effect, translating strategy into a message that is locally relevant. If misinterpretation of that intended strategy is to be avoided, it is therefore vital that middle managers understand and feel an ownership of it.
- *Adapters as events unfold.* A strategy may be set at a certain point of time, but circumstances may change, or conditions in particular units may differ from assumptions held by top management. Middle managers are necessarily involved in strategy adaptation because of their day-to-day responsibilities in strategy implementation.
- *Champions of novel ideas and strategies.* Given their closeness to markets and operations, middle managers may not only provide information but champion new ideas that can be the foundation of new strategies. Their links from deep within the organisation to the C-suite allow them to translate and communicate new ideas that may initiate radical strategic change.

In the public sector, elected politicians have traditionally been responsible for strategy ('policy'), while public officials do the implementation. However, three trends are challenging this division of roles.[19] First, the rising importance of *specialised expertise* has shifted influence to public officials with specialist careers, while

politicians are typically generalists. Second, public sector reform in many countries has led to increased *externalisation of functions* to quasi-independent 'agencies' or 'QUANGOs' (quasi-autonomous non-governmental organisations) which, within certain constraints, can make decisions on their own. Third, the same reform processes have changed *internal structures* within public organisations, with decentralisation of units and more 'executive' responsibility granted to public officials. In short, strategy is increasingly part of the work of public officials too.

17.2.4 External strategists

There are two sets of external actors who often exercise influence from outside the organisation: strategy consultants and investors.

- *External consultants* are often used in the development of strategy. As well as the top three strategy consultancies of Bain, the Boston Consulting Group and McKinsey, there are strategy specialists within the large general consultancy firms such as EY, KPMG and PwC. There are also smaller 'boutique' consultancy firms and individual consultants who specialise in strategy for particular sectors. These consultants play at least four roles in strategy: *design and facilitation* of client strategy processes; *analysis and option generation* for clients; *knowledge transfer*, for example the transmission of strategic best practices between clients; and *implementing strategic change*, often the most profitable kind of strategy work because requiring many consultants working closely with clients for long periods of time.[20] The value of strategy consultants is

controversial. They are often blamed for failures when it is actually the client's poor management of the consulting process that is ultimately at fault. It is important for organisations to select their consultants systematically, give clear initial project briefs, remain consistent in expectations during the process, and learn from projects at the end. Joint teams of external consultants and internal managers are often an effective way of combining outside perspectives with inside knowledge, of transferring learning into the organisation and of getting commitment to implementation.

- *Investors* of various kinds can be influential on strategy. Sometimes, the influence is on the strategy process. Larry Fink, CEO of Blackrock, the world's largest asset manager, has written to the CEOs of the companies he invests in: 'We are asking that every CEO lay out for shareholders each year a strategic framework for long-term value creation. Additionally, because boards have a critical role to play in strategic planning, we believe CEOs should explicitly affirm that their boards have reviewed those plans.'[21] Sometimes, investors more directly influence the actual nature of the strategy. At the initial entrepreneurial stage of a business, venture capitalists (typically with experience from many different entrepreneurial ventures) should, in principle, be able to advise on strategy and professional strategy processes: entrepreneurs in fact report considerable limitations in venture capital inputs on strategy, with an over-focus on financial issues. For more mature companies, *private equity investors* seek to change the strategies or business models in about one-third of the

companies they invest in; they particularly take the initiative in strategic acquisitions or divestments. *Activist investors* also seek to alter the strategies of the businesses they invest in. Activist investors are particularly likely to seek improvements in performance by cutting expensive projects and divesting ill-fitting or poorly performing business units.[22]

17.3 Strategising

Whereas the previous section introduced the key strategists, this section concentrates on how strategy is done – in other words, the activities of strategising. These strategising activities are broad, but this section focuses first on strategy analysis, then issue-selling, decision making and strategy communication. There is a flow here, from initial analysis to final communication. In practice, of course, strategy activities rarely follow this logical sequence entirely and some may not happen at all. As shown in Chapter 14, strategies do not always come about logically and strategic decisions are often made without formal analysis and evaluation. This reminds us that strategy development is often a messy process.

17.3.1 Strategy analysis

Strategy analysis can be an important input into strategy making and, although managers often use a limited set of analytical tools, in practice, managers often deviate from the technical ideal. As explained in Chapter 2, SWOT analysis tends to produce unmanageably long lists of factors (strengths, weaknesses, opportunities and threats), without prioritisation and systematic further analysis and follow-up. Finally, there is the risk of '*paralysis by analysis*', where managers spend too long perfecting their analyses and not enough time taking decisions and acting upon them. How much analysis do managers really need?

However, focusing criticism on managers for their analytical mistakes may sometimes be misplaced. In practice, the purpose of analysis is not always simply about providing the necessary information for good strategic decisions. Ann Langley has shown that setting up a project to analyse an issue thoroughly may be a deliberate form of *procrastination,* aimed at putting off a decision.[23] It may be *symbolic* to rationalise a decision after it has already effectively been made. By asking managers to analyse an issue, it may get their *buy-in* to decisions that they might otherwise resist. Analyses may also be *political,* to promote the agenda of a particular manager or part of the organisation (see Chapter 14).

The different purposes of strategy analysis have two key implications for managers:

- *Design the analysis according to the real purpose.* The range and quality of people involved, the time and budget allowed, and the subsequent communication of analysis results should all depend on underlying purpose, whether informational, political or symbolic. For example, prestigious strategy consulting firms are often useful for political and symbolic analyses. Involving a wide group of middle managers in the analysis may help with subsequent buy-in.
- *Invest appropriately in technical quality.* For many projects, improving the quality of the technical analysis will make a valuable addition to subsequent strategic decisions. On other occasions, insisting on technical perfection can be counter-productive. For example, a SWOT analysis that raises lots of issues may be a useful means of allowing managers to vent their own personal frustrations, before getting on with the real

strategy work. It may sometimes be better to leave these issues on the table, rather than probing, challenging or even deleting them in a way that could unnecessarily alienate these managers for the following stages.

17.3.2 Strategic issue-selling

Organisations typically face many strategic issues at any point in time. But in complex organisations, these issues may not be appreciated by those involved in developing strategy. Some issues will be filtered out by the organisational hierarchy; others will be side-lined by more urgent pressures. Moreover, senior managers will rarely have sufficient time and resources to deal with all the issues that do actually reach them. So, strategic issues compete for attention. What gets top management attention is not necessarily the most important issue.[24] Issues need to be 'sold'.

Strategic issue-selling is the process of gaining the attention and support of top management and other important stakeholders. To gain attention and support of top management, managers need to consider at least four issues:

- *Issue packaging.* Care should be taken with how issues are packaged or framed. Clearly, the strategic importance of the issue needs to be underlined, particularly by linking it to *critical strategic goals* or *performance metrics* for the organisation. Generally, clarity and succinctness win over complexity and length. It also usually helps if the issue is packaged with *potential solutions.* An issue can easily be put aside as too

difficult to address if no ways forward are offered at the same time.

- *Formal and informal channels.* Managers need to balance formal and informal channels of influence. Figure 17.2 indicates some *formal channels* for selling issues in a multidivisional organisation (based on the American conglomerate General Electric). Here, formal channels are split between corporate, line and staff. On the corporate side, they include the annual business reviews that the CEO carries out with each divisional head, plus the annual strategy retreats of the top executive team. The line channel involves the regular line interaction of operational managers, divisional heads and the CEO and other executive directors. Finally, there are the various reporting systems to staff functions, including finance, human resources and strategic planning. However, formal channels are rarely enough to sell strategic issues. *Informal channels* can be very important and often decisive. Informal channels might include ad-hoc conversations with influential managers in corridors, on journeys or over meals or drinks. Illustration 17.3 shows how informal channels can be important for strategists.
- *Sell alone or in coalitions.* Managers should consider whether to press their issue on their own or to assemble a *coalition of supporters,* preferably influential ones. A coalition adds credibility and weight to the issue. The ability to gather a coalition of supporters can be a good test of the issue's validity: if other managers are not persuaded, then the CEO is unlikely to be persuaded either. But notice that enlisting supporters may

involve compromises or reciprocal support of other issues, so blurring the clarity of the case being put forward.

- *Timing.* Managers should also time their issue-selling carefully. For example, a short-term performance crisis, or the period before the handover to a new top management team, is not a good time to press long-term strategic issues.

Figure 17.2 Formal channels for strategy issue-selling

Source: Adapted from W. Ocasio and J. Joseph (2005) 'An attention-based theory of strategy formulation: linking micro and macro perspectives in strategy processes', *Advances in Strategic Management*, vol. 22, pp. 39–62.

Figure 17.2: Long Description

Illustration 17.3 A day in the life of a strategy director Strategy directors work through multiple channels to influence strategy.

We had just finished the annual strategy planning process for the group, and I can remember thinking my busy period was now over as my phone rang. It was 22.30 and I was walking out of the airport in Delhi, India. I had flown in from Bangalore and had planned a night in an airport hotel before flying home to Connecticut, USA for the first night in my own bed for over a month.

I had come from Bangalore as we had opened a global R&D centre for the group just over a year ago. It was one of three R&D centres; the others were in Stockholm and Connecticut. The group I work for is over 100 years old and manufactures security products. Originally, our products were all mechanical but, three years ago, we had agreed a strategy to add electronics to virtually everything we built. The centre in Bangalore focused on developing the software that gave our products their functionality and gathered the data we could use from the products we installed. This transformed the use of our products and, armed with data they generated, our customers deluged us with inspired requests for new features. Run on agile principles of product development, we were delighted with the speed with which Bangalore could respond to these requests, but this had created unforeseen issues in some of our manufacturing facilities. I had planned and run a two-day workshop with the group chief technical officer aimed at addressing some of these issues.

In the recently completed strategic planning round, I had put a huge amount of effort into finding ways of accelerating the group's shift from mechanical to electronic. For this to happen, I knew I needed to encourage change from both head office and from the

regional business units. Our original strategic plan was to build the skills we needed in-house by recruiting the right people and investing in group centres of excellence, such as the one in Bangalore. However, in some of the business units, there was a cultural resistance that prevented some of the technologies being developed at a group level being adopted locally. However, I had observed that some of the most successful cultural shifts had come in geographical regions that had integrated acquisitions targeted at bringing new technology into the group. I knew that the annual strategic planning process was an opportunity to formally convince head office that we should aim to build our technology capabilities more through acquisition than had been originally planned and to persuade the regional business units that they should be leading the acquisition and integration process.

In fact, this was the reason for the phone call I received in Delhi. It was the Group Chief Executive, phoning at midday Connecticut (USA) time saying that he needed me in Frankfurt tomorrow. A European technology acquisition we had targeted as a group, but lost in a process of sealed bids, was back on the market. The CEO had no other details but that our merchant bank had called suggesting that, if we acted quickly, we had a chance of securing an exclusivity period in which to carry out due diligence. I knew two things: one, this was an acquisition that we really wanted and two, it should be the European region executive team leading the process, not me.

I changed my flight and made an appointment to meet the European regional director in Starbucks at Frankfurt airport when I landed. Tonight, though, I would spend some time reminding myself of the details of our original bid, the discounted cash flow forecasts based on estimated combined organisational performance, that we used for valuation, the strategic due diligence we had completed and the key legal protections we had included in our draft sale and purchase agreement. I resigned myself to more nights away from home.

Acknowledgement: The authors are grateful to this strategy director for sharing their experience of their strategy work.

Questions

1 What strategic activities is this strategy director involved in?

2 What skills do you think the strategy director needs to be effective in the role?

17.3.3 Strategic decision making

Strategic decision making is not always rational. Nobel Prize-winner Daniel Kahneman was introduced in Chapter 2, with his distinction between fast and slow decision making. He and colleagues have developed an approach called 'behavioural economics', which seeks to improve decision making by taking into account real-life human behaviour.[25] Kahneman points out that even senior managers bring 'cognitive biases' to their decisions: their mental processes are liable to neglect, distort or exaggerate certain issues. The trouble with cognitive biases is that, by definition, it is very hard for people to recognise what they are suffering from. However, Kahneman suggests that designing good decision-making processes can help remedy the ill effects of these biases. He highlights five common decision-making biases, along with ways to reduce them:

- *Confirmation bias* is the tendency to seek out data that confirm a favoured course of action, and to neglect information that might disconfirm it. One way to counter this confirmation bias is to insist that alternative options are always considered in decision processes. Then the discussion shifts from whether or not to

take a favoured action, to how much better it really is compared to the alternatives.

- *Anchoring bias* is the common error of being tied ('anchored') to one piece of information in making a decision. Anchors are often things that might have been valid in the past but may not hold true in the future. For example, managers may rely on past sales trends, and neglect the possibility that these trends might change. Sometimes, managers will make an initial estimate of a cost or revenue and allow that value to become entrenched in their decision making, forgetting that it was only an estimate in the first place. One way of countering anchoring biases is introducing different analytical methods into the process (for instance, a discounted cash flow as well as a pay-back period analysis). A different analysis may surface unacknowledged assumptions or force out new data or insights.
- *Saliency bias* refers to when a particular analogy becomes unduly influential ('salient'). For example, managers may say a particular project is just like a successful project in the past, minimising differences: on the analogy with past experience, they simply expect success to be repeated. It is important here to ask for other analogies, or to seek out possible differences between the successful case and the one being considered. A form of this saliency bias is the so-called 'halo effect', where a manager or organisation that has been successful in one domain is simply assumed to be successful in another: the manager or organisation is treated like a saint (with a 'halo') and assumed to do no wrong. Again, it is important here to check for differences. Just because a manager has been successful in

managing a series of acquisitions does not mean he or she will be equally successful in managing a joint venture.

- *Affect bias* occurs when managers become too emotionally attached to a particular option (too ‘affectionate’). In cases of issue-selling, this is often called *champion’s bias*: the likelihood that people will exaggerate their case in favour of their particular proposal. If the proposal comes from a team, it might be worth checking with members individually for signs of discomfort: a more balanced view may come from the less enthusiastic team members. Having just the lead ‘champion’ present the proposal on his or her own maximises the danger of hearing the most positive side of the argument.
- *Risk bias* is where managers hold distorted views of risk. Managers are often over-optimistic in assessing their ability to deliver on projects. Here Kahneman recommends that instead of relying on the organisation’s own assessment of its capabilities (an ‘inside view’), decision makers also look at the record of *other* organisations undertaking similar projects (an ‘outside view’). It is easier to acknowledge the failures of other organisations than to undertake a sceptical review of one’s own internal capabilities. On the other hand, managers can sometimes be biased towards pessimism, so-called ‘risk aversion’. Their fear of failure may be greater than their appetite for success. Risk aversion can be reduced by reviewing incentives: the rewards of success can be increased and the penalties for failure reduced.

Thus, Kahneman’s behavioural view leads to concrete methodologies to reduce biases in strategic decision making. As in

Chapter 2, his overall advice is to ‘think slow’ – to take the time to ask for additional views, analysis and data. Of course, managers should recognise the danger of paralysis by analysis (Section 17.3.1): in fast-moving environments, the informed intuition of experienced managers may be more effective than thorough but time-consuming analyses.[26] However, Kahneman believes that the costs of error generally outweigh the costs of missed opportunities.

Behavioural economics underlines the potential benefits of constructive *conflict* in decision making.[27] Conflict can expose champion’s biases. It can challenge the risk bias of optimistic self-assessments. Constructive conflict is fostered by having diverse managerial teams, with members prepared to be devil’s advocates, challenging assumptions or easy consensus. In managing conflict, it is important to respect differences and avoid personalisation and emotion. The losers should be given dignity and risk taking should be rewarded.[28]

However, Oxford University’s Thomas Powell argues that focusing upon cognitive biases is not sufficient for better strategic decisions. Strategy is not primarily a cognitive endeavour but about *getting things done*.[29] To this end, it is important that strategies are *behaviourally* rational, which means they generate sufficient enthusiasm for implementation. Powell makes the distinction between *mercenary strategies,* which are economically rational but do not enthuse people to act (relying instead on financial incentives for example) and *romantic strategies,* which inspire and motivate people on their own account. Romantic strategies may be more effective at ensuring implementation. However, excessive emphasis on either may lead to disappointing outcomes: mercenary

approaches can demotivate and inhibit adaptation, while romance can lead to impulsive and excessive strategies with high risk. A more blended approach that accommodates both the mercenary and romantic may well result in both good strategic choices and effective adaptation.

One final point: it is important not to exaggerate the importance of decision making in strategy. As explained in Chapter 14, many strategies are emergent rather than consciously decided anyway. Organisations often slip into strategies with very little explicit discussion or choice.

17.3.4 Communicating strategy

Deciding strategy is only one step: strategic decisions need to be communicated.[30] Managers have to consider which stakeholders to inform (see Chapter 6) and how they should tailor their messages to each. Shareholders, key customers and employees are likely to be particularly central, all with different needs. For every new strategy, there should be a communications strategy to match. It is also important to remember that communication is a two-way process. Harvard's Michael Beer and Russell A. Eisenstat[31] argue that effective communication needs to involve *both* advocacy of a strategy by senior management *and* inquiry about the concerns of influential internal and external stakeholders. In the absence of the former, there is lack of clarity, confusion and frustration. In the absence of the latter, concerns will surface in any case, but in ways that actively or passively undermine the new strategy.

Strategy can be communicated by telling inspiring stories, by picturing it persuasively and by embodying it authentically, as follows:

- *Narrating strategy*: it is important to link up the bullet-points of a typical strategy presentation into a coherent narrative. The elements of strategy need to be assembled into a consistent and motivational story. When Italian appliances company Alessi changes strategy, it even writes a book about it. London Business School Professor Michael Jacobides describes narrative communications as moving from ‘plans’ to ‘playscripts’. A good story has a compelling plot and energising players: it should vividly tell how you will overcome obstacles and outwit rivals in order to achieve your vision.[32]
- *Visualising strategy*: a picture is worth a thousand words. To communicate effectively, it is often valuable to translate a strategy into powerful graphics, something that is sometimes called ‘stratography’ (see also Chapter 2). Diagrams, maps, pictures or even cartoons can be used to convey meaning memorably. In 2001, Amazon founder Jeff Bezos drew his famous flywheel model on the back of a paper napkin. The diagram showed a virtuous circle starting from ‘customer experience’, leading through ‘traffic’ to ‘lower cost structure’, then to ‘lower prices’ and finally back to ‘customer experience’. The simple flywheel diagram communicated to managers, employees and investors the self-reinforcing momentum that helped make Amazon one of the top five most valuable companies in the world.[33]

- *Embodying strategy*: strategists need to walk the talk of their strategies. In his new product presentations, Apple's Steve Jobs embodied his company's strategy not only by the simple elegance of his famous black jeans and polo-necks but also by the precision of his stage movement and the expressiveness of his hand gestures.[34] Jobs was the physical representation of his company's elegant products. On the other hand, as CEO of Microsoft, Steve Ballmer's baggy appearance and dress-sense diverged from the stereotype of technology company leader: investors did not back him. Balmer's successor at Microsoft, Satya Nadella, has many similar stylistic characteristics to Jobs: investors regard Nadella a great success.[35]

It is important to recognise how the rise of more open approaches to strategy puts a greater premium on continuous transparency (Section 17.4.5). Communication does not necessarily come only when the final decision has been made at the end of the strategy process. Strategists need to consider appropriate communication all the way through. NICE (Illustration 17.2) publishes all its strategy agendas, papers and minutes on its website. Germany's Pirate Party even live-streamed its internal strategy meetings.[36]

17.4 Strategy methods

Strategists have a range of standard methods or tools to organise and guide their strategising activity. The methods introduced here are not analytical concepts or techniques presented earlier in the book, but widely used approaches to managing aspects of strategy work such as issue-selling or decision making. These could include digital strategizing, strategy workshops (or 'away-days'), strategy projects and 'open strategy'.

17.4.1 Digital strategy tools

Digital tools are having an increasing impact upon strategy practice. The technological landscape is moving fast, but there are at least three areas where such tools are already changing strategy work:

- *Environmental analysis*: here, *artificial intelligence* (AI) is facilitating new ways of environmental scanning, for example sifting through massive amounts of data (media and analyst reports, search histories, internal email logs, and so on) using key terms to identify emergent trends. The regular tracking of expert sentiment, as expressed in the media, has been shown to predict successful investment. Patterns emerging in these masses of data can be communicated and manipulated increasingly effectively through *digital visualisation* techniques (word clouds, for example) allowing dynamic and interactive analysis.[37]

- *Strategic option generation*: here, corporate *social media* such as Yammer can be used as a way of crowdsourcing ideas for strategy, along the lines of open strategy (Section 17.4.4). As for the strategic planners at Swedish technology company Ericsson, more specialised internal and external communities can be created with the mandate to generate strategic options and develop them through continuous conversations. IBM's *strategy jamming* technology is a similar means of accessing strategy ideas, typically undertaken in short blocks of time. Wikis can be used for continuous development of strategic ideas. Finally, digital-polling technologies can identify preferences and inform strategic decisions.[38]
- *Strategy implementation and adjustment*: again, *CEO blogs* and *social media* are effective ways of disseminating and interpreting strategic initiatives across organisation levels and over time. Microsoft top managers connect vividly with employees via monthly *virtual town halls* and question and answer sessions using video technologies, allowing dynamic conversations about the meaning of strategy across the world.[39]

17.4.2 Strategy workshops

Strategies are often made through series of managerial meetings. These meetings frequently take the specific form of **strategy workshops** (sometimes called strategy away-days or off-sites).[40] Such workshops usually **involve groups of executives working intensively for one or two days, often away from the office, on organisational strategy.** Such executives are typically senior

managers in the organisation, although a wider group of managers can be used. Typically, workshops are used to formulate or reconsider strategy, but also to review the progress of current strategy, address strategy implementation issues and to communicate strategic decisions to a larger audience. Workshops can be either ad hoc or part of the regular strategic planning process, and they may be stand-alone or designed as a series of events. As well as facilitating strategy making, workshops can have additional roles in team building and the personal development of individual participants. Illustration 17.4 shows how they can contribute to strategy development as well as how they can go wrong.

Illustration 17.4 A tale of two workshops How strategy workshops are designed is a significant influence on their success.

In the context of rapid growth, the directors of Hotelco (a pseudonym for a UK hotel group) decided to hold two two-day workshops to rethink the organisational structure needed for the company's future strategic direction. Both workshops were facilitated by an external consultant.

Workshop 1

The first workshop was held in a luxury rural hotel in the South of England far away from Hotelco's modest offices. This was not just to 'get away from the office', but also because: 'It freed up the mind . . . It was a great experience'.

Together with one of the directors, the facilitator had organised the agenda. The 'command style' of the CEO was replaced by a participative approach orchestrated by

the facilitator: ‘He made it a more level playing field.’ He had interviewed staff about the core values of the business and provided a report to the directors as a basis for the discussion: ‘Does everyone know what Hotelco stands for?’

The directors became genuinely engaged with the discussion: ‘It focused our minds. It made us all understand the things we were good at and . . . the things we were weak at and what we needed to do.’ They regarded the workshop as a success, concluding that a change was needed from an authoritarian, command management style to a more structured and devolved approach to management, with responsibility being passed to middle levels, so freeing up the top team to focus more on strategy.

This outcome was not, however, carried forward. On their return to the office, the directors came to the conclusion that what was agreed during the workshop was unrealistic, that they were ‘carried away with the process’. The result was significant backtracking but without a clear consensus on a revised structure for the business.

Workshop 2

The second two-day workshop, two months later, was for the top team and their seven direct reports and used the same facilitator. It took place in one of the group’s own hotels. Again, the workshop began with a discussion of the interviews on Hotelco’s values. One of the directors then made a presentation raising the idea of an operational board. However, in discussion, it emerged that the directors were not uniformly committed to this – especially the CEO. Eventually, as the facilitator explained: **I had to sit the four directors in another room and say: look, until you sort this out; you’re just going to create problems . . . The four directors got into a heated argument and forgot about the other seven.**

This was not, however, how the directors saw it. Their view was that the facilitator was seeking to impose a solution rather than facilitate discussion.

With the directors in one room and the direct reports in another, the comments of each group were transmitted between rooms by the facilitator. It was a situation that satisfied no one. In the afternoon, the CEO intervened, replacing the idea of a seven-person 'operational board' with an intermediary level of three 'divisional directors'.

No one was content with the workshop. One of the seven who was not to be a divisional director commented: 'I didn't know where I sat any more. I felt my job had been devalued.' A director also recognised: 'We left these people feeling really deflated.'

Questions

1 Evaluate the design of the two workshops in terms of the guidelines in Section 17.4.1.

2 If you were a facilitator, how would you have organised the workshops differently?

3 What benefits (or disadvantages) might such workshops have in comparison with other approaches to strategy development for such an organisation?

Strategy workshops can be a valuable part of an organisation's strategy-making activity. However, their form can influence the nature of participants' debate of strategy and its likely success – workshop design matters. Above all, whatever the purpose of the workshop, clarity of purpose is strongly correlated with perceived success. Given this, if the purpose is to *question existing strategy or develop new strategy*, successful workshops are likely to involve:

- *Strategy concepts and tools* capable of promoting the questioning of the current strategy.

- *A specialist facilitator to* guide participants in the use of such tools and concepts, free managers to concentrate on the discussion, help keep the discussion focused on the strategic issues and ensure participants contribute equally to discussion.
- *The visible support of the workshop sponsor* (perhaps the CEO) for the questioning and the facilitator. In the absence of this, the workshop is unlikely to succeed.
- *The diminishing of everyday functional and hierarchical roles.* This may be aided by a distinctive off-site location to signal how different from everyday routine the workshop is, help detach participants from day-to-day operational issues and symbolically affirm the occasion is not subject to the usual norms of executive team discussion. Ice-breaking and other apparently playful exercises – sometimes called 'serious play' – at the beginning of a workshop can help generate creativity and a willingness to challenge orthodoxies.[41]

On the other hand, workshops with the purpose of *reviewing the progress of current strategy* are likely to be successful if they have a more operational agenda and if participants maintain functional and hierarchical roles.

Workshops are, however, prone to at least two problems. First, when reduced to a routine part of the strategic planning cycle and involving the usual group of senior managers every year, workshops may not be able to produce new ideas that significantly challenge the status quo. On the other hand, workshops that are too radically separated from the ordinary routines of the organisation can become

detached from subsequent action: it can be difficult to translate radical ideas and group enthusiasm back into the workplace.

In designing workshops that will be closely connected to subsequent action, managers should consider:

- *Identifying agreed actions to be taken.* Time should be set aside at the end of the workshop for a review of workshop outputs and agreement on necessary actions to follow up. However, this, of itself, may well not make a sufficiently powerful bridge to operational realities.
- *Establishing project groups.* Workshops can build on the cohesion built around particular issues by commissioning groups of managers to work together on specific workshop-derived tasks and report on progress to senior management.
- *Nesting of workshops.* Especially if a workshop has expected participants to question current strategy and develop radical new ideas, it may be useful to have a series of workshops, each of which becomes more and more grounded in operational realities.
- *Making visible commitment by the top management.* The CEO or other senior manager needs to signal commitment to workshop outcomes not only by their statements but by their actual behaviours.

17.4.3 Strategy projects

Both strategy making and strategy implementation are often organised in the form of projects or task forces.[42] **Strategy projects involve teams of people assigned to work on particular**

strategic issues over a defined period of time. Projects can be instituted in order to explore problems or opportunities as part of the strategy development process. Or they might be instituted to implement agreed elements of a strategy, for example, an organisational redesign or the negotiation of a joint venture. Translating a strategic plan or workshop outcomes into a set of projects is a good means of ensuring that intentions are translated into action. They can also include a wider group of managers in strategy activity.

Strategy projects should be managed like any other project. In particular they need:

- *A clear brief or mandate.* The project's objectives should be agreed and carefully managed. These objectives are the measure of the project's success. 'Scope creep', by which additional objectives are added as the project goes on, is a common danger.
- *Top management commitment.* The continuing commitment of top management, especially the top management 'client' or 'sponsor', needs to be maintained. Top management agendas are frequently shifting, so communications should be regular.
- *Milestones and reviews.* The project should have from the outset clear milestones with an agreed schedule of intermediate achievements. These allow project review and adjustment where necessary, as well as a measure of ongoing success.
- *Appropriate resources.* The key resource is usually people. The right mix of skills needs to be in place, including project management skills, and effort should be invested in 'team-building' at the outset. Strategy projects are often part-time

commitments for managers, who have to continue with their 'day jobs'. Attention needs to be paid to managing the balance between managers' ordinary responsibilities and project duties: the first can easily derail the second.

Projects can easily proliferate and compete. Senior management should have careful oversight of the whole portfolio of projects in an organisation and be ready to merge and end projects according to changing circumstances. Otherwise, a proliferation of projects can easily end up with so-called 'initiative fatigue'.

17.4.4 Hypothesis testing

Strategy project teams are typically under pressure to deliver solutions to complex problems under tight time constraints. **Hypothesis testing is a methodology for setting priorities in investigating issues and options** and is widely used by strategy consulting firms and members of strategy project teams.

Hypothesis testing in strategy is adapted from the hypothesis testing procedures of science.[43] It starts with a proposition about how things are (*the descriptive hypothesis*), and then seeks to test it with real-world data. For example, a descriptive hypothesis in strategy could be that being large-scale in a particular industry is essential to profitability. To test it, a strategy project team might begin by gathering data on the size of organisations in the industry and correlate these with the organisations' profitabilities. Confirmation of this initial descriptive hypothesis (i.e., small organisations are relatively unprofitable) would then lead to several *prescriptive hypotheses* about what a particular organisation should do. For a

small-scale organisation in the industry, prescriptive hypotheses would centre on how to increase scale: one prescriptive hypothesis would be that acquisition of another producer would be a good means to achieve the necessary scale; another prescriptive hypothesis would be that a joint venture with another producer would work. These prescriptive hypotheses might then become the subjects of further data testing.

This kind of hypothesis testing is ultimately about setting practical priorities in strategy work. Hypothesis testing in organisational life therefore differs from strict scientific procedure. The aim finally is to concentrate attention on a very limited set of promising hypotheses, not on the full set of all possibilities (consultants call looking at too many possibilities ‘boiling the ocean’). Data are gathered in order to support favoured hypotheses, whereas in science the objective is formally to try to refute hypotheses. Organisational hypothesis testing aims to find a robust and satisfactory solution within time and resource constraints, not to find some ultimate scientific truth.

Selecting the right hypotheses can be helped by applying *Quick and Dirty Testing* (QDT). This relies on the project team’s existing experience and easily accessed data in order to speedily reject unpromising hypotheses, before too much time is wasted on them. As above, a QDT approach to the descriptive hypothesis regarding scale might involve checking out the performance (relative profitability) of small versus large organisations. If this QDT approach found that small organisations were reasonably successful, then the initial descriptive hypothesis would be abandoned, and with it the prescriptive hypotheses about acquisitions and joint ventures. A new descriptive hypothesis would

be developed (perhaps around technology, for instance) and new prescriptive hypotheses would flow from this (about whether the organisation should develop its own technology or buy existing technology, for instance). It is on these new prescriptive hypotheses that the project team should concentrate its attention: the old ones of acquisition or joint venturing are addressing a problem of scale that does not really exist.

17.4.5 Open strategy

Section 17.2.1 described a range of strategists, from CEOs to consultants. However, ordinary employees are increasingly being included in strategising activities, alongside many other participants. Town Halls, pioneered by General Electric in the 1990s, and All Hands Meetings, pioneered by Californian tech companies at the beginning of this century, are now common means of bringing together large groups of employees to hear about strategy from top management. These initiatives to include employees are part of a general move towards more 'open strategy'.[44]

Open strategy processes involve the wider inclusion of internal and external stakeholders and greater strategic transparency to audiences inside and outside the organisation. For example, internally open strategy can draw in middle managers and lower-level staff; externally, it can engage key suppliers, customers, partners and investors. Open strategy increases what is revealed not only to employees but sometimes also to outside audiences such as investors, partner organisations, social movements and regulators. Transparency has already been

discussed under Communicating (see Section 17.3.4) but, meanwhile, employee inclusion in the strategy process can take various forms, with differing degrees of participation:

- *Strategy workshops:* drawing upon many organizational levels. At the Finnish city of Vaasa, a new mayor used 100 one-day strategy workshops to draw the city's middle managers and staff into the creation of a new strategy for the Finnish industrial city.
- *Strategy projects and task forces:* in which groups of employees are invited to develop particular strategy initiatives over weeks or months, often making use of 'next generation' managers. Mario Greco the new Chief Executive of Zurich Insurance, sought to regenerate the strategy by setting up eight task forces made up of 40 low-level managers and professionals from all over the world and meeting with them regularly over 12 weeks.
- *Delegated decisions:* for example, the computer games company Valve operates a 'rule of three' for its games strategy: any new project that can gather the commitment of three games designers automatically goes ahead; if the project is no longer able to retain the loyalty of three designers, it is automatically dropped.
- *Social media and polling technologies:* can be used to solicit ideas and vote on them (see also Section 17.4.1). As above, IBM has been using strategy 'jams' based on digital technologies to solicit and prioritise strategic ideas involving tens of thousands of employees since 2001.

There are pros and cons to greater inclusion of employees in the strategy process. On the one hand, it can improve strategy

formulation by accessing more ideas, and improve implementation by increasing staff understanding and commitment. On the other hand, too many participants can slow down the strategy process; elevating lower-level staff into the strategy process can seem to undermine the status and authority of managers higher up the hierarchy; employees are typically not incentivised to take risks or to jeopardise jobs; and there is the risk of leaking commercially sensitive information to competitors, campaign groups or regulators.[45]

There is no general rule about inclusion or exclusion in strategy making, but there are criteria that can guide managers. Figure 17.3 suggests that the people involved should vary according to the nature of the issue. For example, urgent issues that could involve major changes to strategy (such as an acquisition opportunity) are best approached by small special project teams, consisting of senior managers and perhaps planners and consultants. Important, but less urgent, issues (such as deciding on key competitors) can benefit from more prolonged and open strategic conversations, both formal and informal. Urgent issues that do not involve major change (such as responding to competitor threats) require only limited participation. Issues that may involve major changes but require idea generation over time (such as the search for global opportunities) might benefit from more open participation. This might be organised more formally through a series of planned events, such as conferences bringing together large groups of managers in particular geographical regions.

The Wikimedia end of chapter case provides an example of inclusive strategising in a non-profit environment.

Figure 17.3 Who to include in strategy making

Figure 17.3: Long Description

Thinking differently

Press open for control

Open strategy could be good for society as well as organisations Strategy matters not only for the future of organisations, but for society as a whole. Strategy is about where organisations invest, how they innovate and diversify, who they employ, environmental impact and the accessibility of their products and services. In today's digital economy, it is also about the data they gather on ordinary users and the ways they put it to use. All these strategic choices have major societal

repercussions. The scale of some organisations – consider Alphabet, whose Google engine accounts for 85 per cent of search worldwide, or Airbus which has 57 per cent of the world's airline market, or TSMC which holds 53 per cent of the global semiconductor foundry market – means that their strategic choices have worldwide implications.

So, it is important that these organisations' strategies are subject to some societal accountability and control. There are several options. Consumers can push back on organisations by choosing whether or not to use their products, but that is hard when facing dominant suppliers or where the product is not very visible as, for example, with semiconductors. Some degree of state ownership can help – the French, German and Spanish Governments own just over a quarter of Airbus – but that is not a realistic prospect for a US company like Alphabet. Government regulations offer some means of control but, in technology, it is hard for regulators to keep up with the pace and complexity of contemporary innovation.

Another means of controlling powerful organisations is by requiring the kind of transparency and inclusion implied by open strategy.[46] Organisations can include more stakeholders in strategic decision-making forums (for example, company boards) and be more transparent with strategic information (perhaps with delays to protect organisations from competitors). Regulators can use such governance reforms to increase control indirectly, rather than directly through regulation of particular technologies or markets. Where formal governance reforms are not feasible, regulators can encourage informal openness by protecting internal whiste blowers – employees who are prepared to go public with their insider knowledge of irresponsible decisions. Through fear of public shame or controversy, both formal and informal openness can help keep powerful organisations responsible in their strategies.

Questions

Think of a powerful organisation that you know. With an eye to ease of regulation, potential consumer power, feasibility of public ownership and opportunities for greater formal or informal openness, ask which would be the most effective ways of exercising some societal control over it.

Key takeaways The practice of strategy involves critical choices about *who to involve* in strategy, *what to do* in strategising activity, and *which strategising methods or tools* to use in order to guide this activity. This chapter suggests the following issues in thinking about developing strategy for a particular organisation:

- Choose consciously the kinds of people to involve in various strategising activities, considering not only the *CEO and senior managers*, but also *non-executive directors*, *strategic planners, middle managers, employees* and *external actors* such as investors, strategy consultants and other stakeholders.
- Key strategising activities include *analysing, issue-selling, decision making* and *communicating.* Take into account various sources of possible *bias* and consider the balance between economically rational approaches (*mercenary*) and less rational approaches (*romantic*).
- Practical methods and tools to guide strategising activity include *digital tools*, *strategy workshops, strategy projects, hypothesis testing,* and *open strategy.* Analyse the specific strategy tasks in hand and then choose the appropriate mix of methods and tools given those tasks.

Work assignments

✱ Denotes more advanced work assignments.

17.1 Go to the careers or recruitment web page of one of the big strategy consultants (such as **www.bain.com, www.bcg.com, www.mckinsey.com**). What does this tell you about the nature of strategy consulting work? Would you like this work?

17.2 Go to the website of a large organisation (private or public sector) and assess the way it communicates its strategy to its audiences. With reference to Section 17.3.4, how focused is the communication; how impactful is it; and how likely is it to engage employees? Do the visuals, including the presentation of senior managers, support the strategy?

17.3 If you had to design a strategy workshop, suggest who the participants in the workshop should be and what roles they should play in: (a) the case where an organisation has to re-examine its fundamental strategy in the face of increased competitive threat; (b) the case where an organisation needs to gain commitment to a long-term, comprehensive programme of strategic change.

17.4* For any case study in the book, imagine yourself in the position of a strategy consultant and propose an initial descriptive hypothesis (Section 17.4.3) and define the kinds of data that you would need to test it. What kinds of people would you want in your strategy project team (see Sections 17.2.)?

Integrative assignment

17.5* For an organisation with which you are familiar, or one of the case organisations, write a strategic plan (for simplicity, you might choose to focus on an undiversified business or a business unit within a larger corporation). Where data are missing, make reasonable assumptions or propose ways of filling the gaps. Comment on whether and how you would provide different versions of this strategic plan for (a) investors; (b) employees. Guidance is provided in Chapter 2.2.

Recommended key readings

- For a textbook overview of practice issues in strategy, see S. Paroutis, L. Heracleous and D.N. Angwin (2016) *Practicing Strategy: Text and Cases*, 2nd edn, London, Sage.
- A review of recent research on the practice of strategy is M. Kohtamäki, R. Whittington, E. Vaara and R. Rabetino (2021) 'Making connections: Harnessing the diversity of strategy-as-practice research', *International Journal of Management Reviews*, 10.
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Case example

Wikimedia's Open Strategy

Richard Whittington, Eero Vaara and Nicole Ebber

In 2021, Nicole Ebber, Leader of the Wikimedia 2030 Movement Strategy, explained to a group of MBA students the motivation behind their strategy process: 'Our hope was that our new strategy process would help set us up to create a society where everybody can make informed choices and decisions and where democratic structures and emancipation leads to freedom, openness and shared power for everyone. This is what makes me want to contribute to my strategy work every day'.[47]

Nicole Ebber was speaking at a momentous time for the Wikimedia Movement. Its main product, Wikipedia, the free online encyclopaedia, was celebrating the start of its third decade since its creation in 2001. Wikipedia had become the seventh most visited website in the world, averaging just over 20 billion page views per month. Wikipedia is ultimately run by the Wikimedia Foundation, a non-profit charity with annual revenues of $129mn in 2021, mostly made up of donations (Wikipedia has no advertising or subscriptions). The Foundation is based in San Francisco and has 550 employees worldwide. As well as Wikipedia, the Foundation owns other services such as Wikinews, Wiktionary and Wikidata. The Foundation states that it seeks to develop education contact in the public domain and to disseminate for free effectively and globally and that it needs to engage people globally to collect the content it publishes. The Foundation reports to a Board of 16 Trustees: one board seat is reserved for Jimmy Wales, the founder; seven seats are appointed by the rest of the Board on grounds of expertise; and eight seats are sourced from the Wikimedia community through elections. This Wikimedia community is made up of hundreds of thousands of volunteer editors, operating around the world in languages from Arabic (about 15,000) to Zulu (40). Editors

often identify passionately with Wikipedia's values, calling themselves 'Wikipedians' (their annual conference is known as 'Wikimania').

As it approached its third decade, Wikipedia faced some strategic challenges. Page views had been static for 5 years and were concentrated geographically, with the USA accounting for about 40 per cent. China received just 5 million monthly page views. English was the most frequent language for contributed articles, but Mandarin Chinese only ranked 8th, Arabic 16th and Hindi 42nd. The number of English-language volunteer editors had fallen from a peak of around 450,000 in 2017 to about 380,000 in 2021. Fewer than 20 per cent of editors were women.[48] At the same time, technologies are moving fast, with the emergence of video, interactive, artificial intelligence and virtual reality technologies that are very different from Wikipedia's traditional lengthy articles originating in the desk-top computing age. Wikipedia competes for page views with giants such as Alphabet (owner of Google), with revenues of about $180bn, and Baidu, the Chinese equivalent with revenues of $16bn.

At the start of 2017, Wikipedia's new Chief Executive, Katherine Maher, launched the 2030 Wikimedia Movement Strategy with the following central question: 'What do we want to build or achieve together over the next 15 years?' The first task was to define a 'strategic direction', a broad guide for the whole period to 2030 within which more detailed and shorter-term plans could be built. Movement consultations were run via online forums, social media and surveys, starting at the annual Wikimedia Conference in Berlin in April 2017 and concluding with a four-day Wikimania meeting in Montreal in August. Research and expert interviews ran alongside these Movement consultations. In October, the final strategic direction was endorsed by the Movement's members: 'By 2030, Wikimedia will become the essential infrastructure of the ecosystem of free knowledge, and anyone who shares our vision will be able to join us.' The Movement further committed itself to the principles of 'Knowledge as a service', with Wikimedia becoming a platform to serve open knowledge to the world across diverse interfaces and

communities, and ‘Knowledge Equity’, focusing on the knowledge and communities left out by current structures of power and privilege.[49]

Once the broad strategic direction was set, the task was to follow through with detailed recommendations. At this point, Nicole Ebber took overall responsibility for the 2030 Movement Strategy process. Based in Berlin and working for Wikimedia Deutschland, Nicole had coordinated one part of the strategy process already and had been managing dialogues and conferences for Wikimedia since 2010. She led a core team with between seven and nine members, drawn largely from the broader Wikimedia movement and given temporary contracts with the Wikimedia Foundation. This team managed a process of further research and consultation over nearly three years. A key idea was to follow the movement’s tradition and to make the strategy process as engaging and open as possible.

Core to this next stage of the process was the creation of nine working groups based on themes such as capacity building, diversity, community health, product and technology and resource allocation.[50] Working group membership was by open application, with selection based on expertise and representativeness in terms of gender, geographies, status (staff or volunteer) and similar. About half the applications were accepted by Nicole Ebber’s strategy team, with advice from a volunteer Steering Committee. The 88 working group members selected through this process were added to by using a ’diversification template’ designed to bring in members from under-represented groups. Including Board and staff members, 102 working group members finally took part: 37 were volunteers; 27 identified as partly or wholly from North America; 43 identified similarly as partly or wholly from Europe. About half the initial working group members were able to meet in person at the 2018 Wikimania in Cape Town, where Nicole’s team ran a Strategy Space and Strategy Bar to help groups get to know each other and understand their tasks. CEO Katherine Maher gave a short speech underlining the importance of the Movement Strategy.

Work on the Movement Strategy was both virtual and in-person. Report drafts from each group were shared with the whole Wikimedia Movement and feedback came via virtual 'Global Conversations', online discussion spaces and in-person consultative events (for example, 48 'strategy salons' in 29 countries, supported by central funds). Working groups made extensive use of videoconferencing (with more than 200 participants sometimes), social media and, of course, extensive documentation and videorecording on public Wikipedia pages.[51] A firm 'friendly space' policy was followed, translation of the various documents and live interpretation were provided in languages like Arabic, Chinese, French, German, Hindi, Indonesian, Russian and Spanish (live translation was provided at a later stage).

The working groups eventually produced 89 recommendations. A three-day 'Harmonization Sprint' took place in Tunis in September 2019 to synthesise all these recommendations into a more coherent set. Tunis brought together representatives from each working group, as well as members of the core strategy team, Wikimedia Foundation and Wikimedia Deutschland staff and the Chair of the Wikimedia Foundation Board of Trustees. They used Quirkos software to develop rough groupings of recommendations and then worked intensively in small groups with whiteboards and sticky notes. However, the three days were not enough to achieve synthesis. A new process was begun, led by 15 'writers' drawn from the working groups. The writers met for five days in Berlin and were joined briefly by Katherine Maher. The writers synthesised 13 recommendations, which were translated into 12 languages and then debated widely within the Wikimedia community via social media, messaging apps and in-person local meetings from Kampala to the Ukraine. From all this emerged a final set of 10 recommendations, approved by the Foundation Board and published at the start of 2020. The recommendations were as follows:

- Increase the sustainability of our movement.
- Improve user experience.

- Provide for safety and inclusion.
- Ensure equity in decision making.
- Coordinate across stakeholders.
- Invest in skills and leadership development.
- Manage internal knowledge.
- Identify topics for impact.
- Innovate in free knowledge.
- Evaluate, iterate and adapt.[52]

In general, the participants saw this process as an exceptional opportunity to conduct strategy work in a new way engaging people. There were significant problems and challenges in forming the strategy and the whole process was not comfortable. Every idea was discussed, written, re-written and redrawn on many occasions with volunteers taking part in many calls, meetings and conversations working at all times and across multiple time zones. However, the diversity of the group of volunteers delivered the best for the Movement that all were engaged in, loved and believed in.[53]

One member of the writing team, Marc Miquel-Ribé, admitted that many demographics had not been equally represented in the recommendations process, for example, women and older generations. The most active members of the Wikimedia movement generally were still those who had been active eight to ten or twelve years before. Some experienced editors had felt threatened: ‘Editors who might feel their influence or power position is diminished should be aware that, when changes will benefit the growth and diversity of the people of the movement, not opposing them . . . can also be a great contribution.’ However, he argued that the final 2030 Movement Strategy recommendations writing process had been much better than the alternatives and that by separating a group of representative members of the Movement to create an in-depth view of the problems rather than involving the whole Movement in a discussion allows clarity in needs, refinement of language and rich in-depth insight to be developed and

final actions drawn up to execute that a wider consultation or the act of locking people into a room for months on end, or even bringing in an outside agency, would not have been capable of producing.[54] Overall, according to Miquel-Ribé, 'It's been a long, long ride, sometimes even bumpy . . . [but] I could not be happier with the results we were able to deliver as a movement.'

In talking to the MBA students, Nicole Ebber also noted that the process had been challenging to lead: 'Everything you do in the open takes time. It's very long and complex . . . The working groups were expected to self-manage, but in practice the forming, storming and norming between so many cultures was difficult . . . We underestimated the support and guidance that they needed.' [55] There was also less engagement with the process than she hoped for: 'How do you get people to think strategically? Not everybody even wants to think strategically, they just want to get on with the problems they have today.' At the same time, Nicole felt that some people 'thought we already had the strategy in our drawer, and just pretend to consult with the communities and Movement'. The final recommendations had also been less radical than she had hoped: 'If you do these open strategy processes, where you involve lots of voices, the results are going to be less radical or ground-breaking.' Even so, the recommendations generated some 'pain'. Nicole felt that such pain was an inevitable part of strategy making: 'You will never make everybody happy. That is what strategy is. You have to deal with it.'

However, Nicole concluded that the process had ultimately built a strong platform for strategy implementation: 'You wouldn't have the necessary buy-in if somebody else had written radical recommendations. We are united to change Wikimedia for the better. This unity means we have commitment for the implementation . . . If you work behind closed doors, people will not buy into the strategy and its implementation . . . You have to involve people who are affected by the decisions. Change needs to be co-owned and co-designed with those actors who belong.'[56] In introducing a *Strategy Playbook*,

summarising lessons from the Movement Strategy process, CEO Katherine Maher wrote: ‘The best way to imagine and shape the future you want is to do so together.’[57]

Questions

1. What were the pros and cons of adopting an open strategy approach for the 2030 Wikimedia Movement Strategy addressing the following 15 years?
2. Wikimedia's open strategy process made extensive use of digital technologies as well as in-person meetings. What do you think digital technologies were more effective for and what were in-person meetings more effective for?
3. What were the challenges of diversity in Wikimedia's process and what were key measures the organisation used to deal with them?

Commentary on

Part III Strategy in action

This part of *Exploring Strategy* has considered strategy in action. Although this is the last part, this does not imply that action necessarily follows logically from the analysis of strategic position and choices. Chapter 1 introduced the overall model for this text, made up of three overlapping circles of position, choices and action. The point of the framework is that strategy should not be seen as simply a linear process: the issues raised in different parts of this text interact and inform each other. While, for purposes of clarity, this text presents strategy implementation following strategy formulation in a logical sequence, in practice this is by no means always so.

Design lens

The design lens builds on the notion that thinking precedes organisational action, so that strategy is, indeed, a linear process. Rational analysis and design are seen as powerful motivators of strategic action. In this view therefore, managers should:

- *Make the business case*: the most important factor in persuading managerial colleagues and other internal and external stakeholders is logical analysis and evidence, for example using the rigorous evaluation criteria of Chapter 13.
- *Exercise tight change management*: strategies are best implemented through systematic use of the levers for change (Chapter 16) and formal structures and systems (Chapter 15), leaving little scope for improvisation.
- *Reinforce coherent action*: strategies will be most effectively implemented if organisational structures and systems are configured so that they are mutually supporting (Chapter 15).

Experience lens

The experience lens is sceptical about the place of rationality in securing strategy implementation. Managerial biases and organisational conservatism mean that strategy is heavily influenced by the past. The experience lens suggests it is important to:

- *Challenge biases*: strategy evaluation and strategic plans (Chapters 13 and 14) are likely to be shaped by the experience of those who do them, so it is important to challenge what may be taken for granted.
- *Pick your teams carefully*: if strategies are shaped by the people involved in making them, then it really matters who is in your strategy development teams and projects (Chapter 17).
- *Recognise the challenge of change*: given the weight of past experience on organisations, the issues of leadership and change (Chapter 16) are likely to be among the most important and difficult in this whole text.

In this Commentary, the strategy lenses are used to explore more deeply this key issue of how formulation and implementation fit together. What are the practical implications of the various lenses for how to put strategy into action?

Note that:

- There is no suggestion here that any one of these lenses is better the others. The point is to avoid using just one. Each lens gives you extra ways to explore strategic issues.

- For a deeper understanding of this Commentary, you might want to review the Part I Commentary, following Chapter 7, which provides a fuller introduction of the four lenses, plus an illustrative case. The Commentary at the end of Part II is also relevant.

Variety lens

According to the variety lens, strategies can bubble up from the periphery and are then often selected and retained according to semi-conscious organisational processes. Innovation does not come simply from top management command. The variety lens therefore encourages you to:

- *Favour inclusiveness*: in deciding who to include in strategy development (Chapters 14 and 17), innovative strategies are more likely to come – and be implemented – if you include as many people as possible from outside the usual organisational elite.
- *Check the rules*: the variety lens points to the power of taken-for-granted procedures, so it is wise to review standard strategy evaluation criteria and organisational systems for hidden biases in strategy selection and retention (Chapters 13 and 14).
- *Be ready to go 'off-plan'*: given the role of surprise and spontaneity, it may be wise to allow for flexibility with regard to plans (Chapter 14) and formal strategic change programmes (Chapter 16).

Discourse lens

Through this lens, language is highly influential on how strategies are interpreted and implemented. Discourse can both smooth and inhibit putting strategy into action. It is important to recognise that:

- *Words matter*: the symbolic power of language can make the difference between success and failure, for example, in leading transformational change (Section 16) or communicating strategy (Section 17).
- *Organisations are political*: discourses can be used to promote sectional interests, so it is important to be sensitive to, and sometimes challenge, the language of issue-selling (Chapter 17) and alliance and network building (Chapter 15), for example.
- *Language is an entry ticket*: for managers and consultants who seek to enter into the organisation's strategy conversation (Chapter 17). It is vital to be able to speak the organisational language of strategy fluently and confidently.

Glossary

Acceptability is concerned with whether the expected performance outcomes of a proposed strategy meet the expectations of stakeholders (p. 407) **acquisition** is achieved by purchasing a majority of shares in a target company (p. 361)

Agile teams are small, entrepreneurial groups given the autonomy to respond quickly to the needs of (internal or external) customers (p. 462) **alignment** refers to how strategy and organisation should flow logically from the organisation's central goals (or purpose or mission) (p. 472) **Allocentricism** involves thinking not only about your own organisation but about other actors, for example customers, suppliers, rivals, partners and governments (p. 41) **Backward integration** (p. 272)

balanced scorecard considers five perspectives on performance simultaneously in order to prevent the dominance of a single perspective (p. 400) **BCG matrix** uses market share and market growth criteria for determining the attractiveness and balance of a business portfolio (p. 283) **business ecosystem** then is an arrangement through which a group of mutually dependent and collaborative partners interact and combine their individual offerings into a coherent customer solution to create value for all (p. 105) **business model** describes a value proposition for customers and other participants, an arrangement of activities that produces this value, and associated revenue and cost structures

(p. 247) **Business-level strategy** is about how the individual businesses (or operating units) should compete in their particular markets (p. 12) **CAGE framework** emphasises the importance of cultural, administrative, geographical and economic distance (p. 311)

change kaleidoscope highlights how contextual features can take various forms supporting or resisting change (p. 489)

Collaborative advantage is about managing alliances better than competitors (p. 372)

Collective strategy is about how the whole network of alliances, of which an organisation is a member, competes against rival networks of alliances (p. 372) **competitive advantage** is about how a company, business unit or organisation creates value for its users both greater than the costs of supplying them and superior to that of rivals (p. 232) **Competitive strategy** is concerned with how a company, business unit or organisation achieves competitive advantage in its domain of activity (p. 232) **complementor** enhances another organisation's business attractiveness such that customers value the organisation's product or service more when they also have the complementor's product or service (p. 106) **Configurations** are the set of organisational design elements that fit together in order to support the intended strategy (p. 473) **Corporate entrepreneurship** refers to radical change in the organisation's business, driven principally by the organisation's own capabilities (p. 360) **Corporate social responsibility** (CSR) is the commitment by organisations to behave ethically and contribute to economic development while

improving the quality of life of the workforce and their families as well as the local community and society at large (p. 169) **Corporate strategy** is about the overall scope of the organisation and how value is added to the constituent businesses of the organisation as a whole (p. 263) **Corporate-level strategy** is concerned with the overall scope of an organisation and how value is added to the constituent businesses of the organisational whole (p. 12) **cost-benefit analysis** (CBA). It is often used to determine the strengths and weaknesses of different strategic alternatives and may also be the basis for comparing courses of action (p. 416) **Cost-leadership strategy** involves becoming the systematically lowest-cost organisation in a domain of activity (p. 233)

cultural web shows the behavioural, physical and symbolic manifestations of a culture (p. 195)

Decision trees can also be used to assess strategic options against a list of key factors (p. 406)

Deliberate strategy involves intentional formulation or planning (p. 430)

Differentiation strategy involves uniqueness along some dimension that is sufficiently valued by customers to allow a price premium (p. 237) **Diffusion** is the process by which innovations spread among users (p. 343)

Digital transformation is pervasive and discontinuous change triggered and shaped by the widespread use of digital technologies (p. 491) **digital transformation** the pervasive and discontinuous change triggered and shaped by the widespread

use of digital technologies (p. 18) **disruptive innovation** creates substantial growth by offering a new performance trajectory that, even if initially inferior to the performance of existing technologies, has the potential to become markedly superior (p. 347) **Distinctive resources and capabilities** are required to achieve competitive advantage (p. 126)

Diversification involves increasing the range of products or markets served by an organisation (p. 264)

divestment (p. 371)

Divestment occurs when the organisation decides to pull out of one or more of its businesses (p. 275)

divisional structure is built up of separate divisions based on products, services or geographical areas (p. 459)

dominant logic is the set of corporate-level managerial capabilities applied across the portfolio of businesses (p. 269)

Du Pont model which dissects a company's return on capital employed (ROCE) in order to work out the components that add value to, or subtract from the whole (p. 399) **dynamic capabilities** by which he means an organisation's ability to renew and recreate its resources and capabilities to meet the needs of changing environments (p. 142) **economies of scope** (p. 269)

emergent strategy: that strategies emerge on the basis of a series of decisions, which forms a pattern that becomes clear over time (p. 436) **entrepreneurial life cycle** progresses through start-up, growth, maturity and exit (p. 333)

Entrepreneurship is a process by which individuals, start-ups or organisations identify and exploit opportunities for new products or services that satisfy a need in a market (p. 330) **Entry mode strategies** differ in the degree of resource commitment to a particular market and the extent to which an organisation is operationally involved in a particular location (p. 316) **Evaluation** is the process of identifying strategies that pass all the criteria of suitability, acceptability and feasibility (p. 419) **Feasibility** is concerned with whether a strategy could work in practice (p. 417)

first-mover advantage exists where an organisation is better off than its competitors as a result of being first to market with a new product, process or service (p. 345) **focus strategy** targets a narrow segment or domain of activity and tailors its products or services to the needs of that specific segment to the exclusion of others (p. 239) **forcefield analysis** compares the forces at work in an organisation acting either to block or to facilitate change (p. 487)

forecasting takes three fundamental approaches to the future based on varying degrees of certainty: single-point, range and multiple-futures forecasting (p. 78) **Forward integration** (p. 272)

functional structure divides responsibilities according to the organisation's primary specialist roles such as production, marketing and finance (p. 459) **Functional-level strategies** are concerned with how the components of an organisation deliver effectively the corporate- and business-level strategies in terms of resources, processes and people (p. 12) **Game theory** encourages an organisation to consider competitors' likely moves

and the implications of these moves for its own strategy (p. 244) **Gap analysis** which compares actual or projected performance with desired performance (p. 398)

global integration encourage organisations to coordinate their activities across diverse countries to gain efficient operations (p. 307) **global sourcing** purchasing services and components from the most appropriate suppliers around the world, regardless of their location (p. 306) **Global strategy** involves high coordination of extensive activities dispersed geographically in many countries around the world (p. 298) **global–local dilemma** the extent to which products and services may be standardised across national boundaries or need to be adapted to meet the requirements of specific national markets (p. 307) **governance chain** shows the roles and relationships of different groups involved in the governance of an organisation (p. 174) **Governance** is concerned with the structures and systems of control by which managers are held accountable to those who have a legitimate stake in an organisation (p. 174) **Hybrid organisations** combine values and structures that would not normally go together (p. 171)

hybrid strategies that combine different generic strategies (p. 240)

Hypothesis testing is a methodology for setting priorities in investigating issues and options (p. 525)

Implementation refers to the translation of a chosen strategy into organisational action in order to achieve strategic goals (p. 457) **industry** is a group of firms producing products and services that are essentially the same (p. 91)

inimitable resources and capabilities those that competitors find difficult and costly to imitate or obtain or substitute (p. 129) **innovation ecosystems** and consist of a group of mutually dependent and collaborative partners that need to interact to innovate and create value for all (p. 341) **Innovation** involves the conversion of new knowledge into a new product, process or service *and* the putting of this new product, process or service into actual commercial or other use (p. 336) **International strategy** refers to a range of options for operating outside an organisation's country of origin (p. 298)

Issue trees involve the systematic breaking-down of big issues into subsidiary issues for further analysis (p. 42)

Key drivers for change are the environmental factors likely to have a high impact on industries and sectors, and the success or failure of strategies within them (p. 77) **Leadership** is the process of influencing an organisation (or group within an organisation) in its efforts towards achieving an aim or goal (p. 484) **learning organisation** an organisation that is capable of continual regeneration from the variety of knowledge, experience and skills within a culture that encourages questioning and challenge (p. 439) **Legitimacy** is concerned with meeting the expectations within an organisational field in terms of assumptions, behaviours and strategies (p. 192) **local responsiveness** implies a greater need to disperse operations and adapt to local demand (p. 307)

Logical incrementalism was a term coined by James Quinn in his study of how strategies developed in multinational businesses. It is the development of strategy by experimentation and learning (p.

437) **macro-environment** consists of broad environmental factors that impact, to a greater or lesser extent, many organisations, industries and sectors (p. 63) **Market development** involves offering existing products/services to new markets (p. 267)

market is a group of customers for specific products or services that are essentially the same (e.g., a particular geographical market) (p. 91) **Market penetration** implies increasing share of current markets with the current product or service range (p. 265)

market segment is a group of customers who have similar needs that are different from customer needs in other parts of the market (p. 111) **matrix structure** combines different structural dimensions (axes) simultaneously, for example, product divisions and geographical territories or product divisions and functional specialisms (p. 462) **merger** differs from an acquisition, as it is the combination of two previously separate organisations in order to form a new company (p. 361) **mission statement** aims to provide clarity about what the organisation is fundamentally there to do on a daily basis (p. 9)

multi-sided platform brings together two or more distinct, but interdependent groups of participants to interact on a platform (p. 251) **network effects** in an industry when one customer of a product or service has a positive effect on the value of that product for other customers (p. 108) **non-market environment** typically involves interactions with non-governmental organisations (NGOs), politicians, government departments, regulators, political activists, campaign groups and the media (p. 65) **Non-profit organisations** are self-governing, non-profit distributing and

involve some degree of voluntary participation (p. 17) **Open innovation** involves the deliberate import and export of knowledge by an organisation in order to accelerate and enhance its innovation (p. 340) **Open strategy** processes involve the wider inclusion of internal and external stakeholders and greater strategic transparency to audiences inside and outside the organisation (p. 526) **Opportunity recognition** means recognising an opportunity, i.e., circumstances under which products and services can satisfy a need in the market or environment (p. 330) **organic development** is where a strategy is pursued by building on, and developing, an organisation's own capabilities (p. 360) **Organisational ambidexterity** is the capacity both to exploit existing capabilities and to explore for new capabilities (p. 494) **organisational culture** is the taken-for-granted assumptions and behaviours of an organisation's members (p. 185)

organisational field is a community of organisations that interact more frequently with one another than with those outside the field (p. 70) **organisational identity** refers to how organisations express and project a sense of organisational self: a claim about 'who we are' (p. 200) **Outsourcing** is the process by which value chain activities previously carried out internally are subcontracted to external suppliers (p. 273) **paradigm** is the set of assumptions held in common and taken for granted in an organisation (p. 195)

parenting advantage (p. 264)

PESTEL analysis highlights six environmental factors in particular: political, economic, social, technological, ecological and legal (p.

64) **political view of strategy development** is, then, that strategies develop as the outcome of bargaining and negotiation among powerful interest groups (p. 440) **Porter's diamond** suggests that locational advantages may stem from local factor conditions; local demand conditions; local related and supporting industries; and from local firm strategy structure and rivalry (p. 304) **Porter's Five Forces framework** assists industry analysis and helps to identify industry attractiveness in terms of five competitive forces: (i) extent of rivalry between competitors; (ii) threat of entry; (iii) threat of substitutes; (iv) power of buyers; and (v) power of suppliers (p. 92) **Procedural justice** refers to the fairness of the process by which decisions are made (p. 472)

Product and service development is where organisations deliver modified or new products (or services) to existing markets (p. 267) **Profit pools** refer to the different levels of profit available at different parts of the value system (p. 137)

Purpose is concerned with the value an organisation seeks to create for its stakeholders, potentially including both financial and non-financial forms of value (p. 157) **Purpose** is the reason why a company exists (p. 8)

Rare resources and capabilities on the other hand, are those possessed uniquely by one organisation or by a few others (p. 128) **recipe** is a set of assumptions, norms and routines held in common within an organisational field about the appropriate purposes and strategies of field members (p. 192) **Related diversification** involves expanding into products or services with relationships to the existing business (p. 264)

Resilience refers to the capacity of organisations to recover from shocks fast and easily after they have happened (p. 501) **resource-based view** (RBV) of strategy pioneered by Jay Barney at the University of Utah: that the competitive advantage and superior performance of an organisation are explained by the distinctiveness of its resources and capabilities (p. 123) **resources and capabilities** of an organisation contribute to its long-term survival and, potentially, to competitive advantage (p. 124) **returns** These are measures of the financial profitability and effectiveness of a strategy (p. 407)

Risk concerns the extent to which strategic outcomes are unpredictable, especially with regard to possible negative outcomes (p. 413) **SAFE** *Suitability, Acceptability, Feasibility, Evaluation (p. 397)*

Scenarios offer plausible alternative views of how the macro-environment might develop in the future, typically in the long term (p. 79) **S-curve** reflects a process of initial slow adoption of innovation, followed by a rapid acceleration in diffusion, leading to a plateau representing the limit to demand (p. 344) **sensemaking** is the cognitive and emotional process through which managers understand, interpret and make coherent their changing environments (p. 471) **situational leadership** encourages strategic leaders to adjust their leadership style to the context they face (p. 486)

Social entrepreneurs are individuals and groups who create independent organisations to mobilise ideas and resources to address social problems, typically earning revenues but on a not-

for-profit basis (p. 335) **staged international expansion model** proposes a sequential process whereby companies gradually increase their commitment to newly entered markets, as they build knowledge and capabilities (p. 316) **Stakeholder mapping** identifies stakeholder power and attention in order to understand strategic priorities (p. 162)

Stakeholders are those individuals or groups that depend on an organisation to fulfil their own goals and on whom, in turn, the organisation depends (p. 157) **strategic alliance** is where two or more organisations share resources and activities to pursue a common strategy (p. 372)

strategic business unit (SBU) supplies goods or services for a distinct domain of activity (p. 231)

Strategic drift is the tendency for strategies to develop incrementally on the basis of cultural influences, failing to keep pace with a changing environment (p. 200) **Strategic groups** are organisations within the same industry or sector with similar strategic characteristics, following similar strategies or competing on similar bases (p. 109) **Strategic issue-selling** is the process of gaining the attention and support of top management and other important stakeholders (p. 517) **strategic plan** is a roadmap for seizing the opportunities and minimising the threats facing an organisation (p. 49)

Strategic planners are those with a primary responsibility for contributing to the strategy process (p. 512)

strategic planning systematic analysis and exploration to develop an organisation's strategy (p. 432)

strategy canvas tool compares competitors according to their performance on critical success factors (CSFs) in order to establish potential strategies for the future (p. 241) **strategy** is the long-term direction of an organisation (p. 6)

Strategy projects involve teams of people assigned to work on particular strategic issues over a defined period of time (p. 524) **Strategy statements** should have three main themes: the fundamental *goals* (purpose, vision, mission or objectives) that the organisation seeks; the *scope* or domain of the organisation's activities; and the particular *advantages* or capabilities it has to deliver all of these (p. 9) **strategy workshops** (sometimes called strategy away-days or off-sites). Such workshops usually involve groups of executives working intensively for one or two days, often away from the office, on organisational strategy (p. 522) **Structures** give people formally defined roles, responsibilities and lines of reporting (p. 458)

Suitability is concerned with assessing which proposed strategies address the *key opportunities and threats* an organisation faces (p. 404) **Sustainability transformation** is pervasive and discontinuous change of organisational business models, capabilities and operations aimed at creating positive economic, social and environmental impact (p. 492) **Sustainable development** strategies involve managing positive relationships with organisations' natural and social environments at the same time as meeting their economic needs (p. 18) **SWOT analysis** involves the systematic analysis of an organisation's strengths, weaknesses, opportunities and threats (p. 36) **Synergies** are benefits gained where activities or assets complement each other

so that their combined effect is greater than the sum of the parts (p. 269) **System maps** show the consequential links between the elements of a strategic problem (p. 43)

Systems support and control people as they carry out structurally defined roles and responsibilities (p. 458)

Thinking slow is deliberative, analytical and thorough (p. 34)

three-horizons framework suggests organisations should think of their businesses or activities in terms of different 'horizons', defined by time (p. 6) **Threshold resources and capabilities** are those needed for an organisation to meet the necessary requirements to compete at all in a given market and achieve parity with competitors in that market (p. 126) **Transactional leaders** emphasise 'hard' levers of change such as designing systems and controls (p. 485)

Transformational (or charismatic) leaders emphasise 'soft' levers for change such as building a vision for their organisation (p. 485) **triple bottom line** pays explicit attention to corporate social responsibility and the environment (p. 400)

Turnaround strategies emphasise rapidity in change, cost reduction and/or revenue generation, with the aim of fast recovery (p. 492) **unrelated diversification** involves moving into products or services with no relationships to existing businesses (p. 265)

unrelated diversification is when an organisation expands into markets, products and services completely different from its own (p. 268) **value chain** describes the categories of activities within an organisation which, together, create a product or service (p.

133) **value system** the set of inter-organisational links and relationships that are necessary to create a product or service (p. 133) **values** are the underlying and enduring ideals, beliefs and principles that guide an organisation's strategy and define the way that the organisation should operate (p. 159) **Vertical integration** describes entering activities where the organisation is its own supplier or customer (p. 272)

vision statement is concerned with the future the organisation seeks to create (p. 9)

VRIO analysis thus helps to evaluate if, how and to what extent an organisation or company has resources and capabilities that are (i) valuable, (ii) rare, (iii) inimitable and (iv) supported by the organisation (p. 132) **Yip's globalisation framework** sees international strategy potential as determined by market drivers, cost drivers, government drivers and competitive drivers (p. 299)

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